obligation on the CMRS marketplace at this time. What CMRS providers need in order to develop the industry is access to the public switched network--not the likelihood that they will need systems that will accommodate an incalculable number of interconnections.

There is simply no demonstrated need which justifies mandating interconnection among CMRS providers, especially at this time. Instead, the factors at this time which argue against the imposition of such a requirement, are: the fact that one CMRS provider is being forced against its better business judgment to direct connect with another CMRS provider instead of through the public switched network, the fact that forcing such interconnection may raise the forced carriers' costs, and the fact that such loss of business control may discourage potential qualified entrants in the CMRS market. In addition, the additional costs incurred over the carriers' better business judgment, may be passed on to the customers.

2. The Commission Should Preempt State Mandated CMRS Interconnection.

It is well settled that the Commission may exercise preemption authority when interstate and intrastate services are inseparable and the state regulations would thwart or impede the Commission's public policies.[170] The Commission properly exercised such authority to preempt state regulation over the types of and rights to CMRS interconnection with the local exchange carriers.[171] The Commission is correct in finding that the same authority supports preemption of state regulation of the types of and rights to CMRS

---

[170] Louisiana Public Service Commission v. Federal Communications Commission, 476 U.S. 355, 375 n. 4 (1986).

[171] See, In the Matter of the Need to Promote Competition and Efficient Use of Spectrum for Radio Common Carrier Services, Declaratory Ruling, 2 FCC Rcd 2910, ¶¶ 17-18 (1987); CMRS Second Report at ¶¶ 228-29.

interconnection with other CMRS providers.[172] Further, the Commission should clarify that its exercise of such authority includes prohibiting states from placing interconnection requirements on CMRS providers. As explained above, placing interconnection requirements on CMRS providers would have a detrimental effect on competition.[173] Thus, the Commission should preempt the states from mandating CMRS interconnection or otherwise regulating the types of and rights to CMRS interconnection.

3. Any CMRS Interconnection Mandates Should Be Uniform.

The Commission requests comments on whether different types of mandates for interconnection should be imposed on different types of CMRS or whether similar obligations should be placed on all CMRS providers. As discussed above, mandating interconnection means forcing a CMRS provider to take actions which it believes are inefficient, unduly costly and that it would otherwise not take, all because a competitor has an economic self-interest in forcing such action. To allow competitors to force such inequities on only a certain class of competitors in a market is even more unconscionable. If interconnection between CMRS providers is to be mandated, all CMRS carriers should be subject to the mandate. The Commission also requests comments on whether CMRS providers should be required to interconnect with private carriers (PMRS) or individuals on the same rates and in the same manner that CMRS providers interconnect with each other.[174] The CMRS providers do not control the facilities such providers need to establish their business. The Commission

---

[172] NPRM/NOI at p. 61.

[173] See Section V. B. 1.

[174] NPRM/NOI at pp. 55 - 56.

has stated that the PMRS licensee has the right to obtain interconnection to the LEC on the same terms and conditions offered a CMRS provider. The fact that it might make business sense for CMRS providers to interconnect does not mean that it makes business sense for a CMRS provider and a PMRS provider to interconnect. There is no legitimate reason why the Commission should force CMRS providers to interconnect with PMRS providers.

4. Implementation Issues If CMRS Interconnection Is Mandated

The Commission requests comments on various issues which would arise if interconnection is mandated between CMRS providers. The Commission requests information regarding the type of facilities the CMRS providers employ or will employ and queries whether the way they connect to the LEC networks should affect the type of interconnection that is required between CMRS providers.[175] The Commission should not mandate forms of interconnection. Rather, like the decision to interconnect, the manner of interconnection should be by mutual agreement of the parties. There is no reason to mandate interconnection technologies because competition encourages interoperable technologies. No rational telecommunications provider would build a system which would fail to interconnect with other systems as such would ensure failure. It makes no sense to deploy a technology which results in an island network, from which the customers cannot reach the outside world. In order to be competitive, every provider of telecommunications services must ensure that its chosen technology is interoperable with other technologies, including the public switched network. It is this market mandate which ensures that the telecommunications industry will not develop non-interoperable technologies and networks. The Commission has already ruled

[175] NPRM/NOI at p. 56.

that cellular carriers must be provided access to the public switched network and, as discussed above, it should extend such right to all CMRS providers. As long as such right of access is in place, no other regulatory intervention is necessary. The new entrant should design its system to be compatible with the industry, not the other way around.

