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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

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REPLY COMMENTS OF GTE

GTE Service Corporation and its affiliated domestic telephone operating companies

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January 16, 1996

TABLE OF CONTENTS

		PAGE
SUMMARY		iv
I.	INTRODUCTION	1
II.	BASELINE PRICE CAP RULES MUST REFLECT THE COMPETITIVE LANDSCAPE IN WHICH LECS OPERATE TODAY	3
	A. Baseline price cap changes should not be conditioned on a demonstration of competition	3
	B. Competition exists for LEC access services	5
III.	THE PROPOSED CHANGES TO BASELINE PRICE CAP REGULATION WILL PROVIDE IMMEDIATE PUBLIC BENEFITS REGARDLESS OF THE LEVEL OR TYPE OF COMPETITION PRESENT IN A GIVEN MARKET	9
	A. Baseline changes will provide economic and public benefits regardless of the level of competition present	10
	B. Baseline changes proposed by GTE will continue to provide adequate safeguards	16
	C. Changes to baseline price cap regulation can and should be considered separately from comprehensive access reform	20
	D. No competitive "checklist" should be adopted as a precondition for changes in baseline regulation	23
IV.	SPECIFIC CHANGES TO BASELINE PRICE CAP REGULATION WILL WORK TO ACHIEVE THE COMMISSION'S STATED GOALS	24
	A. Part 69 Waivers	25
	B. New Service Tariff Filings	29
	C. Additional Pricing Flexibility	33

D. Alternative Pricing Plans (APPs) 35

E. Baskets 43

F. Lower Service Band Index and Rate Reductions 47

G. ICB and Contract-Based Tariff Filings 53

H. Restructured Services 55

IV. THE COMMISSION SHOULD ESTABLISH A FRAMEWORK FOR STREAMLINING LEC ACCESS MARKETS BASED ON CLEARLY ESTABLISHED CRITERIA 56

A. A framework should be established which will adapt to competition as it develops 57

B. The Commission should define the geographic dimension of relevant markets by establishing reasonable guidelines for grouping wire center serving areas 60

C. Relevant markets should be based on a combination of the geographic, service and customer dimensions 63

D. The Commission should establish simple competitive criteria, based on supply and demand responsiveness 67

E. Relevant LEC markets found subject to competition should be removed from price caps and made subject to streamlined regulation 70

V. THE COMMISSION SHOULD ESTABLISH A FRAMEWORK FOR DESIGNATING LECS AS NONDOMINANT WHEN THEY LACK MARKET POWER 71

IV. CONCLUSION 72

SUMMARY

GTE urges the Commission to move forward with its "procompetitive agenda" and adopt changes in baseline price cap regulation without regard to the actual level of competition present. The proposals set forth in the *Second Further Notice of Proposed Rulemaking* (*"Second Notice"* or *"SFNPRM"*) for baseline changes in the price cap plan provide a reasonable framework for adapting price cap regulation to the *emergence* of competition.

Because there is a critical need for immediate new services flexibility, GTE strongly supports the Commission's efforts to adopt changes to the new services rules, to eliminate the need for LECs to seek a waiver of Part 69, to adopt separate tariff standards for Alternative Pricing Plans, to extend zone pricing to most access rate elements, to allow LECs to employ contract-based tariffs subject to appropriate safeguards, to remove limitations on downward pricing flexibility, to simplify the price cap basket structure and to establish the criteria to define relevant markets and the terms by which these markets can receive streamlined or nondominant treatment.

As the Commission has recognized in the *SFNPRM*, access competition has developed steadily in many markets since the Commission first adopted its LEC price cap plan. It is well documented, in this proceeding and in others, that there is facilities-based competition for LEC access services in a significant number of markets today. LECs have shown that a significant percentage of their access revenues is subject to erosion. At least 27 CAPs have established a presence in 106 GTE central office serving areas in 16 states. GTE is also facing

formidable competition from other providers as well. Cable companies already have facilities in place which reach most customers in many markets; major IXCs have announced their decision to directly compete in local and access markets; and existing wireless providers already reach a significant, and rapidly growing, proportion of the telecommunications users in the United States.

