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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
	)	
A Request For the Amendment of the Commission's Rules Regarding Access Charge Reform and Price Cap Performance Review For Local Exchange Carriers	)	RM-9210

ERRATUM

Ameritech[1] submits this erratum with respect to its comments filed yesterday in the above-captioned proceeding. Specifically, Ameritech hereby amends its comments as follows: on page two of the comments, in the second line from the bottom of the page, the word "lower" is changed to "increase".

A copy of the corrected page and a complete copy of the comments, minus the attachments, including the corrected page are attached hereto.

Respectfully submitted,

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Dated: October 27, 1998

[1] Ameritech means: Illinois Bell Telephone Company, Indiana Bell Telephone Company, Incorporated, Michigan Bell Telephone Company, The Ohio Bell Telephone Company, and Wisconsin Bell, Inc.

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I. INTRODUCTION AND SUMMARY.

Evidence produced almost a year ago in response to the CFA and MCI petitions showed that, despite petitioners' complaint to the contrary, competition is thriving. Updated evidence merely confirms the fact that competition continues to grow and that, therefore, there is no reason for the Commission to abandon its market-based approach to access reform by prescribing access rates.

In addition, existing price cap regulation has resulted in substantial access rate decreases overtime. This, coupled with the fact that interexchange carriers ("IXCs") have been reluctant to flow through the full effect of these rate decreases, means only that there is no policy reason for the Commission to force a lowering of access charges through the prescription of rates. Moreover, prescribing rates will only ensure a distortion of the market that will result in disincentives to competitive entry.

Instead of prescribing rates, the Commission should act immediately to complete the implementation of its market-based approach by adopting a pricing flexibility framework which will reflect the realities of a competitive marketplace. Ameritech's pricing flexibility proposal provides such a framework with three phases implemented separately for transport services and switched services. The criteria or triggers for each phase are easily verifiable and reasonably measure differential degrees of competitive pressures. Implementation of such framework will permit customers to realize the benefits of full competition that will result from the ability of price cap carriers to compete on basis of price.

Further, the Commission should resist calls to increase the price cap X-factor. As the evidence offered by USTA shows, the existing 6.5% productivity factor is in fact too high.

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COMMENTS OF AMERITECH

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COMMENTS OF AMERITECH

Ameritech[1] submits these comments in response to the requests articulated in the Commission's recent Public Notice[2] to update the record in the above-captioned proceedings and to comment on the petitions of CFA, *et al.*, and MCI concerning the prescription of access rates,[3] on proposals by Ameritech and Bell Atlantic for phased-in pricing flexibility as competition increases, and on possible revision of the price cap X-factor.

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[1] Ameritech means: Illinois Bell Telephone Company, Indiana Bell Telephone Company, Incorporated, Michigan Bell Telephone Company, The Ohio Bell Telephone Company, and Wisconsin Bell, Inc.

[2] "Commission Asks Parties to Update and Refresh Record for Access Charge Reform and Seeks Comment on Proposals for Access Charge Reform Pricing Flexibility", CC Docket Nos. 96-262, 94-1, 97-250, RM-9210, Public Notice, FCC 98-256 (released October 5, 1998) ("Public Notice").

[3] Petition of CFA, *et al.*, for Rulemaking, RM-9210, filed December 9, 1997; MCI Emergency Petition for Prescription, CC Docket No. 97-250, CCB/CPD 98-12, filed February 24, 1998.

I. INTRODUCTION AND SUMMARY.

Evidence produced almost a year ago in response to the CFA and MCI petitions showed that, despite petitioners' complaint to the contrary, competition is thriving. Updated evidence merely confirms the fact that competition continues to grow and that, therefore, there is no reason for the Commission to abandon its market-based approach to access reform by prescribing access rates.

In addition, existing price cap regulation has resulted in substantial access rate decreases overtime. This, coupled with the fact that interexchange carriers ("IXCs") have been reluctant to flow through the full effect of these rate decreases, means only that there is no policy reason for the Commission to force a lowering of access charges through the prescription of rates. Moreover, prescribing rates will only ensure a distortion of the market that will result in disincentives to competitive entry.

