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

FEDERAL COMMUNICATIONS COMMISSION  
OFFICE OF SECRETARY

CC Docket No. 96-61

In the Matter of )  
)  
Policy and Rules Concerning the )  
Interstate, Interexchange )  
Marketplace )  
)  
)  
Implementation of § 254(g) of )  
the Communications Act of 1934, )  
as amended )

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**AT&T COMMENTS**

**Market Definition, Separations,  
Rate Averaging and Rate Integration**

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## SUMMARY

In the first phase of this proceeding, the Commission has requested comments on three separate issues and proposals.

Market Definition. The Commission has consistently held that all services offered by today's interexchange carriers comprise a single national market. The NPRM proposes revisions to this definition for the purposes of (1) better assessing future applications by Bell Operating Companies ("BOCs") for interexchange services authority under § 271 of the 1996 Act and (2) allowing more refined determinations of the competitiveness of specific services offered by today's interexchange carriers. However, the proposed revisions are not necessary to achieve either objective and are inconsistent with settled principles of market definition.

(1) The Commission is correct that conditions in today's national interexchange market will have little, if any, pertinence to a BOC application for interexchange authority. The reason is that the BOCs have been excluded from this market, previously by the MFJ and now by § 271, because their local monopolies give them the ability and incentive to impede interexchange services competition in their regions. Thus, the pertinent question in any § 271 proceeding will be whether and to what extent the BOCs have lost this local power, and there are three quite separate reasons why reconsidering the interexchange market definition would be improper at that time.

First, the techniques of defining markets and drawing inferences from market shares are wholly unnecessary when the presence of market power can be proven directly. Correlatively, as the Commission and the courts have long recognized, the BOCs'

control of local bottleneck access facilities gives them the power to increase price and reduce output of interexchange services.

Second, the BOCs' access and local services monopolies give them the ability to leverage a monopoly in one market (local service) to gain improper advantages in another "downstream" market (interexchange services). In that circumstance, the critical issue is not the definition of the "downstream" market but whether the BOC has lost the ability to leverage power in the local input market.

Third, in all events, the likely effect of BOC entry would be to obliterate today's distinctions between local and interexchange service markets, and create markets for all telecommunications services (local as well as interexchange) offered to business or residential customers in particular local areas. One of the critical questions in ruling on any § 271 application will therefore be whether the BOC could monopolize these broader markets.

(2) Nor is there any basis for modifying the longstanding interexchange market definition that the Commission applies to determine whether other carriers who do not control bottleneck facilities nonetheless possess market power in individual services. The Commission has properly defined the interexchange market as a single national market because even though all interexchange services may not be perfect demand substitutes, there will be perfect supply substitution so long as each LEC will allow any carrier to offer interexchange services to the LEC's customers on nondiscriminatory terms. For example, while a caller that wishes

to place a call between two cities will not regard calls between other cities as substitutes, every market participant has the ability to provide service in every area of the country. For these reasons, the Commission's proposed revisions to existing market definitions are inconsistent with settled economic and legal principles, including the Merger Guidelines.

Separations. The NPRM next raises the question of whether and how the Commission should modify separations requirements applicable to a LEC's out-of-region interexchange services. The answer is that the separation requirements should be strengthened because BOCs are now free for the first time to offer these services and other Tier One LECs may begin to do so.

The overriding fact is that both BOCs and independent LECs have a significant ability to use their in-region monopolies to obtain illicit advantages with respect to calls that originate outside their regions. For example, they can do so by (1) pricing terminating access in ways that improperly favor their interexchange affiliates and to effect prize squeezes and cross-subsidies, (2) misusing national interexchange competitors' confidential information (provided to the LEC in region) to obtain illicit advantages in providing out-of-region service, and (3) engaging in monopoly abuses to obtain the out-of-region business of customers who also have in-region locations.

For these reasons, AT&T urges the Commission to consider imposing the full structural separations requirements of the Second Computer Inquiry. At a minimum, however, the existing separations requirements should be supplemented with the added requirements

that LECs not engage in joint marketing or any sharing of information with their interexchange affiliates.

**Rate Averaging.** Finally, the Commission seeks comment on implementation of the rate averaging and rate integration provisions of the 1996 Act. As Congress made clear, these provisions were designed generally to codify the Commission's existing rate averaging and rate integration policies, and not to impose a rigid new rate averaging structure. Beyond that, Congress vested the Commission with substantial discretion -- including express forbearance authority -- to ensure that even those general rate averaging and rate integration principles did not undermine the pro-competitive policies that are the Act's primary goal.