The *SFNPRM* draws a fundamental distinction between changes to "baseline" price cap regulation, which should not be conditioned on a demonstration of competition, and "streamlined" regulation, which should be based on a finding that competition in a relevant access market is sufficient. This distinction, which many commenters choose to ignore, is a reasonable basis for Commission action in this proceeding and should be maintained.

Baseline changes will provide economic and public benefits regardless of the level of competition present. Granting LECs greater pricing flexibility will encourage the development and introduction of new and better services; will result in the development of more efficient access pricing by allowing LECs to establish access prices which more closely reflect underlying costs; and will work to send more accurate price signals to guide efficient investment in the infrastructure by incumbents and entrants alike. Because of these benefits, policies to encourage efficient pricing should be initiated *before* there is any evidence that competition is affecting pricing decisions. As a result, customers will be the ultimate beneficiaries of vigorous price and service quality competition.

Baseline price cap changes proposed by the Commission, and the modifications as suggested by GTE, would continue to provide adequate

safeguards. LECs would still be prevented from offsetting losses for competitive services with higher prices for less-competitive services. LECs would have little incentive or opportunity to engage in anti-competitive pricing and the anti-discrimination provisions of Section 202 of the Act and the Commission's statutory responsibility to ensure just and reasonable rates would continue to apply.

The Commission should also take action now to establish a framework for streamlining LEC access markets based on clearly established criteria. LEC competitors again assert that the current level of competition does not warrant the adoption of standards to treat LEC service under streamlined or nondominant carrier regulation. However, the matter under consideration in this proceeding is not whether any particular access market is competitive, but whether a framework should be established which will adapt to competition as it develops. Then, if a market does not meet the criteria established, it would not be streamlined. It is not at all "premature" to establish a framework for the criteria and procedures for streamlining.

The Commission should define the geographic dimension of relevant markets by establishing reasonable guidelines for grouping wire center serving areas. The wire centers in each group should be required to be contiguous, and some part of each wire center would have to be included in an addressable "footprint." Relevant markets should be based on a combination of the geographic, service and customer dimensions. Further, measures of supply and demand elasticity should be established as criteria for streamlining.

Finally, GTE urges the Commission to adopt standards for applying nondominant regulation to LEC services. The Commission should conclude that a LEC is nondominant in any new market it enters outside its traditional serving area, that a nondominant framework would be based on the framework adopted for streamlining, and that any LEC found to be nondominant in a given market should be regulated in the same manner as any other nondominant carrier with which it must compete.

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REPLY COMMENTS OF GTE

GTE Service Corporation ("GTE"), on behalf of its affiliated domestic telephone operating companies, submits the following Reply in response to comments submitted regarding the *Second Further Notice of Proposed Rulemaking* (*"Second Notice"* or *"SFNPRM"*) in the Price Cap Performance Review for Local Exchange Carriers, FCC 95-393, released September 20, 1995.

I. INTRODUCTION

Building on its earlier finding articulated in the *First Report and Order* that competition is indeed emerging in access markets, the *Second Notice* (at ¶11) sets out to achieve the Commission's clearly articulated goals: encourage market based prices that reflect the cost of access services; encourage efficient investment and innovation; promote competitive entry; and permit regulation of noncompetitive markets in an efficient and least intrusive way. Accordingly, GTE endorsed the proposals in the *Second Notice* to improve the efficiency of the Local Exchange Carrier ("LEC") price cap plan.

In its Comments, GTE urged the Commission to adopt improvements in baseline price cap regulation, without regard to the extent of competition in those markets. Because there is a critical need for immediate new services flexibility, GTE strongly supported the Commission's efforts to adopt changes to the new services rules, to eliminate the need for LECs to seek a waiver of Part 69 in order to offer a new switched access service, and to adopt changes which would accommodate optional discounted services by establishing separate tariff standards for Alternative Pricing Plans ("APPs"). To align access rates more closely with differences in cost, GTE recommended that zone pricing should be extended to most access rate elements. GTE also urged the Commission to permit LECs to employ contract-based tariffs, subject to appropriate safeguards, under baseline regulation and to revise its current policy regarding Individual Case Basis ("ICB") rates to encourage development of new service offerings. Limitations on downward pricing flexibility should be removed, and GTE also encouraged the Commission to simplify the price cap basket structure in this proceeding.

