General Services Administration
Office of General Counsel
Washington, DC 20405

January 12, 1996

DOCKET FILE COPY ORIGINAL

Mr. William F. Caton
Acting Secretary
Federal Communications Commission
1919 M Street, N.W., Room 222
Washington, D.C. 20554

Subject: 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. 93-127.

Dear Mr. Caton:

Enclosed please find the original and nine copies of the General Services Administration's Reply Comments for filing in the above-referenced proceeding. Copies of this filing have been served on all interested parties.

Sincerely,

Jody B. Burton

Jody B. Burton
Assistant General Counsel
Personal Property Division

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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 Video Operator Services Under Price Cap Regulation	CC Docket No. 93-124
Revisions to Price Cap Rules for AT&T	CC Docket No. 93-197

REPLY COMMENTS OF THE GENERAL SERVICES ADMINISTRATION

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January 12, 1996

SUMMARY

The market for interstate access services is neither as competitive as the LECs claim nor as monopolized as the IXCs, CAPs and Cable Parties contend. Only a minuscule proportion of end-users can be served by multiple, competing access providers, but those end-users tend to be large business, institutional and government consumers of high-volume telecommunications services. The LECs must be allowed to compete for the access services to these entities.

While GSA is sympathetic to the concerns of the IXCs, CAPs and Cable Parties regarding the incentives and the power of the LECs to use pricing flexibility to retain their dominant market position, it does not believe that the Level 1 pricing flexibility proposals in the Commission's Notice pose a sufficient threat to competition to offset their benefits. GSA concurs with the LECs that regulation should not discourage the introduction of new services, pricing elements, and pricing plans designed to meet specific customers' needs.

GSA also agrees with the LECs that the present limitations on ICB arrangements and contract pricing are overly restrictive. Permanent ICB arrangements can be allowed without the new services test for pure price cap carriers so long as those carriers do not later opt for one of the earnings sharing alternatives of the price cap plan.

Federal Government agencies are under statutory mandate to

acquire their telecommunications services through competitive bidding procedures whenever possible. Since contracts are the vehicle for these competitive procurements, the LECs must be allowed to enter into contracts if they are to respond to Government RFPs. GSA therefore supports the observation of several LECs that prices submitted in response to RFPs for which there have been multiple responsive bids qualify as competitive. GSA specifically recommends that such contracts be subject to streamlined regulation.

Finally, GSA agrees with the IXCs that ICBs and contract services between LECs and affiliated entities could be a source of anti-competitive abuse. Such arrangements should therefore be regarded as highly suspect and subjected to close Commission scrutiny.

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REPLY COMMENTS OF THE GENERAL SERVICES ADMINISTRATION

The General Services Administrations ("GSA"), on behalf of all Federal Executive Agencies, submits these Reply Comments in response to the Commission's Second 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. 93-137 ("Notice"), released September 20, 1995.

I. Introduction

In preparing these Reply Comments, GSA reviewed the initial comments of:

- Ten Local Exchange Carriers ("LECs") and the United States

Telephone Association ("USTA");

- Five Interexchange Carriers ("IXCs") and the Competitive Telecommunications Association ("CompTel");
- Four Competitive Access Providers ("CAPs") and the Association for Local Telecommunications Services ("ALTS");
- Three cable TV parties ("Cable Parties");
- The Telecommunications Resellers Association ("Resellers");
- The Ad Hoc Telecommunications Users Group ("Ad Hoc"); and
- The Information Technology and Telecommunications Association ("TCA").

In light of the bulk of these comments, GSA cannot respond to every point of interest made by each party. Nor is it possible to describe the collective opinions of each group of commentators -- the LECs or the IXCs, for example -- in a manner that captures the variations in emphasis and tone within the group. What follows is GSA's reaction to the general positions of the various interest groups, illustrated with citations to opinions expressed by individual parties within the groups. GSA recognizes that the groups are not always unanimous in the opinions ascribed to them.

II. The Market For Interstate Access Services Is Neither As Competitive As the LECs Claim Nor As Monopolized As the IXCs, CAPs and Cable Parties Contend.

Like the fable of the blind men attempting to describe an elephant, the opposing parties' views of the competitiveness of the interstate access market are so different that one might wonder whether they are examining the same animal.

