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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C.

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

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
	)	

BELL ATLANTIC REPLY COMMENTS ON NOTICE TO REFRESH THE RECORD

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The comments make clear that the Commission made the pro-competitive choice when it adopted a market-based approach to regulation. Independent competitors for local exchange and access services not only recognize the growth in competition, but they rightfully give credit to the Commission's market-based approach for facilitating that competition. Just as importantly, they warn that the "use of a prescriptive approach in the midst of market-driven reform could chill the current positive environment for CLEC investment and freeze the development of actual competition in access markets." NEXTLINK at 4-5.

In contrast, the long distance incumbents argue for anticompetive and counterproductive prescriptive policies as part of their relentless efforts to increase their

[1] The Bell Atlantic telephone companies ("Bell Atlantic") are Bell Atlantic-Delaware, Inc.; Bell Atlantic-Maryland, Inc.; Bell Atlantic-New Jersey, Inc.; Bell Atlantic-Pennsylvania, Inc.; Bell Atlantic-Virginia, Inc.; Bell Atlantic-Washington, D.C., Inc.; Bell Atlantic-West Virginia, Inc.; New York Telephone Company; and New England Telephone and Telegraph Company.

profits. They fail to confront the complete lack of a factual record to support the level of their desired prescription.

The one change that the Commission should make is to reduce the annual price cap adjustment – the so called "X factor" – to reflect more recent experience and trends in productivity growth. In making the contrary argument for an increase in the X factor, the long distance incumbents repeat the same invalid arguments already rejected by the Commission and do not even attempt to refresh the record, as sought in the Notice.

Finally, as most parties agree, it is necessary and appropriate for the Commission to create a framework that delineates the competitive benchmarks necessary to obtain reduced regulation of prices, up to and including removal of price caps for competitive services. Competitors nevertheless make self-serving protectionist arguments to delay prompt action. But the Commission already has safeguards in place that address all of the concerns raised by those competitors. Creating the framework for pricing freedom will facilitate greater competition and advance all of the goals expressed by the Commission in its Access Reform Order.

I. A Departure From The Commission-Adopted Market-Based Approach To Regulation Would Be Both Unlawful And Inconsistent With Sound Economic Policy

MCI/WorldCom candidly acknowledges that it and the other long distance incumbents search for "every possible opportunity" to reduce access charges – up to and

including the artificial claims they raise again now.[2] MCI/WorldCom Comments, Affidavit of Wayne Rehberger at ¶ 4. In particular, the arguments by the long distance carriers that the Commission should reverse course and impose additional prescriptive access cuts are not founded in sound legal or economic principles.

As a preliminary matter, arguments that the Commission has a legal obligation to make additional prescriptive access rate cuts have already been rejected in MCI/WorldCom's appeal of the original Access Reform Order. There, the Court recognized that the FCC's decision "to adopt a market-based approach rather than a prescriptive approach" was "neither arbitrary nor capricious." *Southwestern Bell Telephone Company v. FCC*, 153 F.3d 523, slip op. at 54 (8th Cir. 1998) ("Southwestern Bell"). Indeed, the Court went much further and recognized that the market-based approach is consistent with the Telecommunications Act of 1996 and "Congress's preference for 'a pro-competitive deregulatory national policy framework' for the telecommunications industry." *Id.* at 50 (citing Access Reform order at ¶ 1).

In fact, independent competitors acknowledge that not only does the market-based approach not inhibit competition, as is self-servingly claimed by the long distance incumbents, it *facilitates* such competition. As a former AT&T spokesperson explains on behalf of NEXTLINK:

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[2] At the same time as long distance carriers complain that price cap regulated access rates are too high and bear no relationship to market forces, AT&T is also complaining that rates for unregulated competitive access carriers (ironically including carriers owned by AT&T) are even higher – according to AT&T, more than 20 times what incumbent local access carriers charge under current regulation. *AT&T Petition for Declaritory Ruling on Interexchange Carrier Purchases of Switched Access Services Offered by Competitive Local Exchange Carriers*, Docket No. CCB/CPD 98-63 (filed Oct. 23, 1998).

