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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF SECRETARY

December 11, 1995

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

Subject: 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. 93-127.

Dear Mr. Caton:

Enclosed please find the original and nine copies of the General Services Administration's Comments for filing in the above-referenced proceeding.

Sincerely,

Jody B. Burton
Assistant General Counsel
Personal Property Division

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FEDERAL COMMUNICATIONS COMMISSION
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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 Video 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 THE GENERAL SERVICES ADMINISTRATION

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December 11, 1995

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SUMMARY

With one exception, GSA agrees with and endorses the Commission's proposals for increased pricing flexibility under the current price cap regimen. That exception is the proposal to consolidate price cap baskets. While the present baskets should not be considered immutable, the Commission should recognize that consolidating baskets allows LECs to escape some of the price increase constraints of the price cap plan.

GSA does not observe any increase in the flexibility of the Commission's rules governing Individual Case Basis ("ICB") prices. It recommends that such flexibility be extended by removing all time limits on ICB arrangements and by exempting all such prices from the new services test for carriers subject to the "pure" price cap option.

GSA believes that the Commission's pricing flexibility proposals are justified on their own merits without regard to the state of competition in the interstate access markets. For this reason, GSA opposes the Commission's proposal to tie these changes to demonstrations of reduced barriers to entry.

GSA endorses the Commission's evident intention to apply the same criteria to LEC services as it applied to AT&T services in determining whether to extend streamlined regulation.

GSA is concerned by the limitation of contracting authority to streamlined services. It is possible that price cap services, which are normally subject to LEC market power, might become competitive in the context of large contractually determined packages of services. Accordingly, GSA recommends that the Commission qualify contract service

for streamlined regulation based on the competitiveness of the contract itself, not the constituent services within the contract.

GSA does not believe that the present state of competition for switched access services justifies the Commission's consideration of criteria for LEC nondominance at this time.

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Revisions to Price Cap Rules for AT&T	)	CC Docket No. 93-197

COMMENTS OF THE GENERAL SERVICES ADMINISTRATION

The General Services Administration ("GSA"), on behalf of all Federal Executive Agencies, submits these Comments in response to the Commission's Second Notice of Proposed Rulemaking in CC Docket No. 94-1, Further Notice of Proposed Rulemaking in CC Docket No. 93-124, and Second Further Notice of Proposed Rulemaking in CC Docket No. 93-137 ("Notice"), released September 20, 1995.

I. INTRODUCTION

The Notice seeks comment on proposed modifications to the Commission's rules under three alternative conditions. First, without regard to the presence or absence of competition, the Commission inquires whether it should allow the Local Exchange Carriers ("LECs") additional flexibility in various aspects of its Price Cap Plan. It also

inquires whether and to what extent this added flexibility should be made contingent on evidence of increased competition.

Second, the Commission inquires as to the appropriate basis for determining when competition for specific services or service areas is sufficient to justify streamlined regulation. As part of this inquiry, the Commission proposes to allow the price cap LECs to offer contract prices for services subject to streamlined regulation, with the proviso that the contract prices must be made available to similarly situated customers.

Finally, the Commission inquires whether it is now time to adopt rules that would define the conditions of competition that might allow a LEC to be designated as nondominant.

The issues raised in this Notice reflect the difficult and delicate balance that the Commission must maintain between the sometimes contradictory goals of protecting ratepayers from the exercise of LEC pricing power, and alternatively, of stimulating innovation and competition. On the one hand, limitations on the carriers' pricing flexibility that are too stringent can inhibit the initiation of new services and could harm the LECs' ability to respond to competition. On the other hand, premature relaxation of needed constraints on the ability of the LECs to extract monopoly rents from services over which they exercise pricing power could result in excessive ratepayer costs and an abrogation of the Commission's responsibility to protect the public interest.

In GSA's view, the three objectives set forth in paragraph 29 of the Notice provide excellent guidance for the achievement of this balance. First, the modifications should

not cause competitive harm. GSA interprets this objective to mean that the changes should not inhibit the development of effective competition in telecommunications markets. Second, the focus of the modifications should be toward rate reductions. GSA concurs that rate reductions are pro-competitive so long as they do not prompt offsetting rate increases. Finally, regulations that are no longer necessary to prevent anti-competitive behavior should be eliminated. GSA believes that regulation in general, and price cap regulation in particular, must bear the continuing burden of proof that it serves the public interest. Any aspect of regulation that does not meet this burden should be discarded.

