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Confidential Release

Case Number: 96-694-TP-ARB

Date of Confidential Document:
September 3, 1996

Today's Date:
August 25, 2009

Identification of unresolved issues for arbitration, statement of position on each unresolved issue and summary of resolved issues filed on behalf of Ameritech Ohio by D. Conway. (30 pgs.)FILED UNDER SEAL

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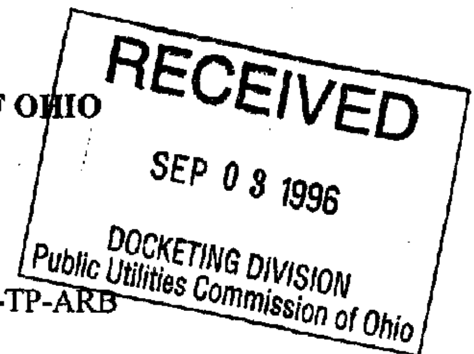
BEFORE
THE PUBLIC UTILITIES COMMISSION OF OHIO



In the Matter of the Petition of TCG Cleveland for Arbitration of Open Issues Pursuant to §252(b) of the Telecommunications Act of 1996 to Establish an Interconnection Agreement with Ameritech Ohio	)	Case No. 96-694-TP-ARB

AMERITECH OHIO'S IDENTIFICATION OF UNRESOLVED ISSUES FOR ARBITRATION, STATEMENT OF POSITION ON EACH UNRESOLVED ISSUE AND SUMMARY OF RESOLVED ISSUES

Ameritech Ohio, by its undersigned attorneys, respectfully submits this Brief as part of its arbitration package filed pursuant to Commission Mediation and Arbitration Guideline X.C.

UNRESOLVED ISSUES FOR ARBITRATION

Correspondence from TCG Cleveland's Indiana affiliate introduced in its recently completed arbitration with Ameritech Indiana stipulated to the three unresolved issues identified below. Ameritech Ohio understands that TCG Cleveland will stipulate to these same issues for this arbitration. This statement addresses these three open issues in the following order:

(1) MEET-POINT BILLING/SWITCHED ACCESS CHARGES:

TCG advocates a "meet-point billing" arrangement that would revamp Ameritech Ohio's existing — and FCC- and state-approved — switched access charges. Should TCG's proposed revision of the switched access charge regime be approved in the face of the Act's — and the FCC's — declaration that that regime shall remain unchanged until the FCC reforms it? (Pet. ¶ 12.B.)

(2) RECIPROCAL COMPENSATION:

TCG advocates bill-and-keep in place of the cost-based reciprocal compensation for local transport and termination that the Act requires. Should the Commission approve TCG's bill-and-keep proposal, or Ameritech Ohio's cost-based proposal for reciprocal compensation? (Pet. ¶ 12.A.)

(3) INDEMNIFICATION:

In place of TCG's formerly proposed and wholly unreasonable system of performance standards and penalties [See Ameritech Ohio's Response to TCG's Petition, pp. 25-34], TCG now advocates an equally unacceptable indemnification standard. Notwithstanding the availability and common use of tariff provisions limiting the liability of telecommunications companies, should Ameritech Ohio nevertheless be forced to accept unlimited and unrestricted liability to TCG's customers or, should each party include liability limiting provisions in their tariffs and mutually indemnify the other party for any loss resulting from claims by customers of the party?

The first two issues are readily resolved as a matter of law based upon the Act and the rules of the Federal Communications Commission ("FCC") implementing the Act: TCG's proposed "meet-point billing" arrangement must be rejected because the Act, and the FCC's rules as well, prohibit changes to switched access charges at this time. And TCG's proposed imposition of bill-and-keep must be rejected because the Act mandates that reciprocal compensation for the transport and termination of traffic be cost-based. Ameritech Ohio submitted its TELRIC studies for transport and termination to permit the Panel to set a cost-based rate in the event severance of the cost issue is reconsidered by the Commission. If cost-based rates are to be determined in a separate docket, Ameritech Ohio's TELRIC studies will support the Commission's selection of rates at the high end of the FCC proxy range.

With respect to the newly raised third issue[1], Ameritech Ohio and TCG agree that their interconnection agreement should incorporate an indemnification provision and each party has a proposal in this regard. Thus, the issue for the Commission is which proposal best fulfills the requirements of the Act in a reasonable manner.

In addition to the legal discussion in this Statement, Ameritech Ohio will present its positions in this arbitration through the direct testimony of the following witnesses, prefiled herewith:

1. Dr. Kent A. Currie,
2. William J. McSorley,
3. Suzanne J. Springsteen,
4. Debra J. Aron, and
5. James Farmer.

Exhibits supporting Ameritech Ohio's position and the testimony of these witnesses are separately identified as part of the arbitration package submissions.

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[1] TCG did not specifically raise this issue in its Petition filed on July 17, 1996 or in its clarification of Open Issues, filed on August 15, 1996. TCG formerly raised as its third open issue the subject of performance standards and penalties.

STATEMENT OF AMERITECH OHIO'S POSITION ON THE UNRESOLVED ISSUES

I. TCG'S PROPOSED "MEET-POINT BILLING" ARRANGEMENT IS AN IMPROPER ATTEMPT TO REVAMP THE EXISTING STATE AND FEDERAL SWITCHED ACCESS CHARGE REGIME APPLICABLE TO INTERLATA AND INTRALATA TOLL TRAFFIC TERMINATING ON AMERITECH OHIO'S NETWORK; TCG'S PROPOSAL IS THEREFORE OUTSIDE THE SCOPE OF THE ACT AND IS NOT SUBJECT TO ARBITRATION; EVEN IF IT WERE WITHIN THE SCOPE OF THE ACT AND SUBJECT TO ARBITRATION, TCG'S PROPOSAL WOULD BE UNACCEPTABLE. (Pet. ¶12.B.)