Because the interexchange market includes both national carriers that serve all high cost areas and regional carriers that may elect to serve only relatively low cost areas, failure to strictly adhere to this congressional guidance would turn the Act on its head. It would drive nationwide carriers from low cost areas, discourage low cost carriers from serving high cost and rural areas, and virtually guarantees that all consumers will experience less competition and higher prices.

Accordingly, AT&T supports flexible rate averaging and rate integration rules for nondominant carriers that: (1) confirm that existing pro-competitive practices which allow deaveraging may continue, (2) confirm that competitive necessity will justify any pricing action that might otherwise conflict with rate averaging or rate integration policies, (3) provide, at most, that each nondominant carrier establish a single tariffed schedule of

averaged rates available to residential customers on a nationwide basis, and (4) assure that intrastate rate averaging rules are consistent with the Commission's interstate rules.

However, to assure that the Act's rate averaging provisions do not undermine its broader pro-competitive goals, the implementation of these rate averaging and rate integration provisions should be deferred until the Commission completes its reform of access charges. In this regard, the Commission should recognize that one of the principal causes of the pressures to deaverage interexchange rates -- access charges imposed on interexchange carriers -- is also among the most formidable obstacles to the local competition that is the overriding object of the Act. The 1996 Act thus contemplates and requires that the access charge mechanism be completely overhauled, so that subsidies are removed and prices are driven to efficient, forward-looking cost-based levels. After this occurs, of course, access prices will be far lower and more uniform than they are today, and a reasonable averaging policy should impose fewer burdens and anomalies.

Until access reform is complete, it is thus critically important that interexchange carriers not be doubly penalized, first by having to pay inflated prices for monopoly access services, and second by being forbidden efficiently to reflect those costs in competitive pricing.

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**I. THE COMMISSION'S PRIOR INTEREXCHANGE MARKET DEFINITIONS ARE CORRECT, BUT THE COMMISSION NEEDS TO DEVELOP APPROPRIATE LOCAL MARKET DEFINITIONS TO ASSESS BOC § 271 APPLICATIONS.**

Since it first addressed the issue more than a decade ago, the Commission has consistently held that the existence of broad demand substitutability and nearly perfect supply substitutability means that "all interstate, domestic, interexchange telecommunications services comprise a single relevant product market with no relevant submarkets"<sup>2</sup> and that there is likewise "a single national relevant geographic market" for those services.<sup>3</sup> The NPRM suggests that these definitions be revised and narrowed to some extent, although the Commission proposes to continue to analyze most of the relevant issues that come before it with reference to the current market definitions rather than the proposed revisions.

Specifically, the NPRM suggests that the Justice Department's Merger Guidelines<sup>4</sup> would support narrowing the existing product market definition so as to place in separate markets those services which are not close demand substitutes for one another (such as, for example, outbound residential service and

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<sup>2</sup> See Fourth Report and Order, Policy and Rules Concerning Rates for Competitive Common Carrier Servs. and Facilities Authorizations Therefor, 95 F.C.C.2d 554, 563-64 (1983) ("Fourth Report and Order"), vacated on other grounds, AT&T v. FCC, 978 F.2d 727 (D.C. Cir. 1992). See also, e.g., Order, Motion of AT&T Corp. to be Reclassified as a Non-Dominant Carrier, 1995 FCC LEXIS 6877, at \*6 (¶ 7) (FCC Oct. 23, 1995) ("AT&T Nondominance Order").

<sup>3</sup> See Fourth Report and Order, 95 F.C.C.2d at 574-75; AT&T Nondominance Order, ¶ 22.

<sup>4</sup> See 1992 U.S. Department of Justice/Federal Trade Commission Merger Guidelines, 4 Trade Reg. Rep. (CCH) ¶ 13,104, at 20,569 (1992) ("1992 Merger Guidelines").

inbound service.)<sup>5</sup> At the same time, the NPRM states that, in light of the competitiveness of interexchange services, the Commission would not actually analyze any service under its proposed new approach in the absence of "credible evidence" that that particular service is not competitive.<sup>6</sup> Similarly, the NPRM suggests that the geographic market might be defined as service "between two particular points" (which would create a multiplicity of atomized "separate markets") but that the Commission would nonetheless continue to analyze issues of market power by "treat[ing] interstate, interexchange calling generally as one national market."<sup>7</sup>

The NPRM states that these revisions are being proposed for two reasons. First, it suggests that "more sharply focused market definitions" might be helpful "in evaluating whether the BOCs possess market power with respect to the provision of interLATA services in areas where they provide local access service."<sup>8</sup> Second, it states that "more narrowly drawn" markets might provide "a more refined analytical tool for evaluating whether a carrier or a group of carriers has market power," and cites analog private line services and 800 directory assistance as

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<sup>5</sup> See NPRM, ¶¶ 41, 44-46.

