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

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In the Matter of	)	
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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

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SUMMARY

Comcast Corporation ("Comcast"), by its attorneys, respectfully submits these comments regarding the Commission's Notice tentatively proposing regulatory relief for price cap LECs. In proposing to reduce regulation of price cap LECs when they control over 90 percent of the local exchange market, the Notice would place the cart before the horse. It is axiomatic that firms that possess market power will charge unjust and unreasonable rates and engage in anticompetitive conduct, absent a regulatory backstop and other competitive safeguards. Thus, the Notice's proposed regulatory streamlining for dominant LECs is entirely premature.

At the same time, the optimal regulatory framework to achieve the Commission's goals for price cap regulation — achieving economic efficiency and competitive deployment of local exchange service — must foster competitive new entry by alternative local exchange service providers. Open and nondiscriminatory network access and interconnection to dominant LEC networks by means of just, reasonable and mutually compensatory co-carrier agreements will form the pillars of a competitive regulatory architecture for the local exchange market.

Constructing appropriate competitive safeguards to apply to dominant LECs while also fine-tuning a competitive paradigm to promote new entry by competitive local exchange service providers involves a broader but more focused degree of analysis than that presented in the Notice. Accordingly, to ease the Commission's administrative burden, this price cap proceeding should be divided into three separate phases. In Phase I, the Commission should expeditiously assess the state of competition in the local exchange market. Phase II would establish a competitive paradigm for the local exchange market. A

regulatory paradigm that will effectively limit LEC market power and stimulate new entry must remove all state restrictions to local exchange competition, eliminate the LEC monopoly in local franchising, and require LECs to engage in good-faith negotiation to make available interconnection arrangements with competitors on just, reasonable and nondiscriminatory rates, terms and conditions. Finally, Phase III would match changes in LEC regulation with elimination of regulatory barriers to entry and growth of competition in state and interstate markets.

In Phase I of this proceeding, the Commission must conduct an expeditious assessment of the state of competition in the local exchange market. By collecting baseline data such as LEC revenues, network usage and capacity, the Commission will be able to form a complete picture of the local exchange market. Incumbent LECs control the lion's share of the local exchange market, and thus are most able to engage in anticompetitive conduct. Accordingly, only a relatively limited amount of data ought to be collected from new entrants such as competitive access providers ("CAPs"), wireless competitors, and potentially cable operators, relative to information collected from dominant LECs.

In Phase II of this proceeding, the Commission must establish a competitive paradigm for the local exchange market. The core focus of a regulatory paradigm for local exchange competition must be on promoting new entry by competing facilities-based local exchange service providers. Just as the Commission eased regulation on non-dominant long distance carriers in the *Competitive Carrier* proceeding, the Commission must facilitate competition into the local exchange market by eliminating LEC-imposed barriers to entry. In this regard, the competitive paradigm must include elements to eliminate LEC

monopolies in local franchising and rights of way and to promote good-faith negotiation of mutually compensatory interconnection arrangements with just, reasonable and nondiscriminatory rates, terms and conditions for access to LEC network facilities, databases, signaling systems and information.

Another impetus for the competitive paradigm must be the elimination of regulatory subsidies of LEC market power. First, the Commission must abolish policies such as the residual interconnection charge ("RIC") that artificially support LEC competitive ventures at the expense of LEC rivals and new entrants. Similarly, the competitive paradigm must redress LEC incentives to engage in jurisdictional whipsawing and other types of regulatory gamesmanship to delay direct competition.

As Phase III of this proceeding, the Commission must apply the competitive paradigm established in Phase II to foster the growth of competition in the local exchange market and eliminate LEC market power. Just as the Commission in the *Competitive Carrier* proceeding promoted competing long distance carriers to reduce AT&T's ability to exploit market power, the Commission must encourage competition in the local exchange market by promoting new entry as a top priority. In order to ensure new entry by means of a "competitive checklist," the Commission must target the core elements of LEC network and infrastructure that are essential to local exchange competition. The competitive checklist must impose a duty on LECs to provide access and interconnection to these essential network facilities and functions by engaging in good-faith negotiations to provide just, reasonable and non-discriminatory co-carrier interconnection arrangements. The terms and conditions of such interconnection arrangements must also provide for

mutually compensatory terms and a trunk-side point of interconnection on any LEC switch, where technically feasible.