Bell Atlantic, for example, opens with a section titled, "The

Revolution Is Here," in which it asserts the immediacy of access competition:

> At the same time, the pace of competition has accelerated. As Bell Atlantic and others demonstrated in prior filings in the price cap review docket, LECs face competition in every major market area in the country. This is particularly true in concentrated areas such as those served by Bell Atlantic. While competition has continued to expand in the interim, the competitive terrain for interstate access services -- the relevant markets for Commission consideration -- has fundamentally altered in the short time since those comments were filed.[1]

Bell Atlantic goes on to describe AT&T's "declaration of competitive war" and the efforts of MCI and Sprint to invade the markets for subscriber access. Bell Atlantic concludes that this competition renders obsolete the Commission's distinction between dominant and non-dominant carriers.[2]

At the other extreme are the IXCs, the CAPS and the Cable Parties, who argue that there is virtually no access competition whatever. As Time Warner states:

> The framework and structure of the NPRM appears premised upon the presumption that the LECs currently face significant competitive challenges in the marketplace and that these challenges necessitate immediate modifications to the price cap regime. This presumption is not supported by actual marketplace conditions. The LECs' market power remains virtually unfettered today and they continue to be the dominant force in the local exchange market.[3]

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[1]Bell Atlantic Comments at 4 (footnotes deleted).

[2]Id. at 5, 6.

[3]Comments of Time Warner Communications Holdings, Inc. ("Time Warner"), at 6 (footnote deleted).

AT&T examines each of the sources of competition to the LECs and finds it inadequate. According to AT&T, the CAPS' competition is "embryonic and scattered," wireless and cable telephony are "incapable of providing a viable alternative to the LECs' monopoly landline networks," and the Commission's expanded interconnection initiatives are limited to transport services and do not address other components of access. AT&T quotes from a recent study which concluded that "little if any competition has emerged in...the local exchange and access markets," and that competitive entry is "unlikely to be sufficient to eliminate or even significantly reduce the control of essential facilities by the [LECs]."[4]

GSA believes that the truth lies somewhere between these extremes. The IXCs, CAPs and Cable Parties are correct that the LECs hold, and will continue to hold, a monopoly position over access to the overwhelming majority of telephone subscribers. The penetration of the access market by the CAPS is indeed minuscule, and that by the cable TV industry is currently non-existent.

But the small proportion of customers for which there is access competition is misleading. Studies by the LECs have demonstrated that the CAPs have consistently targeted large, high-volume business, institutional and governmental customers whose collective calling volume represents a much greater percentage of

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[4]Comments of AT&T Corp. ("AT&T") at 4, 5.

the market than their proportion of total subscribers.[5] These customers are able to acquire interstate access services from two or more alternative providers, and they buy according to the prices charged.

The LECs must be allowed to compete for these customers' requirements. To do so, the LECs need the greater pricing flexibility proposed in the Notice. Indeed, with respect to contract services, the LECs require more flexibility than recommended in the Notice.

III. Most of the Level 1 Pricing Flexibility Proposals Should Be Adopted Without Regard to the Level of Competition.

The Notice proposes three levels of relaxed regulation. Level 1 refers to flexibility provisions that could be implemented immediately for LECs subject to the current price cap restraints. Level 2 refers to the "streamlining" of regulation for certain services or markets for which there is demonstrable competition. Level 3 refers to the designation of a carrier as "nondominant."

In its Notice, the Commission initially suggested that the Level 1 provisions might be appropriate without regard to the degree of competition.[6] Later, it suggested that the granting of this pricing flexibility might be made contingent on the LECs'

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[5]See, e.g., "Competition for Local Telephone Service - Seattle," by US West Communications, Inc., Washington Utilities and Transportation Commission Docket No. UT-941464, Exhibit 14.

[6]Notice, ¶ 34.

demonstrating threshold movement toward local service competition.[7] In its initial comments, GSA supported the proposition that, with the exception of consolidating service categories, the Level 1 pricing flexibility provisions should be adopted without regard to the extent of competition.[8]

Unanimously, the LECs support the Commission's Level 1 pricing flexibility proposals without regard to the level of competition.[9] Almost unanimously, the CAPS, IXCs and Cable Parties oppose any added pricing flexibility without a clear demonstration that competition is effectively controlling the pricing power of the LECs. Indeed, most of these parties regard that the entire thrust of the Notice is misguided because it does not focus on the conditions required to create effective competition. In their view, any added flexibility whatever will be used by the LECs to discriminate against their incipient competitors.[10]

GSA is sympathetic to the concerns of the IXCs, CAPs and Cable Parties with respect to both the incentives and the power of the LECs to use any opportunity to retain their dominant market

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[7]Notice, ¶ 106.

[8]Comments of GSA at 4, 5.

