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*1996 Ill. PUC LEXIS 699, *; 173 P.U.R.4th 486*

AT&T Communications of Illinois, Inc: Petition for Arbitration of Interconnection Terms, Conditions and Prices from GTE North Incorporated [and GTE South Incorporated, in their respective services areas]

96-AB-005

ILLINOIS COMMERCE COMMISSION

1996 Ill. PUC LEXIS 699; 173 P.U.R.4th 486

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CORE TERMS: network, unbundled, customer, carrier, interconnection, wholesale, technically, telecommunication, switch, feasible, incumbent, space, resale, retail, discount, collocation, tariff, Fcc Rule, loop, routing, transport, interim, pricing, recommend, database, provider, directory, unbundling, volume, conduit

OPINION:
[*1]

ARBITRATION DECISION

I. INTRODUCTION

On August 16, 1996, AT&T Communications of Illinois, Inc. ("AT&T") filed a petition ("AT&T Arbitration Petition") with the Illinois Commerce Commission ("Commission") requesting that the Commission arbitrate certain terms, conditions and prices for interconnection and related arrangements from GTE North Incorporated and GTE South Incorporated (collectively "GTE"), in their respective service areas, pursuant to Section 252(b) of the Communications Act of 1934, as amended by the Telecommunications Act of 1996 ("Telecommunications Act" or "Act"). The AT&T Arbitration Petition pointed out that at the time of filing, AT&T and GTE had not agreed in writing upon any issues during their negotiations. Thus, because all issues were unresolved and would need to be decided by the Commission, AT&T submitted as Exhibit A to the AT&T Arbitration Petition a complete proposed Interconnection Agreement (the "AT&T Interconnection Agreement") and requested that the Commission adopt it as the interconnection agreement between the parties. On October 29, 1996, AT&T filed revisions to its proposed Interconnection Agreement. References in this decision are to **[*2]** the revised Interconnection Agreement.

GTE subsequently filed a Motion to Dismiss, or, in the Alternative, to Suspend the Petition, contending that GTE is a "rural telephone company" as defined in Section 153(37) of the Act, and thus is automatically covered by the "rural exemption" of Section 251(f)(1). The Hearing Examiners issued a ruling denying GTE's Motion in its entirety.

On September 10, 1996 GTE filed its Response to the AT&T Arbitration Petition, pursuant to Section 252(b)(3) of the Act ("GTE Response"). In its Response, GTE included matrices identifying various issues and summary statements of the parties' positions regarding those issues. GTE also represented that no written agreement on any of the issues had been reached by the parties, and attached to its Response a proposed interconnection agreement (the "GTE Interconnection Agreement").

On October 1, 1996, the Hearing Examiners granted AT&T's Motion to Sever, and on October 7, 1996, the Commission established a separate docket, No. 96-0503, initiating an investigation of GTE's cost studies and the proper allocation of forward-looking common costs. Therefore, for this arbitration, we determine interim prices for the **[*3]** services offered in the Interconnection Agreement.

On November 8, 1996, a Hearing Examiners' Proposed Arbitration Decision was duly served on the parties. Each of the parties filed exceptions and said exceptions are considered herein.

II. JURISDICTION

This cause was initiated by the petition of AT&T for arbitration of certain terms, conditions and prices for interconnection and related arrangements from GTE, pursuant to Section 252 (b) of the Communications Act of 1934, as amended by the Telecommunications Act. Section 252(b) specifically empowers this Commission to arbitrate any "open issues" between a requesting telecommunications carrier and an incumbent local exchange carrier ("incumbent LEC" or "ILEC") and sets forth certain procedural requisites for such arbitration by a state commission. Section 252(c) provides the following arbitration standards to be applied by the Commission:

> In resolving by arbitration under subsection (b) any open issues and imposing conditions upon the parties to the agreement, a State commission shall --
>
> (1) ensure that such resolution and conditions meet the requirements of section 251, including the regulations prescribed by the [Federal **[*4]** Communications] Commission pursuant to section 251;
>
> (2) establish any rates for interconnection, services, or network elements according to subsection (d); and
>
> (3) provide a schedule for implementation of the terms and conditions by the parties to the agreement.

(Act, § 252(c)).

III. PARTIAL STAY OF FCC ORDER

As a preliminary matter, we address the stay of portions of the FCC Order. On October 15, 1996 the Eighth Circuit issued a temporary stay of certain portions of the Rules appended to the FCC Order pending full briefing and argument on the merits. Iowa Utilities Board v. Federal Communications Commission, No. 96-3321 (8th Cir. Oct. 15, 1996) (available on Westlaw at 1996 WL 589204). We do not believe that the stay issued by the Eighth Circuit should stop, delay or affect the parties' or this Commission's obligations under the Act.

As an initial matter, the Eighth Circuit stay applies only to certain limited portions of the Rules appended to the FCC order. See Iowa Utilities Board, 1996 WL at <*>8 n.8 ("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 . **[*5]** . . established in the FCC's Order on Reconsideration, dated September 27, 1996.").

The balance of the FCC Order was not addressed in the Eighth Circuit's ruling and is not subject to the stay. This includes the portions of the FCC Order and Rules dealing with interconnection, unbundled network elements, services available for resale, collocation,

operations support systems, parity and service standards, and numerous other issues to be decided in this arbitration. Consequently, the Commission finds the FCC Order to be authoritative as to those portions which were not stayed by the Eighth Circuit.

The foregoing conclusion bears strongly upon the issues herein. There are many open issues where GTE's position is in direct conflict with the FCC Order and Rules. With respect to such issues GTE, both explicitly and implicitly, urges the Commission to reject the FCC's conclusions found in the First Order. The Commission is of the opinion, however, that this is the wrong forum for GTE to be making such an argument.

