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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
	)	
Implementation of Section 254(g) of the Communications Act of 1934, as amended	)	

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To: The Commission

COMMENTS OF BELLSOUTH (PHASE II)

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SUMMARY

BellSouth supports the detariffing of interstate interexchange services. While this is a necessary precondition to the development of a competitive interstate interexchange marketplace, it will not suffice to cure the lack of true competition that exists in today's interexchange services. Three companies—AT&T, MCI, and Sprint—currently have virtually the entire interexchange market to themselves and have acted as an oligopoly, pricing above competitive levels.

BellSouth submits extensive evidence concerning the tacit price coordination of the big three IXCs. Declarations by Professors Jerry Hausman and Paul MacAvoy, and a prepublication copy of THE FAILURE OF ANTITRUST AND REGULATION TO ESTABLISH COMPETITION IN LONG-DISTANCE TELEPHONE MARKETS, a new book by Prof. MacAvoy, are submitted with these comments, documenting that there is no meaningful price competition and MCI and Sprint repeatedly follow the upward pricing moves of the price leader, AT&T. The evidence shows conclusively that:

- The big three IXCs have engaged in lock-step price increases throughout the 1990s, despite decreasing costs. The big three IXCs have not reduced prices in response to lowered access costs. Indeed, AT&T itself states that its margins have increased due to lower access costs. From January 1990 through August 1995, the IXCs' costs dropped at least 12%, due to a 27% reduction in access charges, yet interexchange prices did not reflect these decreases. Similarly, a 50% reduction in California intrastate access charges in 1995 lowered IXCs' costs by 40%, but the big three IXCs left their prices virtually unchanged, increasing their profit margins by 20%. Moreover, AT&T's 1993 price increase, which was based solely on an AT&T-specific change in regulatory accounting costs, was immediately followed by MCI and Sprint price increases, even though MCI's and Sprint's costs were essentially unchanged. Such price leadership behavior is found in oligopolies with a low level of competition.

- Incumbent IXCs' price-cost margins have been increasing, which would not have been possible in the absence of tacit price collusion.

- The IXCs' discount plans do not affect the conclusion that the market is characterized by tacit collusion. First, most residential customers are not on a discount plan, so they pay the "list price," which the big three IXCs have repeatedly increased in lock-step. Second, per-minute revenues have increased for both discount and non-discount customers. Third, the big three IXCs' price-cost margins for discount plans are nearly as high as for their non-discount plans. Finally, the discount plans are set up as discounts off standard rates, so that the discount rates are increased when the IXCs engage in their lock-step increases in standard rates. Accordingly, discounts do not break down the collusive pricing pattern found in interexchange service generally.

- The existence of interexchange resale carriers cannot curtail the ability of facilities-based carriers to exercise market power, because resellers have minimal pricing flexibility.

BellSouth supports the mandatory detariffing of all domestic interstate interexchange services. Tariff filings disserve the public interest by interfering with the functioning of a competitive market—they delay pricing and quality initiatives and competitive responses, they create opportunities for regulatory intervention that impedes competition, they impose substantial costs, and they otherwise act as a damper on a competitive marketplace. More importantly, tariff filings facilitate the tacit collusion in which the big three IXCs have engaged, to the detriment of consumers. Removal of tariffs will reduce carriers' ability to coordinate prices.

New Section 10(a) of the Communications Act requires the Commission to forbear from tariff regulation. First, enforcement of the tariff requirement is not necessary to ensure just and reasonable rates and practices—indeed, it facilitates lock-step price increases. Second, enforcement of the tariff requirement is not ultimately necessary for consumer protection, given the eventual entry of the BOCs into interexchange services. Non-tariff arrangements may be more effective ways to inform consumers about IXC rates and services than cryptic references to tariffs on file in Washington, D.C. In the short term, detariffing may allow the incumbent IXCs to engage in some price increases. The Commission, therefore, should minimize the IXCs' incentives to do so by moving swiftly to authorize BOC entry, which will place competitive constraints on the IXCs' ability to raise prices. Finally, mandatory detariffing will serve the public interest by allowing carriers to respond quickly to competitive conditions and by eliminating the means by which AT&T, MCI, and Sprint have been able to engage in tacitly collusive pricing that harms consumers.

Detariffing is a necessary but not sufficient condition for a competitive interexchange market. Detariffing alone will not suffice to make the market competitive. AT&T will likely continue to preannounce its price moves, and MCI and Sprint may continue to follow AT&T's lead. The way to end the interexchange oligopoly is to add more competitors by facilitating entry by facilities-based carriers. The BOCs, once permitted to enter this market, are positioned to set prices independently and could disrupt the tacitly collusive price structure of today's interexchange market. Shielding AT&T, MCI, and Sprint from BOC competition does not serve the public interest—it hurts consumers. BOC entry into interexchange services will ultimately result in lower prices, saving consumers more than $24 billion per year

Allowing competitive BOC entry is the best solution to the tacit collusion of the big three IXCs. Accordingly, the Commission should move swiftly and effectively to implement Section 271 and open up interexchange competition to BOC entry

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COMMENTS OF BELLSOUTH (PHASE II)

BellSouth Corporation ("BellSouth"), by its attorneys, hereby submits these comments in response to Sections III, VII, VIII, and IX of the Commission's *Notice of Proposed Rule Making*, CC Docket No. 96-61, FCC 96-123 (released Mar. 25, 1996), *summarized*, 61 Fed. Reg. 14,717 (1996) ("*NPRM*"). In these sections, the Commission has asked for comment on the detariffing of interexchange services through regulatory forbearance pursuant to the Telecommunications Act of 1996 (the "1996 Act"),[1] the issue of tacit price coordination by interexchange carriers ("IXCs"), and other issues.

