competitive entrants into inter-exchange services.

Congress recognized that the new local competitors would require access to portions of the critical local exchange network that the incumbent LECs still controlled as bottleneck facilities. As in the past, this control enables an incumbent LEC to hinder competition -- for example, by refusing access to its network facilities, by charging unreasonable rates for such access, by stalling in the negotiation of interconnection agreements, or by otherwise discriminating against new entrants in the types of facilities and services made available. Accordingly, the 1996 Act requires the incumbent local exchange carrier ("ILEC") to provide access to certain services and facilities to new competitors (Section 251(a), (b), (c)), and directs the FCC to act within six months to implement these statutory requirements in specific regulations (Section 251(d)).

Congress did not require each new entrant to build an entire local telephone network. Rather, Sections 251(c)(2)-(4) of the 1996 Act establish three specific federal requirements to foster competitive entry:

- ***interconnection*** -- Section 251(c)(2) requires that ILECs allow competitors to interconnect with the ILECs' local exchange networks at fair, non-discriminatory rates;[10]

- ***unbundled network elements*** -- Section 251(c)(3) requires that ILECs permit competitors to lease parts of the ILECs' networks at fair, non-discriminatory rates;[11] and

---

[10] Section 251(c)(2) prescribes that such interconnection be available at any point in the incumbent LEC's network that is technically feasible, and that it be at least equal in quality to the interconnection the incumbent LEC maintains for its own lines.

[11] Under this "unbundling" provision, an individual competitor may lease or combine network elements it needs (*e.g.*, the local loops) without paying for others (*e.g.*, a local exchange switch) that it may not need.

- *resale* --Section 251(c)(4) requires that ILECs allow competitors to purchase local telephone services at wholesale rates and resell those services to the competitors' customers.[12]

In taking advantage of these requirements, a competitor is not limited to one option or another. The competitor may resell to some customers, for example, while leasing unbundled elements or constructing separate networks to serve others.

Section 252 sets forth the "Procedures for Negotiation, Arbitration, and Approval of Agreements" that individual telecommunications carriers must follow when invoking the Section 251 requirements. In broad outline, the Act gave the FCC the function of issuing certain rules of general applicability (*e.g.*, Section 251(d)(1)), and authorized the state PUCs to review and, if necessary, arbitrate the terms of specific agreements consistent with the Act and the FCC rules (*e.g.*, Section 252(c), (d)). The Act further provides that all agreements between incumbent LECs and new entrants must be submitted to the appropriate state PUC for approval (Section 252(e)(1)). The Act provides for review of agreements approved by state PUCs in the federal district courts (Section 252(e)(6)), where the question is whether the agreements meet the requirements of Sections 251 and 252.

C. Implementation of the Interconnection Provisions.

On August 8, 1996, the FCC issued implementing regulations under Section 251(d) of the Act. *In re Implementation of Local Competition Provisions of the Telecommunications Act of 1996*, First Report and Order, 11 FCC Rcd 15499 (1996) ("*FCC Order*"). The FCC concluded that the congressional objective of eliminating the disparity in bargaining power

---

[12] Section 252(d)(3) further provides that the "wholesale rates" charged to resellers under section 251(c)(4) must be based on retail rates, excluding the portion of those rates attributable to "costs that will be avoided."

between the ILEC and a would-be competitor (who has little to offer the ILEC and threatens to take its customers) is best addressed by defining the requirements of the 1996 Act in sufficient detail to advise parties of their minimum rights and obligations, and by establishing a national regulatory baseline to reduce transaction costs. *Id.* ¶¶ 55, 60-61.

The FCC adopted rules construing various interconnection requirements under Section 251(c). Thus, the FCC rejected the claims of some ILECs that they should be required only to unbundle the physical components of their networks under Section 251(c)(3). Instead, the FCC noted that the definition of "network element," added by the 1996 Act to Section 3 of the Communications Act, 47 U.S.C. § 153(29), defined the term to include not only the physical facilities and equipment of a local exchange network, but also any "features, functions, and capabilities that are provided by means of such facilit[ies] or equipment." *FCC Order* ¶ 262.

With respect to resale, the statute requires ILECs to make their services available to new entrants at "wholesale" prices that are determined by excluding from retail prices "the portion thereof attributable to any marketing, billing, collection, and other costs that will be avoided" by selling at wholesale. Sections 251(c)(4), 252(d)(3). Noting the concurrence of a number of state regulators on the issue, the FCC construed the statute to exclude those costs that will be avoided by a reasonable ILEC selling at wholesale. *FCC Order* ¶ 911. The FCC found that excluding only those costs that an incumbent LEC actually avoids would "allow incumbent LECs to sustain artificially high wholesale prices by declining to reduce their expenditures to the degree that certain costs are readily avoidable." *Id.*

The FCC found that "[t]he price levels set by state commissions [in Section 252 arbitration proceedings] will determine whether the 1996 Act is implemented in a manner that

is *pro-competitor* and favors one party . . . or, as we believe Congress intended, *pro-competition*." *FCC Order* ¶ 618 (emphasis in original). Thus, the FCC deemed it "critical" to establish among the states "a common, pro-competition understanding of the pricing standards" for interconnection, unbundled access, and resale. *Id.* For interconnection and unbundled access -- which, by statute, must be priced at "just" and "reasonable" levels (Section 251(c)) "based upon the cost" (Section 252(d)(1)) -- the FCC adopted a forward-looking, replacement cost methodology known as Total Element Long Run Incremental Cost (TELRIC). *Id.* ¶¶ 620, 672-732. This cost methodology is based on a carrier's long-run incremental costs, plus a reasonable share of its forward-looking joint and common costs. The FCC concluded that a forward-looking pricing methodology would allow ILECs a reasonable market return and, at the same time, give new entrants an appropriate economic incentive to enter a monopoly market. *Id.* ¶ 672.

