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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	
Price Cap Performance Review for Local Exchange Carriers	CC Docket No. 94-1
Treatment of Operator Services Under Price Cap Regulation	CC Docket No. 93-124
Revisions to Price Cap Rules for AT&T	CC Docket No. 93-197

COMMENTS OF AT&T CORP.

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SUMMARY

The SFNPRM finds (¶ 5) that "LECs retain considerable market power" and that LECs' access services represent "bottlenecks" for their actual and potential competitors. Id., ¶ 19. Notwithstanding these facts, the SFNPRM seeks comments on a number of proposals that would significantly alter the price cap regulation of the LECs. The SFNPRM also seeks comments on the measures and procedures the Commission should adopt in connection with possible future streamlining of the LECs' services.

Part I shows that the LECs' bottleneck monopolies are entrenched and that there are systemic impediments to full and fair competition in the interstate access and local exchange markets. Thus, there is no practical likelihood that the LECs' dominance in these markets will decline meaningfully for many years. Given the LECs' monopoly position, the Commission should not expend current resources to relax price cap rules significantly. Neither does it need to address at this time the complex market definition questions that must be resolved before it can reduce regulation of the LECs. Rather, the Commission should focus its energies on assuring that the preconditions for competition are effectively implemented, including the establishment of access rates that are based on economic cost and assurances that effective resale mechanisms are in place.

All reduced regulation of the LECs' services should follow a LEC's demonstration -- on a market-by-market basis -- that there is substantial measurable competition. The SFNPRM (¶ 106) is thus correct that LEC services should not be streamlined until the LEC demonstrates there is actual competition in the relevant markets. Part II shows that the critical analytical tools necessary to determine whether actual and effective competition exists in the relevant markets require considerably more rigor than is assumed in the SFNPRM. In particular, Part II.A shows that the SFNPRM ignores that the price cap service categories the Commission proposes to use to define relevant markets are service components, rather than stand-alone services, and thus are not appropriate to define relevant markets. Part II.B demonstrates that the Commission's analysis of geographic markets fails to recognize several economic principles that have a significant impact upon the future success of its regulation. Part II.C explains that the existence of preconditions to competition is not a guarantee that actual competition will develop or actually exist in any market. Thus, it is fundamentally wrong to presume that a "checklist" of preconditions is sufficient proof of effective competition.

Finally, although any regulatory system should be reviewed periodically to assure that its rules achieve its desired ends, the Commission only recently reviewed the operation of its LEC price cap regime. There is no new

reason for another general review of those rules at this time. Moreover, Part III demonstrates that the Commission should not adopt most of its proposed LEC price cap modifications, because they would cause competitive harm and thus would not achieve the Commission's goals in this proceeding or serve the public interest. In all events, the Commission should assure that any modifications in price cap regulation reflect the fact that the LECs continue to operate in a monopoly environment.

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Pursuant to the Commission's Second Further Notice of Proposed Rulemaking ("SFNPRM") in CC Docket No. 94-1, FCC 95-393, released September 20, 1995, and Section 1.415 of the Commission's Rules, 47 C.F.R. § 1.415, AT&T Corp. ("AT&T") submits these comments on the Commission's specific proposals to modify the price cap rules for local exchange carriers ("LECs") and to establish a framework for additional "gradations of increasingly less stringent price regulation" for these monopoly carriers.[1]

[1] SFNPRM, ¶ 2. The Common Carrier Bureau extended the time for filing comments until December 11, 1995. See Order on Motion for Extension of Time, DA 95-2340, released November 13, 1995.

ARGUMENT

I. GIVEN THE LECS' CONTINUING BOTTLENECK MONOPOLIES, THE COMMISSION SHOULD FOCUS ON ENSURING THE ESTABLISHMENT OF PRECONDITIONS NECESSARY FOR COMPETITION IN THE ACCESS AND LOCAL EXCHANGE MARKETS.

