



MCI Telecommunications Corporation

1801 Pennsylvania Avenue, NW
Washington, DC 20006
202 887 2551
FAX 202 887 2676

Mary L. Brown
Senior Policy Counsel
Federal Law and Public Policy

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September 12, 1997

Mr. Richard Metzger
Deputy Chief, Common Carrier Bureau
Federal Communications Commission
1919 M Street, N.W.
Washington, D.C. 20554

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

**Re: EX PARTE in Local Number Portability, CC Docket No. 95-116;
Southwestern Bell Transmittal No. 2638, filed June 6, 1997;
Pacific Bell Transmittal No. 1927, filed July 7, 1997**

Dear Mr. Metzger:

MCI recently advocated that telecommunications regulators adopt the "Fair Play Test" to ensure that local markets are open to competition, and that new entrants like MCI can compete with the incumbents on a fair and equitable basis. Key components of the Fair Play Test are prices that are set on a pro-competitive basis, and assurances that the costs of implementing pro-competitive policies are spread across the industry in a competitively neutral fashion. Establishment by the Federal Communications Commission (Commission) of a cost recovery mechanism for local number portability (LNP) can help to open markets if it is competitively neutral and drives carriers to maximize efficiency in the use of industry facilities and the design and operation of their networks.

Some of the most profitable companies in America, the Regional Bell Operating Companies (RBOCs), would like to have it another way. They continue to advocate that their competitors, new entrants to local markets, and interexchange carriers (IXCs), should bear the RBOCs' over-inflated, unsubstantiated and unjustified LNP costs. Adoption by the Commission of the argument that companies, such as MCI, should be burdened with RBOCs', as well as their own, costs would not be competitively neutral, and would serve only to further prolong the day when consumers have a meaningful choice of local service providers.

The Telecommunications Act of 1996 requires that LNP costs be borne by all carriers on "a competitively neutral basis." 47 U.S.C. § 251(e)(2). In implementing this Congressional mandate, the Commission should ensure that, prior to implementation of a

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cost recovery mechanism, the incumbent local exchange companies (ILECs), including RBOCs, have submitted definitive and substantiated documentation of the actual costs incurred by them to implement LNP. The Commission should further ensure that ILECs are not permitted to recover LNP costs in a way that adversely impacts the ability of new entrants to penetrate local markets.

I. Background

In the cost recovery Notice of Proposed Rulemaking (Notice), the Commission tentatively identified the following three categories of costs that will be incurred as the industry implements permanent LNP:

Category 1 – the costs of shared facilities, such as the number portability database, and administration of that database. The Notice proposed that these costs might be recovered as a tax on revenues net of access charges and/or per query charges;

Category 2 - carrier-specific costs to implement permanent LNP, such as software upgrades. The Notice asked if these costs should be recovered from end users or other carriers, and if recovery is from end users, whether the Commission should prescribe an explicit recovery mechanism; and

Category 3 - carrier-specific costs not directly related to permanent LNP, such as adding Signalling System 7 (SS7) capabilities. The Notice tentatively concluded that these costs “should be borne by individual carriers as network upgrades” since network improvements will enable carriers to generate new revenue streams.

The Notice sought comment on whether and how each of these cost categories should be treated, including for price cap purposes. Based on MCI's review of the record, there appears to be no substantial dispute about cost recovery mechanisms for Category 3 costs, since most parties agree that those carrier-specific costs that are not directly related to LNP should not be a part of the Commission's cost recovery scheme. Thus, Category 3 costs are not addressed here.

With respect to Category 1 and 2 costs, at least one ILEC, BellSouth, urges the Commission to apply exogenous cost treatment to the remaining costs of deploying permanent LNP. The notion that an exogenous cost recovery mechanism could ever be described as “competitively neutral” is unfathomable, and the Commission should dismiss any arguments to the contrary.

II. LNP is associated with a local service, and the Commission should mandate that Category 1 and Category 2 LNP costs be recovered in the intrastate jurisdiction.

No party disputes that LNP is specifically associated with local service, permitting subscribers to retain their local telephone number when switching carriers (service provider portability), moving locations (location portability), or simply changing services (service portability). An end user's selection of a new local service provider, while retaining his existing telephone number, is an affirmative election, which facilitates local competition, and thus improved local service quality and lower prices, by allowing him to change carriers without having to change his telephone number.

