stimulate demand by making lower prices available. Applying volume discounts to LEC access service prices is consistent with existing business practices and will ultimately benefit the public interest.

Access customers will obtain significant access cost reductions even if the LEC is not allowed to offer them. Alternative sources of supply are becoming increasingly more common in markets that historically have been considered LEC monopolies. As competitive entry into carrier access markets continues, new entrants, striving to capture customers, will certainly offer IXCs and end users alternative pricing options, including volume discounts. Thus, pricing and marketing strategies that are characteristic of competitive markets will emerge in the carrier access and local exchange markets as entry occurs, whether or not the incumbent LECs are allowed to make use of these standard pricing practices. Restricting the LECs from offering discounts just like the LECs' competitors will not prevent access customers from obtaining input cost reductions. Thus, even without LEC participation, volume and term discounts are now and will be increasingly available to access customers.

Volume discounts can more accurately reflect the actual costs of providing services. To the extent that LEC economies of scale result in declining costs for higher demand levels as compared to lower demand, volume discounts represent a price structure which more

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[21](...continued)
a certain minimum threshold amount. As such, IXCs make relatively extensive use of volume discounts in the long distance market. As another example, SWBT has introduced a volume and term plan for intrastate switched access that allows customers to commit to place a certain percentage of their switched access usage on SWBT's network for a term commitment. The initial plan will provide discounts for all applicable switched access usage elements that are billed on a minutes-of-use basis. This plan allows different sized customers to be eligible for the same percentage level of discount based on the length of term and a commitment to include a certain percentage of the customer's usage volume.

closely reflects the actual costs of supplying access services. Also, businesses obtain significant long distance price discounts from IXCs when the business customers agree to reduce IXCs' costs by securing access to the IXCs' networks themselves.[22] When large corporations request bids for telecommunications services specifically designed to suit their particular requirements (such as facilities to link corporate buildings to IXC networks), competitive incentives are dampened if LECs are restricted to offering services only at averaged tariffed rates without being able to incorporate volume and term discounts.

Volume discounts are not unduly discriminatory, but represent a movement toward economically efficient pricing. Volume discounts for access services are no more discriminatory than volume discounts for long distance services, or for goods sold in other properly functioning competitive markets.[23] IXC pricing variations exist in the interstate and most, if not all, state jurisdictions. Price discrimination, likewise, has traditionally been entrenched in regulation of basic telephone services by requiring business customers to pay a higher price for local loops than residential customers. Incorporating volume discounts into LEC access service prices is not a radical departure from traditional regulatory practices.

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[22] Examples include AT&T's Megacom™ and MCI's Prism I™ services.

[23] There are many examples of reasonable price discrimination in everyday life. For example, if a movie theater offers discounts on tickets to students and senior citizens, it is engaging in price discrimination. If a restaurant simultaneously offers a "lunch special" as well as an à la carte menu, it too is engaging in price discrimination. Similarly, the unit price of soft drinks sold in single servings from vending machines differs from the unit price of a large "family size" bottle and may differ from the unit price of a six-pack of that soft drink; this process is also price discrimination. It is clear that such price discrimination does not run counter to the public interest.

Volume discounts prevent uneconomic facility-provisioning decisions. Many access customers have sufficient capital to construct their own transport facilities and thereby reduce access costs substantially. Permitting LECs to offer volume discounts will provide LECs an opportunity to retain some portion of the access business that otherwise might be lost, if the discounts are comparable to the potential cost advantages that customers would derive from self-provisioning alternatives.

Volume and term discounts are appropriate competitive pricing tools used commonly in all industries, including telecommunications. SWBT should likewise be able to use such discounts. The only requirements placed on volume and term discounts should be: (1) the prices used in volume discounts must exceed the corresponding incremental costs; (2) the offering must be available to all similarly situated customers; and (3) all market participants should be allowed to engage in volume and term discounts equally, with no asymmetric restrictions placed on any market participant or group of market participants. This will foster an efficient National Information Infrastructure, one that meets customers' needs at the lowest cost.

3. Individual Case Basis Tariffs

Issue 3:

Under what conditions, if any, should we permit price cap carriers to establish ICB rates? What showing would enable us to determine that the carrier cannot reasonably be expected to establish generally available averaged rates at the time the common carrier service is introduced? How long should we permit those rates to remain in effect before we require generally available averaged rates? What cost support requirements should apply when the carrier files ICB tariffs, and when the LEC files tariffs establishing generally available averaged rates?