The Commission also must acknowledge that granting LECs non-dominant status under current market conditions will produce rates that violate the Communications Act. In *Competitive Carrier*, the Commission only recently declared AT&T to be non-dominant after it had ceded about 40 percent of its market share as well as control of bottleneck facilities, and faced full-fledged competition from facilities-based competitors. In contrast, the local exchange market is still dominated by incumbent LECs that remain in undisturbed control of local loop bottleneck facilities. Competing local exchange service providers such as CAPs, wireless service providers and potentially cable operators have not reached the build-out and operational phases in the local exchange market that even begin to approximate the strong rivalry well-established in the long distance market.

The Notice's proposed streamlining of existing price cap regulation for dominant LECs will have an untoward effect on local exchange competition. Absent a rate backstop, introducing pricing flexibility for LECs with market power will fail to produce competitive rates. In particular, eliminating competitive safeguards with regard to existing LEC pricing flexibility mechanisms such as new services, individual case basis ("ICB") offerings, alternative pricing plans ("APPs") will only facilitate discriminatory and anticompetitive pricing by the LECs.

Finally, elimination of existing competitive safeguards in the price cap basket structure and the Part 69 access charge system will eliminate safeguards against LEC anticompetitive conduct and cross-subsidization. By proposing to eliminate the service

band index ("SBI") floor, the Notice will not facilitate competition by "moving prices closer to cost." Rather, the absence of a regulated lower rate floor will free up LECs to engage in predation and cross-subsidization of competitive ventures to the detriment of competitors and captive monopoly ratepayers. Moreover, the Notice's proposed establishment of a single price cap basket and blanket waiver of Part 69 access charge rate elements will allow LECs freely to shift costs among services in an anticompetitive manner without threat of detection by regulators, competitors or the public.

In sum, the Notice's proposed regulatory relief for incumbent LECs will not advance the Commission's goals for competition in the local exchange market. Rather than facilitating incumbent LECs in extending their market power into new and advanced telecommunications services, the Commission must engage in an expeditious and timely inquiry to establish a pro-competitive regulatory paradigm for the local exchange market. A fundamental part of this paradigm must be the promotion of competitive new entry to allow market forces to reduce the competitive advantage of incumbent LECs. Only by eliminating LEC-induced and regulatory barriers to new entry will the Commission fully be able to realize the competitive potential for the local exchange market. Comcast thus respectfully urges the Commission to adopt the proposals in these comments.

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COMMENTS

Comcast Corporation ("Comcast"), by its attorneys, hereby submits its comments regarding the above-captioned notice to address proposed changes in regulation of price cap local exchange carriers ("LECs").[1/] With both wireless and competitive access operations, in addition to its cable offerings, to be provided in competition with incumbent LECs, Comcast has an essential stake in the outcome of this proceeding.[2/]

1/ *See Price Cap Performance Review for Local Exchange Carriers; Treatment of Operator Services Under Price Cap Regulation; Revisions to Price Cap Rules for AT&T*, Second Further Notice in CC Docket Nos. 94-1; Further Notice of Proposed Rulemaking in CC Docket No. 93-124 and Second Further Notice of Proposed Rulemaking in CC Docket No. 93-197 (released September 20, 1995) ("Notice").

2/ For example, one of Comcast's subsidiaries is a partner in WirelessCo, L.P. the licensee of 30 broadband PCS licenses in MTAs including New York, San Francisco-Oakland-San Jose, Detroit and Dallas-Ft. Worth. Another of Comcast's subsidiaries is the A Block cellular licensee in the Philadelphia Metropolitan Statistical Area ("MSA") and surrounding MSAs. Comcast is a substantial owner/investor in Teleport Communications Group. In addition, Comcast's subsidiary Eastern Telelogic, Inc., also provides competitive access service.

I. INTRODUCTION

The goals of promoting economic efficiency and encouraging the transition to competition in the local exchange market are important ones.[3/] The proposed regulatory relief for incumbent LECs in the Notice, if adopted, will fail to achieve these goals and even hinder them. Because price cap and Tier 1 LECs retain the lion's share of the local exchange market, they may exercise market power at will to hinder competition. The Notice's proposals to streamline price cap regulation and declare LECs non-dominant are entirely premature, absent a finding that they may no longer exploit market power to disadvantage new entrants. The Commission must take preliminary steps to assess the competitive condition of the local exchange market, articulate a necessary competitive paradigm and eliminate regulatory barriers to entry by competitors.

