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July 28, 1999

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EX PARTE OR LATE FILED

William J. Bailey
Office of Commissioner Harold Furchgott-Roth
Federal Communications Commission
The Portals
445 – 12th Street, SW
Room 8A302E
Washington, DC 20554

Re: Notice of *Ex Parte* Presentation by the Association for Local Telecommunications Services

Access Charge Reform	)	**CC Docket No. 96-262**
	)	
Petition of U S West Communications, Inc. For Forbearance from Regulation as a Dominant Carrier in the Phoenix, Arizona MSA	)	**CC Docket No. 98-157**
	)	
SBC Companies For Forbearance from Regulation as a Dominant Carrier for High Capacity Dedicated Transport Services in Specified MSAs	)	**CC Docket No. 98-227**
	)	
Petition of Bell Atlantic Telephone Companies For Forbearance from Regulation as a Dominant Carriers in Delaware; Maryland; Massachusetts; New Hampshire; New Jersey; New York; Pennsylvania; Rhode Island; Washington, D.C.; Vermont; and Virginia	)	**CC Docket No. 99-24**

DC01/CANIJ/87738.1

Petition of Ameritech For Forbearance from Dominant Carrier Regulation of its Provision of High Capacity Services in the Chicago LATA	))))	**CC Docket No. 99-65**

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Dear Bill:

This *ex parte* letter is being submitted on behalf of Intermedia Communications Inc., and elaborates on Intermedia's position that, if the Commission grants ILECs the authority to negotiate individually priced Customer Specific Arrangements ("CSAs") with carriers and end users, such CSAs must be made available to CLECs for resale. Specifically, this letter addresses the following ratemaking question that flows from this position:

If : 1) ILECs are able to set CSA rates at levels that reflect Average Variable Cost ("AVC"), and
2) CLECs are able to resell retail CSAs at a discount that reflect avoided costs,
3) will this result in forcing ILECs to price their resale CSAs below cost, and constitute an unconstitutional taking of ILEC property?

As Intermedia explains in this letter, the answer to the above question is a categorical "No."

Over the past 10 years, the Commission has used AVC to set price floors for services offered by ILECs, finding that, as long as ILEC rates recover average variable costs, they are not being set a predatory levels. This is another way of saying that, as long as rates are priced at AVC or above, they recover all relevant direct costs that the ILEC incurs in providing the service. Intermedia notes that it does not endorse AVC as the appropriate basis for setting a floor for ILEC rates, but acknowledges that the Commission has done so in the past.

Under § 251(c)(4) of the Communications Act, ILECs are required to provide to CLECs and other requesting carriers "any telecommunications service that the carrier provides at retail to subscribers who are not telecommunications carriers." Under § 252(d)(3) of the Act, these services must be provided to requesting carriers at rates that reflect avoided costs.

There is no tension between the application of an AVC standard for CSAs and the avoided cost standard mandated by the Act. If an ILEC establishes a CSA, it incurs costs for marketing, negotiating, and legal/regulatory analysis – in fact these costs typically are higher than the avoided marketing costs associated with tariffed services. The avoided cost standard of § 252(d)(3) requires that these costs be excluded from the wholesale rates that the ILEC must provide to CLECs and other requesting carriers.

As you know, the wholesale rates mandated by the Act are set by State Public Utility Commissions. Generally, the States have set these wholesale rates by establishing an across-the-board discount for wholesale services at about 20% below retail rates. This is the discount percentage that must apply to CSAs when are made available for resale to CLECs.

In the Commission's *Local Competition Order*, the FCC held that services offered through CSAs are telecommunications services subject to the wholesale discount resale requirement of Section 251(c)(4)(A):

> Section 251(c)(4) provides that incumbent LECs must offer for resale at wholesale rates "any telecommunications service" that the carrier provides at retail to noncarrier subscribers. This language makes no exception for promotional or discounted offerings, including contract and other customer-specific offerings. We therefore conclude that no basis exists for creating a general exemption from the wholesale requirement for all promotional or discount service offerings made by incumbent LECs.[1]

