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**Joint Affidavit of G. Mitchell Wilk and Steven M. Fetter**

**Part I: Personal Statement of G. Mitchell Wilk**

1. My name is G. Mitchell Wilk. I am President of Wilk & Associates, Incorporated, a public policy research and consulting firm located in San Francisco, CA. I am an expert consultant in public policy and regulation, and my firm principally provides advisory services regarding the regulation of telecommunications and energy industries.

2. I hold a bachelor's degree and MBA in finance from the American University in Washington, D.C. From 1972 to 1983, I worked as a financial analyst and public affairs executive in the insurance industry in Washington, D.C. and San Francisco. In 1984, I joined the staff of California Governor George Deukmejian, serving as Deputy Legislative Secretary, and later as Deputy Chief of Staff, prior to my appointment as a member of the California Public Utilities Commission (CPUC).

3. From December, 1986, to October, 1991, I served as a CPUC Commissioner, including two terms as Commission President during 1989 and 1990. My principal policy focus during my tenure on the Commission was the regulation of telecommunications, and with the concurrence of my colleagues, I served as the lead Commissioner on telecommunications issues. During this time, my colleagues and I instituted new regulatory frameworks for local

exchange, cellular telephone, private pay phone, and long distance markets in California. Prior to our adoption of the "New Regulatory Framework" for Pacific Bell and GTE California in 1989, we also concluded traditional cost-of-service rate cases for those two utilities that included substantial rate reductions.

4. Among numerous activities on the national front, I was active in the National Association of Regulatory Utility Commissioners (NARUC), where I served on both the Executive and the Communications Committees, and was Chairman of the Consumer Issues Subcommittee. I was appointed as a member of the 410b Conference Committee established by the Federal Communications Commission (FCC) to address Open Network Architecture and related issues involving regulatory policies and competitive safeguards to assure that competitors have full access to the bottleneck portions of local telephone company networks. In 1991, I was the only sitting state regulator invited by the FCC to address a special en banc hearing regarding "Networks of the Future" and the role of state regulation.

5. Since leaving the California PUC I have been actively involved in providing public policy research and advice for a wide range of clients. The primary emphasis of my practice has been the public utility regulation of telecommunications, and I have continued to monitor, review and analyze the practice of public utility regulation in numerous states and at the federal level. Among other activities, I have testified as an expert in regulatory proceedings in Missouri, Illinois, Virginia, and before the Canadian Radio and Telecommunications Commission, and I have filed expert affidavits before the District Court reviewing and

assessing the capabilities of state regulation on a national level, and with specific reference to California. In 1994, I was chosen to serve as a member of the California State Senate Utilities and Communications Committee Advisory Group on CPUC Reform. In 1996, I was asked to join the CPUC's Vision 2000 advisory committee considering the future structure and responsibilities of the CPUC, a subject I also recently addressed in invited testimony before the Commission on California State Government Organization and Economy (Little Hoover Commission). And during this summer's meeting of the National Association of Regulatory Utility Commissioners (NARUC) in Los Angeles, I served as an invited facilitator for a wide-ranging discussion and analysis of NARUC's future role, as utility industries and regulation continue to change.

**Part II: Personal Statement of Steven M. Fetter**

6. My name is Steven M. Fetter. I am Senior Director and Group Manager of the Global Power Group at Fitch Investors Service, L.P. (Fitch), a credit rating agency based on New York City. In that role, I manage a 14-employee group responsible for credit research and rating of fixed income securities of U.S. and foreign electric and natural gas companies and independent power projects. I also analyze utility and telecommunications regulatory developments and have achieved national recognition as a speaker and commentator evaluating the effects of regulatory developments on the financial condition of the utility and telecommunications sectors. In addition to my day-to-day duties, with the permission of Fitch I have at times taken on consulting assignments on my own behalf involving the

telecommunications and energy industries. My involvement in this matter is under these conditions, and, accordingly, the views expressed are my own and do not represent Fitch policy judgments or positions in any way. Fitch does not now carry an outstanding credit rating on Ameritech due to the absence of a formal rating relationship.

7. I hold bachelor's and juris doctor degrees from the University of Michigan. From 1979 until 1987, I held legal and policy positions for the federal government and the State of Michigan, including Acting Associate Deputy Under Secretary of the U.S. Department of Labor, Legal Counsel to the Michigan Senate, Assistant Legal Counsel to Michigan Governor William Milliken, and appellate litigation attorney at the National Labor Relations Board. In 1987, I was appointed to the Michigan Public Service Commission (MPSC) by Democratic Governor James Blanchard and, in 1991, I was promoted to MPSC Chairman by Republican Governor John Engler.