GTE commends the Commission for tentatively proposing a system of adaptive regulation for LEC interstate access services and encourages the Commission to establish the criteria to define relevant markets and the terms by which these markets can receive streamlined treatment. The mechanism for adaptive regulation should be simple and predictable; it should allow LECs to respond to competition and it should ensure that customers in less competitive markets continue to be protected by price caps.

Finally, GTE strongly endorses proposals which would establish procedures for reclassifying those LEC services not already found to be nondominant. The criteria for

the determination of nondominance should be similar to those used for streamlining, relying on indicators which are simple to measure and for which clear thresholds can be defined. A LEC found to be nondominant in a given market should be regulated in the same manner as any other nondominant carrier with which it must compete in that market.

II. BASELINE PRICE CAP RULES MUST REFLECT THE COMPETITIVE LANDSCAPE IN WHICH LECS OPERATE TODAY.

A. Baseline price cap changes should not be conditioned on a demonstration of competition.

With respect to changes proposed for baseline regulation, the Commission stated in the *Second Notice*: "we propose generally that these rule revisions be effective for all price cap LECs *without regard to the level of competition* because they will serve our goal of moving prices towards cost, encouraging efficient investment in infrastructure, and ultimately producing robust competition."[1] (emphasis added) In essence, the proposals set forth by the Commission for baseline changes in the price cap plan provide a reasonable framework for adapting price cap regulation to the *emergence* of competition.[2]

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1 *Second Notice* at ¶2.

2 In recent months, several Commissioners have recognized the need to revise regulation of LEC services to accommodate emerging competition: "If we do not proactively reform current rules, we may severely limit the breadth and depth of real competition." Speech by Chairman Reed Hundt, Telecompetition '95, Washington D.C,, December 5, 1995, at 2,3. "The FCC is moving forward with a procompetitive agenda...As competition begins to take hold in local exchange and access markets, I believe our access charge rules may become counterproductive...We must develop more durable price cap rules...strive to tailor our price caps rules so that they acknowledge and accommodate competition." "Our rules should be flexible and adaptive." Remarks of

In stark contrast to this "pro-competitive policy" direction and the clear emergence of competition for LEC access services, the Comments of exchange carriers' competitors in response to the *Second Notice* diametrically oppose making any changes in baseline price cap rules for LECs to make them more adaptive to current market conditions. In most cases, these commenters, many of whom provide services in direct competition with LEC local and access services, deny that there is any real growth in competition in access markets and cite concerns over possible exploitation of market power if LECs are granted *any* additional flexibilities. Generally, these competitors insist that any additional pricing flexibilities be tied to an overly broad showing of effective competition. Others insist that no pricing flexibility be granted until markets for local telephone services become much more competitive or until the Commission conducts a comprehensive proceeding to reform its access charge rules.

The Commission should not be guided by these self-serving comments. The *Second Notice* draws a fundamental distinction between changes to "baseline" price cap regulation, which should not be conditioned on a demonstration of competition, and "streamlined" regulation, which should be based on a finding that competition in a relevant access market is sufficient to discipline the LEC's actions. This distinction, which many commenters choose to ignore, is a reasonable basis for Commission action in this proceeding and should be maintained.

The Commission must adopt changes to baseline regulation which will further the Commission's goals even if competition is not sufficient to replace price caps as a constraint on LEC pricing in a given market. GTE will show *infra* why the *SFNPRM*

Commissioner Rachelle Chong Before the Practicing Law Institute and Federal Communications Bar Association, December 14, 1995.

proposals, with the modifications recommended by GTE, would: allow access prices to better reflect costs; encourage efficient investment; promote efficient competitive entry; and reduce unnecessary interference in access markets. These changes would allow the price cap mechanism to more closely replicate a competitive outcome, without causing "competitive harm." Because these changes would be beneficial even in the absence of effective competition, they should not be conditioned on any competitive criteria.[3] As discussed *infra*, the Commission should also establish an adaptive framework which will remove price cap regulation when the growth of competition in an access market makes price caps unnecessary. This streamlining would be conditioned on criteria which would measure a LEC's market power in specific markets.

