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

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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 SECTION 254(g))
OF THE COMMUNICATIONS ACT OF)
1934, AS AMENDED)

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COMMENTS OF THE
TELECOMMUNICATIONS RESELLERS ASSOCIATION

TELECOMMUNICATIONS
RESELLERS ASSOCIATION

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SUMMARY

The Telecommunications Resellers Association ("TRA"), an organization consisting of more than 450 resale carriers and their underlying product and service suppliers, recommends that the Commission take the following actions in the captioned rulemaking proceeding:

- TRA strongly urges the Commission to continue to impose as a condition to non-dominant treatment of independent LEC provision of interstate, interexchange telecommunications services the requirement that such services be offered through a structurally-separate affiliate. TRA further urges the Commission, as it has proposed to do in CC Docket No. 96-21, to extend this requirement to the provision by the RBOCs of "out-of-region" long distance services. Moreover, TRA submits that in order to ensure meaningful separation between RBOC local exchange/exchange access and interexchange operations, the separation requirements adopted in the Competitive Carrier proceeding should be strengthened in several key respects. In TRA's view, structural-separation requirements should be retained until such time as meaningful local exchange/exchange access competition has emerged.
- TRA agrees with the Commission's view that it should focus more sharply the product and geographic market definitions it will use in the future to assess market power in the provision of interstate, interexchange telecommunications services and supports the practical manner in which the Commission proposes to apply these more refined product and geographic market definitions in conducting market power analyses.
- TRA urges the Commission to exercise caution in implementing the geographic rate averaging and rate integration mandates set forth in Section 254(g) of the '96 Act so as not to hinder the operation of a competitive interstate, interexchange telecommunications services market.

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**COMMENTS OF THE
TELECOMMUNICATIONS RESELLERS ASSOCIATION**

The Telecommunications Resellers Association ("TRA"), through undersigned counsel and pursuant to Section 1.415 of the Commission's Rules, 47 C.F.R. § 1.1415, hereby submits its Comments in response to the Notice of Proposed Rulemaking, FCC 96-123, released by the Commission in the captioned docket on March 25, 1996 (the "Notice"). The Notice, and the rulemaking proceeding initiated thereby, represents the first major exercise by the Commission of the expanded "forbearance" authority granted to it in Section 401 of the Telecommunications Act of 1996 ("96 Act").¹ In this, the first phase of the proceeding, the Commission seeks comment on (i) the nature and scope of the product and geographic market definitions it should use in assessing market power in the interstate, interexchange

¹ Pub. L. No. 104-104, 110 Stat. 56, § 401 (1996).

telecommunications services market; (ii) the potential modification or elimination of the structural separations requirements adopted in the Competitive Carrier Proceeding² as a precondition for non-dominant treatment of local exchange carrier ("LEC") provision of interstate, interexchange telecommunications services; and (iii) the implementation of, and the advisability of forebearing from enforcing, the geographic rate averaging and rate integration mandates set forth in Section 254(g) of the '96 Act.³

I.

INTRODUCTION

TRA was created, and carries a continuing mandate, to foster and promote telecommunications resale, to support the telecommunications resale industry and to protect the interests of entities engaged in the resale of telecommunications services. TRA's more than 450 members are all engaged in the resale of interexchange, international, local exchange, wireless and/or other services and/or in the provision of products and services associated with such resale. Employing the transmission, and often the switching and other, capabilities of underlying facilities-based carriers, TRA's resale carrier members create "virtual networks" to serve generally small and mid-sized commercial, as well as residential, customers, providing such entities and individuals with access to rates otherwise available only to much larger users. TRA's resale

² Policy and Rules Concerning Rates for Competitive Common Carrier Services and Facilities Therefor, First Report and Order, 85 F.C.C.2d 1, ¶ 54 (1980); Second Report and Order, 91 F.C.C.2d 187 (1982), *recon. denied*, 93 F.C.C.2d 54 (1983); Third Report and Order, 48 Fed. Reg. 46,791 (1983); Fourth Report and Order, 95 F.C.C.2d 554 (1983), *rev'd and remanded sub nom.*, American Tel. & Tel. v. FCC, 978 F.2d 7272 (D.C.Cir. 1992), *cert. denied*, 113 S.Ct. 3020 (1993); Fifth Report and Order, 98 F.C.C.2d 1191 (1984); Sixth Report and Order, 99 F.C.C.2d 1020 (1985), *rev'd and remanded sub nom.*, MCI Telecommunications Corp. v. FCC, 765 F.2d 1186 (D.C.Cir. 1985).

³ 47 U.S.C. § 254(g).

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 reserved for large-volume corporate users.

