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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

In the Matter of	
Price Cap Performance Review for Local Exchange Carriers	CC Docket No. 94-1
Treatment of Operator Services Under Price Cap Regulation	CC Docket No. 93-124

NYNEX COMMENTS

The NYNEX Telephone Companies

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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

NYNEX COMMENTS

The NYNEX Telephone Companies[1] ("NYNEX") hereby file their Comments in response to the Commission's *Second Further Notice* in the above-referenced proceedings.[2]

I. Introduction

In the *Second Further Notice,* the Commission proposed to modify its price cap rules to rely more heavily on market forces to achieve its policy goals as the local exchange market becomes more competitive. The Commission proposed a three-tier plan that would culminate in nondominant treatment when a local

[1] The NYNEX Telephone Companies are New York Telephone Company and New England Telephone and Telegraph Company.

[2] Second Further Notice of Proposed Rulemaking in CC Docket No. 94-1, Further Notice of Proposed Rulemaking in CC Docket No. 93-124, FCC 95-393, released September 20, 1995 ("*Second Further Notice*").

exchange carrier ("LEC") no longer had market power for particular services in a geographic market.[3]

NYNEX agrees with the Commission that increased reliance on market forces as competition grows for local exchange services will promote the Commission's policy goals more effectively than rate regulation. However, the Commission's three-tier proposal does not provide a sufficient number of gradations in the level of regulation to ensure that the amount of pricing flexibility matches the degree of competition in the local exchange market. In addition, the Commission's proposed model does not address other regulatory changes that would be necessary, such as changes in the access rate structure, revisions of the price cap baskets, and adjustments to the price cap productivity standards.

Essentially, the Commission's proposal is an all or nothing approach. In Phase I, which assumes no competition for local exchange service, the Commission proposes to adopt reforms in the price cap plan that would

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[3] The Commission also raised other price cap issues, such as a NYNEX proposal to modify the sharing provisions for LECs that face increased competition, and a proposal to allow increased pricing flexibility to LECs who select higher X-Factors. *See Second Further Notice* at paras. 159-72. Subsequently, the Common Carrier Bureau issued an order directing interested parties to include their comments on these issues in their responses to the Fourth Further Notice of Proposed Rulemaking ("*X-Factor NPRM*") in this docket. *See* Order on Motion for Extension of Time, CC Docket No. 94-1, DA 95-2340, released November 13, 1995. Accordingly, NYNEX will include its comments on these issues in its comments in the *X-Factor NPRM*, which are due on December 18, 1995. *See* Order on Motion for Extension of Time, CC Docket No. 94-1, DA 95-2361, released November 21, 1995.

eliminate unnecessary impediments to efficient pricing regardless of the level of competition. In Phase II, which would require a showing of substantial actual competition for a particular service within a geographic market, the rates for that service would be taken out of price caps, and placed under streamlined regulation. Under streamlined regulation, tariffs would be presumed lawful, and could be filed on 14 days' notice without cost support. In Phase III, a LEC that could demonstrate that it no longer had market power for a service in a particular geographic area would qualify for non-dominant treatment with respect to that service. However, since Phase II would have already taken the LEC's rates out of price caps, the only effect that Phase III would have on rates would be to allow tariffs to be effective on one day's notice. Therefore, the truly significant difference is between Phases I and II. In Phase I, the LEC is highly regulated, and in Phase II the LEC is effectively deregulated.

The basic problem is that the Commission's plan does not recognize that significant market changes occur between Phases I and II that warrant reduced regulation and increased reliance on market forces. If the Commission's plan were more finely tuned, it would be more effective in achieving the Commission's goals of (1) encouraging market-based prices that reflect the cost of service; (2) encouraging efficient investment and innovation; (3) encouraging competitive entry in the interstate access and related local exchange markets; and (4) permitting the Commission to regulate noncompetitive markets in the

most efficient and least intrusive way.[4] By establishing a regulatory model that is adaptive to the transition to actual competition, the Commission would provide incentives for the LECs to promote competition, and it would give potential competitors a predictable environment in which to make their business plans.