Because Section 252(b) requires state PUCs to complete arbitration proceedings on a tight schedule, the FCC recognized that some state PUCs might not be able to complete the cost studies necessary for full application of the FCC's forward-looking pricing methodology. *FCC Order* ¶ 623. The FCC therefore established optional "default proxies," designed to approximate application of that methodology, that state PUCs may elect to employ until full cost studies are completed. *Id.* ¶¶ 623, 768-71. *See also id.* ¶¶ 921-34.

D. Review of the *FCC Order*.

Various interested parties filed petitions for judicial review of the *FCC Order*, which ultimately were consolidated in a massive proceeding in the Eighth Circuit. *Iowa Utils. Bd. v. FCC*, 8th Cir. No. 96-3321 (and consolidated cases). Several petitioners asked that court to

stay the *FCC Order* in its entirety pending review. The court did not grant a comprehensive stay, but stayed only the FCC's rules related to pricing and the so-called "pick-and-choose" rule. *See Iowa Utils. Bd. v. FCC*, 109 F.3d 418, 421 & nn.3-4 (8th Cir. 1996).

After full briefing and oral argument, the Eighth Circuit in July 1997 issued an opinion that addressed many of the challenges to the FCC Order. *Iowa Utils. Bd. v. FCC*, 120 F.3d 753 (8th Cir. 1997). With respect to arbitration agreements adopted under Sections 251 and 252 of the Act, the court held that the FCC lacked jurisdiction to adopt rules implementing the pricing provisions of the Act. 120 F.3d at 793-800. The court vacated the FCC's pricing rules solely on jurisdictional grounds.[13] It expressly declined to rule on whether the FCC had reasonably construed Section 251 to require rate making on the basis of forward-looking costs. 120 F.3d at 800.

The Eighth Circuit reached the merits of the challenges to the FCC's non-pricing rules promulgated pursuant to Section 251. For example, the court rejected challenges to various aspects of the FCC's rules concerning unbundled network elements. 120 F.3d at 807-18. The court also held that the FCC properly exercised its statutory authority when it found that a LEC's discounted and promotional offerings are "telecommunication service[s]" subject to the resale requirement of Section 251(c)(4). *Id.* at 819.

Thus, the Eighth Circuit did not hold that the FCC lacks all regulatory authority over the provision of intrastate telecommunications services under Sections 251 and 252. To the

---

[13] The court made clear that it was not vacating 7 C.F.R. § 51.515(b), which it had previously found to be a legitimate interim rate for interstate access charges. 120 F.3d at 800 n.21 (citing *Competitive Telecommunications Ass'n v. FCC*, 117 F.3d 1068 (8th Cir. 1997)). The court also indicated that it was not vacating the pricing rules insofar as they pertain to Commercial Mobile Radio Service (CMRS) providers because Congress had expressly authorized the FCC to regulate CMRS in this manner. *Id.*

contrary, the Eighth Circuit specifically recognized that the FCC has regulatory authority (including authority to regulate the intrastate aspects) over such diverse matters as local number portability (Section 251(b)(2)), prevention of discriminatory conditions on resale (Section 251(c)(4)(B)), the obligation to provide unbundled network elements (Section 251(d)(2)), numbering administration (Section 251(e)), continued enforcement of local exchange access (Section 251(g)), and treatment of comparable carriers as incumbents (Section 251(h)(2)). *See Iowa* Utils. Bd., 120 F.3d at 794 n.10, n.23. The court further acknowledged that the FCC's rules in these areas would preempt any state rules that conflict with the substantive provisions of Section 251 or substantially prevent their implementation. 120 F.3d at 807.

On October 14, 1997, the Eighth Circuit, on rehearing, vacated the FCC's rule requiring ILECs, rather than the requesting carriers, to recombine network elements that are purchased by the requesting carrier on an unbundled basis. It otherwise left intact its initial decision. *Iowa Utils. Bd. v. FCC*, No. 96-3321 *et al.* (8th Cir. Oct. 14, 1997), *petitions for cert. filed,* No. 97- ____ (November 1997).

ARGUMENT

AT&T sought judicial review of three issues decided by the MPSC. One of those issues -- whether the MPSC erred in excluding certain Contract Service Arrangements ("CSAs") entirely from BellSouth's statutory resale obligation and providing that other CSAs shall be available for resale by AT&T but not at "wholesale rates" -- remains fully in dispute. The FCC submits that the MPSC's determination on this issue is inconsistent with the Act and binding FCC regulations, and requires reversal by this Court pursuant to Section 252(e)(6).

As to the remaining two issues, the MPSC concedes that, to the extent that the approved agreement can be read to mean that AT&T may not itself recombine unbundled elements to provide services identical to those of BellSouth, the agreement is incompatible with FCC regulations upheld by the Eighth Circuit. Moreover, the MPSC and BellSouth now admit that the exclusion of vertical features from unbundled local switching is also inconsistent with the FCC regulations. We address these issues briefly and urge the Court to direct the MPSC to modify the Agreement as required to comport with the Act and binding FCC regulations on these issues.

I. THE STANDARD OF REVIEW OF STATE PUC INTERCONNECTION ORDERS UNDER SECTION 252(e)(6).

Under Section 252(e)(6), this Court must review the MPSC's interconnection order to determine whether it conforms with the requirements of the 1996 Act. In particular, the Court is charged with ensuring that interconnection agreements satisfy the requirements of Sections 251 and 252, including compliance with rules that the FCC was authorized to adopt to implement those requirements. The Act, for example, specifies in Section 252(c)(1) that a state PUC shall "ensure" that its arbitration decisions "meet the requirements of section 251 *including the regulations prescribed by the [FCC] pursuant to section 251*" (emphasis added). Likewise, Section 252(e)(2)(B) requires the state PUC to reject any argument that does not "meet the requirements of section 251 *including the regulations prescribed by the [FCC] pursuant to section 251*" (emphasis added). The Act, therefore, underscores that state PUCs must adhere to the FCC's authorized rules as a matter of binding federal law.

