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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

REPLY COMMENTS OF AMERITECH

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TABLE OF CONTENTS

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Ameritech submits this reply to comments on the Commission's recent Public Notice[1] which requested parties to update the record in the above-captioned proceedings and to comment on: i) the petitions of CFA, *et al.*, and MCI concerning the prescription of access rates;[2] ii) on proposals by Ameritech[3] and Bell Atlantic for phased-in pricing flexibility as competition increases; and iii) on a possible revision of the price cap X-factor.

[1] "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").

[2] 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.

[3] *See*, *ex parte* filings of Ameritech in CC Docket No. 96-262 dated April 9, 1998, June 5, 1998, September 14, 1998.

I. INTRODUCTION AND SUMMARY.

Despite the claims of interexchange carriers ("IXCs") and others, the evidence shows that the presence of competition for incumbent local exchange carrier ("ILEC") access services is significant and growing. Moreover, the total market for access services itself is growing so rapidly that embedded market share is virtually irrelevant as an indicator of market power. In other words, with a very small base of potential customers (IXCs and large business customers) new competitors can become quite successful competing for new business. In fact, it is this competition for new growth that is placing downward pressure on ILEC access prices.

Further, price cap regulation has itself already placed significant downward on ILEC access prices. The recent changes in the X-factor have lowered indices substantially. Moreover, since the inception of price caps, price cap carriers' rate reductions have been greater, by at least an order of magnitude, than the access rate reductions of rate of return carriers. In this light, LEC earnings cannot be regarded as unreasonable given the fact that the price cap LECs have borne the risk of "beating" the efficiency gains assumed in the X-factor.

Thus, there is no market "failure" that would justify the Commission's represcribing access rates. Further, the evidence shows that consumers have not yet received the full benefits of ILEC access rate reductions in any event. So the Commission should be wary of any claims that consumers will benefit from any further reductions.

Further, discussions of presumably lower price cap LEC cost of capital are irrelevant to the issue of whether rates should be prescribed. Any lowering of ILEC cost of capital due to the operation of the marketplace (*i.e.*, lower interest rates generally) has already been reflected in price cap indices through the operation of the GDP-PI. Further, the only shift in ILEC cost of capital relative to the marketplace has been upward due to the increased risk of ILEC regulated operation that has taken place since the inception of price caps.

Finally, because of the increasingly competitive marketplace, the Commission should act quickly to adopt a pricing flexibility proposal along the lines proposed by Ameritech or USTA, to enable customers to achieve the benefits of full competition of interstate access services.

II. COMPETITION FOR LOCAL EXCHANGE AND EXCHANGE ACCESS SERVICES CONTINUES TO GROW.

A. Competitive Presence Is Significant and Growing.

Several parties suggest that competition for LEC services is at insignificant levels, and that, therefore, access rates should now be prescribed and the Commission should continue to deny LECs any pricing flexibility with respect to interstate services.[4] Yet the record demonstrates that competitive providers abound and that their segment of the market is growing. With its comments, Ameritech showed the explosive growth in the numbers of unbundled loops, end office integration trunks, and resold lines ordered by competitive providers. In addition, it also showed the growth in the deployment of fiber facilities and stand-alone switches by other carriers and in their share of special access services. This data is undisputed and cannot be ignored.

Moreover, while AT&T cries loudly about the lack of competition[5] and complains that

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[4] *See, e.g.*, AT&T, MCI, TRA, Sprint.

[5] AT&T at 4-8.

LEC mergers "threaten the public interest,"[6] its actions speak louder than its rhetoric. As further proof of the openness of the telecommunications market, AT&T has initiated a series of acquisitions and mergers to position itself as the world's largest fully-integrated telecommunications concern -- thus massively affecting the telecommunications competitive landscape.

Through its recent and proposed acquisitions, AT&T is accumulating all of the functionalities necessary to serve the total communications needs of its customers. AT&T, still the largest provider of domestic and international long distance service in the United States, has recently acquired the largest CLEC -- Teleport.[7] It had already acquired what was then the leading provider of cellular telephone service in the United States -- McCaw Cellular.[8] And now it is purchasing Vanguard Cellular Systems to fill in gaps in its facilities-based wireless service in the northeastern portion of the United States, adding to its already leading wireless infrastructure.[9]

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[6] *Id.* at 12.