Section 252(c) of the Act establishes the standards that this Commission must follow when resolving open arbitration issues. In particular, Section 252(c)(1) requires this Commission's **[*6]** decisions to adhere to "the regulations prescribed by the [FCC] pursuant to section 251." The FCC Order and Rules establish numerous requirements that are not subject to the Eighth Circuit's stay Order. As such, we are compelled to follow those portions of the FCC Order and Rules which remain in full force and effect.

IV. OPEN ISSUES SUBJECT TO ARBITRATION

As discussed above, pursuant to Section 252(b)(1) the Commission is authorized to address and resolve all open issues. Prior to evidentiary hearings, there remained outstanding 69 separate issues, excluding sub-parts, as well as a basic disagreement regarding the overall form and content of the ultimate Interconnection Agreement. Subsequently, the parties have resolved only a few issues.

The parties submitted a matrix which identified and grouped the issues. The briefs which were submitted present, in the same order as the matrix, each parties' respective position. The following discussion of issues mirrors that sequence and presents a brief summation of the positions of AT&T, GTE and Staff.

ISSUE 1: WHAT IS THE PROPER METHODOLOGY FOR DETERMINING THE PRICES FOR GTE RESOLD SERVICES?

AT&T asserts that resale prices **[*7]** should be based on avoided retail costs as defined in the FCC Order. FCC Rule § 51.609 defines avoided retail costs as those costs that reasonably can be avoided. (Act § 252(d)(3); FCC Order P 911). AT&T argues that wholesale rates are to be determined on the basis of retail rates less the portion thereof attributable to billing, collection, and other retail costs that will be avoided by the LEC. (Act § 252(d)(3)). Avoided retail costs are those that reasonably can be avoided when an incumbent LEC provides a telecommunications service at wholesale rates to a requesting carrier. (FCC Rule § 51.609 (b)). AT&T recognizes that § 51.609(b) has been stayed by the Eighth Circuit decision, but argues that the rationale of the FCC is persuasive, and the reasoning is consistent with that adopted previously by this Commission.

AT&T also points to the fact that this Commission has directed that permanent prices, including wholesale prices, be severed to a separate docket, Docket 96-0503 (October 7, 1996 Order). In this arbitration, the Commission will set only interim prices, which will remain in effect until permanent prices are set pursuant to the order of the Commission in the separate docket. **[*8]**

AT&T has proposed a 25% average baseline wholesale discount applicable to all telecommunications services that AT&T will purchase from GTE. (Merrick Direct, p. 9; AT&T Interconnection Agreement, Appendix 1 to Attachment 14). Within the Basic Local Service (Residence and Business) category, the baseline discounts for the subcategories range from 20% to 55%, but the weighted average for the category, based on GTE's revenues, is 25%. (Merrick Direct, pp. 9-10; Merrick Ex. PHM-1). The wholesale discount advocated by AT&T is based upon consideration of a number of things, including the results of the AT&T simplified

avoided cost model, the discount range set forth in the FCC Order, and the weighted average 22.05% discount ordered for Ameritech by the Illinois Commerce Commission in the Illinois resale docket. (Merrick, Tr. 157-58, 175-78). In the event that the Commission does not accept AT&T's recommendation, it argues for the adoption of the wholesale pricing proposal of Staff witness Jennings.

GTE maintains that the proper methodology is the one reflected in GTE's Avoided Cost Study, which calculates avoided costs based on GTE's actual operations and workcenters. This type of study **[*9]** is much more precise and reflects a greater level of detail than studies that rely exclusively or primarily on the account groupings established by the Uniform System of Accounts.

GTE submitted two avoided cost studies in the arbitration, but is relying here on its preferred and most thorough study, which better comports with the Act's requirements. This study calculates specific discounts for GTE's five categories of services: (1) usage services, 7.1%; (2) vertical services, 5.5%; (3) residence, 6.6% (4) combined, 6.2%; and (5) advanced services, 15.3%, and results in a composite discount of approximately 7%.

GTE contends that the proper methodology for the arbitrator to rely upon is the one it advocates, where GTE's wholesale prices equal GTE's retail prices minus GTE's net avoided costs. Net avoided costs equal avoided retail costs, offset by the additional costs of providing wholesale service.

GTE's Avoided Cost Study is based on an analysis of GTE's work centers and reflects GTE's current operations. (See GTE Exs. 9.01 (Tab 20)). In this study, GTE analyzed all of its work centers (for example, GTE's customer care center) to determine which activities or functions in each work **[*10]** center would be avoided in a wholesale environment. The costs associated with these "avoided" activities were determined using GTE's actual 1995 cost data. The results of this work center analysis were then used to calculate an avoided cost discount for each of GTE's five service categories: residential services, business services, usage, vertical services, and advanced services. The avoided cost discount for each of these services was calculated on a national basis, because most of the costs that will be avoided are incurred primarily on a national (or regional) basis. (See GTE Ex. 7.00).

GTE's Modified Study, which GTE proposes as an alternative to its avoided cost study in the unlikely event the Eighth Circuit's stay is lifted, is a modification of the MCI avoided cost study that the FCC relied upon, in part, to calculate its default avoided cost discount range. In accordance with Paragraph 909 of the First Report and Order, GTE modified certain inputs to the ARMIS-based model to properly identify its avoided costs. The three basic modifications made by GTE--direct expense factors, revenue base calculation, and plant related return and taxes were included as avoided costs--are **[*11]** discussed in GTE Exhibit 7.00. The latter two modifications actually result in an increase to GTE's avoided cost discount. (Id.)