For administrative ease, the Commission should divide this proceeding into discrete phases. In Phase I, the Commission should expeditiously assess the state of competition in the local exchange market. Phase II would establish a competitive paradigm for the local exchange market. A regulatory paradigm that will effectively limit LEC market power and stimulate new entry must remove all state restrictions to local exchange competition, eliminate the LEC monopoly in local franchising, and require LECs to engage in good-faith negotiation to make available interconnection with competitors on just, reasonable and nondiscriminatory rates, terms and conditions. Finally, Phase III would match changes in

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3/ *See Price Cap Performance Review for Local Exchange Carriers*, First Report and Order, CC Docket 94-1, FCC 95-132, at ¶¶ 93-4 (released April 7, 1995) ("*Price Cap Performance Review Order*").

LEC regulation with elimination of regulatory barriers to entry and growth of competition in state and federal markets.

II. MEANINGFUL LOCAL EXCHANGE COMPETITION WILL NOT OCCUR WITHOUT AFFIRMATIVE REGULATORY ACTIONS TO LIMIT AND ELIMINATE LEC MARKET POWER

As a threshold matter, the Commission must assess the current state of competition in the local exchange market before it can identify appropriate regulatory measures. The Commission should expeditiously conduct a competitive assessment of the local exchange market. If a such a market study reveals that incumbent LECs exercise market power in the local exchange market, as Comcast believes, then the Commission must strengthen rather than streamline regulation of incumbent LECs.

A. In Phase I of This Proceeding, the Commission Must Conduct an Assessment of the State of Competition in the Local Exchange Market.

As the first phase of this proceeding, the Commission should conduct an expeditious assessment of competition in the local exchange market. Absent such a market assessment, the Commission will have no way of knowing whether a particular regulatory model will promote or hinder competition in the local exchange market. The Commission initiated the *Competitive Carrier* docket by assessing the relative market share of AT&T and specialized common carriers such as MCI Communications Corporation ("MCI") in the long distance market.[4/] The Commission, therefore, must not adopt its tentative proposal

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4/ *See Policy and Rules Concerning Rates for Competitive Carrier Services and Facilities Authorization Therefor*, Docket No. 79-252, 85 F.C.C.2d 1 (1980) ("*Competitive Carrier I*"). The FCC then forbore from Title II regulation of resellers. *See Competitive Carrier*, 91 F.C.C.2d 59 (1982). In the *Competitive Carrier* decision, 95 F.C.C.2d 554

that granting price cap LECs pricing flexibility and regulatory relief "need not be conditioned on a competitive showing."[5/]

In order to study competition in the local exchange market, the Commission must first establish a proper market definition, consisting of both a product market and geographic market.[6/] The Commission's proposal to define the relevant product market using current price cap service categories is unacceptable. These service categories unduly segment the product market for local exchange service. The price cap service categories are also outdated. Instead, the Commission should establish functional definitions of the relevant product market. Under this approach, services would be deemed to be cross-elastic if they are functionally equivalent, *i.e.* customers perceive the services to serve functionally equivalent purposes.[7/]

(1983), the FCC applied a market power analysis to forbear from applying tariff regulations to specialized common carriers (*i.e.* MCI), who were free to file tariffs if they so wished ("permissive detariffing"). The Commission extended the permissive detariffing policy to domestic satellite licensees in *Competitive Carrier*, 98 F.C.C.2d 1191 (1984). In 1985, the Commission adopted a policy of mandatory detariffing and directed cancellation of the tariffs filed by all non-dominant carriers. *See Policy and Rules Concerning Rates for Competitive Common Carrier Services and Facilities Authorizations Therefor*, Sixth Report and Order, CC Docket No. 79-252, 99 F.C.C.2d 1020 (1985) ("*Competitive Carrier VI*"), *rev'd and remanded sub nom.*, *MCI Telecommunications Corp. v. FCC*, 765 F.2d 1186, 1192 (D.C. Cir. 1985) (reversing mandatory detariffing on the grounds that, while Section 203 may authorize the Commission to modify its tariffing filing requirements by means of permissive detariffing, it does not allow a "wholesale abandonment" by the Commission of tariffing requirements through "mandatory detariffing"); *see also Tariff Filing Requirements for Interstate Common Carriers*, 7 FCC Rcd 8072 (1992), *rev'd AT&T v. FCC*, 978 F.2d 727 (D.C. Cir. 1992), *aff'd MCI Telecommunications Corp. v. AT&T*, 114 S.Ct. 2223 (1994).