The Eighth Circuit's decision upheld several of the FCC's rules that are directly

relevant to the three issues before this Court. Specifically, the Eighth Circuit upheld the FCC's rules 1) allowing a competing carrier to provide finished telecommunications services by acquiring access to the unbundled elements of an ILEC's network (120 F.3d at 814); 2) setting forth the scope of services that are subject to the resale requirement (*id.* at 818-19); and 3) identifying the features that are included as part of the "unbundled local switching network element" (*id.* at 808). These rules remain fully in force, and, the Court, in carrying out its review function under Section 252(e)(6), must determine *inter alia*, whether the MPSC complied with the FCC's regulations interpreting the standards of the Act.[14] The state PUC has no discretion either to depart from or to reinterpret those regulations as part of its arbitration decision.

The MPSC asserts that its interpretations of federal law ought to be accorded great deference, to the extent they do not conflict with the Act or FCC regulations. It further asserts that where there is no question of statutory interpretation, the appropriate standard for review of a state agency decision is whether it is "arbitrary or capricious." MPSC Mem. at 8; *accord* BellSouth Mem. at 15. To the extent, however, that the MPSC's interpretation of the Act or FCC regulations conflicts with FCC's interpretation, the Act makes it clear that the FCC's interpretation, as set forth in its Orders, is binding on the MPSC. Thus, there should be no

---

[14] The parties may not attempt to challenge the substantive validity of the FCC's rules here by, for example, claiming that those rules are inconsistent with the underlying standards of the 1996 Act. Under 28 U.S.C. § 2342, the Hobbs Act, "the exclusive jurisdiction for review of final FCC orders . . . lies in the Court of Appeals." *FCC v. ITT World Comm., Inc., 466 U.S. 463, 468 (1984); Wilson v. A.H. Belo Corp., 87 F.3d 393, 398 (9th Cir. 1996); Bywater Neighborhood Ass'n v. Tricarico, 879 F.2d 165, 167-68 (5th Cir. 1989).* Unless and until the court of appeals stays or invalidates federal regulations, a district court must assume their validity as binding rules. *Southwestern Bell Tel.Co.v.Arkansas Pub. Serv. Comm'n, 738 F.2d 901, 905-07 (8th Cir. 1984), vacated on other grands, Arkansas Pub. Serv. Comm'n v. Southwestern Bell Tel. Co., 476 U.S. 1167 (1986).*

deference to an MPSC interpretation that conflicts with the FCC's Orders. *Orthopaedic Hospital v. Belshe*, 103 F.3d 1491, 1495-96 (9th Cir. 1997); *Turner v. Perales*, 869 F.2d 140, 141 (2d Cir. 1989) (per curiam); *cf. Clark v. Alexander*, 85 F.3d 146, 152 (4th Cir. 1996) .

II. THE MPSC's LIMITATIONS ON RESALE BY AT&T ARE INCONSISTENT WITH THE 1996 ACT AND FCC REGULATIONS.

The MPSC and the Arbitration Panel, in making their determination on BellSouth's resale obligation, divided into two categories the services BellSouth sells at retail to end users as CSAs: 1) CSAs BellSouth entered into before March 10, 1997 -- the effective date of the Arbitration Report; and 2) CSAs BellSouth entered into after March 10, 1997.[15] With respect to pre-March 10, 1997 CSAs, the MPSC concurred with the Arbitration Panel's finding that it is reasonable to exempt them from the resale obligation. MPSC Order at 21. With respect to CSAs entered into after March 10, 1997, the MPSC further concurred with the Arbitration Panel that it would be "reasonable and competitively neutral" to make them available for resale, but without the wholesale discount rate prescribed in Section 252(d)(3). MPSC Order at 21.

The Act and FCC regulations that were in force at the time of the MPSC's decision, and have since been upheld by the Eighth Circuit, require BellSouth to offer AT&T for resale all CSAs that were entered into by BellSouth, including those entered into prior to March 10, 1997. They also require that both the pre- and post-March 10, 1997 CSAs be available for

---

[15] CSAs are contractual agreements made between a carrier and a specific, typically high-volume, customer, tailored to that customer's individual needs. CSAs may include volume and term arrangements, special service arrangement, customized telecommunications service arrangements, and master service arrangements.

resale at the wholesale discount rate, which will be less than the retail rate, unless record evidence establishes that BellSouth would avoid no costs when it provides its CSAs to AT&T for resale.

A. CSAs Entered Into Prior to the Date of the Arbitration Report Are Not Exempt From the Resale Requirement In The 1996 Act And Binding FCC Regulations.

The 1996 Act imposes upon BellSouth and other ILECs a duty to "offer for resale at wholesale rates *any* telecommunications service that the carrier provides at retail to subscribers who are not telecommunications carriers." 47 U.S.C. § 251(c)(4)(A) (emphasis added). Section 251(c)(4)(A) does not distinguish among retail "telecommunications services" for purposes of determining the scope of an ILEC's resale obligation. Nor does Section 251(c)(4)(A) contain any general exception for CSAs, or other types of retail services offered by ILECs before arbitration.

