

EX PARTE OR LATE FILED

HOGAN & HARTSON

L.L.P.

COLUMBIA SQUARE  
555 THIRTEENTH STREET NW  
WASHINGTON DC 20004-1109  
(202) 637-5600

LINDA L. OLIVER  
COUNSEL  
DIRECT DIAL (202) 637-6527

December 15, 1994

RECEIVED

DEC 15 1994

FEDERAL COMMUNICATIONS COMMISSION  
OFFICE OF SECRETARY

*BY HAND DELIVERY*

DOCKET FILE COPY ORIGINAL

Mr. William F. Caton  
Acting Secretary  
Federal Communications Commission  
1919 M Street, N.W.  
Washington, D.C. 20554

**Re: Notice of Ex Parte Communication in CC Docket No. 94-1  
and Bell Atlantic Transmittal No. 700**

Dear Mr. Caton:

On December 15, 1994, WilTel, Inc., met with Geraldine Matise, Chief, Tariff Division, Common Carrier Bureau, and with Dan Grosh, Peter Batacan, and Gene Gold of the Tariff Division. The purpose of the meeting was to discuss points raised by WilTel in its petition to reject Bell Atlantic Transmittal No. 700 and its comments in CC Docket No. 94-1. WilTel was represented by Richard Fruchterman, WilTel's Director of Government Affairs, by myself, and by Peter Rohrbach. The attached handout was distributed at the meeting.

I have hereby submitted two copies of this notice and attachment for each of the referenced proceedings to the Secretary, as required by the

No. of Copies rec'd 024  
List A B C D E

Mr. William F. Caton  
December 15, 1994  
Page 2

Commission's rules. Please return a date-stamped copy of the enclosed (copy provided).

Please contact the undersigned if you have any questions.

Respectfully submitted,

A handwritten signature in cursive script that reads "Linda L. Oliver".

Linda L. Oliver  
Counsel for WilTel, Inc.

Enclosures

**SWITCHED TRANSPORT DISCOUNT TARIFFS**

**Ex Parte of WilTel, Inc.**

**Bell Atlantic Transmittal No. 700  
CC Docket No. 94-1**

**December 15, 1994**

**RECEIVED**

**DEC 15 1994**

**SWITCHED TRANSPORT DISCOUNT TARIFFS**

**FEDERAL COMMUNICATIONS COMMISSION  
OFFICE OF SECRETARY**

**PROBLEM:** LECs are beginning to propose discounts for switched access services that unreasonably discriminate between tandem-switched and direct-routed transport users (and among direct-routed transport users) in the recovery of common costs.

**POTENTIAL ANTI-COMPETITIVE IMPACT:**

**Short-term:** \* Smaller carriers suffer an unjustified access cost disadvantage that interferes with their ability to compete with larger IXCs, especially AT&T.

\* CAPs face an unfair barrier to their ability to compete.

**Long-term:** \* Failure to enforce statutory prohibition on unreasonable discrimination would set the stage for RBOCs to discriminate in favor of themselves if and when the MFJ is eliminated.

**ACTION REQUESTED:**

1. Reject any discount tariff for dedicated transport that does not also include a reasonable and non-discriminatory discount for tandem-switched service.

\* Such tariffs fail the new services test because they presumptively fail to include sufficient overhead on dedicated services.

\* They also violate Section 202(a) because they are unreasonably discriminatory.

2. Closely scrutinize transport discount tariffs for evidence that relative term or volume discounts provided to different customers are cost-based.

## **WILTEL DOES NOT OPPOSE COST-BASED ACCESS DISCOUNTS**

- **We have supported zone density pricing to permit LECs more flexibility to reflect cost differences.**
- **We have indicated our willingness to discuss refinements to zone density pricing that give LECs additional flexibility to reflect cost -- provided that they do so on a non-discriminatory basis.**
- **We have supported cost-based term discounts.**

**On the other hand, we have opposed volume-based discounts on the ground that LEC transport costs do not vary based on volume.**

## **THE IMPORTANCE OF REVIEWING SWITCHED TRANSPORT DISCOUNTS**

### **FOR LONG DISTANCE COMPETITION:**

**Artificial benefits to the largest carrier without corresponding benefits for consumers.**

Access charges make up approximately 40% of an IXC's costs.