The Commission queries whether it should adopt differing interconnection obligations due to differences in interconnection facilities.[176] Again, if interconnection obligations are adopted they should be adopted uniformly for all CMRS providers--to do otherwise would put certain providers at a competitive disadvantage. The Commission should not impose burdensome and costly mandates on only a portion of the competition. Normally, if a specific entity feels that compliance with Commission rules is unduly burdensome that entity is required to seek a waiver. The waiver procedure is a more equitable means of weighing the individual burden of complying with an obligation against the unfairness associated with failing to treat competing providers equally. However, as discussed above, the ideal way to proceed would be not to mandate interconnection obligations on any CMRS provider and allow market conditions and the individual CMRS providers to determine when and how interconnection will occur. There is simply no legitimate reason why the Commission should force CMRS providers to interconnect with other CMRS providers against their will.

However, if the Commission decides to mandate CMRS interconnection, the rates, terms and conditions should be set through negotiated agreements. Negotiated agreements would save administrative expenses associated with tariff filings and provide the flexibility

---

[176] Id.

needed in an evolving market.[177] Thus, the Commission should exercise its forbearance authority under Section 332(c)(3) of the Communications Act[178] and not require the filing of tariffs if interconnection is mandated between CMRS providers.

The Commission also requests comments on certain interoperability standards. The Commission notes that MCI has requested information sufficient to access mobile location databases and to routing information. As the various commenters noted in the CMRS rules docket, such access constitutes an unlawful deprivation of property rights by allowing access to confidential proprietary information.[179] As discussed above, the Commission should not force CMRS providers to allow competitors access to proprietary databases. The industry is already decided upon an industry standard for passing necessary information, IS-41. Regulatory intervention is not needed to assure interoperability to that standard and regulatory intervention should not be used to force exceptions to that standard. Questions of interoperability and standards should continue to be worked out through industry consensus and standards committees--Commission involvement is not required.

5. Billing and Collection/Customer Database Access

In 1986 the Commission correctly determined that billing and collection was not a common carrier service under Title II of the Communications Act and that it was not necessary to exercise ancillary jurisdiction under Title I because there are no barriers to entry

---

[177] See, Section V.A.

[178] 47 USC 332(c)(3)

[179] See NPRM/NOI at p. 58 and fn. 246.

in the billing and collection market.[180] The only potential barrier to billing and collection is customer name and address information -- once such information is provided an IXC is free to bill its service itself or hire a third party to do its billing for them. Additional requirements should not be placed on CMRS providers.

As demonstrated by the cellular markets offering equal access today, there is not a problem with the billing of interexchange calls placed by cellular customers. Cellular carriers provide IXCs with the information they need to transport calls that originate or terminate on a cellular system. Certain IXCs however want to use the whole issue of billing and collection to gain access to proprietary databases and to possibly force the CMRS providers to perform billing and collection for them.[181] The Commission should reject such efforts.

The primary issue is what information is necessary for the interexchange carriers to bill and collect the charges for the interexchange service they provide. The IXCs tend to distort the issue by equating what is necessary for them to bill with a wish list of information they would like to have concerning the CMRS customers. The IXCs also tend to distort the issue by equating the issue of what is necessary to bill and collect with the issue of obtaining the information in a means and in a format that meets their business needs and reduces their costs regardless of what the cost is to the CMRS provider which is providing the information. The issue is what information is necessary for the IXCs to bill and collect for the interexchange service--that information already is being provided.

---

[180] Detariffing of Billing and Collection Services, 102 FCC 2d 1150 (1986).

[181] NPRM/NOI at pp. 41-42.

The IXCs also tend to distort what service they are actually providing. For example, at MCI's request the Commission seeks comments on whether they should mandate:

> IXC access to cellular databases to permit IXCs to locate **their customers** (either in their home system or when roaming) and to route calls to the appropriate destination.MCI explains that in the cellular context, "destination" should be construed broadly to include all call-routing and call handling options available to the cellular customer via cellular, LEC or IXC networks.[182]

MCI's request overlooks the fact that the customers are MCI customers only for the purpose of interexchange service. The customer has chosen a CMRS provider for its local wireless service and MCI to carry the calls from one exchange to another. MCI however claims a need to know "customer profile information"[183] and a need for access to the CMRS provider's proprietary databases. Other interexchange carriers are somehow able to provide interexchange service without access to customer profiles and the proprietary databases, why is it so critical for MCI to have access? As past experience demonstrates, access to such data bases is not required in order to complete calls or properly bill the customer.

