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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF SECRETARY

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

In the Matter of	)	
	)	
Policy and Rules Concerning the Interstate, Interexchange Marketplace	))	CC Docket No. 96-61
	)	DOCKET FILE COPY ORIGINAL
Implementation of Section 254(g) of the Communications Act of 1934, as amended	))	

BELL ATLANTIC[1] COMMENTS ON SECTIONS IV, V AND VI

SUMMARY AND INTRODUCTION

Regardless of how the Commission decides here to regulate the incumbent long distance carriers, consumers will only receive the full benefits of long distance competition if the Commission's rules permit the Bell company entrants to compete on equal terms with the incumbents.

The Commission recognizes that the legislatively mandated entry of the Bell operating companies "can be expected to intensify competition in the interstate, domestic, interexchange market."[2] Indeed, as Professor Paul W. MacAvoy has explained, the entry of Bell Atlantic and the other Bell operating companies into the long distance market "should have a disruptive effect on

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[1] This filing is on behalf of Bell Atlantic Communications, Inc. and the Bell Atlantic telephone companies ("Bell Atlantic"), which are Bell Atlantic-Delaware, Inc.; Bell Atlantic-Maryland, Inc.; Bell Atlantic-New Jersey, Inc.; Bell Atlantic-Pennsylvania, Inc.; Bell Atlantic-Virginia, Inc.; Bell Atlantic-Washington, D.C., Inc.; and Bell Atlantic-West Virginia, Inc.

[2] ***Policy and Rules Concerning the Interstate, Interexchange Marketplace***, CC Docket No. 96-61, Notice of Proposed Rulemaking, ¶ 1 (rel. Mar. 25, 1996) ("Long Distance NPRM").

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the current tacitly collusive price-setting behavior of the three large interexchange carriers."[3] As a result, the most pro-consumer action the Commission can take here is to regulate (or in this case deregulate) all participants in the long distance markets same, including the Bell operating companies. The Commission must avoid imposing regulatory burdens only on the new entrants. By undermining the competitive force of the new entrants, such actions would hurt competition, and thereby harm consumers.

I. The Commission should not impose a burdensome separate subsidiary requirement on out-of-region Bell operating company long distance services.

As Bell Atlantic has shown in its prior comments, there is no basis to impose a burdensome separate subsidiary requirement on Bell companies' provision of out-of-region long distance services.[4] Such a requirement is exactly the type of asymmetric regulation that the Commission must avoid. Indeed, the Commission has committed to regulating with the "minimum necessary degree of separation" because structural separation is an onerous burden that can "decrease efficiency and affect the interexchange carriers ability to compete."[5] AT&T and MCI have proclaimed their intent to offer both local and long distance services through a single entity and to

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[3] P. MacAvoy, "The Failure of Antitrust and Regulation to Establish Competition in Markets for Long-Distance Telephone Services" at 374, Yale School of Management Working Paper Series C (1995).

[4] ***See Bell Operating Company Provision of Out-of-Region Interstate, Interexchange Services***, CC Docket No. 96-21, Bell Atlantic Comments (filed Mar. 13, 1996); Bell Atlantic Reply Comments (filed Mar. 25, 1996). For the Commission's convenience, these comments along with the accompanying Affidavit and Reply Affidavit of Robert W. Crandall are attached hereto.

[5] ***Policy and Rules Concerning Rates for Competitive Common Carrier Services and Facilities Authorizations Therefor***, Fifth Report and Order, 98 F.C.C.2d 1191, 1197 (1984).

combine these into "bundled offers like the industry has never seen before."[6] The Commission should not give free reign to the market incumbents and at the same time impose special separation burdens on the new entrants.

As new entrants competing against a nationwide cartel of the three largest long distance providers, there is no legitimate argument that the Bell companies could be considered dominant. As demonstrated in Bell Atlantic's comments and in the supporting affidavits of Dr. Crandall, there are at lease five reasons why a separate subsidiary requirement should not be imposed for out-of-region long distance services.