Staff recommends the same methodology as adopted in the Commission's Order in Docket 95-0458 et al., Consol. That methodology provides that the wholesale price for each service has the same percentage mark-up above the Long Run Service Incremental Costs ("LRSIC") as does the corresponding retail service. In order to accomplish that result, a pro rata amount of contribution must be "attributed" to the direct avoided costs. The equation for calculating the maximum wholesale price for each service is stated as follows:

P(w) = P(r) - [TAC(r) - TAC(w)] - [P(r) - TAC(r)] <*> [1 - TAC(w)/TAC(r)]

P(w) - wholesale price

P(r) - retail price

TAC(w) - is the wholesale LRSIC plus the wholesale administrative costs associated with that service.

TAC(r) - is the retail LRSIC plus the retail administrative costs associated with that service.

Staff asserts that this method is consistent with Section 252(d)(3) of the Act since the wholesale price is calculated "on the basis of" retail rate excluding costs that can be "attributed" to retailing costs that are avoidable. **[*12]** In addition, this method is efficient and equitable, will allow GTE to recover its forward-looking economic costs, plus a pro rata amount of common costs. (Tr. 902-904) (Staff Ex. 1.00 at 9-16).

Commission Conclusion

The Commission concludes that Staff's methodology for calculating the appropriate wholesale rate should be adopted. Staff's methodology utilizes GTE's retail rates as a starting point. Hence, GTE's costs associated with the provisioning of such retail service will be reflected when arriving at the wholesale rate.

Regarding the controversy regarding whether the use of "avoided" or "avoidable" costs is appropriate, the Commission finds that we have previously addressed this issue in our Wholesale/Resale Order in Docket 95-0458, et al. Our interpretation of the Act is settled, and we believe that calculating the wholesale rate based upon the removal of "avoidable" costs comports with the law. Therefore, with respect to Issues 1a - 1i which follow, the Commission believes that our conclusion herein effectively resolves those issues. For purposes of clarity in this decision, we will list those issues in order to identify those matters at issue between GTE and AT&T.
[*13]
ISSUE 1A: ARE ADVERTISING EXPENSES IN THEIR ENTIRETY AN AVOIDED COST?

ISSUE 1B: ARE CALL COMPLETION COSTS (OPERATOR SERVICES) IN THEIR ENTIRETY AN AVOIDED COST?

ISSUE 1C: ARE NUMBER SERVICE COSTS (DIRECTORY ASSISTANCE) IN THEIR ENTIRETY AN AVOIDED COST?

ISSUE 1D: ARE GENERAL & ADMINISTRATIVE COSTS AN AVOIDED COST?

ISSUE 1E: ARE PRODUCT MANAGEMENT COSTS IN THEIR ENTIRETY AN AVOIDED COST?

ISSUE 1F: ARE TESTING AND PLANT ADMINISTRATION COSTS AN AVOIDED COST?

ISSUE 1G: WHAT PERCENTAGE OF SALES EXPENSES IS AN AVOIDED COST?

ISSUE 1H: WHAT PERCENTAGE OF UNCOLLECTIBLE EXPENSES IS AN AVOIDED COST?

ISSUE 1I: DOES THE ACT'S METHODOLOGY FOR DETERMINING WHOLESALE RATES RECOGNIZE ANY NEW COSTS THAT MIGHT BE CAUSED BY THE REQUIREMENT TO OFFER SERVICES FOR RESALE?

ISSUE 1J: IS A VOLUME DISCOUNT APPROPRIATE IN A RESALE ENVIRONMENT, AND IF SO, WHAT SHOULD THE DISCOUNT BE?

AT&T states that commercial contracts which involve volume or term commitments should reflect correspondingly reduced prices. AT&T recognizes that a cost basis is required for any volume/term discount. (FCC Order P 860). AT&T further **[*14]** notes that GTE has praised

volume discounts, stating that volume discounts stimulate usage to efficient levels by allowing customers to pay rates, at the margin, which more closely reflect incremental cost, and that volume discounts assist customers in making efficient economic choices among different service options. (Merrick Direct, p. 10). Such discounts are also appropriate in light of the decline in costs and risk GTE will experience in a wholesale environment. (Merrick Direct, p. 11). AT&T alleges that the FCC has recognized that volume and term discounts are permissible under the Act based upon legitimate variations in costs. (FCC Order P 860). AT&T has proposed a minimum volume discount of 0.5% based on 2,800 lines and has requested a maximum discount of 10% based upon a volume of 44,800 lines. (Merrick Direct, p. 10). Additional discounts are set for term commitments.

GTE contends that the Act's provisions governing resale are quite clear; they do not provide for any volume discount. Rather, Section 252(d)(3) provides that wholesale rates are to be based on an incumbent LEC's retail rate minus the LEC's avoided cost--there is no mention of a "volume discount." Also, there **[*15]** is no evidence that GTE will avoid any additional costs simply because of AT&T's "volume" requirements (assuming, of course, these volume requirements are not entirely speculative), and therefore any arbitrary reduction in costs would be contrary to the express language of the Act. Accordingly, the Commission should adopt GTE's recommended wholesale prices as set forth in the appropriate attachment to Mr. Dye's testimony.

Commission Conclusion

The Commission concludes that volume discounts are appropriate in the resale market. Neither Section 252(d)(3) nor Section 251(c)(4) prohibit the inclusion of volume discounts for resale. Such a conclusion is also supported in the FCC Order. See, FCC Order P 951 and 953.

