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Before the
Federal Communications Commission
Washington, D.C. 20554

In the Matter of	)	
	)	
Price Cap Performance Review for Local Exchange Carriers	)	CC Docket No. 94-1
	)	
Treatment of Operator Services Under Price Cap Regulation	)	CC Docket No. 93-124
	)	
Revisions to Price Cap Rules for AT&T	)	CC Docket No. 93-197

COMMENTS OF LDDS WORLDCOM

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SUMMARY

LDDS WorldCom submits that the *Notice of Proposed Rulemaking* in this docket is fundamentally flawed. It fails to address growing LEC discrimination incentives as the LECs increasingly compete with their access customers. It fails to address the increasing opportunities for LEC discrimination as other carriers come to depend upon use of the LEC local network in the provision of competing retail local services as well as long distance. And the *Notice* fails to appreciate how these increasing incentives and opportunities for LEC discrimination threaten the overall telecommunications market as local and long distance services converge in the future.

As a result, the *Notice* fails to consider the need for new regulatory mechanisms to supplement price caps. In particular, the Commission should be considering structural separation of more competitive LEC retail services from the monopoly wholesale local network platform that the vast majority of local and toll traffic will ride over the next decade. Structural separation of Tier I LECs would reduce the need for resource-intensive and intrusive regulation of LEC retail service prices, while permitting the Commission and state regulators to focus more directly on pricing of the local network platform that all retail competitors will require to offer service.

The *Notice* does not recognize these issues, or the transformation of the telecom market that is on the horizon. For the most part the *Notice* tends to

assume that price caps are satisfactory today, and that the only question is when LECs should be given additional pricing flexibility.

Thus, for example, the *Notice* does not recognize the weakness of price caps as a safeguard against discrimination. First of all, the primary protections against discrimination in the past have not been price cap baskets and bands. They have been strong structural policies that reduce the incentive of LECs to discriminate. LECs have enjoyed a legal monopoly in the local market, leaving them no competitors to discriminate against. And the BOCs were divested from AT&T and barred from the long distance market expressly because regulatory controls on discrimination had failed. Yet the *Notice* does not recognize that discrimination incentives are rising rapidly as the Commission and others try to create more competition.

Second, the *Notice* continues to rely heavily on the AT&T price cap experience as it proposes to grant the LECs more pricing flexibility. In doing so, the *Notice* disregards reasons why much stronger discrimination safeguards are needed in the LEC context. There are essential differences between the retail long distance market and the access market. For example, in the case of AT&T price caps, baskets and bands <u>supplemented</u> emerging market forces to check discrimination. If AT&T tried to discriminate against an end user, that end user could go elsewhere. And more fundamentally, the presence of retail long distance competition meant that AT&T's rates were priced closer to cost both at the point

when price caps took effect and thereafter. In contrast, LEC baskets and bands do not supplement any market forces. They are the only line of defense.

Moreover, the consequence of LEC access discrimination is far more serious than AT&T long distance discrimination. When a LEC discriminates in the pricing of access, the largest input to long distance service, it disrupts the long distance market. In contrast, when AT&T discriminates among end users in the retail long distance market, the consequences are much less important. The *Notice* misses the weaknesses of price caps because it disregards these central distinctions at the same time that it ignores the increasing danger of LEC discrimination.

The *Notice* also demonstrates an incomplete understanding of the fact that local exchange competition is not the same thing as access competition. The *Notice* correctly recognizes that the provider of most access is selected by the end user when the end user selects a local service carrier. That being so, however, the Commission must also recognize the full consequence: that IXCs have no local access choice, especially beyond the interoffice network. Whether LECs provide local service to 100% of the market, or 90%, or less, IXCs still will have to pay the LEC's access rates to originate and terminate service to the LEC's end users. They will be just as exposed to the danger of excessive access rates -- and just as exposed to increasing LEC incentives to discriminate as LECs expand into the long distance market themselves.