B. Competition exists for LEC access services.

Several commenters argue that the Commission is premature in advancing the *SFNPRM* proposals, claiming that access competition has not yet developed.[4] In fact, none of the changes proposed in the *SFNPRM* would require the Commission to find that any particular access market is competitive today. The proposed baseline changes do not and should not presume that any competitive criteria have been met.

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3 As discussed *infra*, no competitive "checklist" should be adopted as a precondition for changes in baseline regulation. Even if all of the "checklist" conditions proposed by commenters were relevant to the measurement of market power -- which is not the case -- they would not be useful in determining whether the proposed baseline changes should be adopted, since these proposals are not based on any assumption regarding LEC market power. Further, the proposed "checklist" items should only be incorporated into the competitive criteria for streamlined regulation if they are found to be necessary for a determination of market power in a particular access market.

4 *See, e.g.*, Telecommunications Resellers Association ("TRA") at 4-5, Sprint Telecommunications Venture ("SVT") at 3, MFS at 1.

Furthermore, while the proposals for streamlining and nondominant treatment would apply to competitive markets, this *Second Notice* is considering adopting only a framework. No access market would actually be afforded streamlined treatment until the LEC had demonstrated that the criteria established in the framework had been satisfied. The proposals therefore are not premature, regardless of the actual state of competition.

Of course, as the *SFNPRM* recognizes (at ¶5), access competition has developed steadily in many markets since the Commission first adopted its LEC price cap plan. In 1990, there were only a handful of competitive access providers. Today, there are carriers competing for LEC services in hundreds of access markets, both large and small. It is well documented, in this proceeding and in others, that there is facilities-based competition for LEC access services in a significant number of markets today. USTA identifies a substantial number of CAPs actively operating in over 550 separate markets.[5]

For example, within GTE's service areas, a significant percentage of its access revenues is subject to erosion. At least 27 CAPs have established a presence in 106 GTE central office serving areas in 16 states. These serving areas, while representing only three percent of GTE's total central offices, generate nearly 25 percent of GTE's

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5 *See* USTA Attachment 2. While the *SFNPRM* observes (at n.2) that the growth of competition is most pronounced in major urban markets, the USTA list makes it clear that competitive entry has moved well beyond a few major cities, to include virtually any area which has a customer base that generates high levels of demand. Thus, GTE faces competition not only in large metro areas around Los Angeles and Dallas, but in medium-sized cities like Tampa, Florida and Beaverton, Oregon, as well as in less obvious places such as Harrisonburg, Virginia, Broken Arrow, Oklahoma, and Andalusia, Alabama.

total equivalent minutes of use.[6] Claims that access service competition does not exist or is not likely to develop soon is a gross misstatement and completely ignores the facts.

CAPs, of course, are not the only sources of access competition. Cable companies already have facilities in place which reach most of the customers in many markets.

> For example, a high proportion of households has both standard telephone service and cable telecommunications services. In August 1993, it was estimated that over ninety-one million homes have cable service available. The coaxial cable that delivers cable television is already capable of delivering telephone and other telecommunications services as well. Cable companies, now allied with out-of region telephone companies, are reportedly planning to spend fourteen billion dollars deploying fiber over the next decade.[7] (footnotes omitted)

Since cable firms control most of the larger CAPs, the power of the cable-CAP combination cannot be ignored. AT&T is currently reorganizing itself to prepare for its re-entry into local and access markets, and MCI has already formed a subsidiary for that purpose. Existing wireless providers already reach a significant, and rapidly growing, proportion of the telecommunications users in the United States. PCS providers have already invested six billion dollars to obtain licenses in the auction held

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6 For a more thorough discussion of the extent of competition in GTE serving areas, *see* Exhibit 2, GTE Telephone Operating Companies Petition for Waiver of Part 69 Rules to Geographically Deaverage Switched Access Services, filed November 27, 1995 (GTE "ZonePlus" Plan).

