later date would not be charged for such fixed cost. This problem is known as a "free rider" problem in that future competitors get a free ride because others bore the initial cost. The ~~Staff's~~ proposal that such cost be recovered in a competitively neutral manner ensures that a single provider does not bear a disproportionate share. However, facilities-based entrants are not required to share in these costs. In the resale context, there is no basis in the 1996 Act to recover implementation costs from facilities-based entrants. Requiring facilities-based providers to pay for these costs would be entirely inconsistent with the 1996 Act's preference for facilities-based competition and would seriously hamper its development at this critical juncture.

Ameritech shall fully recover the initial incremental expenditures associated with the provision of wholesale services over a time period which should not unduly burden or shock the resale market. Furthermore, the cost recovery mechanism ordered in the instant proceeding shall be applied to all services which are available in the LEC's wholesale offerings. In addition, because the LEC's current retail customers should benefit from the competitive entry encouraged by a wholesale offering, the charges should also be applied to the LEC's retail services if those services have wholesale counterparts.

III. THE COMMISSION SHOULD NOT REQUIRE THE SEPARATE PROVISIONING OF OPERATOR ASSISTANCE AND DIRECTORY ASSISTANCE

MFS-II also opposes AT&T's request for separate provisioning of operator services and directory assistance ("OS/DA"). The Hearing Examiner recommends that the Commission grant AT&T's request, concluding that "[u]nbundling of OS/DA is a necessary requirement for effective competition." HEPO at 45. MFS-II takes exception to this recommendation.

AT&T's request should be denied because it does not seek the resale of retail services contemplated under the 1996 Act.[10] The 1996 Act requires an incumbent LEC to offer for resale only services "that the carrier provides at retail to subscribers who are not telecommunications carriers." 1996 Act, § 251(c)(4). There is no local exchange service at the end user level for which OS/DA is not provided. Thus, under the 1996 Act, the Commission cannot order an incumbent LEC to make resold local service available apart from its OS/DA.

From a policy standpoint, the Commission would establish a poor precedent if it allowed resellers to take over the aspects of local service that provide the greatest contribution, while leaving the incumbent with the aspects that provide the least contribution. For example, Ameritech has many high contribution services, such as operator services, that offset low contribution services. Ameritech Ex. 1.25 (Gebhardt) at 40-41. "If the Company is left selling only low contribution services, it will not be able to recover its shared and common costs." *Id.* Forcing facilities-based carriers to offer resellers the option to resell only the parts of local service that provide low levels of contribution could jeopardize the financial integrity of facilities-based carriers and would discourage facilities-based carriers from entering the market.[11]

Accordingly, paragraph 3 on page 45 of the HEPO should be modified as follows:

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[10] It appears from his use of the term "unbundling" that the Hearing Examiner confused the resale requirement of the 1996 Act (Section 251(c)(4)) with the unbundling requirement (Section 251(c)(3)). AT&T's petition plainly invokes only resale, not unbundling.

[11] "Allowing resellers to strip high margin services off of a bundled wholesale offering, while leaving the low margin services with Ameritech Illinois, will ultimately produce a wholesale rate structure that is not self-sustaining." Ameritech Ex. 1.0 (Gebhardt) at 71-72.

The Commission must deny AT&T's request to resell local service without operator services and directory assistance ("OS/DA"). Section 251 (c)(4) of the 1996 Act governs the resale of telecommunications services. This section requires incumbent carriers to provide wholesale pricing of only those services provided to subscribers who are not carriers. Because local service is not provided to such subscribers without operator services and/or directory assistance, the Commission cannot require Ameritech to strip those services from its wholesale offerings.

