

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

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In the Matter of

Access Charge Reform

Price Cap Performance Review
for Local Exchange Carriers

Transport Rate Structure
and Pricing

Usage of the Public Switched
Network by Information Service
and Internet Access Providers

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CC Docket No. 96-262

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REPLY COMMENTS OF AT&T CORP.

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SUMMARY

The vast majority of commenters agree that current access charges exceed the costs of providing access by billions of dollars. This broad consensus dramatically confirms that access charges are presently unreasonable and unlawful because they are too high relative to their cost. Indeed, most commenters acknowledge that today's excessive access charges not only harm consumers, but they also impede the development of competition, stymie productivity gains, thwart efficient usage, and foster discrimination and other anticompetitive practices. To alleviate these problems and to comply with the Act, the Commission must therefore reduce access charges to long-run economic cost as expeditiously as possible. This criterion, not administrative convenience or other concerns, should guide the Commission's decisions in this proceeding.

As the comments confirm, the only expeditious and lawful means of reducing rates is to reinitialize price caps to reflect a reasonable approximation of forward-looking costs. State regulators, consumer groups and competitive local exchange carriers all agree that the so-called "market-based" approach to achieving rate reductions is destined to fail, because price-constraining competition has not yet developed in switched access markets, and is not likely to do so any time in the near future. Indeed, the markets for both local service and access are still characterized by numerous barriers to entry. Furthermore, competition based on unbundled elements is not a reality nor will it be an effective check when and if it does become a reality.

In this regard, reliance on the "market forces" said to be created by the availability of unbundled elements is particularly misplaced. Whatever the potential future impact of unbundled elements, what cannot be disputed is that they are not now, and are unlikely soon to be, available to new entrants at prices and under terms and conditions that make their use economically rational.

Most tellingly, although the Act and the Commission's rules thereunder properly require that incumbent LECs provide electronic interfaces to operation support systems (ordering, provisioning, repair, billing, and the like) needed for both resale and the use of unbundled elements, not a single LEC has yet come close to meeting this obligation. Until such systems are in place that have been shown to permit new entrants to place, process, and support orders in sufficient volumes, with sufficient accuracy, and with sufficient speed to attract meaningful numbers of customers, it is premature for the Commission even to consider the possibility of the "market-based" approach to access reform.

Contrary to the claims of the incumbent LECs, reinitializing price caps will not require the "mother of all rate cases." That rate case is already underway -- in the fifty state commissions pursuant to Section 252 of the Act. In many cases, the state commissions have already determined rates, based on long-run incremental costs (under a total element long-run incremental cost or "TELRIC" methodology), for per-minute local switching, per-minute tandem switching, common transport, and dedicated transport, which together constitute a large percentage of access charges. The Commission can and should use those state-determined rates to establish appropriate price cap levels, and should use appropriate cost models (such as the Hatfield model) in the interim until the states can completely fill the gaps.

The commenters also agree that there is no basis for large "make-whole" payments to the ILECs. In that regard, the ILECs' various constitutional and policy arguments are baseless, as the commenters show and as is explained in the attached article by Thomas Merrill and William Baumol.

There is also substantial support for modifying the rate structures to conform to principles of cost-causation. In particular, the Commission should eliminate the CCLC; remove the subscriber line

charge cap; institute a combination of flat-rate and usage charges to recover switching costs; eliminate the TIC; and adopt its proposed signaling rate structure but delay implementation until measurement problems can be resolved. The commenters broadly agree that the Commission should not convert the CCLC into a flat-rate charge assessed on IXCs.

There is widespread agreement in the comments that all explicit and implicit subsidies should be eliminated from access charges. Contrary to the ILECs' claims, however, this requires an exogenous adjustment to account for the completed amortization of equal access expenses. And virtually all commenters (except for the ILECs) acknowledge that the X-Factor should be increased to ensure that reinitialized rates will remain just and reasonable in the coming years.

Finally, virtually all parties acknowledge that increased pricing flexibility would be unnecessary and counterproductive at present. The ILECs currently have full authority to *decrease* rates in response to competitive entry. Price-constraining competition does not now exist, however, and therefore giving the ILECs increased pricing flexibility under such circumstances would permit anticompetitive and discriminatory behavior, including cross-subsidization and price squeezes. Indeed, contrary to ILEC claims, price squeezes remain a realistic, serious threat, notwithstanding the recent market and regulatory changes on which the ILECs rely.

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REPLY COMMENTS OF AT&T CORP.

Pursuant to the Commission's Notice of Proposed Rulemaking,¹ AT&T Corp. ("AT&T") hereby submits its reply comments with respect to the designated issues concerning interstate access charges paid to incumbent local exchange carriers ("ILECs").

INTRODUCTION

Now that the comment cycle is complete, the Commission is poised to finish the task it began some 14 years ago to rationalize the inefficient system of access charges that has burdened the telecommunications industry since the breakup of the Bell System. As AT&T demonstrated (at 3, 13-14), the social costs imposed by the current system are enormous: more than \$10 billion *per year* in inflated access charges that are ultimately borne by consumers, and as much as \$45 billion per year in deadweight losses resulting from inflated prices and inefficient pricing structures. With certain important modifications, the Commission's proposals will provide the framework within which to reduce and, eventually, eliminate those costs. This, in turn, will result not only in lower long distance prices, but in higher quality service and greater innovation.

¹ Access Charge Reform, CC Docket No. 96-262, Notice of Proposed Rulemaking, Third Report and Order, and Notice of Inquiry (released Dec. 24, 1996) ("NPRM").