The FCC has, at least twice, reaffirmed its conclusion that CSAs are subject to the resale requirements of Section 251(c). In *BellSouth-South Carolina*, the FCC found that BellSouth did not comply with item fourteen of the Competitive Checklist because it refused to offer CSAs at a wholesale discount.[2] Similarly, in *BellSouth-Louisiana I Order*, the FCC found BellSouth noncompliant with item fourteen of the Competitive Checklist for the same reason identified in *BellSouth-South Carolina*.[3] Indeed, consistent with the Commission's determinations, several State commissions have already found that ILECs must resell CSAs for intrastate services at the wholesale discount prescribed by the States.[4]

Intermedia acknowledges one instance in which the state-prescribed wholesale discount may not be appropriate for CSAs, and that is when the ILEC prices the CSA at AVC. As Intermedia explained above, even if a CSA is priced at AVC, there will still be marketing, negotiating and legal/regulatory costs that will be avoided when a CLEC resells the CSA. As a result, some discount below the retail CSA price is necessary in order to comply with the avoided cost standard of § 252(d)(3). The full 20% wholesale discount prescribed by most states may exceed these avoided costs, however, and in this limited range of cases, a lesser wholesale discount may be appropriate.

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1 *Implementation of the Local Competition Provisions in the Telecommunications Act of* 1996, CC Docket No. 96-98, First Report and Order, 11 FCC Rcd 15499, 15966 (1996).

2 *Application of BellSouth Corporation, et al. Pursuant to Section 271 of the Communications Act of 1934, as amended, to Provide In-Region, InterLATA Services in South Carolina*, CC Docket No. 97-208, Memorandum Opinion and Order, 13 FCC Rcd 539, 658 (1997) (*BellSouth-South Carolina*).

3 *Application by BellSouth Corporation, et al. Pursuant to Section 271 of the Communications Act of 1934, as Amended, to Provide In-Region, InterLATA Services in Louisiana*, CC Docket No. 97-231, Memorandum Opinion and Order, a13 FCC Rcd 6245, 6283 (1998) (*BellSouth-Louisiana I*).

4 *See, e.g., Petition by AT&T Communications of the Southern States, Inc., MCI Telecommunications Corporation and MCI Metro Access Transmission Services, Inc., for Arbitration of Certain Terms and Conditions of Proposed Agreement with GTE Florida Incorporated Concerning Interconnection and Resale Under the Telecommunications Act of 1996*, Docket Nos. 960847-TP & 960980-TP, Order No. PSC-97-0064-FOF-TP, Final Order on Arbitration (issued Jan. 17, 1997) (Florida Public Service Commission).

In order to properly address this issue, Intermedia proposes the following rules:

1. ILECs must specifically identify any CSA rates that are set at AVC.

2. Retail CSAs that are priced above AVC must be made available to CLECs and other requesting carriers at the wholesale discounts prescribed by the States.

3. Retail CSAs priced at AVC must be made available to CLECs and other requesting carriers at avoided cost, the rates for which must be established by State Commissions.

4. Wholesale CSAs (CSAs negotiated with carriers) must be made available for resale to CLECs and other requesting carriers at the CSA rate, without further wholesale discounts, and without restrictions.

Intermedia attaches to this *ex parte* letter a copy of a written presentation that it distributed at various Commission *ex parte* meetings yesterday. That presentation summarizes Intermedia's position on ILEC pricing flexibility in general, and resale of CSAs in particular. That handout has also been filed as a separate *ex parte* filing.

Please address any questions concerning this matter to the undersigned.

Respectfully submitted,

Jonathan E. Canis / ERS

Jonathan E. Canis

cc: Chairman William E. Kennard
Commissioner Harold Furchgott-Roth
Commissioner Michael K. Powell
Commissioner Gloria Tristani
Commissioner Susan Ness
Thomas Power, Senior Legal Advisor to Chairman Kennard
Kathryn Brown, Legal Advisor to Chairman Kennard
Ari Fitzgerald, Legal Advisor to Chairman Kennard
Dorothy Attwood, Legal Advisor to Chairman Kennard
Helgi C. Walker, Legal Advisor to Commissioner Furchgott-Roth
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