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Ms. Blanca S. Bayo, Director
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Florida Public Service Commission
2540 Shumard Oak Boulevard
Tallahassee, FL 32399-0850

January 17, 1997

Re: Docket No. 961537-TP
Petition by American Communications Services, Inc., and its local exchange operating subsidiaries, for Arbitration with GTE Florida Incorporated pursuant to the Telecommunications Act of 1996

Dear Ms. Bayo:

Please find enclosed an original and fifteen copies of GTE Florida Incorporated's Response to American Communications Services, Inc.'s Petition for Arbitration and Notice of Intent to Seek Confidential Classification for filing in the above matter. Service has been made as indicated on the Certificate of Service. If there are any questions regarding this matter, please contact me at (813) 483-2615.

Very truly yours,

Anthony P. Gillman

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GTE'S RESPONSE TO ACSI'S ARBITRATION PETITION

DOCKET NO. 961537-TP

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GTE'S BRIEF IN RESPONSE TO PETITION BY AMERICAN COMMUNICATIONS SERVICES, INC. FOR ARBITRATION

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BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In re: Petition by American Communications Services, Inc., and its local exchange operating subsidiaries, for Arbitration with GTE Florida Incorporated pursuant to the Telecommunications Act of 1996	))))))	Docket No. 961537-TP Filed: January 17, 1997

GTE'S BRIEF IN RESPONSE TO PETITION BY AMERICAN COMMUNICATIONS SERVICES, INC. FOR ARBITRATION

GTE Florida Incorporated (GTE) respectfully submits this Brief to the Commission in support of GTE's legal and factual presentation on the issues presented for arbitration by ACSI pursuant to section 252 of the Telecommunications Act of 1996. GTE's response to the Petition for Arbitration consists of this Brief (Tab 1); a matrix of issues for arbitration (Tab 3); a glossary (Tab 5); a legal report setting forth the reasons why the Act, if incorrectly applied to GTE, would result in an unconstitutional taking of property without just compensation (Tab 4); and a copy of the Order of the U.S. Court of Appeals which stayed critical provisions of the FCC's First Report and Order purporting to implement the Telecommunications Act of 1996 (Tab 2). In accordance with the Commission's Procedural Order, direct testimony in support of GTE's positions will be filed on January 24, 1997. GTE also relies upon the detailed cost study (six binders) submitted to the Commission with this response.

I. INTRODUCTION

The Telecommunications Act of 1996 (the "Act"), if properly applied, holds out great promise to usher in an era of facilities-based competition in the local exchange telephone market. Congress required incumbent local exchange carriers ("ILECs"), such as GTE,

to permit access to their networks by new entrants who request interconnection, unbundling of the network, and the sale of retail services at wholesale rates. In order to implement the access by competitors, Congress created a market-based negotiation process between the parties to arrive at the rates, terms and conditions of interconnection agreements between each ILEC and each requesting carrier. Congress chose the States (through their public utility commissions) to assist the negotiation process through State-sponsored arbitrations of discrete issues on which the parties cannot reach a negotiated agreement. In addition to providing access to the local network, Congress intended to ensure that ILECs recover their costs, earn a reasonable profit on their investments and continue to be viable competitors.

That promise would be frustrated, however, if the requesting carriers were permitted to emerge from the negotiating process with provisions that impose unfair or unrealistic obligations on the ILECs, or with prices that fail to compensate the ILECs for the provisioning of their network elements and services to alternative local exchange carriers (ALECs) without just and reasonable compensation. Such a result would frustrate competition for the ILEC would be harmed by the imposition of unfair and costly burdens. Congress did not intend that the ILECs would have to absorb substantial interconnection costs or subsidize their competitors. Likewise, Congress did not relegate ILECs to mere service providers who must conform to the dictates of individual ALECs.

This arbitration was initiated by ACSI -- a new entrant -- after a short round of negotiation sessions to address terms of connection with GTE in this state. ACSI seeks

arbitration not of all issues that might be addressed in the ultimate interconnection agreement, but rather a small handful of discrete issues which will assist the parties in completing their agreement. GTE promotes the resolution of those issues promptly by this Commission, so that the parties may thereafter return to negotiate their agreement on those and the remaining terms and conditions.

Part II of this Brief sets out the scope and limitations of this Commission's responsibilities, as prescribed by the Telecommunications Act. This context will be helpful to the Commission in choosing how to address those issues that it must address within the statutory time period. In Part III, this Brief discusses the critical issues of pricing, including the manner in which GTE's cost study supports the pricing that GTE witnesses present for adoption by the Commission. Part III also discusses the recent Order of the U.S. Court of Appeals for the Eighth Circuit, which stays the FCC's versions of pricing rules and prevents ACSI from relying upon the FCC's default proxy rates in lieu of presenting cost studies to support the rates it wants. Part IV provides an overview of the individual pricing and technical issues that the Commission must resolve.

II. THE ACT REQUIRES THE COMMISSION TO LIMIT ITS DETERMINATION TO THE OPEN ISSUES SUBMITTED BY THE PARTIES

ACSI has submitted seven issues to arbitration. Under the Telecommunciations Act, the Commission is to resolve those seven issues only, and has until April 30, 1997, nine months from the date on which ACSI submitted its request for negotiation, to issue its decision.

Congress relied upon market-oriented negotiations between the parties to achieve the terms and conditions of interconnection. The arbitration mechanism is merely an aid to negotiation; it neither begins nor ends the process whereby the parties themselves produce a contract. Rather, the parties take limited open issues to arbitration, and after arbitration they return to negotiate their full contract. This is proven by the terms of the Act itself.

First, Congress made clear that the Commission's authority to resolve issues is limited to the issues presented to him by the parties for arbitration. The Act provides:

> The State commission <u>shall limit</u> its consideration of any petition under paragraph (1) (and any response thereto) to the issues set forth in the petition and in the response, if any, ...

47 U.S.C. § 252(b)(4)(A) (emphasis added). Thus, the Commission is not to write the parties' contract for them, and is not to resolve issues the parties may allude to but have not properly pleaded as an issue for arbitration. Beyond the issues that the parties expressly present for arbitration, the Commission has no jurisdiction.

Second, Congress made clear that the nine-month deadline imposed on the Commission is a deadline to resolve the issues presented for arbitration; the completion of the contract negotiations and adoption of the contract is to occur <u>thereafter</u>. The Act states:

> The State commission shall resolve each issue set forth in the petition and the response, if any, by imposing appropriate conditions as required to implement subsection [252](c)] upon the parties to the agreement, and shall conclude the resolution of any unresolved issues not later than 9 months

after the date on which the local exchange carrier received the request under this section.

47 U.S.C. § 252(b)(4)(C).

After the issues are resolved, the parties are to complete their agreement in accordance with the Commission's decisions and then submit their agreement to the Commission for approval under section 252(e) of the Act.

ACSI and GTE have worked together to resolve many issues and will continue these discussions. GTE has and will continue to engage in good faith negotiations with ACSI.

While pricing and costing are the main issues raised by this arbitration, there are a few other related issues that still remain open between the parties. To assist the Commission in resolving all seven open issues, GTE has included in its Brief a matrix detailing the respective positions of the parties.

Exhibit A to ACSI's Petition for Arbitration identifies categories of additional topics which ACSI states, and GTE agrees, are issues on which the parties have reached an agreement in principle. Since these issues are not in dispute, ACSI's request for arbitration of these issues is improper. ACSI's Exhibit A, by its own admission, does not contain "issue[s] set forth in the petition and the response" as contemplated in Section 252 (b)(4)(c). ACSI lists them as issues that are resolved, but await contract language. GTE

and ACSI should negotiate that language outside of the arbitration room, and the arbitration should be limited to review of the seven issues set forth in ACSI's Petition.[1]

III. THE PRICING PROVISIONS ESTABLISHED BY THE FCC'S FIRST REPORT AND ORDER HAVE BEEN STAYED, AND THIS COMMISSION MAY NOT APPLY THE FCC'S DEFAULT PROXY RATES FOR ANY PURPOSE

A number of state commissions and ILECs, including GTE, petitioned the Eighth Circuit to review the FCC's First Report and Order, and moved to stay the FCC's regulations pending resolution of the merits of the petitions for review. The central contentions of the Stay motions were that (i) the FCC lacked the authority to impose pricing methodologies and default proxy rates for intrastate telephone service and (ii) the FCC's methodologies and proxy rates were arbitrary and effected a taking.

The FCC's First Report and Order was due to become effective on September 28, 1996. On September 27, the Eighth Circuit granted a Temporary Stay pending oral argument, which was held on October 3.[2]

On October 15, 1996, the Eighth Circuit "stay[ed] the operation and effect" of the "pricing provisions" and the "pick and choose" rule contained in the First Report and

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[1] If, however, ACSI's position is that no agreement has been reached as to these issues, GTE reserves the right to amend, supplement, and refine this Brief as well as its supporting testimony.

[2] Order Setting Hearing and Imposing Temporary Stay (Sept. 27, 1996) at 3 ("the effective date of the [FCC's] First Report and Order . . . is hereby temporarily stayed until the order resolving the Stay motions is filed").

Order.[3] (Order at 8.) The Court's Stay extended to every portion of the FCC's pricing rules, and was founded on the Court's conclusion that GTE was likely to prevail on the merits because the FCC had no intra-state pricing authority and GTE and others would suffer irreparable injury without a Stay.[4]

The Court determined that a Stay was necessary because petitioners had demonstrated that they "will likely succeed on the merits of their appeals based on their argument that, under the Act, the FCC is without jurisdiction to establish pricing regulations regarding intrastate telephone service." (Order at 16 (emphasis added).) The Court reached its conclusion by finding that "nowhere in section 251 is the FCC specifically authorized to issue rules on pricing" and that "Congress intended to grant the state commissions the authority over pricing of local telephone service, either by approving or disapproving the agreements negotiated by the parties, or, when the parties cannot agree, through compulsory arbitration, thereby preserving what historically has been the States' role." (Id. at 14 (emphasis added).) Furthermore, the Court expressed "serious doubts" that the FCC's interpretation of the Act constituted the "straightforward or unambiguous"

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[3] See Order Granting Stay Pending Judicial Review, Nos. 96-3321 et al. (Oct. 15, 1996) (the "Order") at 8. A copy of the Court's Order is attached.

[4] The Eighth Circuit's Stay extended to the pricing rules of the FCC's First Report and Order: Subpart F ("Pricing Of Elements", 47 C.F.R. §§ 51.501 - 51.515); Subpart G ("Resale", 47 C.F.R. §§ 51.601 - 51.617); Subpart H ("Reciprocal Compensation for Transport and Termination of Local Telecommunications Traffic", 47 C.F.R. §§ 51.701 - 51.717); Subpart I ("Procedures for Implementation of Section 252 of the Act, 47 C.F.R. § 51.809); and the proxy range for line ports used in the delivery of basic residential and business exchange services established in the FCC's Order on Reconsideration, dated Sept. 27, 1996. See Order at 9 n.3, 21 n.8.

grant of authority necessary to qualify as an exception to Section 2(b) of the Communications Act of 1934, which restricts the FCC's authority to inter-State matters, not intra-State matters. The Court further concluded that the FCC's "roundabout construction of the statute" conflicts with "what, at first blush, appears to be a rather clear and direct indication . . . that the state commissions should establish prices." Id. at 15 (emphasis added).

The Eighth Circuit -- in no uncertain terms -- has stayed the pricing provisions of the First Report and Order. That means that the pricing provisions have no current legal effect.[5] Accordingly, the FCC's pricing provisions may not be enforced by anyone -- including the FCC, this State, the Commission, the Commission, and any party to this arbitration. Until further Order of the Court, the FCC's pricing rules should be treated as if they never existed. Indeed, to treat the FCC's pricing rules in any other manner would run directly contrary to the policy underlying stays of administrative actions, as expressed over fifty years ago in Scripps-Howard Radio, Inc. v. FCC: "an appellate court should be able to prevent irreparable injury to the parties or to the public resulting from the premature

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[5] Reports in the trade press indicate that the FCC is suggesting that the states can still use the FCC proxy rates if the states adopt the FCC's record in an arbitration proceeding. Such a suggestion, if true, should be taken and then dismissed for exactly what it is -- an effort to do an end-run around the serious problems of constitutional dimension which gave rise to the Stay in the first place. Moreover, GTE's testimony will unequivocally demonstrate that the FCC record does not rise to the level of competent and substantial evidence in the first instance.

enforcement of a determination which may later be found to have been wrong." 316 U.S. 4, 9 (1942) (Frankfurter, J.).[6]

The Eighth Circuit's well-reasoned, thorough opinion leaves no doubt that the FCC's pricing rules cut squarely against the regime envisioned by Congress for conducting arbitrations. The Court concluded that the FCC's pricing provisions would prevent "free negotiations" between parties, would artificially fix the results at unjustifiably low prices, and would prevent the very case-specific, individualized decision making required under the Act.

The Eighth Circuit's decision staying the First Report and Order is binding on this and every Commission and State nationwide. The Eighth Circuit was selected at random pursuant to the "lottery statute," 28 U.S.C. § 2112(a), as the only Court of Appeals to hear the multiple petitions for review that were filed after the publication of the First Report and Order. Pursuant to the "lottery statute," no other court will be authorized to consider a review of the First Report and Order.

The consequences of the Court's ruling are clear. First, the Commission may not rely on any aspect of the pricing rules, including the FCC's default proxy rates and pricing methodologies. Second, the Order does not disturb the Commission's statutory duty to hold localized, case-specific determinations, applying the Act and State law, to establish

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[6] Scripps-Howard continues, stating that a stayed order cannot be applied because "[i]f the administrative agency has committed errors of law for the correction of which the legislature has provided appropriate resort to the courts, such judicial review would be an idle ceremony if the situation were irreparably changed before the correction could be made." 316 U.S. at 10.

"just and reasonable" rates for interconnection with GTE's network. Third, the Order only makes more compelling the case for relying on GTE's proposed rates for unbundled network elements and resold services, which are supported by extensive cost studies and economic testimony now in the record. Fourth, the Eighth Circuit's Order now requires that the Commission set aside the FCC's default proxy rates and arbitrate all "open issues" based upon the parties' evidence of cost. As explained, those rates should be GTE's proposed rates.

IV. THE PRICING AND TECHNICAL ISSUES PRESENTED BY THE PARTIES IN THIS ARBITRATION SHOULD BE RESOLVED IN FAVOR OF GTE'S POSITION IN ORDER TO PRESERVE AND ENHANCE COMPETITION

A. GTE's Pricing Proposals Are Properly Based Upon M-ECPR And Carry Out the Purposes of the Act In Enhancing Competition

1. Issue in Dispute

ACSI's Position: ACSI has requested GTE set the prices for unbundled network elements and network element combinations at TELRIC consistent with *FCC Rule §51.505*. It asserts that prior to the filing of the petition, GTE has not provided necessary cost information from which to calculate TELRIC costs. In the absence of cost data from GTE, ACSI proffers rates, based on publicly available data for the dominant ILEC in each state (generally the RBOC) and the Hatfield Model. ACSI also seeks application of the FCC's default proxy rates. At the same time, ACSI agrees that rates should be based on the ILEC's best cost information. Petition at 7.

GTE's Position: The FCC Rules on pricing have been stayed and cannot be used by this Commission. The FCC's default proxy rates also cannot be applied, as explained above and in the testimony of Mr. Trimble. The Hatfield model and results that ACSI presents are not a valid measurement for GTE.

