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

In the Matter of	)	
	)	CC Docket No. 94-1
Price Cap Performance Review for Local Exchange Carriers	)	
	)	
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 THE SPRINT TELECOMMUNICATIONS VENTURE ON SECOND FURTHER NOTICE OF PROPOSED RULEMAKING

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SUMMARY

In its Second Further Notice of Proposed Rulemaking, the Commission proposes to relax the protections against anticompetitive pricing of local exchange carrier ("LEC") access charges just when those protections are needed the most. New competitors are beginning to offer an alternative to the LECs' monopoly switched access services, but those competitors must depend on the LECs for the facilities needed to reach their customers. The LECs already are using this bottleneck control over an essential input to inflate the competitors' costs and delay their entry into the market, and they are no less likely to abuse any new pricing flexibility the Commission may grant them by strategically pricing their own access services wherever they face competition. The resulting cost-price squeeze will have a devastating effect on companies who are trying to bring customer choice to this market for the first time. The LECs already have all the pricing flexibility they need to compete fairly, and it would be dangerous and premature for the Commission to undermine the price cap system before the LECs face real, facilities-based competition in their local service markets.

It also would be premature for the Commission to consider, at this time, a plan for streamlined or nondominant treatment of LECs in the access service markets. If the Commission nonetheless outlines such a plan, it must permit deregulation only when the LECs face effective competition from service providers with their own facilities for reaching their customers. For the present, the continuing LEC monopoly of the local exchange requires more -- not less -- vigilance over the conduct of the dominant carriers.

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COMMENTS OF THE SPRINT TELECOMMUNICATIONS VENTURE ON SECOND FURTHER NOTICE OF PROPOSED RULEMAKING

Sprint Telecommunications Venture ("STV") hereby submits its comments in response to the Federal Communications Commission's ("FCC" or the "Commission") September 20, 1995 Second Further Notice of Proposed Rulemaking in the above-captioned matter (the "FNPRM").[1]

INTRODUCTION

The present constraints on the interstate access charges of price cap local exchange carriers ("LECs") must not be relaxed or removed until the LECs no longer enjoy economic power in the markets for local exchange and exchange access services.[2] The present condition of those markets offers no basis for further dilution of the

[1] 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 No. 95-393 (Sept. 20, 1995)("FNPRM"). By subsequent order, the Commission extended the time for filing of comments to December 11, 1995.

[2] As discussed at pp. 5-6, *infra*, the Commission already has authorized sufficient access pricing flexibility to permit the LECs to compete fairly with alternative access providers.

safeguards contained in the price cap rules; and neither the weakening of those safeguards, nor streamlined or nondominant regulation of interstate access charges, should be contemplated until the LECs face substantial competition that deprives them of bottleneck control of the local exchange. To the extent the proposed rules would remove competitive safeguards in the absence of effective competition, they are premature and invite anticompetitive abuse by price cap LECs. STV therefore urges the Commission not to adopt the proposed rules.

STATEMENT OF INTEREST

STV is a joint venture formed by subsidiaries of Sprint Corporation, Cox Communications, Inc., Tele-Communications, Inc. and Comcast Corporation to provide nationwide wireline and wireless telephony services. The wireline component of STV will develop, deploy and operate digital broadband integrated networks in competition with incumbent LECs using cable telephony technologies, while the wireless component of STV will establish a nationwide seamless network for offering personal communications services ("PCS"). As a potential competitor of price cap LECs, the wireline component of STV is particularly vulnerable to inappropriate relaxation of price cap regulation of Tier 1 LECs and thus has a strong interest in this proceeding.

DISCUSSION

The FNPRM proposes three levels of increasingly relaxed access price regulation. The first level would remove some of the competitive safeguards built into the present price cap rules; the second level would establish a framework for streamlined regulation of LECs' interstate rates; and the third level would establish a framework for

nondominant treatment of LECs in particular geographic and service markets. The following discussion considers each of these proposals in turn.