The comments reflect a strong consensus that the current system produces access prices that, by any measure, are far too high. Indeed, the commenters all agree on both the *direction* and the general *magnitude* of the change, namely, downward, and by billions of dollars a year. As explained in Section I, this consensus merely confirms as a matter of policy what the 1996 Telecommunications Act established as a matter of law: that current access charges are unreasonable and unlawful because they are too high relative to the cost of providing the service. This conclusion, in turn, provides the touchstone by which the Commission can evaluate and compare the various options before it: whatever policy is most likely to reduce access charges to their long-run incremental costs (as measured by TELRIC), and do so most quickly, should be adopted.

Only one of the options described in the NPRM will satisfy the Commission's legal and policy obligations: a policy in which price caps are kept in place and reinitialized to TELRIC levels. As explained in Section II, the comments confirm this key conclusion. They also demonstrate that the "market-based" approach articulated in the NPRM cannot possibly comply with those obligations. Exchange access markets are neither competitive nor contestable today, and they cannot magically be made competitive simply by the availability of unbundled network elements ("UNEs").

Indeed, the fundamental but unresolved question posed by this proceeding is *whether* access markets are capable of sustained competition, or, as many economists have opined in the past, they are natural monopolies. If exchange access markets are natural monopolies -- *i.e.*, if average costs are above marginal costs over the relevant range of production -- then no amount of unbundling can create competitive markets. And the proposed "market-based" approach will only exacerbate the irrationality of the current system.

The comments also confirm that, regardless of how the Commission resolves the need for cost-based access charges, certain additional changes must be made (and certain proposed changes avoided) if the new access charge regime is to comply with the relevant legal mandates. As explained in Section III, the comments show that significant reforms to the Part 69 rate structures - including the elimination of the carrier common line charge (or "CCLC"), the cap on the

subscriber line charge ("SLC"), and the transport interconnection charge ("TIC") -- are needed in order to move the existing system toward cost-causation. Similarly, as explained in Section IV, the comments demonstrate a broad consensus that the Part 61 price cap rules should be modified so as to remove all express and implicit cross-subsidies, and to ensure, by increasing the X-Factor, that access rates remain just and reasonable in the future. And finally, as shown in Section V, the comments show that the ILECs should be granted only limited pricing flexibility prior to the emergence of substantial competition.

I. THE COMMENTS REFLECT A STRONG CONSENSUS THAT EXISTING ACCESS RATES ARE UNREASONABLY HIGH AND FAR ABOVE COST, AND THAT THE SYSTEM THAT PRODUCES THEM MUST BE FUNDAMENTALLY REFORMED.

The comments reflect widespread agreement on three critical facts, which show that the existing access rate scheme is unjust, unreasonable, and unlawful.

First, as AT&T explained (at 10-13), existing regulation has produced exchange access prices that far exceed efficient levels. Indeed, in the aggregate, AT&T estimates that existing prices exceed the LECs' costs (measured under an appropriate TELRIC standard) by some \$10.6 billion per year. AT&T at 13. Qualitatively, the other commenters are in nearly unanimous agreement with this point, although their estimates of the direct costs (*i.e.*, the excess of existing charges over economic costs) vary from \$7 billion per year to \$11.6 billion.² As a result of this unconscionable differential between rates and underlying costs, existing access rates are unjust and unreasonable in violation of Sections 201 and 202 of the Communications Act, and fail to satisfy the forward-looking, cost-based rate requirements of Sections 251(c)(2) and 252 of the 1996 Telecommunications Act. See AT&T at 12.

Second, there is also widespread agreement that excessive access rates not only harm consumers, but also impede the development of competition, stymie productivity gains and efficient usage by sending the wrong economic signals, and foster discrimination and other anticompetitive

²See MCI at 8 (\$11.6 billion, consisting of \$6.6 billion in excessive costs and \$5 billion in universal service support); GSA at 6 (\$7 billion); Ad Hoc at 56 (\$11 billion); TRA at 30 (\$11 billion).

practices.³ Even most of the ILECs express agreement with this fundamental point.⁴ Indeed, one of the economists who has appeared in this proceeding on behalf of the ILECs, Robert Crandall, has elsewhere estimated that the direct and indirect social costs of the existing access charge system total some \$45 billion annually.⁵ And there is broad consensus that the access charge system not only impedes competition for access services,⁶ but that it will also thwart competition in interexchange markets (if ILECs are allowed to enter them) by allowing ILECs to engage in "price squeezes" directed at their interexchange competitors.⁷

Third, there is virtually unanimous agreement on the remedy for these ills: reducing access prices to their long-run incremental costs.⁸ Even the ILECs concede that driving access prices "toward their competitive levels . . . is necessary if the goals of the Act are to be achieved successfully." Schmalensee and Taylor at 2 (USTA).

This conclusion, then, provides the appropriate benchmark by which to evaluate the various alternatives for reforming the access charge regime. Whatever policy is most likely to reduce access charges to their long-run incremental costs, and do so most quickly and permanently, should be adopted. Any alternative that does not satisfy this key criterion, no matter how attractive it might otherwise be, must be rejected.

³See AT&T at 13-17; MCI at 9-10; Tele-Communications, Inc. at 2; Texas OPC at 4-5.

⁴See Ameritech at 4-5; GTE at 17-21; SWBT at i.

⁵ Robert Crandall and Jerry Ellig, Economic Deregulation and Customer Choice: Lessons for the Electric Industry, Center for Market Processes, George Mason University (January 1997).

⁶ See, e.g., Tele-Communications, Inc. at 2; ACC Long Distance at 5.

⁷ See, e.g., AT&T at 15-17; MCI at 35.

⁸ See, e.g., AARP, CFA and Consumers Union at 9; AT&T at 18-20; MCI at 3; NCTA at 21-23; TRA at 30-31.

