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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
	)	

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REPLY COMMENTS OF SOUTHWESTERN BELL TELEPHONE COMPANY

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Reply Comments of
Southwestern Bell Telephone Company

CC Docket No. 94-1
CC Docket No. 93-124
CC Docket No. 93-197

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SUMMARY*

This round of comments has turned out to be a battle in the regulatory arena between the LECs and their competitors. The LECs' competitors unearth every argument they believe might convince the Commission to impose additional delay before making any changes to baseline price cap regulation. They find even more outrageous reasons to have the Commission handicap LEC requests for streamlined and nondominant treatment after competition is shown.

The Commission should reject the positioning by the LECs' competitors and return to the basic purpose of this docket -- meaningful price cap reform to benefit consumers. Handicapping LECs produces no meaningful benefit to consumers and only gives the LECs' competitors comfort while they continue to build their businesses. The goal of the Commission should be not to give such comfort (or as one competitor puts it, "stability") to any participant in the competitive marketplace that exists today for access services.

Many of the specific changes to price cap regulation suggested by the LECs' competitors would serve no useful purpose other than to give comfort to the suggesting party. For example, ALTS argues that no additional downward pricing flexibility should be granted to the LECs (even though the status quo provides the ALTS members with a price umbrella), utilizing unfounded claims of "predatory pricing." The Commission must reject this and other similar claims from the LECs' competitors for "protection," and instead adopt the meaningful reforms proposed by SWBT.

* All abbreviations used herein are referenced within the text.

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REPLY COMMENTS OF
SOUTHWESTERN BELL TELEPHONE COMPANY

Southwestern Bell Telephone Company (SWBT), pursuant to the Second Further Notice of Proposed Rulemaking (Second FNPRM),[1] hereby files its Reply Comments. SWBT replies to the Comments filed by the other parties to the proceedings.[2]

I. THE OPPONENTS OF LEC PRICING FLEXIBILITY ARE USING REGULATION TO THWART COMPETITION.

The Commission should recognize the record in this proceeding for what it essentially is -- a battle in the regulatory arena by two distinct factions, the local exchange carriers (LECs) and the LECs' competitors. Virtually all of the opposition to positions taken

[1] Price Cap Performance Review for Local Exchange Carriers, Second Further Notice of Proposed Rulemaking in CC Docket No. 94-1, Further Notice of Proposed Rulemaking in CC Docket No. 93-124, and Second Further Notice Of Proposed Rulemaking in CC Docket No. 93-197, FCC 95-393 (rel. Sept. 20, 1995). (Second FNPRM).

[2] Parties filing Comments are listed in Attachment 1.

by SWBT in this proceeding comes from the LECs' competitors.[3] The LECs' competitors are opposed to the pricing, notice period and other regulatory flexibility modifications that are required for the LECs to more fairly compete.

The LECs' current and future competitors include the competitive access providers (CAPs), cable providers, wireless providers and interexchange carriers (IXCs). The CAPs currently compete directly with the LECs. The cable providers are currently operating directly as CAPs, are partnering with CAPs, and are providing telephony over cable networks or have announced their plan to compete directly with the LECs over cable in the near future.[4] IXCs are operating as CAPs, are partnering with CAPs and/or wireless providers, and are self-provisioning access, all in direct competition with the LECs.[5] Each of these parties financially benefits from delays in needed regulatory reforms as the existing regulatory processes hamstring the LECs' ability to compete on the merits for telecommunications business.

A. LECs' Competitors Propose Unnecessary Delays.

The LECs' competitors propose tactical delays more numerous than monuments in Washington, D.C. Some suggest that the Commission complete comprehensive access reform

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[3] Other than the LECs and the LECs' competitors, very few other parties filed Comments.

[4] For example, Cox, not a newcomer to telephony competition issues, describes its many telephony business interests, including wireless and CAP operations. Cox, pp. 1-2. Comcast, in addition to cable operations, has wireless and competitive access operations in competition with incumbent LECs. Comcast, p. 1.