[7] *See, Teleport Communications Group, Inc. and AT&T Corp.*, Memorandum Opinion and Order, 13 FCC Rcd 15236, ¶¶3, 5 (released July 23, 1998). In approving the merger, the Commission specifically noted the extent to which competitive activity has, and will proliferate:

> [T]here are competing providers of originating access in most markets in which Teleport is competing, and that further entry appears likely. Since there are, or soon will be, other providers for originating exchange access services in these markets, it does not appear likely that Teleport could profitably raise prices to rival long distance companies since customers could switch to other access providers. *Id.* at ¶44.

[8] *See, Applications of Craig O. McCaw and American Telephone and Telegraph Company*, 9 FCC Rcd 5836, 5840 (1994), aff'd sub nom., *SBC Communications, Inc. v. FCC,* 56 F.3d 1484 (1995).

[9] *See, e.g.*, Rebecca Blumenstein, *AT&T's Internet-Technology Plans Call for Spending 'Billions and Billions,'* Wall St. J., October 9, 1998, at B6. AT&T's mergers and acquisitions have not been limited to the domestic telecommunications marketplace. On July 26, 1998, AT&T and British Telecom announced the merger of their international operations into a jointly owned corporation. This joint venture unites the largest carriers in the United States and Great Britain. The combined entity will be the dominant carrier of transatlantic traffic and the

Of course, most recently, AT&T proposed to acquire TCI -- which together with its affiliates is the largest cable system operator in the United States.[10] Following the merger, the AT&T wholly-owned and affiliated cable systems will pass 33 million homes.[11] And, according to press reports, AT&T's Chairman Michael Armstrong is seeking more cable partners to broaden its reach to 60 percent of United States homes.[12] AT&T has stated that following the merger it plans to integrate its consumer long distance, wireless, and Internet services with TCI's cable, telecommunications, and high speed Internet businesses in a new subsidiary, AT&T Consumer Services.[13] AT&T proclaims that this integrated subsidiary "will own and operate the nation's most extensive broadband local network platform" and "will bring to people's homes the first truly integrated package of communications, electronic commerce and video entertainment services."[14] This integrated package of services will be offered under the AT&T

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largest carrier of cross-border traffic in Europe. During the first year of operations, the AT&T/British Telecom joint venture is estimated to generate approximately $10-11 billion in revenue by serving over 237 countries. In 1998, the combined international traffic of AT&T and British Telecom is expected to reach 25 billion minutes. (*See, generally, AT&T and BT to Form $10 Billion Global Venture To Serve Customers Around the World,* PR Newswire, July 26, 1998.)

[10] *See*, Paul Kagan Assoc., *Top Cable System Operators as of May 1998, Cable TV Investor*, September 11, 1998.

[11] TCI's systems directly pass 20.9 million homes and its affiliated systems pass 13.2 million additional homes. *See generally,* AT&T/TCI Merger Application, Description of Transaction, Public Interest Showing, and Related Demonstrations at 6-7 ("AT&T/TCI Application"); Tele-Communications, Inc., Form 8-K, at Exhibit 99.1 (July 1, 1998) (attaching AT&T News Release, AT&T and TCI To Merge, June 24, 1998) ("AT&T Merger News Release").

[12] *See* Rebecca Blumenstein, *AT&T's Internet-Technology Plans Call for Spending 'Billions and Billions,'* Wall St. J., October 9, 1998, at B6.

[13] *See* AT&T Merger News Release at 1; AT&T/TCI Application at 11.

[14] AT&T Merger News Release at 2.

brand name, which enjoys a high level of consumer recognition nationally.[15] And AT&T's commitment to upgrade acquired cable facilities will enable a complete bypass of LECs -- even in residential contexts.[16] In addition, as a result of the merger, AT&T will acquire TCI's controlling interest in @Home Network, which is the leading provider of high-speed Internet access and content services.[17] By its own admission, AT&T will own and operate the most extensive and advanced communications network, the nation's largest wireless infrastructure, the Teleport local access network reaching 250 cities from coast to coast, and cable systems that pass at least 33 million homes across the United States.[18] This vertically integrated AT&T with national brand name recognition undoubtedly will possess unique competitive advantages.

