where they remain necessary. MCI's arguments ignore many of the benefits of reduced regulation, particularly in the face of developing competition.

The Commission has long believed that, as a matter of policy, unnecessary regulations are contrary to the public interest because they impose costs on the regulated entities that are passed on to consumers. *Order* ¶¶ 89, 90, 144 (JA 281-82, 307). As competition develops in the local exchange and exchange access markets, regulatory restrictions may become counter-productive. *Order* ¶ 19 (JA 243-44). The Commission has stated that it will endeavor "to ensure that our own regulations do not unduly interfere with the operation of these markets as competition develops." *Order* ¶ 1 (JA 235).

Over the course of many years, the Commission has worked to open the interstate access market to competition and to relax regulation as competition develops. *Order* ¶ 67 (JA 267-68). *See also Access Charge Reform*, 12 FCC Rcd 16094 (¶ 63). The *Order* in this case is the logical next step in a series of decisions to reduce regulation and allow pricing flexibility. *See, e.g.*, *Order* ¶ 14 (JA 240) (since 1990, the Commission has taken "significant steps to increase the LECs' pricing flexibility and ability to respond to the advent of competition in the exchange access market"). *See also Order* ¶¶ 15-18 (JA 241-243).

MCI's claim that the Commission's decision departs from longstanding regulatory tradition is premised on several inaccurate assertions. MCI asserts that the Commission in the past has granted pricing flexibility only upon a showing of "substantial competition," and suggests that the Commission may not deviate from existing price cap regulation in the absence of such a showing. MCI Br. at 38. This assertion ignores the fact that the Commission is not required to regulate by any particular method, but instead is permitted to establish regulations it deems necessary in the public interest. 47 U.S.C. § 201(b). *See Permian Basin Area Rate*

Cases. 390 U.S. 747, 776-77 (1968) (unless applicable statute indicates otherwise, agencies are not bound to use any single regulatory method and may "make pragmatic adjustments which may be called for by particular circumstances"); *FPC v. Hope Natural Gas*, 320 U.S. 591, 602 (1944).

The transition from rate-of-return regulation to price cap regulation was itself a significant grant of pricing flexibility, and that grant did not depend on a determination that the ILECs faced "substantial" competition. *Policy and Rules Concerning Rates for Dominant Carriers*, Second Report and Order, 5 FCC Rcd 6786. In other instances, too, the Commission has reduced regulation and allowed pricing flexibility without requiring such a showing. *See, e.g., Special Access Expanded Interconnection* Order, 7 FCC Rcd at 7454 n.411; *Virtual Collocation Order*, 8 FCC Rcd at 7426, 7433-34, ¶¶ 98-99, 115-117 (relying on collocation and interconnection agreements to determine whether to give ILECs flexibility to deaverage rates and offer volume and term discounts).

MCI points to the findings that the Commission required prior to declaring AT&T to be non-dominant. Those decisions are not analogous to this case. The Commission has not deregulated the ILECs, nor has it declared them to be non-dominant, as it did in the case of AT&T.[20] It has merely reduced regulation with respect to *certain services* in limited areas if *certain showings* are made. MCI's reliance on the Commission's analysis with respect to

[20] In fact, the Commission rejected several ILEC petitions requesting forbearance from regulation as "dominant" carriers with respect to special access and dedicated transport services. *U S WEST Forbearance Order, supra.*

AT&T's status as a non-dominant carrier is thus misplaced.[21] There is no merit to MCI's claim that the Commission was somehow deficient because it failed to apply the same "detailed economic analysis" in this case that it has applied in non-dominance proceedings in a different regulatory context. *See* MCI Br. at 8, 39. The Commission is not required to apply this rigorous standard to pricing flexibility proceedings, nor has it done so in the past.

The Commission reasonably determined that the limited regulatory relief it was making available did not warrant the costly, time-consuming proofs typically required in non-dominance proceedings. *Order* ¶¶ 90, 92 (JA 281-83). The Commission was justified in adopting a standard that relies on information that is currently available, reliable, and verifiable. *Order* ¶ 103 (JA 289). The Commission did not commit reversible error by choosing as one of its criteria "an easily verifiable bright-line test" that would avoid unnecessary administrative burdens. *Order* ¶ 78 (JA 273). *See also* MCI Br. at 40-41 (acknowledging that Commission need not ignore concerns of administrative convenience). Nor was the Commission required to delay granting pricing flexibility until it had a very precise measure of competitive entry. *NARUC*, 737 F.2d at 1116; *Allied Local and Regional Manufacturers Caucus v. EPA*, 2000 WL 737750, *7

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[21] MCI notes that the Commission found that AT&T remained dominant despite capital investments by competitors totalling more than $300 million. MCI Br. at 29. Even if that were a relevant comparison, there is evidence that competitive local exchange carriers have invested more than $30 *billion* in new networks since the 1996 Act was passed and are investing more than $1 billion every month in their networks. *See* ALTS' [Association for Local Telecommunications Services] Annual Message on the State of Competition in Local Telecommunications, February 2000, *An Open Letter From John Windhausen, Jr., President of ALTS*, Feb. 2, 2000 at 1 and Graphic F; http://www.alts.org/ALTSAnnual%20Report.pdf. *See also* Telecommunications @ the Millenium, The Telecom Act Turns Four, Office of Plans and Policy, FCC, Feb. 8, 2000 at 6, Figure 10; http://www.fcc.gov/Speeches/Kennard/2000/telecomatthemilleniumbw.pdf.

(D.C. Cir. 2000) (agency may rely on imperfect information that exists and is not required "to invest in resources to conduct the perfect study").

