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

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In the Matter of	)	
	)	
Price Cap Performance Review for Local Exchange Carriers	)	CC Docket 94-1
	)	
Treatment of Operator Services Under Price Cap Regulation	)	CC Docket 93-124
	)	
Revisions to Price Cap Rules for AT&T	)	CC Docket No. 93-197

REPLY COMMENTS OF SPRINT TELECOMMUNICATIONS VENTURE

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TABLE OF CONTENTS

SUMMARY

The comments in this proceeding demonstrate no need for fundamental change in the pricing of local exchange carrier ("LEC") access services, and confirm that until the incumbent LECs face substantial competition from access service providers that reach end users over nonLEC facilities, competing providers of interstate access services will face predatory pricing and cost-price squeeze strategies based on LEC control of bottleneck facilities. Under these circumstances, liberalization of the price cap rules, including elimination of lower service bands, relaxation of the rules concerning new services and creation of a vaguely-defined class of alternative pricing plans, is imprudent and premature.

The record also demonstrates that until competing access providers have a choice of nonLEC local facilities through which to reach their customers, neither the market share of competitive access providers ("CAPs") nor their capacity to serve additional customers will offer a meaningful check on the market power of the incumbent LECs. Any competitive checklist used to assess when streamlining or nondominant treatment of LEC access services may be appropriate, therefore, must set out meaningful measures of facilities-based, rather than LEC-dependent, competition.

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REPLY COMMENTS OF SPRINT TELECOMMUNICATIONS VENTURE[1]

The extensive comments filed in this proceeding offer no substantial support for the drastic proposals made in the Second Further NPRM ("SFNPRM"), which represent an abandonment of longstanding Federal Communications Commission policies. Until now the Commission consistently has recognized that where local exchange carriers ("LECs") control bottleneck facilities, their pricing decisions in competitive markets that depend on those facilities must be confined by strict notice and cost support requirements. The Commission also has consistently found that only facilities-based competition offers an effective check on the market power of carriers that control essential facilities. Since the record in this proceeding offers no rational basis for the Commission's rejection of these policies, further dilution of the competitive safeguards

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[1] Sprint Telecommunications Venture ("STV") is a joint venture formed by subsidiaries of Sprint Corporation, Cox Communications, Inc., Tele-Communications, Inc. and Comcast Corporation to provide nationwide wireless telephony services.

contained in the existing price cap rules -- much less streamlined or nondominant treatment of the LECs' access services -- must wait until the LECs face effective competition from competitive access providers that do not depend on LEC local exchange facilities to reach end users.

I. The Record Does Not Support Liberalization Of The Price Cap Rules In The Absence Of Effective, Facilities-Based Competition

Beginning with the historic initiatives of the 1970s, the Commission's efforts to promote competition have been based on the premise that where LECs are the only source of local facilities without which new entrants cannot compete, LECs enjoy market power in the market for any product or service that depends on those facilities. The Commission further has recognized that LECs can exploit their local exchange bottleneck in two ways: first, by raising competitors' cost of service through delay, inferior interconnection and overpricing of LEC-controlled inputs; and second, by strategic pricing of competing LEC services.

The Commission has sought to blunt the first prong of the LEC attack -- overpricing of LEC-controlled inputs -- by mandating prompt, efficient interconnection and requiring cost support for all interconnection charges. The equal access rules, comparably efficient interconnection and ONA rules, and the recent proceedings concerning collocation charges for expanded access service interconnections all are efforts of this kind.[2]

In meeting the second prong of the attack, the Commission has recognized that anticompetitive pricing can take at least two forms. One approach is classic, predatory pricing: *i.e.*, pricing competing services below cost until competitors are driven from the market, then recouping

[2] *See, e.g., Investigation into the Quality of Equal Access Services,* 60 Rad. Reg. 2d (P&F) 417 (1986); *Filing and Review of Open Network Architecture Plans,* 5 FCC Rcd 3103 (1990); *Local Exchange Carriers' Rates, Terms, and Conditions for Expanded Interconnection through Virtual Collocation for Special Access and Switched Transport,* 10 FCC Rcd 6375 (1995).