The Commission proposes stringent requirements as to the number of Individual Case Basis filings (ICBs) that may be allowed and the length of time LECs would be allowed to offer a service on an individual case basis. Unfortunately, the Commission's proposals for ICBs lag behind the marketplace. Specifically, the increasing use of Requests for Proposal (RFPs) by telecommunications customers and the proliferation of ICB pricing by carriers classified as nondominant by the Commission makes these proposed rules completely unworkable.

ICB and contract-type (individualized) pricing should be allowed in response to any RFP issued to the incumbent LEC by another provider, regardless of competitive classification of the market.[24] Thus, individualized pricing in response to RFPs should be an integral part of the "baseline" regulation. The fact that RFPs are requested demonstrates that competition is present, regardless of the regulatory classification of the LEC market. The use of individualized pricing can be an important tool for fostering economic efficiency, for meeting the needs of LEC customers in a time of increasing competition, and in recovering the overheads of the LECs, but it must be allowed on a fair and equal basis. Such pricing is consistent with the Commission's objective to encourage efficient prices. Competitive entry into LEC markets makes tariffs based on average costs an ineffective and economically inefficient method of pricing. Individualized pricing allows LECs to engage in legitimate responses to meet customers' needs via pricing in the same manner as their competitors.

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[24] See, Southwestern Bell Telephone Company, Tariff F.C.C. No. 73, Transmittal Nos. 2433 and 2449, CC Docket No. 95-140, Direct Case of Southwestern Bell Telephone Company, pp. 5-8.

The RFP process is an established time-tested process which large business customers have used for many decades to acquire goods and services.[25] With dramatically increasing frequency, business customers are choosing to acquire telecommunications services in this manner. Prospective customers use the RFP process to find the vendors whose services offer them the "best fit," the highest quality and the lowest cost. In essence, the RFP process is the marketplace in which business is done.

The LECs should be allowed to participate in competitive markets under the terms dictated by customers. LECs should be allowed to respond to customer RFPs without being subject to market loss quotas, lengthy delays, floors on the number of respondents, evaluation of the state of competition in other unrelated markets, "checklists" or other elaborate competitive "tests" designed to handicap only the incumbent providers.

LEC individualized pricing should be allowed as it represents a limited response that makes the marketplace more, not less, competitive. For that reason, individualized pricing is consistent with the Commission's public interest objectives and must be allowed. In addition, individualized pricing in response to RFPs produces efficient pricing even in areas that have not yet been classified as competitive. Because the RFP exists, competitive alternatives are available to that particular customer. If the LEC "wins" the RFP, and because the individualized prices provide contribution to joint and common costs, both the customer and the LEC benefit. This form of limited response to competition in selected pockets of larger markets is in the public interest.

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[25] For example, well over half of all railroad traffic is offered under contract pricing arrangements as opposed to general tariffed rates.

The Commission's proposed requirement that LECs must demonstrate that a proposed ICB offering is so unlike existing services that averaged rates cannot be developed is improper. LECs should only be required to prove that the proposed rates are not unreasonably discriminatory. Since the Act does not necessarily preclude different rates for like services, LECs do not have to prove that the service in question is unlike all other offerings. Further, the Commission's requirement that an ICB offered for 6 months be followed by an average tariff filing is unreasonably burdensome and completely contrary to market realities. Many ICB offerings will never be repeated. At the same time, most ICB offerings are taken for terms that greatly exceed six months. Thus, the Commission's proposal would force the LECs to create averaged service offerings for services that may never have demand.

4. Part 69 Waiver Process

Issue 4a:

Should we eliminate the requirement for, or simplify the process of, obtaining a waiver of Part 69 for new switched access services and, if so, how? What standard should we use in determining whether to grant a petition proposing to establish new rate elements for a switched access service? Would there be any anti-competitive or other negative effects from modifying the current system?

The Part 69 waiver process for new services is unnecessary for price cap LECs and should be replaced as USTA recommended in the Petition for Rulemaking filed September 17, 1993.[26] Part 69 rules were developed to provide for an orderly transition at divestiture as interstate access services were first defined and initially regulated by rate-of-return regulation. Most Part 69 rules are no longer needed for LECs regulated under price cap

[26] See, USTA Petition for Rulemaking, filed September 17, 1993; see also, SWBT Comments in support of USTA Petition, filed November 1, 1993; SWBT Reply Comments, filed November 16, 1993.

regulation. Sufficient safeguards exist which mitigate the need for a codified rate structure. These safeguards include the tariff review process under Section 203, investigation and suspension authority under Section 204, and complaint oversight authority under Section 208. These safeguards will provide adequate opportunity for oversight of new services and technologies as well as any rate structure changes LECs may propose to respond to competition. Notably, the Commission has never found reason to invoke such a codified structure on AT&T's services.

