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March 2, 1999

Ms. Magalie R. Salas
Secretary
Federal Communications Commission
445 12th Street, S.W., Room TWB-204
Washington, D.C. 20554

Re: Ex Parte CC Docket No. 96-98,
Implementation of the Local Competition
Provisions in the Telecommunications Act of 1996

Dear Ms. Salas:

This letter responds to requests that the Commission "suspend" operation of its geographic deaveraging rule that was recently reinstated by the Supreme Court. *See* 47 C.F.R. § 51.507(f) ("State commissions shall establish different rates for elements . . . within the state to reflect geographic cost differences"). As shown below, the substance of the Commission's rule is compelled by the terms of the Telecommunications Act of 1996 ("Act") and the Commission's own pronouncements, as many state commissions held even before the Supreme Court's decision in *AT&T Corp. v. Iowa Utilities Board*, No. 97-826, 1999 WL 24568 (Jan. 25, 1999). Moreover, excusing incumbent LECs from properly reflecting geographic cost differences in their network element rates would severely undermine both the core local competition goals of the Act, and the very universal service policies upon which opponents of network element deaveraging purport to rely.

Section 252(d)(1) of the 1996 Act, 47 U.S.C. § 252(d)(1), expressly provides that an incumbent local exchange carrier's rates for network elements must be "based on the cost . . . of providing" the requested elements. Thus, as the Commission properly recognized more than two years ago, where the costs of providing requested elements vary significantly across an incumbent's service territory, the incumbent's network element rates "must be geographically deaveraged" to reflect those cost differences.

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First Report and Order, *Implementation of the Local Competition Provisions in the Telecommunications Act of 1996*, 11 FCC Rcd 15499, ¶ 764 (1996) ("*Local Competition Order*") ("deaveraged rates more closely reflect the actual costs of providing . . . unbundled elements"). The Act also expressly requires that network element rates be "nondiscriminatory." 47 U.S.C. § 251(c)(3). If an incumbent's actual forward-looking cost of providing an element (both to itself and to competing carriers) in an area is $10, charging competing carriers $20 for the $10 element based on some notion of statewide "average" costs would be flatly discriminatory. In light of the Act's requirements, more than twenty state commissions required deaveraging even before the Supreme Court reinstated the Commission's deaveraging rule.[1]

But the validity and importance of the Commission's deaveraging rule does not end with the fact that it is compelled by the terms of the Act. Literally hundreds of intervening state commission arbitration and cost proceedings have confirmed that with respect to one key network element – local loops – enforcement of the Commission's geographic deaveraging rule is critical if the Act's promise to bring local telephone competition to all consumers is to be fulfilled. No incumbent LEC has even seriously disputed that it costs much less to provide local loops in urban, densely populated areas than in rural sparsely populated areas.[2]

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[1] *See, e.g.*, *Consolidated Petition of AT&T Communications, Inc., and MCI Telecomms. Corp. and Affiliates for Arbitration with Southwestern Bell Tel. Co.*, Case Nos. TO-97-40 and TO-97-67, at 35-36 (Mo. P.S.C. Dec. 11, 1996); Findings of Fact, Conclusions of Law and Order at 28, *In re Interconnection Contract Between AT&T Communications, Inc. and U S WEST Communications, Inc.*, Docket No. 96-411-TC (N.M. S.C.C. Mar. 20, 1997); *In re Petition of AT&T Communications, Inc. for Arbitration with GTE Hawaiian Tel. Co.*, Docket No. 96-0329, Decision No. 15528 at 36 (Haw. P.U.C. Apr. 18, 1997); Opinion and Order at 31-32, *Petition of Sprint Communications Co. for Arbitration with GTE North, Inc.*, Docket No. A-310183F002 (Penn. P.U.C. Dec. 19, 1996) ("Geographical deaveraging would enhance the benefits of competition to be experienced by Pennsylvania and its citizens as envisioned by the Act, and, therefore, should be implemented"); Opinion and Order at 140, *In re Joint Complaint of AT&T Communications, Inc., against New York Tel. Co. Concerning Wholesale Provisioning of Local Exchange Service by New York Tel. Co*, Opinion No. 97-2, Case 95-C-0657(N.Y. P.S.C. Apr. 1, 1997); Supplemental Decision at 2-3, *AT&T Communications, Inc. Interconnection Arbitration Application*, Case No. PU-453-96-497 (N.D. P.S.C. Apr. 2, 1997), *aff'd*, Order Approving Arbitrated Agreement (June 23, 1997).

