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Decision 97-01-039 January 23, 1997

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Petition of MCI Telecommunications Corporation for arbitration pursuant to 252 (b) of the Telecommunications Act of 1996 to Establish an Interconnection Agreement with Pacific Bell.

Application 96-08-068
(Filed August 30, 1996)

ORIGINAL

OPINION

I. Summary

MCI Telecommunications Corporation (Entrant) and Pacific Bell (Incumbent) filed their last, best, and final proposed agreements for interconnection between their telecommunications networks, unbundled network elements, and other telecommunications services pursuant to the Telecommunications Act of 1996 (the Act[1]) on January 21, 1997. As directed by the assigned Commissioner, such agreements were combined in a single form, and the parties indicated all contractual language that was not in dispute and all contractual language that was in dispute (while preserving any right to appeal the decision of the Commission). The parties present nine issues for the Commission to determine, which we will do. We find the resulting agreement consistent with applicable legal standards.

II. Procedural Background

On August 30, 1996, Entrant timely filed a petition for compulsory arbitration of open issues with respect to a proposed interconnection agreement (Agreement) with Incumbent pursuant to Section 252(b)(1) of the Act and the implementing rules adopted by this Commission. On September 24, 1996, Incumbent timely filed its response pursuant to Section 252(b)(3).

[1] All section references are to the Act unless otherwise stated.

An arbitration hearing was held on October 4, 7-10, and 15, 1996, and each party filed a post-hearing brief and proposed Agreement on November 1, 1996. The parties each filed a reply brief on November 7, 1996, and Entrant filed an alternative proposed Agreement.

The arbitrator issued a report on December 3, 1996, and the parties filed what appeared to be a conformed Agreement on December 10, 1996. Initially, it appeared that despite the efforts of the parties, they were unable to reach closure on how the Agreement should be conformed to the arbitrator's report in a large number of particular clauses, for which the parties submitted alternative contract language for the Agreement. This would have been a reasonable approach had not both parties then proceeded to contend that the conformed Agreement should be rejected and to offer a variety of competing agreements that proved impracticable to sort out.

At our meeting of January 9, 1997, we asked the parties if they would consent to the Commission acting, on January 23, 1997 if we gave them a final opportunity to narrow their differences. The parties agreed that they would benefit from additional time to discuss the Agreement, and Commissioner Duque issued an Assigned Commissioner's Ruling on January 9, 1997. The ruling provided that:

1. The parties were to prepare their last, best, and final proposed agreements for interconnection between their telecommunications networks, unbundled network elements, and other telecommunications services by marking the form of agreement, which they filed on December 10, 1996, to show (a) each agreed clause; (b) each clause that Entrant proposes that differs; and (c) each clause that Incumbent proposes that differs.

2. The parties were free to agree to variations in language from the filing of December 10, 1996, and they could introduce clauses from their subsequent filings, subject to their duty under Section 251(c)(1) of the Act to appropriately work to narrow, rather than to expand, differences.

3. Parties were prohibited from ex parte communications that did not include both parties.

4. Parties could obtain the assistance of the assigned Administrative Law Judge (ALJ) for the purpose of discussing and preparing the final agreements.

5. If the parties sufficiently reduced the number of disputed clauses to a manageable number and scope, the Commission would consider resolving disputes on a clause-by-clause basis; otherwise, all disputed clauses would be decided in favor of one party or the other.

6. The parties were to jointly file the final agreements on January 21, 1997.

On January 17, 1997, the parties jointly met with the assigned ALJ to discuss remaining differences and received his suggestions on how they might resolve such differences. Their filing, on January 21, 1997, reflected substantial progress in narrowing points of disagreement to nine discrete issues, some of which involve competing individual clauses, while others involve multiple competing clauses reflecting the same underlying questions. It is clear both that the parties benefited from the additional time provided and that the resulting scope of disagreement reflects an improved understanding by the parties of the necessity to present the Commission with a manageable number of issues for final resolution.

III. Standards for Review

The standards for review of an interconnection agreement adopted by arbitration are set forth in Section 252, subject to the other provisions of the Act, and principally require us to determine whether the conformed Agreement meets the requirements of Section 251(c).