II. THE COMMISSION MADE REASONABLE PREDICTIVE JUDGMENTS ABOUT FUTURE COMPETITIVE ENTRY.

The Commission tailored its pricing flexibility rules in a manner designed to benefit consumers and permit ILECs to respond to competition. Moreover, the Commission took significant steps to protect consumers from potentially adverse consequences of reduced regulation. The Commission described both the benefits of granting pricing flexibility and the consumer protections that would be available with respect to each of the pricing flexibility rules that MCI challenges. Each of the Commission's decisions to grant regulatory relief should be evaluated with regard to (1) the extent of the relief granted, (2) the benefits of pricing flexibility, (3) the protections for consumers, (4) and the costs associated with denying LECs pricing flexibility to respond to competition. MCI's criticisms largely ignore these considerations.

A. The Decision To Offer Phase I Pricing Flexibility Was Reasonable.

The Commission's decision to permit ILECs to offer contract tariffs and volume and term discounts pursuant to "Phase I" pricing flexibility enables consumers to obtain lower rates, either through negotiation or through bulk purchases. Prior to the pricing flexibility decision, price cap LECs could lower their rates, but only if they did so throughout a study area or density pricing zone. *Order*, ¶ 122 (JA 298). With their new flexibility, price cap LECs no longer need to "choose between lowering a rate throughout the area at issue or not lowering it at all." *Id.* The Commission found that volume and term discounts encourage ILECs "to develop efficient rate structures," and also "avoid distorting the market or impeding the development of effective competition." *Order*, ¶ 126 (JA 300). Similarly, the Commission found that contract tariffs benefit access customers "because they enable incumbent LECs to tailor services to their customers' individual needs." *Order*, ¶ 128 (JA 301).

The Commission established significant protections to ensure that Phase I pricing flexibility will not harm consumers either directly or by enabling the LECs to exclude competitors. First, ILECs must continue to offer under price caps any services for which they obtain Phase I pricing flexibility. Thus, customers may be able to obtain *lower* rates, pursuant to volume and term discounts or contract tariffs, but the ILECs' ability to *increase* rates for those services is still constrained by price caps. *Order*, ¶ 122 (JA 298). MCI largely ignores this fact. For example, MCI claims that under Phase I, ILECs may offer contract tariffs that are "entirely free of price cap regulation...." MCI Br. at 18. The ability to offer contract tariffs, however, does not relieve the ILEC of its obligation to offer those same services pursuant to general schedules that remain subject to price caps. *Order*, ¶ 132 (JA 303).

Second, in order to attain Phase I flexibility, ILECs must show that "competitors have made irreversible investments in the facilities needed to provide the services at issue...." *Order* ¶ 69 (JA 268). Once competitors have made this irreversible investment, the Commission concluded, "we no longer need to protect competition from exclusionary pricing behavior by incumbent LECs because efforts to exclude competitors are unlikely to succeed." *Order* ¶ 77 (JA 272). The Commission observed that "in the past, the presence of an operational collocation arrangement in a wire center almost always implied that a competitor has installed transmission facilities to compete with the incumbent." *Order* ¶ 82 (JA 276). MCI does not disagree that collocation facilities indicate the presence of a potential competitor. MCI Br. at 28 (existence of collocation indicates "the presence of a single, potential competitor").

Third, the Commission requires the ILEC to show that, in each wire center relied on by the ILEC in its petition for pricing flexibility for special access and dedicated transport, at least one competitor is obtaining transport from facilities of a carrier other than the ILEC. *Order* ¶ 82 (JA 276-77). This requirement provides additional assurance that competitive transport facilities exist within the applicable MSA. The Commission imposed this additional protection because it recognized that, with the "advent of services such as digital subscriber line (DSL) services," carriers might have an incentive to collocate for reasons other than providing transmission in competition with the ILEC. *Id.*

Fourth, the Commission noted that price cap LECs still have an obligation to charge just and reasonable rates, and that their rates are subject to challenge pursuant to sections 201 and 208 of the statute. *See, e.g., Order* ¶¶ 127, 131 (JA 300-01, 302-03). These remedies are not inconsequential, as MCI suggests. MCI Br. at 42-43.[22] The Commission's enforcement procedures constrain the ILECs' freedom to establish unreasonable rates at the outset, and can award damages when rates are successfully challenged.[23] MCI argues that the Commission "has never before relied on the mere existence of a complaint procedure as the sole bulwark" against a company with market power. MCI Br. at 43. But, as set forth herein, the complaint procedures are only one of a myriad of protections to alleviate concerns about market power abuse.

[22] In fact, long distance carriers recently argued to this Court that the Commission's enforcement procedures subject carriers to "'damages as well as fines and penalties.' 47 U.S.C. §§ 206-208, 501-03 (1994)." *American Public Communications Council v. FCC*, No. 99-1114 (D.C. Cir. June 16, 2000) slip op. at 10.

[23] Carriers that knowingly charge unjust or unreasonable rates are subject to additional penalties. 47 U.S.C. § 202(c).

Fifth. ILECs must make their volume and term discounts "available to any customer with sufficient volumes or willing to commit to a given term." *Order* ¶ 124 (JA 299). Similarly, ILECs must make their contract tariffs available to all similarly situated parties. *Order*, ¶ 130 (JA 302). The Commission also imposed an additional check to make sure that ILECs do not offer contract tariffs in an exclusionary manner: An ILEC may not offer a contract tariff to an affiliate until an unaffiliated customer purchases service pursuant to that contract. *Order*, ¶ 129 (JA 301-02).

Finally, the Commission eliminated the low-end adjustment mechanism for ILECs that qualify for and obtain Phase I or Phase II pricing flexibility. *Order* ¶ 162 (JA 314). The low-end adjustment enables price cap carriers to increase their caps if their earnings fall below a prescribed rate of return. *Order* ¶ 160 (JA 313-14). The Commission recognized that, as the demand associated with non-price cap services increases (as it likely will once an ILEC obtains Phase I or Phase II pricing flexibility), the ILEC has an incentive to underallocate the costs of its non-price cap services. *Order* ¶ 163 (JA 314-15). By eliminating the low-end adjustment mechanism, the Commission significantly reduced the incentives to misallocate costs.

