Now that the Commission has made reliable estimates of the costs of the elements used to construct an efficient telephone network,[30] the Commission has also recognized that existing access rates are far above their economic costs [31] Having recognized a significant gap between existing rates and their efficient costs, the Commission must reinitialize existing rates and bring them into alignment with those efficient costs. As MCI explains below, the Commission can accomplish this task with a minimal regulatory effort by relying on publicly available estimates of the economic cost of the elements used to provide switched access services. Total Element Long Run Incremental Cost (TELRIC) estimates made by proxy cost models, such as the Hatfield Model employed by MCI and AT&T, may be used to reach a reasonable approximation of the forward looking cost of services residing in existing price cap baskets.

B. The Commission Should Require Incumbent LECs to Immediately Reinitialize Their Actual Price Indices (API) At Economic Cost.

The Commission seeks comment on whether to require incumbent price cap LECs to reinitialize their price cap indices (PCI) to reflect estimates of forward-looking efficient costs made by a proxy cost model. MCI supports reinitialization of rates on the basis of a forward looking economic cost model,

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30 See, Local Competition Order.

31 Notice at para. 5.

and strongly recommends the Commission reinitialize all indices, APIs, PCIs, and Service Basket Indices (SBIs), to 100.

There are a number of advantages to this approach. First, the Commission would finally be able to ensure that rates would actually be reduced to economic cost. The initial rates under price caps were not set at economic cost. The Commission now has additional, and direct, evidence that rates, even under price caps, remain above economic cost. These excess costs should be immediately removed. The Commission could not be certain that actual rates would decline to economic cost were it to require price cap LECs to reinitialize their PCIs at economic cost, since many price cap baskets are below their "cap."

Second, reinitializing APIs at economic cost would immediately bring access charges to cost. This would hasten the benefits of competition to both local customers and long distance providers, and hasten the entry of the Regional Bell Operating Companies (RBOCs) into long distance.

Third, as discussed above, the Commission has never set actual rates in line with the costs of constructing a forward-looking, efficient, telephone network. Consequently, it is almost certain that initial APIs have always been above economic cost. By requiring price cap LECs to reinitialize their APIs based on economic models that consistently estimate the elements used to construct a complete network, the Commission may subsequently proceed to a pure price cap plan and for the first time be confident that above-normal profits the price cap LECs may earn are the result of their own efforts, and not the transfer of monopoly revenues to their shareholders.[32]

The Commission notes the minimal administrative burden imposed by the reinitialization approach. MCI concurs with this assessment. The Commission does express concern that reinitialization might only lower rate levels, and not yield an efficient rate structure. This concern is largely misplaced. As discussed below, it is a relatively straightforward task to use unbundled element costs to develop economic costs for price cap services. Long distance minutes do not utilize switches, make data base queries, etc., differently than do local or intraLATA toll minutes. Therefore, TELRIC estimates can be directly employed to estimate the economic revenues associated with local switching, information, database access, tandem switched transport, voice grade and high cap dedicated access, and signaling interconnection.

It is not surprising that TELRIC estimates readily translate into Total Service Long Run Incremental (TSLRIC) estimates of interstate access services. First, the Hatfield Model estimates are built from the assumption that the network provides local, access, and intraLATA toll services; and includes general

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[32] Cost support for LEC tariffed services is inadequate and inconsistent. Only the simultaneous estimation of the costs of all services and/or elements will yield consistent estimates of efficient costs.

overhead, and the wholesale costs of billing. Retail marketing costs are not incurred for wholesale, interstate access services.[33]

Reinitializing API's for interstate access services by mapping estimates of costs for unbundled elements from proxy models such as the Hatfield Model is a relatively straightforward and administratively unburdensome procedure. Table III-1 shows the revenues for price cap services and baskets for Tier 1 LECs compared to the forward-looking economic costs of those services and baskets.[34] Embedded revenues were used for those services that did not have

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33 At some point it will be necessary to examine the separations process to be sure that allocations of common costs between state and interstate jurisdictions conform to cost-causing criteria. In the meantime, the Commission may immediately bring the existing interstate share of common line costs down to the existing interstate share of its economic cost, and immediately reduce both the CCL and the SLC.

