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July 27, 1995

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

Re: Notice of Ex Parte Communication in CC Docket Nos. 94-1 and 95-20 and RM-8614

Dear Mr. Caton:

On July 26, 1995, Richard S. Whitt, Director, Federal Affairs, WorldCom, Inc., d/b/a LDDS WorldCom 1/, and Peter A. Rohrbach and I of Hogan and Hartson met with Karen Brinkmann, Special Counsel, Tariff Division, Common Carrier Bureau, to discuss the referenced proceedings. The purpose of the meeting was to discuss the points made in LDDS's April 7, 1995, comments in CC Docket 95-20 and LDDS's April 10, 1995, response in RM-8614. The attached handout and the attached LDDS WorldCom July 1995 White Paper entitled "The Pressing Need for Wholesale Local Exchange Services" were 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 each of the referenced proceedings 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 BH

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

Enclosures

cc: Karen Brinkmann

EX PARTE PRESENTATION OF LDDS WORLDCOM

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

JULY 26, 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.
-
- 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.

The Pressing Need for Wholesale Local Exchange Services

A LDDS WorldCom White Paper

July 1995

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The Pressing Need for Wholesale Local Exchange Services

A LDDS WorldCom White Paper

INTRODUCTION AND EXECUTIVE SUMMARY

Commissions throughout the country are grappling with the long (and growing) list of issues that must be resolved to plant the seeds for competitive entry in the local exchange telephone market. If successful, then in several years business and residential consumers could find themselves wooed by competing vendors offering innovative local services and lower retail prices, just as has developed over the past decade in the long distance market.

For the foreseeable future, however, we cannot expect to see multiple carriers duplicating the ubiquitous wireline network facilities of the LECs. It follows that the vigor of *retail local services* competition will depend upon new vendors having non-discriminatory access to the LEC *wholesale network facilities platform*. This paper explains why state commissions must elevate creation of wholesale local exchange service to the highest priority in their efforts to develop a competitive local telecommunications marketplace. If properly priced and provisioned, wholesale local exchange service could bring the following benefits to consumers and to competition:

1. More competition faster. Consumers benefit because wholesale local service permits vibrant retail local service competition to begin immediately.

2. Foundation for RBOC entry. Wholesale local service is one necessary precondition to RBOC provision of interLATA service.

3. More consumer choice. Wholesale local service allows all potential retail service providers to participate in the offering of a diverse range of full-service packages to consumers.

4. Promotion of new facilities-based local networks. Wholesale local service helps potential facilities-based local service providers enter the local market and build out in an efficient way.

These goals are all desirable. However, state commissions do not have the luxury of pursuing them slowly over the next few years at their own pace. RBOC efforts to eliminate the MFJ make wholesale local service an urgent priority. This service must be in place, at correct prices, and fully debugged of operational problems, before the interLATA restriction can be lifted. At that point RBOCs would be able to offer full-service, one-stop shopping for both local and long distance services immediately -- using wholesale *interexchange* services available today. But at that time, consumers also must have other competitive choices for retail full-service telecommunications. Only a commercially viable wholesale *local* service can provide them that choice.

Wholesale Local Service is Necessary to True Local Competition

Regulators have recognized the technical and economic fact that *retail* local service competition for consumers will depend upon access by other vendors to the *wholesale* facilities platform of the incumbent LEC. Much attention has been

paid to how the LEC network might be "unbundled" so that a new entrant could use network piece parts to create a "semi-facilities-based" competing service.

However, this emphasis on unbundling puts the cart before the horse in important respects. It underestimates the magnitude of the task of replacing the LEC network -- even the partial replacement of individual components. And in particular, it misses the point that unbundling does not permit the benefits of retail local service competition to be enjoyed quickly throughout a region or a state, rather than simply in limited core business centers. Investment in new competing facilities networks may proceed in the future where it is efficient, and "unbundling" is useful for that purpose. But local retail competition should proceed first, building a competitive market that can justify such facilities investment.

State commissions can address this dilemma by requiring LECs to offer a "carrier's carrier" wholesale local exchange product. By this we mean a new wholesale version of LEC retail services that other carriers can purchase at wholesale rates and use to build retail products for consumers. The wholesale service is essentially one input to the retailer's overall local service product, along with the retailer's own customer service, billing, and other operations.

