- modifying the price cap plan to accommodate competition in those areas where it exists or is evolving; and
- streamlining the rules for introducing new services.

By doing so, the Commission can serve the public interest by increasing the efficiency incentives of the current plan.

IV. CONCLUSION

U S WEST urges the Commission to modify the LEC price cap plan as discussed in the above comments.

Respectfully submitted,

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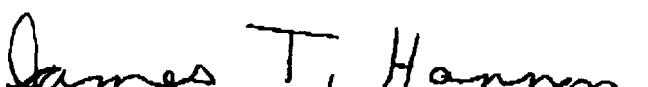
By: 

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Attachment 1

MARKET POWER:

AN ANTITRUST APPLICATION FOR THE LEC PRICE CAP REVIEW

**Filed in CC Docket No. 94-1 as "Attachment 1"
to U S WEST's Comments in Response to the NPRM**

May 9, 1994

by:

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ATTACHMENT 1

MARKET POWER: AN ANTITRUST APPLICATION FOR THE LEC PRICE CAPS REVIEW

I. Introduction

This paper addresses market power issues for purposes of U S WEST's comments to the Federal Communications Commission (the "Commission") in response to the Commission's Notice of Proposed Rulemaking ("NPRM") on its performance review for price caps imposed on local exchange carriers ("LECs"). Specifically, this paper applies antitrust legal principles to evaluate the impact of competition on the LEC price cap plan in partial response to Transition Issue 1 (p. 40, ¶95) of the NPRM. Through this antitrust framework, the discussion below seeks to help the Commission determine the most effective methods to measure competition as a prerequisite to implementing streamlined regulation. Antitrust analysis is appropriate here because the Commission's effort to assess the ability of a price cap LEC to exercise market power will engage it in precisely the sort of market power appraisal that federal courts undertake in deciding cases that assert a claim of unlawful monopolization or attempt to monopolize in violation of Section 2 of the Sherman Act, 15 U.S.C. §2.[1] Moreover, "[t]he antitrust laws are a component of the public interest standard in the Communications Act." E.g., Policy and Rules Concerning Rates for Competitive Common Carrier Services and Facilities Authorizations Therefor (hereinafter "Competitive Carrier"), Fourth Report and Order, 95 FCC 2d 554, 558 n. 9 (1983). Thus, the benefit of the federal judiciary's previous market power antitrust analyses may be instructive to the Commission as it works to establish its mechanisms to assess competitive pressures facing price cap LECs.

The Commission has observed the "dramatic changes in telecommunications technology and markets" that have occurred during the "last few years," and recognizes that "adjustments [now are] needed to prepare the baseline [price cap] plan for anticipated changes in market structure, technology, and regulation within the next few years." NPRM, ¶2, ¶7. Given the vigorous tempo at which competition is evolving in telecommunications, the Commission will not have the luxury to undertake detailed, lengthy proceedings to determine, case by case, each instance in which competition is sufficient to constrain an exercise of market power. Such an approach would fail to keep pace with the rapid changes in this industry, where competition sprouts and blooms quickly. During the interim regulatory lag time, costly market distortions would occur. Rather, the Commission must be

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[1] Likewise, cases that allege a violation of Clayton Act §7, 15 U.S.C. §18 (merger that may substantially lessen competition or tend to create a monopoly) provide guidance, because their assessments of market power coincide with Sherman Act cases. Courts often rely on Clayton Act §7 cases when engaged in market power analysis in Sherman Act §2 cases, and vice versa. For that reason, this paper draws on both types of cases as precedent. Additionally, this paper uses principles contained in the Federal Merger Guidelines that the Department of Justice and the Federal Trade Commission use in antitrust enforcement. 4 Trade Reg. Rep. (CCH) ¶13,104 (May 5, 1992)(the "Guidelines"). The Guidelines contain an analytical paradigm for market power measurement.

equipped in advance to clear the regulatory underbrush swiftly as circumstances dictate to allow competitive market forces to operate. For that reason, this paper attempts to assist the Commission to conceive an overall process that will enable it to act with the requisite speed to permit streamlined regulation routinely in specific cases so that competition can flourish. The Commission must create a regulatory framework sufficiently comprehensive and flexible to meet the upcoming challenge of facilitating smooth and effective transitions into increasingly more competitive climates for LECs.

The NPRM states: "The most likely basis for applying more streamlined regulation to LECs is that the LECs' market power has been reduced, and competition has increased." NPRM p. 40, ¶95. While the NPRM does not define "market power," the Commission has previously defined the term as the "power to control price" or "the control a firm can exercise in setting the price of its output." Competitive Carrier, First Report and Order, 85 FCC 2d 1, 10 ¶26, 20-21 ¶¶ 55-56 (1980). See also Competitive Carrier, Fourth Report and Order, 95 FCC 2d at 558 ¶7 ("the ability to raise prices by restricting output"). More recently and descriptively, the Commission has stated that market power is "the ability to restrict output or raise price over what would prevail in a competitive market, and maintain it over time." Competition, Rate Deregulation and the Commission's Policies Relating to the Provision of Cable Television Service, Report, 5 FCC Rcd. 4962, 4968 n. 19 (1990). Antitrust cases employ essentially this same meaning of "market power," traditionally expressed as the "power to control market prices or exclude competition." U.S. v E.I. du Pont de Nemours & Co., 351 U.S. 377, 391 (1956). More recent antitrust formulations closely track the Commission's expression; for example: "The ability of a firm profitably to increase prices above competitive levels and to maintain such higher prices for a significant period of time." E.g., U.S. v. Archer-Daniels-Midland Co., 781 F.Supp. 1400, 1402 (S.D. Iowa 1991).

With the above definitions in mind, this paper proceeds with the following structure: first, it demonstrates the misguidedness of using market share as any kind of market power proxy for the Commission's purposes. Second, it discusses the primary structural features of the access services business that most heavily impact potential market power exercise (i.e., the character of the predominant purchasers; entry and operational barriers; and market trends). Third, it presents antitrust market definition factors that bear on the establishment of a regulatory framework able to accommodate anticipated industry developments. Fourth, it applies those market definition principles to summarize the sources of actual and potential competition for LECs in view of the ongoing "convergence of services." Finally, it briefly evaluates the leading access reform model in light of antitrust precepts. In separate Attachments, U S WEST furnishes antitrust standards to assess potential essential facilities issues and leveraging issues identified in the NPRM (Transition Issues 1c and 1e, responded to in Attachments 2 and 3, respectively).