This proceeding may be a measured step until such time that the Commission initiates a comprehensive proceeding to extensively revise Part 69 rules. The existing codified structure will apparently continue to remain in place until that comprehensive proceeding is completed. Therefore, SWBT proposes the following guidelines for the introduction of new services and technologies.

The Commission should permit new elements and subelements associated with the introduction of new services to be filed without a waiver.[27] The Commission has an explicit, statutory obligation to encourage the provision of new services and technologies.[28] Moreover,

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[27] In those instances when a waiver of Part 69 continues to be required, the Commission must streamline the waiver process in order to better serve the pubic interest. Once a waiver has been filed, Sections 1.45(a) and (b) of the Commission's rules should be utilized. The Commission should not extend the filing periods specified within these sections. Following conclusion of the filing periods, the Commission should act to resolve the issues within 45 days. In those instances where a LEC has previously been granted a waiver, current and future introductions involving similar rate elements should be allowed under an expedited 14-day waiver process. Waivers should not be required to add new transport elements if the elements or services are preexisting tariffed special access services.

[28] As stated in the Communications Act of 1934, "It shall be the policy of the United States to encourage the provision of new technologies and services to the public. Any person or party

(continued...)

by this Commission's own design and definition in this proceeding, new services "add to the range of options already available to customers"[29] and therefore, should raise no "public interest" issues. If the element or subelement associated with the introduction of a new service does not fit within the existing structure, a burden of showing that the service is in the public interest does not fall upon the entity introducing the service. First, as indicated in the Communications Act, the new service must be presumed to be in the public interest. Thus, a burden to demonstrate that the service would not be in the public interest rests upon those intervening against the filing. The intervening party must conclusively demonstrate that introduction of the new service will necessarily result in consumer harm.

Issue 4b:

How should any new procedures with respect to Part 69 waivers be coordinated with the process for determining whether a new service is a Track 1 or Track 2 service as defined in the previous subsection herein if those concepts are adopted?

There is no need to divide new services into separate tracks as proposed in paragraphs 45 through 49 of the Second FNPRM. The Commission should merely use its own definition of new services. The Commission has repeatedly defined new services as those which add to the existing range of services -- new alternatives are made available to customers without realizing a loss in the current options. Customers can only gain from the introduction of new services. In any event they cannot be made worse off. Any attempt to create two classes of

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[28](...continued)
(other than the Commission) who opposes a new technology or service proposed to be permitted under this Act shall have the burden to demonstrate that such proposal is inconsistent with the public interest." 47 U.S.C. 157(a) [emphasis added]

[29] Policy and Rules Concerning Rates for Dominant Carriers, 5 FCC Rcd. 6786, para. 314.

services would be arbitrary, and given the rapid convergence and evolution of markets, competitors and technologies, meaningless. Codifying such a distinction likely would result in the same problems which are inherent in the current structure in that the definitions would become outdated and a new waiver process would be required to accommodate certain service offerings.

5. Elimination Of Lower Service Band Index Limits And Other Pricing Flexibilities

Issue 5a:

Should we further expand or eliminate the lower service band index limits for all access services? Does there remain a danger of predatory pricing or other anti-competitive practices? Would this additional downward pricing flexibility harm any LEC customers? Would it harm competition?

The Commission initially adopted lower band pricing constraints to guard against the potential of predatory pricing. However, having lower bounds on prices in a market as dynamically changing as telecommunications may actually impede the legal, pro-competitive, and pro-consumer pricing responses of the price cap LECs, making them unable to compete on price with their rivals as competition develops. The Commission has recognized this and proposes to eliminate the lower limits to allow price competition to develop.[30] The Commission also tentatively concludes that elimination of the lower pricing bands will not lead to undetected anti-competitive practices, such as predatory pricing.[31] This assessment is correct.

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[30] Second FNPRM, para. 83.

[31] Second FNPRM, para. 83.

Predatory pricing is defined as pricing at a level calculated to exclude from the market an equally efficient or more efficient competitor.[32] Predatory pricing occurs when a firm sets its prices for a competitive service temporarily below its costs (the "rival-bashing" stage) in hopes that the low prices will drive competitors out of business (the exit stage). The predatory firm then plans to raise its prices so that it will recoup its temporary losses and earn additional profits (the recoupment stage), all before new firms, attracted by the high prices, enter its market and force prices down again.