I. THE PROPOSED NEAR-TERM REVISIONS TO THE PRICE CAP PLAN ARE PREMATURE, UNNECESSARY AND INVITE ANTICOMPETITIVE ABUSE

The FNPRM proposes a number of near-term changes to the present price cap rules, including relaxation of the notice and cost support requirements for certain new services, elimination of lower service band limits and greater freedom for LECs to offer alternative pricing plans and individual case basis rates. The FNPRM proposes that those changes take place automatically or, in the alternative, after a prior showing that certain barriers to competitive entry in the local market have been removed. These proposals are a substantial departure from the Commission's past treatment of price cap regulation, and are neither prudent nor necessary in the present competitive environment.

A. The Proposed Revisions To The Price Cap Plan Are Contrary To Longstanding Commission Policy

Since it instituted price cap regulation for Tier 1 LECs in 1991, the Commission consistently has treated certain competitive safeguards as central to the price cap system. Notably, the Commission has required detailed cost support for new services, and maintained limits on the ability of LECs to lower rates for particular service categories, in order to discourage selective rate reductions that might deter new entry into competitive markets. The Commission also has required price cap LECs to provide access services to all customers on tariffed, nondiscriminatory terms in order to protect ratepayers and the competitive process.

Where the FCC has relaxed these safeguards, it has done so within specific limits, conditioned on evidence that real-world competitive conditions would protect ratepayers and the competitive process from abuse. So, for example, when the Commission permitted LECs to institute zone density pricing,[3] it limited the extent to which rates could be lowered within zones and required LECs to show that at least one competitor existed in the study area for which zone pricing was to be used.[4] Similarly, when zone pricing was extended to interstate switched transport services,[5] specific downward pricing limits were imposed and LECs proposing to offer volume and term discounts within their highest-density pricing zones were required to demonstrate that either: (1) 100 DS1-equivalent switched cross-connects were operational in the Zone 1 offices in the study area; or (2) an average of 25 DS1-equivalent switched cross-connects per Zone 1 office were operational.[6]

The Commission reconfirmed its reliance on competitive safeguards as recently as April of this year, when it completed a review and analysis of the first four years of the LEC price cap plan.[7] Specifically, the Commission retained -- although it somewhat

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[3] *Expanded Interconnection with Local Telephone Company Facilities* (Special Access), CC Docket No. 91-141, Report And Order And Notice Of Proposed Rulemaking, 7 FCC Rcd 7369, 7454, n. 411 (1992).

[4] *Id.*

[5] *Expanded Interconnection with Local Telephone Company Facilities* (Switched Transport), CC Docket No. 91-141, Second Report And Order And Third Notice Of Proposed Rulemaking, 8 FCC Rcd 7374, 7433 (1993).

[6] *Id.*; *See also Expanded Interconnection with Local Telephone Company Facilities* (Virtual Collocation), CC Docket No. 91-141, Memorandum Opinion and Order, 9 FCC Rcd 5154, 5202 (1994).

[7] *Price Cap Performance Review for Local Exchange Carriers*, CC Docket No. 94-1, 10 FCC Rcd 8961 (1995)("Price Cap Review Order").

relaxed -- the lower boundaries on rate reductions within service categories,[8] and declined to dilute the rules governing notice and cost support for new services.[9] The Commission pointed out that it lacked sufficient information to support more fundamental changes to the price cap rules, and suggested that it would make further changes cautiously in light of the LECs' continuing control of bottleneck facilities.[10]

Although the state of competition and the information available to the Commission have not changed materially since April of this year, the FNPRM proposes to eliminate lower limits on rate reductions, reduce the cost support requirements for new services and liberalize alternative access pricing on an industry-wide basis. These proposals, which have grave anticompetitive potential,[11] are advanced as a means of ensuring that LECs will not be forced by regulation to set their rates above cost and hold a price umbrella over inefficient competitors.[12]

The notion that the present rules force LECs to price above cost, however, is unsupported by the record. The LECs have been granted substantial flexibility in the form of zone pricing and volume and term discount authority. Against this background,

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[8] *Id.* at 9139.