II. THE COMMENTS DEMONSTRATE THAT THE ONLY VIABLE MEANS OF ACHIEVING LAWFUL AND REASONABLE ACCESS RATES IS TO REINITIALIZE PRICE CAPS WITHOUT ANY "RECOVERY" OF ALLEGED UNDER-EARNINGS.

As the comments confirm, the only effective, lawful, administratively feasible means of quickly driving access charges to cost is an immediate reinitialization of access price caps to reflect the reasonable forward-looking costs of key access elements. The "market-based" approach suggested in the NPRM will not accomplish that objective, and any payment to the LECs of alleged past underrecoveries would affirmatively thwart the achievement of that goal.

A. Because Price-Constraining Market Forces Do Not Now Exist In Access Markets -- And Cannot Be Expected For Some Time -- The "Market-Based" Proposal Will Not Produce Lawful Access Rates.

As to the proposed market-based approach, the State Consumer Advocates state (at 37) the problem succinctly and correctly: "In order to have a true market-based solution, pricing must result from a competitive market, not a market dominated by a monopoly or a company with great power in that market." Accordingly, the Commission cannot rationally rely on a "market-based" approach "to discipline [access] pricing unless and until competition develops." Ad Hoc at 35.⁹

Today, price-constraining competition has not yet developed in the vast majority of switched access markets.¹⁰ Thus, state regulators, who, like the Commission, generally "favor[] market-based solutions," express near unanimous concern that "the market-based approach as proposed . . . will not result in access rates that are based on economic cost."¹¹ Consumers

⁹ See also Texas OPC at 4 ("The Commission cannot rely on competition for access to promote efficient pricing before there is full and effective competition for local service"); ACC Long Distance at 7 ("Without the presence of actual competition in the access market, it is difficult to understand what competitive forces will provide incumbents with the incentive to reduce their access charges"); Ameritech at 36 ("where market forces are now in operation, they should be relied on to achieve efficient prices") (emphasis added).

¹⁰ See U S WEST at 24 ("Meaningful competition,' in this context, is competition sufficient to constrain the practices of the ILECs").

¹¹ See, e.g., Wash. UTC at 7 ("We do not believe that sufficient competitive forces exist for local exchange and access services . . . to warrant exclusive reliance on a market-based approach"); Florida PSC at 6 ("While our preference is to rely on market based approaches wherever possible, we do not
(continued...)

likewise stress that the “market-based” approach “is fundamentally flawed” (API at 4), “fails to provide timely relief from the high access charges that have resulted in excessive LEC earnings for several years” (GSA at i), and “will impede competition and add yet another barrier to the formidable obstacles already in place on the road to local competition.”¹²

And AT&T and other access customers explain why it is a simple fact that incumbents “have no market-based incentive to reduce their excessive access charges.”¹³ This is because incumbent LECs retain monopoly or near monopoly control in virtually all access markets. Non-trivial facilities-based competition exists only in the most urban areas. Unbundled network element competition has yet to emerge, much less develop on a widespread basis. And, as explained in more detail below, there remain numerous substantial entry barriers to both forms of competition in most markets. As one state commission notes of the status of UNE competition:

“A full year after the Act, only the first few competitors have actually begun competition. It may well be another year before any significant competition develops beyond these tentative first steps. Interconnection agreements and arbitration activities are in progress or just completed with the initial competitive companies.”

Missouri PSC at 4. Further, as AT&T explained in its opening comments (at 45-46), even if UNE-based competition does eventually flourish, it will create only indirect price discipline and will provide no effective constraint on terminating access prices.¹⁴ Thus, as the Ohio PUC (at 12)

(...continued)

believe that this approach can effectively lower access charges”); Alabama PSC at 12-13 (“We agree that implementation of the market-based approach immediately before true competition develops, may allow ILECs to assess inflated access charges”).

¹² AARP, CFA and Consumers Union at 8 (“Market forces are not adequate today to impose market discipline on incumbent LECs”). See also Comp. Policy Inst. at 9 (“the total amount of competition on a national basis, especially for switched access, is so small that much of the discussion about the market-based approach is an academic exercise”).

¹³ NCTA at 13; AT&T at 46-47; MCI at 35-37; Time Warner at 17 (“The market-based approach as proposed by the Commission in the Notice would surely retard the development of competition. It would provide unprecedented opportunities for ILECs to abuse their market power on the mere showing of potential competition”).

¹⁴ Cf. Price Cap Performance Review for Local Exchange Carriers, Second Further Notice of Proposed Rulemaking, CC Docket No. 94-1, 11 FCC Rcd. 858 (¶ 27) (1995) (dichotomy between who selects
(continued...))

confirms, "there is a continued need for the regulation of terminating access prices regardless of the level of competition for access services, since long distance carriers have little or no control on whose network their calls will terminate."¹⁵

In short, "[a] 'market-based' approach for access reform is not a viable policy option." API at 2-3. Indeed, "[a]llowing market-based recovery while significant market power still exists is likely to simply result in excessive recovery from the captive customer." Wash. UTC at 12.¹⁶

Incumbent LEC claims to the contrary amount to little more than hand-waving. Although incumbents submit reams of appendices trumpeting the supposed proliferation of facilities-based competition, upon close examination, it is clear that this CAP bonanza is unknown in most parts of the country and that much of the incumbents' "evidence" is, in any event, prediction rather than description.¹⁷

The facts are these. Incumbents continue to receive more than 95 percent of all access traffic and revenues, figures which approach 100 percent in most markets, including virtually all rural markets.¹⁸ And the incumbents' constant refrain that access purchasers like AT&T are "sophisticated" customers that take advantage of every opportunity to reduce their access payments

¹⁴(...continued)

terminating access and who pays for terminating access "may inhibit competition and delay efficient pricing for access services," and thus competition for access services may develop "at a different pace and in a different manner" than competition in local service).