A. TCG's Proposed "Meet-Point Billing" Arrangement Is An Improper Attempt To Revamp Ameritech Ohio's Current Switched Access Charges.

TCG's proposed "meet-point billing" arrangement indisputably would restructure Ameritech Ohio's existing method of calculating and recovering its switched access charges, as set forth in Ameritech Ohio's FCC- and state-approved tariffs. Given TCG's repeated admission that its proposal would redistribute switched access revenues that would otherwise be collected and retained by Ameritech Ohio (see, e.g., Pet. at p.9), TCG's proposal is plainly outside the scope of the Act and not even subject to arbitration.

TCG concedes that its "meet-point billing" proposal is intended to establish a "set of assumptions for the billing of switched access charges to interexchange carriers" (Pet. at p.8). Indeed, as noted above, TCG acknowledged during negotiations that its "meet-point billing" proposal was a substitute for, and produced the "same economic result" as, its FGI proposal, which would have given TCG a direct discount off of Ameritech Ohio's existing switched access charges by means of a "blended" reciprocal compensation rate applicable to transport and termination of all traffic exchanged between Ameritech Ohio's and TCG's networks —

including interLATA and intraLATA toll ("IXC") traffic as well as local traffic. (See Exhibit A to Ameritech Ohio's Response; TCG Petition Exhibit 7.)

TCG's "meet-point billing" proposal appears to be a "multiple tariff/single bill" arrangement, under which TCG would be the sole biller of switched access charges to an IXC in instances where TCG provides the tandem switching function (and transport to Ameritech Ohio's end office) for that IXC's traffic to and from Ameritech Ohio's customers. TCG would then remit to Ameritech Ohio only the local switching and carrier common line portions of the billed charges, keeping a major share of the switched access revenues received — including all residual interconnection charge ("RIC") revenues — for itself.

Because it would reduce Ameritech Ohio's existing access charge rates for IXC traffic, TCG's "meet-point billing" proposal (as well as its predecessor, TCG's FGI proposal) is, as we show below, clearly outside the scope of the Act, which addresses the transport and termination of local traffic, not IXC traffic.

TCG tries to shoehorn its "meet-point billing" proposal into the confines of the Act by pretending that the proposal involves something other than compensation for the transport and termination of IXC traffic.[2] According to TCG, its "meet-point billing" proposal purportedly constitutes "Switched Access Interconnection," and therefore is sanctioned by Sections 251(a)(1) and 251(c)(2) of the Act. (Pet. at p.8.) Notwithstanding TCG's verbal sleight-of-hand, TCG's position is untenable for at least three reasons:

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[2] TCG fails even to mention its FGI proposal in its Petition, or the fact that its proposed "meet-point billing" arrangement "provides the same economic result" (see Exhibit A to Ameritech Ohio's Response) as that proposal.

First, there is no such thing as "switched access interconnection." Switched access is a service, not a physical facility. Services do not "interconnect"; networks do.

Second, as a matter of law, Sections 251(a)(1) and 251(c)(2) do not address the "interconnection" of services; they address the interconnection of networks. Specifically, Section 251(c)(2) does not establish an obligation to provide, nor does it even refer to a concept of, "switched access interconnection" or any other "interconnection" of services. Rather, that Section identifies — and circumscribes — the ILEC's obligation as a duty "to provide, for the facilities and equipment of any requesting telecommunications carrier, interconnection with the local exchange carrier's network . . . ." (Emphasis added.) Indeed, if TCG's proffered interpretation — that Sections 251(a)(1) and 251(c)(2) establish an obligation to provide "switched access interconnection" — were correct, then the reciprocal compensation provisions of the Act (Sections 251(b)(5) and 252(d)(2)) would be superfluous, because local traffic transport and termination also would be an "interconnection" service subject to Sections 251(a)(1) and 251(c)(2), just like switched access.

The FCC has reached precisely the same conclusion. In its recently-issued rules, the FCC stated:

> We conclude that the term "interconnection" under Section 251(c)(2) refers only to the physical linking of two networks for the mutual exchange of traffic. Including the transport and termination of traffic within the meaning of section 251(c)(2) would result in reading out of the statute the duty of all LECs to establish "reciprocal compensation arrangements for the transport and termination of telecommunications," under Section 251(b)(5) . . . . We note that because interconnection refers to the physical linking of two networks, and not the transport and termination of traffic, access charges are not affected by our rules implementing section 251(c)(2).

FCC Report and Order No. 96-325, ¶ 176 (emphasis added); see also, id., ¶ 191, n. 398.

Third, regardless of how TCG attempts to characterize its "meet-point billing" proposal, the unavoidable fact of the matter is that the proposal would operate to reduce the level of switched access charges currently received by Ameritech Ohio under applicable state and FCC switched access rules. Accordingly, as explained below, TCG's proposal not only is outside the confines of, but also is contrary to, the Act.

B. TCG's Switched Access Proposal Is Outside The Scope Of, And Contrary To, The Act, And Therefore Not Subject To Arbitration.

In its recently promulgated rules, the FCC made it perfectly clear that Sections 251 and 252 do not alter the prevailing access charge rules and that it will address the subject of access charge reform in a separate proceeding. As noted above, the FCC has concluded that the interconnection provisions of Section 251(c) do not involve access charges. The FCC further noted that access charges are a separate part of a "trilogy" of activities that it is currently pursuing:

> 6. The rules that we adopt to implement the local competition provisions of the 1996 Act represent only one part of a trilogy. In this Report and Order, we adopt initial rules designed to accomplish the first of the goals outlined above — opening the local exchange and exchange access markets to competition . . . .
>
> 8. The third part of the trilogy is access charge reform. It is widely recognized that, because a competitive market drives prices to cost, a system of charges which includes non-cost based components is inherently unstable and unsustainable. It is also well-recognized that access charge reform is intensely interrelated with the local competition rules of Section 251 and the reform of universal service. We will complete access charge reform before or concurrently with a final order on universal service.