Instead of prescribing rates, the Commission should act immediately to complete the implementation of its market-based approach by adopting a pricing flexibility framework which will reflect the realities of a competitive marketplace. Ameritech's pricing flexibility proposal provides such a framework with three phases implemented separately for transport services and switched services. The criteria or triggers for each phase are easily verifiable and reasonably measure differential degrees of competitive pressures. Implementation of such framework will permit customers to realize the benefits of full competition that will result from the ability of price cap carriers to compete on basis of price.

Further, the Commission should resist calls to increase the price cap X-factor. As the evidence offered by USTA shows, the existing 6.5% productivity factor is in fact too high.

II. THE COMMISSION SHOULD CONTINUE TO REFUSE TO PRESCRIBE ACCESS RATES.

A. Competition Has Expanded Significantly Since the Adoption of the Access Charge Reform Order.

In its Access Charge Reform Order,[4] the Commission specifically rejected requests for the prescription of access rates to forward-looking costs. As the Commission noted:

> We decide that adopting a primarily market-based approach to reforming access charges will better serve the public interest than attempting immediately to prescribe new rates for all interstate access services based on the long-run incremental cost or forward-looking economic cost of interstate access services. Competitive markets are superior mechanisms for protecting consumers by ensuring that goods and services are provided to consumers in the most efficient manner possible and at prices that reflect the cost of production. Accordingly, where competition develops it should be relied upon as much as possible to protect consumers and the public interest. In addition, using a market-based approach should minimize the potential that regulation will create and maintain distortions in the investment decisions of competitors as they enter local telecommunications markets.[5]

The Commission was rightly concerned about the "distortions" that would be created by regulations. The Commission was specifically concerned that:

> precipitous action could lead to significant errors in the level of access charge reductions necessary to reach competitive levels. That would further impede the development of competition in the local markets and disrupt existing services. Consequently, we strongly prefer to rely on the competitive pressures unleashed by the 1996 Act to make the necessary reductions.[6]

Yet, the ink was barely dry on the Access Charge Reform Order when CFA and MCI in separate petitions asked the Commission to find that competition was not working and that, therefore,

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[4] *In the Matter of Access Charge Reform, etc.*, CC Docket No. 96-262, *et al.*, First Report and Order, FCC 98-158 (released May 16, 1997) ("Access Charge Reform Order").

[5] *Id.* at ¶263.

[6] *Id.* at ¶46.

access rates should be prescribed.[7] The evidence at the time proved them wrong; and, since then, the evidence shows that competitive pressure on incumbent local exchange carrier ("ILEC") services is increasing at an even faster rate.

At the time of the comments on the CFA and MCI petitions, the AT&T-Teleport merger and the MCI-WorldCom merger (incorporating the previous WorldCom-MFS and WorldCom-Brooks mergers) were pending. Since that time, those mergers have been completed and AT&T and TCI have announced their merger plans making an already giant AT&T an even bigger player in the world of telecommunications. These mergers are not without effect in the access world. As Ameritech noted in its comments on the CFA petition, the total savings in access charges that the merging parties estimated from the self-provision of access as a result of their unions amounts to nearly $1.8 billion in 1998, growing to $3.3 billion in 2002. As shown on Attachment A, more than 80% of Ameritech's estimated carrier access revenue is potentially affected by merger activity.

Clearly, these mergers will result in a significant reconfiguration of the market for ILEC access services. In the case of AT&T, Teleport's extensive network of fiber and switches in the Ameritech region is now available for AT&T's use. Moreover, AT&T has stated its intent to upgrade TCI's cable distribution facilities to handle two-way telecommunications and thus to bypass the ILEC local loop entirely.[8] Similarly, in the case of MCI-WorldCom, the fiber and

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[7] See, note 3, *supra*.

[8] AT&T, in its comments submitted in response to the Commission's §706 Notice of Inquiry (at note 42), stated:

> As AT&T's Chairman C. Michael Armstrong recently testified before the Senate Judiciary Committee, Subcommittee on Antitrust, Business Rights and Competition, the TCI acquisition changes the equation for broad-based telecommunications competition in the local exchange. After $1.8 billion in network upgrades is completed in the coming three years, and AT&T adds equipment that permits these upgraded facilities to be used for the provision of telephony services, AT&T will have an avenue to provide high-

switching facilities of the former MFS, Brooks, and MCImetro can now be utilized for the benefit of the combined MCI-WorldCom access needs.

