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Before The
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In The Matter of	)	
Price Cap Performance Review for Local Exchange Carriers	)	CC Docket No. 94-1
Treatment of Operator Services Under Price Cap Regulation	)	CC Docket No. 93-124
Revisions to Price Cap Rules for AT&T	)	CC Docket No. 93-197

To the Commission:

COMMENTS OF THE TELECOMMUNICATIONS RESELLERS ASSOCIATION

TELECOMMUNICATIONS RESELLERS ASSOCIATION

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December 11, 1995

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SUMMARY

The Telecommunications Resellers Association ("TRA"), is a staunch proponent of regulatory initiatives that promote competition. Indeed, the emergence of marketplaces in which competitive, entrepreneurial telecommunications service providers such as the resale carrier members of TRA have been able to grow and prosper has been largely attributable to a series of pro-competitive initiatives undertaken, and pro-competitive policies adopted, by the Commission. But, as experience in the interexchange services market teaches, competition can only develop fully if firms with dominant market positions are constrained by regulatory oversight from wielding their power in an anticompetitive manner.

TRA cautions the Commission that premature relaxation of local exchange carrier ("LEC") price caps regulation in the absence of meaningful competition can thwart, rather than promote, emerging competition in local exchange/exchange access services. Accordingly, TRA urges the Commission not to implement the regulatory relief and pricing flexibilities proposed in the Second Further Notice of Proposed Rulemaking ("FNPRM") unless a compelling demonstration is made that meaningful competition exists in the service and geographic markets for which regulation is to be relaxed.

There is overwhelming evidence that the incumbent LECs still have near-monopoly power within their service areas, accounting for 97% of all interstate access revenues and controlling almost 100% of intraLATA toll calling. According to the Common Carrier Bureau, the development of competition in the local exchange may be some 12 years behind the development of competition in interexchange services.

No other providers pose even the slightest competitive threat to the incumbent LECs. Competitive Access Providers ("CAPs") control less than one percent of access revenues. Because of the high cost of their services, and because they rely on the LECs to originate and terminate their traffic, cellular service providers can not compete for local exchange business with the LECs. And in any event, the largest cellular systems are owned by the LECs.

Technological limitations currently prevent cable television companies from providing switched service competitive with that of the LECs. And Personal Communications Service ("PCS") is in its infancy. Even when it is widely available, PCS may, like cellular, be more of an adjunct to than a replacement for landline local exchange service. And the LECs have demonstrated both the means and the inclination to blunt competition as it appears.

Less than a year ago the Commission recognized that the LECs faced insufficient competition to constrain anticompetitive behavior by the LECs and to justify broad relaxation of price cap regulation. Nothing of significance has occurred in the few months since that would warrant a different conclusion.

The Commission has proposed that its regulatory relief and pricing flexibility measures be adopted without regard to competitive conditions; or, if competition is to be considered, that only a showing that barriers to competition have been removed should be required before regulatory relief is implemented. TRA strongly advocates that, before any regulatory relief is adopted for the price cap LECs, a compelling demonstration should be made that a meaningful level of actual competition exists in the product and geographic

markets for which regulatory relaxation is contemplated. It should not be sufficient merely to demonstrate that barriers to entry have been removed.

In this regard, the Commission should not confuse actual and potential competition. The former may constrain anticompetitive behavior by the LECs; the latter surely will not. Thus, a showing only of potential competition for LEC services would not provide adequate assurances that regulation can be relaxed without inviting the LECs to unleash their considerable market power in anticompetitive ways.

In determining the level of competition LECs face, TRA concurs with the Commission that the current price cap service baskets, service categories, and subcategories should be used to define the relevant product markets. TRA advocates using LEC wire centers as the base unit for defining relevant geographic markets.