Furthermore, separating operator services and directory services from wholesale local service threatens the economic viability of facilities-based carriers. Doing so would enable new entrants to resell high contribution services while forcing the LEC to bear the cost intensive burdens of providing local service. Accordingly, the Commission must preserve Ameritech's financial integrity by allowing it to continue to offset low contribution services with services, such as operator services, which generate higher contribution. ~~Unbundling of OS/DA is a necessary requirement for effective competition. Ameritech's objections to AT&T's request in this regard are not adequately supported by the record. Ameritech argues that unbundling of OS/DA is not technically feasible, but has failed to provide persuasive evidence in support of that claim. Moreover, AT&T has presented what it deals a workable solution, i.e., the use of "line class codes" to route OS/DA calls, in opposition to Ameritech's claim that the separate routing of calls is not possible at this time. Given the importance of this issues and the potential that competition will be the likely result of unbundling OS/DA from the wholesale offering, the Commission orders Ameritech and Centel to unbundle its OS/DA calls from it total service resale offering pursuant to Section 251 (c)(3).~~

IV. THE COMMISSION SHOULD DENY LDDS'S PETITION

There are two distinct reasons why LDDS's Petition must be denied. First, although LDDS now claims that it seeks unbundling, its Petition states on its face that it seeks "resale" of "bundled" service. Moreover, LDDS explicitly invokes only the "resale," and not the "unbundling," provisions of the Illinois Public Utilities Act ("PUA"). LDDS's Petition therefore cannot serve as the basis for the unbundling relief sought by LDDS and ordered by the Hearing Examiner. Second, even if LDDS's Petition were construed as a petition for unbundling, the 1996 Act provides a pricing methodology applicable to those, who like LDDS, seek to purchase "total" service (and furnish none of it themselves) that squarely conflicts with the pricing methodology sought by LDDS and ordered by the Hearing Examiner. Applying the pricing methodology sought by LDDS would render the resale pricing methodology of the 1996 Act a nullity.

A. LDDS's Petition Seeks to Resell Bundled Local Service

While LDDS claims that its Petition seeks to unbundle the LEC network, LDDS's Petition is really a request to resell local service that LDDS only recently has begun to characterize as a request for unbundling. After the 1996 Act was signed by the President, LDDS hastily altered the tenor of its testimony and pleadings before the Commission. Although never amended, a Petition that originally, by its own terms, sought resale of "bundled" LEC network services supposedly became a request for access to "unbundled" network elements.

The text of LDDS's Petition gives every indication that it is a request to resell bundled local service. In its own words, the Petition seeks a "'*bundled offer*' of . . . *all* the local network service features and capabilities currently offered by Ameritech and Centel . . .." LDDS's Petition at 4 (emphasis added). The Petition expresses LDDS's desire to purchase virtually every component of

the LEC network save for the few functions that resellers normally provide themselves (*e.g.*, billing and collection, customer service and product marketing). LDDS's Petition at 5-6. Unlike facilities-based carriers that provide some of their own network elements, in the form of local transport or switching, LDDS intends to buy *every* element from incumbent LECs. *See* AT&T Ex. 1.3 (Fonteix) at 10 ("The wholesale platform proposed by Mr. Gillan encompasses the entire bundled local exchange network service . . . .") As a practical matter, the service LDDS proposes to provide is not significantly distinguishable from that of any other local reseller.[12]

Noticing the similarities between its Petition and those of would-be local exchange resellers, LDDS embraced the resemblance: "LDDS and AT&T both seek for this Commission to order Ameritech and Centel to provide a total wholesale network service. These petitions are similar in most respects for the service requested . . . ."[13] LDDS's Petition at 1. As LDDS's Petition admits: "LDDS and AT&T both intend to become *resellers* of Ameritech's and Centel's services on a broad basis." LDDS Petition at 10 (emphasis added). LDDS so strongly believed in the similarities between AT&T's request to resell LEC services and its own Petition that it moved to consolidate the two the day after filing its Petition, arguing:

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[12] To be fair, LDDS does not intend to be a traditional reseller of LEC services. Although LDDS does not wish to modify the underlying LEC network, it does plan to rearrange the retail offerings based on network components. LDDS Ex. 2.0 (Gillan) at 4, 8. In other words, it wants to present customers with a choice of different product packages and pricing plans. *Id.* at 15. Though LDDS's scheme differs somewhat from typical resale strategies, it is entirely distinct from unbundling. The fact that LDDS wishes to manipulate network components, under the LEC's auspices, does not mean it is acquiring the elements in an unbundled manner so as to qualify for the unbundled, "bottoms-up" pricing methodology in the Act.