[9]Comments of NYNEX at 14; Pacific Bell at 32; Cincinnati Bell at 12; Southwestern Bell at 9; Southern New England Telephone at 16; US West at 6; GTE at 35; Ameritech at 22; Bell Atlantic at 6 et.seq., BellSouth at 40; USTA at 10.

[10]Comments of AT&T at 2 et.seq.; CompTel at 5; LDDS at 1 et.seq.; MCI at 4; Sprint Telecommunications Venture ("STV") at 5; ALTS at 2 et.seq.

position. However, the specific proposals in the Notice are sufficiently modest that they should not foreclose competition from developing. Indeed, their very modesty is roundly denounced by several of the LECs.[11]

In GSA's view, the benefits of the proposed Level 1 changes outstrip the dangers. Of particular concern to GSA is the likelihood that the present rules may inhibit the offering of new services, rate elements, and pricing plans. The proposed rules address this problem by establishing a two-track standard for the review of new services, with competitively sensitive services retaining the present filing requirements and evidentiary test, and new services designed to respond to specific customer needs subject to reduced notice and cost support requirements.[12]

GSA acknowledges Ad Hoc's objection that there is no "bright line" between the services subject to Track 1 and Track 2,[13] but the alternative, which is the across-the-board retention of 45 days' notice and the burdensome "new services" test, would certainly slow the development of new services and could forestall some of them altogether.

Similarly, it is possible that alternative pricing plans might

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[11]See, e.g., Bell Atlantic at 1 et.seq., Pacific Bell at 5.

[12]Notice, ¶ 47.

[13]Comments of Ad Hoc at 7.

be a source of unreasonable discrimination, as the IXCs fear,[14] but their continued treatment as "new services," or as waivers from Part 69, as MCI proposes,[15] would render infeasible the offering of plans targeted for limited, but legitimately low-cost customer applications. Given the delays, paperwork, legal obstacles and data generation involved in the present new services application procedure, the LECs would likely think twice before offering any new service, rate element, or pricing plan that did not deliver a major market impact. The LECs would not be able to respond to the specialized needs of individual customers or limited groups of customers. Those "niche" markets would become the exclusive preserve of the CAPs, an expectation that may have motivated their objections to the Commission's proposals.

Another inhibition to the offering of new services is the requirement that a LEC must obtain a waiver from Part 69 rules to provide a new switched service. The Notice proposes that LECs only file a petition demonstrating that the new service is in the public interest. If the new service is approved, all other LECs may file "me too" filings for the same service that would be presumptively acceptable.[16]

Several of the non-LEC parties objected to this provision on

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[14]See, e.g. Comments of AT&T at 28.

[15]MCI at 13.

[16]Notice, ¶ 71.

the grounds that revisions of Part 69 are to be considered in a separate, comprehensive review of the access charge mechanism.[17] Some of these parties also advocate retention of the present waiver procedure for the very reason that it represents a substantial procedural obstacle to implementing new services.[18]

GSA questions the value of requiring the LECs to jump through procedural hoops simply because the established rules are too rigid to accommodate the introduction of new services. When Part 69 was established, switched access service was a fairly straightforward matter, involving only standard, voice-grade lines. As technology provides the ability to switch signals of varying bit rates and bandwidths, the expectation that all switched access services can be fitted into a preconceived mold becomes increasingly outdated. Neither the LECs nor the Commission should be burdened with the requirement to wade through the lengthy and tedious rule waiver process every time a new switched service is developed.

IV. The Rules Governing Individual Case Basis Contracts Between Unaffiliated Parties Should Be Relaxed.

The Notice reaffirmed the Commission's prior position that an Individual Case Basis ("ICB") arrangement must not have been provided previously, must not be "like" any other service, and must

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[17]See, e.g., Comments of National Cable Television Association ("NCTA") at 27; AT&T at 34.

[18]See, e.g., Comments of AT&T at 37.

be used only as an interim measure.[19] The Notice proposed that if two or more customers use the service for more than six months, the LEC would be required to develop an average rate, and the arrangement would be treated as a new service.[20]

On the related issue of contract carriage, the Notice proposed that LECs be permitted to offer contract rates for access services subject to substantial competition and streamlined regulation, provided such rates are made available to similarly situated customers.[21]

A. The LECs Are Correct That the Present ICB Limitations Are Overly Restrictive.

In its Comments, GSA recommended that ICB rates be allowed without time limits and, for price cap carriers, without a new services test.[22] While most of the non-LEC parties echoed the Commission's ICB policies, GSA found support among the LECs. Southwestern Bell, for example, supported the use of ICBs, particularly in response to Requests for Proposal ("RFPs"):

> ICB and contract-type (individualized) pricing should be allowed in response to any RFP issued to the incumbent LEC by another provider, regardless of competitive classification of the market. Thus, individualized pricing in response to RFPs should be an integral part of

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[19]Notice, ¶ 64.

