competitive alternatives as well. Indeed, even as long as a year and a half ago, two thirds of Bell Atlantic's high capacity demand came from areas served by competing providers,[60] and competitors have continued to expand in the intervening period. In addition, the services included in the interexchange basket, by definition, all compete with interexchange carriers that have a national presence.[61]

### 2. The Commission Should Avoid Pre-Set Limitations on the Scope of Services That Can Be Grouped Together For Removal From Price Cap Regulation

Competition will not evolve according to some regulatory plan. Competition will spread to wherever competitors perceive a market opportunity. In some cases, such as video dialtone service, an entire service may face competition anywhere it is offered by a LEC.[62] In other circumstances, competition may vary depending on customer characteristics. For example, competition is increasing at a far faster rate for multi-line business customers than it is for single-line customers.[63] Competition may also develop on different geographic bases for different services. For example, as CAPs develop their

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60 Beville Affidavit at ¶ 34.

61 In establishing this basket, the Commission acknowledged that these services compete with AT&T. ***Policy and Rules Concerning Rates for Dominant Carriers***, 5 FCC Rcd 6786, ¶ 207 (1990) ("Price Cap Order").

62 Crandall Affidavit at ¶¶ 8-14.

63 Indeed, the divisions may be even more discrete. For example, rules on customer information recognize categories for business customers with 20 or more lines. ***See Computer III Remand Order***, 6 FCC Rcd 7571, n.159 (1991).

networks, they offer competitive alternatives to all potential customers within a given radius of their lines.[64]

Because it is the marketplace and not the Commission or the LECs that control the scope of competition, it makes no sense to pre-define a "market" that is eligible to be removed from price regulation. This means that the Commission should not include a specific market definition as part of the criteria for removing services from price regulation. As long as LECs can make the appropriate factual showing for the service boundaries they define in a petition to remove price constraints, LEC services within those boundary definitions should be removed from price regulation.[65] There can be no competitive harm from such a flexible standard, because LECs still must make a competitive showing before any relief is granted. Moreover, the relief will be limited to those areas where the competitive showing can be made. Thus, services that have no competitive alternative will remain under price regulation.

### 3. Market Share is the Wrong Test

Market share is a backward looking measure that can fail to capture the presence of competitive alternatives. Firms with very high market share may lack sufficient

64 Beville Affidavit at ¶¶ 8-9. Indeed, competitors may first target a small geographic area and then expand their facilities to meet demand after it has a sufficient number of customers already signed up. ***See Price Cap Performance Review for Local Exchange Carriers***, CC Docket 94-1, Comments of Citizens For A Sound Economy at 11 (filed May 9, 1994); R. Posner, "The Appropriate Scope of Regulation in the Cable Television Industry," Bell J. of Econ. and Mgmt. Sci. at 98, 112 (1972).

65 ***See*** Gilbert and Harris Affidavit at ¶ 24-30.

market power to control prices.[66] This is especially true if, as it is for most LEC interstate services, there is unconstrained entry and exit for potential competitors.[67] Indeed, the Commission recognized that a market share test was not essential when it declared AT&T a non-dominant carrier.[68] Most recently, a Commission proposal suggested that notwithstanding a zero market share, video dialtone service provided a sufficient competitive alternative to cable television providers with virtually a hundred percent market share so as to obviate the need for continued cable rate regulation.[69]

Unlike the cable TV industry, LECs allow competitors to purchase services and compete in a resale market. As the Commission has previously held,[70] this provides price competition for downstream customers without the need for any sunk costs.[71] In such a market, historical market share figures are irrelevant.

Indeed, reliance on market share is affirmatively harmful when used to force markets to remain price regulated well after competition is present. LECs incur higher costs and are at a competitive disadvantage when operating under price regulation rather

66 *Id.*, ¶ 36.

67 *Id.*

68 "It is well established that market share, by itself, is not the sole determining factor of whether a firm possesses market power." AT&T Non-Dominance Order, ¶ 68.

69 ***Waiver of the Commission's Rules Regulating Rates for Cable Services***, CUID Nos. NJ0213, NJ0160, Order Requesting Comments (rel. Nov. 6, 1995).

70 ***See, e.g., Competition in the Interstate Interexchange Marketplace***, 5 FCC Rcd 2627, 2630 (1990); AT&T Non-Dominance Order, ¶ 61.