<sup>6</sup> See id., ¶¶ 41, 47.

<sup>7</sup> See id., ¶¶ 42, 48-55.

<sup>8</sup> See id., ¶ 40.

examples of services in which such an evaluation might be warranted.<sup>9</sup>

AT&T shares the Commission's interest in developing a proper framework to analyze future Bell Operating Company ("BOC") applications to provide interLATA service and to protect against leveraging by the BOCs of the market power they possess in their local and access markets into the interexchange market. AT&T likewise agrees with the Commission that the existing definition of the interexchange market will not aid in that analysis. The Commission's proposals to revise the established interexchange market definitions, however, should not be adopted. The proposed revisions would not advance either of the Commission's objectives, and are, in any event, contrary to settled principles of both law and economics.

First, the interexchange market definition is simply not relevant to the issue of whether the BOCs could abuse their power in the local market to impede interexchange competition. Settled law establishes that market definitions and market share analyses are unnecessary when the presence of market power can be proven directly -- as it can here, because of the BOCs' control of local bottleneck facilities that are essential to the provision of long-distance service -- or when undisputed power in one market (local services) can be leveraged to impede competition in a second market (interexchange). The proper markets to analyze in determining whether BOC entry should be permitted are therefore the markets in

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<sup>9</sup> See id.

which those bottlenecks exist -- the markets for local services and for interstate services -- and not the interexchange services market. That is especially so because BOC entry could likely destroy today's separate markets for local and interexchange services and create new markets comprised of all residential or business telecommunications services (local as well as interexchange) used by consumers in particular regions or metropolitan areas.

Second, while the interexchange market definition can, in contrast, be relevant to the Commission's second objective -- determining whether any current providers of interexchange service, none of whom control bottleneck facilities, nonetheless possess market power in individual services -- the existing definitions are correct and should not be modified. Contrary to the premise of the NPRM, the 1992 Merger Guidelines support the Commission's existing approach. The Commission has properly defined the interexchange market as a single national market because (a) while all interexchange services may not be perfect demand substitutes, there is pervasive supply substitution and (b) while a caller that wishes to call from one particular point to another will not regard calls originating or terminating elsewhere as a substitute, every market participant has the ability to provide service in every area of the country -- which is the case precisely because those firms that possess and could abuse bottleneck monopolies are excluded.

**A. The Proper Focus In Reviewing BOC Applications To Provide In-Region InterLATA Services Is On Their Bottleneck Control Of Local Markets, And The Interexchange Market Definition Is Irrelevant To That Determination.**

The NPRM states that one of the Commission's principal reasons for considering revisions to its established market definitions is the possibility that such revisions might "aid" it in evaluating BOC applications for in-region interLATA entry under Section 271 of the 1996 Act.<sup>10</sup> AT&T strongly supports the Commission's early attention to the issues that may arise under Section 271, because the Commission's actions on any such applications will have powerful consequences for competition in the interexchange market. In that regard, while the Commission is certainly correct that the transformation of that market from one that had been dominated by a single firm to one that is now vigorously competitive is attributable "in part" to Commission policies,<sup>11</sup> it is equally clear that that development could not have occurred absent the MFJ's exclusion of the BOCs from the provision of interexchange service. It was only after the BOCs' bottleneck monopolies were separated from the interexchange market that genuine competition in that market developed.

The MFJ provided that the BOCs would remain excluded from the interexchange market as long as they continue to have the incentive and ability to use such bottlenecks to impede

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<sup>10</sup> See NPRM, ¶ 40. The NPRM states that the Commission is considering these proposed revisions apart from any consideration of the classification of LECs as dominant or non-dominant in their provision of in-region interexchange service. Id., ¶ 53 & n.122; see also id., ¶ 61.