First, such a requirement is inconsistent with Section 271 (b) (2) of the 1996 Act,[7] which specifically allows a "Bell operating company or any affiliate of the Bell operating company" to provide out-of-region interLATA services. The decision allowing individual Bell telephone companies to themselves provide out-of-region telephone service is reinforced by Section 272 (a) (2) (B), which excludes out-of-region interLATA service from even the temporary separate affiliate requirement that applies to in-region long distance.

Second, the geographic separation between a Bell Company's local exchange operations and its of out-of-region long distance services eliminates the potential for undetected cost shifting.[8] There is simply no conceivable way a company could shift the costs of long distance in a remote state into the books of its local operations in a different state.

6 AT&T Chairman Robert E. Allen in AT&T News Release "AT&T's Allen outlines plans to enter local telephone market" (rel. Feb. 8, 1996).

7 ***See*** Bell Atlantic Comments at 4-5.

8 ***See*** Crandall Affidavit, ¶ 7.

Third, price cap regulation creates incentives similar to a competitive market and therefore makes regulatory cost allocation unnecessary.[9] Moreover, most local exchange carriers ("LECs") regulated by price caps have elected the FCC's "pure" price cap option, which makes any cost shifting meaningless because regulated prices are completely divorced from underlying costs.

Fourth, even if it were possible to cost shift, which it is not, it makes no economic sense given the size and capital investment of the major incumbent long distance providers. As Dr. Crandall explained, predation makes no sense against these large rivals because "the BOCs would find that their 'predatory' prices would simply be matched by their rivals for as long as the BOCs maintained them."[10] The notion that an individual Bell company could drive the much larger AT&T from the long distance market is absurd.

Fifth, there is also no basis to argue that the Bell companies could or would discriminate against their rivals' calls that terminate in-region. Competition has flourished in the market for other competitive services that connect to the LEC networks.[11] Moreover, the scenario required for Bell Atlantic to make such discrimination worthwhile borders on the ludicrous. To succeed, Bell Atlantic would have to sabotage its own access services to selected competitors to such a degree that individual customers would notice the difference and switch long distance carriers, yet at the same time conceal such sabotage from sophisticated access customers like AT&T and MCI and

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9 ***See*** Crandall Affidavit, ¶ 8; ***see also Price Cap Performance Review for Local Exchange Carriers***, First Report and Order, 10 FCC Rcd 8961, 8973 (1995).

10 Crandall Affidavit, ¶ 9.

11 Examples of connecting services where competitors have thrived include cellular, voice messaging and customer premises equipment. ***See*** Crandall Affidavit, ¶¶ 12-13.

from the Commission. There is simply no credible scenario under which such self-destructive actions in an increasingly competitive access market are economically viable.[12]

II. The relevant geographic market is national in scope.

The Commission tentatively endorses what AT&T has characterized as the Commission's "unbroken line of decisions,"[13] and proposes to treat long distance services as a single "national market" for market power analysis.[14] As the Commission recognizes in the Notice, consumers do not purchase single point to point service, but rather they purchase services to call from one point to all points.[15] Moreover, rate averaging proposed by the Commission links prices charged in one area to prices charged in all areas.[16] Thus, the Commission's original conclusion of a nation market remains equally valid today.

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12 ***See*** Crandall Affidavit, ¶ 11; Crandall Reply Affidavit, ¶ 6.

13 ***Bell Operating Company Provision of Out-of-Region Interstate, Interexchange Services***, CC Docket No. 96-21, AT&T Comments at 4 (filed Mar. 13, 1996).

14 Long Distance NPRM, ¶ 42; ***see also Motion of AT&T Corp. to be Reclassified as a Nondominant Carrier***, Order, FCC 95-427, ¶ 22 (rel. Oct. 23, 1995); ***Policy and Rules Concerning Rates for Competitive Common Carrier Services and Facilities Authorizations Therefor***, CC Docket No. 79-252, Fourth Report and Order, 95 FCC 2d 554, 564 (1983), vacated in part, ***AT&T v. FCC***, 978 F.2d 727 (D.C. Cir. 1992), ***cert. denied***, 113 S. Ct. 3020 (1993).