B. The Decision To Offer Phase II Pricing Flexibility Was Reasonable.

The Commission concluded that it should allow even greater pricing flexibility with respect to a limited set of services – special access and dedicated transport – upon a showing that "competitors have established a significant market presence, *i.e.*, that competition for a particular service within the MSA is sufficient to preclude the incumbent from exploiting any monopoly power over a sustained period." *Order* ¶ 141 (JA 306). The Commission found that retaining the Part 69 rate structure where and when it was no longer necessary "can impose costs on an incumbent LEC by limiting its ability to develop rate structures in response to market forces." *Order* ¶ 144 (JA 307). The Commission held that "retaining the Part 69 rate structure imposes costs on society by perpetuating inefficiencies in the market for interstate access services." *Id.* The Commission concluded that ILECs should be free to compete against competitors once the Phase II triggers are satisfied, and that the market, rather than regulation, would work best "in setting efficient rate levels and rate structures." *Order* ¶ 154 (JA 311).

The Commission also took steps to protect consumers under the relaxed Phase II regime. First, ILECs must continue to file generally available tariffs. *Order* ¶¶ 151, 153 (JA 310-11).[24] The Commission pointed out that the relief offered under Phase II was not equivalent to non-dominant treatment, because of the tariff filing requirement and because relief was granted only with respect to a limited area rather than on a nationwide basis. *Order* ¶ 151 (JA 310).

Second, in order to obtain Phase II flexibility, ILECs must show that competitors have established a "significant market presence" and that "IXCs have a competitive alternative for dedicated transport facilities needed to reach the majority, although not necessarily all, of their local customers throughout the MSA, and that almost all special access customers have a competitive alternative." *Order* ¶¶ 141-142 (JA 306). These triggers "are sufficient to ensure that incumbent LECs cannot exercise any remaining monopoly power indefinitely." *Order* ¶ 144 (JA 307). The Commission found that, if an ILEC attempted to charge an unreasonably high rate

[24] This enables the Commission to review and potentially suspend the rates before they take effect. 47 U.S.C. § 204(a)(1). As a practical matter, the Commission will be limited in its ability to suspend tariffs before they take effect because they are subject only to one day's notice. The Commission has, however, exercised its authority to suspend a tariff filed on one day's notice. *See Interexchange Carrier End-User Charges to Recover Universal Service Contributions*, Suspension Order, 14 FCC Rcd 20032 (Competitive Pricing Division, Common Carrier Bureau 1999).

for a part of the MSA that lacks a competitive alternative, such behavior would induce competitive entry, which in turn would restore rates to reasonable levels. *Id.* Third, the Commission required the ILEC to show that, in each wire center relied on by the ILEC in its petition for pricing flexibility, as least one competitor is obtaining transport from a carrier other than the ILEC. 47 C.F.R. § 69.711(c).

Fourth, even after obtaining Phase II relief, carriers remain subject to statutory obligations to charge just, reasonable and nondiscriminatory rates. 47 U.S.C. §§ 201(b), 202(a). Parties may challenge an ILEC's tariff filing, and they may bring complaints pursuant to the Commission's enforcement procedures. As noted above, these provisions constrain the ILEC's incentive to charge unreasonable prices at the outset, and help ensure that any unreasonable charges that become effective do not continue. Finally, as noted above, carriers that obtain Phase II pricing flexibility must relinquish the protection afforded by the low end adjustment mechanism. *Order* ¶ 162 (JA 314).

C. The Commission Reasonably Relied on Collocation Arrangements as Indicia of Competition.

The Commission established two alternative collocation "triggers" for ILECs seeking pricing flexibility for special access and dedicated transport services.[25] The Commission determined that these triggers provided a reasonable indication that competitors have made capital investments significant enough to alleviate concerns about anticompetitive pricing by the ILECs. The Commission found that carriers collocated for the purpose of providing service in

[25] The requirement for obtaining Phase I pricing flexibility for common line and traffic-sensitive services is different from the trigger for obtaining pricing flexibility for special access and dedicated transport services. Pricing flexibility for common line and traffic-sensitive services requires a showing that competitors are actually offering service to 15 percent of the ILEC's customer locations within the MSA. *Order* ¶¶ 108, 119-120 (JA 291, 295-96).

competition with the LEC and that the presence of operational collocation arrangements is a good indicator of competitive entry. The first method considers whether there are collocation facilities in a certain percentage of wire centers within the MSA for which the ILEC seeks pricing flexibility. The second method looks at whether there are collocation facilities in wire centers accounting for a certain percentage of the ILEC's revenues for the services for which the ILEC seeks pricing flexibility within the MSA. MCI objects to these triggers on several grounds.

1. MCI argues that Phase I and Phase II pricing flexibility permits deregulation without any showing that competitors have acquired a substantial share of the market. MCI Br. at 28, 30, 31, 38, 39. MCI's argument is premised on two false assumptions. First, it assumes that the Commission "deregulated" the ILECs and gave them the equivalent of non-dominant status. Second, it assumes that the Commission was required to apply the evaluation criteria in this case that it has applied to petitions for non-dominance. As explained above, the Commission did not deregulate the ILECs but in fact retained tariffing and other requirements to restrain abuse of market power. Moreover, the Commission explained and justified its decision not to rely on market share.