> The Commission's use of a market-based approach has begun the development of competition in access markets.
>
> Based on the Commission's decision not to impose a prescriptive or regulatory approach to access charges, but to allow market forces to reform access charges, the investment community has had the confidence to make substantial investments in the competitive local exchange carriers, including companies like NEXTLINK. The Commission's decision to allow market forces to reform access markets has spurred capital funding of over twenty billion dollars in investments by CLECs in facilities and other local infrastructure that will be utilized to provide competition in access markets. *The investment by these new entrants have resulted in the deployment of literally hundreds of switches as well as thousands of miles of fiber that would not have been as economically feasible absent the Commission's commitment to a market-based approach to access reform.*

NEXTLINK at 4 (emphasis added). Time Warner agrees that market-based policies "continue to represent the preferred means of accomplishing public interest objectives" and will allow "the realization of dynamic long-term benefits, such as the entry of firms with lower costs" than incumbent local exchange carriers. Time Warner at 3 and 4.

Not only would it be unsound and anticompetitive policy for the Commission to mandate additional prescriptive access price cuts, such action by the Commission would be unlawful. When the Court of Appeals rejected these same arguments raised by the long distance incumbents, it recognized that section 205(a) of the Communications Act "permits the FCC to take the extreme action of prescribing rates only when, among other things, the rates currently charged are 'or will be in violation of any of the provisions' of the Act." *Southwestern Bell* at 50 (citing 47 U.S.C. § 205(a)). Here, where the Commission is in the unique position of having the policy under review already upheld in the face of the identical attacks, the current rates are undisputedly not "in violation" of the Act and consequently no prescription of rates is permissible.

Regardless, as previously explained, the Commission may not legally set rates at a level that does not allow for carriers to recover the costs they actually have incurred. It is long standing law that the Fifth Amendment requires that a utility be permitted to charge a price that will allow it to "maintain its financial integrity, to attract capital, and to compensate its investors for the risk [they have] assumed." *Duquesne Light Co. v. Barasch,* 488 U.S. 299, 310 (1989) (*quoting Fed. Power Comm'n v. Hope Natural Gas Co.*, 320 U.S. 591, 605 (1944)). Thus, to meet the constitutional floor, "rates must provide not only for a company's costs, but also for a fair return on investment." *Tenoco Oil Co. v. Dept. of Consumer Affairs*, 876 F.2d 1013, 1020 (1st Cir. 1989); *see also Accounting for Judgments and Other Costs Associated with Litigation*, 12 FCC Rcd 5112, ¶34 (1997) ("rates are not just and reasonable if a carrier cannot recover legitimate and prudent expenses incurred in operating the business for the benefit of ratepayers, plus a fair return on its investment"). Before a return on investment can be contemplated, the company's "costs" must be recovered. These costs cannot be based on someone else's costs, or on a hypothetical network as contemplated under a TELRIC measure. They must be the company's actual costs. Moreover, they cannot ignore past investment as contemplated under either TELRIC or a pure TSLRIC standard.

In particular, any rate recovery method must recognize the fixed loop costs that carriers have been required to assign to their interstate books for recovery under Part 36 of the Commission's rules. USTA has proposed to remove that cost recovery from access rates and include it as a separate universal service charge. Regardless, the Commission must have in place some mechanism for recovery of these costs which were assigned by Commission rule for interstate recovery.

Even if the Commission could prescribe rates to forward-looking cost levels, which it can not, it has no basis to use to set such rates.

Some commenters argue that the Commission should prescribe access reductions based on state (or overturned federal) decisions setting the rates for unbundled network elements. Cable and Wireless at 7; Comptel at 13; Excel at 10. But as both the Commission and the reviewing Court of Appeals have recognized, the setting of access prices, which must include the shared costs to provide the service, is different and far more complex than determining the price of isolated network elements. In particular, access charges must address "long recognized regulatory problems associated with the allocation of common costs." *Southwestern Bell* at 48. In contrast, unbundled elements, the Commission has argued, "are generally treated as distinct facilities, the entire cost of which is reflected in the rate for that particular element." *Id.* at 49.

