

## 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

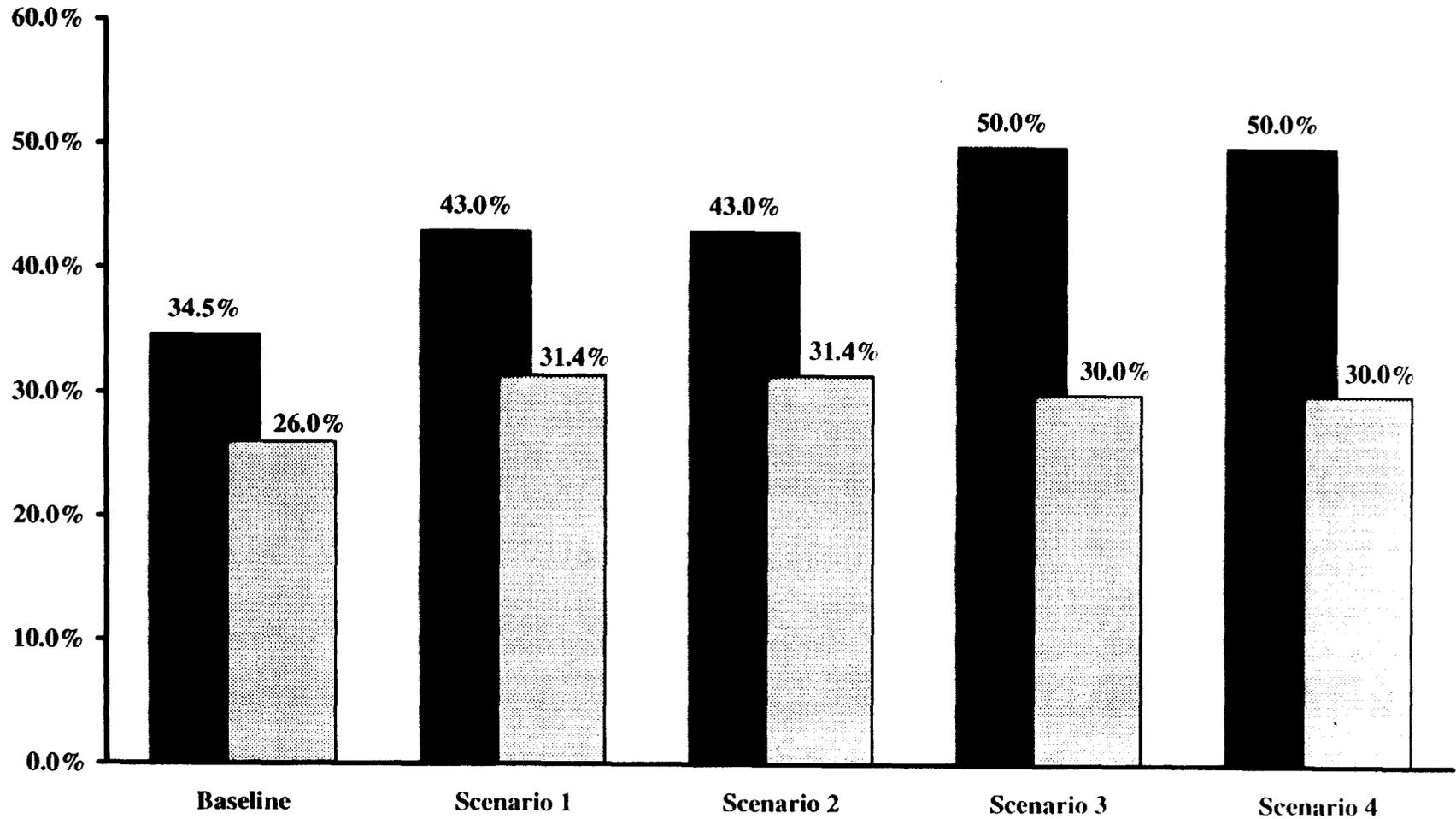
- LECs will begin offering in-region InterLATA service in mid-1997
- Margins on interLATA start low, due to marketing expenditures, and increase over several years
- If CLECs win additional local market share (relative to the Baseline View) the LECs will win less in-region interLATA market share