5/ *See* Notice, at ¶ 34.

6/ *See* Notice, at ¶¶ 116-126.

7/ *See Ad Hoc Telecommunications Users Committee v. FCC*, 680 F.2d 790, 797 (D.C. Cir. 1982) ("*Ad Hoc*").

The Commission should not adopt its tentative proposal to define the relevant geographic market for the local exchange market based on density pricing zones. Density pricing zones are unsuitable for a study of the local exchange market because zone-density pricing was established with the intent of promoting interconnect competition in only one discrete aspect of the local exchange market — alternative access to interexchange carriers through competitive access providers ("CAPs") under expanded interconnection.[8/] Furthermore, zone density pricing would not fit the Commission's overall pro-competitive goals when it has in fact failed to produce competition in CAP markets.[9/] No unitary geographic market exists for local exchange service as Bell Operating Companies ("BOCs") operate in local access and transport areas ("LATAs"), and wireless carriers operate in large regional or national markets such as the PCS Metropolitan Trading Areas ("MTAs"). That being so, the Commission must adopt a geographic definition of the local exchange market that encompasses an inclusive set of local exchange services while also providing the flexibility to reflect new and advanced wireless and fiber optic technologies.[10/]

8/ *See Expanded Interconnection with Local Telephone Company Facilities; Amendment of Part 36 of the Commission's Rules and Establishment of a Joint Board*, 8 FCC Rcd 7374, 7430-7432 (1993) ("*Switched Transport Expanded Interconnection Order*"), *Expanded Interconnection with Local Telephone Company Facilities*, 9 FCC Rcd 5154, 5196 (1994) ("*Virtual Collocation Remand Order*").

9/ Recent studies by the FCC's Industry Analysis Division show that Tier 1 LECs control "97% of access revenues—a level roughly comparable to the Bell System's share of toll revenues in 1981." *See Common Carrier Competition; Spring 1995*, at 5 (Industry Analysis Div. released May 31, 1995); *attached to FCC Releases Common Carrier Competition Report*, News Release, Rep. No. CC 95-31 (released May 31, 1995) ("*1995 Competition Report*").

10/ The data collection, for example, proposes that all reporting entities identify local exchange data by state, Primary Metropolitan Statistical Area ("PMSA"), and zip code using existing internal records of customer addresses. *See The Common Carrier Bureau Seeks*

The Commission should base its market inquiry and market definition on the results of the recently announced local competition data collection.[11/] The market study would collect a small and appropriate amount of data for all competitors in the local exchange market, while the large, incumbent LECs would provide data on revenues, number of customers, minutes of service, measures of capacity, expenses, and details on market structure. This information could provide the basis for matching the degree of regulation with the relative market share of incumbent LECs for purposes of determining the level of regulation that should be applied to them.

B. The Commission Must Acknowledge in its Competitive Assessment That Firms With Market Power Are Wont To Charge Anticompetitive Prices and Engage in Anticompetitive Conduct.

Incumbent Tier 1 LECs possess substantial market power to impose unjust rates and unreasonably discriminatory terms and conditions to exclude competitors absent affirmative regulatory action. In light of LEC market power, the regulatory streamlining proposals contained in the Notice will have ruinous effect on the local exchange market. The Commission must therefore strengthen rather than eliminate regulation of dominant Tier 1 LECs. Given that incumbent LECs already enjoy significant pricing flexibility, strengthened regulation will not harm Tier 1 LECs.

It is well-accepted that firms with market power can and will charge anticompetitively high or low prices and engage in unreasonable price discrimination unless they are prevented

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Comment on Telecommunications Access Provider Survey, Public Notice, CCB-IAD 95-110, DA 96-2297 (released November 3, 1995) ("Data Collection").

11/ *See id.*

from doing so.[12/] An assessment of the local exchange market today would find that incumbent LECs control the lion's share of the interstate access market.[13/] A grant of substantial pricing flexibility will permit them to preempt the emergence of competition the Commission seeks to foster.

The main elements of the Commission's proposed Data Collection, as applied to incumbent LECs, reveal that such LECs have market power. Among these elements are network usage, revenues and capacity.[14/] In 1993, BOC revenues of $16.337 billion represented 71.0 percent of the interstate access market, and other LECs' reported revenues of $5.993 billion accounted for a 26.0 percent of the market.[15/] In comparison, interexchange carriers, CAPs and wireless providers aggregate revenues of $682 million accounted for only 3.0 percent of interstate access revenues.[16/] LEC excess capacity also far outstrips that of competitors.[17/]

12/ *See Competitive Carrier I*, 85 F.C.C.2d at 20-22.