This is not the same thing as simply reselling the LEC's own retail local services, and it is important to understand that removal of resale restrictions alone is totally insufficient. Rather, LECs must introduce new wholesale products specifically designed to be used by other carriers to provide retail service. First, those products must be priced on a non-discriminatory basis at levels that do not include the LECs' retailing costs (and, importantly, do not bear a discriminatory share of contribution and universal service burdens). Second, LECs must develop

new support systems with which other local service retailers will interface for the ordering, provisioning, maintenance, and billing of the wholesale local product.

At the end of the day, a customer should be able to call a new carrier to order local service at that carrier's retail rates, and the carrier should be able to supply the customer using the LEC's wholesale local exchange service, as easily as if the customer were dealing directly with the LEC itself. The customer would thus make its decision among local retail competitors based on their relative retail rates, and on other value that retailers can overlay on the basic wholesale local service input. This value may be in the form of superior customer service, innovative pricing plans, or new "bells and whistles" still to be developed. In short, consumer demand will drive a competitive retail market, while regulators focus their attention on preventing LEC discrimination in the non-competitive wholesale local facilities market.

This is not to minimize the value of LEC network unbundling. That process is essential to the creation of competing local networks. Such new facilities must eventually be deployed to reduce LEC power in the underlying wholesale market. But to achieve the goal of *retail local services* competition for consumers anytime soon, it is self-evident that new entrants will be required to use the *wholesale local facilities* networks already deployed by the LECs. And in particular, new entrants will require access to the wholesale local exchange service that is the subject here.

Wholesale Local Service Requires Attention Now

Why is this a "pressing" issue, as referenced in the title of this paper? First of all, little experience with wholesale local exchange service exists. So far the Rochester Telephone experiment marks the only trial of this product. Problems in

pricing and systems interfaces in Rochester demonstrate that much work needs to be done to make the wholesale product available on a non-discriminatory basis so that retail competition with the LEC can proceed fairly.

Second, it is increasingly clear that facilities-based local competition itself depends upon the availability of a commercially-viable wholesale exchange service product. As in the interexchange market, the natural development path for a carrier is first, win a customer base and serve those customers over resold wholesale facilities, and second, substitute your own network facilities where it is efficient and cost-effective to do so. Only this plan permits new competitors to market services widely (and meet the general duty to serve imposed by many statutes) as they go into business. And only this plan permits new local carriers then to raise the investment capital (and justify the investment) in extensive local facilities networks of their own. The only exception, perhaps, may be the local cable television company with its preexisting network endowment. But obviously local competition should be more than a division of the market between LEC and cable.

Third, and most important, wholesale local exchange service is urgently needed as a precondition to proposed changes in the Modified Final Judgment, and the changes in telecommunications industry structure that would result. As noted above, if the RBOCs are allowed to offer long distance service, becoming full service providers overnight, then it becomes absolutely *critical* that all other long distance companies immediately be able to offer local exchange services to compete. IXCs will have this opportunity only if they have access to mature wholesale local service products that they can easily pair with their own long distance products -- just as the RBOCs will enjoy immediate use of the long distance industry's wholesale products. Loop unbundling and similar measures, while useful in the eventual development of new local facilities networks, are not

adequate to permit IXCs to respond to full-service RBOC competition in the "Brave New World" to come.

Put simply, in an environment in which retail local and long distance services are sold together, the overall telecommunications market will only be as competitive as its least competitive link. The weak link now, and likely for the future, is local exchange service. Clearly the RBOCs must be prohibited from damaging today's retail long distance competition by discriminating in favor of themselves with respect to interexchange access -- a use of their wholesale local network that is a necessary input to all *retail toll services*. But RBOCs also must be required to make their wholesale local network available on an equal and nondiscriminatory basis to competing carriers who require the use of that network for *retail local services*. If the RBOCs do not, then they will be able to leverage their unique position in the local market (singularly positioned as a full service provider), to damage toll competition no matter how well "access" is regulated.

