lower rates for their services closer to the economic costs of those services.[18] As discussed in Section VII supra, MCI concurs with this goal. However, the Commission should grant this additional pricing flexibility only if the LECs first lower their access rates to economic cost. Otherwise, the LECs will be able to distort the access market.

Consumers would be better off if LEC access rates were first lowered, because the rates they pay would reflect the true cost of providing the service. At the same time, the LEC would have greater incentive to reduce its costs. In addition, potential competitors of the LEC would not be encouraged to make inefficient investments based on the belief that it could provide service at lower than the inflated costs of the LEC.

XII. A COMPETITIVE CHECKLIST IS NECESSARY, ESPECIALLY IF THE COMMISSION DOES NOT REQUIRE LECS TO REDUCE RATES TO ECONOMIC COST

If the Commission does not first require LECs to lower access rates to economic cost, it must adopt a competitive checklist before giving the LECs substantial additional pricing flexibility. The current pricing restrictions were put in place to ensure that the LECs would be unable either to charge excessive rates or to price predatorily so as to preclude competition. The additional flexibility the Commission proposes thus is reasonable only if other factors have changed so that regulation is no longer necessary to ensure that these two

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[18] Second Further Notice at para. 105

things will not happen. The best method for ensuring that rates are not excessively high is to ensure that market conditions are such that competitors are able to get into business.

Before the Commission can grant the LECs additional pricing flexibility, regulation must ensure that the LECs do not have an unfair advantage over potential entrants. A competitive checklist is necessary to assure that entrants can effectively compete with the incumbent LEC. MCI discusses infra the items it believes should be on that checklist. Although many of the items on the list refer to services other than interstate access, they are all necessary to ensure that competing access providers can become and remain financially viable. Without the ability to provide the full range of services offered by the LEC -- local service, intrastate access, and interstate access -- new entrants will be less likely to achieve the scale and scope economies to compete against the LECs. The Commission has also previously cited the development of local competition as justification for additional pricing flexibility and Part 69 waivers.[19]

First, all monopoly franchises and conditions on entry and interconnection which insulate the incumbent LECs from the effects of competition must be

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[19] See The NYNEX Telephone Companies Petition for Waiver, Transition Plan to Preserve Universal Service in a Competitive Environment, 10 FCC Rcd 7445 (1995) (NYNEX USPP Order); and Rochester Telephone Corporation, Petition for Waivers to Implement its Open Market Plan, 10 FCC Rcd 6776 (1995).

eliminated at both the state and interstate levels. Technological change is eroding the scope of any natural monopoly for telecommunications, and has created the need for a regulatory paradigm allowing competition to serve the public interest. Although eliminating monopoly franchises is a necessary first step in opening markets, competition will be unable to develop if entry is conditioned on protecting incumbent LECs' revenue streams or profits. Entry and interconnection terms should be conditioned only on the public interest concern that local exchange service of acceptable quality continues to be available at reasonable rates. Non-cost-based charges should be excluded from the rates competitive providers must pay to interconnect to an incumbent LEC's network When competitive alternatives became available for a previously monopolized service, customers should be allowed to choose their provider during a "fresh look" period during which they would not be subject to penalties for changing provider. This will prevent the incumbent LECs from locking up the market by signing customers to long-term contracts before competitive alternatives are available.

Second, regulation must ensure equal access to rights of way, easements, conduit, poles, and building entrance facilities. Competition cannot develop unless new service providers have equal access to pathways across public and private property. Local governments often charge new entrants fees for access to rights of way that are higher than fees charged to the incumbent LEC and thus place new entrants at a competitive disadvantage. New federal

or state laws must be enacted that require local governments to set nondiscriminatory charges for access to public rights of way, limited to actual costs. All other terms and conditions for access to rights of way also must be structured in a competitively neutral fashion that does not impose a larger burden on new entrants than on incumbent LECs. Where LECs have the power of eminent domain, new entrants must have the same rights. The ability of landlords of multi-tenant buildings to restrict the access of new local telephone service providers to their tenants is widely recognized as a barrier to competition. New federal or state laws must be in place that require landlords to accord all local exchange providers the same access to end user tenants. Since it is often impossible or infeasible for new entrants to place their own conduits or poles, incumbent LECs must be required to tariff rates for conduit and pole attachments, and must impute these tariffed rates to the rates for their own retail services.