BellSouth supports the detariffing of interstate interexchange services. While this is a necessary precondition to the development of a competitive interstate interexchange marketplace, it will not suffice to cure the lack of true competition that exists in today's interexchange services. Three companies—AT&T, MCI, and Sprint—currently have virtually the entire interexchange market to themselves and have acted as an oligopoly, pricing above competitive levels. Their only

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

"competition" consists of hundreds of far smaller companies with minimal market share; these companies resell the service of the big three or operate facilities-based networks within very limited geographical regions. As long as the big three are protected from competition from substantial telecommunications firms such as the Bell Operating Companies ("BOCs"), the market will continue to perform as an oligopoly, in which the big three can continue their practice of pricing above competitive levels and raising prices in lock-step, as they have done on repeated occasions despite steadily reduced costs, to the detriment of consumers. The solution to this less than fully competitive market is not simply to eliminate tariff regulation, but, in addition, to eliminate barriers to competitive entry and end the incumbents' ability to engage in tacit collusion.

Congress recognized in passing the Telecommunications Act of 1996 that the entry of the BOCs into interexchange service will end the structural problems that characterize the market today. Indeed, *the Commission itself has long supported BOC interexchange entry as a way of making interexchange telecommunications truly competitive.*[2] Thus, while BellSouth supports the Commission's attempt in this proceeding to reduce barriers to the emergence of a competitive inter-exchange market, true competition must await the Commission's proceeding to implement Section 271 of the 1996 Act.

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[2] *See United States v. Western Elec. Co.*, Civ. Action No. 82-1092 (D.C. Cir.), Brief of the FCC as Amicus Curiae on Question No. 1 on Stipulation and Modification of Final Judgment at 11 (June 14, 1982); *see also* Brief of the FCC as Amicus Curiae on Stipulation and Modification of Final Judgment at 30, 53-54 (Apr. 20, 1982); Reply Comments of the FCC as Amicus Curiae (Nov. 30, 1987).

I. DETARIFFING IS NECESSARY BUT NOT SUFFICIENT TO ESTABLISH A COMPETITIVE INTEREXCHANGE MARKET; ELIMINATION OF BARRIERS TO BOC INTEREXCHANGE ENTRY IS NECESSARY BEFORE THERE CAN BE TRUE COMPETITION

The Commission acknowledged in the *NPRM* that there is evidence that existing IXCs have engaged in "alleged tacit price coordination" with respect to residential services and that mandatory detariffing will "discourage price coordination by eliminating carriers' ability to ascertain their competitors' interstate rates and service offerings from publicly available tariffs."[3] When Congress was faced with these facts, it ended the MFJ's long-standing bar to BOC entry into interexchange service and established criteria for allowing BOC entry. Accordingly, the Commission found that "the best solution" to any tacit price coordination that may exist is the fact that the 1996 Act "allow[s] for competitive entry in the interstate interexchange market by the facilities-based BOCs and others."[4]

BellSouth agrees with this conclusion. As shown herein, there is extensive evidence that the incumbent IXCs have long engaged in tacit price coordination with respect to residential services and that even their business rates have been less than fully competitive. Tariff filings facilitate this tacit collusion and clearly should be eliminated. Detariffing alone, however, will not end the long-distance oligopoly. Only the entry of substantial viable new competitors, such as the BOCs, will end the opportunities and incentives of the IXCs to engage in cartel-like behavior and make truly competitive interexchange service available to residential and business consumers alike.

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3 *NPRM* at ¶ 81.

4 *Id.*

A. Domestic Interstate Interexchange Telecommunications Is Currently an Oligopolistic Market Characterized by Tacit Collusion and Oligopoly Pricing, to the Detriment of Consumers

There is substantial evidence that the domestic interstate interexchange market is not highly competitive and is, essentially, an oligopoly of the big three IXCs—AT&T, MCI, and Sprint—in which there is no meaningful price competition and MCI and Sprint repeatedly follow the upward pricing moves of the price leader, AT&T. BellSouth has included herewith extensive documentation demonstrating the noncompetitive nature of the interexchange market. Specifically, BellSouth submits a declaration by Jerry A. Hausman, McDonald Professor of Economics at MIT,[5] and an affidavit by Professor Paul MacAvoy, Williams Brothers Professor of Management Studies at the Yale School of Management.[6] Appended to Prof. MacAvoy's review is a prepublication copy of his forthcoming book, THE FAILURE OF ANTITRUST AND REGULATION TO ESTABLISH COMPETITION IN LONG-DISTANCE TELEPHONE MARKETS.[7] In the following discussion, BellSouth addresses the principal points made by Profs. Hausman and MacAvoy. Their full statements, as well as Prof. MacAvoy's book, are incorporated herein and made part of the record of this proceeding.

Profs. Hausman and MacAvoy both conclude that there has been "tacit collusion" or "coordinated interaction" among the big three IXCs. Prof. Hausman states:

> Coordinated interaction has been long discussed by economists as an example of non-competitive oligopoly behavior. The *DOJ and FTC Horizontal Merger Guidelines* describe coordinated interaction as follows: "Coordinated interaction is comprised of actions by a group of firms that are profitable for each of them only as a result of the

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5 Declaration of Prof. Jerry A. Hausman ("Hausman"), appended as Exhibit A hereto.