FCC Report and Order No. 96-325, ¶¶ 6, 8.

Moreover, TCG's "meet point billing" approach to overriding the existing switched access charge regime also is in conflict with this Commission's June 12, 1996 decision in Case No. 95-845-TP-COI. See Finding and Order, at page 36; and Local Service Guidelines, attached as Appendix A to the Finding and Order, at Section IV.D.2.a. TCG never sought rehearing of this decision and fails to acknowledge the impact of this decision on its argument.

The FCC re-emphasized these points in its rules addressing the situation where an IXC seeks to "rebundle" an ILEC's unbundled network elements in order to provide an end-user with local telecommunications service, in addition to interexchange service. In that situation, the FCC's rules require the IXC to pay the portion of the ILEC's current switched access charges not already recovered through the ILEC's unbundled network element prices. The FCC imposed this requirement in order to "preserv[e] the status quo with respect to subsidy payments" until the FCC's access charge reform efforts are completed. Id., at ¶ 30-31; see also 47 C.F.R. § 51.515.

The FCC's decision in this regard is consistent with, and in fact mandated by, the Act, in which Congress expressly retained the FCC's Part 69 access charge rules. Section 251(g), for example, provides that:

> each local exchange carrier . . . shall provide exchange access . . . and exchange services for such access to interexchange carriers . . . in accordance with the same equal access and nondiscriminatory interconnection restrictions and obligations (including receipt of compensation) that apply to such carrier on the date immediately preceding the date of enactment of [the Act] under any court order, consent decree, or regulation, order or policy of the Commission, until such restrictions and obligations are explicitly superseded by regulations prescribed by the Commission after such date of enactment. (Emphasis added.)

In other words, until the FCC promulgates new regulations and establishes new rates for switched access, Congress directed that local exchange carriers not only can, but shall "provide exchange access . . . and exchange services for such access" on the terms that applied before the Act. No matter what label TCG may give it, TCG's demand for a reduction in Ameritech Ohio switched access charges under the rubric of interconnection — and, specifically, its position that Ameritech Ohio should be prohibited from collecting the RIC (and from directly billing the IXC for any switched access charges) in instances where TCG provides tandem switching (and transport to an end office) for IXC traffic to and from Ameritech Ohio customers — is a transparent attempt to evade the switched access regime of Part 69. That attempt cannot be reconciled with Section 251(g).[3]

The legislative history of the Act confirms that Section 251(g) means what it says. According to the Conference Report, the purpose of Section 251(g) was to retain the existing switched access regime until the FCC takes up access charge reform and promulgates new regulations. (See Conference Report on the Telecommunications Act of 1996, H.R. Rep. No.

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[3] In addition, Section 251(i) of the Act provides that, "Nothing in this section shall be construed to limit or otherwise affect the Commission's authority under section 201." The FCC's authority over switched access, including its power to set Part 69 switched access rates, derives from Section 201. (See 47 C.F.R. § 69.1.) TCG would not merely "limit" or "affect" the FCC's authority over switched access under Part 69, but would completely nullify it. If TCG and other competitive access providers were allowed to use the Act to reduce an ILEC's existing switched access revenues, and correspondingly, its switched access rates, then prices for switched access plainly would not be the prices set forth in the Part 69 rules. At the same time, primary jurisdiction and control over exchange access for IXC traffic would, in effect, be transferred to the state regulatory bodies, in their capacity as Commissions and reviewers of interconnection agreements under Section 252 of the Act. This, of course, would divest the FCC of authority over the origination and termination of interstate calls.

458, 104th Cong., 2d Sess. 123 (1996) ("In the interim, between the date of enactment and the date the Commission promulgate[s] new regulations under this section, the substance of th[e] new statutory duty [imposed by Section 251(g)] shall be the equal access and nondiscrimination restrictions and obligations, including receipt of compensation, that applied to the local exchange carrier immediately prior to the date of enactment, regardless of the source").) The Senate Report reflects the same view: "The obligations and procedures prescribed in this section [Section 251] do not apply to interconnection arrangements between local exchange carriers and telecommunications carriers under section 201 of the 1934 Act for the purpose of providing interexchange service, and nothing in this section is intended to affect the FCC's access charge rules." S. Rep. No. 23, 104th Cong., 1st Sess. 19 (1995).[4/]

[4/] Several members of Congress, including Speaker Newt Gingrich, Minority Whip David Bonior, and House Judiciary Committee Chairman Henry Hyde, recently reconfirmed that the Act was intended to keep access charges intact. Chairman Hyde, who offered Section 251(g) as an amendment at conference, explained in a letter to the FCC that "the conferees adopted [Section 251(g)] because we wanted to keep in place the equal access, nondiscrimination, and access charge regimes as they existed under the AT&T Consent Decree and the Commission's rules until the Commission specifically addressed these topics in a rulemaking." (Letter from Henry J. Hyde to Reed Hundt, 1-2 (July 15, 1996) (Exhibit C to Ameritech Ohio's Response) (emphasis added). Chairman Hyde added that "the broader language" of Section 251(g) was intended to encompass Section 251(k) of the Senate bill, which "explicitly kept the current access charge regime in place." Id. at 2. Accord, Letter from Newt Gingrich, David Bonior, et al. to Reed E. Hundt (July 12, 1996) ("In Section 251(g) of the Act we indicated that we did not intend for the access charge system to be undermined through the completion of the interconnection docket") (Exhibit D to Ameritech Ohio's Response) (emphasis added). (See also NPRM ¶164 ("[A]s with section 251(c)(2), allowing interexchange carriers to circumvent Part 69 access charges by subscribing under section 251(c)(3) to network elements solely for the purpose of obtaining exchange access may be viewed as inconsistent with other provisions in section 251, such as sections 251(i) and 251(g)").)