[9] *Id.* at 9138-39. USTA , along with a number of LEC commenters, had proposed several changes to the rules governing new services, including relaxed notice requirements, adoption of an incremental cost standard for new services cost support, and elimination of new services from price caps altogether. *Id.* at 9135-38. The Commission adopted none of these proposals.

[10] "While local access competition has begun to develop, the LECs continue to exercise a substantial degree of market power in virtually every part of the country, and continue to control bottleneck facilities." *Id.* at 9122.

[11] *See* discussion at pp. 6-8, *infra*

[12] *See,* FNPRM at ¶¶ 6, 24, 25 & 83.

the proposed changes in FCC policy would not be supported by the record.[13] Any further increases in LEC pricing flexibility should follow the Commission's prudent, historical pattern and occur only if competitive conditions justify such a change.

B. Further Relaxation Of LEC Price Caps Is Especially Dangerous In The Current Competitive Environment

The FNPRM discounts the likelihood that expanded LEC pricing flexibility will lead to predatory conduct. Specifically, the FNPRM assumes that effective misuse of pricing flexibility could occur only through a single, predatory pricing scenario -- *i.e.*, through below-cost LEC rates followed by monopoly pricing after rivals have been driven from the market.[14] The FNPRM suggests that such a predatory pricing campaign is improbable in the present regulatory environment, and accordingly concludes that increased pricing flexibility for LECs will be innocuous.[15]

Unfortunately, the FNPRM severely understates the range of predatory options available to the LECs. As the Commission recognizes, the cost of an essential input required by competitors -- interconnection with the local exchange -- is entirely controlled by the LECs. Expanded interconnection of competitive access providers to the local network has been mandated by this Commission, but the rates and other terms of interconnection are set in the first instance by the LECs, who manipulate them

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[13] Changes in FCC policy must be "based on consideration of relevant factors, and supported by the record." *People of the State of California v. Federal Communications Commission*, 905 F.2d 1217, 1230 (9th Cir. 1990).

[14] FNPRM at ¶ 83.

[15] *Id.*

systematically to harm competitors and preserve their market dominance.[16] At the same time, most of the new entrants operate on slim margins that make them highly vulnerable to LEC behavior that raises their costs.[17] Downward pricing flexibility, combined with the LECs' control over the timing and cost of interconnection with the local network, will permit LECs to engage, if not in classic predatory pricing, then in an equally effective price squeeze strategy.[18] All that is needed is for the LECs to raise their rivals' costs at the same time that they lower the LEC rates with which those rivals must compete. Even where those rates exceed the LECs' costs, they may prove devastating to competitors whose costs of service have been inflated by the LECs.[19]

The proposed rules afford a number of opportunities for just this kind of rate and cost manipulation. Removal of the lower band limits will increase the ability of LECs to

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[16] *See Rivals Are Hung Up On Baby Bells' Control Over Local Markets,* Wall Street Journal, Oct. 24, 1995, at A1 *("WSJ Article").* ("[T]he Bells employ an arsenal of tactics to keep competitors at bay. Rivals say the Bells have stalled negotiations, imposed arbitrary fees and set Byzantine technical requirements that jack up costs and cut profits.").

[17] As the Chairman of Teleport Communications Group ("TCG") pointed out in a recent letter to Chairman Hundt, even where "TCG provides *all* of the Local Transport for an interexchange carrier [in the New York Metro Area], NYNEX is receiving 97 percent of the payments made by the IXC for switched access and TCG keeps just three per cent." At the same time, according to its Chairman, TCG pays 71% of its New York Area switched access service revenues to NYNEX. Letter from Robert Annunziata, Chairman, President & Chief Executive Officer, TCG, to Hon. Reed Hundt, Chairman, FCC, at 2 (Nov. 15, 1995). As these figures show, alternative access providers pay LECs a huge price for the opportunity to serve a tiny share of the access market - creating the ideal environment for a cost/price squeeze.

