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

In the Matter of Request of U S WEST Communications, Inc. for Interconnection Cost Adjustment Mechanisms	CC Docket No. 97-90 CCB/CPD 97-12

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Federal Communications Commission
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OPPOSITION OF GTE SERVICE CORPORATION TO PETITION FOR DECLARATORY RULING AND CONTINGENT PETITION FOR PREEMPTION

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SUMMARY

Petitioners herein request that the Commission ignore the Eighth Circuit Court of Appeals' stay and issue a ruling which would preclude states from allowing ILECs to recover the costs of modifying their networks to accommodate competitive local exchange carriers. Not only would such a ruling conflict directly with the Eighth Circuit stay but it is contrary to the Act and the Commission's rules, violates takings law, and is beyond the Commission's authority. The Commission should leave to state commissions, which regulate intrastate rates and are familiar with local conditions, the determination of the appropriate mechanisms through which incumbent LECs ("ILECs") should recover their costs of implementing interconnection and unbundling.

Section 252 of the Act provides that the charges for interconnection and unbundled elements should be based on the cost of providing these elements plus a reasonable profit. The legislative history confirms that Congress intended that CLECs pay the costs they incur to use the ILECs' networks. In the *Interconnection* proceeding, the Commission likewise affirmed this requirement, stating numerous times that CLECs must pay the costs ILECs incur responding to CLEC requests for services or network elements. As the Commission has acknowledged, recovering costs from cost causers is long-standing agency policy that is undisturbed by the Act. Petitioners' requested ruling would be in direct conflict with these controlling authorities.

In any case, the Eighth Circuit has preliminarily determined that the Commission does not have the authority to issue intrastate pricing rules, such as the ruling

requested here. The Commission must refrain from acting in derogation of that *Order* while the issues remain pending before the Court.

Nor can U S WEST's proposed charges properly be characterized as barriers to entry within the meaning of Section 253, as alleged by Petitioners. Plainly, merely requiring that CLECs pay the costs of new functionalities ILECs must provide solely for the CLECs benefit is not a barrier to entry. The Commission has previously found that, absent a convincing showing that recovery of such costs will prevent the development of competition, they do not constitute a barrier to entry. Moreover, the relevant state commission, not this Commission, would be the appropriate forum for such a showing.

Finally, forcing ILECs to subsidize competitive entry by CLECs would result in a taking without compensation and would leave the ILECs unable to compete effectively. Congress has mandated that CLECs have access to ILEC networks in order to provide local exchange service. ILECs are incurring significant costs modifying their networks and building new systems to accommodate CLEC needs. To avoid a taking, ILECs must be allowed to recover these costs.

For the foregoing reasons, GTE urges the Commission to decline to issue the ruling requested by Petitioners and to allow the states to determine the method by which these costs should be recovered in their respective jurisdictions.

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OPPOSITION OF GTE SERVICE CORPORATION TO PETITION FOR DECLARATORY RULING AND CONTINGENT PETITION FOR PREEMPTION

GTE Service Corporation ("GTE"), on behalf of its affiliated domestic telephone operating companies, hereby files its Opposition to the Petition filed by various competitive local exchange carriers ("CLECs") in the above-captioned matter.[1] Petitioners urge the Commission to issue a declaratory ruling that the initial costs incurred by U S WEST to implement the provisions of the Communications Act of 1934 (the "Act"), as amended, may not be recovered through state-imposed surcharges on either CLECs or end user customers on the grounds that: (1) such costs are not recoverable under Section 252(d) of the Act and (2) the imposition of surcharges would violate the prohibition in Section 253 of the Act against state-imposed barriers to entry.

[1] Electric Lightwave, Inc., McLeodUSA Telecommunications Services, Inc., NEXTLINK Communications, L.L.C. ("Petitioners"), Petition for Declaratory Ruling and Contingent Petition for Preemption (filed Feb. 20, 1997)("Petition").

Petitioners' arguments are based on a misreading of the Act and applicable law and should, therefore, be rejected.