13/ *See Preliminary Statistics of Communications Common Carriers*, (Industry Analysis Div. released July 7, 1995) ("*1995 Preliminary Common Carrier Statistics*").

14/ *See id.*

15/ *See 1995 Competition Report*, at 6.

16/ *See id.*

17/ A recent fiber deployment study shows that the BOCs possessed 7.8 million miles of fiber at the end of 1994. Over that same period of time, CAP systems had only 429,000 fiber miles. *See* Jonathan M. Kraushaar, *Fiber Deployment Update End of Year 1994* (Industry Analysis Div. July 1995); *FCC Releases Fiber Deployment Analysis*, News Release, Mimeo No. 54730 (released July 12, 1995).

In *Competitive Carrier*, one key factor leading to the Commission's identification of AT&T as a dominant carrier was "the control of bottleneck facilities."[18/] The Commission explained that "a firm controlling bottleneck facilities has the ability to impede access of its competitors to those facilities."[19/] Complementary to the decision to extend streamlined regulation to non-dominant carriers, moreover, was the Commission's finding that AT&T and the Bell System (and independent telephone companies) exercised market power sufficient to "continue to apply the full panoply of [the Commission's] traditional regulations to AT&T[]."[20/] The Commission explained that the control of bottleneck facilities "confers market power upon a firm" and gives it "the ability to impede access of its competitors to those facilities."[21/] Finding that AT&T controlled the overwhelming share of MTS, WATS and private line markets and that "the Bell System control[led] access to over 80% of the nation's telephone lines[]",[22/] the Commission concluded that AT&T and the Bell System control of bottleneck facilities required "detailed regulatory scrutiny."[23/] In today's local

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18/ *See* 85 F.C.C.2d at 21.

19/ *See id.*

20/ *See Competitive Carrier I*, 85 F.C.C.2d at 23.

21/ *See id.*, 85 F.C.C.2d at 21 n.52 (citing *United States v. Terminal Railroad Ass'n of St. Louis*, 224 U.S. 383 (1912); *Eastman Kodak v. Southern Photo Materials Co.*, 273 U.S. 359 (1927); *Associated Press v. United States*, 326 U.S. 1 (1945); *United States v. Klearflax Linen Looms, Inc.*, 63 F.Supp. 32 (D. Minn. 1945); *Times Picayune Co. v. United States*, 345 U.S. 594 (1953); *Otter Tail Power Co. v. United States*, 410 U.S. 366 (1973); *Mt Hood Stages v. Greyhound Corp.*, 555 F.2d 687 (9th Cir. 1977), *vacated on other grounds*, 437 U.S. 322 (1978)).

22/ *See id.*, 85 F.C.C.2d at 23.

23/ *See id.*, 85 F.C.C.2d at 21.

exchange market, by comparison, LECs control virtually all — if not all — access to customers of the public switched telephone network ("PSTN").

Contrary to the Notice's proposal that a competitive showing is inconsequential in determining the scope and degree of regulatory oversight of dominant LECs, a competitive assessment is essential to the molding of a pro-competitive regulatory framework for the local exchange market. Furthermore, because incumbent LECs wield market power, strengthened regulatory oversight is warranted and further streamlining is entirely premature. As developed more fully below, rather than loosening regulation for incumbent LECs that possess market power, the Commission must increase existing regulatory safeguards under price caps and its access charge regime to prevent LECs from engaging in discriminatory interconnect pricing and anticompetitive cost-shifting.

III. AS PHASE II OF THIS PROCEEDING, THE COMMISSION MUST ESTABLISH A COMPETITIVE PARADIGM FOR THE LOCAL EXCHANGE MARKET

Having assessed the state of competition in the local exchange market, the Commission may institute a proceeding to fashion a pro-competitive regulatory paradigm for the local exchange market as Phase II of this proceeding. A predicate element of any regulatory paradigm the Commission proposes must be the elimination of regulatory subsidies for incumbent LECs at the state and federal levels. The core focus of a regulatory paradigm for local exchange competition must not merely repeat the "open entry" policies of *Competitive Carrier*, but rather, must also direct incumbent LECs to comply with just, reasonable and nondiscriminatory pricing and interconnect policies, and strengthened rules

of conduct to require dominant LECs in control of essential facilities to engage in good faith interconnection negotiations.

