UNITED STATES
TELEPHONE
ASSOCIATION

January 29, 1997

William F. Caton
Secretary
Federal Communications Commission
1919 M Street, NW - Room 222
Washington, DC 20554

Re: CC Docket 96-262
Access Charge Reform

Dear Mr. Caton:

Enclosed please find 4 diskettes containing a copy of the USTA Comments and Attachments 1 through 16 (except Attachment 12, which is not available in electronic format) in response to the Commission's Notice of Proposed Rulemaking in CC Docket 96-262.

Should you have any questions, please feel free to contact me at (202)326-7266.

Sincerely,

Frank McKennedy
Director Legal & Regulatory Affairs

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UNITED STATES
TELEPHONE
ASSOCIATION

Enclosed is a Disk Copy of the USTA filing on Docket No.'s 96-262, accompany by Attachments on separate Disks in the following order. Disk # one consists of Attachments one through three, Disk # two consist of Attachments four through nine, and the last Disk # three consist of Attachments ten, eleven, thirteen, fourteen, fifteen, sixteen .

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Before the
Federal Communications Commission
Washington, D.C. 20554

In the Matter of	)	
	)	
Access Charge Reform	)	CC Docket No. 96-262
	)	
Price Cap Performance Review for Local Exchange Carriers	)	CC Docket No. 94-1
	)	
Transport Rate Structure and Pricing	)	CC Docket No. 91-213
	)	
Usage of the Public Switched Network by Information Service and Internet Access Providers	)	CC Docket No. 96-263

COMMENTS
OF THE
UNITED STATES TELEPHONE ASSOCIATION

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SUMMARY

The reform of the access charge system is an essential step toward the continuing evolution of a competitive marketplace as intended by the 1996 Act. ILECs cannot respond to competition without the ability to establish economically efficient prices. ILEC network access must compete with the offerings of facilities-based competitors and with access that is supplied through the use of unbundled network elements. Thus, ILEC prices must be market-based. Allowing the market to transition rates to competitive levels enhances economic efficiency.

A market-based approach advances the competitive opportunities mandated by the Act. An integral part of that approach is the need for regulatory relief. A state-approved interconnection agreement is sufficient evidence that barriers to entry in the local market have been removed. ILECs should then be permitted the flexibility to offer volume and term discounts, to deaverage switched access service rates by geographic area and by class of customer, and to offer contract tariffs and responses to RFPs. Price cap LECs should no longer be subject to the current Part 69 rules. The current price cap basket structure should be simplified to consolidate the baskets and bands. Services, which are highly competitive, such as Interexchange Basket services, special access, collocated direct trunked transport and directory assistance, should be forborne from regulation. In fact, the current price cap rules should be amended to remove the sharing requirements and the consumer productivity dividend. A fixed X-factor, based on the five year moving average TFP, should be adopted which takes into account the impact of rate structure changes. Such relief will reduce the unneeded asymmetrical regulation after competition has been authorized.

Services should be removed from price cap regulation upon the presence of actual competition in geographic areas smaller than a state to allow ILECs to respond to targeted entry by competitors. This will ensure that market forces are sufficient to constrain prices. Tariff filings on one day's notice without cost support should be permitted. Forbearance is required any time the criteria in Section 10 of the Act are met.

A prescriptive approach is a reversal of Commission policy and is contrary to the intent of the Act. It requires the Commission to assert its judgment over the natural operation of the marketplace. Constraints on prices in a competitive marketplace will not produce economic efficiencies. ILECs must be provided a reasonable opportunity to recover their full economic costs. Prices based on TSLRIC or TELRIC will not provide that opportunity.

Current access prices contain contributions and regulatory costs resulting from historical, deliberate and systematic allocation of costs to the interstate jurisdiction. ILECs must be provided an opportunity to recover those costs as well. USTA has identified and quantified the components of the TIC, the depreciation reserve deficiency and the separations rules. All of these costs are legitimate costs that must be recovered.