34 Notes for Table III-1:

a. Sources: (1) 1996 TRP, and (2) Hatfield 2.2.2 . 25% of Hatfield 2.2.2 estimate of annual loop cost for RBOCs increased by 6% to estimate annual interstate allocation of Tier 1 LECs loop cost.
b. End office usage cost estimated from Hatfield 2.2.2 ($0.oo21/min) times annual switched access minutes of Tier 1 LECs. (401.5 billion)
c. Interstate share (14.3%) of Hatfield estimate of annual operator costs for RBOCs increased by 6% ($226 million) to estimate annual interstate allocation of Tier 1 LECs operator cost.
d. Hatfield 2.2.2 estimate of unit cost of 800 data base access (.00213/query) times 29.5 billion 800 data base queries of Tier 1 LECs.
e. Included in Hatfield estimate of 800 data base access.
f. Interconnection charge is a make whole charge without a cost basis.
g. Hatfield 2.2.2 estimate of unit tandem switched transport costs times tandem switched transport fixed minutes (156 billion) of Tier 1 LECs.

TELRIC estimates immediately available. Consequently, this table provides a conservative estimate of the gap. Reinitializing the APIs at economic cost would reduce rates by 54%, an amount equal to approximately $11.6 billion ($21.5 billion - $9.9 billion) for price cap LECs.[35]

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h. Hatfield 2.2.2 estimate of tandem switched costs ($.00000094/min) times tandem switched minutes (245.6 billion). Data on voice grade and high cap tandem switched minutes were not separately available, so economic cost of these two services were combined.

i-m. Uses existing embedded costs as an upper bound cost estimate.

35 TELRIC estimates were not immediately available for 5 services: voice grade special, audio & video; high caps & DDS special, sideband, and signaling interconnection. Embedded revenues were used for these services. Consequently, this table provides is a conservative estimate of the gap.

Table III-1

Existing Price Cap Baskets v TELRIC Baskets

	A	B	C	D	E
Note		Embedded	TSLRIC	Upper Bound	Reduction in Rates
		($M)	($M)	($M)	
a	**Common Line**	10,358.63	5,592.11	5,592.11	46.02%
	Traffic Sensitive				
b	Local Switching	3,887.04	843.13	843.13	78.31%
c	Information	331.98	32.42	32.42	90.23%
d	Database Access	122.31	62.83	62.83	48.63%
e	BNA	0.99	0.00	0.00	100.00%
	Total Switched	4,342.32	939.38	939.38	78.39%
	Trunking				
f	IC	2,752.39	0.00	0.00	100.00%
g	Tandem Switched Transport	321.00	299.30	299.30	6.76%
h	Voice Grade + High Cap (Switched)	700.87	0.23	0.23	99.97%
i	Voice Grade, etc. (Special)	527.20	n/a	527.20	0.00%
j	Audio & Video	46.48	n/a	46.48	0.00%
k	High Caps & DDS (Special)	2,450.92	n/a	2,450.92	0.00%
l	Wideband	0.05	n/a	0.05	0.00%
m	Signaling Interconnection	0.82	n/a	0.82	0.00%
	Total Trunking	6,799.73		3,325.00	51.10%
	Total Access	21,500.68		9,855.49	54.16%

It should be noted that while rates will be reduced by approximately 50%, LECs will not lose $11.6 billion in revenues by having the "gap" between embedded costs and economic costs eliminated.[36] The $11.6 billion in excess

36 Estimates of rate reductions in Table IV-1 show the average rate reduction in each price cap basket required to bring average access rates for Tier 1 LECs to economic cost. In practice, the Commission may

access revenues represents a combination of implicit subsidies, unrealized efficiency improvements, and assets acquired in preparation of entry into video and long distance markets. MCI estimates that the interstate portion of implicit subsidies is $1.3 billion, leaving a "gap" of $10.3 billion to account for through rate decreases.[37] Nevertheless, the $1.3 billion must be removed from interstate access charges, otherwise incumbent LECs will recover twice for universal service.[38]

C. The Commission May Use A Combination of One-time Exogenous Changes and a One-time Increase in the Productivity Factor to Reduce PCIs.