71 Indeed, because customers make no distinction as to whether or not a competitive alternative is a reseller, there should be no requirement that addressability be limited to "facilities-based" suppliers. ***See*** AT&T Non-Dominance Order at ¶ 70. The only question is whether customers have a viable competitive alternative. ***See*** Gilbert and Harris Affidavit at ¶¶ 26-36.

than under market conditions. If the Commission were to continue that one-sided burden until the LECs suffer a significant loss of market share, the Commission would be imposing a regulatory burden that skews the market results with no benefit to consumers. Indeed, to the extent the LEC is the more efficient provider, by adding costs to the service, the Commission would be increasing costs to consumers -- all in the name of the public interest. The Commission must resist inevitable calls by LEC competitors to mandate a market share test that prolongs the competitors' regulatory advantage over the LECs at the expense of the public.

## V. The Commission Should Adopt Pro-competitive Reforms for the Price Regulation of Services Remaining Under Price Caps

As set forth above, the Commission must overhaul its rules to allow new services and pricing structures into the market without regulatory delays. For existing services that remain under price caps, the Commission must avoid stifling the market by imposing excess regulatory burdens.

### 1. No Limits on Downward Price Adjustments

There is simply no justification for downward price constraints on price regulated services. The only justification for any price regulation is a lack of competitive check on prices. This is accomplished through the price cap. While imposing a price floor supposedly offers a protection against predatory pricing, in reality this is not a genuine concern. As the Commission and the Supreme Court have recognized, while predatory pricing is "often alleged", it is "fairly uncommon, and proven cases are rare."[72] Moreover, there is no reason that predatory pricing is more likely in the markets LECs compete in than in other markets. Indeed, LECs regulated under pure price caps have no opportunity to raise prices to recover the losses inherent in predatory pricing.[73] At the same time, the LECs face large well financed competitors that are unlikely to be pushed out of the market.[74] The existing networks of the interexchange carriers and the cable TV operators have low marginal costs and could survive any price war.[75]

In contrast, downward pricing limits put a real constraint on a LEC's ability to lower prices. Limiting upward price adjustments for a LEC that has lowered its prices below the price caps produces a similar disincentive to make price reductions.[76] Allowing a LEC subject to a price cap to price flexibly so long as it is below the cap is consistent with Commission policy and offers the best chance for reduced prices.

Moreover, the Commission retains the complaint process to investigate allegations of predatory pricing. The test in such proceedings is the true price floor --

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72 ***LEC Price Cap Order***, 5 FCC Rcd at 6824 (1990); ***Matsushita Elec. Ind. Co. v. Zenith Radio Corp.***, 475 U.S. 574, 588-93 (1986).

73 ***See*** Affidavit of William E. Taylor at ¶ 12, attached as Exhibit 1 to Opposition of Bell Atlantic to Petition to Deny and Response to Comments, Statement and Protest, W-P-C 6912, W-P-C 6966 (filed Aug. 11, 1994) ("Taylor 214 Affidavit").

74 ***See*** Beville Affidavit.

75 ***See*** Crandall Affidavit at ¶ 19. Moreover, even in the unlikely event a major competitor were to leave the market, any facilities owned by that competitor would be purchased and would continue to be a source of competition for LEC services.

76 ***See*** Gilbert and Harris Affidavit at ¶¶ 21-22.

incremental cost. Requiring add-ons to incremental costs is unsound economics[77] and customers will suffer if LECs face a regulatory price floor that is too high.[78]

### 2. Modify Composition and Treatment of the Interexchange Basket

The Commission has recognized that LEC-provided interexchange services are a "separate category" of services.[79] As previously explained, these services are competitive and should be removed immediately. If the Commission determines that a formal showing is necessary to remove these services, it should, in the interim, continue its policy and apply the same productivity offset for these services as it applies to AT&T.[80] Given that AT&T is removed from price caps altogether, this means a productivity offset of zero.

In addition, as a precursor to price deregulation of these services, the Commission should modify the basket to include other operator services that compete with AT&T and other interexchange carriers. These operator services do not belong with access services and are no less competitive with interexchange carriers than the services already included

77 Kahn Affidavit at ¶ 25; Gilbert and Harris Affidavit at ¶ 18.

78 Under current rules, the same concern is raised by the new service rules, which can require uneconomic loadings above and beyond incremental cost. These loadings can raise the level of the price umbrella and allow competitors to raise their prices as well.