The Commission has an obligation to ensure that prices are compensatory in order to avoid committing an uncompensated taking of property in violation of the Fifth Amendment of the Constitution. In addition, such pricing will cause access to be priced inefficiently, will impede the ability of ILECs to compete for access and will create incentives for inefficient investment decisions and inefficient use of the network.

It is important to note that over the period that price cap regulation has been in effect, LECs have implemented approximately $9 billion in access charge reductions. The three largest IXCs have all raised their prices six times over roughly that same period. On behalf of consumers throughout the nation, the Commission should respond: "show me the money".

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COMMENTS
OF THE
UNITED STATES TELEPHONE ASSOCIATION

The United States Telephone Association (USTA) respectfully submits its comments in the above-referenced dockets. USTA is the principal trade association of the incumbent local exchange carrier (LEC) industry. Its members provide over 95 percent of the incumbent LEC-provided access lines in the U.S. USTA submitted a Petition for Rulemaking in 1993 proposing a comprehensive restructuring of the interstate access charge rules.[1] Those proposals were refined and discussed in CC Docket No. 94-1.[2] USTA applauds the steps taken by the

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[1]Reform of the Interstate Access Charge Rules, Petition for Rulemaking, RM 8657, September 17, 1993.

[2]Comments of USTA, December 11, 1995, Price Cap Performance Review for Local Exchange Carriers, Second Further Notice of Proposed Rulemaking, CC Docket No. 94-1,
(continued...)

Commission in adopting two of those proposals by eliminating the lower service band indices (SBIs) and streamlining the process for price cap LECs to offer new switched access services. (¶¶ 305 and 309). As indicated by the instant Notice of Proposed Rulemaking (NPRM) however, much remains to be accomplished to eliminate the excessive regulation of incumbent LECs and to initiate the appropriate competitive paradigm for access pricing.

I. INTRODUCTION (Paragraphs 1-13).

This proceeding is the third in the Commission's "trilogy" of dockets which form the basis of the pro-competitive, deregulatory national policy framework mandated by the Telecommunications Act of 1996. The interconnection, universal service and access reform proceedings are interrelated. Decisions reached in one proceeding will necessarily impact the others. There is a great deal of debate over whether the decisions reached to date in the interconnection and universal service proceedings will further the objectives of the Act. Needless to say, however, those decisions must be taken into consideration when evaluating the proposals presented here.

The Interconnection Order significantly altered the exchange access market by creating a wholesale/retail market structure.[3] Opening the local exchange market to competition also

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[2](...continued)
released September 20, 1995.

[3]Implementation of the Local Competition Provisions of the Telecommunications Act of 1996, CC Docket No. 96-98, First Report and Order, 11 FCC Rcd 15499 (1996), petition for review pending and partial stay granted, sub nom. Iowa Utilities Board et. al v. FCC, No. 96-3321 and consolidated cases (8th Cir., Oct. 15, 1996).

dramatically accelerated switched access competition. The Order creates significant arbitrage opportunities for competitors to use unbundled network elements and/or resold services to expand into the exchange market and to avoid access charges. Competitors will target their entry into the exchange market to take advantage of any subsidies remaining in incumbent LEC rates. Switched access will be replaced immediately by unbundled network elements when the competitor has "won" the end user. Interstate and intrastate access revenues will erode as competitors capture customers using unbundled network elements. Competitors will also be able to provide "one stop shopping". Interexchange carriers (IXCs) will have ample time to take advantage of these opportunities before the RBOCs have the opportunity to enter the "in region" long distance market. Competitors will be able to take advantage of their quick entry into the local exchange market by offering combined local and long distance packages at less expensive rates to their own customers and charging incumbent LEC customers higher long distance prices.

