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Before the
Federal Communications Commission
Washington, DC 20554

Access Charge Reform	)	CC Docket No. 96-262
	)	
Hyperion Telecommunications, Inc. and Time Warner Petitions for Forbearance, Complete Detariffing for Competitive Access Providers and Competitive Local Exchange Carriers	)))))	CC Docket No. 97-146

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COMMENTS OF Z-TEL COMMUNICATIONS, INC.

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Dated: January 11, 2001

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**COMMENTS OF
Z-TEL COMMUNICATIONS, INC.**

Z-Tel Communications, Inc. ("Z-Tel"), by its counsel, hereby submits its comments in response to the Commission's Public Notice (DA-00-2751) in the above-captioned proceedings. The Public Notice invites interested parties to comment on a variety of topics related to access charges assessed by competitive local exchange carriers ("CLECs").

I. INTRODUCTION AND SUMMARY

Z-Tel is a Tampa, Florida-based integrated communications provider that offers local, long-distance, and enhanced services to residential consumers in California, Georgia, Illinois, Maryland, Massachusetts, Michigan, New York, Oregon, Pennsylvania, Texas, Virginia, and Washington. Z-Tel has recently begun testing with a limited number of residential consumers in Alabama and Louisiana. Z-Tel delivers its telecommunications service to residential customers over the unbundled network element ("UNE") combination known as the UNE Platform. Z-Tel self-provisions the long distance and enhanced services portions of its package.

In addition to the local, long distance, and enhanced services provided to retail customers, Z-Tel also offers access services to interexchange carriers ("IXCs") that originate calls from or terminate calls to Z-Tel's retail customers. Z-Tel provides originating interstate access services to IXCs with which Z-Tel "shares" end users. Z-Tel also routes originating dial-around (*i.e.*, 10-10-XXX) and toll free (*e.g.*, 800) calls to interexchange carriers over Z-Tel's access service. Z-Tel terminates interstate traffic generated by over 200 long distance companies to Z-Tel's end users over its terminating access service. The rates, terms, and conditions of Z-Tel's originating and terminating interstate access services are described in its federal tariff, which is on file with the Commission.

In these comments, Z-Tel supports the establishment of a benchmark for CLEC access charges so that tariffed access rates at or below the benchmark would be presumed just and reasonable. Any attempt to prescribe mandatory detariffing of CLEC access charges, regardless of their level, would place Z-Tel at a substantial competitive disadvantage as compared to incumbent local exchange carriers ("ILECs") and IXCs. ILECs – Bell Operating Companies ("BOCs") and independent ILECs – would continue to have the ability to bind IXCs with tariffs, but Z-Tel and other similarly situated CLECs would have to negotiate access arrangements with hundreds of IXCs to provide those same services. By forcing CLECs to incur negotiation costs not incurred by incumbents, mandatory detariffing raises a barrier to entry in local exchange markets.

Z-Tel recognizes the Commission's desire to avoid engaging in rate cases to set CLEC interstate access charges. However, mandatory detariffing of CLEC access charges would create substantial confusion and uncertainty for carriers and for the Commission. Although the Commission may avoid complaints filed pursuant to sections 203 and 204 of the Communications Act of 1934, as amended ("Act"),[1] the Commission will face a landslide of new

1 47 U.S.C. §§ 203-204.

complaints and primary jurisdiction referrals regarding the interconnection requirements of the Act (*e.g.*, 251(a) interconnection complaints) and the appropriateness of rates set by CLECs.

II. MANDATORY DETARIFFING WOULD PLACE CLECS AT A SUBSTANTIAL COMPETITIVE DISADVANTAGE AS COMPARED TO ILECS

At present, intercarrier compensation arrangements for access charges are governed by tariffs for all carriers, including BOCs, independent ILECs, and CLECs. Within their service territories, BOCs and independent ILECs have considerable market power over interstate access markets, and IXCs are required to pay the BOC or ILEC tariffed rate for interstate access charges. The Commission has not proposed mandatory detariffing for BOC or independent ILEC interstate access charges. In fact, by approving the CALLS proposal,[2] the Commission has assured that the major ILECs will submit tariffed access charges through July 2004.

Pursuant to this proceeding, only CLECs – the new entrants with the least negotiating leverage over national IXCs – stand to lose the ability to rely on tariffs for establishing the rates, terms, and conditions for intestate access charges under the detariffing proposal. Such a result would place CLECs at a substantial competitive disadvantage to BOCs and independent ILECs. LECs with market power – BOCs and independent ILECs – would continue to have the protection of their tariffs, yet competitors would be forced to negotiate originating and terminating interstate access agreements with literally hundreds of interexchange carriers.