6 Declaration of Paul W. MacAvoy ("MacAvoy"), appended as Exhibit B hereto.

7 Paul W. MacAvoy, THE FAILURE OF ANTITRUST AND REGULATION TO ESTABLISH COMPETITION IN LONG-DISTANCE TELEPHONE SERVICE MARKETS (1996) ("COMPETITION IN LONG-DISTANCE"), reproduced as an attachment to Exhibit B (uncorrected page proofs, reprinted with the permission of The American Enterprise Institute for Public Policy Research, Washington, D.C.).

> accommodating reactions of the others. This behavior includes tacit or express collusion, and may or may not be lawful in and of itself." *The pricing behavior of the 3 major long distance carriers satisfies this description extremely well. AT&T, MCI, and Sprint have engaged in "lock-step" pricing with 7 price increases over the past 4 years.* Each time the pattern has been the same. AT&T has announced a price increase, and both MCI and Sprint have followed with their own price increase, by virtually the same amount, almost immediately. Note that AT&T's price increases have required the "accommodating reactions" of MCI and Sprint. Given their modern fiber optic networks, if MCI and Sprint had not raised their prices along with AT&T, it is likely that sufficient customers would have switched from AT&T to either MCI or Sprint to force AT&T to rescind its price increase. However, *MCI and Sprint each time decided that it would be profitable to follow AT&T's price increase. Residential customers have been forced to pay the increase in prices each time.*[8]

The lock-step pricing results from AT&T's price leadership, according to Prof. Hausman, who observes that tacit collusion through "price leadership" results from noncompetitive markets under well-established conditions:

> "Price leadership implies a set of industry practices or customs under which list price changes are normally announced by a specific firm accepted as the leader by others, who follow the leader's initiatives. . . . [C]ollusive price leadership is most likely to emerge when five conditions co-exist: The industry is tightly oligopolistic, the sellers' products are close substitutes, the oligopolists' cost curves are similar, there are barriers to the entry of new competitors, and demand for the industry's output is relatively inelastic (so that price raising pays)."[9]

Prof. Hausman concludes that today's interexchange market satisfies these conditions: "(1) 3 firms control about 85% of output; (2) the products are nearly perfect substitutes; (3) the cost curves are similar because the technology used is similar; (4) huge barriers to entry exist because of the requirement of hundreds of millions of dollars to construct a fiber optic network; and (5) demand

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8 Hausman at 3-4 (citations and footnote omitted) (emphasis added).

9 Hausman at 7 (*quoting* F.M. Scherer, INDUSTRIAL MARKET STRUCTURE AND ECONOMIC PERFORMANCE 176 (2d Ed. 1980).

is relatively inelastic, as AT&T itself has stated in previous filings and econometrics has demonstrated."[10]

Prof. MacAvoy echoes this conclusion, finding that the necessary structural requirements for tacit collusion "*all exist in markets for long-distance telecommunications services*."[11] He concludes:

> [T]he three large facilities-based carriers AT&T, MCI, and Sprint account for more than 80 percent of toll revenues. During the period 1984 to 1989, AT&T's market shares in the provision of message toll service ("MTS"), inbound wide-area telecommunications service (inbound WATS), outbound WATS, and virtual network services declined as the shares of MCI and Sprint increased. During the period 1990 to the present, the decline in AT&T's market shares slowed and the shares of the three carriers stabilized. The three firms offer essentially identical packages of services under publicly available terms, and their marginal costs are virtually identical (access charges they pay to local exchange carriers, by Federal Communications Commission policy, are the same, and the remainder of costs incurred in day-to-day operations is also quite similar given their use of fiber-optic transmission and switching systems). Barriers to entry are substantial given the large sunk costs of the fiber-optic systems now in place and dominated by significant excess capacity.[12]

Having concluded that the structural conditions for tacit collusion exist, Prof. MacAvoy then examined the competitiveness of IXC pricing behavior by determining each major carrier's price-cost margin, a measure of market power, and reviewed how these price-cost margins were affected when concentration in market shares declined. Prof. MacAvoy posited the use of the single, definitive test of competitive behavior in economics: "when there is competition, and more competition over time, price-cost margins are lower and they decline over time. Carrier

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10 Hausman at 7-8.

11 MacAvoy at 2-3 (emphasis added).

12 MacAvoy at 3 (footnote omitted).

concentration has declined in long-distance telecommunications markets. Carriers' price-cost margins also should have declined unless they successfully prevented the diminution of their market power through tacit price collusion."[13]

In conducting this test, Prof. MacAvoy conducted an extensive review of evidence including the big three IXCs' FCC tariffs[14] and AT&T testimony concerning its marginal costs.[15] He concludes that the evidence of tacit price collusion is clear and convincing:[16]

> *[D]espite large declines in seller concentration in long-distance markets, the price-cost margins of AT&T, MCI, and Sprint increased over the last ten years.* The largest increases were in the early and mid 1990s, when market shares of the three carriers had stabilized. This result held for MTS, inbound WATS, outbound WATS, and virtual network services provided in the U.S.[17]

In his book, Prof. MacAvoy further analyzes the evidence from a wide variety of long-distance telecommunications markets, which paints a clear picture of tacit collusion in price-setting behavior on the part of AT&T, MCI, and Sprint:

> [B]y 1990, AT&T's then-reduced shares provided an increased threat of credible price reductions. The importance to AT&T of maintaining prices for existing customers had diminished, while the importance of reducing prices to profit from adding customers had increased. At the same time, MCI and Sprint's larger shares provided more incentive for them to match AT&T's prices, since cuts they would make otherwise left their relatively new but now established customer base less profitable. Thus, emerging coordination provided the basis for each carrier setting higher price-cost margins in long-distance markets in the 1990s.