[13] According to LDDS, its Petition differed from AT&T's in regard to "the extent of the request on exchange access service and establishing the pricing of total wholesale network service." LDDS's Petition at 1-2.

> Since the testimony, cross examination, briefs, arguments, and policy to be presented by LDDS in the AT&T Petition and in the LDDS Petition *are one and the same*, in the interest of completeness, consistency, and expediency . . . it is necessary to consolidate the AT&T Petition and the LDDS Petition.

LDDS's Motion to Consolidate, at 3 (emphasis added).

In testimony, LDDS affirmatively distinguished its proposal from unbundling: "The total wholesale network configuration, however, reflects a *fuller* use of Ameritech's network than the unbundled-network concepts discussed in prior Commission decisions." LDDS Ex. 1.0 (Gillan) at 4 (emphasis in original). LDDS witness Joseph Gillan further stressed the ways that LDDS's Petition differs from requests for unbundling:

> unlike the unbundled-loop configuration, the total wholesale network solution *does not fundamentally change the underlying network platform* used to provide the retail service. This exchange-platform would be used by a new retail provider in *essentially the same form that it is presently used by Ameritech.* As a result, customer initiated changes between retail providers can be accomplished quickly and easily since *the underlying facility arrangement is unaffected.*

Id., at 19 (emphasis added). Mr. Gillan's rebuttal testimony permits no doubt that "[t]he wholesale platform [sought by LDDS] is equivalent to the lease of Ameritech's network . . .." LDDS Ex. 2.0 (Gillan) at 15. There can be little doubt that LDDS's Petition seeks a wholesale tariff for the resale of LEC service, not unbundled LEC network elements.

The Commission should treat LDDS's Petition as what it really is: a request to resell the LEC network, not to unbundle it. The 1996 Act makes plain that the prices that resellers must pay are determined through the avoided cost methodology set forth in Section 252(d)(3). On that basis, the Petition should be denied because it seeks (and the Hearing Examiner proposes to order) a bottoms-up pricing methodology that conflicts with the avoided-cost approach of the 1996 Act. It would be

fundamentally unfair for the Commission to permit LDDS to amend its Petition *sub silentio* through testimony and briefs before the Hearing Examiner.

In addition, LDDS's Petition is procedurally defective. LDDS filed its Petition pursuant to § 13-505.5 of the PUA, which grants the Commission authority only to order resale arrangements. LDDS chose not to invoke Section 13-505.6, which governs unbundling of LEC network elements. LDDS's failure to invoke this Section precludes the Commission from treating the Petition as one for unbundling because LDDS has not invoked the proper statutory provisions to create jurisdiction for such a ruling. The Commission also cannot grant LDDS's Petition on the theory that it is a request to resell local service because Congress has eliminated any possibility that wholesale service may be priced with a "bottoms-up" approach. Since it is too late for LDDS to amend its Petition, the Commission must deny the Petition.

According to the Hearing Examiner, these arguments "are of no consequence. Ameritech and the other parties knew what LDDS was requesting in the LDDS petition. The record is well-developed and contains a substantial amount of testimony admitted both in support of, and in opposition to, the LDDS petition." HEPO at 65. The Hearing Examiner goes on to try to fit LDDS's Petition, recently construed as a request for unbundled network elements, within the parameters of § 13-505.5. HEPO at 65-66. The Hearing Examiner argues that LDDS's alleged request for unbundling may be satisfied by both §§ 13-505.5 *and* 13-505.6. The logic of the Hearing Examiner suggests that there was no need for the Illinois legislature to enact § 13-505.6 of the PUA, that this section is mere surplusage. MFS-II submits that the Hearing Examiner has applied twisted principles of statutory construction. Sections 13-505.5 and 13-505.6 were enacted together as part of the same statutory scheme. It is inconceivable that the legislature considered the two sections to

be interchangeable. A party cannot meet the requirements of both sections by filing under either one. The Commission should weigh LDDS's failure to amend its Petition to invoke § 13-505.6 as it considers how to preserve the statutory scheme enacted by the Illinois legislature.

