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

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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

REPLY COMMENTS OF AD HOC TELECOMMUNICATIONS USERS COMMITTEE

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SUMMARY

After reviewing the comments in this docket, the Ad Hoc Telecommunications Users Committee ("Ad Hoc" or "Committee") is convinced that this proceeding is at best premature. LECs have not presented persuasive evidence that they need additional pricing flexibility at this time. Indeed, there is now evidence that the LECs have not used the pricing flexibility already available under the current rules.

The Commission's establishment of this docket in the absence of marketplace evidence justifying pricing flexibility for the LECs is puzzling, particularly when it reportedly will soon begin a comprehensive review of its access charge system and is in the midst of a pleading cycle that aims at obtaining the views of interested parties on the type of information that the Commission should obtain to assess the competitiveness of the interstate access service market. Observers have speculated that the Commission's action may have been promted by several reasons. One could be that the LECs have kept up a constant drumbeat of demands for more pricing flexibility claiming repeatedly but without proof that the market justifies it. By making this assertion often enough, the LECs may have convinced the Commission that it is true, or at least possibly true, even in the absence of evidence to support it. Another possibility is that the Commission staff includes adherents to the theory of contestable markets. Whatever may have prompted this proceeding, one point stands out clearly in the comments: premature pricing flexibility, (*i.e.*,

pricing flexibility before the reality of effective competition), could damage the prospects for more competition in the access service market.

Not surprisingly, LECs want virtually all new services classified as Track 2 services. Long distance carriers, competitive access service providers and major consumers of telecommunications services oppose the Commission's Track 1/Track 2 proposal. The proposal will not facilitate the introduction of new services, or remove the controversy that could surround LEC introduction of new services. It is noteworthy that the largest consumers of access services do not support the Track 1/Track 2 proposal. They are not clamboring for new access services. Even if they wanted certain new access services, they undoubtedly understand that LECs can price new services outside the zone of reasonableness because there are at present insufficient market place forces to constrain LEC prices and practices.

The assertion of some LECs that pricing flexibility is needed so that they can price more efficiently represents a shift in argument and is preposterous on its face. Heretofore, LECs have argued that they need pricing flexibility to meet competition. Now when the Second Further Notice of Proposed Rulemaking proposes pricing flexibility without regard to the level of competition, the focus is on efficient pricing. But in the absence of competition, there is absolutely no reason to believe that LECs will price in economically efficient manner. Just the opposite should be expected.

The members of the Committee would be among the chief beneficiaries of lower, economically sound access charges. In the long-run,

however, only effective competition will produce such pricing. The Committee respectfully suggests that the comments demonstrate that proposals to grant LECs additional pricing flexibility without regard to the actual level of competition are ill-advised.

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INTRODUCTION

The Ad Hoc Telecommunications Users Committee ("Ad Hoc" or "Committee") hereby replies to comments filed in the above captioned proceeding. In the Second Further Notice of Proposed Rulemaking,[1] the Federal Communications Commission ("FCC" or "Commission") proposed three stages of pricing flexibility for local exchange carriers ("LECs"):

Stage 1: Additional pricing flexibility, without regard to the level of competition;

Stage 2: "Streamlined Regulation" for specific services; and

Stage 3: Establishment of tests for determining when LECs can be declared "Non-Dominant."

[1] *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, released Sept. 20, 1995. ("Second FNPRM")

Many of the non-LEC commenters in this proceeding echoed the strong misgivings that were expressed in Ad Hoc's Comments on the inadvisability of granting LECs increased pricing flexibility without a persuasive demonstration that actual and effective competition exists. Like the Committee, these parties indicated that evaluation of guidelines for granting streamlined regulation status and for determining when a LEC is non-dominant would be premature;[2] and, like the Committee, they also concluded that evaluation of the level of actual competition through some sort of market share assessment is absolutely essential.[3] Not surprisingly, the LECs have a different view.[4]

I. THE LECS HAVE FAILED TO ESTABLISH THAT THE EXISTING PRICE CAPS RULES PREVENT LECS FROM MOVING TOWARD MORE "EFFICIENT" PRICING.