IV. Discussion

A. Remaining Disputed Clauses

1. Limitation of Entrant's Liability to Incumbent

Generally, Entrant's obligations under the Agreement are to pay Incumbent for network elements or resale services. In addition, however, Entrant may become obligated to incur expense as a result of the Agreement for its own compliance with

governmental obligations. In Paragraph 10.1 of the conformed Agreement[2], which limits the liability of Entrant to Incumbent, both parties agree that such expenses should be excluded from any limitation on the liability of Entrant. Likewise, the parties agree that Entrant's potential liability to Incumbent for environmental contamination (should that occur) not be limited; nor should Entrant's potential liability for willful or intentional misconduct (including gross negligence) or bodily injury, death or damage to real or tangible personal property by negligence be contractually limited. Also, the parties agree that no limitation of liability should apply to certain indemnities. As noted, what remains to be limited, or not, is Entrant's payment obligations under the Agreement, and this is where the parties differ. On page 6 of the conformed Agreement, Incumbent proposes to limit Entrant's obligations during any defined "Contract Year" to the "total of any amounts due and owing" under the conformed Agreement (with the exclusions previously noted). By contrast, Entrant would further limit its obligations to such amounts or $25 million, "whichever is less."

We believe that Entrant overlooked the commercial effect of its language, which is to impose a fixed annual price ceiling of $25 million on its compensation to Incumbent, regardless of the volume of services that it requests. This is so clearly inconsistent with applicable pricing principles in the Act (and those that we would require even in the absence of the Act), that we are compelled to select Incumbent's Paragraph 10.1 on page 6.

2. Exclusion of Consequential Damages

During the course of a contract of the magnitude of the Agreement, it is to be expected that shortfalls in the performance of Incumbent may occur, and the conformed Agreement provides for a range of remedies that match the seriousness of the default. It is common in commercial transactions, however, for the parties to agree that lost revenues, lost savings, or lost profits be excluded as an element of recovery, on the grounds that otherwise a chain of causation could arise from a minor breach that could

[2] All further references to the conformed Agreement, except as specifically stated, are to the final agreements filed jointly by the parties on January 21, 1997.

expose one or the other party to wholly disproportionate consequences. This is sometimes referred to as the "for want of a nail, the shoe was lost" situation.[3] The parties agree that they generally should have no exposure for consequential damages. They disagree, however, on whether an exception should be made for conduct that "causes reasonably foreseeable material harm to the other" party, as Entrant proposes.

We are not the proper tribunal to undertake a detailed analysis of *Hadley v. Baxendale*.[4] Should one party or the other ever find itself seeking compensatory damages for breach of the Agreement, we would not be in a position to render a money judgment, and so it is unlikely that the task of construing the California law of contracts on this point would fall to our lot. Rather, it would be the responsibility of a court of civil jurisdiction. Nonetheless, we must decide whether or not to include the disputed language.

On the one hand, excluding the clause would have the effect of encouraging Entrant to plan for the contingency that lack of performance on Incumbent's part might render Entrant unable to perform its own obligations to its customers. This would have the beneficial effect[5] of encouraging investment in additional infrastructure, and it would tend to discourage major litigation over the Agreement. On the other hand, without the clause Entrant could be left without a remedy in situations that are clearly foreseeable.

For example, it is not difficult to imagine situations in which Entrant has won a major customer from Incumbent and finds itself dependent upon Incumbent for steps required to transfer the customer's business. Through inadvertence[6], assume that the

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[3] "...and for want of a shoe, the horse was lost; for want of the horse, a rider was lost; for want of the rider, the battle was lost; for want of the victory, the kingdom was lost."

[4] (1854) 9 Ex. 341, 156 Eng. Rep. R. 145. This case, visited upon every first-year law student, dealt with the claim of a miller against a carrier who was slow to carry a broken shaft to the manufacturer for repair, causing the mill to stand idle for longer than necessary.

[5] Or the adverse effect of promoting un-needed, redundant investment in duplicative facilities, depending on one's viewpoint.