[18] It is well recognized that where a monopolist's control of an input needed by its competitors is sufficiently strong, a price squeeze "could be effected with little or no short-run loss of profits, unlike predatory pricing generally." A. Areeda and D. Turner, *Antitrust Law* at ¶ 728c5 (1978). Accordingly, where a price squeeze of this kind is employed it is not necessary, as the FNPRM assumes, for the monopolist to raise its prices promptly in order to recover profits it lost when its prices were reduced.

[19] As the Bell System demonstrated when interexchange markets first were opened to new entry, firms that control an input essential to competition may raise rivals' costs substantially through excessive interconnection charges, inferior terms of interconnection and delay. Where competitors are faced with these disabilities, a monopolist's selective reductions in the prices of competing services may complete a successful program of delaying or eliminating competition.

reduce rates selectively, forcing competitors to enter the market with increasingly low, or even nonexistent, profit margins. Strategic pricing of this kind would make it difficult for a competitor to enter the market at a price that would justify its significant start-up costs. Similarly, LECs could use the proposed "Track 2" new services category, through creative service classification schemes, to price "new services" at anticompetitive rates that discourage new entry and encourage customer migration. So long as the LEC can react quickly to any service offering of a competitor by providing a "new" service in response, competitors will have difficulty gaining a toe-hold in the market.[20] Finally, the proposed alternative pricing plans ("APPs") for interstate access will encourage LECs to fashion strategic pricing schemes for their largest business customers in markets where the LECs face competition, and to offer those customers discounted access services that may be indistinguishable from services offered to other customers at higher rates.[21]

In light of these competitive dangers, the Commission should not undertake across-the-board relaxation of the pricing safeguards contained in the present rules. Instead, the Commission should continue its policy of incremental adjustments to those rules where justified by real-world conditions.[22] Comprehensive changes should occur

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[20] The proposed Individual Case Base ("ICB") tariffs offer similar opportunities for discrimination.

[21] Unlike, for example, the services offered to end users by AT&T under Tariff 12 and other custom service arrangements, access services are straightforward arrangements that offer little scope for specialized features not covered in the access tariffs. Access service APPs, therefore, will amount to little more than devices for discriminatory pricing of like services.

[22] Such adjustments might include, for example, elimination of the requirement that LECs demonstrate the presence of competition in a study area before instituting zone discount pricing. So long as lower service band limits and other safeguards contained in the present price cap rules are retained, zone discounts could be instituted wherever the appropriate traffic density exists, regardless of the presence or absence of competition. Elimination of the price cap safeguards, however, can occur only where effective competition assures that the LECs will not benefit from anticompetitive pricing.

only after genuine, facilities-based competition breaks the grip of the LECs on the local exchange bottleneck.[23]

In no event should the Commission change the rules until it gathers more information about the state of competition. The Commission does not now have adequate information about the scope, and nature, of local exchange competition or LEC service offerings to determine whether pricing flexibility for LECs is appropriate. In its price cap review, for example, the Commission noted that the record:

> requires further development to permit us to identify when interstate access services are adequately competitive to trigger [ ] streamlining... [and] also contains insufficient data concerning the competitiveness of specific markets upon which to base a decision to revise our price cap system.[24]

In recognition of this problem, on November 3, 1995, the Common Carrier Bureau of the FCC issued a Public Notice seeking comment on a reporting program pursuant to which specific data concerning the nature of local competition in the local exchange and interstate access markets would be collected.[25] Since the FCC clearly does not already have such data on hand, it would be unwise to initiate a broad restructuring of pricing rules involving LECs until such a study is completed.

Finally, only when the Commission has gathered sufficient information about local exchange and interstate access competition should the use of a competitive checklist

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[23] For this reason, as discussed at pp. 9-10, *infra*, any "competitive checklist" for further regulatory relief must include the presence of alternative, facilities-based providers of local exchange service.

