GTE supports the extension of zone density pricing to all other switched access elements in addition to its existing application for transport services. Zone pricing would allow prices to be aligned more closely with geographic differences in cost associated with density. In its recent petition seeking a waiver of the Part 69 rules to offer its ZonePlus service, GTE demonstrated that its costs for access services do in fact vary with differences in density. The recent record in the Commission's proceeding on the Universal Service Fund ("USF") also provides evidence that both loop and switching costs vary with density.

Sprint (at 3, 6) supports zone pricing for other switched access elements, including the CCL and Residual Interconnection Charge ("RIC"). As both the Commission and Sprint observe, allowing deaveraged CCL and end office switching elements will enable LECs "to target rate reductions to the customers who are most likely to bypass LEC switched services in favor of potentially less efficient services.[35] CompTel (at 38) also supports allowing LECs to vary rates geographically, "without regard to the existence of access competition."

GTE also agrees with Sprint and STV (at 8, n.22) that the existing thresholds at which carriers can implement volume and term discounts for switched access should be removed. This requirement is particularly problematic for GTE, whose study areas are generally smaller and less dense than those of other large LECs.[36] As Sprint observes

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35 Sprint at 13, *citing* NYNEX Telephone Company Petition for Waiver, Memorandum Opinion and Order, FCC 95-185, released May 4, 1995 at ¶56.

36 For a detailed discussion of this point, see GTE's Petition for Waiver of the 100 DS-1 threshold requirement. Petition for Waiver of the GTE Telephone Operating Companies, CC Docket No. 91-141, filed Jan. 6, 1995.

(at 12), "by removing the cross connect prerequisite to zone density pricing, the FCC will enable LECs to begin migrating rates towards cost which will eliminate uneconomic pricing umbrellas and will foster more vigorous competition, to the benefit of access providers, access customers and end users."

D. Alternative Pricing Plans (APPs)

In the *SFNPRM*, the Commission reaches the tentative conclusion that LECs should be allowed to establish alternative pricing plans, including both temporary promotional offerings and long-term discounted rate plans for switched access. GTE wholeheartedly agrees. LECs should be allowed to file temporary, promotional APPs, without cost support, to remain in effect not more than 90 days. These temporary offerings should not be included in price caps. Permanent APPs should be supported with a showing that rates exceed direct cost, and should then be incorporated into the calculation of the annual PCI adjustment in the next annual filing following the year in which they were introduced, in the same way that new services are today.[37]

Most commenters appear to support the introduction of APPs, provided adequate safeguards are in place to guard against predatory pricing and discrimination.[38] For example, MCI (at 12) states that "optional additional pricing plans,

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37 As access markets become more competitive, cost information becomes more proprietary. GTE suggests that LECs should be able to submit their cost showings for APPs under a protective arrangement. Forcing the LEC to reveal its cost floor to its rivals imposes an asymmetric handicap on the LEC, and by reducing a competitor's uncertainty concerning LEC pricing, could constitute an undesirable form of signaling which would discourage aggressive price competition.

38 CompTel at 28-30, MFS at 5, Time Warner at 14-16.

if competitively neutral from the perspective of the interexchange industry, ought to be permitted." Further, MCI agrees (at 13) with GTE that APPs should be rolled into price caps at the next annual filing, as are new services today.

Commenters opposing any flexibility in the introduction of APPs[39] cite the usual string of arguments against volume and term discounts that the Commission has previously addressed and rejected before in its Docket 91-141 proceedings. These include concerns of predatory pricing, the ability to "price squeeze," and potential harm to the development of competition. Others claim that if allowed, LEC APPs should be subject to stringent cost support requirements. As stated *supra*, concerns over predatory pricing and offsetting rate increases and decreases are unfounded.

Competitors would be protected against pricing too low by the requirement that the LEC demonstrate that the proposed APP rates exceed direct cost. Prices which meet this test cannot deter efficient entry. Ad Hoc (at 14) proposes that a LEC should provide the same cost support for an APP that it would for a below-band tariff filing. This is essentially the same as the direct cost showing GTE proposes.

Customers would be protected against too high prices by the continued availability of the existing service at a price capped rate.[40] The introduction of the APP would not create any "headroom" which would permit the LEC to raise the rate for the existing service -- or any other rate in that price cap basket. During the first year, the APP would be held out of price caps. At the next annual filing, the APP would be rolled

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39 CompTel at 28-30, Ad Hoc at 12-14, NCTA at 24-25.

40 *See SFNPRM* at 60.

in as new services are today. Under this procedure, the inclusion of the APP does not affect the year-over-year calculation of the PCI or the SBIs, and hence does not create any headroom under these indices.