In light of the foregoing, TCG has no basis to contend that the Act supports, or even permits, its "meet-point billing" proposal.[5/] Because TCG's proposed access charge reductions are not only clearly outside the scope of, but are squarely contrary to, the Act, TCG's proposal is not a proper subject of this arbitration.[6/]

[5/] TCG witness William Page Montgomery's analysis of Competitive Telecommunications Ass'n v. FCC, 87 F.3d 522 (D.C. Cir. 1996), at page 34 of his "Preliminary Statement" filed on August 15, 1996 is irrelevant here. Indeed, the D.C. Circuit confirmed in that opinion that the access charge issues it was addressing are outside the scope of the Act. (See id. at 528-29).

[6/] Nor may TCG plausibly assert that its switched access proposal is mandated by Section 251(b)(5), which imposes on all LECs the duty "to establish reciprocal compensation arrangements for the transport and termination of telecommunications." Any such argument would ignore Section 252(d)(2)(A), which governs the terms and conditions of reciprocal compensation in the event of arbitration. Section 252(d)(2)(A) makes clear that an incumbent ILEC's obligation to provide reciprocal compensation under Section 251(b)(5) applies only to "calls that originate on the network facilities of the other carrier." (Emphasis added.)

In the context of this arbitration, then, the reciprocal compensation requirements of the Act apply only to local traffic originating either on TCG's or on Ameritech's network facilities. These requirements do not apply to interLATA and intraLATA toll traffic subject to existing switched access charges. The FCC's implementing rules confirm this. (See 47 C.F.R., §§51.701-51.717 (Reciprocal Compensation for Transport and Termination of Local Telecommunications Traffic") (emphasis added).)

C. **Even If TCG's "Meet-Point Billing" Proposal Were Within The Scope Of The Act And Properly Subject To Arbitration, <u>It Should Be Rejected.</u>**

TCG's "meet-point billing" proposal flies in the face of sound policy, and would therefore be unacceptable even if it were properly subject to arbitration under the Act.

<u>First</u>, as the relevant policymakers at the FCC and Congress, and virtually all commentators, have recognized, any reform of the existing state and federal switched access regimes — including any revision regarding the level of an ILEC's RIC or regarding which party is permitted in joint billing situations to bill that RIC to the applicable IXC — will have significant repercussions on a wide variety of telecommunications programs and policy objectives, including existing programs and policies designed to promote universal service. Given the historical role that switched access revenues have played in covering the total cost of providing universal service and keeping local exchange rates affordable, especially in high-cost areas, any reform of switched access charges should be addressed not on an <u>ad hoc</u>, carrier-by-carrier basis, but in a comprehensive manner that permits all interested parties and competing interests and objectives to be heard and considered. This is precisely what the FCC has said it will do.

<u>Second</u>, as a practical matter, given the FCC's announced plans to address switched access reform separately on a comprehensive basis, it would make little sense for the Commission to attempt to predict, in a carrier-specific proceeding, how the FCC will resolve the myriad issues raised by switched access charge reform. And, of course, to the extent that the Commissioner's prediction was wrong, that would only complicate, and in fact could harm, the FCC's objective of accomplishing rational, comprehensive access charge reform.

Third, if TCG's proposed "meet-point billing" arrangement were adopted, then any requesting carrier, including IXCs such as AT&T, MCI and Sprint, could evade the existing FCC and state access charge regime by providing its own tandem functionality for IXC traffic and then asserting that it was entitled to the same "meet-point billing" arrangement as TCG. As demonstrated above, this is not what Congress provided, and would lead to the de facto nullification of the existing switched access charge regime before the FCC has had a meaningful opportunity to address that regime.

* * * * *

In sum, TCG's "meet-point billing" proposal is not only outside the scope of, but squarely contrary to, the Act, and should be rejected. Even if that were not so, the Commission should still, for the reasons last stated, reject that proposal and adopt Ameritech Ohio's proposed "meet-point billing" arrangement (Exhibit B to Ameritech Ohio's Response). This arrangement reflects terms and conditions consistent with those negotiated and agreed to by other requesting carriers, including, in Ohio, MFS and Time Warner,[7] and properly preserves Ameritech Ohio's recovery of switched access revenues associated with the transport (and termination) of IXC traffic to and from Ameritech Ohio's customers.

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[7] In Re Ameritech Ohio's Application for Approval of an Interconnection Agreement between Ameritech Ohio and MFS Intelenet of Ohio, Inc., PUCO Case No. 96-565-TP-UNC (Application filed June 4, 1996); In Re Complaint of Time Warner, PUCO Case No. 96-66-TP-CSS (Agreement submitted for review and approval July 12, 1996).

II. MANDATED BILL-AND-KEEP WOULD VIOLATE THE ACT, THE FCC'S REGULATIONS, AND FUNDAMENTAL PRINCIPLES OF FAIRNESS AND ECONOMIC EFFICIENCY. (Pet. ¶12.A)

A. Ameritech Ohio Is Entitled To Actual Cost-Based Reciprocal Compensation

TCG's demand for bill-and-keep as a surrogate for reciprocal compensation for local transport and termination (Pet. ¶ 12.A.) directly conflicts with the Act.[8/] Pursuant to Section 252(d)(2)(A),

> a State commission shall not consider the terms and conditions for reciprocal compensation to be just and reasonable unless —
>
> (i) such terms and conditions provide for the mutual and reciprocal recovery by each carrier of costs associated with the transport and termination on each carrier's network facilities of calls that originate on the network's facilities of the other carrier; and
>
> (ii) such terms and conditions determine such costs on the basis of a reasonable approximation of the additional costs of terminating such calls. (Emphasis added.)