Direct competition for ILEC dedicated service has been growing rapidly. Attachment B shows, for the seven major market areas in the Ameritech region, the growth in competitively provided transport services. The data tells a significant story -- with competitors holding 60% of DS1 equivalents in Chicago and 44% in the top seven market areas combined. In addition, investment by competitors in fiber facilities has increased by 38% since 1996, as shown on Attachment C. Further, Attachment D shows the increase in the number of buildings on competitive providers' networks. Where the building is "on net", the entire traffic from that building may be routed directly to an IXC's point of presence ("POP") using the facilities of the competitive provider.

However, direct competition with ILEC access services is only one source of competition for those services. Obviously, to the extent that CLECs are successful in capturing the local exchange business of end users, either on a facilities basis or through unbundled network elements, they will also provide access services between those end users and interexchange carriers. While CFA and MCI in their petitions complain of BOC/ILEC court activity that would stifle local competition, the facts show otherwise. In the Ameritech region, local exchange competition is vibrant. Attachment E shows that competitors' switch deployment has ballooned from 15 in 1996 to more than 30 currently. Attachments F and G update information Ameritech submitted in response to the CFA petition. Attachment F shows the status of the

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speed data and telephone services over two-way broadband facilities to the approximately 17 million households currently passed by TCI. . .

substantial CLEC activity in the Ameritech region. The presence of these CLECs has not been without effect. Attachment G shows vividly that the growth in cumulative[9] end office integration trunks, unbundled loops, resold lines, and Ameritech-provided competitive lines in Ameritech-served areas is astounding. When the information was filed with Ameritech's opposition to the CFA petition, December, 1997, data showed 95,019 end office integration trunks. By September 1, 1998, that figure had exploded by over 200% to 223,160. Similarly, cumulative unbundled loops, resold lines, and Ameritech-provided competitive lines each almost doubled in the first eight months of this year. Unbundled loops grew from 68,636 to 114,942. Resold lines grew from 489,174 to 911,260.[10] And total competitive lines provided by Ameritech (unbundled loops plus resold lines) increased from 557,810 to 1,026,202.[11]

These figures, of course, do not capture the effect of total facilities-based bypass. As noted above, large customers with buildings on competitors' fiber-based networks will originate and receive traffic that never touches the Ameritech network. And, as noted above, AT&T's merger with TCI will enable it to utilize cable distribution facilities for a complete facilities-based bypass in the residential context as well. In other words, an updated record in these proceedings shows only that CFA's and MCI's "sky is falling" predictions of the death of

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[9] *I.e.*, not net of any disconnect activity.

[10] Ameritech is aware that it retains the access service on resold lines. Nonetheless, the amount of resale competition is still indicative of competitive pressure on access services because resale is a stepping stone to UNE-or facilities-based local exchange competition.

[11] Ameritech also submits for consideration, as Attachment H, its Section 271 Status Report, revised as of September 1, 1998, which demonstrates Ameritech's checklist compliance as of July 1, 1998. Of particular note is the estimate of bypass lines at 402, 236. The number of in-place collocation arrangements, listed in the report at page 5 as 447 as of July 1, had grown to 593 by September 1. By late September, there were 950 arrangements either in-place or in-process in 339 wire centers, giving collocating carriers accessibility to 13 million access lines -- 65% of Ameritech's total.

competition were completely disconnected from reality. Instead, the proliferation of competition has validated the Commission's initial decision to rely on market forces.