A. As a Threshold Matter in Phase II of This Proceeding, the Commission Should Alleviate Regulations That Subsidize Incumbent LEC Market Power.

The Commission aptly recognized in *Competitive Carrier* that the "regulatory process itself may have both direct and indirect anticompetitive results."[24/] As a primary element of a pro-competitive regulatory paradigm for the local exchange market, the Commission should eliminate those aspects of price cap regulation and other regulatory oversight of Tier 1 LECs that directly or indirectly reward or otherwise encourage anticompetitive conduct.

1. The Commission must abolish regulatory subsidies of incumbent LECs

The elimination of regulatory subsidies is a key to local exchange competition. Removal of such subsidies will prevent LECs from exploiting the regulatory process to erect barriers to new entry.[25/] Abolishing regulatory subsidies will also encourage LECs to become more efficient — a central tenet of price cap regulation.[26/]

Elimination of regulatory policies such as the residual interconnection charge ("RIC") that subsidize incumbent LECs will promote new entry. In expanded interconnection, the Commission authorized LECs to recover costs associated with LEC

24/ *See Competitive Carrier I*, 85 F.C.C.2d at 2-3.

25/ *See* S. 652, Section 254; H.R. 1555, Section 243.

26/ *See Price Cap Performance Review Order*, at ¶ 1.

facilities used to provide expanded interconnection to interconnectors through the residual interconnection charge, priced on a per-minute basis.[27/] The RIC is a "transport" rate element.[28/] The RIC is designed to recover LEC costs of expanded interconnection not already recovered through the "dedicated" and "common" transport rate elements — the "residual" costs.[29/] That is, if the dedicated and common transport rate elements fail to recover as much revenue as LECs recovered under the pre-expanded interconnection transport regime, the RIC would recover the shortfall. The lower the rates for common and dedicated transport, the higher the interconnection charge.[30/]

The Commission concluded that application of a RIC as part of the interim transport rate structure would promote the goals of interexchange competition and efficient network use.[31/] Although price cap regulation is designed to sever prices from cost, the RIC gives the LECs an incentive to load the costs of expanded interconnection, which is supposed to

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27/ *See MTS and WATS Market Structure; Transport Rate Structure and Pricing*, Order and Further Notice of Proposed Rulemaking, Phase I, Order and Further Notice of Proposed Rulemaking, CC Docket Nos. 78-72, 91-213, 6 FCC Rcd 5341, 5345 n.47 (1991) ("*RIC Order*").

28/ Interstate switched access is a service that LECs provide to enable IXCs and other customers to originate and terminate interstate telecommunications traffic. "Transport" is the component of the interstate switched access consisting of transmission between the access customer's point of presence ("POP") and LEC end offices.

29/ *See Transport Rate Structure and Pricing*, Report and Order and Further Notice of Proposed Rulemaking, CC Docket No. 91-213, 7 FCC Rcd 7006, 7046, 7063 (1992) ("*Transport First Report and Order*").

30/ *See RIC Order*, 6 FCC Rcd at 5347.

31/ *See RIC Order*, 6 FCC Rcd 5343.

promote network competition, on competing network service providers.[32/] In the *Price Cap Performance Review Order*, the Commission observed that "it might be in the public interest to reduce the residual interconnection charge so that it is not as high relative to other transport charges" and promised to initiate a further notice of proposed rulemaking on the issue.[33/] Furthermore, by allowing the LEC to recover the "shortfall" from other transport rate elements through a "residual" charge, the RIC is not cost-based.[34/] LECs may thus take license under the RIC policy to erect barriers to entry by imposing artificially high rates for access by competitive access providers and other interconnectors to essential LEC facilities.

2. The Commission must prevent jurisdictional whipsawing by incumbent LECs

In addition, Phase II must take into account relevant state policies that may have the unintended effect of rewarding anticompetitive conduct or impairing competition. Jurisdictional whipsawing by incumbent LECs should be a bar to federal regulatory relaxation. Pacific Bell ("PacBell"), for example, has staked out inconsistent positions before the Commission and the California Public Utilities Commission ("California PUC") with regard to its video dialtone offerings, evidencing its willingness and ability to engage in anticompetitive attempts to "game" the Commission's and the state's rules.