Not only is there no statutory basis for exempting CSAs from the resale obligation of Section 251(c)(4)(A), the FCC Order implementing that section expressly precludes the exclusion of CSAs from the resale obligation of Section 251(c)(4)(A). *FCC Order* ¶ 948 provides that Section 251(c)(4) makes "no exception for promotional or discounted offerings, *including contract and other customer-specific offerings* (emphasis added)." Moreover, the *FCC Order* makes clear that "[i]f a service is sold to end users, it is a retail service, even if it is priced as a volume-based discount off the price of another retail service." *FCC Order* ¶ 951. The FCC's resale regulations were not stayed by the Eighth Circuit at the time of the arbitration and that court has since affirmed the FCC's authority to issue regulations regarding the ILEC's duty not to prohibit or impose unreasonable limitations or restrictions of the resale

of telecommunications services. *Iowa Utils. Bd.*, 120 F.3d at 819. The Eighth Circuit also made clear that the provisions of an FCC order, and the rules adopted therein, are equally enforceable. *Id.* at 803. As such, paragraphs 948 and 951 of the *FCC Order*, like the regulations adopted by that Order, were binding in the arbitration at issue.

As long as the services BellSouth offers through the pre-March 10, 1997 CSAs are "telecommunications services" that are "provided at retail to subscribers," it is required, consistent with the Act and FCC regulations, to sell such services to AT&T for resale. It was undisputed before the Arbitration Panel that post-March 10, 1997 CSA services constitute retail services under Section 251(c)(4)(A) and thus "should be available for resale." MPSC Order at 20. None of the parties contends that BellSouth's pre-March 10, 1997 CSAs offer different retail services to end users than the post-March 10, 1997 CSAs. BellSouth did not maintain before the Arbitration Panel that the services it offered through the pre-March 10, 1997 CSAs were not "telecommunications services."[16] Further, it is not disputed that BellSouth offers both the pre-and post-March 10, 1997 CSA services for sale at retail to non-telecommunications carriers -- that is, end users who subscribe to BellSouth for telephone services. *See e.g.*, AT&T Mem. at 32.

The sole basis upon which the MPSC excluded the pre-March 10, 1997 CSAs from the statutory resale requirement is because they were entered into prior to the effective date of the Arbitration Report. It did not offer any statutory support for the distinction it made between

---

[16] AT&T states that the services it seeks to purchase from BellSouth for resale involve the transmission of telephone calls from residential and business subscribers over Bellsouth's network in Mississippi, and that such "core telephone services fall squarely within the broad definition of 'telecommunications services' under [Section 153(46)] of the Act." AT&T Mem. at 31-32 & n.19. BellSouth does not dispute this contention in its submission to this Court.

pre- and post-March 10, 1997 CSAs, nor did it even address the FCC's binding regulations expressing including CSAs within the scope of Section 251(c)(4)(A). Rather, it asserted only that it is "reasonable" to exclude the pre-March 10, 1997 CSAs from BellSouth's resale obligation because they "were negotiated in a different environment, and to require resale of those CSAs would be competitively unfair to BellSouth." MPSC Order at 21. BellSouth contends that it could not be certain that it would be required to make its pre-March 10, 1997 CSAs available for resale until the Arbitration Panel ruled in March, 1997. BellSouth Mem. at 26. It further states that the limitation imposed on these CSAs will ensure that AT&T will have an incentive to compete with BellSouth, not only through resale, but through facilities-based strategies -- a goal that is consistent with the pro-competitive intent of the 1996 Act. *Id.* That the pre-March 10, 1997 CSAs were negotiated in a "different environment" does not negate BellSouth's statutory obligation under Section 251(c)(4)(A) and the FCC's binding regulations. BellSouth was on notice long before March 10, 1997 that it would be required to provide retail services to resellers at wholesale rates, as the Act was passed on February 8, 1996. *See* AT&T Mem. at 33. Nor does the MPSC's blanket assertion that it would be "competitively unfair" to BellSouth to make its pre-March 10, 1997 CSAs available to AT&T upon request support a general exemption for these CSAs from the statutory resale obligations.

Section 51.613(b)[17] of the FCC's rules allows a BOC to impose a resale restriction if it proves to the state PUC that a particular resale restriction is reasonable and nondiscriminatory.

---

[17] Section 51.613(b) provides: "With respect to any restrictions on resale not permitted under paragraph (a) [which authorizes two types of restrictions having no bearing on CSAs], an incumbent LEC may impose a restriction only if it proves to the state commission that the restriction is reasonable and nondiscriminatory." 47 C.F.R. § 51.613(b).

The rule does not contemplate, however, that a state PUC can create a general exemption for a category of retail offerings that would effectively negate the resale requirement in Section 251(c)(4)(A), and the FCC's implementing regulations. The FCC, in adopting Section 51.613(b), explained that it was intended to grant state PUCs the authority only to approve "narrowly tailored"[18] resale restrictions that an ILEC proves to a state PUC are reasonable and nondiscriminatory. Both the Act and the relevant FCC regulations recognize that resale restrictions generally are presumed to be unreasonable because ILECs have the incentive to thwart competition by imposing anticompetitive restrictions. Thus, the FCC stated that excluding certain types of services from the "any telecommunication service" language of Section 251(c)(4) would be at odds with the goal of the 1996 Act to encourage competition. *Id.* ¶ 956.

Under Section 251(c)(4)(A), the services provided by BellSouth under its pre-March 10, 1997 CSAs plainly constitute retail services that it must make available to resellers. The MPSC erred in excluding these services from BellSouth's resale obligation.