The Commission notes, however, that in the event costs associated with volume discounts differ from costs for wholesale rates that are not volume-sensitive, GTE may be allowed to demonstrate this difference and alter its volume sensitive rates accordingly. The Commission also notes that the extent to which GTE's retailing cost may be avoided in a wholesale environment will be addressed in Docket 96-0503.

Neither the 1996 Act nor the FCC Order requires an ILEC to provide **[*16]** a volume discount to a CLEC when the CLEC purchases the services at a wholesale rate. The Commission therefore, will not require GTE to provide a volume discount to AT&T in excess of the existing wholesale rate. The Commission notes that GTE must provide volume discounts at a wholesale rate where it provides volume discounts to its retail customers. See Issue 16.

ISSUE 2: SHOULD THE COMMISSION ADOPT THE FCC'S "DEFAULT PROXY" DISCOUNT RATES?

AT&T contends that due to the lack of reliable state-specific cost data for establishing rates, its proposed baseline discount of 25%, is within the FCC default range. (FCC Order P 932; FCC Rule § 51.611 (resale discount)). AT&T believes, however, that the Commission need not resolve this issue because it has established that its recommendation of a 25% wholesale discount is proper. Although the FCC default range of 17% - 25% has been stayed, AT&T asserts that its avoided cost information approximates the amount of retail costs GTE could avoid in a wholesale environment. (See Merrick Direct, pp. 3, 9).

GTE points out that these rates have been stayed by the Eighth Circuit, and that court's ruling is binding upon this Commission. Until **[*17]** further Order of the court, the FCC's proxy rates and pricing rules should be treated as if they never existed. Indeed, to treat them in any other manner would run directly contrary to the policy underlying stays of administrative actions, as expressed over fifty years ago by the Supreme Court in Scripps-Howard Radio, Inc. v. FCC, 316 U.S. 4, 9, 62 S.Ct. 875, 86 L.Ed. 1229 (1942)

Staff recommends that the Commission adopt its proposed pricing methodology and interim discounts for GTE's wholesale services.

Commission Conclusion

In light of our decision to utilize Staff's wholesale pricing methodology in Issue 1, there is no need to utilize the FCC proxy. However, the Commission recognizes that GTE will not be able to implement Staff's pricing methodology until Docket 96-0503 is completed. Therefore, we adopted Staff's recommendation that GTE's wholesale discount rates be set equal to the discounts of Ameritech Illinois in Docket 95-0458 et al., Consol. In situations where GTE offers a service that does not correspond to that offered by Ameritech Illinois, then GTE should apply the average Ameritech Illinois wholesale discount which is currently equal to 17.5 percent.

[*18]

ISSUE 3: HOW SHOULD THE COST OF INTERCONNECTION AND UNBUNDLED NETWORK ELEMENTS BE CALCULATED, AND WHAT PRICES SHOULD BE ESTABLISHED?

AT&T posits that GTE is required to set the prices for unbundled network elements and network element combinations at TELRIC. (FCC Rule § 51.505). GTE, however, has not provided necessary cost information from which to calculate TELRIC costs. In order to calculate prices for unbundled network elements, AT&T used Ameritech cost studies for the State of Illinois. (Act § 252(b)(4)(B); §§ 252(d)(1) and (2)). AT&T asserts that the Act requires an incumbent LEC to provide interconnection with its network at "rates, terms, and conditions that are just, reasonable, and nondiscriminatory, in accordance with the terms and conditions of the agreement and the requirements of this section and section 252." (Act § 251(c)(2)). Further, the Act requires an incumbent LEC "to provide, to any requesting telecommunications carrier for the provision of a telecommunications service, nondiscriminatory access to network elements on an unbundled basis at any technically feasible point on rates, terms, and conditions that are just, reasonable, and nondiscriminatory in **[*19]** accordance with the terms and conditions of the agreement and the requirements of this section and section 252." (Act § 252(c)(3)). AT&T further states that the Act requires this Commission to determine the price for interconnection and unbundled network elements on the basis of the cost of providing the interconnection or the network element. AT&T also notes that rates are to be nondiscriminatory and may include a reasonable profit. (Act § 251(d)(1); see also FCC Rules §§ 51.501-51.515; FCC Order PP 625-877).

AT&T proposed that GTE's prices for interconnection and unbundled elements be set at forward-looking, long-run incremental cost, or TSLRIC. (Merrick Direct, p. 12). TSLRIC supports prices at economically efficient levels because it is the forward-looking, long-run incremental cost of providing an entire service at the least cost technologies that are consistent with principles of cost causation. (Kaserman Direct, pp. 18-19). AT&T states that the FCC has proposed a virtually identical cost methodology, TELRIC. (Kaserman Direct, p. 18). While these rules with regard to TELRIC have been stayed, AT&T contends that the Commission need not now determine whether TELRIC is an appropriate **[*20]** methodology, as that will be examined in Docket 96-0503. For the purpose of resolving this issue, AT&T concludes that the Commission need only set interim prices that are consistent with the Act's requirement that prices be based on costs that are nondiscriminatory, and that may include a reasonable profit. (Act, § 252(d)(1)).

GTE proposes that the costs for interconnection and unbundled network elements should be calculated based on GTE's cost studies. The prices that are established should be those submitted by GTE, because they are the only prices that are based on GTE state-specific costs, as required by the Act.

GTE used engineering process modules to calculate the incremental costs of local, toll,

switched access, unbundled loops, unbundled ports and other network features. (See GTE Exhibit 9.00.) The models are populated with company-specific inputs including actual office or system size, technology, traffic data and mileage information. The modeling process calculates both the volumesensitive and volume-insensitive costs necessary to develop a TELRIC. The model's results are conservative because GTE did not add any calculations to reflect the increased risks in the local **[*21]** exchange marketplace.

