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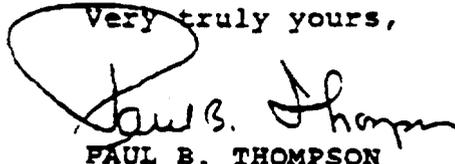
Michael P. Gallagher
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 Two Gateway Center
 Newark, New Jersey 07102

Re: **Telecommunications Arbitration**
T096070519

Sir/Madam:

I enclose my Opinion in the above matter.

Very truly yours,


 PAUL B. THOMPSON

For Tompkins, McGuire & Wachenfeld

PBT:fo
encl.

NEW JERSEY BOARD OF PUBLIC UTILITIES

In Re: Petition of At&T)
 Communications of New Jersey, Inc.)
 For Arbitration with Bell Atlantic) Docket No. T096070519
 New Jersey, Inc. Pursuant to Section)
 252 of the Telecommunications Act)
 of 1996)

JUDGMENT OF THE ARBITRATOR

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This matter comes before the arbitrator pursuant to the Telecommunications Act of 1996. The purpose of the arbitration is to determine wholesale rates based on avoided costs by the local exchange carriers.

The stated aim of the legislation in question was to allow access to the utilization of the equipment of a local exchange carrier by any other telecommunications company seeking same. After avoiding all costs that pertain to retail sales the local exchange carrier still must be allowed to make a reasonable rate of return on the wholesale leasing of its equipment.

It is obvious that a delicate balance must be set so that the local exchange carrier makes a reasonable rate of return on its investment yet not so much so that it would stifle competition with respect to the entities that seek to utilize the equipment. The whole purpose of the Act was to open to competition all areas of telecommunications based upon the premise that ultimately there would be a benefit to the consumers.

To achieve this delicate balance many days of hearings were undertaken. As one would expect with respect to such a vast undertaking there are certain gray areas that required careful development by the adverse parties. Some of the data developed by AT&T was presented through the utilization of the so-called Hatfield Model 2.2.2. This was software developed to furnish forward looking costs to utilize in the planning process. It has

been the directive that the utilities not use embedded costs to develop an appropriate rate. The language utilized is that forward looking costs should be the basis for a decision. Forward looking costs have also been described as total element, long run incremental costs. As the data utilized must be forward looking and must be long run it is obvious that to a great extent it must be hypothetical. The Act specifically requires that all relevant documentation be made available to the arbitrator and further requires that the arbitrator make a decision on "the basis of the best information available to it". See 47 U.S.C. §252(b)(1), (b)(4). With that in mind it should be obvious that the cost data developed by the Hatfield Model can be utilized by the arbitrator but the arbitrator can also use other information to arrive at a just result.

As AT&T Communications of New Jersey filed the petition I will take up the decision in the order as set forth in their brief.

Avoided Direct Expenses

Consequently the first concerns deal with product management costs, customer service costs and product advertisement costs. We adopt the reasoning of AT&T Communications of New Jersey with reference to these three items based upon our perception that to a great extent these cost deal with a retail market.

Advertising with respect to all of the telecommunications companies appears to emphasize what one company can do cheaper than another company. Therefore, it would certainly appear to be inappropriate to have the wholesaler paying for advertising which has a negative connotation to it. With respect to customer service and product management the parameters of the duties in those job descriptions by their very nature refer to retail sales.

Further with reference to the opinion before the Board of Public Utilities as to call completion services costs, the parties have generally agreed that when a reseller is going to provide its own call completion services with its own operators then call completion cost should be substantially avoided. AT&T agrees, however, that completion cost associated with intercept and E911 functionalities are not avoided because Bell Atlantic would still perform those services in a wholesale environment. Again, on a forward looking basis, it is impossible to be precise, however, I accept AT&T's argument that 77% of the call completion account should be avoided.

As to number services costs, they will be avoided by all resellers who will be supplying their own directory services except for those portions relating to providing white pages. That service will continue to be utilized by resellers such as AT&T. Thus, it would appear that as to account 6622 numbered services, 83% should be avoided and as to account 6623 customer services, Bell Atlantic

did perform an extensive study of the functions in its resident service center or its business service center. Consequently, they have met their burden of proof in that regard and I find and determine that 80% of account 6623 should be deemed avoidable.