That is, the Act requires that each carrier recover the costs it incurs in providing local transport and termination. Bill-and-keep does not base reciprocal compensation on costs; indeed, it does not provide for "compensation" or "cost recovery" of the costs incurred. Rather, it foregoes cost-based reciprocal compensation for the sake of administrative convenience. Bill-and-keep therefore conflicts with the Act's requirement that reciprocal

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8/ It is unclear from TCG's Petition whether TCG proposes bill-and-keep for only end office termination or for both end office and tandem office termination. (See Pet. 6-7; Preliminary Statement of W.P. Montgomery, at 18-21, 26.) In either event, as discussed below, there is no statutory or policy basis for bill-and-keep with regard to end office or tandem termination.

compensation be cost-based.

TCG at Pet. ¶12.A. appears to advance an interpretation of the phrase "additional costs" in Section 252(d)(2)(A)(ii) that precludes cost-based reciprocal compensation of local transport and termination. (Montgomery Preliminary Statement at 18-19). This makes no sense, and is contradicted by the text of the statute itself. The pertinent provision of the Act (quoted above) requires cost-based reciprocal compensation. Equally untenable is TCG's related contention that "cost" in Section 252(d)(2) means something different than it does in Section 252(d)(1) (which applies to the pricing of network elements and interconnection).

It is no surprise, then, that the FCC has expressly rejected these two interpretations of the Act. Specifically, the FCC has concluded that "the pricing standards established by Section 252(d)(1) for interconnection and unbundled elements, and by Section 252(d)(2) for transport and termination of traffic, are sufficiently similar to permit the use of the same methodologies . . . ." FCC Report and Order No. 96-325, ¶ 1054. Accordingly, the FCC has ordered that reciprocal compensation rates must recover both the forward-looking incremental costs ("TELRIC") of transport and termination, as well as "a reasonable allocation of common costs," id., ¶¶ 1054, 1058, which under the FCC's nomenclature includes both joint and common costs.

In keeping with this, the FCC's regulations go on to expressly provide that the "additional costs" in Section 252(d)(2)(A)(ii) shall be the sum of TELRIC and a reasonable allocation of common costs, based on "a cost study [in conformity with 47 C.F.R.] §§ 51.505 and 51.511." As discussed below, Ameritech Ohio conducted such studies for the transport and termination of local traffic [copies of which were earlier supplied to TCG and the Panel, a

copy of which is being submitted as an exhibit, and which is both described and sponsored by Dr. Currie in his prefiled Direct Testimony] and has endeavored to base its proposed rates to TCG (and others) on their results, in conformity with the Act and the implementing rules.

The FCC has concluded that the Act permits bill-and-keep in only two circumstances. The first is where the carriers voluntarily agree to it. That is, the Act does not "preclude arrangements that afford the mutual recovery of costs through the offsetting of reciprocal obligations, including arrangements that waive mutual recovery (such as bill-and-keep arrangements)." § 252(d)(2)(B) (emphases added). An "arrangement" is "an agreement or settlement" (Merriam-Webster's Collegiate Dictionary 64 (10th ed. 1994)), and to "waive" means to "give up a right or claim voluntarily" (Black's Law Dictionary 1580 (6th ed. 1990)). By using those terms, Congress clearly expressed that use of bill-and-keep is to be voluntary. Ameritech Ohio has neither agreed to an "arrangement" nor "waived" its statutory right to recover the costs it incurs in transporting and terminating calls originating on another carrier's network.

The second circumstance where the Act permits bill-and-keep is this: A state commission may impose bill-and-keep where, but only where, (i) traffic is in balance and is expected to remain so (47 C.F.R. § 57.713(b)), and (ii) the state commission also "impose[s] compensation obligations [in the event] traffic becomes significantly out of balance." FCC Report and Order No. 96-325, ¶ 1113. Ameritech Illinois' experience is that traffic between TCG and Ameritech Illinois is wildly out of balance; the disparity is on the order of 10 to 1. (See Direct Testimony of Suzanne J. Springsteen.) Ms. Springsteen anticipates traffic between

TCG Cleveland and Ameritech Ohio also will be unbalanced. Id. Moreover, the TCG proposal makes no provision for compensation of any sort, no matter how great the imbalance.

Thus, the Act and the FCC's implementing rules leave no room for debate: The TCG proposal must be rejected. In addition, sound public policy and considerations of basic fairness compel the same conclusion:

First, as the FCC recognized, "carriers [such as Ameritech Ohio] incur costs in terminating traffic that are not de minimis, and consequently, bill-and-keep arrangements that lack any provisions for compensation [such as the TCG proposal] do not provide for the recovery of costs." FCC Report and Order No. 96-325, ¶ 1112. Ameritech Ohio will incur substantial additional costs in transporting and terminating local traffic from TCG and other CLECs, for which Ameritech Ohio would not be compensated under TCG's proposal. (See Direct Testimony of William J. McSorley.)

Second, as the FCC also recognized, "as long as the cost of terminating traffic is positive, bill-and-keep arrangements are not economically efficient because they distort carriers' incentives, encouraging them to overuse competing carriers' termination facilities by seeking customers that primarily originate traffic." FCC Report and Order No. 96-325, ¶ 1112. For example, under TCG's proposal, TCG could target customers with primarily outgoing calls, such as telemarketers (and avoid customers with primarily incoming calls, such as ticket agencies and certain government agencies). In addition to running up Ameritech Ohio's costs, such cherry-picking would enable TCG to derive revenues from those calls without having to pay the costs of terminating them on Ameritech Ohio's network. In effect, under TCG's bill-and-keep proposal, Ameritech Ohio and its low volume-originating

customers would be subsidizing TCG and its high volume-originating users, thereby encouraging the former to underuse the network and the latter to overuse it, thus diverting telecommunications resources from their most fair and efficient uses.[9] (See Direct Testimony of Debra J. Aron/Robert G. Harris.)