The Act recognizes that pricing must cover all of the ILECs costs including a reasonable share of joint and common costs. Even the FCC agrees that a TELRIC methodology does not recognize such costs. GTE has presented its cost study to the Commission and will serve it upon ACSI subject to a confidentiality agreement to be arranged. GTE's proposal is consistent with the Act and recognizes a reasonable share of joint and common costs. The proper rates for the pricing issues presented in this arbitration are supported by the cost study, and are presented in GTE's Brief and supporting testimony.

2. GTE Properly Calculated Pricing of Interconnection and Unbundled Elements

a. M-ECPR is the correct method to determine GTE's costs

The proper method for pricing interconnection and unbundled network elements begins with the market-determined efficient-component pricing rule. Under M-ECPR pricing,[7] the Commission would establish prices for unbundled elements that would reflect

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[7] M-ECPR is the identical methodology that GTE submitted to the FCC in connection with the Interconnection Docket 96-98. It has been designated "M-ECPR" here to avoid any possible confusion because the FCC's version of ECPR bore no relationship to the version submitted by GTE. In short, M-ECPR is not the simplistic, strawman version of ECPR that the FCC created and then destroyed in its First Report and Order.

all of GTE's true forward-looking costs. In addition, any price set by the Commission should further reflect any costs to GTE of actually unbundling the network element.

Because M-ECPR is a forward-looking market-based model, however, it fails to capture all of GTE's true network costs. First, GTE will not have an opportunity to recover all of its forward-looking costs through M-ECPR, as it would with regulated rates absent competitive entry. That means there will be "stranded costs" -- defined as revenues under regulation less revenues under competition (on a present value basis). Second, GTE will not earn a fair rate of return on its historic investments in the very network with which ACSI now seeks interconnection.

Both the shortfall in forward-looking costs and historic costs presents a significant but ***separate*** issue for this Commission. As will be explained more fully in GTE's Economic Testimony and Report, a separate charge is necessary to allow GTE to recover these costs. Without a full recovery of all of its forward-looking and historic costs, GTE would be forced to fund the transition from regulation to competition, and subsidize not only ACSI's, but all other ALECs' entry into the market. Such a situation would effect an unconstitutional taking of GTE's property without just compensation.

b. GTE's approach properly accounts for joint and common costs

GTE's cost studies provide ample evidence of GTE's substantial joint and common costs. Indeed, these cost studies demonstrate that the Company's joint and common costs are about 35-50% of the Company's total annual revenues. This result is not surprising,

given GTE's significant economies of scale. In fact, the FCC itself recognized that GTE's network enjoys significant economies of scale and scope.[8] ACSI wants the benefits of these economies, but it is unwilling to pay for them.

GTE's pricing proposals -- including its proposed end user charge[9] -- are consistent with the pricing standards of the Act. Establishment of an end-user charge is also consistent with (and required by) Section 254(f) of the Act which requires every telecommunications carrier to contribute on an equitable and nondiscriminatory basis, to universal service. The end user charge, by definition, allows for the recovery of subsidies inherent in the existing rate structure. As such, these subsidies are an element of actual costs for which GTE must be compensated.

In addition to adopting GTE's pricing proposals and end user charge, the Commission also should permit GTE to continue to recover 100% of its access charges (e.g., residual interconnection charges and common carrier line charges) for both interstate and intrastate calls in an unbundled and resale environment. The Act permits

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[8] See, e.g., First Report and Order at ¶ 679 ("As a result of the availability to competitors of the incumbent LECs' unbundled network elements at their economic cost, consumers will be able to reap the benefits of the incumbent LECs' economies of scale and scope . . . .").

[9] A more detailed description of GTE's position will be contained in the testimony of Dennis Trimble.

continued recovery of these charges, and GTE requests that the Commission affirmatively approve them.[10]

c. With the Stay in place, and ACSI agreeing that rates are properly to be set using GTE cost study, the Commission should adopt GTE's proposed rates

In its Petition for Arbitration, ACSI noted that it has not had the opportunity to examine GTE's cost studies so instead requests rates based on the best publicly available information. GTE contends that this approach is flawed and the Commission instead should utilize the rates based on the cost studies provided by GTE in connection with this arbitration. GTE's rates are supported by expert testimony; GTE's rates are State-specific and are backed up by extensive State-specific cost studies; and GTE's rates are fully consistent with the Act's requirement to determine just and reasonable rates that reflect GTE's costs.

In light of the Stay, there can be no justification for the use of the FCC's default proxy rates, and this Commission would be proceeding at its own peril if it relied upon those rates. Nor is there any evidentiary support in the record of this arbitration that could conceivably justify the methodology suggested by the FCC or the default proxy rates.

GTE urges the Commission to adopt its pricing methodology -- the Market-Determined Efficient Component-Pricing Rule ("M-ECPR") -- which will achieve all the

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[10] See 47 U.S.C. § 251(g). The Virginia State Corporation Commission, for example, expressly approved continued recovery of these charges. See Order Resolving Rates at 17, Petition of AT&T, et al. for Arbitration with GTE South, Case No. PUC960017 (Dec. 11, 1996) ("Carriers will be assessed the applicable GTE interstate or intrastate switched access charge elements . . . .").

Commission's goals. M-ECPR is a market-based method for determining GTE's share of forward-looking joint and common costs that should be allocated to prices for its unbundled network elements. This model does not permit GTE to charge a price for an unbundled element that exceeds the market price.

ACSI's reliance on the Hatfield Model is completely misplaced and the Commission should not rely on ACSI's proffer in any respect. First, as noted by ACSI, the inputs to the model are based on non-GTE inputs; this makes the results produced irrelevant. The cost differences between the RBOC inputs used and GTE's actual cost position substantially understates the GTE rates required to cover costs. Second, the Hatfield Model is based on totally unrealistic network replacement assumptions and does not reflect reality. Indeed, the Hatfield Model assumes a network that will never be built or transport a single call. Third, the Model is not validated and the inputs utilized are inappropriate. Fourth, the Model's results do not comport with other industry models that are based on firm specific data.

B. ACSI is Not Entitled to "Most Favored Nation" Treatment on Individual Contract Terms and Conditions

1. Issue in Dispute

ACSI's Position: The "most favored nations" clause must be part of the agreement.

GTE's Position: GTE strongly opposes the inclusion of any MFN clause in any GTE-ALEC contract. Each agreement negotiated is a process of give and take. A party

desiring to obtain the terms of another agreement must abide by the entire agreement. Otherwise, the Act's provisions encouraging negotiations would be meaningless. The Eighth Circuit has stayed the terms of the FCC's Order which permitted the use of Most Favored Nations clauses. Moreover, the Commission has held in other arbitration cases that this issue is not the proper subject for arbitration under the Act. See, e.g., Petition by Sprint Communications Company Limited Partnership d/b/a Sprint for Arbitration with GTE Florida Incorporated Concerning Interconnection Rates, Terms, and Conditions pursuant to the Federal Telecommunications Act of 1996, Docket No. 961173-TP.

2. The Eighth Circuit Has Ruled That The Most Favored Nations Clause Is Improper

ACSI's position is essentially the same as the position taken by the FCC in its First Report and Order. The FCC's "pick and choose" rule would allow a competitive local exchange carrier to "cherry pick" favorable provisions from a variety of different agreements, without regard to the arbitration or negotiation of the agreement.

In their recent challenge to the FCC's Order, GTE and other parties sought a Stay of the FCC's "pick and choose" rule because the rule would cause irreparable injury. The FCC's "pick and choose" rule went well beyond the provision of the Act that requires ILECs to make available interconnection, services or network elements on the same terms and conditions as those provided under other agreements approved under the Act. See 47 U.S.C. § 252(I). The Court held that the FCC's "pick and choose" rule would cause

irreparable injury by "further undercut[ting] any agreements that are actually negotiated or arbitrated." (Order at 17.)

In its recent opinion, the Eighth Circuit accurately described GTE's position on the destabilizing impact of MFN clauses in these circumstances:

> The petitioners' objection is that the rule would permit the carriers seeking entry into a local market to "pick and choose" the lowest-priced individual elements and services they need from among all of the prior approved agreements between that LEC and other carriers, taking one element and its price from one agreement and another element and its price from a different approved agreement. Moreover, if an LEC and Carrier A, for example, reach an approved agreement, and then the LEC and a subsequent entrant, Carrier B, agree in their agreement to a lower price for one of the elements or services provided for in the LEC's agreement with Carrier A, Carrier A will be able to demand that its agreement be modified to reflect the lower cost negotiated in the agreement with Carrier B. Consequently, the petitioners assert that the congressional preference for negotiated agreements would be undermined because an agreement would never be finally binding, and the whole methodology for negotiated and arbitrated agreements would be thereby destabilized.

(Order at 12).

While GTE is willing to offer any ALEC the same <u>entire</u> contract as any other ALEC, ACSI's insistence on being given the right to substitute any of the more favorable terms that may be contained in another GTE-ALEC agreement severely inhibits GTE from negotiating individual provisions with ACSI.

C. GTE's Position on the Pricing of Number Portability is Proper

1. Issue in Dispute

<u>ACSI's Position</u>: New entrants' share of costs is too high. ACSI's contribution to the costs of interim number portability should be limited to an amount based upon its size relative to GTE and other carriers the Commission determines must contribute.

<u>GTE's Position</u>: GTE should recover its total costs for providing interim number portability. New entrants can allocate or recover their costs as they choose. GTE's costs for interim number portability should be determined based on the network in place today, and allowing for capital, transport and termination, and opportunity and investment costs. The specific rates presented by GTE should be adopted.

2. GTE's Cost For Interim Number Portability Should Be Based on the Network In Place and Allow for Capital, Transport and Termination, and Opportunity and Investment Cost

The Act requires all local exchange carriers to provide number portability to the extent "technically feasible." Until the implementation of long-term number portability, there are several methods available to provide interim number portability ("INP"), and GTE has negotiated with ALECs over methods and pricing of INP.

GTE's position with regard to INP is consistent with FCC regulations and the additional requirements imposed on INP by various State commissions.

All INP methods impose costs on the service provider that is providing INP. These costs can be classified as follows:

- **Switching Costs**: These costs are incurred when the service provider reroutes the call (call forwarding and route indexing), changes the dialed digits (digit substitution) and adds digits (pseudo NPA code addition). Additional switching costs may be incurred where end offices exhaust their software capacity to provide these forwarding, indexing and digit manipulation functions.

- **Transport Costs**: Service providers offering INP will incur the cost of transporting all ported calls from switch to switch. Many times, such transport may occur not only once but twice over the same trunks, potentially causing blockages and overuse of the network. To the extent trunking capacity is exhausted, this will impose an additional cost on the carrier. The trunks required for DID will also add to transport costs.

- **Opportunity Costs**: Whenever a service provider provides number portability for a customer it has, of course, lost that customer. Thus, one of the costs of providing INP is the lost opportunity to receiving revenues from that customer for other services that may have offset the costs of INP.

With regard to pricing of number portability, the Act states that "[t]he cost of establishing . . . number portability shall be borne by all telecommunications carriers on a competitively neutral basis as determined by the [FCC]." 47 U.S.C. § 251 (e)(2) (1996).

The Act mandates competitive neutrality and GTE's pricing proposal attains this goal. By determining forward-looking costs based on the existing captive network, GTE is able to fully capture the costs associated with providing INP. If GTE were not able to recover all the costs of providing INP, it would be at a competitive disadvantage vis-a-vis other LECs in contravention of the Act.

D. GTE'S Position On Bill-and-Keep Is Proper

1. Issue In Dispute

ACSI's Position: Bill-and-keep should be used for 12 months as an initial method of setting interconnection charges unless one party's volume of terminating traffic exceeds the other party by plus or minus 10 percent and the amount of compensation for the excess traffic would exceed $10,000.

GTE's Position: GTE should not be required to use a bill-and-keep arrangement, either initially or permanently. However, GTE would be willing to discuss with ACSI a method to assume that traffic is in balance in order to apply bill-and-keep initially. But as and when traffic is out of balance by plus or minus 10%, regardless of the number of months, bill-and-keep is not appropriate and the interstate end office switching rate should apply.

2. ACSI's Position that Bill-and-Keep Should be Employed Only After Excess Traffic Exceeds $10,000 is Untenable

While the Act allows significant flexibility in the parties' arrangements for interconnection, transport and termination, it nevertheless imposes fair and rational limits. GTE should be allowed to charge rates for interconnection, transport and termination that are just, reasonable and nondiscriminatory and that allow GTE full recovery of its costs.[11]

At their basic levels, the terms interconnection, transport and termination refer simply to functions within and between telephone networks. Interconnection means the

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[11] A more detailed discussion of GTE's position will be contained in the testimony of Bill Munsell.

physical linking of two networks for the mutual exchange of traffic. Interconnection takes place at a point of interconnection. Transport means carrying a call between switches, or from a point of interconnection to a switch. Thus, transport may involve transmission of a call from a tandem switch to an end office switch or from one end office switch to another end office switch. Termination means switching that is performed at the end office, and the delivery of the call to the called party.

Transport and termination agreements may provide for compensation arrangements, which allow the parties to bill the amounts owed to one another on a periodic basis. Alternatively, transport and termination agreements may provide for a "bill-and-keep" system whereby each party keeps whatever it bills to the end user and does not pay the other party for the costs of transport and termination. Where traffic exchanged between the two carriers is approximately equal, a bill-and-keep system may be appropriate.

The Act provides that a State commission may not consider reciprocal compensation to be just and reasonable unless the terms and conditions "provide for the mutual and reciprocal recovery by each carrier of costs associated with the transport and termination of each carrier's network facilities of calls that originate on the network facilities of the other carrier" and determine costs "on the basis of a reasonable approximation of the additional costs of terminating such calls." 47 U.S.C. § 252 (d)(2)(A)(I)-(ii) (1996). Section 252(d) also states that such pricing standards shall not be construed to prevent parties from arranging for "the mutual recovery of costs through the offsetting of reciprocal

obligations, including arrangements that waive mutual recovery (such as bill-and-keep arrangements)." 47 U.S.C. § 252(d)(2)(B)(I) (1996).

With regard to TELRIC and default rates, the FCC established the presumption that an ILEC's prices for transport and termination are a suitable proxy for an ALEC's costs of transport and termination. Id. ¶ 1085. Thus, the FCC ruled that TELRIC and default rates should be presumed to be symmetrical unless this presumption can be rebutted. See id. ¶ 1089.

With regard to bill-and-keep, the FCC ruled that State commissions may impose bill-and-keep arrangements if (1) neither carrier has rebutted the presumption of symmetrical rates and (2) the volume of terminating traffic from one network to the other is "approximately equal to the volume" of terminating traffic flowing the other way "and is expected to remain so." Id ¶ 1111.

These provisions of the FCC's Order now are stayed, and the Commission need not apply either the notion that the ILEC's costs are a suitable proxy for the ALEC's, or the notion of how the presumption is to be rebutted. Indeed, even under the Order, the Commission is not required to impose bill-and-keep; bill-and-keep is not mandated anywhere. The Order states that a State commission "may" impose bill-and-keep if neither party has rebutted the presumption of symmetrical pricing and if the volume of traffic exchanged is approximately equal. See id. As shown by GTE's testimony and cost study, the presumption of symmetrical rates is properly rebutted, and there presently exists no

way for the Commission to determine whether the volume of traffic exchanged will, in fact, be equal. Thus, neither precondition has been met.

While GTE's preferred position is stated above, the Company is willing to enter into a bill and keep compensation arrangement with ACSI given certain conditions. The proposed arrangement, predicated upon approximately equivalent traffic flows, would be for the transport and termination of end users local traffic. The arrangement would specifically exclude any toll or access traffic. Also, interLATA access traffic must be carried over separate trunk groups and may not be included with the local and local toll traffic.