The model should provide increasing pricing flexibility as a LEC opens its markets to more competition and as the competitive local exchange carriers ("CLECs")[5] develop a competitive presence in a particular market. It should also serve as a framework for actions in other proceedings concerning access charge reform and prescription of price cap productivity factors. By defining specific phases that will occur in the transition from a baseline, non-competitive environment to a more competitive local exchange market, the model would provide points at which the Commission could permit changes in rate structures, such as increases in end user common line charges, consolidation of price cap service categories and baskets, and adjustments in productivity factors to reflect the fact that LECs in the transition to competitive markets tend to experience lower productivity growth than LECs in monopoly markets.[6]

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[4] *See Second Further Notice* at para. 1.

[5] In these comments, the term "CLEC" is used to include all companies that compete for the traditional LEC market. These companies include CLECs, CAPs, IXCs, Cable TV, CMRS providers and other companies.

[6] The adaptive regulatory model that NYNEX proposes herein indicates the phases at which the productivity factor under price caps should be adjusted as barriers to entry are removed and as competitors enter the market. In its comments in the *X-Factor Rulemaking*, NYNEX will provide a discussion of how the X-Factor adjustments will be appropriate to the level of competition.

NYNEX has recently engaged in a series of *ex parte* communications at the Commission in which it has proposed a regulatory model that would be adaptive to the emergence of competition.[7] In these *ex partes,* NYNEX has proposed that the Commission take a holistic view as it makes individual decisions in specific dockets concerning the type of regulatory structure that the LECs need to operate under as competition evolves in the marketplace. The NYNEX proposal also distinguishes between Special Access and Switched Access markets, because of the significant differences in entry barriers in the two markets.

II. Summary Of Position

NYNEX proposes that the Commission create three regulatory frameworks in Phase 1 of the Commission's proposal, during which the LEC's rates would still be under the price cap rules. Broadly speaking, Framework I-A would be the baseline condition, where there is essentially no competitive presence or market entry. Framework I-B would apply where barriers to entry had been removed throughout most of the LEC's operating area, and where a competitor had taken advantage of this situation to begin operating in the region. Framework I-C would apply when the barriers to entry had been completely removed throughout the LECs operating region, and when competition was present throughout major segments of the LEC's market.

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[7] See Attachment A for a summary of the *ex parte* presentations.

The regulatory frameworks in Phase I should be applied to a LEC's services throughout its operating territory. However, given the differences in the barriers to entry between Switched Access and Special Access/transport, the frameworks should be determined separately for each of these services.

To demonstrate that barriers to entry had been removed for Switched Access, the LEC would have to show that it had met a checklist for removing barriers to entry similar to the checklist proposed in the *Second Further Notice*. There would be different criteria for Special Access, for which the Commission has already eliminated most of the barriers to competition. In identifying whether competitors had developed a presence in a market, the Commission would examine data showing presence in the area served by a LEC wire center. A competitive presence within a wire center could be indicated by such factors as: a competitor had collocated in the wire center; a competitor had provided fiber facilities in office buildings within the area served by the wire center; or a competitor had customers in zip codes within the area served by the wire center.

This Commission should use this adaptive regulatory model as a template for rendering decisions in other dockets concerning the regulatory structure under which the LECs would operate. In Framework I-A, the Commission should adopt access charge reforms which would produce public benefits even in a non-competitive environment. This would include streamlined procedures for introducing new Switched Access and Special Access services, greater downward pricing flexibility, and inclusion of operator services in the

Information Services category. In Framework I-B, the Commission should allow rate deaveraging by zone and by multiline/single line categories, alternative pricing plans and volume and term discounts for usage-based Switched Access services, market trials, consolidation of service categories, and greater downward pricing limits. In Framework I-C, a LEC should have unlimited downward pricing flexibility, and it should be allowed to deaverage its rates further into "small" and "large" business categories, to deaverage the EUCL charge, to offer individualized tariffs in competitive bidding situations, and to combine its services into two price cap baskets, "Switched" and "Trunking."[8]

Phases II and III should be as proposed by the Commission. Phase II would apply streamlined regulation to specific services in geographic areas where the CLECs had achieved 15 percent or more of the demand for the service in that market. In Phase II, services would be taken out of price caps, and tariffs could be filed on 14 days' notice. Phase III should allow nondominant treatment for specific services in geographic areas which have been subject to Phase II treatment for 1 year, during which time competition had not been impeded. Under Phase III, a LEC would be subject to the same regulatory regime with respect to those services as other nondominant carriers, including the ability to file tariffs on 1 day's notice.

