Section Five

Q.

One of the key elements of MCI's "Competition Plus" price cap proposal involves reducing switched access rates to their economic cost. Is it necessary to reduce access rates to this degree, in order to change from rate base to price cap regulation?

A.

No, it is not. To the contrary, this aspect of MCI's proposal really has little to do with price cap regulation, per se. In fact, I suspect MCI would like to see a reduction in the switched access rates it pays, regardless of whether or not the Commission adopts some form of price cap regulation for Bell Atlantic-MD.

Having defined "economic cost" as being equal to the lowest cost "firms in the given market would face when operating efficiently" (NWC page 10, line 6), MCI's witness Dr. Nina Cornell argues that, ". . . it is very important to set the rates for the monopoly switched access functions at direct economic cost now." (page38, lines 14 - 15). Since switched access functions are currently priced well in excess of direct economic cost, Dr. Cornell is advocating a massive reduction in these rates. Under the current intrastate switched access tariff, MCI and other interexchange carriers are paying an average of roughly five cents per minute. While one can reasonably debate the precise level of "direct economic costs" associated with this service, MCI has presented an estimate of .0042 cents per minute through its witness Bob Mercer, and this figure is generally consistent with direct cost estimates I have developed in other jurisdictions. Given this cost estimate, MCI's proposal would result in a 91% reduction in the rates it is paying for switched access service.

Q.

In your opinion, should access rates be reduced to this degree?

A.

No. Recent FCC actions to encourage unbundling, expanded interconnection rights, and co-location are designed to increase competition in the switched access market, and potentially to improve efficiency and drive down access rates. However, the full impact of these changes may be years away. Even if one accepts the conclusion that access charges need to be redesigned, or that access charges should be lowered, it does not follow, by any known logic, that access prices must immediately be reduced by 91%.

To the extent access charges need to be redesigned, much of this can be accomplished within the access category alone. For example, terminating access rates could be increased, in order to fund a reduction in originating rates (and vice versa, with regard to 800 service). Similarly, transport rates can be reduced, to be more consistent with the underlying pattern of costs. However, there is no basis for concluding that an immediate and massive shift in revenue responsibility away from switched access is necessary, due to the trend towards increased competition in the local exchange category. Quite the contrary is true. The evidence suggests that access markets are characterized by monopoly conditions, and that new entrants into local telephone markets are unlikely to emphasize switched access rate reductions as a primary strategy for gaining market share.

Competition, as it increases, should eventually drive down the overall level of switched access rates--but it may also serve to drive down other local rates, as well. There is every reason to anticipate that competitive forces will create downward pressures on the underlying costs of all local services, including both switched access and basic local exchange service. Furthermore, if competition is strong enough, profit margins may decline, creating further downward pressure on all local rates. Hence, access prices are likely to decline over time, as a result of increased volume, reduced cost, and lower profits. However, that type of gradual access price reduction, the product of external economic forces, is quite different than the massive "rebalancing" of local and switched access rates that is effectively advocated by MCI. This aspect of their Competition Plus proposal essentially consists of a massive, government-enforced, shifting of revenue responsibility from access to local markets prior to opening those markets to competition. This shift would be quite advantageous to MCI, since it would reduce MCI's cost structure, allowing it to cut its toll prices, and/or expand its profit margin. However, such a massive rebalancing would not be in the public interest.