7 Spulber, Daniel F., "Deregulating Telecommunications," Yale Journal on Regulation, Volume 12 Number 1, Winter 1995, at 39.

by the Commission last year, and in doing so have committed themselves to still further investments to meet their build-out requirements.[8]

Interestingly, many commenters opposed to additional baseline pricing flexibility cannot even agree among themselves whether competition truly exists in the market today. For example, AT&T (at 2), MCI (at 33) and TRA (at 4) suggest that no real competition exists, but the California Cable Television Association ("CCTA") refers (at 14) to "several hundred networks operational or under construction" and that in the long run "there will be sufficient competition" to discipline LEC behavior.[9]

In an attempt to downplay the true extent of competition, several commenters attempt to distort the true picture of the competitive landscape. These parties generally misspecify the relevant market. Any analysis of competition for LEC access services should properly focus on that set of substitutable services provided in a given customer segment within a specific geographic market. The fact is, end users are exercising their options today. LEC switched and special access services are highly elastic, particularly for large end user customers in certain markets. It is in these markets that competition is emerging and for which pricing flexibility is warranted.

Some commenters attempt to paint CAP operations as severely limited and inflexible with respect to their ability to serve customers. For example, AT&T (at 14)

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8 To meet these build-out requirements, it is estimated that PCS firms will invest another $30 to 50 billion. This will make PCS service available to most customers in 51 major market areas across the country, with a combined population of approximately 200 million people. This is not, as some commenters would suggest, merely a possibility, it is a commitment to which the major firms in the industry have already staked $7 billion in earnest money. *See* Nicholas W. Allard, "The Brave New World of PCS," PCS Focus, August, 1995

9 Similarly, Cox (at 6, n.15) states that "alternative facilities-based networks are already here and the Commission should support their use to full capacity."

states that a CAP facility operating on a particular block has no relevance to a customer one block away. GTE has recognized (and will discuss *infra*) that access markets are limited geographically. However, it is clearly in a CAP's interest to extend service on request to customers who are located near the CAP's existing facility. The economics of facility placement are such that an "addressable" corridor extends up to about a kilometer on either side of a CAP facility.[10] This fact, combined with the considerable extent of existing fiber networks, means that a large proportion of the high-usage customers who represent the CAPs' target market already have CAP alternatives available in many metro areas.[11]

The issue in this proceeding is not whether any particular market is competitive. Therefore, it is clear that the Commission is well-justified in viewing its *SFNPRM* proposals within a context of rapidly developing access competition. Further, it is not at all "premature" to establish a framework which would establish criteria and procedures for streamlined regulation and nondominant treatment. GTE submits that several markets within its serving areas would meet any reasonable criteria for streamlining today.

III. THE PROPOSED CHANGES TO BASELINE PRICE CAP REGULATION WILL PROVIDE IMMEDIATE PUBLIC BENEFITS REGARDLESS OF THE LEVEL OR TYPE OF COMPETITION PRESENT IN A GIVEN MARKET.

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10 GTE's Comments (at 67-68) in response to the *SFNPRM* discusses the extent to which an addressability measure, when used to gauge the elasticity of supply, would include potential capacity.

11 CAP networks are no longer limited to a small areas in downtown business districts. For example, CAP fiber now extends through most of the Los Angeles basin, and across the Dallas-Fort Worth metroplex.

Changes to baseline regulation as proposed by the Commission represent reasonable improvements over the current system. In Comments filed in this proceeding, GTE generally supported the Commission's efforts to: reduce the barriers for the introduction of new services; implement zone pricing for all switched access elements; revise the existing basket structure; and allow the introduction of APPs for switched access. GTE has also proposed a number of improvements to certain specific aspects of the Commission's proposals.

A. Baseline changes will provide economic and public benefits regardless of the level of competition present.

The changes to baseline price cap regulation proposed in the *SFNPRM*, including the modifications GTE has proposed, should be adopted, without any requirement for a competitive showing, because they will advance the Commission's goals in this proceeding, without creating any possibility of competitive "harm."