In fact, there do not exist forward looking cost studies that capture the full cost of access. As Bell Atlantic explained in its initial comments here, the recently approved universal service model platform is untested and regardless, is inappropriate for use in setting prices. As Commissioner Furchtgott-Roth explained, while the model may have some potential value in "evaluating relative costs" it is not very good at evaluating "absolute costs –i.e. how much it actually costs to provide service to a resident." *Forward Looking Mechanism for High Cost Support for Non-Rural LECs*, 5th Report and Order, Statement of Commissioner Harold Furchtgott-Roth Dissenting in Part, CC Dkt. No. 96-45 (rel. Oct. 28, 1998). But, as Commissioner Furtchgott-Roth recognized, that is exactly what is required if the model were to be used to set access prices.

Ultimately, as the Commission acknowledged in the Access Reform Order, regulatory setting of forward looking costs is fraught with risk of error and both competition and customers are better served by reliance on market-based pricing. *See* Bell Atlantic Comments at 3-5.

II. The X Factor Should Be Reduced

In its initial comments, relying on the results of the Commission's own model, Bell Atlantic demonstrated why updated data confirms a downward trend in expected total factor productivity growth for regulated local exchange carriers. In contrast, the long distance incumbents do not even attempt to refresh the record on productivity growth, as requested by the Commission. Instead, they try to distort the record by repeating rejected arguments concerning a supposedly higher interstate level of productivity growth. But as the Commission recognized in the 1997 Price Cap Order, and the economic evidence makes clear, "interstate total factor productivity growth is an oxymoron." *See* Affidavit of William E. Taylor at Section II, attached to USTA reply comments; *see also Price Cap Performance Review*, 12 FCC Rcd 16642, ¶ 110 (1997) ("1997 Price Cap Order") (finding no "factual or theoretical explanation" as to why there is any difference between interstate and total company productivity growth).

AT&T and Ad Hoc attempt to paper over the economic inadequacy of their own argument for an interstate productivity offset by distorting the record and claiming that Bell Atlantic and other local exchange carriers have supported reliance on an intrastate total factor productivity offset in state price cap proceedings. This is simply untrue. For example, in the Washington D.C. case cited by Ad Hoc (p. 15), Bell Atlantic proposed a productivity offset of one half of GDP-PI as an "administratively simple" proposal that

was offered to avoid "inevitable litigation that would accompany developing a productivity factor for every price adjustment." Washington, D.C. PUC Formal Case No. 814, Phase IV, Supplemental Direct Testimony of Marie C. Johns at 10-11 (filed Mar. 3, 1995). Indeed, in the very testimony cited by Ad Hoc, Bell Atlantic argued *against* the filing of so called intrastate productivity studies (which are not true total factor productivity studies) because such a filing would "only serve to collect data relating to the mechanics of the price regulation formula" and would not be "germane to evaluating the end result." Washington, D.C. PUC Formal Case No. 814, Phase IV, Rebuttal Testimony of Richard G. Petzold at 18 (filed Sept. 15, 1995). In fact, in all of the cited state proceedings, while there may have been use of some "imprecise language to explain a technical concept," there is no question that the positions taken in those proceedings "are entirely consistent: that TFP growth for the entire firm – not for a subset of services – should be the basis on which the productivity offset is determined in both interstate and intrastate jurisdictions." Taylor Affidavit at ¶ 8.[3]

AT&T also argues to lower access rates by retroactively applying the 6.5% offset for more than the one year "look back" adopted by the Commission. The Commission has already rejected an additional "look back" based on a "balance between stockholder and ratepayer interests." 1997 Price Cap Order, ¶ 179. Since then, it has become clear

[3] For example, in Pennsylvania and New Jersey some accommodation in the level of the offset was based on a commitment for infrastructure investment. In other jurisdictions, state conditions were examined and taken into account to the extent they impacted total company productivity within that state. Ad Hoc goes so far as citing to Vermont, which does not even operate under price cap regulation. In no instance did Bell Atlantic advocate an intrastate total factor productivity study for the basis of any ratemaking.

that it was inappropriate to apply back the 6.5% productivity for *any* period, much less extend a retroactive application beyond one year. Indeed, with the 20/20 hindsight now available with the submission of updated data, there is proof that the 5.3% offset did not *understate* productivity, but rather it *overstated* actual results (the historical X factor for 1996 and 1997 respectively were 2.1% and 4.1 %). USTA Comments, Attachment D at 1.