B. Prescription Is Not Necessary Since Price Cap Regulation Is Lowering Access Rates.

The petitioners' argued that there is an immediate need for the Commission to prescribe lower access rates. However, as Ameritech pointed out in its opposition to MCI's petition, Ameritech's interstate access rates were lowered by approximately $200 million as a result of the 1997 annual access filing and the access reform filing effective January 1. In addition, Ameritech's 1998 annual access filing resulted in $99.3 million of additional rate reductions as well. Attachment I shows graphically the dramatic reduction in Ameritech's MOU equivalent access rates since the inception of price caps. Those rates have fallen by approximately 73 % over that period of time. Even if the PICC is factored in, the reduction is still a substantial 60%.[12]

In addition, Attachment J shows dramatically how the "gap" between the X-factor and inflation has grown. Since the inception of price caps, the base line productivity factor has grown from 3.3% to 6.5%. At the same time, inflation (GDP-PI) has cascaded from 4.8% in 1991 to an estimated 1.3% in 1999. The differences between these two figures is the effective decrease in price cap indices called for by the price cap formula. As can be seen on Attachment K, as currently configured, price cap regulation has already required greater access rate

[12] AT&T itself has admitted that access charges have been significantly reduced. The October 20, 1998 edition of Communications Daily reported:

> [AT&T] said access charges and interconnection expenses as a percentage of long distance revenues fell to 34.7% in the first half from 37.4% a year earlier on cuts in per-min. access charges that were offset in part by primary interexchange carrier charges.

decreases year-over-year without the necessity of the Commission's becoming involved in the problematic cost calculations that would be necessary for represcribing rates.

However, putting aside these substantial rate reductions, Ameritech's access rates are at a reasonable level. The Commission should be equally concerned with the level of investment and competition if it fails to provide a mechanism to phase out the market distortions caused by price regulation.

C. Prescription of Access Rates Will Not Benefit Consumers.

Any IXC's stated willingness to flow through access rate reductions to end users must be questioned. In this regard, Ameritech commends to the Commission for its consideration the two studies recently filed by USTA -- "AT&T MCI, and Sprint Failed to Pass Through the 1998 Interstate Access Charge Reductions to Consumers" and "Assessment of AT&T's Study of Access Charge Pass Through," both by Paul S. Brandon and William E. Taylor and both dated October 16, 1998. The studies demonstrate that consumers have been left out of a substantial portion of the benefits of access rate reductions.

Further, MCI, in its petition, has stated:

> [B]ut the current level of interstate access charges constrains the financial resources available for IXCs to pursue a facilities-based local strategy . . . as long as access rates remain above forward-looking economic costs, RBOCs will control local bottleneck facilities and continue to line their pockets with capital that long distance companies could otherwise invest in local facilities.[13]

Thus, MCI appears to be saying that any access charge reductions that would result from the Commission's prescription of access rates to forward-looking costs would be kept by the IXCs and used for strategic business purposes -- not flowed through to their interstate service

[13] MCI petition at 7-8.

customers.

That IXCs have no intention of automatically flowing through access charge reductions in their rates for end user services is perhaps most vividly proven by the testimony of Mr. Dennis L. Ricca of MCI. In the context of a case before the Michigan Public Service Commission dealing with the intrastate presubscribed interexchange carrier charge ("PICC"), when asked if Ameritech Michigan's July, 1997, access reduction was "passed through" by MCI, Mr. Ricca answered:

> No, that's not the way the market works, Mr. Anderson, and if you think that because we get a reduction, that we gladly flow that through to the consumers because we're good guys, that's not the case. We hold on to every penny that we can.[14]

Moreover, further in his testimony, Mr. Ricca essentially admits that MCI will lower its rates only if AT&T does:

> I think I indicated earlier we're going to hold on to every penny that we can, but I think the market will force flowthrough, and I think it will force the flowthrough in the per-minute rates that we charge. . . [I]f you have companies like AT&T who are saying they're committed to flowing it though, I can tell you that MCI historically has prided itself on pricing below AT&T. So that if AT&T makes a change in its rates that flows through any reduction, there will be a competitive response from MCI.[15]

Mr. Ricca's testimony, of course, constitutes a candid admission that the interexchange market is not working. There is no price competition. AT&T is clearly the price leader creating an umbrella under which everybody else can operate freely. If AT&T decides not to change price, nobody else will. Moreover, as the Brandon and Taylor studies demonstrate, IXC prices have not completely reflected the access charge reductions to date. In this light, there is nothing from

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[14] Attachment L at 643-644.

[15] *Id.* at 647.

a policy perspective to argue in favor of a clear "need" to prescribe lower access rates just so that IXCs can line their pockets.