AT&T's conduct demonstrates its decision not to grow complementary facilities-based businesses in house, but rather to obtain them through acquisitions of (or joint ventures with) the largest potential competitors in the various market segments (*i.e.*, McCaw Cellular, Teleport, British Telecom, Vanguard Cellular, and TCI). Indeed, the latest proposed merger would eliminate TCI as an actual competitor of AT&T for Internet access service and as an actual

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[15] *Id., see also* Opening Remarks of Leo Hindery, President, TCI, before the En Banc Hearing of the Commission on Telecommunications Mergers, on October 22, 1998 (stating that AT&T/TCI "will provide the most compelling selection of high quality, high value local and long-distance telephone, video, wireless and Internet ever offered by a single entity -- all under the AT&T brand name").

[16] *See*, Ameritech comments at 4.

[17] *Id.* at 3. @Home is an Internet-access joint venture with seven leading cable operators, including TCI. The combined cable networks of @Home cable partners reach approximately 40% of U.S. households and have approximately 150,000 customers. As part of the merger with TCI, AT&T has agreed to pay $2.5 billion for TCI's 38% stake in, and voting control of, @Home.

[18] *Id.* at 4.

competitor in the long distance services market as a reseller of Sprint long distance.[19]

The competitive presence posed by these mergers and by others, such as the MCI/WorldCom/MFS/Brooks mergers, is substantial. The largest purchasers of access services have very deliberately put themselves in the position of migrating large portions of their access service needs away from the ILEC if the ILEC's rates are economically unreasonable. It is completely incongruous for AT&T to say that ILECs have little competition for their services.

Moreover, AT&T has itself recently provided the Commission with evidence of substantial competitive activity. On October 23, 1998, AT&T filed a petition for declaratory ruling ("AT&T Petition") complaining of the high switched access charges assessed by "a substantial number of CLECs". (Emphasis added.) While other implications of AT&T's Petition will be discussed below, it should be clear that the presence of these CLECs and the volume of their switched minutes is substantial enough to cause AT&T such significant financial "discomfort" that it decided to file the petition in the first instance and ask the Commission to devote its resources to addressing the problem. In other words, AT&T's Petition, by itself, demonstrates substantial CLEC activity throughout the country.

B. Embedded Market Share Fails to Reflect Significant Competitive New Growth Opportunity.

Those parties who narrowly focus on current market share data to bolster their claim of the absence of competition ignore the fact that the current telecommunications marketplace is

[19] *See* AT&T/TCI Application at 6-8 & n. 9. Through the Internet capability of @Home Network, TCI likely is already competing in the long distance services market via Internet telephony. In any event, TCI in the past has expressed its intention to enter the long distance services market as a reseller. *See* Martin Rosenberg, *Single-Stop Communications Shopping Remains Sprint Goal*, The Kansas City Star, February 24, 1996, at B1 (noting that TCI intends to resell Sprint long distance service in telephony test markets in a Chicago suburb and across Connecticut); *see also* Jon Van, *Risk, Rewards High in AT&T, TCI Deal*, Chicago Tribune, June 25, 1998.

experiencing rapid growth. In a period of rapid growth, embedded market share means little since new entrants can be highly successful simply by focusing on growth business.

An example of the fallacy of focusing on the "embedded base" is MCI's discussion of the "problem" of "excessive" termination charges on existing long-term contracts for LEC dedicated access circuits.[20] Nonetheless, the fact is that, as MCI admits, despite termination liabilities on embedded contracts, competition for "growth" or "new circuits" is still eminently feasible.[21]

And competitive new growth opportunities <u>are</u> significant. In the Ameritech region, the total market for dedicated access services is growing at an astronomical rate. In Ameritech's seven major market areas, total DS1 local distribution channels grew by 34% from 1Q96 to 1Q97 and by 35% from 1Q97 to 1Q98! The story is the same in most other major market areas. With such growth in demand and a small customer base to address, it is ridiculous for anyone to say that competitors lack a meaningful opportunity to compete in the marketplace. In fact, because the customer based is so small and, therefore, easily approached,[22] it is this competition for <u>new</u> circuits that is putting the most pressure on ILEC pricing of these services.

C. <u>Ameritech Pricing Reflects the Realities of the Competitive Marketplace.</u>

MCI erroneously alleges that Ameritech and other RBOCs have failed to take advantage

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[20] MCI at 20 and Attachment B. In Ameritech's case, such charges are extremely reasonable. Customers that wish to terminate service before the end of a contract generally only pay for the portion of a contract actually utilized at the rate associated with a shorter-term contract. Further, MCI's use of Ameritech as an example of the expense of collocation (Attachment B at ¶¶32-33) is also misleading. None of the costs on its Table 3, except those specifically marked "collocation" are paid to Ameritech. Rather, they are simply costs associated with building a network.

