BEFORE THE

Federal Communications Commission

WASHINGTON, D.C. 20554

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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**
	)	
Consumer Federation of America Petition for Rulemaking	)	**RM-9210**

To: The Commission

REPLY COMMENTS OF THE AMERICAN PETROLEUM INSTITUTE

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EXECUTIVE SUMMARY

The Commission need only "fine-tune" its basic price caps scheme of regulation to ensure that interstate customers pay just and reasonable rates. Toward this end, API urges the Commission to reinitialize its price cap formula back to the 1995 tariff year, and increase the X-Factor by focusing exclusively on interstate productivity. This is not intrusive rate regulation.

The record clearly reflects that the local exchange access market does not meet the historical competitive benchmarks set by the Commission, and,in fact, lags far behind. While the numbers of CLECs have grown, their power in the local exchange access market pales in comparison to the bottleneck stronghold of the incumbents.

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REPLY COMMENTS
OF THE
AMERICAN PETROLEUM INSTITUTE

The American Petroleum Institute (API), by its undersigned attorneys, hereby respectfully submits these Reply Comments in response to the Public Notice released by the Federal Communications Commission (Commission) on October 5, 1998.[1/] API urges the Commission to recalibrate the existing price cap scheme of regulation by reinitializing local exchange carrier access charges back to 1995, and increasing the X-Factor using interstate-only factors.

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

I. COMPETITION IN THE EXCHANGE ACCESS MARKETS IS NEITHER PRESENT NOR IMMINENT

But for the wishful, strained positions of a number of the incumbent local exchange carriers (ILECs), the commenting parties universally reject the notion that ILEC access services are subject to meaningful competition. As API emphasized in its Comments, it remains premature, at best, to rely on competition to ensure market-based rates for interstate access services.

Unable to argue with any credibility that access rates are priced competitively, the ILECs attempt to shift the focus to the number of entities that can be characterized as "competing" local exchange carriers.[2/] In touting the number of new competitive local exchange carriers (CLECs), ILECs largely ignore more conventional measures of market shares. API submits that the large number of CLECs confirms what interested parties have maintained for years: the ILEC earnings on interstate access are so favorable that many entrepreneurs desire to compete in this market.

A. CLECs do not yet have substantial market share

Several ILECs contend that "competition is growing."[3/] Intuitively, there is merit to the ILECs' view that the growing number of CLECs should suggest that competition

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[2/] Bell Atlantic Comments at 7; BellSouth Comments at 3,12; Southwestern Bell Comments at 3; USTA Comments at 6 (stating the positive market trends experienced by incumbent LECs are overshadowed by the dramatic growth in competition from competitive LECs).

[3/] See Bell Atlantic Comments at 7; Bell South Comments at 12; Southwestern Bell Comments at 3; USTA Comments at 6.

exists in the access exchange and local markets. However, despite the growing number of CLECs, their aggregate revenue share falls far short of what one would reasonably expect in a competitive market.

Market share figures are an important indicator of a competitor's ability to compete for the incumbent's business. When measured on a revenue basis, CLECs lag far behind ILECs in terms of market share. The share of CAP/CLEC nationwide local service revenues in 1996 was only 1 percent.[4/] While, as USTA points out, the number of CLECs may have grown by over 250 percent, the sheer number of potential competitors does not establish that ILEC access rates are subject to meaningful competition.[5/] Nothing proves the absence of competition more than the inability of new entrants to obtain more than 1 percent of market share revenues nationwide. Even given the figures of the Competition Policy Institute, the CLEC revenue share for the local market is 4.1 percent.[6/] These figures indicate the level of competition remains nascent, at best.

Today's marketplace is not nearly as competitive as it needs to be for the Commission to determine that ILECs do not dominate the local exchange and exchange access markets. As MCI emphasizes, "drawing on the AT&T precedent, competitors should have to achieve at least a 50 percent market share in revenue terms or 50 percent

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[4/] See Exhibit I. Table 8.1 excerpted from the Industry Analysis Division, Common Carrier Bureau's *Trends in Telephone Service Report* at 29 (July 1998).

[5/] USTA Comments at 6.

