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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

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**
	)	
	)	**RM-9210**

To: The Commission

COMMENTS OF THE AMERICAN PETROLEUM INSTITUTE

AMERICAN PETROLEUM INSTITUTE

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Dated: October 26, 1998

TABLE OF CONTENTS

Page No.

EXECUTIVE SUMMARY ii

I. PRELIMINARY STATEMENT 2

II. THE COMMISSION'S EXPECTATIONS OF THE EMERGENCE OF ACCESS COMPETITION ARE INCREASINGLY UNREALISTIC 2

A. Premature Implementation of a Market-Based Approach Poses Significant Risks 2

B. The Commission's Market-Based Approach Is Replete With Flaws as it Ignores Present Marketplace Realities 3

C. For the Foreseeable Future Access Regulation Should Reflect the Absence of Meaningful Competition 6

1. Key Elements of the Local Competition Order Are, at Best, Delayed for Years as a Result of Appellate Rulings 6

2. Price Cap ILECs Continue to Secure Improved Rates of Return on Interstate Services and Many Users Are Paying More For Interstate Services 9

II. AN INTERSTATE PRODUCTIVITY FACTOR SHOULD BE USED 10

III. CONCLUSION 14

EXECUTIVE SUMMARY

Updating the record associated with its May 1997 access charge decisions will confirm that the market-based approach to interstate access services was premature. The Commission's *Local Competition Order* has not and is not reasonably expected to spur competition in the local services market within a reasonable time frame. Numerous reasons account for this unanticipated result. Moreover, the anticipated implicit "spillover effect" into the market for access services is not occurring.

The Commission need only fine tune its basic price caps scheme of regulation to ensure that interstate customers pay just and reasonable rates. The principal step is that the Commission focus exclusively on interstate productivity, as advocated by users and interexchange carriers for several years. This will support a substantial increase in the X-Factor. This step is amply supported by the Commission's longstanding jurisdictional focus on interstate rates and services. Further, the Eighth Circuit's recent opinion affirming the Commission's *Access Charge Reform Order* confirms that the Commission has broad discretion in ratemaking in those instances where jurisdictional issues are not implicated.

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To: The Commission

COMMENTS OF THE AMERICAN PETROLEUM INSTITUTE

The American Petroleum Institute (API), by its undersigned attorneys, hereby respectfully submits these Comments in response to the Public Notice released by the Federal Communications Commission (FCC or Commission) on October 5, 1998 in the above-captioned proceeding. API urges the Commission to increase the productivity factor, the so-called "X-factor" in the price cap formula applicable to the rates which the largest incumbent local exchange carriers (ILECs or incumbent LECs) charge for interstate access services.

I. PRELIMINARY STATEMENT

API is a national trade association representing approximately 300 companies involved in all phases of the petroleum and natural gas industries, including exploration, production, refining, marketing, and transportation of petroleum, petroleum products and natural gas. Among its many activities, API acts on behalf of its members as spokesperson before federal and state regulatory agencies. The API Telecommunications Committee is one of the standing committees of the organization's Information Systems Committee. The Telecommunications Committee evaluates and develops responses to state and federal proposals affecting telecommunications services and technologies used in the oil and gas industries.

II. THE COMMISSION'S EXPECTATIONS OF THE EMERGENCE OF ACCESS COMPETITION ARE INCREASINGLY UNREALISTIC

A. Premature Implementation of a Market-Based Approach Poses Significant Risks

Marketplace forces derive from competitive alternatives, a point the Commission has long recognized. " A goal of our policies is to promote economic efficiency, which includes regulating prices so that they emulate the economic performance of competitive markets as closely as possible until *actual competition arrives.*"[1/] The Commission has

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[1/] *Price Cap Performance Review for Local Exchange Carriers,* Second Further Notice of Proposed Rulemaking in CC Docket No. 94-1, Further Notice of Proposed Rulemaking (continued...)

also recognized that premature deregulation of prices can pose significant risks. "Deregulation before competition . . . can expose consumers to the unfettered exercise of monopoly power and, in some cases, even stifle the development of competition leaving a monopolistic environment that adversely affects the interests of consumers."[2] It is API's contention that the Commission's decision to adopt a market-based approach to access charge reform constituted a premature deregulatory measure, as viable competition in the interstate access service market is not a reality, particularly the market for interstate switched access service.