lost profits through supracompetitive pricing after the rivals are gone.[3] The other approach is the equally well-recognized cost-price squeeze: *i.e.,* reducing competitors' profits by simultaneously charging inflated prices for the inputs they need and dropping prices for LEC services with which the new entrants compete.[4]

Historically, the Commission has treated the second prong of the LEC attack with the same seriousness as the first, and has put in place regulations intended to control both predatory pricing and price-cost squeeze strategies. The Commission correctly has concluded that predatory pricing is most effective where regulation permits losses in competitive markets to be made up through supracompetitive pricing of monopoly services. Accordingly, the Commission has sought to reduce the incentives for predatory pricing by instituting price cap regulation. At the same time, however, the Commission has recognized that its price cap regulations do not entirely remove predatory pricing incentives or the LECs' ability to engage in cost-price squeeze strategies. Accordingly, the Commission's price cap rules include carefully crafted safeguards against anticompetitive pricing of competitive services, including limits on the downward movement of access charges and notice and cost support requirements for new access services.[5] Until now, the Commission consistently has declined to weaken its price cap safeguards against anticompetitive LEC pricing. Where the Commission has increased the LECs' pricing flexibility, it has done so

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[3] SFNPRM at ¶ 22; *see* Areeda & Turner, *Predatory Pricing and Related Practices under Section 2 of the Sherman Act,* 88 Harv. L. Rev. 697 (1975).

[4] *See, e.g.,* SFNPRM at ¶ 10. While the two strategies are easily confused, they are in fact very different: successful predatory pricing may be accomplished without simultaneously raising rivals' costs, but requires the monopolist to sacrifice short-term profits in the competitive market; cost-price squeezes, on the other hand, may not require the monopolist to sacrifice profits in the competitive market, so long as prices for the monopolized inputs are sufficiently high.

[5] *See, e.g.,* SFNPRM at ¶ 22; *see also id.* at n.51.

incrementally and has continued to place on the LECs, rather than their nascent competitors, the burden of showing that the LECs' charges are cost-justified. Where limits on downward pricing flexibility have been relaxed, they have been relaxed within set limits and in exchange for an appropriate *quid pro quo*, such as a demonstration of increased competition and the LECs' implementation of density pricing plans that also require stringent cost support.[6]

The initiatives proposed in the SFNPRM are very different from these gradual approaches. By creating a partly deregulated category of new services, eliminating lower service band index limits outright, and recognizing a loosely-defined class of alternative pricing plans not subject to the usual safeguards, the FCC would, for the first time, adopt rules that increase the LECs' opportunities for anticompetitive pricing in the interstate access market. Such a stark departure from past policy must stand on a rational basis -- for example, on changed competitive circumstances that clearly reduce the competitive risks on which the safeguards are based. The SFNPRM does not offer such a basis, and the comments filed in this proceeding not only fail to supply the missing record, but underscore the inappropriateness of these proposals.

A. The Record Does Not Support Elimination Of The Lower Service Band Index Limits

As the SFNPRM acknowledges, the lower service bands were instituted to prevent anticompetitive pricing.[7] By permitting rate reductions within those limits to be made without cost justification, and permitting below-band rates so long as the LECs showed that those rates exceeded

[6] *Expanded Interconnection with Local Telephone Facilities,* 7 FCC Rcd 7369, 7454 n.411, *vacated in part and remanded, Bell Atlantic Telephone Companies v. Federal Communications Commission,* 24 F.3d 1441 (D.C. Cir. 1994); *Expanded Interconnection with Local Telephone Facilities,* 9 FCC Rcd 5154, 5196 (1994).

[7] SFNPRM at ¶ 78; *Policy and Rules Concerning Rates for Dominant Carriers,* 5 FCC Rcd 6786, 6811 (1990)(*"LEC Price Cap Order").*

the associated costs, the Commission carefully balanced the LECs' need for flexibility, on the one hand, and the integrity of the competitive process, on the other. The Commission now proposes to eliminate those protections for two reasons: because they supposedly prevent the LECs from moving their charges closer to cost, and because they are not needed to protect consumers or the competitive process. Neither conclusion is supported by the record.