[6] We are assuming for analysis that any default is unintentional.

Incumbent fails to effectuate the transfer with the result that on the appointed date, the customer is still being served by Incumbent, causing the customer to cancel the contract with Entrant for non-performance. Here, Entrant's direct damages might be modest; it could be out-of-pocket the cost of a lunch meeting between customer and a marketing representative. Yet, through no fault of its own, Entrant would have been deprived of its opportunity to perform on its contract with the customer and that opportunity to perform would return to Incumbent, instead.[7]

In such a situation, Paragraph 10.3 of the conformed Agreement, with its stringent limitation on consequential damages, including lost profits, could unfairly operate to the prejudice of Entrant if the proposed exclusion in Entrant's proposed Paragraph 10.4 is not adopted.

We recognize the possibility that Paragraph 10.4 opens the door to the "meltdown" scenario that Paragraph 10.3 is intended to preclude. We trust in the courts, however, to sensibly construe Paragraph 10.4 to give it a commercially reasonable meaning and appropriately to limit it to the kind of situation we have described. Accordingly, we direct the inclusion of Paragraph 10.4 (at page 7 of the conformed Agreement) in the Agreement.

3. Whether Liquidated Damages Should be an Exclusive Remedy

In Paragraph 12.1 on pages 10-11, the parties propose different remedies provisions relating to the role of liquidated damages. The essential difference is that Incumbent's formulation would make liquidated damages the exclusive remedy for a default, and Entrant's version would not. Consistent with our adoption of Entrant's clause for Paragraph 10.4 on Page 7, we direct the selection of Entrant's clause on pages 10-11 of the conformed Agreement.

[7] A more problematic case arises when Incumbent's default leads the customer to select a third carrier.

4. White Page Listings During Interim Number Portability

Until October 1997, in some areas, and for the next few years in others, when an Entrant customer has dual numbers for a line as a result of a method of interim number portability, the Agreement needs to determine whether both the ported number and the number assigned by Entrant should be shown in the white pages directory. In Paragraph 1 on page 1 of Attachment 4, Incumbent proposes to list only the ported number in the basic listing, and Entrant proposes that both numbers should be considered part of the basic listing. To minimize the bulk of directories and to avoid the potential for confusion, we will direct that Incumbent's clause be included in the Agreement.

5. Resale of Promotions of Less than 90 Days Duration

Entrant proposes that its Paragraph 2.3.1 on page 2 of Attachment 5 be included, to permit it to resell retail services at the same rate that Incumbent offers to the public,[8] in the case of promotions of less than 90 days, and at the promotional rate less the wholesale discount in the case of promotions of greater than 90 days.

The Federal Communications Commission (FCC) has adopted a rule covering resale of promotions.[9] Under that rule, Incumbent must "apply the wholesale discount to the ordinary rate for a retail service rather than a special promotional rate only if ... such promotions involve rates that will be in effect for no more than 90 days."

The rule is no model of clarity. We note that there are a number of possible constructions that we could give it. There is a better analysis, however.

Under Section 251(c)(4)(B) of the Act, Incumbent has the duty not to impose unreasonable restrictions on resale. In light of the purposes of the Act to promote competition, restrictions on resale of promotions of less than 90 days duration could be unreasonable if they gave Incumbent an unfair competitive advantage. Marketing is the essence of promotions, which are designed to persuade the consumer to order a service

[8] That is, not subject to the wholesale discount.

[9] 47 C.F.R. § 51.613(a)(2), which has not been stayed in the pending appeal involving FCC rulemaking on certain provisions under the Act.

now rather than later. From "free to the first 50 callers, a beautiful new toaster," to "order by January 31, and we'll waive installation charges," promotions are designed to spur action. In a market where competitors are offering a commodity service and have similar basic costs, promotions permit competition on the basis of such marketing considerations involving temporary price inducements.