While TRA's resale carrier members range from emerging, high-growth companies to well-established, publicly-traded corporations, the bulk of these entities are not yet a decade old. Nonetheless, TRA's resale carrier members collectively serve millions of residential and commercial customers and generate annual revenues in the billions of dollars. The emergence and dramatic growth of TRA's resale carrier members over the past five to ten years have produced thousands of new jobs and new commercial opportunities. In addition, TRA's resale carrier members have facilitated the growth and development of second- and third-tier facilities-based interexchange carriers 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.

TRA's interest in this proceeding is in protecting, preserving and promoting competition within the interstate, interexchange telecommunications services market, as well as in speeding the emergence and growth of facilities-based and resale competition in the local exchange/exchange access services market. In TRA's view, market forces are, all things being equal, generally superior to regulation in promoting the efficient provision of diverse and affordable telecommunications products and services. TRA is well aware, however, that the emergence, growth and development of a vibrant telecommunications resale industry is a direct product of a series of pro-competitive initiatives undertaken, and pro-competitive policies

adopted, by the Commission over the past decade. TRA thus understands that the market is an effective regulator only if market forces are adequate to discipline the behavior of all market participants. If one or more such participants are possessed of market power sufficient to exert control over the market, thereby impeding the competitive provision of service, regulatory intervention is essential to protect the public interest. TRA, accordingly, urges the Commission to exercise its newly-granted forbearance authority with caution, ensuring in so doing that it does not eliminate or reduce regulatory safeguards that are still necessary to protect, promote and enhance competition in the provision of telecommunications services.

The '96 Act directs the Commission to forebear from applying regulations and/or statutory provisions only if it first determines that enforcement of the requirements embodied therein is no longer necessary either to ensure the just, reasonable and nondiscriminatory provision of service or to protect consumers and that such forbearance would further the public interest.⁴ Moreover, as acknowledged by the Notice (at ¶ 17), the '96 Act requires the Commission in exercising its newly-granted forbearance authority to determine "whether forbearance will promote competitive market conditions, including the extent to which forbearance will enhance competition among providers of telecommunications services."⁵ And as further acknowledged by the Notice (at ¶¶ 1, 4), the '96 Act not only provides for not only a "de-regulatory," but a "pro-competitive . . . national policy framework,"⁶ but recognizes that

⁴ 47 U.S.C. § 160(a).

⁵ 47 U.S.C. § 160(b).

⁶ H.R. Rep. No. 104-458, 104th Cong., 2nd Sess., p. 1 (Jan. 31, 1996)

competition would be furthered by reducing or eliminating only those regulations "which may no longer be in the public interest."

Consistent with this theme, TRA strongly urges the Commission to continue to impose as a condition to non-dominant treatment of independent LEC ("ITC") provision of interstate, interexchange telecommunications services the requirement that such services be offered through a structurally-separate affiliate. TRA further urges the Commission, as it has proposed to do in its Notice of Proposed Rulemaking in CC Docket No. 96-21,⁷ to extend this requirement to the provision by the Regional Bell Operating Companies ("RBOCs") of "out-of-region" long distance services. Moreover, TRA submits that in order to ensure meaningful separation between RBOC local exchange/exchange access and interexchange operations, the separation requirements adopted in the Competitive Carrier proceeding should be strengthened in several key respects.

As the Commission has recognized, "LECs continue to exercise a substantial degree of market power in virtually every part of the country, and continue to control bottleneck facilities."⁸ Until such time as actual -- not merely theoretical -- local exchange/exchange access competition emerges, this "bottleneck" control will continue to provide LECs with the ability to act anticompetitively to disadvantage competing providers of interstate, interexchange telecommunications services. Whether the anticompetitive conduct takes the form of discriminatory access or other strategic price or service manipulation or misallocation of costs

⁷ Bell Operating Company Provision of Out-of-Region Interstate, Interexchange Services, Notice of Proposed Rulemaking, CC Docket No. 96-21, FCC 96-59 (released Feb. 14, 1996) ("BOC Out-of-Region NPRM") .

⁸ Price Cap Performance Review for Local Exchange Carriers, First Report and Order, 10 FCC Rcd. 8961, ¶368 (1995).

and/or assets between competitive and monopoly activities or other forms of cross-subsidization, the result will be the same -- competition in the interstate, interexchange telecommunications services market will be adversely effected and it will be the smaller carriers that comprise the rank and file of TRA's membership that will be most directly impacted and most seriously harmed. Thus, as TRA will demonstrate below, whatever may be the economic and administrative burdens imposed on the LECs by the structural-separation requirements, these burdens are more than offset by the compelling public interest in safeguarding competition in the interstate, interexchange telecommunications services market.