The concern most often cited in opposition to LEC APP pricing is that APPs would be used to discriminate among different classes of customers, or that a LEC may use such offerings to provide an advantage to an affiliate providing long distance interLATA services. To the contrary, GTE has demonstrated in its recent ZonePlus proposal that such a plan can be developed in a "competitively neutral" manner which would benefit all IXCs, large or small.[41] The availability of the APP to all similarly situated customers, as well as the Commission's long-standing open resale policy, will guard against any unreasonable discrimination.[42] The Commission has adequate tools, through the tariff filing and complaint processes, to determine if potential discrimination could result from the filing of an APP tariff, including any attempt by a LEC to construct a plan that benefits only its affiliate.[43] Anti-discrimination rules and strict regulations regarding transactions with affiliates would help guard against any potential discriminatory actions.

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41 *See* GTE's ZonePlus Petition. GTE proposes a volume discount which would depend on the number of minutes which originate or terminate at a given end-user location. This structure ensures that any IXC, regardless of the carrier's size, can obtain the same discount from GTE to serve the same end user.

42 *See* Schmalensee and Taylor at 11 on the effect of resale in guarding against unreasonable discrimination.

43 The example cited by some parties of an APP designed so that only the LEC's affiliate could purchase it, is hardly a realistic concern. First, it is not clear what basis the LEC could find by which to distinguish its own affiliate from other large IXCs. Second, such a plan, if it were ever to succeed, would be too transparent to escape detection.

Sprint contends (at 17) that APPs are unnecessary if the Commission expands zone density pricing. While expansion of zone pricing is indeed crucial, APPs are very appropriate in the marketplace for exactly the same reasons Sprint supports zone pricing (*i.e.*. prevents uneconomic bypass, more efficient pricing, etc.). Zone pricing will enable LECs to move access rate elements towards their economic cost. Even with zone pricing, however, the LEC will still experience economies of scale within each geographic zone which will cause the incremental cost of service to be less than the average cost. By offering volume and term discount options, the LEC can bring the rate the customer pays at the margin closer to the economic cost of service than would be possible with a uniform rate within the zone. CAPs and other local competitors, unlike LECs, can deaverage their rates geographically.[44] Nonetheless, they use various discount offerings in order to compete directly with the LECs.

MCI suggests that, if allowed, APPs should be subject to a Part 69 waiver requirement. This is unnecessary. The essence of the APP proposal is that it provides a vehicle, short of a comprehensive access reform, for introducing attractive new service options, without imposing the barrier which the waiver process has represented for innovative proposals in the past. If a waiver requirement is imposed, the APP concept will lose its value. The tariff review process will provide ample opportunity for the Commission to review APPs for possible discrimination. As the present round of comments makes clear, the IXCs will be vigilant for any hint of discrimination, and will have an opportunity to intervene against any proposed tariff that violates Commission

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44 These carriers, of course, are also able to negotiate customer-specific contract tariffs, which LECs are not permitted to do.

policy.[45] Although the opponents argue discrimination, none of the commenters has explained what a LEC would have to gain by favoring one of its large customers over another.

Further, MCI opposes granting LECs the ability to file temporary promotional offerings, claiming that such offerings can easily be used to discriminate among customers. There is no evidence that such activity would occur. Indeed all the major IXCs, including MCI, have made extensive use of promotional plans, some of which are targeted to specific customer segments based on current market trends. As long as customers are allowed to retain the basic service offering and similarly situated customers are treated alike, targeting of promotions does not necessarily constitute discrimination. Here again, it would simply be impractical for a LEC to design a promotional offering that would favor one IXC, or its own affiliate. Such a design would be too transparent, and could hardly escape attention in the tariff review process. In addition, MCI cites concerns over giving immediate "credit" for promotional offerings in price cap calculations, which would increase the ability of the LEC to take advantage of greater headroom. To the contrary, promotions would not create headroom if the Commission adopts GTE's proposal that promotional offerings, limited to a specific time period, were kept entirely out of price caps.

AT&T (at 29) contends that LECs should not be allowed to introduce term and volume discounts for those elements in which subsidies are incorporated, such as the

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45 If the Commission believes that it needs an opportunity, outside the tariff review process, to examine APP proposals, then it should require LECs to file NOIs, as GTE has suggested for new services, rather than waiver petitions.

CCL and RIC. Again, GTE recognizes the urgent need to address current subsidy problems through action on access reform and universal service. However, the existence of such implicit support flows makes it all the more important that efficient pricing structures -- such as nonlinear prices -- be employed in order to minimize the efficiency losses caused by the need to recover this support through access charges.