II. Market Share is a Poor Indicator of Market Power Here

Historical market share statistics provide an inaccurate measure of present and future

ability to control prices or exclude competition. E.g., General Foods Corp., 103 F.T.C. 204, 357 (1984)(using market share data to measure market power "has been increasingly questioned on both theoretical and empirical grounds."); Krattenmaker, Lande, and Salop, Monopoly Power and Market Power in Antitrust Law, 76 Georgetown L.J. 241, 259 (1987)(hereinafter "Krattenmaker")("Use of market share as a proxy for market power has rightfully been criticized for ignoring other important market information such as the ability of competing firms to expand or of new competitors to enter."). Indeed, a firm can possess 100% market share and yet possess no market power. Los Angeles Land Co. v. Brunswick, 6 F.3d 1422 (9th Cir. 1993), cert. denied, 62 U.S.L.W. (March 21, 1994)(defendant with 100% market share did not have market power absent evidence that it could prevent entry of other market participants); Metro Mobile CTS, Inc. v. NewVector Communications, 892 F.2d 62 (9th Cir. 1989) (firm with 100% market share had no market power where it lacked ability to prevent inevitable entry). If market share is considered at all, it must be calculated using an appropriate unit of measure and cannot be considered in an analytical vacuum. For market share evidence to provide any useful information in assessing market power, it must be interpreted in light of all economic realities of the market. E.g., Hunt-Wesson Foods, Inc. v. Ragu Foods, Inc., 627 F.2d 919, 924 (9th Cir. 1980) ("reliance upon market share, divorced from commercial reality, could give a misleading picture of a firm's actual ability to control price or exclude competition."), cert. denied, 450 U.S. 921 (1981). The Commission itself has noted previously that "market share alone is not necessarily a reliable measure of competition, particularly in markets with high supply and demand elasticities." Competition in the Interstate Interexchange Marketplace, Report and Order, 6 FCC Rcd. 21, 5880, 5890 ¶51 (1991)(hereinafter "Business Services Order")(see also, Section V, below, on elasticities).

The Guidelines (see supra fn. 1, p.1) likewise acknowledge the shortcomings of market share evidence to gauge market power:

> [M]arket share and market concentration data may understate or overstate the likely future competitive significance of a firm or firms in the market.... Market concentration and market share data of necessity are based on historical evidence. However, recent or ongoing changes in the market may indicate that the current market share of a particular firm either understates or overstates the firm's future competitive significance.

§1.52 and §1.521. The Guidelines specifically identify "new technology" as a market condition that affects future competition among firms and explain that such changes in market conditions must be considered to obtain an accurate market power picture. §1.521. So too, theorists at the forefront of antitrust analysis recommend that, particularly in industries marked by a high degree of technological innovation, the concept of inferring market power from market share information should be abolished, or at least radically transformed. See generally, R. Hartman, D. Teece, W. Mitchell, & T. Jorde, Assessing Market Power in Regimes of Rapid Technological Change, Vol. 2, No. 3 Industrial and Corp. Change 317 (1993)(hereinafter "Hartman, et al."); see also, Ordover & Willig, Antitrust for High-

Technology Industries, 28 J.L. & Econ. 311-33 (1985).

Significant antitrust decisions in the telecommunications industry convincingly explain that market share statistics are an especially feeble measure of market power in an historically regulated industry:

> Reliance on statistical market share [to show market power] in cases involving regulated industries is at best a tricky enterprise and is downright folly where ... the predominant market share is the result of regulation. In such cases, ... focus [must be] on the regulated firms ability to control price or exclude competition.

Metro Mobile, 892 F.2d at 63.

> [R]eliance on market share statistics is likely to be an inaccurate or misleading indicator of 'monopoly power' in a regulated setting. ... Indeed, while a regulated firm's dominant share of the market typically explains why it is subject to regulation, the **firm's statistical dominance may also be the result of regulation**. ... Ultimately, [the] analysis must focus directly on the ability of the regulated company to control prices or exclude competition....

MCI Communications Corp. v. AT&T, 708 F.2d 1081, 1107 (7th Cir.), cert. denied, 464 U.S. 891 (1983)(emphasis added).[2] Southern Pacific Communs. Co. v. AT&T, 740 F.2d 980, 1000 (D.C.Cir. 1984)("Reliance on statistical market share is a questionable approach in cases involving regulated industries. ... Ultimately, a [decision maker] should focus upon the ability of the regulated firm to control prices or exclude competition."), cert. denied, 470 U.S. 1005 (1985). See also, Illinois ex rel. Hartigan v. Panhandle E. Pipe Line Co., 730 F.Supp. 826, 903 (C.D.Ill. 1990)(in an extensively regulated industry, an inference of market power cannot be premised on a firm's predominant market share), aff'd sub nom., Illinois ex rel. Burris v. Panhandle E. Pipe Line Co., 935 F.2d 1469 (7th Cir. 1991), cert. denied, 112 S.Ct. 1169 (1992); Bright v. Moss Ambulance Serv., 824 F.2d 819, 824 (10th Cir. 1987)("enjoyment of the market share [that] devolved from the [city's regulatory scheme] cannot support allegations of market power.").

The market share of an incumbent firm in a market in transition from a regulated monopoly to a competitive environment presents an unreliable barometer of its market power under current and future market conditions. This is especially true in the telecommunications

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[2] Courts in antitrust decisions frequently use the terms "monopoly power" and "market power" interchangeably. E.g., Town of Concord v. Boston Edison, 721 F.Supp. 1456, 1459 (D.Mass. 1989)(the terms "are generally used interchangeably"), rev'd on other grounds, 915 F.2d 17 (1990), cert. denied 499 U.S. 931 (1991). See Krattenmaker, 76 Georgetown L.J. at 241.

industry today, where technological innovation is rampant and demand is expanding. The often-asserted "dominant" market shares of LECs, in particular, by whatever measure, are historical vestiges of market conditions governed by regulatory strictures that prohibit competition. Indeed, the type of havoc wrought on market share measurement by regulation is quite evident in the case of LECs. In measuring LEC market share of local exchange services, inclusion of all lines that a LEC must sell for less than cost (under regulatory controls promoting universal service through built-in subsidies) is awkward at best, and without question distorts the calculus. It is at least inappropriate to count against the LEC as an earmark of market power those lines on which it makes no profit and is forced to supply at a loss by regulation. Absent contrary regulatory obligations, LECs, as rational, profit-maximizing, economic actors would not have sold these below-cost services.

More generally, if market share figures represent only a snapshot of interstate access revenue percentages at any single point in time, LEC loss of access business to private networks, self-supply by IXCs, or otherwise, never translates into loss of market share. See U.S. v. Baker Hughes Inc., 731 F.Supp. 3, 8 (D.D.C. 1990)("... [A]rtificially shrinking the line of commerce [product market] [limits] the significance of the market share figures...".), aff'd, 908 F.2d 981 (D.C. Cir. 1990); see also, Section V, below. Accord, Ball Memorial Hospital, Inc. v. Mutual Hospital Ins., 784 F.2d 1325, 1336 (7th Cir. 1986)("Market share reflects current sales, but today's sales do not always indicate power over sales and price tomorrow."). Reliance on a measure of market share based exclusively on current access revenues neglects significant implemented bypass connections that obviously provided choices to purchasers, who, in turn, elected these alternatives in place of LEC (or CAP) services.[3]

If any measure of market share for interstate access is appropriate as part of the Commission's market power consideration, the most accurate approximation derives from the