GTE, in an effort to expedite the competitive process, is proposing a fairly broad definition of "roughly balanced." The company is proposing that roughly balanced equates to plus or minus ten percentage points. This means that the originating/ terminating split could be up to 60/40. The following parameters are fundamental to GTE's proposed bill-and-keep arrangement:

1. The arrangement applies to the termination of interconnected calls and does not apply to internetwork facilities.
2. The arrangement applies to local and EAS traffic only and has no implications for access (or wireless) compensation.
3. Traffic must be local end user traffic. An ALEC may not aggregate traffic other than its end user local/mandatory EAS traffic for the purposes of this arrangement.

4. Traffic is assumed to be roughly balanced unless there are records available that would indicate otherwise. Either party may request traffic studies be performed not more frequently than on a quarterly basis.
5. If traffic studies indicate that traffic is outside of the roughly balanced range, either party may request that billing commence utilizing agreed upon rates no lower than GTE's TELRIC, plus the appropriate joint and common costs as discussed earlier in this report.
6. If bill-and-keep is employed initially, it should be for six (6) months (unless a given state commission requires a longer period) unless one party's volume of terminating traffic exceeds the other party's by more than 10% and the amount of composition for the excess traffic exceeds $2,000.
7. Either party may terminate the arrangement with twelve months' notice.

ACSI's position that bill-and-keep should be employed only after the excess traffic exceeds $10,000 is simply untenable. GTE is currently negotiating and arbitrating with approximately ten ALECs. To allow each to avoid compensating GTE unless excess traffic exceeds $10,000 could result in an enormous potential loss to the Company.

E. GTE's Position With Respect to the Collocation of Remote Switching Units is Proper

1. Issue In Dispute

ACSI's Position: ACSI should be permitted to collocate its remote switching module (RSM) at GTE's central office.

GTE's Position: Section 251(c)(6) of the Act requires incumbent LECs to provide physical or virtual collocation of equipment "necessary for interconnection or access to unbundled network elements." Therefore, ACSI may collocate on GTE's premises transmission equipment, concentration equipment and multiplexing equipment. Collocation of switching equipment, enhanced services equipment, and customer premises equipment are not required under the Act and should not be imposed upon GTE.

2. ACSI Should Not Be Permitted To Collocate Its RSM At GTE's Central Office

ACSI's position completely disregards the plain language of the Act which limits collocated equipment to that "necessary for interconnection or access to unbundled network elements."[12] While the FCC's interpretation of the "necessary" qualifier as "used or useful" is questionable, the FCC correctly concludes that switching equipment, enhanced services equipment and CPE may not be collocated.[13] Thus, both the Act and the First Report and Order foreclose ACSI's demand to collocate on GTE facilities equipment that it not necessary.

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12 47 U.S.C. §251(c)(6) (emphasis added).

13 First Report and Order at ¶¶ 579-82.

The fundamental purpose of the "interconnection and access" provisions is to enable an interconnector to use ILEC network components without having to purchase completed switched access or exchange service.[14] The FCC has recognized the importance of limiting the types of equipment that must be collocated on a LEC's premises to equipment that is necessary and directly related to the competitive provision of basic transmission service, and it has consistently rejected suggestions that LECs be required to provide collocation of enhanced services equipment, customer premises equipment, switches, or other non-transmission equipment.[15] Congress was clearly aware of this history when it enacted Section 251(c)(6).

Under the language of the Act, ACSI should be permitted to install only equipment that must be near GTE network elements in order to make interconnection technically feasible. Such equipment is limited to concentration and circuit termination equipment (including optical line terminating equipment and multiplexers). Concentration equipment aggregates multiple loops to a single loop for more efficient transport. Termination equipment allows an ALEC to convert the optical signals on its loops to electrical signals that can be used by GTE's network equipment. Because current cross-connection

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[14] **See** *Expanded Interconnection with Local Telephone Company Facilities*, CC Docket No. 91-141, and *Amendment of Part 36*, CC Docket No. 80-286, Second Report and Order and Third Notice of Proposed Rulemaking, 8 FCC Rcd. 7374 (1993), **vacated insofar as it requires physical collocation**, Bell Atlantic Tel. Cos. v. FCC, No. 93-1743 (D.C. Cir. Apr. 17, 1995), **rules modified on remand**, 9 FCC Rcd. 5154 (1994).

[15] **See** Special Access Order at ¶ 63; *In re Expanded Interconnection with Local Telephone Company Facilities*, Memorandum Opinion and Order, 9 FCC Rcd. 5154 (1994) ("Virtual Collocation Memorandum and Order") ¶ 94.

technology limits the maximum distance between these various pieces of equipment, collocation is necessary and should be permitted for concentration and termination equipment. No similar justification exists for collocating switches, enhanced services equipment and customer premises equipment.[16]

F. GTE's Position on Collocators' Cross-Connection is Proper

1. Issue in Dispute

ACSI's Position: ACSI should be able to cross-connect with other entities collocated at the same interconnection point without GTE's assistance free of charge. In the event GTE's assistance is requested, GTE should be compensated on a time and materials basis for personnel and equipment.

GTE's Position: GTE will provide this connection through the purchase of an unbundled network element.

2. The Cross-Connection Should Occur Only Through ACSI's Purchase of Unbundled Network Elements

The Act only requires ILECs to interconnect their network with a requesting ALEC's collocated equipment. Nonetheless, the FCC's First Report and Order requires an ILEC to permit ALECs to cross-connect through ILEC-provided facilities. First Report and Order, ¶ 595. GTE maintains that this requirement to permit ALECs to cross-connect with each

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[16] The FCC left to State commissions the determination whether particular equipment not discussed in the Order is entitled to collocation. First Report and Order at ¶ 581.

other and bypass GTE's network, works a "taking" of GTE's property in excess of the FCC's authority under the Act and under Bell Atlantic v. FCC, 24 F.3d 1441 (D.C. Cir. 1994). GTE is willing to permit cross-connection between ALECs so long as the interconnection is accomplished through the purchase of an unbundled network element from GTE.

G. GTE's Position with Respect to Combining Unbundled Network Elements is Proper

1. Issue in Dispute

ACSI's Position: ACSI is free to combine and use the unbundled network elements it purchases from GTE to provide any telecommunications service it chooses which the unbundled network elements can be used to support.

GTE's Position: ACSI may lease and interconnect to whichever of these unbundled network elements ACSI chooses, and may combine these unbundled elements with any services or facilities that ACSI may itself provide, pursuant to the following terms: (I) interconnection for access to unbundled elements shall be achieved via expanded interconnection/collocation arrangements that ACSI shall maintain at the wire center at which the unbundled services are resident; (ii) each loop or port element shall be delivered to the ACSI collocation arrangement over a loop/port connector applicable to the unbundled services through other tariffed or contracted options; (iii) ACSI may combine unbundled network elements with ACSI's own facilities, but ACSI shall not combine unbundled network elements purchased from GTE to bypass resale offerings.

2. ACSI May Not Combine Network Elements Pursuant to GTE's Terms and Conditions

The FCC's rules permit ACSI and other requesting carriers to unbundle elements and then reassemble them to provide end-to-end telephone service. First Report and Order at ¶ 328. These rules, however, contradict the Act, which draws a distinction between the purchase of unbundled elements and the resale of wholesale services. Under the Act, unbundled elements must be provided at rates based on costs plus a reasonable profit, 47 U.S.C. § 252(d)(1), whereas charges for resold services are set at retail rates less avoided costs, 47 U.S.C. § 252 (d)(3). These different costs serve entirely different purposes, and the "cost plus" rate for unbundled elements is intended to encourage facilities-based competition. The FCC's rules, however, render this distinction meaningless, and permit ACSI to obtain existing retail services at the cost standard applicable to unbundled elements. Under this scheme, ACSI has little incentive to build its own facilities until it has exhausted GTE's capacity.

The FCC's rules also contradict the intent of the Act because they discourage investment by ILECs. What economic incentive is there for an ILEC to invest in the research and development of new technologies? The very day the ILEC deploys these technologies, ACSI "unbundles" them, obtains them at TELRIC prices, and reassembles them. Congress could not have intended such an illogical result.

V. CONCLUSION

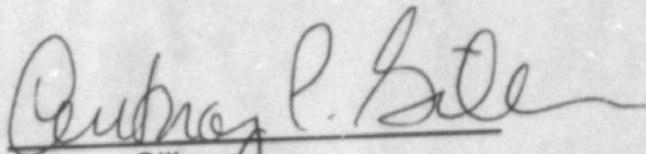
In determining the appropriate price for the sale of unbundled elements or resold services, the Commission must provide for the recovery of at least all of GTE's historic and forward-looking costs plus a reasonable profit. If the Act were interpreted to provide anything less, then it would effect a taking of GTE's property without just compensation in violation of the Constitution.

ACSI should not be permitted to acquire GTE's network and services at rates well below GTE's costs. Nor should GTE and its customers be forced to subsidize ACSI's foray into the local telecommunications marketplace.

To ensure that the purposes of the Act are met, GTE respectfully requests that the Commission do two things: first, the Commission should refuse to adopt the FCC's arbitrary default rates and refuse to establish any rate for GTE's network elements or services until the parties have presented their evidence. Second, the Commission should establish pricing methodologies and cost recovery mechanisms that will ensure ACSI pays for its own entry into the local telecommunications market.

GTE's proposals – especially its M-ECPR pricing methodology -- properly balance the interests of the parties and the public with the letter and spirit of the Act. Accordingly, GTE respectfully requests that this Commission adopt GTE's proposals.

Respectfully submitted on January 17, 1997.

By: 

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CERTIFICATE OF SERVICE

I HEREBY CERTIFY that copies of GTE Florida Incorporated's Response to American Communications Services, Inc.'s Petition for Arbitration and Notice of Intent to Seek Confidential Classification in Docket No. 961537-TP were hand-delivered (*) or sent via overnight delivery (**) on January 17, 1997 to the parties listed below.

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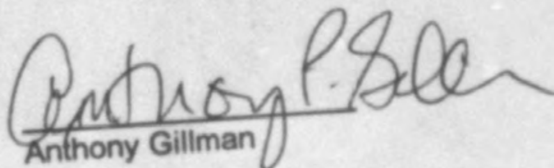

Anthony Gillman

United States Court of Appeals

FOR THE EIGHTH CIRCUIT

FILED

OCT 15 1996

MICHAEL GANS
CLERK OF COURT

No. 96-3321

Iowa Utilities Board,

Petitioner,

v.

Federal Communications Commission; United States of America,

Respondents.

No. 96-3406

National Association of Regulatory Utility Commissioners,

Petitioner,

v.

Federal Communications Commission; United States of America,

Respondents.

No. 96-3410

The Southern New England Telephone Company,

Petitioner,

v.

Order Granting Stay Pending Judicial Review

Federal Communications
Commission; United States of
America,

Respondents.

No. 96-3414

Bell Atlantic Corporation;
Bellsouth Corporation; Pacific
Telesis Group,

Petitioners,

v.

Federal Communications
Commission; United States of
America,

Respondents.

No. 96-3416

Ameritech Corporation,

Petitioner,

v.

Federal Communications
Commission; United States of
America,

Respondents.

No. 96-3418

US West, Inc.,

Petitioner,

v.

Federal Communications Commission; United States of America,

Respondents.

No. 96-3424

GTE Service Corporation; GTE Alaska, Incorporated; GTE Arkansas, Incorporated; GTE California, Incorporated; GTE Florida, Incorporated; GTE Midwest, Incorporated; GTE South, Incorporated; GTE Southwest, Incorporated; GTE North, Incorporated; GTE Northwest, Incorporated; GTE Hawaiian Telephone Company, Incorporated; GTE West Coast, Incorporated; Contel of California, Inc.; Contel of Minnesota, Inc.; Contel of the South, Inc.,

Petitioners,

v.

Federal Communications Commission; United States of America,

Respondents.

No. 96-3430

New York Telephone Company; New England Telephone and Telegraph Company,

Petitioners,

v.

Federal Communications Commission; United States of America,

Respondents.

No. 96-3436

Cincinnati Bell Telephone Company,

Petitioner,

v.

Federal Communications Commission; United States of America,

Respondents.

No. 96-3444

People of the State of New York; The Public Service Commission of the State of New York,

Petitioners,

v.

Federal Communications Commission; United States of America,

Respondents.

No. 96-3450

SBC Communications, Inc.

Petitioner,

v.

Federal Communications Commission; United States of America,

Respondents.

No. 96-3453

Louisiana Public Service Commission,

Petitioner,

v.

Federal Communications Commission; United States of America,

Respondents.

No. 96-3460

Florida Public Service Commission,

Petitioner,

v.

Federal Communications Commission; United States of America,

Respondents.

No. 96-3507

South Dakota Public Utilities Commission,

Petitioner,

v.

Federal Communications Commission; United States of America,

Respondents.

No. 96-3519

The People of the State of California; The Public Utilities Commission of the State of California,

Petitioners,

v.

Federal Communications Commission; United States of America,

Respondents.

No. 96-3520

United States Telephone Association,

Petitioner,

v.

Federal Communications Commission; United States of America,

Respondents.

No. 96-3603

Rural Telephone Coalition,

Petitioner,

v.

Federal Communications Commission; United States of America,

Respondents.

No. 96-3604

Competitive Telecommunications Association,

Petitioner,

v.

Federal Communications Commission; United States of America,

Respondents.

No. 96-3608

Mississippi Public Service Commission,

Petitioner,

v.

Federal Communications Commission; United States of America,

Respondents.

Submitted: October 3, 1996

Filed: October 15, 1996

Before BOWMAN, WOLLMAN, and HANSEN, Circuit Judges.

HANSEN, Circuit Judge.

These cases have been consolidated in this circuit by the September 11, 1996 order of the Judicial Panel on Multidistrict Litigation, Docket No. RTC-31, pursuant to Rule 24 of the Rules of Procedure of the Judicial Panel on Multidistrict Litigation. See 28 U.S.C. § 2112(a)(3) (1994). Numerous petitioners have moved this court for a stay pending judicial review of the Federal Communications Commission's First Report and Order.[1] The FCC promulgated the rules and regulations in its First Report and Order pursuant to its reading of its statutory duty to implement the local competition provisions of the Telecommunications Act of 1996 (the Act).[2] This court granted a temporary stay on September 27, 1996, pending oral argument. After hearing oral argument on October 3, 1996, from representatives of the concerned parties, we have decided to stay the operation and effect of only the pricing

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[1]First Report and Order, Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, CC Docket No. 96-98 (Aug. 8, 1996) [hereinafter First Report and Order].

[2]Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (to be codified as amended in scattered sections of 47 U.S.C.).

provisions[3] and the "pick and choose" rule[4] contained in the FCC's First Report and Order pending our final determination of the issues raised by the pending petitions for review.

I.

In the Telecommunications Act of 1996, Congress enacted a plan to alter the monopolistic structure of local telephone service markets with an injection of competition. The Act effectively opens up local markets by imposing several new obligations on the existing providers of local telephone service in those markets. The Act refers to the current local providers as "incumbent local exchange carriers" (incumbent LECs). See 47 U.S.C.A. §§ 251(c), (h), 252(j) (West Supp. May 1996). Among other duties, the Act requires incumbent LECs (1) to allow other telecommunication carriers (such as cable television companies and current long-distance providers) to interconnect with the incumbent LEC's existing local network to provide competing local telephone service (interconnection); (2) to provide other telecommunication carriers access to elements of the incumbent LEC's local network on an unbundled basis (unbundled access); and (3) to sell to other telecommunication carriers, at wholesale rates, any telecommunications service that the incumbent LEC provides to its retail customers (resale). Id. § 251(c).

