Key Assumptions - Costs

- With resale and unbundling, LECs continue to incur significant costs for the access lines controlled by CLECs
  - CLEC leased lines reduce LEC costs by foregone variable costs such as marketing and customer care
  - LECs continue to incur the cost of operating and maintaining the services purchased by CLECs

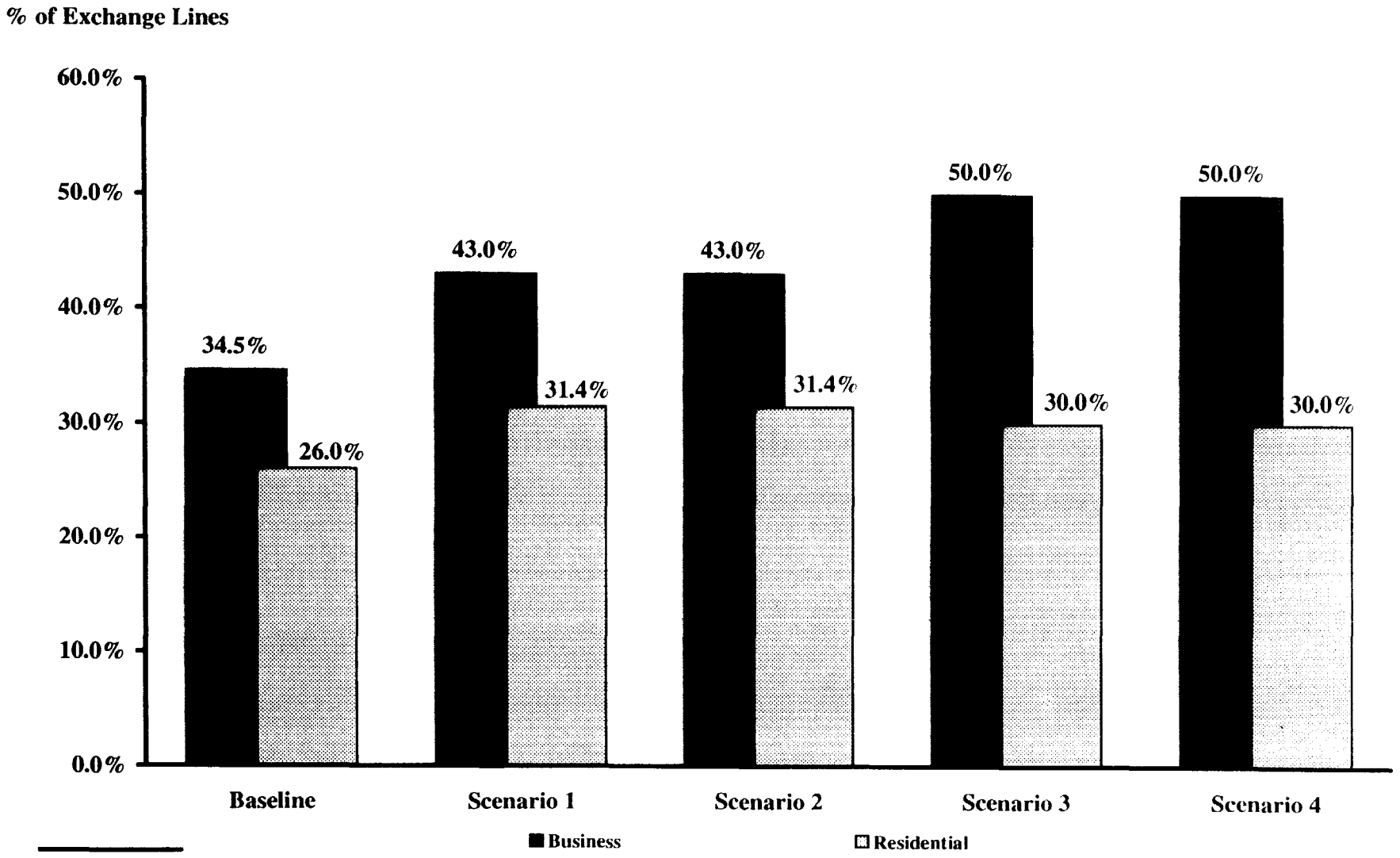
Key Assumptions - InterLATA

- LECs will begin offering in-region InterLATA service in mid-1997
- Margins on interLATA start low, due to marketing expenditures, and increase over several years
- If CLECs win additional local market share (relative to the Baseline View) the LECs will win less in-region interLATA market share