[5] Because of their business interests in operating as CAPs, and/or partnering with CAPs, cable and/or wireless providers, the regulatory objectives of the IXCs reach far beyond the dynamics explained by the customer/supplier relationship. IXCs, as customers of the LECs stand to receive immediate and substantial benefits from LEC pricing flexibility. Their opposition to LEC pricing flexibility demonstrates that they see their primary long-term identity as LEC competitors.

before it considers adopting an appropriate long-term price cap plan or streamlined regulation.[6] Many of the LECs' competitors suggest that the LECs not be allowed any increased pricing flexibility until access markets (and some suggest all LEC markets) are demonstrated to be fully competitive. Some ask that the Commission first require all price cap service prices to be reset to remove all contribution to overhead before the LECs are allowed pricing flexibility.[7] Others suggest that the Commission wait until the completion of a broad universal service proceeding(s).[8] Some recommend the Commission proceed initially to determine the extent of competition in various access and local exchange markets, or how to measure the degree of competition in these markets, before and without any consideration of the proper form of regulatory relief that should accompany such a competitive showing.[9] Others suggest examination of structural separations and imputation rules.[10] Some want lengthy advance notice of LECs' proposed actions, and periods of monitoring a LEC's actions before a LEC is allowed any relaxed regulatory treatment.[11] Some wish to have the Commission subsequently review

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[6] AT&T, p. 8; LDDS, p. 32; CompTel, pp. 18-19, 23.

[7] MCI, pp. 8-11. See, Comcast, pp. 9-12, recommending first the elimination of all "regulatory subsidies," including the Interconnection Charge (IC).

[8] See, e.g., LDDS, p. 3;

[9] See, e.g., Comcast, pp. 3-4; Time Warner, p. 3. Interestingly, in the comments on the Common Carrier Bureau competition measurement proceeding (CCB-IAD 95-110, filed December 11, 1995), these same competitors of the LECs oppose providing the information about their own operations that is necessary to make accurate assessments of access competition.

[10] LDDS, pp. 28-30. "Reduced regulation of LEC pricing should not be discussed unless the LEC first makes available a wholesale network platform at cost-based rates for use by other providers in developing their own retail services." LDDS, p. 33.

[11] Time Warner, pp. ii, 8-9.

the market success of the LECs' competitors and add additional preconditions to LEC flexibilities at later dates.[12]

These pleadings are all flawed. The LECs' competitors imply that they favor pricing flexibility for the LECs in some way but not in the foreseeable future.[13] The Commission should instead recognize that as long as the LECs are allowed to compete only in the regulatory arena and not in the marketplace, the real benefits that true competition on its merits can bring to customers will not be realized.[14]

B. The LECs' Competitors Try To Minimize The Extent of Existing Competition.

Competitors of the LECs generally claim that existing competition is minuscule.[15] These filings, however, unduly minimize the existing competition.

The LECs' competitors drastically understate the degree of competition for access services. Such understatements are intended to delay needed reform. SWBT, USTA and other LECs have presented extensive evidence that the increase in the degree of competition in access markets has been very rapid and that the extent of competition is substantial. While it is true that significant competition does not now exist for all of SWBT's access services in all of its geographic markets, the existence of significant competition in major segments of major geographic markets in SWBT's territory is incontrovertible and has been well documented on

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[12] Time Warner, fn. 31.

[13] See, e.g., AT&T, pp. 19-22; CompTel, fn. 12; MCI, pp. 33, 36; Time Warner, pp. 4, 9.

[14] Consumers are not represented by the IXCs, the CAPs, the cable providers, or the wireless providers in this proceeding. GSA, which is a telecommunications user without a direct interest as a telecommunications provider, comes closer to articulating the consumer interests in this proceeding.

[15] See, e.g., CCTA, pp. 13-19; TCG, pp. 2-7.

the record in this proceeding.[16] Contrary to the assertions of LECs' competitors, there is a chronic need for immediate modifications to the existing price cap and related rules.

Examples of significant competition in LEC access markets abound. For example, ICG states that it operates competitive access networks serving over 32 markets, that it now serves Tier II and Tier III markets (cities with population between 250,000 and 2,000,000) and, that it has installed 13 high capacity digital switches throughout its networks that enable ICG to offer transport and switched access services.[17] Thus, the claims by some that competition is limited to transport services are false.