8. During my six years on the MPSC, I led successful efforts to fashion incentive plans in all regulated industries based on performance, service quality, and infrastructure improvement. In the telecommunications sector, these actions helped to facilitate the formulation and passage of the Michigan Telecommunications Act of 1991 (MTA), a regulatory reform law that has served as a model for other states. While the MPSC was initially written out of the proposed law to be replaced by a new regulatory agency, my formation of an internal MPSC task force charged with working to promote telecommunications competition while ensuring fairness (comprising representatives from the MPSC policy, operations, and legislative

divisions) helped us ultimately to play a major role in formulating the final language and concepts of the MTA, which maintained the MPSC continuing authority for oversight of the telecommunications sector.

9. My activities at the national level while a regulator included serving on the National Association of Regulatory Utility Commissioners (NARUC) Executive, Natural Gas, and International Relations Committees; as Chairman of the Board of the National Regulatory Research Institute at Ohio State University, the research arm of NARUC responsible for carrying out research activities involving regulation of the telecommunications, electric, natural gas and water industries; and membership on the Federal Energy Regulatory Commission (FERC) Task Force on Natural Gas Deliverability and the Steering Committee of the U.S. Environmental Protection Agency/State of Michigan Relative Risk Analysis Project. I also served as an Adjunct Professor of Legislation at American University's Washington College of Law, and was selected to be an Eisenhower Fellow to Japan to study their telecommunications and utility structure and lecture on the U.S. regulatory model.

10. I have testified on utility regulatory policy issues before the U.S. Congress, the Michigan Legislature, the New Jersey Legislature, the California Public Utilities Commission, the Illinois Commerce Commission, the Michigan Public Service Commission, and the New York Public Service Commission. I have been a featured speaker at conferences sponsored by Telecommunications Reports, Edison Electric Institute, American Gas Association,

Natural Gas Supply Association, National Association of Regulatory Utility Commissioners, and Canadian Electricity Association.

11. I authored "*A Rating Agency's Perspective on Regulatory Reform*," a book chapter published by Public Utilities Reports (1995), serve on the Advisory Committee of *Public Utilities Fortnightly*, and was a featured columnist for *Electric Utility Business and Finance* and *Power Regulation Monitor*.

**Part III. Joint Statement of G. Mitchell Wilk and Steven M. Fetter**

12. We have been asked by Ameritech to evaluate whether its proposed provision of interLATA services in Michigan would be consistent with the public interest, convenience and necessity. In particular, we will address the ability of Michigan state regulation to prevent, limit, or rectify potential anticompetitive abuses that could, in theory, be attempted by Ameritech in connection with being permitted to provide interLATA services to customers in Michigan under the authority and statutory scheme provided by the Federal Telecommunications Act of 1996 (Telecom Act).

13. We have reviewed relevant Michigan law as well as applicable precedents and practices of the Michigan Public Service Commission, and have drawn upon Mr. Fetter's experience while serving on that body from 1987 to 1993. We have also considered how Michigan's state-level regulation will mesh with relevant protections provided by the Telecom Act. Our

conclusion is that Michigan regulation is fully capable of policing potential anticompetitive abuses by Ameritech that could be related to its provision of interLATA service. Therefore, because the entry of Ameritech into interLATA service will bring the benefits of additional competition to customers (as described elsewhere in Ameritech's application, supporting affidavits and evidence), it is clear that Ameritech's provision of interLATA services in Michigan will advance the public convenience and necessity, and further the public interest. Since the public interest should consider the benefits and costs or risks, we will evaluate to what extent (or whether) Ameritech's interLATA entry will create such costs or risks. As we describe below, our review of Michigan regulation has confirmed that it is fully up to the task of preventing potential harm that might relate to Ameritech's interLATA entry.