Only a few months ago, after an extensive review, the Commission correctly found that the LECs "retain substantial market power in providing local exchange and access services"[2] and "continue to control bottleneck facilities."[3] There have been no significant competitive changes that would justify, much less necessitate, the price cap reforms the Commission now proposes. Indeed, the comments in Phase I of this proceeding left no serious doubt that the LECs' monopoly control over these services will continue well into the future.[4]

The LECs' only actual competitors are competitive access providers ("CAPs"), whose offerings are predominantly restricted to dedicated, high capacity services to customers in a limited number of buildings in the nation's largest

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[2] Price Cap Performance Review for Local Exchange Carriers, CC Docket No. 94-1, First Report and Order, 77 R.R.2d 783, ¶ 92 (1995) ("First Report") (emphasis added).

[3] Id., ¶ 368 (emphasis added).

[4] See the Phase I Comments in CC Docket No. 94-1, submitted May 9, 1994 by AT&T, pp. 6-21; Ad Hoc, pp. 32-34; ALTs, pp. 12-20; MCI, p. 64; MFS, p. 37; Sprint, pp. 24-27; Teleport, pp. 16-17; Time Warner, pp. 6-12; WilTel, pp. 34-35.

cities.[5] Collectively, CAPs generate a mere two percent of total access revenues, and they face inherent limitations that make it unlikely they can significantly expand. Moreover, most CAPs offer only transport and must rely on the LECs for the switching and distribution components of the services they sell to end user customers. Thus, at best, competition in the access and exchange markets is embryonic and scattered. Furthermore, the existing competition may be as much the artificial result of regulatory rules as of economically-based competition.[6] Accordingly, there is no evidence that the LECs' access monopolies could be broken by competing facilities-based landline carriers for many years.

Wireless technologies and cable telephony, which LECs have often cited as potential competitors, are also currently incapable of providing a viable alternative to the LECs' monopoly landline networks. The LECs themselves have admitted that cellular service is not a substitute for

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[5] The SFNPRM's request for comments (¶ 173) on whether AT&T's price caps should treat changes in CAP access charges as exogenous costs has been mooted by the recent reclassification of AT&T as a nondominant carrier. See Motion of AT&T Corp. to be Treated as a Nondominant Carrier, 10 FCC Rcd. 10980 (1995) ("AT&T Nondominance Order").

[6] See AT&T's Phase I Reply Comments, filed June 29, 1994, pp. 4-11.

landline service "as a matter of commercial reality."[7] Similarly, projections concerning the potential impacts of cable telephony[8] have proven optimistic, as even limited trials of such technology have become mired in technical and other difficulties.[9]

Finally, the Commission's expanded interconnection initiatives are limited to transport services and do not address the other components of access. Thus, these initiatives alone could not achieve effective competition in the local exchange market in the foreseeable future.

The strength of the LECs' monopoly power is confirmed by a study recently reported in The Enduring Local Bottleneck, which analyzed competition in the local exchange and concluded that "little if any competition has emerged

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[7] See United States v. Western Electric Co., Civ. No. 82-0192 (D.D.C.), Reply of the Bell Companies in Support of Their Motion for Removal of Mobile and Other Wireless Services from the Scope of Section II of the Decree, p. 38 n.48 (filed with the Department of Justice August 3, 1992). See also id., AT&T's Opposition to RBOCs' Motion to "Exempt" Wireless Services From Section II of the Decree, pp. 16-33 (filed April 27, 1992).

[8] See, e.g., Petition for a Declaratory Ruling and Related Waivers to Establish a New Regulatory Model for the Ameritech Region, DA 93-481, March 1, 1993, p. 9 and Att. 1A, p. III-4.

[9] L. Cauley, "Calls Waiting: Rivals Are Hung Up On Baby Bells Control Over Local Markets," Wall Street Journal, October 24, 1995, p. 1.

in . . . the local exchange and access markets."[10] The study also found that any competitive entry that develops in the next decade is "unlikely to be sufficient to eliminate or even significantly reduce the control of essential facilities by the [LECs]."[11] These findings are particularly striking, given the fact that LEC access prices substantially exceed their economic cost.

Because the LECs' monopolies are virtually intact, the Commission should not expend its resources on a substantial revamping of LEC price cap regulation.[12] Neither does it need to define at this time the procedures and market conditions under which it might adopt streamlined regulation for the LECs' access services. Instead, the Commission should devote its resources to assuring that the

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[10] Economics and Technology, Inc. and Hatfield Associates, Inc., The Enduring Local Bottleneck: Monopoly Power and the Local Exchange Carriers, p. 5 (February 1994); see also id., pp. 31-32, 79-80, 151-52.