The gaming of the regulatory process by the LECs' competitors is also evidenced by their misuse of data on the extent of competition in access markets. The LECs' competitors often use seriously dated statistics and carefully-worded obfuscations to minimize the extent of competition.[18] They incorrectly focus on market share data, which has been widely rejected

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[16] See, e.g., SWBT, pp. 2-3, Attachment A; SWBT Comments, filed May 9, 1994, pp. 7-11, Appendix COMP; SWBT Reply Comments, filed June 29, 1994, pp. 3-14; and numerous ex parte communications filed by SWBT that describe access competition in the Houston area as an example.

[17] ICG, p. 1.

[18] See, e.g., the TCG representation that "71% of TCG's local switched services revenues are currently paid to NYNEX," (TCG, p.3); Sprint's representation that in LATA 132, "NYNEX receives 96% of Sprint's access dollars, either directly or via CAPs," (Sprint, p. 25). and TRA's statement that "CAP facilities, where available, are still used principally for redundancy." (TRA, p. 8).

as a measure of market power.[19] The Commission should reject the attempts of the LECs' competitors' to seriously misapply data and concepts to achieve their regulatory objectives.

LEC competitors cite market share statistics to claim that tight regulation of price cap LECs is still needed. By citing these statistics out of context, the competitors of the price cap LECs hope to maintain an artificial regulatory advantage over the price cap LECs. The Commission should reject such attempts to maintain unfair competitive advantages and recognize that, at a minimum, the marketplace has changed a great deal even from the outset of this docket.[20] Given the magnitude of these changes in such a short amount of time, SWBT's proposals for baseline modifications should be adopted immediately.[21]

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[19] SWBT, pp. 64-67; USTA, pp. 53-55, Attachment 1, "Pricing Flexibility for Interstate Carrier Access Services," by Richard Schmalensee and William Taylor, pp. 23-26. If market shares are to be useful at all, they should be based on measures of supply capacity, not on revenues. As an example of an incorrect focus on revenue market share, Comcast suggests that the Commission match "the degree of regulation with the relative market share of the incumbent LECs for purposes of determining the level of regulation that should be applied to them." Comcast, p. 6.

[20] See, e.g., SWBT, pp. 2-3, USTA, pp. 4-7.

[21] Under NYNEX's proposed plan, movement to streamlined regulation would require documentation that the incumbent LEC has lost 15% market share. Thus, the NYNEX plan would utilize regulation as a means to impede one service provider until a threshold amount of market share has been transferred to other market providers, regardless of consumer benefits or economic efficiency. Regulation of this type directly damages certain service providers while assisting others with no consideration as of the consequences to the public interest. SWBT's proposal is not predicated on market share loss. Market share is a backward looking indicator that provides no insight on the extent to which customers have alternative supply or the extent to which suppliers lack market power. A measure of alternative supply provides the best indicator as to the market's ability to constrain prices. SWBT supports utilizing availability of alternate supply as the appropriate indicator of market competitiveness.

II. THE BASELINE MODIFICATIONS PROPOSED BY SWBT MUST BE ADOPTED IMMEDIATELY.

A. Baseline Price Cap Reforms Should Not Be Predicated on Competitive Showings.

Significant and important changes in the baseline price cap plan must be made now. None of the improvements that SWBT recommends for the baseline price cap plan should be contingent on specific competitive showings.

Instead of the delays requested by the LECs' competitors, SWBT's proposed baseline modifications should be adopted immediately to address the changes that have already occurred within the interstate access marketplace. These changes do not just respond to competition, but provide benefits to consumers even in the absence of competition. SWBT's Comments have fully explained the needed changes and the reasons for moving quickly. As further explained below, none of the alleged harm to the public interest will occur from either the Commission's proposed modifications or those provided by SWBT. Just as the Commission has determined that benefits to consumers will result from reclassifying AT&T as a nondominant carrier, the Commission should be consistent in determining that relaxing regulation for price cap LECs will result in similar benefits.