To evaluate the level of competition in a given product and geographic market, TRA proposes that the Commission use the following competitive checklist:

1. Authorization of competing providers of local switched telephone service;

2. Unbundling of fundamental network elements, including local loops (distribution, concentration, feeding), switching (end office, tandem, packet), signalling, transport (dedicated, common) and operator services;

3. Availability of expanded interconnection (physical or virtual collocation);

4. Availability of service provider number portability;

5. Availability of compensation arrangements by which the LEC and its competitors may complete telephone calls originated on one another's networks;

6. Access by competitors to directory assistance, 911, and other databases;

7. Implementation of IntraLATA toll dialing parity;

8. Availability of meaningful opportunities to resell local exchange and exchange access service;

9. Availability of nondiscriminatory arrangements for sharing pole attachments and conduit space; and

10. Fair and equal access to numbering resources.

At a minimum, LECs should have to demonstrate that each of these barriers has been eliminated prior to any relaxation of regulatory oversight. In addition, relaxation of regulatory oversight should be conditioned on a showing that actual competition exists in the pertinent geographic and product market and that the competitor or competitors serving those markets actually provide service to a threshold percentage of the user population.

In conducting its analysis, the Commission should also consider whether the LEC seeking regulatory relief has been responsive to competitors' requests for interconnection, has engaged in discrimination of or among competitors, shown a pattern of predatory pricing, cross-subsidization, or attempts to avoid legal or regulatory requirements, and demonstrated any other indicia of resistance to competition.

To obtain regulatory relief, a LEC should be required to make the required competitive showing in a petition similar to a petition for waiver of the Commission's rules, which would be placed on public notice and made available for comment.

As for the Commission's specific proposals for regulatory relief, to the extent that the Commission is seeking to give the LECs increased flexibility to respond to competition, it is premature to provide such relief, since competition does not yet exist to any meaningful degree. For example, the Commission should not adopt its proposal to

eliminate the lower pricing bands for all service categories within the traffic sensitive and trunking baskets until sufficient competition exists to discourage, or at least withstand, LEC attempts at predatory pricing.

Although TRA supports the proposal to re-evaluate the composition of the four service baskets as competition in different services develops at different rates, there is inadequate competition in any LEC service at this point to justify such a re-evaluation.

If the Commission adopts its proposal to categorize new services as either Track 1 services, which would receive traditional regulatory treatment, or Track 2 services, which would be accorded relaxed regulation, TRA proposes that Track 1 services include not only services which are essential to the LECs' competitors and services which the Commission requires the LECs to offer, but also services that have a cognizable economic effect on other services, such as interexchange services and commercial mobile radio services ("CMRS"). LEC requests for Track 2 treatment of a new service should be made available for meaningful public comment, and should not be automatically granted.

The Commission's proposal to reduce the notice requirement for restructured LEC services is not warranted by existing competitive conditions and should be rejected.

Any expansion of permitted alternative pricing plans or reduction of regulation of such plans should be adopted only if the Commission finds that no potential exists for any interexchange carrier ("IXC") or group of IXCs to be disproportionately advantaged or disadvantaged as a result.

If the Commission adopts its proposals for relaxation of Part 69's waiver requirements, it should condition grant of LEC requests for approval of new rate elements

for interstate switched access service on satisfaction of the following minimum criteria: (1) that the offering poses no risk of adverse effects on competition, either in access services or other services that depend on them (*e.g.*, interexchange services, CMRS); (2) that the offering is made available on nondiscriminatory terms for resale at rates that only recover LECs' direct costs; and (3) that the offering does not alter an existing service in a manner that materially adversely impacts existing customers of the service. Requests of this sort should be made available for meaningful public comment.

TRA supports the Commission's proposal to condition streamlined regulation of any LEC service on a demonstration of substantial competition within that market. It also supports the use of the criteria used to evaluate AT&T's market power in the Interstate Interexchange Carrier proceeding, CC Docket 90-132, but it cautions that direct application of such criteria to the LECs may be inappropriate since they control bottleneck facilities and AT&T did not.

The four criteria by which the Commission should evaluate competitive conditions to determine whether substantial competition exists are demand and supply elasticities, market share, and pricing behavior. Of these criteria, TRA believes market share should be accorded the greatest weight, since it is the most reliable measure of actual competition. In TRA's view, the Commission has overemphasized the importance of demand and supply elasticities as determinants of competition, since these would seem more measures of potential, rather than actual, competition.

LECs seeking streamlined regulation of certain services should be required to submit a petition for waiver of the Commission's rules, which should be made available for

meaningful public comment. To obtain streamlined regulation, a LEC should be required to demonstrate the existence of substantial competition in the relevant markets according to the four criteria discussed above.