[11] Id., p. 4.

[12] On the other hand, it may be appropriate to make a small number of the price cap modifications proposed in the SFNPRM now, because they may eliminate regulatory requirements that are unnecessary notwithstanding the LECs' monopoly status. See Section III below. However, such modifications should be reviewed on a stand-alone basis in light of the existing monopoly conditions. See SFNPRM, ¶ 110. Such an approach is consistent with the Commission's traditional and conservative approach to reducing regulation for dominant carriers. See, e.g., AT&T Nondominance Order, nn. 74, 75.

preconditions to effective competition are in place in the access and local exchange markets.[13]

AT&T's Phase I Comments (pp. 16-18) detail nine specific steps that are necessary -- but may not be sufficient -- to allow effective competition to develop in the access and local exchange markets. These conditions include:

(1) elimination of state franchise restrictions;[14]

(2) effective and nondiscriminatory access for competitors to conduits and rights of way;

(3) LEC unbundling of basic network functions;

(4) full and nondiscriminatory interconnection rights with LECs;

(5) LEC duties to furnish unbundled network functions on reasonable request and pursuant to uniform technical standards;

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[13] The Commission expressly recognizes the relationship between the interstate access and local exchange service markets. See SFNPRM, ¶ 7 ("[w]e are of the view that interstate switched access competition cannot reach meaningful levels so long as end-users are exclusively reliant upon the incumbent LEC's switch to direct calls to interexchange carriers"). See also id., n.31 (Commission's intention in refining the LEC price cap plan is to advance the goal of "fostering an efficiently competitive local market").

[14] The SFNPRM (¶ 109) is clearly correct that elimination of state-imposed entry barriers to the local service market is necessary to enable effective competition to emerge in the interstate access market.

(6) elimination of restrictions on competitors' rights effectively to resell LEC services;[15]

(7) nondiscriminatory rates for unbundled LEC network functions;

(8) rates for basic network functions and basic network elements that are based upon total service long run incremental costs; and

(9) full local number portability, with local numbers managed by an impartial administrator.

Until all of these conditions have been in place for a reasonable time, there is no prospect that effective facilities-based competition could emerge for either access or local exchange services.[16]

Further, the SFNPRM (¶¶ 24-26) clearly recognizes that "rate regulation may distort the prices access customers pay" and that regulations which force rates above (or below) their actual costs lead to economically

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[15] The lack of appropriate resale pricing was particularly apparent in Rochester. See SFNPRM, ¶ 110. There, the LEC's 5% wholesale discount was so inadequate that the Rochester experiment could not test the commercial viability of resale. Moreover, the LEC's ordering and provisioning processes were discriminatory and reflected an unwillingness to devote appropriate resources to serving resellers.

[16] The SFNPRM (¶ 108) references many, but not all, of these conditions. AT&T firmly believes that LECs could (and would) stifle effective competition if any of these conditions is not met in a specific market. Moreover, the only type of competition the Commission should review is that from facilities-based providers. Resale-based competition is insufficient to limit a LEC's ability to control service quantities. See Appendix A, pp. 14-15

inefficient results. Thus, the Commission should also take decisive action now to assure that prices for access services are based upon actual economic costs and are not burdened with regulatory subsidies or excess contributions that distort behavior by the LECs, by their access and end user customers, and by their potential competitors.[17] Indeed, the Commission cannot hope to achieve its stated goal of promoting economic efficiency (SFNPRM, ¶ 18) if access reform does not precede significant price cap reform. Otherwise, some potential competitors will be encouraged to make uneconomic investments, while others will be discouraged from entering markets where competition would be viable but for the distortions in access prices, thus depriving consumers of the benefits of efficient competition.

II. THE SFNPRM FAILS TO ESTABLISH APPROPRIATE CRITERIA FOR DETERMINING THE EXISTENCE OF ACTUAL COMPETITION IN THE ACCESS AND LOCAL EXCHANGE MARKETS.