The Federal government's purchasing administration correctly recognizes that most of the proposals for relaxed regulation and pricing flexibility are justified without regard to the extent of competition.[22] Granting pricing flexibility at the outset, before the relevant market has been certified "competitive," encourages efficient entry and ensures that the growth of competition benefits the users of telecommunications services, and not just the new entrants

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[22] GSA, p. 4. "The particular changes proposed by the Commission are valuable even when there is no weakening of the LECs' pricing power." GSA, p. 12.

(the LECs' competitors).[23] Customers are still protected from so-called "monopoly" prices as a result of the price caps imposed on LEC services. Thus, the creation of tests to measure the advancement of competition unnecessarily complicates the regulatory process and dilutes the needed changes to the price cap plan that are fully justifiable independent of the need for any further tests.

Some of the LECs' competitors clearly admit that a significant number of the Commission's proposals are largely unrelated to changes taking place in the competitive landscape.[24] Improvements in the baseline price cap plan can and should proceed absent any requirement for specific competitive showings.

Many of the LECs' competitors predicate their opposition to improvements in the LEC price cap plan on the lack of competition in access markets. Ironically, the increase in the number and types of competitors filing positions in direct opposition to those of the LECs is itself potent evidence of the growth and intensity of competition. The recommendations of the LECs' competitors hinge on their claimed lack of competition. Yet, their supposed evidence, that access competition does not exist, has been eroded, rendering their recommendations inappropriate.

For example, AT&T suggests that price cap reforms should not be adopted because the LECs face virtually no access competition.[25] Because access competition has been

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[23] Second FNPRM, para. 83; GSA, pp. 5-6.

[24] Time Warner, p. 1.

[25] AT&T suggests that reforms may be appropriate "if competition develops." AT&T incorrectly claims that "there is no meaningful facilities-based competition in access or local exchange markets, nor is effective competition likely to develop any time soon." AT&T, p. 48.

(continued...)

shown to exist, AT&T's rationale for opposing the needed improvements in the basic price cap plan is groundless.

B. Increased Baseline Pricing Flexibility Will Encourage Real Competition To Develop.

Cox incorrectly claims that increases in LEC pricing flexibility would give the LECs the ability to drive all competitors from the market permanently.[26] On the contrary, increases in pricing flexibility will not prevent competition, but will enhance it. Moreover, as Schmalansee and Taylor demonstrate, because the networks of competitors remain in place and could be acquired by new competitors, the disciplinary effect of competitors' capacity on LEC pricing remains intact.[27] The improvements to the baseline price cap recommended by SWBT will allow prices to move toward costs, encourage efficient investment, encourage competition, and will not pose any threats to competition or consumers.[28]

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[25](...continued)
Interestingly and in direct conflict with these statements, AT&T is restructuring its entire firm with the intent, at least in part, to allow it to rapidly enter local exchange markets in direct competition with the LECs.

[26] Cox, p. 4.

[27] USTA, Attachment 1, p. 14. See also, GSA, pp. 7-8.

[28] Second FNPRM, para. 2.

C. The Existing Price Cap Basket Structure Must Be Modified To Fit The Current Marketplace.

Competitors of the LECs assert that little or no immediate modification to the basket structure is necessary.[29] This position cannot be sustained. SWBT's proposed modifications are reasonable and are not drastic departures from the current structure.

As SWBT has explained in its Comments, the Commission should use a basket structure which logically groups like service elements (i.e., substitutes) together for the purpose of safeguarding the marketplace. Service elements should be grouped according to the functionality of the service elements, and for certain elements, the competitive characteristics of the element. As demand shifts between like service elements, price changes for those elements would not impact other service elements. SWBT's proposed restructure of the baskets merges existing service categories where services share similar functional and market characteristics (i.e., all services that are reasonably close substitutes). SWBT's proposal also permits zone pricing of all services within all service categories where costs vary as a function of traffic density.

D. Revisions To The New Services Rules Would Best Serve The Public Interest.

The LECs' competitors claim that the current cost support notice requirements for new services should not be relaxed.[30] Other competitors argue that the Commission should not adopt the proposed changes to Part 69 to facilitate the creation of new rate elements for new

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[29] AT&T, pp. 45-48; CompTel, pp. 33-35; MCI, pp. 18-20; Sprint, p. 22; and Time Warner, pp. 21-25.