In the event the Commission decides to initialize LEC access rates by altering the PCI rather than the API, the record established in the Price Cap Performance Review, the March 1996 Preliminary Rate of Return Inquiry, and the recent Universal Service Docket permits the Commission to order a combination of: a one-time exogenous change in LEC rates of return; a one-time

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convert TELRIC estimates specific to individual carriers to TSLRIC rates and reinitialize APIs, PCIs, and SBIs for each price cap carrier following the method illustrated in Table IV-1.

37 $1.3 billion is the current subsidy recovered by price cap LECs through interstate access rates. It is equal to 25% of the Hatfield 2.2.2 estimate of the universal service subsidy required by price cap LECs plus the LTS revenues of price cap LECs documented in Transmittal 707, Vol 4, Exhibit 4, July 96-June 97.

38 Of course, the incumbent LEC will have an opportunity to earn some of this money back by providing universal service.

exogenous change removing implicit universal service subsidies; and annual productivity increases to transition PCIs to economically efficient levels.

MCI believes that to conform to the requirements of the Communications Act, it would be best to implement immediate reinitialization of rates. If the Commission chooses a transition approach, it might take 3-5 years before the various price cap mechanisms bring access rates to economic cost. This would deny immediate reductions in access rates to long distance customers, and delay RBOC entry into long distance, since RBOCs would not be able to meet the competitive checklist or the public interest test until access is brought to cost.

MCI submitted evidence in the Preliminary Rate of Return Inquiry that shows that a 10% rate of return will fully compensate LEC shareholders for the risk they have borne investing in LEC financial assets.[39] Ex Parte Comments filed by the CARE Coalition in the LEC Price Cap Performance Review support increasing the productivity factor to 10%.[40] Reducing current rates of return from

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39 MCI Comments, Attachment A, Preliminary Rate of Return Inquiry, AAD 96-28, AAD 95-172, March 11, 1996.

40 The CARE coalition includes long distance companies such as MCI, AT&T and WorldCom as well as business and residential users including Consumer Federation of America, National Association of State Utility Consumer Advocates, International Communications Association, Ad Hoc Telecommunications Users and others.

"Total Factor Productivity (TFP) studies ... show that the LECs have been able to achieve interstate productivity of as much as 9.9 percent over the last five years. The LECs' choice of X-factor, coupled with their high returns under the Commission's original and interim price cap plans, provide further evidence supporting the CARE analysis calling for an X-

13.6% to 10% would reduce LEC interstate revenues by $1.5 billion. Raising the productivity factor to 10% from the current 5.3% would reduce PCI-based charges $4.6 billion over a 5 year period. The gap between embedded revenues and economic costs estimated in Table III-1 amounts to $11.6 billion. Accurately accounting for rate of return, productivity, and universal service contributions would account for $7.4 billion of this $11.6 billion gap, leaving a residual of $4.2 billion, that could be removed by raising the consumer productivity dividend from .5% to 5.2% for 5 years.[41]

Table III-2 shows the percentage decrease in the PCI is large the first year, due to the simultaneous transfer of $1.3 billion in implicit subsidies to an explicit universal service fund, the removal of $1.5 billion after reducing the rate of return from 13.6% to 10%, and the removal of $2.13 billion by raising the productivity factor to 15.2%. Revenue changes subsequent to 1996 are due solely to the higher productivity factor.

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factor between 8 and 10 percent." CARE Coalition Ex Parte Comments, CC Docket No. 94-1, Price Cap Performance Review for Local Exchange Carriers, April 16, 1996.

41 The Consumer Productivity Dividend (CPD) was originally intended as a mechanism that increased the chances that access rates would eventually decline to economic cost. Consequently, it is appropriate to use a temporary increase in the CPD as a means to drive access rates to cost.