B. The Commission's Market-Based Approach Is Replete With Flaws as it Ignores Present Marketplace Realities

The Commission has stated that "if [it] successfully reform[s] [its] access charge rules to promote the operation of competitive markets, interstate access charges will ultimately reflect the forward-looking economic costs of providing interstate access services."[3] Specifically, the Commission has asserted that, "this is so, in part, because

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[1] (...continued)
in CC Docket No. 93-124 and Second Further Notice of Proposed Rulemaking in CC Docket No. 93-197, 11 FCC Rcd 858, ¶ 18 (1995) (*Price Cap Second FNPRM)* (emphasis added).

[2] *In re Access Charge Reform; Price Cap Performance Review for Local Exchange Carriers; Transport Rate Structure and Pricing; End User Common Line Charges*, First Report and Order (CC Docket Nos. 96-262, 94-1, 91-213, 95-72), FCC 97-158, 12 FCC Rcd No. 27 15982, ¶ 270 (released May 16, 1997) (*First Report and Order).*

[3] *Id.* at ¶ 262.

Congress established in the 1996 Act a cost-based pricing requirement for incumbent LECs' rates for interconnection and unbundled network elements, which are sold by carriers to other carriers."[4]

As API indicated in its initial comments in this proceeding, the market-based approach is fundamentally flawed. First, it proposes to rely on competitive forces to set rates for services which are not remotely competitive. Second, it proposes to rely solely on the prospect of competition in one potentially prospective open market, the local exchange market, to deregulate or substantially reduce regulation of ILEC services in the distinct exchange access market.

Alternatives to an ILEC's interstate switched access services do not exist now, nor will they exist in the immediate future. The anticipated, pro-competitive regime created in the 1996 Act and implemented in the *Local Competition Order*, has yet to be realized.[5] The prospects for resale-based local exchange service competition presented by the *Local Competition Order* are deferred indefinitely because of adverse court decisions, excessive wholesale prices and the broad resistance on the part of the ILECs in meeting the statutory criteria required for competitors to obtain the baseline level of ILEC commitments and support to compete in the local exchange market.

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[4] *Id.*

[5] See, generally, *Implementation of the Local Competition Provisions* in the Telecommunications Act of 1996, Order on Reconsideration, CC Docket No. 96-98, FCC 96-394, ¶13 (rel. Sept. 27, 1996) (hereinafter *Local Competition Order*).

It is unreasonable to believe that competitive pressures in the local exchange market that have yet to materialize are or will be sufficient to drive down rates for exchange access services. In fact, until a customer can actually obtain service from an alternate facilities-based provider, the entrenched provider has little if any incentive to reduce its rates or improve service. At the very most, the monopoly provider may engage in defensive posturing by preparing for rate reductions when a competitive presence appears imminent.

Nor is it realistic for purchasers of unbundled network elements ("UNEs") to provide the requisite marketplace discipline. These entrants do not offer a true competitive alternative to the incumbent LEC in the local service market. The ILEC continues to control necessary facilities and to generate revenue from the competitor's provision of services. Additionally, whatever limited ability entrants may have had to utilize UNEs to offer a competitive alternative to ILEC access services was squelched when the Commission determined that carriers may not use unbundled switching to substitute for switched access services:

> We thus make clear that, as a practical matter, a carrier that purchases an unbundled switching element will not be able to provide solely interexchange service or solely access service to an interexchange carrier. A requesting carrier that purchases an unbundled local switching element for an end user may not use that switching element to provide interexchange service to end users for whom that requesting carrier does not also provide local exchange service.[6]

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[6] *Local Competition Order* at ¶13.

Given these restrictions, it is unlikely that a competing provider of exchange access services entering a market could usurp significant LEC business, particularly switched access. Under the Commission's *Local Competition Order,* end-users must agree to obtain local service from the competing provider before that provider may offer efficiently priced access. In API's view only *actual* competition from facilities-based providers offers a competitive alternative that may impose sufficient marketplace discipline to drive prices towards forward-looking economic cost. By any measure, however, such actual competition is neither present nor foreseeable in the immediate future.

C. For the Foreseeable Future Access Regulation Should Reflect the Absence of Meaningful Competition

1. Key Elements of the Local Competition Order Are, at Best, Delayed for Years as a Result of Appellate Rulings.

As alluded to above, much of the Commission's rationale in adopting a market-based approach is centered around the regime envisioned in the *Local Competition Order*. Key elements of that Order included the FCC's determination that operational support services, operator services, signaling systems, and interoffice transmission facilities are network elements that ILECs must make available to competitors on an unbundled basis.[7]

Appellate rulings, however, have undermined the *Local Competition Order's* key tenets for implementing local competition. In 1997, the Court of Appeals reasoned that

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[7] See generally, *Local Competition Order*.

interconnection duties that ILECs owe to new market entrants under the 1996 Act, are intrastate in nature. The Court further reasoned that since section 2(b) of the Communications Act states that the Commission does not have jurisdiction over any intrastate communications services, the Commission's pricing regulations in the *Local Competition Order* exceeded its authority.[8] Unless and until the Supreme Court determines that interconnection rates for local service and resale are under the Commission's jurisdiction, resale-based competition and local competition based on efficiently priced UNEs are inconceivable. Even if revised by the Supreme Court, local service competition remains a desired goal, not a reality.