15 Long Distance NPRM, ¶ 50. Analogies to the airline industry are inappropriate to telecommunications. Clearly air travel consumers purchase seats to fly between two points. Telecommunications consumers purchase service to communicate with many points. Long Distance NPRM, ¶ 49, n. 116.

16 Long Distance NPRM, ¶ 51.

III. The Commission must apply market power tests uniformly.

While various service providers may differ in the degree of market power they can exert over the long distance market, the size of the market is uniform across all providers. For example, AT&T, which has more customers, more capacity, more capital, and higher brand awareness than any other competitor or potential competitor, has greater market power than its long distance rivals. Nonetheless, the Commission did not attempt to create a market definition that only applied to AT&T when the Commission evaluated AT&T's status as a nondominant provider of long distance services.

Similarly, it would be unreasonable for the Commission to treat long distance as a national market when evaluating the market power of incumbents, but isolate portions of the market for market power analyses of newcomers. Consumers do not make a separate selection of long distance providers for each point to point call they make. Rather, they make a uniform selection for nationwide calling.

The Commission should reject the suggestion in the Notice that the Bell operating companies' offering of in-region long distance could create special concerns that require a separate market definition.[17] The Commission acknowledges that geographic rate averaging reduces the ability for a carrier to exercise market power selectively in a limited geographic area.[18] The Commission hypothesizes that this check would be less strong for a regionally-based LEC, but this ignores market realities. So long as customers are selecting a carrier for

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17 Long Distance NPRM, ¶ 53.

18 The Commission's proposals for rate averaging and integration are consistent with requirements of the 1996 Act and will help ensure that any long distance provider will be unable to isolate geographic areas for special rate treatment.

nationwide coverage, it is the nationwide prices that will drive the market. Carriers with prices that significantly exceed the national averages will have no more success in their region than outside the region. This is especially true because the LECs will be new entrants to the market without the established market presence of incumbents AT&T and MCI.

The Commission recognizes that excess capacity in long distance transport "undermines the ability of any carrier to raise and maintain the price of interstate transport above the competitive level."[19] This is also true for LECs, which have no special ability to raise interstate long distance transport prices. To the extent a LEC has market power for terminating or originating access, those prices are already controlled by existing regulations and the Act expressly requires that a Bell company's long distance affiliate pay the same tariff access rates as any other provider.[20] For the remaining portion of the long distance call, status as a LEC is irrelevant.

The logic of the Commission's endorsement of a national market is sound. Regardless of what market definition is ultimately adopted, however, the market definition cannot vary based on the identity of the supplier. There is no economic basis for such an adjustable definition, and the result would be to encourage disparate regulatory treatment for the entities most likely to provide vibrant price competition in the long distance market.

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[19] Long Distance NPRM, ¶ 52.

[20] 47 U.S.C. § 272 (c) (1).

CONCLUSION

The best way for the Commission to spur long distance competition is to reduce regulatory barriers for all providers, especially new entrants. In order to avoid creating regulatory roadblocks to competition, the Commission should not make a separate subsidiary a condition of non-dominant regulation for Bell operating companies' out-of-region long distance service and should use a uniform market definition for all long distance service providers.

Respectfully submitted,

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April 19, 1996

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Interstate, Interexchange Services	)	

BELL ATLANTIC COMMENTS

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Table of Contents

Introduction and Summary

The Commission correctly decided that Bell Atlantic and the other regional Bell companies are nondominant providers of out-of-region interLATA service. Bell Atlantic will operate as a new entrant in this business competing against established incumbents, all of which are already regulated as nondominant. By acting quickly to provide the same treatment to Bell Atlantic and other new entrants, the Commission will spur "efficient and rapid entry" of new competitors in the long distance market.