<sup>11</sup> See NPRM, ¶ 2.

interexchange competition,<sup>12</sup> and the 1996 Act codified that principle. Section 271 prohibits any BOC from providing in-region interexchange service in a State unless the Commission first determines, inter alia, that the BOC has taken the steps required by Section 251 of the Act to open its local market in that State to competition, that the BOC faces facilities-based competition in the provision of exchange services to business and residential customers, and that the BOC's proposed entry into the interexchange market would serve the public interest.<sup>13</sup> It is well-established that the Commission's "public interest" determinations include consideration of competitive and antitrust issues. Thus, if a BOC continues to have the ability to use monopoly power in the local market to impede interexchange competition, that fact will not only demonstrate the lack of meaningful facilities-based competition, but it will also necessarily be critical to the Commission's "public interest" analysis of any application by that BOC to provide interexchange service.<sup>14</sup> Indeed, it is because of the

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<sup>12</sup> See United States v. Western Elec. Co., 552 F. Supp. 131, 231 (D.D.C. 1982) (Section VIII(C)).

<sup>13</sup> See 47 U.S.C. § 271(d)(3).

<sup>14</sup> See, e.g., FCC v. RCA Communications, Inc., 346 U.S. 86, 94 (1953) ("There can be no doubt that competition is a relevant factor in weighing the public interest" under the Communications Act); United States v. FCC, 652 F.2d 72, 88 (D.C. Cir. 1980) ("we have insisted that the agencies consider antitrust policy as an important part of their public interest calculus"); ITT World Communications, Inc. v. FCC, 725 F.2d 732, 747 n.33 (D.C. Cir. 1984) ("the FCC must consider whether competition is hindered, and whether the risk of reduced competition affects the public interest"); see also Order, Applications of OTI Corp. & MCI Communications Corp. for Consent to the Transfer of Control of Overseas Telecommunications, Inc., 6 FCC Rcd. 1611, 1612 (1991) (continued...)

importance of these competitive issues to the Section 271 entry test that the 1996 Act specifically requires the Commission to consult with the Department of Justice on any BOC application and give "substantial weight" to the Department's views and its application of whatever antitrust standard the Department applies.<sup>15</sup>

As the NPRM recognizes, an examination of the current characteristics of the interexchange market will not be helpful in making these determinations.<sup>16</sup> The solution, however, is not to change the interexchange services market definition. For at least three reasons, the focal point in future Section 271 applications will not be the definition of the interexchange market, but the extent to which a BOC has lost its monopoly power in local exchange and exchange access services.

First, market definitions, and inferences from related determinations of market shares, are decidedly imperfect techniques for assessing the presence or absence of market power. They are

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<sup>14</sup> (...continued)

("the Commission is required to consider anticompetitive consequences as one part of its public interest calculus"); Memorandum Opinion and Order, Telemarketing Communications of S. Cent. Ind., Inc. & One Call Communications, Inc., Application for Auth. to Assign Int'l Resale Authorization of Telemarketing Communications of S. Cent. Ind., Inc., 5 FCC Rcd. 7712 (1990) (the Commission is required to consider whether proposed transaction "will inhibit competition and thereby be detrimental to the public interest"); Memorandum Opinion and Order, Western Union Corp. & Hughes Communications Galaxy, Inc., Application for Consent to Assignment of Licenses, 3 FCC Rcd. 6792, 6794 (1988) ("the Commission is required to consider anticompetitive effects as one part of its public interest finding").

<sup>15</sup> See 47 U.S.C. § 271(d)(2)(A).

<sup>16</sup> See NPRM, ¶ 53.

used as indirect measures only when there is no direct proof of market power, and are unnecessary and inappropriate when such direct proof is available. As the Supreme Court has explained, the only "purpose of the inquiries into market definition . . . is to determine whether an arrangement has the potential for genuine adverse effects on competition."<sup>17</sup> Accordingly, "[w]hen there are better ways to estimate market power, the [decision-maker] should use them."<sup>18</sup> Consistent with this basic principle, "other market conditions . . . must be examined to determine whether a particular firm exercises market power in the relevant market,"<sup>19</sup> and "[t]he important question . . . is the ultimate one: whether [a firm] has power over pricing."<sup>20</sup>

Here, direct proof of market power is present and indisputable. The Commission has consistently "treat[ed] control of bottleneck facilities as prima facie evidence of market

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<sup>17</sup> See FTC v. Indiana Fed'n of Dentists, 476 U.S. 447, 460 (1986).