The Commission determined that the presence of collocation facilities was a reliable indicator "that there is irreversible investment sufficient to discourage exclusionary pricing behavior...." *Order*, ¶ 78 (JA 272-73). MCI does not meaningfully address the Commission's determination that collocation facilities are a reliable indicator of competitive pressures. In fact, MCI acknowledges that collocation arrangements indicate the presence of a competitor, but claims that such facilities do not demonstrate that competitors have a significant market share in that wire center. MCI Br. at 28.

The Commission's reliance on collocation facilities was reasonable. The Commission found (and MCI does not dispute) that "competitors incur considerable expense to establish an operational collocation arrangement." *Order*, ¶ 81 (JA 276). In addition to the significant financial outlays necessary to establish collocation facilities, competitors spend substantial time and resources to negotiate collocation agreements. *Id.* Competitors go to this expense and expend these resources for the purpose of providing competitive service. Looking to the presence of collocation arrangements, moreover, represents a reliable and relatively simple way to evaluate whether competitive pressures exist. *Order*, ¶ 84 (JA 277-78). The Commission found that other potential indicators of competition – such as satisfaction of an extensive checklist modeled on section 271 of the Act, 47 U.S.C. § 271(c)(2)(B), which governs BOC entry into long distance service -- are costly and difficult to verify and not necessary to the task at hand. *Id.*

MCI contends that the existence of collocation arrangements in itself does not demonstrate that there is significant competition. MCI's argument is inapposite because it equates competitive pressure with market share. But the Commission did not conclude that a loss of market share was necessary to constrain an ILEC's prices. To the contrary, the Commission found that the presence of substantial sunk investment by a competitor imposes restraints on anticompetitive behavior. The Commission noted:

> Another firm can buy the facilities at a price that reflects expected future earnings and, as long as it can charge a price that covers average variable cost, will be able to compete with the incumbent LEC. In telecommunications, where variable costs are a small fraction of total costs, the presence of facilities-based competition with significant sunk investment makes exclusionary pricing behavior costly and highly unlikely to succeed.

Order, ¶ 80 (JA 274-75).[26] The Commission reasonably relied on the economic principle that an incumbent monopolist's ability to set unreasonable prices is constrained if competitors can readily enter the market without incurring additional costs. *See Order* ¶¶ 79-80 (*citing in support, e.g.*, S. Martin, INDUSTRIAL ECONOMICS: ECONOMIC ANALYSIS AND PUBLIC POLICY 414-15 (1998)). *See also* Areeda, Hovenkamp & Solow, IIA, *Antitrust Law: An Analysis of Antitrust Principles and Their Application* 160-61 (1995); Landes and Posner, *Market Power in Antitrust Cases*, 94 Harv. L. Rev. 937, 950 (1981); Baumol, Panzer & Willig, *Contestable Markets and The Theory of Industry Structure* 292 (1982) (if a market is subject to costless reversible entry, an incumbent will charge market rates even if it is a monopolist).

2. MCI contends that, even if there is some competition in the market for entrance facilities (the connection between the serving wire center and the IXC's POP), there is no competition for interoffice transport (the connection between the LEC's end office and the serving wire center). MCI thus argues that the Commission should have established different triggers for entrance facilities and interoffice transport. MCI's argument ignores the fact that wire centers include end offices as well as serving wire centers, and in fact, the vast majority of wire centers *are* end offices.[27] In addition, evidence in the record before the Commission

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[26] MCI's reference to the Commission's decision in *Implementation of the Local Competition Provisions of the 1996 Act*, Third Report and Order, 15 FCC Rcd 3696 (1999) (*UNE Remand Order*) is not on point. *See* MCI Br. at 30. As the Commission noted, the Commission's determination that new local service providers need access to unbundled transport was different from (and not inconsistent with) its determination here that, once competitors have established a significant market presence marked by collocated facilities, the Commission should allow pricing flexibility. *UNE Remand Order*, 15 FCC Rcd at 3849 n. 673 ("Competition evidenced by the satisfaction of certain triggers, to the extent they are met, does not demonstrate that a requesting carrier is not impaired without access to unbundled dedicated transport"). Indeed, ensuring unfettered entry into the local exchange market through the use of unbundled elements goes hand-in-hand with the need to allow ILECs to meet competition as it develops.

[27] Serving wire centers may themselves serve as end offices.

showed that collocation in serving wire centers was only a fraction of all collocated facilities within an MSA. *See, e.g.*, May 27, 1999 Ex Parte from Kenneth Rust, director, Federal Regulatory Affairs, Bell Atlantic, to Magalie Roman Salas, Secretary, FCC (JA 221, 229) (maps delineating collocation in serving wire centers and other wire centers). The Commission's decision not to distinguish between interoffice transport and entrance facilities for purposes of quantifying collocation arrangements was reasonable. *See United States v. FCC*, 652 F.2d 72, 93-94 (D.C. Cir. 1980) (it is within Commission's authority as expert agency to determine relevant market for purposes of evaluating competition); *SBC Communications, Inc. v. FCC*, 56 F.3d 1484, 1492 (D.C. Cir. 1995).