First, the streamlined tariff and waiver filing proposals will encourage the development and introduction of new and better services. As the Commission has recognized (*SFNPRM* at ¶69), its existing tariff filing rules, coupled with the requirement to file waivers of the Part 69 rules to introduce new switched access rate elements, constitute unreasonable restrictions and place undue delays on a LEC's ability to introduce new offerings. Customers will benefit from a LEC's increased ability to bring innovative new services to market in a timely fashion as technology develops and economics permit. These benefits would result even if the market in question is not yet

sufficiently competitive to provide market discipline for the LEC.[12] Of course, to the extent that competition is developing in the market, new services will also constitute an important part of the LEC's response to that competition.

Second, implementation of flexible pricing measures in baseline regulation will result in the development of more efficient access pricing by allowing LECs to establish access prices which more closely reflect underlying costs. Under current rules, LECs are limited in their ability to implement innovative pricing plans such as zone pricing and volume and term discount offerings for switched access services and to target meaningful rate reductions in particular markets. By removing features of the price cap plan which discourage rate reductions, the Commission can promote lower prices which would directly and immediately benefit consumers. By allowing the adoption of more efficient price structures, the proposed baseline changes would allow more accurate price signals to be provided to not only access competitors, but access customers. This would encourage efficient levels of access services consumption, efficient utilization of access facilities, and efficient choices among different access services.[13]

Third, accurate price signals are required if the market is to guide efficient investment in the infrastructure by incumbents and entrants. If LECs are inhibited from

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12 In fact, even if a market is not competitive, and has no prospect of ever becoming so, the timely introduction of new services would still be an important policy concern.

13 As with new services, more efficient price structures will improve consumers' welfare even in the absence of any competition. Of course, since competition is actually developing in these markets, the ability to adjust prices -- within price cap constraints -- will minimize pricing umbrellas and promote effective rivalry among providers, which would allow consumers to benefit from competitive entry.

making rate adjustments, and prevented from adopting efficient rate structures, inaccurate price signals would be sent to potential entrants. This results in the creation of a "price umbrella" under which higher cost firms could enter and survive in the market, raising industry costs and reducing technical efficiency.[14] Sprint agrees (at 5) that competitors may currently receive incorrect signals about the long-term economic feasibility of entering access markets. Incorrect pricing signals may also distort investment decisions by the incumbent LEC. If, for example, a LEC is considering investment in a new network capability, policies which create uncertainty regarding the LEC's ability to offer new services using that capability, or its ability to set prices for such services at competitive levels, would make the investment less attractive. If efficient prices are to influence entry and investment decisions, they should be in place before those decisions are made. Therefore, policies to encourage efficient pricing should be initiated *before* there is any evidence that competition is affecting pricing decisions.[15] If the establishment of some degree of "adequate" competition is a prerequisite before allowing access prices to be set at economically efficient levels, then the Commission can never be fully assured that entry is indeed efficient.[16]

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14 *See* Comments of USTA, "Pricing Flexibility for Interstate Carrier Access Services", Richard Schmalensee and William Taylor, ("Schmalensee and Taylor") at 8.

15 Schamalensee and Taylor at 3.

16 *See, e.g.,* Statement of Dr. Mark Schankerman, "Competition through Regulatory Symmetry", submitted as an attachment to GTE's Comments in response to the Notice of Proposed Rulemaking in this docket, May 9, 1994 ("Schankerman"): "As long as such umbrellas exist, the fact that new entry successfully erodes the market share of incumbents does not mean that the level and composition of the new investment is socially efficient. *Ex post* success is an indication of relative efficiency only if price signals are meaningful and restrictions are symmetric."

Finally, in order to maximize benefits to consumers as the marketplace becomes more competitive, the rules under which competitors must operate should become more homogeneous (*See* TRA at 4.) Regardless of how many customers they serve, CAPs are unconstrained in their ability to introduce new services, offer volume and term discounts and entice customers with promotional offerings. If the Commission allows LECs to respond to customer demands in a similar fashion -- subject to effective price cap constraints where effective competition has not yet been demonstrated -- customers will be the ultimate beneficiaries of vigorous price and service quality competition.[17]

Some commenters argue that the benefits the Commission expects from its proposed baseline changes will not be realized. For example, The Association for Local Telecommunications Services ("ALTS") suggests (at 8) that, in the absence of competitive pressure, LECs will not use any new pricing flexibility to make rate changes which will benefit consumers. This argument ignores two important points.