[20]Id., ¶ 65.

[21]Id., ¶ 148.

[22]Comments of GSA at 8-11.

> the "baseline" regulation. The fact that RFPs are requested demonstrates that competition is present, regardless of the regulatory classification of the LEC market. The use of individualized pricing can be an important tool for fostering economic efficiency, for meeting the needs of LEC customers in a time of increasing competition, and in recovering the overheads of the LECs, but it must be allowed on a fair and equal basis. Such pricing is consistent with the Commission's objective to encourage efficient prices. Competitive entry into LEC markets makes tariffs based on average costs an ineffective and economically inefficient method of pricing. Individualized pricing allows LECs to engage in legitimate responses to meet customers' needs via pricing in the same manner as their competitors.[23]

While GSA agrees with these statements, it is concerned that Southwestern Bell has confused two issues, individualized pricing in the absence of competition, and contract pricing in the presence of competition. Southwestern Bell's remarks concerning the economic efficiency of individualized pricing to meet specific customer needs are relevant quite regardless of the presence or absence of competition. Carriers should not be discouraged by burdensome regulations from responding to the specific needs of individual customers. That is why GSA urges the Commission to allow ICB arrangements on a permanent basis, and if the carrier is on "pure" price caps, without a new services test.

Dr. Leland Johnson, whose declaration is attached to the Comments of NCTA, is correct that price caps do not fully insulate pricing from considerations of cross-subsidization. A "pure" price cap carrier can always reestablish the link between price and

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[23]Comments of Southwestern Bell at 25.

allowed return by opting for one of the alternatives that allow a lower "X" factor in return for earnings sharing. Such a carrier could use below-cost ICB arrangements to depress earnings, thereby accessing a lower "X" factor and avoiding the sharing of otherwise excess earnings.[24] That is why GSA recommends that the ICB arrangements of any carrier moving from pure price caps to one of the earnings sharing alternatives be subject immediately to the new services test.

Dr. Johnson is also correct that there could be a cross-subsidy provided by intrastate services to interstate services as a result of misallocations of costs through the separations procedures.[25] This issue is particularly relevant for interstate services that use a large amount of plant in common with intrastate services, such as, for example, video dialtone systems. ICB arrangements, however, usually involve discrete equipment and facilities devoted to the specific customer. For such arrangements, therefore, the danger of jurisdictional cross-subsidies is substantially mitigated.

B. The LECs Are Correct That Contract Services Should Be Permitted When They Are Awarded In Response To Competitive RFPs.

Southwestern Bell is also correct that the RFP process means that the LEC is encountering competition to which it must be

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[24]Declaration of Leland L. Johnson, attached to the Comments of NCTA, page 3.

[25]Id., page 13.

allowed to respond. The case for allowing contract service in response to RFPs is made persuasively by USTA:

> Allowing contract carriage in response to a RFP as part of baseline regulation would provide substantial consumer benefit. Currently, exchange carriers are precluded from offering interstate services pursuant to a contract-based price. Exchange carrier competitors can simply price their services at a lower rate than the exchange carrier's tariffed rate. As a result, customers do not receive competitive prices. Introduction of contract-based pricing would rectify this problem and provide additional consumer benefits. First, because contract offerings are customer specific arrangements, they can be tailored to meet specific needs. Second, because contract services are not based on averaged costs, but rather on specific costs, exchange carriers are better able to reflect cost. Third, knowledge that an exchange carrier can effectively bid on a service will incent other carriers to make their best offers. Thus, a more truly competitive environment can be realized and customers can receive lower prices, higher quality and better service.[26]

USTA further points out that the competitive nature of RFPs ensures a market driven price. To ensure this effect, USTA makes the same proposal as GSA, which is that the Commission require that at least one other party make a responsive bid for the contract service in question.[27]

C. ICB Contracts With LEC Affiliates Could Be a Source Of Competitive Abuse.

Several IXCs express concern that the greater pricing flexibility proposed in the Notice could be used by the LECs to

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[26]Comments of USTA at 27.

