BEFORE THE
FEDERAL COMMUNICATIONS COMMISSION
WASHINGTON, D.C. 20554

In the Matter of)
)
Price Cap Performance Review) CC Docket No. 92-134
For AT&T)

REPLY COMMENTS OF
SOUTHWESTERN BELL TELEPHONE COMPANY

Southwestern Bell Telephone Company (SWBT), by its attorneys, and pursuant to the Notice of Inquiry[1] released July 17, 1992, hereby files its reply comments to comments[2] filed in response to the Notice of Inquiry. In these reply comments, SWBT restates its request that an aspect of AT&T's price cap plan should be altered to remove the bias against the use of local exchange carrier (LEC) access services. SWBT also shows that MCI misconstrues the relationship between competition and price cap regulation.

I. THE CURRENT PROVISIONS OF AT&T'S PRICE CAP PLAN DO NOT PROPERLY FULFILL THE COMMISSION'S INTENT.

In the following discussion, SWBT explains that the requirement for AT&T to flow-through LEC access charge reductions is either redundant or is skewed against LECs. SWBT agrees with U.S. West that the AT&T price cap mechanism should be modified to

[1] Price Cap Performance Review for AT&T, Notice of Inquiry, CC Docket No. 92-134 (FCC 92-257) (released July 17, 1992). The Common Carrier Bureau (Bureau) later extended the submission dates for comments and replies. Price Cap Performance Review for AT&T, CC Docket No. 92-134, Order, (DA 92-1042) (released July 29, 1992).

[2] SWBT references Comments filed by American Telephone and Telegraph (AT&T), MCI Telecommunications Corporation (MCI) and U.S. West Communications, Inc. (U.S. West).

eliminate any bias in the purchase of access services.[3]

The current AT&T price cap plan requires reductions in its long distance price cap indexes with the intent to flow-through any cost savings that result from decreases in LEC access charges.[4] If the interstate long distance market is sufficiently competitive, then the flow-through requirement is not necessary. On the other hand, if competition in the interstate long distance market is not sufficiently vigorous, the flow-through requirement should be redesigned to guarantee that toll customers will receive the benefits of lower LEC access charges without causing distortions in the access market.

The current flow-through, which requires AT&T to lower its price cap indexes when LEC access prices decline, causes an unnecessary bias against AT&T's selection of LEC access services versus competitive assess provider (CAP) access services. With competition evolving in the exchange carrier access market, the Commission should alter the AT&T price cap plan so that it does not bias AT&T's selection of carrier access providers away from LEC access service providers toward CAP access service providers.

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[3] U.S. West, at pp. 3-6.

[4] One interpretation of the need for the "flow-through" requirement is that competition in the interstate long distance market was not considered sufficiently vigorous at that time to guarantee long distance prices would decline in response to a decrease in the cost of providing toll service. See, Policy and Rules Concerning Rates for Dominant Carriers, CC Docket No. 87-313, 4 FCC Rcd. 2873 (1989), at paras. 254, 259-61, 304, 320-21.

A. If Competition Is Sufficient, The Flow-Through Is Unnecessary.

Under the current rules, AT&T does not have the same incentive to purchase LEC services as CAP services when it expects access prices to decline.[5] Maintaining the flow-through requirement for LEC access charge reductions but not for similar CAP price changes effectively provides CAPs a competitive advantage without regard to the relative efficiencies of LEC versus CAP network operations.

One option is to eliminate the flow-through requirement. The use of a flow-through requirement (to reduce interstate long distance prices to end users) is irrelevant if the toll market is sufficiently competitive. A sufficiently competitive environment in the interstate long distance market will not permit AT&T to avoid lowering toll prices to end users when LEC access prices are reduced. Thus, interstate long distance price reductions following access charge decreases will occur as a result of market forces regardless of any flow-through requirement if the retail toll market is sufficiently competitive.

An efficiently functioning competitive market will produce price changes that approximate changes in input costs. If, as AT&T contends,[6] the interstate toll market is characterized by

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[5] This provides an incentive for uneconomic purchasing decisions by AT&T that would result in inefficient allocation of resources.