[30] AT&T, pp. 22-26; MFS, pp. 2-4; Time Warner, pp. 10-13; and CCTA, pp. 23-24.

services.[31] The Commission should reject these arguments because they are merely unfounded attempts to make it more difficult for price cap LECs to expediently introduce and deliver new services, and should instead adopt the reforms suggested by SWBT and USTA.[32]

MCI recommends that any time a LEC introduces a new service, the LEC should be forced to reduce the prices of its existing services by the total amount of contribution provided by the new service.[33] Nothing would thwart new service introduction more rapidly or more completely than this bizarre MCI recommendation. It would eliminate all benefits to the American public of any LEC innovations. MCI would have the Commission prevent the price cap LECs from ever experiencing any financial benefits from the introduction of any new services. MCI's proposal would ensure that the research and development expenditures of LECs would never be recovered from any new service prices.[34] The Commission must reject MCI's recommendation.

Comcast asks for rejection of the Second FNPRM's proposal to allow the more rapid introduction of new services. In doing so, Comcast misinterprets the current relationship of Part 69 access charge rules with Part 61 price cap rules; stating that "the Part 69 access

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[31] CompTel, pp. 30-31; LDDS, p. 32; MCI, pp. 8-11.

[32] Dr. Hausman has noted that new service introduction creates probably the greatest gains in consumer welfare out of the actions that telecommunications providers may take. BellSouth, Statement of Dr. Jerry A. Hausman, p. 12.

[33] MCI, p. 11. The means recommended by MCI is an exogenous cost reduction equal to overhead cost loading recovered by the new service.

[34] Typically, the general research and development costs incurred by LECs are not included in the forward-looking long-run incremental cost (LRIC) estimates (which are computed using the most current technologies) that are the price floors calculated for regulatory applications. Clearly, joint and common costs and fixed costs (i.e., overheads) are also not included in these LRIC estimates.

charge rules are designed to allocate the appropriate access revenues and costs to the relevant access charge elements so that they are flowed-through to the appropriate price cap basket and service category."[35] In reality, price cap baskets and service categories can and should be created regardless of the antiquated Part 69 cost allocation rules. Interestingly, the AT&T price cap plan, including baskets and service categories, never utilized cost allocation rules. Thus, Comcast's call for greater emphasis on cost allocation is groundless.

As SWBT has noted in its Comments,[36] consumers can only gain from the introduction of new services. Section 7a of the Communications Act recognizes that those opposing new services have the burden to demonstrate that such proposals are inconsistent with the public interest. None of the parties opposing SWBT's position in this proceeding have done so. Thus, the Commission should follow the presumptions of the Communications Act and design its rules for new services accordingly.

The rules outlining cost support requirements for new services should be revised to eliminate rate-of-return principles. Price cap LECs introducing new services should be permitted to file them without a requirement for data that is relevant only to estimated rate-of-return calculations. Likewise, price cap LECs should not be required to forecast total costs and revenues for their new price cap services. Prices for new services should cover the direct costs of providing the services plus a contribution to overhead. Therefore, the simple direct unit cost and unit price provides sufficient data to determine whether the proposed rates cover the direct cost and a contribution to overhead. Since even this information would provide an advantage

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[35] Comcast, pp. 27-28.

[36] SWBT, p. 16.

to competitors, the Commission should rule that such cost information, if required, be kept confidential from public disclosure.[37]

As stated in SWBT's Comments,[38] the Part 69 waiver process currently used for new services is unnecessary and should be replaced, as SWBT and USTA have recommended for years.[39] The tariff review process and complaint oversight authority of the Commission provide adequate opportunity for Commission review of any rate structure changes LECs may propose to respond to competition.

E. Volume And Term Discounts, Including APPs, Are Legitimate Marketing Tools.

Even though volume and term discounts are widely used by LEC competitors, those competitors do not wish to allow price cap LECs to use them.[40] None of these parties, however, provide any credible reason to deny access customers the same benefits of volume and term discounts that IXCs, for example, provide to their customers.