[2] That is because customers in urban areas are closer together and, because there are more of them, economies of scale are realized. *See, e.g.,* In re

Because local loop costs are such a significant portion of the total cost of providing local telephone service, failure to account for cost differences in loop rates can create prohibitive entry barriers. The threat that averaged loop rates pose to competitive entry in urban areas is direct and obvious. As shown in Table 1 (attached hereto), which lists the zone-by-zone deaveraged loop rates ordered in 23 states that have required deaveraging, as well as the average loop rate that would have applied if deaveraging had not been required, a loop rate based on statewide average costs can exceed the actual costs of providing urban loops by 50-100% or more. Thus, there can be no dispute that the failure to deaverage loop rates discourages the "efficient entry and utilization of the telecommunications infrastructure" sought by Congress. *See Local Competition Order* ¶ 630. *See also* Evaluation of the United States Department of Justice, In re Second Application by BellSouth Corp., No. 98-121, at 21 (FCC Aug. 19, 1998) ("a ratemaking methodology that geographically averages rather than deaverages these costs will produce above-cost prices for unbundled loops in densely populated areas, thus inefficiently imposing costs upon and thereby impeding [network element-based] entry in those areas").

The harm to rural customers is equally serious, if less obvious – any policy that discourages entry in the urban areas in which a new entrant is likely to be able most quickly to attract a sufficiently large customer base to support entry will necessarily discourage any broader entry plans that encompass widely dispersed rural areas that would be unlikely to attract standalone entry. In short, averaged loop rates, which require competing carriers to pay network element charges that bear no relation to the costs borne by an incumbent in actually providing the network elements, constitute a classic entry barrier that would harm competition and consumers nationwide.

A number of state commissions have nonetheless accepted incumbents' claims that averaged loop rates are necessary to further universal service policies reflected in averaged retail rates.[3] Quite the

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Federal-State Joint Board on Universal Service, 12 F.C.C.R. 8776, ¶ 11 (May 8, 1997).

[3] *See, e.g., Petitions by AT&T Communications of the Southern States, Inc., MCI Telecomm. Corp. and MCI Metro Access, for Arbitration of Certain Terms and Conditions of a Proposed Agreement with GTE Florida, Inc.*, No. 960847-TP (Fla. PSC Jan. 17, 1997) at 25; Arbitrator's Decision, *Petition of AT&T Communications of the Pacific Northwest, Inc. for Arbitration of Interconnection Rates, Terms, and Conditions with GTE Northwest, Inc.*, (Oregon PUC, issued December 12, 1996) at 13; *aff'd*, Commission Decision (Oregon PUC, issued January 13, 1997) at 2; Order Resolving Arbitration

opposite is true. As the Commission has recognized, the Act mandates that all universal service subsidies "be explicit." *See* 47 U.S.C. § 254(e) ("[a]ny such support should be explicit and sufficient to achieve the purposes of this section"); Report and Order, *Federal-State Board on Universal Service*, 12 FCC Rcd 8776 at ¶ 9 (1997) (subsidies should "be explicit rather than implicit as many support mechanisms are today"). Thus, any attempt to preserve implicit subsidies through averaged loop rates violates both the Act's express requirements that loop rates be cost-based and nondiscriminatory, and the Act's core universal service policy to replace anticompetitive implicit subsidies with explicit subsidies.

It is no answer that this universal service reform has not been completed. As the Commission, the courts and numerous state commissions have consistently recognized, Congress clearly contemplated that the market-opening requirements of Section 251 of the 1996 Act would be implemented prior to the completion of universal service reform. Congress directed the Commission to promulgate rules implementing § 251 by August, 1996, 47 U.S.C. § 251(d)(1), but gave the Commission until May 1997 to issue universal service rules and even then required only "a specific timetable for [future] implementation." *Id.* § 254(a)(2). *See, e.g.*, *Southwestern Bell Telephone Co. v. FCC*, 153 F.3d 523, 536-37 (8th Cir. 1998).