79 LEC Price Cap Order, 5 FCC Rcd 6786, ¶ 211.

80 *Id.*, ¶ 207; ***Price Cap Performance Review for Local Exchange Carriers***, 10 FCC Rcd 8961, ¶ 249 (1995).

in the basket today. These services include call completion,[81] electronic directory assistance, and directory assistance.[82]

## CONCLUSION

For the foregoing reasons, the Commission should adopt the reforms as set forth above.

Respectfully submitted,

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Attorneys for the
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Edward D. Young, III
Of Counsel

December 11, 1995

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81 Both MCI and AT&T offer long distance directory assistance featuring a call completion option. See promotional materials attached hereto at Tab 3.

82 *See, e.g.*, "Rochester Telephone Corporation and Metromail to Offer National Directory Services," PR Newswire (Nov. 8, 1995). In addition operator transfer and busy-line verification and interrupt are discretionary non-access services that should be grouped with other operator services in the interexchange basket.

## CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing "Comments of Bell Atlantic" was served this 11th day of December, 1995 by hand on the parties on the attached list.

Jaynemarie Lentlie

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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 |

## AFFIDAVIT OF RICHARD J. GILBERT AND ROBERT G. HARRIS

### A. INTRODUCTION AND OVERVIEW

1. In this affidavit we recommend that the Commission make fundamental changes in its regulation of interstate access services. In spite of the Commission's avowed commitment to promote competition in interstate access services, its current regulations – and those proposed in the Second Further Notice – are directly contrary to that policy objective in several respects. The Commission's regulation of interstate services and prices inhibits competition by delaying new services and by protecting individual competitors from fair competition. In our view, it is time for the Commission to make a fundamental break with traditional regulatory mechanisms and adopt policies that will accelerate the offering of new services, expedite the development of competition and ensure the lowest prices and highest quality of services during the transition to full and open competition. At the heart of our recommendations is a simple, but powerful economic principle: competition is promoted and customers are better off when new services can be offered or price

decreases can be made sooner, rather than later. In this affidavit, we will explain, justify and apply this principle to the reform of the Commission's regulation of interstate services and prices.

2. As economists, our recommendations are based on microeconomic theory, industrial organization and the principles of antitrust and regulatory policy analysis. In our experience, economic regulation – however well-intentioned – is too often used by competitors to protect themselves from the rigors of competition.[1] Hence, our recommendations also incorporate the political realities of the regulatory process, based on our experience as regulators and as consultants in the design and implementation of regulations in energy utilities, transportation and telecommunications. Professor Gilbert has drawn on his experience as the Deputy Assistant Attorney General for Economics in the Antitrust Division of the U.S. Department of Justice from 1993 until May 1995, as well as his extensive experience in the regulation of public utilities. Professor Harris has drawn on his experience in the implementation of the motor carrier and railroad regulatory reforms as Deputy Director of Cost, Economic and Financial Analysis at the Interstate Commerce Commission from 1980-81, and his involvement in the development of price cap plans for local exchange carriers in nine states. Further details of our academic and professional qualifications are provided in our attached vitas.

3. The Second Further Notice of Proposed Rulemaking conveys the impression that the Commission presumes that the benefits of regulations for most interstate telephone services, including new services, outweigh their costs. We think this presumption is incorrect, because the

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1 Because competitors often seek protection from more vigorous competition through the public policy process. antitrust agencies have traditionally been skeptical about bringing enforcement actions based on the premerger claims of the competitors to the companies in question; the courts have become cautious about granting standing to competitors in merger cases. unless there is a clear showing that <u>competition</u> is being. or will be, harmed.

costs of regulation often outweigh their benefits, especially when markets are as dynamic, fast-changing and unpredictable as telecommunications services. These regulatory costs include delays in new services and price changes inherent to the administrative process; inefficiencies caused by holding prices above competitors' or preventing prices from reflecting differences across geographic markets; obtaining and providing information to comply with filing requirements; and the strategic use of regulation by competitors to inhibit the regulated firm from competing effectively in the marketplace.

