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

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JUN - 9 1997

In the Matter of	)	
	)	
Access Charge Reform	)	CC Docket No. 96-262
	)	
Price Cap Performance Review for Local Exchange Carriers	)	CC Docket No. 94-1
	)	
	)	

OPPOSITION OF THE COMPETITION POLICY INSTITUTE

TO THE

JOINT PETITION FOR A PARTIAL STAY AND FOR IMPOSITION OF AN ACCOUNTING MECHANISM PENDING JUDICIAL REVIEW

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SUMMARY

The Competition Policy Institute (CPI) opposes the Joint Petition for a Partial Stay and for Imposition of an Accounting Mechanism Pending Judicial Review filed by Southwestern Bell Telephone Company, Pacific Bell and Nevada Bell (Petitioners). The Petitioners have asked the Federal Communications Commission (Commission) to stay portions of its orders implementing reforms to the system of carrier access charges and the price cap regulatory structure that applies to local exchange carriers. The Petitioners have failed to establish the four traditional criteria that must be met for a stay. CPI believes that a stay of these portions of the two orders is not required and further, that a stay would impose irreparable harm on consumers.

The Commission's decision in the ***Price Cap Performance Review Order*** to require local exchange carriers (LECs) to use a 6.5% productivity factor is supported by ample evidence in the record and the Commission is likely to be upheld on judicial review. The Commission's decision in its ***Access Reform Order*** to exclude unbundled network elements from the application of access charges is consistent with Telecommunications Act of 1996 and implements the sound public policy of encouraging the development of competition in local exchange and exchange access markets. The Commission is not required to issue a stay to this portion of its order due to the decision of the Eighth Circuit Court of Appeals.

The Petitioners argue that, unless the Commission issues a stay, local exchange companies will be harmed. If the Commission's decision is overturned or remanded on appeal, incumbent LECs will have an opportunity to recoup any revenue shortfall, so that such speculative harm is not irreparable. On the other hand, the Petitioners have failed to consider the harm that will inure to consumers if the Commission issues a stay. Consumers would be harmed by a stay because local exchange competition will be delayed and long distance rates will be higher than they would otherwise have been. This harm to consumers is likely to be greater than any speculative harm to incumbent local exchange companies and is irreparable.

INTRODUCTION

Joint Petitioners Southwestern Bell Telephone Company, Nevada Bell and Pacific Bell have petitioned the Commission to stay portions of its First Report and Order in CC Docket No. 96-262 (***Access Reform Order***), released May 16, 1997 and its Fourth Report and Order in CC Docket No. 94-1 and Second Report and Order in CC Docket No. 96-262 (***Price Cap Performance Review Order***), released May 21, 1997. The Petitioners ask the Commission to stay the portions of these two orders that a) prohibit the application of Part 69 access charges to unbundled network elements; b) reduce price cap indices (PCIs) to reflect the completion of amortization of equal access costs; c) reduce PCIs by a productivity factor of 6.5%; and d) reduce PCIs due to the use of a 6.5% productivity factor for 1996.[1]

CPI is an independent non-profit organization that advocates policies to bring competition to energy and telecommunications markets in ways that benefit consumers. CPI opposes the Joint Petition for a Partial Stay in this case because the Petitioners have failed to establish that a stay is warranted and because a stay would cause irreparable harm to telecommunications consumers.

ARGUMENT

The Petitioners set out the four traditional criteria that the Commission should consider in deciding whether to grant the requested stay: 1) the likelihood that the Petitioners will prevail on appeal; 2) whether Petitioners will suffer irreparable harm without a stay; 3) whether a stay will

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[1]Petitioners appear to have misstated this fourth request for relief on page 1 of the Joint Petition in the "Relief Requested" section. CPI discerned the corrected request for relief from the argument contained in the subsequent pages of the Joint Petition.

harm other parties; and 4) whether the public interest favors the *status quo* pending a decision on an appeal. In order to decide to grant this Joint Petition for a Partial Stay, the Commission must find that the outcome of considering *each* of these four criteria favors the Petitioners. CPI submits that the Joint Petition fails on all four criteria.

1. The Petitioners Have Failed to Show That They are Likely to Prevail on the Merits Upon Judicial Review.

A. The Commission's Decision that Interstate Access Charges Should Not Apply to Unbundled Network Elements is Consistent with the Telecommunications Act of 1996 and Represents the Correct Public Policy.

