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

In the Matter of	)	
	)	
Access Charge Reform	)	CC Docket No. 96-262
	)	
Price Cap Performance Review for Local Exchange Carriers	)	CC Docket No. 94-1
	)	
Transport Rate Structure and Pricing	)	CC Docket No. 91-213
	)	
End User Common Line Charge	)	CC Docket No. 95-72

COMMENTS OF THE COMPETITION POLICY INSTITUTE

IN SUPPORT OF THE PETITION FOR RULEMAKING

OF THE CONSUMER FEDERATION OF AMERICA, INTERNATIONAL COMMUNICATIONS ASSOCIATION AND NATIONAL RETAIL FEDERATION

January 30, 1998

COMMENTS OF THE COMPETITION POLICY INSTITUTE

A. Introduction and Summary

The Competition Policy Institute (CPI) is a non-profit organization that advocates state and federal policies to bring competition to telecommunications and energy markets in ways that benefit consumers. In these Comments, CPI supports the Petition for Rulemaking of the Consumer Federation of America, International Communications Association and National Retail Federation (Petitioners) to the extent that the Petitioners ask the Commission to undertake a rulemaking to consider additional prescriptive reductions to interstate exchange access charges.

In our Comments[1] in response to the Commission's original Notice of Proposed Rulemaking in this matter, CPI endorsed the general approach to access charge reductions adopted by the Commission: an initial prescriptive reduction followed by regulatory reliance on increasing market forces, backed up with the promise of additional prescriptive reductions if market forces proved to be insufficient to reduce access charges on a timely basis. While we disagreed with the level of initial access charge reductions eventually ordered by the Commission,[2] we thought the Commission adopted the right approach.

We have not abandoned our support for that basic approach. However, it now appears

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[1]See Comments of the Competition Policy Institute, January 29, 1997, 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 Providers. CC Dockets Nos. 96-262, 94-1, 91-213 and 96-263.

[2]CPI advocated that the Commission reduce interstate access rates by $2 billion beyond the reductions that would have occurred under price cap regulation. In its *Price Cap Fourth Report and Order*, the Commission ordered reductions of approximately $1.7 billion, of which about $700 million were previously scheduled annual rate cap reductions.

that consumers have been abandoned by market forces (and the Court of Appeals) — at least for the foreseeable future. CPI agrees with the Petitioners that the changed circumstances since the Commission issued its *First Report and Order*[3] require the Commission to review its decision to rely fundamentally on market forces to reduce access charges, at least in the intermediate term.

Specifically, the recent adverse rulings of the 8th Circuit Court of Appeals will retard or halt the entry of new local exchange competitors using unbundled network elements (UNEs). This means that the Commission cannot confidently rely on its assumption that UNEs will provide the engine for the growth of competition in exchange access services. Further, it appears that facilities-based competition for access services is insufficient to provide any real pressure for lower access rates at the present time. Mergers and consolidations among CLECs, IXCs and competitive access providers may indicate that growth in facilities-based competition in the access market will not provide any real pressure on access rates within a reasonable time frame.

Perhaps sooner than anticipated, the Commission must now review the assumptions that underlie its trust in market forces to bring down the level of access charges and consider additional prescriptive reductions. We do not suggest that the Commission must abandon its long term commitment to using market forces to reduce access charges, we simply suggest that the prospects of market forces offering relief in the short or intermediate term are now remote. We submit that the Commission should demonstrate its commitment to a path of reducing access charges to economic cost levels by considering additional prescriptive reductions now. In the

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[3]*First Report and Order*, In the Matter of Access Charge Reform, Price Cap Performance Review for Local Exchange Carriers, Transport Rate Structure and Pricing, End User Common Line Charges. CC Dockets Nos. 96-262, 94-1, 91-213 and 95-72.

Comments that follow, we offer several specific inquiries that the Commission should undertake as part of this consideration in a rulemaking proceeding.

B. In View of Changed Circumstances Since Adoption of the First Report and Order, the Commission Should Consider Additional Prescriptive Access Reductions

There is near uniform agreement that interstate access services are priced well in excess of their forward looking economic costs. This pricing distortion affects all levels of the market: end user consumers pay prices that are too high with the result that use of long distance service is artificially suppressed; interexchange carriers pay prices for access services that are artificially high and are induced to build or order access arrangements that are economically inefficient; finally, competition among full service providers of bundled services is distorted when one of the competitors, an incumbent LEC, is also charging excessively high prices for access services to its competitors. For these reasons, the merits of lower access charges need little elaboration here. The Commission recognized the central role that exchange access prices play in the new competitive scheme designed by Congress: "to fulfill Congress's pro-competitive mandate, access charges should ultimately reflect rates that would exist in a competitive market."[4] Perhaps the only contentious question left is how quickly, and by what mechanism, access charges should be reduced to competitive levels.