Finally, the *Notice* misses the point that as the telecom market moves towards "one-stop shopping," other carriers will become even more dependent upon

use of the LEC's monopoly local network platform. They will need to use that platform both to originate and terminate interexchange calls, and now to provide the vast majority of competitive retail local services as well. This is particularly true in order for full retail service competition to be brought to all consumers, as long distance is today. For example, if the BOCs are allowed to offer interLATA services, they will do so immediately over one or more of the four national fiber networks that will compete for their "carrier's carrier" wholesale business. IXCs will need an equivalent wholesale "carrier's carrier" local service, as well as operational systems that permit a customer to change local retail service providers as easily as they can change long distance carriers.

Those wholesale local network services must be developed in order for end users to have the same kind of retail choices that they now enjoy in the long distance market. But for present purposes, the point is that the danger of discrimination will only increase, at least until competing local networks are sufficiently deployed to permit carriers to choose among other local wholesale options to the LEC on a competitive basis.

Until then, the current LEC price cap system is not adequate to control increasing LEC discrimination incentives and opportunities. LDDS WorldCom strongly believes that the answer lies in structural separation of more competitive LEC retail services from the wholesale local network. This approach permits the Commission to reduce the regulation of LEC retail services sold to end users, and let the market govern the development of those retail product lines. Discrimination

would be controlled by the fact that other retailers could obtain the local network inputs to their own retail services on the same basis as the competitive LEC subsidiary. Structural separation also could permit relatively less regulation of the LEC wholesale company, though even here supplements to price cap rules would be necessary to prevent direct or indirect discrimination in favor of the LEC retail company.

LDDS WorldCom submits that the Commission should impose structural separation on the Tier I LECs as a necessary step towards the development of competitive markets. But at the least, the Commission should condition any further pricing flexibility for the LECs on their voluntary adoption of separation.

Absent separation, the Commission will be required to develop wholly new safeguards to prevent LEC price discrimination -- safeguards that go far beyond the current price cap system, scrutinizing both retail and wholesale rates. The Commission, for example, will need to have ongoing imputation rules to ensure that LEC retail services contain at least as much joint and common costs as LECs charge their competitors. The Commission will need to prohibit LEC bundling and joint marketing activities that can hide discrimination. The Commission and the states also will need to monitor closely other non-price areas where the LEC could discriminate in favor of itself, such as processing of local service orders, installation of new accounts, maintenance and billing.

In short, the *Notice* asks the wrong questions because it does not look ahead to the regulatory problems that will predominate in the next decade. The Commission should recognize that LEC discrimination will be the largest single threat to developing local competition, as well as to the long distance competition that exists today. The Commission should recognize the weaknesses of price caps alone as a check on discrimination. And the Commission should develop new discrimination safeguards, starting with the structural separation of LEC retail services sold to end users from LEC network platform services required by all telecom providers. If the Commission refocuses the rulemaking in this fashion, it will move towards a new regulatory paradigm that frees market forces where it is safe to do so, and controls LEC discrimination with the least amount of regulatory oversight.

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COMMENTS OF LDDS WORLDCOM

WorldCom, Inc., d/b/a LDDS WorldCom ("LDDS WorldCom" or "WorldCom"), by its attorneys, hereby submits its comments in response to the *Second Further Notice of Proposed Rulemaking in CC Docket No. 94-1, Further Notice of Proposed Rulemaking in CC Docket No. 93-124, and Second Further Notice of Proposed Rulemaking in CC Docket No. 93-197*, FCC 95-393 (released Sept. 20, 1995) ("*Notice*").

INTRODUCTION: THE NEED FOR IMPROVED DISCRIMINATION SAFEGUARDS

In this docket the Commission contemplates revisions to LEC price cap rules that would provide substantial additional pricing flexibility. However, it is striking that the word "discrimination" does not appear in the table of contents of

the *Notice*. Indeed, it barely appears elsewhere in the text.[1] Like the dog that did not bark in the old Sherlock Holmes story, the absence of this word is telling evidence that something is wrong. The *Notice* fails to appreciate that LEC price discrimination will be the number one, two and three problem facing regulators in the transition to a more competitive market.

As a result of this lapse, the *Notice* fails to discuss the inability of price cap regulation alone to constrain such discrimination. The *Notice* fails to consider other mechanisms that could address discrimination concerns more effectively and with less regulation -- most notably structural separation of more competitive LEC services from the provision of bottleneck local network platform functions. LDDS WorldCom explains here why structural separation is crucial to the development of a competitive full service communications market. But at the least, the Commission should defer consideration of how to regulate LEC prices until it considers the structural separation issue.