Table III-2: Existing Price Cap Baskets v TELRIC Baskets Interstate Switched Access Revenues

	A	B	C
Year	Revenue ($Billion)	Revenue Reduction ($Billion)	Percent Change in PCI
1996	21.50		
1997	16.57	4.93	22.93
1998	14.65	1.92	11.59
1999	12.91	1.74	11.88
2000	11.34	1.57	12.16
2001	9.92	1.42	12.52

Column "C" shows the annual change in the PCI required each year to bring existing price cap rates down to economic cost.

Table III-2 shows the amount PCI's would have to be reduced each year in order bring the rates of each price cap service to the average economic cost of price cap LECs. In practice, the Commission should calculate the percent reduction in PCIs for each price cap basket separately for each price cap LEC. This would require:

- estimating the difference between each price cap LEC's rate of return and 10%, and exogenously removing this amount from each basket's share of interstate revenues for the first year of the transition;

- estimating each price cap LECs minimal universal service subsidy, and exogenously removing this amount times each basket's share of interstate revenues for the first year of the transition;
- applying a 10% productivity factor to each price cap basket every year of the 5 year transition; and
- estimating an interim consumer productivity dividend specific to each LEC[42] that removes the remaining difference between embedded revenues and TSLRIC estimates of each price cap basket.[43]

IV. Constitutional and Jurisdictional Arguments

A. Bringing Access to Cost Using a Prescriptive Approach Is Not an Unconstitutional Taking under the Fifth Amendment.

The Commission is charged with assuring just and reasonable rates for all interstate services.[44] For long distance service, the Commission has found that competition achieves this objective.[45] For interstate access, however, there is virtually no competition and regulation remains essential. In light of the fundamental changes brought on by passage of the 1996 Act, the level of access charges must be brought down to economically reasonable levels and changes

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42 This interim consumer productivity dividend would terminate after 5 years, as would the 10% productivity estimate. At that point, a total factor estimate of long-run productivity would be used.

43 This estimate of the interim consumer productivity dividend would have to be increased by the ratio of the PCI to API for each price cap basket to eliminate headroom. Otherwise rates will remain above economic cost.

44 1934 Act Title I, Sec. 2, 47 U.S.C. 151 - 52.

45 In the Matter of Motion of AT&T Corp. to be Reclassified as a Non-Dominant Carrier, FCC 95-427, Order, October 12, 1995.

should be made to the mechanism for collecting these charges.[46]

Bringing down access charges to forward-looking economic cost is not an unconstitutional taking of property.[47] The Supreme Court has held that a regulated utility has no right to the maintenance of a particular overall level of return. The Court in Hope explained that, "the mere fact that the value [of the utility's property] is reduced does not mean that the [rate] regulation is invalid." Hope, 320 U.S. at 601.

The Commission has an obligation to balance the interests of the utility and its investors against the consumer interest in and legal obligation of establishing just and reasonable rates, id. at 603. The Takings Clause is only implicated if an agency's regulatory scheme produces overall rates so low as to "jeopardize the financial integrity of the [regulated] companies, either by leaving

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46 The Commission need not be concerned with changing the mechanisms used to establish and regulate rates for access. In the seminal case on this issue, Federal Power Commission v. Hope Natural Gas Co., 320 U.S. 591, 602 (1944), the Supreme Court held that agencies are "not bound to the use of any single formula or combination of formulae, in determining rates." Regulatory agencies are not required to maintain any specific rate methodology and are free to change their approach on a going forward basis. See, e.g., Duquesne Light Co. V. Barasch, 488 U.S. 299 (1989); Wisconsin v. Federal Power Commission, 373 U.S. 294 (1963). Had that not been the case, the incumbent local exchange carriers would not have been able to move from traditional rate of return regulation to price caps, a change which has been very lucrative to the incumbent LEC's.