In support of the first claim -- that LECs require additional downward pricing flexibility -- neither the SFNPRM nor the LECs' comments point to a single case in which access charges were held above cost because of the lower service band rate limits. The SFNPRM merely speculates that lower service band limits "*might* inhibit a LEC from lowering its prices to cost in certain instances . . . ," without specifying a single such instance.[8] Similarly, the LEC comments make conclusory claims, for which no factual support is offered, that downward pricing limits may prevent efficient rate reductions.[9] But in fact, as one LEC commenter admits and no commenter disputes, the present rules governing density pricing, volume discounts, term discounts and out-of-band filings permit the LECs to make any access charge reduction, of whatever magnitude, where they can show that

[8] SFNPRM at ¶ 83 (*emphasis added)*.

[9] *See* Comments of Southwestern Bell Telephone Company ("SWBT Comments") at 30 (speculating that "having lower bounds on prices . . . *may* actually impede . . . pro-consumer pricing responses of the price cap LECs . . .")(*emphasis added);* Comments of US West Communications, Inc. ("US West Comments") at 25 (repeating the SFNPRM's suggestion that "the current price cap plan *may* discourage LECs from lowering prices approaching cost . . .")*(emphasis added)*. Other LEC comments are equally general, and none of the LEC comments points to a single service, market or occasion on which a LEC wished to make a rate reduction and was unable to do so because of lower service bands or any other constraint contained in the present rules. *See* Ameritech Comments in Response to Second Further Notice of Proposed Rulemaking ("Ameritech Comments") at 21; Comments of BellSouth Telecommunications, Inc. ("BellSouth Comments") at 26; Comments of GTE at 29; Bell Atlantic Comments at 22; NYNEX Comments at 18; Comments of Pacific Bell and Nevada Bell at 19; Comments of the United States Telephone Association ("USTA Comments") at 30.

the reduced charges recover the associated costs.[10] The LECs contend, not that these mechanisms are inadequate to permit them to move their prices closer to cost (BellSouth, for example, admits that "none [of its below-band] filings has ultimately been rejected . . ."),[11] but only that the support requirements for out-of-band filings are administratively inconvenient.[12] The LECs' comments compel the conclusion that lower band limits prevent nothing except below-cost filings and anticompetitive manipulation of the rate structure.[13]

The comments also fail to support the conclusion that the lower service bands can be eliminated because they are not needed to protect competition.[14] In support of this conclusion, the

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[10] Pacific Bell and Nevada Bell acknowledge that elimination of lower service band limits would give the LECs "little or no downward pricing flexibility that [they] do not already have . . ." Comments of Pacific Bell and Nevada Bell at 19.

[11] GTE Comments at 29.

[12] "GTE . . . has reduced access rates under the price cap plan, including below-band filings for both switched and special access rates. *While none of these filings has ultimately been rejected,* GTE has expended considerable time and effort in justifying below-band filings, and has had such reductions suspended for a period of time." Comments of GTE at 29 *(emphasis added)*. "[T]he current price cap plan may discourage LECs from lowering prices approaching cost in many situations as the administrative burdens associated with a below-band filing are extensive and time consuming." US West Comments at 25. The claim of administrative inconvenience, too, is vitiated by the failure of the LECs to identify a single instance in which a desired rate reduction was prevented by the burden of complying with the present rules.

[13] The LECs' claim to need additional downward pricing flexibility is further undermined by their failure to make full use of the flexibility afforded by the present rules. As the comments of the Association for Local Telecommunications Services point out, of the 132 service sub-baskets so far populated by the LECs, "the Service Band Index (SBI) for only two of the 132 groups is even below the *midpoint* of the upper and lower bands." Further, "[n]one of the SBI's is close to its lower limit, and many other SBIs are at the upper price constraint." W. P. Montgomery, *Pre-Competitive Pricing Flexibility for Price Cap LECs* at 6, appended to Comments of the Association for Local Telecommunications Services.