The resulting benefits to consumers could be subverted, however, if nondominance is made contingent on a burdensome and unwarranted separate subsidiary requirement. Such a requirement is inconsistent with the Telecommunications Act of 1996. Under the Act's own language, the individual Bell Atlantic telephone companies[1] are authorized to provide this service themselves, and are expressly authorized to do so immediately without a separate affiliate.

Not only are the proposed restrictions inconsistent with the Act, but as Dr. Robert Crandall explains in his accompanying affidavit, they are without economic justification. The Commission has sufficient safeguards to prevent cost shifting to any long distance service. Where, as it is here, the service is geographically separated from the existing local exchange services, the separate subsidiary requirement is particularly inappropriate.

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[1] This filing is on behalf of Bell Atlantic Communications, Inc. and the Bell Atlantic telephone companies ("Bell Atlantic"), which are Bell Atlantic-Delaware, Inc.; Bell Atlantic-Maryland, Inc.; Bell Atlantic-New Jersey, Inc.; Bell Atlantic-Pennsylvania, Inc.; Bell Atlantic-Virginia, Inc.; Bell Atlantic-Washington, D.C., Inc.; and Bell Atlantic-West Virginia, Inc.

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BELL ATLANTIC COMMENTS

The Commission correctly decided that Bell Atlantic and the other regional Bell companies are nondominant providers of out-of-region interLATA service. By acting quickly, the Commission will spur "efficient and rapid entry"[2] of new competitors in the long distance market. By regulating those competitors as nondominant, the Commission will regulate the entrants under the same rules applied to the existing service providers. This will help assure that competition will be on a level playing field so that the market, and not the regulators, will decide the eventual winners. The real winners of such a decision are consumers, who will have more choices and lower prices as a result of competition.

These benefits are at risk, however, because the Commission has proposed making out-of-region nondominant status contingent on a burdensome separate subsidiary requirement. ***Any*** separate subsidiary requirement is inconsistent with the new Telecommunications Act, and the Commission's proposal includes burdens that are greater than even those required in the Act for

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2 ***Bell Operating Company Provision of Out-of-Region Interstate, Interexchange Services, Notice of Proposed Rulemaking***, ¶ 7 (rel. Feb. 14, 1996) ("***NPRM***").

in-region long distance services. The end result from such a requirement would be to increase costs and undermine the very competition the Commission and the Act set out to encourage. Moreover, as explained in the accompanying affidavit of Dr. Robert Crandall, there simply is no sound economic basis for imposing a separate subsidiary requirement on out-of-region long distance services. As a result, the Commission should remove any separate subsidiary requirement for the provision of nondominant out-of-region long distance services.

I. Bell Atlantic is Not a Dominant Provider of interLATA Services

Bell Atlantic will be a new entrant in an established interLATA market and it is appropriate to regulate it as a nondominant service provider generally. This is particularly true, however, for services provided outside its in-region states, where Bell Atlantic historically has had a smaller market presence.

Today there are several carriers with a national presence that together serve close to 90% of the market.[3] AT&T, MCI and Sprint together spend around a half a billion dollars annually on advertising and brand name recognition.[4] All of these carriers are already considered nondominant and there is no basis to treat Bell Atlantic and other new entrants more restrictivly.

In its decision to classify AT&T as a nondominant carrier, the Commission concluded that the national interLATA market had sufficient supply and demand elasticity to allow AT&T

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[3] ***FCC, Statistics of Communications Common Carrier***, p. 348 (1994/95 ed.) ("***FCC Statistics***"). While market share is backward a backward looking measure, Bell Atlantic and the other new entrants also would have no market power using a more forward looking criteria such as addressability. ***See, Price Cap Performance Review of Local Exchange Carriers***, CC Docket 94-1, Comments of Bell Atlantic at 16-21 (filed Dec. 11, 1995).

