

The BOCs' wholesale local switching offerings universally suffer from fundamental defects that preclude their compliance with the Checklist obligation. These take-it-or-leave-it arrangements⁸⁰ contain rates and terms that are not just and reasonable. This fact was brought to the Commission several years ago by Momentum Telecom, Inc. ("Momentum"), a small competitive carrier operating in the southeastern U.S. Momentum filed a formal complaint against BellSouth under Section 271(d)(6) of the Act,⁸¹ charging that BellSouth has offered Checklist Element 6 (local switching) only at rates that far exceed the Section 201(b) just and reasonable standard.⁸² Momentum produced an economic analysis showing that the rates offered by BellSouth are substantially in excess of BellSouth's costs of providing local switching, in violation of the just and reasonable standard and that despite repeated requests BellSouth has refused to offer any meaningful modifications to those rates.⁸³

Any doubts regarding whether the BOCs' post-UNE local switching offerings comply with the just and reasonable standard disappears upon review of Commission data on the number of unbundled loops with switching that are being provided to competitive carriers by the ILECs. The number of unbundled loops with switching provided by ILECs has steadily declined every year since elimination of local switching as a Section 251(c)(3) UNE. In June 2006,

loop-based) competition is properly included in the Section 251(c)(3) forbearance analysis. *See, e.g., Omaha Forbearance Order*, at ¶ 64.

⁸⁰ It is well documented that the BOCs are flatly unwilling to negotiate with CLECs regarding any material term of these agreements. *See, e.g., Momentum Telecom, Inc. v. BellSouth Telecommunications, Inc.*, Formal Complaint, File No. EB-05-MD-029 (filed Nov. 17, 2009) ("*Momentum Complaint*"), Legal Analysis, at 2-3.

⁸¹ 47 U.S.C. § 271(d)(6).

⁸² *Momentum Complaint*, at ii. Momentum's complaint was withdrawn before a decision was reached by the Commission.

⁸³ *Id.*, Affidavit of Joseph Gillan, at ¶¶ 30-34.

ILECs were providing 22% fewer UNE loops with switching than six months earlier.⁸⁴ As of June 2007, that number had dropped another 26%⁸⁵ and by June 2008 the number of UNE loops with switching provided by ILECs had dropped an additional 20%.⁸⁶ Despite a 70% decline in loops with switching from December 2004, there was no parallel increase in stand-alone loops as predicted by the Commission in its local switching impairment analysis.⁸⁷ It is not surprising that use of unbundled loops with switching has decreased precipitously, since carriers have been faced with non-negotiable rates that far exceed just and reasonable levels. The unfortunate but predictable result has been an exodus of competitors from the mass market, leaving (in most cases) only the ILEC and the incumbent cable company as duopoly wireline service providers.⁸⁸

III. COMMISSION RULES ARE NECESSARY TO ENSURE BOC COMPLIANCE WITH THE COMPETITIVE CHECKLIST

The preceding sections have explained why Commission action is needed to restore the competitive promise of Section 271 to economically viable offerings. Section 271 was intended to establish clear-cut *additional* obligations – obligations beyond those of Section

⁸⁴ *Local Telephone Competition: Status as of June 30, 2006*, Industry Analysis and Technology Division, FCC, at Table 4 (Jan. 2007).

⁸⁵ *Local Telephone Competition: Status as of June 30, 2007*, Industry Analysis and Technology Division, FCC, at Table 4 (Mar. 2008).

⁸⁶ *Local Telephone Competition: Status as of June 30, 2008*, Industry Analysis and Technology Division, FCC, at Table 4 (Jul. 2009).

⁸⁷ *Id.*

⁸⁸ It is well documented that non-incumbent service providers generally cannot economically serve residential customers absent cost-based access to ILEC network facilities. *See, e.g.*, Initial Comments of the Arizona Corporation Commission, WC Docket Nos. 06-172, 07-97 (filed Sept. 21, 2009), at 11 (“Since the demise of UNE-P, CLECs find themselves in a nascent stage in the small business market [in the Phoenix MSA]; while at the same time having exited for the most part the residential market with the exception of the large cable provider, Cox.”).

251 that apply to all ILECs,⁸⁹ and obligations beyond the Commission's special access duties already preserved by the Act.⁹⁰

The central purpose of the rules proposed here is to establish clear requirements describing what constitutes each individual Checklist item, as well as to give effect to the just and reasonable rate standard that the Commission has previously determined applies to Checklist Elements. Checklist Elements are clear and unambiguous obligations that were not circumscribed in any way by Congress. Congress specifically listed each element that it would require a BOC to offer in exchange for its ability to offer in-region interLATA service and expressly prohibited the FCC from modifying the list.⁹¹ Importantly, unlike unbundling obligations under Section 251 of the Act, Congress expressly mandated the availability of Checklist Elements under Section 271, whether or not the FCC could conclude that a carrier would be impaired without access to such elements.

Although the statute makes clear the central obligations of the Checklist (*i.e.*, unencumbered access to Checklist Elements), the Commission lacks rules to ensure that Checklist Elements are offered free of restriction and discrimination, at rates that are just and reasonable, and offered under administrative processes that give affected parties an opportunity to object. The fundamental purpose of this petition is to correct this critical deficiency by adopting rules that:

⁸⁹ Section 251 unbundling and interconnection requirements apply to all incumbent LECs other than Rural Telephone Companies which are exempt under Section 251(f) of the Act. 47 U.S.C. § 251(f).

⁹⁰ Section 251(g) of the Act preserved rules and obligations relating to exchange access, including the Commission's special access rules and obligations that existed at the time of enactment of the Act. 47 U.S.C. § 251(g).