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13 MacAvoy at 4.

14 *See* COMPETITION IN LONG-DISTANCE, chapter 5; MacAvoy at 5 & n.5.

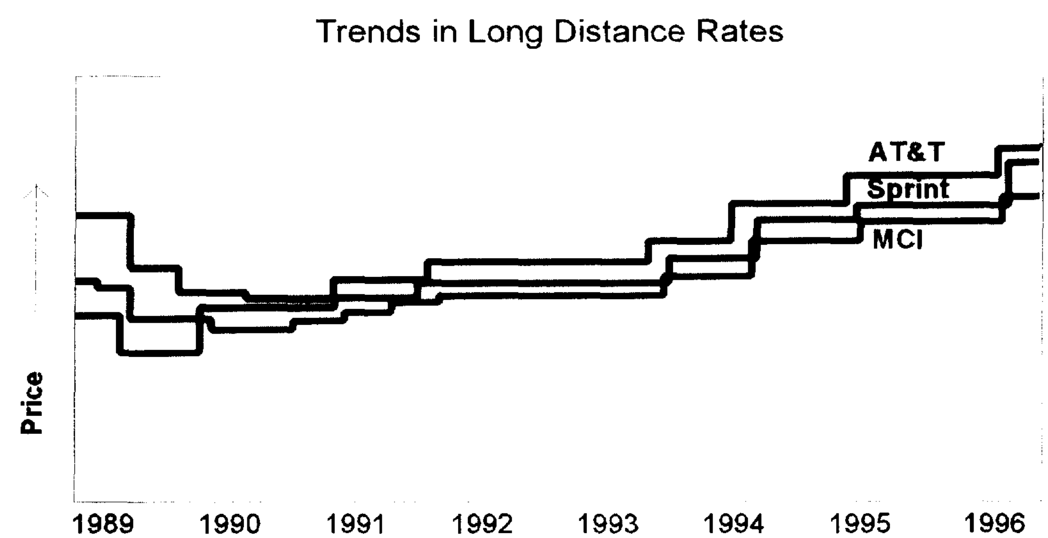
15 *See* MacAvoy at 5 & n.6.

16 MacAvoy at 26.

17 MacAvoy at 5-6 (footnote omitted).

> That price-cost margins increased in all major long-distance service markets confounds propositions about increasing "competitiveness." Changes in regulation—the setting of uniform access charges, and the establishment of price-cap regulation—made regularization of price formation possible in the tariff submissions of the three carriers. The dynamic behavior of margins in the early 1990s provides evidence that the three major carriers were able to establish coordinated strategies over that period in place of competition.[18]

Prof. Hausman demonstrates graphically that AT&T, MCI, and Sprint have engaged in lock-step pricing in Exhibit 2 to his declaration, the essence of which is reproduced here:[19]



Prof. Hausman observes that this pattern of lock-step price increases was not based on increases in economic costs

> Each time AT&T announced a price increase, MCI and Sprint followed. The remarkable economic fact about most of these price increases was that they were not the result of changes in AT&T's

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18 COMPETITION IN LONG-DISTANCE at 180

19 While this chart depicts moves in the standard "list prices" for interexchange service of the big three IXCs, the carriers' discounted rates are generally referenced to the standard rates. Thus, when standard rates increase, the discounted rates also increase. *See* discussion starting on page 11, *infra.*

> economic costs. Instead, they were the result of changes in the FCC price cap regulation of AT&T, which allowed for price increases . . . because of non-economic accounting regulation changes.[20]

He notes, for example, that in 1993, the adoption of accrual accounting for certain AT&T post-retirement benefits resulted in a $200 million increase in AT&T's price cap index. AT&T raised its residential rates by about 1% and its commercial rates by about 3.9%, after which "MCI and Sprint almost immediately matched AT&T's rate increases," even though their accounting costs did not change significantly.[21] Prof. Hausman explains:

> [I]ndividual firms cannot raise prices in response to cost changes that are unique to that firm in competitive models of price formation; rather, industry prices can only rise in response to general increases in true economic costs for all firms. Any price increase based upon firm-specific cost changes would prove unprofitable for that firm in a competitive model, as consumers would switch in sufficient numbers to competing firms to render the price increase unprofitable.[22]

Thus, Prof. Hausman states, "[e]vidence of pricing behavior to the contrary suggests non-competitive price formation. . . . MCI and Sprint must follow AT&T's price increases for AT&T's announced price increases to be profitable [to AT&T]."[23] The fact that MCI and Sprint "followed along" after AT&T's 1993 price increase is a "troubling outcome," because

> MCI's and Sprint's economic costs did not change significantly. MCI and Sprint could have kept their prices at the old level and gained share from AT&T. Instead, they decided it would be more profitable to increase their prices along with AT&T. Another price increase episode soon followed. . . . Thus, once again the dominant

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[20] Hausman at 4. *See generally Policy and Rules Concerning Rates for Dominant Carriers; Revisions to Price Cap Rules for AT&T*, CC Docket Nos. 87-313 & 93-197, *Further Notice of Proposed Rule Making*, 10 F.C.C.R. 7854, 7867-68 (1995).