Because the TELRIC methodology does not include any common costs, GTE added a reasonable contribution of common costs based on GTE's actual data. GTE's forward-looking common costs for its network in Illinois are approximately 43% of GTE's total revenues. (See GTE Exhibit 9.00, Attachment 2.) This percentage is to be expected, because it reflects GTE's significant economies of scale--economies that can be taken advantage of by all requesting carriers through interconnection with GTE's network and through the purchase of unbundled elements.

In developing prices, GTE assigned a reasonable share of its common costs pursuant to the Market-Determined Efficient Component Pricing Rule (M-ECPR). As discussed in the testimony of GTE witness Spulber, the M-ECPR does not afford GTE the opportunity to recover all of its actual costs. Professor Spulber explained that M-ECPR pricing of unbundled network elements will permit certain stranded costs to arise, resulting in economic losses--for example, losses incurred in the provision of services to preferred classes of customers at regulated prices that are below GTE's actual costs--unless an end-user charge is established. **[*22]**

GTE maintains that the establishment of an end-user charge is compelled by the Eighth Circuit's Stay Order. Indeed, one of the reasons GTE and other incumbent LECs sought a stay was because the forward-looking TELRIC methodology "does not consider historical or 'embedded' costs (i.e., costs that an incumbent incurred in the past)." (Stay Order at 11). GTE further asserts that there is no doubt that GTE's cost studies are forward-looking TELRIC studies, and therefore an end-user charge must be established in this proceeding so that GTE may, as Professor Spulber explained, "recover the cost of its past investment." (GTE Exhibit 8.00, Direct Testimony of Daniel F. Spulber at 13). This approach is consistent with 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.

Staff proposes that the prices for interconnection and unbundled network elements should be based on GTE's forward-looking **[*23]** costs. (Staff Ex. 1.00 at 26). However, Staff maintains that GTE has not provided sufficient information in a timely manner. Therefore, Staff has not had an opportunity to determine if GTE's proposed forward-looking costs studies are reasonable. The only other forward-looking pricing option in the record is AT&T's proposal to use Ameritech's prices for interconnection and unbundled network elements. Staff believes that the only available forward-looking cost information in the record that can be used are the rates of Ameritech resulting from arbitration 96 AB-003/004.

Staff recommends, consistent with the requirement in Section 252(b)(4)(B), that the Commission find that the best information available is Ameritech's prices for interconnection and unbundled network elements. Since AT&T has no plans on interconnecting with GTE in the next year nor has the Company developed a facilities build out plan for GTE in Illinois, adopting Ameritech's rates will not harm GTE. (Staff Ex. 1.00 at 6).

Commission Conclusion

The Commission is placed in very difficult position in trying to evaluate the merits of this issue. On one hand, GTE has proffered cost studies to support its proposed pricing **[*24]** of unbundled network elements. Conversely, neither Staff nor AT&T have had sufficient opportunity to evaluate, with the necessary precision, whether said cost studies are

reasonable.

While the Staff's proposal to utilize Ameritech's costs as a proxy has a certain appeal, the Commission does not believe that its use is appropriate. Section 252 (b)(4) provides that a state commission "proceed on the basis of the best information available," but only when a responding party "refuses or fails unreasonably to respond on a timely basis to any reasonable request." In this instance we cannot conclude that GTE has either refused to respond or that the timing of its response was unreasonable. Moreover, the Commission is concerned that these proxy prices must have some relationship to GTE's costs; especially where the costs are likely to be unique due to the ILEC's operating characteristics. Otherwise, there may be a question as to whether the ultimate pricing was just and reasonable. Consequently, we cannot accept the use of Ameritech's costs in this instance.

Absent the use of Ameritech's costs, the Commission is left only with the cost studies offered by GTE. Clearly, we cannot make any determination **[*25]** as to whether such studies are reasonable: that decision is left to Docket 96-0503. In the interim, however, we believe the use of GTE's cost studies to establish the rates for unbundled network elements should be utilized, with two significant modifications.

First, the Commission rejects the method utilized by GTE to calculate its common costs. As noted by Staff, equating common costs as contribution is a "make whole" proposal. Therefore, GTE is directed to set its rates for interconnection and unbundled network elements equal to its forward-looking costs studies, excluding any contribution toward non-forward-looking costs.

Second, while the Commission cannot comment regarding the intricacies of the cost studies, we do find that GTE's use of an end user charge ("EUC") as part of its pricing component is not supported by this record. As discussed in this record, GTE urges the adoption of an EUC in order to fully recover its costs. However, the EUC appears to be a mechanism that will insulate GTE from the impacts of competition. As such, we will not accept the inclusion of an EUC adder to the costs calculated in GTE's studies. Therefore, the EUC should be eliminated from the calculation **[*26]** of the prices for unbundled network elements.

We reiterate that the application of these prices, reflecting the above modification, is interim in nature. The pricing of such unbundled elements will be finalized in Docket 96-0503 and those prices will be incorporated as the ultimate prices to be used in this Interconnection Agreement. Our decision herein should, in no way, be interpreted or represented as an acceptance of GTE's cost studies at this time.

As Staff noted, there is little likelihood that these interim unbundled network element prices will be utilized. The record demonstrates that AT&T has no plans on interconnecting with GTE in the next year nor has it developed a facilities build out plan for GTE in Illinois. Consequently, these interim rates should have not deleterious impact on AT&T.

ISSUE 4: WHAT RATES ARE APPROPRIATE FOR TRANSPORT AND TERMINATION OF LOCAL TRAFFIC?