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[3] One variation of the market share by revenues approach is to look at relative profits as a measure of market power. Modern antitrust law views profit levels generally as a poor indicator of market power. First, most profit data measure accounting profits (using a variety of accounting conventions), not economic profits. Economic profits are the only sort that have meaning to market power measurement. A court may decline to consider profitability as a factor in a market power analysis based on the sheer complexity of attempting to reconcile accounting methods to get an accurate measure of relative profits. Telerate System v. Caro, 689 F.Supp. 221, 238 (S.D.N.Y. 1988). Second, antitrust courts recognize that the profitability of a leading firm may result from marketing efficiencies and product superiority, not the exercise of market power. General Foods Corp., 103 F.T.C. 204, 362-64 (1984). See also, IBM Peripheral EDP Devices Antitrust Litig., 481 F.Supp. 965, 981 (N.D.Cal. 1979)("[T]he inference that a [firm] that enjoys healthy profits only does so because of an unhealthy market structure is not a strong one. Good management, superior efficiency and differences in accounting provide explanations that are just as plausible, and none of those explanations is inconsistent with an effectively competitive market."), aff'd, 698 F.2d 1377 (9th Cir.), cert. denied, 464 U.S 955 (1983).

measure of relative capacities among firms. This approach captures the percent of demand that could be displaced by alternative suppliers, which is the relevant market power inquiry. Antitrust decisions confirm the propriety of using productive capacity to measure market share. E.g., Archer-Daniels-Midland, 781 F.Supp. at 1414. Likewise, the Guidelines support use of productive capacity to measure market share where appropriate, as here. §1.41 ("Market shares will be calculated using the best indicator of firms' future competitive significance.... Physical capacity or reserves generally will be used if it is these measures that most effectively distinguish firms").[4] The most important and competitively significant distinguishing characteristic of firms in the sale of interstate access services is their ability to absorb demand shifts in the face of anticompetitive pricing. Of course, the fact that self-provisioning (and the resale of such capability) is largely unreported limits the ability to measure market share by capacity. To alleviate this problem, the Commission may want to consider an appropriate reporting requirement of, for instance, access self-supply and resale by IXCs.[5]

III. Market Share Decline is not Necessary to Show Lack of Market Power

One disturbing regulatory approach asserts that LECs should be forced to suffer substantial loss of market share (measured in subscribers or revenues) before they receive regulatory relief to enable them to compete on the merits with other firms. The suggestion is troublesome in part because, as identified in detail below (Section V), the firms who are supposedly in need of such protectionist measures are themselves commercial heavyweights like AT&T/McCaw, MCI, and TCI. Indeed, one source that has suggested this approach, Teleport Communications Group ("TCG"), has the financial backing of nearly every major cable television concern in the country. More importantly, as a matter of antitrust analysis and economic reality, while past decline in market share may be some evidence of lack of

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[4] The previous iteration of the Guidelines elaborated further on characteristics that favor use of capacity to measure market share: "... physical capacity, reserves, or dollar production generally will be used if relatively homogeneous, undifferentiated products are involved." 1984 DOJ Merger Guidelines §2.4, Trade Reg. Rep. ¶13,301 (1988). Interstate access is just this sort of undifferentiated, intermediate service.

[5] Even if the Commission ultimately determines that market share measurement, in any format, is unhelpful, it separately should consider latent capacity of non-incumbent firms as a control on the exercise of market power by the incumbent. The Commission has recognized in other rulings the importance of excess capacity as a check on market power exercise. Business Services Order, 6 FCC Rcd. 21 at 5888 ¶46 (where existing capacity of competitors would enable them to absorb "as much as fifteen percent of AT&T's business day traffic without any expansion," the Commission considered the capacity "more than sufficient to constrain AT&T's pricing behavior insofar as it could accommodate a substantial number of new customers."). Application of a consistent approach in this inquiry suggests that areas served by existing CAP networks are competitive today (see discussions of capacity as supply substitution and of existing CAP networks, Section V. below).

market power, e.g., Greyhound Computer Corp., Inc. v. IBM Co., 559 F.2d 488, 496, fn. 18 (9th Cir. 1977), cert. denied, 434 U.S. 1040 (1978), it most assuredly is not a prerequisite to show absence of market power. Metro Mobile, 892 F.2d at 62; Brunswick, 6 F.3d at 1422.[6] "Since market share lost will probably never be recovered, the inability of a LEC to react ... rapidly, flexibly, and appropriately literally gives away market share to competitors." J.S. Kraemer, The Future of Local Competition: The War of All Against All, Deloitte, Touche, Tohmatsu Int'l, Telecommunications & Electronic Service Industry Program Monograph Series at p. 4 (1993) (hereinafter "Kraemer"). If so, one inequitable consequence of delaying implementation of reduced regulation until LECs lose considerable "market share" is that LECs will suffer economic losses from which they likely cannot recover, and that have no connection to their market performance.[7]

Regulation should enable firms to compete but should not, in effect, subsidize the operations of some firms by hog-tying others until revenues "equalize." To do so would rob consumers improperly of the advantages of competition. Further, the inaccurate economic signs that entrants would receive ultimately would reduce allocative efficiency. If the Commission leaves regulation in place beyond its useful life, potential entrants will receive "false economic signals."[8] If firms then enter under faulty market information, later regulatory movement will displace these competitors, with the consequent social welfare loss.

Under modern antitrust principles, a regulatory process that operates to shield new competitors from true market forces until they reach some level of performance (by

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[6] If revenue data were measured with adequate scope to show the true losses that LECs have experienced to private bypass options, rather than an artificial remaining subset, no doubt the LEC market share figures would show noticeable decline. Recent attempts by AT&T and others to manipulate revenue share figures to purport to show LECs maintaining 99 percent share have been discredited effectively by the recent report of Dr. Peter W. Huber, The Enduring Myth of the Local Bottleneck, March 14, 1994 (hereinafter "Huber"), filed March 15, 1994, in CC Docket No. 94-1 (see Ex. Parte letter from William F. Adler, Pacific Telesis Group, to William F. Caton, FCC).

[7] Adoption of the Cable Act's effective competition standards to this market (50% and 15%, as TCG suggests) would only enhance competitors' incentive to "cream skim" high volume, lucrative business customers, while remaining just below threshold to preclude their LEC rival from qualifying for streamlined regulation. Such a result would be contrary to the public interest.

[8] The Commission previously has acknowledged that "false economic signals" to new entrants will result from overly restrictive pricing regulation on LECs. Expanded Interconnection with Local Telephone Company Facilities, CC Docket No. 91-141, (hereinafter "Expanded Interconnection"), Report and Order, 7 F.C.C. Rcd. 7369, 7451 ¶172 (1992), appeals pending sub nom. Bell Atlantic Telephone Companies, et al. v. FCC, No. 92-1619 (D.C. Cir. pet. for rev. filed Nov. 25 1992).

incumbent firms suffering significant economic losses) is inappropriate:

> It is the nature of free enterprise that fierce, no holds barred competition will drive out the least effective participants in the market, providing the most efficient allocation of productive resources. ... [T]he nature of competition is to make winners and losers. ... [The inquiry] should not speculate as to the details of a potential competitor's performance; [it] need only determine whether there [are] barriers to the entry of new faces into the market. ...[I]n making that determination [the inquiry is] not concerned with whether, once in the market, the competitor will wind up doing well. The thing to remember is that doing business in the crucible of free enterprise is inherently unpredictable.

U.S. v. Syufy Enterprises, 903 F.2d 659 at 662, 664, and 667, fn. 13, (9th Cir. 1990).

To the extent that LECs remain bridled with outmoded regulatory strictures in the face of competitive entry (until they hit some lower market share level), they will be unable to compete fairly in the marketplace. They then, of course, will be less able to devote capital to new frontiers. This fact would no doubt impede creation of the "information superhighway" and, ultimately, the Global Information Infrastructure which the Commission's Chairman considers "key to our country's economic growth." Remarks of Chairman Reed Hundt to National Association of Broadcasters Convention for Delivery by Satellite on March 23, 1994, at p. 4.