AT&T (at 30) also argues against the adoption of any discount schemes for local switching, arguing that switching scale economies are minimal. However, evidence presented in the Commission's proceeding on the Universal Service Fund strongly suggests that scale economies in switching are significant. Certainly, AT&T has discounted its own switched service offerings for many years. In any event, the degree of scale economies will be reflected in the direct cost floor. If the economies are great, the floor will be low relative to the rate; if they are small, the floor will be closer to the average rate. Use of a cost floor will prevent LECs from gaining approval of discounts which are not justified.

The simple fact is that optional plans similar to APPs have been widely used in the industry by most telecommunications providers, and for almost every service -- except LEC switched access. The Commission adopted procedures in 1985 -- long before it found any of AT&T's long distance markets to be competitive -- which allowed AT&T to offer Optional Calling Plans ("OCPs") for its switched MTS service. In CC Docket No. 84-1235, the Commission considered how such OCPs should be regulated. The NPRM in that proceeding took note of "the increase in competitive market forces faced by AT&T." However, for the purposes of the OCP proceeding, the Commission did not find that competition was sufficient to constrain AT&T:

> In this docket we do not address the issue of whether AT&T continues to have substantial market power but assume arguendo that it does have

> sufficient dominance to justify regulatory scrutiny of its MTS offerings. Rather we focus narrowly on how the Commission can most effectively guard against unjust and unreasonable discrimination without unduly impeding strenuous price competition until this Commission reaches any different determination about AT&T's market power.[46]

In other words, the Commission considered changes to "baseline" regulation for AT&T which would allow it to price more efficiently, and respond to emerging competition, in the absence of a specific finding that AT&T's markets had yet become competitive. Faced with essentially the same question that the *SFNPRM* raises, the Commission chose to permit AT&T to offer APPs.

Then, as now, parties raised concerns with respect to discrimination and predation.[47] The Commission correctly identified the value of volume discount options:

> We are unpersuaded by MCI and TDX that multipart tariffs should not be permitted....The major thrust of this proceeding is to allow carriers flexibility in designing MTS packages to meet customers' varying demand characteristics. Prohibiting multipart pricing would greatly limit that flexibility. We do not adopt the requirement that all customers must be charged the same variable rate for the last unit of consumption because that restriction would not ensure against rates that were too high or too low. Moreover, this proposal would unduly restrict pricing flexibility while contributing nothing to our major concerns regarding predation and burdening other ratepayers.[48]

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46 Notice of Proposed Rulemaking, CC Docket 84-1235, Guidelines for Dominant Carriers' MTS Rates and Rate Structure Plans, 50 Fed. Reg. 1881, January 14, 1985 at ¶1. ("*OCP Notice*")

47 Interestingly, MCI proposed a FDC cost standard for OCPs, which the Commission rejected, finding that it would prevent AT&T from realizing the potential efficiency gains from OCPs.

48 Memorandum Opinion and Order, CC Docket No. 84-1235, FCC 85-540, 50 Fed. Reg. 1881, October 17, 1985 at ¶81. ("*OCP Order*").

The Commission's action in the *OCP Order* led to a wide array of new, optional pricing offerings from AT&T, including Reach-Out America, Pro-America and Pro-WATS, which in turn prompted responses from competitors, such as MCI's Friends and Family. Over the next few years, the Commission approved a series of other flexible pricing arrangements for AT&T, including Megacom, SDN and Tariff 12. All of this took place before AT&T's price cap plan began, before the Commission developed competitive criteria for AT&T's markets, and before the Commission found any of AT&T's markets to be competitive.

Customers have benefited from the availability of these attractive service options, and from the rivalry they have sparked in the long distance market. It is these nonlinear discount offerings, rather than across-the-board reductions in basic, uniform MTS rates, which have generated all of the benefits customers have received from long distance competition. With the exception of reductions ordered by the Commission to pass through access reductions, GTE is not aware of a single occasion since divestiture when AT&T has made a voluntary reduction in its basic MTS rates.[49]

Now the Commission seeks to repeat in access markets the success it has achieved with its pro-competitive policies in long distance markets. GTE submits that

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49 The Commission recognized in the *OCP Order* (at ¶61) that optional discount plans had been the primary vehicle for rate reductions in the interexchange market: "although basic rates have remained relatively high, AT&T passed on its savings from lower access charges in the form of optional calling plans and other discounts and promotions. We also have no doubt that AT&T's long distance competitors have been forced by competition to follow suit. Thus, although the data BellSouth offered to show that basic long distance rates have not decreased may be correct, that data fails to capture the effect of optional calling plans and other discounts."

the Commission should not begin by prohibiting the very pricing arrangements that have produced all of the benefits consumers have realized in the long distance market.