The wholesale prices that incumbent LECs are required to charge will not sustain the implicit contribution contained in current interstate access rates which is needed to support affordable universal service. The Joint Board recommendation in the universal service proceeding does not eliminate the implicit support in incumbent LECs' rates, despite the requirement of the Act.[4] It relies on a formula that understates the actual costs of providing universal service and overstates revenues in order to reduce the size of the funding mechanism. Thus, implicit support is maintained and the fund itself is neither sufficient, predictable nor

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[4]Federal-State Joint Board on Universal Service, CC Docket No. 96-45, Recommended Decision, FCC 96J-3 (rel. Nov.8, 1996).

competitively neutral.

Given the impacts of these two decisions on access reform, it is imperative that the decision in this proceeding provide incumbent LECs with the ability to compete by reducing regulatory requirements, by providing much-needed pricing and structural flexibility and by minimizing the immediate financial impact through adequate cost recovery mechanisms. In addition, implicit subsidies in access rates ultimately should be recovered, in an explicit, competitively neutral manner. This can only be accomplished and be consistent with the 1996 Act through the implementation of a market-based approach to access charge reform.

A. A Market-Based Approach to Access Reform Must Allow the Competitive Marketplace to Work (Paragraphs 161-168).

A true market-based approach to access reform should rely on the market to determine the appropriate prices for access services. Unwarranted regulatory intervention to establish prices which do not reflect market realities or to arbitrarily reduce revenues under the guise of enhancing competition will only serve to perpetuate the inequities and inefficiencies of the current access structure.

There is little, if any, disagreement that the current structure must be reformed. Basically unchanged since 1983, the current access structure no longer accommodates the present marketplace, much less the accelerated growth in competition resulting from the implementation of the local competition provisions of the 1996 Act.

> The transition from the current level of exchange access rates toward their competitive level has been underway for some time. In conjunction with the efficiency improvements elicited from price cap regulation, technological changes and market forces are restructuring the exchange access market, driving exchange

> access prices in some geographic areas toward their competitive level and increasing alternatives available to exchange access customers. Coupled with the Act and the Interconnection Order, these forces will accelerate the transition and introduce exchange access alternatives to all geographic areas. In light of these technological and market circumstances, sound economics and public policy require that market forces rather than a prescriptive approach be relied upon to determine efficient pricing and output parameters.[5]

Indeed, as competition has developed, the current rules have created market distortions by encumbering incumbent LECs with the burden of decades of regulatory decisions which have increased the magnitude of the interstate cost recovery problem. As explained in an affidavit of several former state and federal regulators, appended hereto at Attachment 2, "Through a long series of decisions spanning six decades, federal and state regulators decided to allocate a large share of these costs to the interstate jurisdiction, in order to further explicit public policy objectives, notably the promotion of universal service and the maintenance of low local telephone service rates. These policy decisions have determined the jurisdictional allocation of billions and billions of dollars of LEC costs."[6] Requiring that interstate per minute access rates recover costs of other services is not sustainable in a competitive marketplace. Such a system encourages inefficient entry to avoid the charges embedded in current switched access rates. These subsidies reflect legitimate costs which have been allocated to interstate access rates through the current Part 36 and 69 rules as well as the capital recovery process. Incumbent LECs

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[5]Richard Schmalensee and William E. Taylor, "Economic Aspects of Access Reform", January 27, 1997 at 2. [Appended hereto at Attachment 1].

[6]Affidavit of James M. Fischer, Albert P. Halprin, Henry M. Rivera and Marvin R. Weatherly, "Implications of the Separations Legacy for Implementation of the Telecommunications Act of 1996", Attachment 2, at 3.

must be provided a reasonable opportunity to recover these costs to avoid an impermissible takings. "The benefits of competition, however, do not include forced transfers of income from shareholders of utilities to their customers and competitors as a result of asymmetries in regulation. Asymmetric regulation can only serve to impede competition and impair the financial health of incumbent utilities. As regulators dismantle barriers to entry and other regulatory restrictions, they must honor their past commitments and avoid actions that threaten to confiscate or destroy the property of utility investors on an unprecedented scale."[7]