[27]Id. at 28.

provide favorable treatment to the new long-distance affiliates that may be established if the current prohibitions of the 1982 Modifications of Final Judgement ("MFJ")[28] are lifted.[29] There is no denying that ICB contracts could contribute to this abuse. Specifically, it would not be difficult for a LEC to describe the integration of its interexchange trunking system into its local network as an ICB arrangement and to write a contract with its affiliated long-distance provider for a very favorable rate.

In view of the fact that the MFJ prohibitions are still in effect, this concern is arguably premature. However, the Commission may wish to anticipate this problem by requiring that any ICB arrangements between affiliated entities be subject to the new services test. Further, if the ICB involves any substantial cost, it should be presumptively suspect and be set for Common Carrier Bureau investigation. The carriers should not be allowed to use the freedom to provide ICB contract services to engage in discriminatory self-dealing.

V. Level 2 Steamlined Regulation Should Be Based on Three Market Dimensions: Service, Geography and Customer.

Beginning at paragraph 116 of the Notice, the Commission discusses the relevant market definitions that might be used in

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[28] United States v. American Tel. and Tel. Co., 552 F. Supp. 131 (D.D.C. 1982).

[29] Comments of CompTel at 14, 15; LDDS Worldcom at 20, 21.

evaluating competitiveness for purposes of relaxing regulation. The location of this discussion in the Notice implies that it is principally relevant in determining whether the Level 1 pricing flexibility proposals should be adopted. As noted earlier in these Reply Comments, however, GSA believes that most of the Level 1 pricing flexibility proposals should be adopted without regard to the degree of competition.

Market definition, however, is still quite relevant in determining whether to grant streamlined regulation such as that which was conveyed on AT&T. In its initial Comments, GSA supported the Commission's apparent intention to employ the AT&T model, using demand responsiveness, supply responsiveness, market share and the relationship of service prices to price caps as factors for determining competitiveness.[30] In the case of AT&T, these factors applied only to one dimension: services, or to use the Commission's term, "product markets." AT&T's interstate services were ubiquitous, so geography had little relevance. No other dimension appeared important.

In the case of LECs, product markets continue to be relevant. It is widely recognized, for example, that special access is much more competitive than switched access. Moreover, geography is important, as noted by the Commission at paragraph 120 of the Notice. The Commission proposes to recognize density zones as

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[30]Comments of GSA at 13, 14.

relevant determinants of both cost and competitiveness. That is because competition can be expected to develop in the higher density, more urbanized areas long before it will be seen in suburban, exurban and rural regions.

GSA commends to the Commission a third market dimension, discussed in the Comments of USTA, that of the customer. USTA points out that high-volume end-user locations are likely to have substantially greater access to alternative providers than low-volume locations. That is because a high-volume user can separate interexchange traffic from local traffic and acquire access services for the former from a different vendor than the LEC. That vendor may be a CAP or the IXC itself. Moreover, high-volume locations are most likely to be targeted by local service competitors, who will also provide interstate access service as part of their service package.[31]

The Federal Government operates from many locations that fit USTA's description of high-volume locations. As USTA describes, these locations are increasingly accessible to access providers other than the serving LEC. Federal agencies generally acquire telecommunications services through competitive procurements whenever possible. This means that if a Federal agency location can be served by multiple access providers, the agency will acquire the service from the vendor providing the lowest cost service

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[31]Comments of USTA at 44-47.

consistent with the Governments service quality requirements.

The Commission's present regulations impose severe handicaps on LECs seeking to respond to the government's desire to acquire services in a competitive environment. They are forbidden from engaging in contract service, even though contracts are the medium through which the Government usually acquires services. They are required to provide cost and revenue information which is both burdensome and competitively sensitive. Indeed, it is possible that the only way a LEC can provide services in a competitive environment is to be declared subject to streamlined regulation.

It is clearly infeasible for the Commission to conduct an investigation into the demand responsiveness, supply responsiveness, market share and price cap relationship of the services that a LEC might provide a Federal agency in response to an acquisition in a competitive environment. Even if those measures were relevant to the services at issue, it would be impossible to consider them within the procurement schedule likely to be established by the acquiring agency.

That is why GSA recommends that LEC services provided in a competitive environment for which there is at least one other viable vendor be declared subject to streamlined regulation. GSA submits that the procurement process itself is sufficient demonstration of the adequacy of competition. No further investigation is required.

VI. Conclusion

The General Services Administration, on behalf of all Federal Executive Agencies, urges the Commission to consider carefully the arguments presented in these Reply Comments and to implement the recommendations made therein.

Respectfully submitted,

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January 12, 1996

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