VI. CONCLUSION

Equal access is an anomaly in the competitive wireless marketplace. The regulatory parity that would make the most sense in the wireless arena is for no CMRS provider to be saddled with this regulatory relic. Working to support that end would be the best use of this Commission's expertise and oversight. However, if the Commission is of the opinion that it must impose equal access on some or all CMRS providers under the principle of regulatory

---

[182] NPRM/NOI at p. 41. (emphasis added).

[183] See Section IV. D.

parity, the following conditions should be imposed: (1) a sunset provision, (2) exclude CDPD, AIN, and other non-voice services, (3) designate the largest local calling scope feasible, preferably Major Trading Areas, and (4) establish clear procedures for the immediate removal of equal access obligations from all CMRS providers once such obligations are removed from current Equal Access Cellular Providers. Further regulation, such as mandatory CMRS interconnection or additional resale obligations are unnecessary and of no benefit to the public interest.

Respectfully submitted,

SOUTHWESTERN BELL MOBILE SYSTEMS, INC.

By: Wayne Watts
Vice President & General Attorney,
Carol Tacker
General Attorney,
Bruce Beard
Attorney
17330 Preston Road, Suite 100A
Dallas, TX 75252
(214) 733-2005

and

SOUTHWESTERN BELL CORPORATION

By: James D. Ellis
Sr. Executive Vice President &
General Counsel
Mary Marks
Attorney
175 E. Houston, Suite 1306
San Antonio, TX 78205
(210) 351-3478

Affidavit of Professor Jerry A. Hausman

1. My name is Jerry A. Hausman. I am the MacDonald Professor of Economics at the Massachusetts Institute of Technology in Cambridge, Massachusetts, 02139.

2. I received an A.B. degree from Brown University and a B.Phil. and D. Phil. (Ph.D.) in Economics from Oxford University where I was a Marshall Scholar. My academic and research specialties are econometrics, the use of statistical models and techniques on economic data, and microeconomics, the study of consumer behavior and the behavior of firms. I teach a course in "Competition in Telecommunications" to graduate students in economics and business at MIT each year. Mobile telecommunications, including competitive and technological developments in cellular, ESMR, satellite, and PCS, are some of the primary topics covered in the course. I was a member of the editorial board of the Rand (formerly the Bell) Journal of Economics for the past 13 years. The Rand Journal is the leading economics journal of applied microeconomics and regulation. In December 1985, I received the John Bates Clark Award of the American Economic Association for the most "significant contributions to economics" by an economist under forty years of age. I have received numerous other academic and economic society awards. My curriculum vitae is attached.

3. I have done significant amounts of research in the telecommunications industry. My first experience in this area was in 1969 when I studied the Alaskan telephone system for the Army Corps of Engineers. Since that time, I have studied the demand for local measured service, the demand for intrastate toll service, consumer demands for new types of telecommunications

technologies, marginal costs of local service, costs and benefits of different types of local services, including the effect of higher access fees on consumer welfare, demand and prices in the cellular telephone industry, and consumer demands for new types of pricing options for long distance service. I have also studied the effects of new entry on competition in paging markets, telecommunications equipment markets, exchange access markets, and interexchange markets and have published a number of papers in academic journals about telecommunications. Lastly, I have also edited two recent books, Future Competition in Telecommunications (Harvard Business School Press, 1989) and Globalization, Technology, and Competition in Telecommunications (Harvard Business School Press, 1993).

4. I have been involved in the cellular industry since 1984. I participated in PacTel's purchase of Communications Industries in 1985 and have provided testimony on previous occasions on cellular competition and regulation to the California PUC, the North Carolina PSC, and the Connecticut PUC. I also previously submitted testimony to the FCC on questions of cellular regulation, including the question of whether cellular companies should be allowed to bundle cellular CPE with cellular service and whether the FCC should forbear from regulation of mobile service providers. During the PCS proceedings I have filed 6 affidavits which considered eligibility questions for LECs, the presence of economies of scale and scope in providing PCS, the design of an appropriate auction framework for PCS spectrum, spectrum allocation and band size, eligibility for in-region cellular companies, and the appropriate framework for pioneer preferences. I spoke at the FCC Task Force meeting on PCS held on April 11, 1994. I also have done significant academic research in mobile telecommunications and it is one of the primary topics in my graduate course, "Competition in Telecommunications", which I teach each year at MIT.