[21] MCI at 20.

[22] Competitive providers of access services need only address a relative handful of customers to be successful. The situation was very different for competitive IXCs who had to market to millions of customers in order to succeed in the marketplace.

of the limited pricing flexibility currently available under the Commission's rules.[23] As MCI noted: "Ameritech has implemented zone structure for most DS1 and DS3 rate elements." (Emphasis added.)[24] MCI complains, however, that Ameritech is only fully utilizing flexibility for channel terminations and that the fixed portion of transport is the same for zones 1 and 2 and that per mile transport and multiplexing have no price differences among zones.[25]

Despite this, Ameritech is fully utilizing all pricing freedoms available to it. That does not necessarily mean that prices have to be different in each zone for each service. Ameritech has made market-based decisions concerning the pricing of rate elements based on the competitive landscape, the nature of the services in question, basket pricing limitations, and service costs characteristics to determine whether zone differentials are justified in a particular case. In certain cases, Ameritech will choose not to take advantage of zone differentials if there are no cost differences in supplying a particular service among the zones. In certain cases where rate elements are the same for zones 1 and 2, Ameritech needed to take into account the fact that the competitive landscape does not often parallel Ameritech's zone structure. In other words, in some situations, there may be greater competitive pressure in zone 2 than in zone 1. Under these circumstances, it would be inappropriate to have zone 1 rates lower than zone 2 rates.

MCI further argues that price cap LECs' pricing "at the cap" reflects the absence of competitive pressure.[26] Again, MCI's claim is without merit. The reason ILEC rates are close

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[23] MCI at 38-39.

[24] *Id.*

[25] *Id.*

[26] *Id.* at 37-38.

to their caps is because the Commission's changes to the base-line X-factor have, by themselves, resulted in an uncompounded 13.1% reduction to price cap indices since 1995.[27] As MCI has acknowledged, CLEC competition has been developing for interstate transport services for 10 years. Ameritech's prices have reflected that competitive pressure; however, the massive changes in the X-factor have squeezed out much of the "head room" that Ameritech and other LECs had already provided due to these marketplace pressures. Thus, the lack of head room caused by X-factor changes is in no way reflective of a lack of competition.

III. CURRENT ACCESS RATE LEVELS ARE REASONABLE AND THEY SHOULD NOT BE PRESCRIBED TO A LOWER LEVEL.

A. Rate Levels Have Been Falling.

Several parties encourage the Commission to force an immediate reduction in access rates by prescribing them at forward-looking cost.[28] However, there has been no showing that current rates are unjust or unreasonable. The fact of the matter is that price caps has operated to effect a steady and substantial reduction in access charges.[29] In fact, since the inception of price caps, Ameritech's rates have dropped by 60% through 1998, while rate of return LECs' rates had, by 1997, fallen a paltry 3.7%. As noted above, changes in the X-factor alone have resulted in an uncompounded 13.1% reduction to price cap indices since 1995.

[27] The Commission's 1995 increase of the base-line X-factor from 3.3% to 4.0%, plus its one-time adjustment of 2.8% (to account for the change back to 1991) has a cumulative affect of 5.6% when brought forward to 1998. Similarly, the Commission's increase of the base-line X-factor to 6.5%, retroactive to 1996, has an additional cumulative affect of 7.5% when brought forward to 1998. This, of course does not take into account the effects of compounding with resulted in an actual reduction in indices by an even greater amount.

[28] *See, e.g.*, note 3, *supra*. Although CompTel proposes a transition to prescribed rates, its plan still involves a presubscription, with all the infirmities described in Ameritech's comments and these reply comments.

[29] *See* Attachment I of Ameritech's initial comments.

Further, AT&T's Petition demonstrates the reasonableness of incumbent LEC rates. If ILEC rates were so outrageously high, one would naturally expect CLEC rates to be below those rates. The fact that a substantial number of CLECs have priced access charges well above ILEC rates may in fact be an indication that ILEC rates are below market level.

Finally, despite IXCs' claims for mandatory additional reductions in access charges, the evidence indicates that consumers have not fully benefited from the substantial reductions that have already taken place as reports recently filed by USTA[30] show, and as the Small Business Administration points out,[31] IXCs have failed to flow through to consumers the full extent of past access charge reductions. Therefore, the Commission should not be swayed by claims that consumers will benefit from forced access charge reductions.