To accomplish these directives, the Act places a duty on incumbent LECs to privately negotiate, in good faith, comprehensive

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[3]The pricing provisions refer to First Report and Order, Appendix B-Final Rules §§ 51.501-51.515 (inclusive), 51.601-51.611 (inclusive), 51.701-51.717 (inclusive) and to the default proxy range for line ports used in the delivery of basic residential and business exchange services established in the FCC's Order on Reconsideration, dated September 27, 1996.

[4]The "pick and choose" rule refers to First Report and Order, Appendix B-Final Rules § 51.809.

agreements with other telecommunication carriers seeking to enter the local market. See id. §§ 251(c)(1), 252(a). If the incumbent LEC and the carrier seeking entry are unable to reach a negotiated agreement, either party may petition the respective state utility commission to conduct a compulsory arbitration of the open and disputed issues and arrive at an arbitrated agreement. See id. § 252(b). The final agreement, whether arrived at through negotiation or arbitration, must be approved by the state commission. Id. § 252(e)(1). Certain portions of the Act also require the FCC to participate in the Act's implementation. See, e.g., id. §§ 251(b)(2), (d)(1), (e), 252(e)(5). The FCC's regulations pertaining to the Act form the heart of the controversies at bar.

On August 8, 1996, the FCC released its First Report and Order in which it published its comments and rules regarding the local competition provisions of the Act. The petitioners in this consolidated proceeding, consisting, at the moment, primarily of incumbent LECs and state utility commissions, argue that the FCC exceeded its authority in promulgating these rules. While several of the petitioners object to the FCC's regulations in their entirety, others specifically challenge the FCC's rules regarding the prices that an incumbent LEC may charge an incoming competitor for interconnection, unbundled access to network elements, and resale of its services.

Despite the different approaches, it is clear that all of the petitioners object principally to the FCC's pricing rules. One such rule is a mandate from the FCC that state commissions employ the "total element long-run incremental cost" (TELRIC) method to calculate the costs that an incumbent LEC incurs in making its facilities available to competitors. See First Report and Order, Appendix B-Final Rules §§ 51.503, 51.505. After applying the TELRIC method and arriving at a cost figure, the state commissions, acting as arbitrators, must then determine the price that an

incumbent LEC may charge its competitors, based on the TELRIC driven cost figure. See id.

Many of the incumbent LECs object to the TELRIC method for two reasons. First, it does not consider their "historical" or "embedded" costs (costs that an incumbent incurred in the past) in calculating the cost figure to be used to determine the rates. See id. § 51.505(d)(1). Second, it requires that an incumbent LEC's cost be measured as if the incumbent were using the most efficient telecommunications technology currently available, regardless of the technology presently employed by the incumbent and to be used by the competitor. See id. § 51.505(b)(1). The incumbent LECs argue that the TELRIC method underestimates their costs and results in prices that are too low. The incumbent LECs maintain that these low prices would effectively require them to subsidize their competitors and thereby threaten the viability of the LECs' own businesses.

For similar reasons, the petitioners also object to the FCC's proxy rates, which are to be used by the state commissions if they elect not to employ the TELRIC method to set prices. See id. §§ 51.503(b)(2), 51.513, 51.705(a)(2), 51.707. The incumbent LECs argue that these proxy rates do not accurately reflect their costs and are artificially low. In addition to the rules regarding TELRIC and the proxy rates, the petitioners object to several other FCC regulations that pertain to the pricing of intrastate telephone service.[5]

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[5]The state utilities commissions take issue with the "deaveraging" rule requiring them to establish different rates in at least three different geographic areas within each state. See id. § 51.507(f). Many of the incumbent LECs also challenge the FCC's wholesale rate rules, asserting that the FCC's mandated method for calculating these rates, as well as its interim wholesale rates, result in rates that are also too low and threaten the incumbent LECs' viability. See id. §§ 51.607, 51.609, 51.611.

Some of the petitioners also seek to stay the FCC's so-called "pick and choose" rule, id. § 51.809, with which the FCC purports to implement § 252(i) of the Act. Section 252(i) requires an LEC to make available any interconnection, service, or network element contained in an approved agreement to which it is a party to any other telecommunications carrier upon the same "terms and conditions" as those provided in the agreement. Here again, price becomes a key issue. When the FCC promulgated its rule, it expanded the statutory language of § 252(i) to include "rates, terms, and conditions." Id. § 51.809 (emphasis added). The petitioners' objection is that the rule would permit the carriers seeking entry into a local market to "pick and choose" the lowest-priced individual elements and services they need from among all of the prior approved agreements between that LEC and other carriers, taking one element and its price from one agreement and another element and its price from a different approved agreement. Moreover, if an LEC and Carrier A, for example, reach an approved agreement, and then the LEC and a subsequent entrant, Carrier B, agree in their agreement to a lower price for one of the elements or services provided for in the LEC's agreement with Carrier A, Carrier A will be able to demand that its agreement be modified to reflect the lower cost negotiated in the agreement with Carrier B. Consequently, the petitioners assert that the congressional preference for negotiated agreements would be undermined because an agreement would never be finally binding, and the whole methodology for negotiated and arbitrated agreements would be thereby destabilized.

II.

We consider the following four factors in determining whether a stay is warranted: (1) the likelihood that a party seeking the stay will prevail on the merits of the appeal; (2) the likelihood that the moving party will be irreparably harmed absent a stay; (3) the prospect that others will be harmed if the court grants the

stay; and (4) the public interest in granting the stay. See Arkansas Peace Ctr. v. Dep't of Pollution Control, 992 F.2d 145, 147 (8th Cir. 1993), cert. denied, 114 S. Ct. 1397 (1994); Wisconsin Gas Co. v. F.E.R.C., 758 F.2d 669, 673-74 (D.C. Cir. 1985), cert. denied, 476 U.S. 1114 (1986). Applying these factors to the case at hand leads us to conclude that a stay pending final review of the FCC's pricing and "pick and choose" rules is justified.

A.

In evaluating the likelihood of the petitioners' success on appeal, we note that the petitioners "need not establish an absolute certainty of success." Population Inst. v. McPherson, 797 F.2d 1062, 1078 (D.C. Cir. 1986). Instead, as the actual terms of the test indicate, the petitioners must show that they are "likely" to succeed on the merits. Here, the petitioners allege primarily that the FCC exceeded its jurisdiction by imposing national pricing rules for what is essentially local service. They argue that the text and the structure of the Act give the States, not the FCC, authority over the pricing of intrastate telephone service. After evaluating the contentions of all of the interested parties, we believe that the petitioners present a strong argument that is sufficient to satisfy the first prong.

Historically, the state commissions have determined the rates for intrastate communications services. See Communications Act of 1934, § 2(b), 47 U.S.C. § 152(b) (1994). Subsection 252(d), which indicates that state commissions have the authority to determine "just and reasonable rates" necessary to implement the local competition provisions of the Act, appears consistent with that past practice. This subsection, entitled "Pricing standards," makes no mention of FCC rules on pricing. Moreover, subsection 252(c)(2) directs state commissions to "establish any rates for interconnection, services, or network elements according to

subsection (d) of this section." Again, no reference is made to FCC regulations regarding rates. By contrast, where Congress intended for the state commissions to follow FCC rules in arbitrations, it expressly said so. In subsection 252(c)(1), the Act requires state commissions to ensure that their resolutions of arbitrated disputes comply with both section 251 and with the regulations that the FCC is specifically authorized to issue under section 251. But nowhere in section 251 is the FCC specifically authorized to issue rules on pricing. The sections of the Act that directly authorize the state commissions to establish prices are devoid of any command requiring the state commissions to comply with FCC pricing rules (or, for that matter, authorizing the FCC to issue any pricing rules). This absence indicates a likelihood that Congress intended to grant the state commissions the authority over pricing of local telephone service, either by approving or disapproving the agreements negotiated by the parties, or, when the parties cannot agree, through compulsory arbitration, thereby preserving what historically has been the States' role.

We are mindful of the FCC's contrary interpretation of the Act. The FCC asserts that subsection 251(d)(1), when read together with subsection 252(c)(1), authorizes the FCC to establish rules regarding pricing. Subsection 251(d)(1) directs the FCC to complete the promulgation of regulations pursuant to its duties under section 251 by August 8, 1996. The FCC also urges us to read the general provisions of subsection 251(c) together with subsection 252(d) (the pricing standards) and conclude that these portions of the Act supply the FCC with the power to issue pricing rules.

We recognize that courts must give deference to an agency's reasonable interpretation of an unclear statute. See Chevron U.S.A., Inc. v. Natural Resources Defense Council, 467 U.S. 837, 843-45 (1984). In this case, however, we believe that the petitioners have a better than even chance of convincing the court

that the FCC's pricing rules conflict with the plain meaning of the Act, in which case the court would not be bound by Chevron deference and would be entitled to overturn the agency's interpretation. See id. at 842 ("If the intent of Congress is clear, that is the end of the matter, for the court, as well as the agency, must give effect to the unambiguously expressed intent of Congress."); id. at 844 (indicating that courts should not give controlling weight to regulations that are contrary to the statute). In this, our first look at the issue, we are skeptical that the FCC's roundabout construction of the statute could override what, at first blush, appears to be a rather clear and direct indication in subsections 252(c)(2) and 252(d) that the state commissions should establish prices.

Moreover, we have serious doubts that the FCC's interpretation of the Act constitutes the straightforward or unambiguous grant of intrastate pricing authority to the FCC sufficient to qualify as an exception to the provisions of subsection 2(b) of the Communications Act of 1934, 47 U.S.C. § 152(b) (1994). See Louisiana Pub. Serv. Comm'n v. FCC, 476 U.S. 355, 377 (1986). Subsection 2(b) provides that "nothing in this Chapter shall be construed to apply or to give the [FCC] jurisdiction with respect to . . . charges, classifications, practices, services, facilities, or regulations for or in connection with intrastate communications service." 47 U.S.C. § 152(b) (1994). In Louisiana, the Supreme Court determined that in order to overcome subsection 2(b)'s limits on the FCC's jurisdiction with respect to intrastate communications service, Congress must "unambiguously" or "straightforwardly" either modify subsection 2(b) or grant the FCC additional authority. 476 U.S. at 377. We acknowledge that portions of the Telecommunications Act of 1996 expressly grant the FCC authority over some aspects of intrastate telephone service. See, e.g., 47 U.S.C.A. § 251(e) (West Supp. May 1996) (FCC authority regarding numbering administration). We have been unable, however, to find such an express grant of authority to the FCC over the pricing of

intrastate telephone service, nor does there appear to be a modification of subsection 2(b).[6] The combination of these omissions indicates a sufficient likelihood that the petitioners will succeed on the merits of their appeal. We, of course, remain open to being persuaded that the FCC's read is the correct one when full briefing and argument on the merits have been concluded.

Because we believe that the petitioners have demonstrated that they will likely succeed on the merits of their appeals based on their argument that, under the Act, the FCC is without jurisdiction to establish pricing regulations regarding intrastate telephone service, we think that it is unnecessary at this time to address the remaining theories which the petitioners use to challenge the legality of the FCC's pricing rules.

B.

With respect to the likelihood of irreparable harm, the petitioners initially assert that their interest in productive ongoing negotiations and arbitrations regarding the implementation of the Act will be irreparably harmed if the FCC's pricing regulations are not stayed. They argue that the competitors seeking entry into the local phone markets will refuse even to consider prices that are higher than the FCC's proxy rates and will simply hold out for the proxy rates that the States will feel obligated to impose in their arbitrations. In this manner, the proxy rates effectively establish a price ceiling, an observation recognized by the FCC itself, which inevitably confines and restricts the give and take characteristic of free negotiations and arbitrations. The state commissions specifically argue that the FCC's pricing regulations effectively undermine their authority,

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[6]In fact, we are told that a provision which specifically modified subsection 2(b) was expressly rejected by Congress before the bill was passed. <u>See</u> S. 652, 104th Cong., 1st Sess. § 101(c) (1995).

and if not stayed, the rules will disrupt the predictability and continuity of the existing regulatory system. The state commissions explain that the FCC pricing rules essentially handcuff their discretion in determining the just and reasonable rates in arbitrations required under subsection 252(d)(1).

In order to demonstrate irreparable harm, a party must show that the harm is certain and great and of such imminence that there is a clear and present need for equitable relief. See Packard Elevator v. I.C.C., 782 F.2d 112, 115 (8th Cir. 1986), cert. denied, 484 U.S. 828 (1987) (quoting Wisconsin Gas, 758 F.2d at 673-74). The FCC asserts that the petitioners' allegations of irreparable harm are merely speculative and that there is no certainty that its proxy rates will ever be applied to the petitioners. We are persuaded, however, by the petitioners' evidence that the negotiations preferred by the Congress are already breaking down due to the competitors' desire to hold out for the FCC's proxy rates. Moreover, given the time constraints under the Act, some state commissions have already felt obliged to impose the proxy rates in their arbitrations. These experiences indicate that the FCC's pricing rules will derail current efforts to negotiate and arbitrate agreements under the Act, and the "pick and choose" rule will operate to further undercut any agreements that are actually negotiated or arbitrated. The inability of the incumbent LECs and the state commissions to effectively negotiate and arbitrate agreements free from the influence of the FCC's pricing rules, including the "pick and choose" rule, will irreparably injure the interests of the petitioners. If the FCC's rules are later struck down, it will be extremely difficult for the parties to abandon the influence of their previous agreements that were based on the national pricing rules and to recreate the atmosphere of free negotiations that would have existed in the absence of the FCC's dictated presumptive prices. Without a stay, the opportunity for effective private negotiations will be irretrievably lost. We initially believe that this result would be

contrary to Congress's intent that these matters be resolved through negotiation and/or arbitration.

The petitioners also argue that the FCC's pricing rules will force the incumbent LECs to offer their services to requesting carriers at prices that are below actual costs, causing the incumbent LECs to incur irreparable losses in customers, goodwill, and revenue. The FCC contends that its pricing rules, in particular its proxy rates, are merely an option for the parties and the state commissions to consider, and consequently the petitioners cannot make a showing that the harm is certain and imminent, as required in Packard Elevator, 782 F.2d at 115. As we explained above, we are persuaded that, absent a stay, the proxy rates would frequently be imposed by the state commissions and would result in many incumbent LECs suffering economic losses beyond those inherent in the transition from a monopolistic market to a competitive one. We are mindful of the precedents that declare that "economic loss does not, in and of itself, constitute irreparable harm," Wisconsin Gas, 758 F.2d at 674, and that "revenues and customers lost to competition which can be regained through competition are not irreparable." Central & S. Motor Freight Tariff Ass'n v. United States, 757 F.2d 301, 309 (D.C. Cir. 1985), cert. denied, 474 U.S. 1019 (1985). Both of these propositions, however, rest on the assumption that the economic losses are recoverable. The threat of unrecoverable economic loss, however, does qualify as irreparable harm. See Baker Elec. Coop., Inc. v. Chaske, 28 F.3d 1466, 1473 (8th Cir. 1994); Airlines Reporting Co. v. Barry, 825 F.2d 1220, 1227 (8th Cir. 1987). In this case, the incumbent LECs would not be able to bring a lawsuit to recover their undue economic losses if the FCC's rules are eventually overturned, and we believe that the incumbent LECs would be unable to fully recover such losses merely through their participation in the market. Moreover, the petitioners' potential loss of consumer goodwill qualifies as irreparable harm. See

Multi-Channel TV Cable Co. v. Charlottesville Quality Cable Operating Co., 22 F.3d 546, 552 (4th Cir. 1994) (holding that the possibility of permanent loss of customers to a competitor or the loss of goodwill satisfies the irreparable injury prong). For the foregoing reasons, we believe that the petitioners have adequately demonstrated that they will be irreparably harmed if a stay of the FCC's pricing rules is not granted.