Turning then to further avoided direct expenses, accounts numbers 6620 operator assistance expense, 6533 operations testing, 6534 operations planned administration and 6560 depreciation and amortization expense for operator system assets. With respect to all of these items, there is considerable diversion with respect to the views of the parties. A complete review of the testimony of Mr. Kirshberger and Mr. Dionne together with the testimony of Mr. Hall for Bell Atlantic demonstrates that the analysis of by Mr. Hall of these accounts is the correct one. As testified to by Mr. Hall, there is an agreement between the parties that as to the intercept equipment, Bell Atlantic will provide it. Mr. Hall testified as follows "there is no way to take that equipment and somehow extract the intercept portion from it. Moreover, that equipment is going to be required for the provision of operator services to those resellers who will chose to buy our operator services."

As to the testing account, according to Mr. Hall, the most important equipment is the mechanized loop testing. Only Bell Atlantic will have the ability to utilize that particular mode. Bell Atlantic will still be involved even if AT&T gets the first

trouble call. Consequently, Bell Atlantic's approach to these accounts is the most appropriate and none of these costs should be avoided.

Avoided Indirect Expenses

As to account No. 6301, Telecom Uncollectible expense we are dealing with an expense that is difficult to quantify. All businesses have a percentage of their accounts which are uncollectible. Here AT&T argues that in view of the fact that Bell Atlantic will be dealing with wholesalers, uncollectables should be minimal. That of course would be true if all of the wholesalers were similar in reliability to AT&T. It is obvious, however, that there are going to be a number of companies that attempt to get into this market and undoubtedly as competition becomes more antagonistic, bankruptcy can be anticipated as the weak fall by the wayside. Consequently, it is my determination that there are going to be some accounts which are uncollectible. It would seem that 10% of the uncollectible expense would be the appropriate percentage to be avoided.

As to general support expenses, corporation operations expenses and telecommunications uncollectables account 5301, the presumption is that they are to be avoided in proportion to the avoided direct expenses identified above. The mandate therefore seem clear and that is the formula that should be utilized to obtain the ratio to determine the avoided indirect expenses.

As to the so-called new cost, I adopt the reasoning as set forth in the brief of Bell Atlantic in view of the fact that no one has suggested that nor can any formula be devised to indicate the term of any contract that may be entered into between Bell Atlantic and AT&T or any other entities that are seeking the utilization of the Bell Atlantic network.

Unbundled Network Elements

As to the pricing of unbundled network elements, it is clear the rate should be based upon total element long run incremental cost.

It is obvious that the local exchange carrier would have greater access to cost information necessary to calculate the incremental cost of the unbundled elements of the network. It is also clear, however, that only those forward looking costs that are directly attributable to the network element are to be included in the TELRIC. This requires that rates for a network element be set on the basis of an efficiently designed and operated local network. The Act mandates that the parties must submit "all relevant documentation concerning the unresolved issues" and in addition that the rates must be set "on the basis of the best information available". The rates for the unbundled elements as proposed by AT&T are based upon the results utilizing the Hatfield Model. As the use of embedded costs is proscribed by its very definition a

cost determined by TELRIC must in a sense be hypothetical. Most significantly, testimony was elicited from William J. Baumol, a distinguished economist who was one of the intellectual fathers of forward looking costing. In his opinion, the Hatfield Model corresponded generally with the principals of economic analysis in the sense they address themselves to incremental cost, to the total element incremental cost as the FCC quite properly chooses to call them. They are forward looking.

However, he did not contend that the arbitrator had to accept the precise estimates developed by Dr. Mercer and the Hatfield Model. He further opines that the Hatfield Model may not be the best choice but it does present a rational choice.

The setting of rates for interconnection and access to unbundled network elements is certainly one of the more difficult aspects of this inquiry. The rates must be set pursuant to forward looking economic pricing methodology described as total element long run incremental cost. The position of Bell Atlantic is that given the time frame involved in these proceedings, they just didn't have the opportunity to perform the necessary cost studies. However, one would expect that with all of the information available as to the costs involved and given the availability of computers to aid in an analysis that the task was one that could have been accomplished. The choice then for all intents and purposes is between the default rates set by the FCC and the rates

produced by the Hatfield Model 2.2.2. As was referred to previously, the study under the formula presented by the FCC must of necessity be hypothetical in nature. The inability to utilize embedded cost give rise to a host of imponderables. Bell Atlantic argues that in view of the fact that they did not have the opportunity to perform their cost studies that the determination should be made based upon the default rates as set forth by the FCC. The efficacy of these rates what seem to be open to the same questions that are posed by the rates set by the Hatfield Model.

Bell Atlantic also argues that the Hatfield Model has never been accepted as a reliable instrument for the purpose of setting rates. The testimony disclosed however that there are a number of cost models that are in use by the utilities and it would appear that even the FCC is ultimately going to make some determination with respect to the utilization of the Hatfield Model or some version thereof. The goal of everyone concerned is to make a determination that allows for healthy competition but at the same time assures the local exchange carrier that it will have an adequate revenue stream.