[14] The Commission seems to have discarded, without explanation, its earlier view that further relaxation of the lower service bands must await an increase in competition. As the SFNPRM points out, "[i]n the *First Report and Order* in this proceeding [entered in 1995], we considered once again the issue of expanding the service bands and concluded that enlarging the lower service band limits would not greatly increase the risk of successful predation. This conclusion was based in part on the growth in competition that the industry has experienced since the adoption of expanded interconnection for special access and switched transport . . . Although the changes we imposed in the *First Report and Order* were limited in scope, we indicated a willingness to make additional changes in the price cap rules *as competition developed.*" SFNPRM at ¶ 81-82 *(emphasis added)*. But the SFNPRM neither shows that competition has increased meaningfully since 1995, nor explains why advances in competition apparently have become irrelevant. The Commission merely announces, without explanation, that lower service bands and other price cap safeguards now can be eliminated regardless of the state of competition. SFNPRM at ¶ 2.

LEC commenters make a number of arguments. Notably, the LECs contend that price cap regulation prevents below-cost pricing of competitive access services by eliminating incentives for cross-subsidization.[15] The LECs also argue that retention of the upper service bands, and the price cap itself, defeat predatory pricing strategies by preventing the LECs from recouping profits lost through below-cost pricing of competitive services.[16] Further, the LECs maintain that if the LECs nonetheless are tempted to engage in predatory pricing strategies, the section 208 complaint process is available to redress any harm the LECs might do.[17] Taken as a whole, the record shows that the rationale for these conclusions is seriously flawed.

First, as the SFNPRM recognizes and the comments of nonLEC parties explain in some detail, the replacement of rate of return regulation with the present price cap rules has not eliminated opportunities for cross-subsidization of competitive LEC access services. The FCC's system is not a "pure" price cap regime, but a compromise approach that includes sharing provisions, a low end adjustment mechanism, choices among X factors, and substantial LEC discretion in the amount and distribution of overhead loadings.[18] All of these mechanisms create

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[15] *See, e.g.,* Bell Atlantic Comments at 21-22; BellSouth Comments at 27 and appended Statement of Professor Jerry A. Hausman at ¶ 21-25; Comments of GTE at at 29; SWBT Comments at 32; R. Schmalensee and W. Taylor, *Pricing Flexibility for Interstate Carrier Access Services* at 14, appended to USTA Comments. While the Commission has found that incentive regulation discourages cross-subsidization, the Commission has never found that its price cap rules remove *all* opportunities for cross-subsidization or prevent all forms of predatory pricing. In fact, the SFNPRM describes structural features of the telecommunications industry that encourage predatory pricing by incumbent LECs. SFNPRM at ¶ 22.

[16] *See* FNPRM at ¶ 83; Ameritech Comments at 21; Bell Atlantic Comments at 22; SWBT Comments at 31-32.

[17] *See* Ameritech Comments at 21; Bell Atlantic Comments at 22; SWBT Comments at 33. Some LECs also suggest that aggrieved competitors can find redress in the antitrust courts. *See* Ameritech Comments at 27; BellSouth Comments at 27; Comments of GTE at 30.

[18] *See* Declaration of Leland L. Johnson, Ph.D. at 6-15, app. to Comments of the National Cable Television Association, Inc.; W.P. Montgomery, *Pre-Competitive Pricing Flexibility for Price Cap LECs* at 9-14, app. to Comments of the Association for Local Telecommunications Services.

opportunities for LEC manipulation of price-cost relationships among interstate services.[19] Whatever the merits of theoretical price cap approaches, therefore, the existing price cap regulations give LECs ample reason to believe that strategic, below-cost pricing will not cost them profits in the long run.

Contrary to the Commission's suggestion, the retention -- or even the tightening -- of upper service bands will not frustrate these pricing strategies. If LECs are able to compensate for below-cost pricing of one service with above-cost pricing of another, then they will have no need to raise the subsidized rate to a supracompetitive level after rivals are driven from the market. Upper service bands that prevent such increases, therefore, cannot themselves deter predatory pricing; lower bands also must be retained.