AT&T argues that FCC Rule § 51.705 authorizes the state commission to set GTE's rates for the transport and termination of local traffic at TELRIC, by default proxy, or by bill and keep. (Act § 252(b)(4)(B), 252(d)(1) and (2)). Incumbent LECs are obligated "to establish reciprocal compensation **[*27]** arrangements for the transport and termination of telecommunications." (Act § 251(b)(5)).

The starting point for AT&T's development of such prices was the price for usage contained in Ameritech Michigan's tariff filing for unbundled network elements, dated July 5, 1996, in response to the Michigan Public Service Commission's Opinion and Order in Case No. U-0860. (Merrick Direct, p. 29). That tariff contained local usage prices of 0.65 cents per initial minute

or fraction and 0.22 cents per additional minute or fraction. (Id.). The price for an initial minute contained costs related to call set-up that are not incurred in terminating a call. (Id., p. 30). Thus, the additional minute cost is a good proxy for estimating the cost of terminating a local call. (Id.).

The price per additional minute represents a blend of end office and tandem routed calls. (Id.). Cost ratios among end office routed, tandem office routed, and transit-switched calls were developed from cost information provided informally to AT&T by Ameritech during negotiations. (Id.). Such ratios were used in conjunction with the tariff price for processing a local call and an adjustment for Illinois-specific **[*28]** cost levels to develop unique prices for end office routed, tandem office routed, and transit-switched calls. (Id.). However, because the Ameritech end office rate fell below the FCC proxy range, AT&T increased its proposed end office rate to .0020 cents. (Id.). AT&T's proposed tandem office routed rate of .0027 cents was set by adding additional tandem switching and transport costs to the end office rate. (Id.). The recommended terminating traffic prices were compared with publicly available information to ensure the prices were reasonable. (Id.). Finally, charges for Busy Line Verification and Busy Line Verification Interrupt (in addition to the Busy Line Verification charge) were developed by adjusting costs provided informally to AT&T by Ameritech. (Id. at 31).

GTE states that the appropriate rates to be charged are those set forth in GTE's interstate access tariff The appropriate rates that AT&T should charge to GTE cannot be determined at this time, because AT&T has not submitted any cost study. Symmetrical pricing is not warranted because, as explained in the testimony of GTE witness Munsell (GTE Ex. 4.00 at 20), AT&T's prices likely will be lower than GTE's. **[*29]** Accordingly, AT&T should be directed to submit its own cost study so that this Commission can establish the prices GTE must pay for transport and termination.

It is Staff's understanding that GTE has proposed a "bill and keep" solution until Docket 96-0503 is completed. (Tr. 492). Staff supports "bill and keep" until such time as rates are established in Docket 96-0503.

Commission Conclusion

The Commission concludes that as an interim measure, the "bill and keep" method should be used. One cautionary note, this solution should only be applied to AT&T's local calls. This restriction reflects the fact that AT&T's interexchange calls are otherwise regulated by federal access rules.

ISSUE 5: SHOULD BILL-AND-KEEP BE USED AS A RECIPROCAL COMPENSATION ARRANGEMENT FOR TRANSPORT AND TERMINATION OF LOCAL TRAFFIC ON A TEMPORARY OR PERMANENT BASIS?

AT&T states that bill-and-keep should be used for 12 months as an initial method of setting interconnection charges, until the necessary cost information is available to calculate TELRIC costs. (FCC Order PP 1055, 1111-13; FCC Rule § 51.713; Act § 252(d)(2)(B)(i) and (ii)). It is AT&T's position that state commissions may impose bill-and-keep **[*30]** arrangements if neither carrier has rebutted the presumption of symmetrical rates and if the volume of terminating traffic that originates on one network and terminates on another network is roughly equal to the volume of terminating traffic flowing in the opposite direction, and is expected to remain so. (FCC Order PP 1111-12). Traffic between carriers is presumed to be balanced, with the burden of proving an imbalance imposed on the carrier asserting imbalance. (FCC Order P 1113). AT&T asserts that GTE has failed to rebutted this presumption.

GTE has agreed to enter into a "bill and keep" compensation arrangement with the following parameters: First, traffic must be "roughly balanced," i.e., plus or minus ten percentage

points for both originating and terminating traffic, which means that the originating/terminating split could be up to 60/40. Second, this "bill and keep" arrangement would apply only to the transport and termination of 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 local and local toll traffic. Third, when traffic becomes **[*31]** out of balance (i.e., exceeds the 10% split discussed above), then the "bill and keep" arrangement will end and the parties shall use a reciprocal compensation system, under which the parties shall pay each other their respective rates for transport and termination. (See Testimony of GTE Witness Munsell, GTE Ex. 4.00 at 22-23).

It is Staff's understanding that GTE has proposed a "bill and keep" solution until Docket 96-0503 is completed. (Tr. 492). Staff supports "bill and keep" until such time as rates are established in Docket 96-0503.

Commission Conclusion

The Commission concludes that, as an interim measure, the bill and keep solution is appropriate pending the resolution of Docket 96-0503. By this conclusion, we are not accepting GTE's proposed modifications to the bill and keep issue. We believe that GTE has not demonstrated that there will be an imbalance of traffic which will negatively impact GTE.

ISSUE 6: WHAT METHOD SHOULD BE USED TO PRICE INTERIM NUMBER PORTABILITY AND WHAT SPECIFIC RATES, IF ANY, SHOULD BE SET FOR GTE?