Key Assumptions - LEC Investment

- LEC investment obligations (e.g. must provide ubiquitous service and must provide facilities and features requested by CLECs) remain unchanged across all scenarios
  - Congress and the Administration actively support delivering telecom services and information technologies to all citizens
  - Large LECs deploy enhancements (e.g. digital switches, SS7) throughout their networks
  - IXCs and other CLECs are demanding that LECs maintain "modern infrastructure...to allow local service competitors access to bundled and unbundled network elements, functionalities and capabilities..." (CA Telecommunications Coalition, 5/30/96)

LEC Tenth Year Total Market Share Loss



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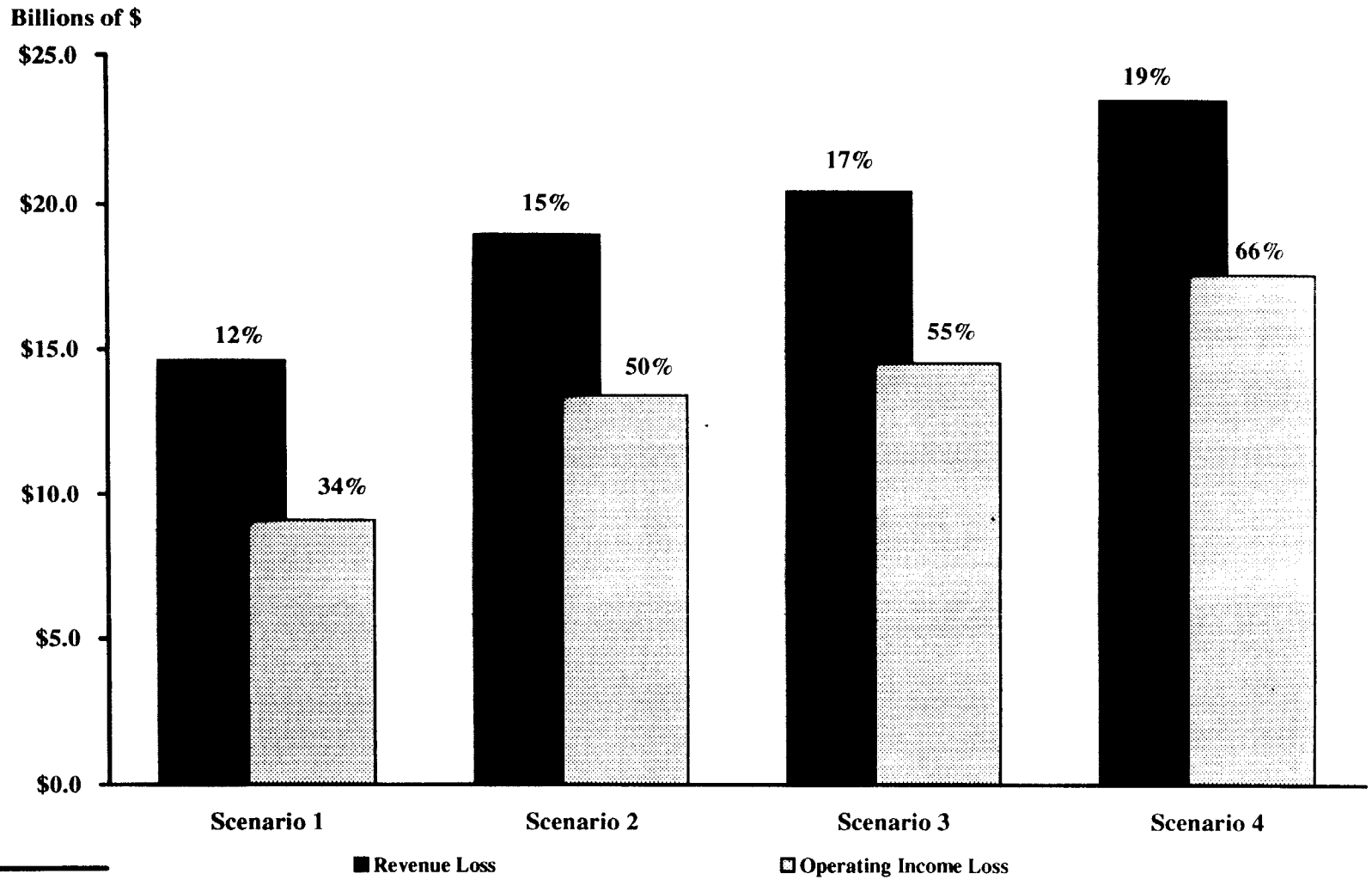
LEC Tenth Year Annual Revenue Loss and Operating Income Loss Relative to Baseline