The success of a price cap system of regulation in deterring anticompetitively high or low rates depends, in part, on the selection of a correct productivity factor to challenge

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32/ It is also ironic that the RIC, the single cost-based rate element under the price cap plan, was initially proposed by the BOCs, although price caps is designed to make the BOCs more efficient. *See RIC Order*, 6 FCC Rcd at 5344 nn.43-4.

33/ *See Price Cap Performance Review Order*, at ¶ 256.

34/ *See RIC Order*, 6 FCC Rcd at 5347.

regulated LECs to become more efficient and reduce costs. In support of its Section 214 applications to provide video dialtone service before the FCC, PacBell emphasized that its choice of a 5.3 percent productivity factor in its 1995 access tariff would sufficiently protect ratepayers from being burdened with the costs of its estimated $16 billion video dialtone venture by forcing it "to achieve long-run increases in productivity and reliability."[35/] The FCC accepted PacBell's reliance on the more stringent productivity factor as evidence that it would not "game" the price cap system by recovering below-cost video dialtone rates from its telephony ratepayers. The Commission stated its belief that the 5.3 percent productivity factor guaranteed that any "loss [from video dialtone service] would fall primarily on Pacific's shareholders and not on its telephone ratepayers."[36/]

Before the California PUC, however, PacBell is making every effort to eliminate its state productivity factor. For example, in a brief filed in the California PUC's proceeding concerning whether to establish competitive local exchange service rules, PacBell advocated the wholesale elimination of the inflation and productivity factor elements in California PUC's price cap formula.[37/] In support of elimination of the California PUC productivity

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35/ *See Pacific Bell; For Authority Pursuant to Section 214 of the Communications Act of 1934, as Amended, To Construct, Operate, Own, and Maintain Advanced Fiber Optic Facilities and Equipment To Provide Video Dialtone Service to Selected Communities in Orange County, the Southern San Francisco Bay Area, the Los Angeles Area, and the San Diego Area in California*, Order and Authorization, File Nos. W-P-C-6913 through W-P-C-5916, FCC 95-302, at ¶ 119 (released July 19, 1995) ("*PacBell 214 Order*").

36/ *See PacBell Section 214 Order*, at ¶ 120.

37/ *See* Brief of Pacific Bell (U 1001 C), at 17 *et seq., filed* on October 13, 1994 *in Order Instituting Rulemaking and Investigation on the Commission's Own Motion into Competition for Local Exchange Service*, Decision 95-07-054, R.95-04-043, I.95-04-044 (California PUC, released July 24, 1995) ("PacBell Brief").

factor, PacBell asserted that "[i]t is impossible . . . to achieve the productivity gains — outputs minus inputs — that we did in the past."[38/] PacBell concluded that elimination of the productivity factor would benefit consumers by allowing them to "enjoy some of the lowest basic service prices in the country" and to "receive protection against price increases due to inflation."[39/]

PacBell thus has tried to have it both ways at the FCC and the California PUC with regard to a central component of effective price cap regulation of dominant LECs — the productivity factor. This instance of gamesmanship is not an isolated one or limited only to PacBell. The Commission therefore must take a substantive approach to all proposed changes in regulation to discern such regulatory gamesmanship.[40/] In this particular case, the Commission must prevent LEC jurisdictional whipsawing by requiring fundamental

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38/ *See* PacBell Brief, at 22.

39/ *See* PacBell Brief, at 24.

40/ For example, the Commission's "all-or-nothing" rule provides that when a rate-of-return company and a price cap company merge, or one company acquires the other, the resulting company must comply with price cap regulation within a year after the transaction. *See* 47 C.F.R. § 61.41(c)(2); *see also Policy and Rules Concerning Rates for Dominant Carriers*, 5 FCC Rcd 6796, 6821 (1990) and Erratum, 5 FCC Rcd 7664 (1990), *modified on recon.*, 6 FCC Rcd 2367 (1991) ("*LEC Price Cap Reconsideration Order*"). The Commission has explained that, absent an "all-or-nothing" rule: (i) a company could attempt to shift costs from its price cap affiliate to its rate-of-return affiliate, allowing the rate-of-return affiliate to earn more, by reason of its greater revenue requirement, while generating earnings for the price cap affiliate; and (ii) if a carrier were allowed to switch back and forth between rate of return regulation and price cap regulation, it could "game the system" by building up a large rate base under rate of return regulation, then opting for price cap regulation again, and reducing its costs to an efficient level. *See LEC Price Cap Reconsideration Order*, 6 FCC Rcd at 2706; *see also Maine Telecommunications Group, Inc. et al.: Petitions for Waiver of Sections 61.41(c) of the Commission's Rules*, Order, DA 94-602 (Tariff Div. released June 8, 1994).

consistency in LEC pricing proposals at the state and federal level as a condition of federal certification.