TRA agrees with and supports the manner in which the Commission proposes to define the product and geographic markets it will use in assessing market power in the provision of interstate, domestic, interexchange telecommunications services, as well as the manner in which the Commission proposes to apply these product and geographic market definitions in conducting market power analyses. With respect to geographic rate averaging and rate integration, TRA urges the Commission to implement the mandate of Section 254(g) of the '96 Act in a manner consistent with the reasonable aims of that provision, as well as with the "pro-competitive, de-regulatory national policy framework" embodied in the '96 Act generally.⁹ Certainly, geographic rate averaging and rate integration requirements should not be implemented in a manner which reduces the benefits of a competitive interstate, interexchange telecommunications services market.

⁹ H.R. Rep. No. 104-458, 104th Cong., 2nd Sess. at p. 1.

II.

ARGUMENT

A. **The Commission Should Not Only Retain, But Bolster, Structural Separation Requirements For Non-dominant Treatment Of LEC Provision Of Interstate, Interexchange Telecommunications Services**

As noted above, the Notice (at ¶¶ 56-63) seeks comment on the possible reduction or elimination of the structural-separation requirements that are currently imposed by the Commission as a condition for non-dominant treatment of LEC provision of interstate, interexchange telecommunications services. Among other things, the Notice (at ¶ 62) asks commenters to address "whether there is a possibility of cost-shifting or other anticompetitive conduct that could result if the separation requirements are modified or eliminated," as well to discuss the burdens that retention of the separation requirements would impose on LECs. TRA submits that the threat to a competitive interstate, interexchange telecommunications services market posed by the premature elimination or relaxation of the separation requirements far outweighs any burden such requirements impose on LECs and, accordingly, urges the Commission not only to retain structural separation as a condition of non-dominant treatment of LEC provision of "out-of-region" interLATA services, but to strengthen the current separation requirements to the extent recommended herein.

1. **LECs Retain Monopoly, Or Near Monopoly, Control Of Local Exchange/Exchange Access 'Bottlenecks'**

The '96 Act has eliminated all legal barriers to local exchange/exchange access competition.¹⁰ The '96 Act further provides for the dismantling of many of the practical barriers

¹⁰ 47 U.S.C. § 253.

to local competition by mandating, among other things, the deployment and/or availability of number portability, intraLATA dialing parity, unbundled access to network elements, collocation, reciprocal compensation arrangements, access to rights-of-way and unlimited resale.¹¹ "Contestable" markets, however, should not be confused with "contested" markets; while competitive potential may ultimately evolve into actual competition significant enough to discipline market power, the lag in time before competition actually emerges may, and likely will, be substantial. It belabors the obvious to suggest that the local exchange/exchange access services market cannot be deemed competitive merely because competition is no longer legally prohibited.¹²

As the Commission has recently recognized, "LECs in most parts of the country continue to exercise market power in the provision of both intrastate local exchange service and local switching and common line components of interstate switched access service."¹³ Acknowledging that "the transformation from monopoly to fully competitive markets will not take place overnight,"¹⁴ the Commission has further recognized that in addition to legal and

¹¹ 47 U.S.C. §§ 251, 271(c)(2)

¹² In the view of the United States Department of Justice ("DOJ"), "[i]t is hard to think of a market less likely to be 'contestable' than local exchange service." "Memorandum of the United States in Support of Its Motion for a Modification of the Decree to Permit a Limited Trial of Interexchange Service by Ameritech" filed in United States v. Western Electric Co., Civ. Action No. 82-0192 (HHG) on May 1, 1995 at p. 31 ("DOJ Memorandum").

¹³ Ameritech Operating Companies: Petition for Declaratory Ruling and Related Waivers to Establish a New Regulatory Model for the Ameritech Region, FCC 96-58, ¶ 66 (released February 15, 1996). In addressing the state of competition in one of the nation's largest metropolitan areas, the Commission, for example, found that "actual competition does in fact remain quite limited." As the Commission explained, "most customers in most of the Chicago LATA are still unable to choose the services of a competing provider of local exchange services." Moreover, the Commission noted that "as of January 15, 1996, no unbundled loops had been sold in Chicago." Id. at ¶77.

¹⁴ Id. at ¶ 130.

regulatory barriers, "there are also substantial technical and economic barriers to entry in local exchange markets."¹⁵ The presence of these barriers, when combined with the substantial market power possessed by LECs throughout the country, has prompted the Commission to steadfastly refuse to relax regulation "solely on the basis of market contestability."¹⁶

While stressing 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."¹⁷ According to the Common Carrier Bureau's Spring, 1996 "Common Carrier Competition" report, "competitors have begun offering switched local service in only seven states."¹⁸ Of the remaining 43 states, less than half had even partial or temporary rules in place and more than a quarter had not even initiated the rulemaking process.¹⁹ In any given geographic market, therefore, the incumbent LEC continues to be the primary, if not the sole, source of the connectivity that allows consumers within that market to communicate by telephone.