I. Summary and Conclusions

5. I have been asked by Southwestern Bell Corporation to consider questions of equal access and geographic scope of local calling areas for commercial mobile radio services (CMRS) providers which are raised in the FCC NPRM and NOI "In the Matter of Equal Access and Interconnection Obligations Pertaining to Commercial Mobile Radio Services" (CC Docket No. 94-54).

6. I conclude that equal access should not be required for cellular service providers. Equal access requirements on BOC cellular providers, caused by the MFJ, currently cost consumers about $900 million per year and have led to decreased competition among providers of cellular service. A much better policy for the FCC would be to petition the MFJ court to eliminate the current equal access and interLATA restrictions on BOC cellular carriers. This policy change is especially timely given the pending full scale inception of operation by Nextel and the pending PCS broadband auctions.

7. Geographical calling areas for extended local service should at a minimum be as large as an MTA. The current LATA boundaries are not based on any realistic economic basis for users of cellular telephone service or of current and future competition among CMRS providers. Consumers would have lower costs of using their cellular telephone and competition would increase with large area calling scopes.

8. The proper framework for regulation of cellular telephone is to attempt to encourage high quality service and the lowest price for consumers. This goal is far different from a goal of "protecting" IXCs from having to deal with large buyers who can achieve much lower prices on long distance service than individual cellular customers currently pay. Competition among IXCs to provide cellular long distance service has been almost non-existent with AT&T and the other IXCs engaged in anti-competitive price discrimination against cellular long distance customers. Thus, a requirement of equal access

will not lead to a decrease in cellular long distance rates. Instead, it will likely lead to an increase in cellular long distance rates because of the anti-competitive actions of the IXCs.

II. Market Structure of Cellular and CMRS

9. The FCC licensed 2 cellular carriers in each MSA and RSA. The Block B carrier is the wireline carrier; in the large majority of situations this carrier is an equal access cellular provider (EACP), e.g. a BOC cellular provider. The MFJ Court has applied the interLATA restrictions and equal access provisions to the BOC Block B cellular companies. The Block A carrier can be either a non-BOC, e.g. McCaw the largest cellular provider in the U.S., or a BOC which purchased the license subsequent to the original FCC allocation. To date, the non-BOC Block A cellular carriers have not been subject to the equal access and interLATA restrictions, except for AT&T/McCaw, while the Block A BOC cellular carriers have been subject to the restrictions.[1] I will use the term EACP to refer to cellular providers which are currently required to provide equal access--the BOCs and AT&T/McCaw.

10. Nextel is beginning full operation of its ESMR network this year. Thus, increased competition in CMRS will be created by this new entrant. Nextel began operation in Los Angeles in 1993 and plans to begin operation in San Francisco and New York in 1994: "Nextel expects to activate the Digital Mobile networks in San Diego,..., the New York tri-state area, Chicago and Milwaukee sometime later in calendar year 1994...." (Nextel Prospectus, Feb. 11, 1994, p. 4) Nextel has now expanded its plans, and has purchased sufficient ESMR spectrum from Motorola and other companies to be able to offer

[1] Under the recent consent decree to allow its acquisition by AT&T, McCaw has agreed to provide equal access to its cellular customers. GTE cellular companies have not been subject to equal access and interLATA restrictions in contrast to restrictions on GTE landline companies as discussed in para. 8 of the NPRM.

its services to about 70% of the population in the U.S.[2] Nextel's proposed service areas cover about 180 million people and 47 of the top 50 U.S. SMSAs.

11. Nextel has not encountered any difficulty in raising capital to finance these expansion plans.[3] Indeed, the market capitalization of Nextel currently exceeds $3.0 billion. Nextel recently announced plans to acquire the other two major ESMR providers, Dial Call and OneComm. Dial Call (formerly Dial Page) is constructing an ESMR network throughout the Southeastern U.S. Similarly, Onecomm (formerly Cencall) plans to offer ESMR service throughout the Rocky Mountain Region and the Pacific Northwest. These 3 ESMR companies cover almost the entire U.S, so that Nextel will be able to offer service to over 80% of the U.S. in almost every major MSA, with over 200 million pops in its service area when the acquisitions are completed. Nextel is likely to have a competitive advantage over cellular because of the larger geographical areas covered and the seamless roaming arrangements. No cellular carrier has more than about a 24% share of pops with McCaw having about 63 million pops. Thus, McCaw's coverage is only about 1/3 as large as Nextel. This considerably greater geographical coverage will provide a significant competitive advantage to Nextel's network. Nextel does not plan to provide equal access to its customers.[4]

12. The recent FCC decision to allocate 120 MHz of spectrum for the construction of Personal Communications Service (PCS) networks will also lead to significant new entry by CMRS providers. Interest is very high among potential PCS providers which includes local telephone companies (both in and

---

[2] McCaw, the largest cellular carrier, has service areas which cover about 25% of the U.S. population.