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2 *See generally Access Charge Reform*, Sixth Report and Order in CC Docket No. 96-262 and 94-1, Report and Order in CC Docket No. 99-249, Eleventh Report and Order in CC Docket No. 96-45, FCC 00-103 (rel. May 31, 2000) ("*CALLS Order*").

Mandatory detariffing could similarly lead to discrimination against CLECs and their customers by IXCs. In a detariffed world, IXCs could discriminate against CLECs and their customers by providing the IXCs' local exchange customers with long distance service while simultaneously denying competitors' customers their long distance carrier of choice.[3] Moreover, dialing-parity obligations require CLECs to connect dial-around and toll-free calls to interexchange carriers, and without tariff protection, CLECs would be forced to deliver these calls without any assurance of reasonable compensation. At the same time CLECs become embroiled in regulatory uncertainty, BOCs and independent ILECs would continue to have the protections afforded by their tariffed rates, terms, and conditions for originating access services.

For terminating access minutes, mandatory detariffing would create a substantial barrier to entry for CLECs. Z-Tel presently renders terminating interstate access bills to over 200 IXCs that utilize Z-Tel's terminating access services. Without the benefit of its tariff, Z-Tel would have to negotiate individual arrangements with each of these carriers before providing interstate service, or risk not being compensated for terminating access services rendered. BOCs and other ILECs, by contrast, would have the ability to rely on their tariffs for terminating interstate access traffic for each of these 200 IXCs. The cost to CLECs of negotiating access rates with over 200 IXCs would be substantial and these costs would be borne only by the CLECs, not by the ILECs. Forcing CLECs to obtain contracts with IXCs for terminating interstate traffic while BOCs and independent ILECs can rely on tariffs for these same services would thus create a substantial regulatory barrier to entry.[4] Negotiation costs in a detariffed

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3 Z-Tel notes that this result may violate IXC rate integration, which is mandated by section 254(g) of the Act and the Commission's rules.

4 Under the most commonly used definition of the term, "[a] barrier to entry may be defined as a cost of producing (at some or every rate of output) which must be borne by a firm which seeks to enter an industry but is not borne by firms already in the industry

environment represent a substantial barrier to entry. Z-Tel has attempted for at least one-year to negotiate with AT&T and Sprint regarding payment of access charges. To date, we have been unable to reach agreement on an acceptable rate level. In the meantime, AT&T has refused to pay Z-Tel anything for terminating AT&T's customers' calls. Sprint has made some payments, but it has refused to pay our tariffed rate for access usage.

The Commission's history of promoting competition by reducing entry barriers is incompatible with detariffing of CLEC access charges in that detariffing unequivocally establishes an entry barrier in local telecommunications markets. Raising entry barriers through detariffing not only reduces the prospects for competition in local telecommunications markets, but also violates the intent of section 257 of Act[5] and other provisions that require the Commission to identify and eliminate market entry barriers for entrepreneurs, small businesses, and suppliers of advanced telecommunications services.

III. DETARIFFING WOULD CREATE REGULATORY UNCERTAINTY

Z-Tel submits that maintaining tariffs pursuant to section 203, instead of undercutting section 203 through mandatory detariffing, is the most appropriate means of ensuring that CLEC access charges are just, reasonable, and nondiscriminatory. Mandatory detariffing would result in a shift from complaints pursuant to sections 203 and 204 to complaints pursuant to other sections of the Act, such as 251(a), which requires carriers to interconnect with one another.[6]

George Stigler, *The Organization of Industry*, Homewood, IL, Richard D. Irwin, 1986, p. 67.

5 47 U.S.C. § 257.

6 *Id.*, § 251(a).

A shift of Commission enforcement activity from sections 203 and 204 complaints to section 251(a) complaints would result in substantial regulatory uncertainty and could cause substantial service disruptions. Complaints filed under section 203 presume that carriers are interconnected with one another and will continue to exchange traffic until such time as the Commission resolves the rate issue, and section 204 expressly authorizes the Commission to direct parties to "track and true-up" disputed rates pending resolution of the complaint. In addition, section 204 sets statutory timeframes for the resolution of rate disputes, which serve to minimize regulatory uncertainty.

If the Commission were to forbear from sections 203 and 204 for CLEC access charges, the presumption of interconnection and continued traffic flow would cease, and service disruptions would likely result. As AT&T and Sprint have made abundantly clear, large IXCs in a detariffed world will likely refuse to interconnect with CLECs as a means of gaining leverage in pricing negotiations. Given the substantial market power of the largest IXCs, CLECs will either have to acquiesce to the demands of these IXCs or file interconnection complaints pursuant to section 251(a) of the Act.