B. ILEC Returns and "Margins" Are Reasonable and Do Not Justify a Rate Prescription.

AT&T asks the Commission to scuttle price caps because it claims that price cap LEC accounting earnings are higher than 11.25%[32] But nowhere does it demonstrate that prices are unreasonable, because they are not.

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[30] "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.

[31] SBA, *passim.*

[32] Interestingly, AT&T itself is earning 100 percent on equity, on its consumer base. According to investment analyst Anna Marie Kovacs:

> [AT&T's] return on assets right now and that particular -- in the long-distance consumer business is about 30 percent, and return on equity is well over 100 percent right now partly because of its equity over the years but simply because there's very small asset base. (Anna Marie Kovacs before the Illinois Commerce Commission in the Matter of Telecommunications Policy Open Meeting, Chicago, Illinois, July 14, 1998.)

According to Kovacs, AT&T has found a way to get 100 percent returns from its customers (primarily its consumer base). AT&T and MCI have done this by keeping the RBOCs out of the long-distance business and maintaining their cozy oligopoly.

As noted above, between 1991 and 1998, Ameritech access rates declined 60% compared to only 3.7% by 1997, for the rate of return carriers. Clearly, IXCs have been the up-front beneficiaries of the price cap plan; the LECs took the risk of finding efficiencies and the situation is a win-win one. Now that the price cap LECs have (at least to date) surmounted the required X-factor and increased their earnings somewhat, the IXCs are back for more.

AT&T suggested prescription[33] would have the Commission require that LECs price at the lower of price cap or rate of return rates. This converts a win-win regulatory regime into heads-I-win, tails-you-lose regulation. The increase in efficiency resulting from price caps are positive and should be encouraged. Represcribing rates would actually discourage further efficiency gains. In addition, there is no reason to "recapture" those gains at this point. IXCs have already received the benefits of price cap regulation by obtaining up-front, real-dollar rate reductions in access charges driven by the price cap index itself. Price caps put the risk on LECs to be more efficient. The IXCs bore no risk in that regard. In this context, it would be inappropriate to represcribe rates in a manner that essentially transferred the benefit of risk taking away from price cap LECs and to the IXCs who had no risk in the first instance.

MCI recommends using a modified rate of return methodology: the forward-looking computer models. Like traditional rate of return regulation, these models propose rates based on an analysis of expenses and rate base, with a return component. Unlike traditional rate of return, the models are not based on accounting information, but seek to pre-specify the rate base based on what is argued to be a better way to build a network. Thus, not only is the rate of return up for grabs, but so too is the entire rate base. The forward-looking cost model therefore has all of the incentive-damaging aspects of traditional rate of return regulation and does not even hold out the opportunity for the firm to earn a return commensurate with risks. The proposal should be rejected.

Moreover, the earned returns cited by AT&T and MCI as evidence of unreasonable rates are artifacts from regulatory accounting that (from an economic perspective) arbitrarily allocates joint and common costs from the firm as a whole to the interstate jurisdiction when computing a "return." According to Dr. Darby,[34] from an economic perspective, the return calculations are unreliable indicators of firm profitability:

> Earnings measures derived from regulatory accounting data, like those offered in IXC comments, are crude and unreliable indicators of "real economic" earnings. Earnings based on FCC-prescribed cost data are accounting fictions. Investors and managers alike understand the noneconomic content of the rules and simply do not rely on them to make "real economic" decisions. Both investors and managers are aware that FCC-reported earnings are extremely sensitive to assumptions made about the ration of capital consumption and prescribed depreciation schedules.[35]

The replacement of the price cap plan with de facto rate of return regulation based on FCC accounting data would give the ILECs the incentives to "manage to the numbers," which would be a step backward in policy efforts to align the incentives of all market participants to meeting the wants and needs of consumers rather than to the meeting of the complexities of regulation.

Moreover, as perceived by Dr. Darby, an attempt by the FCC to manage LEC earnings by manipulating the X-factor is a policy error because it would attempt to adjust a non-

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[33] AT&T at 24-27.

[34] *See*, Statement of Dr. Larry F. Darby submitted with USTA's reply comments this date.