[4] According to ***Advertising Age's*** "Top 100 Business Market Advertising Report", AT&T, Sprint and MCI spent a combined $433 million on media advertising alone in 1994.

to be considered a nondominant carrier.[5] Those conclusion must apply with no less force to Bell Atlantic's interLATA services.

Comparing AT&T's relative position in that market to that of the new market entrants only makes the nondominance case even more compelling. While AT&T has the largest market share in the industry with a majority of the nationwide customers,[6] Bell Atlantic's new interLATA services do not have a single customer out-of region. Even after the announced corporate restructure, the remaining AT&T telecommunications company will be larger than any of the regional Bell operating companies or other LEC competitors.[7]

There is simply no economically sound argument that Bell Atlantic and other regional operating companies entering the interLATA market will have the ability "to raise prices by restricting output."[8] If all existing interexchange carriers are nondominant, "surely the BOCs are also."[9]

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[5] ***Motion of AT&T Corp. to be Reclassified as a Non-Dominant Carrier***, FCC 95-427 at 57-66 (rel. Oct. 23, 1995) ("***AT&T Nondominance Order***").

[6] ***FCC Statistics*** at 348.

[7] AT&T's ***1995 Annual Report*** (p. 9) projects "the new AT&T" to have $56 billion in assets at its inception.

[8] ***Policy and Rules Concerning Rates for Competitive Common Carrier Services and Facilities Authorizations Therefor, Fourth Report and Order***, 95 F.C.C.2d 554, 558 (1984) ("***Fourth Report and Order***") (quoting P. Areeda & D. Turner, Antitrust Law 322 (1978)).

[9] Affidavit of Robert W. Crandall, ¶ 5, attached hereto ("Crandall Affidavit").

II. A Separate Subsidiary Requirement is Inconsistent With the New Telecommunications Act

Having correctly determined that Bell Atlantic and other regional Bell operating companies will be nondominant providers of out-of region services, the proposed rules make that determination contingent on the establishment of a separate subsidiary. Such a requirement is inconsistent with the Telecommunications Act of 1996. Section 271 (b) (2) of the Act specifically allows a "Bell operating company, or any affiliate of that Bell operating company" to provide out-of-region interLATA services upon the date of enactment of the Act. Thus, the individual Bell Atlantic telephone companies are authorized by statute to provide this service themselves, not through a separate affiliate. This decision is reinforced by Section 272 (a)(2)(B), which specifically excludes out-of-region interLATA service from a separate affiliate requirement.

The rulemaking not only proposes to impose a burden rejected by Congress, but it goes further by proposing burdens on out-of-region services that are inconsistent with even those imposed on in-region services. For example, the statutory in-region separation requirement automatically sunsets after three years.[10] In contrast, the proposed rulemaking's requirement for out-of-region is open ended.

The Commission's proposed out-of-region requirement also forbids joint ownership of transmission and switching facilities. There is no similar limitation in the Act for in-region long distance services, nor should there be. To provide the best service at the lowest price, the Bell

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[10] ***Telecommunications Act of 1996***, Pub. L. 104-104, 110 Stat. 56, § 272 (f) (1) (Feb. 8, 1996) ("***1996 Act***").

operating companies should be encouraged to use the most economical combination of assets. There is no economic basis to require costly artificial separation or duplication of facilities.

As a result of the current proposal, Bell Atlantic could be required to create two separate long distance affiliates, one for in-region, and one for out-of-region interLATA services. These additional burdens are inconsistent, not only with the specific provisions of the Act, but with its intent to reduce regulation and spur competition in the long distance market.

III. There Is No Need For A Separate Subsidiary Requirement

Not only is the separate subsidiary requirement inconsistent with the legislation, it imposes an unreasonable constraint. Once the Commission determines, as it must, that Bell operating companies' out-of-region interLATA services lack market power, there is no economic justification to encumber these new entrants with extra regulatory burdens. As the Commission has recognized, excessive regulatory burdens "lessen competition and impose costs on consumers."[11] The Commission has also recognized that structural separation is particularly onerous and "can also decrease efficiency and affect the interexchange carrier's ability to compete."[12] As a result, the Commission has committed to regulating with the "minimum necessary degree of separation."[13] Here, none is required.