## 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

% of Exchange Lines



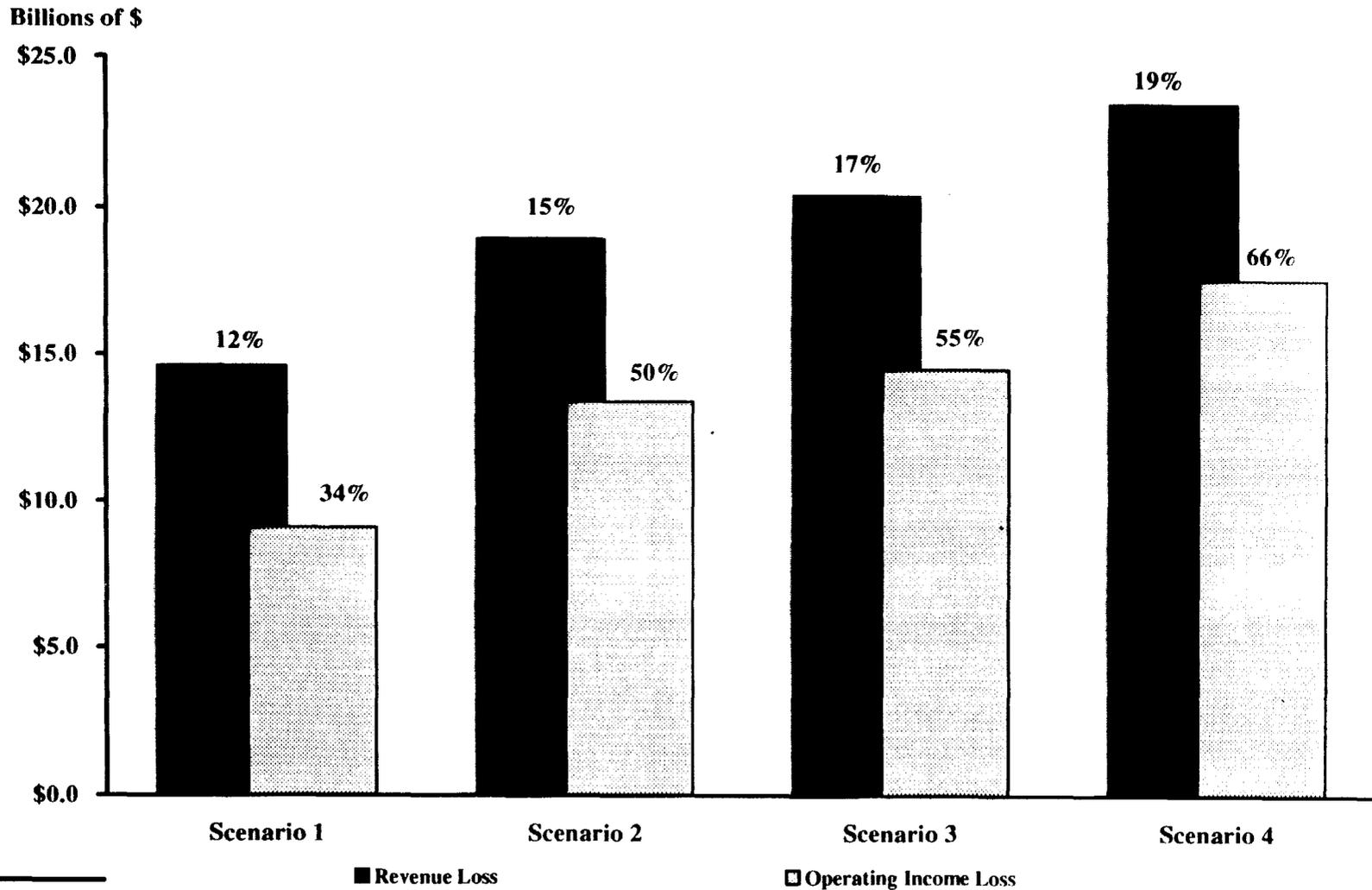
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# LEC Tenth Year Annual Revenue Loss and Operating Income Loss Relative to Baseline



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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