[3] Nextel recently raised approximately $700 million in a public debt offering in February 1994.

[4] Indeed, until very recently Nextel expected to provide all long distance service to its customers through a contract with MCI. Nextel's choice of an IXC to provide long distance service is now unclear due to the recent breakup of the Nextel/MCI venture.

outside their regions), local cable TV companies, cellular companies, and many other companies. The recently completed narrowband PCS auction demonstrates the high degree of interest in the provision of new services. PCS broadband auctions are likely to begin by the end of 1994. PCS will begin to provide significant new competition to cellular beginning in 1995 or 1996. A minimum of 3 new 30 MHz band PCS providers will offer service in each geographical area, plus one or more other new providers in the 10 MHz bands.

13. PCS already works. In December 1993 when I visited the United Kingdom (UK), I used the PCS network which has been constructed by Mercury in partnership with U.S. West. The second PCS network in the UK, the Orange network operated by Hutchison Telecom, began operation in April 1994. The Orange network already covers 50% of the UK population, and it plans to cover 70% by the end of 1994, and 90% by the end of 1995. Both the Mercury and Orange networks have been successful almost from their inception--about 25% of new mobile activations in the UK in the latest quarter have been on these new networks.

14. PCS operates in the 1800 MHz band in the U.K. which is approximately the same frequency band that much of PCS is scheduled to utilize in the U.S.[5] The handsets offered, manufactured by Nokia and Motorola, are virtually identical to the smallest cellular handsets available in the U.S. Thus, PCS is convenient to use and offers a wider range of services than are offered by the 2 UK cellular operators. Since PCS began operation in the UK during 1993, cellular prices in the UK have decreased by about 20-33%. Thus, PCS will provide increased competition to cellular. With 2 cellular providers in each market, 1 nationwide ESMR provider, and 4 or more multi-state PCS providers, market competition provides a superior means to "protect" consumers than a regulatory process which will lead to regulatory costs to CMRS

---

[5] The frequencies are not exactly the same. However, the frequencies are close enough so that no difference in operation is expected.

providers and actually will decrease competition.

III. IXC's Have Charged Anti-Competitive Prices to EACP Customers

15. BOC cellular customers have been required to buy their cellular long distance service from IXCs because of the MFJ restrictions. Almost all of these customers have purchased their service from the Basket 1 tariff prices from AT&T or virtually identical prices charges by other IXCs. Very few cellular customers (other than large companies) place enough long distance calls to find the various discount programs offered by the IXCs to be economical. The undiscounted prices charged by the IXCs have risen by 9.6% during the latest 12 month reporting period of March 1993-March 1994 well in excess of the CPI or PPI or the 0.4% increase in the price of local residential service over the same period. (FCC, "Trends in Telephone Service", May 1994, p. 8) Furthermore, anti-competitive price discrimination against cellular customers has been exercised by AT&T and the other IXCs. Thus, IXC support for mandatory equal access will afford them the opportunity to engage in anticompetitive actions against all cellular customers and lead to higher long distance prices for all cellular customers while to date, their anti-competitive actions have affected the approximately 70% of cellular customers who subscribe to BOC cellular systems.

A. AT&T has Exercised Market Power for Basket 1 Prices Paid by EACP Customers

16. AT&T's recent actions demonstrate that AT&T has market power which is not constrained effectively by competition in the long distance market. The FCC regulates AT&T as a dominant firm. The FCC's definition of dominance demonstrates a lack of competition: a dominant firm has the ability to exercise market power absent regulation.[6] The usual definition of market

[6] Regulation is not always effective in stopping the exercise of market power, as the current situation in long distance services demonstrates.

power is the ability to charge prices above the competitive price for a significant amount of time. One important purpose of regulation is to constrain the exercise of market power through either price or profit regulation; thus, the FCC continues to regulate AT&T as a dominant carrier. AT&T has market power for Basket 1 services, i.e. residential and small business services. BOC cellular customers who use AT&T long distance almost always are charged the Basket 1 service prices. In its evaluation of AT&T's performance under price caps, the FCC concluded that services in Baskets 2 and 3 (primarily services for large business customers) were sufficiently competitive to warrant a limited relaxation of then-existing regulation, although the FCC still classifies AT&T as dominant with respect to these services and still regulates them.[7] However, the FCC did not relax its regulation of Basket 1 services, which are used predominantly by cellular long distance customers. Thus, I will focus my analysis on recent events for these Basket 1 services which are the cellular services bought by BOC cellular customers.