While LNP is primarily an intrastate function, Congress has specifically mandated that the Commission define how LNP is provided, including any and all requirements that will ensure that LNP is deployed in a competitively neutral manner. Section 251(b)(2) creates the obligation for all local exchange carriers to provide, to the extent technically feasible, LNP. The statute also directs the Commission to establish "requirements" for LNP. Congress's unambiguous grant to the Commission of plenary jurisdiction over LNP allows the Commission to specify cost recovery principles for permanent local number portability under the same legal authority the Commission used to specify the criteria for a uniform, nationwide LNP method.¹

MCI urges the Commission to exercise the jurisdiction granted by the statute by specifying the following cost recovery principles that states must follow with respect to LNP²:

- **Competitive neutrality** means that each carrier should bear its share of shared facilities costs (Category 1) costs, and its own carrier-specific direct costs (Category 2 costs) to install number portability, and these costs should not be passed through to carriers as local interconnection rates or access rates. To the extent a state permits, the carrier should recover these charges via any appropriate state-imposed mechanism, and not through access rates.

- To the extent any direct costs are recovered from retail rates, they should be based on **forward-looking cost** recovery methods to ensure that LNP is deployed as efficiently as possible.

¹ See Iowa Utilities Board v. FCC, No. 96-3321 et seq., slip op., filed July 18, 1997 (8th Cir.), nn. 10, 12 and accompanying text (drawing a distinction between pricing for local interconnection, where the statute did not specifically provide a role for the Commission in determining pricing, and LNP and other statutory provisions, where the Commission's role is explicit).

² The costs at issue here are not those incremental costs incurred by a carrier to perform LNP queries on behalf of another N-1 carrier. MCI agrees with most parties to this proceeding that those costs should be recovered directly from the N-1 carrier as interstate or intrastate charges, depending on the nature of the call.

•**Costs must be specific to LNP deployment**, and must not be costs for general network upgrades that can be utilized to provide other telecommunications services or enhanced services.

•**No double counting of costs**. The record before the Commission demonstrates that the ILECs are attempting to include unspecified, undocumented, and undefined operational support systems (OSS) costs as part of LNP cost recovery. There is no showing that these OSS costs are incremental to LNP or that they are not being recovered in other nonrecurring or recurring charges.

Adoption by the Commission of these basic principles, and their application to state regulation, is essential since: (1) the statute specifically provides for Commission decision-making, thereby permitting the Commission to determine all of the "requirements" for LNP that will fulfill Congress's intent; and (2) absent clear guidance to the states, costs for LNP could be unjustifiably placed on certain carriers, such as competitive LECs, who would have to bear their own LNP costs in addition to ILECs' LNP costs. This would unfairly burden new entrants and circumvent the Congressional requirement that cost recovery for LNP be competitively neutral.

III. Even if the Commission finds that some costs should be recovered in the interstate jurisdiction, there is no legal requirement for price cap carriers to receive exogenous treatment of Category 1 or 2 costs.

The Commission has no existing rule with respect to exogenous treatment of LNP costs, and is thus free to consider whether to grant exogenous treatment in this case.³ In considering whether to grant exogenous treatment, the Commission should consider, among other things, the extent to which exogenous treatment provides efficiency incentives⁴ or double counting of other price cap index elements.

A mechanism allowing ILECs to pass through LNP costs to IXC and new entrants would not be competitively neutral, would provide no efficiency incentives, and would plainly contradict the fundamental purpose of price cap regulation. As to the double counting issue, the record in the present docket is wholly insufficient to determine if double counting exists with respect to gross domestic product (GDP). At a minimum,

³ Compare Southwestern Bell Tel. Co. v. Federal Communications Comm'n., 28 F.3d 165, 169 (D.C. Cir 1994) (Commission decision reversed and remanded because it failed to follow existing rule on exogenous cost treatment of certain post-retirement employment benefits.)

⁴ Compare In The Matter of Price Cap Treatment of Regulatory Fees, 9 FCC Rcd 6060 (Com. Car Bur., 1994) (endogenous treatment would not stimulate efficiency).

the Commission must recognize that there are substantial and material factual issues that would need to be addressed, since regulatory compliance costs are part of GDP.⁵

IV. If the Commission finds that permanent LNP costs should be recovered in interstate rates, the Commission should limit recovery to Category 2 "direct costs," require that these costs be forward-looking, and exclude these costs from price cap regulation.

If the Commission concludes that permanent LNP costs should be recovered in interstate rates, those costs should remain outside of price caps. The Commission excluded expanded interconnection rates from price cap regulation in order to prevent anti-competitive gaming of the rates, and to allow a cost-based review of rates. Permanent LNP costs, if recovered in interstate rates, should be accorded the same treatment, since the anti-competitive price squeeze potential recognized by the Commission in expanded interconnection rates is also present in the case of permanent LNP.