TCG's proposal also would give TCG an incentive to configure its network so that calls terminate at Ameritech Ohio's tandem switches, rather than at its end offices. Because, as TCG acknowledges, the costs of tandem termination are greater than the costs of end office termination, TCG's bill-and-keep proposal would encourage TCG not to build its own facilities to Ameritech Ohio's end offices but instead to take a free ride on Ameritech Ohio's tandems. This may not be the most socially beneficial outcome; the most efficient allocation of resources might call for TCG to build to the end offices — which is precisely what it would do if required to bear the true costs of its decisions. (Id.) It is no accident, then, that no other network industry uses bill-and-keep to settle cross-network accounts. (Id.) In sum, as Congress well understood, rates that are not based on costs would result in uneconomic entry and a disincentive to efficient investment, thereby impeding competition and harming consumers.

[9] To the extent TCG attempts to assert that it would not take advantage of bill-and-keep to run up Ameritech's costs because it would not be rational to forego other customers (Montgomery Preliminary Statement at 26 and n. 21), such would not be credible. First, it would ignore the windfall that TCG would enjoy by not having to pay the costs of terminating calls on Ameritech's network. Second, there is no reason to believe that targeting telemarketers and other customers that would similarly impose higher costs on Ameritech would foreclose TCG from any opportunities to serve other customers.

TCG's contention that bill-and-keep would benefit consumers by promoting flat-rate calling ignores these economic consequences, as well as the will of Congress as expressed in Section 252(d)(2). In addition, it ignores that TCG's costs against which any flat-rate it would offer might be measured is net of what it receives from Ameritech Ohio for terminating local calls on its network that originate on Ameritech Ohio's network. In any event, cost-based reciprocal compensation between carriers does not preclude flat-rate local calling. How carriers compensate each other for the costs they incur in transporting and terminating calling traffic is a completely separate issue from how carriers charge their customers for local calls. (See Direct Testimony Debra J. Aron and Robert G. Harris.)

B. Ameritech Ohio's Cost Studies Itemize the Forward Looking Economic Cost of Providing Transport and Termination in Compliance with FCC Order 96-325 by Determining the Sum of Total Element Long-Run Incremental Costs ("TELRIC") and a Reasonable Allocation of Forward-Looking Shared (Joint) and Common Costs

The Communications Act of 1996 ("the Act") requires that ILECS price unbundled network elements based on costs. 47 U.S.C. §252(d)(1). The Federal Communications Commission ("FCC") has ruled that the appropriate cost on which prices are to be based is the forward-looking economic cost of providing each element, that is, the sum of total element long-run incremental costs ("TELRIC") and a reasonable allocation of forward-looking joint and common costs. 47 C.F.R. SEC. 51.5059(a). Thus, TELRIC, plus a reasonable allocation of joint and common costs, constitutes a pricing model for unbundled network elements, unlike LRSIC, TSLRIC, and other cost measures used in pre-Act regulatory proceedings. As the FCC put it, "States may not set prices lower than the forward-looking incremental costs directly attributable to provision of a given element" FCC 96-325 para.620, and shared and common costs shall be

included in the prices for interconnection and access to network elements. Ameritech Ohio's local transport and termination costs were determined by reviewing its earlier long-run incremental cost studies and updating certain assumptions used in those studies as necessary to reflect the emerging competitive environment and the wholesale provision of unbundled network elements.

As Dr. Currie explains in his direct testimony, TELRIC is the forward-looking additional cost incurred by a telecommunications carrier in the provision of an unbundled network element. It has three components -- operating expenses, depreciation cost, and the appropriate risk-adjusted costs of capital. FCC 96-325 para. 703. Operating expenses include costs such as maintenance and recordkeeping and reflect the use of resources such as labor, plant, and equipment. Depreciation cost is based on a depreciation rate that reflects the true changes in economic value of an asset. Id., para. 703. The cost of capital reflects the risks incurred by investors. Id. TELRIC is equivalent to the costs that a firm would save if it entirely stopped providing that element. TELRIC does not include costs, such as common costs, that would not be avoided if the firm entirely stopped producing the element, or costs that are shared jointly between or among network elements. TELRIC is forecast over a planning horizon sufficiently long to eliminate sunk inputs or costs, and is calculated as if the element is being provided for the first time and reflects planned adjustments in the firm's plant and equipment. It is based on the least cost technology currently available, the cost of which can reasonably be estimated based on available data. Finally, TELRIC assumes that the equipment (or facilities) being studied is operating at its optimal target capacity, which is the point at which the network is being used as efficiently as possible. Ameritech Ohio's TELRIC study meets all of these requirements.

Ameritech Ohio's TELRIC studies employ the same fundamental methodology as its LRSIC studies, but include modified assumptions in three primary areas: the length of depreciation lives, the cost of capital, and network utilization.

Dr. Currie explains that it was necessary to shorten the depreciation lives of network elements from those used in the earlier studies because the increased demand for state-of-the-art network elements that is already developing and is expected to escalate as competition heightens will accelerate the pace of technological change. Although Ameritech Ohio has known for some time that a highly competitive local exchange market was on the horizon, passage of the Act earlier this year represented a fundamental change in the provisioning of telecommunications services that provided a compelling reason for the re-evaluation of existing assumptions regarding depreciation lives. As the FCC has recognized, TELRIC must include a depreciation rate that reflects "the true changes in economic value of an asset."

To help determine the appropriate economic lives for the assets underlying Ameritech Ohio's unbundled network elements, the Company reviewed orders of the FCC and other federal and state agencies and published literature in the field dealing with established ranges of economic lives of service elements and related assets, including industry standards published by Technology Futures, Inc. These supported Ameritech Ohio's understanding that economic lives are distinct from accounting lives for such assets, and helped explain the impact of competition on economic lives. Moreover, a review of office replacement plans published by the Ameritech companies revealed that replacements generally occur first in the urban areas and later in rural areas, supporting the concept that the lives of the assets underlying unbundled network elements (to be used largely in the competitive urban areas) fall in the lower end of the range of reasonable

lives. Ameritech Ohio also consulted with Ameritech's business departments to project the likely customer base for unbundled network elements. In addition, Ameritech Ohio accounted for the decline in value of certain capital goods that represent a sunk investment (and that previously had been considered a residual cost) by assigning appropriate depreciation schedules. See FCC 96-325 para. 686.