[6/] See Competition Policy Institute Comments, Merrill Lynch &Co. Report, "CLEC Update: Continued Weakness in the Sector Creates a Great Buying Opportunity," 2Q98 Review (Sept. 22, 1998).

of the channel terminations between end offices and customer premises."[7] The Commission has historically noted that significant market share declines are appropriate gauges of competition. In the *Motion of AT&T to be Reclassified as a Non-Dominant Carrier*, the record reflected that AT&T's overall long-distance industry revenues had fallen from 90 percent to 55.2 percent; that at least three other facilities-based carriers existed; and that equal access or dialing parity was universally deployed.[8] These conditions could support a conclusion that AT&T was a nondominant carrier in the interexchange market.[9] The ILECs make no such showing in this proceeding. Similarly, in the declaring AT&T nondominant for international service, the Commission heavily weighted the decline in AT&T's share of the IMTS market to less than 60 percent.[10]

In regard to access services, competition has only recently come into existence. Ubiquitous facilities-based competition in the exchange access market does not exist, nor do CLECs have significant market share. The bottleneck is as strong as ever. The idea that today's local and access exchange markets are subject to competition cannot be squared with these benchmarks for competitive markets.

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[7] MCI Comments at 55. See also *In the Matter of Competition in the Interstate Interexchange Marketplace,* Report and Order, FCC 91-251, 6 FCC Rcd 5880, ¶ 50 (1991) (*Interexchange Report and Order)* (determining that AT&T's 50% market share in revenues and in minutes of business services did not render the business services market non-competitive).

[8] *Motion of AT&T to be Reclassified as a Non-Dominant Carrier*, Order, FCC 95-427, 11 FCC Rcd 3271, ¶ 67 (1995).

[9] *Id.* at 163.

[10] *Motion of AT &T to be Declared Non-Dominant for International Service*, Order, FCC 96-209, 11 FCC Rcd 17963, ¶ 5 (1996).

II. A PROPERLY CALIBRATED X-FACTOR WILL BETTER SERVE THE PUBLIC INTEREST IN THE ABSENCE OF COMPETITION

In light of market realities, a prescriptive approach is more than warranted. Nevertheless, ILECs persist that any regulation constitutes a form of prescriptive regulation. USTA argues that a prescriptive approach "constitutes a return to cost-based rate of return regulation and a reversal of the incentive improvement intentions of price cap regulation."[11/] Bell Atlantic goes on to say that "imposing prescriptive rates cuts would undermine incentives to improve efficiency by denying carriers the benefits of their efforts to become more efficient."[12/] BellSouth even goes so far as to say, "while retro-music, clothes and cars may be chic, retro-regulation is not the way to establish public policy."[13/] We agree with BellSouth, to the extent that the Commission should not focus on what is politically "chic," but rather focus on what is best for consumers.

API is not looking to overhaul the infrastructure of the Commission's regulatory scheme. Rather, API encourages the Commission to "fine-tune" or recalibrate the existing price cap scheme that is already in place. Specifically, API encourages the Commission to implement this "fine-tuning" by: (i) reinitializing LEC access charges back to 1995; and (ii) increasing the X-Factor using interstate - only factors.

[11/] USTA Comments at 11.

[12/] Bell Atlantic Comments at 3.

[13/] BellSouth Comments at 4.

API supports AT&T's recommendation to reinitialize LEC access charges back to 1995.[14/] According to AT&T estimates, this would require LECs to reduce their revenues by $2.396 billion to bring their combined interstate rate of return in 1997 down to the prescribed level of 11.25 percent.[15/] As the Commission is aware, 11.25 percent is an extraordinarily generous measure in light of the ILECs declining cost of capital. MCI provides substantial record evidence which establishes that: (i) "ILECs cost of capital has been no more than 10 percent for some time now;" and (ii) that the ILECs current "cost capital [is] now standing at 9.1 percent."[16/] Reinitialization as proposed by AT&T would ensure that consumer interests would receive a modicum of protection in light of the steadily declining ILEC costs of capital. Absent reinitialization, price cap LECs will continue to profit enormously from a grossly understated historical productivity offset. And, as noted below, exclusive reliance on ILEC interstate - only factors would support a 50 percent increase in the X-Factor.[17/]

These two changes are consistent with the Commission's 1997 decision not to micromanage the affairs of price cap LECs.[18/] As stated in the Commission's *Price Cap*

[14/] A&T Comments at 25-26.