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[8] The latter would include Special Access and Switched Access Trunking Services, except for the Interconnection Charge.

III. The Commission Should Provide Increased Pricing Flexibility In Phase I Of Its Proposal As Access And Local Exchange Markets Become Open To Greater Competition.

In the *Second Further Notice*, the Commission recognizes that certain reforms to its price cap and access charge rules would promote more efficient pricing even in the absence of competition. Its proposals to modify the rules for new services, the Part 69 waiver process, and greater downward pricing limits would produce public benefits regardless of the level of competition. However, the Commission has underestimated the degree to which the LECs will need to modify their rate structures and rate levels well before they would qualify for the additional regulatory freedoms allowed under streamlined regulation in Phase II.

Current LEC access charges are responsive to regulatory controls, rather than market demand. They become obsolete as soon as a new supplier enters the market. There are two basic reasons for this. First, interstate access charges are totally unrelated to the LECs' costs of service, or to the costs that would be incurred by an alternative supplier. It is well-established that interstate access charges carry an enormous burden of subsidy for universal service in the form of below-cost state rates for residential exchange service. It has been estimated that subsidies for residential service are as much as $20 billion.[9] Of this amount, approximately $6.5 billion is recovered through interstate access charges.

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[9] *See* The $20 billion Impact of Local Competition in Telecommunications, Calvin S. Monson and Jeffrey H. Rohlfs, Strategic Policy Research, July 16, 1993.

Although the Commission is considering modifications to its high-cost funding mechanisms to deal with this problem, it is unlikely that the Commission would adopt a fund that would recover all of the subsidy. For this reason, the LECs will have to restructure and deaverage their rates when competitors, whose rates are not dictated by regulatory rules, begin to target their efforts at customers who currently are involuntary contributors to the LECs' universal service obligations. Pricing flexibility and a reformed access charge structure, and not new government subsidy programs, will be the primary method that the LECs will use to maintain their support for universal service in a competitive market.

Second, rates that were reached through the regulatory process are highly unlikely to match the rates that would be determined by supply and demand in a competitive market. Regulatory rates are determined according to complex rules and as a result of rate investigations that often span several years. In unregulated markets, prices vary constantly in response to day-to-day changes in supply inputs, demand, market plans, and myriad other factors which may or may not be predictable or measurable. Most importantly, regulatory rates cannot be expected to replicate the marketing strategies that would be implemented in a free market. For example, no regulatory commission could have been expected to design a pricing plan such as MCI's Friends and Families, and it would have been impossible to predict the degree to which such a plan would have been successful. In addition, in a competitive market, some subsidies might be a rational response to customer needs. For example, the

cellular telephone industry responded to customer resistance to the high initial price of mobile telephones by developing subsidies that are paid to equipment suppliers by the cellular telephone system operators as incentives to sign up customers. These subsidies have resulted in some cellular telephones selling for as little as one dollar. It is likely that new entrants into the local telephone business will also develop original marketing strategies that will require a competitive response by the LECs.

It is impossible to predict what types of innovative pricing plans will evolve in the local exchange market. However, it is extremely unlikely that the current rate structure, with its subsidies, study-wide averages, and regulatory prescriptions is the optimum pricing structure in a competitive market. The CLECs have initially targeted their services at the high volume business customers in urban areas for two very good reasons. First, the cost of business service in urban areas is far less than the cost of residential service in rural areas, while the LEC prices are set to recover the average cost of service throughout a study area. Second, usage-based rates for business, toll, and access services carry a large amount of universal service contribution, particularly for high-volume business users. For these reasons, the CLECs can easily underprice the LECs in serving business customers. The fact that the CLECs have no apparent trouble in under-pricing the LECs in business markets throughout the country demonstrates that current LEC pricing is not responsive to the marketplace.