Ultimately, the long distance carriers abandon any effort for consistency with the Commission's adoption of a price cap incentive-based regulation model, and argue that the X factor should be increased (or access rates otherwise reduced) because of the supposedly high level of local exchange carrier earnings. As an initial matter, it is clear that such an argument is antithetical to price cap regulation, whose purpose "is to promote efficient use of the network" by regulating "*rates*, as opposed to *earnings*." *Southwestern Bell* at 51 (emphasis added).

Even setting aside this fundamental defect in the long distance incumbents' argument, their characterization of local exchange carrier earnings as excessive does not bear scrutiny. For example, for 1997, AT&T, which the Commission has found to be nondominant in its market, earned about 30% return on long distance assets (ROA). Anna-Maria Kovacs, Janney Montgomery Scott, TELECOM INDUSTRY NOTE: JOINT BOARD MEETS TO DISCUSS THE UNIVERSAL SERVICE FUND, June 9, 1998. In contrast, the returns of the regional Bell companies range between 7% and 13% ROA. *Id.* Indeed, over the price cap years, the earnings performance of regulated local exchange carriers has lagged far behind the performance of other corporations. *See* USTA Comments, Attachment C, chart 1 (index of local exchange carrier earnings performance

for the price cap period is almost doubled by the earnings performance of domestic non-financial corporations).[4]

MCI/WorldCom attempts to buttress its over-earnings argument by comparing local exchange carrier returns to a MCI/WorldCom-created benchmark, rather than the 11.25% adopted by the Commission.[5] *See* MCI Comments, Appendix C. But the Commission has already rejected any effort to reduce access rates based on a new earnings prescription because such a policy would have substantial pernicious effects on the efficiency objectives of price cap regulated carriers by "making carriers less confident in the constancy of [Commission] regulatory policies." *Access Reform Order*, 12 FCC Rcd 15982, ¶ 292 (1997). Moreover, the specific changes proposed by MCI/WorldCom have already been shown to be riddled with errors that dramatically deflate their proposed rate of return benchmark. *See Preliminary Rate of Return Inquiry for Local Exchange Carriers Subject to Rate of Return Regulation*, AAD No. 96-28, Statement of Dr. Randall S. Billingsley at 7, attached to Reply Comments of the USTA (filed Apr. 15, 1996).

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[4] Despite lagging in earnings, as a result of price cap incentives, capital investment has grown in that same period, with the Bell operating companies investing at more than three times the rate of the Value Line industrial companies. USTA Comments, Attachment C, chart 3.

[5] Because the 11.25% rate of return benchmark was calculated as an economic rate of return that did not rely on regulatory accounting (including depreciation rates determined by the Commission), it is inappropriate to compare simple regulatory accounting earnings to that benchmark. Instead, the Commission should make an apples to apples comparison to an economic rate of return that similarly avoids reliance on regulatory accounting conventions. The average economic rate of return for price cap regulated local exchange carriers for the period 1993-97 is 8.61% -- slightly lower than the previously filed 8.75% result for the period 1991-95, and well below the 11.25% benchmark. *See Access Charge Reform*, CC Dkt. 96-262, Affidavit of Dr. James H. Vander Weide, attached to USTA Comments (filed Jan. 29, 1997).