LDDS WorldCom strongly believes that the Commission's proposals to give the LECs additional pricing flexibility are premature in other respects. First, the LECs do not yet face material competition in the access market -- the single LEC service that traditionally has been the subject of Commission oversight. Indeed, the Commission's attempts to create such competition have been stymied by

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[1] The *Notice* briefly restates that price cap basket and bands can limit discrimination, and that aggrieved parties can file complaints. *See Notice* at ¶ 19. However, the adequacy of these "safeguards" are not evaluated, particularly when set against changes in the telecommunications marketplace.

LEC resistance to expanded interconnection requirements and similar pro-competitive initiatives. The Commission has been embroiled in the problem of discrimination in LEC interconnection tariffs from the day that it ordered such tariffs to be filed.

But second, the proposals are premature because the Commission has not yet begun to take the many other actions necessary to promote full competition with the LECs. These steps include reform of access pricing to bring rates to cost, development of a competitively neutral universal service fund, and implementation of structures and operating systems necessary to promote local service competition. Absent these actions, giving the LECs more pricing flexibility is tantamount to giving them a "hunting license" to block incipient entry wherever it occurs.

More fundamentally, the *Notice* is flawed because it fails to recognize the basic transition in the telecommunications marketplace that is on the horizon. The *Notice* barely acknowledges the possibility of MFJ changes -- even though BOC provision of interLATA service would multiply the discrimination problems facing the Commission with respect to access.

Similarly, the *Notice* fails to recognize the need to adapt access regulation to a world of full service competition in which carriers must use the LEC local network for more than interexchange access. They will depend upon the LEC network platform not only to originate and terminate interexchange traffic, but also to provide retail local services. The Commission will have to confront LEC pricing issues more broadly in its access reform docket, working with the states, to ensure

that LECs cannot use their control of the only ubiquitous facilities network to block either local or interexchange competition. Meanwhile, however, a narrow focus on conventional access alone threatens to miss the forest for the trees.

In short, the *Notice* is in many ways a backward-looking document, viewing the telecommunications world through the prism of the last decade when the long distance and local markets have been segregated and distinct. This docket instead should look ahead to the more complex environment that will exist over at least the next five to ten years. The Commission will see the lines between local and long distance service begin to break down, yet the dependence of LEC competitors on use of the LEC local network platform will remain strong. The Commission can meet the interests of telecommunications consumers only if it understands where the market is headed, and adopts new rules to meet the new challenges of this new environment.

In the comments that follow LDDS WorldCom first responds to the market structure premises that appear to underlie the *Notice*.[2] We explain why the primary pricing issue for the transition to more competitive markets is LEC discrimination. We explain why price cap regulation fails to deal adequately with discrimination, and why new safeguards are needed.

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[2] We also incorporate by reference herein the comments and reply comments that were filed by WilTel, Inc. ("WilTel") in response to the Commission's *First Notice of Proposed Rulemaking* in CC Docket No. 94-1. WilTel was subsequently acquired by LDDS WorldCom, which fully endorses the views expressed in those filings.

In the second section of these comments LDDS WorldCom discusses the relationship of structural separation to the issue of increased LEC pricing flexibility. If the LECs provide their monopoly access and related network platform services separately from their more competitive retail services, then it would be possible to design a much less regulatory system for those retail services. On the other hand, if the LECs offer wholesale network services to their competitors through an integrated company that also offers competitive retail services, an entirely different regulatory scheme is required.

WorldCom strongly believes that the Commission should require structural separation of competitive LEC retail services to limit discrimination. At the least, the Commission should condition reduced regulation of a LEC's pricing on its voluntary adoption of such separation. But in any event, the issue of structural separation must be considered at the outset, before more specific new rules and policies are evaluated that necessarily turn on whether or not structural separation exists.