There are several reasons why the Commission's proposal to eliminate the lower pricing bands is reasonable. First, a firm engaging in a predatory pricing episode would, theoretically, expect to earn greater profits than if it did not engage in predation at all. Such a predatory pricing strategy is considered either irrational or extremely risky and is extremely rare in American industry. No firm, regulated or not, has a credible incentive to engage in this type of pricing strategy.[33]

As the Commission recognized,[34] the price cap itself and the upper service band limits would prevent the firm from recouping its temporary losses sustained in the rival-bashing

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[32] W. KIP VISCUSI, JOHN M. VERNON & JOSEPH E. HARRINGTON, JR., ECONOMICS OF REGULATION AND ANTITRUST 262, 272-278 (1992); WILLIAM J. BAUMOL & J. GREGORY SIDAK, TOWARD COMPETITION IN LOCAL TELEPHONY 63 (1994); and DENNIS W. CARLTON & JEFFREY M. PERLOFF, MODERN INDUSTRIAL ORGANIZATION 402-407 (1990). And see Simran K. Kahai & David L. Kaserman & John W. Mayo, Deregulation and Predation in Long-Distance Telecommunications: An Empirical Test, 40 ANTITRUST BULL 645 (1995) (concluding that the price reductions observed in long-distance since divestiture and with increased competition have had no predatory effects).

[33] See, e.g., Franklin Fisher, *Matsushita: Myth v. Analysis in the Economics of Predation*, 64 CHI.-KENT L. REV. 969 (1989). See, also, Wesley J. Liebeler, *Whither Predatory Pricing? From Areeda and Turner to Matsushita*, 61 NOTRE DAME L. REV. 1052 (1986).

[34] Second FNPRM, para. 83.

stage and earning additional profits. Price caps provide substantial safeguards against cross-subsidization and predatory pricing within baskets. Within a price cap basket subject to an average aggregate price index, there is one profit-maximizing set of prices for the services within the basket. This profit-maximizing set of prices does not involve cross-subsidization, thus, a LEC cannot make itself better off by engaging in cross-subsidization between services within a service basket. This is one area where price cap regulation differs markedly from standard rate base rate-of-return regulation, under which there can be several sets of prices that yield the same profits for the LEC. A predatory pricing strategy is pointless for a firm subject to price cap regulation; hence there is no need to have lower bounds on prices.[35]

A predatory pricing strategy could only be successful if a carrier could eliminate its rivals and prevent them and other potential new entrants from entering the market again during the recoupment stage. This is simply not possible in telecommunications. A facilities-based carrier incurs sunk costs when it initially enters the market. These facilities would still be in place after the rival was driven from the market and could readily and easily be put to use again during the recoupment stage. As the Commission noted, the existence of these facilities will deter the carrier from raising rates in the future[36] and will not allow it to recover the earlier losses.

A fundamental objective of all firms is to increase shareholder value and remain financially attractive to investors. A predation strategy, where the firm cannot expect to charge

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[35] Calvin S. Monson & Alexander C. Larson, *Pricing and Investment Incentives Under Price Ceiling Regulation*, in PRICE CAPS AND INCENTIVE REGULATION IN TELECOMMUNICATIONS 221, 233-34 (Michael A. Einhorn ed. 1991).

[36] Second FNPRM, para. 149.

monopoly prices long enough to at least recover earlier losses and make additional profits, would be an exceptionally bad business decision since it would reduce shareholder value.

The Commission correctly concludes that prices deemed predatory could still be challenged through a petition against a tariff or the formal complaint process, with the petitioning party bearing the burden of proof.[37] LEC services are becoming increasingly competitive, and the technology and cost information necessary to evaluate a tariff is available within the industry. Relying on the formal complaint process as the appropriate vehicle ensures that predatory conduct, if it ever could arise, can be detected and corrected. As long as prices cover at least incremental costs they cannot be predatory. In today's dynamically changing telecommunications markets, the LECs should be allowed to engage in legitimate competitive pricing responses without being subjected to the cries of "predatory pricing" by their competitors whenever a LEC engages in legitimate downward price competition.[38]

Issue 5b:

Should we place additional limits on the ability of a LEC that decreases prices pursuant to this flexibility to subsequently increase those prices in order to preclude the potential for anti-competitive pricing strategies?

The Commission asks whether additional limits should be imposed on a LEC's ability to subsequently increase rates that were previously lowered due to the elimination of lower service bands. The Commission proposes a 1% upper SBI limit for any category in which prices are lowered pursuant to the proposed pricing flexibility (i.e., elimination of SBI lower

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[37] Second FNPRM, para. 83.