The Telecommunications Act of 1996 requires, in Section 252(c), that rates for unbundled network elements (UNEs) must be just and reasonable. Section 252(d)(1) requires that:

> the just and reasonable rate for network elements for purposes of subsection (c)(3) of such section--
> (A) shall be--
> (i) based on the cost (determined without reference to a rate-of-return or other rate-based proceeding) of providing the interconnection or network element (whichever is applicable), and
> (ii) nondiscriminatory, and
>
> (B) may include a reasonable profit

The Commission's decision in CC Docket No. 96-98 (***Local Competition Order***) determined that the appropriate cost standard for UNEs was a standard based upon forward looking economic costs -- called Total Element Long Run Incremental Costs (TELRIC). That decision recognized that TELRIC prices fully compensate incumbent local exchange companies for the cost of providing unbundled network elements, including the full cost of the loop. Although the pricing rules adopted by the Commission have been stayed by the Eighth Circuit Court of Appeals, the vast majority of States have proceeded to endorse the same pricing policy, recognizing how critical these correct prices are to the development of competition.[2]

In its ***Local Competition Order*** and ***Access Reform Order***, the Commission correctly found that competitors to local exchange companies that enter the market using purchased UNEs may provide any telecommunications services supported by those facilities, including the completion of long distance telephone calls made by or received by the local customer being served over the facilities. In other words, local competitors to the incumbent LECs can provide access services using the UNEs that have been fully paid for. The Commission reasoned, correctly, that it would be inappropriate to impose additional "access" costs on these elements when they were used to provide exchange access service.

There is debate about the exact components of access charges. Interstate access charges collect the interstate portion of the revenue requirement for the common line, pay for service-related costs, contain some element of universal service support and undoubtedly compensate access providers for some inefficiencies and costs that are in excess of efficient prices. To the extent that interstate access charges recover the interstate portion of the cost of common facilities, it is inappropriate to assess such costs on top of prices that already compensate the incumbent companies for the economic costs of the underlying facilities. To the extent that access charges

[2]One notable exception to the rule that states are adopting TELRIC-based prices is Arkansas. Accompanied by strong advocacy from Southwestern Bell Telephone Company, the Arkansas General Assembly passed legislation which was signed into law by the Governor to require the use of "actual" costs for the pricing of UNEs. "Actual costs" are widely taken to mean "historic" costs.

recover costs of the loop, costs of switching, or costs of transport, purchasers of UNEs have already paid for those services. To the extent that access charges recover "universal service" costs, interstate carriers will support the high costs of the incumbent LECs through contributions to the universal service fund created in the companion order in CC Docket No. 96-45, based on their interstate revenues (which will include revenues from long distance services using UNEs). Thus, application of access charges to UNEs fails as a correct policy on all scores.

In addition to the fundamental unfairness of imposing access charges on top of UNE prices, the practice will have anti-competitive effects. Congress's requirement that the price of unbundled network elements be based on cost stems from the fact that UNEs play a central role in the development of competition for both local exchange service and exchange access service. Congress understood that competition would not develop simply because it was declared to be legal. The duties imposed by new Section 251 of the Communications Act on incumbent local exchange carriers were carefully crafted to induce competition in local exchange and exchange access services.

In order for this plan to work, competitors must be able to acquire access to unbundled network elements at competitive prices. By making UNEs available at economic costs and by permitting these paid-for facilities to be used for all telecommunications services, the Commission has acted in concert with the pro-competitive thrust of the Telecommunications Act of 1996.

CPI recognizes that many incumbent LECs disagree with the Commission's (and subsequent

States') decisions to price UNEs at economic costs. The Petitioners' position that access charges should continue to apply to UNEs represents a "second bite" at the UNE pricing issue. The Commission should not permit the Petitioners to unravel the Commission's (and the States') policies designed to enable and encourage competition in exchange access service and local exchange service.

Neither should the Commission be moved by the arguments of the Petitioners that the exemption of UNEs from access charges means that incumbent LECs will not have the opportunity to recover the associated embedded costs. The question of whether, and in what manner, LECs should be able to recover differences between historic costs and economic costs can be examined by the Commission without a stay of the pro-competitive and pro-consumer decisions in adopted the ***Access Reform Order.*** The Commission, in numerous public statements, has stated clearly its intention to consider this issue in a further proceeding, demonstrating that it is not acting in an arbitrary or capricious manner as stated or implied by the Petitioners.

B. The Commission is Not Required to Stay its Decision to Avoid Conflict with the Stay Issued by the Eighth Circuit Court of Appeals.