Finally, the suggestion that the section 208 complaint process -- and perhaps the antitrust courts -- are an adequate substitute for lower service bands and the out-of-band filing rules ignores reality. The existing system puts the burden of justifying out-of-band filings where it belongs: on the LECs, who have ready access to the relevant information. Placing the onus on competitors to extract this information from unwilling defendants in the course of adversarial proceedings, through an overburdened formal complaint process or the antitrust courts, is unfair and ultimately ineffective.

[19] State price cap regulation also tends not to divorce rates entirely from costs, and may permit LECs to subsidize their interstate access charges through above-cost pricing of intrastate services that use some of the same facilities. Declaration of Leland L. Johnson, Ph.D., *supra* at 13-15.

B. The Record Does Not Support The Proposed Treatment Of New Services And Alternative Pricing Plans

Just as the LECs' comments fail to demonstrate a need for increased downward pricing flexibility for existing access services, those comments also fail to show a need for liberalized treatment of new services and discount pricing plans. Since these proposals, like the proposed elimination of lower service bands, will invite anticompetitive abuse, they should not be adopted.

1. The Proposed Rules Concerning New Services Should Not Be Adopted

The existing rules recognize that when LECs introduce new access services, they are in an ideal position to circumvent the price cap safeguards and game the system. Because the LECs can represent that the cost and demand characteristics of a "new" service are unknown, the Commission has little ability to determine whether new service rates are procompetitive. What the Commission does know is that where the new service is an essential input needed by competitors, the LECs will be tempted to charge well in excess of the associated costs;[20] and that where the service competes with those of new entrants, the LECs will be equally tempted to price below cost.

The present rules seek to restrain anticompetitive pricing of new services by requiring notice and cost support for those filings, and by requiring those services to be brought within price caps within a reasonable time. The rules proposed in the SFNPRM, however, will weaken those safeguards for reasons that are unpersuasive and unsupported by the record. As with the proposal to eliminate lower service bands, the SFNPRM's rationale for weakening the new services rules

[20] The Commission recently encountered dramatic evidence of this tendency, when it found that LECs had proposed unlawful virtual collocation rates based on unjust and unreasonable overhead loading levels. *Local Exchange Carriers' Rates, Terms, and Conditions for Expanded Interconnection through Virtual Collocation for Special Access and Switched Transport,* 10 FCC Rcd 6375, 6376 (1995).

combines speculative claims that the LECs need additional flexibility, with equally speculative claims that the new rules will not harm competition.

In support of the claim that LECs need additional flexibility in pricing of new services, the SFNPRM simply repeats the LECs' claim, made in response to the Phase I Notice in this proceeding, that "the new service rules are unreasonably time-consuming and burdensome, and may impede the development and introduction of new services."[21] Neither the SFNPRM, nor the extensive comments filed by the LECs, points to a single case in which a LEC has declined to introduce a new service because of the cost of compliance with the present rules.[22] So far as the record shows, the LECs' concern is speculative at best.

As to the second argument -- that the new rules will not harm competition -- the Commission proposes that the competitive process will be sufficiently protected if higher scrutiny is limited to a class of so-called "Track 1" services, which the Commission proposes to define as services that are essential to competitors or services (such as expanded interconnection) that the Commission has ordered LECs to provide.[23] Neither criterion, however, offers any protection against anticompetitive pricing. Predatory measures are just as likely in competitive services as in the markets for monopolized inputs needed by competitors. And as a petition recently brought by MFS shows, it is dangerous to rely on the LECs to decide what services the Commission has

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[21] SFNPRM at ¶ 44.

[22] As with their claims to need relief from lower pricing bands, the LECs' complaints about the new services rules are equivocal and nonspecific. *See, e.g.,* Ameritech Comments at 6 ("[t]hat these restrictions constitute a disincentive to the investment and development of new services *goes without saying")(emphasis added); see also* Bell Atlantic Comments at 8; BellSouth Comments at 7; Comments of GTE at 3; Comments of Pacific Bell and Nevada Bell at 6-7; SWBT Comments at 15-16; USTA Comments at 16; US West Comments at 7-8; Comments of Cincinnati Bell Telephone Company at 3.

[23] SFNPRM at ¶ 47.

ordered the LECs to provide.[24] Liberalization of the rules concerning new services, therefore, should await the presence in the access services market of competitors that do not rely on LEC facilities to reach their end users.