<i>\$ billions</i>	Baseline LEC
Revenue	\$101.5
Operating Income	\$20.9

**Scenario 3:** Recombination of low price network elements by CLEC

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

Scenario 1

Scenario 2

Scenario 3

Scenario 4

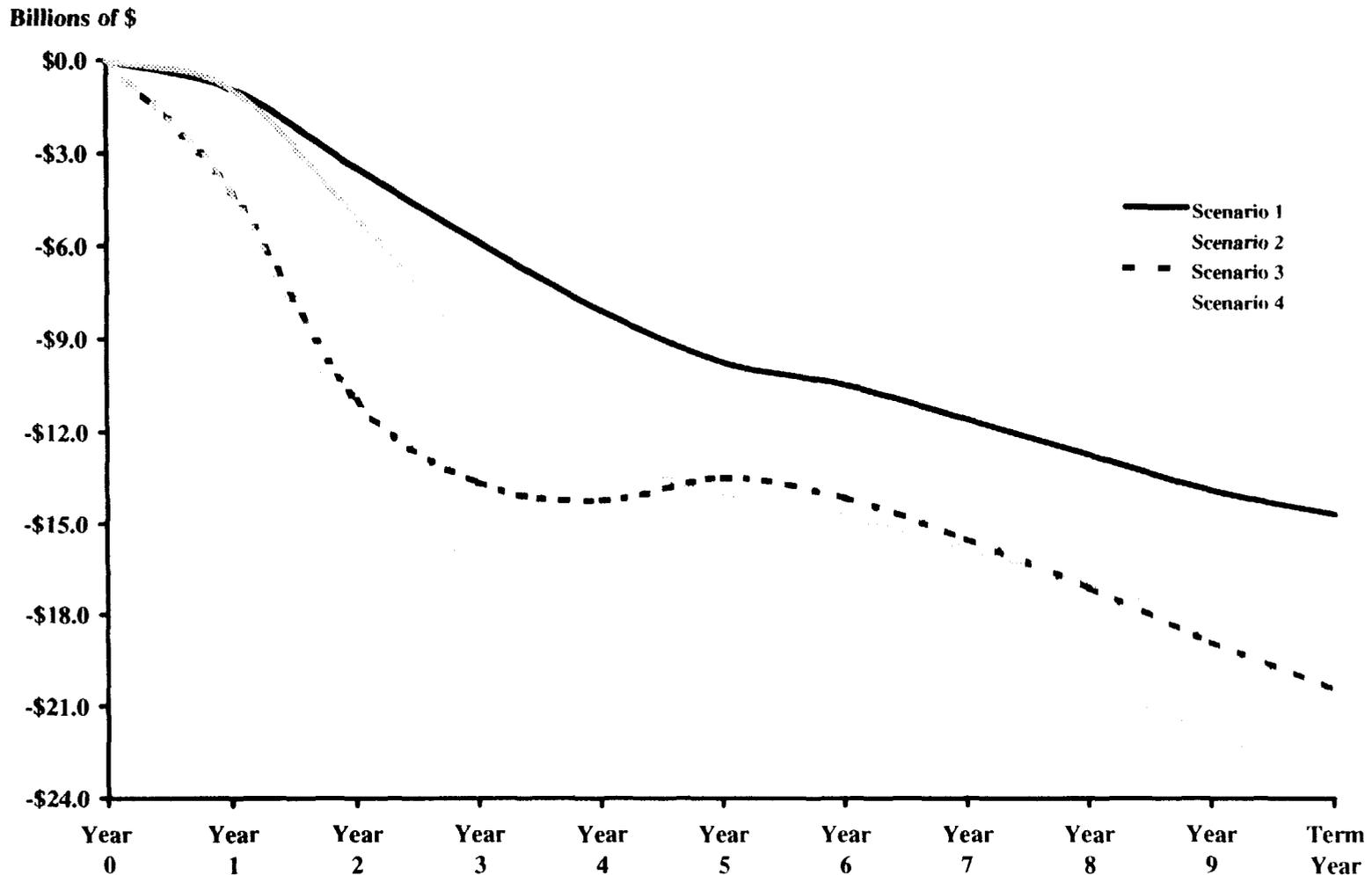
<i>\$ billions</i>	Levels	Change (from Baseline)
Revenue	\$93.4	(\$8.1)
Operating Income	\$16.3	(\$4.6)

