

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

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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

CC Docket No. 96-61

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**Comments of the
Independent Data Communications Manufacturers Association**

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SUMMARY

The Independent Data Communications Manufacturers Association is strongly opposed to the Commission's proposal to allow interexchange carriers to bundle customer premises equipment ("CPE"). The Commission seeks to justify this proposal on the grounds that, as a matter of antitrust law, interexchange carriers lack the ability to harm competition in the CPE market. The Commission's CPE No-Bundling Rule, however, is intended to do more than prevent carriers from violating the federal antitrust laws; it seeks to serve the public interest by allowing consumers to use the premises equipment that best meets their needs -- regardless of whether it is provided by a carrier or an independent manufacturer. Rather than promoting competition, elimination of the Commission's highly successful No-Bundling Rule would impair competition while harming the public interest.

Public Interest Considerations

The Independent Manufacturing Sector. Adoption of the Commission's rebundling proposal would threaten the survival of a truly independent manufacturing sector. Independent manufacturers have been the primary source of cost-effective, innovative products that are specifically designed to meet the varied needs end-users. Such equipment often provides a competitive alternative to network-based services and facilities.

If the Commission were to adopt the rebundling proposal, interexchange carriers would be able to require transmission service customers to use carrier-provided CPE. Carriers also would be able to use transmission service revenue to offer CPE at cross-subsidized, deeply discounted prices. These practices would threaten the viability of many independent

manufacturers. Those manufacturers that survived, moreover, would shift their orientation from the end-user market and, instead, would act primarily as vendors for the carriers.

The Telecommunications Act. The Commission's rebundling proposal also is inconsistent with the Telecommunications Act of 1996. Section 304 of the Act not only preserves the Commission's No-Bundling Rule, it directs the Commission to extend the existing unbundling regime to multichannel video programming systems. The Commission's proposal to retreat from its long-standing unbundling policy reflects a disturbing disregard for the clear and controlling policy choices made by the Congress.

CPE Reregulation. Adoption of the rebundling proposal would allow interexchange carriers to provide CPE as part of their regulated transmission service offerings. As a result -- for the first time in nearly twenty years -- CPE would be subject to the regulatory requirements, contained in Title II of the Communications Act, governing common carrier offerings. Such CPE "reregulation" plainly is inconsistent with congressional directives and Commission policy. CPE reregulation also would complicate administration of the Commission's Part 68 registration program and its network disclosure rules by blurring the boundary between regulated transmission service and CPE.

International Trade. Allowing CPE bundling in the interexchange market also would violate the binding obligations imposed by the GATS Telecommunications Annex and the North American Free Trade Agreement. While these agreements commit the United States to allow users to attach terminal equipment to carrier networks, the Commission's proposal would permit an interexchange carrier to refuse to provide service to a user that declined to use carrier-provided terminal equipment.

Antitrust Considerations

The Commission has based its proposal to allow interexchange carriers to bundle CPE solely on antitrust grounds. Yet, the Notice fails to recognize that the unique relationship between the interexchange service and CPE markets allows interexchange carriers to "force" their customers to purchase carrier-provided CPE. As a result, if the No-Bundling Rule is eliminated, interexchange carriers would be authorized to impose "tying" agreements that would constitute a per se violation of the federal antitrust laws. The Commission's rebundling proposal also would extend to the now-competitive CPE market the oligopoly conditions that exist in the interexchange service market.

Alternate Proposal

The Commission's alternate proposal -- which would allow interexchange carriers to offer bundled interexchange service/CPE packages, provided that they continue to offer interexchange service on an unbundled, nondiscriminatory basis -- also should be rejected. If this proposal were adopted, interexchange carriers would be likely to offer bundled service/CPE packages at the same price as the stand-alone transmission service. Once customers obtained transmission service from the carrier, they almost certainly would accept the "free" CPE from the carrier, even if it was not the equipment that best met their needs.

Three Year Deferral

Even if the Commission disagrees with IDCMA's analysis, it should defer consideration of its rebundling proposal for at least three years. This will allow the Commission to assess the costs and benefits of any alteration in the No-Bundling Rule in light of the substantial changes that are likely to occur in the coming years.