2. The Commission Should Not Create A New Category Of Alternative Pricing Plans

In addition to its proposal to create a new class of partly-deregulated new services, the Commission proposes to permit LECs to create alternative pricing plans ("APPs") for existing access services. These plans could be filed on fourteen days' notice and without cost support for up to ninety days.

As with elimination of lower pricing bands and the proposed "Track 2" new services, the APP proposal addresses a need that has not been demonstrated and creates new opportunities for predatory conduct. As STV pointed out in its Comments, STV does not oppose discount plans that are based on identifiable cost characteristics of the underlying service, geographic region or customer group.[25] Neither the SFNPRM nor the comments, however, offers such specific criteria for the proposed APPs. As all segments of the industry except the LECs have pointed out in their comments, this open-ended proposal will give the LECs a predatory pricing tool of surgical precision. In the absence of a clear definition of the customer cost characteristics that will justify

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[24] MFS Communications Company, Inc. Petition for Declaratory Ruling that Interconnector Access to LEC Services May Not Be Restricted, CC Docket 91-141 (Dec. 4, 1995.) As the documents appended to the MFS Petition show, the LECs have taken the position that only expanded collocation arrangements specifically mentioned in the Commission's orders must be provided to the competitive access providers. This position is contrary to the Commission's intention to authorize interconnection to "the broadest array of special access services" (*Expanded Interconnection with Local Telephone Company Facilities,* 9 FCC Rcd 5154, 5159 (1994)), and underscores the danger of letting LECs decide when a service has been ordered by the Commission.

[25] STV, in fact, would support elimination of the requirement that LECs demonstrate the presence of competition in a study area before instituting zone discount pricing, so long as the discounts are based on detailed cost support and lower service bands and other safeguards contained in the present price cap rules are retained. STV Comments, n. 22 at 8.

creation of an APP, LECs will fashion customized discount plans for their larger customers, not based on cost, wherever they face competition. The LECs will find this device especially useful if they are permitted to enter the interexchange market, where they undoubtedly will fashion APPs that favor their own long-distance operations.

C. The Competitive Environment Calls For Greater, Rather Than Lesser, Vigilance Over LEC Pricing Practices

The most striking feature of the proposals made in the SFNPRM is their timing. The safeguards contained in the price cap rules were, if anything, less critical before expanded interconnection made competition in the access market fully feasible. Those safeguards will, again, become less critical when facilities-based competition reduces the ability of the LECs to misuse their control of the local exchange to engage in anticompetitive pricing. Now, however -- when competitors are beginning to enter the switched access market in earnest, but still are a marginal phenomenon dependent on the LECs for access to their customers -- is the time when safeguards against abusive LEC pricing behavior are most vital. Competition in the interstate access market is miniscule, even in those geographic areas where it is most advanced.[26] Nearly all of the nascent competition is dependent on the LEC bottleneck for access to end users, and therefore is competition of a kind the Commission has acknowledged as insufficient to overcome the LECs' market power.[27] Since the competitive environment is highly unfavorable to the Commission's

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[26] The Comments show that even in New York, where competitive access services are most advanced, 71% of Teleport Communications Group's local switched services revenues are paid to NYNEX. Comments of Teleport Communications Group, Inc. at 3; *see also* Comments of Sprint Corporation at 25-26, noting that "in NYNEX's LATA 132 -- which the Commission has found is one of the most competitive access markets in the country -- NYNEX receives 96% of Sprint's access dollars, either directly or through CAPs, despite Sprint's policy of giving as much of its access business to CAPs as they are able to handle . . ."

[27] "We treat control of bottleneck facilities as prima facie evidence of market power requiring detailed regulatory scrutiny." *Policy and Rules Concerning Rates for Competitive Common Carrier Services and Facilities Authorizations Therefor,* 85 FCC 2d 1, 21 (1980).

deregulatory proposals, and since the record shows that the asserted need for relaxation of the price cap safeguards is entirely speculative, there is no rational basis for weakening of the price cap rules in the absence of effective, facilities-based competition.