[38] See, generally, Alexander C. Larson & William E. Kovacic, *Predatory Pricing Safeguards in Telecommunications Regulation: Removing Impediments to Competition*, 35 ST. LOUIS U. L.J. 1 (1990).

band limits).[39] It is unclear whether the proposed 1% upper limit would apply only if the price reductions result in an SBI that is lower than the previously-required -10% lower SBI limit, or whether the proposal would apply in the case of any category price decrease. Clearly, if the proposal were to apply to any price reduction, that would result in significantly less pricing flexibility than the current rules. SWBT presumes the Commission implied the former.

In any event, such a pricing restriction should not be imposed. It would only add complexity and confusion to the price cap plan. It could lead to the anomalous situation where a LEC would be forced to extensive involuntary pricing below cap because of an upper SBI pricing limit that is determined by current base period price reductions.[40]

The current upper band limits provide sufficient protection against a strategy of reducing and increasing prices to thwart competition. Upward pricing flexibility cannot be "banked" for future use. Service band limits are reinitialized in each annual filing and together with the additional proposed restriction could prevent a LEC from reestablishing the price that was in effect prior to a previous base period price reduction. The Commission recognized that a 5% upper service band limit restricts a LEC to a 5% increase over the new lower rate.[41]

Such additional restrictions are not necessary to preclude the potential for anticompetitive pricing. The pricing restriction contemplated by the Commission is more likely to prohibit perfectly legal pro-competitive pricing behavior rather than anticompetitive pricing.

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[39] Second FNPRM, para. 85, Issue 5b and para. 105, Issue 10c.

[40] The inability to price to the cap because of SBI upper band limits can occur under the existing rules if below cap pricing exists at the time of an annual filing. However, the price reductions leading to the current below cap pricing may not be reversible in the current base period.

[41] Second FNPRM, para. 83.

Even in competitive markets, all firms need considerable pricing flexibility to vie with other firms for the market. To preclude one firm from engaging in price increases is most likely to hamper that firm's ability to compete or to seize upon profitable opportunities that would otherwise be available to all competitors. For example, when oil prices rose precipitously in the 1970s, oil companies needed to raise their gasoline prices because their primary factor input, crude oil, had quadrupled in price. To prevent one or a subset of firms from raising their prices would have done nothing to prevent anti-competitive pricing behavior, but could easily have hampered firms from engaging in justifiable and legal price increases associated with the rapidly changing external market forces (in this case, a massive industry-wide cost shock).

The primary way in which consumers benefit from competitive markets is through price decreases. Yet, if the Commission's contemplated rule were enacted, it would chill the very incentive to lower prices in the first place. Knowing that by voluntarily lowering a specific price in the near term, a firm would be forever prohibited from raising that price in the future would create strong disincentives for lowering prices. This proposal could only be to the long term detriment of consumers and is very likely to do more harm than good.

Issue 5c:

Are there any other pricing flexibilities which we should adopt to promote cost-based pricing? How would the proposal promote our objectives? Would added flexibilities cause competitive harm? What is the relationship between downward pricing flexibility and the varying cost, demand, and other characteristics of different geographic markets? Should additional pricing flexibilities be considered in this proceeding or in another context?

The price cap modifications that SWBT proposes would promote cost-based pricing in a number of ways. Specifically, the use of zone pricing, volume and term pricing, individualized pricing in response to RFPs, pricing reflective of customer segment needs, the elimination of lower pricing bands, and the establishment of a new price cap basket structure would lead to more efficient prices.

Furthermore, the Commission must allow all market providers the same flexibilities in the provisioning of services. Customer specific proposals, the ability to rapidly bring new services to the marketplace, and increased responsiveness to customer demand and changing market conditions are examples of the general categories of flexibilities which must be afforded to all market providers.

Zone pricing should apply to all transport services, local switching CCL[42] and the Interconnection Charge.[43]

6. Revision of Baskets

Issue 6a:

Would any revisions to the price cap baskets serve our goals in this proceeding? If so, explain how they would serve those goals. Would there be any adverse effects on end-users or competition?

The Commission already recognizes that the existing price cap basket structure has very little in common with the service structure that it is intended to regulate.[44] For this

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[42] CCL is an implicit support mechanism. The proper reform is to remove implicit support from the LECs rates and replace them with price rebalancing. Until such reform is implemented, the CCL charge should be zone priced.

[43] The End User Common Line Charge (EUCL) could also be zone priced. However, the Commission has indicated its intent not to address reforms affecting pricing flexibility for the EUCL in this proceeding.