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The Commission initiated this proceeding to consider whether the public interest would be served by revising the regulatory regime governing the interstate, interexchange services market.¹ The Independent Data Communications Manufacturers Association ("IDCMA") supports the Commission's effort to adapt its regulations, to the extent appropriate, in light of changing market conditions. As part of this process, however, the Commission has proposed to eliminate the long-standing prohibition against interexchange carriers bundling customer premises equipment ("CPE") with their transmission services.² IDCMA is strongly opposed to this proposal.

¹ See Policy and Rules Concerning the Interstate, Interexchange Marketplace, Notice of Proposed Rulemaking, CC Docket No. 96-61, at ¶ 4 (rel. Mar. 25, 1996) ("Notice").

² See id. at ¶¶ 84-91.

The CPE No-Bundling Rule,³ which was adopted during the Second Computer Inquiry, has been one of the Commission's most successful policy initiatives. The Rule has allowed consumers to obtain the premises equipment that best meets their needs, whether provided by a carrier or an independent manufacturer. IDCMA recognizes that, in the 16 years since the Rule was adopted, there have been important changes in both the CPE and interexchange markets. These changes, however, do not alter the Commission's finding -- reiterated only last year -- that "the underlying rationale for the Commission's procompetitive CPE policies and rules remains as valid today as it was during the Computer II decisions."⁴

Rather than advancing the Commission's pro-competitive policies, permitting interexchange carriers ("IXCs") to bundle CPE would turn back the clock to the 1960s, when the carrier provided premises equipment as part of its regulated transmission service offering, and consumers were unable to deal directly with independent manufacturers. There can be no justification for such a result. The only appropriate action, therefore, is for the Commission to reject the "rebundling" proposal contained in the Notice.

³ 47 C.F.R. § 64.702(e).

⁴ Verilink Corporation's Petition for Rulemaking to Amend the Commission's Part 68 Rules to Authorize Regulated Carriers to Provide Certain Line Build Out Functionality as a Part of Regulated Network Equipment on Customer Premises, 10 FCC Rcd 8914, 8917 (Com. Car. Bur. 1995) ("Verilink LBO Order") (quoting NYNEX Telephone Companies Tariff F.C.C. No. 1, Transmittal No. 127, Memorandum Opinion and Order, 9 FCC Rcd 1608, 1608 (1994) ("NYNEX Enterprise Service Order").

I. THE COMMISSION HAS PROVIDED NO BASIS TO RETREAT FROM ITS HIGHLY SUCCESSFUL, PRO-COMPETITIVE CPE POLICIES

The Notice devotes only a few paragraphs to the Commission's radical proposal to allow interexchange carriers to bundle CPE with interexchange services.⁵ This brief analysis, however, contains numerous fundamental flaws: it misstates the reasons the Commission adopted the No-Bundling Rule, ignores the substantial benefits the Rule has provided, provides no reasoned justification for abandoning the Rule, and disregards the costs that rebundling would impose. These factors alone justify rejection of the proposal.

A. The No-Bundling Rule is Designed to Protect Consumers' Rights to Use the CPE of Their Choice, Not Merely to Prevent Dominant Carriers from Violating the Federal Antitrust Laws

The Notice rests on a fundamental misconception: it suggests that the sole rationale for the No-Bundling Rule is to prohibit a carrier from engaging in conduct that would constitute a violation of the federal antitrust laws. Under this view, the No-Bundling Rule is intended to do nothing more than prevent a carrier with "monopoly power" in the transmission service market from using this power to "force" customers to purchase carrier-provided CPE and, ultimately, to "monopolize" the market for CPE.⁶

Because the Commission previously has determined that the interexchange service market is "substantially competitive," and that the CPE market is "fully competitive," the Notice reasons that "it is unlikely" that interexchange carriers could engage in conduct that would

⁵ Notice at ¶¶ 84-91.

⁶ Id. at ¶ 87.

violate the antitrust laws.⁷ Therefore, the Notice concludes, there no longer is any need to prevent CPE bundling in the interexchange market.⁸ Indeed, the Notice suggests that elimination of the No-Bundling Rule in the interexchange market would "promote competition" by allowing interexchange carriers to offer "attractive service/equipment packages for customers."⁹

Contrary to the assumption that underlies the Notice, the Commission did not adopt the CPE No-Bundling Rule solely to codify the Sherman Act proscription against tying by firms with market power. Rather, the adoption of the Rule was the culmination of a generation-long effort to ensure that users have the right to use the premises equipment that best meets their needs -- regardless of whether they obtain such equipment from a carrier or an independent manufacturer.