<sup>18</sup> Allen-Myland, Inc. v. IBM Corp., 33 F.3d 194, 209 (3d Cir. 1994) (quoting Ball Memorial Hosp., Inc. v. Mutual Hosp. Ins., Inc., 784 F.2d 1325, 1336 (7th Cir. 1986)). See also Coastal Fuels of Puerto Rico, Inc. v. Caribbean Petroleum Corp., 1996 U.S. App. LEXIS 4365, at \*39 (1st Cir. Mar. 12, 1996) ("finding the relevant market and its structure is not a goal in itself but a surrogate of market power") (citation omitted); E.W. French & Sons, Inc. v. General Portland Inc., 885 F.2d 1392, 1404 (9th Cir. 1989) ("the market definition approach is only an indirect and attenuated way of measuring anticompetitive effect").

<sup>19</sup> See AT&T Nondominance Order, ¶ 68.

<sup>20</sup> Town Sound & Custom Tops, Inc. v. Chrysler Motors Corp., 959 F.2d 468, 479 n.13 (3d Cir. 1992).

power,"<sup>21</sup> for control over essential inputs means BOCs can increase the price or reduce the output of all long distance services -- through cross subsidization or access discrimination -- such that neither demand substitution by consumers nor supply substitution by other interexchange carriers can prevent harm to consumers located in those service areas. Courts have endorsed that approach, holding that "[a] carrier with monopoly control over bottleneck facilities is in a position to . . . discriminate against competing carriers" and to harm competition and consumers.<sup>22</sup>

In this regard, as the NPRM recognizes, the BOCs control bottleneck access facilities that are essential inputs into the provision of interexchange services, and there are numerous ways in which the BOCs could "raise [their] interexchange rivals' costs."<sup>23</sup>

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<sup>21</sup> First Report and Order, Policy and Rules Concerning Rates for Competitive Common Carrier Servs. and Facilities Authorizations Therefor, 85 F.C.C.2d 1, 21 (1980); see also id. ("An important structural characteristic of the marketplace that confers market power upon a firm is the control of bottleneck facilities"); Memorandum Opinion, Order and Certificate, Application of Iowa Network Access Div. for Auth. Pursuant to Section 214 of the Communications Act of 1934 and Section 63.01 of the Comm'n's Rules and Regulations to Lease Transmission Facilities to Provide Access Serv. to Interexchange Carriers, 3 FCC Rcd. 1468, 1469 (1988) ("One of the indicia of market power is the control of bottleneck facilities, with a concomitant ability to impede competition"); NPRM, ¶ 8 (noting that Competitive Carrier examined "whether the firm controlled bottleneck facilities" in assessing market power).

<sup>22</sup> See Atlantic Tele-Network, Inc. v. FCC, 59 F.3d 1384, 1389 (D.C. Cir. 1995); see also MCI Communications Corp. v. AT&T, 708 F.2d 1081, 1132-33 (7th Cir. 1983) ("A monopolist's control of an essential facility (sometimes called a 'bottleneck') can extend monopoly power from one stage of production to another, and from one market into another"); United States v. Western Elec. Co., 900 F.2d 283, 301 (D.C. Cir. 1990) (same); Southern Pac. Communications Co. v. AT&T, 740 F.2d 980, 1001 (D.C. Cir. 1984) (same).

<sup>23</sup> See NPRM, ¶ 52 n.120.

Thus, the BOCs possess substantial market power over all interexchange services offered to customers in their regions regardless of (1) how the interexchange market and market shares are otherwise defined, (2) the ability customers otherwise have to turn to alternative interexchange services (demand substitution), or (3) the ability interexchange carriers otherwise have to enter particular geographic areas (supply substitution). Indeed, premature BOC entry could readily change the market from one in which there is open entry and numerous competitors to one in which a small number of regional carriers obtain illicit advantages to the detriment of consumers and competition.

Second and relatedly, an inquiry into the interexchange market is misdirected in this context because the issue is not simply whether the BOCs have direct market power over interexchange services, but whether they would be able to leverage their power in the local market into the interexchange market. In addition to their ability to use their control over essential access facilities to disadvantage unaffiliated interexchange competitors, the BOCs would have every incentive to use their monopoly over local services to gain other improper advantages in interexchange services. For example, the BOCs' local monopolies mean that they have control over facilities critical to all potential interexchange customers, because every purchaser of interexchange service needs local service as well. And, in any event, the desire of many customers to engage in "one-stop shopping" and obtain as much of their communications services as possible from a single

provider means that any advantage in the local market can be leveraged into the interexchange market.<sup>24</sup>

In such circumstances, where the abuse of market power would occur through leveraging, the courts have recognized that the critical market is not the "downstream" market (here, interexchange services) but the input market in which the monopolist controls bottleneck facilities (here, the markets for access and local services).<sup>25</sup> Accordingly, in reviewing BOC applications to provide in-region interLATA services, the critical question will be whether conditions in access and local services have changed sufficiently that the BOCs could enter the interexchange market without undermining the vigorous interexchange competition that has developed over the course of the last twelve years. The NPRM acknowledges this reality, correctly observing that "the BOCs'