As shown below, incumbent local exchange carriers ("ILECs") are entitled under the Act, the Commission's *First Interconnection Order,*[2] long-standing Commission policy, and "takings" law to recover the costs they are forced to incur to implement the Act. Moreover, grant of the relief requested by Petitioners would conflict with the *Stay Order* entered by the U.S. Court of Appeals for the Eighth Circuit. Instead, the Commission must allow state commissions, which are in the best position to consider issues relating to the pricing of local interconnection services, to determine how the costs of implementation of the Act should be recovered.

I. ILECS ARE ENTITLED TO RECOVER THE COSTS OF PROVIDING INTERCONNECTION, OTHER SERVICES, AND UNBUNDLED NETWORK ELEMENTS TO CLECS.

A. The language and legislative history of the Act confirm that Section 252 requires that a CLEC pay the costs of its interconnection and unbundled elements.

Section 252(d) of the Act states that charges for interconnection and unbundled network elements ("UNEs") should be "based on the cost ...*of providing* the interconnection or network element," and "may include a reasonable profit."[3] Thus, the

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[2] *Implementation of the Local Competition Provisions in the Telecommunications Act of 1996*, 11 FCC Rcd 15499, 161-32 (1996)("*First Interconnection Order*"), *recon.*, 11 FCC Rcd 13042 (1996), *petition for review pending and partial stay granted, Iowa Utilities Board, et al. v. FCC*, No. 96-3321, 1996 WL 589204 (8th Cir. filed Oct. 15, 1996)(granting stay of pricing rules and "pick and choose" rule)("*Stay Order*").

[3] 47 U.S.C. § 252(d)(1)(A)-(B)(emphasis added).

literal language of the Act clearly states that a CLEC will pay all of the ILECs costs, including the costs the ILEC must incur to fill the CLEC's orders for interconnection and UNEs. This language is confirmed by the legislative history of the Act. The House Report on H.R. 1555 (the House Telecom Reform bill) explained that questions of economic reasonableness should not be considered in determining technical feasibility in the predecessor provision to Section 252(d) because ILECs are entitled to recover all costs caused by the requesting party:

> During the Committee's consideration of the bill, the Committee deleted a requirement that unbundling be done on an "economically reasonable basis" out of concern that this requirement could result in certain unbundled services, elements, features, functions, and capabilities not being made available. The Committee clarified, however ... that the beneficiary of unbundling must pay its cost.[4]

This requirement was carried over into the bill as passed.

Nonetheless, contrary to the unambiguous language of the Act and the legislative history, the Petitioners claim that the "costs associated with upgrading and rearranging an incumbent LEC's network to provide the necessary interconnection pursuant to Section 251 of the Act are not permitted to be recovered through an ILEC's charges for interconnection and network elements" because such recovery would violate Section 252(d).[5] However, Petitioners fail to explain why these costs are not costs "of providing" interconnection and network elements and, hence, fully recoverable under the express terms of Section 252(d). As set out above, that section states, and

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[4] H.R. Rep. No. 104-204, 104th Cong., 1st Sess. 71.

[5] Petition at 4, 6.

the legislative history confirms, that Congress intended that CLECs pay all of the costs of providing the interconnection and UNEs they request.

Moreover, as explained in Section III below, ILECs would suffer an unconstitutional taking if not allowed to recover the costs they are forced to incur on behalf of CLECs. Therefore, consistent with the norms of statutory interpretation which require that statutes be interpreted to avoid conflict with constitutional requirements,[6] Section 252 should be construed as establishing ILECs' rights to be compensated for the costs they incur as a result of implementation of local competition.

Also contrary to Petitioners' contentions, U S WEST has not "acknowledge[d]" that the Act does not permit recovery of the costs of interconnection and unbundling.[7] U S WEST merely pointed out the obvious, that the Act does not prescribe an explicit stand-alone mechanism to provide this compensation.[8] This is not surprising because the Act expressly delegates authority over such cost recovery to the states, which is where U S WEST now properly seeks approval of its proposed recovery mechanisms. In fact, as U S WEST states in its Opposition, "U S WEST did not claim that the Act was unconstitutional in its comments before the Commission in the *Interconnection*

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[6] *See, e.g.*, *Arizonans for Official English v. Arizona*, 117 S. Ct 1055, 1074 (1997)("Federal courts, when confronting a challenge to the constitutionality of a federal statute, follow a 'cardinal principle': They 'will first ascertain whether a construction...is fairly possible' that will contain the statute within constitutional bounds.")(quoting *Ashwander v. TVA*, 297 U.S. 288, 348 (1936)(Brandeis, J., concurring)).