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Issues and Opening Cost Proceeding, *AT&T Communications of the Midwest, Inc.'s Petition for Arbitration with Contel of Minnesota*, (Minnesota PUC, issued December 12, 1996) at 26; Arbitration Panel Report, *Sprint Communications Company L.P. Petition for Arbitration with GTE North Inc.*, Case No. 96-1021-TP-ARB (Ohio PUC, December 27, 1996) at 34; *aff'd*, 1997 WL 120220, at *16 (Ohio PUC Jan. 30, 1997); Arbitrator's Report and Decision, *Petition for Arbitration of an Interconnection Agreement between MCIMetro Access Transmission Services, Inc. and GTE Northwest Inc.*, Docket No. UT-960338 (Washington Utilities and Transportation Commission, January 3, 1997) at 12; Findings of Fact and Conclusions of Law; Order and Notice of Entry of Order, *Interconnection Contract Negotiations between AT&T Communications of the Midwest, Inc. and US West Communications Inc. Pursuant to 47 U.S.C. Section 252*, TC96-184 (S.D. PUC Mar. 20, 1997) at 12; First Order Addressing Substantive Arbitration Issues, *Interconnection Contract between AT&T Communications of the Mountain States, Inc. and US West Communications, Inc.*, Docket No. USW-T-96-15, ATT-T-96-2 (Idaho PUC Mar. 24, 1997) at 28; Arbitration Order, *Arbitration by the Public Service Commission of an Interconnection Agreement between U S WEST Communications Inc., and AT&T Communications of the Mountain States, Inc., under 47 USC § 252* (Wyoming PSC April 23, 1996) at 41.

Further, whatever the merit of the incumbents' policy arguments, the Commission cannot ignore the fact that, despite repeated opportunities to do so in the past three years in scores of litigated proceedings, *no* incumbent has ever *proved* that deaveraged loop rates pose any real threat to universal service (or even to the incumbent's own bottom line) – and for good reason. First, incumbents have never shown that their current revenues (which have produced enviable returns) are inadequate to cover their actual forward-looking costs of providing services. Second, even if some subsidy is necessary, incumbents already receive enormous subsidies from numerous other sources, including bloated access and vertical features charges. Third, and most fundamentally, network element-based competition remains at *de minimus* levels and will not, under any plausible scenario, significantly erode incumbents' revenues prior to the completion of universal service reform. That is why the Commission rejected more than a year ago incumbents' similar pleas that they be allowed to impose non-cost-based access charges on network element purchasers until universal service reform is completed. *See Southwestern Bell Telephone Co.*, 153 F.3d at 537, 540 ("The Commission has made a predictive judgment, based on evidence in the record and adequately explained in the Order, that competitive pressures in the local exchange market will not threaten universal service during the interim period until the permanent, explicit universal service support mechanism has been fully implemented"). Because the Commission has since moved forward on universal service reform, the incumbents' claims are even less compelling today than when they were first raised and rejected. By contrast, the harm to consumers and to new entrants from unnecessary delay in implementing cost-based rate deaveraging would be real and substantial -- as shown in Table 1, averaged loop rates force new entrants who have invested heavily to provide competing local services to incur considerably greater costs than the entrenched incumbents.

Finally, there is no justification for even a temporary suspension of the deaveraging rule to allow a transition to application of that rule. States that have independently required deaveraging have no such transition to make. Those that have not yet done so will now be required to implement deaveraging. But even under the most optimistic scenario, that could not occur instantaneously. Where a state commission's failure to deaverage is currently on appeal, for example, the court will presumably grant the relief that AT&T and other potential entrants have sought – a remand to the state commission for further proceedings consistent with the FCC deaveraging rule. In sum, suspending the deaveraging rule is unnecessary, contrary to both the terms and core goals of the Act, and would increase uncertainty and thereby discourage capital investment. It also would send mixed signals to the courts and state commissions alike as the Commission continues vigorously to defend its landmark *Local Competition Ord*er pricing determinations.