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<sup>24</sup> Recent customer research conducted by Pacific Bell shows that 66% of consumers and 80% of business customers would buy their local and long distance calling from a carrier that offered one-stop shopping packages. See Comments of Pacific Bell and Nevada Bell, Price Cap Performance Review for Local Exchange Carriers at 14, CC Docket No. 94-1 (December 11, 1995). Other published research shows that 53% of Americans would choose their local phone company to provide both local and long distance if it could provide those services at the same price as other providers. See "Brave New AT&T," Barron's, March 11, 1996, p. 37. These are statistics which the Commission simply cannot ignore.

<sup>25</sup> See Olympia Equip. Leasing Co. v. Western Union Tel. Co., 797 F.2d 370, 373-75 (7th Cir. 1986) (carrier's monopoly power over Commission-regulated telex services could give it "power to curtail competition in the complementary equipment market" notwithstanding that it held "only a tiny fraction" of equipment market); see also Otter Tail Power Co. v. United States, 410 U.S. 366, 375 (1973) (leveraging by denial of access); Town of Concord v. Boston Edison Co., 915 F.2d 17, 25-28 (1st Cir. 1990) (leveraging by price squeeze); Berkey Photo, Inc. v. Eastman Kodak Co., 603 F.2d 263, 275 (2d Cir. 1979) (discussing leveraging of monopoly power in one market to obtain improper competitive advantage in another market).

control of access facilities in their local service regions may require us to examine those regions individually in determining whether the BOCs have market power with respect to in-region interexchange services."<sup>26</sup> Its error lies in assuming that such an examination would be made by looking at the interexchange market, rather than the interstate access and local service markets in which those bottlenecks exist. The Commission's focus should therefore be on defining the relevant local markets for purposes of Section 271.

Third, consideration of today's interexchange service market would be peculiarly inappropriate in the context of a future Section 271 application, for the likely effect of BOC entry would be to obliterate today's distinctions between local and interexchange markets. In particular, the probable consequence would be to establish a separate market comprised of all telecommunications services (i.e., local and long distance) that are offered to business and residential customers in a specific geographic area and to create an industry structure in which carriers would separately offer "one stop shopping" to residential or business customers. Another focal point in any Section 271 application will thus be whether BOCs would have market power in such broadened product markets.

Finally, in all these regards, one area in which a more refined market analysis would be of substantial benefit to the Commission is in its definition of the local services and access

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<sup>26</sup> See NPRM, ¶ 53.

markets that exist today or that will exist at the time BOCs' file any Section 271 application.<sup>27</sup>

**B. The Commission's Single National Market Definition Correctly Describes The Realities Of The Interexchange Marketplace.**

Where the market power of a local bottleneck monopolist to impede interexchange competition is not at issue, the Commission's existing market definition will continue to have utility as part of any analysis seeking to measure market power.<sup>28</sup> In that context, the Commission's well-established position that "all interstate, domestic, interexchange telecommunications services comprise a single relevant product market with no relevant submarkets"<sup>29</sup> accurately describes "the realities of competition"

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<sup>27</sup> The Commission seeks comment (NPRM, ¶ 54) on what the boundaries should be of the local areas that might be used if it were to define separate point-to-point interexchange markets. That point-to-point approach would be both unnecessary (as explained in Section IA, supra) and incorrect (as explained in Section IB, infra), and therefore interexchange boundaries should not be defined for that purpose. However, the Commission will need to define the local markets it will examine in assessing Section 271 applications. Under the 1996 Act, that determination will have to be made on a State-by-State basis, and, because the situation in each LATA may be different, the Commission will need to examine each individual LATA (or even smaller areas) within the relevant State to determine whether such areas are competitive in the provision of local service and exchange access. See, e.g., Comments of Southwestern Bell Tel. Co., Price Cap Performance Review for Local Exch. Carriers at 10, CC Docket No. 94-1 (submitted Dec. 11, 1995) (proposing sub-LATA markets comprised of contiguous wire centers).

<sup>28</sup> E.W. French & Sons, Inc. v. General Portland Inc., 885 F.2d 1392, 1404 (9th Cir. 1989).

<sup>29</sup> Fourth Report and Order, 95 F.C.C.2d at 563-64. See also, e.g., AT&T Nondominance Order, ¶ 7.