Ameritech Ohio reduced the economic life of outside plant cable from fifteen to twelve years. Supporting this modification was the FCC's Order earlier this year establishing twelve-year economic lives for distribution facilities in cost studies of cable TV firms. Ameritech Ohio also reduced the economic lives of switches and circuit equipment from seven to five years. As support for this modification, Ameritech Ohio found that the Internal Revenue Service allows five years as the acceptable average service life for switching equipment.

Ameritech Ohio's testimony also explains that it was necessary to increase the cost of capital rate from that used in the earlier studies to reflect the higher risk of investing in the emerging highly competitive environment. As the FCC noted, the increased risk of investing in a competitive local exchange service market "can and should be captured" in TELRIC. FCC 96-325 para.687. Competition and network unbundling are likely to increase certain financial and business risks of the local exchange business to investors -- risks that historically have not been major concerns. These include high operating leverage (a high ratio of fixed-to-variable costs), low asset portability, and a higher churn (customer change) rate.

To determine an appropriate cost of capital rate, Ameritech Ohio studied other industries that historically were regulated but now are largely competitive and unregulated, such as the trucking and airline industries. Ameritech Ohio found that the risks posed by high operating

leverage and low asset portability in the local exchange market are not shared by either the trucking or airline industries, and that the risks posed by a higher churn rate do not confront the trucking industry. Moreover, Ameritech Ohio considered that investors may be particularly wary of this risk during the early stages of competitive restructuring in the local exchange market, in contrast to the more established environment in the trucking and airline industries. Yet, the trucking and airline industries presently have, on average, higher equity "betas" (measures of volatility) than local telephone exchange carriers. For example, the trucking industry has a beta of 1.05, the airline industry 1.25, and long distance carriers 1.05. Using these figures as boundaries, Ameritech Ohio determined that a reasonable beta measure for LECs in the new era of local exchange competition is 1.15. Exhibit 2 to Dr. Currie's testimony shows the development of the composite cost of capital rates used in Ameritech Ohio's TELRIC studies.

The FCC's TELRIC methodology requires that unit costs be derived from total costs by using "reasonably accurate 'fill factors' (estimates of the proportion of a facility that will be 'filled' with network usage)" and, more specifically, unit costs are to be derived "by dividing the total cost associated with the element by a reasonable projection of the actual total usage of the element." FCC 96-325 para. 682.

Finally, as Mr. Farmer details in his testimony, Ameritech Ohio identified and reasonably allocated shared and common costs with shared costs allotted in proportion to the extended TELRIC costs of unbundled network elements, and common costs apportioned based on either direct or indirect measures of cost causation (for example, square footage for real estate costs) or, if these were not available, on a general allocator reflecting total expenses.

The rates that Ameritech Ohio's cost study supports for local transport and termination on its network of local calls originating on TCG's network are .5248 cents per minute for end office termination and .6910 cents per minute for tandem termination. (See Direct Testimony of Kent A. Currie and James E. Farmer.) These rates reflect the sum of Ameritech Ohio's TELRIC, shared, and common costs of terminating local calls for end office termination (excluding local transport facilities ("LTF")) and for tandem office-based termination. To arrive at the tandem costs sum, it was necessary to multiply the LTF figure by a mileage factor, the average length of the transport between tandem switch and end office, which, in Ohio, is 12 miles. (See Direct Testimony of Kent A. Currie)[10/] These rates permit Ameritech Ohio to recover the long-run incremental, joint, and common costs that it necessarily incurs in transporting and terminating local calls originating on facilities of other carriers, including TCG. Accordingly, Ameritech Ohio believes that its rates comply with the pricing standards

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[10/] In its August 12, 1996 Response to TCG's Petition at pp. 23-24, Ameritech Ohio identified slightly higher costs based on the cost study updates incorporated just after and in response to the FCC's issuance of its regulations on August 8, 1996. Further review of the FCC's Order 96-25 dictated a reapportionment of shared and common costs among all unbundled elements including those relating to transport and termination. The impact on transport and termination was to slightly reduce the shared and common costs allocated to its related unbundled elements from the levels described in Ameritech Ohio's August 12 Response and the cost study submitted the same day to TCG and the panel. This reapportionment of shared and common costs to the unbundled elements associated with transport and termination was due to changes in the TELRICs of other elements and the development of additional unbundled elements required by the FCC Order 96-325. [See Ameritech Ohio's August 27, 1996 response to TCG Data Request Nos. 4 and 5].

set forth in the Act and elaborated in the FCC's implementing rules, as do Ameritech Ohio's expert economists, Debra J. Aron and Robert G. Harris.[11/]

Finally, there is no administrative impediment to monitoring and measuring the transport and termination usage of particular carriers. Ameritech Ohio has efficient measurement and billing procedures in place — and is prepared to implement them immediately — in order to make usage sensitive reciprocal compensation immediately workable.[12/] There is, then, no basis — other than its desire for a windfall — for TCG's opposition to cost-based reciprocal compensation.

Should the Commission defer determination of actual cost-based rates to a future proceeding, the TELRIC studies introduced by Dr. Currie and Mr. Farmer in this arbitration convincingly establish that proxy rates at the highest end of the range approved by the FCC in Report and Order No. 96-325 must be used.

11/ Ameritech Ohio's cost studies also belie TCG's speculation (Montgomery Preliminary Statement at 27-28) that local transport and termination costs are trivial. (See also Aron/Harris Testimony). In addition, they undermine any contention in Montgomery's Preliminary Statement at pages 5-6 that a true determination of termination costs must await the full development of competition in the local exchange market.

12/ Contrary to TCG's assertion, there is no sound economic rationale for excluding the billing expenses that Ameritech Ohio incurs in providing usage sensitive billing for reciprocal compensation. No business, including TCG, could long survive if it did not recover the costs of billing its customers. (See Direct Testimony of Aron/Harris).