Finally, in the third section of these comments we briefly respond to some of the specific questions raised in the *Notice*. However, we do so with some trepidation. For the reasons suggested above, we do not think that the *Notice* is asking the right questions because it is not looking ahead to the more complex world of developing local competition. We believe that if the Commission more closely considered these market changes, it would ask different questions that would go more directly to the competitive issues presented by the next decade. All

the more reason that this docket should be set aside until after the Commission takes the many actions needed to create real local competition, and in particular until the preliminary question of structural separation is addressed.

I. LEC PRICE REGULATION MUST RESPOND TO THE INCREASING INCENTIVE OF LECS TO DISCRIMINATE IN A DEVELOPING COMPETITIVE MARKET

As discussed above, the *Notice* does not propose new price cap rules to address the growing problem of LEC price discrimination. It simply discusses how to reduce old rules designed to address a different problem. The *Notice* posits a world in which LECs face increasing competition for interstate access, and therefore anticipates that price cap regulation should be relaxed to respond to this change. The *Notice* proposes to give LECs immediate freedom for new and restructured services and for certain price reductions. The *Notice* also proposes that, upon demonstration of substantial competition for a particular access service in particular geographic market, the LECs would receive streamlined regulation and then later forbearance.

However, this model represents old thinking based on erroneous assumptions. First, it presumes that the access market today is similar to the long distance market several years ago. The *Notice* seems to expect that access competition is just a matter of time. By failing to recognize key differences between the long distance and access markets, the *Notice* overestimates the speed with which LECs will face competition. Even more important, the *Notice* overlooks the

need for new safeguards to address discrimination beyond those in the current price cap system.

Second, the *Notice* does not come to grips with the distinction between "local competition" and "access competition." The *Notice* appears to anticipate deregulating LEC pricing when another local facilities-based carrier is present in a market. Yet the Commission must focus more clearly on the fact that, for most access expenses, the IXC will not have an option of choosing an access vendor. *See Notice* at ¶ 27. Rather, the IXC's access vendor will be forced upon it when the end user chooses a local service provider -- a choice made based on the local rates the user pays directly, and not the access rates that the facilities vendor then charges to IXCs. This practical reality raises questions regarding how the Commission should regulate access when sold by parties other than the LEC. But for present purposes, this reality suggests the need for more sophisticated thinking regarding when LEC services should face reduced regulation.

Third, and more fundamentally, the *Notice* does not consider what kind of industry structure is before us, and how regulation of LEC prices fits in that structure. Again, the *Notice* barely acknowledges the possibility that the BOCs may be freed to provide interLATA services. Yet this change, and the trend towards one-stop shopping that accompanies it, will entirely redefine conventional "access" service. These matters are discussed further below.

A. Focus on the "AT&T Model" of Deregulation Ignores the Larger Danger of LEC Discrimination

The central weakness of price cap regulation is its inability to constrain unlawful discrimination. This problem received little attention when LEC price caps were introduced. The primary goal of LEC price caps was to reduce incentives for LECs to inflate their rate base, and create incentives for them to become more efficient by letting them retain a share of the resulting savings.[3] Discrimination received much less attention.

The primary reason was divestiture. Discrimination control could be a low priority in LEC price caps because the worst discrimination problems already had been dealt with *structurally* -- through complete divestiture of the BOCs from AT&T. Presumably the Commission would have created a wholly different regulatory scheme for the LECs (or at least the BOCs) if divestiture had not occurred. The Commission then would have had to focus very closely on devices to prevent the BOCs from continuing to discriminate against AT&T competitors in the use of the Bell System network. Divestiture itself arose from the inability of regulatory policies and enforcement to prevent such discrimination.

Along with divestiture came another structural restriction on LEC discrimination: the equal charge rule. That rule, rooted in the MFJ, required the BOCs to provide access to AT&T competitors at the same price they charged AT&T.

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[3] *See, e.g., Second Report & Order, Policy and Rules Concerning Rates for Dominant Carriers*, 5 FCC Rcd 6786, 6789-91 (1990).