¹⁵ *Id.* at ¶ 66; *id.* at ¶ 65 ("[I]t is difficult for local exchange competition to emerge even in the absence of legal prohibitions because there are no arrangements in place governing the technical and financial aspects of interconnection between competing networks") and ¶ 72 ("[T]he development of the facilities necessary to provide competitive exchange and access services requires significant investment"); *see also* United States v. Western Electric Co., 673 F.Supp. 525, 543-44 (D.D.C. 1987), *aff'd in relevant part*, 900 F.2d 283 (D.C.Cir.), *cert denied*, 498 U.S. 911 (1990).

¹⁶ *Id.* at ¶ 72.

¹⁷ Common Carrier Bureau, "Common Carrier Competition" (Spring, 1995) ("Spring '95 Competition Report") at 5.

¹⁸ Common Carrier Bureau, "Common Carrier Competition" (Spring, 1996) ("Spring '96 Competition Report") at 3. Information about local competition in the Fall Competition Report was provided as of March 21, 1996.

¹⁹ *Id.* at 3-5.

With respect to exchange access, IXCs still rely on franchised RBOCs to originate and terminate more than 95 percent of their traffic. Indeed, in its Spring, 1995 "Common Carrier Competition" report, the Common Carrier Bureau found that the RBOCs "continue to account for 97% of access revenues -- a level roughly comparable to the Bell System's share of toll revenues in 1981."²⁰ 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."²¹ The fiber deployed by competitive access providers ("CAPs") is but a small fraction of the fiber deployed by the RBOCs.²² 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."²³ CAP facilities, where available, are still used principally for redundancy.²⁴

The reality then is that LECs retain monopoly, or near monopoly, control of local exchange "bottlenecks" and do not now face, and are unlikely to face in the near future,

²⁰ Spring '95 Competition Report at 5.

²¹ Kraushaar, J.M., Fiber Deployment Update: End of Year 1994, Urban Fiber Systems (July 12, 1995) ("Fiber Deployment Update (1994)"). 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. In commenting on the impact of competitive access providers ("CAPs"), DOJ suggests that "competition from CAPs has just begun to develop." DOJ Memorandum at p. 5.

²² Fiber Deployment Update (1994) at Urban Fiber Systems. And while the CAPs may have installed a not insignificant amount of fiber during 1994, the major LECs were installing a comparable level of fiber every two months. P. Montgomery, "Tough Road for Competition in Local Switched Service," Business Communications Review, Vol. 25, No. 3, p. 53 (March, 1995).

²³ Spring '95 Competition Report at 5.

²⁴ "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) at Urban Fiber Systems.

meaningful competition in their provision of local exchange/exchange access services.²⁵

Wireline competitors are only beginning to enter the market. And 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.²⁶ As described in The Enduring Local Bottleneck:

²⁵ The 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." Price Cap Performance Review for Local Exchange Carriers, First Report and Order, 10 FCC Rcd. 8961 at ¶ 368.

²⁶ Cellular service supplements rather than replaces local telephone service. Not only do the overwhelming majority of cellular calls transit the local exchange network, but the costs to consumers for cellular service are significantly more expensive than for local telephone service. Confirming that cellular service supplements rather than replaces local telephone service is that the impressive growth in cellular demand has not 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.

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 "bottleneck" are grossly speculative. PCS is still in its infancy. PCS service is currently available only in one market. 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 be held by RBOCs.

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.

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

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 optics transmission will alleviate these problems to some degree, it will not remedy them completely because coaxial cable is generally used to complete the transmission path to the home even in the more advanced systems. And at present, many CATV systems have not been enhanced by fiber. DOJ refers to competition from CATV provides as "largely a theoretical possibility." DOJ Memorandum at p. 5.

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.²⁷

This assessment was recently reconfirmed in The Enduring Local Bottleneck II: A Preliminary Assessment published in January, 1996.²⁸

[T]he overall findings in the earlier report appear to be equally valid today. Local telephone company predictions about the imminent arrival of effective competition are as inaccurate today as they were two years ago. The degree of local competition is still trivial, as demonstrated by an analysis of structure, conduct and performance in the market. There have been no cost breakthroughs in the technologies available to competitors that would suggest the investment results found in [The Enduring Local Bottleneck] will substantially change. Nor have any hypothetical "volume production" cost reductions materialized, because these technologies are not yet in mass production.