Contract carriage should only be permitted for services subject to streamlined regulation and only if a number of competitive safeguards are adopted, including (1) filing of tariffs containing the terms of LEC-customer arrangements; (2) making available to resellers on a nondiscriminatory basis all contracts entered into with any other customer; (3) provisioning of orders for contract services within a reasonable time, *e.g.*, 30 days; (4) establishing deposit requirements that are reasonable in relation to the LEC's costs and not set in a manner that discourages purchase of the services; (5) establishing termination provisions, including termination fees, that are reasonable in relation to the LEC's costs, that do not unreasonably discourage early termination of term plans, are not punitive, and do not provide a windfall for the LECs; and (6) requiring advance customer approval for any material change to term plans.

It is premature to consider classifying the LECs as nondominant in the provision of any service.

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To the Commission:

COMMENTS OF THE TELECOMMUNICATIONS RESELLERS ASSOCIATION

The Telecommunications Resellers Association ("TRA" or "Association"), by its attorneys, and pursuant to Section 1.415 of the Commission's Rules, 47 C.F.R. § 1.415, hereby submits its Comments in response to the Second Further Notice of Proposed Rulemaking in CC Docket No. 94-1, the Further Notice of Proposed Rulemaking in CC Docket No. 93-124, and the Second Further Notice of Proposed Rulemaking in CC Docket No. 93-197 (collectively, the "FNPRM") released September 20, 1995.[1]

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[1] On November 13, 1995, the Common Carrier Bureau released an Order on Motion for Extension of Time, DA 95-2340, extending to December 11, 1995, the date for filing initial comments in these consolidated proceedings. Comments addressing issues relating to the X Factor are to be filed on December 18. Order on Motion for Extension of Time, DA 95-2361 (Com. Car. Bur. November 21, 1995).

I.

INTRODUCTION

To say that these consolidated proceedings raise issues of historic significance would be a gross understatement. Given the potential ramifications of its decisions herein, the Commission should proceed with deliberation and circumspection, taking care to develop a record which reflects the reality of the market, not mere theory.

Since its inception, TRA has been a champion of competition in the telecommunications industry, first in interexchange telecommunications, and more recently, in local exchange services, wireless services, and other sectors of the industry. TRA's interest in this proceeding is in promoting competition within the markets occupied by the price cap local exchange carriers ("LECs"),[2] with the constant recognition that actions taken in this proceeding can have significant effects – positive and negative – not only on the interexchange services market in which most of TRA's resale carrier members currently compete, but in the nascent local exchange services resale market in which many of TRA's resale carrier members are prospective competitors.

TRA was created to foster and promote the interests of entities engaged in the resale of domestic interexchange and international telecommunications services.[3] Employing the

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[2] As used herein, "LECs" means local exchange carriers currently subject to price caps regulation, *i.e.*, incumbent LECs.

[3] TRA's mission has expanded considerably since its inception. As noted above, its focus now also includes resale of local, wireless and Internet services and it numbers among its members entities engaged in the resale of all of these services, as well as facilities-based interexchange carriers, foreign facilities-based carriers ("IXCs"), Regional Bell Operating Companies ("RBOCs"), independent telephone companies, competitive access providers ("CAPs"), and commercial mobile radio service ("CMRS") providers.

transmission, and often the switching, capabilities of underlying facilities-based network providers, the resale carriers comprising TRA create "virtual networks" to serve generally small and mid-sized commercial, as well as residential, customers, providing such entities and individuals with access to long distance rates otherwise available only to much larger users. TRA resale carrier members also offer small and mid-sized commercial customers enhanced, value-added products and services, including a variety of sophisticated billing options, as well as personalized customer support functions, that are generally not provided to low-volume users.

TRA's members – more than 350 resale carriers and their underlying service and product suppliers – range from emerging, high-growth companies to well-established, publicly traded corporations. They represent the fastest growing sector of the long distance industry. Already populated by more than 1,000 carriers, the interexchange resale community currently generates annual revenues in the billions of dollars. And the market share of the interexchange resale industry is forecast to double by the end of the century.