⁹¹ See 47 U.S.C. § 271(d)(4).

- (a) Clearly define the requirements that must be satisfied for the provision of Checklist Elements to be nondiscriminatory in practice and effect (proposed §§ 53.601 to 53.608);
- (b) Establish a safe-harbor contribution level to ensure that Checklist Element rates are just and reasonable (proposed § 53.609); and
- (c) Set forth the filing requirements for the principal administrative device – a federally filed Statement of Generally Available Terms of Conditions (SGAT) – needed to ensure compliance with Competitive Checklist obligations (proposed §§ 53.610 to 53.614).

Attachment B provides a section-by-section comparison of the changes required to the Commission’s existing Section 251 rules to ensure that the rules applicable to Section 271 Checklist Elements track the statutory mandate of that provision. The most significant changes to current Section 251 rules are edits needed to eliminate all use and user restrictions, including those that deny access to mobile wireless service providers and interexchange carriers.⁹²

The basis for the restrictions in Part 51 (which contains the rules applicable to Section 251 unbundled network elements) is the impairment analysis required by Section 251(d)(2).⁹³ In adopting those restrictions in the *Triennial Review Remand Order* (“*TRRO*”), the Commission determined that whether a telecommunications carrier is eligible to access UNEs should “depend[] solely on [its] ‘impairment’ analysis and other factors that [it] consider[s] under section 251(d)(2).”⁹⁴ More specifically, the Commission determined that access to Section 251 UNEs should be restricted to those cases where the requesting carrier seeks to provide

⁹² The proposed rules also contain changes required to limit their application to BOCs (in contrast to all incumbent LECs).

⁹³ 47 U.S.C. § 251(d)(2).

⁹⁴ *Unbundled Access to Network Elements; Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers*, WC Docket Nos. 04-313, 01-338, Order on Remand, 20 FCC Rcd 2533, at ¶ 34 (2005) (“*Triennial Review Remand Order*” or “*TRRO*”), *affirmed Covad Communications v. FCC*, 450 F.3d 528 (D.C. Cir. 2006).

service in a market that is not sufficiently competitive without the use of UNEs.⁹⁵ The Commission found the mobile wireless market and the long distance services market to be markets “where competition has evolved without access to UNEs” and it therefore declined to order unbundling of network elements under Section 251 to provide service in those markets.⁹⁶ Unfortunately, after the Commission’s 2005 decision to deny long distance and mobile wireless carriers access to Section 251(c)(3) UNEs, the BOCs’ market share in those markets increased significantly. Today, the BOCs enjoy substantial market power in the mobile wireless and long distance services markets.

Importantly, no such impairment analysis applies to Checklist Elements, which are *mandatory* offerings for any BOC that chooses to provide interLATA services within its incumbent operating territory. Thus, there is no legal justification for the Commission to dilute the network element obligations required under Section 271 by limiting their availability or use. Indeed, to do so would directly conflict with Congress’s directive that the Commission “not, by rule or otherwise, limit or extend the terms used in the competitive checklist set forth in subsection (c)(2)(B).”⁹⁷

Structurally, the petition proposes a new Subpart G to the Commission’s existing Part 53 Rules – Special Provisions Concerning Bell Operating Companies.⁹⁸ As a threshold matter, the petition proposes that five new definitions be added to §53.3 – Terms and Definitions:

Checklist Network Element. A *Checklist Network Element* is any facility or equipment, including the features, functions, and capabilities that are provided by

⁹⁵ *Id.*

⁹⁶ *Id.*, at ¶ 36 (footnote omitted).

⁹⁷ 47 U.S.C. § 271(d)(4).

⁹⁸ Subpart G – Compliance with Section 271 Checklist Requirements.

means of such facilities or equipment, enumerated in Section 271(c)(2)(B)(iv)-(x) of the Act.

Customer's Premises. A customer's premises as referred to in Section 271(c)(2)(B)(iv) of the Act is any technically feasible point designated by the requesting telecommunications carrier.

Statement of Generally Available Terms. A Statement of Generally Available Terms ("SGAT") is a statement of the terms and conditions and prices that a BOC generally offers to fulfill its obligations under Section 271(c)(2)(B)(iv)-(x) of the Act.

Telecommunications Carrier. Telecommunications Carrier has the same meaning as that term is defined in Section 153(a)(49) of the Communications Act of 1934, as amended.

These definitions set the stage for new Subpart G – Compliance with Section 271 Checklist Requirements, setting forth rules to govern the filing and approval of a federal Statement of Generally Available Terms ("federal SGAT") so central to the nondiscriminatory offering of Checklist Elements.

The rules appropriate to each area are discussed separately below. The full text of the proposed rules can be found in Attachment A. In addition, Attachment B compares (in "track changes" format) the differences between the proposed Section 271 rules and their Section 251 counterparts with respect to those rules addressing the provisioning and processes required to form combinations of Checklist Elements and other services, facilities, and unbundled network elements.

A. Rules Relating to Provisioning and Non-Discrimination: Proposed §§ 53.601 Through 53.608

Proposed rules 53.601 through 53.608 set forth basic requirements for Checklist Elements to ensure that they remain free of unlawful use restrictions or discrimination. In large part, these rules are patterned after comparable rules applicable to Section 251 UNEs, adjusted to eliminate restrictions or other factors that are not relevant to Checklist Elements.