[15/] *Id.*

[16/] MCI WorldCom Comments at 34.

[17/] See also Ad Hoc Telecommunications Users Committee Comments at 20-25.

[18/] See *In the Matter of Request for Amendment of the Commission's Rules Regarding Access Charge Reform,* CC Docket Nos. 94-1 and 96-262, Fourth Report and Order in CC Docket 94-1 and Second Report and Order in CC Docket No. 96-262, 12 FCC Rcd 16642 (1997) (*Price Cap Fourth Report and Order).*

Fourth Report and Order, "[p]rice cap regulation is intended to encourage growth in productivity by permitting incumbent LECs that increase their productivity to earn higher profits, while at the same time ensuring that interstate access customers share in the benefits of productivity growth in the form of lower rates. The price cap formula was designed to ensure that '[b]oth carriers and customers will be better off' under price cap regulation."[19/] Consistent with this philosophy, the Commission eliminated ILEC sharing obligations.[20/] By eliminating sharing, the Commission has provided every reasonable incentive for the ILECs to emulate competitive firms to achieve cost savings, including increased efficiencies.

The fine tuning of the price cap scheme does not entail, as USTA argues "detailed Commission intervention in the exchange access market . . . a process that carries with it significant costs and risks of error."[21/] The price cap formula and rate adjustment process is generally understood, as it has been in place for eight years.[22/] The price caps regime is a well-understood mechanism for Commission oversight of this critical, largely noncompetitive market. Until accepted competitive benchmarks are achieved, a properly calibrated price caps regime ensures that users do not continue to pay excessive rates and that ILECs retain appropriate incentives to pursue efficiencies and cost savings.

[19/] *Id.* at 2.

[20/] *Id.* at 148.

[21/] USTA Comments at 11.

[22/] Price cap regulation was considered by the Commission eight years ago *In the Matter of Policy and Rules Concerning Rates for Dominant Carriers*, CC Docket No. 87-313, Second Report and Order, 5 FCC Rcd 6786 (1990) (*LEC Price Cap Order).*

III. THE COMMISSION SHOULD REJECT THE ILECs' REQUEST FOR A LOWERED X-FACTOR

Users and interexchange carriers share the widely held position that the X-Factor is far below its appropriate level for interstate services.[23/] The FCC's measurement of LECs' interstate productivity on the basis of "total company" (combining local, interstate and intrastate) data rather than on an interstate only basis, has only served to understate the X-Factor since its implementation. As AT&T points out, the larger price cap LECs have conceded that the LECs' relatively higher interstate output growth rate would require an upward adjustment in the LECs' total factor productivity rate determined on a total company basis.[24/]

The process by which individual LEC services are produced vary considerably. As noted, again, "variations typically turn on the pace of technological change or the inputs with which each service is created, and the relative cost shares of labor and capital."[25/] Advances in technology have been concentrated in aspects of the ILEC infrastructure which support interstate services. The dichotomy between intrastate and interstate inputs is highlighted by the Ad Hoc Telecommunications Users Committee:

[23/] Ad Hoc Telecommunications Users Committee Comments at 12; AT&T Comments at 15; Consumers Union Comments (citing Consumer Federation of America, International Communications Association, and National Retail Federation, Petition for Rulemaking, RM-9210 (Dec. 9, 1997) ("Consumer Petition"), MCI WorldCom Comments at 27-29.

[24/] AT&T Comments at 15.

[25/] Ad Hoc Telecommunications Users Committee Comments at 13-14.

Intrastate Services

- utilize subscriber access lines that require highly stable technology (copper loops).
- exhibit a relatively high labor component for installation, maintenance and customer service (retailing) functions.

Interstate Switched Access Services

- continue to be heavily impacted by technology (digital switching, Signaling System 7, Advanced Intelligent Network).
- require minimal labor input on an ongoing basis.[26/]

Based on the distinctions in interstate and intrastate technology profiles, services regulated at the interstate level will experience significantly lower overall cost growth on a per-unit basis and higher productivity gains than services regulated at the intrastate level.[27/] AT&T's comparison study of X-Factor calculations based on total company outputs and interstate-only outputs further evidences this divergence.[28/] API submits that where quantifiable distinctions exist between interstate productivity and total productivity measures, the Commission should focus on the interstate productivity factor. This is consistent with the Commission's limited jurisdiction over intrastate ratemaking.[29/]

[26/] *Id.*

[27/] *Id.*

[28/] AT&T Comments at 21.