3. MCI makes a similar argument regarding the Commission's decision to allow pricing flexibility for "channel termination" facilities used to provide service between the end office and the customer premises. MCI argues that carriers are more likely to deploy transport facilities at entrance facilities than between the end office and the customer premises. The Commission recognized that collocation arrangements at the end office that connect the end office and the customer premises do not represent the same competitive threat to the ILEC as collocation arrangements used to connect the end office and the serving wire center, which carry traffic from one point of traffic concentration to another. *Order*, ¶ 102 (JA 288). The Commission addressed

this by requiring a substantially higher demonstration of collocation for an ILEC to qualify for pricing flexibility for channel terminations between the end office and the customer premises.[28]

MCI argues that the Commission's triggers would provide pricing flexibility for channel termination even if there were no competitive facilities used to connect the end office and the customer premises. The Commission recognized and responded to this concern. *Order*, ¶ 103 (JA 289). The Commission nevertheless concluded that the presence of competitive collocation facilities was the most reliable indicator of competition, including between the end office and customer premises. Moreover, the Commission reasoned that, because competitors have an incentive to extend their facilities all the way to customer premises, it was likely that some of the sunk investment in collocation facilities was used for channel terminations between end offices and customer premises. *Order*, ¶ 104 (JA 289-90). The Commission found that, to the extent that competitors were leasing unbundled loops from the ILEC to reach customers, this was most likely transitional. *Id.*

The Commission found that there was no reliable way to measure actual competition, such as by measuring market share or competitors' revenues from channel termination, because those data were not available. *Id.* The petitioners do not assert otherwise.[29] The Commission

[28] To obtain Phase I pricing flexibility for channel terminations, ILECs must show that competitors have collocated in at least 50 percent of the wire centers in the MSA, or in wire centers accounting for at least 65 percent of the ILEC's revenues from those services. 47 C.F.R. § 69.711(b). To obtain Phase II pricing flexibility, ILECs must show that competitors have collocated in at least 65 percent of of the wire centers in the MSA, or in wire centers accounting for at least 85 percent of the ILEC's revenues from those services. 47 C.F.R. § 69.711(c). In addition, at least one collocator in each of the wire centers relied on by the ILEC in its petition must be using transport facilities owned by an entity other than the ILEC. 47 C.F.R. § 69.711(b) and (c).

[29] AT&T acknowledged that there is no way, currently, to accomplish its proposal to measure competitors' revenues. *Order*, ¶ 103 (JA 289).

was not required to delay making a decision until it had obtained such information. As the Court has stated, "Someone must decide when enough data is enough. In the first instance, that decision must be made by the Commission . . . not by parties to the proceeding and not by the courts. . . . To allow others to force the Commission to conduct further evidentiary inquiry would be to arm interested parties with a potent instrument for delay." *United States v. FCC*, 652 F.2d at 90-91.

4. The Commission reasonably determined that, in addition to considering whether competitors had collocated in a certain percentage of wire centers within the MSA, it could, alternatively, consider whether competitors had collocated in wire centers accounting for a certain level of the ILEC's revenues within the MSA. The Commission concluded that "collocation in wire centers representing a significant percentage of incumbent LEC revenues from a particular service also indicates meaningful investment by competitors." *Order* ¶ 97 (JA 286). As the Commission recognized, "competitors are drawn to new markets by the prospect of earning revenues...." *Order* ¶ 87 (JA 280). Thus, in determining whether there is a competitive presence that will constrain the ILEC's ability to charge unreasonable prices, it is significant that competitive facilities exist in revenue-generating portions of the serving area.[30] MCI argues that looking at the ILEC's revenues ignores whether competitors have a substantial market share. MCI Br. at 31-32. MCI once again misses the point: the Commission did not purport to determine whether competitors had captured a certain portion of the market, but rather whether there exists a competitive presence significant enough to constrain abusive pricing practices. If

[30] The Commission set a higher threshold for the revenue-based trigger to account for the fact that in some areas, a small number of wire centers may account for a large portion of revenues, and "to ensure that competitors have extended their networks beyond a few revenue-intensive wire centers." *Order* ¶ 98 (JA 286).

competitors are poised to compete for a significant portion of the ILEC's revenues, the ILEC has disincentives to charge unreasonable prices.

5. MCI argues that the Commission improperly included unbundled network elements in evaluating whether there is a sufficient level of competitive facilities to warrant pricing flexibility for common-line and traffic-sensitive services. Competitors must provide their own transport and switching in order to satisfy the pricing flexibility triggers for common line and traffic-sensitive services. *Order*, ¶¶ 111-113 (JA 292-93). Thus, ILECs will not be granted pricing flexibility unless competitors have made sunk investment. Where competitors use their own transport and switching, however, the fact that they also may lease unbundled loops from the ILEC does not disqualify those competitive facilities from being included for purposes of determining whether the pricing flexibility triggers are satisfied. This decision is consistent with the Commission's determination that, in deciding whether to grant pricing flexibility, it should look at whether competitors have sunk investment in facilities. *Order*, ¶ 111 (JA 292).[31]

6. MCI notes that, in order to qualify for Phase I or Phase II relief, an ILEC must show that at least one competitor is relying on transport facilities provided by an entity other than the ILEC. The Commission imposed this requirement to provide additional assurance that each wire center relied on by the ILEC in its pricing flexibility petition has competitive transport facilities. *Order* ¶ 82 (JA 276-77). MCI argues that, by not imposing any capacity requirements, an ILEC might qualify for pricing flexibility even if there are "competitors possessing facilities that are

[31] MCI ignores the fact that to qualify for pricing flexibility for common line and traffic-sensitive services, competitors must "actually offer" these services to 15 percent of an ILEC's customer locations within the MSA. *Order* ¶ 120 (JA 296). Thus, the trigger for these services differs from the trigger for special and dedicated transport services, which only requires the ILEC to show that competitors have collocated in 15 percent of the MSA's wire centers.

capable of serving only a small fraction of the customers in that wire center...." MCI Br. at 31. MCI's argument is without merit. The technological advances in fiber and electronics have made expansion of transport capacity relatively inexpensive. *See, e.g., Application of WorldCom, Inc. and MCI Communications Corporation for Transfer of Control of MCI Communications Corporation to WorldCom, Inc.*, Memorandum Opinion and Order, 13 FCC Rcd 18025, 81063 (¶ 64) (1998). Once a competitor has infrastructure in place, the marginal cost of adding customers is not significant, and competitors are not likely to lack sufficient capacity for an extended period. *See, e.g.*, Mitchell and Vogelsang, *Telecommunications Pricing: Theory and Practice* 14 (1991).