¹⁵ See also Missouri PSC at 4-5; CompTel at 3; Evans Telephone at 7.

¹⁶ See also GSA at 18 ("end users deserve more immediate relief from the requirement to fund excessive LEC earnings through unnecessarily high charges for interstate telecommunications services"); NCTA at 14 ("Under the market-based alternative, the ILEC will continue to exercise substantial market power indefinitely").

¹⁷ See, e.g., Pacific at 13-14; Ameritech at 33-34.

¹⁸ AT&T derived this estimate by comparing ILEC revenue from NPRM (Table 1) and CAP revenue from 1997 Annual Report on Local Telecommunications Competition, New Paradigm Resources Group, Inc., Chicago, IL.

merely confirms the extent of the incumbents' market power.¹⁹ AT&T, for one, does do everything it can to avoid monopoly access charges, and yet AT&T remains dependent on incumbent LECs for more than 99 percent of its access needs. In most places, the incumbent is the only game in town.²⁰

That is unlikely to change in the foreseeable future. In this regard, incumbents ignore the substantial -- and, in many areas, growing -- entry barriers that CAPs face. These include the inability to obtain pole attachments or access to buildings (often as a result of opposition from incumbents), see ALTS at 13, the unavailability of collocation at cost-based rates, see id. at 7;²¹ and, perhaps most disturbing, looming legal battles as municipalities increasingly erect regulatory barriers to entry by imposing unreasonable franchise terms (that often apply only to new entrants) and limiting access to public rights-of-way. See API at 13; ALTS at 12 ("A year after passage of the Act there are still statutes on the books that prohibit outright the provision of service by any company other than the ILEC, unless the ILEC consents").²² Indeed, even the ILECs' own experts ultimately recognize that the Commission cannot reasonably depend upon facilities-based competition to constrain ILEC access prices.²³

Incumbents' UNE-based competition arguments are equally lacking in substance. The incumbents largely ignore the fundamental theoretical problems with relying on UNE-based competition to constrain access prices. Thus, there is no mention of the undeniable distortions

¹⁹ See, e.g., BellSouth at 25; Ameritech at 28; SNET at 10.

²⁰ Contrary to SNET's claim that access competition is widespread and flourishing in Connecticut, for example, AT&T continues to purchase more than 99% of its switched access from SNET, notwithstanding that SNET's switched access rates remain at 2.7 cents, many multiples of the economic-cost-based rates that would be produced by price-constraining competition.

²¹ Expanded Interconnection with Local Telephone Company Facilities, 9 FCC Rcd. 5154, 5155 (1994) ("Our decisions mandating expanded interconnection and collocation are fundamental to opening the interstate special access and switched transport markets to greater competition").

²² See, e.g., Wyoming Stat. § 37-15-20.

²³ See Emerson at 13 (Pacific) ("Given the role of sunk costs in producing entry barriers, the relevant inquiry concerning pricing flexibility for exchange access services is the openness of access achieved through voluntary negotiations and arbitration under the Act"); Schmalensee and Taylor at 5 (USTA) ("Any alleged natural monopoly conditions are nonexistent in high-density urban areas") (emphasis added).

created by the Commission's determination that carriers may not use unbundled switching to substitute for switched access services, but must instead "win" the local customer. See AT&T at 16. As the Florida PSC (at 7) notes, "this creates a great incentive for competitors to operate in both local and toll markets, and discourages more limited market entry." As a result, "more experience would be needed to determine if unbundled network elements are actually used to create viable competitive alternatives" for incumbent-provided access. Id.²⁴ Indeed, U S WEST (at 20) touts this entry barrier as a virtue (as it unquestionably is -- for incumbents).

More importantly, no commenter has demonstrated how even widespread UNE-based competition will drive down *exchange access* prices if it does emerge. Economics dictates that both incumbents and entrants will compete for customers by reducing end user prices -- long distance and local exchange services -- not prices for inputs such as exchange access services. This undeniable fact undermines the proposed "market based" approach, as explained more fully in the Baumol/Willig/Ordovery (Appendix A).

With respect to terminating access, incumbents either feign surprise that any such problem exists,²⁵ proclaim that some undefined "[c]ompetition in the local exchange market will provide alternative methods of call termination," USTA at 67, or offer "solutions" that simply would not work.²⁶ As at least one ILEC concedes, however, "[n]either the calling party nor the long distance service provider has much ability to influence the called party's choice of service provider." Ameritech at 52. Given that more than half of all switched access traffic is terminating traffic, that alone precludes reliance on UNE-based competition to constrain access rates.

²⁴ See also Comp. Policy Inst. at 12; State Consumer Advocates at 39.

²⁵ See Bell Atlantic/NYNEX at 42.

²⁶ Emerson, for one, apparently would have the parties to telephone calls bargain to reach efficient originating and terminating access supplier arrangements. See Emerson at 18 (Pacific). Bell Atlantic/NYNEX suggest (at 42) that "the Commission could simply add a safeguard, by requiring that terminating access be priced at the same level as originating," but that would work only if originating access were capped at TELRIC, and even then the ILECs would retain opportunities to execute price squeezes. See Baumol/Ordovery/Willig (Appendix A).

But the incumbents depart furthest from reality in describing the present and future state of UNE-based local service competition. Indeed, their breezy claims that unbundled network elements are “freely available” (U S WEST at 27) can only be designed to mislead. As incumbents are well aware, numerous regulatory barriers to entry, combined with the incumbents’ own relentless anticompetitive efforts to defeat UNE-based competition, guarantee that new entrants will not be winning any significant number of local customers in the near future – and, indeed, will have no real opportunity to provide UNE-based local service to any customers in many markets for some time.