The MPSC's exclusion from the statutory resale requirements of services provided through pre-March 10, 1997 CSAs also is contrary to Section 251(c)(4)(B) of the Act and the FCC's binding regulations implementing that provision. Section 251(c)(4)(B) of the Act prohibits "unreasonable or discriminatory conditions or limitations" on the services that are subject to the resale requirement of Section 251(c)(4)(A). The FCC concluded that it is consistent with the pro-competitive goals of the 1996 Act to presume restrictions to be

---

[18] *See FCC Order* ¶ 939.

unreasonable and, therefore, in violation of section 251(c)(4), because the ability of ILECs to impose resale restrictions is likely to be evidence of market power and may reflect an attempt by incumbent LECs to preserve their market power. *FCC Order* ¶ 939. An ILEC can rebut this presumption, but "only if it proves to the state commission that the restriction is reasonable and nondiscriminatory." 47 C.F.R. § 51.613(b). As stated above, the Eighth Circuit expressly recognized that Section 251(c)(4)(B) authorizes the FCC "to issue regulations regarding the incumbent LECs' duty not to prohibit, or impose unreasonable limitations on, the resale of telecommunications services," including Section 51.613(b). *Iowa Utils. Bd.*, 120 F.3d at 819.

Because the MPSC lacked the authority to exempt generally pre-March 10, 1997 CSAs from the resale requirement, it was not open to BellSouth to argue that their exclusion from the resale requirement was reasonable and nondiscriminatory. While the MPSC has discretion to impose a "narrowly tailored" resale restriction under Section 51.613(b), this section is not properly invoked to create a general exemption for a category of services, as the MPSC did with respect to the pre-arbitration CSAs.

The MPSC's determination that it would be "competitively unfair" to require BellSouth to make its pre-March 10, 1997 CSAs available to AT&T for resale does not relieve BellSouth of its statutory resale obligation and, is erroneous. Section 251(c)(4)(B) authorized the MPSC to impose only such "narrowly tailored" restrictions that are neither unreasonable nor discriminatory and are "consistent with regulations prescribed by the Commission [FCC] under this section." Moreover, Section 51.613(b), as stated above, does not authorize the MPSC to exempt a category of services such as the pre-March 10, 1997 CSAs wholly from the resale

requirement. In any event, there is nothing to the MPSC's contention that the resale restriction at issue would be "competitively unfair." Resale obligations are not competitively unfair; with respect to both pre- and post-March 10, 1997 CSAs BellSouth is entitled to charge competitors the full retail price of the contract, excluding only its avoidable costs. Further, "revenue losses or rate structure changes which may result from such competition" do not "automatically justify[ ] a denial of service to intermediary entities," such as AT&T. *Resale and Shared Use Decision*, *supra*, 60 F.C.C. 2d at 283-84.

B. BellSouth's Pre- And Post- March 10, 1997 CSAs Must Be Made Available For Resale At The Wholesale Discount Rate, Absent Record Evidence Establishing that BellSouth Would Not Avoid Any Costs When It Provides CSAs To AT&T For Resale.

The MPSC determined that requiring AT&T to pay contract rates (i.e. the same rate paid by BellSouth's retail customers, with no wholesale discount) for services offered through post-March 10, 1997 CSAs would be "reasonable and competitively neutral" and would meet the applicable standards and requirements of Sections 251(c)(4) and 252(d). MSPC Order at 21. It did not elaborate further. To the contrary, Sections 251(c)(4)(A), (c)(4)(B), and 252(d) of the Act and binding FCC regulations, which were in effect at the time of the MPSC's decision and which have since been affirmed by the Eighth Circuit, require that BellSouth offer its CSAs at the wholesale discount rate, which will be less than the retail rate unless BellSouth shows that it had no avoidable costs.[19]

---

[19] The FCC's contention that the MPSC erred in excluding post-March 10, 1997 CSAs from the wholesale discount requirement applies equally to the pre-March 10, 1997 CSAs. The MPSC's arguments are directed only to the post-March 10, 1997 CSAs because it excluded the earlier ones completely from the resale requirement. As stated above, the FCC maintains that the pre-March 10, 1997 CSAs were wrongfully excluded from the resale requirement. As such, the wholesale discount should be applied to the pre- and post-March 10, 1997 CSAs.

As stated above, there is no dispute that BellSouth's post-March 10, 1997 CSAs are retail services for purposes of Section 251(c)(4)(A). Thus, Section 251(c)(4)(A) compels that these services be made available at "wholesale rates." The statute directs state PUCs to "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." 47 U.S.C. § 252(d)(3).[20]

Various provisions of the Act compel state PUCs to ensure that retail services are offered for sale at wholesale rates, in accordance with Section 251(c)(4)(A). Section 252(c)(1) requires a state PUC to "ensure" that the terms of the arbitration agreement meet the requirements of Section 251, including regulations prescribed by the FCC pursuant to Section 251. Further, Section 252(c)(2) directs a state PUC to establish rates for interconnection, services, or network elements according to Section 252(d). Section 252(d)(3) expressly provides that for purposes of Section 251(c)(4), a state PUC "*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 (emphasis added)."

The Act thus mandates the imposition of wholesale rates for retail services, subject to regulations prescribed by the FCC to implement Section 251. The FCC has issued several

---

[20] The phrase "costs that will be avoided" in Section 252(d)(3) establishes an objective standard for avoided costs. The statute does not require the wholesale discount rate to take into account only those costs that an ILEC actually avoids. The FCC required that wholesale rates by set by excluding from retail rates "those costs that reasonably can be avoided when an incumbent LEC provides a telecommunications service for resale at wholesale rates to a requesting carrier." 47 C.F.R. § 51.609(b); *see also FCC Order* ¶ 911.

regulations relevant to this issue, all of which the Eighth Circuit affirmed. The FCC, in implementing Section 251(c)(4)(B), determined that resale restrictions, including those on CSAs, are presumptively unreasonable. *FCC Order* ¶¶ 939, 948. Moreover, as stated above, the FCC determined that state PUCs have the authority only to approve "narrowly tailored" resale restrictions that an ILEC proves to the state PUC are reasonable and nondiscriminatory. 47 C.F.R. § 51.613(b). Finally, the FCC recognized that in calculating the proper wholesale rate, the ILEC may prove that its avoided costs differ when selling in large volumes. *FCC Order* ¶ 953.