[35] Darby statement at p.10.

compounding target (earnings) using a compounding policy lever (the X-factor).[36] That is, a constant X-factor places downward pressure on earnings in the sense that any cost-saving and productivity-enhancing achievements in one period will not help the company meet its X-factor goal in the next period; instead new achievements are needed. Accordingly, even a constant X-factor, over time, will serve to keep rates reasonable while ensuring that the incentive structure is aligned properly for the development of a fully competitive market.

In a further misguided application of financial analysis, MCI attempts to demonstrate that access charges are too high by saying that LEC profit margins are higher than MCI's profit margins. One of the margins that MCI evaluates is the EBITDA margin (earnings before interest, (income) taxes, depreciation and amortization) divided by revenue. An EBITDA charts is labeled "RBOCs Continue to Report Monopoly Profits". One serious error is that EBITDA is not a measure of profits. Basically, EBITDA is an accountant's quick way of developing cash flows from operations (CFO), an important indicator of cash inflow. But because EBITDA does not consider capital consumption and because EBITDA does not align the timing of revenues and expenses, it is not an indicator of profit or value. While EBITDA is useful for some financial analyses, it is useless in indicating profitability either for a single firm or between firms, especially firms such as IXCs and ILECs that have very different cost structures. All else the same (i.e.; same growth rates, etc.) providers of local exchange and exchange access services have a lot more cash outflow for capital spending than do providers of interexchange service, and a focus on EBITDA neglects this fundamental difference.

For example, to generate a dollar of interstate (access) revenue, Ameritech has had to

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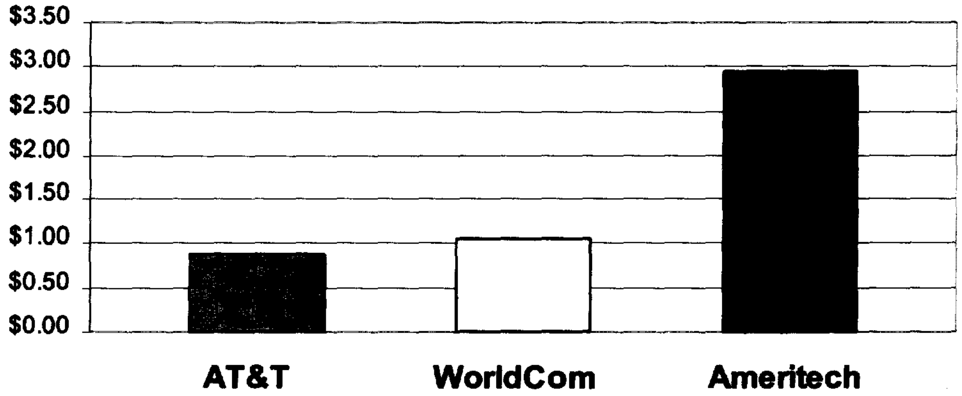
[36] *Id.* at footnote 6.

install a base of $2.93 of plant.[37] In contrast, AT&T needs an installed base of only $0.87 to generate a $1.00 of revenue, and MCI has a base of $1.06 (on a total corporate basis).[38] In other words, Ameritech needs about 3X as much telephone plant per dollar of revenue as AT&T or MCI. The costs associated with ILEC capital has to be covered, and ultimately, this is provided by EBITDA.

Gross Assets per Dollar of Revenue (1997)



MCI's also examines the net margins (*i.e.*, net income divided by revenues) of the RBOCs. The analysis is also flawed because it reports the margins of the holding companies, including the other diversified, non-regulated business.

MCI's varied analyses of margins therefore are wide of the mark from both a financial theory standpoint (*i.e.*, they ignore differences in capital intensity) and from a regulatory policy standpoint (the purpose of the analyses is to seek to convert price caps back into rate of return

[37] Source: ARMIS 43-01, 1997.

[38] Source: Bloomberg Investor Services.

regulation).