Over and above *Iowa Utilities Board*, purchasers of unbundled switching are precluded from using that unbundled element as a substitute for the ILEC's switched access services.[9] Thus, as noted above, the predicate for the market-based approach does not exist.

Further evidencing the futility of the Commission's "market-based" approach is the fact that no RBOC has satisfied the baseline criteria established by Congress in 1996 required to secure interLATA entry. Even in the recent *BellSouth Application* wherein six of the checklist requirements were met, the Commission found that BellSouth failed to provide competing carriers with nondiscriminatory access to unbundled network

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[8] *Iowa Utilities Board v. FCC*, 120 F.3d 753 (8th Cir. 1997) *cert. granted*, 97-0826 (Jan. 26, 1998). See also *Iowa Utilities Board v. FCC*, 135 F.3d 535 (8th Cir. 1998) (granting motions to enforce mandate in *Iowa Utilities Board v. FCC*, 120 F.3d 753).

[9] *Local Competition Order* at ¶ 13.

elements.[10] RBOCs have chosen not to satisfy the competitive checklist which is the benchmark for a potentially competitive local exchange market.

The Commission can no longer deny the reality that wholesale prices for local services and UNEs are too high for local service resale to succeed. AT&T and the previously independent MCI have publicly acknowledged resale-based competition in the local market is not viable. AT&T has embarked on a strategy of multi-billion dollar acquisitions of Teleport Communications Group (acquisition-complete) and Tele-Communications, Inc. ("TCI") (acquisition-pending) to establish a viable, facilities-based network in selected markets. Thus, the barriers to viable entry into the local service and the related exchange access markets are far more substantial than the Commission may have believed in May of 1997. These marketplace realities confirm that the competitive model is premature, at best.

The experience of API members is consistent with these general trends. API member companies continue to rely on ILECs almost universally for local service and switched access service. Competitive dedicated access is confined largely to urban areas. Very little has changed in this regard since either passage of the 1996 Act or adoption of Access Charge Reform in May of 1997.

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[10] *Application of BellSouth Corporation, BellSouth Telecommunications, Inc., and BellSouth Long Distance Inc. for Provision of In-Region, InterLATA Services in Louisiana*, Memorandum Opinion and Order, CC Docket No. 98-121, FCC 98-271, ¶10 (rel. Oct. 13, 1998).

2. Price Cap ILECs Continue to Secure Improved Rates of Return on Interstate Services and Many Users Are Paying More For Interstate Services

LEC interstate earnings reported from 1990-1997 are significantly higher than any incentive plan would have imagined, with an average return of 15.64 percent and total earnings of almost $2.4 billion in excess of an 11.25 percent rate of return in 1997. ILECs' interstate earnings which have increased steadily form 11.81 percent in 1991 to 15.64 percent in 1997, are, in themselves, compelling evidence that the Commission's offset productivity has been set too low.[11/] Were the interstate access markets competitive or the productivity factor set at an appropriate level, the ILECs' rates of return for interstate access services would not be improving.

The notion that potential competition or the current price caps regime promotes competitive pricing is very difficult for a large plurality, if not a majority, of business users to accept. The marketplace reality for these users is that costs of their interstate telecommunications services are increasing. This is due in part to a number of related Commission actions decided in May 1997. The Commission established its Universal Service Fund (USF) and primary interexchange carrier charge ("PICC"), and set in motion increases in the multiline Subscriber Line Charge (SLC). As reflected in their tariffs, USF fund payments are typically flowed through by interexchange carriers and paid by business

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[11/] Information excerpted from written ex parte of Care Coalition in CC Docket No. 94-1, filed August 11, 1998.

users. Apart from the largest users, many business customers are paying more for interstate services today than in early 1997 because of the imposition and restructuring of these charges. Competitive entry is not occurring at the requisite level to lower access rates so that the total costs for interstate telecommunications services for many business users are stabilizing or declining.

API does not intend to reargue the merits of the policy determinations that lead to the imposition of these charges or creation of these programs. However, API does believe that were access charges set at appropriate levels, this major cross-section of users would be realizing overall reductions in the cost of interstate telecommunications services.