For these reasons, the Commission should allow the LECs to begin the transition to market-based pricing well before they have lost so much demand that the Commission decides to allow streamlined regulation or non-dominant status. In the context of the Commission's proposals in the *Second Further Notice,* this can be accomplished by expanding Phase I to include three frameworks that would reflect three distinct stages in the transition to a competitive market. The attached chart outlines NYNEX's proposal for a regulatory framework that would provide greater regulatory flexibility as a LEC's markets become more competitive:

Proposed Regulatory Model

Phase [1]	Criterion	Productivity Factor	Rate Structure	Pricing Flexibility	Price Cap Structure
I-A	• Baseline (No Competition)	• X	• No Change	• Introduce "Track 2" New Services on 14 Days' Notice and with Cost Support • Streamline or Eliminate Part 69 Waiver Process • Adopt More Flexible Band Limits (+5%, -15%)	• Place Operator Services and Call Completion Services in Information Services Category
I-B	• Barriers To Entry Removed in Areas/Jurisdictions Covering 75% of LEC Access Lines or 75% of Special Access/Transport revenues • Competitor is Operating	• X - (a)	• Zone Structure for LS, CCL, and IC • LTS Recovered on Market Share • SL/ML Structure for LS, CCL, and IC • ML CCL Recovery on Basis of IXC Presubscribed Lines • Increase EUCL	• Switched Volume and Term Pricing • Alternative Pricing Plans • Market Trials • Greater Downward Pricing Flexibility (e.g., 50%)	• Consolidate Services in Trunking Basket (Combine Services in Trunking Basket into Analog and Digital; Move IC to Traffic Sensitive Basket Except for Tandem Switching Costs)

[1] In view of the differences in entry barriers in the Switched Access and Special Access/transport markets, the Commission should apply these frameworks separately for each service. For instance, most markets would be in Phase I-B for Special Access/transport prior to the time that Switched Access would qualify for Phase 1-B treatment.

I-C	• Barriers To Entry Removed In All Jurisdictions • Competitive Presence in Areas Representing 40-50% of LEC Business Lines or 40-50% of LEC Special Access Revenues	• X - (b)	• Segment ML Structure into "small" and "large" business • Deaverage EUCL by Zone • Higher EUCL for Zones 2 & 3	• Unlimited Downward Pricing Flexibility (- 100%) • Authority to Respond to RFPs	• Combine Common Line and Switched • Only Two Baskets, Switched, and Trunking (including Special Access)
II	CLECs Have 15% or More of Demand For A Service In A Geographic Area		• Services Removed From Price Caps	• Tariffs Filed On 14 Days' Notice with No Cost Support	• Streamlined Regulation
III	LEC Services Have Been Subject To Phase II Treatment for 1 Year And Competition Has Not Been Impeded		• Services Removed From Price Caps	• Tariffs Filed On 1 Day's Notice with No Cost Support	• Non-Dominant Status

There would be important public policy benefits to this approach. It would provide clear signals, in advance, to the market of the regulatory environment that would apply at each stage in the transition to full competition. This would aid both the LECs and the CLECs in making decisions about network investments and marketing plans, and it would allay CLEC fears that the LECs would be able to use excessive pricing flexibility to impede competition. It would provide an incentive for the LECs to go beyond the initial requirements for lifting barriers to competition and to take additional actions in the future that might help promote competition. Finally, it would reduce the regulatory burden on the Commission and the carriers of processing individual waiver requests for pricing flexibility in response to competition. As described below, the procedures for applying each phase would be relatively straightforward, relying upon checklist items and reported data on competitive presence.[10]

IV. The Commission's Regulatory Model Should Recognize The Differences In Entry Barriers Between Switched Access And Special Access.

The NYNEX proposal is based upon experience it has gained in the competitive marketplace as competition emerged, first in the Special Access market, and later into the local exchange market for multiline business

[10] Attachment B provides a description of the procedure for making the competitive showings for the transition to each framework and phase in the model.

customers. Broadly speaking, the three areas of services that will face competition over time are Special Access, multiline business Switched Access, and Switched Access for single line business and residence customers.

The differences in the levels of competition for Special Access and Switched Access reflect the differences in barriers to entry. Because the Commission has exclusive jurisdiction over Special Access, there are no state certification requirements that must be met by a carrier seeking to provide Special Access services. In addition, the Commission has promoted expansion of competitors in the Special Access market (as well as in the Switched Access transport market) through its mandating of expanded interconnection and its policies on resale and unbundling. In contrast, the only way a competitor can compete for usage-based Switched Access services is to provide alternate dial tone. Therefore, a competitor needs to be authorized by the state regulatory authority to operate as a local exchange carrier, and it needs to overcome regulatory and operational barriers to entry that currently preclude local exchange competition in many states. The Commission has enunciated many of these barriers in its checklist proposal in this proceeding. In light of the significant differences in entry barriers between Special Access and Switched Access, the Commission must differentiate between these services in adapting the regulatory scheme to increasing competition.