The Commission's access rules then extended this structural check on discrimination to other LECs.[4]

The Commission also failed to recognize the limitations of price caps as a check on LEC discrimination because it relied so heavily on the AT&T price cap plan as a model. The Commission implicitly assumed that the same general price cap structure was appropriate for all dominant carriers. In doing so, the Commission did not consider core differences between the two markets that make discrimination a much more serious problem in the case of access than in the retail pricing of competitive long distance services, and therefore require different regulatory responses. For example:

(1) LEC discrimination is more serious because access is a primary input to another product. LEC access is clearly the largest cost element of another

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[4] LDDS WorldCom discusses briefly below how replacement of the equal charge rule exposed the weaknesses of price caps as a check on discrimination. In the Access Transport Rulemaking we did not argue for retention of the equal charge rule, but we did ask for new structural rules that would preserve protections against discrimination after the rule expired. In particular, we requested "benchmarking" rules so that rate relationships among various LEC services provided over the same network would reflect cost, including a non-discriminatory share of contribution to common costs.

We continue to object to the failure of the price cap rules for access transport to contain such safeguards. However, it is not our intent to reargue the specific problem of transport here. Our focus is on the broader problem of discrimination in the evolving market ahead, and therefore the even broader danger of LEC discrimination under price caps as they stand today.

product (interexchange service),[5] so discrimination in access pricing directly distorts the long distance market. In contrast, long distance is generally a minor element of a company's cost of production or a consumer's budget. Thus, LEC access discrimination does far more damage to the downstream interexchange market than retail price discrimination by AT&T does to any other market.

(2) Access discrimination, unlike AT&T long distance discrimination, has not been checked by competition -- either before the initial price cap rates were set or since then. AT&T price caps have been a supplement to a competitive market that was already in its adolescence by the time the price cap system began. The Commission could rely on those market pressures as the primary check on discrimination, with the price caps rules themselves as a "safety valve." But LEC price caps have been a complete substitute for competition. There has been no market-based check on discrimination at all. Insofar as the price cap rules are the only obstacle to LEC discrimination, those rules alone are not enough.

More specifically, when AT&T's long distance rates were initially brought under price caps, those rates necessarily were closer to cost because AT&T had been subject to competitive pressure for some time. The Commission therefore risked less by using those rates as a starting point for price caps. Furthermore, the Commission could more safely conclude that ongoing AT&T discrimination under price caps could be adequately controlled by the basket and band structure because

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[5] Access represents roughly 40 percent of an IXC's costs. *See Federal Perspectives on Access Charge Reform, FCC Access Reform Task Force* at 1 (Apr. 30, 1993).

AT&T faced competitive pressure in its markets, albeit to varying degrees. If AT&T tried to discriminate unreasonably against one of its customers, that customer had a remedy. It could go to a different long distance provider, including (importantly) resellers of AT&T services. Even so, the Commission faced repeated complaints that AT&T was using devices like Tariff 12 and contract tariffs to favor certain customers while preventing resellers from obtaining and reselling those more favorable rates to other end users.[6]

For present purposes, however, the Commission should focus on two fundamental distinctions in the local market. First, because (unlike AT&T) LECs faced no competition before price caps took effect, there is little reason to assume that that their initial rates were cost-based and non-discriminatory. Just the opposite, one of the assumptions of LEC price caps was that prior rate-of-return regulation was resulting in excessive and inefficient rates. Such rates not only are unreasonably high; they also create large opportunities for discrimination. And second, because (unlike AT&T) the LECs face little ongoing competition, they have faced no external pressures to control their decisions regarding how to allocate cost reductions as they respond to the incentives and requirements of price caps. Quite

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[6] *See, e.g., Notice of Apparent Liability for Forfeiture and Order to Show Cause,* 10 FCC Rcd 1664 (1995) (finding AT&T apparently liable for a $1 million forfeiture based on its failure to provide service to resellers under the terms of a contract tariff).

the contrary, to the extent that price caps require rate reductions, the LECs have every reason to reduce rates strategically to block competition.[7]

(3) The danger of LEC discrimination is increasing as incentives to discriminate rise. The weakness of LEC price caps was less serious so long as LEC incentives to discriminate were limited. As discussed above, in the past those incentives were controlled by the structural restrictions underlying divestiture: the statutory LEC monopoly over local services, and the prohibition on BOC interLATA services.[8] However, as those restrictions erode, LEC incentives to discriminate are unleashed, and the weakness of price cap regulation is fully exposed.