The struggle to allow customers to use the premises equipment of their choice, free from carrier interference, began in 1948. In that year, the Hush-A-Phone Corporation filed a petition with the Commission in which it challenged AT&T's attempt to bar users from attaching a cup-shaped device, designed to enhance privacy during a call, over the mouthpiece of the customer's handset. Hush-A-Phone's effort bore fruit eight years later, when the D.C. Circuit held that AT&T's application of its "no foreign attachment" rule constituted an

⁷ Id. at ¶ 86.

⁸ Id. at ¶ 88.

⁹ Id.

unwarranted interference with the "subscriber's right reasonably to use his telephone in ways which are privately beneficial without being publicly detrimental."¹⁰

Consumers were required to wait an additional twelve years, until 1968, before the Commission ruled in the Carterfone case that the right to use premises equipment in a manner that is "privately beneficial without being publicly detrimental" includes the right to attach competitively provided electrical equipment to the network.¹¹ The Commission subsequently adopted the Part 68 equipment registration program, which is intended to allow users to connect registered customer-provided equipment directly to the public switched network without causing technical harm.¹²

In the Second Computer Inquiry, which began in the late 1970s, the Commission took several actions designed to further its efforts to ensure that consumers have the ability to select and use a wide choice of competitively provided customer premises equipment. As part of this effort, the Commission deregulated the provision of all CPE and adopted a stringent regulatory regime designed to prevent use of basic service revenues to cross-subsidize premises-

¹⁰ Hush-A-Phone Corp. v. United States, 238 F.2d 266, 269 (D.C. Cir. 1956), on remand, 22 F.C.C. 112 (1957).

¹¹ Use of the Carterfone Device in Message Toll Telephone Service, 13 F.C.C.2d 420, recon. denied, 14 F.C.C.2d 571 (1968). Even after the right of end-users to interconnect equipment to the network was established, AT&T continued its efforts to thwart the ability of consumers to use the CPE of their choice. Ultimately, however, the Commission rejected these efforts. See, e.g., Proposals for New or Revised Classes of Interstate and Foreign Message Toll Telephone Service (MTS) and Wide Area Telephone Service (WATS), First Report and Order, 56 F.C.C.2d 593, 598 (1975) ("Part 68 Order") (striking down protective connecting arrangements for non-carrier-provided CPE as "unnecessarily restrictive"); Implications of the Telephone Industry's Primary Instrument Concept, 68 F.C.C.2d 1157 (1978) (rejecting AT&T's effort to require basic telephone service customers to lease at least one carrier-provided telephone set).

¹² See Part 68 Order, 56 F.C.C.2d at 599.

based equipment.¹³ The Commission also adopted the CPE No-Bundling Rule.¹⁴ Adoption of the Rule, the Commission explained at the time, "is only another in a series of steps to isolate terminal from transmission offerings, increase consumer choice, and to open equipment markets to full and fair competition."¹⁵

The CPE No-Bundling Rule, codified at Section 64.702(e) of the Commission's rules, provides that:

[T]he carrier provision of customer-premises equipment used in conjunction with the interstate telecommunications network shall be separate and distinct from provision of common carrier communications services and not offered on a tariffed basis.¹⁶

The Rule prevents carriers from engaging in conduct that limits the ability of consumers to obtain competitively provided CPE -- even if this conduct would not, in itself, constitute a violation of the federal antitrust laws. In particular, the Rule prohibits carriers from requiring their basic service customers to purchase or lease carrier-provided CPE.¹⁷ The Rule also bars carriers from offering "special discounts" on CPE available only to customers that also agree to purchase the carrier's basic transmission service. Carriers also are barred from

¹³ Amendment of § 64.702 of the Commission's Rules & Regulations, Final Decision, 77 F.C.C.2d 384, 439 (1980) (subsequent history omitted) ("Computer II Final Decision").

¹⁴ Id. at 442-47.

¹⁵ Id. at 453.

¹⁶ 47 C.F.R. § 64.702(e).