C.

In assessing whether others will be harmed if the court grants the stay, we acknowledge that our decision, either way, will unavoidably adversely affect the interests of either the incumbent LECs or their potential competitors. If we decide to grant the stay, we recognize that the companies seeking entry into the local telephone markets will have to negotiate and arbitrate their agreements without the added leverage of the FCC's pricing rules, and assuming that the FCC's rules were later upheld, they would likely renegotiate the terms of their agreements. The inconvenience of this scenario, however, is outweighed by the harm and difficulties of its alternative, discussed in the previous section. In other words, we think that it would be easier for the parties to conform any variations in their agreements to the uniform requirements of the FCC's rules if the rules were later upheld than it would be for the parties to rework agreements adopted under the FCC's rules if the rules were later struck down. Consequently, we conclude that any harm that other parties may endure as a consequence of imposing a stay is outweighed by the irreparable injury that the petitioners would sustain absent a stay.

D.

The FCC argues that a stay would not promote the public interest because it would not maintain the status quo and it would

block the road to competition in local telephone service markets. We reject both contentions. Before the FCC published its regulations pursuant to the Act, several incumbent LECs, potential competitors, and state utility commissions were all working together to implement the local competition provisions of the Act. The Act's system of private negotiation backed by state-run arbitration was operating without the input from the FCC. A stay would preserve the continuity and stability of this regulatory system -- a system that has initially proved to be successful. The FCC asserts that without its pricing regulations in effect, the incumbent LECs will be able to exert their superior bargaining power over their potential competitors and impose unreasonable rates for their services. This argument ignores the empirical success that private parties and the state commissions have had in implementing the local competition provisions of the Act.[7] It also denigrates the proven ability of the state commissions to prevent incumbent LECs from charging excessive rates for their services. The Act requires rates to be just and reasonable and it authorizes state commissions to enforce these requirements. Presently, we have no reason to doubt the ability of the state commissions to fulfill their duty to promote competition in the local telephone service markets and thus conclude that the public interest weighs in favor of granting a stay.

III.

Having concluded that the petitioners satisfy the four

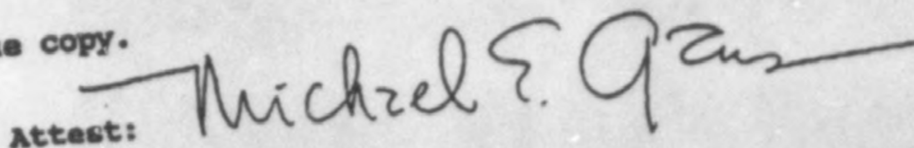
[7]We note that some states, Connecticut, Florida, and Iowa in particular, have already established rates based on local conditions and are already involved in opening up their local markets to competition under both the federal Act and state statutes which foreshadowed the new federal law. Moreover, the FCC-imposed rate for Iowa is substantially higher than the state-set rate which was based on the full record from a contested case proceeding, while in Florida, the FCC proxy rate is substantially lower than the state-set rate.

requirements for granting a stay, we grant the petitioners' motion to stay the FCC's pricing rules and the "pick and choose" rule contained in its First Report and Order[1] pending a final decision on the merits.

Upon the filing of this order, the stay imposed by our order of September 27, 1996, is dissolved, and is replaced by the stay imposed by the terms of this order.

A true copy.

Attest:



CLERK, U. S. COURT OF APPEALS, EIGHTH CIRCUIT.

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[1]The stay pertains only to §§ 51.501-51.515 (inclusive), 51.601-51.611 (inclusive), 51.701-51.717 (inclusive), § 51.809, and the proxy range for line ports used in the delivery of basic residential and business exchange services established in the FCC's Order on Reconsideration, dated September 27, 1996.

GTE/ACSI MATRIX

Issues	GTE Position	ACSI Position
1. What rates should be charged to ACSI by GTE for (1) unbundled exchange access loops (2) associated charges for linking ACSI's collocated equipment to the main distribution frame, and (3) use of the NID?	The Act recognizes that pricing must cover all of the ILECs costs including a reasonable share of joint and common costs. The parties disagree about how to measure TELRIC, and also about whether GTE is entitled to recover its joint and common costs. GTE's proposal is consistent with the Act and recognizes a reasonable share of joint and common costs. The rates for the two items subject to this arbitration (local loop and NID) are presented in GTE's Response.	ACSI has requested GTE set the prices for unbundled network elements and network element combinations at TELRIC consistent with *FCC Rule §51.505*. ACSI agrees that rates should be based on the ILEC's best cost information. Prior to the filing of the petition, GTE has not provided necessary cost information from which to calculate TELRIC costs. In the absence of cost data from GTE, ACSI developed rates based on publicly available data for the dominant ILEC in each state (generally the RBOC) and the Hatfield Model.
2. What method should be used to price interim number portability and what specific rates, if any, should be set for GTE?	GTE should recover its total costs for providing interim number portability. New entrants can allocate or recover their costs as they choose. GTE's costs for interim number portability should be determined based on the network in place today, and allowing for capital, transport and termination, and opportunity and investment costs. The specific rates presented by GTE should be adopted.	New entrants' share of costs is too high. ACSI's contribution to the costs of interim number portability should be limited to an amount based upon its size relative to GTE and other carriers the Commission determines must contribute.
3. Should GTE permit collocators to cross-connect with each other with equipment collocated at GTE's central office, and if so, what should be charged for such collocation?	GTE will provide this connection through the purchase of an unbundled network element.	ACSI should be able to cross-connect with other entities collocated at the same interconnection point without GTE's assistance free of charge. In the event GTE's assistance is requested, GTE should be compensated on a time and materials basis for personnel and equipment.
4. Should bill-and-keep be used as a reciprocal compensation arrangement for transport and termination of local traffic?	GTE should not be required to use a bill-and-keep arrangement, either initially or permanently. However, GTE would be willing to discuss with ACSI a method to assume that traffic is in balance in order to apply bill-and-keep initially. But as and when traffic is out of balance by plus or minus 10%, regardless of the number of months, bill-and-keep is not appropriate and the interstate end office switching rate should apply.	Yes. Bill-and-keep should be used for 12 months as an initial method of setting interconnection charges unless one party's volume of terminating traffic exceeds the other party by plus or minus 10 percent and the amount of compensation for the excess traffic would exceed $10,000.

Issues	GTE Position	ACSI Position
5. To what extent should ACSI be permitted to combine network elements?	ACSI may lease and interconnect to whichever of these unbundled network elements ACSI chooses, and may combine these unbundled elements with any services or facilities that ACSI may itself provide, pursuant to the following terms: I. Interconnection for access to unbundled elements shall be achieved via expanded interconnection/collocation arrangements that ACSI shall maintain at the wire center at which the unbundled services are resident. II. Each loop or port element shall be delivered to the ACSI collocation arrangement over a loop/port connector applicable to the unbundled services through other tariffed or contracted options. III. ACSI may combine unbundled network elements with ACSI's own facilities. ACSI shall not combine unbundled network elements purchased from GTE to bypass resale offerings.	ACSI is free to combine and use the unbundled network elements it purchases from GTE to provide any telecommunications service it chooses which the unbundled network elements can be used to support.
6. Should GTE be required to permit ACSI to collocate its remote switching modules in GTE's central offices?	No. ACSI should be permitted to collocate only equipment that is necessary for interconnection or access to unbundled network elements. This would include transmission equipment for termination, concentration equipment and multiplexing equipment.	Yes. ACSI should be permitted to collocate its remote switching module at GTE's central office.
7. Must the agreement provide for a Most Favored Nations clause?	No. Each agreement negotiated is a process of give and take. A party desiring to obtain the terms of another agreement must abide by the entire agreement. Otherwise, the Act's provisions encouraging negotiations would be meaningless.	Yes. The "most favored nation" clause must be part of the agreement.

GTE objects to arbitration of any issues on which ACSI states that it has or believes it will reach agreement in principle with GTE. Those issues are not properly submitted to arbitration at this time, as ACSI states that they are at or near resolution. Under § 252(c) of the Telecommunications Act, the parties are to create and finalize contract language after the arbitrator's decision on disputed issues.

TAKINGS REPORT

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TAKINGS REPORT

Introduction

In determining the appropriate price for the sale of unbundled elements or the resale of services by GTE in response to ACSI's Arbitration Petition (dated September 10, 1996) ("ACSI Petition"), this State Utilities Commission (the "Commission") must interpret the federal Telecommunications Act of 1996 (the "Act" or "1996 Act") to provide for the recovery of at least all of GTE's historic and forward- looking costs of unbundled elements or resold services plus a reasonable profit. As we demonstrate below, if the Act were interpreted to require GTE to sell unbundled elements or resell services at prices that do not cover all of GTE's costs associated with those elements or services, then the Act would effect a taking of GTE's property without just compensation, in violation of the Fifth and Fourteenth Amendments of the U.S. Constitution as well as Article 10, Section 6 and Article 1, section 9 of the Florida Constitution.

Under familiar principles of statutory construction, such an interpretation must be avoided because the Commission must read the Act to avoid serious constitutional questions. See, e.g., Rust v. Sullivan, 500 U.S. 173, 190-91 (1991); Ashwander v. Tennessee Valley Authority, 297 U.S. 288, 347 (1936) (Brandeis, J., concurring). Indeed, in the specific context of takings, the Supreme Court has admonished that if an "identifiable class of cases [exists] in which application of a statute will necessarily constitute a taking," then concerns for avoiding uncompensated takings properly require a narrowing construction of the statute. United States v. Riverside Bayview Homes, Inc., 474 U.S. 121, 128 n.5 (1985).

As we demonstrate below, under either a regulatory takings or physical occupation analysis, the Act would effect an unconstitutional taking if it were interpreted

to require GTE to sell its elements or services below their true costs to ACSI or to any competitive local exchange carrier ("CLEC"). Thus, to avoid constitutional infirmity, the Commission must read the Act to require prices that cover <u>all</u> of GTE's costs plus a reasonable profit. In the specific context of this arbitration, that principle requires at least two things:

<u>First</u>, at a minimum, the prices set for unbundled elements or resold services must cover <u>at least</u> the following five elements, which comprise GTE's true <u>forward-looking</u> costs:

(i) **<u>Incremental Costs</u>.** The prices set must cover GTE's total element long-run incremental cost of providing that service ("TELRIC"). Moreover, the principle that all of GTE's true costs must be recovered requires that TELRIC be calculated based on GTE's actual network architecture, not on some hypothetical, more efficient network that could now be constructed.

(ii) **<u>Joint And Common Costs</u>.** The principle that GTE must be allowed to recover all its costs further requires that prices be set to allow GTE to recover <u>all</u> of its forward-looking joint and common costs, not just a portion of those costs. Any pricing rule that denies GTE recovery for all its joint and common costs, or provides for the recovery of only a portion of those costs, necessarily requires GTE to sell below its true costs and thereby would effect an uncompensated and unconstitutional taking.

(iii) **<u>Cost of Subsidies</u>.** To the extent that the current price of an unbundled element or a resold service contains a subsidy, or "contribution" towards either the cost of the provision of a service that this State requires GTE to provide at regulated prices that are below cost or the cost incurred as a result of incumbent burdens that GTE

continues to bear after the advent of competition, then GTE must recover its costs unless and until this State allows GTE to rebalance its rates or eliminates the mandated subsidy.

(iv) **Costs of Unbundling or Resale**. Any price set under the Act must include any additional costs incurred to accomplish unbundling or resale.

(v) **No Overstated Avoided Costs**. With respect to resold services, GTE cannot be required to resell services below their true costs (considering all other elements listed here) or with a discount that exceeds GTE's truly avoided costs.

Second, even if the Commission were to allow GTE a recovery of its forward-looking incremental costs plus a reasonable profit, GTE still must be allowed to recover any portion of its historical costs not yet recovered and to earn a fair rate of return on that investment. Accordingly, the Commission must provide for some mechanism -- such as an end-user charge or surcharge -- by which GTE recovers the difference between the reasonable return that it was promised on its historical, embedded costs and what it will now receive under a regime of competition. For GTE, the transition from regulation to competition means that its market will be opened up to competition yet it will be saddled with the heavy costs of an incumbent local exchange carrier (like universal service and carrier of last resort), while its competitors will not only be free of those burdens but will also be allowed to purchase or lease GTE's services or network elements at heavily discounted prices -- which GTE itself will subsidize. The Takings Clause requires that GTE be allowed to recover the substantial investments it made under a regulated-monopoly regime in which the Commission promised GTE that it would be able to recover and earn a fair rate of return on its investments.

Discussion

I. THIS COMMISSION IS NOT BOUND BY THE FCC'S PRICING RULES.

As a predicate matter, it is important to point out that the Commission is not bound by the pricing rules set in the Federal Communications Commission's ("FCC's") First Report and Order for two wholly independent reasons.[1] First, the FCC had no statutory authority to set the pricing rules and default prices it did (see Part I.A below). Second, even if it did, the prices it did set would work an unconstitutional taking. (See Part II.B.) In either case, the Commission is not bound to follow the FCC's prices. Indeed, the Commission is under a statutory duty to interpret the Act for itself and a constitutional duty to ensure that GTE receives just compensation for opening up its network to unbundling and resale.

A. The FCC Lacks Authority To Promulgate National Pricing Standards Governing Agreements Under Section 251 of the Act.

The FCC's attempt to set national pricing standards to govern interconnection, unbundling, and resale agreements negotiated under Sections 251 and 252 of the Act is inconsistent with Congress' scheme to have the States (through arbitrations) and private parties (through negotiations) establish prices. It is clear -- both under the Act and under Section 2(b) of the Communications Act of 1934 -- that the FCC lacks the power to promulgate national pricing standards. See 47 U.S.C. § 152(d).

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[1] In re Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, First Report and Order, CC Docket 96-98, CC Docket 95-185, FCC 96-325 (released Aug. 8, 1996) ("First Report and Order") ¶¶ 618-984.

1. Only The Commission Was Granted Pricing Authority.

In the event that the parties to a negotiation cannot agree on the price for interconnection, unbundled access or resale, the Act expressly assigns to State commissions, not the FCC, the power to determine those prices through the arbitration process. Section 252(c)(2) provides, in terms that could not be clearer, that "a State Commission shall . . . establish any rates for interconnection, services, or network elements according to subsection (d)." 47 U.S.C. § 252(c)(2) (emphasis added). Subsection (d)(1) then goes on to provide that "[d]eterminations by a State commission of the just and reasonable rate for . . . interconnection . . . and [access to unbundled] network elements" shall be based on "cost" and "may include a reasonable profit." 47 U.S.C. § 252(d)(1) (emphasis added). Similarly, subsection (d)(3), governing resale, expressly provides that "a State Commission shall determine wholesale rates . . . ." 47 U.S.C. § 252(d)(3) (emphasis added). These sections, in unambiguous terms, assign to the State commissions -- not the FCC -- the power to set prices for interconnection, unbundling, and resale.

If the explicit statutory text assigning the power to determine prices to State commissions were not clear enough, then the structure of the Act makes the point even clearer. Section 252(c)(1) provides, generally, that in imposing conditions on the parties to a negotiation, a State commission shall ensure that such conditions meet the requirements of both "section 251" and "the regulations . . . prescribed by the [FCC] pursuant to section 251." 47 U.S.C. § 252(c)(1). By contrast, the very next subsection -- § 252(c)(2), which governs pricing -- provides that a State commission shall establish rates for interconnection and unbundling "pursuant to subsection (d)." 47 U.S.C. § 252(c)(2).