The most obvious regulatory barriers to entry include the continued unavailability of long-term number portability and dialing parity (e.g., API at 13), and, as described above, the existence of state and local laws and regulations that discriminate against (and, in some cases, preclude) entry. Further, state commissions are only now beginning to approve interconnection agreements. Although most states have, like the Commission, embraced forward-looking pricing methodologies, it “is not certain that unbundled network elements will be priced at economic cost in all cases.” Comp. Policy Inst. at 12. Further, key pricing issues remain unresolved even after interconnection agreements are approved, and whatever prices are established for network elements, necessary functionalities, such as collocation, are available only at extravagant prices that far exceed the incumbents’ true economic costs of providing those functionalities.²⁷ Finally, notwithstanding the Act and the Commission’s rules, many

²⁷ See, e.g., ACC Long Distance at 6 (“the extraordinary cost of physical collocation is one of the most significant impediments to utilizing unbundled network elements to provide local exchange service”).

state commissions deny the use of network element combinations,²⁸ extend deadlines for the availability of electronic access to incumbents' critical operational support systems,²⁹ authorize

²⁸ See, e.g., Petition of AT&T for Arbitration of Interconnection Rates, Terms and Conditions with BellSouth Telecomm. Under the Telecommunications Act of 1996, Docket No.6801-U, "Order Ruling on Arbitration" (Ga. PSC Dec. 4, 1996) at 5 (if the CLEC recombines UNEs to create services identical to those provided by the ILEC, the CLEC will be charged the wholesale rate); Interconnection Agreement Negotiations between AT&T Communications of the South Central States, Inc. and BellSouth Telecomm., Inc. of the Unresolved Issues Regarding Cost Based Rates for Unbundled Network Elements, Pursuant to the Telecommunications Act, Docket U-22145, "Report and Recommendation" (La. PSC Jan. 8, 1997) (hereinafter "Louisiana BellSouth Arbitration Order") at 39 (same); Petition of AT&T Communications of the Southern States, Inc., for Arbitration of Interconnection with BellSouth Telecommunications, Inc., Docket No. P-140, SUB 50, "Recommended Arbitration Order" (N.C. Util. Comm'n Dec. 23, 1996) (hereinafter "N.C. BellSouth Order") at 30 (same); AT&T Communications of the South Central States, Inc. and BellSouth Telecomm., Inc. Pursuant to 47 U.S.C. §252, Docket No. 96-01152 "First Order of Arbitration Awards," (Tenn. Reg. Auth. Nov. 25, 1996) (CLECs may only recombine to provide a new service); Petition of AT&T Communications of Wisconsin for Arbitration per §252(b) of the Telecommunications Act of 1996 to Establish an Interconnection Agreement with GTE North, Inc., Docket Nos. 265-MA-102, 2180-MA-100, "Decision of the Arbitration Panel" (Wisc. PSC Dec. 12, 1996) at 47 ("UNEs will not be combined to provide complete access to any customer.").

²⁹ See, e.g., Louisiana BellSouth Arbitration Order at 16 (Bell South to provide interfaces within 12 months of receiving AT&T's specifications); Petition of AT&T Communications of Virginia, Inc. for Arbitration of Unresolved Issues from Interconnection Negotiations with GTE South, Inc. Pursuant to § 252 of the Telecommunications Act of 1996, Case No. PUC960117, "Order Resolving Non-Pricing Arbitration Issues and Requiring Filing of Interconnection Agreement" (Va. State Corp. Comm'n Dec. 11, 1996) (hereinafter "Virginia GTE Non-Pricing Arbitration Order") at 11 (interfaces to be implemented by May 1998).

massive nonrecurring charges,³⁰ and erect other regulatory barriers that render competitive entry all but impossible.³¹

³⁰ See, e.g., Petition by AT&T Communications et al. for Arbitration of Certain Terms and Conditions of a Proposed Agreement with BellSouth Telecommunications, Inc. Concerning Interconnection and Resale under the Telecommunications Act of 1996, Docket Nos. 960833-TP, 960916-TP, "Final Order on Arbitration" (Fla. PSC Dec. 31, 1996) at 116 (non-recurring rates of \$140 for unbundled loop, \$38 for end office switching port, and \$400 for signaling link); Petitions by AT&T Communications of the Southern States, et al. for Arbitration of Certain Terms and Conditions of a Proposed Agreement with GTE Florida, Inc. Concerning Interconnection and Resale under the Telecommunications Act of 1996, Docket Nos. 960847-TP, 960980-TP, "Final Order on Arbitration" (Fla. PSC Jan. 17, 1997) at 155 (nonrecurring rates of \$47.25 for initial service order, \$16 for transfer of service, and \$5.25 for customer service record); Petition of AT&T Communications of Indiana, Inc. Requesting Arbitration of Certain Terms, Conditions and Prices for Interconnection and Related Arrangements from Indiana Bell Tel. Co., Inc. d/b/a Ameritech Indiana Pursuant to §252(b) of the Telecommunications Act of 1996, Cause No. 40571-IN7-01 (Ind. Util. Reg. Comm'n Nov. 27, 1996) (nonrecurring charges of \$46.42 to establish new service, \$13.50 for provision charge, and \$13 for record change); Arbitration of AT&T Communications of the Midwest, Inc. and GTE Midwest, Inc. Docket No. ARB-96-3, "Preliminary Arbitration Decision," (Iowa Utilities Board Nov. 14, 1996) (nonrecurring charge of \$13.30 for customer change), aff'd, "Final Arbitration Decision," (Dec. 11, 1996); AT&T Communications of Ohio, Inc.'s Petition for Arbitration of Interconnection Rates, Terms and Conditions and Related Arrangements with Ohio Bell Tel. Co. d/b/a Ameritech Ohio, Case No. 96-752-TP-ARB, "Arbitration Panel Report" (Ohio PUC Nov. 5, 1996) at 30 (nonrecurring charges of \$25.19 for new service order and \$25.02 for line connection), aff'd, "Arbitration Award" (Ohio PUC Dec. 5, 1996) (hereinafter "Ohio Ameritech Order").