B. Granting LDDS's Petition as One for Unbundling of LEC Network Elements Would Subvert the Resale Pricing Methodology of the Act

Congress created two pricing regimes for distinctly different activities: one for the lease of the LEC network by resellers and another for the lease of individual unbundled network elements by facilities-based carriers. The most important distinction between the two regimes, especially from LDDS's point of view, has to do with the resulting profit margins for resellers and facilities-based carriers. In contrast to § 252(d)(3)'s avoided-cost pricing methodology for resale, § 252(d)(1) provides for cost-based, "bottoms-up" pricing of unbundled network elements that will reduce the prices of the purchasing-carrier's wholesale inputs and, in turn, boost its retail returns.[14] Congress based the prices of network elements upon their economic cost so as to recognize the greater contribution made by carriers that add their own network elements to the LEC's unbundled components.[15] Under the avoided-cost methodology of § 252(d)(3), profit margins of entrants shrink to reflect Congress's view of the limited contribution resellers make to the eventual service offering — a contribution that generally involves nothing more than the reseller taking over the LEC's billing and collection, marketing and customer service functions.

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[14] Section 252(d)(1) states that prices for unbundled network elements "shall be based on cost . . . and may include a reasonable profit."

[15] Congress plainly expressed a preference for the facilities-based competition that results from unbundling. *See* pages 10-11, *supra*.

Congress deliberately fashioned two pricing methodologies so as to funnel more profits toward facilities-based carriers that accept substantially more risk in entering the market.[16] The 1996 Act presents new entrants with a "make or buy" decision. *See* ICC Staff Post-Hearing Brief at 69-70. As competitors assess the risks of the local exchange market, the 1996 Act forces them to decide whether "making" their own facilities is worth the prospect of reaping greater returns. Under the 1996 Act, competitors that opt to "make" some of their own facilities are offered the option to "buy" other facilities as unbundled elements priced at cost. For more conservative competitors — or those lacking sufficient capital — the 1996 Act provides the opportunity to "buy" resold LEC services at wholesale and to market them for adequate, yet distinctly lower profit.[17] The existence of the "make or buy" decision for new entrants helps to ensure that an economically rational allocation of telecommunications resources occurs. The 1996 Act thereby encourages facilities-based competition by reserving the highest profits for those carriers that make significant investments in the local network.

LDDS's proposal to purchase the *entire* LEC network, piece by piece, cannot be allowed to override the resale pricing methodology adopted by Congress in favor of "bottoms-up" pricing.[18]

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[16] Unlike resellers, which merely purchase local service at wholesale and perhaps invest in marketing, customer service and billing/collection operations, facilities-based carriers must actually construct their own facilities. They undertake the expensive tasks of purchasing switches and switching software and laying fiber optic cable for local transport.

[17] Clearly, through the resale option, Congress provided LDDS with access to the service functionalities that it seeks.

[18] There is no question that when Congress speaks in regard to any matter within its powers, its decisions supersede the rulings of state courts and administrative tribunals. *New York State Conference of Blue Cross & Blue Shield Plans v. Travelers Insurance Company*, __ U.S. __, 115 S.Ct. 1671, 1676 (1995) ("the Supremacy Clause, U.S. Const., Art. VI, may entail pre-emption

Permitting LDDS to repackage the LEC's retail offerings would subvert the resale pricing mechanism of the 1996 Act and eliminate the possibility that facilities-based entrants would come into the local exchange market to offer truly competitive service based on a combination of some of the LEC's unbundled elements and some of their own facilities. If LDDS's position prevails, every would-be reseller will submit applications identical to LDDS's with the intent of securing cost-based pricing for resold service. Facilities-based competition would be destroyed, since no facilities-based carrier could expend the sums necessary to build its local network and still compete with resellers that have access to cost-based resold service. Consumers would naturally prefer to purchase local service from resellers able to offer lower prices and, in the process, would improperly incent

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of state law either by express provision, by implication, or by a conflict between federal and state law"); *Rice v. Santa Fe Elevator Corp.*, 331 U.S. 218, 230 (1947).