Under a 251(a) complaint, IXCs will have the ability to withhold interconnection pending the resolution of a complaint. In contrast to section 204, section 251(a) imposes no statutory deadline for resolving disputes, and without such a deadline, section 251(a) complaints will likely be protracted, creating increased regulatory uncertainty for CLECs. Moreover, because traffic will not likely flow during the course of a section 251(a) complaint, substantial service outages could result while these complaints are pending.

IV. THE COMMISSION SHOULD ALLOW PERMISSIVE DETARIFFING AND SET A BENCHMARK FOR CLEC ACCESS CHARGES

Under permissive detariffing competitive providers of exchange access would have no obligation to file tariffs with the Commission under section 203 of the Act. Carriers that seek the protection of tariffs, however, would have the ability to continue to file tariffs. Z-Tel believes that the Commission should adopt a "safe harbor" rate. CLECs would not be prohibited from setting rates above this level, but would be subject to challenge under the section 208 process if they tariff a rate in excess of the bellwether rate. Over time, IXCs could petition the Commission to revisit any bellwether rate adopted by the Commission as the industry evolves. Z-Tel submits that such an approach would minimize the burden placed on the Commission, minimize access charge regulation on CLECs, set a reasonable benchmark for IXCs to compensate CLECs, and further the goals of the Act by encouraging, rather than discouraging, all carrier to interconnect with one another. Additionally, a "safe harbor" rate avoids much of the anticompetitive consequences of mandatory detariffing.

Given the lack of experience with competitive access markets, the "safe harbor" approach to CLEC access charges is sensible, even if only temporarily employed. At present, the exact nature and extent of supply-side or demand-side market power in access markets, consisting of multiple firms, is unknown. The relative efficiency of the various suppliers of access service also is yet to be determined. By setting a "safe harbor" rate, the Commission limits both the abuse of market power, perhaps unforeseen at this time, and the ability of gross inefficiency to flow through to access rates.

V. A SIMPLE COMPARISON OF ILEC AND CLEC ACCESS CHARGES IS INAPPROPRIATE

In Public Notice, the Bureau sought additional information regarding a comparison of CLEC access rates and ILEC rates, including such things as whether the multi-line business PICC or other charges included in ILEC access revenue when comparing incumbents' and competitors' rates for switched access service. The short answer to this inquiry is that, without question, the PICC must be considered in the comparison of CLEC and ILEC access charges. In fact, the prices and price/cost margins for all products and services offered by the ILEC and CLEC must be considered. Competition among multi-product firms has but one certain, long run outcome: zero economic profits. Prices between firms for any particular product or service may differ for a number of reasons. At the same time, however, the Commission's inquiry regarding the treatment of the PICC when comparing prices between LECs illustrates the problem with any simplistic comparison of CLEC and ILEC access rates.

Both CLECs and ILECs are multi-product firms that typically differ in the size and scope of their product and service mix. Further, both types of LECs are regulated to various degrees. In both monopolistic and competitive markets, multi-product firms recover their fixed costs, which are generally substantial in the telecommunications industry, with differing markups over (or under) marginal cost for each product or service in the firms portfolio. These markups depend on a number of factors (in both the short-run and long-run), including the company's own: price and cross-price elasticities of demand for products and services; cost complementarities between products and services; the nature of the purchase agreement between buyer and seller; and a plethora of other factors.[7] These "other factors" certainly include the

[7] *See* T. Randolph Beard, *A Theory of Competitive Cross Subsidies*, Unpublished Manuscript, www.egroupassociates.com.

regulation of output prices by federal and state agencies. In general, given the differences among multi-product telecommunications firms in product mix, customer mix, regulatory constraints, cost characteristics, and other factors, it is nearly impossible to fully explain price differences between multi-product firms for any single product.

While the PICC is an explicit subsidy mandated by the Commission from business to residential consumers, it is certainly possible that such a "subsidy" would exist even without Commission mandates. The PICC probably follows, albeit loosely, either a Ramsey-style or monopoly markup scheme where the markup of price over marginal cost is inversely related to the elasticity of demand.[8] If residential consumers are more price sensitive than business consumers to the price of local phone service, then both Ramsey markups and multi-product monopoly markups will be higher for business customers, increasing the proportion of fixed costs recovered from that customer group. Ramsey style markups are compatible with competition, particularly oligopolistic competition, among multi-product firms with fixed cost. Without question, some markup over marginal cost, Ramsey or not, is necessary for competitive multi-product firms with fixed costs.[9] The choices of particular competitive firms, including CLECs, about where to recover fixed costs will no doubt differ given differences in firm and market characteristics.