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[11] ***Policy and Rules Concerning Rates for Competitive Common Carrier Services and Facilities Authorizations Therefor, Fifth Report and Order***, 98 F.C.C.2d 1191, 1198 (1984).

[12] ***Id.*** at 1197.

[13] ***Id.***

While the Commission's twelve year old admonitions against unnecessary separation requirements are still applicable today, the same cannot be said for the Fifth Report and Order's market analysis relied on in the proposed rulemaking. In the 1984 order, the Commission adopted a separate subsidiary requirement to eliminate any possible concern about "cost shifting and anticompetitive conduct."[14] As Dr. Crandall explains, in the current situation, any possible concerns have been addressed in other ways for companies entering the interLATA market outside their LEC service territories.

First, because this decision only applies to out-of-region service, there is no chance of commingled accounts and cost shifting.[15] Even if such cost shifting were possible, the fact that the out-of-region facilities will be geographically separated from the in-region facilities makes detection a simple matter. Because the facilities will be geographically separated,[16] there is no reason to impose a secondary burden of structural separation.

Second, under modern regulation, the regional carriers have lost any ability and incentive to shift costs. In 1984, common carriers were governed by rate of return regulation. Through its perverse incentive structure, rate of return "encourages cost-shifting by carriers that participate in

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14 ***Id.*** at 1198.

15 Crandall Affidavit, ¶ 7.

16 Indeed, for many companies, out-of-region interLATA services, at least initially, will be offered on a resale basis, with no physical plant owned by the company or its affiliates. The Commission has already found that "[t]here has not appeared to be much public need for regulating resellers. This makes the burdens imposed by our regulations appear especially onerous in the case of resellers." ***Policy and Rules Concerning Rates for Competitive Common Carrier Services and Facilities Authorization Therefor, Second Report and Order***, 91 FCC 2d 59, 62 (1982).

both competitive and noncompetitive markets."[17] As a result, the Commission required "elaborate regulatory oversight of all the carrier's costs" as a safeguard.[18] In contrast, price cap regulation "can create profit incentives similar to those in fully competitive markets and generates positive motivations for . . . accurate cost allocation, while reducing regulatory burdens."[19] Under the pure price caps that most LECs operate under, cost shifting has become meaningless because regulated prices are completely divorced from underlying costs.

Third, LECs will be facing a group of large and well financed competitors in the interLATA market. As economist Dr. Robert Crandall explains, "it would simply be unprofitable for the BOCs to engage in anticompetitive conduct in out-of-region long distance services."[20] Predation makes no sense because "the BOCs would find that their 'predatory' prices would simply be matched by their rivals for as long as the BOCs maintained them."[21] The notion that an individual Bell company could drive the much larger AT&T out of the long distance market is absurd.

There is also no chance that Bell Atlantic could create any advantage in the out-of-region market based on its status as a LEC connecting calls that are terminated in-region. As Dr. Crandall explains, Bell Atlantic and the other operating companies are facing new local competition and would have no incentive to discriminate among various carriers' long distance

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17 ***Price Cap Performance Review for Local Exchange Carriers*, *First Report and Order***, 10 FCC Rcd 8961, 8973 (1995).

18 ***Id.***

19 ***Id.***

20 Crandall Affidavit, ¶ 9.

21 ***Id.***, ¶ 9.

calls that terminate in-region.[22] The actions required to implement such discrimination are both strange and implausible. In order to make such discrimination profitable, Bell Atlantic would have to identify that portion of its access service that originates in areas where it competes for long distance customers. It would have to isolate and sabotage its own access services for only calls from those areas that are carried by competitors. And it would have to do so at such a level that customers would reject their long distance carrier, but at the same time the sabotage would have to be undetectable to the Commission or the incumbent carrier. Even the most avid conspiracy theorist would reject such a bizarre scenario.