The Petitioners argue that the Commission is without authority to determine that unbundled network elements should not be assessed access charges because the Eighth Circuit Court of Appeals stayed the rule, adopted in the ***Local Competition Order*** that addressed this issue. But the decision of the Commission in the ***Access Reform Order*** not to apply access charges to unbundled network elements is distinct from the action taken in the ***Local Competition Order***. In the ***Local Competition Order***, the Commission was interpreting new Sections 251 and 252 of the Communications Act concerning the pricing of unbundled network elements. Section 51.515 of the Commission's rules was stayed because of a concern that the FCC lacked the jurisdiction to establish prices for unbundled network elements. The ***Access Reform Order***, on the other hand, concerns the reforms to interstate access charges, included in Part 69 of the Commission's rules. There is no question in this proceeding concerning the Commission's jurisdiction to consider reforms to the rules for interstate access charges, and the Petitioners have not challenged the Commission's jurisdiction over these rules. The Court's stay of Rule 51.515 prevents the Commission from enforcing its TELRIC pricing methodology and its proposed proxy prices for unbundled elements. The stay, however, does not affect the structure, level or applicability of interstate access charges or limit the Commission's jurisdiction to modify these access charges.

The Commission could not have undertaken a complete review of interstate access charges in CC Docket No. 96-262 without facing the question of which carriers, and on which services, interstate access charges should be levied. In its ***Access Reform Order***, the Commission decided how and when access charges are collected on the basis of a record that is not before the Court. In the same way the Commission is able to determine that access charges should not apply to Enhanced Service Providers, or that they should be structured in a particular fashion, the Commission has jurisdiction to determine whether and how access charges should apply to carriers that use network facilities, purchased as UNEs, to provide exchange access service. The Commission is not precluded from determining to which services interstate access charges should apply.

Even if we accept, *arguendo*, the Petitioners' position that the Court's stay prevents the Commission from applying access charges to UNEs, there is no need for the Commission to enter an order staying the effect of that portion of its ***Access Charge Order***. If the Petitioners are correct, the order is already stayed. We also note that the Court will soon render its decision on the merits of the appeal. In view of this schedule, it is not necessary for the Commission to stay the effect of a rule that the Petitioners claim has been stayed by the Court. In this circumstance, the impending decision of the Court will either permanently stay the rule or affirm the Commission. If the Commission is affirmed, the policy should rightly take immediate effect.

C. The Petitioners are Not Likely to Prevail on an Appeal of the Commission's Decision to Increase the X-Factor to 6.5%.

It is clear that the Petitioners strongly disagree with the Commission's decision to adopt a productivity offset of 6.5%. It is also clear that the Petitioners plan to appeal the decision. These two facts do not justify a stay of the Commission's order. A stay can only be issued if the petitioners can establish that a court is likely to find that the Commission adopted a 6.5% productivity factor on an incomplete record.

In fact, the Commission arrived at its decision to adopt 6.5% as an appropriate X-factor on the basis of a very complete record and a thorough analysis of the data and arguments presented in the rulemaking. The evidence before the Commission ranged from analysis from incumbent LECs that the X-factor should be lowered, to analysis from other parties that the X-factor should be raised to 10.0%. As a result of its extensive analysis, described in detailed exposition in its ***Price Cap Performance Review Order***, the Commission concluded that 6.5% (6.0% total factor productivity plus a consumer productivity dividend of 0.5%) is the appropriate X-factor and was the correct X-factor that should have been applied during 1996.

The Petitioners' main criticism of the Commission's decision seems to be that the Commission "trimmed" the data to arrive at a desired result. But the analysis presented in support of the Commission's decision to adopt an X-factor of 6.0% belies that criticism. Further, CPI believes that "the proof of the pudding is in the eating." Interstate earned rates of return for price cap LECs are at all-time high levels. Increasing the X-factor (without re-initalizing rates to achieve a benchmark rate of return) means that these high returns will persist for years following, *ceteris paribus.* These excessive rates of return are sufficient reason alone for the Commission to raise the productivity factor.

CPI also notes that the Commission derived the productivity estimates looking at an entire firm's productivity, and did not restrict its view to those aspects that affect the productivity of the provision of interstate exchange access service, which is likely to be higher than total firm productivity. We think it is likely that an X-factor of 6.5%, like its predecessors, may well prove to be **too low** to constrain interstate returns of price cap LECs to market levels. Finally, we note that the Commission retained the low-end adjustment mechanism that permits upward adjustment in access price cap index if a carrier's earned return falls below 10.25%.

In view of these facts, arguments that an X-factor of 6.5% is unfair and claims of substantial unjustified harm to incumbent LECs ring hollow. The Commission is on firm ground with this decision and CPI believes it is very unlikely the Court will substitute its judgment for the Commission in a technical matter such as this. We do not think this is a close call — the Petitioners have failed to provide a convincing rationale why they will prevail on appeal. In view of this failure, the Commission should not stay this portion of its order.