Again, LEC discrimination already has become a problem under price caps even without these incentives for the LECs to discriminate in favor of themselves. LDDS WorldCom and other interexchange carriers have raised serious objections to discrimination in LEC transport rates in favor of high volume customers like AT&T now that the structural check of the equal charge rule is gone. Access discrimination is distorting the long distance market today by requiring smaller carriers to pay a disproportionately higher share of LEC overhead and other

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[7] Furthermore, LEC discrimination opportunities have increased as a higher percentage of their costs have become joint and common. Since LEC price caps were adopted, LECs have completed construction of predominantly fiber optic based interoffice networks characterized by easily expandable capacity. Incremental service costs approach zero in a fiber network. LECs therefore have an even greater incentive and ability to lay off joint and common costs in a discriminatory fashion.

[8] Similarly, GTE incentives to discriminate have been checked by consent decree requirements that they provide interexchange services through a separate subsidiary. *See United States v. GTE Corp.,* 603 F.Supp. 730, 737-739 (D.D.C. 1984). However, GTE has asked for that decree to be vacated.

indirect costs. This problem would worsen if the Commission revises the interim transport plan before completing access reform.[9]

The danger of LEC discrimination, notwithstanding price caps, only will increase as LECs compete more directly with their access customers, and therefore have greater incentives to discriminate. First, the Commission already is wrestling with the problem of LEC discrimination as it tries to implement expanded interconnection. It is no surprise that discrimination by LECs against CAPs in the recovery of overhead loadings has been a primary focus of the various ongoing investigations of the interconnection tariffs.[10] Nor is it a surprise that the

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[9] It is not our intent to reargue transport issues here, as strongly as we may believe that the Commission's transport decisions are unlawful. We simply note that in the past LECs have been driven to discriminate in favor of AT&T by AT&T's unique position as an access purchaser, caused by its unique traffic volumes rather than any economies of scale that materially lower LEC transport costs.

LDDS WorldCom continues to insist that such transport rate discrimination is unlawful, anti-competitive and unfairly raises costs to consumers. Put simply, when LECs charge us a higher share of their overhead than AT&T in access rates, they artificially increase our cost structure, and therefore the rates we must charge consumers. Thus, even where WorldCom operates a more efficient interoffice network than AT&T, unfairly high access rates can deprive us and our potential customers of the benefits of that efficiency, and give AT&T an artificial cost advantage.

However, looking to the future, the broader problem facing the Commission will be discrimination by the LECs against all competitors, and in favor of themselves. The weaknesses of price caps as a check on discrimination will be even more fully exposed unless other safeguards are in place.

[10] Early in its *Expanded Interconnection* proceedings the Commission recognized the danger that LECs would discriminate by imposing excessive overhead costs on prospective competitors. *See, e.g., Expanded Interconnection with Local Telephone Company Facilities,* 9 FCC Rcd 5154, 5189 (1994). The Commission's concerns were borne out by the LECs' tariffs, which "strategically assign[ed] high overhead loadings to deter efficient entry by interconnectors into

Commission has had to step outside the framework of the price cap plan to try and deal with this problem. What is evident is that price caps simply do not control LEC discrimination once the LECs are given an incentive to discriminate by the prospect of new competition. This will be as true for ongoing interconnection rates as it is for the initial rates.

Similarly, it is not a surprise that the CAPs have been complaining loudly that LECs are cross-subsidizing rates in areas where they face competition with rates from non-competitive services. LDDS WorldCom believes that all access rates are too high. But we also can see that the LECs have strong incentives to recover overhead and common costs from access services where they face no competition. And in the future the LECs can just as easily discriminate in favor of themselves where they face competition. As we have repeatedly pointed out, price cap regulation fails because it allows such competition-distorting practices to occur.