II. PRICING FLEXIBILITY WITHIN THE PRICE CAP PLAN

In Section IV.B. of the Notice, the Commission seeks comment on a number of initiatives that provide the LECs with greater pricing flexibility:

- Exclude alternative pricing plans from the definition of "new services" subject to detailed cost support;[1]
- Reduce the notice and cost support for new services that raise no competitive implications;[2]
- Allow LECs to offer alternative pricing plans in addition to volume and term discounts;[3]

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[1] Notice, ¶39.

[2] Notice, ¶46.

[3] Notice, ¶59.

- Allow LECs to offer volume and term discounts on all switched services;[4]
- Clarify the rules covering Individual Case Basis ("ICB") rates;[5]
- Amend Part 69 to allow new rate elements for switched access services;[6]
- Allow other LECs to provide the same rate elements as the initial applicant;[7]
- Relax the filing requirements for new switched access rate elements;[8]
- Eliminate lower service band index limits;[9]
- Revise baskets and service categories.[10]

Initially, the Commission solicits comment on these proposals without regard to the presence of competition. Then, it inquires whether any or all of these modifications should be contingent on a showing of a certain level of competition.

A. The Proposed Modifications Should Be Made Without Regard To The Presence Or Absence Of Competition.

Most of the proposals for relaxed regulation and pricing flexibility are justified quite without regard to the effect of competition. Indeed, the proposal for "Level 2" treatment of new service rates is specifically contingent on the absence of any competitive

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[4] Notice, ¶59.

[5] Notice, ¶65.

[6] Notice, ¶71.

[7] Id.

[8] Notice, ¶72, 73.

[9] Notice, ¶75.

[10] Notice, ¶93-102.

implications.[11] The proposals to allow carriers to restructure rates, to offer alternative pricing plans, and to provide term and volume discounts are justified without reference to competition. This increased flexibility has a dual advantage. It allows carriers to set prices closer to the corresponding levels of cost, and it provides ratepayers with greater options in the manner in which they buy services.

The danger of relaxing regulation in the absence of competition is that the carrier may use its new-found freedom to increase rates where demand is particularly inelastic, thereby abusing its pricing power. However, a careful review of the specific proposals outlined in the Notice reveals no instance where this danger is imminent. The relaxation of the rules for filing new services and alternative rate plans does not influence rate increases because these new filings are initially kept out of the price cap baskets. The proposal to remove the lower limit from the service band indexes arguably could allow some increases, but those increases would continue to be limited by the five percent upper band limit.[12]

B. The Advent Of Competition Increases The Importance Of Downward Pricing Flexibility.

While there is already justification for greater downward pricing flexibility in the absence of competition, the presence of competition increases that justification. This point is made persuasively in ¶ 83 of the Notice, where the Commission observes that

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[11] See Notice, ¶46.

[12] See Notice, ¶83

artificial constraints on price reductions could cause rates to be maintained at levels above cost, inviting inefficient entry. GSA made exactly this argument two years ago in its Reply Comments on Ameritech's "Advanced Universal Access Plan":

> GSA agrees with Ameritech that it should be granted increased pricing flexibility concurrent with the unbundling of its network. If the Commission does not allow increased pricing flexibility when Ameritech opens its markets to competition, some competitors will grow, not because they are more innovative and efficient, but because the Commission has created an artificial pricing umbrella. Were Ameritech required to recover areawide fully distributed costs from all customers, for example, competitors could grow by underpricing Ameritech in low cost areas even if their incremental costs were greater than Ameritech's. Growth achieved under these circumstances is not economically efficient, and benefits only competitors, not the public. If the Commission waits until competitors are fully developed to allow Ameritech to compete, it will be faced with countless appeals by relatively inefficient parties to keep Ameritech's pricing umbrella in place. By granting Ameritech pricing flexibility at the outset, the Commission will be ensuring that the growth of competition benefits the users of telecommunications services, and not just the competitors.[13]

C. Limitations On Price Increases Within Service Categories Should Not Be Tightened.

As the Commission notes, the danger that LECs could engage in predatory pricing could be mitigated by limiting the ability of the carriers to increase prices following their reduction.[14] GSA would favor such a proposal. However, GSA does not see this proposal spelled out in the Notice.

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[13] Reply Comments of the General Services Administration, DA 93-481, July 12, 1993.

[14] Notice, ¶83.

What is spelled out in the Notice is a proposal to constrain to one percent the price increases within any service category in which there are rate reductions.[15] GSA does not favor this proposal because it is likely to have a severe dampening effect on the willingness of the carriers to offer price reductions. This constraint would virtually guarantee that every price reduction would generate a net loss of revenue to the LECs.