17. For Basket 1, the FCC reports that actual prices have been close to the price cap index over the four years following the start of price caps in July 1989. These results are shown in the following table.

---

[7] In the Matter of Price Cap Performance Review for AT&T, CC Docket No. 92-134, June 24, 1993.

Table A: AT&T's Price Under Price Cap Regulation

	6/30/89	7/1/90	7/1/91	7/1/92	6/30/93
Price Cap Index (PCI)	96.6	94.3	94.1	94.4	94.7
Actual Price Index[8]	98.4	94.3	93.6	94.3	94.1
Residential Index	98.8	94.5	94.1	94.5	93.6
PCI - 3.3[9]	96.6	94.1	93.8	93.9	94.0
PCI - 4.3	96.6	93.5	92.6	92.2	91.7

Source: FCC, June 24, 1993, Chart 1.

18. Prices at or under the price cap index may be consistent with competition constraining prices if the productivity expected during the price cap period exactly matches the 3 percent target built into the price cap formula. The available evidence indicates that AT&T's actual productivity has been substantially higher than the target. While exceeding the target is a desirable outcome when price caps are necessary to constrain market power, such productivity gains would be reflected in lower prices in competitive markets.

---

[8] The actual price index apparently exceeded the price cap index on the day before price caps began. Because AT&T is required to be at or under the price cap index, the reduction in actual prices between 1989 and 1990 is the result of regulatory action, not competition.

[9] The following two rows calculate the price cap index if AT&T had the same productivity factor which the FCC uses for LECs in their price cap formulae.

19. AT&T's network, in particular the fiber optic transport facilities, continues to benefit from productivity improvements due to technological advancement. Over the past five years, the capacity of installed fiber optic facilities has more than doubled.[10] This technological advance implies annual cost reductions on the order of 13 percent. These cost savings, coupled with the new service opportunities provided by the increased capacity, provide the opportunity for substantial, sustainable productivity gains.

20. Subsequent to the FCC's evaluation of price caps, which resulted in the June 23, 1993 report, AT&T's price cap index was increased by over $200 million, primarily due to the adoption of accrual accounting for other post-retirement benefits (SFAS 106). Effective August 1, AT&T raised its rates for residential services by about one percent and its commercial rates by about 3.9 percent.[11] If competition existed in the Basket 1 long distance market, MCI and Sprint should have constrained AT&T from raising its prices. Instead, MCI and Sprint almost immediately matched AT&T's rate increases. In reporting on this event, the trade-press noted the following:

> "Following hard on AT&T's heels, MCI Telecommunications Corp. and Sprint Communications Co. L.P. have proposed across-the-board increases in their interstate rates for business and residential services. Exactly one week after AT&T filed tariff revisions with the FCC raising its business service rates by an average of 3.9% and its residential rates by about 1% overall, Sprint and MCI both filed tariffs on July 23 introducing similar rate increases. A veteran Washington observer said last week that the rate increases 'don't say much for the level and intensity of competition in the interstate services market.'
>
> .....
>
> Asked why MCI appears to be matching AT&T's rate increase, MCI's spokesman said the company 'historically has been competitive in pricing our services relative to AT&T's rates. Despite this increase, our prices remain competitive with AT&T's,' he said. Similarly, Sprint's spokeswoman said: 'We face the same costs and competitive pressures as the rest of the long distance industry, and we routinely adjust our rates to reflect those pressures."[12]

---

[10] P.W. Huber, M.K. Kellogg, and J. Thorne, The Geodesic Network II, 1992, p. 6.25.

[11] Telecommunications Reports, July 26, 1993.

[12] Telecommunications Reports, August 2, 1993. Interestingly, Sprint and MCI have raised their prices in response to AT&T's lead, mainly reflecting costs that many sought to deny the LECs the opportunity to recover under their

AT&T announced yet another price increase for Basket 1 services in January 1994 which has lead to even higher prices for BOC cellular customers who mostly purchase Basket 1 long distance services.