Regardless of the existence or non-existence of competition, the introduction of more efficient rate structures incorporating zone pricing and nonlinear tariffs (with respect to volume) would provide customer benefits. In order to control LEC market power, it should not be necessary to force LECs to use inefficient price structures. n addition, the fact that competitive criteria for streamlining may not yet

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17 Schankerman (at 4) argues that asymmetric regulation should be minimized, even where asymmetric market power is present. Such regulation should be adopted only when there is a demonstrated capacity of the incumbent to deter efficient entry, and then only when the regulation is "the least costly way to resolve the potential problem."

have been satisfied in a given market does not necessarily mean that no competition exists there. In fact, as discussed *supra*, competitive entry has already occurred in hundreds of cities across the country. Even if, in a given market, the extent of competition is not yet sufficient to completely eliminate a LEC's market power, the LEC should be allowed to respond to competition – as long as price caps continue to protect against any abuse of whatever market power the LEC retains. Failure to allow a LEC to respond would preserve a price umbrella for the entrant, and discourage the competitive rivalry which would benefit consumers.

GTE's pricing behavior under price caps belies ALTS' argument. GTE has made a series of voluntary rate reductions, including below-band filings for both switched and special access. These reductions have included Carrier Common Line ("CCL") rates as well as those for switched and special transport. At times, GTE's rates have been set half a billion dollars below cap, on an annual basis. GTE agrees with ALTS that LECs do not make rate reductions out of altruism. GTE's behavior can only be explained as a response to genuine competitive pressure, even though no formal showing has been made that these markets meet any competitive criteria. ALTS' assumption that a LEC would never voluntarily reduce rates in a baseline market is simply incorrect.

A LEC's decision to adjust its rates, however, will be affected by the constraints imposed by the price cap rules. Like any firm, the LEC will weigh the benefits of a reduction, in terms of demand response, against the cost in terms of revenue. Any unnecessary regulation that increases the cost of the rate reduction will tend to deter

the LEC from making a that reduction.[18] The Commission is correct in suggesting that its baseline reforms, which are intended to minimize artificial disincentives to reduce rates, will in fact benefit consumers.

ALTS also takes the astonishing position (at 10) that the Commission should not be concerned with sending efficient entry signals. Inefficient entry, and the circumstances which lead to it, harm consumers. First, inefficient investment involves a waste of scarce resources. Consumers are harmed when society's resources are not put to productive use.[19] Second, once firms have entered a market, they form a constituency interested in the maintenance of the inefficient prices which induced their entry. The Commission's recent experience in establishing switched transport rates, in the wake of the equal charge rule, is a perfect example of this phenomenon. Third, as noted *supra*, bad price signals can deter the incumbent from making otherwise productive investments. This could raise industry costs and deprive consumers of new technology. Finally, as Schankerman points out (at 4), consumers may make complementary, sunk investments in order to adopt the entrant's services. To the

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18 For example, if the LEC is required to average its rate across a study area, the cost to the LEC of responding to competition within a particular relevant market will be increased.

19 Inefficient entry causes a loss of technical efficiency and raises average industry costs. As Schankerman notes (at 3): "Technical efficiency in this broader sense must be a central regulatory objective. Otherwise, very substantial social resources will be wasted in the design, construction, and continued development of the information infrastructure."

extent that these are idiosyncratic, they represent additional technical efficiency losses associated with the inefficient entry.[20]

B. Baseline changes proposed by GTE will continue to provide adequate safeguards.

Those parties who oppose granting additional pricing flexibility to LECs primarily cite the following concerns: (1) that LECs will be afforded greater opportunities to "price squeeze" or raise prices of monopoly services while lowering the price for competitive services; (2) that consolidation of certain price cap categories will enable LECs to engage in cross-subsidization; (3) that LECs will lower rates to predatory levels; and (4) that LEC new service offerings and discount plans will discriminate among users. Several commenters also argue that because existing LEC access rates are set at levels that exceed "economic costs," no additional pricing flexibility should be granted until "subsidy rates," such as the CCL and RIC charges, are reduced or eliminated. As discussed below, revisions to baseline price cap regulation, as proposed by GTE, would continue to provide adequate safeguards against any anticompetitive behavior. Further, there is a critical need for immediate relief and the Commission should not wait until it resolves all rate subsidy issues in a comprehensive access reform proceeding before granting LECs the flexibility to establish more efficient rates, introduce new services, and respond to emerging competition.