Two copies of this letter are being submitted to the Secretary of the Commission in accordance with Section 1.1206 (b)(1) of the Commission's rules.

Sincerely,

Attachment

cc: Chairman William E. Kennard
Commissioner Susan Ness
Commissioner Harold Furchtgott-Roth
Commissioner Michael K. Powell
Commissioner Gloria Tristani
Ms. Kathryn C. Brown
Mr. Larry Strickling

# TABLE 1

| Company[1] | State | State Commission Ordered Loop Rates | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | | *No. of Zones* | *Zone 1 (most dense)* | *Zone 2* | *Zone 3* | *Zone 4* | *Loop Average*[2] | *$ Impact of Averaging on Zone 1 Rates* | *% Impact of Averaging on Zone 1 Rates* |
| Ameritech | Illinois | 3 | 2.59 | 7.07 | 11.40 | - | 9.65 | 7.06 | 273% |
| Ameritech | Michigan | 3 | 9.43 | 12.02 | 14.86 | - | 12.56 | 3.13 | 33% |
| Ameritech | Ohio | 3 | 8.36 | 11.68 | 13.73 | - | 12.29 | 3.93 | 47% |
| Ameritech | Wisconsin | 3 | 8.10 | 12.80 | 13.84 | - | 11.02 | 2.92 | 36% |
| Bell Atlantic | Delaware | 3 | 10.07 | 13.13 | 16.67 | - | 12.05 | 1.98 | 20% |
| Bell Atlantic | Maryland | 4 | 11.87 | 12.09 | 16.13 | 19.38 | 13.36 | 1.49 | 13% |
| Bell Atlantic | New Jersey | 3 | 11.95 | 16.02 | 20.98 | - | 16.21 | 4.26 | 36% |
| Bell Atlantic | Pennsylvania | 4 | 11.52 | 12.71 | 16.12 | 23.11 | 16.78 | 5.26 | 46% |
| Bell Atlantic | Virginia | 3 | 9.52 | 13.31 | 19.54 | - | 14.13 | 4.61 | 48% |
| Bell Atlantic | West Virginia | 3 | 14.49 | 22.04 | 43.44 | - | 24.58 | 10.09 | 70% |
| Bell Atlantic | Maine | 4 | 7.54 | 14.11 | 16.12 | 20.04 | 14.98 | 7.44 | 99% |
| Bell Atlantic | Massachusetts | 4 | 7.54 | 14.11 | 16.12 | 20.04 | 14.98 | 7.44 | 99% |
| Bell Atlantic | New Hampshire | 3 | 13.39 | 16.31 | 23.72 | - | 18.25 | 4.86 | 36% |
| Bell Atlantic | New York | 2 | 12.49 | 19.24 | - | - | 14.52 | 2.03 | 16% |
| Bell Atlantic | Rhode Island | 3 | 13.39 | 16.31 | 23.72 | - | 18.25 | 4.86 | 36% |
| Bell Atlantic | Vermont | 3 | 13.39 | 16.31 | 23.72 | - | 18.25 | 4.86 | 36% |
| SBC | Kansas | 3 | 19.65 | 26.55 | 70.30 | - | 31.93 | 12.28 | 62% |
| SBC | Missouri | 4 | 12.71 | 18.23 | 20.71 | 33.29 | 16.48 | 3.77 | 30% |
| SBC | Oklahoma | 3 | 20.70 | 27.75 | 49.30 | - | 27.77 | 7.07 | 34% |
| U S West | New Mexico | 3 | 19.49 | 21.30 | 26.74 | - | 21.21 | 1.72 | 9% |
| U S West | Colorado | 4 | 19.65 | 26.65 | 38.65 | 84.65 | 32.33 | 12.68 | 65% |

[1] RBOCs only, GTE companies with loop deaveraging include PA, HI, and MO. SNET also has deaveraged loops.

[2] Loop averages are either state commission estimated average loop rates or, if no statewide average is reported, a weighted average has been calculated using zone density distributions.