IV. Structural Features Beyond Market Share are Key in Market Power Evaluation

An adequate assessment of market power requires consideration of market realities wholly independent of market share. Among the most important structural factors are the nature of the buyers, barriers to entering or operating in the market, and market trends. See, e.g., Archer-Daniels-Midland, 781 F.Supp. at 1400

A. Power Buyers of Interstate Access Constrain LEC Market Power Exercise

Antitrust decisions, especially in recent years, have realized that market structure is central to the analysis of potential exercise of market power. One crucial aspect of market structure is the nature of purchasers for the subject product or service. Specifically, antitrust decisions confirm that, when a market serves large and sophisticated purchasers, sellers cannot exercise market power, regardless of their market share. Baker Hughes, Inc., 731 F.Supp. at 11 (large market share does not give firm power over price because sophistication of customers and bidding process ensure keen price competition), aff'd, 908 F.2d at 981. Syufy, 903 F.2d at 663 and 670 (affirming judgment for defendant in monopolization case where "alleged victims are humongous national corporations with considerable market power of their own," and defendant was "in no position to put the squeeze on" alleged victims, who "have substantial leverage over [defendant]"). FTC v. R.R. Donnelley & Sons Co., 1990-2

Trade Cas. (CCH) ¶69,239 (D.C.Cir. 1990)(the existence of power buyers "make[s] any anticompetitive consequences very unlikely.").

In such markets, customers wield power sufficient to constrain supracompetitive pricing by sellers. No seller could afford to risk losing sales to such buyers by engaging in anticompetitive behavior. The threat of large shifts of purchases away from the incumbent firm acts to police the pricing behavior of that firm. Sophisticated purchasers monitor prices and market conditions. They will find and support alternative sellers in response to an unjustified price increase. Moreover, big, financially sound purchasers can vertically integrate. This reality acts as a similar check on sellers' behavior in such markets. "[T]he threat ... of vertical integration by [purchasers] is a potent antidote to monopolistic behavior on the part of [sellers]." U.S. v. Country Lake Foods, 754 F.Supp. 669, 680 (D.Minn. 1990). This 'power buyer' factor is "not only appropriate, but imperative" to consider in assessing the likelihood of anticompetitive effects in a market. Baker Hughes, Inc., 908 F.2d at 986 (Clarence Thomas, J.).

One antitrust court set out the overall "power buyer" market effect this way:

> The existence of large, powerful buyers of a product mitigates against the ability of sellers to raise prices. Empirical studies have shown that the stronger and more concentrated the buyers' side of the market is, the less is any ability of sellers to elevate their prices. ... There is no question that the size and sophistication of buyers in the [relevant] industry is a powerful other factor that strongly mitigates against the possibility of any attempt by ... suppliers to raise prices anticompetitively

Archer-Daniels-Midland, 781 F.Supp. at 1416 and 1422.

In Country Lake Foods, 754 F.Supp. at 669, the court specifically relied on the power buyer doctrine in denying the government's petition to enjoin a merger alleged to lessen competition in violation of Clayton Act §7. The Court considered the character of the large purchasers in the market to be the "most persuasive argument" to rebut the alleged anticompetitive effects and described the constraining impact that sophisticated buyers have on sellers' market power, as follows:

> Competition is ensured in the market by the power of [the] buyers. The major purchasers ... are large... . [The purchasers'] industry is extremely concentrated with the three largest [firms] accounting for more than 90% of industry sales. Because of their size and the volume of their purchases, the [purchasers] possess substantial power over the sellers.... They monitor ... prices closely and are generally very sophisticated buyers. They could and would immediately challenge increases in ... prices not related to normal market conditions, and could and would quickly seek ... suppliers outside of the [market] if their current suppliers attempted to increase their prices. They

> also have the capability to vertically integrate should ... prices become noncompetitive and other sources not be available. ... The possibility of losing these high volume customers will prevent [the sellers] from exercising such market power. Id. at 674 and 679.

Interstate access is just this sort of "power buyer" market. The market is concentrated with three national carriers (AT&T, MCI, and Sprint) comprising the vast majority of demand. These IXCs have the ability and incentive to self-supply access services should LECs attempt to price anticompetitively. Moreover, they can and do facilitate new entry and/or expansion by alternative access providers. They already typically use more than one supplier and can readily shift their purchases. They are thus well positioned to detect any market power exercise by LECs, and are well equipped to guard against it.[9] The exact analysis of Country Lake Foods applies to interstate access services. The three largest purchasers comprise nearly 90% of long distance sales (precisely, 86.2%, according to shareholder reports figures in Long Distance Market Share: Fourth Quarter, 1993, Table 6, Industry Analysis Division, FCC, released April 15, 1994). They thus represent the bulk of LEC access sales. For that reason, these buyers maintain a firm handle over LECs on terms of sale for interstate access services. No LEC would attempt to price anticompetitively for fear of suffering a crippling loss of sales. IXCs monitor pricing closely and are acutely aware of their options (to support CAPs, vertically integrate, etc.) should a LEC attempt to boost prices unwarrantedly. In U S WEST's territory, the power of these purchasers is further enhanced by the fact that the bulk of access services sales are contained within relatively compact portions of the overall land area. The top 5 MSA's in the region alone comprise 41% of U S WEST's interstate access revenues, with a full 62% contained within the top 15 MSA's. See chart attached to U S WEST's Comments depicting "Percent of USWC Revenue, 1993 Revenues by Type." This relatively narrow distribution of the majority of sales enables large access buyers to exercise their power over U S WEST with relative ease. These IXCs are fully capable of exerting their purchasing power to eliminate any chance of anticompetitive pricing by LECs.

B. Regulatory Barriers to Entry and to Effective Operation Stall Competition

Entry barriers represent another set of structural factors in the market power equation. They are conditions that inhibit firms from entering the market in response to an increase in the incumbent's prices above competitive levels. Consideration of entry barriers is essential because "[m]arket power can persist only if there are significant and continuing barriers to entry." 2 P. Areeda & D. Turner, Antitrust Law, ¶505 (1978). See also, Syufy, 903 F.2d at 664. ("If there are no significant barriers to entry ... eliminating competitors will not enable the survivors to reap a monopoly profit; any attempt to raise prices above the competitive level will lure into the market new competitors able and willing to offer their ...

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[9] A description of vertical integration and entry facilitation by these prominent IXCs appears in Section V, p. 21 - 22, below.

services for less.") citing, Metro Mobile, 892 F 2d at 63.

The NPRM refers to potential "regulatory, economic or technical" barriers in this market. The invention of new technology has diminished the most significant economic and technical barriers that formed the basis for major interconnection antitrust decisions of the past decade (see Attachment 2 to U S WEST's Comments (immediately following this paper), entitled, "A Facility is 'Essential' Only When Alternatives are Not Feasible," at p. 4, which describes how those earlier decisions foreshadowed the advent of technological breakthroughs that would make competition with LEC's economically feasible.). Fiber optic technology makes new wireline networks cost-effective for alternative access, enhancing both capacity and quality. See Meltzer, et al., Federal Perspectives on Access Charge Reform, FCC Staff Analysis, pp. 17 - 18, April 30, 1993 (hereinafter "Meltzer"). Radio and other technologies further enhance competitive options to LECs. In addition, the Commission's Expanded Interconnection decisions have removed economic barriers to the provision of special and switched access.[10] Under those decisions, CAPs and others now are "provide[d] ... expanded opportunities to permit entry into new cities," because they can effectively "use collocation to leverage a LEC's network in order to enter smaller markets." Kraemer, p. 5.