First, the MPSC and BellSouth contend that the denial of a wholesale discount to AT&T on post-March 10, 1997 CSAs constitutes a "reasonable" restriction on resale, and therefore, does not violate Section 251(c)(4)(B) or 47 C.F.R. § 51.613(b). As with the pre-March 10, 1997 CSAs, the MPSC was not authorized to exempt post-March 10, 1997 CSAs from the wholesale discount requirement pursuant to Section 51.613(b). This section authorizes only "narrowly tailored" exceptions that are proven to be reasonable and nondiscriminatory; however, it does not authorize a general exemption for these service offerings from the statutory wholesale discount requirement. In this case, the MPSC simply adopted the finding of the Arbitration Panel that requiring BellSouth to offer already discounted CSAs for resale at wholesale prices "would place BellSouth at a permanent competitive disadvantage with respect to price." MPSC Order at 20; Arbitration Report at 3. The FCC, however, specifically considered and rejected this argument, concluding that any service sold to end users is a retail service, and thus, is subject to the wholesale discount requirement, even if it is already priced at a discount off the price of another retail service.

FCC Order ¶ 951, and that determination is binding on the MPSC.

The introduction of price competition through resale, and the resulting lowering of BellSouth's monopoly prices, furthers the essential pro-competitive goals of the 1996 Act.[21] The discount for cost that will be avoided, by definition, only takes into account costs incurred by selling at the "retail" level. Because it is the reseller, not the ILEC, that incurs those costs on resales, the ILEC suffers no loss, and, indeed, realizes a profit, on sales made by it to resellers at wholesale rates. *See Resale and Shared Use Order, supra,* 60 F.C.C.2d at 299 (explaining that "[t]o the extent that the service offered is cost related, the underlying carrier [*i.e.*, BellSouth] is not adversely affected by the change in its relationship with the ultimate end user"). The MPSC's decision eliminates resale price competition for customers of BellSouth that receive services under the CSAs by requiring AT&T to price its services high enough to cover both its own retailing costs, and also BellSouth's avoided retailing costs, which are included in BellSouth's retail rates. The net result is that BellSouth will likely preserve its market power. This result is not only unreasonable, but is discriminatory in violation of Section 251(c)(4)(B) and 47 C.F.R. § 51.613(b), because AT&T must recoup BellSouth's retail costs, in addition to its own, while BellSouth is allowed to price at resale based solely on its own costs.

Second, the MPSC contends that its restriction was consistent with *FCC Order* ¶ 953.

---

[21] The asserted harm to BellSouth from the introduction of competition in its market is not "anticompetitive" in any sense. The courts have long recognized that the focus of antitrust analysis must be on the effect of a practice on "competition," not the effect on the revenues of any particular competitor. *See e.g. Smilecare Dental Group v. Delta Dental Plan of California, Inc.*, 88 F.3d 780, 783 (9th Cir. 1996) ("The courts have repeatedly observed that 'the antitrust laws protect competition, not competitors.'"). Removal of restrictions on resale plainly increases competition among the participants in the market, lowers prices for consumers, and is therefore pro-competitive under the 1996 Act.

MPSC Mem. at 13. In paragraph 953, the FCC determined that the amount of avoided costs, and hence, the wholesale price to the reseller, may be affected if the ILEC establishes that some of the marketing and billing cost savings from retail rates are already represented when the ILEC sells in large volumes. This provision, however, affects only the level of the wholesale discount; it does not exclude CSAs from the wholesale discount obligation. And only if the evidence establishes that there are no avoided costs in providing CSAs for resale, would there be no discount.

The MPSC could only have appropriately determined that AT&T is not entitled to a wholesale discount with respect to the post-March 10, 1997 if BellSouth established that it avoids no costs when it provides CSAs to AT&T for resale. MPSC and BellSouth contend that the requisite determination was made, and AT&T strongly refutes this contention. The MPSC submits that it had evidence that "avoidable costs" are lower when CSAs are resold than when standard retail services are resold and that BellSouth avoids no costs when it provides its CSAs to AT&T for resale. MPSC Mem. at 13 & n. 8.[22] *Accord* BellSouth Mem. at 25. AT&T contends that BellSouth failed to prove that no costs will be avoided on sales made through CSAs. AT&T Mem. at 36.[23] The FCC is not in a position to resolve this factual dispute, but

---

[22] The MPSC also states that it did not even need authority to craft reasonable and nondiscriminatory restrictions on resale of CSA to find that new CSAs must be sold without a discount because the pricing rules of Sections 252(d) and its jurisdiction over intrastate pricing provided it with the necessary authority. MPSC Mem. at 13 n.8. The Eighth Circuit made clear that the FCC has authority to determine whether resale limitations are reasonable and that state PUCs have jurisdiction only with respect to specific rates determinations with respect to the resale restrictions. *Iowa Utils. Bd.*, 120 F.3d at 819.

[23] In its order, the MPSC stated that: 1) the evidence showed that "avoidable costs do differ for BellSouth's CSAs, inasmuch as CSAs represent customer specific discounts" and that applying a fixed wholesale discount would place BellSouth at a permanent competitive disadvantage with respect to price; 2) AT&T did not show that there are "avoided or avoidable" marketing costs for existing CSAs, and it appears that such costs are not avoided or avoidable because, by definition, BellSouth has already incurred costs for marketing to the customer,

provides the Court the following standards established in the FCC's regulations regarding the type of evidence that would be sufficient to make the requisite showing.