D. The Commission's Selection of Particular Triggers Was Reasonable.

The Commission recognized that establishing specific collocation triggers was a policy determination rather than a scientific endeavor. *Order* ¶ 96 (JA 286). The Commission made a reasonable judgment on the basis of evidence before it. *Association of Oil Pipelines v. FERC*, 83 F.3d 1424, 1436 (D.C. Cir. 1996) (Commission is entitled to deference where it considered the options and articulated the reasons for its decision). This Court has said that it is "generally 'unwilling to review line-drawing performed by the Commission unless a petitioner can demonstrate that lines drawn ... are patently unreasonable, having no relationship to the underlying regulatory problem.'" *Cassell v. FCC*, 154 F.3d 478, 485 (D.C. Cir. 1998) (quoting *Home Box Office, Inc. v. FCC*, 567 F.2d 9, 60 (D.C. Cir. 1977)). The Commission's triggers bear a clear relationship to the underlying regulatory problem. Moreover, the Court has held that, in reviewing a numerical standard, the question is "whether the agency's numbers are within a 'zone of reasonableness.' not whether its numbers are precisely right.'" *Hercules Inc. v. EPA*, 598 F.2d 91, 107-08 (D.C. Cir. 1978).

The collocation triggers are of a predictive nature: they rest on a prediction that a certain amount of collocation will be sufficient to constrain monopoly pricing practices by ILECs. Courts have repeatedly refused to strike down such predictive judgments on the grounds that they are imprecise or lack extensive support in the record. As the Supreme Court has said, "In such circumstances, complete factual support in the record for the Commission's judgment or prediction is not possible or required; 'a forecast of the direction in which future public interest lies necessarily involves deductions based on the expert knowledge of the agency.'" *FCC v. National Citizens Committee for Broadcasting*, 436 U.S. 775, 814 (1978) (quoting *FPC v. Transcontinental Gas Pipe Line Corp.*, 365 U.S. 1, 29 (1961)). *Accord, FCC v. WNCN Listeners Guild*, 450 U.S. 582, 593-95 (1980); *NARUC v. FCC*, 737 F.2d at 1117. In *NARUC*, this Court held that the Commission was not required to delay implementing a regulatory response until the anticipated concern – in that case, uneconomic bypass – had "matured as a market-place force to be reckoned with." 737 F.2d at 1116.

The Commission determined that, to obtain Phase I pricing flexibility, competitors needed to have made "irreversible investments in facilities" within the MSA. *Order* ¶ 77 (JA 272). The Commission considered the investments associated with negotiating collocation agreements and establishing collocation facilities, and concluded that, if competitors had made such investments in at least 15 percent of the wire centers within the MSA, that constituted "irreversible investment." *Order* ¶ 81 (JA 275-76).[32] The Commission noted that record evidence indicated that, where there was collocation in 15 percent of the wire centers in an MSA, competitors had installed a substantial amount of competitive transport facilities. *Order* ¶ 95 (JA 284-85). The Commission also found that collocation is likely to underestimate the amount of competitive facilities because it ignores competition that completely bypasses the ILEC's facilities. *Order* ¶¶ 95, 109 (JA 284-85, 291-92).[33]

The Commission was well aware that different parties were advocating different methods of measuring competitive entry. For example, the Commission stated that it was setting its Phase I collocation trigger at 15 percent (less than the level advocated by IXCs and some ILECs) because Phase I would offer less extensive relief than the relief proposed in the ILECs' comments. *Order* ¶¶ 94-95 (JA 284-85). *See also Order* ¶ 117 (JA 295). Moreover, the Commission rejected the ILECs' proposal that triggers be determined on the basis of the percentage of demand that was "addressable" by competitors. This would have included competition provided using collocation, unbundled network elements, or the presence of competitive facilities anywhere in the wire center (*i.e.*, total bypass). The Commission rejected

[32] The Commission noted that a single collocation arrangement could exceed $300,000. *Order* ¶ 81 (JA 276). The Commission refused to include resale and unbundled network elements in its trigger because those methods of competitive entry do not require substantial sunk investment. *Order* ¶ 88 (JA 280-81).

[33] The Phase I trigger for common line and traffic-sensitive access services does take into account competitors that have bypassed the ILEC's facilities. *Order* ¶ 110 (JA 292). The Commission noted that competition for these services is relatively new, and that, in contrast to dedicated transport and special access, the Commission did not have a history upon which to predict entry methods for switched services. *Order* n.319 (JA 296). The Commission thus decided that, because total bypass may be a key method of entry in the switched access service markets, it could not ignore such entry methods for purposes of evaluating whether the trigger had been satisfied. *Order* ¶ 119 (JA 295-96).

suggestions that it include unbundled network elements and resold services in calculating the degree of competitive entry because, it concluded, those facilities did not represent substantial sunk investment. *See, e.g.*, *Order* ¶ 88 (JA 280-81). The Commission rejected proposals to include competition that bypassed the ILEC's facilities because there was no reliable method to measure such competitive activity. *Order* ¶¶ 95, 104 (JA 284-85, 289-90).

The Commission determined that, to obtain Phase II pricing flexibility, IXCs should have a competitive alternative for dedicated services to reach "the majority" of their long distance customers in the MSA and that "almost all" special access customers should have a competitive alternative. *Order* ¶ 142 (JA 306). The Commission's triggers are consistent with this determination.