[21] Hausman at 4-5.

[22] Hausman at 6.

[23] Hausman at 6.

> price leader, AT&T, increased its prices followed by its two closest competitors, which in aggregate control about 85% of long distance markets.[24]

According to Prof. Hausman, such "'price leadership' behavior is often found in oligopolies which exhibit a low level of competition."[25] In the long-distance industry, this is made possible by the current structure of the industry.[26] As a result, "AT&T finds it profitable to raise prices so long as it is confident that MCI and Sprint will follow the price increase."[27] Given the known level of elasticity of demand for long-distance services, AT&T can readily predict whether MCI and Sprint will follow its lead. For example, a 5% increase in all three carriers' prices will cause demand to decrease by only about 3.7%, and all three carriers will see revenues increase by about 1.3%.

Further evidence that the big three IXCs' repeated lock-step price increases demonstrate a lack of competition is the fact that the principal cost component of the carriers' service, access charges, have been falling even while the IXCs raise prices. Prof. Hausman shows that from January 1990 through August 1995, access charges fell by 27%, which suggests that the IXCs' costs "fell by 12% or more," while transport costs were also likely to have fallen.[28] "Thus," he concludes, "two major cost components of long distance service—access and transport—have both decreased significantly over the past few years, yet residential long distance prices have not reflected these price decreases. *This outcome is another indication of non-competitive behavior.*"[29] Prof. MacAvoy

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[24] Hausman at 6-7 (footnote omitted).

[25] Hausman at 7.

[26] As discussed above, Prof. Hausman concludes that all of the conditions for price leadership are satisfied. *See* text accompanying note 10, *supra*; Hausman at 8.

[27] Hausman at 7.

[28] Hausman at 9.

[29] Hausman at 9 (emphasis added).

similarly observed that in 1995, following a 50% reduction in California intrastate access charges, which lowered the IXCs' costs by about 40%, the big three IXCs, in lock-step, reduced their prices by only "three, three, and zero percent respectively, thus adding an additional twenty percent to their already high (fifty percent) profit margins."[30] Prof. MacAvoy notes that other economists have reached the same conclusion about the big three carriers' failure to reduce prices in response to lowered access costs.[31]

AT&T itself acknowledges that its profit margin is increasing due to lowered access charges. AT&T states in its 1995 Annual Report:

> [T]he gross margin percentage on telecommunications services rose to 44.9% in 1995 from 42.4% in 1994 and 39.9% in 1993. This upward trend is mainly the result of lower per-minute access costs—costs for reaching customers through local networks. The Federal Communications Commission (FCC) approved changes to the price-setting methodology for access costs, effective August 1995.[32]

The fact that the big three IXCs offer a variety of optional calling plans and discounts does not detract from the conclusion that the interexchange market is characterized by tacit collusion. First, as Prof. Hausman observes, in 1994 only about 36% of AT&T's residential long-distance calls were made under a discount plan, and "non-discount customers made about 64% of long distance

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30 MacAvoy at 9.

31 MacAvoy at 11 (citing W.E. Taylor and J.D. Zona, National Economic Research Associates, Inc., *An Analysis of the State of Competition in Long-Distance Telephone Markets* ("On an aggregate basis, AT&T's price reductions have failed to match reduction in access charges. In fact, AT&T's pricing relating to costs suggest the company may continue to enjoy significant market power. The adverse effects appear to have been experienced disproportionately by low-volume residential and small business customers, for whom prices deviated from the maximum levels allowed under price-cap regulation.")).

32 AT&T 1995 ANNUAL REPORT 26; *cf.* AT&T 1994 ANNUAL REPORT 24 ("Total cost of telecommunications services declined both years despite higher volumes, in part because of reduced prices for connecting customers through local networks. . . . With lower costs and higher revenues, the gross margin percentage rose to 41.8% in 1994 from 39.0% in 1993 and 37.2% in 1992.").

calls."[33] In 1995, only about 40% of AT&T's customers were on a discount plan. Thus, he concludes that:

> approximately 60% of AT&T's customers pay "list price" which increased by about 11% in 1994 and increased another 5% in January 1996. Among IXCs, approximately the same percentage of all customers did not receive a discount in 1995 so that they are paying the list price, which increases in lock step every time AT&T announces another price increase.[34]

Prof. Hausman noted that while there was an increase in the number of AT&T customers using discount plans from 1994 to 1995, AT&T's revenue per minute increased for both discount and non-discount customers, resulting in only a slight average per-minute revenue decrease.[35] Based on an econometric model, he concluded that the decrease in average revenue per minute was not statistically significant and that "individual customers have not had their long distance bills decrease by a significant amount, despite a decrease in average access charges during this period of between 6-15%. These individual customer bills also demonstrate the lack of competition for residential customers."[36] Thus, focusing on a decline in *average* revenue per minute would not only ignore the fact that per-minute revenues are increasing for both discount and non-discount customers, but would also mask the lack of competition among the IXCs with respect to residential customers. The average revenue per minute test would permit AT&T to raise its prices under both discount and non-discount rate plans and increase its revenues thereby, while showing declining per-minute revenues, due to plan-shifting by heavy users.