Most of TRA's resale carrier members are not yet a decade old. Their emergence and dramatic growth over the past five to ten years have produced thousands of new jobs and new opportunities. In addition, TRA's resale carrier members have facilitated the growth and development of second- and third-tier facilities-based long distance providers by providing an extended, indirect marketing arm for their services, thereby further promoting economic growth and development. And perhaps most critically, by providing cost-effective, high quality telecommunications services to the small business community, TRA's resale carrier members have helped other small and mid-sized companies expand their businesses and generate new employment opportunities.

The emergence of marketplaces in which competitive, entrepreneurial telecommunications service providers such as the resale carrier members of TRA have been able to grow and prosper has been largely attributable to a series of pro-competitive initiatives undertaken, and pro-competitive policies adopted, by the Commission. Competition – though far from perfect – has taken hold in the interexchange services market. For true local exchange/exchange access competition to emerge, regulatory measures which permit LECs to operate with less oversight and to respond to competition should be judiciously adopted only after actual compe-tition warrants such action. Relaxation of constraints on LEC flexibility before meaningful com-petition develops will only hinder competition and delay its emergence and viability.

The proposals set forth herein are intended to facilitate the emergence of local exchange/exchange access competition, recognizing that when full competition finally exists, its benefits can only be maximized when all competitors are subject to the same rules. Until such time, the Commission should follow the course it has taken in the interexchange services market and use regulatory oversight and safeguards against abuses of market power to provide a fertile environment for competition to take root.

II.

ARGUMENT

A. The LECs Do Not Currently Face Sufficient Competition to Justify Relaxation of Regulation.

The question at the heart of this proceeding, which must be answered beyond dispute before the Commission plunges forward with regulatory relief for the LECs is: Are

any LEC services in any geographic area subject to competition adequate to provide the check on LEC market power that regulation presently provides and to justify relaxation of regulation? The answer, at least today, is clearly no.

In making this assessment, competitive potential should not be confused with the emergence of actual competition significant enough to discipline market power. Contestable markets should not be equated with contested markets. And the Commission should not assume that the presence of an alternative service vehicle translates into meaningful competition. It belabors the obvious to suggest that merely because competition may someday emerge or because certain barriers to entry have been removed, the local exchange/exchange access market cannot now be deemed competitive. It is no less obvious that the mere presence of some form of limited service alternative does not render a market competitive or justify treating it as such

The local exchange/exchange access telecommunications market is not fully contestable, much less contested to a meaningful extent, and certainly lacks the competitive forces necessary to discipline the LECs' near monopoly control of local exchange "bottlenecks."[4] Meaningful local exchange competition simply does not exist. Although a

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[4] As characterized by Assistant Attorney General Anne K. Bingaman:

> Local telephone markets are in greatest need of added competition for they are still monopolized by local companies in the old Bell System . . . the Bell Operating Companies (BOCs) in most areas of the country still have a lock on local telephone traffic, carrying more than 99 percent of all local calls in their service areas.
>
> The important task is to subject the BOCs, which still have monopoly power in local telephone service, to real competition.

(continued...)

number of states have taken steps toward opening the LECs' traditional markets to competition, gradually rewriting statutes and regulations that have historically insulated the LECs from competition, there still are few cities and towns in the country today in which a consumer has a real choice among local carriers for local telephone service. While noting that the "seeds of local competition are widespread," the Common Carrier Bureau has acknowledged that "the development of competition in local services is roughly a dozen years behind the development of competition in long distance."[5/]

Relatively little progress has been made on the state level to introduce local exchange service competition. According to the Common Carrier Bureau's Fall, 1995 "Common Carrier Competition" report, only four states have what the report characterizes as "active competition in switched local service."[6/] In contrast, eight states have not yet begun to address the issue of local competition, and an additional 11 states and the District of Columbia merely have the issue under consideration. Of the 31 states in which local competition is now permitted, implementing regulations are not yet in place in 20 states, three more states have yet to certify competing providers and competing local service providers in four more states have yet to commence operations.

[4/](...continued)
Statement of Anne K. Bingaman, Assistant Attorney General, Antitrust Division, United States Department of Justice, before the Subcommittee on Telecommunications and Finance, Committee on Energy and Commerce, U.S. House of Representatives on H.R.3636, the National Communications Competition and Information Infrastructure Act of 1993, and H.R.3626, the Antitrust Reform Act of 1993 and the Communications Reform Act of 1993 (presented January 27, 1994).