To obtain Phase II pricing flexibility (other than for channel terminations), an ILEC must demonstrate that competitors have established collocation facilities in 50 percent of wire centers in the MSA or in wire centers comprising 65 percent of the ILEC's revenues for the services for which pricing flexibility is sought. For channel terminations, the triggers are 65 percent and 85 percent, respectively. As in Phase I, the Commission noted that these triggers do not account for competitive carriers that bypass the ILEC's facilities completely. *Order* ¶ 148 (JA 308). Competitive providers have been offering special access service over their own facilities for many years. *See, e.g.*, *Special Access Expanded Interconnection Order*, 7 FCC Rcd at 7373 ¶ 4 and n.5 (competitive access providers have deployed their own facilities to provide "significant amounts of high capacity special access traffic in certain urban areas"). Thus, the amount of competitive facilities for special access that is not reflected in the collocation triggers may be significant, especially in certain areas.[34]

MCI asserts that ILECs have said they can immediately qualify for Phase I pricing flexibility in 45 of the 50 largest MSAs and Phase II pricing flexibility in 35 of the 50 largest MSAs – as if that were an indictment of the triggers. MCI Br. at 21, 41-42. In the first place, that claim is unverified: No carrier has petitioned yet for Phase I or Phase II pricing flexibility. More importantly, the fact that there may be substantial levels of competitive facilities in the largest urban areas hardly proves that the Commission's standard was erroneous. In fact, it suggests that the triggers are most likely to be satisfied initially in large urban areas, where competition would be expected to develop first.

III. THE DECISION TO GRANT PRICING FLEXIBILITY ON AN MSA-WIDE BASIS WAS REASONABLE.

The Commission evaluated the record and determined that petitions for pricing flexibility should be decided on an MSA basis.[35] The Commission found that "MSAs best reflect the scope of competitive entry." *Order* ¶ 72 (JA 270). The Commission explained its reasons for not selecting a larger or a smaller geographic area. *Order* ¶¶ 72-75 (JA 270-71). That decision is entitled to deference. *Association of Oil Pipelines v. FERC*, 83 F.3d at 1436; *Indiana Municipal Power Agency v. FERC*, 56 F.3d 247, 254 (D.C. Cir. 1995). In particular, the Commission found that granting pricing flexibility in geographic areas smaller than MSAs, such as individual wire centers, would require incumbents to file many additional pricing flexibility petitions and that

[34] In addition, the Commission observed that these triggers correlated to a substantial amount of fiber deployment. *Order* ¶ 148 (JA 308-09).

[35] The Commission found that pricing flexibility petitions for areas that are not included in an MSA should be decided on a study area basis. *Order* ¶ 76 (JA 271). MCI does raise any object to that determination.

"the record does not suggest that this level of detail justifies the increased expenses and administrative burdens associated with these proposals." *Order* ¶ 74 (JA 271). MCI does not offer any evidence to suggest that that decision was unreasonable.

MCI contends that the decision to grant pricing flexibility on an MSA-wide basis "will grant the LEC dramatic pricing flexibility *throughout* the MSA," including areas where the ILEC does not face competition. MCI Br. at 33 (emphasis in original). First, as noted above, the pricing flexibility offered under Phase I merely allows the ILEC to offer lower rates via contract tariffs and volume and term discounts. Indeed, the biggest beneficiaries of this deregulatory measure will likely be customers in portions of the MSA that do *not* otherwise have competitive options. This is because ILECs must make the terms of contract tariffs available to similarly situated customers, and make volume and term discounts available nondiscriminatorily. Second, if a carrier qualifies for Phase II relief, there necessarily will be competitive facilities located throughout much of the MSA. The Commission found that the triggers it adopted were adequate to justify the particular degree of pricing flexibility that would be granted if the triggers are satisfied. *Order* ¶ 74 (JA 271). To the extent that competition in a portion of the MSA causes the ILEC to reduce rates, customers *throughout* the MSA will benefit because the ILEC must make those rates available either through general tariff schedules or through contract tariffs that are available to similarly-situated customers.

The Commission recognized that granting regulatory relief on an MSA-wide basis might give ILECs pricing flexibility for portions of an MSA that did not have a competitive presence. *Order* ¶ 142. (JA 306). The Commission concluded, however, that it was not possible as a practical matter to "time the grant of regulatory relief to coincide precisely with the advent of competitive alternatives for access to each individual end user." *Order* ¶ 144 (JA 307). The

Commission also noted that the purchasers of special access and dedicated transport services (services for which Phase II relief is potentially available) are primarily IXCs and large businesses that have some bargaining power with respect to the ILEC, even in the absence of competitive pressure throughout the MSA. *Order* ¶ 142 (JA 306). The Commission reasonably balanced the need for a practical method of reviewing pricing flexibility petitions and the need to protect consumers from market power abuses.

IV. THE COMMISSION'S DECISION TO EASE ITS REGULATION OF NEW SERVICE OFFERINGS AND RATE AVERAGING WAS REASONABLE.

A. New Services

The Commission immediately allowed ILECs to offer new services to consumers without making time-consuming public interest demonstrations and cost showings. *Order*, ¶¶ 37-44 (JA 250-54). The Commission found that its pre-existing requirements "clearly delay the introduction of new services," and that new services, by definition, expand the range of choices available to consumers. *Order*, ¶ 37 (JA 250). Retaining significant constraints on ILECs' ability to offer new services "can place price cap LECs at a competitive disadvantage," and this in turn could further harm consumers by "diminishing the incumbent's incentives to develop and offer new services." *Order*, ¶ 38 (JA 251).

The Commission pointed out that consumers would not be harmed by the relaxed regulation of new services because the services already offered by the ILEC would continue to be available and subject to regulatory constraints. *Order*, ¶ 37 (JA 251-52). Customers may continue to rely on the existing, price cap services. *Order*, ¶ 40 (JA 252). The Commission also noted that ILECs would continue to be prohibited, under section 202, from engaging in unreasonable discrimination, and that complaints could be brought pursuant to section 208. *Order* ¶ 41 (JA 252).