D. The Commission Has Adequately Justified the Application of the 0.5% Consumer Productivity Dividend.

In its ***Price Cap Performance Review Order***, the Commission found that it was appropriate to maintain the practice of including a 0.5% Consumer Productivity Dividend (CPD) in the X-factor. The Commission retained the application of the CPD both for prospective application and as part of the X-factor to be applied as a one-time adjustment to the PCIs for 1996.

Notwithstanding the Petitioners' acerbic criticism of the Commission's retention of the CPD and its application to 1996 results, the Commission has adequately justified the application of the CPD. The Commission's rationale for including a Consumer Productivity Dividend in its price cap plan dates from the earliest consideration of price caps by the Commission in 1987. There have always been twin justifications for the CPD: i) increased incentives for the carriers subject to price caps to reduce costs; and ii) considerations of equity as between shareholders and ratepayers. In their criticism of the application of the CPD to 1996, the Petitioners focus on only one aspect of the Commission's justification for the CPD — the incentive effect. They argue that the CPD cannot affect a carrier's productivity for a past period. But the Petitioners completely ignore the second rationale for applying the CPD to 1996 performance — flowing through a portion of productivity gains to consumers. The equity-based justification for the

CPD is not diminished merely because it is applied to a past period.[3]

In its order, the Commission spoke clearly in justifying its retention of the CPD:

> The CPD will act as a mechanism to ensure that price cap LECs flow-through a reasonable portion of the benefits of productivity growth to ratepayers. The importance of this purpose in our revised price cap plan is enhanced because we are eliminating the current sharing requirements and we are not adopting a moving average method of updating the X-Factor.[4]
>
> * * *
>
> The CPD remains necessary to require LECs to transfer some portion of their unit cost reductions to their access customers. Also, the CPD was, in a sense, an expression of certainty that LECs would respond to the incentives provided by the price caps plan by becoming more productive, and that there would be productivity gains that could be shared between ratepayers and shareholders. The passage of time has not altered the need to strike this balance between ratepayer and shareholder interests.[5]

The issue of whether to retain the CPD was fully vetted in comments filed in the Price Cap Performance Review Case. The Petitioners appear to be asking the Commission to stay the effect of this portion of the order, not because of the merits of the issue on appeal, but because their arguments were not adopted by the Commission. CPI believes that the Commission's decision will be affirmed on appeal so that, conversely, the Petitioners are not likely to prevail

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[3]It is not even clear that the Petitioners are correct that applicability of the CPD to a past period will not provide an incentive to additional efficiencies. Obviously, the LECs' performance in 1996 cannot be changed retroactively. But the reduction in (excess) earnings caused by the application of the CPD for this past period might well provide an extra incentive for a LEC to increase its efforts to be efficient in the future period in an attempt to restore earnings to the previous (excess) level.

[4]***Price Cap Performance Review Order***, Paragraph 123.

[5]Ibid., Paragraph 125.

on appeal. For that reason, the Commission should deny the Joint Petition and decline to issue a stay on this portion of the ***Price Cap Performance Review Order***.

2. If the Commission's Decision on the X-Factor is Reversed, the LECs Will Have A Future Opportunity to Recover the Difference in Revenues.

The Petitioners suggest that it will be "difficult, if not impossible" for the LECs to recoup access charge reductions in future rates if the Commission is reversed on appeal and a stay has not been granted. We disagree. First, there is no doubt that the Commission will have the legal authority to permit LECs to recover the difference between the rate charged and the rate determined after judicial review of the access charge order. While such a procedure may be complicated, and could even be "difficult", this does not equate to "irreparable harm." Second, the Commission and many parties to the Access Charge Reform docket have stated their expectation that market forces will gradually lower access charges. The Commission rejected a "flash cut" of access charges to economic costs in favor of a market-based approach. The Petitioners merely speculate that access prices will not be sufficient in the future to allow them to recoup revenues which might be restored to them following judicial review of the ***Access Reform Order***.

3. Imposition of a Stay Will Harm Consumer Interests.

In the Joint Petition for a Partial Stay, the Petitioners have focused on the "harm" that will be visited upon local exchange companies such as Southwestern Bell Telephone Company, Pacific Bell and Nevada Bell. The Petitioners also argue that the payers of access charges, the long distance companies, will not be harmed by the imposition of a stay. But the Petitioners give short shrift to the effect of a stay on consumers.