14. All of Ameritech's local telephone service offerings in Michigan are now open to competition, and as detailed in the affidavit(s) of Gregory Dunny, and Robert Harris and David Teece, significant local service competition has already developed. Indeed, the Telecom Act removed all legal barriers to entry for the provision of all local telephone services provided by the former Bell Operating Companies (BOCs). As local telephone service becomes competitive, the need for regulatory oversight diminishes (especially if there is no "bottleneck" or captive customer base that requires governmental protection against the potential use of market power by local telephone companies). However, because it may be argued that competition is not yet a broad and full substitute for the oversight of regulation and applicable law, we have reviewed Michigan regulation on the assumption that vigorous competition has yet to develop for at least some Ameritech services or customers, in order to

provide a conservative perspective with regard to the protections that regulation will afford if Ameritech is authorized to provide interLATA services.

15. What follows is organized into nine sections each addressing a different aspect of these issues: (A) The Federal--State Regulatory Framework, (B) Regulatory Concerns and the Public Interest Balance, (C) Cross-Subsidy, (D) Preventing A Cross-Subsidy to Ameritech's New InterLATA Business, (E) Preventing A Cross-Subsidy From Other Service Prices, (F) The Promotion of Local Competition Through Regulatory Safeguards, (G) The Added Protections of Regulatory "Benchmarking" Among States, (H) The Role of the Mandated Separate Subsidiary, and (I) Conclusion.

#### A. The Federal--State Regulatory Framework

16. An understanding of the efficacy of Michigan regulation must begin with the applicable federal and state laws that establish and condition that regulation. This is particularly apt because recent legislation in both jurisdictions has had a major impact on the regulatory framework that is envisioned for Ameritech, and its potential provision of interLATA services.

17. In the Telecom Act, Congress undertook to clarify and specify requirements that were necessary (including the competitive characteristics of the regions in which the BOCs provide local telephone service) for BOCs to offer interLATA services without any undue risk of

related harm to competition, or to telephone service customers. Similarly, in its revisions to the Michigan Telecommunications Act (1995 Public Act 216 [PA216]),<sup>1</sup> the Michigan Legislature specified the regulatory framework that is appropriate to the provision of interLATA services by Ameritech and other Michigan local exchange carriers. Among its many provisions and complexities, the Telecom Act also has preemptive effect in a number of significant ways we will discuss below. Together, these federal and state statutes are the starting place for evaluating the role that Michigan regulation will play if Ameritech is authorized to offer interLATA services.

18. It is important to recognize two critical and related public interest goals that are central to both the Telecom Act and the Michigan Telecommunications Act. The first is the promotion and acceleration of competition, while the second is assuring safeguards to protect that competitive process. For Ameritech, this mandates a set of obligations, but also provides new opportunities (such as interLATA entry). As these obligations and opportunities are paired in the legislation, so should they be paired in the FCC's consideration of Ameritech's application for interLATA authority: Both are urgent, and both should be achieved as quickly as possible for the benefit of customers and the competitive process as envisioned by both the Congress and the people of Michigan.

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<sup>1</sup> Our subsequent references to the Michigan Telecommunications Act refer to the Act as amended by PA 216, except where otherwise indicated.

19. Sections 271 and 272 of the Telecom Act establish the requirements that Ameritech must satisfy in order to provide interLATA service.<sup>2</sup> These involve a considerable amount of shared responsibility between federal and state jurisdictions. For example, before interLATA entry can be approved, the applicable state commission must certify that a BOC is in compliance with the "checklist" provisions of Section 271(c). State commissions must also review and approve the various negotiated agreements with competitors that incumbents must undertake under Section 252 (e.g., for interconnection and unbundling). As another example, the state commission is to receive the results of the biennial audit required of the BOC's separate subsidiary under Section 272(d).

20. The FCC has also been active in helping to implement the Telecom Act, and has assumed a central role in interpreting many of its provisions. In particular, the FCC's 700-page First Report and Order addressing local competition issues<sup>3</sup> includes detailed determinations regarding how BOCs shall go about interconnecting with, unbundling for, and generally facilitating the presence of local telephone competitors of all kinds. We will return to these provisions below in addressing specific public interest issues potentially related to Ameritech's authorization to provide interLATA services in Michigan. Although appeals of the FCC's First Report and Order have resulted in a Federal Court stay with regard to

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<sup>2</sup> By reference, Section 271 also encompasses most or all of the requirements of Sections 251 and 252.

<sup>3</sup> In the Matter of Implementation of the Local Competition Provisions in the Telecommunications Act of 1996 (CC Docket No. 96-98) and Interconnection between Local Exchange Carriers and Commercial Mobile Radio Service Providers (CC Docket No. 95-185).

certain of its requirements, Ameritech has been complying with the pricing methodology that the FCC promulgated, and Ameritech is prepared to comply with whatever the ultimate results will be of the appeals process, including adjusting the prices or other terms of its agreements with competitors (regarding interconnection, unbundling, resale, etc.).