As indicated above, the Section 271 Competitive Checklist straightforwardly enumerates specific network elements that must be offered to telecommunications carriers, without *any* reference to – much less any limitation on – the services offered by that carrier. The only limitation on Checklist Elements is that their availability is restricted to telecommunications carriers.⁹⁹ Consequently, although the Commission’s Section 251 rules provide a useful *starting* point to develop rules applicable to Section 271 Checklist Elements, limitations in those rules that are grounded in the impairment analysis unique to Section 251 must be removed.

The following provides an overview of the goals and structure of the first group of proposed rules (§§ 53.601 to 53.608).

§ 53.601 Applicability and Compliance	This rule is new, and makes clear that Subpart G applies in any state where a BOC has obtained approval to provide interLATA services. The rule establishes an affirmative obligation to have on file an approved federal SGAT describing the rates, terms and conditions of service for each Checklist Element. In addition, the rule makes clear that a BOC may negotiate alternative agreements (which must be filed and be made available to other carriers); provided, however, that such alternative negotiated agreements do not relieve the BOC of its obligation to have available an approved SGAT.
§ 53.602 General Terms and Conditions	This rule is patterned on the existing § 51.307 – Duty to Provide Access on an Unbundled Basis to Network Elements, modified primarily to conform to the editorial requirements of Subpart G (<i>i.e.</i> , by referencing BOC instead of ILEC and referring to Checklist Elements in place of Section 251 UNEs). Two new rules are added, however. First, § 53.602(e) has been added to make clear that BOCs are required to perform routine network modifications necessary to make available a Checklist Element.

⁹⁹ See Section 271(c)(2)(B), which states: “COMPETITIVE CHECKLIST- Access or interconnection provided or generally offered by a Bell operating company to *other telecommunications carriers* meets the requirements of this subparagraph if such access and interconnection includes each of the following [lists specific elements]...” (emphasis supplied).

Second, § 53.602(g) has been added to require that Checklist Elements remain subject to the performance and/or remedy plans applicable to corresponding Section 251 UNEs. This provision is particularly appropriate because most performance/penalty plans were adopted to gain Section 271 authority and, as such, should be retained for all Section 271 Checklist Elements.

§ 53.603 Use of Checklist Network Elements

This rule is patterned on existing § 51.309 – Use of Unbundled Network Elements. The principal modifications were necessary for editorial conformance. In addition, any language that imposes a use restriction on a network element has been removed because no such restrictions are permitted for Checklist Elements.¹⁰⁰

Finally, the existing parallel § 51.309(g), which in the context of Section 251 network elements is intended to preserve some access rights potentially weakened by the Commission’s impairment-based use restrictions, is unnecessary in this context (and, therefore, not repeated) because of the unambiguous requirements in the proposed Subpart G that no use restrictions are permitted.

§ 53.604 Nondiscriminatory Access to Checklist Network Elements

This rule is patterned after § 51.311 – Nondiscriminatory Access to Unbundled Network Elements, modified for editorial conformance.

§ 53.605 Just, Reasonable and Nondiscriminatory Terms and Conditions for the Provision of Checklist Network Elements

This rule is patterned after § 51.311 – Just, Reasonable and Nondiscriminatory Terms and Conditions for the Provision of Unbundled Network Elements, modified for editorial conformance to the unique circumstances of proposed Subpart G, with one notable addition.

This addition, § 53.605(c), prohibits a BOC from conditioning any term, condition or price of a Checklist Element through a volume or term commitment to purchase additional BOC services or facilities. The purpose of this provision is to ensure that a BOC may not frustrate the competitive deployment of facilities through financial penalties designed to keep a carrier chained to BOC services.

¹⁰⁰ Specifically, provisions in comparable § 51.309 which deny access to a Checklist Element for the exclusive provision of wireless or interexchange service, or which require that the element be used to provide a telecommunications service, have been eliminated.

§ 53.606 Combination of Checklist Network Elements

This rule parallels § 51.305 – Combination of Unbundled Network Elements, with the editorial changes needed to conform to Subpart G, as well as additional clarity to ensure that Checklist Elements can be connected to any other facility or service, irrespective of its label (*i.e.*, Checklist Element, unbundled network element, or wholesale service).

In addition, § 53.606(g) has been added to ensure that any charge for combining or commingling any Checklist Element with any other facility or wholesale service shall not exceed the direct cost of performing the requested functions.

§ 53.607 Methods of Obtaining Interconnection and Access to Checklist Network Elements

This rule adopts the existing requirements of § 51.321 – Methods of Obtaining Interconnection and Access to Unbundled Network Elements without modification. That is, each of the rules applicable to the methods to obtain interconnection and access to Section 251 UNEs applies with equal force to the Checklist Elements required under Section 271.

§ 53.608 Conversion

This rule is generally patterned after comparable § 51.316 – Conversion of Unbundled Network Elements and Services.

The principal (non-editorial) modifications to these rules is to make clear that the obligation to convert an existing arrangement to its equivalent Checklist Element offering or combination is not affected by whether the existing arrangement is comprised of services or facilities purchased as unbundled network elements, combinations of unbundled network elements, commingled arrangements of unbundled network elements and other wholesale services (including special access) or any other arrangement.

In addition, § 53.608(d) has been added to require that any charge to effect a conversion shall not exceed the direct cost and that, unless agreed to by the BOC and requesting telecommunications carrier, no conversion should require any physical rearrangement of network elements or wholesale services.

By adopting the rules summarized above, the Commission would be explicitly establishing that Checklist Elements must comply with those provisions intended to prevent discrimination and other unreasonable terms that currently apply to unbundled network elements

required under Section 251. Most of the changes in the proposed rules set forth in §§ 53.601 through 53.608 are required for editorial conformance to the particular requirements of the new proposed Subpart G (*i.e.*, that the rules apply only to BOCs and that the impairment-based use restrictions applicable to Section 251 UNEs do not apply to the Checklist Elements required by Section 271). Other changes (as explained above) incorporate provisions to ensure that the Commission's *existing* policies relating to combinations apply with equal force to the various combinations that will now include Checklist Elements or otherwise correct gaps in the Commission's rules created by this additional category of wholesale offering.