A. A Stay Will Deny Consumers the Benefits of Lower Long Distance Rates.

The initial impact of reducing access charges will be to lower the costs of access to long distance companies purchasing these services from affected LECs. What the Petitioners fail to point out is that competition among long distance carriers will cause them to lower long distance rates as a result of reductions in access charges.

The reductions will be led by the two largest long distance companies, AT&T and MCI, each of whom have committed to pass through access charge reductions. Importantly, AT&T has also committed to reduce the rates paid by its basic schedule customers who do not subscribe to a calling plan. Nominal rates for long distance service for these basic schedule customers have been increasing in recent years. AT&T's commitment to lower rates to these customers represents a very important special case of the reductions that consumers generally will realize from access reductions.

Not only will consumers be denied the benefit of immediate reductions in long distance rates, a stay of the order will also retard progress toward the economic pricing of access charges and the concomitant future reductions in long distance rates. As developed above, staying the portion of the ***Access Reform Order*** that prohibits the application of interstate access charges to UNEs means less competition in exchange access services in the future. Less competition means that price cap LECs will maintain higher interstate access charges and, correspondingly, long distance rates will remain higher than they otherwise would be.

B. A Stay Will Harm Consumers by Delaying Competition for Local Exchange Service.

One effect of the stay requested by the Petitioners is to maintain the collection of access charges on long distance calls made by consumers over facilities provided by local exchange competitors that enter the market using unbundled network elements. Industry analysts uniformly recognize the importance for carriers to have the ability to offer consumers a bundle of local and long distance service (among potentially many other services). The imposition of access charges on top of the price paid for unbundled network elements will harm consumers by handicapping new local market entrants that wish to self-provide exchange access through UNEs and thereby compete with the incumbent. The effect will be fewer choices for consumers, less competition, and higher prices in both local and long distance markets.

4. The Equities Favor Denying the Stay: Consumers Will Be Irreparably Harmed By a Stay.

As described above, consumers will be harmed in two ways if the Commission's order is stayed. First, consumers will be denied the immediate effect of lower long-distance rates. The reductions that will flow from the access charge reductions ordered by the Commission are important to consumers. The FCC's chief economist has estimated that long distance rates will fall significantly as a result of these reductions. The long distance price reductions triggered by access charge reductions will, in turn, stimulate increased use of long distance service. The combination of these two effects, lower prices and increased usage, can be combined to measure the increase in consumer welfare brought about by lowering access charges. Since long distance usage is relatively price elastic, this means that the increase in consumer welfare will be much larger than the benefit measured simply as a reduction in access charges.

If the Commission enters a stay, preventing access charges from being reduced, consumers will lose these certain benefits. An accounting mechanism, as proposed by the Petitioners, will not restore those benefits to consumers, no matter how carefully measured or constructed. Interest payments calculated on the account balance cannot estimate the total harm caused by delaying the increase in consumer welfare. Accounting "measures" yield a static rendition of the dynamic changes in the market caused by access reductions and the related boost to competition. Rebates of access charges to purchasers of UNEs two years hence cannot reproduce the market stimulative effect that reductions will cause today.

Neither will an accounting mechanism ensure that "compensation is delivered precisely to the parties that deserve it."[7] To be blunt, some of today's customers will not be living when the Petitioners have finally exhausted their appeals and are required to rebate the funds. In the meantime, the benefits of lower long distance rates and increased competition will have been denied to these customers. This harm will be irreparable.

Second, consumers will be harmed since the continued application of access charges to UNEs will retard the development of exchange access service and local competition. The harm from the delay in competition may be difficult to estimate, but CPI expects that the value of a foregone

[7]Joint Petition, page 24.

increase in consumer welfare will be very large.

CONCLUSION

The Petitioners have failed to establish the conditions that must be met for the Commission to issue a stay of portions of its ***Access Charge Reform Order*** and its ***Price Cap Performance Review Order***. For the reasons presented above, the Commission should affirm its findings and conclusions in the relevant portions of these two orders and deny the Joint Petition for a Partial Stay and for Imposition of an Accounting Mechanism Pending Judicial Review filed by Southwestern Bell Telephone Company, Nevada Bell and Pacific Bell. The Partial Stay of these two orders, if granted by the Commission pending judicial review, will cause consumers irreparable harm because the development of local competition will be delayed and long distance rates will remain higher than they otherwise would be.

Respectfully Submitted,

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CERTIFICATE OF SERVICE

I, Jennifer A. Lowiec, do hereby certify that the foregoing "Opposition of the Competition Policy Institute to the Joint Petition for a Partial Stay and for Imposition of an Accounting Mechanism Pending Judicial Review," has been served June 9, 1997, to the parties of record.

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