Moreover, this proposal would inhibit the rationalization of rates. Just as there are rate elements that are priced above cost, so there are likely to be other elements that are price below cost. By preventing the carriers from increasing below-cost prices, the proposal would perpetuate inefficient rates in a manner equally as deleterious as the perpetuation of above-cost rates.

Presumably, the objective of this proposal is to discourage the carriers from offsetting predatorily low prices with increases in other prices for which the carriers may exert market power. In GSA's view, the concern over predatorily low prices and monopolistic high prices is overstated. Any LEC must know that it stands very little likelihood of eliminating competitors through below-cost pricing. As the number and resources of its competitors grow, the more likely result of such pricing will be to leave the LEC with the dominant market share of a loss operation, hardly a happy outcome.

Similarly, the likely effect of above-cost pricing by the LEC will be to hasten the challenge by its competitors to its most profitable services. Faced with these prospects, the LECs are more likely to cut prices that are now above cost and increase prices that

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[15] Notice, ¶105.

are below cost. This is exactly what the Commission should be encouraging the LECs to do.

D. The Proposal To Consolidate Service Categories Does Not Appear To Be Competitively Beneficial.

The only proposal discussed in Section IV.B of the Notice that does not appear to have a beneficial effect on ratepayers is the suggestion that service categories within the respective baskets should be consolidated.[16] The principal effect of such consolidation would be to grant the carriers greater "headroom" in which to increase rates for individual services. This headroom would be created by rate reductions in one service category that could be applied to rate increases in another, newly consolidated category.

GSA is not suggesting that the existing service categories remain immutable, just that the motivation for consolidation seems, at first blush, to be an effort to avoid the price increase constraints of the price cap plan. If the LECs can provide good reasons why consolidation of categories would benefit ratepayers, then possibly their proposals should be adopted. However, the Commission should view these proposals with considerable circumspection.

E. Individual Case Basis Prices Should Be Allowed Without Time Limits And, For Price Cap Carriers, Without The New Services Test.

Beginning at paragraph 61, the Notice discusses Individual Case Basis ("ICB") tariff filings. It notes the current constraints on ICB pricing: they must not be "like" any other previously offered service and they must be used only as an interim measure until the

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[16] See Notice, ¶93-95.

carrier can develop appropriate averaged rates. The Commission notes that it has not considered five years as being an unreasonable term for an ICB rate.

If anything, the Commission proposes to tighten the constraints on ICB pricing. The requirement for a demonstration of "unlikeness" is reaffirmed and emphasized. If two or more customers receive an ICB type service for six months, the rate has to be averaged and subject to new service requirements.[17] The only concession to pricing flexibility is the promise to continue to permit LECs to offer special construction on an ICB basis without requiring averaged rates.[18]

As the Commission correctly notes, ICB prices have the characteristics of contract tariffs:[19] they are one-of-a-kind rates, unlike other services. It is GSA's experience that the characteristic of "unlikeness" is not always well understood. It does not necessarily relate to technology or to distinct communications functions. Indeed, a service may be "unlike" all other services and still use the same technology and provide the same communications functions as other tariffed services. The "unlikeness" may lie in the organization and arrangement of that technology and those functions.

This issue was debated over four years ago when the United States Court of Appeals remanded the Commission's order in CC Docket No. 89-1382 pertaining to the "integrated service packages" offered under AT&T's Tariff 12. In Comments submitted

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[17] Notice, ¶65.

[18] Id.

[19] Notice, ¶61.

in that inquiry, GSA emphasized that the architecture of a multi-service arrangement, not the individual services of which it is composed, is the characteristic of the Tariff 12 service that is "unlike" other services:

> The service packages at issue are a product in which the total is greater than the sum of the parts. The highly complex communications requirements of large business and government entities involve elaborate system configurations requiring a sophisticated understanding of service requirements, performance standards, and facilities capabilities. The formulation of those requirements, standards and capabilities into the lowest cost system design consistent with the consumer's requirement is the valuable "product" that the customer acquires in obtaining a Tariff 12 service package. To suggest that the price that AT&T charges for the resultant network should somehow reconcile with the prices it charges for unconfigured piece parts that make up that system fails to recognize this critical element of system design as the basic service offered.
>
> * * *
>
> ...(M)ajor business, government and institutional users of telecommunications services purchase integrated systems and networks from AT&T and other carriers. The system is the product that the customer is acquiring. While the system may consist of piece-parts that are separately available on the retail market, that fact, from the customer's perception, is totally irrelevant to its purchase. [20]

With the ever-increasing variety and complexity of communications services available, these comments are even more relevant today than they were four years ago. The Commission's test of "likeness" must consider that system architecture is itself a product that will usually be one-of-a-kind, and "unlike" other system architecture products.