4. It is evident to us that the costs of the Commission's proposed three-tiered approach to regulating interstate access prices and services substantially outweigh their benefits. Instead, we recommend a two tiered approach. First, immediately eliminate the disparate tariff filing requirements for "dominant" and "non-dominant" carriers and allow all providers to introduce new services or implement price changes for existing price-capped services with one-day notice and no cost support provided existing services remain available to customers. In its recent decision on the dominant status of AT&T, the Commission has recognized that the current distinction has anticompetitive effects. Hence, in Section B, we explain why certain reforms in the regulation of interstate access services should be implemented immediately, without regard to competition. In addition to modifying the tariff rules, we also explain why the Commission should immediately eliminate the Part 69 waiver process.

5. Second, immediately remove new services, including alternative pricing plans, as well as services for which competitive alternatives are available, from all forms of rate or price regulation. As part of our discussion of immediate reforms in Section B, we elaborate on the need for removal of these services from price caps and suggest modifications to the Commission rules to better reflect market forces that impact even those services that remain subject to price caps.

6. Third, remove any other existing services from price cap regulation as soon as customers have competitive alternatives available to them. In Section C, we address the standards for determining when sufficient alternatives exist to remove a service from price cap regulation. We explain why market share is not a reliable basis for such a determination and recommend the use of addressability as a superior indicator of competition. Addressability measures the capacity of competitors to serve customers, which constrains the ability of a local exchange carrier (LEC) to raise price or lower output of that service in a given market area. We also recommend that LECs be allowed to present other kinds of evidence to demonstrate the availability of sufficient actual or potential competitive alternatives to justify removal of a service from price cap regulation.

## B. IMMEDIATE REFORMS OF ACCESS PRICE & SERVICE REGULATION

7. Under both the current rules and the proposal in the Second Further Notice, the tariff filing process is expedited to permit new services to go into effect on one day's notice only when a LEC can show non-dominance. This is directly contrary to economic efficiency and actually reduces competition. Instead, the Commission should take the opportunity to adopt a new regulatory scheme that is based on sound economic principles.

8. In particular, the Commission should adopt measures to promote development and introduction of new access services. These proposed measures will facilitate the deployment of new information technologies, which are transforming business practices[2] and helping American

[2] "...[W]hen you change dramatically how the businesses is conducted you transform the business itself. Changes in information technology are doing just that to every enterprise in the economy." Stan Davis and Bill Davidson, *2020 Vision: Transforming Your Business Today to Succeed in Tomorrow's Economy*. Simon and Schuster: New York, 1991, p. 51.

businesses face one of their toughest challenges: the time compression of product development and the dramatic decreases in the length of product life cycles.[3] To respond to these challenges, enterprise managers have become much more demanding of their suppliers, because "time-based" competition demands timely delivery of existing and new services.[4] The crucial importance of information technologies to business enterprises explains why they are so eager to use new communications services, why they often take the initiative in developing and demanding new communications services, and why the costs of delay of new communications services are so high. Hence, it is not just the regulated LECs that suffer from delays in new service offerings: it is also their customers. In many cases, those customers can and do turn to other suppliers to fill their immediate demands even though other suppliers may not be the most efficient; in others, customers may lack such alternatives to supply by the LEC, which means the cost of delay are all the greater.

9. The Commission's regulation of new services can slow the rate of technological progress by reducing the profitability of new services in the following ways, thereby blunting the incentive for investing in the development and deployment of the technologies that enable the LEC to offer new services in the first place:

- If regulation delays new service offerings, then the revenue streams from those new services are pushed forward, reducing the present value of the service;
- Limitations on pricing flexibility can reduce the sales volumes and profitability of new services;

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3 "...[M]arket and product demands are changing faster than ever... to keep pace with this change, firms are finding that they must be able to build and deliver high-quality, customized goods and services... and get products to market quickly. Boynton, Andrew C., "Achieving dynamic stability through information technology," *California Management Review*, January, 1993, 35(2), p. 58.

4 Mendez, Eduardo G. ; Pearson, John N., "Purchasing's role in product development: the case for time-based strategies," *International Journal of Purchasing and Materials Management*, January, 1994, 30(1), p. 3.

- The cost of complying with regulation reduces the profitability of new services.