Therefore, with some modifications, I am relying on the results of the Hatfield Model. To set interim rates only prolongs the problem of balancing the interest of all of the parties which of necessity must take place through experience. It is all very well to talk about achieving a delicate balance, but the fact of the matter is that until there is a period of time over which what

actually transpires can be experienced, it is impossible to attain the goal to which everyone aspires.

Consequently, I am setting the monthly cost for the unbundled loop at a figure of \$11.76. The basis for that decision starts with the Vintage Retirement Unit Cost (VRUC). The ancillary costs were then zeroed out. The Hatfield Model produces a cost of \$10.92. By substituting the VRUC data for the Hatfield default value you get a value of \$11.29. Making those changes and adopting the FCC depreciation lives and costs of capital produces a monthly cost of \$11.76 for the unbundled loop.

The parties should then use the approach of Mr. West for deaveraging. This is based on the testimony that it would be highly inefficient to reorganize all the records when there are already board approved rate zones to divide the loops.

Switching Charges

The rate for end offices switching should be set at 0.2 cents per minute. The Hatfield Model generated a cost of 0.19 per minute. The FCC set a default range of 0.2 or 0.4 cents per minute. Consequently, the 0.2 cents would be at the low end of the FCC range.

The Tandem switching charge should be set at 0.15 cents per minute. This based on the study the FCC did among diversified LEC's to arrive at that rate.

For the same reasons the rate for calls terminating at an end office should be set at 0.3 cents per minute and 0.5 cents per minute of use for calls terminating at a Tandem switch.

For line port changes the rate should be \$1.10. Again, the FCC established a default range of \$1.10 to \$2.00 per line port a month. The Hatfield Model generated a cost of \$1.06 per line. Therefore, a cost at the low end of the FCC range would seem to be appropriate.

I am not in complete agreement with the distribution cable fill factors utilized in the Hatfield Model. It is my concern that the forwarding looking percentage which has been utilized by Bell Atlantic of about 35% is not only based upon their engineering standards but based upon the approach that constructing a line is an expensive proposition. The experience of Bell Atlantic in the retail area of the industry should be given much consideration. It is also my feeling that the cost of capital should be sufficient to keep the company with the strength to perform reliable service. One only has to remember the decline of the railroads which were unable to compete with the trucking industry due to any number of restrictions placed upon them, which were not placed upon their competitors, which gradually eroded their income stream. In an effort to survive, maintenance was the first function to suffer and bankruptcy was the final result. While competition may benefit the consumer price wise, it is of no

particular advantage to have poor service and a deteriorating infrastructure.

Cost of Capital

With respect to the cost of capital the chart in the brief of Bell Atlantic New Jersey amply demonstrates the differences between the various experts and the Hatfield Model. After considering the testimony of the witnesses and taking into consideration the rates as set by the Hatfield Model the cost of capital should be 11.9%. The equity debt structure should be 60/40. The cost of debt should be 7.9%. The cost of equity should be determined using those percentages.

Additional Services

An additional disagreement has resulted with respect to the question of tariff directory listings. The question is whether additional listings, or choice not to be listed, constitute telecommunications services subject to the Acts requirements that they be made available for resale as wholesale discount. My determination in this is that such listings are to be made available for resale at a wholesale discount. The basis for this determination is that this is obviously an integral part of telecommunications. In today's market additional listings are quite commonplace, inability to provide same would certainly inhibit any type of competition.

With respect to operator services/directory assistance routing, the parties are in agreement that this will be implemented no later than April of 1997. There is an open question as far as cost are concerned with respect to same it would seem that the appropriate method of addressing this problem is to use an interim rate based on the rate for a "data base dip". At the time the final rate is addressed, then there will be a "true-up" between Bell Atlantic and AT&T. At that time any over charges or any under charges can be arranged between the parties.

With respect to customer specific pricing arrangements AT&T seeks to have a date positive by which they can examine the special rating arrangements and specific pricing arrangements. It is difficult to perceive how this can be handled without giving out information which would be very detrimental to Bell Atlantic's interests. I adopt Bell Atlantic's proposed solution to this problem.

Another issue which has to be determined is the utilization of dark fiber. Whether or not dark fiber is a network element cannot be decided at this level. However, it seems clear that this dark fiber is to be utilized by Bell Atlantic and even though there is no present plans for its deployment, there would certainly seem that provisions for its use by Bell Atlantic should not be disrupted. Consequently, the application to utilize dark fiber is denied.