¹⁷ This restriction bars conduct that would not necessarily constitute a violation of the federal antitrust laws. The antitrust laws prohibit "tying" only when it is either undertaken by a firm with market power or when it unreasonably restrains trade. See Jefferson Parish Hosp. Dist. No. 2 v. Hyde, 466 U.S. 2, 12 (1984). The No-Bundling Rule, in contrast, prohibits any offering in which a common carrier ties the provision of basic communications service to the provision of customer premises equipment.

providing discounts on their regulated transmission service to customers that buy carrier-provided CPE.¹⁸

To be sure, at the time the Commission adopted the No-Bundling Rule, the Bell System monopoly provided most of the nation's telecommunications services. The Commission, however, did not limit application of the Rule to AT&T. To the contrary, the Commission applied the Rule to all carriers -- including then-fledgling "specialized" common carriers such as MCI and non-facilities-based resellers.¹⁹

Soon after adoption of the No-Bundling Rule, the Commission released the First Competitive Carrier Order, in which it determined that certain regulations (such as the obligation to file tariffs) should be applied only to "dominant" carriers, which the Commission defined as

¹⁸ These restrictions go well beyond the prohibition, contained in the federal antitrust laws, against predatory pricing. See Brook Group Ltd. v. Brown & Williamson Tobacco Corp., 113 S. Ct. 2578, 2588 (1993) (requiring evidence that a firm cut prices below cost and, at a minimum, have a reasonable prospect of later recouping the lost revenues). Indeed, the Rule may prohibit some discounts that could be seen as advancing antitrust goals. See id. (absent predation, "discouraging a price cut . . . does not constitute sound antitrust policy"). The Rule does this in order to create a "diverse" market in which customers may obtain CPE from both carriers and independent manufacturers. As Chief Judge Posner explained in connection with another Commission rule, "[i]f the Commission were enforcing the antitrust laws, it would not be allowed to trade off a reduction in [price] competition against an increase in . . . 'diversity.' Since it is enforcing the . . . public interest standard instead, it is permitted, and maybe even required, to make such a trade off" Schurz Communications, Inc. v. FCC, 982 F.2d 1043, 1049 (7th Cir. 1992).

¹⁹ See Computer II Final Decision, 77 F.C.C.2d at 443 (The "provision of bundled offerings" by any carrier "presents [the] distinct potential for limiting the freedom of customers to be able to put together the service and equipment package most desired by them.").

those that possess market power.²⁰ Although the Competitive Carrier proceeding continued for much of the 1980s, at no time did the Commission ever suggest that application of the No-Bundling Rule should be limited to dominant carriers. As the Commission subsequently observed, the "classification of carriers as dominant or nondominant . . . does not, without further analysis, determine whether carriers should be allowed to bundle . . . CPE and transmission services."²¹ Rather, the Commission concluded, the agency "must take into account other factors," including the effect that bundling would have on competition in the CPE market and the public interest considerations raised by bundling.²²

B. The No-Bundling Rule Has Been One of the Commission's Most Successful Policy Initiatives

The Notice entirely ignores the fact -- repeatedly recognized in prior Commission decisions -- that the CPE No-Bundling Rule has yielded substantial benefits to consumers. By prohibiting carriers from requiring transmission service customers to use carrier-provided CPE, and barring carriers from using transmission service revenues to cross-subsidize CPE, the Rule has allowed independent manufacturers to provide consumers with a wide array of innovative

²⁰ Policy and Rules Concerning Rates for Competitive Common Carrier Services and Facilities Authorizations Therefor, First Report and Order, 85 F.C.C.2d 1, 20-21 (1980).

²¹ Bundling of Cellular Customer Premises Equipment and Cellular Service, Report and Order, 7 FCC Rcd 4028, 4034 n.22 (1992).

²² Id.; see also H.R. Conf. Rep. No. 458, 104th Cong., 2d Sess. 201 (1996) (noting that "one of the underlying themes" of the Telecommunications Act of 1996 is to get the Commission and the Department of Justice ("DOJ") "back to their proper roles The Commission should be carrying out the policies of the Communications Act, and the DOJ should be carrying out the policies of the antitrust laws.").

products. As users' communications needs have increased, these manufacturers have developed equipment that creates efficient alternatives to network-based facilities and services.