[24] Price Cap Review Order at 9138.

[25] "Common Carrier Bureau Seeks Comment On Local Competition Data Collection," FCC Report No. CC 95-66 (Nov. 3, 1995).

be considered to identify markets in which price cap regulation will be relaxed. Any such checklist should require proof, not just of the removal of entry barriers, but of the presence of effective competition in the market.[26] Effective competition, in turn, requires the presence of at least one alternative, facilities-based provider of switched, local exchange service, not affiliated with the incumbent LEC, serving a substantial number of subscribers in the market. Only where these conditions are met will the LECs lose their ability to control the price alternative access providers must pay for local exchange interconnection.

II. STREAMLINED OR NONDOMINANT REGULATION SHOULD NOT BE CONSIDERED UNTIL THE LOCAL EXCHANGE IS OPENED TO EFFECTIVE, FACILITIES-BASED COMPETITION

STV strongly believes that it is premature at this time to adopt standards and procedures by which eligibility for streamlined or nondominant treatment may be determined. Those standards can be more intelligently formulated after the industry and the Commission have gained more experience with the emerging competitive environment, including the LECs' responses to competition in the switched access and local service markets, and after pending legislation has defined the role of the BOCs in the interexchange market.

If standards for streamlined and nondominant treatment are adopted at this time, those standards should not be based on the AT&T experience. Unlike the LECs, AT&T

[26] Adoption of a competitive checklist at this time also might prove premature because pending telecommunications reform legislation contemplates adoption of a separate checklist for use in determining that local markets are ready for interexchange competition. The contents of any such checklist are among the information the Commission should have available, and take into account, before adopting a checklist for relaxation of price cap controls on interstate access pricing.

at no time in its post-divestiture history controlled a bottleneck facility. Accordingly, criteria such as demand responsiveness, supply responsiveness, market share and pricing experience were sufficient to identify the point at which relaxed regulation of AT&T was appropriate.

In the case of the LECs, the mere presence of alternative suppliers of access and local exchange service -- whatever their market share -- does not ensure that deregulation of the LECs is appropriate. So long as the alternative suppliers depend on the local LECs for access to their customers, the LECs' incentives and opportunities for raising competitors' costs and engaging in price-squeeze strategies remain. Any set of criteria for streamlined or nondominant treatment of LECs, therefore, must begin with the presence in the relevant market of alternative, facilities-based suppliers. Only when such facilities-based competition is in place in a particular market should the conventional, AT&T-style analysis be applied to determine whether that competition has developed sufficiently to erode the market power of the incumbent LEC.[27]

CONCLUSION

The alternative access and local exchange service industries have entered a phase similar to the early stages of interexchange competition, when new long-distance companies undertook the heavy financial demands of entering the telecommunications industry at the same time that they depended on an entrenched monopoly for access to

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[27] LEC market shares have a long way to go, of course, before they reach the levels at which the Commission found relaxed regulation of AT&T to be appropriate. Whereas AT&T has a market share as low as 60% in the long-distance market, Tier 1 LECs continue to retain overwhelming market shares in all but the most urban areas of the U.S. *See WSJ Article, supra.* ("The Bells still lock up 98% of local revenues in their regions.").

their customers. If the past is any guide, the new local-service competitors will face obstacles similar to those that dogged the new interexchange entrants of the 1970s. The FCC should proceed cautiously in relaxing its regulatory oversight of the LECs during this critical time, and should not adopt the proposals made in the Second Further NPRM.

Respectfully submitted,

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December 11, 1995

CERTIFICATE OF SERVICE

I, Bonnie G. Eissner, do hereby certify that copies of the foregoing COMMENTS OF THE SPRINT TELECOMMUNICATIONS VENTURE ON SECOND FURTHER NOTICE OF PROPOSED RULEMAKING were this 11th day of December, 1995 delivered by hand to the following:

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