(see Balaklaw v. Lovell, 14 F.3d 793, 799 (2d Cir. 1994) (citation omitted)).<sup>30</sup>

That is so primarily because "it is clear that there is no significant difference between the interexchange facilities used to provide" the many different services offered in that intensely competitive market. AT&T Nondominance Order, ¶ 23.<sup>31</sup> Thus, whatever consumers' willingness to substitute among those services, it is indisputable that numerous interexchange suppliers could (and would) use existing interexchange facilities to divert customers away from any hypothetical "monopolist" foolish enough to attempt to charge anticompetitive rates for any interexchange service.<sup>32</sup>

In light of these economic and commercial realities, no meaningful subdivisions of the interexchange services market can be drawn, because "[t]he touchstone of market definition is whether a hypothetical monopolist could raise prices." Coastal Fuels of

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<sup>30</sup> See also United States v. Continental Can Co., 378 U.S. 441, 449 (1964) ("In defining the product market . . . we must recognize meaningful competition where it is found to exist").

<sup>31</sup> See also Memorandum Opinion and Order, Application of MCI Communications Corp. & S. Pac. Telecommunications Corp. for Consent to Transfer Qwest Communications, Inc., 10 FCC Rcd. 1072, 1075 (1994) ("telecommunications transmission media . . . generally can be adjusted readily to provide virtually any interexchange telecommunication service efficiently"); Fourth Report and Order, 95 F.C.C.2d at 565 ("facilities readily can be switched among voice, data, facsimile, and video services, private line and switched services, and point-to-point and point-to-multipoint services").

<sup>32</sup> Indeed, given the enormous excess interexchange capacity that currently exists, competing carriers likely would not even have to forego any other sales to displace a would-be monopolist. See, e.g., AT&T Nondominance Order, ¶ 59 (noting, for example, that AT&T's largest competitors could absorb almost one-third of AT&T's existing traffic within 90 days and two-thirds of that traffic within twelve months with little or no incremental cost).

Puerto Rico, Inc. v. Caribbean Petroleum Corp., 1996 U.S. App. LEXIS 4365, at \*44 (1st Cir. Mar. 12, 1996). Here, as the Commission has long recognized, "[s]upply substitutability . . . a well-accepted consideration in market definition," AT&T Nondominance Order, ¶ 23, means that there is a single product market -- because competing carriers can quickly and costlessly shift all or a portion of their idle or otherwise employed facilities to the production of any interexchange service sought to be "monopolized."

The Commission's tentative conclusion that it should follow the Justice Department Merger Guidelines in assessing market power on the basis of market shares not only does not undermine this conclusion, it supports it. The Guidelines expressly recognize that where, as here, "production substitution among a group of products is nearly universal among the firms selling one or more of those products . . . an aggregate description of those markets" is appropriate.<sup>33</sup> And even where, unlike here, supply substitutability is less pervasive and the Guidelines therefore define the relevant market with reference only to demand substitutability, see 1992 Merger Guidelines § 1.0, "[s]upply substitution factors are considered . . . in the identification of firms that participate in the relevant market and the analysis of entry." Id. at 20,571. The more narrowly "defined" Guidelines market is therefore deemed to include the sales of all firms that currently sell in that "market" and firms that within one year

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<sup>33</sup> 1992 Merger Guidelines at 20,573-4 n.14.

would likely enter the relevant market in response to "'a small but significant and nontransitory' price increase." Id. at 20,573-3 (§ 1.32). Here, given pervasive supply substitutability, even a misdefined single service Guidelines market would include all sales of all interexchange services providers and would therefore yield precisely the same market share and market power results as the Commission's more rational existing approach.

Indeed, the only conceivable way to reach a different end result would be -- in direct contravention of the Guidelines -- to ignore supply substitutability altogether, an approach which would be "clearly wrong," in Professor Areeda's words,<sup>34</sup> and contrary to all relevant authority.<sup>35</sup> As the D.C. Circuit recently explained

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<sup>34</sup> IIA Areeda, Hovencamp & Solow, Antitrust Law ¶ 561, at 257 (1995). See also id. at 175 ("defining a market or 'submarket' on the basis of demand considerations alone is erroneous. The function of defining a market is to determine that grouping of sales that, if controlled by a single firm or a cartel, could charge non-competitive prices. But that is not possible if either demand or supply elasticity is high"); id. at 255 ("It is of little consequence that consumers have no good substitutes if producers can immediately respond to a firm's price increase by switching production to that firm's products").