The No-Bundling Rule has been one of the Commission's greatest successes. Time and again the Commission has reaffirmed its commitment to the Rule, and has recognized the substantial benefits generated by competition in the market for CPE.²³ In the 1994 NYNEX Enterprise Service proceeding, for example, the Commission observed that:

The CPE industry has exhibited growth and innovation in the fourteen years since the Commission deregulated CPE and required . . . all . . . carriers to detariff CPE and to unbundle it from their network service offerings. . . . The underlying rationale for the Commission's procompetitive CPE policies and rules remains as valid today as it was during the Computer II Decisions The resulting increased competition among manufacturers has driven improvements in equipment quality, lowered CPE prices, and improved the performance of users' data communications networks. These policies have also created new job opportunities in several related sectors of the economy.²⁴

²³ See, e.g., Verilink LBO Order, 10 FCC Rcd 8914 (denying petition to rebundle line build out functionality with regulated transmission service); NYNEX Enterprise Service Order, 9 FCC Rcd 1608 (denying petition to bundle premises-based multiplexing equipment with regulated transmission service); BellSouth Telecomm. Digital Transmission Serv. F.C.C. Tariff No. 1, Order, 7 FCC Rcd 5504 (1992) (denying petition to bundle premises-based multiplexing equipment with regulated transmission service); BellSouth's Petition for Declaratory Ruling, Memorandum Opinion and Order, 6 FCC Rcd 3336 (1991) (denying petition to bundle line build out functionality with regulated transmission service); Competition in the Interexchange Marketplace, Order, 6 FCC Rcd 5880 (1990) (rejecting proposal to allow AT&T to bundle CPE with regulated transmission service); AT&T Communications Revisions to Tariff F.C.C. Nos. 1 and 2, Order, 4 FCC Rcd 4984 (1989) (rejecting tariff revision seeking to bundle multiplexing equipment with regulated transmission service).

²⁴ NYNEX Enterprise Service Order, 9 FCC Rcd at 1608.

The Verilink LBO Order, issued only last year, reiterated the Commission's continued support for the No-Bundling Rule.²⁵

The Commission is not alone in recognizing the substantial benefits that have flowed to consumers as a result of the competitive provision of CPE. Indeed, congressional leaders,²⁶ the National Telecommunications and Information Administration,²⁷ as well as industry analysts²⁸ have recognized that a robust CPE market is the best way to guarantee diversity, innovation, quality, and affordability.

²⁵ See Verilink LBO Order, 10 FCC Rcd at 8921 (observing that the Commission's pro-competitive policies have led to improvements in CPE quality, lowered prices, enhanced performance of users' data networks, and created additional U.S. jobs).

²⁶ In a 1994 hearing before the House Subcommittee on Telecommunications and Finance, for example, Representative Edward Markey noted that "[u]nbundling of [customer premises] equipment . . . [has] allowed for a flowering of manufacturing of telephone equipment for the home and the business. It separated product from service and fostered consumer choice and competition." Oversight Hearings on Interactive Video Systems: Hearing Before the Subcomm. on Telecommunications and Finance of the House Comm. on Energy and Commerce, 103d Cong., 2d Sess. (Feb. 1, 1994).

²⁷ See National Telecommunications and Information Administration, The NTIA Infrastructure Report: Telecommunications in the Age of Information at 205 n.707 (1991) (specifically recommending that the "FCC maintain its rule that bars common carriers from bundling CPE with their [regulated] service offerings"); NTIA Inquiry on Universal Service and Open Access Issues, 59 Fed. Reg. 48,112, 48,113-14 (1994) (noting that the competitive provision of CPE has provided consumers with greater choice, more useful equipment, and a decline in CPE cost of 50 percent when measured in real terms).

²⁸ "The rough rule of thumb in . . . [the CPE] markets is half the price -- or double the functionality -- every two to five years." P. Huber, M. Kellogg, & J. Thorne, The Geodesic Network II 1993 Report on Competition in the Telephone Industry § 6.60 (1992). This improvement in productivity far exceeds that found in the market for transport services.

Within the industry, moreover, widespread support exists for the No-Bundling Rule. In the 1991 Interexchange Competition proceeding, end-users,²⁹ equipment manufacturers,³⁰ and government agencies³¹ all expressed opposition to the Commission's proposal to allow AT&T to bundle CPE with its transmission service offerings. Indeed, with the exception of AT&T, there was virtually no support for the proposal.