[5/] Common Carrier Bureau, "Common Carrier Competition" (Spring, 1995) ("Spring Competition Report") at 5.

[6/] Common Carrier Bureau, "Common Carrier Competition" (Fall, 1995) ("Fall Competition Report") at 4. Information about local competition in the Fall Competition Report was provided as of September 1, 1995.

Thus, in any given geographic market, the incumbent LEC continues to be the sole source of the connectivity that allows consumers within that market to communicate by telephone. And in those states that are trying to open local markets, the incumbent LECs seem to be using their best efforts to suffocate competition. For example, the Wall Street Journal has reported that

> [i]n the states already open to competition, Baby Bells routinely deny or slow access to their networks, price their services below cost, and invoke arcane statutes to protect their turf. Once rivals are up and running, the local Bells can force customers to dial complex access codes or give up their phone numbers when they sign with a competitor.

"Not Welcome Here," Wall Street Journal (March 20, 1995).

The LECs' resistance to competition is well documented. Last year, Commission Chairman Hundt recounted the dilatory tactics employed by the LECs in resisting the Commission's expanded interconnection requirements:[7]

> We're great believers in expanded interconnection. It fosters competition, leading to lower long distance rates, more consumer choice, increased technological innovation, investment in advanced technologies and greater economic growth.
>
> So the Commission decided to require local exchange carriers to provide expanded interconnection. The LECs objected, taking us to the Court of Appeals and winning. But we were able to continue to work toward our goals by directing local telephone companies to provide expanded interconnection through virtual, instead of physical, collocation.
>
> Two lessons there: first, competition doesn't come by itself; it often takes a fight. Second, like all fights worth fighting, it has to be won.

With respect to exchange access, IXCs still rely on franchised LECs to originate and terminate more than 95 percent of their traffic. Indeed, in its Spring, 1995 "Common Carrier

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[7] Remarks of Chairman Reed Hundt before the Networked Economy Conference (Washington, D.C., September 26, 1994), 1995 FCC LEXIS 4936 at * 9.

Competition" report, the Common Carrier Bureau acknowledged that the LECs "continue to account for 97% of access revenues – a level roughly comparable to the Bell System's share of toll revenues in 1981."[8] The limited exchange access competition that the LECs now face tends to be geographically-confined niche competition, which at most "selectively impact[s] growth of demand of the local telephone companies."[9] The fiber deployed by competitive access providers ("CAPs") is but a small fraction of the fiber deployed by the RBOCs.[10] CAPs, according to the Bureau, "remain tiny compared to the local exchange carrier industry . . . [i]ndeed, alternative local service providers still account for less than one percent of access revenues."[11] CAP facilities, where available, are still used principally for redundancy.[12] As one industry observer has noted, "it's hard to see how there will be . . . meaningful CAP penetration of the local exchange much before the 21st century."[13]

8/ Spring Competition Report at 5.

9/ Kraushaar, J.M., Fiber Deployment Update: End of Year 1994 (July 12, 1994) ("Fiber Deployment Update (1994)") (emphasis added). Confirming this point is the fact that the LECs have experienced an annual growth rate of roughly seven percent in access traffic volumes over the past years.

10/ Id. And while the CAPs may have installed a significant amount of fiber during 1994, the major LECs are installing fiber every two months at a rate equal to the CAPs' combined fiber deployment. Fiber Deployment Update (1994); P. Montgomery, "Tough Road for Competition in Local Switched Service," Business Communications Review, Vol. 25, No. 3, p. 53 (March, 1995).

11/ Spring Competition Report at 5.

12/ "The companies typically have offered non-switched services initially, and although they provide end user to end user links, most of their business is either for customer access to a long distance carrier or for links between interexchange carrier points-of-presence." Fiber Deployment Update (1994).

13/ V. Toth, "The Regulatory Agenda – 1995," Business Communications Review, vol. 25, no. 6 (June, 1995) at 26 ("Regulatory Agenda"). As the Commission's Fiber Deployment Update (1994) notes, "metropolitan and urban carriers have faced significant barriers to market entry because they must usually negotiate separately with each building owner, as well as obtain municipal franchises and other permits and meet state legal and regulatory requirements."