LEC comments in this proceeding regarding the need for additional pricing flexibility reveal a curious change from earlier LEC efforts to rationalize reduced pricing constraints. In the past,[5] LECs told the Commission that they

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[2] *See* Comments of Teleport Communications Group ("TCG") at 1-2; Comments of Sprint Telecommunications Venture ("Sprint") at 10; Comments of MCI Communications Corporation ("MCI") at 34-36; and Comments of MFS at 9. Even the Comments of GSA, which were generally supportive of the Commission's proposals, and who in fact urged the Commission to go further in some instances indicated that "the likelihood of any of the major incumbent LECs becoming nondominant in the near future is so remote as to justify the dismissal of this issue at this time." Comments of GSA at 17.

[3] *See* Comments of California Cable Television Association ("CCTA") at 5; Comments of ICG at 7-8; Comments of MCI at 33-34; and Comments of Telecommunications Resellers Association ("TRA") at 35.

[4] *See* Comments of US West at 41; Comment of Southwestern Bell Telephone Co. ("SWB") at 10-14; Comments of NYNEX at 35-37; Comments of Pacific Bell at 42-46; and Comments of BellSouth at 60-61.

[5] In USTA's Comments in *Price Cap Performance Review for Local Exchange Carriers*, CC Docket No. 94-1 (filed May 8, 1994), USTA argues that significant LEC access competition exists now and can be expected to increase rapidly in the near term, which merits pricing flexibility. Specifically,

needed more pricing flexibility to respond to emerging competition.[6] Now, the LECs stress that they need flexibility to price services more efficiently. They, however, offer no evidence that the Commission's existing price caps rules prevent them from setting prices at economically efficient levels. The message in BellSouth's comments is typical of the majority of the LECs: "The presence of competition should be the basis for removing regulation. It should not be used as an excuse to refrain from making regulation more efficient."[7] NYNEX similarly argues that the Commission should grant LECs additional pricing flexibility without any evaluation of, or linkage to, the level of competition for access services that actually prevails at this time.[8]

The LECs, however, ignore completely the fact that the currently effective price caps rules offer LECs a substantial level of pricing flexibility – a level of pricing flexibility that LECs do not fully utilize in setting rates for individual services. The Association for Telecommunications Services ("ALTS") provides evidence in its initial comments that in only 2 of the 132 service sub-baskets in use by the LECs have the LECs lowered prices within a service category below the mid-

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"[T]echnological advances (wireline, wireless) lower the cost of entry into telecommunications, thus facilitating increased LEC competition." Comments of USTA at 27. Regarding customer demand for new services, "[U]nless LECs are provided with sufficient flexibility under the Commission's rules, LECs will be limited in their ability to compete for this new demands." *Id.* at 31. And finally, regarding the need for flexibility to compete with CAPs, "[B]ecause CAPs have chosen not to serve high-cost areas, they have a distinct cost advantage over LECs. CAPs are exploiting these advantages of asymmetric regulation as they expand into switched access and even exchange services." *Id.* at 35.

6 In fact, such statements are still found in some of the LEC comments today. *See Comments* of Pacific Bell at 42-44; Comments of US West at 2-3; and Comments of SWB at 2-5.

7 Comments of BellSouth at 40.

8 Comments of NYNEX at 14. *See also* Comments of US West at 6; Comments of Pacific Bell at 32; Comments of Cincinnati Bell at 12; and Comments of SNET at 8.

point of the upper and lower bands for the category.[9] In all other cases, LECs maintain prices well in excess of the price caps lower limits. These are the same prices that the LECs now claim the existing price caps rules prevent them from lowering to more "economic cost" levels.[10] Moreover, the currently effective price caps rules allow LECs to request authority to make "Below Band" rate filings in order to respond to specific competitive initiatives, but such requests have been few and far between.[11] The LECs' average level of pricing above the lower limit band demonstrates the present availability of substantial additional -- and unused -- downward pricing flexibility, as shown in Table 1 to these Comments.