21. The price increases by AT&T, MCI, and Sprint demonstrate a lack of competition for Basket 1 services. AT&T's price increase demonstrates that price cap regulation, not competition, was constraining AT&T's price. AT&T was able to increase its prices because of the effect of the accounting change on the FCC price cap formula. Thus, the clear implication of AT&T's recent price increases is that AT&T has market power.

22. An even more troubling outcome of AT&T's price increase is that MCI and Sprint followed the price increase. MCI and Sprint could have kept their prices at the old level and gained share from AT&T. Instead, they decided it would be more profitable to increase their prices along with AT&T. This "price leadership" behavior is often found in oligopolies which exhibit a low level of competition. Given that the common industry elasticity estimates for interstate long distance service are in the range of 0.5-0.75, AT&T would find it profitable to raise prices if price cap regulation were removed so long as it were confident that MCI and Sprint would follow the price increase.[13] Thus, if AT&T were to raise price by 5% and MCI and Sprint followed, demand would decrease by only about 3.7%. Thus, the price increase would be profitable because revenue would increase by about 1.3% in addition to cost savings of the IXCs in not meeting the 3.7% decrease in demand.

---

price cap plan.

[13] I report the magnitude of elasticities where the negative sign is understood. AT&T employees have reported an interLATA interstate price elasticity estimate of 0.72.

23. The situation described above is one of a dominant price leader (AT&T) increasing prices on the basis of a regulatory accounting change, with the price followers (MCI and Sprint) following suit. This behavior does not indicate that AT&T's prices are being constrained by competition. Instead, AT&T's prices are being constrained by price caps. When the regulatory constraint is eased, AT&T's prices rise. Even more troubling, AT&T's two largest competitors immediately followed AT&T's price increase.

B. AT&T and other IXCs Price Discriminate Against EACP Customers Because of a Lack of Competition for Residential and Small Business Long Distance Services

24. AT&T and the other IXCs price discriminate against EACP customers. It is well known that a firm cannot anti-competitively price discriminate unless it has market power. (Tirole, The Theory of Industrial Organization, (Cambridge, MIT Press, 1988, pp. 137-139)) Thus, AT&T's and the other IXCs anti-competitive price discrimination against the EACP's customers demonstrates that AT&T has market power.

25. AT&T is currently engaged in price discrimination. Price discrimination is defined by economists to be the practice of charging different prices for goods or services which have the same cost, or equivalently, to be charging prices which lead to different margins (price - cost) for similar goods or services.[14] AT&T is charging EACP customers (who do not have a special discount plan) the same price for long distance calls as landline MTS long distance calls, despite a significantly lower cost for the cellular calls. Thus, AT&T's margin is significantly higher for long distance calls on cellular which is a "textbook" example of price discrimination.

---

[14] See e.g. J. Tirole who defines price discrimination as follows: "Hence, we will say that there is no price discrimination if differences in prices between consumers exactly reflect differences in the costs of serving these consumers (this amounts to considering the net cost of serving a consumer)." (J. Tirole, op. cit., pp. 133-134.)

26. AT&T has significantly lower costs for cellular calls than for landline calls because AT&T is not required to pay switched access rates for cellular long distance calls; instead, usually AT&T pays only for transport.[15] I will use Southwestern Bell's interstate switched access rates and transport rates as an example.[16] For all switched interLATA landline calls AT&T is required to pay Southwestern Bell an access fee of about 2.8 cents per minute for both originating and terminating access. These access fees are significant; AT&T has estimated they are about 40%-45% of its total costs. However, when a long distance call originates from a cellular telephone, AT&T is not required to pay Southwestern Bell for switched access; usually only transport is charged for. The amount charged to AT&T for this transport is about 1.0 cent per minute which is a significant cost savings. Thus, AT&T's access costs are 32% lower for a cellular long distance call than for a landline long distance call.[17] On an incremental cost basis, I estimate that AT&T's costs are about 27% less for a cellular long distance call that terminates to a landline phone than a regular landline long distance call.[18] However, AT&T does not reflect this lower cost in its cellular long distance prices. Thus, AT&T is engaged in price discrimination.

---

[15] The example applies to the other IXCs as well as AT&T.

[16] This example is for Type II Interconnection (via a BOC access tandem switch), which is the most common type of cellular interconnection from the BOC cellular MTSO to the AT&T POP. Type I Interconnection (via a BOC end office) is used only rarely according to Southwestern (and Pacific) Bell personnel. I discuss the other type of cellular access, Direct Connection from the cellular MTSO to the AT&T POP in the following paragraph.