III. AMERITECH OHIO'S PROPOSAL FOR INDEMNIFICATION FAIRLY ALLOCATES TO EACH PARTY THE RESPONSIBILITY TO USE REASONABLE MEANS TO LIMIT ITS OWN LIABILITY. IN CONTRAST, TCG'S PROPOSAL UNREASONABLY SEEKS TO IMPOSE UPON AMERITECH OHIO UNLIMITED LIABILITY FOR THE CLAIMS OF TCG'S CUSTOMERS.

A. TCG's Position.

TCG did not specifically raise the issue of indemnification in its Petition or in its statement purporting to clarify the unresolved issues, filed on August 15, 1996 at the Panel's request. However, in its Rebuttal Testimony filed recently in Indiana TCG argued for the first time that Ameritech's liability to end-user customers of TCG and other carriers should not be limited. In correspondence received August 30, 1996, Counsel for TCG advised us that TCG regards indemnification as an unresolved issue with Ameritech Ohio also and intends to pursue it during arbitration.

B. Ameritech Ohio's Position.

Ameritech Ohio proposed that each party to the Agreement indemnify the other party for any loss (including damages, expenses and attorneys fees) resulting from claims by customers of the party relating to the provision of any service or function under the Agreement. In particular, Ameritech Ohio's proposed Section 24.3 provides:

> In the case of any Loss alleged or made by a Customer of either Party, the Party ("Indemnifying Party") whose Customer alleged or made such Loss shall defend and indemnify the other Party (the "Indemnified Party") and hold such Indemnified Party harmless against any or all of such Loss alleged by each and every Customer.

(See Exhibit No. 9 to TCG's Petition for Arbitration, p. 38.) This proposal would encourage TCG to include provisions in its tariff and contracts that would restrict TCG's customers from making claims against Ameritech Ohio.

Ameritech Ohio's current retail service contracts and retail tariffs limit its liability both to its retail and resale customers. Consistent with these limitations, Ameritech Ohio's proposed agreement provides for limitations on its liability to end user customers of resellers. Ameritech Ohio's proposed indemnification provision is appropriate because it limits liability to TCG's end-user customers in the same fashion as Ameritech Ohio limits its liability to its own end-user customers. Ameritech Ohio should not be forced to assume liability to end-user customers of TCG and other carriers beyond what exists for Ameritech Ohio's own end-user customers.

TCG's proposal would expand Ameritech Ohio's liability to TCG's end user customers beyond that permitted by the existing tariffs. There is no reason why TCG's could not take measures to obtain similar limitations of liability to its own customers, rather than, as it now proposes, have the Commission impose unforeseeable liability on Ameritech Ohio via indemnity requirements designed to subvert the projections in the above tariffs. In fact, TCG in its tariffs elsewhere has included substantial limitations on its own liability. For example, in TCG's CAP Tariff (pertinent portion attached hereto), TCG expressly limits its liability

> for damages arising out of the furnishing of these services, including but not limited to mistakes, omissions, interruptions, delays, or errors, or other defects, representations, or use of these services or arising out of the failure to furnish the service, whether caused by acts of commission or omission, shall be limited to the extension of allowances for interruption. The extension of such allowances for interruption shall be the sole remedy of the Customer, authorized user, or joint user and the sole liability of the Company. The Company will not

> be liable for any special, consequential, exemplary or punitive damages a Customer may suffer, whether or not caused by the intentional acts or omissions or negligence of the Company's employees or agents.

TCG's reasons for not wanting such a provision in its agreement with Ameritech Ohio are readily discernible: TCG could obtain a significant marketing advantage if it were to "guarantee" the quality of resold services to customers by claiming not to limit its liability to them -- while at the same time passing that liability and, thus, the cost of making good on that guarantee onto Ameritech Ohio. However, if TCG chooses not to limit its liability, it should not be permitted to hand off the risks of that business decision to Ameritech Ohio while holding on to the rewards.

Recognition of the inevitability of technical problems obviously is the basis for the provisions in TCG's cap tariff quoted above. No carrier can afford to serve as an insurance company for end-users. Telephone systems are not designed to provide perfect service to each and every customer with absolutely no risk of interruption. Instead, they are designed to strike a balance between quality of service and cost that results in adequate and reliable service for all customers at a reasonable cost. Thus, provisions limiting liability of carriers for service interruptions and other problems are based on sound public policy. TCG's proposal is contrary to this public policy because it seeks simply to pass through liability (to Ameritech Ohio), rather than take commercially reasonable measures to limit liability at the outset. Accordingly, TCG's proposal should be rejected and Ameritech Ohio's should be accepted.

SUMMARY OF RESOLVED ISSUES

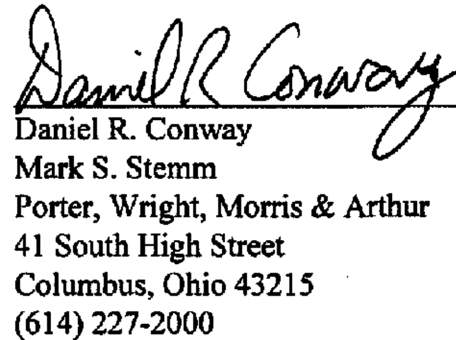
All interconnection issues other than the three discussed above have been resolved and therefore, do not require arbitration.

CONCLUSION

For the reasons set forth above, Ameritech Ohio respectfully urges the Commission Panel to enter an Award consistent with Ameritech Ohio's positions as set forth herein.

Dated: September 3, 1996

Respectfully submitted,



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CERTIFICATE OF SERVICE

This shall certify that a true copy of the foregoing was duly served upon Bruce J. Weston, Law Office, 169 West Hubbard Avenue, Columbus, Ohio 43215-1439 via hand delivery by noon on the 3rd day of September, 1996.

Daniel R. Conway

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