There is no mention of any FCC regulations on pricing issues. Thus, where Congress wanted the State commissions to follow the FCC's regulations (§ 252(c)(1)), it said so explicitly; by contrast, with respect to setting prices, Congress expressly omitted any reference to regulations by the FCC, and referred instead only to the substantive requirements imposed on the State commissions by § 251(d) in determining prices.

2. **The FCC Has No Pricing Authority.**

The textual basis relied on by the FCC to assert jurisdiction to determine prices only highlights the weakness of its position. The FCC concedes that "we recognize that these sections [§§ 251 and 252] do *nct* contain an explicit grant of intrastate authority to the [FCC]." First Report and Order ¶ 84 (emphasis added). The FCC finds purported textual authority to determine prices in the directive in § 251(d)(1) stating that "[w]ithin 6 months after the date of enactment of [this Act], the [FCC] shall complete all actions necessary to establish regulations to implement the requirements of this section." 47 U.S.C. § 251(d)(1).

It is quite unreasonable for the FCC to rely on § 251(d)(1) as granting the FCC authority to determine prices. First, that section has nothing to do with granting the FCC the authority to do anything. It merely sets time deadlines for those tasks the FCC is otherwise given under the Act. Indeed, Section 251(d)(1) is a limitation on the FCC -- requiring it to act within sixth months -- not a grant of authority. Second, to the extent that § 251(d)(1) impliedly grants the FCC authority to issue regulations, it does so only with respect to certain specific tasks expressly assigned to it by the Act. It is not a general grant of authority for the FCC to establish prices. Thus, for example, § 251(e)(1) expressly directs the FCC to "create or designate one or more impartial entities to administer

telecommunications numbering." 47 U.S.C. § 251(e). That obviously has nothing to do with pricing.[2]

Section 2(b) of the Communications Act of 1934 (codified at 47 U.S.C. § 152(b)) provides that "nothing in this chapter shall be construed to apply or to give the [FCC] jurisdiction with respect to . . . charges, classifications, practices, services, facilities, or regulations for or in connection with intrastate communications service." The Supreme Court has held that this "congressional denial of power to the FCC" over prices and other matters regarding the provision of local telephone service can be overcome only if Congress includes "unambiguous" and "straightforward" language in the Act either modifying § 2(b) or expressly granting the FCC additional authority. See Louisiana Pub. Serv. Comm'n v. FCC, 476 U.S. 355, 374, 377 (1986).

Obviously, neither exception to § 2(b) is present here. Whatever else can be said of § 251(d)(1), it cannot be said that that section "unambiguously" or "straightforwardly" gives the FCC the authority to set the prices for interconnection and unbundling of the local telephone network or resale of local telephone service. Similarly, no provision in the 1996 Act expressly modifies § 2(b) in granting to the FCC authority to regulate either prices or other local matters under § 251. To the contrary, such a provision **was expressly rejected by Congress**, for while it was included in the Senate bill, it was

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[2] If anything, § 251(d) **confirms** by implication that the FCC has no authority under the Act to determine the prices for interconnection, unbundling and resale. That is so because § 251(d)(2), while expressly articulating the substantive standards to govern the FCC's power to determine which network elements to unbundle, omits any reference to any substantive standards to govern the determining of pricing. 47 U.S.C. § 251(d)(2). Rather, the only place those substantive standards -- governing pricing -- are found are in § 252(d)(1), which expressly refers to the substantive standards governing the State commissions' determination of prices. 47 U.S.C. § 252(d)(1).

not included in the law as enacted. See Conf. Rep. No. 458, 104th Cong., 1st Sess. § 101(c) (1996). Indeed, even the FCC concedes that no provision of the 1996 Act "contain[s] an explicit grant of intrastate authority to the [FCC] . . . ." First Report and Order, ¶ 84.

In response to this fatal § 2(b) problem, the FCC contends that the 1996 Act supposedly "moves beyond the distinction between interstate and intrastate matters that was established by the 1934 Act" and that section 251 "should take precedence" over any "contrary implications" in § 2(b). First Report and Order ¶¶ 24, 83, 93. But that "reasoning" is plainly flawed on a number of different levels.

Most notably, there is simply no grant of authority over prices in § 251 to "take precedence" over the rule of § 2(b). In addition, the Supreme Court could not have been more clear that § 2(b) deprives the FCC of jurisdiction over intrastate communications services unless some later act expressly modifies § 2(b) or expressly grants the FCC power over intrastate communications services. See Louisiana Pub. Serv. Comm'n, 476 U.S. 355 (1986). The FCC's general "sense" that the 1996 Act impliedly "moves beyond the distinction between interstate and intrastate matters established by [§ 2(b)]" cannot overrule the explicit "congressional denial of power to the FCC" in § 2(b).

In sum, the plain language of the Act, the structure of the Act, the rule of construction specified by Congress in Section 2(b), and important policy concerns all demonstrate that the FCC has no authority to set the prices for interconnection, unbundling, and resale. That task is plainly and unequivocally given to the Commission.

B. **Even If The FCC Had The Authority To Set Prices, Both Its Pricing Methodology And Its Default Proxy Rates, If Followed, Would Effect A Taking.**

1. **The FCC's Pricing Methodologies Would Effect A Taking.**

Even if the FCC had the authority to set prices (which it does not), the standards it has chosen are an impermissible interpretation of the Act because they would not compensate GTE fully for its true costs. As we demonstrate below (Parts II-III), the FCC's pricing methodology is defective for a variety of reasons. Principally, though, it fails to allow GTE full recovery of its historic costs and fails to allow GTE its full measure of joint and common costs on a forward-looking basis. Both aspects of the FCC's defective pricing methodology only underscore why anything less than full recovery of GTE's costs, as discussed in more detail in the testimony of GTE company witnesses, would effect an unconstitutional taking without just compensation.

2. **The FCC's Default Proxy Rates For Unbundling, Interconnection And Resale Are Procedurally Defective And Effect A Taking.**

The FCC also erred in several respects in establishing the default proxy prices for interconnection, unbundled elements, and resale under the Act. See First Report and Order ¶¶ 767, 932. First, the FCC erred by circumventing the congressionally designed State-sponsored arbitration process by establishing default prices through a rulemaking -- and an abbreviated rulemaking at that. By design, the arbitration process was intended by Congress to allow the Commission to engage in the fact-specific decision making tied to the circumstances of each case. By attempting to arrive at default proxy rates through a rulemaking, the FCC usurped the role of the Commission and deprived

parties of the fact-specific adjudicative process contemplated under the Act, violating both the Administrative Procedure Act and the Due Process Clause of the Constitution.

Further, the default proxy rates established by the FCC for interconnection and unbundled elements are defective because they are not only inconsistent with the FCC's own flawed pricing methodology but they also effect an unconstitutional taking. As shown in our Response, the FCC's proposed proxy rates fall well below the minimum that GTE must recover for resale and unbundled elements in order to recover its true costs and avoid an unconstitutional taking without just compensation.

In short, under the Act, the Commission -- not the FCC -- has the right and obligation to set the prices for unbundled elements and resold services. Moreover, the Commission is bound to read the Act in a manner that avoids constitutional infirmity, and it need not follow an interpretation by the FCC that raises such constitutional difficulties. Thus, the Commission should determine on its own what pricing rule the Act and the Constitution require without reference to the FCC's First Report and Order.[3]

II. THE TAKINGS CLAUSE PROHIBITS GTE FROM BEING REQUIRED TO PROVIDE ELEMENTS OR SERVICES BELOW THEIR TRUE COSTS.

Whether ACSI's Petition is analyzed as a regulatory takings issue because its proposed rates would be confiscatory and, therefore, unconstitutional (see Part II.A below) or as a physical per se taking because ACSI's Petition proposes a physical occupation of GTE's network without just compensation (see Part II.B below), the result is the same: The Fifth and Fourteenth Amendments simply prohibit Congress and the States

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[3] On October 15, 1996, the 8th Circuit Court of Appeals granted a stay of the FCC First Report and Order pending judicial review.

from requiring GTE to sell elements or services at prices that do not cover all of their true costs, plus a reasonable profit.

A. Regulatory Takings Analysis.

1. Regulators Cannot Force a Business to Operate at a Loss.

The Supreme Court's Brooks-Scanlon decision long ago established the rule that the Takings Clause of the U.S. Constitution forbids a regulator from forcing a utility to operate a segment of its business at a loss because the firm happens to be profitable elsewhere in another segment of its business. Brooks-Scanlon Co. v. Railroad Comm'n of Louisiana, 251 U.S. 396, 399 (1920). The Supreme Court concluded that

> [a] carrier cannot be compelled to carry on even a branch of business at a loss, much less the whole business of carriage . . . . The plaintiff may be making money from its sawmill and lumber business but it no more can be compelled to spend that than it can be compelled to spend any other money to maintain a railroad for the benefit of others who do not care to pay for it.

Brooks-Scanlon stands for the proposition that the Commission may not force a regulated entity to provide a regulated service below cost without providing compensation. See also Northern Pac. Ry. Co. v. North Dakota, 236 U.S. 585, 595 (1915) (to same effect, noting that "[t]he fact that the property is devoted to a public use on certain terms does not justify the requirement that it shall be devoted to other public purposes").[4]

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[4] Many courts have reaffirmed Brooks-Scanlon's rule that a railroad may not be required to operate part of its business at a loss. See, e.g., Railroad Commission of Texas v. Eastern Texas R.R. Co., 264 U.S. 79, 85 (1924) (state regulators cannot require continued operation of railroad line at a loss); Bullock v. Florida, 254 U.S. 513, 520-21 (1921) (same); National Wildlife Fed'n v. ICC, 850 F.2d 694, 707 (D.C. Cir. 1988) (reaffirming "general rule" set forth by Brooks-Scanlon and Bullock that "[a] carrier cannot be compelled to carry on even a branch of business at a loss, much less the whole business of carriage"); Gibbons v. United States, 660 F.2d 1227, 1233

(continued...)

It is no answer to the Brooks-Scanlon principle that the firm may have an overall rate of return that covers its costs based on sales of other services. In Duquesne Light Co. v. Barasch, 488 U.S. 299 (1989), the Supreme Court carved out an exception to Brooks-Scanlon along those very lines, but that exception has no application here. Duquesne suggests that all that matters for purposes of the Takings Clause is the net effect of regulation on the enterprise. Duquesne involved two utilities that challenged a state statute prohibiting a utility from recovering in its rates an investment that was not used and useful. The $35 million investment at issue in Duquesne reduced the rate base for one of the utilities by 1.9% and reduced its revenue by 0.4%; for the other, it reduced the utility's rate base by 2.4% and its revenue by 0.5%. The Court reasoned that there was a negligible effect on the overall financial status of both utilities. The Court thus focused not on any one aspect of an order, but rather on the overall effect of regulation on the enterprise:

> Errors to the detriment of one party may well be canceled out by countervailing errors or allowances in another part of the rate proceeding.

(...continued)
(7th Cir. 1981) ("Brooks-Scanlon and Bullock define the basic limitations upon a modern railroad's public service obligation in the face of financial loss. . . . The constitutional principle embodied in these decisions retains its vitality; a railroad cannot be compelled to continue unprofitable operations indefinitely") (citation omitted); In re New York, New Haven & Hartford R.R., 304 F. Supp. 793, 804 (D. Conn. 1969) ("This court . . . concludes that Brooks-Scanlon and subsequent cases, reaffirming the validity of its holding, are still applicable and determinative."), aff'd in part, vacated in part, 399 U.S. 392 (1970); New York, New Haven & Hartford R.R. v. United States, 289 F. Supp. 418, 440-41 (S.D.N.Y. 1968) (3-judge court) (Friendly, J.) ("We see no reason to question the validity of Justice Holmes' decision in [Brooks-Scanlon] . . . forbidding the State of Louisiana to require a railroad to continue its deficit operation with no hope for profits in the foreseeable future."), vacated, 399 U.S. 392 (1970) (citation omitted).

The Constitution protects the utility from the net effect of the rate order on its property.

Id. at 314. The Duquesne Court also made clear that there would have been a taking if the allowed rates had been "inadequate to compensate current equity holders for the risk associated with their investments under a modified prudent investment scheme." Id. at 312.[5]

The central insight in Duquesne was that there was no need to analyze closely the method used by the regulator as long as it passed constitutional scrutiny by allowing the firm to earn a competitive rate of return on invested capital. **But, the premise of the decision -- which distinguishes it from Brooks-Scanlon -- was that the regulator could and did insulate the regulated utility from competition and thus guarantee a constitutionally acceptable outcome.** Thus, to the extent that the "end-result" test of Duquesne suggests that a regulator could force a utility to operate one segment at a loss, that reasoning has no application here. It may well be that GTE is still subject to "regulation" by the Commission, but that no longer means what it once did in a regulated monopoly regime. Now, under competition, GTE no longer is insulated from the competitive forces of the marketplace. This has nothing to do with whether competition, as a normative matter, is the best policy. It simply means that ACSI cannot rely on the

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[5] See also Federal Power Commission v. Hope Natural Gas Co., 320 U.S. 591, 603 (1944) ("[R]eturn to the equity owner should be commensurate with returns on investments in other enterprises having corresponding risks."); Bluefield Water Works & Improvement Co. v. Pub. Serv. Comm'n, 262 U.S. 679, 692-93 (1923) ("A public utility is entitled to such rates as will permit it to earn a return on the value of the property which it employs for the convenience of the public equal to that generally being made at the same time and in the same general part of the country on investments in other business undertakings which are attended by corresponding risk and uncertainties").

exception in Duquesne to justify the Commission setting insufficient rates for resale, unbundled elements, and interconnection on the theory that GTE may be profitable elsewhere in its system. For these reasons, the Brooks-Scanlon rule governs this case, and the Commission cannot force GTE to operate any segment of its business at a loss.

2. The Commission Must Ensure GTE A Fair Rate of Return.

Whether the Brooks-Scanlon or Duquesne model applies, a regulator must ensure the utility a fair, non-confiscatory rate of return. That requires a utility's investors to earn a return that is commensurate with investments having a similar risk. As the Supreme Court concluded in Federal Power Commission v. Hope Natural Gas Co., 320 U.S. 591 (1944):

> From the investor or company point of view it is important that there be enough revenue not only for operating expenses but also for the capital costs of the business. These include service on the debt and dividends on the stock. By that standard the return to the equity owner should be commensurate with returns on investments in other enterprises having corresponding risks. That return, moreover, should be sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital.

320 U.S. at 603 (emphasis added).

In Duquesne, as explained above, the Court reaffirmed that "the return investors expect given the risk of the enterprise" is always relevant to the constitutional adequacy of a rate. Duquesne, 488 U.S. at 314. In support of this point, the Court quoted with approval from its opinion in Bluefield Water Works & Improvement Co. v. Pub. Serv. Comm'n, 262 U.S. 679 (1923), which held that a utility is entitled to rates that will enable it to earn a return "'equal to that generally being made at the same time and in the same general part of the country on investments in other business undertakings which are

attended by corresponding risks and uncertainties.'" Id. at 314-15 (quoting Bluefield Water Works, 262 U.S. at 692).[6] Thus, pursuant to the Takings Clause, the Commission must interpret the Act to allow GTE sufficient recovery of its invested capital to maintain its credit, to attract capital, and to ensure an opportunity to earn a return that will be commensurate with investments of a similar risk. See also Tennoco Oil Co. v. Department of Consumer Affairs, 876 F.2d 1013, 1020 (1st Cir. 1989) ("To be just and reasonable, rates must provide not only for a company's costs, but also for a fair return on investment. Rates which fall below this standard are 'confiscatory'") (citation omitted), aff'd, 60 F.3d 864 (1st Cir. 1995); Medical Malpractice Joint Underwriting Ass'n v. Paradis, 756 F. Supp. 669, 676 (D.R.I. 1991) (holding unconstitutional an insurance rate that would have caused insurance companies to incur a loss).