³¹ Examples of these barriers include, among others: (1) not allowing CLECs access to ILECs' dark fiber, see e.g., AT&T Communications of Washington D.C., Inc. Petition for Arbitration with Bell Atlantic-Washington D.C., Inc., "Arbitration Decision," Telecommunications Arbitration Case 1, Order No. 7 (DC PUC Dec. 2, 1996) at 22-23; In re the Petition of AT&T Communications of Hawaii, Inc. for Arbitration with GTE Hawaii Tel. Co. Pursuant to Section 252 of the Telecommunications Act of 1996, Docket No. 96-0329, "Decision" (Haw. PUC Dec. 12, 1996) at 20; Virginia GTE Non-Pricing Arbitration Order at 3; (2) not allowing collocation of RSMs, see e.g., In re the Petition for Arbitration of an Interconnection Agreement between AT&T Communications of the Pacific Northwest and GTE Northwest, Inc., Docket No. UT-960307, "Arbitrator's Report and Decision" (Wash. Util. & Transp. Comm'n Dec. 11, 1996) at 24, or allowing the collocation of such equipment only when the switching functions are disabled, see e.g., Petition of AT&T Communications of the Mountain States, Inc. for Arbitration of Interconnection Rates, Terms, and Conditions with US WEST Communications, Inc. Pursuant to 47 U.S.C. § 252(b) of the Telecommunications Act of 1996, Docket Nos. U-2428-96-417 and E-1051-96-417, "Opinion and Order," (Arizona Corporation Commission, issued November 13, 1996) at 9; Ohio Ameritech Arbitration Order at 23; (3) the imposition of restrictive conditions for customer transfers, see e.g., Application of AT&T Communications of Pennsylvania, Inc.; Petition for Arbitration of Interconnection Agreement with GTE North, Inc., Docket No. A-310125F0002, "Recommended Decision," (Pa. PUC Oct. 15, 1996) (hereinafter "Pennsylvania GTE Arbitration (continued...)

Even if one could somehow imagine realistic prospects for ubiquitous near-term UNE-based competition in the face of these many barriers to entry, a quick comparison of the incumbents' conduct with their sweeping claims here should dash any such hopes. BellSouth (at 13), for example, promotes the availability of UNEs at cost-based rates here, but separately proposes to *assess* access charges on any new entrant that attempts to combine UNEs to provide competing local services. Ameritech likewise sings the praises of UNE-based competition but does not mention that it flatly refuses, *inter alia*, even to provide common transport as a separate unbundled element.³² Similarly, SWBT (at 51) urges "application of the full SLC to all purchasers of unbundled loops"; Pacific (at 53) claims that "carriers using unbundled elements to originate and terminate toll traffic should be required to pay the difference between the cost of the unbundled network elements and the access charges they would be required to pay if they purchased such services directly from the ILEC;" and U S WEST stubbornly resists its obligation to provide potential competitors with the same electronic access to critical operational support systems that it provides to itself.³³

And then there is GTE. The nation's largest local monopolist repeatedly assures the Commission that "the availability of unbundled network elements provides an independent, highly effective check on ILEC access rates." GTE at 45. Where and when will these unbundled elements be available? "[N]ow [and] in every jurisdiction in the country that is not eligible for an

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Order") at 34 (affirmative written consent required), aff'd, *Petition of AT&T Communications of Pennsylvania, Inc. for Arbitration to Establish an Interconnection Agreement with GTE North, Inc.*, "Opinion and Order" (Pa. PUC Dec. 5, 1996) at 42; and (4) not requiring ILECs to unbrand or rebrand their OS or DA, see e.g., *N.C. BellSouth Arbitration Order* at 4, 15-17; *Pennsylvania GTE Arbitration Order* at 45.

³² See *AT&T Communications of Michigan, Inc. v. Michigan Bell Telephone Company*, Complaint, No. 97-60018 (E.D. Mich.) (filed Jan. 24, 1997).

³³ See *Implementation of the Local Competition Provisions in the Telecommunications Act of 1996*, CC Docket No. 96-98, U S WEST *Petition for Waiver* (filed December 11, 1996). U S WEST also "incorporates" here its Eighth Circuit claim that UNE prices must be based on embedded costs (at 29 n. 32) and, indeed, continues to insist that "[t]here is no valid economic basis for mandatory unbundling" at all (Harris and Yao at 18).

exemption," proclaims GTE (at 10-11). Yet it neglects to mention that *it* claims such an exemption in most jurisdictions³⁴ or that it immediately sues every state commissioner that dares hold it to the Act's unbundling requirements -- asking federal courts in premature and harassing lawsuits to declare each such arbitration order "unlawful in its entirety" and to *enjoin* the commissioners from further interconnection efforts.³⁵ At what price will these elements be available? Nothing less than full embedded costs, if GTE has its way, because anything else "leads to an unconstitutional taking whether used to price unbundled network elements, to determine the amount of universal service funding, or to set the level of access charges." GTE at 22.³⁶ And what carrier access charges will UNE purchasers avoid to foster this exchange access competition? Not a penny in GTE's topsyturvy world; indeed, UNE purchasers would pay *additional end user* access charges. GTE at 11 n.19, 32. It is *this* "shell game" that "cannot continue." GTE at 6.