As for the mechanism, the Commission concluded in its *First Report and Order* that "we strongly prefer to rely on the competitive pressures unleashed by the 1996 Act to make the

[4] *First Report and Order*, ¶42.

necessary reductions."[5] As for the timing, the Commission acknowledged that "a market-based approach under this scenario may take several years to drive costs to competitive levels."[6] Finally, the Commission recognized that competition may not develop quickly for some access services and included a remedy in that circumstance: "In addition, we also adopt a prescriptive "backstop" to our market-based approach that will serve to ensure that all interstate access customers receive the benefits of more efficient prices, even in those places and for those services where competition does not develop quickly.[7]

It is important to note that the "market-based" pressure on which the Commission relies to provide price competition for access services actually requires the intervention of regulators (and lawmakers), viz., implementation of section 251 and section 252 of the Communications Act. In its *Local Competition Order*[8], the Commission correctly reasoned that new local exchange competitors should be able to acquire and assemble UNEs to provide both local exchange service and exchange access service without paying additional inflated access charges on top of the price paid for the UNEs. And if UNEs were priced at forward looking economic costs, it would follow that, incrementally, pressure would build on the access prices of incumbent local exchange carriers (ILECs) as the new entrants began to win local customers.

But this scheme obviously depends fundamentally on three premises: 1) that UNEs are

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[5]Id., ¶46.

[6]Id., ¶45.

[7]Id., ¶267.

[8]Implementation of the Local Competition Provisions of the Telecommunications Act of 1996, CC Docket No. 96-98, First Report and Order (rel. August 8, 1996) *aff'd. in part and vacated in part*, Iowa Util. Bd., 120 F.3d 753.

priced at forward looking economic costs; 2) that UNEs are readily available to new entrants at these prices; and 3) that new entrants are able to enter the local exchange service market and serve customers using UNEs. Unfortunately for consumers, the practice has not yet matched the theory. Several events have conspired to reduce or eliminate the assumed pressure that UNEs would exert on access prices. In short none of these three necessary conditions has been met.

First, and most importantly, judicial action by the Eighth Circuit Court of Appeals has invalidated the Commission's pricing rules for interconnection, including UNEs. The authority to set rates for UNEs has now passed to the state commissions. While many states have tended to follow the lead of the FCC by pricing UNEs to reflect economic costs, not all states have done so. In fact, at least one state cannot do so by state law.[9] Many states have not yet adopted final prices that comport with forward looking economic costs; in several cases even the interim decisions of state commissions are on appeal in state and federal courts. Simply put, there is no assurance that states will be able to follow through on the first assumption underlying the Commission's market-based approach. Without an assurance that states will (or even can) set UNE prices at economic levels, the Commission cannot reasonably base its plan for access charge reductions on the assumption that such forces will develop "quickly."

In the last year it has become clear that the second assumption—that UNEs will be readily available to new entrants—also fails to hold. Through its §271 proceedings, the Commission has become well acquainted with the shortcomings of some ILECs' provision of

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[9]At the urging of Southwestern Bell Telephone Company, the Arkansas General Assembly passed legislation requiring that the price of unbundled network elements reflect the "actual cost" incurred by the incumbent local exchange carrier. "Actual cost" is widely interpreted to refer to embedded costs and cannot be interpreted to mean to forward looking economic costs.

operating support systems (OSS). The failure of the incumbents to develop adequate OSS systems has sharply limited the ability of CLECs to enter the local market in a substantial way. The competitive forces "unleashed" by the 1996 Act have proven to be tame indeed, largely because of the failure of the industry to develop a system of back office processes capable of processing the orders that customers will place. As we pointed out in our Comments in the earlier proceeding, the task facing new entrants is enormous: to win the business of just 30% of the lines served by today's incumbent local exchange carriers, CLECs will need to win **42,000 new customer lines every business day for the next five years.** Given the churn of switching customers and the multiple enquiries required to switch and set up service for a new customer, OSS systems will have to be able to handle many times this number of transactions. It is manifestly evident that they cannot meet that challenge now. Without these systems, the Commission cannot assume that market-disciplining UNE-based competition will be a reality any time soon.

