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June 23, 1995

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JUN 23 1995
FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF SECRETARY

BY HAND DELIVERY

Mr. William F. Caton
Secretary
Federal Communications Commission
1919 M Street, N.W., Room 222
Washington, D.C. 20554

Re: Notice of Ex Parte Communication in CC Docket No. 94-1 and RM-8614

Dear Mr. Caton:

On June 22, 1995, on behalf of WorldCom, Inc., d/b/a LDDS WorldCom 1/, Richard L. Fruchterman III, Director, Government Affairs, WorldCom, and Peter Rohrbach and I, of Hogan & Hartson, met with James R. Coltharp, Special Advisor to Commissioner Andrew C. Barrett, to discuss the referenced proceedings. The purpose of the meeting was to discuss the points made in WilTel's comments and reply comments and in LDDS's February 8, 1995, ex parte comments in CC Docket 94-1 and to discuss the points made in LDDS's April 10, 1995, response in RM-8614. The attached handout was also used in our discussion.

1/ LDDS Communications, Inc., recently changed its corporate name to WorldCom, Inc., and will do business under the name LDDS WorldCom.

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List A B C D E

I have hereby submitted two copies of this notice for the referenced proceeding to the Secretary, as required by the Commission's rules. This filing is submitted today because of the late hour of yesterday's meeting. Please return a date-stamped copy of the enclosed (copy provided).

Please contact the undersigned if you have any questions.

Respectfully submitted,

Linda L. Oliver

Linda L. Oliver
Counsel for
WorldCom, Inc.,
d/b/a LDDS WorldCom

Enclosures

cc: James R. Coltharp

EX PARTE PRESENTATION OF LDDS WORLDCOM

LEC PRICE CAPS FURTHER NOTICE CC DOCKET NO. 94-1

JUNE 22, 1995

QUESTIONS THAT SHOULD BE INCLUDED IN THE PRICE CAP FURTHER NOTICE

A. General Issues

- Retail/Wholesale Distinctions. How does discrimination in the pricing of wholesale inputs to competitors (access, interconnection, loops, etc.) differ from discrimination in the pricing of retail services to end users? Should price cap regulation distinguish between the two? Should more stringent regulation apply to wholesale services?

- RBOC Reentry. How much would interLATA entry by the RBOCs increase the incentives for discrimination in access pricing? How should that be dealt with (a) in the regulation of wholesale services used by RBOC competitors?; (b) in the regulation of retail RBOC interexchange services?

- Impact of Separation. Does the transition to a more competitive telecommunications environment require new safeguards in addition to changes to price cap regulation? For example, assuming separation of RBOC retail long distance services is required, should different price cap rules apply to the wholesale interconnection and access rates of the original subsidiary than to the retail long distance rates of the new separated entity?

- Relationship to Local Competition. How will the FCC's price cap rules intersect with attempts to create local competition? To the extent that wholesale LEC network facilities will be used by competitors to provide local service, how will the FCC's regulation of those facilities for interstate access be harmonized with state regulation?

- Distinction between local and access competition. The local service provider will retain bottleneck power over access to its customer required by other vendors such as long distance companies. How should this problem be reflected in price cap considerations for LECs? How should the Commission treat the market power of new LECs over access to their developing customer bases?

- Extent of Competition. At the most general level, how will local network competition develop? Where will it grow first? What elements will present continuing market power problems?

B. Price Cap Specific Issues

- What protections against discrimination can be built into the price cap plan?

- How can increased pricing flexibility be implemented so as to minimize the risk of discriminatory and anticompetitive pricing?

- Should the Commission adopt general guidelines for evaluating the allocation of shared network costs and overheads for access services (similar to those it has adopted in its review of expanded interconnection and video dialtone tariffs)?

- Should the new services test be modified to guard against discriminatory pricing of new services vis-a-vis existing services?

- How should the Commission ensure nondiscrimination in going-forward rates (after the new services test has been satisfied)?

- Should existing access rates be reviewed with discrimination concerns in mind? If not, what other tools should be used to address discrimination in preexisting LEC rates?

- What is the relationship between price cap changes and overall "access reform"? How much discretion should LECs be given in this process, and how will it impact discrimination concerns?

BACKGROUND

I. LEC PRICE CAPS PRINCIPALLY ADDRESS OVERALL RATE LEVEL PROBLEMS -- NOT DISCRIMINATION

- 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.

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

- But discrimination is a problem in the access market. Failure to protect against access discrimination can have serious consequences for competition in other retail markets:

(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.

(b) Discrimination in access is becoming *more dangerous*.

- 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.

- Because access is a wholesale input for downstream retail services, access price discrimination has competitive consequences.

- 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*.

- 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.

- In a world of incipient competition, LECs have increased incentives to discriminate against those customers with the fewest competitive alternatives.
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- The Commission's concern for discrimination in the recovery of common costs and overheads -- which it has made clear in connection with expanded interconnection and video dialtone -- is also critical in connection with access pricing.

(d) Access competition *will not prevent discrimination.*

- Until competition has developed in every access product and geographic market, the LECs will have the incentive and ability to recover the shared and common costs of the network, and overheads, from those services that are less competitive.

- Competition for tandem-switched transport remains virtually nonexistent.

- The Commission therefore cannot rely on competition to prevent discrimination.

(e) Local service competition is *not* the same thing as access competition.

- For example, even if a LEC loses 5% of its local customer base to a new local service provider, it will still have bottleneck control over access to the 95% of customers that remain with the LEC.

- Conversely, IXCs and others will be just as dependent as before on access to the LEC customers. The only difference is that now they also will be dependent on the new local service provider to reach the rest of the local customer market.

- The new local service providers also will be dependent upon the traditional LEC in their market.

- As a result, price cap changes cannot be driven by local service competition per se. LECs will have dominant market power in the wholesale access market for the foreseeable future.

II. THE COMMISSION MUST ADDRESS DISCRIMINATION UNDER LEC PRICE CAP REGULATION

In the Further Notice, the Commission should ask for proposals to address price discrimination within the context of price cap regulation. Such proposals might include the following, which LDDS WorldCom 1/ supports:

1. Structural Reforms: Price cap baskets and bands alone are not sufficient to prevent discrimination. The Commission should re-assess LEC rate relationships and consider measures such as price indexing across baskets to curb the LECs' ability to discriminate in the future. The Commission should also consider other access charge changes that would move access pricing closer to cost.

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 propose the adoption of 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.

1/ WilTel, Inc., discussed these proposals at length in its comments filed in the LEC price cap review proceeding. LDDS WorldCom acquired WilTel early in 1995.