In fact, LEC behavior under existing pricing flexibility rules demonstrates that price levels will be reduced toward economic cost only for those services and in those geographic markets where actual competition is present. Consumers of LEC services do not benefit from LEC pricing flexibility in the absence of effective competition. Indeed, to the extent that LECs increase rates for individual services within a given price cap basket where no competition is present in order to recoup revenues foregone in competitive markets, the net overall effect of pricing flexibility is harmful to consumers for several important reasons:

- Consumers are subjected to less efficient prices in noncompetitive markets.
- LECs are able to use their undiminished market power in noncompetitive market segments to shift revenues from

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9 Comments of ALTS, Appendix: "Pro-Competitive Pricing Flexibility for Price Cap LECs" by William Page Montgomery at 6.

10 Comments of USTA at 24; Comments of GTE at vi; Comments of BellSouth at 32; and Comments of Pacific Bell at 32.

11 *Policy and Rules Concerning Rates for Dominant Carriers*, Second Report and Order, CC Docket No. 87-313, 5 FCC Rcd 6786 (1990).

competitive services to monopoly services, in effect cross-subsidizing the former by the latter.

- Competition is weakened in markets in which it is present to the extent that such cross-subsidies and potentially predatory pricing persist.

Selective application of available pricing flexibility opportunities is fundamentally at odds with the overriding "competitive result" goal of economic regulation. By definition and by deed, such a "competitive result" arises only in competitive market segments, and a distinctly noncompetitive, monopolistic outcome arises where no actual competition is present. Expanding existing pricing flexibility opportunities for LECs in the absence of effective competition will serve only to exacerbate this dichotomy, and clearly should not be pursued.

II. LECS HAVE PROVIDED NO EVIDENCE THAT, WITHOUT THE DISCIPLINE OF ACTUAL COMPETITION, THEY WILL PRICE MORE EFFICIENTLY.

BellSouth attempts to persuade the Commission to grant additional pricing flexibility now -- unrelated to any showing of actual competition -- by arguing that "[i]t is illogical to suggest that the LECs should be prevented from acting like a competitive firm until there is some demonstration that competition is present."[12] But absent actual competition, neither BellSouth nor any of the other LECs has any incentive to "act" like a competitive firm. If monopolists act like competitive firms even where no competitive discipline is present there would be no need for

[12] Comments of BellSouth at 40. Similar requests are made by other incumbent LECs. *See* Comments of NYNEX at 14; Comments of US West at 6; Comments of Pacific Bell at 32; Comments of Cincinnati Bell at 12; and Comments of SNET at 8.

economic regulation. While the LECs argue for the right to "act" like competitive firms, they persist in asserting a constitutional entitlement to be protected from losses to these competitors that have emerged.[13] Competitive firms, however, do not have an expectation of investment recovery and return where the economic value of fixed assets has been eroded by marketplace, technological, or other forces. LECs do. The present level of LEC rates under the FCC's price cap plan are inextricably tied to a traditional embedded cost revenue requirement, and the LECs have been afforded an overall price adjustment mechanism that all but assures full and ongoing recovery of all existing investments. If the Commission grants LECs selective downward pricing flexibility, coupled with an overall revenue level that is rooted in a traditional revenue requirement, LEC prices for services that do not confront actual competition at the present time will necessarily be forced further from "efficient" economic cost levels. Unless and until the Commission is prepared to adopt a price cap system in which the "going in" rate levels are based upon forward-looking, economic cost rather than backward-looking embedded cost, LECs will not on the whole be "acting" like competitive firms.