Third, the industry must implement a local call routing database enabling true local number portability.[20] The lack of local number portability (LNP) is one of the most critical barriers to local exchange competition. Consumer studies show that number portability is a significant factor in customers' decisions to change carriers. The LECs have no incentive to achieve LNP, since the lack of LNP makes customers less likely to switch carriers. Funding for the number

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[20] The Commission is examining this issue in CC Docket 95-116. See MCI Comments in that docket, filed September 12, 1995.

portability database should be generated in a competitively-neutral manner. The interim solutions proposed by incumbent LECs, such as Remote Call Forwarding, have serious limitations, because they involve the incumbent LEC in the processing of every call, creating additional network costs.

Fourth, the LECs must provide open and equal access to all their bottleneck network functions, completely unbundle their networks into their most discrete elements, allow interconnection wherever it is technically feasible, and allow resale of their services at rates set to recover the LECs' economic cost. Once the LECs' networks have been disaggregated into their most discrete elements, these elements must be tariffed at a rate based on their economic costs. All providers and customers must be able to purchase either only those elements they need -- without having to buy other bundled elements -- or a bundled network platform, and must have the right to use all elements individually or in combination, and without restrictions based on the intended use or user. To ensure that competitive providers can efficiently use those portions of the LECs' networks that it would not be feasible to duplicate, interconnection must be allowed wherever it is technically feasible. To limit the LECs' ability to price discriminate by segmenting the market, all LEC services must be available for resale without restrictions. Signaling protocols and information contained in signaling protocols must also be made available on a non-discriminatory basis, and free passage of signaling information between networks should be required.

Fifth, a pro-competitive compensation mechanism based on mutual traffic exchange must be in place to allow the LEC and its competitors to complete telephone calls originated on each others' networks. To create a seamless "network of networks," the relationship between competing local exchange service providers must be that of interconnecting co-carriers rather than customers of each others' services. The incumbent LECs have the incentive to refuse to allow new entrants to interconnect with their networks or to impose compensation rates for the exchange of traffic with new entrants that will prevent competition from developing. Since the vast majority of local telephone calls made by customers of a new entrant will be to parties that are customers of the incumbent LEC, but only a very small percentage of calls made by the incumbent LEC's customers will be to parties that are customers of the new entrant, the compensation mechanism for terminating calls is far more crucial to the competitive viability of the new entrant than to the incumbent LEC. One way for the incumbent LECs to undermine competition is to impose their inefficiencies on the new entrants by recovering costs that are not directly attributable to the termination of a telephone call on new entrants as part of the charge for terminating calls. The best way to protect against this -- and to eliminate billing and other administrative costs -- is to employ Mutual Traffic Exchange whereby each carrier is compensated "in kind" for having its traffic terminated on other carriers' networks. If, as new entrants achieve significant market share, traffic imbalances result in competitive inequities, a reciprocal

compensation rate should be adopted, but no "contribution" or "subsidy" should be included in such a rate.

Sixth, there must be costing and pricing safeguards which protect against price discrimination, price squeezes, and cross subsidization. The incumbent LECs will continue to control essential bottleneck network functions, and will continue to have the incentive to use the resulting market power in anti-competitive ways. To protect consumers and competitors from abuses, costing and pricing safeguards are needed. As a safeguard against an incumbent LEC cross subsidizing any of its competitive services, the total revenues generated by each service must at least cover the economic costs of providing that service. To protect against incumbent LEC predatory pricing, the price of each element of a service must exceed the marginal cost of that element. To protect against a price squeeze, each LEC service that bundles together LEC elements must be priced such that the rate for the bundled service is at least equal to the tariffed rates that it charges others for those elements plus the incremental costs of all the other inputs used to produce the bundled service.

Seventh, the Commission must implement a cost-based, competitively neutral funding mechanism for universal service. The current system of funding universal service through subsidies that are internal to the incumbent LEC is incompatible with the development of local exchange competition. Potential competitive providers of local exchange service -- no matter how efficient -- cannot compete in the provision of basic residential service at subsidized rates.