Tellingly, most of the parties opposing APPs, or supporting strict restrictions on their use, regularly offer volume and term discounts and promotional offerings. Indeed, discounts have been maintained for extended periods in most service markets. In the *OCP Order,* the Commission found the widespread availability and persistence of volume discounts to be evidence that they were reasonable for AT&T as well:

> To the extent that a dominant firm's rivals, firms which surely do not have market power, offer volume discount or other calling plans during a lengthy period of time, however, this may suggest that such plans are consistent with cost-justified pricing.[50]

E. Baskets

The Commission has requested comment on what revisions, if any, are needed to current price cap baskets and categories. For the most part, the LECs, including GTE, advocate a price cap plan incorporating five baskets: Switching, Transport, Common Line, Interexchange and Video Dialtone. The Switching Basket would include three separate categories: local switching, operator services and data base (LIDB and 800). In the Transport Basket, services would be grouped into four categories: analog, digital, interconnection and tandem switching. The Common Line category would retain the CCL and EUCL elements, with some modifications to allow zone pricing. Video Dialtone and Interexchange would remain unchanged from the existing structure.

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50 OCP Order at ¶45. The OCP Order (at n.34) goes on to explain: "The fact that a firm maintains its pricing plan over a lengthy period of time is strong evidence that its prices are at least equal to its costs."

GTE's proposed structure represents only limited change from the current basket structure. The proposal would simplify the existing plan by reducing the number of service categories and subindices, and would permit LECs to adjust relative rates over time without resulting in competitive harm. Also, as discussed *supra*, GTE's proposed structure would accommodate zone pricing for most of the major access rate elements.

Most commenters opposing additional LECs pricing flexibility advocate the retention of the existing basket structure until a competitive showing is made, or until competition has reached a certain level.[51] AT&T (at 52) advocates the creation of a new service category for LIDB and the separation of call completion services into two categories (operator-related and directory assistance-related), citing the potential for rate cross-subsidization if categories are combined. On the other hand, MCI (at 20) agrees with GTE's approach that all operator services should be placed in one category. Finally, CompTel (at 35-36) claims that consolidation of the existing DS1 and DS3 subcategories would harm competition.

As GTE stated in its Comments, the LEC price cap plan should evolve toward a more optimal structure which allows reasonable changes in relative rates to occur over time, as the Commission intended when it first adopted the price cap plan. The current LEC plan is overly complex and in some cases, the creation of subcategories for single rate elements severely restricts the ability of LECs to make any meaningful rate changes in response to market conditions.

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51 Time Warner at 23, CompTel at 33, Sprint at 22.

GTE believes its approach is reasonable. It would place operator services in a separate category under the Switching Basket, which would accommodate the concerns of AT&T and others that operator services be placed in its own category. Further, LIDB and 800 Data Base would also be combined into a category under the Switching Basket, reflecting the similarities of these services. This would provide adequate protection from excessive rate changes for IXCs that rely on these two services without further complicating the price cap plan.

GTE believes it is time for the Commission to remove the artificial distinction between DS1 and DS3 high capacity services and place all digitally-based services in a single category. Transport services at digital bit rates are close substitutes for one another. There is absolutely no need for separate DS1 and DS3 subcategories based on current market conditions for these services. This structure also would easily accommodate the introduction of new digital services, such as SONET-based transport offerings.

The original justification for separating DS1 and DS3 services into separate categories, *i.e.*, the protection of DS1 customers from rate increase to offset DS3 rate reductions, is no longer valid. CompTel (at 35-36) bases its claims on an artificial view of the market which is not supported by the facts. CompTel posits, first, that there are different levels of competition for DS1 and DS3. In fact, any CAP that offers DS3 also offers DS1. The differences in the degree of competition are related to geography, not to the product differentiation between DS1 and DS3. If an alternative provider is offering service in a given area, then both speeds will be available.

CompTel's artificial market view also assumes that there is one set of services that is purchased primarily by large IXCs, and a second set of services that is

purchased by smaller IXCs. LECs, according to CompTel, will then exploit this difference by raising prices to small IXCs in order to fund reductions to large IXCs. In fact, no such distinction exists among services, and no such strategy is available to LECs. Every LEC access service is purchased primarily by large IXCs. For example, during the third quarter of 1995, eighty per cent of all DS1 entrance facilities were provided to the largest IXCs in GTE serving territories. Therefore, GTE cannot discriminate between large and small IXCs by varying rates for DS1 and DS3. If GTE raises its DS1 price, it will be raising it primarily to its larger IXC customers. As explained *supra*, if those customers have alternatives for DS3 service, they will have alternatives for DS1 service as well. Further, the proportion of demand generated by small IXCs is so limited that raising rates to those customers – even if GTE could discriminate against them – would not fund any significant reduction in rates to larger IXCs.