If the Commission's goal is to force lower prices for interstate message telephone services ("MTS"), the answer does not lie in prescribing lower access charges -- unless the Commission also compels IXCs to flow those access rate reductions through. As Mr. Ricca noted, the IXC's first motivation is to "hold on to every penny." It is also apparent that, unless AT&T makes a move, no one else will. There is a clear understanding among IXCs that there is certainly no need to lower rates if AT&T does not make the first move. Thus, there is absolutely no justification for the Commission to compel lower access charges to drive lower interstate MTS rates unless it also compels IXCs to flow those rate reductions through to end users on an equitable basis.

D. Prescription of Access Charges Will Hurt, Not Help, Competition.

However, there is a better and more compelling reason for the Commission not to prescribe lower access charges. That is simply the fact that such a move will actually hinder the competitive provision of exchange access and local exchange services.

The continued imposition of administered prices over open market forces, even after the opening of telecommunications markets, damages the development of competition and harms consumers. Prescribing rates to recover the forward-looking costs of the most efficient conceivable firm would only stifle facilities-based competition and network investment. That is because such a prescription would not and could not replicate the actual operation of the market. Even if it were possible to determine the efficient, forward-looking costs of providing service (which it is not), prescribing rates to these levels could lead to serious adverse consequences.

In competitive markets, there is a distribution of firms with different costs and operating structures. A prevailing market price is determined by the interaction of all suppliers and consumers and, over the long run, will be at the level of the actual costs of the least efficient firm able to stay in the market and vie for customers. In other words, although over time prices tend to move toward cost in a competitive market, they never in the long run settle at the incremental costs of the most efficient provider. This is an efficient result because it provides profit incentives for new entrants and for increased investment by incumbent firms.[16]

Thus, prescribing rates to the forward-looking costs of the most efficient competitor would doom competition and investment. It would make it impossible for Ameritech and other ILECs to recover the costs they have prudently incurred in the provisioning of access services, placing a chill on future network investment. However, it would also preclude, or greatly discourage, entry by new competitors by eliminating any profit that they would hope to earn upon entry. Indeed, the only entry that could take place would be by the hypothetically "most efficient" competitor, and then it would do so with the prospect of earning a return only sufficient to recover its capital costs.

But prescribing rates based on the cost of the least efficient firm would not work either. Such cost would either be unascertainable or the process would lead to an efficient outcome only by accident, and then that condition would not be sustainable over time due to the dynamic nature of the market. In other words, rates prescribed based on any cost methodology would be set either too high or too low leading to inefficient or too little entry and too much or too little

[16] See reply statement of Dr. Kenneth Gordon, filed with Ameritech's reply comments in CC Docket No. 96-262, filed February 14, 1997.

investment. In fact, if prices were set at forward-looking incremental costs, it is likely that little or no real competition would develop since there would be no economic incentive to drive it.

Thus, the Commission should emphatically decline to engage in the process of market prediction by prescribing already low access rates to an even lower level at which it may think they belong. Rather, since those rates have already steeply declined because of the operation of the current regulatory structure, it should permit that structure to operate and to be supplemented with additional pressures from competitive entrants who seek to provide services at a lower rate because of their own efficiencies.

III. THE COMMISSION SHOULD FULFILL THE PROMISE OF ITS ACCESS REFORM ORDER AND COMPLETE THE IMPLEMENTATION OF ITS MARKET-BASED APPROACH.

A. The Commission Must Abandon its Complete Reliance on Price Regulation.

In the Access Reform Order, the Commission indicated its intent to rely on market forces to govern access rates, yet it deferred the details of this market-based approach to a later proceeding.[17] In the Access Reform Notice, the Commission proposed to implement regulatory reforms as ILECs demonstrated that their local markets have achieved "pre-defined, specific transition points, or 'competitive triggers.'"[18] The Commission then proposed triggers based in large part on the §271 "checklist" and opined that:

> We anticipate that at least some incumbent LECs reasonably should be able to satisfy these conditions during 1997. (Emphasis added.)[19]

[17] Access Reform Order at ¶270.

[18] *In the Matter of Access Charge Reform, et. al.*, CC Docket No. 96-262, et al., Notice of Proposed Rulemaking, FCC 96-488 (released December 24, 1996) ("Access Reform NPRM") at ¶162.