21. As noted above, PA 216 is also relevant. That legislation, which amended the initial Michigan Telecommunications Act (1991 PA179), includes a wide range of provisions addressing how basic rates shall be set, how local exchange carriers should relate to their affiliates and competitors, what safeguards are needed to protect competition, and related matters. The current Michigan Telecommunications Act is notable in a number of regards, but especially two. First, it independently established a complete state-level pro-competitive regulatory framework, prior to the enactment of the Federal Telecom Act. While the safeguards of the Michigan Telecommunications Act are similar to those of the Federal Telecom Act, they flow from independent consideration and authority, and thus offer additional, redundant protections. Second, this legislation reflects the clear and recent determination of the people of Michigan, as expressed through their elected state representatives, that competition for all telecommunications services in all markets should occur as soon as possible, with the accompanying safeguards of which we just spoke. That demonstrates the ongoing, active involvement and concern of Michigan in promoting expanded competition on fair and appropriate terms.

22. Thus, in Michigan we have the combined benefit of both recent federal and state legislation directly addressing the concerns of fair and open competition in telecommunications, including specific determinations about the appropriate terms on which Ameritech should offer interLATA services. Both jurisdictions involved have independently confirmed that enhanced interLATA competition is in the public interest, if undertaken under the requirements these statutes provide. While we go further in this affidavit by offering our assessment of the public interest in this instance, as former regulators and senior gubernatorial advisors, we must emphasize the significance and legitimacy of such determinations by the duly-constituted executive and legislative branches of government in both Lansing and Washington, D.C. In our opinion, these are determinations to which administrative agencies such as the FCC should give great weight and deference.

#### B. Regulatory Concerns and the Public Interest Balance

23. We have already noted that the public interest includes a comparison of the additional competitive benefits Ameritech's interLATA services will create, with the harm or risk that could be caused by its entry into these markets. We would note again the evidence and supporting affidavits that Ameritech is offering with respect to the substantial competitive benefits that will result from Ameritech-Michigan's entry (see the affidavits of Robert Harris and David Teece, Paul MacAvoy, and Robert Crandall and Leonard Waverman). The remainder of this joint affidavit will focus on the potential harm or risks of Ameritech's entry under Michigan law and regulation, undertaken in partnership with and under the

requirements of the federal statutory and regulatory requirements that address the same issues.

24. Accordingly, we now turn to possible concerns about anticompetitive conduct by Ameritech in the interLATA market, before discussing the means by which Michigan regulation will police and prevent such actions. These concerns are: (1) anticompetitive actions (such as predation or unlawful discrimination) supported by cross-subsidy from the regulated prices paid for bottleneck services, and (2) anticompetitive denial or degradation of access to essential facilities (including overpricing), or a related failure to comply with measures that federal and Michigan law and regulation have determined are necessary and appropriate to promote competition for local telephone services. If permitted to occur on any significant or sustained basis, either of these kinds of actions could cause harm to customers and/or the competitive process in long distance markets, and therefore affect the balance of the public interest.

25. These same concerns were expressed through the Telecom Act's specification of obligations imposed upon all large incumbent local exchange companies (LECs) in Sections 251 and 252, as well as in the specific checklist measures that Ameritech must satisfy under Section 271 in order to provide interLATA services. These obligations, which are to be overseen jointly by the Michigan Commission, the Federal Communications Commission (FCC), and federal courts, offer very helpful and specific guidance as to how Congress envisions BOC entry into interLATA markets to take place consistent with the public

interest. Additionally, as we have noted, the Michigan Telecommunications Act addresses the same concerns independently, and we will also refer to its provisions as well as other capabilities, actions and policies of the Michigan Commission that are relevant to these questions.

26. The remainder of this affidavit is organized into sections each discussing a different aspect of Michigan regulation and the protections it provides (in conjunction with federal authority, where appropriate) for the competitive process. The reader should note that most of these protections are cumulative and complementary; that is, the many restrictive provisions work in concert to ensure that Ameritech is not in a position to attempt, carry on, nor profit from anticompetitive conduct in the interLATA market.