B. Rules Relating to Just and Reasonable Pricing: Proposed § 53.609

The Triennial *Review Remand Order* concluded that Checklist Elements would be held to Sections 201 and 202 of the Act, but did not provide any meaningful guidance as to how compliance would be judged.¹⁰¹ Proposed § 53.609 fills this gap by offering a safe-harbor methodology by which Checklist Element prices would be presumed reasonable. The safe harbor methodology proposed herein is based on the Commission's conventional methodology to determine just and reasonable rate levels by comparing prices to a measure of direct cost plus a reasonable contribution (sometimes known as the New Services Test).¹⁰²

There are few rules implementing the proposed safe-harbor pricing standard, but they collectively ensure that rates are (and remain) just and reasonable with a minimum of administrative oversight. The rules provide that the cost measure used for direct cost remains the Commission's TELRIC rules, which have been implemented through contested case state

¹⁰¹ The *TRRO* hypothesized ways that a BOC *might* be able to demonstrate compliance with Sections 201 and 202 but provided no explanation as to how such demonstrations would satisfy the traditional Section 201 and 202 standard or provide guidance as to how the demonstration could actually be made. *See TRRO*, at ¶ 664.

¹⁰² *See, e.g., In the Matter of Wisconsin Public Service Commission: Order Directing Filings*, Memorandum Opinion and Order, 17 FCC Rcd 2057 (2002), at ¶ 23 (“*Wisconsin Payphone Order*”).

proceedings and which the Commission has already relied upon in granting BOCs the authority to provide in-region interLATA services. The key variable addressed by the safe-harbor approach is a limit on the level of contribution that would be considered just and reasonable.¹⁰³

Before turning to the justification for (and calculation of) the safe-harbor contribution level, the following presents and explains the very narrowly drawn pricing rules proposed for Checklist Elements:

§ 53.609 Pricing

(a) *Non-recurring charges.* Non-recurring charges for Checklist Elements shall equal non-recurring charges applicable to comparable network elements required under Section 251(c)(3) of the Act.

(b) *Recurring charges.* Recurring charges for a Checklist Element shall recover the direct costs of the element, plus a reasonable allocation of the BOC's common overheads.

(c) *Direct cost calculation.* Direct cost shall be the forward-looking economic cost determined in compliance with § 51.505, prior to the inclusion of any allocation of forward-looking common costs calculated in accordance with § 51.505(c).

(d) *Common cost allocation.* A BOC shall not include in the price of a Checklist Element more than a reasonable allocation of the company's common costs. Common cost allocations less than or equal to 22% shall be presumptively reasonable.

(e) *Stand-alone cost.* In no event shall the sum of the direct costs plus a reasonable allocation of common costs exceed the stand-alone costs associated with the network element. For purposes of this section, stand-alone costs are the total forward-looking costs, including corporate costs, that would be incurred to produce a given element if that element were provided by an efficient firm that produced nothing but the given element.

¹⁰³

The existing TELRIC rules also limit contribution to a reasonable allocation of forward-looking common costs (§ 51.505(a)(2)), subject to a number of conditions. *See* § 51.505(c). As explained herein, however, traditional regulation has generally viewed the allocation of common costs as establishing a *range* of just and reasonable outcomes and we propose here that the Commission adopt a safe-harbor maximum value for the pricing of Checklist Elements.

(f) *Imputation*. No interstate service offered by a BOC shall be priced below its direct cost as computed by the sum of the prices of those Checklist Elements comprising the facilities used to provision the service.

First, § 53.609(a) adopts a pricing rule which requires that *non-recurring* charges for Checklist Elements mirror those applicable to unbundled network elements required under Section 251. The principal reason for this rule is to prevent, to the maximum extent practical, the creation of new barriers to customer choice. By definition, non-recurring charges – for service initiation or reconfiguration – apply to one-time events that largely happen at the point of customer choice (*i.e.*, to start a service or change a provider). Because these charges present a possible barrier to service initiation or customer choice, they are some of the most competitively sensitive charges in the market. Consequently, the Commission should not permit any higher contribution level from non-recurring charges than the levels embedded in existing Section 251 UNE rates.

With respect to the pricing of the *recurring* rates for Checklist Elements, the proposed rules (a) set forth the New Services test (direct cost plus a reasonable contribution),¹⁰⁴ (b) establish the appropriate measure of direct cost as the forward-looking economic cost already described by Commission rules less any contribution,¹⁰⁵ and (c) provide a safe-harbor maximum contribution markup that would presumptively be just and reasonable.¹⁰⁶

This methodology – grounded in existing Commission pricing rules – is fully consistent with prior Commission orders requiring that the rates for Checklist Elements be just and reasonable. In the *TRRO*, the FCC applied a pricing standard drawn from traditional

¹⁰⁴ 47 U.S.C. § 53.609(b).

¹⁰⁵ 47 U.S.C. § 53.609(c).