AT&T argues that interim number portability ("INP") should be priced according to FCC pricing principles to ensure that costs are allocated **[*32]** on a competitively neutral basis. (FCC Order In the Matter of Telephone Number Portability, Docket 95-116, adopted June 27, 1996; Act § 251(e)(2)). Costs of number portability are to be borne by all telecommunication providers on a competitively neutral basis. (Act § 251(e)(2)). AT&T states that the FCC Order adopted June 27, 1996 in CC Docket 95-116, In the Matter of Telephone Number Portability, defined the costs of INP as the incremental costs incurred by a LEC to transfer numbers and subsequently forward calls to new service providers using existing RCF, DID or other comparable measures. (FCC Order PP 134-36). The INP Order describes several approaches to recover these incremental costs on a competitively neutral basis. AT&T asserts that a reasonable approach is to require each carrier to pay for its own costs. Considering the limited time in which interim portability will be used, AT&T recommends that the Commission use this approach.

GTE maintains that Section 251(e)(2) of the Act requires that the cost of number portability be borne by all telecommunications providers on a competitively neutral basis. The FCC's Number Portability Order adopted June 27, 1996 in CC Docket **[*33]** 95-116 defined the costs of INP as the incremental costs incurred by a LEC to transfer numbers and subsequently forward calls to new service providers using RCF, DID or other comparable measures (see PP 134-36). The FCC further provides that states may require tariffs for INP measures, and GTE has such tariffs in some states. GTE's proposed prices reflect the appropriate costs GTE is entitled to recover.

Staff believes that GTE and AT&T should provide INP to each other at a zero rate. They should be allowed to book their short run marginal costs to a deferred account, subject to later recovery from all telecommunications carriers on a competitively neutral basis as determined by the Commission.

Commission Conclusion

The Commission concurs with Staff that INP should be provided at a zero rate pending this Commission's final resolution of the issue. See, Docket 95-0296 Interim Order (entered November 7, 1996). In the interim, both companies should be allowed to book their short run

marginal costs to a deferred account, subject to later recovery from the appropriate telecommunications carriers on a competitively neutral basis as determined by the Commission.

ISSUE 7 [*34] : WHAT METHOD SHOULD BE USED TO PRICE COLLOCATION?

It is AT&T's position that collocation rates should be set at TELRIC. (FCC Order PP 628-29; Act § 251(c)(6); Act § 252 (b)(4)(B)). Citing to both the Act and the FCC Order, AT&T argues that collocation should be subject to the same pricing rules as interconnection and unbundled network elements. (FCC Order P 626). Thus, AT&T recommends that this Commission will apply the same standards used for interconnection and unbundled network elements to its determination of pricing for collocation. (See, e.g., FCC Rule § 51.501; FCC Order PP 625-787).

AT&T asserts that interim rates for collocation "should be no greater than the effective rates for equivalent services in the interstate expanded interconnection tariff." (FCC Rule § 51.514 (c)(6)). The FCC has set the ceiling for interim collocation rates and has given the state commissions the authority to establish interim collocation below that ceiling if appropriate. FCC Rule § 51.513(c)(6)). AT&T argues that GTE has not supplied the information to know what the ceiling is. Nor can it be determined if GTE's proposed collocation prices exceed the ceiling. Accordingly, AT&T states that **[*35]** its collocation prices set forth in Merrick Ex. PHM-4 should be adopted until such time as the Commission establishes permanent prices for collocation in the separate proceeding in which it will consider the TELRIC studies.

GTE argues that virtual collocation rates should be set in accord with GTE's federal virtual collocation tariff. For physical collocation, rates should be set in accord with the rates submitted by GTE, which will soon be filed as GTE's physical collocation tariff. These rates have been set using a method that allows recovery of GTE's costs, including a reasonable share of its joint and common costs, and are therefore fully consistent with the Act.

GTE further asserts that the use of the federal virtual collocation tariff and the rates GTE will submit as its federal physical collocation tariff comports with the rationale and requirements of the FCC's Expanded Interconnection Order.

Staff asserts that, absent any cost data which has been fully reviewed, the best information the Commission has is Ameritech data relating to collocation pricing.

Commission Conclusion

At the outset, the Commission is not persuaded by GTE's position on this issue. As noted herein, **[*36]** the FCC has established parameters for pricing collocation and we believe that GTE's position does not comport with these guidelines. Meanwhile, the Commission is not confident utilizing any other information to establish a permanent price for collocation.

For the interim, we concur with Staff that GTE and AT&T utilize the collocation prices established for Ameritech. At first blush, one may consider this conclusion to be in conflict with our conclusion in Issue 3. We disagree. At issue herein is the pricing of elements that are not necessarily sensitive to geographic and/or operational characteristics unique to GTE. As a result, it is much more reasonable to believe that Ameritech's costs are comparable to GTE's on this point. Consequently, we believe that a distinction can be drawn between these elements and those in Issue 3. GTE and AT&T are therefore directed to utilize as a proxy price, until such time as an order is entered in Docket 96-0503, the prices Ameritech will charge AT&T for collocation.

ISSUE 8: WHAT IS THE PROPER WAY TO CHARGE FOR ACCESS TO POLES, DUCTS, CONDUITS, AND RIGHTS-OF-WAY?

AT&T contends that prices must be set at TELRIC, be nondiscriminatory, and **[*37]** be imputed into GTE's own local service rates. Prices for pathway facilities should be effective for the term of the Interconnection Agreement. (Act § 224; 251(c)(2); FCC Order PP 628, 672). AT&T recommends that the establishment of prices for access to poles, conduits, and rights-of-way be deferred until after the FCC completes its rulemaking. In the interim, the lowest tariff or contract price applicable to any provider should be used. (Merrick Direct, p. 35). The existing menu of potential charges, terms and conditions should be critically reviewed to assure competitive neutrality. (Id.).