Moreover, as long as competitors contribute to a universal service funding mechanism that is not limited to universal service goals, but rather is intended to guarantee the revenues of the incumbent LEC, they are forced to fund their dominant competitor. The current system of funding universal service must be delinked from the incumbent LEC's revenue requirement and replaced with a mechanism that would: (1) explicitly define Basic Universal Service; (2) calculate the subsidy required for Basic Universal Service; (3) generate revenues for the support of Basic Universal Service in a competitively neutral manner, through a percentage assessment on the net common carrier revenues of each telecommunications service provider; (4) distribute Universal Service benefits in a provider neutral manner, in the form of virtual vouchers; and (5) hold a "carrier of last resort" auction to ensure Basic Universal Service in any area where the incumbent LEC proposes to discontinue service to residential customers because the virtual vouchers are allegedly set too low. The revenues generated by the new Basic Universal Service subsidy funding mechanism should be offset by dollar for dollar reductions in revenues generated by the current system of subsidies.[21]

The Commission seeks comment on whether the LEC should have to provide local bottleneck facilities, such as loop and switching, through a

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[21] The Commission is currently considering these issues in CC Docket No. 80-286. See MCI's Comments in that docket, filed October 10, 1995.

separate subsidiary, providing these facilities to all access providers at "wholesale prices." While requiring the LECs to provide bottleneck facilities would provide a measure of protection from LEC abuses, it would not prevent the LEC from being able to harm competition. Any facility that is truly a bottleneck -- and MCI believes that loop and switching are and will remain so for a number of years -- must be made available to competitive providers at its economic cost. "Wholesale prices" which continue to include the LECs' inefficiencies and other non-economic costs are not sufficient to drive LECs' costs down. The Commission must ensure that these rates reflect only the economic costs of the facilities. Otherwise, the rates may simply duplicate the experience in Rochester, which is reselling its local service at an approximately 5 percent discount, which does not allow competitors who must resell Rochester's loops to compete effectively with Rochester.

XIII. ANY REGULATORY FLEXIBILITY GRANTED THE LECS SHOULD BE OBTAINED THROUGH A WAIVER

Regulatory flexibility should be granted only when the competitive conditions faced by the LEC place a sufficient check on the LEC's ability to set prices at above-cost levels. To determine whether this is the case, the Commission will need to examine carefully each LEC's submission to determine that the competitive conditions are met. The ability of interested parties that face the LEC in the marketplace, as either competitors or customers, to provide comment on the LECs' showings will provide valuable information to the

Commission to allow it to assess the LECs' claims. Thus, requiring the LEC to file a waiver petition, with opportunity for other parties to comment, will provide the Commission with the information it needs to determine that additional flexibility is warranted.

Declaratory rulings can be used only in cases where there are no facts at issue, and the only controversy to be decided is a matter of law.[22] Based on the pleadings and ex parte filings in such cases as the NYNEX Universal Service Preservation Plan (USPP) Waiver[23] and Ameritech's Customer First Plan,[24] MCI is highly doubtful that there would be a case in which the facts about competition in a given market would be uncontested. MCI therefore suggests that the only way to treat individual LEC requests for regulatory flexibility is the waiver process.

In no case should the Commission allow the LECs to seek regulatory relief in the context of a tariff filing. The statutory time limits for review of tariff filings would not allow other parties sufficient time to assess the LECs' showings. In addition, part of the regulatory flexibility the Commission proposes to allow the LEC is shorter notice periods on tariff filings. If LECs

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22 See, e.g., American Network, Inc., 4 FCC Rcd 550, 551 (1989).

23 See NYNEX USPP Order.

24 See Petition for a Declaratory Ruling and Related Waivers to Establish a New Regulatory Model for the Ameritech Region, DA 93-481, filed April 12, 1995, and comments filed on May 16, 1995, in response thereto.

were allowed to request regulatory relief in a tariff filing, it would be made on the shorter notice period, even further shortening the time period for interested parties to review and evaluate the LECs' claims.

XIV. THE CURRENT SERVICE CATEGORIES SHOULD BE USED AS THE RELEVANT PRODUCT MARKET

When the Commission determined the initial service categories under price caps, it grouped together services which shared similar customer bases, demand characteristics, and technology.[25] As the Commission has adjusted the service categories, it has continued to group like services. The current service categories continue to be the best access service definitions for determining whether to grant additional pricing flexibility.

XV. THE RELEVANT GEOGRAPHIC MARKET FOR EACH PRODUCT SHOULD BE DETERMINED BY ITS COST CHARACTERISTICS

The Commission seeks comments on the use of the current density zones to determine the relevant geographic market over which to assess market power. Those zones should serve as the relevant geographic market only for trunking services. The zones were set up to reflect the different cost characteristics of trunking. To determine the areas over which trunking costs varied, the Commission used as a proxy the density of traffic in the area served by each central office.