[7] Petition at 6.

[8] Opposition of U S WEST, Inc. to Petition for Declaratory Ruling and Contingent Petition for Preemption at 3-4 (filed Mar. 3, 1997)("U S WEST Opposition").

proceeding (CC Docket No. 96-98) because of precisely this essential premise – that U S WEST was specifically entitled to recover its interconnection costs from interconnectors."[9]

A principal purpose of the Act is to promote competition in local exchange markets. This goal cannot be achieved unless CLECs bear the costs of their operation, which include the cost of obtaining UNEs and interconnection from the ILECs. If ILECs are precluded from recovering these costs, they will be forced to subsidize CLECs' operations. This will encourage inefficient entry and force ILEC customers unfairly to bear the costs of providing service to CLEC customers. Such hidden subsidies to CLECs will distort competition and, ultimately, harm consumers. Accordingly, it is both consistent with and required by the Act that ILECs be afforded the opportunity to recoup the costs of providing UNEs and interconnection.

B. The Commission has consistently recognized that ILECs are entitled to recover the costs of implementing local competition.

In the *First Interconnection Order,* the Commission itself properly construed the Act to entitle ILECs to recover their costs of providing interconnection and network elements.[10] For example, the Commission expressly stated that "a requesting carrier

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[9] U S WEST Opposition at 4.

[10] Although GTE believes that the Commission was correct in its determination that ILECs are entitled to recover their costs, GTE disagrees with the cost methodology adopted by the Commission. It has challenged this methodology before the Eighth Circuit (Brief for Petitioners Regional Bell Companies and GTE, *Iowa Utilities Board, et al. v. F.C.C*, No. 96-3321 (8th Cir. consolidated Sept. 11, 1996)).

that wishes a 'technically feasible' but expensive interconnection would, pursuant to section 252(d)(1), be required to bear the cost of that interconnection, including a reasonable profit."[11] It further observed that: "if a competitor seeks to provide a digital loop functionality, such as ADSL, and the loop is not currently conditioned to carry digital signals, ... [t]he requesting carrier would ... bear the cost of compensating the incumbent LEC for such conditioning."[12]

Similarly, if a competitor requests unbundling of integrated digital line concentrator delivered loops, which requires the use of demultiplexing mechanisms, "the costs associated with these mechanisms will be recovered from requesting carriers."[13] And, if a carrier requests cross-connect facilities, "[i]ncumbent LECs may recover the cost of providing such facilities in accordance with our rules on the costs of interconnection and unbundling. Charges for all such facilities must meet the cost-based standard provided in section 252(d)(1)...."[14] The Commission has likewise required that, if interconnecting parties want higher quality interconnection or unbundled network elements than an ILEC provides to itself, they must reimburse the ILEC for any additional costs.[15] In the same vein, the agency clarified that if an ILEC incurs

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[11] *First Interconnection Order*, 11 FCC Rcd at 15603. Footnote 426 referenced in paragraph 199 references Section 252(d)(1) of the Act. This is the same section Petitioners now erroneously claim precludes ILECs from recovering their costs.

[12] *Id.* at 15692 (footnotes omitted).

[13] *Id.* at 15693.

[14] *Id.*

[15] *See First Interconnection Order*, 11 FCC Rcd at 15615 (interconnection), and at

(Continued...)

additional costs in the resale context for unbranding or rebranding operator services and directory assistance, it is entitled to recover those costs through "fees or wholesale pricing offsets."[16]

The Commission's construction of the Act to ensure that carriers have the opportunity to recover the costs of providing service is consistent with long-standing agency policy that was firmly in place even before passage of the Act. As the Commission itself recently stated:

> Carriers under the Commission's jurisdiction must be allowed to recover the reasonable costs of providing service to ratepayers, including reasonable and prudent expenses and a fair return on investment. This fundamental requirement is unchanged by the Telecommunications Act of 1996.[17]

The Commission was equally clear in providing that ILECs are entitled to establish nonrecurring charges ("NRCs") to recover their nonrecurring costs. Although the U S WEST charges may be assessed over a period of several months, they are in the nature of NRCs because they are designed to recoup specific start-up costs associated

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(...Continued)
15659 (unbundled elements).