47 U.S. Const. amend. V ("nor shall private property be taken for public use, without just compensation").

them insufficient operating capital or by impeding their ability to raise future capital." Duquesne, 488 U.S. at 312. [48]

Requiring the incumbent LECs to set their access charges at economic cost will not deny them an opportunity to earn reasonable returns. To the contrary, because economic cost includes the cost of capital and a reasonable share of overhead costs, setting access charges at economic cost actually guarantees incumbent LECs an ordinary and reasonable profit on their access services so long as they invest and operate efficiently. Moreover, pricing access at economic cost will not disable incumbent LECs from earning reasonable returns -- or even super-reasonable returns -- on their end user services. In addition, Congress has created new opportunities for incumbent LECs to use their interstate facilities to provide new services and gain new sources of revenue.[49] For these reasons, reducing access charges to economic cost cannot constitute a Taking.

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[48] See also, Federal Power Commission v. Texaco, Inc., 417 U.S. 380, 391-92 (1974) ("All that is protected against, in a constitutional sense, is that the rates fixed by the Commission be higher than a confiscatory level."); Permian Basin, 390 U.S. at 769 ("Regulation may, consistently with the Constitution, limit stringently the return recovered on investment, for investors' interests provide only one of the variables in the constitutional calculus of reasonableness.") There is no regulatory taking unless the challenged rates cause "deep financial hardship." Jersey Cent. Power & Light Co. V. FERC, 810 F.2d 1168, 1181 n.3 (D.C. Cir. 1987).

[49] 1996 Act at §271.

The claims, if true, that incumbent LECs will suffer short-term losses to the extent that their embedded costs exceed economic cost is immaterial. Firms in unregulated markets routinely risk losses due, for example, to their own inefficiencies and to improvements in technology that cause them to write off outdated assets.[50] Regulated utilities are not constitutionally entitled to protection against such ordinary market forces.[51]

Indeed, for these reasons, the D.C. Circuit recently rejected BOC challenges to Commission regulations comparable to those contemplated here. In Illinois Bell Tel. Co. v. FCC, 988 F.2d 1254 (D.C. Cir. 1993) the court rejected a Takings challenge to a rate order that served to "exclude part of [an] original investment from the rate base." Id. at 1263. Noting that the Commission has no obligation "to include in the rate base all actual costs for investments prudent when made," the court squarely held that, even if the exclusion resulted in a loss of revenues, "there simply has been no demonstration that the FCC's rate base policy threatens the financial integrity of the [incumbent LECs] or otherwise

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50 A review of the financial books of the incumbent LECs reveals that these companies have taken extensive write downs of assets for tax and other purposes, while leaving these facilities on their books for regulatory purposes in an effort to force their captive customers to pay for their inefficiencies and poor business decisions.

51 See e.g., Duquesne, 488 U.S. at 308-09 (approving rate methodology that "mimics the operation of the competitive market" and "gives utilities strong incentive to manage their affairs well and to provide efficient services to the public"); Farmers Union Cent. Exch., Inc. v. FERC, 734 F.2d 1485, 1503 (D.C. Cir. 1984) (utility has no right to "creamy returns" that are the result of monopoly power).

impedes their ability to attract capital." Id. Here, no such showing could plausibly be made. Put simply, even if requiring the incumbent LECs to set access charges at economic cost would cause them losses on past expenditure, a regulation that sets rates at a level which specifically includes the cost of capital will not prevent them from attracting the capital necessary for them to compete and prosper under a new regulatory paradigm.[52]

B. The Commission Has Exclusive Jurisdiction over Interstate Access Issues.

Interstate access reform, like other purely interstate issues, falls under the exclusive jurisdiction of the Commission. Nothing in the 1996 Act changes this fact. The two other parts of the trilogy, universal service reform and interconnection, required that the Commission, although it has the primary role for establishing the required rules, consult with state regulators. Interstate access reform is different. While the Commission should certainly consider the views of state regulators along with other commenters, this proceeding is the only part of the trilogy that is purely interstate in nature.[53] As such, the Commission should bring interstate access rates down to economic cost

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[52] A risk free rate of return would compensate the incumbent LECs for investments that don't pay off. There is a risk premium already built into their current authorized rate of return. Furthermore the companies have consistently earned in excess of their authorized rate return.

[53] MCI is hopeful that state regulators will bring intrastate access charges down to forward-looking economic costs as well to help maximize competition in their states.

immediately as an example for state regulators that will be dealing with intrastate access issues in the near future.