[29/] See *Louisiana Public Service Commission v. FCC*, 106 S.Ct. 1890 (1986).

IV. THE COMMISSION SHOULD REJECT THE ILECs PRICING FLEXIBILITY PLAN

As stated above, ILECs' access charges face little competitive pressure, and ILECs fully retain their monopoly power in the access market. Therefore, the ILEC proposals for pricing flexibility are singularly inappropriate. While API, like Ad Hoc, supports the availability of pricing flexibility so long as it is linked to clear evidence of competitive conditions in the relevant market,[30/] the ILECs' proposals require substantial refinement.

Bell Atlantic proposes three levels of pricing flexibility (up to an including removal of price cap regulation) based on the degree of competition for a service or group of services.[31/] USTA supports a similar pricing flexibility plan.[32/] In the absence of competition, there are insufficient market "triggers," and the pricing flexibility of the sort proposed by Bell Atlantic and USTA could facilitate cross-subsidization, predatory pricing, and other anticompetitive schemes.[33/] A major difficulty with USTA's "triggers" is that they are based on threshold criteria that are prerequisites for competition, not necessarily indicia of competition. The concept of the RFP pricing flexibility has merit because, as the Ad Hoc Telecommunications Users Committee notes, "it depends on the existence of actual competition."[34/]

[30/] *Id* at 25.

[31/] Bell Atlantic Comments at 17.

[32/] USTA Comments at 30-38. Supported by GTE Comments at 21.

[33/] USTA Comments at 32 (discussing "triggers").

[34/] Ad Hoc Telecommunications Users Committee at 27.

End-users in particular would suffer from pricing flexibility plans that contemplate increasing prices to those customers who do not benefit from the presence of either effective or potential competition. The ILEC proposals would leave unprotected those customers not located in competitive urban centers. Many API member companies have substantial facilities outside of urban areas. The Commission must take appropriate steps to ensure that unfair burdens are not placed on end-users located in non-competitive markets as a result of ILEC rate decreases in other markets.

WHEREFORE, THE PREMISES CONSIDERED, the American Petroleum Institute respectfully urges the Federal Communications Commission to maintain and further the pro-competitive deregulatory goals reflected in the existing price cap scheme, by recalibrating the existing price cap scheme, and increasing the X-Factor using interstate-only factors, and by taking other action consistent with the views expressed herein.

Respectfully submitted,

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Dated: November 9, 1998

EXHIBIT I

TABLE 8.1
NEW LOCAL SERVICE COMPETITORS
(Dollar Amounts Show in Millions)

	1993	1994	1995	1996	Average Annual Growth '93-'96
Number of CAPs/CLECs	20	30	57	109	76.0%
CAP/CLEC Local Service Revenues*	$178	$281	$595	$949	74.7%
Bell Company Local Service Revenues*	$58,838	$61,415	$65,485	$70,290	6.1%
Local Service Revenues* of Other Incumbent Local Telephone Companies	$20,828	$23,424	$24,269	$24,899	6.1%
All Other Local Service Revenues*	$850	$1,298	$388	$379	**
Nationwide Local Service Revenues*	$80,694	$86,418	$90,737	$96,517	6.2%
CAP/CLEC Share of Nationwide Local Service Revenues*	0.2%	0.3%	0.7%	1.0%	

Sources: Industry Analysis Division, *Telecommunications Industry Revenue: TRS Fund Worksheet Data* (rel. Dec. 1994; Feb. 1996; Dec. 1996; and Nov. 1997); Industry Analysis Division, *Carrier Locator: Interstate Service Providers* (rel. Nov. 1997).

* Local service revenues are here considered to include revenues from local exchange, local private line, and other local services, as well as from interstate and intrastate access services, but not to include revenues from cellular or other mobile services or from toll (i.e., long distance) services.

** Not meaningful; reporting of revenues among local and toll categories appears to be inconsistent from year to year.

CERTIFICATE OF SERVICE

I, Cassandra L. Hall, hereby certify that I have served a copy of the foregoing "Reply Comments" of the American Petroleum Institute on this 9th date of November, 1998, upon the following parties via first-class mail:

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