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[13] Pacific Bell has argued before the California PUC that it is entitled to be made whole for "competitive losses," and more recently due to "market conditions" Pacific Bell reported a write-off of $5.7 billion in assets, $4.7 billion for plant assets and $1.0 billion in regulatory assets. The California PUC previously issued a decision for special accounting treatment of the $1.0 billion in regulatory assets, and Pacific Bell advocated a further proceeding to establish a mechanism to recover the remaining $4.7 billion investment. *See* Pacific Bell's Response to the Question Whether the Commission's Regulations Will Deprive Pacific Bell of an Opportunity to Earn a Fair Return before the California PUC in R.95-04-043/I.95-04-044 at 9.

III. THE LECS ARE WRONG WHEN THEY CLAIM THAT MARKET SHARE IS NOT AN APPROPRIATE MEASURE OF COMPETITION.

The Second FNPRM included a "Competitive Checklist" -- essentially a list of existing barriers to entry -- and tentatively proposed that evidence that a carrier had met the items on the "checklist" (*i.e.,* had eliminated the identified barriers) could be used to determine when additional pricing flexibility would be warranted. With the exception of NYNEX, the LECs universally argued that the use of a Competitive Checklist would be sufficient for determining when additional pricing flexibility is warranted, and that evidence of actual competition is neither required nor appropriate.[14] By inference, the LECs suggest that the ability of competitors to succeed in capturing market share once all barriers are eliminated is up to the competitors themselves, and the LECs should not be held responsible (in the form of a denial of regulatory relief) merely because such competitors might fail.

The LECs support for a Competitive Checklist approach places an enormous burden on the "checklist" itself to fully address and resolve all artificial (*i.e.,* LEC-imposed) barriers to competitive entry at all levels. It places a considerable burden upon the Commission. The Commission must determine that all of the elements on the checklist had been addressed and resolved. Perhaps most significantly, the Competitive Checklist tacitly assumes that the checklist is comprehensive and complete, that no impediments to competition remain. Indeed, the comments of Pacific Bell indicate that many of the entry barriers on the checklist have been eliminated or will be very soon[15] -- despite the fact that in the vast

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[14] Comments of NYNEX at 6, 20-21. *See also*, Comments of Cincinnati Bell at 13; Comments of Pacific Bell at 34-37; and Comments of US West at 30-31.

[15] Comments of Pacific Bell at 34-37.

majority of geographic areas and for the vast majority of access customers and services, no viable competitive alternatives exist in California at this time.

The Commission should not accept these burdens and unsupported assumptions. The Commission has predicated a great deal of its policy development over the past three decades upon the expectation that competition in the telecommunications industry will develop and will become an effective economic force once legal and operational barriers are eliminated. If the checklist is nominally fulfilled yet competition fails to develop, there must be a presumption that the fault lies in the checklist rather than in the ability of competitors to viably enter and compete with the LECs. It is thus essential that the Commission look to the results of its policies rather than solely to the mechanics as the LECs would clearly prefer. Only if actual, effective, price-constraining competition is shown to have developed across a broad spectrum of the LEC marketplace should the Commission grant LECs the extreme pricing they seek.

IV. THE COMMISSION SHOULD NOT ADOPT ITS TRACK 1/TRACK 2 PROPOSAL FOR NEW SERVICES.

The commenters take opposite positions on the Commission's proposal to divide new services into two categories: Track 1 and Track 2 services. The Committee's ultimate recommendation was that the Commission classify all new services as Track 1 services unless and until actual competition for those new services is shown to exist.[16] The vast majority of the LECs, however, recommend

[16] In other words, the Track 1/Track 2 distinction should be based upon the competitive characteristics of the market - not on the *use*.

either that the Commission define Track 1 services more narrowly than suggested in the Second FNPRM,[17] or that all new services be classified as Track 2 and filed on fourteen days notice with a minimum of cost support required.[18]