[44] In fact, the origin of the current LEC price cap basket structure dates back to the Part 69 rules developed prior to and immediately following Divestiture. The Part 69 categories were established as cost classifications, unrelated to the marketplace. Federal Perspective on Access Charge Reform April 30, 1993 (FCC Staff Working Paper on Access Reform), Access Reform Task Force, pp. 11-12, 42.

reason, the Commission must use a basket structure which logically groups like service elements together for the purpose of safeguarding the marketplace. Service elements should be grouped according to the functionality of the service element (e.g., Common Line, Switching, Transport, Interexchange and Video Dialtone)[45] and, for certain elements, the competitive characteristics of the element (e.g., density pricing zones). As demand shifts between "like" service elements, price changes for those elements would not impact "non-like" service elements. Moreover, service providers would better be able to manage the revenue effects of demand migrating among its service elements without dramatically affecting end-users or competition.

The current price cap basket structure should be replaced with revised baskets that would allow the grouping or rates for equivalent functions, facilitate pricing flexibility and readily accommodate new services. SWBT proposes here a revised basket structure suitable for baseline regulation and an option which may be more readily applicable in markets with even greater competition. The baseline proposal simplifies the current structure, but leaves it largely unchanged. The optional structure would facilitate the process of streamlining price cap regulation by allowing exchange carriers to remove groups of services or subcategories from price caps.

Under the baseline proposal, as illustrated in Attachment B, the proposed baskets include:

<u>Common Line</u>

- End User Common Line Charge
- Carrier Common Line Charge

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[45] SWBT contends that video dialtone should be removed from price cap regulation.

Switching
- Local Switching
- Information (includes Billing Name and Address, Directory Assistance and Directory Assistance-Related Call Completion)
- Database (includes 800 Database, 800 Vertical Services, Line Information Database)

Transport
- Analog (includes voice grade, audio, analog video and wideband)
- Digital (includes DDS, DS1 and DS3)[46]
- Tandem (includes Tandem Switching and Tandem Transport)
- Interconnection Charge

Interexchange

Video Dialtone[47]

This proposed structure is largely unchanged from the current structure. For example, it maintains Tandem and Interconnection Charge service categories under the Transport basket until the upcoming completion of the comprehensive access reform proceeding that will deal with these issues.

Yet, compared to the current structure, the proposed structure has several advantages that will permit some much-needed simplification. It merges existing service categories where services share similar functional and market characteristics. The proposed structure permits those exchange carriers that may want to make a competitive showing for large customer switching and common line traffic with transport to do so without requiring it of all exchange carriers.

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[46] As an alternative, analog and digital transport service categories could be combined. The evolving relationship between analog and digital services (e.g., both can be and are delivered over the same underlying facilities) indicates that consolidation may be appropriate.

[47] SWBT has explained that video dialtone should be removed from price cap regulation. See SWBT Comments, Third FNPRM, filed October 27, 1995.

The baseline proposal also permits zone pricing of all services within all service categories where costs vary as a function of traffic density. Service band indexes are not necessary at the service category level for those service categories that are zone priced. The zone band index acts as an adequate safeguard to limit price changes between zones within a service category and will minimize revenue shifting between service categories. The IC service category will have a +0% SBI to prevent any opportunity for revenue shifting.

At Attachment C, SWBT proposes another price cap basket structure (the "optional" structure) that would match the price cap baskets and service categories more closely with relevant markets described below. This optional price cap basket structure establishes baskets for Transport, Large Customer, Small Customer, Interexchange and Video Dialtone[48] and Other. Price cap exchange carriers should have the option of recasting their demand and prices into this alternative basket structure.

The optional structure would further facilitate the streamlining of prices by allowing exchange carriers to remove groups of service subcategories from price cap regulation. These subcategories would reflect the market areas for which exchange carriers may choose to make showings in order to obtain streamlined regulation. The optional structure also focuses price cap protection separately for each market segment. For example, the prices for services provided to small customers would be capped independently of the prices for services provided to large customers. Rate reductions for large customers would not create any "headroom" which would allow the exchange carrier to raise rates to smaller customers, since those rates would be

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[48] SWBT has explained that video dialtone should be removed from price cap regulation.

in a separate basket. The Commission adopted a similar basket structure for AT&T, grouping the services provided to residence and small business customers into one basket and those provided to larger businesses in another basket.

However, this structure should be optional as it represents a significant change which should not be imposed on all exchange carriers subject to price cap regulation. Some exchange carriers may not have a market or other need to do so. Some exchange carriers do not currently have the capability of measuring large and small end-user demand separately, which would be necessary in order to implement this optional structure. Further, for those exchange carriers that choose to make their competitive showings on the basis of price cap service categories, the effort of changing to this optional structure may not be justified.