[17] AT&T's cost savings are even greater in some other BOC regions. For instance, in California AT&T's access cost savings are 47% for cellular access compared to landline switched access. Here I am assuming that both calls terminate to a landline phone. If the cellular call terminates at a cellular phone, AT&T's access cost savings are 64% in Southwestern Bell's territory. For cellular to cellular calls in California, AT&T's cost savings is 74%.

[18] Similar cost differences exist for intrastate interLATA cellular long distance calls where AT&T's cost savings due to lower access charges are about 27%-55% compared to landline long distance calls. In these ranges of cost differences I have accounted for other costs which may arise with cellular long distance such as a higher incidence of fraud.

27. AT&T's access cost savings for cellular long distance calls is even greater than the calculation in the example. A significant proportion of BOC cellular long distance calls are carried by direct connections from the cellular MTSO to the AT&T POP by e.g. DS-1 (T1.5) service. In this situation the 1.0 cents per minute transport cost is avoided, and a monthly charge for the DS-1 which typically would be about 0.3 to 0.4 cents per minute of cellular long distance traffic would be paid by AT&T.[19] Here AT&T's access costs savings compared to its usual switched access cost is 44%. This cost difference reflects the usual situation that switched access is significantly more costly than special access for long distance calls.

28. Price discrimination can be pro-competitive if it leads to an increase in output as I demonstrated in my 1988 Rand Journal article, and as other economists have discussed.[20] Here, however, AT&T's price discrimination leads to lower output because it is charging cellular long distance customers a higher price and is not reducing the long distance price to its landline (Basket 1) customers. Thus, the price discrimination by AT&T is anti-competitive. This anti-competitive price discrimination demonstrates AT&T's ability to use its market power to harm consumers.

29. In principle AT&T's competitors, MCI and Sprint, could offer sufficiently lower long distance prices to BOC cellular customers to force AT&T to end its anti-competitive price discrimination. Both MCI and Sprint have the same type of lower costs for cellular long distance customers as does AT&T. However as I discussed above, price competition among AT&T, MCI, and

---

[19] This calculation is based on a monthly price of a DS-1 of about $400 per month from Southwestern Bell and a price of about $300 per month from a competitive access provider (CAP). Despite the significantly lower cost to AT&T, because of the MFJ restrictions all long distance revenues here are remitted to AT&T.

[20] J.A. Hausman and J.K. MacKie-Mason, "Price Discrimination and Patent Policy", Rand Journal of Economics, 19, 1988. For a demonstration that overall quantity must increase for economic welfare to increase see J. Tirole, The Theory of Industrial Organization, (Cambridge, MIT Press, 1988), p. 138.

Sprint for residential and small business users (FCC Basket 1) is quite low. Indeed, both MCI and Sprint have followed each of AT&T's 4 price increases for Basket 1 services (which are residential and small business services) by raising their price by almost exactly the same percentage amounts. Three of these price increases have occurred since July 1993. Thus, MCI and Sprint seem willing to go along with AT&T's price discrimination for cellular long distance. Presumably, MCI and Sprint have decided they can achieve higher profits by going along with AT&T's price increases. The NPRM's tentative conclusion that equal access "creates incentives for the IXCs to compete on the basis of price" (para. 36) is directly contradicted by the experience to date for EACP customers (70% of the total, not including AT&T/McCaw) where no meaningful competition has existed among IXCs for EACP customers' long distance traffic.[21]

30. AT&T's anti-competitive price discrimination against EACP customers affects a large proportion of cellular customers. AT&T's share of presubscribed cellular customers is significantly larger than its share of regular landline customers. The current share of AT&T for presubscribed cellular customers in the 5 largest Southwestern Bell Mobile Systems (SBMS) (Block B) MSAs is:[22]

---

[21] Also the tentative conclusion in para. 42 of the NPRM regarding increased competition in the IXC marketplace is directly contradicted by the experience to date of the 70% of cellular customers who have been required to buy their cellular long distances service from IXCs tariffs which charge supra-competitive and discriminatory prices.

[22] AT&T's price discrimination affects cellular customers served by the BOCs in both Block A and Block B, e.g. both Block A and Block B customers in Boston, Washington, and in many other MSAs where a BOC operates the Block A (non-wireline) system and another BOC operates in the Block B system. Similarly, in St. Louis a BOC operates the Block A cellular system and SBMS operates the Block B system. In these situations, almost all cellular customers are restricted in their choice of long distance service because of the MFJ and are subject to the anti-competitive price discrimination.