C. ILEC Cost of Capital Would Justify an Increase, Not a Decrease, in Price Cap Indices.

MCI's emphasis on changes in cost of capital[39] provides no justification for represcription. Even assuming that MCI's analysis reflects a lower price cap LEC cost of capital, that effect has already been captured in large part by the price cap inflater -- GDP-PI. The GDP-PI captures changes in cost of capital. To the extent that interest rates and the cost of equity capital have declined generally by operation of the marketplace, those changes ultimately flow through to end-product goods and services and are, therefore, reflected in GDP-PI. Arguably the only portion of the change in capital cost not already reflected in the price cap index is any change unique to price cap LECs. Since the inception of price caps, the only possible incremental change in LEC cost of capital relative to market cost of capital is an upward one. Since the inception of price caps, the risk of LEC regulated operations has increased substantially relative to the market. Since the inception of price caps, (1) the Commission has implemented expanded interconnection to stimulate competitive access activity, and (2) the Telecommunications Act of 1996 (the "Act") has effected measures to open up competitive exchange services. The increased risk of competitive local entry -- and with it the migration of exchange access business -- has only increased the risk to price cap LECs' interstate access operations. Thus, if any change is justified, it is an exogenous upward cost change to reflect the fact that GDP-PI has failed to take into account the increase in price cap LECs' capital costs relative to the market.

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[39] MCI at Attachment C.

D. Rejection of a Market-Based Approach and Reliance on Prescription Would Have Anti-Competitive Results.

Finally, several competitive providers themselves point out the benefits of a market-based approach and the corresponding dangers of prescription. NEXTLINK notes the fact that:

> 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 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.[40]

Similarly, Time Warner points out:

> [M]ost importantly, a market-based approach will permit the realization of dynamic long-term benefits, such as the entry of firms with lower costs than the ILECs.[41]

Similarly, ALTS notes that:

> The Commission's discussion of a prescriptive "back stop" in its access reform order was appropriately intended to be only that -- a back stop in those cases in which competition was developing too slowly.[42]

These comments simply confirm what Ameritech demonstrated in its comments -- that prescribing lower access charges is, quite simply, a "sure-fire" way to ensure that competition will not develop. It is in fact the very reason why competition for residential local exchange service is extremely slow in developing -- rates are prescribed at levels that are too low for competitors to realistically and profitably beat or even match in the marketplace.

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40 NEXTLINK at 4.

41 Time Warner at 4.

42 ALTS at note 6.

IV. THE COMMISSION SHOULD QUICKLY ADOPT A PRICING FLEXIBILITY FRAMEWORK THAT REFLECTS CHANGES IN THE COMPETITIVE ENVIRONMENT.

Those who oppose pricing flexibility for ILEC access services simply claim that it is premature because of the paucity of competition for those services. However, as noted above, the evidence is otherwise. Competitive pressure is substantial and growing. Therefore, as noted in Ameritech's comments, the Commission should act swiftly to complete the promise of its market-based approach to access reform by implementing a structure by which price cap LECs may modify their prices to respond to changes in market conditions. It is only in this manner that customers can be allowed to achieve the benefits of full competition for interstate services.[43]

Ameritech has placed on the record a reasonable pricing flexibility framework. USTA, in its comments, proposes a plan substantially similar to Ameritech's, which Ameritech also supports. Although some parties have criticized the use of DS1 equivalents as a trigger by arguing that it does not accurately reflect competitive market share, the utilization of DS1 equivalents in Ameritech's proposal was never intended to be as an indicator of market share. As noted above, with the market rapidly growing, embedded market share is literally irrelevant as an indicator of market power. If customers are easily accessible, and demand is rapidly growing, all competitors can compete on an equal footing for new growth. By looking at the amount of an ILEC's business that is addressable by active collocation arrangements, a picture can be obtained as to the amount of business, embedded and new growth, that is capable of

[43] In fact, AT&T's Petition vividly demonstrates the marketplace disadvantages of carriers' being bound by a hard and fast single tariff rule. Interestingly, granting AT&T's petition would result in potentially sanctioning discrimination in favor of AT&T in the assessment of access charges by its CLEC affiliates by authorizing CLECs to go "off tariff" in negotiating access prices with IXCs.

being immediately targeted by competitors. In this context, a more accurate picture of the actual competitive pressure on ILEC services is obtained by looking at active collocation arrangements as an indicator of the amount of business that is subject to immediate competitive pressure. Embedded market share is irrelevant.

V. CONCLUSION.

In light of the foregoing, the Commission should refuse to prescribe access rates, or to increase the price cap X-factor. Instead, the Commission should act swiftly to implement a pricing flexibility framework, similar to that proposed by Ameritech or USTA, to enable customers to achieve the benefits of increased competition for interstate access services.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I, Todd H. Bond, do hereby certify that a copy of the foregoing Reply Comments of Ameritech has been served on all parties listed on the attached service list, via first class mail, postage prepaid, on this 9th day of November, 1998.

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