Consumers, therefore, need state commissions to create nondiscriminatory wholesale local exchange products for two fundamental reasons: (1) to promote retail local service competition itself, and (2) to preserve vigorous competition in the full-service market to come.

I. THE CRUCIAL ROLE OF WHOLESALE LEC NETWORK SERVICES IN COMPETITION

We take as a given that for the foreseeable future the LEC wireline network will be the only ubiquitous platform for basic local exchange services. 1/

1/ This does not rule out the possibility that, at some point in the future, wireline and wireless services will become marketplace substitutes for one another. At that point it would be appropriate to reevaluate the LEC's dominance of the wireline facilities market, particularly if the LEC does not also substantially dominate wireless services. However, for the next decade end users are likely to

First, as a matter of physical construction, it would take new entrants years to lay out such networks. Second, as a matter of capital finance, adequate investment funds will not be raised, particularly if carriers have not already begun to develop a retail local customer base to support such investment. Third, as a matter of efficiency, it is questionable whether the nation needs multiple local facilities networks deployed everywhere. After all, LECs already operate high capacity local networks -- built at ratepayer expense -- that handle virtually every local and toll call today, and can be expanded easily to meet future capacity requirements. 2/

Last, but not least, as a fundamental tenet of competition policy, deployment of facilities networks should never become an entry requirement to participation in the local telephone market. Otherwise consumers only will have as many retail service companies competing for their business as they have wireline loops to their premises. 3/ Today entry into the *retail long distance* market is simple because new vendors can purchase the "carrier's carrier" wholesale

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find wireline service less expensive, higher quality, more secure (and more comfortable as the established technology), and therefore retain wireline service while using wireless as an additional supplemental service where mobile requirements justify it. Local competition policy should treat wireline local service as a separate market until and unless consumers begin discontinuing wireline service to their homes and businesses.

2/ Regulators should remember that local competition remains an experiment, intended to test -- not establish -- the limits of the LEC's natural monopoly.

3/ Thus, for example, even if a cable company begins to offer local service over its loops, there still must be a means by which other retail vendors can compete to serve customers. Future competition cannot be limited to the incumbent LEC and the cable company, especially in a full-service telecommunications marketplace where the LEC and the cable company are competing in both the local and toll markets. Other vendors must be able to compete for those same customers over either the LEC or the cable company's loop. This way consumers will receive the full benefits of true competition, and not a choice between two oligopolists.

interexchange service products available to them at competitive prices from several network facilities companies, including LDDS WorldCom. They also can easily resell access purchased from the LECs. *Retail local service* competition requires similar "carrier's carrier" wholesale local service products available from the sole source of an essential ubiquitous local facilities network -- the LEC.

In this section of the paper we discuss why wholesale local service is critical, first, to the development of retail local service competition, and second, to the preservation of both local and long distance competition in a post-MFJ world.

A. Creating Retail Local Service Competition: The Limitations of Loop Unbundling

The concept of "local telephone competition" has been complicated by the evolution in the ambition of the new entrants, as well as its recent juxtaposition with MFJ relief for the RBOCs. As recently as a year ago, entrants were labeled "competitive access providers" ("CAPs"), not local telephone companies. The primary business plan of these entrants was the deployment of new fiber optic facilities in major population centers to compete in the market for dedicated transport and special access. For regulators, this facilities-based entry raised difficult but limited issues: the terms and conditions of so-called "expanded interconnection" between LECs and CAPs in particular.

In time the CAPs found that the business opportunity available in the dedicated access market was quite small, and they began to turn their attention to provision of service to end users, beginning a market shift towards full-service providers. The CAP focus, however, was geographically distinct, extending the product lines they could offer to the small universe of customers within reach of their limited "boutique" facilities networks. They began to sell long distance

services to end users themselves, competing with the IXCs that had been their erstwhile "access" customers. And more recently, CAPs have begun the slow process of deploying a few switches capable of handling the local traffic of some of the businesses located near their networks.