II. AN INTERSTATE PRODUCTIVITY FACTOR SHOULD BE USED

In the *First Report and Order*, the Commission concluded that it should prescribe an X-Factor on the basis of aggregate company factor productivity studies, the difference between LEC input price changes and input price changes in the economy as a whole, and the 0.5 percent consumer productivity dividend (CPD).[12] In the companion order, the *Price Cap Fourth Report and Order*, the Commission found that this results in an X-Factor prescription of 6.5 percent.[13] API urges the Commission to revisit its decision on aggregate total company productivity and adopt an interstate-only approach.

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[12] *First Report and Order* at ¶ 286.

[13] *Id.*

API would prefer a less complex approach to calculating an X-Factor than the TFP method. Nonetheless, it would find that method acceptable if, when calculating that factor, the Commission (1) relies on interstate data only; and (2) favors consumer interest by erring on the high side. Further, the various "inputs" into the proper TFP methodology must reflect realistic economic data and assumptions. These measures enhance the economic validity of the X-Factor and ensure that consumers benefit from productivity gains as intended.

In terms of rate regulation, FCC policies have only extended principally to interstate revenues, costs and investments since the enactment of the 1934 Act. Consistent with this approach, the goals of economic validity, consumer benefit, and administrative simplicity will be furthered by the adoption of an interstate-only TFP-based X-Factor. Indeed, in promulgating LEC price cap regulation, the Commission recognized that higher interstate productivity should be reflected in the then new price cap scheme.[14/] Based on data submitted by members of the CARE Coalition, LEC growth and productivity gains have been largely confined to interstate services. The inclusion of intrastate factors in the TFP output index skews the results and ensures a systematic downward bias in TFP.

[14/] *In the Matter of Policy and Rules Concerning Rates for Dominant Carriers*, Second Report and Order, CC Docket No. 87-313 (1990).

This downward bias leads, ultimately, to interstate rates that are higher than warranted, calling into question whether those rates are indeed, just, reasonable, and nondiscriminatory.

The downward bias diminishes the economic validity of the TFP because the resultant higher rates send incorrect market signals. A mechanism that generates incorrect market signals is an impediment to economic development and is inconsistent with the Commission's preference to "minimize distortion of competitive marketplace forces in telecommunications."[15]

Exclusive reliance on interstate data will permit long overdue adjustments to the X-factor, which will provide the necessary downward pressure on access rates. Both individually and as a member of the CARE Coalition, API has advocated a significant X-Factor increase. As stated above, because the X-Factor affects interstate rates only, API has also advocated an interstate-only productivity data. TFP studies filed by members of the CARE Coalition show that the LECs have been able to achieve interstate productivity of as much as 9.9 percent.[16]

The Eighth Circuit's recent decision affirming the *Access Charge Order* unequivocally confirms the Commission's authority to implement modified approaches to rate regulation.[17] Specifically, the court found that the FCC's decision to require LECs

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[15] *First Report and Order* at ¶ 94.

[16] Presentation of CARE Coalition in CC Docket No. 94-1, filed April 16, 1996.

[17] *Southwestern Bell Telephone Co. v. FCC*, 153 F.3d 523 (8th Cir. 1998) (denying (continued...)

to adjust their price-cap indices downward to reflect the completed amortization of extraordinary, one-time equal access conversion expenses was neither arbitrary nor capricious. "[T]he mere change of an administrative opinion after a lawful reconsideration can hardly be arbitrary and capricious on its face." *Southwestern Bell Tel. Co. v. FCC*, 138 F.3d 746, 753 (8th Cir. 1998). The court noted the Commission's determination that upon further reflection, the downward adjustment, although rejected in past decisions, was an equitable and necessary one. It is submitted that a reviewing court would accord the same deference to the Commission's informed judgement with respect to the fine-tuning of the Commission's price caps framework in the near future.

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[17] (...continued)
petitions for review of the FCC's *Access Charge Reform Order*, which overhauled the Commission's rate structure rules governing interstate access charges).

III. CONCLUSION

WHEREFORE, THE PREMISES CONSIDERED, The American Petroleum Institute respectfully urges the Federal Communications Commission to revisit its recent policy determinations on interstate access regulation and take action consistent with the views expressed herein.

Respectfully submitted,

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Dated: October 26, 1998

CERTIFICATE OF SERVICE

I, Sana D. Coleman, hereby certify that I have served a copy of the foregoing "Comments of the American Petroleum Institute" on this 26th day of October, 1998, upon the following parties by hand:

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