[19] *Id.* at ¶163.

Moreover, the Commission proposed that, in its Phase 1 -- Potential Competition, it would eliminate the bans against geographic de-averaging, volume and term discounts, and contract tariffs and individual requests for proposal responses, and restraints on new, innovative access services.[20]

It is now two years later, and it is more imperative today that the Commission implement a mechanism by which ILECs can obtain pricing flexibility commensurate with a demonstration of competition.

As noted above, competition is expanding by leaps and bounds. By refusing to prescribe rates down to hypothetical forward-looking economic costs, the Commission will avoid creating a significant barrier to competitive entry. However, that fulfills only part of the Commission's obligations. If the Commission maintains the current regulated structure for access services subject to competition, it will deprive customers of the benefits that would be achieved by permitting ILECs the ability to respond competitively in competitive situations -- denying customers the full benefits of competition.

One of the enduring legacies of telecommunications regulation is that virtually every service price has been distorted by regulatory intervention and the distortions are proving to be unsustainable. The Commission needs to implement a sustainable market-oriented pricing model in light of the opening of markets to competition. A mandatory decrease in access prices does not move the system toward sustainability because it is not market-driven nor does it address the complete system of administrative ratemaking. Moving to a sustainable and welfare-

[20] *Id.* at ¶168.

enhancing pricing structure requires that the entire system of administered pricing be eliminated totally, not just one part, in order to prevent the rise of distortions that will affect both current consumer welfare and the development of the next generation infrastructure.

In most areas of the country, regulatory intervention has resulted in a pattern of non-market prices: businesses, urban residences, and long-distance users pay more than they would in a free market while those in rural areas, non-urban residences, and those who do not use long-distance services pay less than they otherwise would. Prior to the 1996 Telecom Act, LECs had two roles in the administered rate system. The first was to participate in the market itself providing exchange and exchange access services as common carriers. The second was to serve as the clearinghouse for administered pricing. In this latter role, the LEC took in subsidies from one sector and passed them through to another, all at the direction and oversight of the administrative agency.

This dual role -- provider of specific telecom services and clearinghouse for social pricing of all telecom services -- theoretically can be successful if the system is closed, like a hydraulic system. However, as in any real market, the system is never closed, there are numerous leaks. And so it was with telecommunications. PBXs and other private networks helped many business customers -- subsidy providers -- take their local exchange business off-system. Policies at both the federal and state levels were actively developed to accommodate the subsidy providers' desires for lower prices. For example, interconnection for CAPS created opportunities for businesses to offload exchange access from the nominally closed system. Despite these policy-sanctioned and policy-encouraged leaks to the system, policy was never developed to systematically address the impact of leakages on the sustainability of the

administered rate system itself.

In part, the lack of an overarching policy for ending the administered rate system is due to the fact that there are multiple jurisdictions involved. The federal jurisdiction has the opportunity to lower rates and thereby gain popular credit, while the state jurisdictions face the prospect of raising rates to market levels and thereby earn popular opprobrium.

The fact that the clearinghouse role is intertwined with the role of market participant creates a moral hazard problem for policy makers: the productivity and profitability created from the successful management of the commercial business can be captured through administrative rules to subsidize the clearinghouse function. Social welfare is maximized when all prices are at competitive market levels, not just some of them. Policy that reduces some administered prices to gratify one constituency without permitting the prices of other services to increase simply uses the commercial successes of the LEC to subsidize the social clearinghouse function.

B. The Commission Should Quickly Adopt a Pricing Flexibility Framework that Reflects Changes in the Competitive Environment.

It is important, therefore, that the Commission act swiftly to fulfill the promise of its market-based approach to access reform and implement a structure by which price cap LECs may modify their prices to respond to market conditions. It is especially important that a clear standard be identified in the context of a framework that is simple to administer -- to avoid any unjustified regulatory delay to eliminating unnecessary market-distorting regulations.

In this regard, the Commission has specifically solicited comment on the pricing flexibility proposals of Ameritech and Bell Atlantic. Ameritech's proposal is summarized in the 2-page matrix included as Attachment M and described in detail in Attachment N. The plan is

broken down into three phases which would be implemented separately for transport services and switched services. Interexchange services and directory assistance are treated separately. The criteria or triggers for each phase are easily verifiable and reasonably measure differential degrees of competitive pressure.