Note, therefore, that the relationship between technological change and new services is two directional. It is widely appreciated that new technologies enable firms to provide new services; it is just as true that the revenues from new services enable firms to develop and deploy new technologies. Even short delays in new services can have a considerable negative impact on capital budgeting decisions involving new technologies, by pushing out the revenue stream beyond economic "break-even" and reducing a positive present value to a negative.[5] In the worst cases, delays in new services can eliminate their window of opportunity: being too late to market with a new service is no better than not getting to market at all.[6] Thus, by reforming the regulation of new services, the Commission can make a major contribution to facilitating the development and the adoption of better technologies, ensuring that users will obtain the benefits of innovation, especially lower costs and higher quality goods and services.[7] Moreover, by increasing the number of consumer choices, encouraging new services can further increase consumer welfare by promoting competition.

10. There is no valid argument for retaining a regulatory process that delays new services. So long as they are priced above incremental cost, and existing services remain available to

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5 According to a McKinsey & Company study, in many industries such as telecommunications that are characterized by rapid technological change, a product that is six months late to market will miss out on one-third of the potential profit over the product's lifetime. Mendez, Eduardo G. and Pearson, John N., "Purchasing's role in product development: the case for time-based strategies," *International Journal of Purchasing and Materials Management*, January, 1994, 30(1), p. 3.

6 Indeed, it can be much worse: costs have been incurred and customer relations have been damaged by expectations of new services that are delayed by the regulatory process.

7 The Commission staff report recognized that "access rules must also not impede the introduction of new technologies and services through unnecessary regulatory delay..." Access Reform Task Force, FCC Staff Analysis, *Federal Perspective on Access Charge Reform*, April 30, 1993, p. 29.

customers, new access services increase competition and improve efficiency in all cases. The economic logic for this proposition is straightforward: any new service offering will always make customers better off in the aggregate, provided there is no change in the price and number of existing services, because customers will have more choices with the new service than before. When customers have all of the existing choices as well as the new services, some customers can make themselves better off by choosing the new service. All other customers are no worse off because they can continue to exercise their current choice. *Therefore, we urge the Commission to modify its procedures to eliminate all advance approval requirements, so long as existing services remain available to customers.* If a LEC seeks to eliminate or restructure an existing tariffed service, then the Commission could review the application to see whether customers would be disadvantaged. Note that any delay in the approval of a tariff removal is much less likely to harm customers or competition than a delay in the approval of a new service or pricing plan.

11. Immediate reform of access price and service regulation will increase consumer welfare and promote competition, efficiency, innovation and investment, whether or not LECs face effective competition in access services. In no case are the economic benefits of these reforms contingent upon the existence of competition, much less effective competition. On the contrary, the reforms we advocate will generate substantial benefits even in markets where there are no other providers of interstate access services. When LECs seek to introduce new services under federal jurisdiction they can suffer any or all of three different and cumulative types of delays which their competitors do not experience: (1) costing and tariff preparation delays; (2) Part 69 waiver delays; and (3) typical tariff filing delays of 90 days (45 days notice plus 45 additional days due to third party intervention or Commission investigation). If the Commission implements its

proposed discretionary tracking regime, new services could also face "tracking delays." These delays are costly to LECs, harm the customers who would benefit from earlier availability of new services, and reduce competition in the marketplace. Hence, we offer recommendations for regulatory reforms that will expedite new service offerings, increase pricing flexibility and promote competition.

**1. Eliminate the Part 69 waiver process to reduce delays in new services**

12. To allow customers to realize the enormous potential for new switched access services, the Part 69 waiver requirement should be eliminated immediately. As recognized by Commission staff:

> "There are also technological innovations that may create new LEC services that did not exist when the rules were developed. As stated, although Part 69 prescribes a fixed structure, many new services do not fit neatly into existing Part 69 rate elements."[8]

As a result, waivers must be obtained before new service tariffs can be filed. The Part 69 waiver process, however, delays the introduction of new services to market, increases the uncertainty over when a new service will be allowed in the market and enables competitors to use the regulatory process to create additional delay and exploit it for competitive advantage. In Bell Atlantic's case, for example, the Part 69 Waiver process alone has delayed the introduction of services by as long as a year and a half.[9]

13. There are also significant administrative costs of the Part 69 waiver process, both to the Commission and to LECs. Given the momentous changes occurring in telecommunications, it is

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8 Access Reform Task Force, FCC Staff Analysis, *Federal Perspective on Access Charge Reform*, April 30, 1993, p. 40.