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Simulated Differences in Annual Large LEC Revenues and Operating Income in Year 2000 (Year 4)

Scenario 1: Low loop prices, high resale discount

Scenario 2: Scenario 1 + terminating switched access bypass and low interconnection price

Scenario 3: Recombination of low price network elements by CLEC

Scenario 4: Scenario 3 + terminating switched access bypass and low interconnection price

$ billions	Baseline LEC
Revenue	$101.5
Operating Income	$20.9

Scenario 1

$ billions	Levels	Change (from Baseline)
Revenue	$93.4	($8.1)
Operating Income	$16.3	($4.6)

Scenario 2

$ billions	Levels	Change (from Baseline)
Revenue	$89.0	($12.5)
Operating Income	$11.9	($9.0)

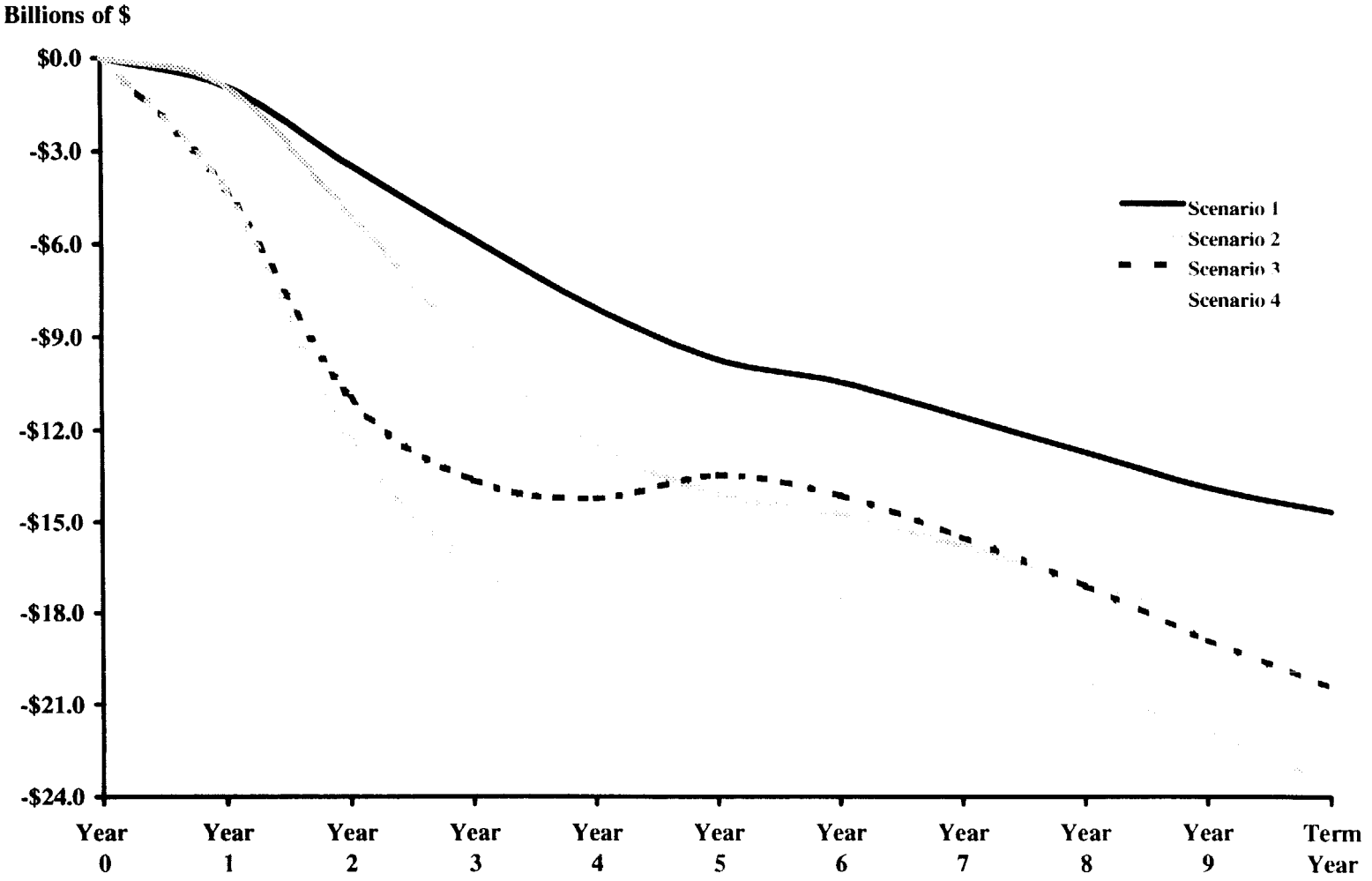
Scenario 3

$ billions	Levels	Change (from Baseline)
Revenue	$87.3	($14.2)
Operating Income	$11.6	($9.3)

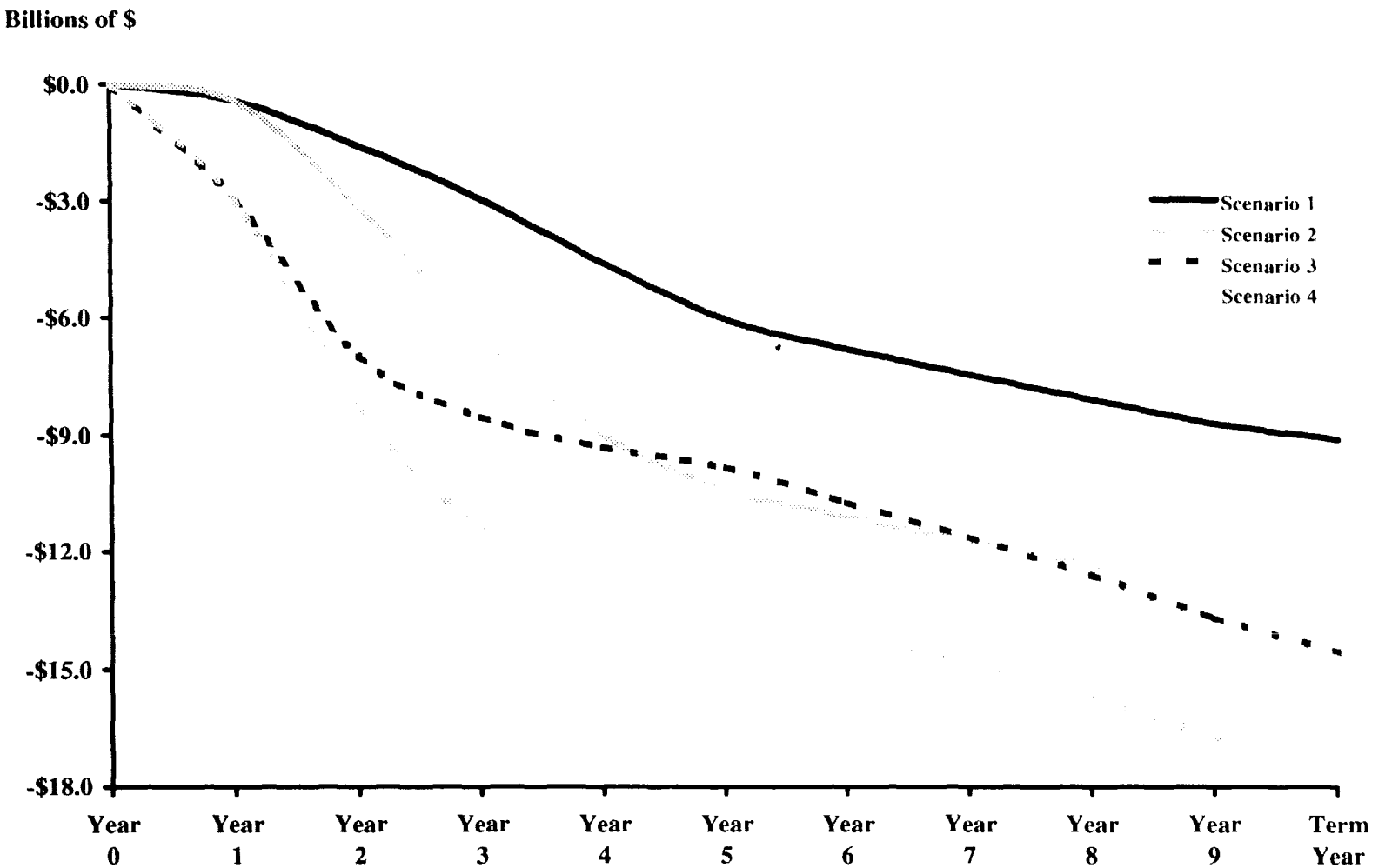
Scenario 4

$ billions	Levels	Change (from Baseline)
Revenue	$83.8	($17.7)
Operating Income	$8.0	($12.9)