Access reform is not contingent on separations reform. While there is an obvious link between the two proceedings, historically access policy has been established and the separations rules have been changed to conform.[54] The Separations Joint Board is neither designed to, nor should it be making the overarching interstate access reform policy decisions. While it is quite possible that changes need to be made to the interstate allocator, the Commission should establish the appropriate access policy based on forward-looking economic costs and apply it to the current separations regime. This will not prevent the Separations Joint Board from making changes to the Part 36 rules.

V. A Market-based Approach Is Unworkable, Fundamentally Unfair and Will Undermine the Commission's Interconnection Order.

Using a market-based approach in a market that remains a virtual monopoly is destined to fail from the perspective of both new entrants and end users, leaving the incumbent monopolist as the only beneficiary. When combined with increased pricing flexibility proposed for the incumbent LECs, a bad policy becomes even worse. It will create even greater incentives for the

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54 See, e.g., MTS and WATS Market Structure, CC Docket 78-72, Amendment of Part 67 (New Part 36) of the Commission's Rules and Establishment of a Federal-State Joint Board, CC Dockets 80-286 and 86-297, 2 FCC Rcd 2639, which changed the allocation of switching costs to reflect cost-causation.

incumbent LECs to slow the development of local competition, consumers will be forced to continue to pay artificially high long distance rates to subsidize the incumbent LECs, and it places the already competitive long distance market at risk by forcing today's interexchange carriers to subsidize the activities of their soon-to-be (or current in the case of GTE and SNET) competitors.

While appearing to embrace the pro-competitive thrust of the interconnection order, the Notice ignores the reality that the incumbent LECs will not give up their monopolies without a fight.[55] It also undermines the policy that recognizes the best way to maximize competition is to encourage efficient entry in as many different ways as possible.[56] The market-based approach put forth in the Notice plainly encourages facilities based competition and the use of unbundled network elements to the exclusion of all other means. Resellers would see no access relief and there is no recognition that deploying facilities will take time with access remaining inflated in the interim.

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55 Absolutely every step taken by the incumbent LECs since the Commission's interconnection order and numerous state utility commission's arbitration decisions were adopted has been designed specifically to delay the onset of local competition. Relying so heavily on the interconnection order, which has been stayed and is being vigorously challenged, in this proceeding seems almost certain to lead toward further attempts to delay by the incumbent.

56 47 U.S.C. 251; See also, Local Competition Order, at para. 12.

A. A Market-based Approach Fails to Address a Host of Competitive Problems, Including the Cost of Terminating Access.

Even if competition could develop overnight for access, half of the access charge problem would remain completely unresolved under the market-based approach outlined by the Commission in the Notice. The market cannot force terminating access charges down to economic cost. This is a problem already being faced by competitive long distance companies. For example, in Arizona, NYNEX is marketing its long distance service by offering lower prices for calls to its home region. The amount of the per minute difference between calls to the NYNEX territory and calls elsewhere is roughly the equivalent of terminating access. This demonstrates a likely price squeeze and, at minimum, a clear price squeeze opportunity. The problem will only get worse if access charges remain inflated and an RBOC is allowed to provide in-region long distance services.

For those territories where the RBOCs are attempting to merge, the potential for this type of price squeeze when a market-based approach is employed will expand even more. One of the primary reasons cited by Bell Atlantic and NYNEX for their merger is the amount of traffic that both originates and terminates in their territories.[57] For calls within their territories, a market-

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[57] New York Public Service Commission, In the Matter of Joint Petition of New York Telephone Company, NYNEX Corporation and Bell Atlantic Corporation for a Declaratory Ruling That the Commission Lacks Jurisdiction to Investigate and Approve a Proposed Merger Between NYNEX and a Subsidiary of Bell Atlantic or, in the Alternative, for Approval of the Merger, Case 96-C-603 et. al., Initial Panel Testimony of New York Telephone Company, NYNEX Corporation and Bell Atlantic

based approach provides these companies with two price squeeze opportunities, one for terminating access, and a second on origination in areas where local competition has not yet materialized.