Thus, unbundled element competition is not a reality today, and indeed, both CompTel (at 9-11) and MCI (at 38) accurately depict the ILECs' successful campaigns in various states, including California, Georgia, Ohio and Tennessee, to preclude UNE purchasers from obtaining logical combinations of network elements needed to create viable alternatives for switched access. Moreover, until further measures to limit ILEC abuses -- particularly in the development of and

³⁴ See, e.g., GTE North Incorporated's Rural Local Exchange Carrier Exemption Under the Telecommunications Act of 1996, Case No. 96-612-TP-UNC at 6 (PUC Ohio June 27, 1996) (rejecting GTE's rural status claim and noting that "[s]uch posturing certainly causes us to step back and ponder [GTE's] intentions including whether the company is positioning itself to act in an anti-competitive fashion going into the emerging local competitive era").

³⁵ See GTE South Inc. v. AT&T Communications et al., Civil Action 3:96CV1015, "Complaint" (E.D. Va. filed Dec. 19, 1996) (GTE requested Court to "permanently enjoin each and every defendant in this case from taking any action to require GTE to execute an agreement with AT&T"); GTE California, Inc. v. Conlon et al., Civ-S-97-0060, Complaint (E.D. Cal. filed Jan. 14, 1997) (GTE requested "[a] permanent injunction restraining each and every defendant, and their successors, from requiring GTE to execute, or enforcing the agreement arbitrated by the [State Commission].").

³⁶ See also GTE Svc. Corp. et al. v. FCC, Case No. 96-3321, "Motion for Stay Pending Judicial Review and for Expedited Judicial Review" (Eighth Cir. filed Sept. 9, 1996) at 23 ("The term 'cost' in § 252(d)(1) must be read to ensure that a LEC is permitted an opportunity to recover all of its true costs. [citations omitted] Indeed, the Constitution requires that a LEC be permitted to recover full costs in each segment of its business.").

access to functioning and viable operations support systems ("OSS") -- are in place, UNE-based competition will not be economically or technically feasible in many jurisdictions, even when elements are nominally available. Indeed, despite the Commission's express requirements that ILECs make OSS -- including access to pre-ordering, ordering, provisioning, maintenance and repair, and billing functions -- available by January 1, 1997,³⁷ as CompTel (at 10) indicates, "no ILEC currently is providing properly-functioning automated OSS access for both unbundled network elements and local exchange service resale."³⁸

³⁷ Implementation of the Local Competition Provisions of the Telecommunications Act of 1996, 11 FCC Rcd. 15499 ¶ 525 (1996) ("*Local Competition Order*"), recon. 11 FCC Rcd. 13042 (1996) petition for review pending and partial stay granted sub nom. Iowa Utilities Board v. FCC, No. 96-3321 (Eighth Cir. Oct. 15, 1996), partial stay lifted in part, id. (Eighth Cir. Nov. 1, 1996).

³⁸ Thus, before the Commission can seriously consider the market-based approach to access reform, it must, at a minimum, ensure that each ILEC is able to provide the necessary OSS interfaces if customers are to have any chance of obtaining from new entrants prompt, seamless local service that is "simple to order, easy to provision, and ... responsive to customer demand." CompTel at 5. To assist the Commission in this task, an industry coalition (Local Competition Users Group) has created a set of five questions that each ILEC must be able to answer in the affirmative before it can be deemed to have effectively complied with the Commission's OSS requirements:

1. Can the customer easily order service from the CLEC? The CLEC must have immediate access to all ILEC information needed to create the order (including features and functions available at each end office, as well as real-time access to current customer profiles), so that, on the initial call from a customer, the CLEC can place the order, confirm installation and in-service dates, and provide the customer with his/her new telephone number.

2. Will the ILEC promptly accept the CLEC's order for processing? The new entrant must be able to transmit orders electronically; the ILEC must have efficient and adequate ordering systems that comply with OBF and all other industry-defined ordering procedures; and the ILEC must give the CLEC prompt commitment of customer order acceptance and any customer changes.

3. Does the customer get what he/she ordered on time? The customer's service order must be completed as quickly as a change in long distance carrier and service must be implemented without disruption and with all features in tact.

4. Will the customer receive a timely, accurate bill? The ILEC must provide electronically and immediately accurate daily usage measurement data needed to allow the CLEC to bill end users and other carriers.

5. Is the service satisfactory and does ILEC fix it when it breaks? All customers served
(continued...)

In sum, “[a]lthough it has been more than one year since the 1996 Act became law, it is a fact that implementation of the 1996 Act remains in its embryonic stages, due in no small part to . . . GTE and the RBOCs.” LCI at 10. “[N]ascent competitive markets need to evolve significantly before they can provide the needed discipline on LEC access charges.” NARUC at 10. And “[t]he Act certainly opens the door for such competition, but it will not be a reality for years to come.” Frontier at 10. In these circumstances, the Commission cannot responsibly adopt the proposed “market-based” approach. “At this time, such an approach would constitute an abandonment of the Commission’s responsibility . . . to ensure the incumbent LECs charge just and reasonable rates for interstate switched access services,” API at 2-3 -- as the Commission itself recently reaffirmed.³⁹

B. Immediate Reinitialization Of Price Caps Is The Only Way To Produce Efficient And Lawful Access Prices.

By contrast, there is widespread support among regulators, consumers and access customers for a prescriptive approach to access reform that will drive inflated access charges toward more efficient levels now.⁴⁰ Indeed, most commenters recognize that, even if it were necessary for the Commission to conduct “the mother of all rate cases” to reduce access levels, that administrative burden would be dwarfed by the resulting consumer benefits.⁴¹ But, of course, it is

³⁸(...continued)

over the ILEC network must receive the same quality of service; trouble reporting and restoration response must be the same for all customers; and the ILEC must promptly inform the CLEC of the status of trouble tickets.