C. The Notice Neither Provides a Reasoned Justification for Allowing Bundling Nor Attempts to Assess the Costs of This Ill-Conceived Proposal

In light of the numerous public interest benefits provided by the CPE No-Bundling Rule, the Commission must provide a compelling justification if the Rule is to be eliminated. The Notice offers none. It merely recites that the interexchange market is now "substantially

²⁹ See, e.g., Comments of the Ad Hoc Telecommunications Users Committee, CC Docket No. 90-132, at 63 (filed July 3, 1990) ("The market will work best if consumers continue to have the greatest number of options, and . . . providers of transmission services and CPE [provide] those components separately."); Comments of the California Bankers Clearing House Association, the New York Clearing House Association and VISA U.S.A., Inc., CC Docket No. 90-132, at 15 (filed July 3, 1990) (opposing removal of structural and non-structural protections against conduct by AT&T).

³⁰ See, e.g., Letter to Alfred C. Sikes, Chairman, Federal Communications Commission, from Edward J. Silberhorn, Associate General Counsel, Mitel, Inc., CC Docket No. 90-132 (filed June 14, 1990) ("The proposed FCC [Bundling] Rule would . . . destroy the competitive gains of the last ten (10) years."); Letter to Donna Searcy, Secretary, Federal Communications Commission, from David L. Johnson, President, Penril DataComm, CC Docket No. 90-132 (filed June 11, 1990) ("We find the concept of bundling unregulated CPE with regulated transmission service to be particularly offensive.").

³¹ See Comments of the Chief Counsel for Advocacy of the U.S. Small Business Administration, CC Docket No. 90-132, at 26 (filed July 3, 1990) ("The ultimate result [of bundling] will not be greater competition but fewer alternatives for the vast number of large and small businesses that currently benefit from competition in services and CPE.").

competitive" and the CPE market is "fully competitive." As demonstrated below, however, despite the increasing competitiveness of the interexchange market, elimination of the No-Bundling Rule would give interexchange carriers the ability to dictate their customers' equipment choice.³² Moreover, the fact that, as a result of the No-Bundling Rule, the CPE market is now fully competitive is a reason to retain the Rule, not to dismantle it.

Nor does the Notice identify any problem that justifies lifting the ban on bundling in the interexchange market. Rather, the Notice does nothing more than baldly assert that, if the Rule were eliminated, interexchange carriers could offer "service/equipment packages for customers."³³ This, of course, is no justification. The No-Bundling Rule does not bar a carrier from offering "service/equipment packages."³⁴ Indeed, such "one-stop-shopping" is common industry practice. Rather, the Rule merely requires that a carrier that offers such packages must separately price the service and equipment components, and must provide its customers with the option of purchasing each component on a stand-alone basis.

The Notice also fails to consider the significant adverse consequences that would occur if the Commission were to allow CPE bundling in the interexchange market. These consequences are addressed in Section II.

³² See infra § III.

³³ Notice at ¶ 88.

³⁴ As a result of the elimination of the Computer II CPE structural separation requirements, Furnishing of Customer Premises Equipment and Enhanced Services by American Tel. & Tel. Co., Order, 102 F.C.C.2d 655 (1985), modified in part on recon., 104 F.C.C.2d 739 (1986), all interexchange carriers are permitted to provide both transmission service and CPE using common personnel and facilities.

II. ALLOWING INTEREXCHANGE CARRIERS TO BUNDLE CUSTOMER PREMISES EQUIPMENT WOULD BE UNLAWFUL AND WOULD HARM THE PUBLIC INTEREST

Although the bundling proposal contained in the Notice is grounded on an antitrust analysis, the Commission has requested comment "on the effect that the proposed amendment of Section 64.702(e) would have on our other policies and rules."³⁵ As demonstrated below, adoption of the proposal would violate the non-discrimination provisions contained in Section 202 of the Communications Act. The proposal, moreover, would adversely affect numerous congressional and Commission policies designed to protect the public interest. In particular, CPE rebundling would:

- reduce consumer choice by eliminating the independent CPE manufacturing sector;
- thwart congressional policy favoring CPE unbundling, while frustrating the Administration's National Information Infrastructure Initiative's goal of promoting broad interconnection of diverse networks;
- create serious administrative problems by blurring the boundary between regulated transmission service and non-regulated CPE; and
- violate binding U.S. international obligations -- under the GATS Telecommunications Annex, NAFTA, and the NGBT "standstill" agreement -- and impede U.S. trade policy.