Professor MacAvoy also examined the effect of long-distance discount plans:

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[33] Hausman at 12 (*citing* PNR and Associates, *Long Distance Company Call Plans* (1994)).

[34] Hausman at 15-16.

[35] Hausman at 16.

[36] Hausman at 16.

> The pattern of price-cost margins for discount plans was similar to that for standard MTS plans. Thus, for example, AT&T's price-cost margins on its *Reach-Out America* Discount Calling Plan were approximately ninety-seven percent of those earned on its standard MTS plan. MCI and Sprint also earned price-cost margins on their discount calling plans that were more than ninety percent of the profit margins on standard plans.[37]

Professor MacAvoy further concludes that consideration of discount calling plans leaves undisturbed the conclusion of tacit collusion among the IXCs. In particular, he notes that many MTS customers have insufficient calling volume to result in lower prices under a discount plan.[38] Indeed, "[m]ore than 39 million of AT&T's customers have monthly bills too low to take advantage of any discount plan, so the claim that 'nobody' pays sticker price is grossly inaccurate."[39] Moreover, he points out:

> The discount plans have been set up as offering percentage discounts off standard MTS rates. . . . As standard tariff rates have increased in recent years and percentage discounts have been constant, discount plan prices have increased. More basic, the discounts have not been based on bargaining between buyer and seller, but instead have been embedded in tariffs . . . . Discounts are no more competitive than the process from which they emerge. By providing competing carriers with notice of proposed price cuts, the tariffing process ensures that a carrier loses any first-mover advantage from making a price cut.[40]

Thus, he concludes, "discounts did not have the effect of causing a breakdown in the tacitly collusive pricing patterns observed in the provision of standard MTS, but instead were part of that strategy of holding shares and price levels steady. Therefore, *advertised discounting does not establish the 'competitiveness' of long-distance telecommunications markets*. . . . In sum, the prices

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37 MacAvoy at 6.

38 *See* MacAvoy at 8 n.12.

39 MacAvoy at 7-8.

40 MacAvoy at 7.

of these 'discount' plans show no more evidence of price competition than do those of the standard rates that they discount."[41]

Prof. MacAvoy also addresses the theory that the availability of resold WATS services causes the MTS market to be competitive, because the "vigorously competitive" discounted WATS market prevents the big three IXCs from selling MTS at supracompetitive prices. This theory fails "because the market for WATS is not competitive and, therefore, resellers cannot prevent facilities-based carriers from raising prices above the competitive level. . . . [and] because resellers by their nature cannot curtail the ability of facilities-based carriers to exercise market power."[42] His conclusions mirror those of the Commission:

> The ability to own and control facilities enables a carrier to manage competition by resellers. A reseller has minimal pricing flexibility when it must rely on a competitor that also supplies the infrastructure and underlying basic services which a reseller must use to provide its own services. In addition, the reseller cannot guarantee the quality of its services because the underlying facilities necessary to provide service are not within its control.[43]

Prof. MacAvoy also considered several studies that have been made in recent years concerning the competitiveness of long-distance markets. Three of those studies found long-distance markets to be noncompetitive. His own 1994 study concluded that price-cost margins of

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41 MacAvoy at 7-8.

42 MacAvoy at 17. MacAvoy found, based on consideration of standard and discount WATS prices, that price-cost margins from these services were increasing in the 1990s as market share stabilized, and that the absolute level of these price-cost margins were at or near the level of the price-cost margins for standard MTS. Thus, MTS and WATS are both priced "far in excess of marginal costs, as expected from collusion among suppliers." *Id.* Further, the market power of the big three IXCs exists because of their ownership of the capital facilities needed to provide service. Resellers are reliant on facilities-based IXCs, so they can only arbitrage the price differences established by the facilities-based carriers, who "render [resellers] incapable of fundamentally changing the competitive performance of long-distance telecommunications markets." *Id.* at 19.

43 *Market Entry and Regulation of Foreign-Affiliated Entities*, IB Docket 95-22, *Notice of Proposed Rulemaking*, 10 F.C.C.R. 5256, 5284-85 (1995), *quoted in* MacAvoy at 19.

the big three IXCs "were rising as sales concentration declined" from 1984 to 1994.[44] The 1993 Taylor and Taylor study found that "AT&T's price decline has not matched access cost decreases (or, again, that price-cost margins have increased)."[45] A 1993 study by the WEFA group found high price-cost margins in the interexchange business using a macroeconomic model and a Cournot model of firm behavior.[46] In addition, as noted above, even AT&T itself acknowledges that its margins have increased in recent years.[47]

Prof. MacAvoy also addresses several studies that conclude long-distance markets are competitive. He finds the 1993 Ward study and the 1995 Kahi, Kaserman, and Mayo study unpersuasive because rather than measure price-cost margins directly, they estimate such margins.[48] Prof. MacAvoy's own study, which derived actual price-cost margins from price and cost data, "cast[s] serious doubt on these two econometric studies."[49] He also found that the 1994 Hall study, which concluded that AT&T's average revenue per minute declined faster than AT&T's access costs, was unpersuasive because average revenue per minute is not the actual price charged for any given call, because his own study found that AT&T's price-cost margins increased over time, and

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44 MacAvoy at 20-21 (*citing* P.W. MacAvoy, *Tacit Collusion by Regulation: Pricing of Long-Distance Telephone Services*, WORKING PAPER SERIES C 37 YALE SCHOOL OF MANAGEMENT (1994)).