[16] *Id.* at 15979.

[17] *Accounting for Judgments and Other Costs Associated with Litigation*, CC Docket No. 93-240, FCC 97-80, ¶ 2 (rel. Mar. 13, 1997)(citation omitted). Consistent with policy, the Commission required compensation when an ILEC incurred expenses so that another carrier could interconnect. *See Expanded Interconnection with Local Telephone Company Facilities et al.*, 7 FCC Rcd 7369, *modified,* 8 FCC Rcd 127 (1992), *vacated on other grounds, Bell Atlantic Tel. Cos. v. F.C.C*, 24 F.3d 1441 (D.C. Cir. 1994)(requiring ILECs to file tariffs for charges designed to compensate the ILECs for services offered to interconnectors).

with implementing systems to meet CLEC needs. Thus, they are likely to be limited in duration. Indeed, the Commission has consistently expressed a preference that nonrecurring costs be recovered through nonrecurring charges.[18]

In addition, the Commission has consistently promoted the structuring of rates so as to ensure that those who cause particular costs to be incurred will pay them. For example, in a proceeding regarding nonrecurring charges for access tariffs, the Commission stated:

> We see no reason why the LECs should not recover through an NRC their full one-time costs of providing, terminating or modifying an access service. This is consistent with our policies encouraging the recovery of costs from cost causers....[19]

Thus, the Commission has long believed that it is a "fundamental requirement" that costs should be recovered from cost causers. The fact that Congress expressed no intent to change this policy is further evidence that it intended that ILECs continue to be

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[18] The Commission maintained this policy in the *First Interconnection Order* rules, now stayed. For example, Rule 51.507(a) states that "[e]lement rates shall be structured consistently with the manner in which the costs of providing the elements are incurred," 47 C.F.R. § 51.507(a)(1996), while Rule 51.507(e) specifies that "[s]tate commissions may, where reasonable, require incumbent LECs to recover nonrecurring costs through recurring charges over a reasonable period of time." 47 C.F.R. § 51.507(e)(1996). *See also Ameritech, et al. Petitions for Waiver of Section 69.4(b) and 69.106 of Part 69 of the Commission's Rules*, 9 FCC Rcd 7873, 7878 (1994)(approving cost structure for AIN-based systems through which recurring charges will recover primarily recurring costs and common nonrecurring costs with an optional additional nonrecurring charge to recover customer-specific nonrecurring costs).

[19] *Investigation of Interstate Access Tariff Non-Recurring Charges*, 2 FCC Rcd 3498, 3501-02 (1987). In the presubscription context, the Commission has also adopted rules to ensure that ILECs recover their costs. *See, e.g.*, 47 C.F.R. § 69.107 (1996).

given the opportunity to recover the costs of implementing local competition and that these costs should be recovered from CLECs, the cost causers.

Nonetheless, Petitioners also argue that any charges the state does permit U S WEST to impose for the recovery of implementation costs must be established on a competitively neutral basis and that "[t]here is nothing competitively neutral about U S West's proposed ICAM surcharges."[20] Petitioners are wrong to conclude that U S WEST's proposal to recover the costs of implementing interconnection and unbundling is not appropriate. In contrast to the general cost recovery scheme in Section 252, in the number portability context Congress expressly provided that "[t]he cost of establishing telecommunications numbering administration arrangements and number portability shall be borne by all telecommunications carriers on a competitively neutral basis as determined by the Commission."[21] However, a competitively neutral cost recovery mechanism for interconnection and unbundled elements still requires that the costs be recovered from the cost causers.[22]

No CLEC is required to use ILEC facilities to provide local service. CLECs are free to build their own networks, use part of the ILEC network, or resell ILEC services. Therefore, any costs ILECs incur to provide CLECs with the services or elements they need should be fully recoverable for the ILEC from the CLECs alone. This will ensure

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[20] Petition at 11.

[21] 47 U.S.C. § 251(e)(2). Obviously, when costs were to be borne by all on a competitively neutral basis, Congress knew how to state this explicitly.