A market-based approach may encourage inefficient entry in the access market. As long as access remains above cost, there will be an umbrella under which firms can enter the market to provide access service, even if they are inefficient providers. The Commission should pursue policies that encourage efficient investment and market entry. The market-based approach may permit inefficient competitors to enter the market while the rates remain artificially high, while permitting the incumbent to keep its rates far above economic cost. Ultimately, the inefficient providers will be forced out of the market if prices are eventually driven to cost.[58]

The problems associated with below cost pricing of access also exist under the market-based approach. It too, highlights the important connection between in-region long distance entry and access reform. Now that the Commission has eliminated the lower bands from the current LEC price cap baskets, an incumbent can engage in predatory pricing. Even if the Commission does not allow prices to fall below TELRIC, once an incumbent LEC is providing

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Corporation at 0747.

58 Potential entrants may decide to enter, knowing full well that the incumbent LEC could drop its rates for access down to economic cost, in the hope that the incumbent will leave rates high for some period of time allowing the new entrant to recover its costs and make a short term gain.

in-region long distance service, the floor becomes meaningless. If an incumbent LEC can offer a bundled local/long distance service, the Commission effectively loses the ability to protect against pricing access below cost. This opens the door to massive problems from anti-competitive cross-subsidy, many of which would not exist if a prescriptive approach to reform were used.

B. The Incumbent LECs Will Have a Greater Incentive to Make the Provision of Unbundled Network Elements Difficult.

This approach to access reform is premised on the notion that the availability of unbundled network elements will force the incumbent LECs to price access in an economically reasonable fashion or, if they fail to do so, new entrants will be able to bypass excessive access charges through the purchase of unbundled network elements from the incumbent LECs. While MCI strongly supports the Commission's interconnection order -- and believes it is fully consistent with Congressional intent, a fair balance of state and federal authority, and necessary for the development of wide spread local competition -- MCI recognizes that obtaining and assembling unbundled network elements and actually providing competitive local service will take money, time, and the cooperation from the incumbent LECs who still own and control the bottleneck elements. Yet, the market-based approach to access reform will only make the incentives even greater for the incumbent LECs not to provision or price unbundled network elements responsibly because they would be losing excess access as well as a local customer. It is clear that under a "market-based" approach, absent constant and vigorous oversight by the Commission, the incumbents have the power to slow or prevent the development of a competitive local market.

MCI's experience thus far in negotiating terms and conditions for obtaining unbundled network elements, providing local resale, and installing necessary equipment for local market entry, illustrates the difficulties involved in dealing with the incumbent LECs. For example, in California, where MCI is trying to provide some very limited local resale to business customers on a trial basis, there have been numerous problems in dealing with the incumbent LEC, Pacific Telesis (PACTEL). MCI customers have been told by PACTEL employees that MCI is not legally authorized to provide local service; customers have had their service disconnected before their new MCI local service is connected; customers have been forced to wait as much as six weeks for their new MCI local service to be started by PACTEL, during which time PACTEL has tried to recruit back customers that were waiting to be switched; and PACTEL has failed to take steps to make customer switches electronic and seamless.

There have also been problems and time delays when MCI has attempted to negotiate terms for both physical and virtual collocation of equipment. From the middle of 1994 until the middle of 1996, it was taking, on average, between six and nine months to obtain a collocation agreement. In September of 1996, MCI made 72 collocation requests. By January 1, 1997, MCI had only taken delivery on five. For many, the regulatory clock had not even begun to run because applications were wrongly rejected by the incumbent LECs, numerous questions were asked consecutively giving the incumbent LEC 30 days to answer each one as a means of further delay, and excessive prices were demanded. The incentives for this kind of anti-competitive behavior will only be heightened under a market-based approach to access reform.

As each of the RBOCs begins to seek permission to provide in-region long distance service, the incentive to cooperate in the provisioning of unbundled elements will end. Allowing incumbent LECs to provide in-region long distance service is the only "carrot" that the Commission has to force the incumbent LECs to minimize their anti-competitive conduct and open their local markets to effective competition. MCI expects all incumbent LECs to try to hold on to as much excess revenue from access charges as possible while at the same time trying to enter the in-region long distance market. A market-based approach to access permits them to do so. If access is not brought to cost before in-region long distance entry is permitted, it will be very difficult, if not impossible, to squeeze out the unwarranted subsidies.