These problems will be exacerbated if the BOCs are allowed to offer interLATA long distance services. At that point the BOCs will have an incentive to discriminate against both their rivals in the local exchange market, and their long

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the interstate access service market." *Local Exchange Carriers' Rates, Terms, and Conditions for Expanded Interconnection Through Virtual Collocation for Special Access and Switched Transport,* 10 FCC Rcd 6375, 6380 (1995). Specifically, the "LECs tended to assign low overheads in markets where they faced actual or potential competition from interconnectors, and high overheads where they did not." *Id.*

To address this discrimination, the Commission was compelled to prescribe maximum overhead loadings on a permanent basis for most LECs and prescribe interim loadings for the remaining LECs. *Id.* at 6377.

distance access customers. The lack of meaningful competition in the intraLATA market due to BOC discrimination is a precursor to the problems that will occur in the interLATA market without improved discrimination safeguards. Indeed, another of the striking omissions in the *Notice* is the absence of any discussion whatsoever of the intraLATA market experience. The *Notice* seems oblivious to both the prolonged history of LEC discrimination against intraLATA rivals with regard to access pricing, and the inability of state regulators to prevent such discrimination through "access imputation" rules or, where they exist, intrastate price cap systems. This intraLATA experience should be the starting point for an evaluation of regulatory problems in a future world in which LECs provide network access to their own competitors. It is the best empirical demonstration of how LECs manipulate pricing to block competition to themselves when they have an incentive to do so.[11]

Discrimination incentives obviously will multiply if the BOCs are allowed to offer interLATA services. LDDS WorldCom does not need to address here why elimination of the interLATA service restriction -- a structural rule to prevent discrimination -- is premature. The point, however, is that the *Notice* is singularly unhelpful in its failure to even begin to come to grips with the risk of

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[11] For example, when LDDS WorldCom analyzed intraLATA pricing in May of 1994, it found that in a number of states, BOC intraLATA access charges exceeded the price the BOC charged for intraLATA toll service, except with respect to very brief calls. In New Jersey, for example, LDDS WorldCom found that under Bell Atlantic's price structure, the amount an IXC paid in access charges exceeded the total price charged by New Jersey Bell for any call lasting two minutes or longer. Such a "price squeeze" makes intraLATA competition economically impossible.

LEC discrimination in the pricing of LEC network services. The local market is different from the long distance market, and the AT&T price cap experience is largely irrelevant to a consideration of the regulatory challenges presented as the local market begins to move towards competition. The Commission should be considering new regulatory controls on LEC discrimination, not elimination of the already unsatisfactory limitations in price caps today.

B. Local Competition Is Not Access Competition

The *Notice* also erroneously equates the development of local competition with access competition. The *Notice* acknowledges the critical fact that the provider of access is selected by the end user, not by the interexchange carrier that pays access charges. *Notice* at ¶ 27. However, it does not come to grips with the implications of that fact.

Simply stated, the discontinuity between who pays for most access, and who selects the access supplier, means that the development of local service competition will not discipline the overall level of access rates or the potential for access discrimination. To serve any given end user, an interexchange carrier will remain dependent on whatever provider the user chooses for local and access service. The end user will select that provider based on the local service rates the user pays, not on the access rates the IXC pays. If the access provider charges an unreasonably high rate for access, the IXC cannot simply go elsewhere. It must pay the rate in order to offer originating long distance service to the customer, and to terminate service to that customer. Similarly, an IXC will have no recourse if the

access provider favors its own long distance operations in the terms and conditions of access.

Thus, for example, if a new local service provider wins away 10% of a LEC's local service customer base, long distance companies still will remain completely dependent upon the LEC to originate and terminate service to the remaining 90%. The LEC will have the same incentives and ability to charge unreasonable rates, and to discriminate in favor of itself, as it did before. The only difference is that now the IXCs will be fully dependent upon the other local service provider to reach the 10% of customers served by that company. This creates new regulatory issues for the Commission to ensure that neither the LEC nor the new provider exploits its control over its respective customer. But it certainly does not justify deregulation of grossly inflated LEC access prices.

Experience to date with the development of local competition confirms the problem. CompTel has provided a number of examples in which new entrants have mirrored the access rates of the incumbent LEC. [12] Thus, the empirical evidence directly contradicts the *Notice's* assumption that local competition will exert downward pressure on access rates -- yet this assumption is the foundation of all the Commission's proposals to give the LECs greater pricing flexibility.

We do not want to overstate the case. Facilities-based competition in the interoffice market, for example, may justify reduced regulation of LEC interoffice price levels so long as safeguards are in place to prevent unreasonable

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[12] *See* CompTel Ex Parte in CC Docket No. 94-1 at 4 (Aug. 3, 1995).