The seedling competition that has managed to emerge hardly provides real competitive alternatives to consumers. While some degree of intraLATA toll competition exists in most states, intraLATA "equal access" – "1+" dialing and the ability to presubscribe to your intraLATA carrier of choice – is rare; indeed, intraLATA equal access is scheduled to be implemented in 1996 in only a handful of states.[14/] Without equal access, customers must dial a five-digit code to reach a long distance carrier, otherwise their intraLATA toll calls default to the LEC. The result: LECs still control almost 100 percent of intraLATA toll calling.

While cellular radio, personal communications services and other wireless offerings and cable television may provide viable competitive alternatives at some point in the future, that day has not yet arrived and will likely not arrive, if at all, for years to come. Cellular service supplements rather than replaces local telephone service.[15/] Not only are the overwhelming majority of cellular calls carried at one time or another by the local exchange network, but the costs of cellular service, particularly cellular airtime charges, are significantly more expensive than local telephone service. Confirming that cellular service supplements rather than replaces local telephone service is the simple fact that the impressive growth in cellular demand has not, as shown below, adversely affected RBOC profitability. Moreover, it must be borne in mind that the RBOCs and GTE Telephone represent eight of the nine largest cellular operators in the country.

14/ National Association of Regulatory Utility Commissioners, NARUC Report on the Status of Competition in Intrastate Telecommunications, (Oct. 4, 1995); Richards, Glenn S., "States Moving Toward IntraLATA Equal Access," Phone +, Vol. 9, No. 11, p. 72 (Sept. 1995).

15/ "It has been suggested, however, that mobile services are converging with landline services. . . [T]hat prediction . . . projects quite a distance into the future. Mobile connections today remain considerably more expensive than stationary ones. In today's market, the two plainly do not compete." Report of the Bell Companies on Competition in Wireless Telecommunications Services, October 31, 1991 ("Bell Report"), pp. 184-85 (footnotes deleted).

Personal communications service ("PCS") may someday fulfill the vision of its most ardent proponents and render the wireline network superfluous at least in part, but at this juncture any claims regarding the potential competitive impact of PCS on the local exchange "bottleneck" are grossly speculative. PCS is still in its infancy. Only a relatively few PCS systems have been built. And PCS service is far from generally available. Widespread PCS system construction and service implementation are likely years away. Moreover, like cellular telephone, many, if not most, PCS applications will rely heavily on the local telephone network and, like cellular telephone, many PCS licenses will likely be held by LECs. A recent report in the trade press[16] characterized the competitive threat posed by PCS providers to the LECs as follows:

> Despite optimistic predictions that PCS will conquer the local loop, there is evidence that it will be more of an adjunct than a replacement for landline networks. But even the successful PCS raider, who wants only a piece of the local exchange action, faces huge obstacles.

Reliance upon the potential competitive threat of cable television ("CATV") is no less speculative. At present, the overwhelming majority of CATV systems lack the two-way transmission and switching capability necessary to provide competitive telecommunications services. CATV systems served by coaxial cable have limited capacity for two-way transmission and will experience significant signal degradation and service disruptions if used for two-way transmission. While introduction of fiber optic transmission will alleviate these problems to some degree, it will not remedy them completely because coaxial cable is generally

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[16] "Raiders of the Local Loop: PCS & Local Competition," PCS Week, vol. 6, no. 41 (October 25, 1995) ("Raiders of the Local Loop").

used to complete the transmission path to the home even in the more advanced systems. And at present, only 35 percent of CATV systems have been enhanced by fiber.[17]

In short, any claim that the local exchange services market is currently competitive reflects a clouded perception of reality. The reality is that the LECs retain monopoly control of local exchange "bottlenecks" and do not now face, and are unlikely to face in the near future, any meaningful competition. As described by the authors of The Enduring Local Bottleneck:[18]

> Expansion of alternative access provider services, FCC mandated interconnection requirements, the growing use of wireless service, even multi-billion dollar alliances between traditional telecommunications carriers and potential future alternative local service providers, have all contributed to a perception that local competition has arrived. While these developments may have increased the prospects for competition, their actual economic impact on the traditional local exchange monopolies is, at the present time, far more smoke than fire. Furthermore, the enormous investments required to build alternative local networks across the country, the time it will take to win customers away from the incumbents, and the power of the dominant local exchange carriers to thwart competitive entry ensure that effective competition will not occur overnight.