The most significant remaining barriers to entry and to effective operation of market forces are regulatory. "It is well known that some of the most insuperable barriers in the great race of competition are the result of government regulation...". Syufy 903 F.2d at 673. State policy that imposes regulated monopoly status on LECs poses the greatest hindrance to local exchange competition. Regulatory price constraints present barriers to full competition for interstate access services. For instance, averaging of LEC access services charges across geographic areas blocks competition among LECs and CAPs because it precludes LECs from pricing true to economic cost and from responding to competitive pricing pressures. Likewise, LEC tariff obligations hinder competition by delaying the ability of LECs to satisfy customer requirements. LECs also contend with earnings regulations; capital recovery constraints; forced subsidies imbedded in price structure; and other "carrier of last resort" obligations. Under present regulatory regimes, LECs are relatively impotent to meet competition in the market. The Commission will help foster economic growth by streamlining regulation of selected services and selected markets in which LECs presently face stiff competition. Relaxation of certain of these constraints in a way that will enable LECs to meet competition will benefit consumers, in the near term, through price rivalry and, in the long term, by spurring incentives to innovate.

Equally as important to competition and economic growth are regulatory burdens on

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[10] Expanded Interconnection, Report and Order, 7 FCC Rcd. 7369 and Second Report and Order, 8 FCC Rcd. 7374 (1993), appeal pending sub nom. Bell Atlantic Telephone Companies, et al. v. FCC, No. 93-1743 (D.C. Cir. pet. for rev. filed Nov. 12, 1993).

LECs that act as barriers to their entry into new markets. For example, U S WEST and others are hampered by regulation in their efforts to build video dialtone platforms. Firms cannot construct even trial projects without Commission approval through the "214 application" process. This process forces LECs to reveal their competitively sensitive plans for future operation. Moreover, Commission consideration of such applications typically is lengthy. Even after a LEC receives approval for construction, Commission rules substantially limit the firm's ability to ensure that the services available through its platform are comprehensive.[11]

C. Market Trends of Dynamic Innovation and Expanding Demand Diminish Market Power Concerns

Current market trends impact the ability to exercise market power by affecting both the magnitude of particular entry barriers as well as the future competitive significance of existing market participants. See Ball Memorial Hospital, 784 F.2d at 1336, citing, U.S. v. General Dynamics Corp., 415 U.S. 486 (1974). CAP and LEC growth rates offer a prime example of relative future competitive significance: In 1992 and 1993, CAP revenues grew approximately 40 percent annually, while LEC revenue growth was limited to 3 - 5 percent on average. TCG, The Unlevel Playing Field: Asymmetric Market Power Demands Asymmetric Regulation, March, 1994, p. 5.[12] Further, Expanded Interconnection is likely

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[11] See Attachment 3 to U S WEST's Comments for a more detailed explanation of the antitrust principles that govern the competitive entry of historical monopolists into new markets.

[12] While this paper cites the TCG document as authority for this industry fact, it disavows any "analytical" content therein. The TCG document is fundamentally flawed in its market power assessment. Among other things, TCG asserts that, merely because of LECs' present size in comparison to CAPs, regulation should hold LECs back from competing against CAPs until LECs lose substantial market share and CAPs "gain a widespread foothold." See TCG, p. 12. TCG fails to realize that size alone does not equal market power. The relevant inquiry is not how big are LECs today, but rather, what would happen (how the market would operate) if a LEC attempted to act anticompetitively. Nowhere does TCG ask the critical questions. TCG's bald assertion that "[e]ven if the local exchange bottlenecks are broadly eliminated, LECs will retain market power" ignores the well settled antitrust truth that "[m]arket power can persist only if there are significant and continuing barriers to entry." 2 P. Areeda & D. Turner, Antitrust Law, ¶505 (1978). TCG's approach is nothing more than a protectionist effort to shield itself from rigorous competition from LECs. Obviously, the longer TCG can hamstring LECs with regulatory constraints, the greater advantage it can obtain, and the greater the benefit to its bottom line. To parallel the goals of the antitrust laws, the Commission's framework should work to protect competition and the competitive process, not individual competitors or classes of competitors, as TCG's approach suggests. E.g., Brooke Group Ltd. v. Brown & Williamson Tobacco Corp., 113 S.Ct. 2578, 2588 (1993)("It is axiomatic that the antitrust laws were passed for the protection

to intensify this growth differential in favor of CAPs. Thus, CAPs promise to become an even more fervent competitive factor in the future.

Two significant trends in telecommunications that make entry more attractive and reduce the likelihood of market power exercise are the interrelated conditions of expanding demand and dynamic innovation. To be meaningful for antitrust purposes, market power must be durable. Metro Mobile, 892 F.2d at 63 (limited "head start" period insufficient to convey lasting market power). See Alaska Airlines, et al. v. United Airlines, et al., 948 F.2d 536 (9th Cir. 1991), cert. denied, 112 S.Ct. 1603 (1992)(power must be "not momentary", and "at least relatively permanent"). Growing demand volume reduces the likelihood that a firm can sustain market power for a significant period of time. Metro Mobile, 892 F.2d at 63 ("[I]t is axiomatic that monopoly power is unlikely to arise in dynamic industries marked by rapidly expanding volume of demand and low barriers to entry."). Maintenance of market power is less likely in a growing market because opportunity for long term growth through new demand promotes entry. Entrants are attracted by the prospect of obtaining new customers, which is often considered easier than having to steal existing customers of other firms. Id. ("untapped potential [in 'rapidly growing wholesale market'] provides a mouth-watering incentive for vigorous competition."). See also, Syufy, 903 F.2d at 667 (no market power in market characterized by "healthy and growing demand," among other things).

The brisk pace of technological change in this industry also reduces the likelihood of durable market power. E.g., ILC Peripherals, Inc. v. IBM Co., 458 F.Supp. 423, 431 (N.D.Cal. 1978)(despite IBM's high market share, court rejected that it had market power, in part because the market involved a high level of product innovation), aff'd, 636 F.2d 1188 (9th Cir. 1980), cert. denied, 452 U.S. 972 (1981). See also, Hartman, et al., p. 319 ("In high technology industries, the competitive positions of firms are never secure; incumbents, even those that appear dominant, can be unseated with alacrity by new technologies developed by others. Market positions built on a technological base which is changing rapidly are vulnerable to being overturned by new entrants from outside the industry as well as by competitors from within it."). The telecommunications industry today is undergoing a technological revolution at least as intense as the one that so quickly transformed the computer industry in past years. Id. at 320 ("Dell Computer grew from nothing to a significant position ... in half a decade; ... Microsoft came to have a market value approaching that of IBM, which was widely considered to be the industry leader at the time. Osborn Computer was the pioneer in portables, grew rapidly, but was then quickly displaced by Compaq Computer."). As in that business, here too, the technologically vibrant nature of the business bears on the relative future competitive significance of individual firms. For instance, where CAPs may have technologically superior networks (all fiber optic), and no

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of competition, not competitors." (emphasis in original)); Hunt-Wesson Foods, 627 F.2d at 927 ("Of course, it is free and open competition that the Sherman Act protects, and not any right of one competitor to be free of rough treatment at the hands of another.").

underdepreciation concerns, they may be better situated to engage in future competition. Likewise, "large integrated structures [like RBOCs] may become excessively hierarchical and less responsive to market needs. Accordingly, at least for some aspects of innovative activity, smaller organizations [like CAPs] are often superior." See T. Jorde & D. Teece, Innovation, Dynamic Competition, and Antitrust Policy, 13:3 Regulation 35, 40 (Fall 1990) (hereinafter, "Jorde & Teece").