Noticeably absent from all of the long distance carrier arguments calling for further access price reductions is any discussion as to whether end-user customers will see any benefit from such reductions. While reductions would not be economically justified regardless of whether the long distance carriers were using the proceeds merely to line their own pockets, the failure of the long distance carriers to pass through past reductions is another policy reason to deny their demands for additional cuts now. As one former AT&T senior executive now freely acknowledges, long distance industry pricing has "no relation to cost," and "nobody really flows through access reductions." *Conference Panelists Discuss Future of Subsidies*, TELECOMMUNICATIONS REPORT, Mar. 16, 1998, at 18 (quoting Joseph P. Nacchio). Indeed, as demonstrated by the Small Business Administration, not only did residential customers fail to receive any benefit from the Commission's most recent round of price cutting, neither did small business customers. Comments of the Office of Advocacy United States Small Business Administration at 5-6 ("small business consumers in the northeastern states have not been the beneficiaries of the FCC's access charge reform policies given *net increases* in telephone bills driven by a *26 percent increase* in [long distance carriers'] profit margins") (emphasis in original, footnote omitted).

Oncor Communications (filing comments under its corporate name of Operator Communications) seeks to lower access rates by denying local exchange carriers the ability to recover their universal service contribution through access rates. This exact argument was made and rejected at the Court of Appeals. The Court recognized that "mandatory contribution to the new universal service fund are real costs of doing business" that will be incurred by all carriers. *Southwestern Bell* at 62. As a result, both

long distance carriers and local exchange carriers have the right to recover their costs from their respective customers. For the local exchange carriers, this means recovery from both end users and from access customers. Access charges that include recovery for universal service "are not 'above cost' since universal service contributions are a real cost of doing business." *Id.*

III. The Commission Should Adopt The USTA Pricing Flexibility Proposal

Commenters are in general agreement that it is appropriate for the Commission to establish a framework to allow gradations of increasing pricing flexibility as competition grows.[6] Indeed, there does not seem to be a real opposition to the proposition that carriers needed increasing levels of flexibility, up to and including price deregulation in order to address increasing levels of competition. The only real substantive dispute concerns the measures of competition that would trigger such flexibly, with competitors of Bell Atlantic arguing that little or no flexibility was appropriate now.[7] Ironically, the number of commenters arguing that providing such flexibility in the near term is premature reflects the growth in the number of competitors, and their preference to see incumbent local exchange carriers continue to be hamstrung by regulatory restrictions that limit their ability to compete in the marketplace. But, as Bell Atlantic demonstrated in its initial comments, these competitors already have significant market impact, and

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[6] Competitors also support USTA's proposal to phase in pricing flexibility by the type of service, transport vs. switched. (Sprint at 3; MCI at 44). And end user commenters supported the proposal to provide for contract based pricing. (Ad Hoc at 27).

[7] The USTA proposed triggers for Phase II and III rely on the percentage of the incumbent local exchange carriers' demand that can be served by competitors through collocation or their own network facilities.

there is no policy basis to deny Bell Atlantic and other incumbent local exchange carriers the ability to meet that competition. *See* Bell Atlantic Comments at 7-11.

Competitors argue that the local exchange carrier proposals are too aggressive because they provide flexibility before the incumbent local exchange carriers suffer dramatic financial harm through large losses in historical market share.[8] But, as AT&T itself has recognized, reliance on market share as a predicate to pricing flexibility is "utterly indefensible" and "the availability of customer choice – not abstract market indicia – is the touchstone [of a] procompetitive policy." *Investigation to Consider Competitive Intrastate Long Distance Telephone Service*, N.C. Util Comm'n Dkt. No. P-100, Reply Comments of AT&T at 16, 17 (filed May 1, 1990). Indeed, AT&T has elegantly articulated why a backward-looking measure like market-share is particularly inappropriate as a benchmark of current telecommunications competition:

> [I]f market share were the only relevant criterion, industries such as chewing and smoking tobacco, malt beverages, local newspapers, household refrigerators and laundry equipment, breakfast cereals and many others would be suspect. . . .
>
> Moreover, *market share data for the telephone industry is particularly misleading, because it is largely the product of past regulation and the bygone days of de jure barriers to entry.* As one frequently-cited source states: "Regulation may increase a firm's market share in circumstances where only the appearance and not the reality of market power is created thereby." Indeed, a high market share can evidence just the opposite . . . , when it is realized that AT&T serves customers throughout the state, in high cost and rural areas as well as the financially more attractive regions