Certainly, LEC profitability has not been undermined by the allegedly intense local exchange/exchange access competition. In "Rate of Return Reports" (Form FCC 492A) filed with the FCC for calendar year 1994, the seven RBOCs showed earnings ranging upward to 15.75 percent, with only one RBOC showing a rate of return of less than 12 percent.[19] And

---

[17] Economics and Technology, Inc. and Hatfield Associates, Inc., The Enduring Local Bottleneck: Monopoly Power and the Local Exchange Carriers (1994) ("The Enduring Local Bottleneck") at 80-84.

[18] Id. at i-ii.

[19] Price Cap Performance Review for Local Exchange Carriers, CC Docket No. 94-1, FCC 95-132, Table 5 (released April 7, 1995).

industry forecasts for the LECs demonstrate that they are well positioned to maintain their economic strength in the face of competitive threats. A January, 1995 article in Telco Business Report[20] illustrates this point:

> Douglas Watson, Moody's managing director of regulated utilities, said recently that "although their pricing and margins are pressured, the (U.S. telephone operating companies) are experiencing rapid growth." In comparison with other utilities, he added they are in a better position to take advantage of technological change, have greater bargaining clout with regulators, and are ahead in streamlining and re-engineering their operations.
>
> . . . Meanwhile, Duff & Phelps reported that U.S. telcos will survive competition, improve their financial performance this year, and retain strong credit ratings, all of which will keep them stable for the next two to four years.
>
> Furthermore, they can expect limited competition, and "by their size," can remain dominant players. [Analyst James] Stork pointed out that entry barriers for competitors remain high, and the capital-intensive investments required to build systems will discourage rivals in the local market. "Even in a fully competitive environment, LECs are likely to face a below-average level of competitive threats," he said.
>
> And revenue from new services, cost-cutting and volume growth will permit companies to improve performance in the near term, Stork predicted . . . . [O]verall, LECs face below-average business risks compared with other industrial companies. . . .
>
> And although the long distance carriers and cable companies are beating a path to the local telephone markets, the one advantage the Bells have is name recognition. That, some analysts said, will help them shut out the competition in the battle to win customers with new products and services there.
>
> "At the end of the day the local carrier controls the customer," said John Bain, telecom analyst with St. Petersburg, Fla.-based Raymond James Associates.

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[20] "Telcos Brace for Tumultuous Year of Investment and Regulation," Telco Business Report, Vol. 12, No. 2 (January 16, 1995).

> Furthermore, the Bells are deep-pocketed, and by comparison with the long distance and cable companies, have built strong reputations for service, so they are expected to at least hold their own as new markets emerge.

The superior ability of the LECs to compete notwithstanding the existing regulatory environment was described in a recent trade press article:[21/]

> LECs have generally adopted a strategy of improving service, lowering overall costs and tactical maneuvers to blunt competitive inroads. . . .
>
> Ameritech, US West and others are reinforcing their hold on residential customers with a fortress strategy by complementing their landline telephony with wireless and cable capabilities. . . .
>
> LECs have also proven effective regulatory tacticians in the state regulatory arenas. . . .
>
> Another [strategy] has been to aggressively price out collocation facilities, thereby increasing competitor costs.
>
> . . . . LECs have formidable customer relationships and service capabilities, and have been adept at legally leveraging their local franchise to combat new competitors.
>
> Also, in the short term, LECs may be able to exploit superior knowledge of customer calling patterns.

Less than a year ago, the Commission itself recognized that, "[b]ecause the LECs appear to retain substantial market power in providing local exchange and access services, regulation continues to be needed to achieve the goals of the Communications Act, and to increase consumer welfare."[22/] As to the presence of competition in LEC-controlled markets,

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[21/] Katz, R., Docters, R. and Junqueira, C., "Strangers in Their Own Land," Telephony, Vol. 229, No. 5, p. 18 (July 31, 1995).