Here, Congress has determined the appropriate method of pricing resold, bundled local service. Section 252(d)(3). While § 251(d)(3) declares that the Act does not override "state access and interconnection obligations" that are consistent with parallel federal obligations in Section 251 (a) and (c) — or, at least, do not "substantially prevent [their] implementation" — nowhere does the Act provide that state *resale* obligations enjoy a similarly privileged status. Section 252(e)(3) directly addresses the balance between Congress's "Pricing Standards" and the powers of state commissions, proclaiming that:

> nothing in [§ 252] shall prohibit a State commission from establishing or enforcing *other* requirements of State law in its review of an agreement, including requiring compliance with intrastate telecommunications service quality standards or requirements.

(Emphasis added). Evidently, Congress expected, and indeed encouraged, states to enforce "other requirements of State law," but did not contemplate permitting a state's resale pricing methodology to supplant the federal one.

every new entrant to become a reseller — even those that could operate more efficiently as facilities-based carriers than the incumbent.[19]

The 1996 Act would be unable to create a "make or buy" decision. If cost-based pricing is made available for resold LEC services, new entrants would only "buy" and never "make" their own facilities. Ameritech Ex. 3.2 (Harris) at 26-27, 32 ("Entrants will presumably make rational 'make or buy' decisions. If the wholesale price of local exchange service is set too low, the rational entrant will *buy* rather than *make*") (emphasis in original). Section 252(d)(3) of the Act, containing Congress's pricing methodology for resellers, would lie dormant as resellers abused § 252(d)(1). As discussed at page 10 above, if wholesale discounts were too high, not only would there be no facilities-based competition, there would be no new investment in the local network.

Moreover, allowing carriers to purchase the functional equivalent of resold service (by purchasing every network element in combined format) would also eviscerate the joint marketing restriction in § 271(e)(1) of the Act. Ameritech Ex. 1.5 (Gebhardt) at 22-23. That section forbids the joint marketing of long distance and resold local service by carriers with more than five percent of the nation's presubscribed access lines. No similar restriction exists for facilities-based carriers that use unbundled network elements, evidencing Congress's preference for facilities-based competition. If the Commission endorses LDDS's pseudo-unbundling proposal, LDDS would technically be considered a facilities-based carrier that is not subject to the joint marketing

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[19] As the Staff has observed, if resellers are granted an excessive discount, even facilities-based competitors that would be potentially more efficient than the incumbent LEC would have to become resellers to survive in the local exchange market. ICC Staff Ex. 1.00 (Jennings) at 18. Society would suffer because facilities are not provided in the most efficient manner possible. *Id.*

restriction. AT&T, MCI and Sprint would then be able to market long distance service and resold local service jointly in violation of congressional intent.

The Commission cannot allow LDDS's Petition to render nugatory the federal resale pricing methodology and the joint marketing restriction. Under basic principles of statutory construction, Congress cannot be interpreted to have created different rate-setting standards for the purchase of resold local service and unbundled network elements *accidentally*.[20] In the same vein, Congress cannot be considered to have enacted a joint marketing restriction that is dead on arrival. Any interpretation that nullifies two portions of the Act is inconsistent with the Act and thereby triggers the preemption provided for in §§ 251(d)(3)[21] and 261(b).[22]

In his discussion of LDDS's Petition, the Hearing Examiner claims that: "The federal Act clearly requires both offerings [wholesale local service and unbundled network elements] to be made available. These offerings were not required alternatively, but to be offered simultaneously." Unfortunately, the Hearing Examiner never directly addresses MFS-II's argument that allowing parties like LDDS to sidestep the resale pricing methodology will eviscerate it. A statute must be construed so as "to give effect, if possible, to every clause and word . . ., rather than to emasculate

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[20] As MFS-II explained in section I.B, above, Congress opted for a tops-down resale pricing methodology in order to preserve contribution in wholesale rates. Allowing resellers to avoid § 252(d)(3) would frustrate the desire of Congress that wholesale prices paid by resellers reflect the exact level of contribution currently embedded in retail rates.