If and to the extent that the regulatory process is denying access customers "new" services, one would expect that the access customers that would theoretically benefit from such services would be clambering for relaxation of the present rules. The exact opposite, however, is the case. AT&T, the largest of the access customers, argues that "[t]here is no basis for relaxing the price cap treatment for any new services" and that "[n]o access customer has urged the Commission to relax the cost support required for introduction of new services."[19] CompTel, MCI and Sprint similarly urge the Commission not to "loosen" the rules applicable to new service filings.[20]

The Commission's existing rules, which include virtually unlimited flexibility on the level of overhead loadings used in the development of new service prices, already offer the LECs tremendous new service pricing flexibility.[21] Ad Hoc urges the Commission not to abrogate its responsibility for ensuring that prices for LEC access service are "just and reasonable." Absent effective competition, the only way of doing that is to retain existing notice and cost support requirements.

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17 Comments of SNET at 12.

18 Comments of USTA at 21; Comments of Bell South at 9; Comments of US West at 10-11; Comments of Cincinnati Bell at 6; and GTE at 7.

19 Comments of AT&T at 23.

20 Comments of CompTel at 26; Comments of MCI at 8-10; and Comments of Sprint at 3.

21 Comments of ALTS, Appendix "Pro-Competitive Pricing Flexibility for Price Cap LECs" by William Page Montgomery at 11; and Comments of MCI at 9-10.

V. GSA'S SUPPORT FOR EXPANDED LEC PRICING FLEXIBILITY "WITHOUT REGARD TO THE PRESENCE OR ABSENCE OF COMPETITION" IS SHORT-SIGHTED AND FLAWED.

GSA argues that most of the proposals contained in the Second FNPRM are "quite justified" without regard to the effect of competition."[22] While maintaining that the additional pricing flexibility can be granted regardless of the level of competition, GSA suggests that "concern over preditorily low prices and monopolistically high prices is overstated."[23] The reason given is that "competition" will regulate the LECs behavior. In stating that "the likely effect of above-cost pricing by the LEC will be to hasten the challenge by its competitors to its most profitable services,"[24] GSA apparently accepts the LECs' theory of market contestability, expecting that high prices alone will be fully sufficient to stimulate immediate and effective competitive responses. GSA, however, fails to recognize that competition is not present at this time in the vast majority of geographic areas, and that rapid, ubiquitous competitive responses cannot reasonably be expected for the vast majority of access services. Moreover, GSA's contention that competition will regulate LEC behavior is inconsistent with its support for additional pricing flexibility regardless of the lack of competition.

GSA also expresses concern with the Commission's proposal to constrain price increases to one percent in any service category in which there are price reductions because it is likely to have a dampening effect on the willingness of

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22 Comments of GSA at 4.

23 *Id.* at 7.

24 *Id.*

carriers to offer price reductions.[25] GSA may be correct, but still seems to miss the point: LEC price reductions, where they may occur, will be driven by the marketplace, not specifically by the extent to which a LEC can raise prices elsewhere; the ability to raise prices elsewhere will, however, diminish or perhaps even eradicate the financial consequences of such price reductions, but will lead to still higher prices being imposed upon and paid by end user customers where no competition is present. Elimination of upward pricing constraints will thus facilitate predation by the LECs while not producing any net savings to the government or to end users generally.[26] GSA is in effect suggesting that the LECs be able to offer below-tariff prices to it, and that they be allowed to make up any revenue shortfall resulting therefrom by imposing higher prices to the larger body of access service customers. The potential chilling impact that such a proposal could have on emerging competition should not be lightly dismissed, but GSA's arguments should be rejected.

CONCLUSION

In view of the foregoing, Ad Hoc respectfully suggests that support for the Commission's proposals to grant price cap LECs additional pricing flexibility without regard to the level of competition present in the relevant market is not credible. The only exception to maintaining the status quo pending development of competition in the interstate access service market is giving the LECs additional

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25 *Id.* at 7-8.