9 Switched Facilities Management Service (18 months and still outstanding), InterLATA Operator Call Completion Service (12 months) and Optional 800 Data base service (11 months).

imperative that the Commission devote its scarce resources where the net benefits are greatest. Likewise, LECs face severe pressures to cut costs to compete effectively, so the compliance costs of obtaining waivers could be put to much more productive uses. Moreover, as the number of new services continues to proliferate, the administrative costs of the waiver process will escalate in the future, unless the process is significantly reformed or eliminated.

14. Eliminating the Part 69 waiver process can also reduce the abuse of the regulatory process by LEC competitors to delay the offering of new services or pricing options to gain artificial competitive advantage. Consider the following example of competitors deliberately delaying new service offerings or pricing options, to the detriment of Bell Atlantic and its customers: In December 1993 Bell Atlantic filed a petition for waiving of Part 69 rules to establish rate elements for InterLATA Operator Services (IOS) to be furnished to small interexchange carriers (IXCs) who lacked the capability to self-supply IOS.[10] Several large IXCs who already provided IOS filed protests, which were later dismissed by the Commission. However, the waiver was not granted until December 1994, a full year later. This gave Bell Atlantic's competitors lead time to develop services and sign long term contracts in anticipation of Bell Atlantic's entry into the market. By the time the tariff was approved, Bell Atlantic lost the opportunity to sign contracts with many potential customers who had already signed with other providers, and those customers lost the opportunity to benefit from the competition that Bell Atlantic would have added for these services. Eliminating the Part 69 waiver process will encourage LEC competitors to compete in the marketplace, by offering new services or better service, rather than in the regulatory arena.

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10 **Specifically, Bell Atlantic was seeking to offer automated and live operator call completion for interLATA collect, calling card and third number calls. Bell Atlantic would perform all functions on these calls including branding, verification, calling card validation and information processing necessary for billing**

15. Moreover, there is no harm to the public interest by eliminating the waiver requirement. As explained below, the Commission still retains the authority to investigate services once they are introduced and take remedial action if warranted. In addition, customers with specific concerns can still obtain relief through the complaint process.

**2. Modify tariff rules to allow changes on one day notice without cost support**

16. The notice periods for tariff filings should be reduced to one day to avoid unnecessary delays in the introduction of new services and service options, and in the offering of alternative pricing plans. Under current rules, tariff effectiveness can be delayed as long as nine months, and then the Commission can still conduct a further investigation for another 15 months.[11] For Bell Atlantic, one third of its tariffs filed in the last year were delayed an average of 45 days due to third party intervention or investigation by the Commission. When this delay is combined with the 45 day notice requirement, the tariff process alone prevents new services from entering the market for three full months on average. By requiring long notification periods before approval of new tariffs filed by LECs, competitors know they will have plenty of time to react to a LEC's lower prices before they actually go into effect, which means they do not need to lower their prices in anticipation of possible price reductions:

> "According to Barbara Sampson, senior vice president and co-founder of Intermedia Communications, a Florida based CAP, 'We are not confronted by <u>the regulatory burden</u> like the telcos and the cable companies,' she said. 'This is a natural competitive advantage.'"[12]

> "Key to the current success of CAPs is the fact that they can be more responsive to customer requests than the average local exchange carrier. 'If a user asks for something

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11 47 U.S.C.§§ 203(b)(1); 204(a)(1); 204(a)(2)(A) & (B).

12 Titch, Stephen, "In a Quest for Growth, Competitors Invade More Telco Markets," *Telephony*, June 28, 1993, p. 6.

off-tariff, the RBOC has to deal with regulatory issues that the CAP doesn't,' says Colleen Beck, managing analyst at Datapro."[13]

17. The Commission has recently concluded that "dominant carrier regulation" inhibited AT&T's ability to offer new services and actually inhibited competition in the market for interexchange services:

> "The cost of dominant carrier regulation of AT&T in this context includes inhibiting AT&T from quickly introducing new services and from quickly responding to new offerings by its rivals. This occurs because of the longer tariff notice requirements imposed on AT&T which allow AT&T's competitors to respond to AT&T tariff filings covering new services and promotions even before AT&T's tariffs become effective. The longer notice requirements imposed on AT&T thus also reduce the incentive for AT&T to initiate price reductions. In addition, to the extent AT&T were to initiate such strategies, AT&T's competitors could use the regulatory process to delay, and consequently, ultimately thwart AT&T's strategies."[14]

These arguments also apply to the regulation of LEC's access services. The Commission should thus be wary of perpetuating regulations that can create a price umbrella which results in higher prices for all customers.