A new competitive paradigm for access pricing is consistent with the objective of the 1996 Act. The Act itself contemplates a market-based approach to access reform rather than one which relies on regulation. Pricing of interstate access must be both efficient and compensatory. "Efficient pricing requires that the prices for access to the telecommunications network convey the proper economic incentives in the marketplace to purchasers of access and other market participants. Compensatory pricing requires that access revenues allow the firm to recover its forward-looking economic costs and any other costs incurred in satisfying its past, current and future regulatory obligations."[8] This includes a reasonable allocation of common costs. Access reform that addresses the rate structure, pricing flexibility, price cap basket structure and common line issues now, by allowing the market to operate without unwarranted regulatory intervention, will produce the framework which Congress anticipated by eliminating the need for

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[7]Affidavit of J. Gregory Sidak and Daniel F. Spulber, Attachment 3, at 76.

[8]Id. at 7.

unnecessary regulatory scrutiny, encouraging efficient investment, lowering prices and promoting economic growth. Mandating artificial prices and maintaining current regulatory constraints will not permit market forces to operate in an effective or efficient manner. Utilizing a true market-based approach will ensure that competition is efficient which will in turn result in lower prices.

There is no reason to believe that the competitive market cannot achieve these benefits. "The Interconnection Order establishes a framework for the pricing of unbundled network elements. Forces of competition--not regulation--will require carrier access to be priced on a similar basis. This will occur because of facilities-based access competition and the high degree of substitutability between carrier access services and unbundled network elements."[9]

It is clear from the immense record established in CC Docket No. 94-1 that price cap regulation, which is designed to replicate a competitive market, has been successful in encouraging LECs to implement competitive efficiencies.[10] To date, the efficiencies of price cap regulation have resulted in approximately $9 billion in reductions in access charges over the past six years.[11] In 1996 alone the decrease was $75 million. Taking into account inflation over the period price cap regulation has been in effect, the real cumulative savings which were passed on to interexchange carriers was $19 billion. This is a real access price reduction of nearly 37

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[9]Schmalensee and Taylor at 1.

[10]Price Cap Performance Review for Local Exchange Carriers, Fourth Further Notice of Proposed Rulemaking, 10 FCC Rcd at 9008 (1995).

[11]USTA Ex Parte, CC Docket No. 94-1, April 2, 1996.

percent over this period. These efficiencies will be enhanced in an approach which relies on the market, not regulation.

Unfortunately, as the price cap LECs have reduced access rates for IXCs, IXCs have refused to pass these savings on to their end user customers. In fact, the three largest IXCs, AT&T, MCI and Sprint, have all raised their rates, simultaneously, six times in the last five years.[12] AT&T alone has increased the price of a 3 minute, weekday, 150-mile call by 29 percent. "AT&T took a radical step the day before Thanksgiving by announcing that effective in four days, it was raising its basic rates by 5.9%. The increase in rates added seven dollars to the yearly bill of the average consumer...Additionally, the Big Three long distance companies continue to favor two-tier pricing schemes which tend to benefit an elite group of high volume customers. We believe that it is no surprise that AT&T's recent price increase affects all of its customers except those customers that sign up for their flat rate plan."[13] It appears that, regardless of LEC access price reductions, the full benefits of the competitive access marketplace will not reach consumers until the interexchange market experiences more robust competition.

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[12]USTA News Release, "USTA Comments on FCC Access Charge NPRM", December 23, 1996. See, also, The WEFA Group, Economic Impact of Deregulating U.S. Communications Industries (February 1995).

[13]Comments of United Homeowners Association and United Seniors Health Cooperative, Rulemaking Number 9006, December 31, 1996, at 3.

B. A True Market-Based Approach to Access Reform Which Reflects Current Market Conditions Should Be Adopted (Paragraph 15).