Finally, the November 1997 decision on reconsideration of the 8th Circuit Court of Appeals did further damage to the assumptions underlying the Commission's theory. By determining that the ILECs could unbundle previously bundled network elements, the Court severely limited the practical usefulness of UNEs as an entry strategy. This ruling effectively eliminated the "UNE platform" which had been identified by many CLECs as a feasible means to enter the local exchange market in a mass market fashion. In addition to negotiating and arbitrating the price of the UNEs, new entrants and state commissions also find themselves grappling with the new issue of special charges for "gluing" UNEs together. This judicial interpretation, if allowed to stand, seriously undermines the third premise of the theory: that new

entrants can actually use UNEs to enter the market.

The collective effect of these assaults on the provision of UNEs is to reduce the rate at which new entrants have been able to enter the local exchange market. This fact has not been lost on Wall Street. Merrill Lynch recently estimated the gross local market share gains from CLECs to be only about 2.7% of the entire local market by year end 1997 and only about 7.7% by the end of 1999. The net revenue losses to the ILECs are even smaller.[10] Since these estimates measure CLEC market share gains from all entry modes, (facilities-based, UNE-based and total service resale) the UNE-based competition is projected to be considerably less than the market's 7.7% projection two years from now.

C. As Part of Its Rulemaking, the Commission Should Undertake Certain Specific Inquiries.

CPI agrees with the Petitioners' fundamental point that the pressure on access rates brought by competition from UNEs is too small to be efficacious and promises to remain small for the foreseeable future. We agree that the Commission should commence a rulemaking to

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[10]On January 5, 1998, Merrill Lynch analysts observed: "Like 1997, we anticipate RBOC share losses will be less than originally expected over the new few years. We estimate that cumulative '97 *gross* local revenue share losses totaled 2.6% and will grow to 7.7% by year end '99. However, after accounting for wholesale revenue recovery (via resale and unbundling), we estimate *net* local share losses will total 1.1% in '97, increasing to only 2.7% by the end of '99. On an incremental basis, we estimate *net* local revenue share losses will total 0.5% in '97, increasing to only 0.8% in '98 and '99." (underlining added; italics in original.) "United States Telecommunications/Services; Telecom Services -- Local: 4Q Preview: Solid Year-End with 10% Average EPS Growth" Merrill Lynch, January 5, 1998.

consider additional prescriptive reductions in interstate carrier access charges. As described above, the key issue to be examined is whether market forces are likely to be effective in reducing access charges to economic costs within a reasonable time frame, given the changed circumstances since the Commission issued its *First Report and Order.*

To inform its judgment on this issue, CPI respectfully suggests that the Commission seek comment on at least the following specific issues:

1) The extent to which state commissions have adopted prices for UNEs that reflect forward looking economic costs; which states have adopted final prices; which orders have been appealed on the issue of UNE prices; whether there are legislative or other impediments to states' adoption of prices for UNEs that reflect forward looking economic costs;
2) The status of UNE "rebundling"; the availability of the UNE platform; the incidence of "glue charges" and the relationship of these charges to forward looking economic costs;
3) The level of actual UNE-based competition;
4) The adequacy of OSS systems to enable the purchase of UNEs;
5) Trends in access charge levels;
6) The extent to which actual access prices are below price cap index maximum prices;
7) Current and projected earnings levels of the price cap LECs;
8) The impact of consolidations and mergers among CLECs and competitive access providers on facilities-based and UNE-based competition for exchange access services.

D. Conclusion

Competition in the local exchange market will translate into lower exchange access

charges and, in turn, lower long distance rates. Consumers expect and deserve this outcome. The Commission's decision to rely on market forces to drive down access charges was a reasonable decision at the time, considering the assumptions. Unfortunately for consumers, those assumptions may no longer be valid. The Commission should acknowledge this reality and institute a rulemaking proceeding to consider additional prescriptive reductions in interstate access charges.

Respectfully Submitted,

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Certificate of Service

I, Bridget J. Szymanski, hereby certify that on this thirtieth day of January, 1998, copies of the foregoing Comments of the Competition Policy Institute were served by hand or by first-class, United States mail, postage prepaid, upon each of the following:

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