<i>\$ billions</i>	Levels	Change (from Baseline)
Revenue	\$89.0	(\$12.5)
Operating Income	\$11.9	(\$9.0)

<i>\$ billions</i>	Levels	Change (from Baseline)
Revenue	\$87.3	(\$14.2)
Operating Income	\$11.6	(\$9.3)

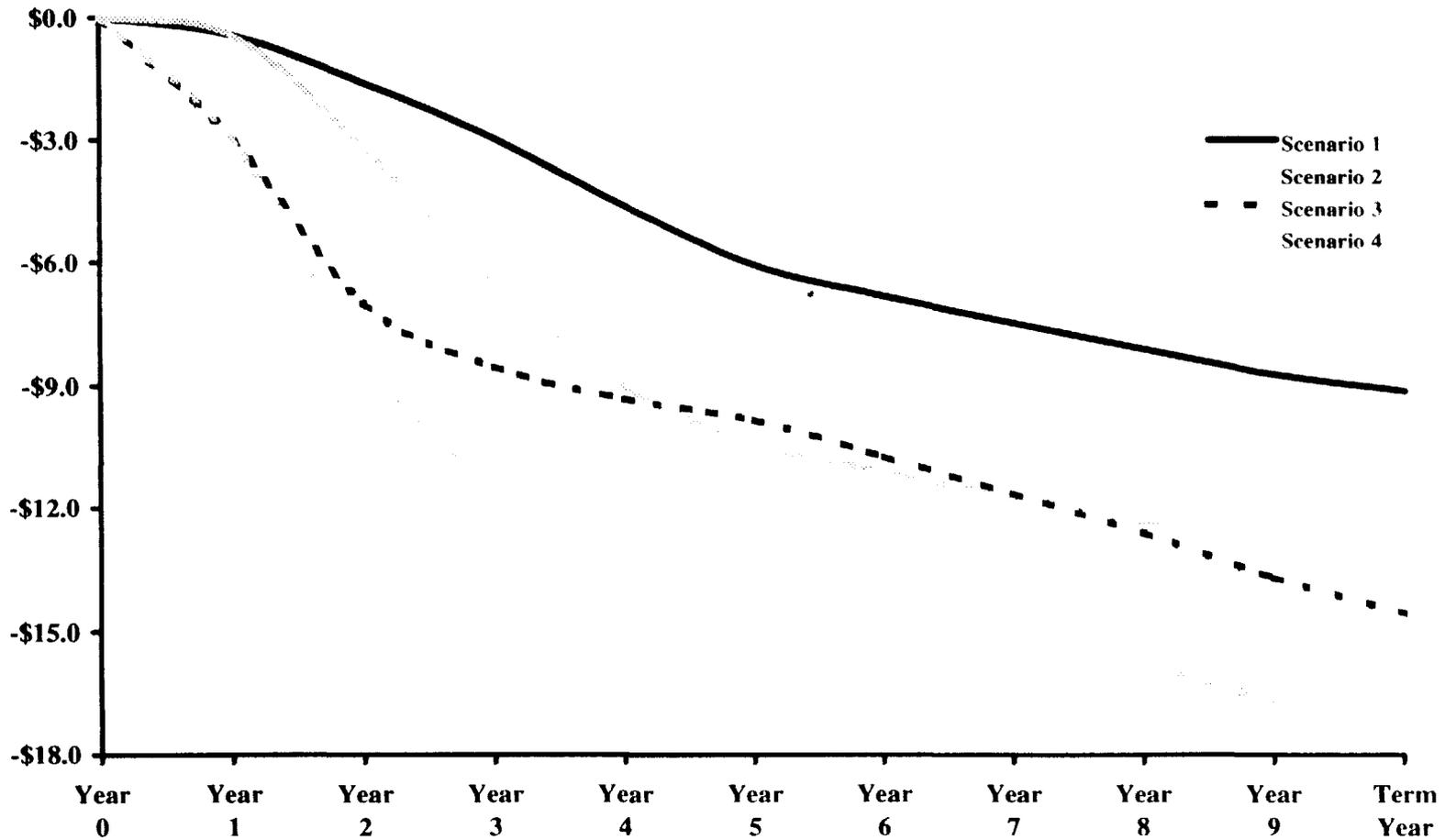
<i>\$ billions</i>	Levels	Change (from Baseline)
Revenue	\$83.8	(\$17.7)
Operating Income	\$8.0	(\$12.9)