[8] Competitors wage a battle of semantics by suggesting that a plan that does not focus on past market share losses ignores "actual" competition in favor of potential competition. But the USTA plan requires actual competition in the form of a presence of a carrier offering a competing service. In contrast, it is clear that competitors would force punitive losses before any relief is granted. *See* MCI/WorldCom at 55, 57 (calling for a one-year waiting period *and* a 50% loss in revenues before granting pricing freedom).

> on which its rivals have chosen to concentrate. Large numbers of low volume customers or revenues from areas of unusually high costs are hardly evidence of market strength, much less dominance.
>
> *If one is to look at market share data at all, the relevant data is that which indicates what is happening today in the marketplace in terms of growth and trends in share.*

Id. at 9-11 (emphasis added and footnotes omitted). As Bell Atlantic demonstrated in its initial comments, the growth trends for access competition are significant, with competitors gaining inroads at a much faster pace than did new competitors of AT&T for long distance service. Bell Atlantic Comments at 9. Moreover, for local exchange carriers, who are dependent on a handful of large customers for the bulk of their business, the ability of a major customer to shift business to a competitor is a far more relevant measure of competition than historical market share.

MCI/WorldCom argues that even where competition is present, incumbent carriers create roadblocks to changes. For example, MCI/WorldCom complains that it should be released from long term access contracts as a condition of granting local exchange carriers pricing freedom. MCI/WorldCom at 20. But Bell Atlantic's long term contracts already allow a customer to terminate and only pay back the discount it received by committing to a longer term than a month to month contract. A customer can therefore obtain the benefit of lower term prices without any risk in switching carriers. MCI/WorldCom's "fresh look" would go beyond this equitable choice and force Bell Atlantic effectively to price month to month contracts at the reduced term rates – thereby undermining Bell Atlantic's ability to offer customers new term discounts. While such a contract arrangement would benefit MCI/WorldCom, it provides no benefit to a competitive market. Similarly, MCI/WorldCom argues that non-recurring charges are

excessive. In fact, to minimize customer barriers to new service, Bell Atlantic prices non-recurring access charges below their loaded cost. For most term plans, the charge is only one dollar.

MCI/WorldCom's additional claim that collocation is unavailable is a red herring. Bell Atlantic has more than 650 collocation sites in switching centers throughout its region. Moreover, as Bell Atlantic has demonstrated, delays in obtaining collocation space are a result of a relatively few collocators that are depriving others of space by warehousing their collocation space and not making productive use of it for providing telecommunications services to the public. Carriers are also exhausting space by failing to occupy collocation arrangements for months, or even years, after Bell Atlantic has prepared the space for occupancy. *See Deployment of Wireline Services Offering Advanced Telecommunications Capability*, CC Dkt. No. 98-147, Bell Atlantic Reply Comments at pp. 47-48 and Attachment D (filed Oct. 16, 1998). Regardless, the benchmark for competition in the USTA plan requires a valid firm order for an available collocation facility already be in place.

Competitors also argue that pricing flexibility should be denied because local exchange carriers would have the ability to force a price squeeze using regulated revenues to cross subsidize the competitive services. This tired argument has been rejected by the Commission on multiple occasions, and most recently in arguing to the Court of Appeals to uphold the current market-based approach to access regulation where the FCC explained that "adequate safeguards are in place to prevent such an occurrence." *Southwestern Bell* At 52. *See also Applications of Pacific Telesis Group and SBC Communications, Inc. For Consent to Transfer Control of Pacific Telesis Group*, 12 FCC

Rcd 2624 at ¶ 54 (1997) ("an attempted price squeeze is unlikely to be an effective anti-competitive tool").