¹⁰⁶ 47 U.S.C. § 53.609(d).

methods of regulation, *i.e.*, the “basic” just and reasonable rate standard that had “historically been applied” under most federal and state statutes:

Thus, the pricing of checklist network elements that do not satisfy the unbundling standards in section 251(d)(2) are reviewed utilizing the basic just, reasonable, and nondiscriminatory rate standard of sections 201 and 202 that is fundamental to common carrier regulation that has historically been applied under most federal and state statutes, including (for interstate services) the Communications Act. Application of the just and reasonable and nondiscriminatory pricing standard of sections 201 and 202 advances Congress's intent that Bell companies provide meaningful access to network elements.¹⁰⁷

Significantly, when determining that Sections 201 and 202 should apply to Checklist Elements, the Commission did not adopt a new and unique perspective on those statutory provisions but rather clearly expressed the intention that Sections 201 and 202 be applied as they had traditionally been. Importantly, the just and reasonable rate standard contained in Section 201(b) has required a reasonable nexus between cost and price even though, over the years, different approaches to cost have been used. If the FCC is to advance “Congress's intent that Bell companies provide meaningful access to network elements,”¹⁰⁸ it must continue to apply its traditional view that prices must be judged in relation to their underlying cost.

¹⁰⁷ *TRRO*, at ¶ 663 (footnotes omitted).

¹⁰⁸ *Id.*

The just and reasonable rate standard is a foundation of traditional regulation, whether that regulation is outlined in a federal or state statute.¹⁰⁹ The touchstone to judging just and reasonableness has commonly been cost. As the Commission has explained:

The Communications Act requires that rates be just and reasonable and not create unreasonable discrimination or undue preference. Sections 201(b) and 202(a), 47 U.S.C. §§ 201(b), 202(a). *Costs are traditionally and naturally a benchmark for evaluating the reasonableness of rates, because cost-based rates both deliver price signals which contribute to efficient use of the networks and generally distribute network costs to the customer who causes those costs.*¹¹⁰

Over time, as FCC regulation has adapted to changing conditions, its underlying commitment that rates should bear a reasonable nexus to cost has not changed. For instance, when the FCC adopted price cap regulation, it made clear that it designed its price cap system to reflect costs:

We proposed to adjust price caps each year according to a predetermined formula that is designed to ensure a continuing *nexus between tariffed rates and the underlying cost of providing service.*

A carrier's services are grouped together in accordance with common characteristics, and the weighted prices in each group are adjusted annually pursuant to formulas designed to *ensure that rates are based on cost ...*

¹⁰⁹ The just and reasonable rate standard is not limited to telecommunications, but is commonly applied to other regulated utilities. The Commission recognized the widespread application of the rate standard in the *TRRO*, describing the standard as having roots in “most federal and state statutes.” *Id.*

¹¹⁰ *Memorandum Opinion and Order, Investigation of Special Access Tariffs of Local Exchange Carriers*, 4 FCC Rcd 12, at ¶ 32 (1988) (emphasis supplied).

... the foundation of the price cap regulatory approach is to ensure that *rates follow costs*, while creating incentives to reduce costs...¹¹¹

Retaining the touchstone of cost to judge the reasonableness of rates is a common thread throughout a wide range of Commission decisions, including those decisions that granted temporary deviations from cost. For instance, the Commission once permitted the BOCs to strategically price special access services, due to the “dislocations” of the AT&T divestiture and the fear of bypass from high initial access rates. Even then, however, the Commission’s approach was to “bracket” allowed pricing relationships in an effort to reflect costs:

As the Commission found in the *Strategic Pricing Order*, the six to one ratio represents the most likely approximation of the cost relationship between HiCap and VG services based on the record. The 4 to 8 range should be broad enough to encompass a “cost based” rate that might be produced by any rational cost allocation methodology used by an exchange carrier in the near future.¹¹²

The cost standard initially used in traditional regulation was based on “accounting” cost, also called historical or embedded costs.¹¹³ Under this approach, the actual book costs incurred by the incumbent would be assigned or allocated to its services through a “fully distributed costing” approach. Fully distributed costing, particularly the fully distributed costing of individual services, relies extensively on allocation methods because many of the firm’s costs cannot be directly attributed to a particular service. For this (and other reasons), the

¹¹¹ *Report and Order and Second Further Notice of Proposed Rulemaking*, CC Docket No. 87-313 (rel. Apr. 17, 1989), at ¶¶ 8, 38, 865 (emphasis supplied).

¹¹² *Order on Reconsideration, Investigation of Special Access Tariffs of Local Exchange Carriers*, 5 FCC Rcd 2, at ¶ 73 (1990).

¹¹³ For instance, as recently as the *TRRO*, the Commission noted: “Special access prices are regulated pursuant to the Communications Act’s ‘just and reasonable’ standard, which predates and bears no necessary relation to this [TELRIC] cost-based standard, relying instead on historical costs.” *TRRO*, at ¶ 51.

regulatory trend has been to move away from using fully distributed historical costs, in favor of more efficient cost-based approaches.¹¹⁴

The Commission began moving toward more forward-looking cost analyses prior to the 1996 Act. In developing its *Open Network Architecture* (“ONA”) policies (a form of unbundling predating the 1996 Telecom Act), the FCC replaced the fully distributed costing approach with a more flexible “direct cost plus reasonable allocation” standard that did not require the incumbent to fully assign all costs to all services.¹¹⁵ The FCC described the approach as follows:

In the Part 69/ONA Order the Commission ... replaced the traditional FDC price ceiling with a more flexible cost-based test. The new test retained the "direct cost" component of the traditional approach but afforded the LECs greater leeway in the application of overhead loadings.¹¹⁶

As recently as 2002, the FCC again relied on the basic “direct cost plus reasonable contribution” methodology to evaluate rates:

The *Bureau Order* summarized the guidelines to be applied under *Computer III* and other Commission proceedings concerning the application of the new services test and cost-based ratemaking principles to services that incumbent

¹¹⁴ Concerns relating to cost allocation become far less relevant when the cost object is a network element because the goal is to identify the cost of discrete facilities, not individual services.