# Changes in Revenue Relative to Baseline Under Each Scenario

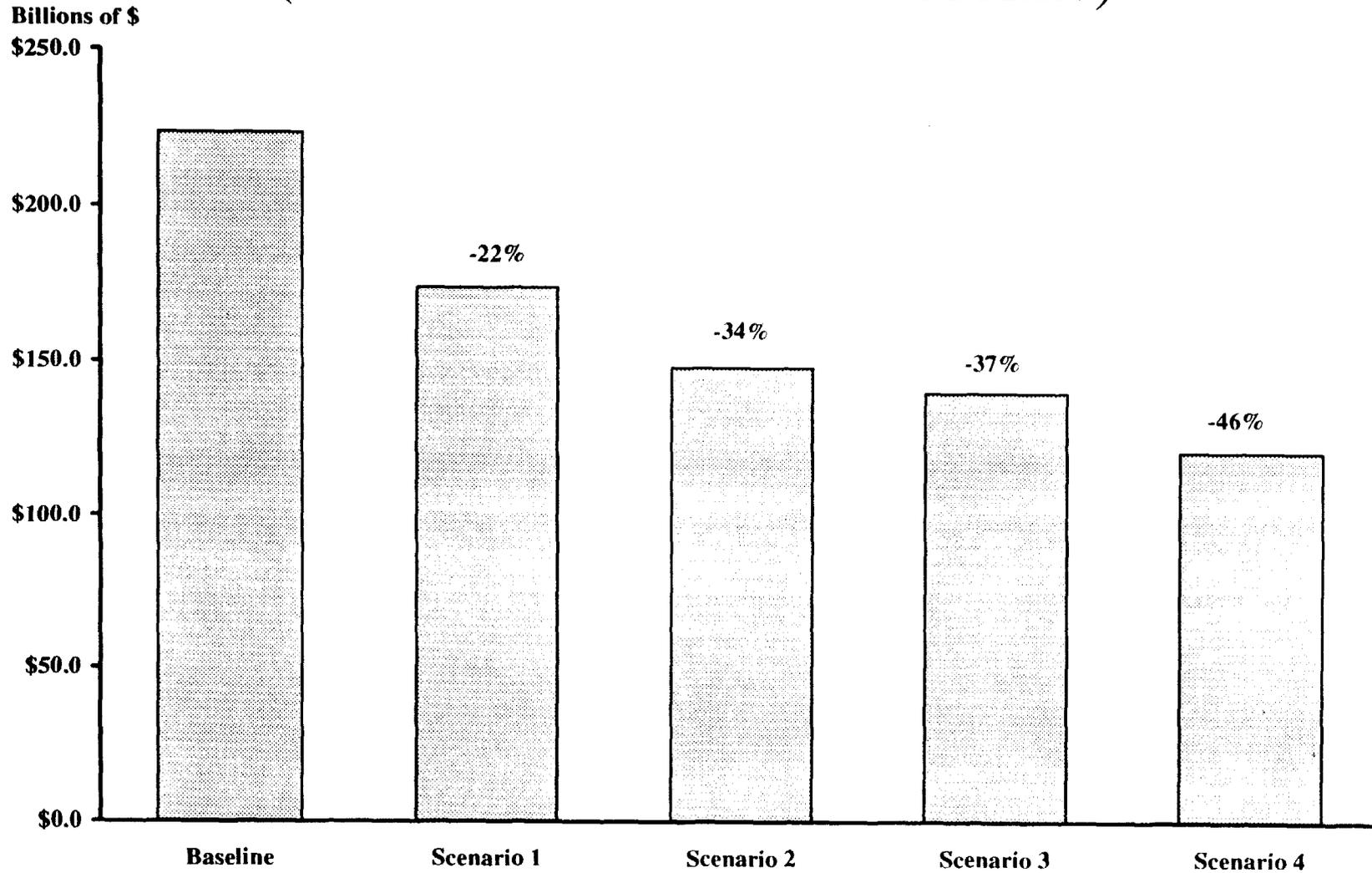


# Changes in Operating Income Relative to