³⁹ Ameritech Operating Companies: Petition for Declaratory Ruling and Related Waivers, 11 FCC Rcd. 14028 at ¶ 130 (1996) (“We recognize that the transformation from monopoly to full competitive markets will not take place overnight. . . . Accordingly, the Commission and state regulators must continue to ensure against any anticompetitive abuse of residual monopoly power, and to protect consumers from the unfettered exercise of that power”). See also API at 8.

⁴⁰ See, e.g., Wash. UTC at 1 (“there remains a need for some prescription, given that sufficient competitive forces do not yet exist in the local market to warrant complete reliance on market forces”); Missouri PSC at 5; Florida PSC at 3; Texas PUC at 23; Northern Marianas at 11; State Consumer Advocates at 53; AARP, CFA and Consumers Union at 7; SDN Users at 2; Ad Hoc at 35; IXC Long Distance at 3.

⁴¹ See, e.g., BellSouth at 62; Ill. Commerce Comm'n at 17 (Commission should “require incumbent price cap LECs to base their charges for terminating access on forward-looking, economic cost (continued...)”).

not necessary to do that. As AT&T explained (at 22-23), the Commission can go a long way toward bringing access rates to efficient levels simply by targeting the key access elements that make up most access revenues, and then relying on state determinations of the forward-looking costs of providing network elements.

Notably, virtually all of the commenters agree that unbundled network elements and access elements are functionally identical and that consistency in pricing is therefore critically important. As SWBT frankly admits (at 4), "By design, unbundled network elements are directly substitutable for switched and special access services provided by LECs." Nor is there any viable distinction between interstate and intrastate access: "although intrastate access and interstate access may be distinguished jurisdictionally, from a network perspective they are identical. Both types of access charges share the use of the same network elements, and therefore the costing standards adopted should be similar." California at 42. Thus, "rates based on TELRIC for both access and non-access unbundled network elements will lead to less confusion, eliminate artificial price disparities for identical network elements, and more easily ensure that ILECs have an opportunity to recover forward-looking common costs."⁴²

Against this compelling need for consistency in pricing, a number of ILECs argue that the prescriptive approach would be administratively difficult. These arguments are wholly inapplicable, however, to AT&T's proposal for a price cap reinitialization based upon a small number of the most important network elements. As Bell Atlantic/NYNEX note (at 43), "the local regulator . . . [is]

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studies"); International Communications Association at 4.

⁴²Texas PUC at 27; see also SNET at 37 ("There is no real disagreement that the components of access are essentially identical to other forms of switched interconnection"); Pacific at 11 ("When unbundled elements are 'combined' they mimic the same functions, features and access to the local network that is provided by our access services today"); USTA at 7 (noting "the high degree of substitutability between carrier access services and unbundled network elements"); Bell Atlantic/NYNEX at 8-9 ("there is no basic difference between the carriage of traffic between an end user premises, on the one hand, and an interexchange carrier ('IXC') point of presence ('POP') or another end user premises, on the other hand); Schmalensee and Taylor at 1 (USTA) ("the supply-side factors underlying access service are the same for local and long distance services, and thus the cost basis for pricing those services will be similar"); U S WEST at 21 ("The fact that interconnection is a technological substitute for switched access cannot be ignored").

the body in the best position to evaluate local conditions,” and they have already done so in arbitrations conducted pursuant to § 252. Thus, the Commission could profoundly reform the access charge system in this proceeding by adopting state-determined TELRIC rates for per-minute local switching, per-minute tandem switching, common transport, and dedicated transport. See AT&T at 22-28. And while it is true that not every state has performed a true TELRIC study, the commenters support using a default model -- such as the Hatfield model -- to fill in the gap until such studies can be completed.⁴³ This prescriptive approach would not be administratively cumbersome, and it would bring access charges to cost in a reasonable time while providing certainty and predictability for all parties.⁴⁴

The ILECs are equally wrong in claiming that the prescriptive method is impermissibly "regulatory."⁴⁵ Both the "market-based" and "prescriptive" approaches retain price cap regulation as an initial matter; the only difference between the two approaches is whether the initial price cap *levels* will be cost-based or whether they will remain billions of dollars above cost. As competition develops, the regulation of access charges can be relaxed under either method. But only the "prescriptive" method addresses the real issue facing the Commission, which is how to ensure that rates are just and reasonable -- *i.e.*, cost-based -- until competition in fact develops.⁴⁶

ILEC claims that a prescriptive approach would undermine investor confidence or reduce the LECs' incentives to invest in their networks are even more baseless. See BellSouth at 41-42; Ameritech at 49. Under the "prescriptive" approach, although the price caps will be reinitialized, the operation of the price cap system will remain the same, and will thus create all of the same economic incentives the ILECs have today. And, as the FCC has previously found, TELRIC

⁴³Florida PSC at 9 (“it might be useful to develop a “default” model, or even a set or range of rates, which, in the absence of state specific data, could reasonably be used for interstate purposes”).

⁴⁴Comp. Policy Inst. at 13; MCI at 14.

⁴⁵See, e.g., USTA at 12; BellSouth at 41-42; SWBT at 23; U S WEST at 44-45.

⁴⁶See Ad Hoc at 42 (“Having established that existing prices set by the existing access charges system do not reflect the prices that would exist in a competitive market, the Commission must first correct that problem through prescriptive reform of not only the access charge rate structures but the rate levels as well”).