Further, the history of the participation by Bell Atlantic and the other Bell companies in a variety of competitive markets proves that they have not impeded competitors by discriminating against other connecting services. Competition has flourished in the cellular market and companies affiliated with the incumbent LEC have not hampered competition.[23] Despite dire warnings, the voice messaging market has also flourished with the addition of Bell Atlantic and other telephone companies as competitors.[24] Similarly, LECs are only a small part of the thriving CPE market.[25] Bell Atlantic competes in-region for interLATA customers in the corridor areas without a separate subsidiary, yet the large long distance carriers dominate that

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[22] *Id.*, ¶¶ 10-12.

[23] *Id.*, ¶ 12.

[24] The three largest independent voice mail providers have experienced a four-fold increase in revenues between 1990 and 1994. Crandall Affidavit, ¶ 13.

[25] After seven years in the market, Bell companies have less than 50% of the CPE market. *Id.*

competition.[26] This solid track record of non-discrimination should quiet any theoretical concerns of discrimination here.

Moreover, even if there were a legitimate concern, it is already addressed through continued regulation of the local LECs' services. A separate subsidiary requirement does nothing to add to those protections.

Conclusion

For the foregoing reasons, the Commission should authorize Bell Atlantic and other Bell operating companies to be nondominant providers of out-of-region interLATA services without subjecting them to a separate subsidiary requirement.

Respectfully submitted,

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26 Crandall Affidavit, ¶ 5.

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Affidavit of Robert W. Crandall[1]

1. I am a Senior Fellow in Economic Studies at the Brookings Institution, a position that I have held since 1978. Prior to that I served on the Council on Wage and Price Stability as Deputy Director and Acting Director. I have held faculty positions in economics at M.I.T., The University of Maryland, and George Washington University and have taught in Stanford University's Washington Program. I served as an advisor to FCC Commissioner Glen O. Robinson and have been a consultant to the Commission on several occasions. I have written widely on communications issues over the past 25 years. My most recent books in this area are After the Breakup: The U.S. Telecommunications Sector in a More Competitive Era (Brookings, 1991); Cheap Talk: The Promise of Regulatory Reform in North America (with Leonard Waverman, Brookings, 1996; and Cable Television: Regulation or Competition? (with Harold Furchtgott-Roth, Brookings, forthcoming) A copy of my curriculum vitae is attached.

2. I have been asked by Bell Atlantic to provide an analysis of certain issues raised by the

[1] The views expressed herein are those of the author and do not necessarily represent those of the Brookings Institution, its Trustees, or other staff members.

Commission's Notice of Proposed Rulemaking in CC Docket 96-21. This proceeding has been launched to establish rules for the Regional Bell Operating Companies' entry into out-of-region interstate interexchange services pursuant to the Telecommunications Act of 1996. The Commission has indicated that it wishes to permit the "rapid entry" of the BOCs into these out-of region markets,[2] a commendable objective that could be achieved rather easily were some of the Commission's proposals modified slightly.

Summary

3. The Commission has correctly decided that the BOCs are unlikely to possess market power in these out-of-region interexchange markets. As a result, its tentative conclusion to declare the BOCs "nondominant" in these markets is surely the correct one. However, its proposal to subject the BOCs to a separate subsidiary requirement in these markets appears to be based on the Commission's historic concerns about problems that are simply irrelevant to this proceeding. This proposed separate-subsidiary requirement should therefore be dropped.

Nondominance

4. The Commission has correctly concluded that the BOCs are not likely to have market power in out-of-region interexchange markets when they commence this service.[3] Indeed, the

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[2]Notice of Proposed Rulemaking at 7.

[3]Notice at 8.

Commission has recently decided that even AT&T is nondominant in the provision of domestic interexchange services. All other interexchange carriers, including MCI and Sprint, are also nondominant.