²⁷ Economics and Technology, Inc. and Hatfield Associates, Inc., The Enduring Local Bottleneck: Monopoly Power and the Local Exchange Carriers, at i-ii, (1994) ("The Enduring Local Bottleneck").

²⁸ Hatfield Associates, Inc., The Enduring Local Bottleneck II: A Preliminary Assessment, at ii, (1996) ("The Enduring Local Bottleneck II").

2. **LEC Control Of Local Exchange/Exchange Access 'Bottlenecks' Can Be Leveraged To Disadvantage Competitors Of LEC Affiliates Providing Interstate, Interexchange Telecommunications Services**

In applying the dominant/non-dominant dichotomy, the Commission has in the past treated the interstate, interexchange telecommunications services market as national in scope.²⁹ Similarly, the Notice tentatively concludes (at ¶¶ 51-53) that "in most cases, [the Commission] should continue to treat interstate, interexchange services as a single national market when examining whether a carrier or group of carriers acting together has market power." Hence, LECs are in a position to leverage their "bottleneck" power to disadvantage competing providers of long distance telecommunications services that are dependent on them for access within their respective local exchange service areas in ways that would injure those entities in the national interstate, interexchange telecommunications services market. And, of course, the potential for misallocation of costs and/or assets between LEC competitive and monopoly activities would not be eliminated merely by differentiating between "out-of-region" and "in-region" long distance services. Moreover, the "mobile bottleneck" would be implicated to the extent that LEC wireless affiliates offer long distance telecommunications services in conjunction with their cellular and other wireless offerings within their landline affiliates' respective local service areas.

In the First Report and Order issued in its Competitive Carrier proceeding, the Commission cited three reasons for classifying AT&T as a dominant carrier, one of which was AT&T's "control of bottleneck facilities:"

²⁹ In the Matter of AT&T Corp. to be Reclassified as a Non-Dominant Carrier, FCC 95-427 (released October 23, 1995) ("AT&T Non-dominance Order"); *see also* United States v. Western Electric Co., 673 F.Supp. 525, 543-44 (D.D.C. 1987), *aff'd in relevant part*, 900 F.2d 283 (D.C.Cir.), *cert denied*, 498 U.S. 911 (1990); United States v. Western Electric Co., 1989-1 Trade Cases (CCH) ¶ 68,619, 61,266 (D.D.C. June 11, 1989).

Currently, the Bell System controls access to over 80% of the nation's telephones. Since many of AT&T's competitors must have access to this network if they are to succeed, AT&T possesses control of bottleneck facilities. Therefore, we believe that AT&T must be treated as dominant.³⁰

While individual LECs may each control only a fraction of the access lines nationwide, the extent of their control of access facilities within their respective local service areas exceeds by a substantial margin the 80 percent figure referenced by the Commission above. And as the Commission has acknowledged, the LECs' interexchange competitors will have no choice but to terminate calls over these "in-region bottleneck" facilities. "A Regional Company that competes against such providers everywhere except in its region would not find it difficult to discriminate against such a provider in its region, thereby damaging the competitor's service and reputation on a national basis."³¹ Bottleneck control even within a confined geographic area provides an LEC with the ability to not only interfere with a rival interexchange provider's customer relations, but to increase such rival's costs of doing business both directly through strategic pricing of

³⁰ 85 F.C.C.2d 1 at ¶ 62. As explained by the Commission: "An important structural characteristic of the marketplace that confers market power upon a firm is the control of bottleneck facilities. A firm controlling bottleneck facilities has the ability to impede access of its competitors to those facilities. We must be in a position to contend with this type of potential abuse. We treat control of bottleneck facilities as prima facie evidence of market power requiring detailed regulatory scrutiny. " *Id.* at ¶ 58

³¹ United States v. Western Electric Co., 1989-1 Trade Cases (CCH) ¶ 68,619, 61,266 (D.D.C. June 11, 1989) ("If, for example, the Miami Herald were to decide to operate a nationwide electronic publishing operation but BellSouth engaged in discrimination and harassment with respect to the Herald's southern operations similar to that which, according to the trial evidence, AT&T was guilty of in the long distance and manufacturing fields, the Herald's customers would soon tire of it and switch to the steadier, more reliable information service of BellSouth or that of another Regional Company. This risk would be multiplied if several or all Regional Companies were engaged in "out-of-region" information services, for it would be to the obvious economic advantage of all of them to eliminate the independent information services providers by parallel action.").

access or indirectly through anticompetitive service manipulation -- *e.g.*, limiting access to certain types of signalling information associated with call termination.³²

With respect to long distance services provided in conjunction with CMRS service offerings, the concern is even more immediate. Many LEC cellular properties are located within their respective local service areas. Given that the vast bulk of calls originating and terminating on cellular systems pass through the local exchange, an LEC operating a cellular system within its local service area will be in a position to indirectly exercise "bottleneck control" with respect to cellular-originated/terminated interexchange calls. This indirect control has been termed the "mobile bottleneck."³³

[T]he "Mobile Bottleneck" gives the local companies (usually the Regional Companies) the ability to control a part of virtually every interexchange cellular call, just as the Landline Bottleneck gives these companies similar, albeit more complex, control over every wired interexchange call.