18. Eliminating the artificial advantages of regulatory delays in pricing changes by LECs will directly benefit customers and enhance competition. Similarly, eliminating requirements for unnecessary cost studies in support for new tariff filings by LECs will not allow competitors to use strategically sensitive information to target those customers or market segments where the incumbent LEC is least likely (or, due to cost floors, unable) to respond to their pricing initiatives. The existing complaint process provides the Commission sufficient opportunities to obtain the

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[13] Briere, Daniel and Finn, Christoper, "CAPitalizing on Local Access," *Network World*, September 6, 1993 (emphasis added).

[14] *Motion of AT&T Corp. to be Reclassified as a Non-Dominant Carrier*, Order, FCC 95-427, ¶ 27, Oct. 23, 1995.

information necessary to establish whether the price of a given service passes the incremental cost price floor, thereby deterring discriminatory or predatory pricing of new service offerings, but without delaying the introduction of new services.

19. Our analysis and conclusions about the benefits of reducing new service delays are not limited to a subset of services. Thus there is no need for the proposed division of new services into two regulatory tracks -- one of which would continue to have regulations imposed on it that are unnecessary for any service -- as proposed in the Second Further Notice. Tracking will be a time-consuming process, no matter who makes the decision or the basis on which the tracking decision is made. Disputes over the tracking of a new service will consume scarce resources and delay introduction of new services. In addition, tracking would provide another avenue for opportunistic uses of the regulatory process by competitors who benefit privately from delaying LEC services, raising LECs' costs of regulatory compliance and gaining access to competitively valuable information. Conversely, there are no significant benefits from tracking new services. New services priced above incremental cost can only increase economic welfare. Hence, there is no reason to track new services. The Commission might choose to require specific procedures such as cost study support for mandatory interconnection services. But a limited and well defined exception does not lessen the harm of tracking new services more broadly.

### 3. Do not impose price cap restrictions on new services

20. Just as a new service or alternative pricing plan should not have artificial regulatory barriers delaying its introduction, it should also not have unnecessary regulation once it is introduced. As Professor Alfred Kahn previously explained in an earlier stage of this proceeding,

there is no reason to subject such services to price cap controls.[15] So long as a service is either truly new -- and thus discretionary -- or it functions as an alternative to an existing service that is either competitive or subject to price cap regulation, there is no reason to place pricing restrictions on it. Discretionary services can be rejected by the market and only will be purchased if the price is deemed reasonable by the market. If they are overpriced, consumers will not buy the service and competitive entry of lower priced providers will be spurred. Alternative pricing plans will only be found attractive by potential customers if they meet a specific need that the original service did not. Thus, the success or failure of these services will be market-driven. In that situation, price caps are an unnecessary regulatory constraint that cause affirmative harm and should yield to market-based pricing.[16]

**4. Remove unnecessary restrictions on downward pricing flexibility**

21. For those services remaining in price caps, the only restriction in downward pricing flexibility that serves a valid public policy purpose is a price floor based on incremental cost to protect against anticompetitive pricing. There are no pro-competitive benefits of other restrictions on downward pricing flexibility. Any additional limitations on downward pricing flexibility harm customers, by keeping prices higher. Preventing a LEC from raising a price after it was lowered simply discourages price reductions, thereby harming customers. Given the complexity and rate of change in telecom markets, carriers need to be able to move prices down

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[15] Affidavit of Alfred E. Kahn, ¶¶ 30-32, filed as an attachment to Reply Comments of Bell Atlantic, *Price Cap Performance Review for Local Exchange Carriers*, CC Docket 94-1, June 29, 1994.

[16] As with the modification to the tariff rules, a narrow exception may be necessary for mandatory interconnection services.