V. Phase 1-A, Or Baseline, Price Cap Modifications Should Include Most Of The Reforms Outlined For Phase I In The *Second Further Notice.*

A. Phase I-A Should Incorporate Baseline Reforms That Would Be Appropriate Even Where There Is No Competition.

NYNEX proposes that Phase I-A would be defined as the baseline situation in which there is minimal or no competition for interstate access or local exchange service. At this phase, the Commission should adopt the following reforms:

Rate Structure	• No Change
Pricing Flexibility	• Introduce "Track 2" New Services on 14 Days' Notice and with Cost Support • Streamline or Eliminate Part 69 Waiver Process • Adopt More Flexible Band Limits (+5%, -15%)
Price Cap Baskets	• Place Operator Services and Call Completion Services in Information Services Category
Productivity Factor	• X

These reforms, which are described below, would promote more efficient pricing, and they would allow the LECs to be more responsive to their customers. Therefore, the Commission should adopt these reforms regardless of the level of competition.

B. The Commission Should Streamline The Procedures For Introducing New Services.

In Phase I-A, the Commission should relax the regulatory requirements relating to all new services except, for new services mandated by the

Commission. NYNEX supports the proposal to establish two categories, called Track 1 (current new service requirements), and Track 2 (reduced requirements).[11] All new services introduced at the LEC's initiative should be automatically subject to Track 2 treatment, without the need for a prior petition or a determination on the Commission's part that Track 2 treatment is warranted.[12] Only those new services that the Commission has deemed essential to LEC competitors or that the Commission has required the LECs to offer at specified rates for public policy purposes should be subject to Track 1 treatment. When the Commission issues an order requiring the LECs to implement such new services, it should specify that the new services would be subject to Track 1 treatment. This approach would be administratively simple, and it would bring new services to the market in a much quicker and more efficient manner, while still providing oversight of any new services that would be necessary to LEC competitors.

For Track 2 services, the proposed 14-day notice requirement would be acceptable. As proposed in the *Second Further Notice,* the LECs should only be required to show that proposed Track 2 rates recover the direct costs of service.[13] This would ensure that the rates would not impede either existing competition or the potential for new entry. There would be no need for a ceiling on rates for

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[11] *See Second Further Notice* at paras. 45-49.

[12] In the *Second Further Notice,* the Commission proposed that the LECs would be required to file petitions seeking Track 2 treatment prior to filing tariffs. *See id.* at para. 48.

[13] *See id.* at para. 49.

Track 2 services because, by definition, they would be introduced at the LEC's initiative, and they would be optional services that increase customer choice.

NYNEX also supports the proposal to reduce the notice period for restructured services to 14 days as a baseline reform.

C. Streamline or Eliminate the Part 69 Waiver Procedure for New Switched Access Services.

Currently, the LECs must file waiver petitions prior to filing tariffs for most new Switched Access services, because the Commission's Part 69 rules prescribe the rate structure for Switched Access services. Such waiver petitions must be based on a showing of "special circumstances" that warrant deviation from a rule, and on a showing that the waiver would be in the public interest. Typically, such waivers take many months to be approved by the Commission. In contrast, no waivers are necessary for new Special Access services, because Part 69 does not prescribe the Special Access rate structure. This has created an unnecessary amount of cost and delay in introducing new Switched Access services, and it has made Switched Access Services less responsive to customer needs than Special Access. There is also some degree of confusion as to when waiver requests are required for Switched Access offerings.

In the *Second Further Notice*, the Commission proposes to modify Part 69 to eliminate the requirement that a LEC seek a waiver when it introduces a new Switched Access service.[14] The Commission proposes to require a LEC to file a

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[14] *See id.* at paras. 70-74.

petition showing that a proposed new Switched Access service is in the public interest. If the petition were granted, the LEC would be permitted to file a tariff for the new service. After the Commission had found that a proposed new service was in the public interest, other LECs would be able to make "me-too" filings on short notice.