This evolution has meant that consideration of how the LEC makes its network available for local competition has, until recently, been viewed from the narrow CAP perspective -- a geographically limited network that begins with no subscribers. First, regulators have been concerned with the rates that the CAPs pay the LEC to terminate local calls originated by the small handful of customers served by CAP lines. (This termination service, which is the same as LEC terminating access service for interexchange calls, has presented enormous pricing problems given the extent to which access rates exceed cost.) 4/ Second, regulators have faced CAP requests for the right to buy unbundled LEC loops between the few CAP switches and the small percentage of customers that can be served by those switches. In other words, the CAP is substantially relying on the LEC's local exchange network (obtained at wholesale rates) as the primary input for its retail local service. For a new entrant such as a CAP, with no preexisting customer base, this niche entry strategy may be satisfactory.

However, it is important to understand the limits of the "unbundled loop" approach for purposes of more widespread local service competition. First of all, no regulator should disregard the extent to which new retail competitors will rely on the LEC transport network. We may see limited networks in certain

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4/ This terminating service is functionally equivalent to the feature group access service presently sold to interexchange carriers. Over time wholesale rates for these services should come together so that terminating charges do not depend upon where a call originated before it hit the local LEC network.

locations. But most competitors will rely heavily on use of the wholesale LEC transport network -- whether this is called "interconnection" or "access" or "resale."

But second, local switching also presents a serious entry barrier to local competition. It is one thing to deploy a single local switch and metropolitan network, and market local service selectively to a small number of customers conveniently located within the range of that boutique network. But it is another to replicate in any material respect the switching capacity of the LECs today so as to serve the public at large, including residential customers and more geographically dispersed business customers. For example, as shown in Table 1, the RBOCs operate nearly 10,000 local switches, and the LEC industry as a whole operates nearly 18,000. In contrast, AT&T serves the interexchange market with only 134 switches nationwide.5/

5/ Source: Testimony of AT&T witness Jane Medlin, Application of AT&T for a Local Exchange Certificate in the State of Michigan.

Table 1: Switching Capabilities of the Local Telephone Industry 6/

Company	Number of Tandem Switches	Number of Local Switches
Ameritech	47	1,422
Bell Atlantic	42	1,405
BellSouth	70	1,661
NYNEX	23	1,307
Pacific Telesis	20	846
Southwestern Bell	64	1,437
US West	52	1,834
Total Bell Operating Companies	318	9,912
Total Local Telephone Industry	503	17,759

This discrepancy in switch facilities underscores the extent to which switch deployment is a barrier to entry into the local exchange market, and hence why loop unbundling alone is not the logical entry path for most new competitors. In particular, it is not practical for any existing retail vendor (such as a long distance company) that wants to offer competitive local service broadly throughout a geographic market, particularly to its base of customers. Such a "full market" capability is necessary for meaningful competition with the incumbent LEC to exist. Otherwise local service will be limited to the small niche of larger business

6/ Source: Infrastructure of the Local Operating Companies Aggregate to the Holding Company Level, Industry Analysis Division, Common Carrier Bureau, Federal Communications Commission, April 1995.

customers in downtown areas that can be marketed door-to-door (not coincidentally the target market of the CAPs).

To understand the barrier that switching investment presents, it is useful to examine the relative switching requirements in the long distance market -- where many firms own toll switches -- with switching requirements for the local market. In 1993, for example, interLATA toll traffic totaled 54.0 billion calls. 7/ This means that the IXC switching capacity in place was sized to handle this volume, plus associated call attempts that went uncompleted. Significantly, approximately 65% of that volume was carried by AT&T, suggesting that other IXCs individually each have switching capacity sufficient to handle only a small portion of the total interLATA traffic.

But the local market is entirely different. Most important, traffic volumes differ by several orders of magnitude. We have noted that total interLATA calls in 1993 were approximately 54.0 billion. But total intraLATA toll calls were 23.4 billion, and total local calls were over 444.7 billion. 8/ In other words, IXCs today switch only one tenth of the number of calls switched by the LECs, recognizing that LECs switch all interLATA calls too as part of access service (because the switch provides access to interexchange networks).

Even these numbers understate the entry barrier presented by local switching. A switch port for local service costs more than an interexchange port because they serve different functions in the network. An IXC port generally is in use in connection with trunked lines a substantial part of the day. In contrast, a local

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7/ Statistics of Communications Common Carriers, 1993/1994 Edition, Table 2.6, at 22.