[21] *See* note 18, *supra*.

[22] Section 262(b) permits only those state regulations that are "not inconsistent" with the 1996 Act.

combine network elements to offer the same services an incumbent LEC offers for resale under subsection [251](c)(4)" could conflict with the 1996 Act's provision in section 252(d) of "different pricing standards" for unbundling and resale and has requested commenters to address this issue. *NPRM*, ¶ 85. The FCC will issue rules concerning Sections 251 and 252 of the 1996 Act by August 8, 1996. Those rules may preclude the use of the unbundling provisions of the 1996 Act by carriers that will not use any of their own facilities. If, notwithstanding MFS-II's argument that Congress could not have intended to allow non-facilities-based carriers to engage in resale by buying and combining all network elements of the incumbent under subsection 251(c)(3), the Commission does not wish to deny LDDS's Petition, it should at least defer decision until the FCC issues rules under the 1996 Act or until the issue is presented in a compulsory arbitration under § 252(b).

Accordingly, paragraphs 3 through 5 on page 54, pages 55 and 56, and paragraphs 1 through 4 on page 57 of the HEPO should be replaced with the following text:

In the 1996 Act, Congress created two distinct pricing regimes: one for the lease of the LEC network, the other reserved for the lease of individual unbundled network elements. In doing so, Congress deliberately constructed a system designed to funnel more profits towards facilities-based entrants that accept the more substantial financial risk associated with the construction of a new network. This regime helps to encourage facilities-based competition by reserving the highest profits for those carriers who undertake more risky investments. Thus, petitions concerning bundling and resale fall under two entirely separate provisions of the 1996 Act.

The Commission can only conclude that LDDS seeks a wholesale tariff, not unbundling of LEC individual network elements. LDDS's Petition makes it clear that LDDS seeks to offer bundled service of all the local network service features and capabilities currently offered by Ameritech and

Centel. The service LDDS plans to offer does not differ in any significant way from similar service provided by other local resellers. Nor does LDDS plan to provide any service not normally offered by its competitors in the resale market. LDDS's procedural posture, filing pursuant to § 13-505.5 of the PUA, also indicates LDDS's intent to pursue a purely resale strategy. Indeed, construing LDDS's resale petition as an unbundling petition would render nugatory the Illinois legislature's enactment of §13-505.6. We do not, therefore, adopt that construction. Finally, the structure of the 1996 Act supports our conclusion. Since all resellers would be able to obtain lower prices by proceeding under §252 (d)(1), no reseller would proceed under § 252 (d)(3). Congress cannot, therefore, have intend this construction.

Since LDDS seeks to resell local exchange service, the Commission must reject LDDS's cost-based pricing methodology for local exchange service. If LDDS were allowed to prevail, every potential reseller would submit identical applications in order to secure cost-based pricing for resold service. Since consumers naturally prefer to purchase local service from resellers which could then offer lower prices, adoption of LDDS's position would destroy facilities-based competition. Acceptance of LDDS's Petition would also abrogate the joint marketing restriction contained in § 271 (e)(1) of the Act. LDDS's position, if adopted, would allow large carriers, such as AT&T, MCI and Sprint, essentially to market long distance and local service jointly, while simultaneously controlling more than five percent of the nation's presubscribed access lines. As a result, LDDS's Petition directly contravenes the 1996 Act and must be rejected.

CONCLUSION

For the foregoing reasons, the Commission should modify the Hearing Examiner's Proposed Order as set forth above.

Respectfully submitted,

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