### C. Cross-Subsidy

27. A cross-subsidy occurs when one product's price is raised (or set above cost) so that another product's price can be lowered (or set below cost). There must be some linkage between these two (or more) prices in order for a cross-subsidy to exist; i.e., some reason that additional revenues from an overpriced product are not simply retained, but instead are used to reduce other prices. The possible reasons can vary widely: (1) from trying to shield revenues from an absolute earnings limit under a rate cap or from counting towards a profit-sharing formula based on revenues above an authorized rate of return; or (2) to predatory pricing to try to drive a competitor out of a particular line of business. An adverse impact

on competition can occur if such a cross-subsidy permits a BOC to charge less than its costs for a competitive offering, and thereby skewing the market away from the traditional determinants of competitive winners, cost efficiency and product quality. Instead, a BOC could sell its own offering at a price that, but for the cross-subsidy, would have yielded unacceptable losses. For purposes of testing for the presence of a cross-subsidy, economists have determined that the appropriate measure of cost is incremental cost. Prices above incremental cost are not subsidized, and therefore cannot be said to be cross-subsidized from the price(s) of other products.

28. The concern with regard to Ameritech's provision of interLATA services would be cross-subsidies coming from the prices for bottleneck or other monopoly facilities, and the potential use of those cross-subsidies to support anticompetitively-low prices for competitive products. Here, we are focusing on potential use of cross-subsidies to produce anticompetitive pricing for interLATA services originating within Michigan, since Ameritech is petitioning to enter those businesses for the first time.

29. We need to be very specific about the particular scenario that is of concern with regard to interLATA services and improper cross-subsidy: (1) Ameritech is given permission to enter businesses in which it now plays no role; (2) Ameritech incurs costs in those businesses, and somehow shifts them to monopoly services through improper accounting practices; (3) Ameritech then covers these competitive costs by obtaining regulatory permission to raise prices paid by captive customers, or, alternatively, by using these

competitive costs as a reason to maintain existing prices above reasonable levels through the regulatory process. Each of these must occur if an improper cross-subsidy is to result. As we will explain, this scenario is impossible for many reasons under Michigan regulatory oversight; there is simply no realistic way for Ameritech to make it work in any meaningful sense.

30. Michigan regulation, as practiced in concert with the applicable provisions of the Federal Telecom Act and coupled with growing competition for basic local service, will permit neither the shifting of costs from interLATA operations to captive customers, nor increases in prices to captive customers as a result of such efforts (if attempted), nor the maintenance of existing prices above reasonable levels. As we noted above and as documented in the affidavits of Gregory Dunny, and Robert Harris and David Teece, the increasingly competitive nature of all telecommunications services in Michigan (including basic local services to business and residential customers) will militate against any opportunity to overcharge any customers, because they will be able to switch to other providers and will thus no longer be captive in any sense. But whether or not one accepts the efficacy of local competition for this purpose in Michigan, regulation is up to the task of preventing potential cross-subsidy abuses that could be associated with interLATA entry.

31. In Section D, we will first address regulatory protections against Ameritech transferring a subsidy to its long distance operations from its other regulated telephone services, and then turn, in Section E, to the additional regulatory protections that would prevent Ameritech

from raising basic service prices to pay for such a subsidy, or, alternatively, maintaining existing prices above reasonable levels through shifting costs from interLATA operations. Both of these actions must occur if Ameritech is to create a cross-subsidy that would cause harm in long distance markets; i.e., the subsidy must both (1) flow to Ameritech's interLATA business to support below-cost prices, and (2) be reflected in prices above reasonable levels for Ameritech services for which it retains enough market power to sustain the prices from which the subsidy would flow. However, neither half of this equation is possible under Michigan regulation.

32. We would also point out that Ameritech is petitioning to enter large, established interLATA markets within Michigan, and for Michigan interstate traffic. For example, a recent preliminary FCC report ("Statistics of Communications Common Carriers") contained a preliminary statistic that customers in Michigan originated over two billion interLATA toll calls in 1995. In order to create an adverse impact upon competition in these markets, any related misconduct by Ameritech would have to be substantial, and accordingly would become readily apparent to regulators and competitors alike.

33. Note also that our specific analysis of cross-subsidy will discuss the Michigan regulatory process and the history of recent complaint proceedings at the Commission. This process is relevant to how the Commission will enforce all of its rules, not just those regarding cross-subsidy.