The widespread use of Alternate Pricing Plans (APPs) and permanent volume and term discounts by IXCs proves that these pricing plans are a legitimate business practice designed to meet customer expectations. Such filings now should be allowed for price cap LECs on a streamlined basis without cost support. APPs are an alternative to existing tariffed services. As such, the existing tariffed services serve as a price ceiling, preventing unreasonable rates.

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[37] See Section II. J., infra.

[38] SWBT, pp. 27-29.

[39] Also, Time Warner recognizes that the Commission's Part 69 waiver process does not properly address the need by LECs to offer new services based on new technologies. Time Warner, pp. 18-19.

[40] AT&T, pp. 26-30; MCI, pp. 12-14; MFS, p. 5; Time Warner, pp. 14-16; CCTA, pp. 19-21.

SWBT's Comments explain the methods proposed by SWBT to integrate APPs into the price cap plan.[41]

F. Additional Deaveraging Is Appropriate In The Baseline Plan.

Some of the LECs' competitors ask that the Commission prohibit the LECs from ever deaveraging prices.[42] The Second FNPRM, however, properly recognizes that additional opportunities to deaverage LEC access prices will promote efficient pricing during the period that specific access markets (geographies and services) are transitioning toward an even more competitive status.[43]

G. Baseline Changes Should Not Be Delayed Pending Evaluation of Costs.

Some parties suggest that LEC access rates should be reduced significantly before pricing flexibility is appropriate. CompTel states that the price/cost relationships of the Carrier Common Line Charge (CCLC), the IC, local switching and transport rates should be examined and recommends stripping out "excessive costs" before any pricing flexibility should be considered.[44] Parties that suggest simplistically that the contribution to LEC overhead costs be totally eliminated do not understand the relevant regulatory and economic principles.

In a similar vein, MCI recommends that any flexibilities for LECs be delayed until all LEC access rates are "driven to economic cost."[45] MCI incorrectly uses information

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[41] SWBT, pp. 19-21.

[42] Time Warner, p. 44.

[43] Second FNPRM, paras. 25-26.

[44] CompTel, pp. 5-7, 20-23.

[45] MCI, pp. 4-8.

from the transport rate restructure and the Universal Service Fund dockets to imply that the overhead contributions currently in LEC access charges should be eliminated in their entirety. No firm, including MCI, can sustain economic viability if none of its services make a contribution to joint and common costs or fixed costs (i.e. overhead). Thus, MCI's suggestion that pricing flexibility wait until all LEC access rates are set at what MCI calls "true economic cost" would merely delay relief for LECs to the benefit of MCI, as a competitor. In numerous dockets, including this one, MCI has consistently implied that all costs incurred by the LECs that are above average variable costs (or incremental costs) are "uneconomic costs." There is no recognized concept in practical cost measurement or regulation called an "uneconomic" cost. Moreover, MCI's recommended objective -- removing all contribution from access rates -- is not reasonable or sustainable.

H. The Baseline Plan Should Not Protect Any Class of Competitors.

The Commission should not guarantee the success of any competitor. Providers should be allowed to be successful based on the merits of their own abilities and efficiencies, not on the existence of artificial pricing umbrellas or restraints on the ability to compete by the incumbent providers.

Cox prefers making no changes to the current price cap plan for LECs because it would provide Cox and other competitors "stability."[46] Cox desires this stability as it

[46] Cox, p. 5. Time Warner, pp. 5-7, also asks that the Commission artificially lower Time Warner's business risks by preventing the LECs from being able to respond competitively until competitors can sustain substantial market share. Time Warner, p. 8, asks for support for its large fixed cost investment in facilities.

considers its investments in capital and resources to compete with the LECs.[47] Essentially what Cox is asking for is an environment with "stability" provided by hamstringing the LECs' from responding competitively to any decision that Cox and other LEC competitors might make. Cox wants the protection and "stability" that LEC pricing umbrellas and the inability of LECs to respond with new service offerings would provide. The Commission should not provide the form of "stability" requested by Cox, but should instead create an environment where the LECs and other competitors alike are capable of providing innovative new services and have the pricing flexibility to offer lower prices and to provide customers with the best value.