¹¹⁵ The Commission explained that ONA was designed to unbundle certain services provided by BOCs, both to promote efficient and innovative use of the network by independent enhanced service providers (“ESPs”) and to prevent discrimination by BOCs in their offerings to competing ESPs and BOC-owned ESPs. The Commission concluded that the provision of unbundled basic service “building blocks” would promote the ability of the BOCs’ ESP competitors to compete effectively. Hence, the Commission ordered the BOCs to unbundle from their existing feature group access arrangements optional features called BSEs. *See Open Network Architecture Tariffs of Bell Operating Companies*, Order, 9 FCC Rcd 440, at ¶ 4 (1993) (“ONA Tariff Order”).

¹¹⁶ *Memorandum Opinion and Order on Reconsideration and Third Further Notice of Proposed Rulemaking*, 10 FCC Rcd 244, at ¶ 212 (1994) (“*Video Dialtone Reconsideration*”).

LECs offer to competitors. The Bureau explained that, to satisfy these requirements, an incumbent LEC must demonstrate that the proposed payphone line rates do not recover more than the direct costs of the service, plus "a just and reasonable portion of the carrier's overhead costs."¹¹⁷

The just and reasonable rate standard has remained a *cost*-based standard, even as it has evolved through price caps and other policies. Whether rates are just and reasonable must include an examination of the relationship of those prices to cost, particularly in markets, such as local markets, where incumbents continue to enjoy substantial market power.

Proposed § 53.609(d) adopts a safe-harbor allocation of common costs that would be presumptively reasonable. The actual calculation of the proposed safe-harbor allocation is presented in Section IV, *infra*. There are a number of advantages to the Commission adopting a safe-harbor approach, however, that are addressed here.

To begin, by adopting a safe-harbor value through rulemaking the Commission can ease its subsequent administration of the federal SGATs that must be filed under these proposed rules. Although each BOC would have the opportunity to propose alternatives – and, of course, each could *voluntarily* implement lower contribution levels if they so desired – a safe-harbor contribution level would enable the Commission to quickly determine compliance with its rules without conducting complex costs analyses. Each BOC would need only to produce its TELRIC-compliant rates, accompanied by a simple calculation removing the common cost allocation approved by the state commission and substituting the safe-harbor value recommended here.

¹¹⁷ *Wisconsin Payphone Order*, at ¶ 23 (footnotes omitted, emphasis supplied).

Moreover, a single nationwide safe-harbor common cost loading would promote uniform common-cost recovery policies across states, thereby promoting universal service and rate comparability.¹¹⁸ The safe-harbor common cost approach would permit underlying differences in cost to be reflected in rates, but these differences would not be further exacerbated by different common cost allocations. Overall, a safe-harbor approach would reduce administrative costs and promote federal policy.

Two additional rules in § 53.609 are intended to cap the level of common cost allocations from becoming excessive. First, § 53.609(e) prohibits the total charge (*i.e.*, direct cost plus a reasonable allocation of common costs) from exceeding the stand-alone cost of a Checklist Element. This provision mirrors an identical provision in § 51.505(c)(2)(a) intended to ensure that the prices for any individual Checklist Element not exceed the level that would be charged by an efficient provider in a competitive market.¹¹⁹

Finally, § 53.609(f) requires that no other interstate service offered by a BOC shall be priced below its direct cost, as computed by the sum of the prices of those Checklist Elements comprising the facilities used to provision the service. Such an imputation standard provides additional protection from excessive Checklist Element rates by ensuring that a BOC's own services may not be priced at rates below the costs the BOC is imposing on rivals.¹²⁰

¹¹⁸ See 47 U.S.C. § 254(b)(3), which calls for “access to telecommunications and information services, including interexchange services and advanced telecommunications and information services, that are reasonably comparable to those services provided in urban areas and that are available at rates that are reasonably comparable to rates charged for similar services in urban areas.”

¹¹⁹ *In the Matter of Implementation of the Local Competition Provisions in the Telecommunications Act of 1996*, First Report and Order, 11 FCC Rcd 15499, at ¶ 698 (1996) (“*Local Competition Order*”).

¹²⁰ Of course, this narrow imputation standard, by being limited to interstate services, would not (by itself) prevent a BOC from affecting a price squeeze for intrastate services, including local services, offered by competitors leasing Checklist Elements. In practice, the Commission may find it necessary to review intrastate rate levels to determine

C. Rules Relating to the Filing and Approval of SGATs and Negotiated Agreements: Proposed §§ 53.610 to 53.614

The final area of proposed rules govern the filing of the SGATs needed to establish Checklist Elements as a generally available offering at just and reasonable rates. Although the SGAT is the baseline requirement to satisfy these obligations, the rules recognize that carriers may negotiate alternative arrangements. Any such alternatives, however, must be filed with the Commission and made available to other carriers. The administrative processes to file an SGAT are described in § 53.610:

§ 53.610 Rules Applicable to SGAT Filings

(a) The general rules (including definitions), regulations, exceptions, and conditions which govern an SGAT must be stated clearly and definitely. All general rules, regulations, exceptions or conditions which in any way affect the rates named in the SGAT must be specified. A special rule, regulation, exception or condition affecting a particular item or rate must be specifically referred to in connection with such item or rate. Rates must be expressed in United States currency, per chargeable unit of service for all services, together with a list of all points of service to and from which the rates apply. They must be arranged in a simple and systematic manner. Complicated or ambiguous terminology may not be used, and no rate, rule, regulation, exception or condition shall be included which in any way attempts to substitute a rate, rule, regulation, exception or condition from or to any other SGAT or tariff.