Given that profit margins in the switched interexchange market are in the tenths of a cent, even small differences in access cost are competitively significant.

If LECs use volume discounts to charge one IXC (such as AT&T) a lesser proportion of overhead than others, LECs thereby confer a material competitive benefit on that IXC through unreasonable discrimination that is not based on cost.

This discrimination does not necessarily result in lower prices for consumers. The IXC receiving the discriminatorily low access price may pocket that savings. Alternatively, it may use some of the savings to reduce prices to pressure other IXCs who cannot respond through access savings of their own.

### **FOR ACCESS COMPETITION:**

**Unreasonable barriers to competition by new entrants**

LECs have an incentive to use volume and term discounts to lock up customers before access competition has an opportunity to develop.

They can accomplish this through imbalanced overhead loadings on transport services, and particularly through disproportionate overhead loadings on services where they face no competition -- such as TST.

### **FOR TELECOMMUNICATIONS COMPETITION IN A POST-MFJ WORLD:**

**RBOC discounts in favor of their own IX services**

WilTel opposes any relaxation in the MFJ interLATA service prohibition.

However, because the RBOCs are pushing for this result, the Commission must contemplate how the RBOCs might price access to themselves.

To the extent, RBOCs are permitted to provide non-cost based and discriminatory volume and term discounts to certain IXCs today, they will have the tool to discriminate in favor of themselves in the future.

**THE COMMISSION HAS AGREED TO SCRUTINIZE SWITCHED  
TRANSPORT DISCOUNTS WITH SPECIAL CARE**

The Commission indicated in the Expanded Interconnection Order that it believed cost differences could justify both volume and term discounts, but left proof on this issue to the tariff process. According to the Commission:

“When LECs first introduce [term and volume] discounts on switched transport offerings, they will be required to provide cost justification because such discounts are new services under the price cap rules.” Order at para. 174.

The Commission also provided for a 120 day notice period so that the Tariff Branch would have time to carefully review new discount tariffs in advance.

**THUS, THE TARIFF DIVISION NOW IS CHARGED WITH ENSURING  
THAT ONLY COST-BASED, NON-DISCRIMINATORY VOLUME  
DISCOUNTS TAKE EFFECT**

## SWITCHED ACCESS DISCOUNTS: BACKGROUND

In July the Commission ordered that careful advance review of switched access discounts is necessary so that LECs do not abuse this pricing flexibility. [Expanded Interconnection, 9 FCC Rcd 5154 (1994)]

### 1. The FCC Has Given the LECs Only Limited Flexibility to Implement Discounts at this Time

The FCC has found that “[p]ermitting volume and term discounts for switched transport is a substantial departure from our past practice, and must be done cautiously.” [Id. at 5204, ¶ 183 (emphasis added)]

The FCC therefore has established a “higher threshold for switched transport discounts” than special access discounts to “gradually introduce LEC pricing flexibility and facilitate the initial development of competitive entry.” [Id. (emphasis added)]

The FCC has refused to grant LECs broader pricing flexibility because “the LECs continue to possess substantial market power in the provision of special access and switched transport services.” The Commission concluded that zone pricing and switched access discounts “under the criteria we have set” are sufficient flexibility at this time. [Id. at 5207, ¶ 195 (emphasis added)]

### 2. Switched Access Discounts Require a Cost Showing Under the New Services Test

- Volume discounts must be “reasonable” and “justified by underlying costs.” [Expanded Interconnection, 8 FCC Rcd 7374, 7433]
- LECs must provide “extensive cost showings” [Expanded Interconnection, 9 FCC Rcd at 5206] regarding the underlying direct costs of the new offering, using the same cost methodology for all related services. [Part 69/ONA Order, 6 FCC Rcd 4524, 4531]
- LECs must justify any departures from uniform loading of overheads. [Id.]
- LECs cannot bootstrap discounted switched transport “based on pre-existing discounted special access rates.” Separate cost justification for the switched access discounts is required. [Expanded Interconnection, 9 FCC Rcd at 5206, ¶ 192]

**3. LEC Discounts Must Not Violate Section 202 Discrimination Prohibitions**

TST, DS1, DS3, and multiple DS3 are different capacities of the same like service -- switched transport. Each option is a functional substitute for the other.