It has also long been required that just compensation for a taking requires that the property owner be put in the same position as he would have been if the exchange had been voluntary -- as opposed to involuntary (as here). Consistent with this principle, courts have held that the owner is "to be put in as good a position pecuniarily as if his property had not been taken." Olson v. United States, 292 U.S. 246, 255 (1934); see also United States v. Reynolds, 397 U.S. 14, 16 (1970); Hedstrom Lumber Co. v. United States, 7 Cl. Ct. 16, 27 (1984) (citing Foster v. United States, 2 Cl. Ct. 426, 445 (1983)) (to same

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[6] See also Illinois Bell Tel. Co. v. FCC, 988 F.2d 1254, 1263(D.C. Cir. 1993) (test to be applied in evaluating a rate order is "whether the 'end result' meets the Hope standards: attraction of capital and compensation for risk"); Jersey Central Power & Light Co. v. FERC, 810 F.2d 1168, 1178, 1181 (D.C. Cir. 1987) (en banc) (utility's inability to pay dividends to common shareholders supported contention that FERC's rates were confiscatory) (citing Permian Basin Area Rate Cases, 390 U.S. 747, 792, 812 (1968)).

effect); see generally Richard A. Epstein, Takings: Private Property And The Power Of Eminent Domain 182 (Harvard University Press 1985) ("In principle the ideal solution is to leave the individual owner in a position of indifference between the taking by the government and retention of the property").[7]

Applying these takings principles here requires that GTE recover its full joint and common forward-looking costs as well as its historic costs. Anything less would jeopardize GTE's ability to continue attracting capital, would not afford its investors a return commensurate with the risk of similar investments, and would fail to place GTE in the position it would have been had its property not been taken through confiscatory pricing.

B. Physical Occupation Analysis.

The Commission must set prices for unbundled elements and resold services that allows GTE a recovery of its true costs and reasonable profit for yet another wholly independent but related reason. ACSI's proposals would amount to a per se taking by physical occupation of various parts of GTE's network.

In Loretto v. Teleprompter Manhattan CATV Corp., 458 U.S. 419 (1982), the Supreme Court held that a New York law requiring a landlord to permit installation of cable

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[7] See also Yancey v. United States, 915 F.2d 1534, 1542 (Fed. Cir. 1990) ("the fair market value of property under the Fifth Amendment can include an assessment of the property's capacity to produce future income if a reasonable buyer would consider that capacity in negotiating a fair price for the property"); Cloverport Sand & Gravel Co. v. United States, 6 Cl. Ct. 178, 188 (1984) (fair market value has been defined as the amount a "willing buyer would agree to pay a willing seller in cash, with neither party being under a compulsion to buy or sell"). Accord United States v. New River Collieries Co., 262 U.S. 341, 343 (1923); Seaboard Air Line Ry. v. United States, 261 U.S. 299, 304 (1923).

television equipment on rental property was a constitutionally compensable taking. The Court held that, while "no 'set formula' existed to determine, in all cases, whether [government regulation of private property constitutes a taking]," where the government authorizes a permanent physical occupation of one's property by a third party, a taking is determinatively established. Id. at 426. The Court held that the law at issue in Loretto plainly amounted to a taking by a physical occupation because the "installation involved a direct physical attachment of" the cable company's equipment to the owner's property. Id. at 438.

The Supreme Court revisited the application of takings principles by permanent physical occupation to highly regulated industries in FCC v. Florida Power Corp., 480 U.S. 245 (1987). In that case, a utility company challenged on takings grounds the provisions of the Pole Attachments Act that authorized the FCC to set the rates that utility companies could charge cable television companies for using their utility poles for stringing television cable. The Court held that

> Loretto ha[d] no applications to the facts of [Florida Power -- and there was no taking by physical occupation -- because while] the statute we considered in Loretto specifically required landlords to permit permanent occupation of their property by cable companies, nothing in the Pole Attachments Act as interpreted by the FCC . . . gives cable companies any right to occupy space on utility poles, or prohibits utility companies from refusing to enter into attachment agreements with cable operators.

Id. at 250-51 (emphasis added).

In other words, where, as in Florida Power, the property owner voluntarily invites the third party onto its property (by lease or otherwise), there is no permanent physical occupation mandated by the government and hence no taking for that reason, and the government is free to regulate the terms of the lease or other invitation (i.e., regulate

the use of the property) without effecting a per se taking by physical occupation. Or, as the Supreme Court put it, the "element of required acquiescence is at the heart of the concept of [per se taking by physical] occupation." Id. at 252. See also Yee v. Escondido, 503 U.S. 519, 527 (1992) ("required acquiescence is at the heart of the concept of [taking by physical] occupation").

Applying these well-settled principles here, it is plain that the obligations imposed on GTE under section 251 -- collocation, unbundled network access to the local loop, pole attachments, and access to GTE databases -- constitute a taking by permanent physical occupation.

1. **Physical Collocation.**

ACSI has requested physical collocation. As described in the testimony of GTE witness Cantrell, physical collocation allows a CLEC to place certain equipment necessary for interconnection in a dedicated space at the facility of an incumbent local exchange carrier ("ILEC"), like GTE. See 47 U.S.C. §251(c)(6); First Report and Order ¶¶ 555-607. The Act obligates ILECs to allow for the physical occupation by the CLEC to establish a mini-facility on the property of the ILEC for an indefinite period with the further right to enter the ILEC's facility to install, maintain, and repair collocated equipment, as it deems necessary.

Physical collocation amounts to an installment and direct physical attachment to GTE's property. Cf. Loretto, 458 U.S. at 438. There is no question that a third party -- as opposed to GTE -- would have an exclusive property interest in the space on GTE's premises. See Id. at 440 n.19. And there is no question that, unlike in Florida Power and Yee, the Act requires an ILEC to allow third parties to physically occupy their premises.

Thus, this case falls squarely within the per se takings rule of Loretto, as clarified in Florida Power and Yee.

The collocation issue has been squarely addressed by the Oregon Supreme Court, which held that physical collocation amounts to a taking by permanent physical invasion. In GTE Northwest Inc. v. Public Util. Comm'n of Oregon, 321 Ore. 458, 468-77, 900 P.2d 495, 501-06 (1995), cert. denied, 116 S.Ct. 1541 (1996), the Supreme Court of Oregon held that state-mandated collocation rules effected an unconstitutional physical taking. Id. The Court reasoned that when the government requires a physical intrusion into one's property that reaches the extreme form of a permanent physical occupation, a taking has occurred. Id.[8]

2. Unbundled Access To The Local Loop.

ACSI has requested access to the local loop on an unbundled basis. The Act provides CLECs with the right to unbundled access to the local loop. 47 U.S.C. § 251(c)(3); First Report and Order ¶¶ 226-541. As described in the testimony of GTE witness Hartshorn, GTE is forced to transfer a property interest in the loop to ACSI. That interest is more akin to a forced lease than a sale. If a customer who elects ACSI as a local telephone provider decides to switch back to GTE, then GTE would again assume the property interest given to ACSI. Once ACSI or any other CLEC assumes an interest

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[8] The one federal court to address this issue has agreed that physical collocation "would seem necessarily to 'take' property regardless of the public interests served in a particular case." Bell Atlantic Tel. Cos. v. FCC, 24 F.3d 1441, 1446 (D.C. Cir. 1994). The D.C. Circuit did not, however, have to reach the taking issue because that court concluded that the FCC did not have the statutory authority to order physical collocation.

in the local loop, however, GTE cannot provide local exchange or any other service over that wire.

The physical occupation here is very similar to the taking in physical collocation. Here, GTE's turning over of the local loop to ACSI -- by compulsion from the government -- amounts to a direct physical occupation of its property by a third party, as it did in Loretto. 458 U.S. at 438. Nor is there a question that GTE owns this property. See id. at 440 n.19. And there is no question that, unlike in Florida Power and Yee, the Act requires GTE to allow ACSI and other third parties to physically occupy its premises. This case, just like physical collocation, falls squarely within the per se takings rule of Loretto, as clarified in Florida Power and Yee.

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It is no response to the various physical takings here that somehow GTE's interest in its real property (e.g., facilities, network, etc.) should be accorded any less respect because GTE's local telephone exchange business has been regulated by the Commission. A long line of cases establishes that a utility's property -- even though subject to regulation -- remains the property of the utility, not the government. See Munn v. Illinois, 94 U.S. 113, 126 (1877); Delaware, L. & W. R.R. v. Morristown, 276 U.S. 182, 193 (1928); Northern Pac. Ry. v. North Dakota, 236 U.S. 585, 595 (1915). Therefore, regulation by the Commission may alter the use of property, but it cannot alter the underlying ownership of the property for purposes of a physical taking.

Put another way, there is nothing about the relationship between GTE, as a regulated entity, and the Commission that suggests that GTE has in any way bargained

away its private property rights in exchange for a franchise that it has enjoyed up until now in the local exchange market in its service territory. ACSI has provided no evidence -- and it will be unable to provide any evidence -- of any agreement by GTE to give up its private property rights in its network facilities. The only bargain that GTE has entered into has been to provide quality universal telephone service to the customers of this State in exchange for an exclusive franchise that would allow for a recovery of and a fair rate of return on its invested capital. Never has GTE turned over any part of its property rights to the State.

To the contrary, GTE has preserved all the traditional incidents of private ownership of its network property -- including title, possession, and the right and obligation to incur debt to finance that property, to depreciate it, and to pay taxes on it. Any suggestion that GTE does not have a full property interest in its property would be news to state and federal taxing authorities, to GTE's creditors, and to its shareholders.

Therefore, GTE is entitled to just compensation for the physical occupation and taking of its property. While recovery of the fair market value is typically the measure of just compensation for a taking, see, e.g., United States v. 564.54 Acres of Land, 441 U.S. 506, 515-17 (1979), the Supreme Court has long recognized that there is no "rigid rule" requiring that standard. United States v. Commodities Trading Corp., 339 U.S. 121, 123 (1950). Thus, where a "market value", as here, would be "difficult to find," other standards may be appropriate. Again, the guiding principle is that the property owner should be put in "as good a position pecuniarily as if his property had not been taken." Olson, 292 U.S. at 255. Here, that means allowing GTE all of its forward looking costs pursuant to the "market-determined efficient component pricing rule" ("M-ECPR") (as

discussed in greater detail in Part III.A below) and a recovery of and a fair rate of return on its historic costs of creating the network that has been taken (Part III.B below). Here, the measure of just compensation for a physical taking is no different from the compensation owed GTE under the regulatory/confiscatory pricing analysis discussed above (Part II.A).

III. GTE MUST RECOVER ALL ITS FORWARD-LOOKING COSTS AND EARN A FAIR RATE OF RETURN ON ITS HISTORIC COSTS.

In Parts I and II above, we explained how ACSI's Petition would effect an unconstitutional taking and why the FCC's First Report and Order provides no safe harbor for that taking. In this Part, we apply these takings principles to this arbitration and demonstrate that GTE must recover its full forward-looking costs (Part III.A) and historic costs (Part III.B) to avoid an uncompensated and unconstitutional taking.

A. There are Four Forward-Looking Costs That GTE Must Recover.

1. Incremental Costs.

For any piece of GTE's network that is either leased or sold, it is commonly accepted that GTE is entitled to its long run incremental cost. In its First Report and Order, the FCC adopted this principle by establishing a pricing methodology for interconnection and unbundled elements based on the TELRIC of providing a particular network element plus a reasonable share of forward-looking joint and common costs. First Report and Order ¶¶ 674-703. Where GTE's incremental cost is higher than its retail rate (in the case of residential service, for example), forcing GTE to sell at "retail" would effect an unconstitutional taking in the absence of some other mechanism to make GTE whole. (Id.) That is to say, even the retail price does not fully cover GTE's incremental costs.

Even worse, forcing GTE to sell at a price that is less than retail -- in the case of wholesale rates, for example -- would only make the taking more pronounced. (Id.)

2. **All Forward-Looking Joint And Common Costs.**

To the extent that ACSI's Petition allows for GTE to receive anything less than the full recovery of all forward-looking joint and common costs for any piece of GTE's network that is either leased or sold, it would be a taking without just compensation.[9] Even the "reasonable" portion of joint and common forward-looking costs that would be permitted under the FCC's interpretation, however, would be insufficient. The First Report and Order suggests two permissible methods of calculating the "reasonable" portion -- both of which would subsidize ACSI's entry into the market by ensuring that GTE earned only a portion of its forward-looking joint and common costs. First Report and Order ¶ 696.

Under one method, GTE would only be entitled to a fixed markup, which would mean that GTE would be forced to forego a significant share of the contribution it otherwise would have earned. Under the other method, the FCC would "allocate" GTE's forward-looking common costs to the elements that are the most competitive and, therefore, least likely to recover their assigned costs. As explained in greater detail in the Economic Report, both methods would foreclose the possibility that GTE would be able to achieve the recovery of forward-looking costs that the FCC purports to endorse, and

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[9] A firm's "joint" costs are those costs incurred when two or more services are produced in fixed proportion. A firm's "common" costs are those costs incurred in the provision of some or all the firm's services that are not incremental to any individual service. Common costs can only be "avoided" by shutting down the entire firm or by not producing a particular group of services under review. (See Economic Report)

would effect an unconstitutional taking without just compensation. ACSI has failed to explain how this basic constitutional defect would be rectified.

Taking a position that is even more aggressive than the FCC, ACSI appears to assume that forward-looking costs are exactly equal to the sum of GTE's TELRICs. That is to say, ACSI's pricing proposal appears to be based on the erroneous proposition that joint and common costs are de minimis in the provision of local telephone service. ACSI has -- once again -- offered no evidence to support this claim. Moreover, ACSI's proposal conflicts with the FCC's interpretation, which assumes there will be some forward-looking joint and common costs that an ILEC is entitled to recover. See First Report and Order ¶¶ 672-73, 694-98.

3. GTE's Costs Of Subsidizing Other Services.

It has long been a fundamental tenet of regulation of local telephone service that the incumbent LEC bears certain burdens -- notably, rate structures that reflect cross subsidies from universal service and carrier of last resort obligations. These burdens, unique to the incumbant, come at a tremendous cost. GTE has explained elsewhere in its submission (GTE Company pricing and cost witnesses) that these costs are certain and quantifiable. Yet ACSI's Petition seeks to avoid any responsibility for paying for these costs. Instead, without any basis whatsoever, it would force the incumbent to bear these costs. If the Commission were to force GTE to bear these costs, that would constitute an uncompensated, unconstitutional taking.

The cost of the subsidy, or "contribution" is particularly severe when considering the sale or lease of an unbundled element (the local loop, for example). If the price of the loop is set too low, then GTE will not recover its full costs associated with the

loop, as discussed in greater detail in the testimony of GTE Company pricing and cost witness. But even worse, GTE will also lose the opportunity to sell other higher-margin services that provide contribution toward universal service and carrier of last resort obligations. So, when GTE sells/leases an unbundled loop to ACSI, for example, ACSI will likely self-provision the switching facilities necessary to provide higher-margin vertical services. Yet these are precisely the higher-margin vertical services that provide contribution to GTE's costs that traditionally served to keep basic telephone rates low. Thus, the more GTE and other ILECs lose the opportunity for contribution, the more compelling is the case that ACSI's proposal would effect a taking. By contrast, the market-determined efficient component pricing rule, as explained in detail by GTE pricing and cost witnesses, derives a mechanism that prices GTE components at their economic costs. This price rule, supplemented with a competitively neutral surcharge, is the proper -- and constitutional -- method for compensating GTE.