The relevant geographic area the Commission should use to determine

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[25] See LEC Price Cap Order at 6813.

regulatory flexibility should be the area over which costs are roughly the same. If the Commission defines the relevant geographic market to be some narrow area, such as a wire center, without determining that the cost characteristics vary across those areas, the LECs will be able to charge different rates to customers for whom the cost of providing service is the same.

Entrants are likely to enter a limited geographic area initially, and then to broaden the area they serve over time. If the LECs are allowed pricing flexibility in only those wire centers where they face competitors, they will be able to fund these decreases by raising rates in other wire centers where they do not face competition. If the costs of providing service to those wire centers in which the LECs raise rates do not differ from those wire centers where they face competition, customers will be charged different rates even though the cost of providing them service does not differ.

As they did in determining zones for trunking basket flexibility, the LECs should determine the zones for flexibility for other services based on the cost characteristics of those services. MCI does not believe that the cost characteristics for switching and loop will vary in the same manner as does trunking. Switching costs may not vary at all[26] and loop costs will vary based

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[26] OPASTCO presented data in CC Docket No. 80-286 (see Figures 4A and 4B in Appendix B of its Comments) that showed that the investment cost per line for large switches is approximately $200 per line whether the switch serves 10,000 lines or 40,000 lines, and that the investment cost per line for a small switch is also about $200 per line between 3,000 and 4,000 lines, rising to $400 per line only when

on subscriber density and terrain.[27] As part of the LECs' petition for declaratory ruling for regulatory flexibility, they should also propose the geographic areas over which their cost of providing loop and switching vary. Interested parties will then have an opportunity to evaluate these claims.

XVI. THE COMMISSION NEED NOT DETERMINE NOW WHEN THE LECS CAN HAVE STREAMLINED REGULATION

The Commission asks several questions regarding how to determine when the LECs face sufficient competition to allow them streamlined regulation, i.e., competition which will constrain the LECs' pricing behavior sufficiently so that the Commission can allow the LECs to file rate changes on short notice and without cost support. The threshold issue which must be met before the Commission needs to examine the sufficiency of competition is whether competition exists at all. The Commission has substantial data on the record in this proceeding and in the data filed in the Telecommunications Relay Service proceeding to indicate that competitive access providers (CAPs) serve a minuscule portion of the access market.[28] Until there is evidence that the CAPs'

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the lines per switch falls to close to 1,000 lines. OPASTCO does not show data for switches serving more than 40,000 lines. However, the curve showing the cost per line is very flat between 10,000 and 40,000 lines, indicating that costs do not vary significantly at any size above that range.

27 See BCM Ex Parte.

28 This data is reported in the Commission's Telecommunications Industry Revenue: TRS Fund Worksheet Data for 1993, released December 29, 1994. In 1993, the CAPs collectively had $0.2 billion

market share has achieved a substantial level, the Commission need not examine demand responsiveness, supply responsiveness, pricing of services relative to the price cap, or any other factors.

XVII. CONTRACT CARRIAGE SHOULD BE LIMITED TO SERVICES FOR WHICH THE LEC FACES SUBSTANTIAL COMPETITION, AND SAFEGUARDS MUST BE INCLUDED TO PREVENT THE LECS FROM UNREASONABLY DISCRIMINATING AMONG ITS CUSTOMERS

MCI agrees with the Commission that contract carriage should be allowed only for services for which the LEC faces substantial competition. Contract carriage provides the LEC with a remarkable degree of pricing flexibility, which has the power to disrupt the emerging competition in the access market.

MCI believes that in no event should contract carriage be permitted today. Moreover, based on current trends in CAP growth, it appears highly unlikely that the LECs will face significant competition in the near future. MCI therefore recommends that the Commission defer any further inquiry into this issue for at least three years, and then seek comment on whether competition has advanced enough to permit consideration of this flexibility.

Should the Commission decide to adopt rules in this proceeding, MCI recommends the following. Any contract carriage the LECs are allowed to tariff must include several safeguards. First, contract carriage rates must be excluded

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of total revenue; the LECs collectively had $95.3 billion.

from price caps to prevent cross-subsidization.[29] In addition, the LEC must make a cost showing that the rates for the contract service exceed the direct costs, and that the direct costs of the contract service differ from the direct costs of the generic service that this contract service replaces. Without these provisions, LECs will be able to charge predatory prices to drive their competitors out of the market, or preclude them from even entering the market.