With this concept in mind, there seems to be little relevance, and certainly no benefit, from imposing any time limit on ICB arrangements. The unique system

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[20] CC Docket No. 87-568, Comments of the General Services Administration, March 4, 1991, pp. 3,4.

architecture of an ICB arrangement of multiple access services is not something that expires with age. Nor is it likely to grow more "like" other system configurations over time.

Appropriately, the Commission excludes ICB arrangements from the price cap mechanism. Obviously, it is impossible to impose a price cap on a unique service.

This being the case, GSA questions the value of applying the new services test to ICBs offered by carriers that have opted for the "pure" price cap alternative, that is, price caps that involve no sharing of earnings. If the ICB is not compensatory, its losses cannot be reflected in the prices of other services because there is no relationship between earnings, or lack thereof, and price caps. The losses are appropriately absorbed by the carrier's shareholders.

For this reason, GSA recommends that ICBs that involve unique system architectures be exempted from the new services test for any carrier that is on the pure price cap regimen. If that carrier later opts for one of the earnings sharing alternatives, then its ICBs should be excluded from the sharing calculation.

In addition to reducing the regulatory burden on both carrier and Commission, this provision would provide a further inducement for carriers to opt for (or remain on) the pure price cap alternative.

F. Pricing Flexibility Should Not Be Made Contingent On Lowering Entry Barriers.

GSA finds an element of self-contradiction in the Commission's views as to the relationship between the pricing flexibility changes and the development of competition.

In paragraph 34, the Commission proposes to implement increased pricing flexibility without regard to the current level of competition. As discussed earlier in these Comments, GSA is wholly in agreement with this intention.

In paragraph 106, however, the Commission appears to backtrack on its earlier resolution by tentatively concluding that the greater pricing flexibility be made conditional on a demonstration of reduced barriers to entry on the grounds that the purpose of pricing flexibility is to allow the LECs to respond to competition. The Commission proposes a tentative "checklist" of criteria that would determine whether the LEC in question is entitled to regulatory relief.

A fine point can be made that there is no contradiction, that the removal of barriers to entry is not the same thing as a demonstration of the presence of competition. Nonetheless, GSA believes that the intrusion of some sort of test of advancement toward competition unnecessarily complicates and dilutes changes to the price cap plan that are fully justifiable quite independently of market conditions. GSA agrees that pricing flexibility is generally more urgent in the face of competition, but as noted earlier, the particular changes proposed by the Commission are valuable even when there is no weakening of the LECs' pricing power.

On the other hand, GSA is sympathetic to the apparent objective of this proposal, which is to offer some form of relaxed regulation as a reward for the removal of barriers to entry. The reward, however, is that presented in the subsequent sections of the Notice, namely "streamlined regulation" and later, non-dominant status. While it is true

that the removal of barriers to entry, by itself, does not (and should not) constitute the qualification for streamlining, nevertheless such removal is a precondition for the competition by which the LECs can escape price cap regulation.

III. STREAMLINED REGULATION

As noted at the beginning of these Comments, the Notice effectively addresses three conditions, each representing a declining degree of pricing power by the LECs. The first is the price cap environment in which the LECs are able to exercise virtually untrammeled market power. The second is a condition in which the LECs exercise limited market power, principally in the form of price leadership. This is the environment of streamlined regulation. The final condition is full competition, when the LECs can be declared nondominant. This portion of GSA's Comments address the basis upon which LECs might migrate from the first to the second condition.

A. The Commission Should Follow The AT&T Model For Streamlined Regulation.

Fortunately, the Commission does not have to "reinvent the wheel" when it comes to defining streamlined regulation and evaluating the qualifications of carriers and services for achieving it. The Commission has "been there, done that" with AT&T. Streamlined regulation applies to services that face substantial competition. It means that tariffs can be filed on shortened notice, do not need to be cost-justified, and are released from price cap and band constraints.

In Section V.2. of the Notice, the Commission reviews the criteria it used to determine whether AT&T's services faced sufficient competition. It suggests four categories of criteria that can be used to establish the necessary degree of competition: demand responsiveness, supply responsiveness, market share, and pricing below price caps. GSA can suggest no reason why these criteria are any less appropriate to judging the competitiveness of LEC services than those of AT&T.

B. The Qualification Of Contract Services For Streamlined Regulation Should Be Based On The Competitiveness Of The Contract, Not The Constituent Services.

At paragraph 148 of the Notice, the Commission proposes to allow LECs to offer contract prices for access services that the Commission has found to be subject to substantial competition and are subject to streamlined regulation.