Issue 6b:

Under what circumstances should the price cap baskets be revised? Can revisions be planned to take place automatically on achievement of particular milestones or must they be done on an individual basis or after a periodic review? If they can be planned to take place on achievement of particular milestones, what should those milestones be? Should any individual review of the basket structure be done as part of a rulemaking proceeding? Are there any other procedures that would be appropriate?

The Commission should immediately establish the price cap basket structure proposed above. As services and markets become competitive they would be removed from price cap regulation and therefore the price cap basket structure would not necessitate further special consideration, modification or treatment.

Issue 6c:

As competition develops at different rates for different services within different geographic markets, should different basket structures be established for a particular LEC or within a particular study area or even within a smaller geographic area?

The proposed basket structure facilitates (especially the service dimension) the competitive showing process by which services are removed from price cap regulation. This eliminates the need for different basket structures based on the degree of competition or regular adjustments to the basket structure as competitive conditions change.

7. Consolidation Of Service Categories

Issue 7a:

Would any service category consolidations serve our goals in this proceeding? If so, explain how they would serve those goals. Would there be any adverse effects on end-users or competition?

The Commission must eliminate unnecessary regulatory service distinctions, including those created by the existing subcategories. If the goal is to prevent revenue shifting between competitive and less-competitive market areas, the Commission should adopt a regulatory scheme which differentiates market areas by competitiveness. There exists no rationale for the arbitrary and counterproductive segregation of services and prices of services into separate price cap categories.[49] Regulating the market based on the competitive characteristics will benefit end-users and competitors alike. SWBT has detailed its proposed price cap basket structure in response to Issue 6a above.

Issue 7b:

Under what circumstances can consolidation of service categories occur?

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[49] The current service categories do not even restrict their differentiation to entire services. They further differentiate LEC rate elements by the type of facility over which services are provided (e.g., analog versus digital) and sometimes between complementary rate elements within an existing overall service offering.

SWBT's proposed price cap basket structure provides an appropriate solution for continued evolution of regulation in response to the evolution of competition. SWBT's proposal depicts the degree of consolidation of price cap categories that is necessary and appropriate. SWBT has outlined the circumstances that warrant service category consolidation as part of its proposal for baseline regulation. Additional consolidation may also be appropriate (e.g., consolidation of the analog and digital service categories).

Issue 7c:

If service categories are combined, how should the relevant SBIs and the SBI upper and lower limits be adjusted?

A simple revenue weighting[50] of the combined categories' SBIs and upper and lower band limits would result in essentially the same total dollar value of upward and downward flexibility for the combined category as existed for the individual categories. An alternative method would be to calculate the current minimum and maximum allowable revenue amounts (calculated using base period demand, as in API and SBI calculations) for each of the categories to be combined. After a revenue-weighted SBI is calculated for the new combined category, the combined upper and lower band limits could be calculated from the relationship of the combined category minimum and maximum allowable revenue to the combined category current revenue. This ratio would be applied to the combined category SBI to calculate the band limits. Both options result in essentially the same band limits.

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[50] Revenue for this purpose would be base period demand times price.

8. Operator Services

Issue 8:

Should operator services be placed in its own service category in the traffic sensitive basket or combined with another new or pre-existing service category?

The Commission seeks comments on whether operator services should be placed in a service category (its own, a new one or an existing one) and the proper treatment of operator-related and directory assistance-related call completion services.[51] There is simply no demonstrated need to add further complexity to the price cap plan by establishing additional service categories for these services. The proposed changes would unnecessarily restrict the ability of price cap LECs to respond to competition, at precisely the time when pricing flexibility is needed in this increasingly competitive marketplace.

Operator Call Processing (operator transfer service and line status verification services) should reside in the Interexchange basket. Directory Assistance-Related Call Completion and BNA services should be in the Information service category in the Switching basket. LIDB services should be in the Database service category in the Switching basket.

Past pricing behavior does not indicate the need for further pricing constraints. In CC Docket No. 93-124, SWBT noted that rates for Operator Call Processing services (currently part of the Interexchange basket), have not increased since the service was first tariffed.[52] SWBT further noted that the operator service market is sufficiently competitive to

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[51] Second FNPRM, para. 98, Issue 8 and para. 102, Issues 9a and 9b.

[52] Treatment of Operator Service under LEC Price Cap Regulation, CC Docket No. 93-124, Erratum, filed July 12, 1993, p. 3.

obviate the need for additional pricing constraints and that the numerous changes made to the price cap plan since its inception have resulted in decreased incentives to offer new services.[53]

Operator Call Processing consists of two basic categories of interstate services readily available to IXCs; 1) "0- Transfer", and 2) "Inward Assistance" (which consists of Busy Line Verification, Emergency Interrupt, and Operator Assistance services). Over 95% of the revenues from the rate elements involved in these two basic categories are generated from the "0- Transfer" service.