In sum, the market distinction CompTel draws between DS3 and DS1 is not valid, and the hypothetical strategy CompTel anticipates would not make good business sense for a LEC. CompTel's view of the world is an egocentric one; it analyzes the market based on what its members buy, rather than on the demand the LECs actually face for what they sell.

Over the past several years, GTE has constructed service offerings that accommodate all sizes and types of IXCs and end user customers. For example, GTE's MetroLAN transport services are made equally available to both large and small access customers at DS1 quantities. The flat-rated nature of MetroLAN (versus a per mile structure) makes it more attractive to some smaller customers. GTE has also introduced a number of DS1 term and volume discount payment plans for special

access which are designed to accommodate both large and small IXCs as well as end users.[52] GTE has also placed into effect discount plans for DS1 switched access entrance facilities in a number of states. In addition, rapid development and use of SONET technology is prevalent in today's networks. Deployment of SONET technologies results in lower per unit transport costs to IXCs irrespective of whether the traffic transiting the network is at a DS1 or DS3 level.

In summary, GTE urges the Commission to further streamline the existing price cap basket structure to reduce its complexity. GTE believes that the structure it has proposed will achieve these goals while providing adequate protection against cross-subsidization and "price squeezing" concerns.

F. Lower Service Band Index and Rate Reductions

In the *SFNPRM* (at ¶75), the Commission concludes that the elimination of the lower service band limits "will result in more efficient pricing, enhance competition, and will not adversely affect ratepayers." In order for the price cap plan to provide consumers with substantial benefits that could be realized from lower prices, it is necessary to remove any artificial barriers that prevent this from occurring. GTE supports the Commission's proposal to eliminate the lower service band limits in the price cap plan. However, GTE is strongly opposed to the Commission's proposal (at ¶48) to apply a one percent upper limit to service categories in which a LEC "makes price reductions pursuant to the pricing flexibilities in this Second Further Notice."

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52 *See* GTOC Tariff FCC No. 1 – DS1 Term Payment Plan, Section 5.6.14; DS1 Optional Payment Plan, Section 5.6.12; and DS1 MetroLAN Transport, Section 5.6.16.

AT&T (at 39) supports the proposal to eliminate the lower banding constraint, only if LECs are prohibited from increasing rates in other service bands by excluding price reductions below the band from the API calculation. AT&T also supports the one percent upper SBI limit. CompTel (at 32-33) contends that any downward pricing flexibility be tempered with a requirement to lower rates in other service categories using the same transmission facilities and that an upper band of zero be established for those LECs taking advantage of such flexibility. MCI (at 7-8), however, opposes any additional downward pricing flexibility, insisting that LECs should continue to support rates with an average variable cost showing. Finally, Sprint (at 21) supports removing the lower pricing band on the condition that LECs be constrained in their ability to subsequently raise such rates.

GTE believes these proposals would seriously dampen the benefits that price cap regulation is intended to achieve. The price cap plan should not penalize LECs for reducing rates. As GTE explained in its Comments (at 32-34) the proposal to impose a one per cent upper band would create a strong disincentive for LECs to reduce rates.[53] In fact, if this proposal were adopted, the Commission's stated objective in eliminating the lower bands would not be met, since the one per cent upper band would create a far stronger disincentive to reduce rates than the lower banding limits do today. GSA

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53 It is important to note that the issue here is not simply the LEC's ability to raise the particular rate it had reduced. The Commission's proposal would also limit the LECs' ability to make other rate adjustments that the LEC might have made in any event. Perhaps most importantly, it would affect the rate at which SBI limits would become binding again in future years, as the PCI moved over time. Thus, a LEC that reduced rates in year 1 might be rewarded for this "good" behavior by being forced to make additional reductions in year 3. *See* GTE Comments at n.43.

(at 7-8) also agrees that the one per cent upper band proposal would deter LECs from reducing rates.