USTA proposes a market-based approach designed to let the competitive market work, consistent with the framework envisioned in the 1996 Act. In Section II, USTA discusses a phased approach which better reflects the current competitive market. As the markets for various services become more competitive, regulation is reduced accordingly. Phase 1 regulation is applied now to services in areas where unbundled network elements are available through interconnection agreements that are effective. Competitive zone pricing, volume and term discount plans and contract pricing should be allowed. New services should be deregulated. Even in Phase 1, however, certain services should be forborne from regulation to reflect the fact that they are already highly competitive. In addition, the price cap basket structure should be simplified to provide the flexibility necessary to respond to market conditions. This will help ensure the economic recovery of costs through market responsive rates. In Phase 2, services are removed from price caps in areas where competitors have made use of unbundled elements or provide service over their own networks. Furthermore, forbearance is *required* whenever a showing that the criteria contained in Section 10(a) of the Act are met. Richard Schmalensee and William E. Taylor of National Economic Research Associates, Inc. provide an economic analysis of the need for the market-based approach recommended by USTA.

In Section III, USTA discusses the Commission's proposals for rate structure modifications. As USTA has consistently maintained, codification of the access rate elements in Part 69 should be eliminated for price cap LECs. LECs must have flexibility to compete. As

noted above, providing the appropriate structure to afford economic pricing of access services is necessary to send correct economic signals to both providers and customers. This will allow the market to ensure economic efficiencies without the distortions caused by unnecessary regulation. Pricing distortions, which impact the decisions made by other providers as well as customers, must be eliminated in order to allow prices to adjust naturally to the market.

In Section IV, USTA recommends competitively neutral mechanisms to recover contributions and regulatory costs resulting from historical, deliberate and systematic allocation of costs to the interstate jurisdiction. Several affidavits are submitted to support USTA's position. Dr. Jeffrey Rohlfs of Strategic Policy Research provides a quantification of the depreciation reserve deficiency. Former state and federal regulators analyze and describe the impact of various Commission and Joint Board separations decisions. J. Gregory Sidak and Daniel F. Spulber, discuss the legal and economic reasons why incumbent LECs must be permitted a reasonable opportunity to recover all of their economic costs.

Finally, while the Commission has determined that issues regarding access reform for rate of return companies will be the subject of a future proceeding, decisions made in this proceeding will have both direct and indirect impacts on rate of return LECs. These companies are vitally interested in the outcome of this proceeding. Pricing flexibility and deregulation must be extended to rate of return companies. Rate of return companies have unique cost and demand characteristics that prevent them from electing price cap regulation. Rate of return LECs do not have the economies of scale and scope to sustain the year-over-year productivity gains required under the interim price cap plan.

Regulatory form, however, does not inhibit the development of competition. Many rate of return companies have already received bona fide requests for unbundled network elements.[14] Such requests will undoubtedly mean that some rate of return companies will be offering unbundled network elements prior to the completion of a proceeding to consider access reform for rate of return companies. This could subject rate of return companies to competitive and arbitrage pressures by such global companies as AT&T, MCI and Time Warner. Such an occurrence could prove disastrous for rate of return companies and their customers. Given the fact that access revenues for rate of return companies account for approximately sixty percent of their total revenues, on average, and reach levels as high as eighty percent, any reduction in access revenues would be detrimental. Further, these companies typically serve geographically sparse areas which often include only one large volume customer. Even for those companies that have a few large volume customers, the loss of even one high volume user would be devastating, particularly for the low volume customers without competitive alternatives. Without pricing flexibility, rate of return LECs cannot be expected to be effective competitors.

C. The Prescriptive Approach to Access Reform is Regressive and Contrary to the Objectives of the Telecommunications Act of 1996 (Paragraphs 218-240).

The prescriptive approach to access reform is anathema to the objectives of the 1996 Act which specify a deregulatory framework and require the Commission to forbear from regulation

[14]For example, the following companies have either completed, are in negotiations, or have received a bona fide request for interconnection agreements: ATU Communications, Bentleyville Telephone Company, Cincinnati Bell Telephone Company, and Puerto Rico Telephone Company.

if it will serve the public interest. There is nothing in the Act to support the additional regulation which this approach would require.