As mentioned above, service reliability and the quality of transmissions are of the utmost importance to each carrier. The testimony did develop that as far as AT&T was concerned that having the remote switching modules available in the Bell Atlantic central offices was of the utmost importance with respect to being in a position to adequately compete. Consequently, such switching modules should be co-located in the central offices on a space available basis. On call termination cost, it would appear that the "bill and keep" pricing modality suggested by AT&T is the most appropriate way of deciding this issue. Certainly for the time being it would appear that this would work to the advantage of Bell Atlantic.

Bell Atlantic argues that by reason of the fact that they have to provide unbundled services to AT&T that AT&T should also be so directed. However, at the present time there is a specific provision with respect to Bell Atlantic obtaining that access. Subsequent to the period of time that AT&T has obtained access to Bell Atlantic's unbundled network, then, Bell Atlantic has the opportunity of filing its petition and obtaining the same access that it now requests. It is not within the power of this arbitrator to rule on that application.

As the parties have agreed that there would be a single discount and it will apply to all services. There is also an agreement with respect to the methodology to be utilized. The numerator is going to be the avoided cost, the denominator is going

to be the revenues from services available for resale. The parties should decide on those figures based upon this opinion and forward immediately to the arbitrator the agreed upon ratio.

AT&T is to present the appropriate order.

Submitted

By *Paul B. Thompson*
Paul B. Thompson,
Arbitrator

DATED:

EXHIBIT I



STATE OF NEW JERSEY
 Board of Public Utilities
 Two Gateway Center
 Newark, NJ 07102

AGENDA DATES: 7/17/97
 9/9/97

TELECOMMUNICATIONS
DECISION AND ORDER

IN THE MATTER OF THE)
 INVESTIGATION REGARDING LOCAL)
 EXCHANGE COMPETITION FOR)
 TELECOMMUNICATIONS SERVICES)

Docket No. TX95120631

(SERVICE LIST ATTACHED)

BY THE BOARD:

PREFACE

The following is an extensive Order of the Board of Public Utilities regarding the generic rates to be charged for the unbundled elements of and interconnection to incumbent local exchange carrier networks. The Order also includes the Board's findings and determinations with regard to wholesale discounted rates for resale of incumbent local exchange carrier services. As such, this Order formalizes the actions taken by the Board at its public agenda meetings on July 17, 1997, in Item No. 8C, and on September 9, 1997, within the context of its discussions on Items 8C and 8D. It is based upon the extensive record developed in an evidentiary proceeding that included 29 days of hearings, 62 expert witnesses, 93 pieces of written testimony, 300 exhibits and over 5,000 pages of transcripts.

Section 1 - INTRODUCTION places the actions taken herein within the context of the Board's continuing efforts to establish deregulatory and pro-competitive policies for application in all telecommunications markets in the State of New Jersey.

Section II - BACKGROUND provides a detailed procedural history of the proceedings leading up to the issuance of this Order.

Section III - UNBUNDLED NETWORK ELEMENTS: RATES outlines in detail the Board's determinations regarding the rates to be charged by an incumbent local exchange carrier for the unbundled elements of and interconnection to its network. Also provided is a detailed summary and analysis of the record upon which the determinations of the Board in these areas is based. Included are discussions of all proposed cost models, along with their inputs and assumptions, and separate discussions regarding the local loop, switching elements and reciprocal compensation. A thorough review of all other network elements concludes the section.

Section IV - UNBUNDLED NETWORK ELEMENTS: TECHNICAL SPECIFICATIONS outlines the technical requirements imposed by the Board on incumbent local exchange carriers regarding unbundled network elements. Included are subsections devoted to discussions of interconnection generally and to 18 network elements and/or issues. Each subsection provides for its element or issue an outline of the record established by the parties and a clear discussion of the Board's final determination based upon that record.

Section V - RESALE outlines the Board's findings and determinations with regard to wholesale discounted rates for resale of incumbent local exchange carrier services. It includes a discussion of the avoided cost methodology, six specific avoided direct expenses, three direct operator expenses, the indirect expense allocator and the accounts to which it applies, profits attributable to avoided costs, new or incremental costs, the revenue base of the wholesale discount, the number of wholesale discounts, the overall wholesale discount, the services available for resale, resale restrictions, reciprocity and other resale issues, such as the wholesale/resale interface, branding, third party charges, operator services and directory assistance routing and the "most favored nation" provision.