[22/] Price Cap Performance Review for Local Exchange Carriers (First Report and Order), 10 FCC Rcd. 8961 (1995) ("LEC First Report and Order") at 9002, ¶ 92.

the Commission observed that, "[w]hile local access competition has begun to develop, the LECs continue to exercise a substantial degree of market power in virtually every part of the country, and continue to control bottleneck facilities."[23]

Noting that it would re-visit in the future the issue of competition facing the LECs, the Commission concluded only last spring that "[t]he record in this proceeding does not support a finding that competition for LEC services is sufficiently widespread to constrain the pricing practices of LECs for new services."[24] TRA submits that no change in the level of competition has occurred in the months that have elapsed since the Commission made these statements which would justify any conclusion other than that the LECs still retain substantial market power and face little meaningful competition.

In short, the local exchange market is still dominated by the incumbent LECs, and their dominance is unlikely to face any meaningful competitive threat in the near future. As the Chairman and Chief Executive Officer of Bell Atlantic, Raymond Smith, recently predicted, competition in the next three to five years is "'farther out and less significant . . . that our potential competitors would have you believe."[25] In light of this admission, TRA submits that the Commission should bear in mind the admonition of an economist with extensive experience in telecommunications policy, that "'[o]ne of the biggest threats to

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[23] Id., 10 FCC Rcd. 8961 at 9122, ¶ 368.

[24] Id., 10 FCC Rcd. 8961 at 9143, ¶ 418.

[25] "Tough Battle Predicted," Communications Daily, vol. 15, no. 66 (April 6, 1995) at 7.

competition'" would be to relax price cap regulation because such relaxation would give the RBOCs "'substantial cash flow to be aggressive' in dominating markets."[26]

B. The Price Cap LECs Should Not Be Granted Pricing Flexibility or Other Relaxed Regulation Absent a Compelling Showing of Actual Competition for the Relevant Service for Each Geographic Market For Which Relaxed Regulation Is Sought.

Before addressing the advantages and disadvantages of the specific regulatory relief measures which the Commission is considering, TRA will discuss the critical threshold issues which the Commission should resolve before it grants any request by a price cap LEC for

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[26] "Are Cross-Subsidies Good," Communications Daily, Vol. 15,No. 18, p. 4 (January 27, 1995) (quoting Lee Selwyn, Economist with Economics and Technology, Inc., at ComNet Conference entitled "Town Meeting"). In large and complex organizations, cross-subsidization of competitive activities in adjacent markets with monopoly-generated earnings can take on myriad forms. Such a cross-subsidy occurs anytime an LEC confers on a competitive activity a benefit derived solely from its monopoly operations without adequate compensation to the monopoly operations. Such a benefit can take the form of transfers of (i) capital, (ii) facilities or equipment, (iii) personnel, (iy) research and development, (v) services or (vi) any of a variety of other items. Adequate compensation can be defined in any number of conflicting and contra-dictory ways. Accounting systems can be established, reports required and an occasional audit conducted to determine what benefits, at what value and for what compensation, are being conferred, but it is fanciful to think that overburdened regulators with budgets a fraction of the size of the regulated entities will be able to ferret out any more than an occasional violation.

The authors of The Enduring Local Bottleneck have identified (at 194-216) a number of potential cross-subsidy opportunities available to the LECs, each of which presents unique, and often insurmountable, problems for federal and state regulators. For example, cross-subsidies can occur with a shift in the boundary between competitive and monopoly activities. Strategic investments can be made by an LEC with the full expectation and/or knowledge that the regulatory status of the activities in which the investments are being made will be changed. Another illustration is use of monopoly resources to construct facilities which while usable in association with monopoly operations, can ultimately be employed in conjunction with competitive activities – e.g., interLATA transmission facilities used for "administrative intra-company transactions," but ultimately usable to provide interexchange services. Transfer or loan of personnel recruited and trained at the expense of LEC monopoly operations to LEC compe–titive activities and funding of research and development by LEC monopoly operations are yet other examples of hard-to-detect cross-subsidization, as are cost allocations between monopoly operations and competitive activities based on the relative use of an asset by monopoly opera-tions and competitive activities rather than the economic rational for the acquisition of that asset.