Baseline Under Each Scenario

Billions of \$



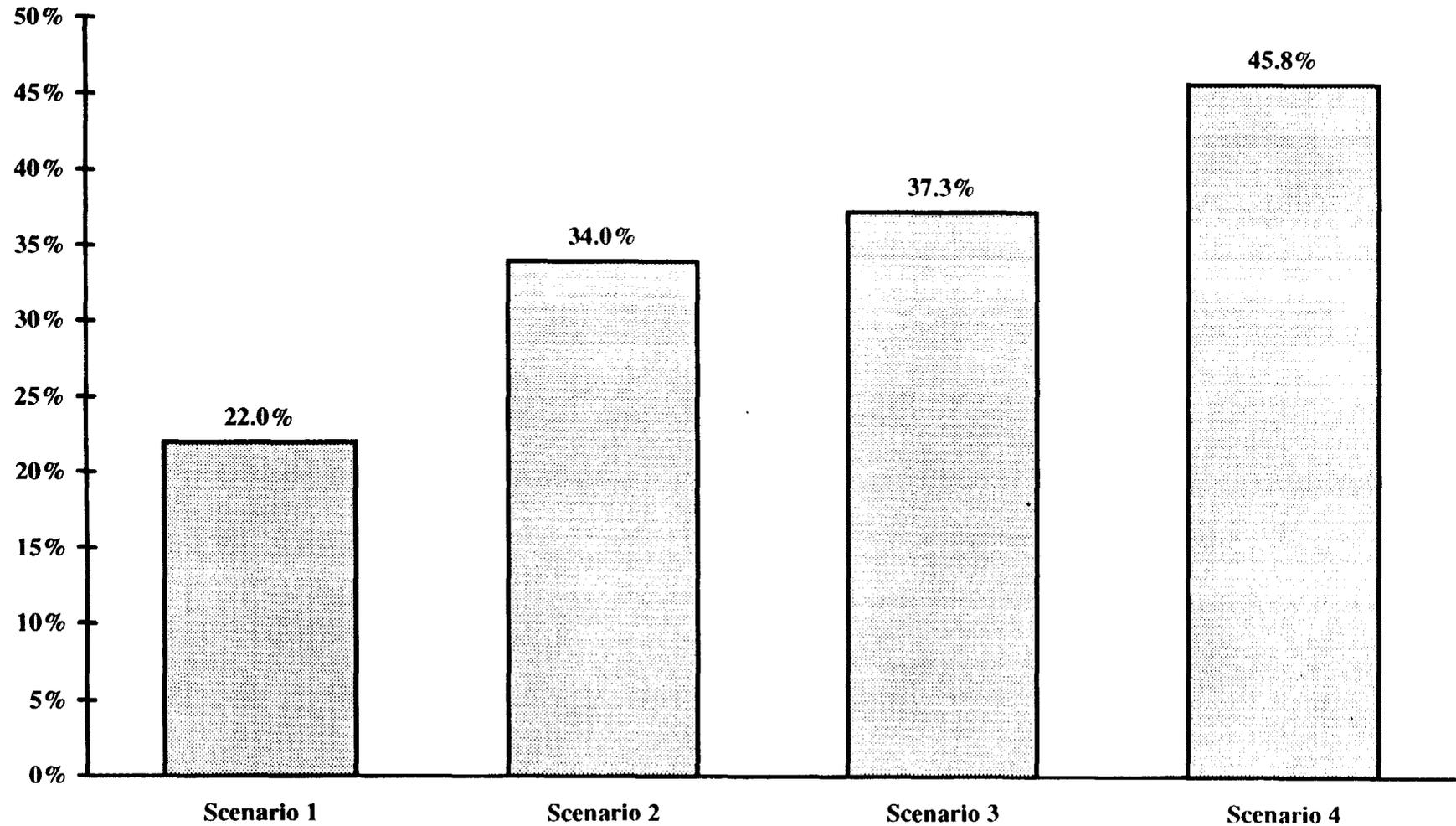
# Equity Net Present Value (Percent decrease from Baseline)