45 MacAvoy at 20-21 (*citing* W.E. Taylor and L.D. Taylor, *Postdivestiture Long-Distance Competition in the United States*, 83 AM. ECON. R. *Papers and Proceedings*, 185-90 (1993))

46 MacAvoy at 20-21 (*citing* WEFA Group, ECONOMIC IMPACT OF ELIMINATING THE LINE-OF-BUSINESS RESTRICTIONS ON THE BELL COMPANIES (1993))

47 *See* page 11, *supra*.

48 MacAvoy at 21 (*citing* M. Ward, *Market Power in Long Distance Communications*, Federal Trade Commission (1993); S.K. Kahi, D.L. Kaserman, and J.W. Mayo, *Is the "Dominant Firm" Dominant? An Empirical Analysis of AT&T's Market Power* 39 J. LAW & ECON. (forthcoming Oct. 1996)).

49 MacAvoy at 21.

because the AT&T price-cost margins are higher than those Hall had elsewhere described as noncompetitive.[50] Finally, Prof. MacAvoy addressed a 1995 estimate by Crandall and Waverman of AT&T's price-cost margin, noting that their estimate "exceeded the average price-cost margin found in a sample of highly concentrated industries."[51]

In summary, there is highly persuasive evidence that the current interexchange marketplace is not competitive, but is instead an oligopoly in which the big three IXCs are free to price above competitive levels. This oligopoly engages in tacit collusion, with AT&T periodically raising prices despite falling costs, with MCI and Sprint following the lead of AT&T in lock step on every occasion. In the following section, BellSouth shows that this tacit collusion is greatly facilitated by the tariffing requirement, which should be eliminated.

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[50] MacAvoy at 13, 22 (*citing* Declaration of Robert Hall, *United States v. Western Electric Co.*, Civ. Action No. 82-0192 (D.D.C. Dec. 2, 1994); R. Hall, *The Relationship Between Price and Marginal Cost in U.S. Industry*, 96 J. POLIT. ECON. 921-47 (1988)).

[51] MacAvoy at 23 (*citing* R.W. Crandall and L. Waverman, TALK IS CHEAP: THE PROMISE OF REGULATORY REFORM IN NORTH AMERICAN TELECOMMUNICATIONS, The Brookings Institution (1995)).

B. The Commission Should Require Detariffing of Domestic Interstate Interexchange Telecommunications Services

1. Mandatory Detariffing Would Serve the Public Interest

The Commission has long recognized that tariff filing requirements are a drag on competitive markets. They delay a market participant's ability to engage in pricing and quality initiatives or to offer a competitive response to a competitor's initiatives. They give competitors an opportunity to impede initiatives or responses by others in the market, through the filing of objections. The preparation, filing, and defense of tariff submissions impose substantial costs as well, and these costs act as a damper on the give and take of a competitive marketplace by imposing uneconomic costs on initiating and responding to competitive developments and customer demands.[52] Moreover, the entire tariff process is an unnecessary waste of both public and private resources. The Commission should devote its limited resources to tasks that facilitate the working of the marketplace, rather than attempting to micromanage it through tariff regulation.

Even more important, however, tariff filings can act as a governmentally-endorsed tool for managing an oligopolistic market through tacit collusion.[53] Requiring (or even permitting) the filing of tariffs facilitates the coordination of competition over price and service offerings by market participants. Prof. Hausman states, "[t]ariffs do not serve a pro-competitive purpose, and indeed

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[52] *See NPRM* at ¶ 29; *Policy and Rules Concerning Rates for Competitive Common Carrier Services and Facilities Authorizations Therefor*, CC Docket No. 79-252, *Second Report and Order*, 91 F.C.C.2d 59, 65, 71-72 (1982) (subsequent history omitted); *Tariff Filing Requirements for Nondominant Common Carriers*, CC Docket No. 93-36, *Memorandum Opinion and Order*, 8 F.C.C.R. 6752, 6752 (1993), *vacated on other grounds sub nom. Southwestern Bell Corp. v. FCC*, 43 F.3d 1515 (D.C. Cir. 1995); *Implementation of Sections 3(n) and 332 of the Communications Act, Regulatory Treatment of Mobile Services*, GN Docket No. 93-252, *Second Report and Order*, 9 F.C.C.R. 1411, 1479 (1994).

[53] *See NPRM* at ¶ 21; *Policy and Rules Concerning Rates for Competitive Common Carrier Services and Facilities Authorizations Therefor*, CC Docket No. 79-252, *Further Notice of Proposed Rulemaking*, 84 F.C.C.2d 445, 471 (1981) (subsequent history omitted).

they may allow for a greater amount of coordinated interaction among the IXCs."[54] Prof. MacAvoy agrees that "[r]emoval of tariffing requirements certainly will reduce the ability of carriers to coordinate prices."[55] He notes that:

> A factor that has facilitated the exercise of tacit collusion in these long-distance markets was the FCC's tariff-filing process. In particular, the requirement that carriers file publicly available tariffs prior to the initiation of price changes and new service offerings enabled other carriers to observe such changes prior to their taking effect. When carriers are knowledgeable of their rivals' price changes, their incentive to cut prices is substantially reduced or eliminated because rivals may respond to such price changes before they have the intended effect of capturing market share.[56]

Accordingly, BellSouth supports the Commission's proposal to forbear from tariff regulation and adopt a policy of mandatory detariffing for all domestic interstate interexchange services.[57] It is essential, however, *that the detariffing policy applies fully and equally to all carriers competing in the provision of interexchange service.* The public interest would clearly not be served by detariffing the incumbent IXCs' offerings, while requiring new entrants such as the BOCs, to file tariffs. Such action would require the BOCs to disclose their plans to competitors who currently control the entire interexchange market. This would irretrievably handicap the BOCs in attempting to introduce new services and offer lower prices than the incumbents. There should be detariffing for all or for none.[58]

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54 Hausman at 3.