[22] Moreover, forcing ILECs to absorb 100 percent of those costs does not, in any event, qualify as competitively neutral.

that CLECs provide competitive services in the most cost-efficient manner – they will use ILEC elements and services only when they are less expensive than building such elements themselves. If CLECs could use the ILEC network without paying the costs associated with that use, there would be no facilities-based competition.

C. Congress intended that state commissions determine the appropriate methods through which ILECs' costs of providing interconnection and unbundled elements should be recovered.

The Eighth Circuit Court of Appeals has stayed application of the pricing rules adopted by the Commission based on an initial judgment that "the FCC is without jurisdiction to establish pricing regulations regarding intrastate telephone service."[23] That Court is currently considering the issue. Petitioners are suggesting that the Commission should ignore the *Stay Order* and adopt additional pricing rules based on Section 252 that would prevent states from allowing ILECs to recover costs incurred in providing these services. The Commission has no independent basis for promulgating such a requirement. Therefore, to avoid flouting the Court's authority, the Commission must wait until the Eighth Circuit has rendered a decision before issuing any additional pricing rules.

Deferral to the states is warranted as a matter of judgment as well as of law. State commissions are in the best position to determine how the ILECs' costs of implementing local competition should be recovered. Each ILEC has a different network and systems, and each requires different changes and new systems in order to

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[23] *Stay Order,* 1996 WL 589204, *5.

provide CLECs with interconnection and UNEs. State commissions are familiar with the unique circumstances of the local networks in their jurisdictions and are responsible for regulating local rates. Thus, they will be able to ensure that the recovery of implementation costs is consistent with the overall rate structure in each state.

II. ALLOWING ILECS TO RECOVER THE COSTS OF PROVIDING INTERCONNECTION AND UNES DOES NOT VIOLATE SECTION 253 AND IS CONSISTENT WITH COMMISSION POLICY.

Section 253 of the Act states: "[n]o State or local statute or regulation, or other State or local legal requirement, may prohibit or have the effect of prohibiting the ability of any entity to provide any interstate or intrastate telecommunications service."[24] Petitioners claim that allowing U S WEST to recover the costs of interconnection and UNEs from either CLECs or end users would constitute a barrier to entry within the meaning of Section 253. However, Petitioners misunderstand the nature of "barriers to entry." Barriers to entry do not include paying the costs of modifying a network to provide new functionality for the sole benefit of requesting entities.

The Commission has considered the issue of upfront recovery of the costs of providing service before and determined that it does not constitute a barrier to entry. In an access tariff proceeding, the Commission stated:

> the concern that full-cost recovery NRCs might create barriers to entry and harm competition and potential competition in the interexchange market does not appear to be well-founded. NRCs have been below full-cost recovery levels for some time, yet the interexchange marketplace has been dominated recently by carrier mergers and

[24] 47 U.S.C. § 253(a).

> consolidations rather than the appearance of new entrants. The commenters have not demonstrated that higher NRCs are in and of themselves a significant disincentive to market entry by new carriers, given the panoply of other cost and marketing considerations that apply in this area. Thus we conclude that our concerns about high NRCs creating "barriers to entry" have not been borne out by either actual experience in the marketplace or by any empirical proof offered in this proceeding. Absent a convincing showing, we believe the public interest is best served, and a competitive marketplace best encouraged, by policies that promote the recovery of costs from the cost causer.[25]

The market factors affecting local interconnection and UNEs are very similar to those involved in the exchange access market. Certain expenses must be incurred to enter the local exchange market; the charges for implementation of interconnection and unbundling are a small part of these expenses. Petitioners have submitted no evidence showing that recovery of such costs will prevent the development of competition. In any event, the relevant state commission, not this Commission, would be the appropriate forum for such a showing, if it could be made. Moreover, the development of real competition will not be aided by forcing ILECs to underwrite the costs of CLECs. Rather, such a policy will only force those customers that the CLECs do not want to serve – apparently including most residential consumers and small businesses – to absorb the costs of CLECs providing service to large businesses and the most profitable residential consumers. Therefore, as the Commission previously concluded, in absence of any "convincing" showing to the contrary, competition is best fostered by ensuring that CLECs pay the costs their business imposes on the ILECs.