IXCs choose among these transport options based on the size of their traffic requirements -- the greater the requirement, the larger the transport capacity required. As a general rule, AT&T buys DS3 DTT; MCI and Sprint buy DS1 DTT, and other IXCs buy TST. This makes discrimination in the pricing of these transport options a ready mechanism for discrimination among IXC access customers.

LECs therefore must demonstrate that any new discount options for these services are not unreasonably discriminatory in violation of Section 202(a).

This requirement is distinct from the cost showing required by the new services test.

**4. RBOCs have a separate legal duty under the MFJ to charge cost-based access rates and not discriminate in favor of AT&T.**

Although the FCC is not responsible for enforcing the MFJ, it should keep this issue in mind as it reviews discount plans.

**THE COMMISSION SHOULD REJECT BELL ATLANTIC'S  
ATTEMPT TO FLAUNT THESE REQUIREMENTS**

Proposed Rates

- DS3:               Discounts up to 50% for a five year term
- DS1:               Discounts up to 30% for a five year term
- TST:               No discounts
- Multiple DS3:    Additional discounts in excess of DS3 levels

Failings in the Proposed Justification

Bell Atlantic has disregarded the specific requirements of the FCC's order and the Communications Act.

1. Bell Atlantic fails to provide detailed cost justification required by the new services test.
2. Bell Atlantic does not even provide overhead loadings, let alone demonstrate that those loadings are reasonable across all services.
3. Bell Atlantic justifies its discounts on the ground that they "reflect the market pricing of the special access services" -- even though the FCC has made clear that a separate cost justification is required for switched access discounts.
4. *And most importantly, Bell Atlantic discriminates against TST users who will see no discount (presumably because they remain captive customers of the RBOC).*

Results of the Proposed Justification

1. Bell Atlantic does not show any cost savings from term service.
2. Bell Atlantic does not show that the differences between the discounts for DS1, DS3 and DS3C volume levels are based on cost. To the contrary, Bell Atlantic's cost showing provides further evidence that even the current non-discounted rates are not cost-based.

## **Action Necessary**

### **THE COMMISSION SHOULD REJECT THE BELL ATLANTIC TARIFF ON BOTH SUBSTANTIVE AND PROCEDURAL GROUNDS.**

1. The Commission should demonstrate that it meant what it said in July when it ordered careful review of volume and term discounts under the new services test. That test requires "extensive cost showings" to determine whether they are "justified by underlying cost."

LEC tariffs that fail to meet these conditions, either procedurally or substantively, should be rejected.

2. In particular, the Commission should make clear that when it reviews transport discounts, it will expect LECs to demonstrate how those discounts are non-discriminatory as required by the Commission's rules and Section 202 of the Communications Act.

- Demonstrate no increase in non-cost-based discrimination *among DTT services.*
- Demonstrate no increase in non-cost-based discrimination *between TST and DTT services.*

**If the Commission permits LECs to implement non-cost-based and discriminatory discounts, it will be giving them the very pricing flexibility it said was inappropriate in July when it established the standards for reviewing these discounts.**

## **THE COMMISSION'S EXPANDED INTERCONNECTION TARIFF DECISIONS SUPPORT CLOSE EXAMINATION OF DISCRIMINATORY OVERHEAD LOADINGS FOR SWITCHED TRANSPORT SERVICES**

In its recent order suspending and investigating the permanent expanded interconnection tariffs, the Common Carrier Bureau found unjustified the LECs' non-uniform allocations of overhead in connection with their expanded interconnection offerings. <sup>1/</sup> The Bureau reached the following specific conclusions, each of which applies equally to transport volume and term discounts:

1. Overhead loadings for expanded interconnection offerings should be compared with the overhead loadings applied to special access services, which are "comparable" to the expanded interconnection offerings (paragraph 20).

- The Commission likewise should compare the overhead loadings for DS1 and DS3 discounted offerings with the overhead loadings applied to tandem-switched transport.

2. The LECs were not permitted to load higher levels of overhead on the expanded interconnection services, which LECs provide to competitors, and lower levels special access services, for which they face competition (paragraph 21).

- The Commission also should reject any attempt by the LECs to load more overheads on tandem-switched transport, for which the LECs face no competition, and less on high-volume dedicated transport, for which LECs do face competition.

3. "Market forces" or "market conditions" do not justify non-uniform overhead allocations. (paragraph 21)

- The Commission also should reject market forces as justification for the discriminatory allocation of overheads among transport services.