It is also contrary to the Commission's stated goal to "have a red-hot rule burning party every chance we get."[15] The regulation anticipated by the prescriptive approach will guarantee a contentious and unproductive year ahead for the Commission. It represents a giant step backward from incentive-based regulation which has been adopted throughout the world as an appropriate surrogate for competition. If there is any lesson to be learned from the current structure it is that regulatory intervention in competitive markets only serves to create perverse economic incentives which encourage inefficient entry and create uneconomic pricing signals. Unnecessary pricing constraints on incumbent LECs will remove any incentives to continue to invest in the infrastructure. It defies reason to adopt an approach which will perpetuate bad economics and bad public policy. "A prescriptive regulatory approach carries the risk of returning to cost-based-rate-of-return regulation, and such an approach would reverse and undo the incentive-improvement intentions of price cap regulation and subsequent reforms. A prescriptive approach would require detailed FCC intervention in the exchange access market and accurate forecasts of long-run competitive prices, a process that carries with it significant costs and risks of error."[16]

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[15]Chairman Reed E. Hundt, "The Hard Road Ahead -- An Agenda for the FCC in 1997", December 26, 1996 at 2.

[16]Schmalensee and Taylor at 2- 3. Schmalensee and Taylor also point out at 17 that even under the prescriptive approach, market forces and the unbundling requirements of the Act will

(continued...)

The Commission notes that a prescriptive approach may be preferred because competition will emerge unevenly among geographic areas, services and customer classes. (¶ 218). That competition may develop in an uneven manner is not a failure of the efficiency of the market. It is a rational operation of market dynamics. Different rates of competitive growth reflect different rates of competitive entry which in turn reflect different profit margins in different service and customer markets. Additional, arbitrary rate reductions, mandated by regulatory fiat, should not be the solution to the development of uneven competition. A market-based approach will facilitate rates which are economically efficient.

1. TSLRIC/TELRIC Pricing Will Not Reflect Total Costs and Should Not be Adopted. (Paragraphs 220-227)

The computer models submitted by AT&T and MCI to calculate so-called forward-looking economic costs are inaccurate and have been discredited by economists in almost every state.[17] Even the Joint Board refused to recommend the adoption of these models.

> Proxy cost models such as Hatfield do not produce the forward-looking economic costs of an efficient entrant because efficient entrants do not construct a network instantaneously to serve the entire market demand. Networks of efficient firms in the real world are constructed over time to provide capacity to serve the uncertain and growing demand throughout the service territory. Prices cannot fall to levels indicated by installing ubiquitously the most efficient technology at any instant. An efficient firm in the real world adds capacity to its existing

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[16](...continued)
continue to affect the access market. This will make the prescriptive approach more difficult to sustain. At best, the prescriptive approach may become irrelevant in the presence of market forces. At worse, the prescriptive approach may confound desirable market forces.

[17]William E. Taylor, "Not the Real McCoy: A Compendium of Problems with the Hatfield Model", USTA Ex Parte, CC Docket No. 96-45, October 16, 1996.

plant thus accounting for the trade-off between lower unit costs for larger installations and the costs of carrying unused capacity over time.[18]

The basic problem with these models is that they assume that TSLRIC and/or TELRIC are appropriate measures of the economic costs of access services and/or unbundled network elements. That assumption is incorrect. "The problem with TSLRIC pricing generally is that it does not equal economic costs. That is why TSLRIC pricing creates economic inefficiencies."[19] As Sidak and Spulber explain in detail, there is compelling economic and legal evidence to support the existence of a regulatory contract that obligates the Commission and the states to ensure that an incumbent LEC has a reasonable opportunity to recover *all* of its economic costs, both forward-looking and historic. Honoring the regulatory contract serves the public interest because it encourages incumbent LECs to make asset-specific investments to discharge their public service obligations.[20]

A multi-product firm, such as an incumbent LEC, has shared and common costs. These costs represent its economies of scope. Shared and common costs are the firm's efficiency gains which arise from jointly producing multiple services. Pricing without regard to these costs in effect penalizes the firm for its efficiencies. Obviously, such pricing is directly contrary to the objectives of price cap regulation which seek to maximize such efficiencies. If all of the firm's services were sold at TSLRIC/TELRIC, the firm would not recover its costs. This would, of

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[18]Schmalensee and Taylor at 21.