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20 Examples might include specialized CPE, installation costs or training of the customer's employees. Further, "Uneconomic entry can also induce subsequent 'localized technical change' directed at improving the technology used by the entrant. If the original choice of technology was distorted by asymmetric regulation, these resources are misdirected and represent additional social waste" (Schankerman at n. 3).

The price cap plan already prevents the LECs from offsetting losses for competitive services with higher prices for less-competitive services. This is accomplished, in part, by the structure of the price cap baskets and service categories themselves. As the Commission has noted in the *Second Notice* (at ¶19), it is the pricing bands associated with the price cap categories which prevent LECs from offsetting price increases in one service with decreases in an unrelated service. Although GTE has proposed to combine several categories and subcategories in the existing plan where similarities in service characteristics exist (*i.e.*, 800 and LIDB data base services) and to combine services in which high cross-elasticities of demand are now present (*i.e.*, DS1 and DS3 services), the underlying pricing band safeguards remain and would effectively eliminate the ability to cross-subsidize one service with another.[21]

Further, even under the more flexible rules proposed in the *Second Notice*, LECs are precluded from charging high anti-competitive prices for services required by IXCs and CAPs. In fact, Expanded Interconnection Service ("EIS"), the set of services absolutely essential to a CAP's ability to interconnect to a LEC network, is completely outside of price cap regulation and can in no way be affected by pricing behavior associated with price cap services. Other LEC services that would be purchased by an interconnector are sold at the same tariffed rates that other access customers pay.[22]

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21 *See* Schamalensee and Taylor at 2.

22 Bernheim suggests that a LEC could leverage its control of "bottleneck" facilities to capture rents in downstream markets. Comments of AT&T, Appendix A, "An Analysis of the FCC's Proposal for Streamlined Regulation of LEC Access Services", B. Douglas Bernheim. ("Bernheim") As a supposed example of this, Bernheim posits that the LEC could raise the price of "loops" to its access

Finally, aggrieved parties could file a complaint under Section 208 of the Act to the extent they believe any rates filed by LECs are unreasonable or discriminatory.

LECs also have little opportunity, or incentive, to engage in broad-scale predatory pricing as many commenters claim. The new service tariff filing rules would continue to maintain the requirement that *all* new services be priced at a level that exceeds direct cost. Under GTE's proposal for pricing flexibility, LECs would also be required to show that APPs were priced above direct cost. Moreover, LECs have no real incentive to engage in predatory pricing, since they would not be able to recoup losses through other rates. As GSA observes (at 7), concern over predatory prices for certain services and corresponding high prices for others is overstated.[23]

As GTE stated (at 29):

> The potential harm from rates that are too low is a second-order effect which could only affect consumers if the LEC were able to carry out a strategy of predation successfully. The chances for such a strategy to succeed in interstate access markets are slim, given the difficulty of recoupment, the rapid growth of entry in these markets, the existence of significant sunk investments in competitors' networks, and the LECs' inability to prevent reentry.

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customers, while reducing the price of "switching." But there is no basis for this example in the reality of interstate access pricing. If the "loops" are special access channel terminations, then they would be sold at the same tariffed rates and terms to any customer. For switched, or common line "loops", the LECs do not charge access customers directly today. The only "per-loop" charge is the EUCL, which is paid by the end-user. The other charge related to switched "loops" is the CCLC, which is applied to essentially the same minutes as the local switching rate. There is therefore no opportunity for the LEC to gain by discriminating between "loops" and "switching." In any event, the rate elements involved are in different price cap baskets.

23 GSA notes (at 7) that as competition grows, below-cost pricing will only result in an unfavorable outcome -- achievement of a dominant share of a specific market but only at a continued loss.