V. Market Power Measurement Begins with Market Definition

To evaluate market power on terms like those discussed above, it is important to determine the contours of the actual market in which a firm may exercise such power. For that reason, the first step in antitrust market power discussions typically is to define the relevant market. See du Pont, 351 U.S. at 377; Archer-Daniels-Midland, 781 F.Supp. at 1402 (citing cases). The market definition inquiry describes a relevant market based both on the products or services it encompasses and its geographic scope. E.g., Brown Shoe Co. v. U.S., 370 U.S. 294 (1962). To identify an economically meaningful market, antitrust cases examine the existence of substitutes for the subject product or service and for the subject supplier. E.g., du Pont, 351 U.S. at 394. Thus, the analysis considers substitution from both production and consumption perspectives. E.g., U.S. v. Empire Gas Corp., 537 F.2d 296, 303 (8th Cir. 1976)(cross-elasticity of supply is as important as the demand factor in determining relevant market), cert. denied, 429 U.S. 1122 (1977).

The Commission has adopted antitrust market definition principles. E.g., Competitive Carrier, Further NPRM, 84 FCC 2d 445, 500 - 501 ¶¶ 149-50 (1981) ("The general approach we take to define telecommunications markets is well-established in antitrust law and scholarly economic literature."), citing, du Pont, 351 U.S. at 377, and Brown Shoe, 370 U.S. at 294. See also, Competition, Rate Deregulation and the Commission's Policies Relating to the Provision of Cable Television Service, Report, 5 FCC Rcd. at 4994 ¶48 ("The conceptual framework for delineating the relevant market comes from antitrust analysis. Relevant markets have both a geographic and a product-line dimension."). The Commission also has confirmed the need to consider both demand and supply elasticities in assessing competition. Business Services Order, 6 FCC Rcd. at 5887 n. 75, citing, among others, Landes and Posner, Market Power in Antitrust Cases, 94 Harv. L.R. 937, 979 (1981); and, Krattenmaker, 76 Georgetown L. Rev. at 259.

Antitrust analysis calls for a "pragmatic, factual approach" to ascertain an "economically significant" market definition. Brown Shoe, 370 U.S. at 336. The overriding consideration in the identification of substitutes and the overall market definition inquiry is that it must "correspond to the commercial realities" of the industry. Id. As one antitrust court recently explained:

> The appropriate line of commerce [or product market] for ... purposes [of assessing market power] must be chosen in terms of the realities of the business situations involved.... Where there are marginal or substitute products or **alternative methods**

> **of achieving a particular function**, these **need to be considered in selecting a line of commerce [product market] even though they may not overall have a direct effect upon all aspects of the principal competition...**". U.S. v. Baker Hughes, Inc., 731 F.Supp. 3, 6 (D.D.C. 1990) (emphasis added).

The existence of alternative methods to achieve a specific function is particularly relevant for the Commission's present purposes. While in the past, LECs were considered and regulated as "natural monopolies" with no reasonable substitutes for their services, technological innovations have resulted in the commercial reality that multiple alternative methods now exist to perform services that previously could be provided only by LECs (see list of sources, below, p. 20).[13]

Demand substitutes include those products or services that are reasonably interchangeable by users for the same purpose. du Pont, 351 U.S. at 395. The analysis takes into account that products or services are often imperfect substitutes and that functional interchangeability is a matter of degree. Id. at 401 (other flexible packaging materials found reasonably interchangeable with cellophane notwithstanding price differences among them of two to three times; thus, sole manufacturer of cellophane lacked market power). Products that differ in price, type, or quality, may be in the same product market, if they maintain some overlapping impact on purchasers. The Commission has acknowledged implicitly this fluid characteristic of substitutability. E.g., Competitive Carrier, Fourth Report and Order, 95 FCC 2d at 565 ¶16 ("While there may be some limits to supply substitutability for certain services, there are sufficient demand or supply linkages to justify treating them as being in a single product market.").

The effectiveness of demand substitutes depends in large part on consumers' willingness to accept them as alternatives in the face of a price increase in the subject product. Here, acceptance of competitive alternatives in local exchange services will proceed even more quickly than it did with long distance services simply because the long distance companies have paved the way. See, Strategic Policy Research, Regulatory Reform for the Information Age, p. 11 - 12, Jan. 11, 1994, filed concurrently with U S WEST's Comments (hereinafter "SPR"). Experience in dealing with multiple interexchange carriers since 1984 has made even the most unsophisticated residential consumers accustomed to making choices among telecommunications providers.

With respect to acceptance of substitutes for interstate access services, the willingness of IXCs to turn to alternative sources of supply is evident. The fact that they currently use multiple suppliers and encourage CAP entry is among the most obvious. See, Meltzer, pp. 25 - 26. IXCs cannot genuinely deny that they would consider alternative sources of supply

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[13] Indeed, the Commission's Expanded Interconnection decisions requiring LECs to interconnect CAPs and others comports with the conclusion that LEC services are not natural monopolies.

the face of a price increase from an incumbent LEC. Indeed, U S WEST had occasion to put the question directly to an AT&T official under oath in a state forum. The resulting testimony manifests the IXC mind set on this point:

> Q: ...[I]f, in fact, there were a 5 percent increase in carrier switched access rates under [the OCC] plan, can you state for an absolute fact that AT&T would not consider purchasing access services from one of those alternative providers, such as Will Tell [sic], Metropolitan Fiber Service [sic] or Teleport?[14]
>
> A: No, I can't say that ... because AT&T's policy ... has been that we will look at the best choices that we have for access and to provide access to reach the customers. And, so, we'll always look at that. ...
> ****
> Q: ... [I]f you got a price increase [from U S WEST], there might be some motivation to look to these alternative providers, wouldn't there be?
>
> A: There is always motivation to look and see if you can, you know, improve your efficiency. When two-thirds of your costs are going to one company, you're always, you know -- would be remiss in not looking at whatever alternatives are available to us on any case, regardless of what the price level is at U S West....

Testimony of Ms. Lola Staggs, AT&T Assistant Vice President - State Government Affairs, before the Colorado Public Utilities Commission, Docket No. 90A-665T, Oct. 25, 1991, p. 223.