And this control of course raises many of the same concerns that the more traditional local exchange/exchange access bottleneck presents:

This Mobile Bottleneck control would be critical if the Regional Companies were allowed also to carry cellular calls on a long distance basis; these companies would then have both the power and the incentive to use this control against their competitors in the cellular long distance business. This potential discrimination directly parallels the discrimination that led to the interexchange restriction in the first place. In this way, the Mobile Bottleneck on the surface raises the same dangers as does the Landline Bottleneck.³⁴

³² Anticompetitive service manipulation opportunities at the termination end of a telecommunications service have expanded as the interface between the IXC and the terminating LEC has grown increasingly more sophisticated, particularly with respect to the delivery of signalling information.

³³ United States v. Western Electric Co., 890 F.Supp. 1, 3 (D.D.C. 1995)

³⁴ Id.

Competitive concerns are not, however, limited to anticompetitive price and service manipulation; misallocation of costs and/or assets associated with LEC long distance activities to LEC monopoly operations could well be more detrimental to competition in the interstate, interexchange telecommunications services market. And while structural separation has probably rendered such cross-subsidization somewhat more difficult, the potential continues to exist.

In large and complex organizations, wrongful cost/asset-shifting between competitive and monopoly activities in adjacent markets can take on myriad forms. Such a cross-subsidy would occur anytime an LEC confers on its long distance operation a benefit derived from its monopoly local exchange activities without adequate compensation to the monopoly sector. Such a benefit could take the form of transfers of (i) capital, (ii) facilities or equipment, (iii) personnel, (iv) research and development, (v) services or (vi) any of a variety of other items. Adequate compensation could be defined in any number of conflicting and contradictory ways. Accounting systems could be established, reports required and an occasional audit conducted to determine what benefits, at what value and for what compensation, were being conferred, but it would be fanciful to think that overburdened regulators with budgets a fraction of the size of the entities they were regulating would 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 "hard-to-detect" wrongful cost/asset-shifting opportunities available to LECs, each of which would present a unique, and often insurmountable, problem for federal and state regulators. For example, cross-subsidies could occur with a shift in the boundary between competitive and monopoly activities. Strategic investments could be made by an LEC with the full expectation and/or knowledge that the regulatory status of the activities in which the investments were being made would be changed. Another illustration would be the use of monopoly resources to

construct facilities which while usable in association with monopoly operations, could ultimately be employed in conjunction with competitive activities -- e.g., interLATA transmission facilities used for "administrative intra-company transactions," but ultimately usable by the LECs to provide interexchange telecommunications services.³⁵ Transfer or loan of personnel recruited and trained at the expense of LEC monopoly operations to LEC long distance activities and funding of research and development by LEC monopoly operations are yet other examples of hard-to-detect cross-subsidization, as are cost and asset misallocations between monopoly and competitive activities based on the relative use of an asset each rather than by the economic rationale for the acquisition of that asset.

In short, their continued control of local exchange/exchange access "bottleneck" positions LECs -- and the RBOCs in particular -- to disadvantage interexchange rivals even if LECs continue to offer such services only through structurally-separate affiliates, as required by the Commission's current rules, and even if the RBOCs were to provide only "out-of-region" long distance services. The Commission recognized as much in its Competitive Carrier Fifth Report and Order when it elected to regulate as dominant RBOC provision of interstate, interexchange telecommunications until such time as an assessment of market power had been undertaken and a review of potential structural safeguards designed to curb the abuse of such power had been completed.³⁶

³⁵ As the authors of The Enduring Local Bottleneck point out, the RBOCs have over the years deployed extensive interLATA digital network switching and fiber optic transmission plant whose potential traffic-carrying capacities greatly exceed the RBOCs' internal needs. While these networks were purportedly constructed for the RBOCs' own "Official Service functions," they will likely provide the backbone for the RBOCs' in-region long distance service networks.

³⁶ 98 F.C.C.2d 1191 at ¶ 9. fn. 23.