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

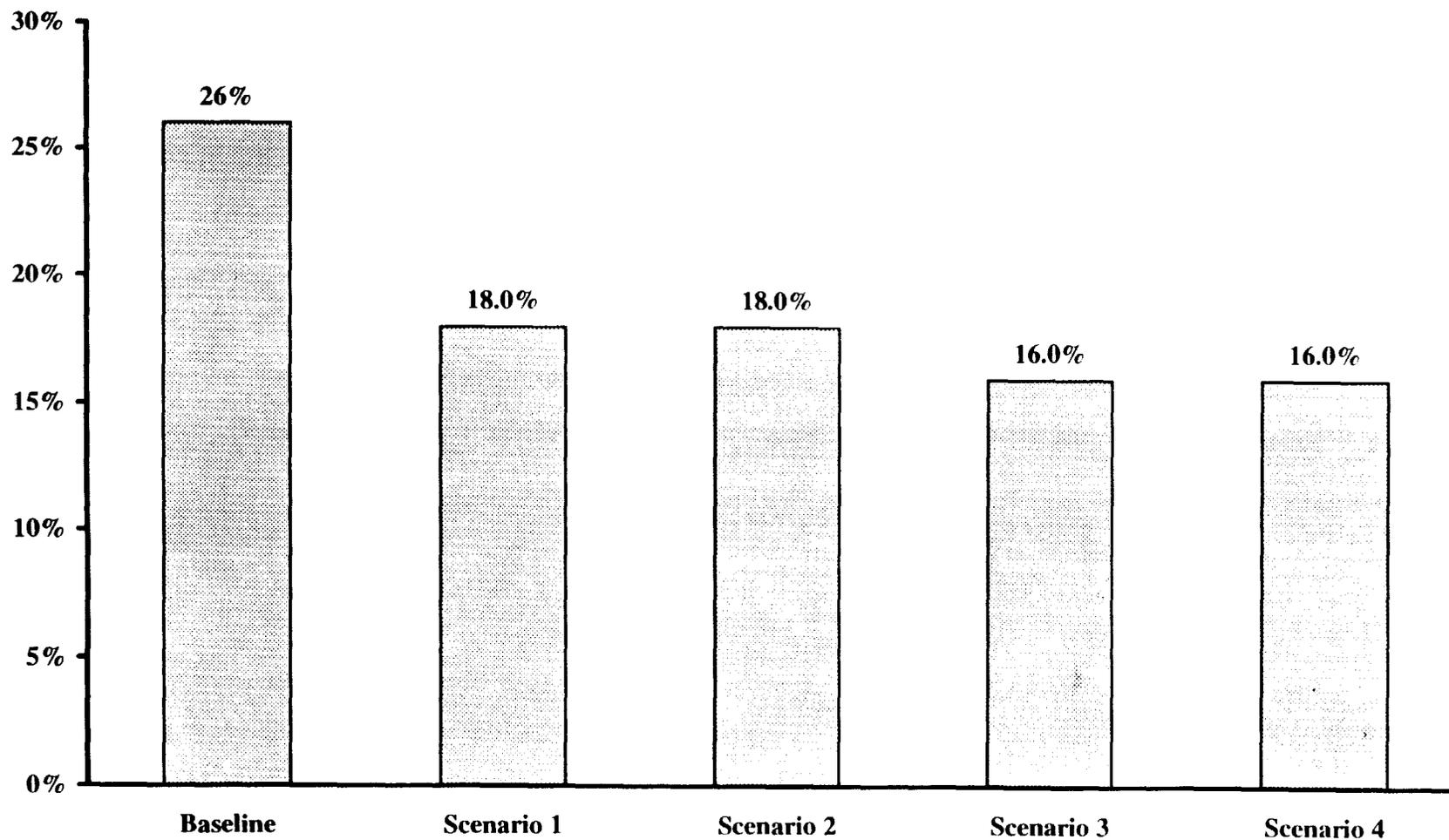


# Conclusions

- 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 competitive local exchange services
- The FCC needs to weigh the potential benefits from an accelerated competition against the dramatic downside risks of inappropriate and policies

# LEC Tenth Year InterLATA Market Share Gain

% of Exchange Lines



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