4. Discrimination is of particular concern when it has potential adverse consequences for competition (paragraph 22).

- So too, discrimination in transport pricing has adverse consequences for long distance competition:

---

<sup>1/</sup> Ameritech Operating Companies, Revisions to Tariff FCC No. 2, CC Docket No. 94-97, DA 94-1421, released December 9, 1994.

- **First, discrimination in overhead allocations requires smaller providers to shoulder a disproportionate share of overheads.**
- **Second, it impedes the ability of CAPs to compete in the provision of dedicated transport, because the LECs are recovering less overhead from competitive services.**
- **Third, transport discrimination will have even greater competitive consequences if the BOCs are allowed to provide interLATA services.**

## **PRICE CAP REVIEW**

**The most important task for the Commission in the price cap review proceeding is to improve the ability of the price cap system to check unreasonable discrimination.**

**This will require modifications to both the new services test and the price cap structure itself, with special focus on discrimination in the recovery of common costs and overhead loadings.**

## TODAY LEC PRICE CAPS PRINCIPALLY ADDRESS OVERALL RATE LEVEL PROBLEMS -- NOT DISCRIMINATION

### Background

1. The price cap band and basket system was designed for AT&T, whose ability to discriminate is constrained by the existence of hundreds of IXC competitors, including both facilities-based carriers and resellers.

2. Price caps were simply imported into LEC regulation, without extensive consideration of why discrimination concerns are more significant in the access sphere. For example:

(a) Discrimination in access is more damaging to competition.

-- Access is the primary input to a product (long distance), so discrimination among purchasers of the access product materially impacts their respective ability to compete. Outside of long distance, there are virtually no industries where a monopolist provider supplies an input that constitutes approximately 40% of the cost of the final product.

-- In contrast, discrimination among customers of long distance services is less damaging to society because long distance is virtually never the principal operating cost in an industry, so such discrimination is not competitively significant. (The only exception is discrimination against those who would resell long distance services in competition with the underlying facilities carrier. Hence the disputes over whether AT&T's contract tariffs are truly available for resale.)

(b) Discrimination in access is becoming more dangerous because LECs (and in the future perhaps RBOCs) compete with those who depend upon access to their local loops, and for the most part other elements of the local network.

-- Insofar as flaws in price cap regulation leave RBOCs free to discriminate, they are a key reason not to modify the MFJ.

(c) Discrimination in access is becoming more likely.

-- First, in a fiber world an even greater amount of LEC costs relate to use of common network plant and overhead, costs that can be shifted in a discriminatory fashion. Second, in a world of incipient competition, LECs have increased incentives to discriminate against those customers with the fewest competitive alternatives.

## **THE COMMISSION MUST BETTER ADDRESS DISCRIMINATION UNDER LEC PRICE CAP REGULATION**

1. **Structural Reforms:** Price cap baskets and bands alone are not sufficient to prevent discrimination. The Commission must re-assess LEC rate relationships and adopt measures such as price indexing across baskets to curb the LECs' ability to discriminate in the future.

2. **The New Services Test:** The current test gives the LECs broad latitude to engage in strategic and discriminatory pricing. It sets a floor to prevent predatory pricing, but does not adequately address the LECs' ability and incentive to discriminate in the recovery of network overheads:

The Commission should adopt pro-competitive pricing principles to evaluate new and restructured LEC services:

- Prospective (not historical) costs should be used.
- Direct costs for all services should be determined using a long-run incremental cost approach.
- Uniform overhead allocations across all price cap services should be required (except as justified by LECs on a case-by-case basis).
- Other common costs or subsidy amounts should be recovered on a nondiscriminatory basis across all services.
- LECs should be given additional pricing flexibility only if price indexing is in place.

Each of these principles is necessary; failure to adopt any one would leave a large loophole for discrimination.

3. **Use LEC productivity gains to reduce discrimination.** WilTel believes that the productivity factor should be increased to more accurately reflect LEC productivity gains, and that LECs accordingly should be required to reduce their rates. The Commission should require the LECs to use these reductions to reduce discrimination in current rates -- not give LECs the flexibility to reduce rates however they want. The latter course would only lead to a worsening of anticompetitive discrimination.

4. **Sharing should be maintained.**