[19]Sidak and Spulber, at 20.

[20]Id. At 6.

course, eventually lead to insolvency.[21]

> If TELRIC costs are used to set switched access prices, one or some of three things will happen: local exchange rates will be increased, explicit universal service subsidies will increase dramatically, or incumbent local exchange carriers will suffer significant financial losses. This last "option" promotes inefficient competition and hinders ILEC network-deployment incentives... [P]ost-divestiture experience clearly has shown that pricing at incremental cost is not necessary for efficient entry into either the inter- or intraLATA toll markets.[22]

TELRIC/TSLRIC pricing would also interfere with market forces. There is no room under such pricing constraints for price adjustment to respond to market conditions.

> Proponents of TSLRIC pricing argue that because prices in competitive markets tend toward incremental costs, regulators should immediately reduce price to its lowest level. That argument is flawed because it presupposes that a competitive market eliminates all margins over marginal cost. To the contrary, competitive markets determine the size of relative margins on products depending on many factors, including the extent of shared costs and common costs, demand elasticities, product differentiation, transactions costs, and marketing and sales efforts. Moreover, the argument presupposes that regulators can discern competitive price levels more accurately than the market can...[23]

Facilities-based competitors certainly will never be subject to such pricing restrictions. The imposition of TSLRIC/TELRIC pricing on incumbent LEC services and unbundled network elements will place them at a severe competitive disadvantage. "Such a constraint ensures that the incumbent LEC will be denied the ability to recover any appreciable amount of its unattributable forward-looking costs. That constraint is tantamount to the Commission ordering every incumbent LEC to write a check to each prospective rival to help pay for its cost of entry

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[21]Schmalensee and Taylor at 17-18.

[22]Id. at 21-22.

[23]Sidak and Spulber at 30.

into the local market "[24] Pricing at TSLRIC/TELRIC should not be required.

> The supposed efficiency of TSLRIC pricing and TELRIC pricing with administratively determined shares of common costs is a mirage. Such pricing would not...cover the firm's total direct costs, nor would it compensate the firm for its economic costs inclusive of opportunity costs...The imposition of TSLRIC or TELRIC pricing would create the perverse incentive for the incumbent LEC to reduce its common costs and shared costs...TSLRIC or TELRIC pricing does not permit the incumbent LEC to have dynamic pricing flexibility. Such pricing discriminates in favor of entrants...In short, the call to apply TSLRIC or TELRIC pricing to interstate access (as well as to resale and unbundled network elements) is a mantra that misapprehends the most basic principles of price theory.[25]

2. Reinitializing Rates Based on Rate of Return is Not Warranted. (Paragraphs 228-230)

There is no basis to reinitialize rates based on the current rate of return of 11.25 percent or to prescribe a new rate of return and then reinitialize rates. USTA's comments in response to the Commission's preliminary inquiry as to whether a represcription proceeding should be instituted provide sufficient reasons why such a represcription is not warranted.[26] As USTA explained, the uncertainty created by the impacts of the 1996 Act, the continuing volatility in interest rates, the inverse relationship of the cost of equity and the level of interest rates and the detrimental effect of a represcribed lower rate of return on smaller exchange carriers are significant factors which indicate that such a represcription is not justified. The record in that

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[24]Id. at 22-23.

[25]Id. at 33.

[26]USTA Comments and Reply Comments, Preliminary Rate of Return Inquiry for Local Exchange Carriers Subject to Rate of Return Regulation for Their Earnings on Interstate Access Services, 11 FCC Rcd 3651 (1996), filed March 11, 1996 and April 15, 1996, respectively.