I. The Use of Below-Band Pricing Should Not Influence Whether Baseline Changes Are Adopted.

MCI implies that LECs have not used the pricing flexibility available to them, citing the scarcity of below-band pricing. Contrary to MCI's claim, the lack of below-band pricing is not sufficient proof of the lack of competition, or of the need for changes to baseline regulation.

The type of pricing flexibility that is needed to respond in today's telecommunications markets is not available to the LECs today. SWBT needs the flexibility to establish new rate elements, to price services in response to different and rapidly changing market conditions, to package services in ways responsive to specific customer requests and to offer volume and term discounts. The flexibility that MCI refers to is the "flexibility" to lower the geographically-averaged service price for all customers across all the various cost situations.

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[47] Cox, p. 5.

This type of "flexibility" is not any flexibility at all, and is clearly insufficient for responding to competitive bids for specific services with specific cost characteristics.

J. Baseline Price Cap Regulation Should Not Require Disclosure Of Confidential Information.

Many of the LECs' competitors request that the LECs be required to provide competitively sensitive information on the LECs' costs on the open public record.[48] For example, Time Warner suggests that a system of cost allocations be expanded to encompass additional geographic dimensions or, alternatively, that LECs be prohibited from deaveraging access prices if they cannot justify the new cost allocations for the discrete geographic markets proposed by Time Warner.[49] In the Comments filed on December 11, 1995 in response to the Common Carrier Bureau's proposed collection of information on access competition,[50] the LEC's competitors claimed that their competitively sensitive cost information should be

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[48] See, e.g., MFS, pp. 2-4; Time Warner, p. 20.

[49] Time Warner, p. 16 and fn. 45.

[50] Public Notice (CCB-IAD 95-110) (released November 3, 1995) In the Matter of Telecommunications Access Provider Survey.

protected.[51] Thus, when the request is made of them, the LECs' competitors agree with SWBT that cost data are competitively sensitive and should not be made publicly available.

By its very nature, detailed service-specific cost information is competitively sensitive and should not be made publicly available without regard to its confidential and valuable nature. SWBT is willing to make cost information available for regulatory review under the understanding that such information will be protected and used only for the intended regulatory review purposes.

In that regard, SWBT has been working with the Common Carrier Bureau to develop prototype proprietary agreements that would allow necessary Bureau personnel and, under appropriate restrictions, other parties, to have access to the cost information necessary to determine that SWBT's tariff filings are in compliance with all relevant cost principles, including a demonstration of pricing above incremental (or direct) cost, where needed. However, SWBT cannot support any requirements that vendor-specific, service-specific, or geographically-specific cost data be made routinely available on the public record. The Commission must recognize and

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[51] See, e.g. comments filed in CCB-IAD 95-110 by AT&T, pp. 8-9; MCI pp. 7-10; MFS, pp. 10-11; Sprint, p. 10; and TCG, p. 17. As MCI has stated in the past:

> Competitive injury from disclosure of information facilitating selective pricing by competitors is almost guaranteed, since "knowledge of . . . price guidelines would permit a competitor to undercut" MCI. This is precisely the type of information that would enable competitors, particularly the dominant carrier in the market, to "'guage [sic] . . . [MCI's] success in gathering various [types of] customers, identify those particular markets which are open for expansion and devise marketing plans accordingly.'"

(Letter from Frank W. Krogh, MCI to Edward J. Minkel, FCC, dated November 14, 1988, at p. 4. [footnotes omitted]).

accept that reasonable protection of confidential LEC cost data is a requirement in today's environment.[52]

K. Allegations of Cross-Subsidization Should Not Delay Needed Baseline Changes.

Some intervenors decry the threat of cross-subsidization[53] and predation[54] by the incumbent exchange carriers. Yet none of these intervenors point to a specific instance where an incumbent exchange carrier has successfully employed such tactics. The concern expressed by the LECs' competitors regarding predatorily low prices and monopolistic high

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[52] The Bureau has already recognized this fact:

> The submission provides specific details of investment components upon which CBT's direct costs are derived and, as such, provides insight into CBT's business strategies with respect to composition of technology mixes and the associated level of investment. Particularly, the information relates to circuit equipment, fiber, and cable investment. Such information could be used by competitors to devise strategies to introduce new services to the competitor's benefit, or exploit weaknesses in the existing CBT operation. Using information obtained from CBT data as a model, a competitor would be provided a "heads up" for use in negotiating their own rates or agreements. Such benefits are particularly undesirable when they accrue because the level of detail of cost support materials is greater than that submitted by other parties. From our review of the subject information, we find that CBT has a legitimate interest in protecting the internal business information at issue.