The Commission has correctly determined that significant reductions in regulation should follow a demonstration of actual competition.[18] The Commission also

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[17] AT&T's proposal on how to achieve comprehensive access reform and eliminate subsidies that undermine the possibility for effective competition was recently submitted in AT&T's Comments in CC Docket No. 80-286, filed October 10, 1995. Those comments are incorporated herein by reference.

[18] See SFNPRM, ¶ 106.

recognizes that proof of competition for access and local exchange services must be based upon economically viable definitions of the markets in which the competition is alleged to exist.[19] However, the SFNPRM's proposals fall far short of the rigor necessary to determine whether effective competition exists. Thus, they will not adequately protect access customers or consumers from the LECs' acknowledged monopoly power.

A. The Existing Price Cap Categories Are Insufficient To Define An Appropriate Product Market.

The SFNPRM (¶ 117) properly notes that the single market definition the Commission developed for interexchange services is inappropriate for LEC services. However, the SFNPRM's proposal (¶ 118) to define the relevant product markets by using only the existing price cap service categories is insufficient to protect access customers or consumers.

The SFNPRM's proposal is inadequate for two reasons. First, the access service categories in the LEC price cap baskets do not represent stand-alone services or economic product markets that reflect the LECs' actual market power. Access purchasers need to acquire all of the components of interstate switched access in order to make any switched service available to an end-user customer.

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[19] SFNPRM, ¶ 116.

Indeed, the LECs frequently offer each access component in conjunction with all of the others. Thus, unlike the complete end-user interexchange services the Commission has previously reviewed, the LECs' market power cannot be assessed by reviewing individual access components in isolation.[20]

Second, different access components face different levels of competition at different times and in different places.[21] Accordingly, even if some components face some (or even substantial) competition in some markets, other components -- particularly local loops -- will remain bottleneck monopolies well into the future. Thus, again unlike the earlier review of interexchange services, the Commission's model for reducing its regulation of LEC access services must account for continuing LEC bottleneck control of at least some, if not all, such components.[22]

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[20] The SFNPRM (¶ 131) recognizes these differences between LEC and interexchange services ("LEC service baskets, organized around network functionalities, differ substantially from the AT&T baskets, which are organized according to end users services").

[21] See SFNPRM, ¶ 124.

[22] All of the Commission's reviews of AT&T's market power for purposes of determining how to reduce regulation in the interexchange market occurred after AT&T had unequivocally severed all control over bottleneck facilities by divesting its local exchange affiliates -- the very monopolies which are pressing for reduced regulation here.

In Appendix A, Dr. B. Douglas Bernheim describes a technique for defining product markets that accounts for the important differences between interexchange and LEC services.[23] In particular, he addresses the interrelationship between access components, and he describes a way that regulation of some access components could be reduced even if a LEC retains its bottleneck monopoly over other components.[24]

Dr. Bernheim recommends that LEC access components be grouped into "bundles" for purposes of product market definition. A separate bundle would be created for each combination in which such components are used to provide access services. Thus, for example, if access were comprised of only three components (transport, switching and local loops) there would be seven product "bundles": transport only; switching only; local loops only; transport and switching; transport and local loops; switching and local loops; and all three components together.

A product bundle could be granted reduced regulation when <u>each</u> component in that bundle is subject to effective competition. Thus, if only the transport

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[23] Appendix A, pp. 21-22.

[24] The Bernheim approach is substantially more liberal than its alternative, which would be to withhold reduced regulation for <u>any</u> access component until <u>all</u> are subject to effective competition.

component were subject to effective competition in a relevant geographic market, regulation of the "transport only" bundle could be reduced in that area. Regulation of the other six bundles would not be affected, however, because they all contain non-competitive components. If both transport and switching were subject to effective competition in a relevant market, three bundles (transport only; switching only; and transport and switching) could be granted reduced regulation. The remaining bundles, each of which contains the non-competitive local loop component, would remain subject to price caps until there is effective competition for that component. This product market definition permits the most rapid form of reduced regulation that also provides access customers and consumers protection against LEC efforts to leverage their monopoly power over non-competitive access components.[25]

B. The Commission's Standard For Defining The Relevant Geographic Market Has A Critical Impact In Determining Whether There Is Effective Competition.