(b) Every proposed SGAT filing must bear an effective date and, except as otherwise provided by regulation, special permission, or Commission order, must be made on at least 45 days notice.

whether particular common cost allocations are reasonable, even if they conform to the safe-harbor provision recommended here. We would expect, however, that such challenges would be made on a case-by-case basis, and would be dependent on the facts unique to a particular state and/or allocation. Limiting § 53.609(f) to interstate services is intended merely to acknowledge the FCC's direct jurisdiction over interstate rates, but is not meant to suggest that a common cost allocation that produced Checklist Element charges higher than a BOC's intrastate prices would be reasonable. Rather, in such instances, the Commission's authority necessarily would permit it to decrease the appropriate allocations, but would not extend directly to requiring that the intrastate rate at issue be raised.

(c) The notice period begins on and includes the date the SGAT is received by the Commission, but does not include the effective date. In computing the notice period required, all days including Sundays and holidays must be counted.

Proposed § 53.611 sets forth the minimum term requirement that a carrier can rely upon when subscribing to an SGAT. This provision is intended to ensure that telecommunications carriers enjoy a stable planning horizon when relying upon Checklist Elements to provide service to their customers. Under this provision, carriers are assured a three-year term for the SGAT, and can subscribe to the SGAT for a full three-year term any time during the first 2 ½ years that the SGAT is available.¹²¹

§ 53.611 SGAT Term Requirements

SGATs shall be made available without modification for a minimum three year term from the effective date. A carrier may subscribe to the initial SGAT for the full term at any time prior to 180 days before the expiration of the SGAT's initial term.

Although the hope and expectation is that BOC SGAT filings would fully comply with the rules set forth herein, additional Commission scrutiny and action may be required. As such, proposed § 52.612 sets forth provisions applicable to petitions to reject or suspend an SGAT.

§ 53.612 Petitions for Suspension or Rejection of SGAT Filings

(a) *Content.* Petitions seeking investigation, suspension, or rejection of a new or revised SGAT filing or any provision thereof shall specify the items against which protest is made, and the specific reasons why the protested SGAT filing warrants investigation, suspension, or rejection under the Communications Act. No petition shall include a prayer that it also be considered a formal complaint.

¹²¹ For instance, if a lawful SGAT becomes effective January 1, 2010, a carrier would be able to subscribe to that SGAT for a full three years beginning on any date up to (and including) June 30, 2012.

(b) *When filed.* All petitions seeking investigation, suspension, or rejection of an SGAT filing shall be filed and served within 15 days after the date of the SGAT filing. If the date for filing the petition falls on a weekend or holiday, the petition shall be filed on the next succeeding business day.

(c) *Replies.* Replies to petitions seeking investigation, suspension, or rejection of an SGAT filing shall be filed and served within 5 days after service of the petition.

(d) *Copies, service.* An original and four copies of each petition shall be filed with the Commission as follows: The original and three copies of each petition shall be filed with the Secretary, 236 Massachusetts Ave., NE., Washington, DC 20002; one copy must be delivered directly to the Commission's copy contractor. Additional, separate copies shall be served simultaneously upon the Chief, Wireline Competition Bureau, and the Chief, Pricing Policy Division.

In addition to the obligation to have a lawful SGAT on file, BOCs would be permitted to negotiate other arrangements. Proposed §§ 53.613 and 53.614 address the filing of negotiated agreements, as well as the rules that would govern protests to such filings.

§ 53.613 Filing of Negotiated Agreements

(a) In addition to having an effective SGAT on file with the Commission, a BOC may also provide Checklist Elements pursuant to one or more negotiated agreements filed in accordance with this section.

(b) The general rules (including definitions), regulations, exceptions, and conditions which govern a negotiated agreement must be stated clearly and definitely. All general rules, regulations, exceptions or conditions which in any way affect the rates named in the negotiated agreement must be specified. A special rule, regulation, exception or condition affecting a particular item or rate must be specifically referred to in connection with such item or rate.

(c) Every filed negotiated agreement shall bear an effective date and, except as otherwise provided by regulation, special permission, or Commission order, must be made on at least 15 days notice.

(d) Notice is accomplished by filing the negotiated agreement with the Commission. The notice period begins on and includes the date the filing is received by the Commission, but does not include the effective date. In

computing the notice period required, all days including Sundays and holidays must be counted.

(e) Negotiated agreements shall be offered for opt-in to any similarly-situated telecommunications carrier. Any telecommunications carrier shall be presumed similarly-situated to any other telecommunications carrier for purposes of this section.

§ 53.614 Petitions for Suspension or Rejection of Negotiated Agreements

(a) All petitions seeking investigation, suspension, or rejection of a negotiated agreement shall be filed and served within 7 days after the date of the filing. If the date for filing the petition falls on a holiday, the petition shall be filed on the next succeeding business day.

(b) Replies to petitions seeking investigation, suspension, or rejection of a negotiated agreement shall be filed and served within 4 days after service of the petition.

(c) A negotiated agreement shall be rejected if it (or any portion thereof) discriminates against a telecommunications carrier not a party to the agreement, or if the implementation of such agreement is not consistent with the public interest, convenience and necessity.