The parties have addressed the potential for Incumbent to abuse the ability to make short-term promotional offers that it is not obligated to provide to Entrant on the same basis. Incumbent may not use promotional offerings to avoid its wholesale rate obligation by, for example, consecutively offering a series of 90-day promotions. There are, perhaps, other means by which Incumbent could obtain an unfair advantage through the use of short-term promotions, and if those arise we will be prepared to prevent their use. However, to give Entrant a meaningful right to resell Incumbent's short-term promotions, we would necessarily have to deprive Incumbent of the marketing nimbleness that it will need to learn and unduly handicap it in competing with Entrant and others. For this reason, we decline to require Entrant's Paragraph 2.3.1 on page 2 of Attachment 5.

6. Effect of Certain Forecasts

Interconnection of Incumbent's facilities with Entrant will entail much joint planning and preparation. While Entrant will be marketing on a statewide or regional basis, Incumbent needs to be prepared to implement on a wire center basis, which requires a degree of specificity. In Paragraph 3.4 on pages 6-7 of Attachment 6, the parties agree that Entrant generally will provide forecasts at the wire center level. However, they disagree on the consequences of errors in such forecasts.

Entrant's forecasts are process inputs to Incumbent's performance. Although there are many other factors that affect Incumbent's performance (such as its internal management, communications, workload planning, state of its existing plant and a multitude of other factors within Incumbent's control), if Entrant's forecasts lead Incumbent to prepare for installations in Riverside, it would be unfair if the demand actually materializes far to the north in San Rafael. Entrant agrees that it would be a

hard result if Incumbent were to incur liquidated damage obligations to Entrant as a result of such a gross forecasting error on Entrant's part. But Entrant believes that Incumbent has enough flexibility at the *regional* level so that if demand forecast for *Sausalito* materializes a few miles up the road at a different wire center in San Rafael, it should be held to its agreed performance standards.

This would be a fair argument if the regional level were finer grained, say within a radius of 50-100 miles. However, Entrant proposes to divide Incumbent's territory into 4 huge regions (*i.e.*, Los Angeles, Bay, North, South). In those circumstances, we do not think Incumbent can be held to any more stringent standard than Entrant, and we will direct that Incumbent's Paragraph 3.4 on page 6 of Attachment 6 be included in the Agreement.

7. Notification for Certain System Changes

Incumbent has the duty under Section 251(c)(5) of the Act to provide reasonable public notice of changes in the information necessary for the transmission and routing of services using its facilities or networks, as well as any other changes that would affect the interoperability of those functions and networks. Under FCC rules, it will be required to give public notice through the FCC in accordance with applicable regulations.

Because Entrant, like similarly situated large telecommunications carriers, has its own internal communications challenges, it would like to obtain the ability to receive direct notice from Incumbent at the same time Incumbent makes its officially required reports to the FCC. The parties agree that this kind of "accommodation notice" is reasonable as a means of assisting Entrant being assured that the information reaches the proper departments within its organization.

The parties differ in Paragraph 10 on page 13 of Attachment 11, however, on whether Incumbent should be relieved of liability in connection with such accommodation notice. Incumbent proposes that it be exempt from any liability. We think Incumbent's proposed limitation is a fair one in light of the primary means of

notification provided by the FCC, and we will direct that its clause be included in the Agreement.

8. Notification for Certain Customer Changes

During the period when interim number portability methods are required, an Entrant customer may elect to choose Incumbent or another carrier, and Entrant may not become aware of the fact in a timely fashion. In Paragraph 5.4.1 on page 5 of Attachment 15, the parties have different clauses to address this situation. We will direct that Entrant's clause be selected, because it provides for a reasonable and definite mechanism, while Incumbent's clause relies on notification procedures to be developed elsewhere that will not necessarily be in place when the problem first arises.

9. Liquidated Damages

On pages 15 and 16 of Attachment 17, the parties propose competing thresholds and resulting liquidated damages for various potential defaults. The purpose of liquidated damages is to provide a remedy to Entrant that is pre-determined. Performance of any contract can be expected to be variable. Sometimes, it is better than average, sometimes it is worse. The measures of performance set standards for determining when performance departs sufficiently from the general run that it should be presumed to damage Entrant. The corresponding liquidated damages are intended to approximate the amount necessary to put Entrant in the position it should have occupied but for the shortfalls. Liquidated damages recognize that while Entrant has clearly lost something, it may be hard precisely to measure how much. They thus provide a measure of "rough justice" and promote speedier resolution of disputes.