8 The difference between a Ramsey and monopoly markup scheme is that the set of Ramsey prices are determined under a zero profit constraint. For a thorough discussion of monopoly and Ramsey pricing within the context of telecommunications, see Stephen J. Brown, and David S. Sibley, *The Theory of Public Utility Pricing*, Cambridge University Press (1986).

9 For an interesting but complex discussion of pricing for multi-product competitive firms, see Koji Okuguchi and Ferenc Szidarovszky, *The Theory of Oligopoly with Multi-Product Firms*, New York, Springer (1999). With increasing costs, prices can equal marginal cost for a competitive, multi-product firms as long as marginal cost lies above average incremental cost. See G. McDonald and A. Slivinski, "The Simple Analytics of Competitive Equilibrium with Multiproduct Firms," *American Economic Review*, Vol 77, (Dec. 1987), pp. 941-953.

The fact that access charges, among other charges, will exceed marginal or incremental cost is unproblematic. The Commission, in its recent CALLS Order, explicitly recognized that the ILEC's switched access charges exceed costs:

> Some commenters have argued that the target rates should be **lower** because, according to state approved interconnection rates, access costs are actually below one half of one cent per minute. The commenters contend that the Commission should reduce access rates to forward-looking costs, like the unbundled network element rates for local transport and termination. The Commission has recognized that, as a legal matter, transport and termination of local traffic are different services than access service for long-distance telecommunications and therefore are regulated differently. As a policy matter, we have determined that a market-based approach, instead of a prescriptive approach in which we set access charge rates at economic cost levels, better serves the public interest. We believe that the target rates we are adopting are a reasonable transitional estimate of rates that might be set through competition. Not only are the target rates supported by both price cap LECs and IXCs, but competitive LECs have also proposed reducing access charges to the same target rates. **Reducing the rates to access costs**, as the commenters suggest, would necessitate a lengthy and complex proceeding.[10]

Clearly, the Commission expects access charges to exceed costs and, presumably, this expectation is valid for CLECs as well as ILECs.

Two additional complexities arise when comparing ILEC and CLEC access charges. First, the Commission, in the CALLS Order, justifies higher access charges for smaller ILECs because those ILECs are "unable to spread [costs] over a large subscriber base."[11] Thus, economies of scale are a legitimate consideration in the reasonableness of a LEC's access charges. In order to assess the reasonableness of a particular CLEC's access charges, or the

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10 *CALLS Order*, ¶ 178 (emphasis added).

11 *Id.*, ¶ 177.

reasonableness of the difference between CLEC and ILEC access charges, the influence of economies of scale on such charges must be determined.

Second, some CLECs use unbundled elements to provide access service. State commissions determine the prices of unbundled elements. While the goal of the TELRIC standard is to bring to equilibrium the incremental cost of the ILEC and CLEC, the rates determined in state cost proceedings often fail to do so. In many states, including New York, the TELRIC cost of terminating an access minute exceeds the CALLS access rate of $0.0055 and even $0.0065. CLECs clearly cannot be expected to provide access service at the lower CALLS rates when their own costs exceed those rates, particularly those CLECs whose incremental cost structure is determined by regulatory fiat. More simply, CLECs cannot be forced to sell access services below cost while the ILEC sells such service above costs. At a minimum, CLECs should be allowed to markup access costs, adjusted for scale economies, by the same markup factor as the ILECs.

Considering the complexities of evaluating CLEC access charges in relation to ILEC charges, the benefits of a "safe harbor" are compelling. Although the Commission must recognize that multi-product firms will differ in the manner fixed costs are recovered, the Commission also can elect to restrain the exploitation of market power revealed in excessive rates, even if market power is transitory or on the supply-side or demand-side of the market. The Commission's "market based" approach to ILEC access charges, which establishes a maximum rate for ILEC access charges to counteract supply-side market power, is an example of such a restraint. A "safe harbor" rate offers the same restraint for CLECs. Moreover, although economies of scale are an important factor in judging the reasonableness of access charges, gross inefficiency should not be promoted by Commission policy. Again, a "safe harbor" rate bounds the extent to which inefficiency, to the extent it exists, can be passed through to price.

VI. CONCLUSION

For the reasons presented herein, the Commission should (1) allow permissive detariffing of CLEC access charges and (2) set a safe harbor rate for CLEC access charges.

Respectfully submitted,

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Dated: January 11, 2001

CERTIFICATE OF SERVICE

I, Michele Depasse, hereby certify that copies of the foregoing Comments of Z-Tel Communications, Inc. were served on January 11, 2001 by messenger on the following persons.

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