The question then is not whether the potential for anticompetitive conduct exists, but rather what measures should be taken to protect against such activities. As the Commission has recently recognized, it must "ensure that sufficient regulatory safeguards are in place to prevent a BOC from gaining any unfair competitive advantage, either through unreasonably discriminatory practices or cross-subsidization, that could arise because of its ownership and control of local exchange facilities."³⁷ Thus the Commission recently explained in dealing with the ramifications of a geographically-limited, well safeguarded entry by an RBOC into the interstate, interexchange telecommunications market that:

We recognize that the transformation from monopoly to fully competitive markets will not take place overnight. We also realize that the steps taken thus far will not result in the immediate arrival of fully-effective competition. Accordingly, the Commission and state regulators must continue to ensure against any anticompetitive abuse of residual monopoly power, and to protect consumers from the unfettered exercise of that power.³⁸

Certainly, structural separation is not a panacea. Separate subsidiaries often provide useful tools, particularly when used to complement other safeguards, in protecting against discrimination and cross-subsidization. But, as noted above, in complex organizations of the size, and with the resources, of the RBOCs and other large LECs, identifying and preventing misallocations of costs and/or assets between competitive and monopoly activities in adjacent markets presents difficult, and often insurmountable, problems for federal and state regulators. While use of separate subsidiaries makes it somewhat easier to track and document cost allocations and asset transfers, policing the myriad means by which an LEC could act

³⁷ RBOC "Out-of-Region" NPRM, FCC 96-59 at ¶ 7.

³⁸ Ameritech Operating Companies: Petition for Declaratory Ruling and Related Waivers to Establish a New Regulatory Model for the Ameritech Region, FCC 96-58 at ¶ 130.

anticompetitively nonetheless requires a massive commitment of regulatory resources. Given that Commission resources are stretched thinner today than perhaps at any prior time in the agency's history,³⁹ it is questionable whether the Commission has the funds, personnel and other tools necessary for this task.⁴⁰ Nonetheless, structural separations would render regulatory oversight far easier and more effective than nonstructural safeguards.

3. Current Structural Separation Requirements Should Be Strengthened To Account For The Substantial New Threat To Competition Posed By RBOC Entry Into The Interstate, Interexchange Telecommunications Services Market

In light of the LECs' retention of monopoly, or near monopoly, control of local exchange/exchange access "bottlenecks" and given that such "bottleneck" control positions LECs to disadvantage rival providers of interstate, interexchange telecommunications services, TRA submits that it is imperative that the Commission continue to condition non-dominant treatment of LEC provision of long distance telecommunications services on the structural separation of LEC local exchange/exchange access and interexchange operations as a necessary safeguard against anticompetitive conduct. This need is rendered all the more compelling by the entry of the RBOCs -- who collectively control more than 80 percent of local exchange/exchange access

³⁹ Statements of Reed E. Hundt, Chairman of the Federal Communications Commission, before the Subcommittee on Commerce, Justice and State, the Judiciary and Related Agencies, Committee on Appropriations, U.S. House of Representatives (March 22, 1996).

⁴⁰ For example, in a study of FCC auditing capabilities conducted in 1993, the General Accounting Office ("GAO") reported that the staff resources it had found inadequate six years earlier had declined while the agency's responsibilities for overseeing carriers' cost allocations had grown. It was GAO's assessment that "the number of FCC auditors remains inadequate to provide a positive assurance that ratepayers are protected from cross-subsidization." Indeed, GAO estimated that the FCC would only be able to conduct audits of the highest priority matters, and to undertake a full audit of major LECs once every 11 and 18 years, respectively. GAO, FCC Oversight Efforts to Control Cross-Subsidization, GAO/RCED-93-34 (Feb. 1993)

facilities nationwide -- into the interstate, interexchange telecommunications services market. As noted earlier, the '96 Act requires, and the Notice recognizes, that the impact of forbearance on both competition and the strong public interest inherent in maintaining a competitive marketplace for telecommunications services should be given considerable weight in the Commission's determination of whether forbearance is appropriate in a given instance. And as the '96 Act and the Notice further acknowledge, forbearance is only appropriate in circumstances in which a regulation has become outmoded or otherwise rendered unnecessary. As TRA has shown above, that certainly is not the case here and will not be the case unless and until meaningful local exchange/exchange access competition emerges on a nationwide scale.