B. As the Central Focus of Phase II of This Proceeding, the Commission Must Tailor a Regulatory Paradigm To Promote Local Exchange Competition.

Based on the conditions assessed in the market study in Phase I of this proceeding, the Commission must fashion a regulatory paradigm that will promote local exchange competition. A pro-competitive regulatory paradigm must above all correlate to the particular concerns in the local exchange market. Use of a derivative model based on the long distance market in the *Competitive Carrier* proceeding thus will not suffice to produce the desired competitive effect in the local exchange market.

Just as the Commission eased regulation for nondominant long distance carriers after completing a competitive assessment of long distance market, the Commission must adopt regulations that facilitate entry by competitive local exchange service providers into the local exchange market. In this regard, the competitive paradigm must remove regulatory barriers to entry at the state and federal level for competitive local exchange carriers. Once new entrants are allowed to flourish in the local exchange market, a sufficient competitive backstop will exist to counterbalance LEC market power.

At the same time, the Commission must establish a competitive paradigm that will effectively limit the incumbent LECs' existing market power. The competitive paradigm must ensure just, reasonable and nondiscriminatory and mutually compensatory co-carrier access and interconnection to network facilities, databases, signaling systems and information of incumbent LECs wielding market power. The paradigm must also impose a duty on incumbent LECs to promote the nondiscriminatory availability to competitors of

LEC rights-of-way. Finally, the paradigm must establish number portability and dialing parity among incumbent LECs and competitors.

Competitive Carrier policies alone will not encourage competition in the local exchange market. The Commission must recognize critical distinctions between local communications markets and the interstate telecommunications marketplace. In the long distance market, there was a backstop in the long distance marketplace against unreasonable or unlawful rates or conduct because AT&T's services, rates, and practices were regulated.[41/] In addition, only those long distance carriers that lacked market power were found to be non-dominant. The Notice's proposals, however, would accomplish the reverse of *Competitive Carrier*. The Commission would deregulate the rates of incumbent LECs who possess over 90 percent of the local exchange market.

In *Competitive Carrier*, separating local and long-distance services, and applying equal access and open entry were necessary and sufficient to support the emergence of competition because the interstate interexchange market existed as a free-standing, and independent market. In the local exchange market, ensuring open entry into interstate access alone will not permit sustainable competition to emerge. In fact, policies meant to stimulate entry by CAPs into the interstate access market have been in place for at least ten years without CAPs making any serious inroads into incumbent LEC market share. If the Commission focuses only on interstate access and substantially deregulates LECs before a competitive paradigm is in place, competition will not emerge. LECs will impair the

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41/ *See Competitive Carrier I*, 85 F.C.C.2d at 28-9.

competitive ability of new entrants in the interstate access market selectively while forestalling intrastate entry.

IV. IN PHASE III OF THIS PROCEEDING, THE COMMISSION MUST APPLY THE COMPETITIVE PARADIGM DERIVED IN PHASE II TO ENCOURAGE THE GROWTH OF COMPETITION IN THE LOCAL EXCHANGE MARKET AND ELIMINATE LEC MARKET POWER

Having established a competitive paradigm based on a thorough and expeditious assessment of the local exchange market, the Commission must apply its regulations in a manner that fosters competition among new entrants into the local exchange market while eliminating LEC market power. Because new entrants into the local loop will require open access to LEC bottleneck facilities and just, reasonable and nondiscriminatory rates, terms and conditions of interconnection to ensconced LEC monopoly networks, the Commission must provide interim regulatory relief to new entrants. At the same time, any "competitive checklist" applied to incumbent LECs with market power must accurately capture the type, nature and scope of market conditions precedent to a finding that sufficient competition exists to reduce regulation of incumbent LECs. In this regard, the Commission must recognize that conditions in the local exchange market do not nearly approximate those which existed in the *Competitive Carrier* docket sufficient to predicate a finding that AT&T was non-dominant. Finally, the Notice's proposals to streamline existing price cap regulation of incumbent LECs is entirely premature, absent completion of a thorough assessment of the competitive status of the local exchange market.