The need for properly defined geographic markets is crucial, because "defining the relevant geographic market

[25] This analysis can also be used to assess whether LEC interexchange services should be granted reduced regulatory treatment. As long as a LEC exercises market power over any component of the bundle of services used to provide its interexchange service -- including any of the components of switched access -- the LEC service should remain subject to price cap regulation. See Appendix A, n.16.

incorrectly will misstate competition."[26] The SFNPRM (¶ 120) recognizes that the supply and demand elasticities for a LEC's access components in a particular area will differ from those in other geographic areas served by it or another LEC. Thus, the Commission seeks comments on its proposal to define the geographic market for access services by using the LEC "density zones" for expanded interconnection service. Id.

The SFNPRM (¶ 124) correctly notes that the LECs' density zones are based only on the traffic densities and cost characteristics of the trunking basket. Thus, at most, density zones might potentially be used to define the geographic market for trunking services. In all events, there does not appear to be any rational basis at all to use trunking density zones as the geographic market for other access components.[27] Therefore, the Commission should look at each access component separately to define its relevant geographic market, using the criteria discussed below. For example, the relevant geographic market for switching may be broader than for access components that use facilities such as trunks and local loops, provided that the cost of routing

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[26] SFNPRM, ¶ 120.

[27] Even the Commission recognizes these zones "may not be useful in defining relevant geographic markets for services in the traffic sensitive, common line and interexchange baskets." SFNPRM, ¶ 124.

calls to a remote switch is not prohibitive.[28] Indeed, Dr. Bernheim concludes that "it is almost certainly inappropriate to use identical geographic boundaries to establish markets for all access components."[29]

The identification of appropriate geographic boundaries for a relevant market generally depends on two factors: (a) the extent to which customers can effectively substitute a product purchased at one location for a product offered at another, and (b) the principal vendor's ability to charge different prices for identical products at different locations.[30] Access customers' ability to buy access services in one area for their end user customers in another area are extremely limited. For example, an IXC that purchases transport from a CAP does not have a competitive source of supply to serve an end user customer located a single block away from the CAP's facilities.[31] Therefore, the substitution factor argues strongly for narrow geographic boundaries defined solely by the pervasiveness of actual competition in the proposed market.

The need for narrowly defined boundaries may, however, be somewhat mitigated if LECs must charge uniform

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[28] See Appendix A, p. 7.

[29] Id., pp. 7-8.

[30] Id., p. 6.

[31] Id., p. 7.

prices over broader areas for access components that are identical in quality, terms of interconnection and conditions of service. In such a situation, the LECs must set their prices on the basis of the total demand in the area subject to the geographic averaging requirement.[32] Even in these cases, however, the Commission also needs to consider the relative amount of traffic in the competitive and non-competitive areas that are combined for purposes of defining the market. If the volume of traffic in the non-competitive area is large compared to the volume in the competitive area, even a strict averaging requirement will not sufficiently limit the LEC's monopoly power in the non-competitive portions of the geographic market.[33]

Thus, the Commission's goal of economic efficiency requires either very narrow geographic boundaries for access components (the actual area of substitutable competition) or strict limitations on the LEC's ability to discriminate in terms of price and other key conditions within the <u>entire</u> geographic market after regulation is reduced. In the latter case, the Commission must also be assured that the

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[32] Appendix A, pp. 8-11.

[33] <u>Id.</u>, p. 10. If, for example, the traffic volumes in the non-competitive geographic region comprised a large majority of the traffic in the entire geographic market, the impacts of competition in the competitive area would not be sufficient to discourage the LEC from raising prices throughout the market.

amount of traffic in the competitive portions of the market equals or exceeds the traffic in the non-competitive areas. Alternatively, if the Commission does not impose strict limitations on the LECs' ability to discriminate in price, it must insist that competition be pervasive in all portions of the geographic market.[34]

C. A "Checklist" Procedure Is Insufficient To Review LEC Requests For Reduced Regulation.

After the competition-enabling conditions described in Part I above have been established and have had a reasonable time to operate, the Commission could assess the competitiveness of the relevant markets to determine whether it is appropriate to reduce regulation of the LECs. In all events, the SFNPRM (¶ 106) correctly recognizes that no LEC services should be removed from price caps until the LEC makes an affirmative showing of actual competition in each relevant market.