8/ Id.

service provider would need to deploy switching capacity for every customer line, even though typically those lines would be inactive the vast majority of the time. This makes the unit cost of local switching much higher than that of toll. Furthermore, the economics of long distance service permit interexchange switches to be centralized so as to serve large geographic areas, even if relatively little traffic comes from any one area. This means that an IXC's total interexchange traffic volumes generally can support its total switch investment. Relatively little switching capacity sits idle and not generating revenue for extended periods of the day. For these reasons, the cost structure of interexchange switching is far less of a barrier to entry than local switching.

Most important, a vigorously competitive long distance market has evolved enhanced by the existence of wholesale interexchange "carrier's carrier" products. These wholesale services permit entry and development of a long distance customer base with little or no switch investment at all. Once a traffic base is established, IXCs can install and expand switching capacity gradually where network savings justify this investment. This is exactly the entry vehicle that the RBOCs can use to enter the long distance market overnight in regions where they do not already have their own switches.

The consequences of these statistics for local competition are overwhelming. First, because LECs already switch all local traffic and virtually all long distance traffic, they already have in place the massive switching investment necessary to support this enormous traffic load. This investment will not be duplicated on a wide scale by any new local service provider in the foreseeable future. But second, and in any event, as a policy matter the nation should not want a telecommunications market in which local switching and local network investment is in any respect a precondition to provision of telecommunications

service. Such a policy would limit competition and encourage inefficient and unnecessary investment. 9/ It follows that for local exchange competition to grow beyond the niche service of the CAPs, new entrants must be able to purchase and resell a wholesale local service, including the loop to the customer, switch-based features and functions, and terminating local service.

Understanding the important role of wholesale local service requires a description of what the service is not, as well as what it is. First, wholesale service is not the same as resale of the LEC's retail local service. As discussed further below, the LEC's retail local service product is not priced at the LEC's wholesale cost. Nor does the LEC have systems in place to provision that service easily and transparently to the customer with the new local carrier's brand.

Second, wholesale local exchange service also is different from the purchase of an unbundled loop, "port" and termination service together -- that is, a "rebundling" of wholesale exchange elements back into a single service. First of all, there is much confusion regarding what "port" service actually is, and how much of the LEC's switching functionality goes with it. For example, does purchase of a port encompass the entire switching and associated switch-based service options of local service (call waiting, call forwarding, operator assistance etc.)? Second, the price of the "bundled loop, port and termination" does not necessarily correctly reflect the LEC's wholesale cost.

But third, and most important, "rebundled" local service does not carry with it the provisioning and related operational systems required to make

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9/ We are not suggesting that deployment of local switches by new entrants will never be economical. But we question whether such situations would be common and whether many new entrants will find deployment of local switches economical.

wholesale exchange service competitively useful to retail carriers who must compete with the LEC's retail services. As discussed in more detail below, these operational systems are just as important to competition as the price at which the wholesale local service is provided.

This is not to say that loop unbundling is without value. Quite the contrary, it is an important step towards facilities-based local competition because it establishes a foundation for substituting new network elements for those of the LEC. But state commissions should not lose sight of the fact that, for the foreseeable future, most new entrants will be able to offer retail local service to most customers only by reselling the bundled wholesale local exchange service of the LEC. It follows that even more regulatory attention should go to development of a wholesale local exchange product than has gone to unbundling that product into smaller wholesale elements.

Indeed, if Commissions mandate wholesale local service, they will be hitting the accelerator towards meaningful facilities competition. As new local retailers attract customers, they will then be able to make rational investment decisions concerning where to construct network elements, invest in switching, or add new capabilities. With tangible market experience, these entrants will be able to more rapidly deploy alternative networks and additional switching capacity where those choices are economical. Moreover, wholesale local exchange service maximizes future retail competition by keeping entry barriers low, so that new carriers can readily enter the market to meet consumer demand.

This process parallels how competitive long distance networks developed. Early entrants such as MCI were able to expand their services and customer base by reselling the incumbent's (i.e., AT&T's) network. This growth