Incumbent local exchange carriers can have no reasonable expectation of recouping lost revenues that they would forgo by under-pricing competitive access services. The only way to recoup such forgone profits is to charge monopoly prices after eliminating the competition. But competition for these services is not going to go away. The competitors include financial giants such as AT&T and MCI/WorldCom that will not be driven out by temporary efforts to under-price. These giants have expanded their market presence by buying the largest competitive access providers. In addition, even if the incumbent local exchange carriers could drive competitors out of the market, which they can not, the fiber installed by those defunct competitors would remain in the ground to be purchased and operated by another competitor.

Even AT&T's own experts concede that predatory pricing is not a workable option and that it is primarily invoked as a theoretical concern by competitors in an effort to shackle incumbents with inappropriate regulation:

> Predatory pricing that is employed to eliminate the competitors and obtain monopoly status is a flagrant violation of U.S. antitrust laws. That is, a policy instrument already exists to protect the public from this sort of thing. It would be an extremely fool hearted strategy to employ in the post divestiture deregulated telecommunications industry, which can only be described as a fishbowl with consumer groups, regulators, academics and politicians scrutinizing every aspect of the industry's performance; such company then would be suicidal. Therefore, the *current incantations that threaten the emergence of the predatory pricing must be viewed with considerable suspicion as to the underlying motivation.*

Petition of Bell Atlantic-Pennsylvania, Inc. for a determination that Provision of

Business Telecommunications Service is Competitive, PA PUC P-00971307, Transcript of Hearing May 29, 1998 at 1180-81 (testimony of AT&T witness John W. Mayo, emphasis added). *See also Matsushita Electric Industrial Co. v. Zenith Radio Corp.*, 475 U.S. 574, 590 (1986) ("there is a consensus among commentators that predatory pricing schemes are rarely tried, and even more rarely successful").

Finally, competitors argue that further pricing flexibility should not be granted because local exchange carriers are not sufficiently using the flexibility they already have.[9] This argument appears to contradict their earlier claim that any flexibility will be used by incumbents to drive out competition. Regardless, this argument is factually wrong.

Bell Atlantic has made use of pricing flexibility wherever practical. For example, Bell Atlantic offers term and volume discounts for special access services. In LATA 132, where the USPP waiver gives Bell Atlantic the option of differential pricing for this competitive area, Bell Atlantic has done so. Bell Atlantic has also used pricing zones, including differentiating the price of channel terminations by zone. The zones are not practical for wider use because they are drawn at too large a level, are difficult to

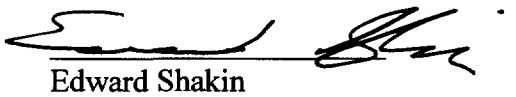
[9] MCI/WorldCom makes a related argument that, in contrast to AT&T when it received streamlined regulation for some services, price cap regulated local exchange carriers are pricing at their caps. But, as shown in the attached chart, the cap on AT&T did not force any price reductions and in fact allowed prices to go up. It is not surprising that competitive pressures pushed AT&T prices below its cap. For Bell Atlantic, the caps have pushed prices down significantly. Without the flexibility to target additional reductions, it is similarly unsurprising that Bell Atlantic's general price levels are at or near its cap levels.

administer,[10] and would impose relatively higher prices in areas where Bell Atlantic faces significant competition. The USTA plan would remedy that by allowing pricing flexibility for a more discrete area on the basis of actual competition.

Conclusion

The Commission should continue to rely on a market-based combination of price caps and competition to control prices, but the annual price cap productivity factor should be reduced and the Commission should adopt the USTA proposal to allow increasing levels of pricing freedom in response to competition.