Changes in Revenue Relative to Baseline Under Each Scenario



Changes in Operating Income Relative to Baseline Under Each Scenario



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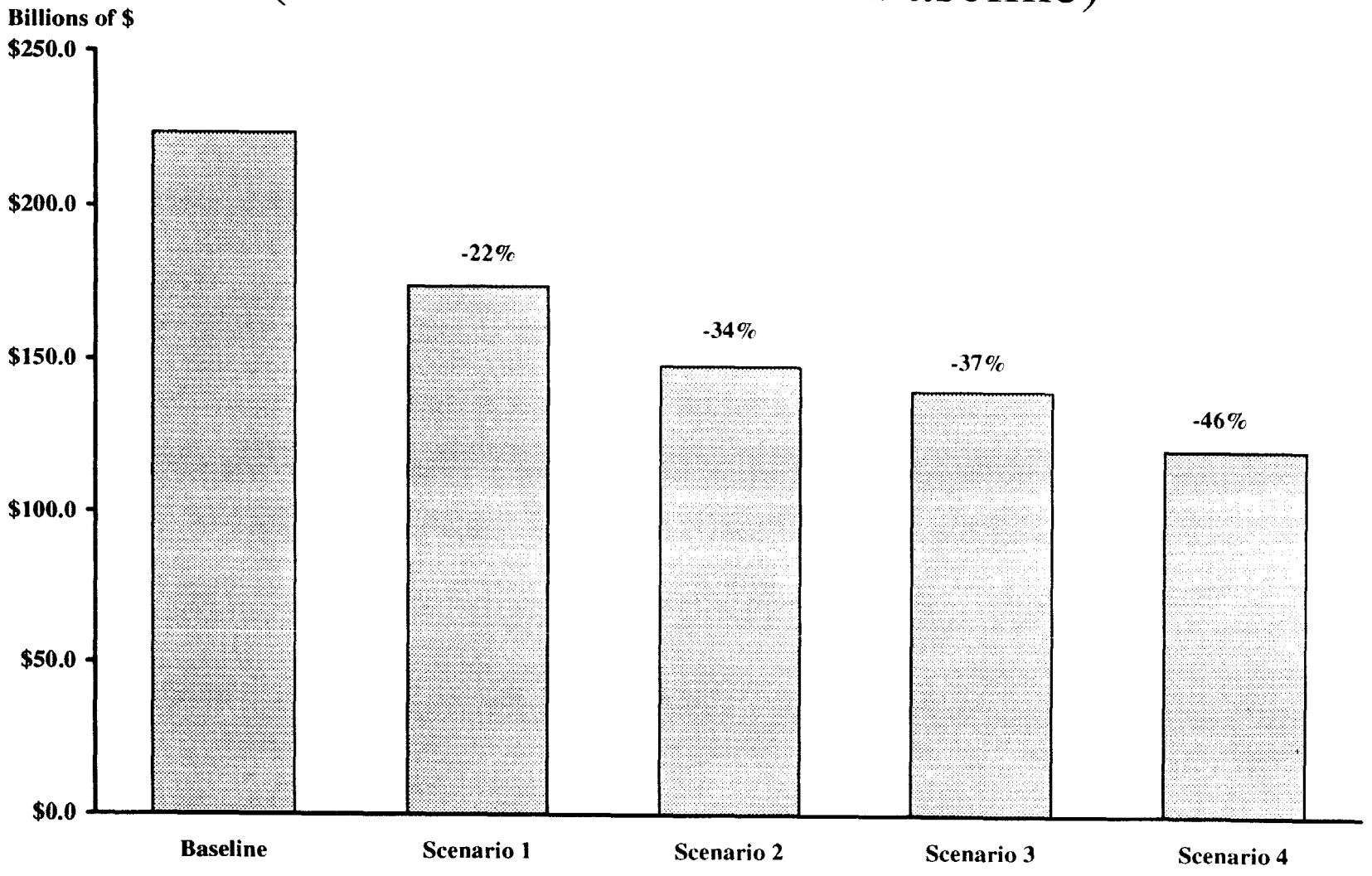
Equity Net Present Value
(Percent decrease from Baseline)