GSA's earlier discussion of ICB arrangements is relevant to this portion of the Notice. GSA pointed out that ICBs may be configurations of existing tariffed services for which the configuration itself, not the piece-part services, is the principal product. The same will be true of the contract services covered by this provision of the Commission's Notice. Many will consist of multiple services, configured according to a system architecture that is discrete to a specific customer's needs. The Commission's test of "likeness" will have to recognize that fact.

Of concern to GSA is the distinction made in the Notice between services that are subject to streamlined regulation and those that are not. Under the provisions outlined in the Notice, an integrated service package consisting of a mix of streamlined and price

cap services would have to be separated into two pieces. The streamlined services could be provided under contract, while the price cap services would be offered pursuant to averaged tariff.

This separation is appropriate if the price cap services represent truly bottleneck functions that only the LEC can provide. Bundling those services into a contract price could provide the LEC with an advantage not available to non-LEC competitors.

GSA is concerned, however, whether price cap services that do not face substantial competition when offered individually might become quite competitive when offered as part of a larger service package. To illustrate, it is widely considered that voice grade switched access service is a bottleneck function securely within the market power of the incumbent LECs. It will probably be the last service to be freed from price caps.

However, if a large governmental, institutional or business customer were to put the entirety of its access requirements up for competitive bidding, it is likely that non-LEC competitors would offer to provide switched access service as part of their package. That would certainly be the case if the competitor were providing Centrex-type intercom switching functions. Switching of interstate calls to the interexchange carriers would be another incremental service bundled into the package.

In this bidding environment, the requirement for the LEC to break out its switched access services for provision at tariffed rates would severely undercut the LEC's competitive position. Indeed, it might render the LEC's bid unresponsive to the customer's procurement request, particularly if the customer is looking for a single, integrated

package of services covered by a single blanket contract.

The resolution is to define the competitiveness of contract services by the competition shown for the contracts, not for the constituent services within the contracts. If a contract is the result of a competitive procurement in which multiple bidders submitted viable proposals, then the Commission can assume that all services provided under that contract are subject to substantial competition and qualify for streamlined regulation.

On the other hand, if the contract was the result of a one-on-one negotiation between the LEC and the customer, then the Commission's service distinction should stand, and the LEC should be required to break out price cap services for tariff treatment.

This provision will require some additional certifications from the applicant LEC, specifically a statement of the circumstances under which the contract was developed and possibly a certification from the end-use customer that competitively viable offers from other suppliers were solicited and received prior to consummation of the contract with the LEC. The Commission's complaint procedures will, of course, provide a further safeguard against abuse of these procedures.

IV. NONDOMINANT TREATMENT

The final market condition discussed in the Notice is that of full competition, when the incumbent LECs can no longer be considered "dominant," and regulation can effectively be removed altogether.

A. The Commission Should Not Address Issues Of Nondominance At This Time.

GSA believes that the likelihood of any of the major incumbent LECs becoming nondominant in the near future is so remote as to justify the dismissal of this issue at this time. The Commission's limited resources would better be put to securing a smooth and beneficial transition of its regulation during the current migration of the access market from its present condition of strong market power by the LECs to one of substantial competition for certain services. That transition is, of course, the subject of the remainder of the Notice.

As a practical matter, the erosion of the dominant status of the LECs in their respective service territories is an issue largely out of the reach of this Commission. Local switched access competition is inextricably tied to the market condition of local exchange service. A LEC that possesses strong market power over local exchange services has, as a by-product, market power over interstate switched access service. Conversely, achievement of viable competition for local exchange service will almost automatically provide equal or greater competition for interstate access services.

Local exchange service is, of course, subject to the jurisdiction of the state regulatory agencies. It is these state commissions that are setting the pace for advancing local service competition. While that pace appears to be accelerating, it is still in its initial stages. There is no community in the nation where viable, effective competition is providing market-based prices for basic local exchange service. That being the case, there is no community in the nation where interstate switched access service is totally

free from the market power of the dominant LEC. To consider the possibility of nondominance at this time is, in GSA's view, premature.

IV. CONCLUSION

The General Services Administration, on behalf of all Federal Executive Agencies, urges the Commission to consider carefully the arguments presented in these Comments and to implement the recommendations made therein.

Respectfully submitted,

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December 11, 1995

CERTIFICATE OF SERVICE

I MICHAEL J. ETTNER, do hereby certify that copies of the foregoing "Comments of the General Services Administration" were served this 11th day of December, 1995, by hand delivery or postage paid to the following parties:

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