26 GSA postulates that there are likely to be rate elements that are set *below cost* and that the LECs will of their own accord choose to move these prices into some sort of equilibrium. GSA, however, offers no evidence to support its supposition, and indeed the LECs themselves do not suggest that increased pricing flexibility is needed in order to somehow "correct" this condition.

downward pricing flexibility, provided that the Commission also takes steps to prevent subsequent sharp price increases and cross-subsidization of the rate reductions from revenues from other less competitive services. But even the need for this relief is extremely doubtful, given the evidence that the number of instances in which LECs have sought to take advantage of the pricing flexibility that the Commission's Rules currently afford them are very few, indeed.

Bluntly put, this proceeding seems very ill-advised at this time. The Commission should gather information regarding the level of competition in the access services market, as it has proposed doing in its Public Notice, D.A. 95-2287, issued on November 3, 1995. When such data indicates the existence of effective competition in access service markets, the Committee will support granting LECs additional pricing flexibility. So far, persuasive evidence of such competition has not been presented, and accordingly, the Commission should not afford LECs additional pricing flexibility at this time.

Respectfully submitted:

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Table 1

Analysis of "Gap" Between SBI Levels Proposed in 1995 Annual Access Filings
and SBI Lower Limits

	Ameritech	BellAtlantic	BellSouth	Nynex	SW Bell	USWest	SNET	PacBellCA
Local Switching								
Proposed SBI	90.4	86.3	87.8	95.6	86.8	86.4	90.2	88.6
GAP	12.4	7.9	8.2	10.6	8.4	11.1	9.0	10.8
Information								
Proposed SBI	70.0	89.6	88.5	93.7	91.2	77.2	78.7	89.8
GAP	1.8	12.7	12.1	13.4	12.2	10.5	5.8	10.0
Database Access								
Vert. Services: SBI	100.0	89.7	95.8	100.0	96.0	99.1	100.0	91.7
GAP	13.7	12.8	13.5	13.7	13.5	13.6	12.2	12.9
Total Database Access								
Proposed SBI	93.9	89.5	85.1	95.3	92.3	93.8	94.3	89.4
GAP	12.9	12.8	12.0	13.0	13.2	12.9	11.5	10.5
Billing Name and Address								
Proposed SBI	100.0	92.3	95.2	100.0	95.8	98.1	100.0	0.0
GAP	13.7	12.7	13.0	13.7	13.4	12.6	12.2	0.0
Tandem Switched Transport								
Proposed SBI	97.4	90.9	84.6	91.4	94.0	96.8	99.9	88.7
GAP	11.5	10.7	3.6	10.7	11.1	10.8	11.8	10.4
VG, MT, TG								
Proposed SBI	97.1	91.1	95.1	109.2	98.0	89.8	101.4	88.3
GAP	13.2	12.1	13.5	14.9	14.0	12.3	12.0	12.5
Audio & Video								
Proposed SBI	90.4	91.9	93.2	111.2	99.3	80.9	96.1	85.5
GAP	12.3	13.1	13.3	15.8	14.2	10.9	11.4	12.2
HiCap								
DS1								
Prop Sub-Index	76.6	74.5	83.1	74.9	76.8	81.9	80.1	74.0
GAP	10.4	10.6	11.9	9.9	9.0	10.2	9.5	9.0
DS3								
Prop Sub-Index	73.6	69.9	79.1	76.2	78.9	90.7	59.2	71.6
GAP	10.0	9.9	11.3	10.3	8.8	11.9	7.0	9.2
Total HiCap/DDS								
Proposed SBI	78.5	73.8	80.0	80.8	78.1	87.6	79.7	71.3
GAP	10.7	8.0	11.4	10.8	9.1	11.8	9.3	10.2

Source - LEC 1995 Annual Access Tariffs, TRP "Analyzer" files.

CERTIFICATE OF SERVICE

I, Meredith Forman, hereby certify that true and correct copies of the foregoing Reply Comments of The Ad Hoc Telecommunications Users Committee were served this 6th day of February, 1996 by hand delivery on the following parties:

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