Section VI - WHY GENERIC RATES SHOULD SUPERSEDE ARBITRATED RATES provides guidance for the application of the provisions of this Order to interim interconnection agreements

approved by the Board prior to its the actions formalized herein and to those presented to the Board for its consideration after those actions were taken. The section identifies and describes a number of unforeseen events occurring in both the local and federal regulatory arenas which have forced the Board to reconsider a prior declaration regarding the status of rates achieved through interconnection arbitration. The determinations outlined by the Board in this section are based upon its desire to proceed along its course of encouraging competition in all levels of the telecommunications marketplace in a manner which is fair and equitable to all concerned.

Section VII - SUMMARY CONCLUSION AND ORDER provides, for the convenience of the reader, a listing of the 64 determinations and directives made by the Board in this Order.

Finally, immediately following this *Preface* is a detailed *Table of Contents* to assist the reader in locating sections of particular interest.

**In the Matter of the Investigation Regarding Local Exchange Competition for
Telecommunications Services BPU Docket No.: TX95120631**

Order Regarding Interconnection and Resale

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STATE OF NEW JERSEY
 Board of Public Utilities
 Two Gateway Center
 Newark, NJ 07102

AGENDA DATE: 7/17/97
 and 9/9/97

**TELECOMMUNICATIONS
 DECISION AND ORDER**

IN THE MATTER OF THE)
 INVESTIGATION REGARDING LOCAL)
 EXCHANGE COMPETITION FOR)
 TELECOMMUNICATIONS SERVICES)

DOCKET NO. TX95120631

(SERVICE LIST ATTACHED)

BY THE BOARD:

I. INTRODUCTION

By this Order, the Board of Public Utilities (Board) issues its findings and determinations with regard to the generic rates for incumbent local exchange carrier (incumbent LEC, or ILEC)¹ unbundled network elements (UNEs) and interconnection, as well as wholesale discounted rates for resale of ILEC services. The action which is set forth herein continues the Board's efforts to make certain that the benefits of competition recognized by the State Legislature in the Telecommunications Act of 1992, N.J.S.A. 48:21.16

¹An incumbent LEC is defined in The Telecommunications Act of 1996, P.L. 104-104, 110 Stat. 56 (codified in scattered sections of 47 U.S.C. §151 et seq.) (The Act) to mean, with respect to a geographical area, a local exchange carrier that (a) as of February 8, 1996, provided local exchange service in such area; and (b)(1) on such date was deemed a member of the exchange carrier association pursuant to 47 C.F.R. §69.601(b); or, on or (2) after such date became a successor or assign of a member described in clause (1) above. See 47 U.S.C. §251(h)(1).

The Board notes that only two of New Jersey's three local exchange carriers (LECs) are affected by this Order. Bell Atlantic-New Jersey, Inc. (BA-NJ) and United Telephone Company, Inc. (United) are ILECs within the definition of an ILEC set forth in the Act. However, Warwick Valley Telephone Company (Warwick), a LEC which serves a small portion of the State, is exempted from the ILEC obligations of 47 U.S.C. §251(c) because it is considered a "rural" telephone company and has not received a bona fide request for interconnection, services or network elements. See 47 U.S.C. §251(f)(1)(A).

et seq., inure to the local exchange market consumers of this State. The Board action also furthers the deregulatory and pro-competitive telecommunications policy which has recently been adopted at the federal level.

The Act, effective February 8, 1996, set forth a national policy framework to establish a competitive and deregulated telecommunications market. In revising communications laws that had been in existence since 1934, the Act removed barriers to entry into the telecommunications marketplace by directing that:

[n]o State or local statute or regulation, or other State or local legal requirement, may prohibit or have the effect of prohibiting the ability of any entity to provide any interstate or intrastate telecommunications service. (47 U.S.C. §253(a))²

Thus, the Act is intended to provide for a pro-competitive, deregulatory policy designed to accelerate rapid deployment of advanced telecommunications and information services, and technology by opening all telecommunications markets to competition. Importantly, the Act imposes on incumbent LECs the duty to negotiate in good faith the terms and conditions of agreements to fulfill their obligations under the Act. These ILEC obligations include, but are not limited to, the duty to provide interconnection with the networks of requesting carriers, the duty to provide nondiscriminatory access to unbundled network elements, and the duty to offer for resale at wholesale rates any telecommunications service that the ILEC provides to subscribers who are not telecommunications carriers. (47U.S.C. §251)

The Board now sets forth its determinations regarding generic ILEC rates for interconnection, UNEs and services offered for resale at wholesale rates.

II. BACKGROUND

²Notwithstanding 47U.S.C. §253(a), pursuant to the Communications Act of 1934, states continue to have jurisdiction over "charges, classifications, practices, services, facilities, [and] regulations for or in connection with intrastate communications service." 47U.S.C. §152(b)