55 MacAvoy at 27.

56 MacAvoy at 8.

57 *See NPRM* at ¶¶ 32, 34, 81.

58 BellSouth notes that the mandatory detariffing should be complete, not merely limited to detariffing of prices. Even non-price tariff filings can be used to facilitate tacit collusion, as BellSouth has previously noted. *See* BellSouth Phase I Comments in this docket at 4 n.7. Accordingly, the Commission should utilize non-tariff mechanisms, such as carrier certifications,

2. Mandatory Detariffing Is Required Under the Section 10 Forbearance Standards

Forbearance from tariff regulation is clearly required under the standards of new Section 10(a) of the Communications Act. Under Section 10(a), the Commission must forbear from applying "any provision of this Act" to a carrier when (1) enforcement is not necessary to ensure that rates and practices are just and reasonable and not unjustly or unreasonably discriminatory; (2) enforcement is not necessary for consumer protection; and (3) forbearance will serve the public interest, including promotion of competitive market conditions.[59]

These criteria are satisfied here. First, tariff filings are not needed to ensure that IXCs' rates and practices are just and reasonable, or that they are not unjustly or unreasonably discriminatory. Indeed, as noted above, in the interexchange market the tariff filing requirement has the opposite effect—tariffs are a vehicle for raising rates to supracompetitive levels. Tariff filings by IXCs do not facilitate a finding that rates or practices are just and reasonable; rather, they simply establish what a carrier's rates and practices are supposed to be. At present, determinations of the justness and reasonableness of an IXC tariff are typically determined in a complaint proceeding, not a tariff review proceeding, and that will be unchanged as a result of mandatory detariffing.[60] Moreover, a determination whether a rate or practice is unjustly or unreasonably discriminatory is a fact-bound determination better suited to resolution in a complaint proceeding, where the discriminatory effects,

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to ensure compliance with the geographic rate averaging and integration requirements of new Section 254(g) of the Communications Act. *See id.* at 4-5

59 47 U.S.C. § 160(a)(1)-(3), (b).

60 IXC tariff filings become effective automatically, unless suspended or rejected, and in recent years IXC tariffs have become effective as scheduled with only rare exceptions. Thus, the elimination of pre-effective tariff review as a result of mandatory detariffing will not significantly diminish the Commission's ability to ensure that IXCs' rates and practices are just and reasonable.

if any, of the carrier's rates and practices, and the justification for any such discrimination, can be evaluated fully.

Second, enforcement of the statutory tariff requirement is not necessary for protection of consumers in the long term, given the eventual entry of the BOCs into interexchange service. In the absence of tariffs, carriers can be expected to use a variety of means for giving consumers notice of their rates and practices, such as contracts, advertising, brochures, and bill inserts. Indeed, such communications could well be more effective at informing consumers than tariffs filed in Washington, D.C., because the carriers could no longer avoid meaningful disclosure through cross-references to FCC tariffs that are not readily available to consumers. Moreover, mandatory detariffing gives IXCs greater flexibility to respond to market-driven consumer demands for services, facilities, and prices that are not already available. Carriers will no longer be able to respond that they are unable to accommodate a request for a new service arrangement because it is not in their tariff, and the cost of filing a tariff transmittal will no longer be an impediment to meeting consumer needs.

In the short term—that is, before the BOCs are able to enter the interexchange market—there is no certainty that incumbent IXCs will not raise rates if tariffing is eliminated. They have done so in the past under a tariff regime, and their lock-step price increases may well continue in the future even without the assistance of tariffs. Prices can be changed more rapidly without the tariff filing requirement, and they can go up as well as down. Thus, for an interim period, detariffing has the potential for some consumer harm, due to the potential of rapid price increases by the big three IXCs in the absence of effective competition from the BOCs. The best way to protect consumers' interests, however, is not to continue the tariff requirement. Instead, the Commission should protect consumers by minimizing the duration of the IXC's window of opportunity for raising prices—namely by moving ahead swiftly with proceedings to facilitate BOC interexchange entry, as BellSouth shows in the following section. The prospect of rapid BOC entry will act as a deterrent to further price increases by the big three because every time they raise prices they are creating new opportunities for the BOCs to garner market share upon their entry.

Finally, mandatory detariffing will serve the public interest because it will permit carriers to respond quickly to competitive conditions and by encouraging the entry of new competitors. Even more important, it will eliminate a means by which AT&T, MCI, and Sprint have been able to engage in tacitly collusive pricing practices in the past. While detariffing may not eliminate parallel pricing, the lack of a filed tariff will make it more difficult for these companies to tacitly maintain what amounts to a cartel that causes substantial harm to consumers.