The Commission refused to amend its rules to "permit price cap LECs to offer new services outside of price cap regulation...." *Order*, ¶ 43 (JA 253). Although the Commission permitted ILECs to introduce new services on a streamlined basis, it required new services to be incorporated into the appropriate price cap basket. MCI concedes that, once the new services are included in price caps, ILECs will be constrained in raising rates for those services. MCI Br. at 48. MCI contends, however, that there is no protection against an ILEC's offering new services at unreasonable rates at the outset. *Id.* Moreover, MCI claims, the ability to introduce new services at unregulated rates may enable price cap LECs to raise the prices of other services once the new services are brought within price caps. *Id.*

MCI's concerns are unfounded. The price cap rules have always provided that rates for new services be established outside of price cap baskets in order to establish demand levels and associated revenue weights before they are incorporated into price caps. *Order* ¶ 35 (JA 249). If a carrier initially offers a new service at an unreasonably high rate, there will be little demand for that service. Under price cap rules, a carrier may adjust the prices of services within a group or "basket" of services so long as, calculated on a revenue-weighted average basis, the charges do not exceed the basket's aggregate "cap." *National Rural Telecom Ass'n v. FCC*, 988 F.2d 174, 178, 181-82 (D.C. Cir. 1993). If the new service is priced too high, it will enter price cap regulation with little revenue weight, and will not give the ILEC significant ability to adjust rates for other price cap services.[36] Thus, contrary to MCI's claims, the requirement that new services be incorporated into price caps provides significant assurance that rates for new services will not be unreasonable even at the outset.

B. Geographic Deaveraging

The Commission immediately expanded the ability of ILECs to deaverage their rates for trunking basket services. Previously, the FCC had permitted ILECs to charge geographically deaveraged rates, but "LECs seeking to establish more than three zones" within a study area were subject to increased scrutiny and had to "carefully justify" those pricing zones. *Order*, ¶ 58 (citing *Special Access Expanded Interconnection Order*, 7 FCC Rcd 7454 n.413) (JA 262). In its pricing flexibility decision, the Commission gave LECs additional flexibility to deaverage rates. The Commission permitted price cap LECs to deaverage rates for access service in the trunking basket, without requiring the LECs to demonstrate that the zones reflect cost differences, as long as each zone except the highest-cost zone accounts for at least 15 percent of the ILEC's trunking basket revenues in the study area. *Order*, ¶ 59 (JA 263).

The Commission has long believed that averaged rates "might create a pricing umbrella for competitors that would deprive customers of the benefits of more vigorous competition." *Order* ¶ 60 (JA 263). The Commission recognized that non-cost-based, geographically averaged rates cannot be maintained as competition develops. *Id.* The Commission found that deaveraged rates promote efficiency, and it agreed with ILECs that the increased scrutiny imposed on pricing

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[36] Moreover, because new services must eventually be included in price caps, an ILEC has little incentive to offer new services at unreasonably low (*i.e.*, predatory) rates, because when the new service is included in price caps, the carrier will not be able to continue to offer the new service at the predatory rate over a long period of time, and it cannot increase rates for that new service unless it lowers rates for other services.

plans that exceed three zones discourages carriers from offering deaveraged rates. *Id.* Further, the Commission agreed with ILECs that the zones in most density pricing plans were too large to be of practical value. *Id.* The Commission thus allowed ILECs to decide for themselves appropriate pricing zones. *Order* ¶¶ 61-62 (JA 264-65). The Commission concluded that the 15 percent revenue threshold requirement it imposed would ensure "that incumbent LECs cannot define zones that are, for all practical purposes, specific to particular customers." *Order*, ¶ 62 (JA 264).

MCI claims that the Commission provided "no safeguard against a price cap LEC drastically reducing prices in the zones where competition is most developed, and raising [its] prices accordingly in the zones that have no competition." MCI Br. at 49. The *Order* limits annual price increases within pricing zones to 15 percent. *Order*, ¶ 63 (JA 265-66); 47 C.F.R. § 61.47.[37] In addition, annual increases within the study area are limited to 5 percent. *Order* n. 171 (JA 265). These restrictions ensure that ILECs do not "drastically" increase or reduce rates. The Commission found that these limits on rate increases and decreases would prevent rate shock, but, at the same time, allow more rapid movement toward cost-based rates. *Order*, ¶ 63 (JA 265-66).

Moreover, the Commission specifically designed its rules to prevent ILECs from establishing rates designed to respond to specific, limited pockets of competition. The Commission concluded that, because each pricing zone except the highest cost zone must generate at least 15 percent of the ILEC's revenues for the relevant services, an ILEC could not effectively target its rate reductions to narrow areas to respond to competitive entry. *Order* ¶ 62

[37] Previously, carriers could increase rates within a zone by five percent annually.

(JA 264). The 15 percent revenue threshold severely constrains any attempt at predatory pricing, because an ILEC could not afford to price below cost throughout the entire rate zone. *Order* ¶ 63 (JA 265-66). Finally, parties may challenge the reasonableness of zone pricing plans as part of the Commission's tariff review or complaint processes. *Order*, ¶ 65 (JA 266-67).

CONCLUSION

For the foregoing reasons, the petition for review should be denied.

Respectfully submitted,

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July 20, 2000

IN THE UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

MCI WORLDCOM, INC., ET AL.,	)	
	)	
PETITIONERS,	)	
	)	
V.	)	NO. 99-1395 (AND CONSOLIDATED CASES)
	)	
FEDERAL COMMUNICATIONS COMMISSION AND UNITED STATES OF AMERICA,	)	
	)	
RESPONDENTS.	)	

CERTIFICATE OF COMPLIANCE

Pursuant to the requirements of Fed. R. App. P. 32(a)(7), I hereby certify that the accompanying "Brief for Federal Communications Commission" in the captioned case contains 13919 words.

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