Numerous carriers willingly participate in SWBT's 0- Transfer service simply as an additional way for the end user to reach the IXC of his or her choice. In the Memorandum Opinion and Order on SWBT's petition for waiver to allow SWBT to establish new rate elements for operator services, the Bureau discussed challenges raised by parties opposed to SWBT's offering of the 0- Transfer service. The Bureau stated:

> 0- transfer services appear to be beneficial to consumers. For example, some consumers will undoubtedly appreciate the ease of dialing merely 0-. Secondly, 0- transfer services are merely providing an alternate way for the end user to reach the IC of his choice--a choice the end user should already have by using an access code or dialing an 800 or 950 number.[54]

Competition for 0- Transfer service exists in various forms, as noted by SWBT in CC Docket No. 93-124.[55] Campaigns by AT&T to promote "1 800 CALL-ATT" and by MCI to promote "1 800 COLLECT" clearly demonstrate the competitive nature of the operator

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[53] Id. pp. 4-8.

[54] Southwestern Bell Telephone Company, Petition for Waiver of Section 69.4(b) of the Commission's Rules, Transmittal No. 1874, 5 FCC Rcd. 3452 (1990), at para. 26.

[55] The Commission is already aware of the aggressive advertising and customer education efforts undertaken by the IXCs to promote access code dialing. See SWBT Comments in CC Docket No. 93-124, Filed July 6, 1993, pp. 4-7.

services market and are primary examples of substitutes for 0- Transfer Service. SWBT has also filed data on the extent to which an IXC will educate consumers on their ability to avoid the use of a SWBT operator.[56]

Since the overwhelming majority of the revenues included in Operator Call Processing are from the 0- Transfer service, the creation of a separate service category essentially results in rate element banding. This would severely reduce a LEC's ability to achieve the pricing flexibility needed in a competitive marketplace and would further reduce incentives for SWBT and others to introduce new services. The Commission should drop its proposal to establish a new "Operator Services" category in the Traffic Sensitive or any other basket, which would needlessly further complicate and restrict the price cap structure.

If additional categories with few rate elements are established, changes in PCIs can require significant rate element price changes. For example, in SWBT's 1995 Annual Filing, a 10% change in the Billing Name and Address usage rate was indicated if BNA rates were to remain in-band. This rate change would not have been indicated if the BNA service was part of a larger service category or in a basket without service categories.

9. Call Completion Services

Issue 9a:

What is the proper price cap treatment of operator-related call completion services?

The Commission correctly recognizes that competition exists for operator-related call completion services "because they may be provided by any operator service provider

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[56] See, Petition for Reconsideration of Southwestern Bell Telephone Company, filed in CC Docket No. 92-77, Phase I, on January 11, 1993.

(OSP)."[57] The Commission's belief that these services are subject to more competition than operator transfer service is debatable, however, since the services differ considerably and it would be difficult to agree on a common measure to determine the extent of competition in each category. Nevertheless, there is substantial agreement that competition exists in the operator services marketplace.

Every filing made by SWBT regarding its Designated Operator Services (DOS) offering has pointed out that the existence of competitors providing operator services call completion services for IXCs is well established.[58] SWBT's DOS is in direct competition with the services of many other operator services providers which have been meeting and adapting to IXCs' needs for years. On September 30, 1992, prior to issuing its final Order implementing provisions of the Telephone Operator Services Consumer Improvement Act (TOSCIA) of 1980, the Commission had on file over 400 informational tariffs from OSPs. Not only is SWBT not a "dominant" provider of operator call completion services for IXCs, SWBT, at the current time, has zero market share.

The Commission acknowledged the competitive nature of the operator services market in its May 25, 1995 Order rejecting MCI's petition to reject SWBT's tariff filing. The Commission stated:

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[57] Second FNPRM, para. 101 Issue 8b, pg. 47.

[58] See, Petition of Southwestern Bell Telephone Company for an Expedited Waiver of Section 69.4(b) filed May 13, 1994. See also SWBT tariff Transmittal No. 2422 filed January 26, 1995 and amended on March 15, 1995. SWBT filed modifications to its DOS service on October 20, 1995 designed to make SWBT's service competitive with the non-regulated products of other OSPs. See SWBT Transmittal No. 2508, and the Reply of SWBT to Petitions To Reject filed November 17, 1995.