GTE's position before the FCC will be the same as it is here: to the extent Section 224 of the Act mandates access, GTE must recover the fair market value of the property taken. This is only compensation standard that comports with Minnesota and federal constitutional law. Accordingly, GTE proposes that whatever rates are set should be subject to a "true up" (with interest) once a lawful rate is established.

Staff asserts that, absent any cost data which has been fully reviewed, the best information the Commission has is Ameritech data relating to pricing of access to poles, conduits, and **[*38]** rights-of-way.

Commission Conclusion

The Commission is of the opinion that our conclusion and reasoning as set forth in Issue 7 are applicable to this Issue.

ISSUE 9: WHAT GTE SERVICES SHOULD BE REQUIRED TO BE MADE AVAILABLE FOR RESALE AT WHOLESALE RATES?

AT&T argues that GTE services available for resale should include all services offered at retail to end-users, including promotional (more than 90 days), proprietary, enhanced, grandfathered, packaged, individual customer based, contracted and sunsetted services. (FCC Rule § 51.603; Act § 251(c)(4)(A); FCC Order PP 871, 948, 956, 968). AT&T argues that commercially viable resale opportunities are vital to the development of competition in the local exchange. Resale is the necessary first step in establishing competition, and facilities placement becomes more feasible as a large stable customer base is established. All pricing options and packages that are available to GTE's retail customers should also be made available to AT&T for resale to its retail customers so that incumbent LECs, such as GTE, do not enjoy the competitive advantage of withholding product offerings from new market entrants.

In sum, AT&T argues **[*39]** that there is no statutory basis for limiting the resale duty to basic telephone services; it applies to all telecommunications services provided by the incumbent LEC at retail to subscribers who are not telecommunications carriers. (FCC Order P 871).

GTE asserts that it should make all its retail services available for resale at wholesale rates except for the following: below-cost services, promotional offers of 90 days or less; and individual case basis ("ICB") services.

GTE will also make the following services available for resale, but a wholesale discount shall not apply: pay phone services purchased by COCOTS providers, nonrecurring charges; access services; operator services; and directory assistance services. (Meny, GTE Ex. 7.00 at 27-29)

GTE also states that Section 252(c)(4) of the Act requires incumbent LECs not to impose "unreasonable or nondiscriminatory conditions or limitations" on the resale of telecommunications services. Thus, the Act plainly recognizes that incumbent LECs may impose reasonable conditions or limitations on resale.

GTE concludes that its conditions and limitations for below-cost services, promotional offers of 90 days or less, and individual case basis **[*40]** ("ICB") services are reasonable. First, with respect to below-cost services, GTE cannot cover its costs through resale of below-cost services unless such services are first repriced to cover their costs. These services receive contributions from other services, such as intraLATA toll, access, and vertical and discretionary services, all of which are priced above incremental cost. If GTE were required to offer its below-cost services on a wholesale basis, then other carriers would (1) obtain avoided-cost discounts for both below-cost and above-cost services, and (2) be able to pocket the contributions from the above-cost services that had been used to price the other services below-cost. Accordingly, GTE could not cover its total costs unless these services are excluded from GTE's wholesale offerings or are repriced to cover their costs. (Seaman, GTE Ex. 14.00 at 12).

Second, offering promotions and ICBs at wholesale discounts would prevent GTE from differentiating its retail services from those of its competitors.

GTE realizes that its proposed prohibition on the resale of below-cost services will preclude the resale of most residential services, but competition will not flourish **[*41]** where one competitor is required to subsidize the offerings of others. GTE would not object to the Commission conducting separate proceedings to consider whether and under what circumstances below-cost services should be made available for resale. For example, if rates cannot be rebalanced immediately, then GTE could recover any stranded costs or lost contribution through a system of competitively neutral end-user charges. Upon conclusion of such a proceeding, the parties could revise their interconnection contract to permit the resale of GTE's current below-cost services. This separate proceeding will allow the parties and the Commission more time to consider this significant public policy issue.

Staff recommends that GTE be required to make all retail services available for wholesale services, even those priced below costs, grandfathered, or sunsetted. (Staff Ex. 1.00 at 19.) Staff's asserts that its position is consistent with Section 251(c)(4) of the Act which requires that incumbent LECs offer for resale any telecommunications service provided to retail subscribers who are not telecommunications carriers.

Commission Conclusion

Section 251(c)(4)(A) clearly provides that an **[*42]** ILEC must offer for resale any telecommunications service. Moreover, the FCC Order also requires an ILEC to provide for resale any telecommunication service. P 871 Resale restrictions are presumptively unreasonable unless such a restriction is narrowly tailored. FCC Order P 939. In this instance, the record does not support the restrictions proposed by GTE. The FCC Order specifically finds that "below-cost services are subject to the wholesale rate obligation of Section 251(c)(4)(A). P 956 Likewise, the FCC found no basis to exclude promotional services. P 948.

The one restriction that the Commission will approve relates to grandfathered and sunsetted services. Our Order in Docket 95-0458, et al., determined that with regard to such services "the wholesale provider can only provide the requested service to the customers that receive the grandfathered service." Id. at 39. We believe that the narrow tailoring of this restriction comports with the FCC Order. P 939.

In conclusion, all telecommunications services GTE offers to retail customers, subject to the one restriction set forth herein, irrespective of whether the retail price is set below cost or whether they are promotional, **[*43]** grandfathered or sunsetted services, shall be offered at wholesale prices to AT&T, except for promotions of less than 90 days duration. Sections 24 and 26 of the AT&T Interconnection Agreement are adopted, subject to the Commission's conclusion herein.

ISSUE 10: SHOULD GTE BE REQUIRED TO OFFER FOR RESALE AT WHOLESALE RATES