The FCC's binding regulations required BellSouth, not AT&T, to establish that its costs differ when selling in large volumes. *See FCC Order* ¶ 953. General statements such as those made in the MPSC's order to the effect that "avoidable costs do indeed differ for BellSouth's CSAs," and that BellSouth had already incurred marketing costs are insufficient to establish that BellSouth has no avoided costs. Whether or not marketing costs might be avoided, other costs such as billing, collection, and customer service costs are avoided when CSAs are resold. The MPSC had no authority to require AT&T to pay cost-based, and not wholesale, rates, for the services provided through the post-March 10, 1997 CSAs unless the record clearly establishes that BellSouth introduced cost studies or some other form of evidence concretely establishing that it had no avoided costs in providing CSAs to AT&T for resale.

III. BELLSOUTH MUST PROVIDE AT&T UNBUNDLED ELEMENTS AT COST-BASED RATES EVEN IF THE SERVICE OFFERED BY AT&T IS IDENTICAL TO THE SERVICE BELLSOUTH OFFERS FOR RESALE.

Section 251(c)(3) requires an ILEC to provide unbundled access "to any requesting telecommunications carrier for the provision of telecommunications service." This section further provides that an ILEC "shall provide such unbundled network elements in a manner that allows requesting carriers to combine such elements in order to provide such telecommunications service." The pricing standard for network elements is set forth in Section

---

determining its needs, and setting up the services configured to meet those needs; and 3) AT&T did not show what discount, if any, could be fashioned for the resale of BellSouth CSAs. MPSC Order at 20-21.

252(d)(1) of the Act. That section requires the state PUC to price unbundled network elements ("UNEs") purchased in accordance with Section 251(c)(3) at cost-based rates.[24]

BellSouth did not challenge before the Arbitration Panel that AT&T may purchase UNEs from BellSouth and rebundle those elements in any manner that is technically feasible. The only question that appeared to be in dispute pertained to the pricing of UNEs to be purchased by AT&T and then recombined to provide a finished service. BellSouth maintained that when a new entrant simply purchases UNEs and recombines them to offer a service substantially identical to that which BellSouth is already offering at retail, the new entrant should not pay cost-based rates pursuant to Section 251(c)(3), but, rather, the rate applicable to resold services under Section 251(c)(4) and Section 252(d)(3). AT&T maintained that it should be permitted to purchase UNEs at cost-based rates and to combine them to provide finished services.

The MPSC concluded that AT&T had failed to distinguish between resale and the rebundling of UNEs for services identical to BellSouth's tariffed service offerings, MPSC Order at 13, and therefore ordered AT&T to pay the discounted wholesale rate applicable to resold services, and not cost-based rates pursuant to Section 251(c)(3), for unbundled BellSouth network elements used to create services "identical" to BellSouth's retail offerings. It affirmed the Arbitration Panel's determination that AT&T will be deemed to be "recombining unbundled elements to create services identical to BellSouth's retail offerings"

---

[24] Section 252(d)(1) provides that "[d]eterminations by a State commission of the just and reasonable rate . . . for network elements for purposes of subsection (c)(3) of [Section 251] (A) shall be (i) based on the cost (determined without reference to a rate-of-return or other rate-based proceeding) of providing the . . . network element . . . , and (ii) nondiscriminatory, and (B) may include a reasonable profit.

when the service offered by AT&T contains the functions, features and attributes of a retail service offering that is the subject of a BellSouth tariff. The MPSC further determined that AT&T will not be deemed to offer "identical" services when it utilizes its own switching or other substantive functionality or capability in combination with unbundled elements in order to produce a service offering, except that AT&T's provisioning of functions such as operator services, caller ID, call waiting, etc., in combination with unbundled BellSouth network elements shall not constitute a "substantive functionality or capability" for purposes of determining whether AT&T is providing services identical to a BellSouth retail offering. MPSC Order at 14. The MPSC stated that to conclude otherwise would obviate the resale provisions of Section 251(c)(4) and would allow AT&T to circumvent the Act's joint marketing restriction, by allowing AT&T to market jointly AT&T's long distance services with local services identical to BellSouth while using solely BellSouth's network elements. *Id.*

Paragraph 1.A of the Agreement, and the MPSC's decision arguably suggest that the MPSC sought to prevent AT&T from purchasing UNEs from BellSouth at cost-based rates, without owning or controlling any of its own facilities, and rebundling them to offer a finished service. The MPSC submits to this Court, however, that what was really at issue was whether AT&T could purchase elements that were "already combined" by BellSouth to provide its services at cost-based, as opposed to resale, rates. MPSC Mem. at 9-10. It concedes that to the extent that Paragraph 1.A of the Agreement is read to mean that AT&T may not purchase elements at cost-based rates, and then recombine them itself, Paragraph 1.A "appears incompatible" with the Eighth Circuit decision. MPSC Mem. at 11. *Accord* BellSouth Mem.

at 21-22. [25]

Thus, there no longer seems to be any dispute that the MPSC erred to the extent it determined that resale rates apply to a competing carrier that provides local telecommunications services entirely through UNEs. The MPSC apparently concedes that Section 251(c)(3) cannot be read as containing any requirement that carriers must own or control some of their own local exchange facilities before they can purchase and use UNEs to provide a telecommunications service. It also concedes that a requesting carrier may purchase UNEs at cost-based rates, consistent with Section 252(d)(1), and then recombine them to offer a finished service, regardless of whether the competing carrier provides service entirely through access to the UNEs of an ILEC's network. The Act and binding FCC regulations that have been affirmed by the Eighth Circuit firmly establish the validity of these principles. [26] To the extent that Paragraph 1.A does not allow AT&T to obtain UNEs at cost-based rates when it recombines them to provide a finished service, the Court should direct the MPSC to modify

---

[25] BellSouth states that when the Eighth Circuit's decision becomes final, it will renegotiate Paragraph 1.A to make clear that AT&T may obtain all of the elements necessary to provide telephone service on a basis that requires AT&T to bear whatever costs are necessary to combine the UNEs. BellSouth Mem. at 22. The Eighth Circuit opinion, however, is final and BellSouth should be directed to revise Paragraph 1.A accordingly.