Although the Commission's proposal would establish a more flexible "public interest" standard in place of the current standard for granting waivers, it would retain the most undesirable features of the current system -- the cost and delay in obtaining approval for new Switched Access services through the petition process. Petitions could languish at the Commission for months, or years, as is the current situation with Part 69 waiver petitions. There is no reason why Switched Access services should be subject to such delays when Special Access services are not. If the Commission believes that it must make a public interest finding before a LEC introduces a new Switched Access service, it can and should make that determination during the tariff filing process. This would retain the Commission's ability to scrutinize new service filings, while enhancing the ability of the LECs to respond to market demands. The Commission should permit the LECs to introduce new Switched Access services through the tariff process as a baseline reform regardless of whether there is any competition for access services.

D. Adopt More Flexible Band Limits

In Phase I-A, the Commission should also adopt more flexible lower band limits for the service categories. All service category lower limits should be increased to 15%. This would make it easier for the LECs to offer lower rates to their customers, and it would make it less likely that the LECs would have to submit cost showings when increases in price cap indexes caused some rates to become below-band. Such increased lower pricing flexibility would not create a danger of cross-subsidization, since the upper band limits would not be changed. In addition, the additional lower pricing flexibility would aid the LECs in making the transition to market-based rates as competition emerges.

E. Place Operator Services and Call Completion Services In The Information Services Category.

In the *Second Further Notice*, the Commission raises the issue, currently under consideration in Docket No. 93-124, whether operator services, specifically 0- transfer service (also called operator pass-through) and busy line verification/interrupt ("BLV/I") services, should be placed in their own service category in the Traffic Sensitive basket, or whether they should be combined in another new or pre-existing service category (such as billing name and address ("BNA") or tandem signaling).[15] The Commission also asks for comments about the proper price cap treatment of two types of call-completion services: (1)

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[15] *See Second Further Notice* at paras. 96-98. Currently, NYNEX includes 0-transfer service in the trunking basket, and it includes BLV/I services in the interexchange basket.

operator-related, which includes automated handling or live operator assistance for calling card, third party, and collect calls; and (2) directory assistance-related, in which the carrier completes the call for the end user after providing directory assistance.[16]

The Commission should combine these services in the current "information" category in the Traffic Sensitive ("TS") basket, because they are ancillary switched services. They should not be combined with BNA, as BNA is a billing and collection service that should be removed from price caps. They should not be combined with tandem signaling, which is a transport service that belongs in the trunking basket. If the Commission is concerned about the degree of competition for these services, it could create a subcategory containing less competitive services, such as BLV/I and 0- transfer.[17]

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[16] *See Second Further Notice* at paras. 99-101.

[17] A case can be made that DA services in the NYNEX region are highly competitive and should be removed from price caps altogether. For example, a major DA customer recently began migration of its DA traffic to an alternate provider, which, when complete in early 1996, will result in a loss of over 60% of NYNEX's DA business.

VI. Phase 1-B Should Include Rate Restructuring, Additional Pricing Flexibility, Consolidation Of Price Cap Service Categories, And A Lower Productivity Factor.

A. Phase I-B Would Be Triggered By Elimination Of Barriers To Entry.

Phase I-B should apply when most of a LEC's operating territory is open to competition. This determination would be made separately for Switched Access and Special Access/switched transport services, since the barriers to entry are significantly different for these two markets.[18] It is likely that a LEC would achieve Phase I-B treatment for Special Access prior to the time that it would achieve Phase I-B treatment for Switched Access, because competition for Switched Access services requires, *inter alia,* significant changes in the regulatory regime at the state level. A LEC would seek Phase I-B status by filing a certification letter with the Commission showing that it had met a checklist for removing barriers to competition in areas or jurisdictions representing 75% of the LEC's access lines for Switched Access, or 75% of the revenues for Special Access/switched transport.[19] In the certification, the LEC would also have to show that at least one competing carrier was already in operation for that service within the region. As proposed in the *Second Further Notice,* the certification should be approved automatically within a specified period of time, such as 30

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[18] The Commission should treat Special Access and switched transport under the same criteria since the barriers to entry and the demand elasticity for these services are similar.

[19] *See* Attachment B.