[6] See, AT&T, at pp. 7-13. AT&T cites the Commission's orders in CC Docket 90-132 to conclude that its Basket 3 services are competitive and to argue that its Basket 1 services are also competitive.

high supply and demand elasticities (indicating that other interexchange carriers (IXCs) have substantial supply capacity and consumers consider the toll services offered by numerous suppliers to be close substitutes for each other), then the market may be sufficiently competitive to ensure AT&T toll prices will decrease as a consequence of declining LEC access charges.

These competitive market conditions imply that if AT&T attempted to strengthen its profitability (in the absence of a flow-through requirement) by retaining the cost savings that resulted from a LEC access charge reduction, then other IXCs would reduce toll prices to improve their competitive positions in the marketplace. To minimize erosion of revenue and market share, AT&T would eventually reduce its retail toll prices. Thus, presuming the presence of vigorous competition, the market itself (in the absence of a regulatory formula) ensures that long distance consumers realize the benefits of declining LEC access charges in the form of lower AT&T long distance prices.

B. If Competition Is Not Sufficient, The Flow-Through Should Be Redesigned.

A second option is to revise the flow-through provision to eliminate any bias between LEC and CAP access services. If the Commission determines that the public interest would be best served by retaining the present form of price cap regulation of AT&T, consideration should be given to its potential effects on the rapidly evolving competitive environment in the access market.

Current regulatory policies require AT&T to reduce its toll prices to offset cost savings resulting from decreases in LEC access charges. However, since cost savings produced by substituting CAP access services for those previously supplied by LECs do not have to be flowed through to price cap index reductions,[7] then consumers can be ensured lower toll prices only if AT&T is required to flow-through all access price decreases regardless of which access supplier provided the cost reduction.[8] Under these circumstances, a flow-through requirement that focuses solely on LEC access prices will not be effective because the customer benefit can be denied by the ability of AT&T to substitute CAP for LEC services (there is no regulatory requirement that AT&T's toll prices be reduced when cost savings result from CAP price reductions or the substitution between LEC and CAP services).

II. MCI MISCONSTRUES THE RELATIONSHIP BETWEEN COMPETITION AND PRICE CAP REGULATION.

MCI wrongly characterizes the relationship between competition and price cap regulation. MCI states: "the switch to price cap regulation was made possible by the increasingly competitive environment in the interexchange market."[9]

Vigorous competition is not a prerequisite for price cap regulation. The upper limit on prices provided by price cap

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[7] Again, this recommendation presumes that competitive market conditions cannot be relied upon to force such a "flow-through".

[8] Access price reductions would come from at least three sources; (1) LEC access price reductions; (2) CAP access price reductions; and (3) the substitution of LEC for CAP or CAP for LEC access, when the substitute is lower in price.

[9] MCI, at p. 2.

regulation becomes irrelevant when the existence of competition sets a *de facto* price ceiling. Thus, it is the lack of competition that necessitates regulation in the first place. The emergence and development of vigorous competition should bring on the demise of any price or earnings regulation, including price cap regulation. The Commission's actions that have relaxed the price regulation of AT&T have recognized that increased competitive pressures have specific implications for the evolution of price cap regulation. Where the marketplace is capable of enforcing price restraints, regulatory price ceilings are no longer needed.[10]

MCI wrongly contends that the AT&T price cap experience should not be applied to the exchange access market. On the contrary, LECs should also be afforded the benefits of increased pricing flexibility, at a time when competition in LEC access markets is becoming more vigorous.

III. CONCLUSION

For the foregoing reasons, SWBT respectfully requests that the Commission remove the bias in AT&T's price cap plan that discourages the use of LEC access services and continue to

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[10] Little or no price regulation has been applied to AT&T's most competitive services. Nevertheless, the Commission has incorrectly applied the tightest pricing constraints on the LECs' most competitive services (i.e., DS3 and DS1 services).

recognize that increased competition should bring on the demise of any price or earnings regulation, including price cap regulation.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I, Gigi Renaud, hereby certify that the foregoing "Reply Comments of Southwestern Bell Telephone Company" in Docket No. 92-134, has been served this 5th day of October, 1992 to the Parties of Record.

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