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[25] *Investigation of Interstate Access Tariff Non-Recurring Charges*, 2 FCC Rcd 3498, 3502 (1987).

III. FORCING ILECS TO SUBSIDIZE CLEC ENTRY WOULD RESULT IN A TAKING WITHOUT COMPENSATION AND WOULD LEAVE ILECS UNABLE TO COMPETE EFFECTIVELY.

One of the principal purposes of the Takings Clause in the U.S. Constitution[26] is to "bar Government from forcing some people alone to bear public burdens which, in all fairness and justice, should be borne by the public as a whole."[27] In the case of utilities, whether a taking has occurred depends on whether a utility has had an opportunity to earn a fair rate of return on its prudent investment.[28] Petitioners claim that the costs for "tandem expansion, systems costs for ordering, provisioning, and billing, and start-up costs for the establishment of CLEC service centers" cannot be recovered "through interconnection and network element charges."[29] Instead, the Petition asserts that these costs "are part of U S West's overall rate base."[30]

Not allowing ILECs to recover the costs of complying with the Act would result in a taking of private property for public use without just compensation. Congress has determined that CLECs must be given access to ILECs' networks in order to provide competition in the local market which will benefit all consumers. However, the Act requires ILECs to expend significant sums to provide the new services and access

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[26] U.S. Const. amend. V.

[27] *Dolan v. City of Tigard*, 114 S. Ct. 2309, 2316 (1994)(citation omitted).

[28] *Federal Power Comm. et al. v. Natural Gas Pipeline Co. et al.*, 315 U.S. 575, 602 (1942)(Black, Douglas, and Murphy, JJ. concurring).

[29] Petition at 9.

[30] Petition at 10.

necessary for this competition. For example, the cost of interconnection includes not only cables and switches, but also modifications to or creation of the "back office" systems used to provision and bill the new "services." Unlike requirements which will benefit the public as a whole, such as number portability, the modifications necessary for CLECs to use ILEC networks will only benefit CLEC customers. Therefore, these costs should be spread among those benefiting, not charged solely to the ILEC and its remaining customers.

In contrast, Petitioners' proposal that the costs of providing interconnection and UNEs be included in U S WEST's rate base will result in an increase in U S WEST's costs of "service." U S WEST will have to raise prices to its customers to cover the costs of CLEC entry, which will encourage more customers to switch to CLECs and leave U S WEST unable to compete due to higher, subsidy-laden prices. Allowing CLECs to gain additional customers in this manner will leave U S WEST with even a smaller rate base over which to spread these costs, causing a spiral of ever-increasing prices over a shrinking customer base.

In addition, the Commission should note U S WEST's argument that forcing ILECs to build facilities is not subject to the same takings standard as confiscatory ratemaking cases.[31] Rather, "when the government forces anyone ... to construct facilities for another, full compensation must be paid for that specific coerced action ....

[31] U S WEST Opposition at 8.

When the Government seized the Youngstown Steel plant, it was no defense to the seizure that the plant might make a profit under its new owners."[32]

IV. CONCLUSION

GTE is firmly committed to implementing the provisions of the Act and bringing local competition to its service areas. GTE has incurred and will continue to incur significant costs as it reconfigures its systems and implements new mechanisms to provide services, interconnection, and UNEs to CLECs. If GTE and other ILECs are not allowed to recoup these costs, as provided for by the Act and the Commission, ILECs will suffer an unconstitutional taking of property and will be unable to compete on a level playing field with new entrants.

Moreover, because these costs are related to local services, the Commission has no authority to mandate recovery mechanisms. Rather, given the unique circumstances of each ILEC, state commissions are in the best position to consider the

[32] *Id.* (citation to *Youngstown Sheet & Tube Co. v. Sawyer* omitted)

appropriate recovery of these costs. Therefore, GTE urges the Commission to decline to issue the ruling requested by Petitioners and to allow the states to determine the method by which these costs should be recovered in each state.

Respectfully submitted,

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I hereby certify that on this 3rd day of April, 1997, I caused copies of the foregoing OPPOSITION OF GTE SERVICE CORPORATION TO PETITION FOR DECLARATORY RULING AND CONTINGENT PETITION FOR PREEMPTION to be served via first class mail, postage prepaid, on:

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