As explained in proposed § 53.614(c) above, a negotiated agreement can only be rejected if it discriminates against another telecommunications carrier, or if implementation of the agreement would not be consistent with the public interest, convenience and necessity. This standard is identical to the standard governing state commission review of negotiated agreements addressing network elements required to be unbundled under Section 251 of the Act.¹²²

IV. CALCULATION OF THE SAFE HARBOR COMMON COST ALLOCATION

As indicated above, the most appropriate just and reasonable rate standard to apply to Checklist Elements is the New Services Test that combines the direct cost of a Checklist Element with a reasonable allocation of common cost (*i.e.*, overhead):

¹²² See 47 U.S.C. § 252(e)(2)(A).

The new services test is a cost-based test that sets the direct cost of providing the new service as a price floor and then adds a reasonable amount of overhead to derive the overall price of the new service. The Commission has applied this test to new interstate access service proposed by LECs subject to price regulation.¹²³

Generally, the burden to demonstrate the reasonableness of any proposed overhead loading rests with ILEC: “[U]nder the new services test and our precedent, BOCs bear the burden of affirmatively justifying their overhead allocations.”¹²⁴ The Commission has in the past, however, suggested an approach that can be used to develop an estimate of a presumptively reasonable overhead loading to simplify the filing of SGATs. Specifically, the Commission has suggested that the overhead loadings for inputs to competitors should be no higher than overhead loadings for “comparable services” for which the incumbent and its competitors compete. For instance, when establishing rates for physical collocation the Commission explained:

We have previously determined that, absent justification, LECs may not recover, in charges for physical collocation, a share of overhead costs greater than they recover in charges for comparable services.

Comparable services are those for which the LEC and the interconnector compete or potentially compete for the same customers.¹²⁵

This same policy is appropriate here in determining a reasonable allocation of overhead to Checklist Elements.

¹²³ *Wisconsin Payphone Order*, at ¶ 12 (footnotes omitted).

¹²⁴ *Id.*, at ¶ 56.

¹²⁵ *Local Exchange Carriers’ Rates, Terms and Conditions for Expanded Interconnection Through Physical Collocation for Special Access and Switched Transport*, Second Report and Order, 12 FCC Rcd 18730, at ¶¶ 308, 309 (1997). *See also Wisconsin Payphone Order*, at ¶ 25, addressing a Bureau analysis of rates charged to payphone providers (“Absent justification, the *Bureau Order* states, the Wisconsin LECs may not recover a greater share of overheads in rates for the service under review than they recover for comparable services.”).

Applying these prior Commission precedents requires an estimate, from publicly-available sources, of the average overhead loading for the services that the BOCs offer in competition with telecommunications carriers using Checklist Elements. In evaluating the reasonableness of overhead loadings when evaluating the rates for ONA elements (which are similar in function and purpose to Checklist Elements), the Commission relied upon an analysis of “overhead ratios” defined as the quotient of price divided by direct unit costs.¹²⁶

Because there are no lawful restrictions on the services that may be offered by a purchaser of Checklist Elements in competition with the BOC, a reasonable method to determine the overhead ratio for *all* “comparable services” is to calculate a ratio of total revenue-to-operating cost based on ARMIS.¹²⁷ In this calculation, Total Revenue is a proxy for unit price,¹²⁸ while Total Operating Expense is a proxy for unit cost.¹²⁹ Applying this calculation to 2007 reported data,¹³⁰ the average overhead ratio for the BOCs is 22%.¹³¹

¹²⁶ See *ONA Tariff Order*, at ¶ 48 and n. 80. The FCC reiterated its support for the overhead methodologies relied upon in its *ONA Tariff Order* in the *Wisconsin Payphone Order*. See *Wisconsin Payphone Order*, at ¶ 54.

¹²⁷ In the *ONA Tariff Order*, the Commission concluded that ARMIS was a reasonable data source to calculate overhead loadings. *ONA Tariff Order*, at n. 73 (“The ARMIS data is a reasonable basis for alternative overhead calculations, and is the only verifiable alternative method available. Our use of ARMIS in the ONA context should not be construed as approving ARMIS as an ideal standard, or as applicable to all circumstances where overhead calculations are questioned, but its use appears reasonable in this instance”).

¹²⁸ See 2007 ARMIS 43-01, Row 1090 “Total Operating Revenues,” Column “Total.”

¹²⁹ See 2007 ARMIS 43-01, Row 1190 “Total Operating Expense,” Column “Total.”

¹³⁰ The analysis above is based on 2007 data because the Commission no longer requires the BOCs to file ARMIS 43-01 (although more current data must be provided if requested by the FCC). See *Petition of Qwest Corporation for Forbearance from Enforcement of the Commission’s ARMIS and 492A Reporting Requirements Pursuant to 47 U.S.C. § 160(c)*, Memorandum Opinion and Order, 23 FCC Rcd 18483, at ¶ 12 (2008).

¹³¹ Because Checklist Elements will only be available in BOC regions in states subject to Section 271, the calculation eliminates data for the former GTE companies, as well as Southern New England Telephone.

Consequently, based on the most recent publicly-available information, the Commission should establish a safe-harbor common cost allocation of no more than 22%. This overhead ratio is higher than a similar ratio developed from the financial reports of the BOCs, which average approximately 15%.¹³² Thus, the ratio based on ARMIS data is a reasonable limit on overhead loadings under the New Services Test.

V. CONCLUSION

For all of the foregoing reasons, the proposed rules set forth herein to govern the provision of certain network elements by the BOCs pursuant to the Section 271(c)(2)(B) Competitive Checklist should be adopted by the Commission on an expedited basis.

Respectfully submitted,

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¹³² See AT&T Inc. 2008 Annual Report (Feb. 12, 2009), at 28; Verizon Communications 2008 Annual Report (Feb. 20, 2009), at 21-22; Qwest 2008 Annual Report (Mar. 18, 2009), at Form 10-K, Part 1, p. 1.