[26] The FCC determined from the plain language of Section 251(c)(3) that Congress did not intend that section to be read to contain any requirement that carriers must own or control some of their own local exchange facilities before they can purchase and use UNEs to provide a telecommunications service. *FCC Order* ¶ 328. *See also* 47 C.F.R § 51.307(c) (requiring an ILEC to provide a requesting telecommunications carrier access to an UNE, along with all of the UNEs' features, functions and capabilities, in a manner that allows the requesting telecommunications carrier to provide any telecommunications service that can be offered by means of that network element). Further, *FCC Order* ¶ 292 and 47 C.F.R. § 51.309(a) bar ILECs from imposing limitations, restrictions, or requirements on requests for, or the sale or use of UNEs that would impair the ability of requesting carriers to offer telecommunications services in the manner they intend. The Eighth Circuit affirmed the FCC's determinations that: 1) allowing new entrants to provide finished telecommunications services to the public entirely by acquiring all of the necessary elements from an ILEC is consistent with the plain meaning of Section 251(c)(3); and 2) resale is not the exclusive means by which a new entrant can enter the local telecommunications market through unbundled access. *Iowa Utils. Bd.*, 120 F.3d at 814-15.

Paragraph 1.A to comport with the mandate in the Act and the FCC's regulations that allows AT&T to purchase UNEs at cost-based rates.

The real dispute the parties present to the Court is the price at which AT&T may purchase UNEs from BellSouth that are "already combined" to create a service identical to BellSouth's service offerings. If, indeed, AT&T is seeking to purchase "already combined" elements at cost-based rates, pursuant to Section 252(d)(1), we offer the Court the following guidance.

The Eighth Circuit held in its recent order on petitions for rehearing that Section 251(c)(3) cannot be read to require the *ILEC* to *recombine* network elements that are purchased by the requesting carriers on an unbundled basis. *Iowa Utils. Bd.*, 120 F.3d at 813 (as amended on rehearing). It vacated 47 C.F.R. § 51.315(b), which prohibited an ILEC from separating network elements that it currently combines. Specifically, it stated that Section "251(c)(3) does not permit a new entrant to purchase the ILEC's assembled platform(s) of combined network elements (or any lesser existing combination of two or more elements) in order to offer competitive telecommunications services." To allow new entrants to acquire combined elements at cost-based rates for unbundled access, it asserted, would "obliterate the careful distinctions Congress has drawn in subsections 251(c)(3) and (4) between access to unbundled network elements on the one hand and the purchase at wholesale rates of an incumbent's telecommunications retail services for resale on the other." 120 F.3d at 813.

The MPSC and BellSouth contend that this decision supports their assertion that AT&T must purchase "already combined" elements from BellSouth at resale rates. It is necessary to know, however, what elements are at issue. If AT&T seeks to purchase on an unbundled basis

elements that are already combined, BellSouth may separate them, but is required to sell them to AT&T at cost-based rates. Nothing in the Eighth Circuit's recent decision undermines this principle. If, however, BellSouth contends that it cannot separate certain elements, we submit that BellSouth cannot thereby avoid its obligation to make them available to AT&T at cost-based rates.

IV. BELLSOUTH MUST PROVIDE AT&T ACCESS TO AN UNBUNDLED LOCAL SWITCHING ELEMENT THAT INCLUDES VERTICAL FEATURES.

None of the parties to the arbitration disputed that FCC regulations unequivocally require an ILEC to provide access to an unbundled local switching element that includes vertical features (*e.g.*, caller I.D., call forwarding, and call waiting).[27] At the time of the MPSC's decision, the Eighth Circuit had not stayed the FCC's regulations on this issue. Because they had not yet been affirmed, however, the MPSC disregarded the FCC's regulations based on its belief that vertical features are retail services and within the MPSC's intrastate pricing authority. MPSC Order at 23-24. The Eighth Circuit subsequently affirmed the FCC's determination that vertical features qualify as network elements that are subject to the unbundling requirements of the Act. *Iowa Utils.Bd.*, 120 F.3d at 808.[28]

---

[27] The *FCC Order* plainly states that "the local switching element includes all vertical features that the switch is capable of providing, including custom calling, CLASS features and Centrex, as well as any technically feasible customized routing functions." *FCC Order*, ¶ 412; *see also id.* ¶¶ 410; 413; Section 51.319(c)(1)(i)(C)(1). The Act defines network element as "a facility or equipment used in the provision of a telecommunications service" and "the features, functions, and capabilities that are provided by means of such facility or equipment." 47 U.S.C. § 153(29). Vertical switching features, such as call waiting, are provided through operation of hardware and software comprising the "facility" that is the switch. Thus, the FCC concluded that such features are "features" and "functions" of the switch. *FCC Order*, ¶ 413.

[28] The Eighth Circuit expressly rejected the argument advanced by petitioners, including BellSouth, that the statutory definition of "network element" does not encompass vertical features because they are not physical components of an ILEC's network that are directly involved in transmitting a phone call from one person to another and because they are "services" that were not intended to be subject to the Act's unbundling requirements.