The market-based approach also exacerbates the problems of in-region entry into long distance before there is meaningful competition for all consumers. Once it can provide one-stop-shopping for local and long distance services, the incumbent LEC's primary interest will be to remain the only provider that can effectively provide combined local and long distance service for as long as possible. That way it can continue to collect inflated access from customers with no competitive alternative while maintaining a significant marketing advantage. One need only witness the behavior, with respect to court challenges of GTE which already provides both local and long distance services, to see these anti-competitive incentives in action.[59]

There is also the serious problem of interim rates. In light of the fact most states have only established interim rates for both resale and unbundled network elements, it is altogether unclear whether and when competition using these means of entry will be viable. The absence of permanent rates makes reliance on the market to deliver access reform even less likely to succeed. Only 13 states and the District of Columbia have established a permanent resale rate[60] and only one state, Florida, has established a permanent rate for unbundled network elements. While the presence of permanent rates does not, by itself, lead to a finding that the competitive checklist has been met, the uncertainty

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[59] Along with being a lead challenger of the Commission's Local Competition Order, GTE has filed suit in more than a dozen states challenging state arbitration decisions.

[60] The states that have established permanent rates to date are: Florida, Illinois, Indiana, Kentucky (but not for GTE), Maryland, Michigan, Missouri, New York, North Carolina, Ohio, Tennessee, Texas and Virginia. Arizona has completed the proceeding reviewing interim rates but has not yet ruled. It is unclear if the rates established through arbitration in Wisconsin will be considered interim or permanent.

created by interim rates would certainly foreclose the Commission from finding that the competitive checklist has been met.[61]

The experiences of new entrants thus far and the potential windfall for the incumbents illustrates the link that must be made between bringing access down to cost, establishing permanent forward-looking rates for unbundled network elements, and entry into in-region long distance. The bottom line is that even in places where the right pro-competitive laws are on the books, the ability of new entrants to actually provide competitive services is constantly under attack by the incumbent. Making access reform contingent on the effective operation of these rules will serve only to make the competitive situation worse.

If access charges are not at cost when an incumbent LEC gains entry into the in-region long distance market, the inevitable result is discriminatory access prices. When a LEC buys access for itself, through its affiliate, it incurs only the economic cost. Competitors, however, are forced to pay the inflated costs. When the LEC was not permitted into the long distance market, it was unfair, but less of a competitive problem because everyone in the long distance industry was forced to pay too much. If the LEC gains entry before access is brought down to economic cost, it gains an unfair competitive advantage.

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[61] Among the challenges brought by the incumbent LECs is a request that the court throw out both permanent and interim rates established by state regulators and arbitrators.

C. Consumers Will Be Harmed Because Competition Takes Time and Always Develops Unevenly.

Local competition is going to take longer to develop than new entrants, most regulators, and consumers would like. A market-based approach to access reform ignores the time it will take and the financial realities faced by new entrants as they try to enter the local market.

Of course, even with multiple means of market entry, a new entrant will not be able to enter all places at once. MCI, for instance, has spent over a billion dollars on local network investments while maintaining the finest long distance network in the world. We currently have local facilities in 17 markets and plan to have facilities in 25 cities and 20 states by the end of the first quarter of 1997. Still, the presence of limited facilities in a market is only the first step toward widespread, effective competition.

MCI believes that over-priced access is essentially a tax levied on consumers for the benefit of the incumbent LECs that the long distance carriers are forced to collect. A market-based approach not only leaves the tax in place, but makes things even worse for the vast majority of consumers. Instead of forcing everyone who uses access services to pay the tax, this approach, particularly when combined with the increased pricing flexibility discussed in the Notice, gives the incumbent LECs an opportunity to pick and choose which customers or market segments will be forced to continue to pay for overpriced access services. The perverse result of such a policy is to force those