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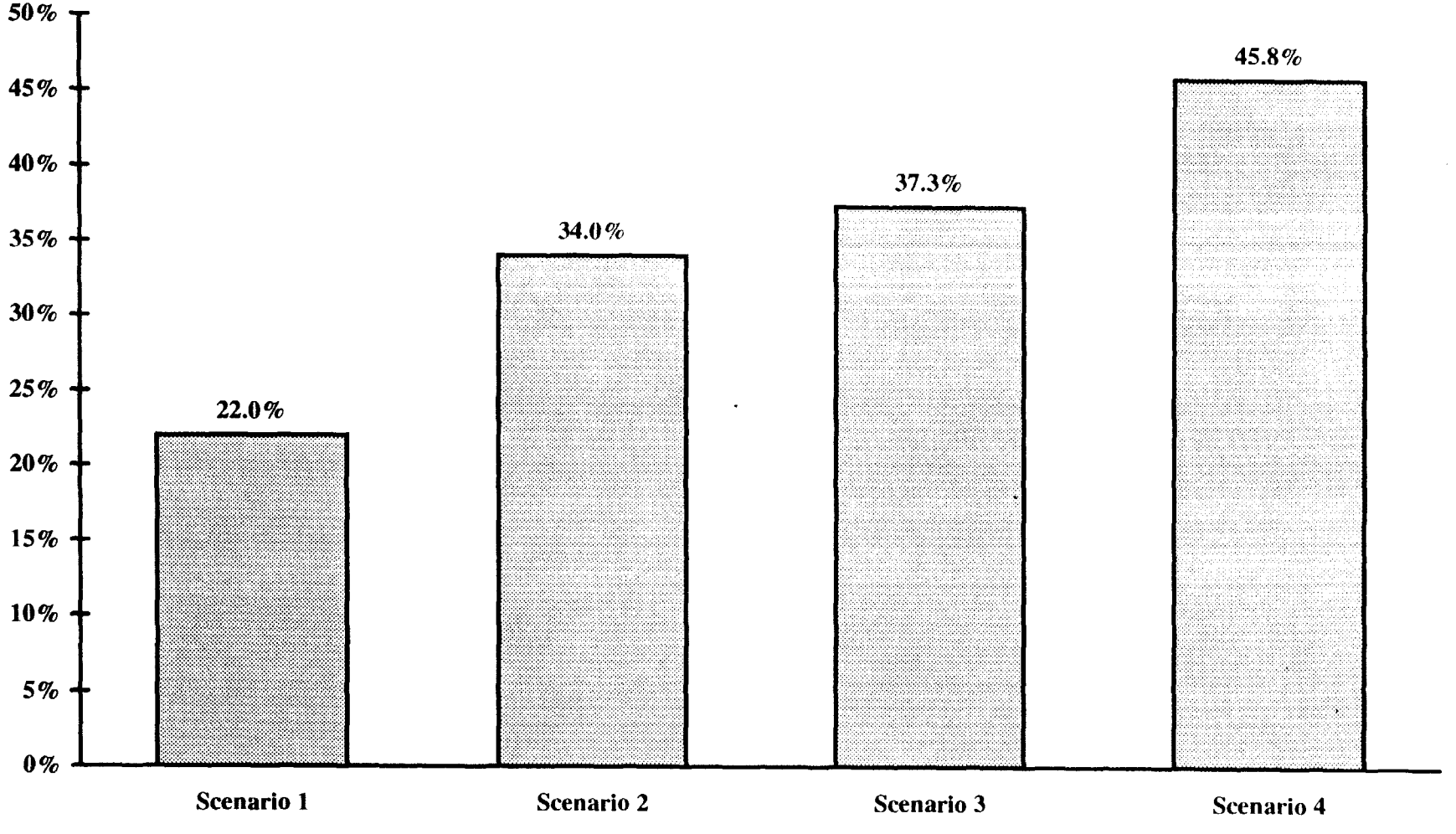
Percentage Loss in Equity Net Present Value in Each Scenario Relative to Baseline