II. The Record Does Not Support Streamlined Or Nondominant Regulation In The Absence Of Effective, Facilities-Based Competition

In addition to the reduced regulation that the Commission has proposed even in the absence of competition, the SFNPRM requests comments on the criteria that could be used to identify competitive conditions that justify streamlining, or nondominant treatment, of LEC access services. As STV pointed out in its comments, and as all commenters in all segments of the industry except the LECs have emphasized, meaningful competition in these markets is so remote that the attempt to apply a competitive checklist at this time is premature.[28] If the Commission does adopt criteria for streamlined or nondominant treatment, however, economic reality and continuity with past policy both require that those deregulatory initiatives occur only when meaningful, facilities-based competition has eliminated LEC control of bottleneck facilities.

A. The Commission Consistently Has Based Streamlined And Nondominant Regulation On Facilities-Based Competition

In the course of relaxing its rate regulation of certain classes of nonLEC service providers, the Commission has reinforced its view that control of bottleneck facilities, and the absence of nonfacilities-based competition, confer market power. When it instituted streamlined and nondominant regulation in the 1980s, the Commission first deregulated those service providers that

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[28] STV Comments at 10-11; Comments of the National Cable Television Association, Inc. at 29; Comments of Time Warner Communications Holdings, Inc. at 61; Comments of Cox Enterprises, Inc. at 8; Comments of Sprint Corporation at 25-27; Comments of AT&T Corp. at 5; Comments of MCI Telecommunications Corporation at 34.

faced facilities-based competition, and declined to streamline AT&T because its continued control of bottleneck facilities was *prima facie* evidence of market power.[29] After divestiture, when AT&T no longer controlled bottleneck facilities, the Commission began to assess AT&T's market power according to such conventional criteria as market share and the availability of substitute sources of supply. When it finally extended nondominant treatment to AT&T, the Commission emphasized that AT&T's present lack of market power derives, not simply from its reduced market share and the availability of substitute sources of interexchange service, but from the fact that AT&T no longer controls essential facilities and faces substantial facilities-based competition. As the recent order confirming AT&T's nondominant status states:

> Our determination fifteen years ago . . . that AT&T possessed market power rested on several market characteristics, including the facts that AT&T controlled, through its ownership of the Bell operating Companies, local access facilities for over 80 percent of the nation's phones . . . Today, conditions in the market are far different. *First, AT&T has not controlled local bottleneck facilities for over ten years. Second, AT&T faces at least two full-fledged facilities-based competitors. Both MCI and Sprint have nationwide networks that are capable of offering most consumers an alternative choice of services relative to AT&T. In addition, there is at least one other nationwide facilities-based provider . . . which primarily serves the business market and could enter the residential market . . . , and dozens of regional facilities-based carriers . . .*[30]

A greater contrast between AT&T's case and that of the LECs can hardly be imagined. As the comments in this proceeding show, the LECs' control of bottleneck facilities on which

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[29] *Policy and Rules Concerning Rates for Competitive Common Carrier Services and Facilities Authorizations Therefore,* 85 FCC 2d 1 at 21 (1980).

[30] *Motion of AT&T Corp. to be Reclassified as a Non-Dominant Carrier,* 1995 FCC LEXIS 6877 at paras. 69-70 (rel. Oct. 23, 1995)(*emphasis added).*

competing access providers depend is unabated, and facilities-based competition in the access service markets barely exists.[31] Consistency with past Commission policy, therefore, requires that streamlined or nondominant treatment of LEC access services await the day when the LECs, like AT&T, no longer control bottleneck facilities and face "facilities-based competitors . . . that are capable of offering most consumers an alternative choice of services relative to [the LECs]."[32]

B. The Economic Arguments Offered In Favor Of Streamlined Regulation In The Absence Of Facilities-Based Competition Are Invalid

In stark contrast to its past policies, the Commission's SFNPRM appears to suggest that a "competitive checklist" to justify streamlined or nondominant regulation of LEC access services might be based on the availability of nonLEC access services from suppliers that remain dependent on the incumbent LECs' local exchange facilities. Specifically, the SFNPRM asks for comment on the applicability of such traditional market power criteria as market share, demand responsiveness and supply responsiveness to an eventual determination that the power of the LECs in the interstate access market has eroded sufficiently to permit substantial deregulation of the LECs' access services. This suggests an unexplained departure from the Commission's past view that LEC control of bottleneck facilities gives them market power regardless of the extent of nonfacilities-based competition.