A showing of effective actual competition cannot, however, be based simply on meeting a "checklist" such as that described in the SFNPRM (¶ 110), which consists solely of preconditions to competition.[35] Rather, any showing offered to support reduced regulation must include specific measurements which confirm the actual presence of

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[34] Appendix A, pp. 10-11.

[35] Id., p. 11.

substantial facilities-based competition in the relevant product and geographic market. AT&T's Phase I comments (pp. 18-19) proposed three specific criteria that would suggest the existence of effective competition:

1. There are at least two alternative providers who are not dependent on the LEC for the facilities they use to provide service;

2. The alternate providers are available to at least 75% of the subscribers in the relevant market; and

3. At least 30% of subscribers in that market in fact use such alternate facilities-based providers.

These criteria take into account the supply and demand responsiveness and market share factors the Commission has previously used in assessing market power in the interexchange services market.[36] They are also similar to the criteria the Commission used in reducing its regulation of AT&T.[37] Such criteria could serve as a

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[36] AT&T agrees with the SFNPRM (¶ 143) that market share may not be a dispositive factor in determining market power, especially if there are high supply and demand elasticities in the market. However, given the LECs' near-total control of access services and the limited impacts of potential competition in the access market (see Appendix A, pp. 12-14), the LECs' current market share is indeed a true reflection of their monopoly power. AT&T also agrees with the SFNPRM's conclusion (¶ 145) that evidence of LEC pricing below the price cap ceiling should only be considered as an indication of competitiveness in areas where there are high supply and demand elasticities.

[37] See, e.g., Competition in the Interstate Interexchange Marketplace, Report and Order, 6 FCC Rcd. 5880 (1991);

(footnote continued on following page)

sufficient prima facie showing of competition by a LEC, permitting it to obtain reduced regulation unless another party produces credible evidence that the identified market is not subject to effective competition. Once challenged with credible evidence, however, the presumption of competitiveness should be negated and the burden of proof should shift to the LEC.

The Commission must also establish an appropriate process to review individual LEC requests for reduced regulation.[38] Because such requests involve critical competitive and consumer interests, the SFNPRM (¶ 114) correctly states that LEC requests should not be reviewed as part of the tariff filing process. For the same reason, as well as the "checklist" problem described above, they should also not be left to a "certification letter" process.[39] Rather, as in the interexchange market, each application for relaxed regulatory treatment should be reviewed on its own

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(footnote continued from previous page)

AT&T Nondominance Order. From an economic standpoint, AT&T's proposed measurements are in fact insufficiently demanding. See Appendix A, p. 18. Indeed, regulation of AT&T's services was streamlined only long after it had satisfied these measurements.

[38] The procedures recommended here could apply to any request for a relaxation of the price cap rules, including, but not limited to, a request for streamlining.

[39] See SFNPRM, ¶ 113.

merits after all interested parties have been given an opportunity to comment.[40] There should be no grants of relief for any LEC which fails to meet the specific objective criteria described above.

III. LEC PRICE CAP REGULATION SHOULD NOT BE RELAXED IN MERE ANTICIPATION OF THE EMERGENCE OF COMPETITION IN THE ACCESS AND LOCAL EXCHANGE MARKETS.

The SFNPRM proposes numerous modifications to the LEC price cap plan, which include: (1) clarifying and simplifying the treatment of new services, and (2) granting downward pricing flexibility and changing the price cap basket/service band structure. The Commission generally proposes to adopt the price cap rule changes "without regard to the current level of competition because they will serve [the Commission's] goals of moving price toward costs, encouraging efficient investment in infrastructure, and ultimately robust competition."[41] According to the SFNPRM, the Commission's proposed "relaxation" of price cap

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[40] Possible ways of proceeding are by a petition for rulemaking, if the LEC seeks any modification of existing price cap rules in connection with its request for reduced regulation, or by motion or petition for declaratory ruling, if the LEC seeks no additional changes in the Commission's rules. All of these methods should be followed by a reasonable public notice and comment period.

[41] SFNPRM, ¶ 2.