5. Given the considerable excess capacity that now exists among interexchange carriers, AT&'s nearly 60 percent share of all interLATA switched minutes[4] and its 55 percent share of revenues,[5] the relative sizes of Sprint, MCI, and LDDS/Worldcom, and the number of established smaller participants in interLATA markets, the BOCs will face formidable competition as they begin to offer interexchange services in out-of-region markets. The existing interexchange carriers have considerable name recognition, substantial technical operating expertise, and enormous excess capacity.[6] The BOCs have little name recognition in these out-of-region markets, zero market share, and no clearly identifiable other advantage in competing with the well-established interexchange carriers. Therefore, if all existing interexchange carriers are nondominant, surely the BOCs are also.

Separate Subsidiaries

6. In developing a policy for BOC entry into out-of-region interstate long-distance services, the Commission relies heavily on its earlier Fifth Report and Order in CC Docket 79-

[4]FCC, Statistics of Communications Common Carriers, 1994/95 edition, p. 347.

[5] Id., p.7.

[6] Motion of AT&T to be Reclassified as a Non-Dominant Carrier, Order, CC 95-427 (rel. October 23, 1995), at 57-60.

6. In developing a policy for BOC entry into out-of-region interstate long-distance services, the Commission relies heavily on its earlier Fifth Report and Order in CC Docket 79-252, in which it established rules for interstate interexchange service provided by affiliates of independent LECs. In order to protect against any possible risk of "cost-shifting and anticompetitive conduct" from these independent LEC-owned long-distance carriers, the Commission required in the Fifth Report and Order that such carriers would be deemed nondominant as long as they were separated from their parents' local exchange facilities.[7] The Commission now proposes to extend this requirement to out-of-region interexchange services of the BOCs based on its conclusions in the Fifth Report and Order.

7. The Commission's Fifth Report and Order was published twelve years ago before price caps were put in place for the LECs' interstate activities and before the Commission's equal-access rules had been tested over time. In that proceeding, the Commission addressed the problems that might develop when a regulated independent LEC offers long-distance services in geographical regions that include the LEC's local-exchange facilities. The potential problems identified there have since been adequately addressed by other Commission rules for in-region services. In this case, however, the Commission is addressing prospective BOC **out-of-region** long-distance service, where any potential concerns are far more attenuated. Given the geographical separation of the BOCs' local-exchange and out-of-region interstate long-distance facilities, it is difficult to see how these companies could commingle their cost accounts of these

[7] Fifth Report and Order as cited in the current Notice at 10.

to shift costs from one of these accounts to another.

8. Moreover, in the past five years, the LECs have been subject to price-cap regulation in the federal jurisdiction and in many state jurisdictions. Price caps directly regulate the prices charged for various services rather than a carrier's rate of return. With price caps, cost-shifting is no longer a possibility since prices cannot be affected by any manipulation of cost accounts. Under price caps, prices are permitted to increase at an annual rate that depends on the rate of inflation and the productivity offset set by the Commission. Prices no longer depend on increases in the carriers' costs, nor on the allocation of those costs among different services. Therefore, carriers have no incentives to engage in the manipulation of cost accounts.

9. In addition, it would simply be unprofitable for the BOCs to engage in anticompetitive conduct in out-of-region long-distance services in which their rates (and AT&T's) will be subject to abridged rate reviews. In an essentially unregulated market, would a BOC be likely to engage in predation against AT&T, MCI, and Sprint? Given the enormous excess capacity in this sector that translates into very low marginal costs and the large, well-financed companies competing in it, the BOCs would find that their "predatory" prices would simply be matched by their rivals for as long as the BOCs maintained them. These rivals would not and could not be driven from the market by the new BOC out-of-region operations, no matter how aggressively the BOCs cut rates to obtain customers. The likelihood that a predatory strategy would be successful, even if it were unchecked by the Commission or the Justice Department, is essentially nil. Given this fact, it would be irrational for a BOC to even attempt such a strategy.