D. Preventing A Cross-Subsidy to Ameritech's New InterLATA Business

34. The first question is whether regulation would be unable to prevent Ameritech from using cross-subsidies from its local telephone operations to support its interLATA business.

35. As an initial answer, the Telecom Act preemptively establishes the most stringent preconditions to assist Michigan regulation in its responsibility to ensure that no cross-subsidy or favorable treatment could flow from Ameritech's BOC local telephone operations to Ameritech's new interLATA services. Ameritech's interLATA business operations must: Enter the interLATA market through a fully-separated subsidiary that shall operate independently from its BOC local telephone operations in Michigan; maintain separate books and accounts in accordance with FCC accounting rules; have separate officers, directors, and employees; obtain credit only under terms providing no recourse to Ameritech's telephone operation assets; and conduct business transactions with Ameritech's local telephone operations only at arm's length and in writing (Telecom Act §272(b)). Ameritech's local telephone operations are prohibited from exercising any discrimination in favor of this separate subsidiary, and all transactions between the two shall be accounted for in the manner the FCC prescribes (Telecom Act §272(c)). By comparison to its dealings with unaffiliated providers, Ameritech's local telephone operations can show no favoritism towards the interLATA operations with respect to how quickly requests are fulfilled, or, the terms of availability of local exchange-related facilities, information or services and the extent to which it may make interLATA or intraLATA facilities available for the affiliate's use

(Telecom Act §272(e)1,2,4). Ameritech's local telephone operations must also charge its affiliate access charges that are no lower than those levied on unaffiliated carriers, and must impute a similar amount into its own service offerings that use such access (Telecom Act §272(e)3). In our experience, these requirements constitute a comprehensive menu to prohibit any foreseeable means by which Ameritech might cause a cross-subsidy from its telephone operations to its new interLATA business. Because these provisions apply preemptively to both federal and state jurisdictions, they are also available as tools for the Michigan Commission to use to assure that no cross-subsidy occurs at the state level.

36. The Telecom Act also established a biennial compliance audit in order to verify that all of the foregoing requirements are faithfully followed by Ameritech (Telecom Act §272(d)). This audit is to be fully funded by Ameritech, and performed by an independent auditor; thus, sufficient resources and expertise will clearly be available to conduct the audit (Telecom Act §272(d)1). The auditor will have full access to accounts and records of Ameritech and all of its affiliates and subsidiaries needed to perform this audit, and the FCC and the Michigan Commission will have access to all documents and work papers developed by the auditor (Telecom Act §272(d)3). The audit report itself will be a public document, and all parties (including Ameritech's competitors) will have the right to comment on its results, including presumably calling for investigations, sanctions, or remedial actions that might be suggested by the auditor's findings (Telecom Act §272(d)2). Thus, the Federal Telecom Act provides an extremely useful tool for evaluating and enforcing these regulatory

safeguards against cross subsidy, including developing and making public information that could serve as a basis for remedying any problems that may occur.

37. The FCC's efforts to update its regulatory safeguards are also relevant as regulatory protections against improper cross-subsidy. Federal regulations impose accounting safeguards applicable to Ameritech's provision of interLATA services. Currently, the FCC is conducting a rulemaking proceeding to review and refine these rules with respect to the requirements of the Federal Telecom Act.<sup>4</sup> The FCC has tentatively concluded that its current affiliate transactions rules generally satisfy the requirement of ensuring that interLATA services are not subsidized by subscribers to regulated telecommunications services.<sup>5</sup> The current FCC rulemaking will explore refinements to the FCC's current rules, as well as any additions that may be related to specific requirements of the Federal Telecom Act not addressed by the current rules. The FCC is also considering new rules related to the non-accounting safeguards in the Federal Telecom Act.<sup>6</sup> Generally speaking, these rules will elaborate on the requirements of Sections 271 and 272 of the Federal Telecom Act, including refining standards to be used for compliance and enforcement. While it may be a matter of some debate whether all of these rulemaking activities (or all of the details within

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<sup>4</sup> In the Matter of Implementation of the Telecommunications Act of 1996: Accounting Safeguards Under the Telecommunications Act of 1996 (CC Docket No. 96-150), Notice of Proposed Rulemaking adopted July 17, 1996.

<sup>5</sup> *Ibid.*, paragraph 64.