In conjunction with such structural separation, TRA urges the Commission, at a minimum, to retain the current Competitive Carrier separation requirements as conditions to non-dominant treatment of LEC provision of interstate, interexchange telecommunications services. To this end, TRA urges the Commission to continue to require all LECs and their long distance services affiliates to (i) maintain separate books of account, (ii) refrain from joint ownership of transmission and/or switching facilities, and (iii) acquire from one another telecommunications services, including exchange and exchange access services, at tariffed rates and under tariffed terms and conditions. TRA further urges the Commission, as it has proposed to do with respect to the RBOCs in CC Docket No. 96-21,⁴¹ to treat LEC out-of-region long distance services

⁴¹ RBOC "Out-of-Region" NPRM, FCC 96-59 at ¶ 13.

affiliates as "non-regulated affiliates" under the Commission's joint cost rules⁴² and affiliate transaction rules⁴³ for exchange carrier accounting purposes.

Separate books of account are necessary to trace and document misallocations of costs and/or assets between an LEC and its long distance services affiliate, making it more difficult to disguise such wrongful transactions, as well as discriminatory conduct. Prohibitions against joint ownership of transmission and/or switching facilities are necessary to safeguard against the most difficult to police of non-regulated/regulated cost/asset misallocations -- *i.e.*, allocation among multiple users of common facilities by extent of usage. Further, the continuation of the requirement that network services be provided to LEC long distance affiliates under tariff is essential to the facilitation "arm's-length" dealings and minimization of opportunities to engage in discrimination and abusive transfers of services at less than market price.⁴⁴

Treating LEC long distance services affiliates as non-regulated entities in applying the Commission's joint cost and affiliate transaction rules should safeguard against the most blatant cost misallocations and/or wrongful asset transfers, providing established standards and

⁴² 47 C.F.R. §§ 64.901-904; Separation of Costs of Regulated Telephone Service from Costs of Nonregulated Activities, 2 FCC Rcd. 1298 (1987).

⁴³ 47 C.F.R. §§ 32.27.

⁴⁴ A requirement that LEC long distance affiliates take network service under tariff, however, addresses but one of a number of associated problems. Given that access rates are set substantially above cost, LECs will be able to inflate long distance rivals' costs while at the same time securing huge profits for themselves. As the record in CC Docket No. 94-1 establishes, access charges currently recover roughly three times the RBOCs' unrecovered economic cost of providing loop and switching services and facilities. *See* Comments of MCI Telecommunications Corporation filed in CC Docket No. 94-1 on December 11, 1995. Further complicating this matter is the ability of non-dominant carriers to file tariff changes on a single day's notice and without cost support. Such relaxed tariff filing requirements will render it virtually impossible for the Commission or interested parties to ascertain whether LEC long distance services affiliates are indeed taking network services under tariff.

generating a discernible and comprehensible paper trail.⁴⁵ The affiliate transaction rules, however, contain a number of loopholes which should be closed for this and other purposes. For example, valuation rules applicable to asset transfers are not applied to transfers of service, "prevailing company" pricing to non-regulated affiliates are inadequately constrained, and the manner in which the "cost" of services is calculated, including the determination of the appropriate profit factor, requires reformation.

As noted above, TRA also urges the Commission to enhance its Competitive Carrier separation requirements as they apply to LEC provision of interstate, interexchange telecommunications services. Among other things, TRA recommends that the Commission (i) require separation of the credit underlying the long distance services affiliate from that which supports the LEC and in so doing prohibit credit arrangements which would allow recourse to the assets of the LEC in association with funding provided to the long distance affiliate; (ii) prohibit the sharing of office space and personnel, requiring the LEC and the long distance services affiliate to maintain separate offices and to hire/appoint separate officers, directors and employees; (iii) consistent with the dictates of Section 222 of the '96 Act, prohibit the sharing of customer proprietary network information and other confidential information obtained solely by virtue of either the LEC's or the long distance services affiliate's role as a provider of

⁴⁵ The immediate need for this latter proposal is made all the more compelling by the disturbing, but predictable, findings of audits of LEC regulated/non-regulated relationships undertaken by the Commission over the past few years. *See, e.g., Southwestern Bell Telephone Co.*, AAD 95-32, FCC 95-31 (released March 3, 1995) (lack of supporting documentation for time charged by employees of one affiliate for another, use of improper marketing allocators, improper use of the general allocator, and intra-corporate provision of services at prevailing company rates which were not reflective of costs); Ameritech Operating Companies, AAD 95-75, FCC 95-223 (released June 23, 1995) (failure to provide adequate documentation supporting assignment of costs associated with a non-regulated affiliate to regulated operations); The GTE Telephone Operating Companies, AAD 94-35, FCC 94-15 (released April 8, 1994) (misallocation of costs between non-regulated and regulated activities); BellSouth Corporation, AAD 93-127, FCC 93-487 (released October 29, 1993) (misallocation of costs between non-regulated and regulated activities).