<sup>35</sup> See, e.g., Brown Shoe Co. v. United States, 370 U.S. 294, 325 n.42 (1962) ("cross-elasticity of production facilities may . . . be an important factor in defining a product market"); United States v. Columbia Steel Co., 334 U.S. 495, 510 (1948) ("If rolled steel producers can make other products as easily as plates and shapes, then the effect of the removal of Consolidated's demand for plates and shapes must be measured not against the market for plates and shapes alone, but for all comparable rolled products"); Rothery Storage & Van Co. v. Atlas Van Lines, Inc., 792 F.2d 210, 218 (D.C. Cir. 1986), cert. denied, 479 U.S. 1033 (1987); Calnetics Corp. v. Volkswagen of Am., 532 F.2d 674, 691 (9th Cir. 1976) ("production cross-elasticity" must be considered when defining a market); Equifax, Inc. v. FTC, 618 F.2d 63, 66 (9th Cir. 1980) ("It is well settled that cross-elasticity of supply is a valid basis for determining that two commodities should be within the same market").

in upholding both the Commission's single interexchange services market definition and its supply substitutability rationale against the BOCs' demand-focused challenges, a market simply is not defined "solely by reference to consumer demand." See SBC Communications, Inc. v. FCC, 56 F.3d 1484, 1493-94 (D.C. Cir. 1995).

For largely the same reasons, the Commission's repeated holding that there is "a single national relevant geographic market" is also plainly correct.<sup>36</sup> Geographic market definition, like product market definition, focuses on the commercial realities which "check the prices charged" to consumers. Fourth Report and Order, 95 F.C.C.2d at 573. See also NPRM, ¶ 50 (geographic market definition should account for "economic factors and the realities of the marketplace"). Thus, the geographic area of effective competition must "reflect[] the reality of the way in which [competitors have] built and conduct their business," United States v. Grinnell Corp., 384 U.S. 563, 576 (1966), and the market is national if, as here, there is "national planning," "rate-making is largely . . . national," and carriers have "a national schedule of prices, rates, and terms." Id. at 575-76 (finding a national market for the provision of central alarm systems with 25 mile radii).<sup>37</sup>

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<sup>36</sup> Fourth Report and Order, 95 F.C.C.2d at 574-75. See also AT&T Nondominance Order, ¶ 22.

<sup>37</sup> See also Memorandum Opinion and Order, United Telecommunications, Inc. & U.S. Tel. Inc., Application for Consent to Transfer Control of U.S. Tel., Inc., 98 F.C.C.2d 1306, 1312 (1984) ("The geographic market is traditionally defined as the area in which sellers of the particular product operate"). That any particular carrier or group of carriers elects to enter on a more  
(continued...)

"[T]he geographic aspect of the relevant market must [also] reflect considerations of supply and demand substitutability." Memorandum Opinion and Order, Application of GTE Corp. & S. Pac. Co. for Consent to Transfer Control of S. Pac. Communications Co. & S. Pac. Satellite Co., 94 F.C.C.2d 235, 250 (1983). Here, "patterns of demand across geographic points favor a nationwide geographic market." Fourth Report and Order, 95 F.C.C.2d. at 574. See also NPRM, ¶ 51 ("customers typically purchase ubiquitous calling that enables them to make calls to all domestic locations").<sup>38</sup> And "supply substitutability [also] shows that the relevant geographic market of interexchange telecommunications suppliers is nationwide," because "[s]everal interexchange suppliers have nationwide networks with the capability to provide alternate geographic routings," GTE Corp., 94 F.C.C.2d at 250, and because "carriers have been able to enter and expand rapidly to serve a pair of points by constructing new facilities to supplement their networks, interconnecting, or

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<sup>37</sup> (...continued)  
geographically limited basis is entirely irrelevant. See, e.g., id. at 1312-13 ("A national geographic market for these carriers' interexchange services is warranted because of supply and demand substitutability, even though [they] do not offer originating interexchange services nationwide"); Memorandum Opinion and Order, Application of MCI Communications Corp. & S. Pac. Telecommunications Corp. for Consent to Transfer Qwest Communications, Inc., 10 FCC Rcd. 1072, 1075 (1994) (relevant geographic markets "are not defined by the areas served by one of many market participants").

<sup>38</sup> In this regard, it is plain that domestic long distance customers evaluate interexchange carriers not by comparing rates for a single point-to-point call, but on the basis of expected monthly costs associated with diverse calling patterns to multiple locations, which the customer often will not even know in advance.