(Letter from Kathleen M. H. Wallman, FCC to John L. McGrew, Willkie, Farr and Gallagher dated August 11, 1995, at p. 3.)

[53] NCTA, through a strained interpretation of analysis presented by Dr. Leland Johnson, alleges that improper cross-subsidies will result when price cap regimes rely on cost allocation to set prices. In Attachment 2, SWBT replies that the answer is to eliminate all ties between prices and cost allocations allowing prices to more freely move toward costs.

[54] ALTS, through William Page Montgomery, argues that LECs will use additional downward pricing flexibility in a predatory manner. In Attachment 3, SWBT responds that any attempt to use such pricing in a predatory manner would fail.

prices is drastically overstated.[55] The Commission should reject these attempts to divert the Commission's attention from needed baseline reforms.

Some of the LECs' rates are supported by contribution from other services due to the vestiges of prior explicit regulatory policies because the effects of those policies remain embedded in the LECs' rate structures today. In Federal and state proceedings, SWBT has asked regulators to allow LECs to equitably rebalance rates, realigning prices with costs. Until this rebalancing occurs, however, economically inefficient market entry will continue to occur.

LECs' competitors recognize this rate structure "imbalance" as an opportunity to enter markets that might not otherwise be fruitful. For example, in those areas where LEC services are priced well above the direct cost of providing the services in order to provide contribution to services in other areas, the LECs' competitors may be able to enter and sell their services at prices under this arbitrarily inflated level. On the other hand, if these LEC prices were not required to unilaterally support other services, such market entry might not be an optimal strategy for the competitor. To the extent these rate imbalances exist and competitors take advantage of these economic inefficiencies, the public interest is not served.

L. New Rate Relationships Should Not Be Mandated.

CompTel would have the Commission manage a new series of rate relationships among access services. CompTel recommends that "if a LEC wishes to lower rates for selected transmission services, it should have to make a corresponding reduction in all transmission

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[55] See, GSA, p. 7.

services that are provided using the same physical facilities."[56] Such a series of rules would be completely unworkable, create an administrative quagmire and would bear no relationship to market-based efficient pricing.

M. The Commission Should Not Further Limit Price Increases that Follow Price Reductions.

Several parties support the Commission's proposal to eliminate lower service band index (SBI) limits, but only if additional safeguards against cross-subsidization or predation are put into place.[57] AT&T's suggestion that the Commission require LECs to exclude price reductions beyond the existing lower band limits from the actual price index (API) calculation and impose a 1% upper band limit for categories with price reductions below the former SBI band limit should be rejected.[58]

1. Some Parties Mischaracterize "Cross-subsidization" And Other Economic Concepts.

Many parties, including AT&T, mischaracterize "cross-subsidization."[59] Cross-subsidies occur when revenues acquired from one service are used to make up a revenue shortfall in another service that is priced below incremental cost. A necessary component for cross-subsidization to occur is that the service being cross-subsidized is priced below incremental cost so that the service can never pay for itself. Other services must be priced above

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[56] CompTel, p. 33. CompTel refers to its proposed artificial construct as "an economically rational indexing mechanism." CompTel, p. 34.

[57] AT&T, p. 39, Sprint, p. 21.

[58] AT&T, p. 42. See also, CompTel, p. 33, recommending 0% upper SBI limit and Time Warner, p. 28, suggesting that 1% may not prove adequate.

[59] AT&T, pp. 39-41. SWBT provides further rebuttal to improper allegations of cross-subsidy and predatory pricing in Attachments 2 and 3.