It is no answer to a taking that there may be alternate funding available at some later point through a universal service fund ("USF"). 47 U.S.C. § 254. Indeed, the very fact that Congress has recognized that there is a need for the USF only underscores why there would be an unconstitutional taking if ACSI's proposal were adopted. The whole point of the USF is that Congress recognized that local telephone service has been subsidized by allowing higher-priced services -- like toll calling, business service, vertical services (voice mail, caller identification, call forwarding etc.) -- to keep rates low for preferred classes of customers. Yet that is precisely what is at issue here. Moreover even if this were somehow an answer (and it is not), it would only be a partial answer because the USF is designed to recover only a limited portion of historical and forward-looking

costs. And, in addition, the USF will not go into effect for quite some time -- which would leave GTE uncompensated until that time and wrongfully leave the burden on GTE to bring a separate action to recover those lost funds.

4. GTE's Costs Of Unbundling And Resale.

As described in more detail elsewhere in GTE's submission, unbundling and resale entail economic costs -- both direct production costs and transaction costs. There is no justification for compelling GTE to bear these costs, and ACSI has offered no rational explanation for doing so. To be sure, ACSI would no doubt prefer GTE to bear these costs, but the Constitution requires that GTE be compensated for these additional costs. These are real costs that will be no less if GTE bears them, as opposed to ACSI.

B. GTE Must Be Allowed A Reasonable Return on Its Historic Costs.

ACSI's proposal forbids the recovery by GTE of any return on its historic, or embedded costs in building the very network with which it now seeks interconnection. Yet, it has long been settled that the Takings Clause requires a fair rate of return for regulated utilities on their investments. See, e.g., Duquesne, 488 U.S. 299. The question for regulators has traditionally been "On which investments is the utility entitled to a fair rate of return?" In his concurrence in Duquesne, Justice Scalia correctly concluded that for purposes of determining whether a taking has occurred, all "prudently incurred investment[s] may well have to be counted." Id. at 317. That is to say, at a minimum, the Commission must include all prudently incurred investments by GTE in constructing the very network that the government would now take from the Company for the use of third parties. Thus, GTE is entitled to recover that portion of its historic costs not yet recovered and to earn a fair rate of return on those investments.

ACSI has presented no evidence demonstrating that GTE's investments in constructing the local exchange network were not prudently incurred or should be excluded. Nor could it, for those very investments were the subject of close regulatory scrutiny by this very Commission. Thus, to the extent that ACSI now seeks access to GTE's network, it should have to either pay for an appropriate share of (and return on) those historic costs or GTE should otherwise be made whole through a rate rebalancing, end user charge, or one-time payment that would account for the monies prudently spent by GTE but now stranded by the transition from regulation to competition.

If the Commission were to afford GTE anything less than a fair rate of return on the very historic costs that the Commission induced GTE to spend to create the local exchange network, it would also run afoul of the principle that a regulator may not switch "back and forth between methodologies in a way which required investors to bear the risk of bad investments at some times while denying them the benefit of good investments at others". Duquesne, 488 U.S. at 315. Indeed, given that the "end result" test in Duquesne has no application where there has been a transition, as here, from regulation to competition, then the Commission's close scrutiny of each element of GTE's expenditures -- including historic, sunk costs -- is compelled by longstanding case law requiring a fair rate of return for a regulated utility.

Thus, the Commission needs to adjust its calculations to either the rate base or to future rate of return to reconcile its obligations to GTE. Alternatively, it may prefer to address this issue in a franchise-impact proceeding. The central issue though remains the same -- GTE must receive fair compensation; the method by which that happens is secondary.

Conclusion

For all of the reasons described above and elsewhere in our response, the Commission must avoid an unconstitutional taking of GTE's property without just compensation by ensuring that GTE will recover its forward-looking costs and any portion of its historic costs not yet recovered and earn a fair rate of return on that investment.

GLOSSARY

The following definitions are taken from Section 153 of the Telecommunications Act of 1996 and the FCC's First Report and Order. Some of the definitions taken from the FCC's First Report and Order apply to only certain FCC rules, and these rules are referenced in the appropriate definitions. GTE does not agree with all of the FCC's definitions, such as the FCC's definition of 'technically feasible', but these definition are provided here for convenience. Moreover, some of the definitions listed here may be inconsistent with State law.

* * *

Act. The Communications Act of 1934, as amended.

Advanced intelligent network. "Advanced Intelligent Network" is a telecommunications network architecture in which call processing, call routing, and network management are provided by means of centralized databases located at points in an incumbent local exchange carrier's network.

Arbitration, final offer. "Final offer arbitration" is a procedure under which each party submits a final offer concerning the issues subject to arbitration, and the arbitrator selects, without modification, one of the final offers by the parties to the arbitration or portions of both such offers. "Entire package final offer arbitration," is a procedure under which the arbitrator must select, without modification, the entire proposal submitted by one of the parties to the arbitration. "Issue-by-issue final offer arbitration," is a procedure under which the arbitrator must select, without modification, on an issue-by-issue basis, one of the proposals submitted by the parties to the arbitration.

Billing. "Billing" involves the provision of appropriate usage data by one telecommunications carrier to another to facilitate customer billing with attendant acknowledgments and status reports. It also involves the exchange of information between telecommunications carriers to process claims and adjustments.

Commission. "Commission" refers to the Federal Communications Commission.

Common carrier. The term "common carrier" or "carrier" means any person engaged as a common carrier for hire, in interstate or foreign communication by wire or radio or in interstate or foreign radio transmission of energy, except where reference is made to common carriers not subject to the Act [47 USC §§ 151 et seq.]; but a person engaged in radio broadcasting shall not, insofar as such person is so engaged, be deemed a common carrier.

Customer premises equipment. The term "customer premises equipment" means equipment employed on the premises of a person (other than a carrier) to originate, route, or terminate telecommunications.

Dialing parity. The term "dialing parity" means that a person that is not an affiliate of a local exchange carrier is able to provide telecommunications services in such a manner that customers have the ability to route automatically, without the use of any access code, their telecommunications to the telecommunications services provider of the customer's designation from among 2 or more telecommunications services providers (including such local exchange carrier).

Directory assistance service. "Directory assistance service" includes, but is not limited to, making available to customers, upon request, information contained in directory listings.

Directory listings. "Directory listings" are any information: (1) identifying the listed names of subscribers of a telecommunications carrier and such subscriber's telephone numbers, addresses, or primary advertising classifications (as such classifications are assigned at the time of the establishment of such service), or any combination of such listed names, numbers, addresses or classifications; and (2) that the telecommunications carrier or an affiliate has published, caused to be published, or accepted for publication in any directory format.

Downstream database. A "downstream database" is a database owned and operated by an individual carrier for the purpose of providing number portability in conjunction with other functions and services.

Equipment necessary for interconnection or access to unbundled network elements. For purposes of section 251(c)(2) of the Act, the equipment used to interconnect with an incumbent local exchange carrier's network for the transmission and routing of telephone exchange service, exchange access

service, or both. For the purposes of section 251(c)(3) of the Act, the equipment used to gain access to an incumbent local exchange carrier's unbundled network elements for the provision of a telecommunications service.

Exchange access. The term "exchange access" means the offering of access to telephone exchange services or facilities for the purpose of the origination or termination of telephone toll services.

Incumbent Local Exchange Carrier (Incumbent LEC). With respect to an area, the local exchange carrier that: (1) on February 8, 1996, provided telephone exchange service in such area; and (2) (i) on February 8, 1996, was deemed to be a member of the exchange carrier association pursuant to 47 C.F.R. § 69.601(b); or (ii) is a person or entity that, on or after February 8, 1996, became a successor or assign of a member described in clause (i) of this paragraph.

Interconnection. "Interconnection" is the linking of two networks for the mutual exchange of traffic. This term does not include the transport and termination of traffic.

Local access and transport area. The term "local access and transport area" or "LATA" means a contiguous geographic area--

(A) established before the date of enactment of the Telecommunications Act of 1996 [enacted Feb. 8, 1996] by a Bell operating company such that no exchange area includes points within more than 1 metropolitan statistical area, consolidated metropolitan statistical area, or State, except as expressly permitted under the AT&T Consent Decree; or

(B) established or modified by a Bell operating company after such date of enactment and approved by the Commission.

Local Exchange Carrier (LEC). A "LEC" is any person that is engaged in the provision of telephone exchange service or exchange access. Such term does not include a person insofar as such person is engaged in the provision of a commercial mobile service under section 332(c) of the Act, except to the extent that the Commission finds that such service should be included in the definition of the such term.

Maintenance and repair. "Maintenance and repair" involves the exchange of information between telecommunications carriers where one initiates a request for maintenance or repair of existing products and services or unbundled network elements or combination thereof from the other with attendant acknowledgments and status reports.

Meet point. A "meet point" is a point of interconnection between two networks, designated by two telecommunications carriers, at which one carrier's responsibility for service begins and the other carrier's responsibility ends.

Meet point interconnection arrangement. A "meet point interconnection arrangement" is an arrangement by which each telecommunications carrier builds and maintains its network to a meet point.

Network element. A "network element" is a facility or equipment used in the provision of a telecommunications service. Such term also includes, but is not limited to, features, functions, and capabilities that are provided by means of such facility or equipment, including but not limited to, subscriber numbers, databases, signaling systems, and information sufficient for billing and collection or used in the transmission, routing, or other provision of a telecommunications service.

Number portability. The term "number portability" means the ability of users of telecommunications services to retain, at the same location, existing telecommunications numbers without impairment of quality, reliability, or convenience when switching from one telecommunications carrier to another.

Operator services. "Operator services" are any automatic or live assistance to a consumer to arrange for billing or completion of a telephone call. Such services include, but are not limited to, busy line verification, emergency interrupt, and operator-assisted directory assistance services.

Physical collocation. "Physical collocation" is an offering by an incumbent LEC that enables a requesting telecommunications carrier to:

(1) place its own equipment to be used for interconnection or access to unbundled network elements within or upon an incumbent LEC's premises;

(2) use such equipment to interconnect with an incumbent LEC's network facilities for the transmission and routing of telephone exchange service, exchange access service, or both, or to gain access to an incumbent LEC's unbundled network elements for the provision of a telecommunications service;

(3) enter those premises, subject to reasonable terms and conditions, to install, maintain, and repair equipment necessary for interconnection or access to unbundled elements; and

(4) obtain reasonable amounts of space in an incumbent LEC's premises, as provided in this part, for the equipment necessary for interconnection or access to unbundled elements, allocated on a first-come, first-served basis.

Pre-ordering and ordering. "Pre-ordering and ordering" includes the exchange of information between telecommunications carriers about current or proposed customer products and services or unbundled network elements or some combination thereof.

Provisioning. "Provisioning" involves the exchange of information between telecommunications carriers where one executes a request for a set of products and services or unbundled network elements or combination thereof from the other with attendant acknowledgments and status reports.

Rural telephone company. A "rural telephone company" is a LEC operating entity to the extent that such entity:

(1) provides common carrier service to any local exchange carrier study area that does not include either:

(i) any incorporated place of 10,000 inhabitants or more, or any part thereof, based on the most recently available population statistics of the Bureau of the Census; or

(ii) any territory, incorporated or unincorporated, included in an urbanized area, as defined by the Bureau of the Census as of August 10, 1993:

(2) provides telephone exchange service, including exchange access, to fewer than 50,000 access lines;

(3) provides telephone exchange service to any local exchange carrier study area with fewer than 100,000 access lines; or

(4) has less than 15 percent of its access lines in communities of more than 50,000 on February 8, 1996.

Service control point. A "service control point" is a computer database in the public switched network which contains information and call processing instructions needed to process and complete a telephone call.

Service creation environment. A "service creation environment" is a computer containing generic call processing software that can be programmed to create new advanced intelligent network call processing services.

Signal transfer point. A "signal transfer point" is a packet switch that acts as a routing hub for a signaling network and transfers messages between various points in and among signaling networks.

State commission. A "state commission" means the commission, board, or official (by whatever name designated) which under the laws of any State has regulatory jurisdiction with respect to intrastate operations of carriers. As referenced in this part, this term may include the Commission if it assumes the responsibility of the state commission, pursuant to section 252(e)(5) of the Act. This term shall also include any person or persons to whom the state commission has delegated its authority under section 251 and 252 of the Act.

State proceeding. A "state proceeding" is any administrative proceeding in which a state commission may approve or prescribe rates, terms, and conditions including, but not limited to, compulsory arbitration pursuant to section 252(b) of the Act, review of a Bell operating company statement of generally available terms pursuant section 252(f) of the Act, and a proceeding to determine whether to approve or reject an agreement adopted by arbitration pursuant to section 252(e) of the Act.

Technically feasible. Interconnection, access to unbundled network elements, collocation, and other methods of achieving interconnection or access to unbundled network elements at a point in the network shall be deemed technically feasible absent technical or operational concerns that prevent the fulfillment of a request by a telecommunications carrier for such interconnection, access, or methods. A determination of technical feasibility does not include consideration of economic, accounting, billing, space, or site concerns, except that space and site concerns may be considered in circumstances where there is no possibility of expanding the space available. The fact that an incumbent LEC must modify its facilities or equipment to

respond to such request does not determine whether satisfying such request is technically feasible. An incumbent LEC that claims that it cannot satisfy such request because of adverse network reliability impacts must prove to the state commission by clear and convincing evidence that such interconnection, access, or methods would result in specific and significant adverse network reliability impacts.

Telecommunications. The term "telecommunications" means the transmission, between or among points specified by the user, of information of the user's choosing, without change in the form or content of the information as sent and received.

Telecommunications carrier. A "telecommunications carrier" is any provider of telecommunications services, except that such term does not include aggregators of telecommunications services (as defined in section 226 of the Act). A telecommunications carrier shall be treated as a common carrier under the Act only to the extent that it is engaged in providing telecommunications services, except that the Commission shall determine whether the provision of fixed and mobile satellite service shall be treated as common carriage. This definition includes CMRS providers, interexchange carriers (IXCs) and, to the extent they are acting as telecommunications carriers, companies that provide both telecommunications and information services. Private Mobile Radio Service providers are telecommunications carriers to the extent they provide domestic or international telecommunications for a fee directly to the public.

Telecommunications equipment. The term "telecommunications equipment" means equipment, other than customer premises equipment, used by a carrier to provide telecommunications services, and includes software integral to such equipment (including upgrades).

Telecommunications service. The term "telecommunications service" means the offering of telecommunications for a fee directly to the public, or to such classes of users as to be effectively available directly to the public, regardless of the facilities used.

Telephone exchange service. The term "telephone exchange service" means (A) service within a telephone exchange, or within a connected system of telephone exchanges within the same exchange area operated to furnish to subscribers intercommunicating service of the character ordinarily furnished

by a single exchange, and which is covered by the exchange service charge, or (B) comparable service provided through a system of switches, transmission equipment, or other facilities (or combination thereof) by which a subscriber can originate and terminate a telecommunications service.

Telephone toll service. The term "telephone toll service" means telephone service between stations in different exchange areas for which there is made a separate charge not included in contracts with subscribers for exchange service.

Virtual collocation. "Virtual collocation" is an offering by an incumbent LEC that enables a requesting telecommunications carrier to:

(1) designate or specify equipment to be used for interconnection or access to unbundled network elements to be located within or upon an incumbent LEC's premises, and dedicated to such telecommunications carrier's use;

(2) use such equipment to interconnect with an incumbent LEC's network facilities for the transmission and routing of telephone exchange service, exchange access service, or both, or for access to an incumbent LEC's unbundled network elements for the provision of a telecommunications service; and

(3) electronically monitor and control its communications channels terminating in such equipment.