Many of the same carriers that will compete with ILECs for local exchange service customers also purchase access services from those same ILECs. As in the case of expanded interconnection, ILECs have the incentive and the ability to raise their rivals' costs by imposing above-cost LNP charges. If LNP charges are included in a price cap basket, ILECs will have significant pricing flexibility to increase rates. On the other hand, if the Commission excludes LNP charges from price caps, it will be able to determine a forward-looking and cost-based rate for LNP, and to cause the rate to remain at cost-based levels.

It is imperative that the Commission recognize that the cost data provided to date by the ILECs is wholly insufficient to allow the Commission to evaluate what the LNP costs would be if the Commission ordered forward-looking recovery of Category 2 costs. It is also important that the Commission closely scrutinize those costs to prevent the inclusion of any Category 3 costs in Category 2 costs.

Category 1 costs are shared industry cost elements specifically associated with the operation of the number portability database. Many ILECs have urged the Commission to apply some sort of artificial allocation scheme to Category 1 costs, such as an allocation to all telecommunications carriers, based on revenues. An artificial allocation scheme is unnecessary, may lead to inefficient use of the NPAC/SMS systems, and may lead to over-payment by some carriers of their fair share of Category 1 costs.

All LNP-participating carriers (including local exchange carriers (LECs), new entrants and IXC) should be assessed for the direct costs associated with their use of the

⁵ See generally, The Changing Burden of Regulation, Paperwork, and Tax Compliance on Small Business: A Report To Congress, U.S. Small Business Administration, Office of Advocacy, October 1995.

NPAC/SMS. Direct assessment of these costs – which include service establishment, access, downloads and miscellaneous charges – will promote efficient use by each carrier of these shared industry facilities, without the need for an artificial allocation mechanism. Any remaining Category 1 costs (*i.e.*, costs that are not direct costs of operating the NPAC/SMS) can be fairly split among the participating LECs based on their share of working telephone numbers in the portability area. This correctly focuses the indirect costs of the number portability on local exchange carriers that are porting numbers. Non-participating telecommunications carriers will also pay their share of Category 1 costs in their charges for default queries, such as those proposed by Southwestern Bell, Pacific Bell and Ameritech. If non-participating telecommunications carriers were assessed a share of Category 1 costs through an allocation mechanism, plus through the query charges paid to participating LECs, those carriers would be unfairly burdened with a double-share of Category 1 costs.

To date, no ILEC has submitted to the Commission the type of definitive cost support that would permit an in-depth examination of what they have labeled as LNP-specific costs. Additionally, as noted above, many ILECs' cost estimates have included unsupported OSS costs as a part of LNP cost recovery. For example, in a July 9 *ex parte*, SBC claims that in 1997, it would spend approximately \$205 Million in 1997, and another \$350 Million after 1997, to implement LNP. These exorbitant figures include unspecified expenses for upgrades to "OSS, SS7 and right to use fees." US West claims in a July 11 *ex parte* that it will spend a total of approximately \$406 Million to implement LNP. Ameritech's estimate contains \$99 Million in OSS costs alone. This data gives rise to the potential for a substantial rollback of the Commission's promise to reduce access charges by \$1.7 Billion. The Commission should reject these artificially inflated cost assessments, each of which has no supportable basis in fact and which greatly increase the chances of double recovery by the ILECs of LNP costs.

While the potential for a substantial rollback of interstate access reductions is real, the potential harm to ILECs of denying recovery from access rates and local interconnection rates is small. For example, using the costs in the first year, which the ILECs claim are the highest, and assuming the ILECs could not flow through any LNP costs in retail rates, and taking at face value the cost figures placed on the record by Bell Atlantic, NYNEX, and BellSouth (which MCI believes are grossly overstated and should be rejected by the Commission), and assuming no cost recovery at all, the cost of deploying permanent LNP would still not have much of an impact on ILEC earnings.

Conclusion

New entrants' ability to take advantage of the statutory mandate that carriers must provide LNP is critical to the existence of effective local competition. The Commission should adopt LNP cost recovery rules that are competitively neutral, and which recognize that LNP benefits local exchange customers. The Commission should dismiss ILEC arguments that they should be able to pass their LNP costs through to IXCs and new entrants to the local market -- the very industry participants that are most likely to challenge their monopolies. If the Commission adheres to the principles outlined in this letter, whatever cost recovery mechanism it adopts will help achieve the overarching goal of making local exchange service competition a reality.

Very truly yours,


Mary L. Brown

cc: Mr. James Schlichting