The Commission has previously considered a mechanism which was intended to make rate reductions permanent as a means of discouraging predation. In its *OCP Notice*, it sought comment on whether AT&T should be required to maintain any discounts it offered for some minimum period of time.[54] AT&T argued then, as GTE does here, that the inability to withdraw a price cut would deter a carrier from offering such reductions. The Commission accepted this argument, and declined to adopt any prohibition on subsequent rate increases.[55]

The Commission should also consider that relative rate adjustments, both increases and reductions, are necessary over time to establish efficient rate relationships. In fact, rate deaveraging, which may involve some rate increases, may be the only way that competition can realistically extend to rural areas. A one percent upper band limit does not allow sufficient scope for relative rate adjustments. The objective of the price cap plan is to mimic the effects of competition. As GTE noted in its Comments (at 33), markets generate information by trial and error, as firms operating under uncertainty experiment with rate changes, new service offerings and promotions. A requirement that attempts to "lock in" rate changes forever will prevent the market from generating information in this way. Further, precisely because the

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54 *See OCP Notice* at ¶¶50-52.

55 *OCP Order* at ¶¶85-86.

effect of any rate change is uncertain, such a requirement would deter LECs from undertaking potentially beneficial changes.

It is also not clear from the *SFNPRM* how the one per cent upper band proposal would be administered. The Commission does not explain how it would distinguish rate reductions made pursuant to the pricing flexibilities in the *SFNPRM* from those that were not. One possibility would be for the one per cent limit to be triggered by a movement of the SBI below some lower threshold. This is not significantly different from the current lower banding limit, except that the "penalty" to the LEC for exceeding the lower band is different. As explained *supra*, it is more severe. This approach will either deter reductions altogether, or create an incentive to find other rates within the SBI which can be raised to offset the reduction. Alternatively, the one per cent limit could be triggered by individual price movements. This again raises the problem of identifying which rate reductions would cause the one per cent limit to be imposed. Further, since the one per cent limit would apply to all of the rates in the SBI, it would create an even greater deterrent to rate reductions. A reduction in one element could trigger an additional constraint on several other elements. This would especially deter reductions in elements whose revenue weight is small relative to other rates in the SBI. In short, there is no reasonable way to administer the proposed one per cent limit.

AT&T (at Appendix B) presents an analysis that demonstrates how LECs could use additional downward pricing flexibility to "game the headroom potential." However, AT&T's numerical example of the removal of lower SBI limits contains numerous errors and its example of cross-subsidy potential is exaggerated. The ability to raise the price of one element in one location to offset reductions in another is dependent on a number of factors within the current plan, such as relative revenue weights and service mix.

AT&T has conveniently used index values, rate change assumptions and exaggerated revenue distributions that results in extensive potential revenue shifts. However, for those LECs that have historically priced consistently below the cap, the possible revenue shifts to be gained by such an effort are not so great.

In GSA's view, the concerns that LECs will make significant corresponding increases in other rates is overstated. As GSA (at 7-8) states: "Any LEC must know that it stands little likelihood of eliminating competitors through below cost pricing and the likely effect of above cost pricing will be to hasten the challenge of competitors." GTE agrees. Concerns over corresponding rate increases are not demonstrated by the facts. GTE, more than any other price cap LEC, has reduced access rates under the price cap plan, including below-band filings for both switched and special access rates. GTE has not made widespread rate increases while, at the same time, proposing rates that are below the lower banding limitations.[56]

The lower banding constraint was first imposed to address concerns over the possibility of predation. As GTE has suggested in the past, cost floors are an effective means of dealing with such concerns.[57] The lower banding constraint is a useful way of applying such a floor. It establishes a "zone of reasonableness" for rate reductions, so that the Commission does not need to seek cost floor information for every proposed reduction, but only for those which fall outside the lower band. Nonetheless, it does impose a cost, since it creates a deterrent to rate reductions which would benefit

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56 In its Comments (at 29), GTE listed the reasons why predation is unlikely to be a viable strategy for any LEC. *See also* Schankerman at 8-9.

57 *See, e.g.*, Schankerman at 10.

consumers. While, as GTE has demonstrated, it is possible for a LEC to make the showing required for a below-band filing, clearly the LEC would prefer not to do so, and may avoid rate proposals which would require such a showing.[58]

The proposal in the *SFNPRM* to remove the lower band constraint correctly assumes that lower bands deter price reductions and the benefit of such rate reductions outweighs any possible risk of predation.[59] GTE agrees with GSA that the risk of predation in LEC access markets is small. The Commission should find that first-order benefits to consumers, in the form of lower prices, are far greater than the remote possibility of competitive harm from predation. Further, as the *SFNPRM* (at ¶83) notes:

> [T]he upper band service limit, at five percent above the LEC's new lower rate, and the price cap itself would remain as disincentives to predatory pricing if the lower service band limits were to be eliminated.