As the above testimony demonstrates, IXCs routinely consider alternative sources of access, even in the absence of a LEC price increase (i.e., "regardless of ... the price level ... at U S WEST"). This is the nature of sophisticated purchasers, and a primary reason why a LEC could not exercise market power over interstate access services even if it so desired. Further, interstate access is an intermediate service that is essentially homogeneous. No

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[14] This examination tracks the methodological tool contained in the Guidelines to assess market definition and ultimately market power. The antitrust enforcement agencies postulate a "small but significant and nontransitory" increase in price above competitive levels and ask whether that increase would cause purchasers to switch away from the hypothetical monopolist's product sufficiently to defeat the profitability of the increase. If so, the product market must include the alternative(s) to which those purchasers would switch. 1992 Guidelines §1.11. Indeed, in direct parallel to the above testimony, the 1984 statement of the Guidelines explained that "a price increase of five percent" constitutes a small but significant increase in most contexts. 1984 Guidelines §2.11. The loss of AT&T's large volume of business most assuredly would make any such price increase unprofitable to U S WEST or any LEC. Under the Guidelines' approach, the above testimony evidences that CAPs compete with LECs in a relevant market.

"brand loyalty" biases will hinder these knowledgeable buyers from accepting better value from a source other than the incumbent. See Country Lake Foods, 754 F.Supp. at 679 (with no significant product differentiation or brand loyalty, power buyer can readily change supplier).

Equally as important as demand substitution is the presence of suppliers who offer alternatives that effectively deter potential anticompetitive conduct. As the Commission previously has noted, two factors play into this supply substitution equation: excess capacity of existing competitors; and entry of new competitors. Business Services Order, 6 FCC Rcd. at 5888 ¶43. If an existing competitor has latent capacity available to absorb sufficient business to make an anticompetitive price increase unprofitable to the incumbent, that condition effectively will deter such pricing. E.g., Country Lake Foods, 754 F.Supp. at 672-674. Likewise, the threat of competitive entry sufficient to defeat an anticompetitive price increase works to protect the market from supracompetitive prices.[15] E.g., Syufy, 903 F.2d at 659.

A fundamental point of supply substitution and entry is that both actual and potential competitors count in defining the market and assessing its competitive realities. E.g., Baker Hughes, Inc., 731 F.Supp. at 10 ("potential competition must be taken into account"), aff'd, 908 F.2d at 981. While latent capacity of existing firms has the most immediate effect, the combined threats of "fringe expansion," vertical integration, and new players exert potent pressure as well. When potential competitors form a looming presence on the horizon, that perception impacts the current behavior of incumbent firms. See FTC v. Proctor & Gamble Co., 386 U.S. 568 (1967). The visible competitive threat of perceived new entrants has a constraining effect on pricing decisions. Ball Memorial Hospital, 784 F.2d at 1336 ("potential rivals" important as constraint on defendant's ability to raise prices). Thus, a firm need not be currently producing in the market to have influence in preventing exercise of market power. See, e.g., id.

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[15] The Guidelines distinguish between "uncommitted" and "committed entrants," and include the former in the relevant market. Uncommitted entrants are those firms that are likely to enter in response to a "small but significant and nontransitory price increase," and can do so within one year without sizable sunk costs. Guidelines § 1.32. These entrants are within the defined market because they have a present day price-constraining effect on firms in the market, even though they do not presently sell within it. Committed entrants, on the other hand, represent new competition (can emerge within two years) that requires expenditure of significant sunk costs. Although committed entrants are not included within the market under the Guidelines framework, they are treated as a check on the exercise of market power to the extent that their entry would be "timely, likely and sufficient" to defeat supracompetitive pricing. Guidelines §3. As a practical matter, both committed and uncommitted entrants, to relative degrees, serve to thwart attempts to raise prices anticompetitively. Excess capacity deters anticompetitive pricing in the first instance, while entry precludes such pricing from being sustained.

The importance of potential competition in examining market definition and market power is even greater still in an industry, like this one, characterized by rapid technological innovation. E.g., Hartman, et al., pp. 335 - 36 ("In high technology innovative industries, it is this potential competition that is often most threatening.... The reason is that potential competition from new technologies can destroy the value not only of a firm's market position in a particular product, but also the value of its underlying technological, physical, and human assets.").[16] The Commission, itself, has identified potential competition as an important market feature in evaluating market power. Competitive Carrier, Further NPRM, 84 FCC 2d at 500 ¶148. See also Jorde & Teece, p. 38 ("In most instances potential competition can be more important than actual competition in industries experiencing or expected to experience rapid technological change. ...Thus, assessing product market competition in industries experiencing [such] change is incomplete unless it explores new products already in the pipeline and those that can easily be put into the new product development pipeline."). Here, to ensure a full treatment of product market competition, the Commission should consider each existing and emerging technology and its effect on LEC market behavior. Toward this end, a list of the major present and potential competitive players is set forth below (infra p. 20, et seq.).

One limitation of the antitrust approach to product market definition is that it "treats each substitute product as either inside the market or outside the market... [and therefore] does not recognize the competitive discipline exerted by those products just outside the market on the products within [it]...". J. Baker and T. Bresnahan, Empirical Methods of Identifying and Measuring Market Power, 61 Antitrust L.J. 3 (Summer 1992). See Weyerhaeuser Co., 106 F.T.C. 172, 286 (1985)("while the definition of relevant markets requires the drawing of bright lines for the inclusion and exclusion of goods and firms, our analysis should not ignore competitive influences at the margin, though outside the bright lines."). Thus, even if some imperfect substitutes are excluded from the present market, the Commission would be correct to accept that those products that today may sit immediately beyond the outer limits of the defined market also serve in some form to police conduct

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[16] To emphasize this long-standing principle that "potential competition ... is the most powerful form of competition," the commentators cited above quote from the 1942 work of J.A. Schumpeter, Capitalism, Socialism and Democracy, Harper & Row, as follows:

> [I]n capitalist reality, as distinguished from its textbook picture, it is not that kind of [price] competition that counts but the competition that comes from the new commodity, the new technology, the new source of supply.... This kind of competition is as much more effective than the other as bombardment is in comparison with forcing a door, and so much more important that it becomes a matter of comparative indifference whether competition in the ordinary sense functions more or less promptly.

Id. at 335, fn. 19.

within the market. Indeed, as ongoing events continue to change the contours of the existing market, and previously separate markets converge, such products may, in the near term, fall well within the market's scope. Antitrust precepts dictate that the parameters of an appropriately defined product market, as it relates to the goals of this price cap review, must encompass both potential and actual competitive forces that impact on LECs.

The geographic market is the area of effective competition in which sellers of the relevant product or service operate and buyers practicably can turn for alternate sources of supply. U.S. v. Philadelphia Nat'l Bank, 374 U.S. 321, 359 (1963); see also, Competitive Carrier, Fourth Report and Order, 95 FCC 2d at 573 ¶25. The point is to locate the region in which purchasers have real choices on price and service offerings. Here, demand and supply substitutes are evaluated by geographic proximity. Of particular importance to the market scope is the subject supplier's perspective of geographic sources of additional supply. E.g., Ball Memorial Hospital, 784 F.2d at 1336 (market defined as "regional, if not national" even though it "may not seem useful from the perspective of consumers ... who must [buy] from firms [locally], because the scope reflects the geographic location of supply-side "rivals and potential rivals"). As with product market definition, those firms on the immediate outskirts of a geographic market constitute, in Guidelines parlance, "uncommitted entrants" (see infra fn. 15, p. 17) and, thus, are within the market to the extent that they can quickly and easily begin supply in response to an anticompetitive price increase (within one year and without significant new investment). As explained above, such potential supply substitutes constitute productive capacity that affects present pricing decisions.