<sup>6</sup> In the Matter of Implementation of the Non-Accounting Safeguards of Sections 271 and 272 of the Communications Act of 1934, as amended; and, Regulatory Treatment of LEC Provision of Interexchange Services Originating in the LEC's Local Exchange Area (CC Docket No. 96-149), Notice of Proposed Rulemaking adopted July 17, 1996.

them) are necessary to enforce the Federal Telecom Act, the FCC's close consideration of these issues (and whatever rules do result) can only buttress the force and effect of the legislation.

38. In addition to the foregoing joint federal-state protections imposed by (or reinforced through) the Federal Telecom Act, Michigan law and regulation have their own separate requirements that apply to Ameritech.

39. Recall that a subsidy occurs when a service is priced below incremental costs. Under Section 321 of the Michigan Telecommunications Act, all Ameritech regulated service prices must be set at or above their total service long run incremental costs (TSLRIC), with the temporary exception of basic exchange, toll, and access charges that must be restructured on an ongoing basis (as provided by §304(a)) to cover their TSLRICs. The Section 321 pricing transition must be completed by January 1, 2000, after which all Ameritech services must cover at least their TSLRIC. Ameritech's toll service prices must also include an imputation of access charges for essential facilities (§311(1), §362). Section 362 also imposes an imputation requirement upon Ameritech's basic exchange services.

40. Thus, subsidized prices are unlawful in Michigan, which would include the prices of any interLATA services Ameritech would offer within the state. This is a fundamental, direct, and (as we will describe below) fully enforceable protection against any cross-subsidy by Ameritech of its interLATA prices within Michigan. Of course, the avoidance of cross-

subsidy does not resolve pricing issues for Ameritech because TSLRIC prices are inadequate to cover Ameritech's total costs (including joint and common costs shared with other services), and therefore, Ameritech's prices must also contain contribution above TSLRIC. This situation is another reason why authorizing Ameritech to provide interLATA services will not cause harm.

41. Section 308 goes further in preventing a potential cross-subsidy that could be related to Ameritech interLATA service. Section 308(1) specifically prohibits any direct or indirect cross-subsidy to other products and services (offered by Ameritech or an affiliate) from basic local exchange or access rates, or the proceeds from the sale, lease or transfer of rate acquired assets. Section 308(2) prohibits the sale or transfer to an Ameritech affiliate of any assets used to provide basic local exchange service if the transfer occurs at less than fair market value. Section 308(3) requires that Ameritech notify the Commission of any transfer to an affiliate of substantial assets, functions or employees associated with basic telephone service, and that Ameritech explain the transaction and what effect, if any, it will have on basic local exchange service. Section 308(4) confirms the Commission's authority to review the books and records of both Ameritech and its affiliates in any investigation related to these requirements. These requirements are supplemented by others articulated in Section 305, which prohibit Ameritech from selling, leasing or otherwise transferring an asset to an affiliate at less than fair market value (§305(k)), or from buying, leasing or otherwise acquiring an asset from an affiliate for more than fair market value (§305(l)).

42. Thus, with respect to possible cross-subsidy, Michigan's state law framework is straightforward and complete -- not only are subsidized interLATA prices unlawful, but any form of cross-subsidy that would potentially support such subsidized prices (from Ameritech's basic local telephone operations to its new interLATA subsidiary) is also unlawful, and Ameritech is affirmatively obligated to report any related transactions (that could serve as a vehicle for cross-subsidy) to the Michigan Commission.

43. Federal and state law also provide sufficient mechanisms and penalties for enforcing these protections against cross-subsidy.

44. Under the Telecom Act, Ameritech is subject to specific remedial action and sanctions by the FCC for failure to meet, on an ongoing basis, each and every condition required for authorization to provide interLATA service. In such cases, the FCC may (1) order that any such deficiency be corrected, (2) impose a penalty under the FCC's Title V authority, or (3) suspend or revoke Ameritech's interLATA authority (Telecom Act, §271(d)6(A)). Any party may bring a related complaint to the FCC, which must adjudicate such cases within 90 days unless all parties to the complaint agree to an extension of time (§271(d)6(B)). It is especially noteworthy that the FCC's remedial and punitive authority extends to all instances in which Ameritech has "ceased to meet" one of the preconditions for interLATA entry; this frames the matter as one of ongoing compliance, with no need to establish wrongful intent or deliberate action on Ameritech's part. This standard, which is a kind of strict liability test, simplifies the oversight process and provides the FCC with the greatest possible latitude to