Consistent with this conclusion, the Commission should remove the lower banding constraint without imposing any new upper band limits.

If, however, the Commission remains concerned that removing the lower bands could raise a significant concern with respect to predation, then it should simply retain the lower banding constraints. The lower band limits are more effective, and less costly, protection against the possibility of predation than the proposed one per cent upper banding constraint. If adopted, the one percent proposal would create an even

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58 MCI's claim (at 7) that no below-band filings "have ever tested the lower boundary of average variable cost" is simply not true. GTE has met this standard in its below-band filings.

59 *SFNPRM* at ¶83.

greater deterrent to price reductions than the current lower bands, thereby defeating the purpose of eliminating the lower bands.

G. ICB and Contract-Based Tariff Filings

The *SFNPRM* proposes to further restrict the LEC's abilities to provide services to customers under an individual case basis ("ICB") approach. In its Comments, GTE urged the Commission not to unreasonably restrict the use of ICB tariffs and to further allow contract based tariffs under baseline price cap regulation. ICBs are a reasonable and practical tool to respond to customer requests for unique service arrangements. To further restrict the use of ICB arrangements would deter LECs from meeting legitimate customer needs, and correspondingly, would deter customers from requesting non-standard service arrangements from LECs.

Not surprisingly, most IXCs competitors support the retention and strengthening of the ICB restrictions.[60] Speaking from a customer perspective, GSA (at 8-11), on the other hand, urges the Commission to allow LECs to continue to file ICB tariffs and opposes the placement of any time limits on their effectiveness.

The inevitable outcome of adopting a more restrictive ICB policy would be to provide LEC competitors with an unfair advantage. If restrictions are imposed as to the type of service for which ICBs can be filed or the length of time an ICB rate could remain in effect, customers would have little incentive to come to a LEC with an ICB request. This would provide the LEC's competitors with a guaranteed market for such

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60 *See, e.g.*, CompTel at 30, MCI at 14, Time Warner at 16-18.

customers, since competing access providers are free to offer any type of custom-designed service arrangements for customers and for any length of time.

GSA observes that the Commission's requirement that ICB service offerings must not be "like" any other previous offered service may often be misunderstood. The ICB service may use the same technology and provide the same functions as a generally tariffed service; however, it may differ in many respects as to the arrangement of service component parts and functions. Therefore, GTE agrees with GSA that the test of "unlikeness" must be extended to system architectures, as well. Customer efforts to customize their telecommunications services would be frustrated if they were forced into taking the "standard" tariff arrangement, or nothing at all.

The *SFNPRM* also proposes to allow LECs to file contract-type tariffs for those services under streamlined regulation. GTE believes that LECs should be able to respond to a customer's Request for Proposals ("RFP") by the development and filing of a contract-type tariff. GTE proposes that under baseline regulation, LECs be allowed to file contract based rates if (1) customers have requested bids for services under and RFP, and (2) two or more telecommunications service providers have responded to the RFP. Once filed, contract tariffs would be subject to a cost support showing.

The LECs' competitors (CompTel 40, MFS 8) are opposed to allowing LECs to use contract-based pricing and some (MCI at 34) would even deny use of contract tariffs in the context of streamlined regulation. As in the case of unique service offerings filed under an ICB tariff, restricting a LEC's efforts to provide such services to customers that issue RFPs unfairly advantages other service competitors and, ultimately, could deprive customers of the ability to obtain the lowest-cost, highest

quality service available. Provision of services via a RFP/contract process is an accepted and normal practice in both the public and private sectors of the economy.

GSA, a prominent purchaser of telecommunications services through the RFP process supports the use of contract tariffs. As GSA notes: "If a contract is the result of a competitive procurement in which multiple bidders submitted viable proposals, the Commission can assume that all services provided under that contract are subject to substantial competition, and qualify for streamlined regulation."[61] According to the GSA, it is the procurement process itself that determines whether competition exists for that service. Clearly, if multiple service providers respond with valid bids to an RFP that meet the service standards and qualifications of the RFP, the only conclusion one could reach with respect to that service is that it is competitive. Accordingly, GTE requests that the Commission allow LECs to file contract-based tariffs that are a result of an RFP process under baseline regulation.

H. Restructured Services

The *SFNPRM* proposes to adopt shorter notice periods for restructured services, an effort GTE supports. GTE believes that a 14-day notice period is reasonable and is consistent with the filing period for within-band rate changes. Both types of tariff filings require the same type of supporting data (*i.e.*, changes in indices, proof of compliance with the PCI).