Those who oppose the LECs' efforts to obtain regulatory relief to enable fair competition in the marketplace engage in market definition sophistry to persuade regulators that LECs operate devoid of competitive pressures. E.g., Economics and Technology, Inc./Hatfield Assoc., Inc., The Enduring Local Bottleneck: Monopoly Power and the Local Exchange Carriers (Feb. 1994)(sponsored by AT&T, MCI, and CompTel). One method that LEC opponents use is to define LEC markets to exclude significant connections that bypass LEC networks (private networks, IXC self-supply and resale, etc.). By ignoring the commercial reality of such bypass and focusing only on the remaining subset of connections retained as access revenues, these opponents create a market in which LECs' historically dominant position never shrinks, regardless of the amount of business they actually lose to such access alternatives. To measure market power, these significant bypass connections properly must be included in the defined market. Otherwise, the analysis neglects real consumer choices and the resulting definition does not represent an economically meaningful market. A necessary step to an accurate assessment is to gain access to data on such bypasses, through reporting requirements or otherwise.

Markets are not static. Market structures transform as players move on and off the scene, as demand fluctuates, and as innovation expands commercial capabilities. Telecommunications, a technologically dynamic industry with growing demand, is presently undergoing a commercial metamorphosis. Some alternative providers employ technologies that were virtually unknown a decade ago to provide local exchange and interstate access

services. The Commission previously has recognized the evolving nature of markets, and the related impact on regulation. Competitive Carrier, Further NPRM, 84 FCC 2d at 502 (describing the "the possibility of technological advancement blurring any meaningful boundaries between ... [identified] submarkets" and explaining that "[a]s market conditions evolve ... we will revisit the question of the appropriate scope of regulation for the communications industry."). Similarly, the Commission presently acknowledges the ongoing "convergence of services" among voice, video, and data, which once were considered economically distinct markets, and seeks to perform a review "broad enough to consider the effect of this convergence of service on price cap regulation of LEC access services." NPRM, ¶21. As the intersection of previously separate markets proceeds, LECs will continue to face competition from a growing pool of sources. The voice, video, and data transmission businesses are well on their way to coalescing into a single industry in which providers, to remain viable, must offer integrated wired and wireless communications, entertainment and information services. These competitive forces are reshaping what the Commission has traditionally considered local exchange and interstate access markets. The Commission's present task, then, is demanding, because it must accommodate the ongoing formation of markets in creating a regulatory framework sufficiently flexible to offer a migratory path to streamlined regulation and, ultimately, to deregulation. With that backdrop, the following list identifies, for market definition purposes, the predominant sources of present and potential competition for LECs, with a brief description of their present role and future significance in disciplining LEC market activity:

Competitive Access Providers ("CAPs") -- CAPS presently compete vigorously with LECs, offering services that are competitive for a substantial segment of the interstate access trade. CAPs connect large long distance subscribers to long distance carriers over state-of-the-art fiber optic networks, obviating connection with the LEC local network. CAPs typically can price lower than LECs, which are hindered by regulatory constraints. CAPs have prompted many large end users to implement mandatory supplier diversity requirements that have "sounded the death knell of the local exchange monopoly for large business users." Kraemer, p. 4. IXCs likewise maintain policies ensuring supplier diversity through CAPs. Id. CAPs are well capitalized (several with backing from large cable television concerns) and technically competent. They continue to pursue aggressive expansion plans.[17] The ongoing dramatic increases in CAP networks (see Kraushaar, FCC, Common Carrier Bureau, Industry Analysis Division, Fiber Deployment Update (1992)), and the Commission's Expanded Interconnection decisions, place CAPs in a position to compete also

[17] The plans of Metropolitan Fiber Systems ("MFS") are illustrative: MFS "has determined to accelerate the expansion of its networks in metropolitan areas through the U.S., ... to expand its customer base to include small and medium sized business customers, and to broaden its service offerings." MFS Commun. Co., Inc., Prospectus, Sept. 14, 1993 (hereinafter, "MFS Prosp."). MFS plans to enter 75 new U.S. cities in the next three to five years, with plans to join U S WEST, Jones Lightwave, IntelCom, and Teleport in Denver by 1995. Denver Post, Phone Firm Expanding to Denver, p. C1, March 17, 1994.

in providing switched access and local service. See SPR, p. 6. Recently and illustratively, Teleport has applied to state regulators in Illinois and Washington "declaring that it wants to become 'the other local telephone company'" in Chicago and Seattle, competing in the latter location head-to-head with U S WEST. Wall Street Journal (hereinafter, "WSJ"), "Teleport Asks to Enter Local Phone Market In Chicago, Seattle," p. A6, April 22, 1994. Under the Commission decisions to require LECs to interconnect CAPs (and other providers) to LEC networks, LEC competition with CAPs becomes exponentially more intense.[18] The Commission recognizes that CAPs' "ability to compete with the LECs should be enhanced by implementation of Commission decisions mandating special access and switched transport interconnection." NPRM, ¶22.

CAPs' fiber optic networks have enormous capacity.[19] One industry expert estimates that "no more than 10 percent of CAP fiber capacity is actually being used to carry traffic." Huber, p. iii. In areas surrounding their networks, CAPs can absorb substantial additional volume. CAPs thus provide the sort of ready supply responses that deter incumbent price increases. As noted previously, CAP growth rate is explosive in comparison to LECs', a relative rate difference that Expanded Interconnection can only magnify. Further, CAPs can offer end users least cost routing services through multiple IXCs. MFJ restrictions leave RBOCs powerless to meet this competitive dimension. Given their performance in the recent past and their present posture, the future competitive significance of CAPs is momentous.

Interexchange Carriers ("IXCs") -- IXCs likewise currently compete with LECs. IXCs are constantly working to reduce their dependence on LECs, often by enhancing their capabilities to provide end-to-end service, completely obviating LEC networks (even while they vigorously resist LEC entry into interLATA long distance). See Kraemer, pp. 1-2. The IXC self-supply factor is crucial to include in drawing the parameters of the relevant product market. Past self-supply implementations are most certainly within the market, as are prospective vertical integration efforts that IXCs can achieve as "uncommitted entrants." IXCs offer dedicated access services (Megacom, Prism, Ultrawats) and virtual private network services (VPN, SDN, and VNET) that substitute for LEC services. IXCs' abilities to vertically integrate and bypass LECs (through wireless or wireline bypass (or both)) are

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[18] MFS credits the Expanded Interconnection decisions with enabling it "to offer interstate special and switched access transport services to virtually every business and government end user in the metropolitan areas which the Company elects to serve." MFS Prosp. at p. 4-5. CAPs, of course, are not obligated to service residential areas, and are not attracted to do so under present business conditions. Regulation promoting "universal service" skews competitive entry away from residential service, providing no profit opportunity there for CAPs. See Huber at ii.

[19] LECs, as competitors to CAPs, do not have access to the CAPs' internal information regarding their exact capacities or expansion plans. To perform the task of evaluating market conditions and trends, the Commission rightfully should issue data requests from all relevant industry sources.