Respectfully submitted,



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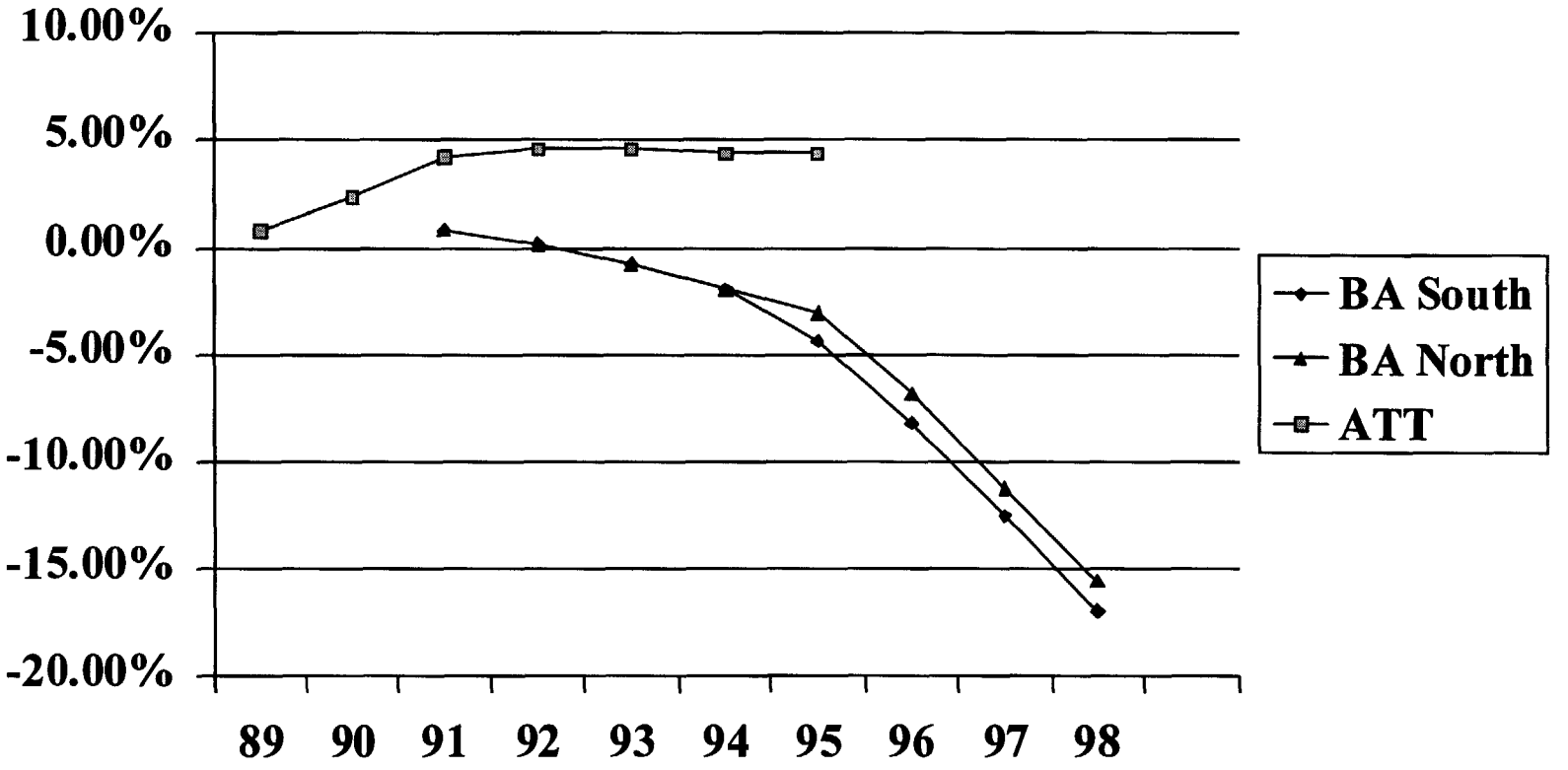
[10] Under Commission rules, if a transport service terminates in a different zone from where it originates, the service must be priced consistent with higher priced zone, rather than simply allowing the service to be priced based on the location of the long distance carriers point of presence ("POP"). This administratively cumbersome requirement makes use of zone pricing less practical.

Cumulative Net Price Cap Index Change
Inflation Minus X-Factor



CERTIFICATE OF SERVICE

I hereby certify that on this 9th day of November, 1998, a copy of the foregoing Bell Atlantic Reply Comments on Notice to Refresh the Record was sent by first class mail, postage prepaid, to the parties on the attached list.

Jennifer L. Hoh

* Via hand delivery.

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