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61 GSA at 16. Under GSA's proposal, LECs may be required to submit certification statements explaining the circumstances under which the contract was developed and possibly statements from the end user customer that competitively viable offers were received from other suppliers. GTE agrees that these procedures are reasonable.

Some commenters oppose this shortened review period, stating that restructured services "demand careful review" (AT&T at 26) or should be accompanied by *increased* cost support (Ad Hoc at 12). These comments, however, ignore the fact that for the most part, restructures of existing services are made to better accommodate customer demands and market trends. As such, GTE's restructure filings are rarely challenged. In addition, rate and service restructure filings made under the existing price cap rules do not require a separate cost support showing. The original service will have been adequately cost supported at the time the service was initially filed. Therefore, submission of additional cost data, as suggested by Ad Hoc, is unnecessary.

Commenters also fail to distinguish restructure proposals which would establish new rate elements from those which simply adjust prices within price cap limits. The *SFNPRM* proposal to reduce notice periods applies to the latter; it assumes that either a waiver is not required, or that one has been granted, Absent the waiver process, the price cap support submitted with a restructure is, as the *SFNPRM* notes, straightforward, and review of that support should not require a long notice period.

GTE recommends that the Commission should also consider ways to improve the waiver process as it applies to restructure filings which involve new rate elements. This could take the form of the petition proposed for new services in the *SFNPRM,* as long as the Commission maintains a specified time period within which it would respond to such a petition.

IV. THE COMMISSION SHOULD ESTABLISH A FRAMEWORK FOR STREAMLINING LEC ACCESS MARKETS BASED ON CLEARLY ESTABLISHED CRITERIA.

In the *SFNPRM* (at 2), the Commission announced its intention to establish a regulatory framework which would adjust the degree of regulation to be applied to LEC

interstate access services to match the degree of completion in each market. GTE has long urged the Commission to develop such a framework.[62] The framework proposed in the *SFNPRM* would include three stages. In the first stage, as discussed *supra*, the Commission has proposed "baseline" reforms to its price cap plan which would yield benefits even in markets where the presence of competition had not yet been demonstrated. In the second stage, the Commission proposes to streamline its regulation of access markets where competition has been shown to be sufficient to discipline LEC pricing decisions. In those markets, the *SFNPRM* proposes to remove LEC interstate access services from price caps. In the third stage, LEC access services would qualify for nondominant treatment.

A. A framework should be established which will adapt to competition as it develops.

Several parties have suggested that the Commission is premature in considering the second and third stages.[63] It is suggested that competition is unlikely to develop soon in access markets. The *SFNPRM*, however, recognizes that access competition has already begun.[64] GTE has discussed *supra* the growth of competitive alternatives. GTE submits that several of the relevant access markets within GTE's serving areas would meet any reasonable competitive criteria today.[65]

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62 *See* GTE's Comments, Reform of the Interstate Access Charge Rules, RM-8356, filed November 1, 1993.

63 *See, e.g.*, AT&T at 5, Sprint at 25.

64 *See, e.g.*, *SFNPRM* at ¶5.

65 In some GTE areas, customers representing more than 75 percent of all interstate access demand -- including both switched and special access, and both large and small end user customers -- have alternative sources of supply available today. This analysis is based on networks which are already in place,

The matter under consideration in this proceeding, however, is not whether any particular access market is competitive; rather, it is whether a framework should be established which will adapt to competition as it develops. The Commission's proposal is timely for a number of reasons. First, relaxation of price cap regulation in those markets which are competitive will benefit consumers by allowing the incumbent to compete more vigorously. Second, even in those markets which have not yet been shown to be competitive, the establishment of a framework in advance, with clearly stated parameters, will establish reasonable expectations for all market participants concerning the ground rules that will govern competition. This will allow both the incumbent LECs, current competitors and potential entrants to base their investment and market entry decisions on more accurate price signals. As the *SFNPRM* notes (at 25) inefficient entry will be promoted by "the expectation that existing price relationships will be maintained." Further, an adaptable framework will encourage efficient investment by the incumbent, as well as by entrants. A LEC may be deterred from making efficient levels of investment in new network capabilities if the LEC is uncertain about whether it will be allowed to compete effectively in the event of entry. An ad hoc, "wait-and-see" approach, advocated by some commenters, cannot provide the correct signals to the market.

Schankerman (at 11-13) presents this concern in the context of a simple analytical model in which firms play a two-stage strategic game. In the first stage, all potential suppliers -- both incumbents and entrants -- make their entry decisions,

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and which can reach the end-user locations which generate the demand without reliance on GTE's network. The analysis is therefore conservative, since it does not consider additions to those networks, potential entry or resale of GTE's services.