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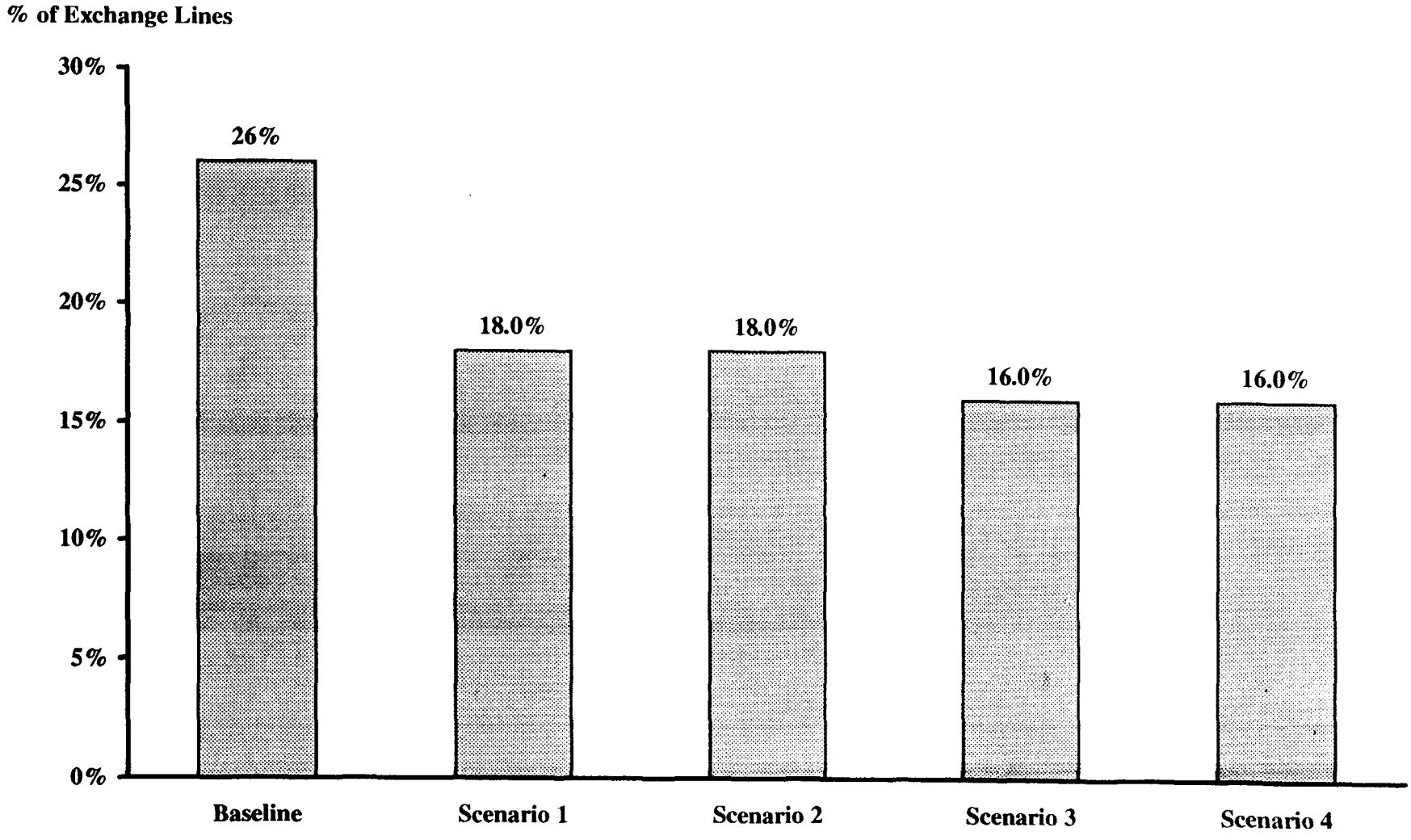
Conclusions

- Low unbundled prices and high resale discounts could have serious implications on LEC financial viability, creating a fundamental disconnect between the LECs' investment obligations and their ability to invest.

- The FCC plays a strong role in guiding the transition to competition in local exchange services

- The FCC needs to weigh the potential benefits from an acceleration in competition against the dramatic downside risks of inappropriate prices and policies

LEC Tenth Year
InterLATA Market Share Gain



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