The LECs' comments offer no sound reason to abandon the Commission's past approach. The LECs' principal, proposed substitute for facilities-based competition is a showing that some

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[31] *See* Comments of Sprint Corporation at 25-26; Comments of Teleport Communications Group, Inc. at 4.

[32] *Id.*

percentage of an access market is "addressable" by competitors, which may or may not be dependent on LEC bottleneck facilities.

The most surprising feature of "addressability" is that the Commission would give this theory any credence at all. The academic literature is singularly barren of references to this concept, which appears to have been introduced into the price cap performance review proceedings by the United States Telephone Association.[33] Even the definition of the concept is fluid: the Commission states that addressability requires "the physical presence of alternative providers with the capacity and geographic coverage to serve a substantial portion of the market,"[34] while the LEC commenters suggest that the mere presence of a competitor operating in a customer's service area--regardless of that competitor's present, operational capacity -- makes that customer "addressable."[35]

Whichever definition of the concept it adopts, the Commission should not place any reliance on the notion of addressability. The concept has no standing among economists, merely is a way of restating the fact that competitors exist in a service area, and does not meet the Commission's test that only facilities-based competition can erode the market power of incumbent LECs.

"Addressability's" veneer of theoretical respectability is based on the attempt to associate it with "contestability" -- itself a controversial concept that has not gained acceptance in the courts

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[33] *See, e.g.*, Comments of the United States Telephone Association Concerning the Transition Issues Set Forth in Paragraphs 92-100, Subsection D of Section VIII, of the Notice of Proposed Rulemaking adopted on January 19, 1994 in CC Docket No. 94-1.

[34] SFNPRM, n.207 at ¶ 139.

[35] Comments of Bell Atlantic, Affidavit of Richard J. Gilbert and Robert G. Harris at 19; R. Schmalansee and W. Taylor, *Pricing Flexibility for Interstate Carrier Access Services*, n.45 at 26, app. to Comments of the United States Telephone Association.

and has no application to the access markets, but that at least has been aired in peer-reviewed journals of economics. Contestability simply means that where barriers to entry in a market are negligible -- a condition that hardly exists in telecommunications -- monopolists' pricing decisions will be restrained by the threat of new entry.[36] Addressability, on the other hand, merely states that competitors are present in the market -- a fact that has little significance, in judging the persistence of a monopolist's market power when those competitors are dependent on the monopolist for their access to essential inputs.

STV agrees with the Commission that market share, alone, should not determine whether LECs are found to have market power. The availability of substitute sources of supply, the existence of barriers to entry, and other factors certainly are relevant and should be considered. But in measuring the extent of competition -- whether expressed as market share or supply responsiveness -- the Commission should count only the supply of access services that are available from competitors that do not depend on the LECs for access to their customers. When cable companies, power companies, CAPs or other providers reach end users through their own facilities, LECs will not be able to drive those competitors from the market through price-cost squeeze strategies, and those competitors will act as a real restraint on monopoly pricing by the LECs. Until then, competition exists at the sufferance of those who own the bottleneck.

CONCLUSION

The comments in this proceeding only underscore the inadequacy of the record to support the radical, deregulatory proposals made in the SFNPRM. The Commission, therefore, should make no fundamental change to the price cap rules in the absence of competition, and should defer

[36] *See* W. Baumol, J. Panzar and R. Willig, *Contestable Markets and the Theory of Industry Structure* (1982).

any attempt to identify the specific conditions under which streamlined or nondominant treatment of LEC access services might become appropriate. In the future, as in the past, the FCC's access charge policies should be guided by the principle that so long as the LECs control bottleneck facilities and do not face substantial, facilities-based competition, their pricing decisions must be subject to reasonable -- but vigilant -- regulation.

Respectfully submitted,

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