Ameritech's proposal deals with three important matters:

1. Pricing flexibility as a result of different levels of competitive pressure;
2. The phasing out of the price cap X-factor with increased competition; and
3. The ultimate removal of services from price cap regulation.

Appropriate pricing flexibility is necessary to respond to market place realities. It is also necessary to provide customers with the full benefits of competition. It is important that the Commission act quickly to eliminate fundamental discrepancies with state efforts to modify regulations to accommodate competitive reality. Attachment O, material previously included with Ameritech's June 5, 1998, ex parte filing, shows state provision of competitive pricing flexibility for exchange based services. Attachment P, Ameritech's September 11, 1998, ex parte material, shows in greater detail the flexible treatment of competitive services in Illinois. Maintaining a federal regulatory regime that ignores competitive reality puts customers in a difficult position when it comes time to telling the ILEC about the jurisdictional nature of the traffic on their dedicated services.

Further, consistent with recognizing the very real effects of competition on ILEC services and pricing, the X-factor should be modified accordingly. Price cap regulation was not deregulation. Price caps was instituted as a substitute for rate of return regulation in what was assumed to be a monopoly environment. The price cap index itself and especially the

productivity offset factor (X-factor) stand as a substitute for competition to ratchet down ILEC rates over time. It only stands to reason that, as competitive pressures increase, the regulatory pressures on prices should decrease. Therefore, Ameritech's plan appropriately provides for the phasing out of the of the X-factor and the ultimate removal of services from price cap regulation as competition increases.

In addition, the plan properly calls for early removal of any restrictions on the introduction of new services. Although the Commission has purported to ease the burden on the introduction of new switched access services by eliminating the previous waiver requirement,[21] what it has substituted is equally as onerous. Having to show that the introduction of a new service is in the public interest essentially requires the same showing that would have been required to justify a waiver of the Commission's rules. The fact of the matter is that any such requirement unnecessarily tips off the competition and delays the introduction of new capabilities which only harms customers.

Ameritech acknowledges Bell Atlantic's proposal and the proposal that USTA has offered with its comments in this proceeding. Ameritech suggests that both of these proposals have much to offer.

In light of the forgoing, the Commission should act quickly to implement a pricing flexibility plan that adequately addresses all of the above concerns.

IV. THE COMMISSION SHOULD NOT INCREASE THE PRICE CAP X-FACTOR.

In its comments in this proceeding, USTA is filing detailed economic information

[21] Access Reform NPRM at ¶¶309-310.

showing why an increase in the X-factor is not justified at this time and why, in fact, it should be lowered. USTA's updates of both the Commission's average model X-factor and USTA's own Total Factor Productivity Review Plan ("TFPRP") model show that the current 6.5% X-factor is too high. In addition, USTA shows that opportunities for productivity growth will be reduced in the future. The restructure of access from per minute to per line rates significantly diminishes the potential for growth in productivity resulting from increased usage. Similarly, the failure of IXCs to flow through access rate reductions has resulted in lower MOU demand and lower productivity than would have otherwise taken place. Moreover, it will be increasingly difficult for price cap LECs to replicate in the future the productivity enhancing effects of past competitive reorganizations and workforce reductions.

Moreover, as noted above, price caps as currently configured has already operated to effect substantial "real dollar" Ameritech rate decreases as the gap between the X-factor and inflation has grown. USTA also provides similar data for the industry as a whole. Thus, despite claims to the contrary, there is no need for the Commission to force rate reductions by increasing the X-factor.

V. CONCLUSION.

The Commission must resist the unreasonable call for a prescription of access rates to forward-looking costs. Substantial competition is taking place and justifies, not the prescription of access rates, but rather the timely implementation of a pricing flexibility framework that will

permit price cap carriers to reasonably respond to that increased competition. Therefore, the Commission should act quickly to complete the implementation of its market-based access reform model by adopting such a framework which would permit customers to realize the full benefits of the increasingly competitive telecommunications marketplace.

Respectfully submitted,

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