We have no way of determining precisely how to balance the competing proposals. Believing that Incumbent's proposal reflects its confidence in meeting the standards and that Entrant's proposal reflects its uncertainty whether it might be relegated solely to liquidated damages as a remedy, we direct that Incumbent's clauses be included in the Agreement because we have permitted Entrant's language that removes the availability of liquidated damages as its sole remedy.

B. Comments of Parties and the Public

Consistent with ALJ-168, we have received comments from the parties. No comments from members of the public were received. We have taken those comments into consideration in evaluating the final offer agreements.

V. Findings of Fact

1. On August 30, 1996, Entrant timely filed a petition for compulsory arbitration of open issues with respect to a proposed interconnection agreement with Incumbent pursuant to Section 252(b)(1) of the Act and the implementing rules adopted by Commission.

2. On September 24, 1996, Incumbent timely filed its response pursuant to Section 252(b)(3).

3. An arbitration hearing was held on October 4, 7-10, and 15, 1996, and each party filed a post-hearing brief and proposed Agreement on November 1, 1996.

4. The parties each filed a reply brief on November 7, 1996, and Entrant filed an alternative proposed Agreement.

5. The arbitrator filed a report on December 3, 1996.

6. The parties filed a conformed Agreement, on December 10, 1996, that included alternative clauses.

7. Comments by the parties were received on or before December 17, 1996.

8. The comments of the parties demonstrated that neither side considered the version of the Agreement that they filed, on December 10, 1996, to represent a workable arrangement.

9. Pursuant to an Assigned Commissioner's Ruling, the parties filed, on January 21, 1997, a revised conformed Agreement that presents a manageable number of disputed clauses for Commission resolution.

VI. Conclusions of Law

1. Approval of the conformed Agreement is governed by Section 252(e) of the Act.

2. The conformed Agreement is consistent with Section 251 (c) of the Act if the clauses indicated in the text are selected.

3. No other changes to the conformed Agreement should be made.

4. The conformed Agreement with such clauses should be approved.

5. Consistent with ALJ-168, no terms of this agreement are precedential.

O R D E R

IT IS ORDERED that:

1. The local interconnection agreement filed by the parties, on January 21, 1997, in response to the Assigned Commissioner's Ruling, dated January 9, 1997, with the clauses set forth herein, between MCIMetro Access Transmission Services and Pacific Bell is approved pursuant to Section 252 of the Telecommunications Act of 1996.

2. The parties shall file an executed copy of such agreement within 10 days of the date of this order and shall supplementally provide two copies to the Telecommunications Division, together with a version thereof in electronic form in hyper text markup language format.

3. Amendments to the agreement referred to in Ordering Paragraph 1 shall be submitted to the Commission via advice letters. Each such advice letter will be deemed approved without a Commission Resolution thirty (30) days from the date the advice letter is filed with the Commission, unless the Commission takes formal action to reject an advice letter. The Director of the Telecommunications Division shall have authority to require additional information explaining the contents of any advice letter and to require parties to file supplements to any advice letter. The Director of the Telecommunications Division may also stay the effective date of any advice letter while requested information and supplements are pending. The advice letter process shall not be used as a vehicle by the parties to appeal the result reached by private arbitration.

4. Application 96-08-068 is closed.

This order is effective today.

Dated January 23, 1997, at San Francisco, California.

P. GREGORY CONLON
President
JESSIE J. KNIGHT, JR.
HENRY M. DUQUE
JOSIAH L. NEEPER
RICHARD A. BILAS
Commissioners

CORRECTION !!

THE PREVIOUS DOCUMENT(S) MAY HAVE BEEN FILMED INCORRECTLY .....

RESHOOT FOLLOWS

4. Application 96-08-068 is closed.

This order is effective today.

Dated January 23, 1997, at San Francisco, California.

P. GREGORY CONLON
President
JESSIE J. KNIGHT, JR.
HENRY M. DUQUE
JOSIAH L. NEEPER
RICHARD A. BILAS
Commissioners