The contract carriage rates must be tariffed and made available to any similarly situated customer. The tariff should include the information identified by the Commission: (1) the term of the contract, including any renewal options; (2) a brief description of each of the services provided under the contract; (3) minimum volume commitments for each service; (4) the contract price for each service or services at the volume levels committed to by the customers; (5) a general description of any volume discounts built into the contract rate structure; and (6) a general description of other classifications, practices, and regulations affecting the contract rate. In addition, there should be unlimited resale of the contract carriage service. This will prevent the LEC from being able to use contract carriage to unreasonably discriminate among its customers.

XVIII. LECS MUST FILE A WAIVER PETITION FOR STREAMLINED REGULATION

For the same reasons as stated in Section XIII supra, the LECs must file

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[29] AT&T's Tariff 12 and other contract-based tariffs are held outside of price caps. See CFR 47, Section 61.42(c)(4) and (8).

a waiver petition before receiving streamlined regulation. This will allow all interested parties opportunity to comment and to provide any data relevant to a finding of sufficient competition.

XIX. NO LEC WILL BECOME NON-DOMINANT IN THE NEAR FUTURE; THE COMMISSION NEED NOT ADOPT RULES FOR LEC NON-DOMINANCE AT THIS TIME

The LECs will remain dominant in the provision of loop and switching for the foreseeable future. No new entrant will be able to build ubiquitous loop plant in a short time frame which will allow it to effectively compete with the LEC. Similarly, no competitor will be able in the near future to build the switching capacity that will allow competition to discipline the LECs' market power. Until loop and switching competition are possible, the Commission need not reach a decision regarding the criteria for ruling a LEC non-dominant in those markets. No one can predict how the access market will evolve, or even if competition will ultimately be successful. The Commission should not limit its options by deciding this issue today.

XX. THE CURRENT ACCESS FLOW-THROUGH RULE FOR AT&T CAN CREATE BIAS ONLY IF CAPS ARE A SUBSTANTIAL SOURCE OF ACCESS

Under the current access flow through rules, AT&T is required to flow through in an adjustment to its own price cap indexes only changes in LEC access charges. Any changes in the price for access services that AT&T purchases from CAPs is treated endogenously. When the Commission initially adopted price caps for AT&T, it adopted this disparate treatment because CAP

access was a small portion of total access costs, and the Commission wanted to provide an incentive for AT&T to select CAPs to provide access.[30] Moving to a CAP was a management decision, which the Commission wished to encourage.

MCI has no objection to changes in CAP access rates being reflected as access charge changes in AT&T's price cap indexes. However, the decision to change from a LEC to a CAP for access is a management decision, and should not be reflected in the price cap indexes.

MCI notes, however, that the only services left under AT&T's price caps are international services, 800 Directory Assistance, and analog private line. The amount of CAP access purchased for these services is likely to be de minimis, so a rule change that requires AT&T to flow through these rate changes is likely to have little practical effect. The Commission should therefore consider the administrative burden introduced by such a rule, weighed against its potential benefits in the IXC market.

XXI. CONCLUSION

For the reasons stated herein, the Commission should tie any grant of further pricing flexibility for the LECs to reductions in access rates toward economic cost and the presence of competitive checks on LEC pricing. Granting additional pricing flexibility while allowing rates to remain excessively high will

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30 Policy and Rules Concerning Rates for Dominant Carriers, CC Docket 87-313, 4 FCC Rcd 2873, 3029 (1989).

allow the LECs to discriminate unreasonably among their customers and maintain their excessive earnings.

Before the Commission grants the LECs streamlined treatment, it must determine that the LECs have met a competitive checklist which ensures that other companies can compete effectively with the LECs. The LECs should be required to file a petition for waiver before being granted any further pricing flexibility. Finally, the LECs retain such market dominance that the Commission need not determine now how it will regulate the LECs when they become non-dominant.

Respectfully submitted,
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December 11, 1995

STATEMENT OF VERIFICATION

I have read the foregoing and, to the best of my knowledge, information, and belief, there is good ground to support it, and it is not interposed for delay. I verify under penalty of perjury that the foregoing is true and correct. Executed on December 11, 1995.

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CERTIFICATE OF SERVICE

I, Stan Miller, do hereby certify that copies of the foregoing Comments on were sent via first class mail, postage paid, to the following on this 11th day of December 1995.

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