A. CPE Bundling Violates Section 202 of the Communications Act

Under the rebundling approach proposed in the Notice, an interexchange carrier could engage in three types of currently prohibited conduct. As demonstrated below, each of

³⁵ Notice at ¶ 90.

these practices would violate Section 202 of the Communications Act.³⁶ The Commission, therefore, lacks the legal authority to authorize such conduct.

Section 202 makes it unlawful for "any common carrier to make any unjust or unreasonable discrimination in charges, practices, classifications, regulations, facilities, or services for or in connection with like communications service . . . to any particular person [or] class of persons."³⁷ This requirement is among the very few provisions of the Communications Act that the Commission may not forebear from enforcing.³⁸ If the Commission adopts the rebundling proposal, an interexchange carrier could choose to make transmission service available only to customers that agreed to obtain carrier-provided CPE. This plainly would constitute unlawful "discrimination" in the provision of transmission "service" against a "class of persons" consisting of customers that chose to provide their own CPE.³⁹

The rebundling proposal also would allow interexchange carriers to provide transmission service at a lower price to customers that agreed to use carrier-provided CPE. Under established precedent, if a carrier charges different prices for identical transmission service, the burden shifts to the carrier to demonstrate that the price discrimination is not unjust

³⁶ See 47 U.S.C. § 202(a).

³⁷ Id.

³⁸ See Telecommunications Act of 1996, Pub. L. No. 104-104, § 401, 110 Stat. 56, 128, 104th Cong., 2d Sess. (1996) (to be codified at 47 U.S.C. § 160(a)) (forbearance provision is applicable only if a statutory provision is "not necessary to ensure that charges, practices, classifications, or regulations by, for, or in connection with . . . telecommunications service . . . are not unjustly or unreasonably discriminatory.").

³⁹ This action also would violate the carrier's duty, under Section 201 of the Communications Act, to "furnish . . . communication service upon reasonable request therefor." 47 U.S.C. § 201(a).

or unreasonable.⁴⁰ A carrier's desire to favor customers that accept carrier-provided equipment plainly does not provide a lawful basis under the Communications Act to engage in price discrimination.

If the Commission adopts the rebundling proposal set forth in the Notice, interexchange carriers also would be permitted to provide deep discounts on customer premises equipment to customers that agree to buy the carrier's transmission service. Here, again, the Commission lacks statutory authority to authorize such conduct. The Commission has stated that, consistent with Section 202, "a carrier may not . . . price terminal equipment with the intent of providing extra benefits or inducements for regulated service customers."⁴¹ This statutory prohibition, the Commission has further explained, is violated "[w]here a carrier directly ties an offer of free or reduced cost terminal equipment to exclusive use of its

⁴⁰ See MCI Telecommunications Corp. v. FCC, 917 F.2d 30, 39 (D.C. Cir. 1980). The courts have recognized only a handful of permissible reasons for price discrimination -- such as the need to meet a bona fide offer from a competing transmission service provider, see American Tel. & Tel. Co. v. FCC, 449 F.2d 439, 448 (2d Cir. 1971), or to "preserve . . . [the] financial viability" of a class of customers, see National Ass'n of Reg. Util. Comm'rs v. FCC, 737 F.2d 1095, 1136 (D.C. Cir. 1984).

⁴¹ See ITT World Communications, Inc. v. TRT Telecommunications Corp., ENF-82-4, 51 Rad. Reg.2d (P&F) 1386, 1390-91 (Com. Car. Bur. 1982).

transmission service."⁴² Because the Commission's rebundling proposal would authorize conduct that would violate the Communications Act, it must be rejected.

B. Allowing Interexchange Carriers to Bundle CPE Would Deprive Consumers of the Benefits That Only a Strong Independent Manufacturing Sector Can Provide

The No-Bundling Rule benefits users by ensuring that every customer has the freedom to select the CPE that best meets his or her needs. Consumer choice, however, is meaningful only because of the existence of a strong, truly independent manufacturing sector. The Commission should reject the rebundling proposal contained in the Notice, because it threatens the continued survival of this critical market sector.

1. The role of independent manufacturers

Historically, independent manufacturers have worked directly with end-users to develop cost-effective, innovative products specially designed to meet end-users' widely varied communications needs. As a result, "to a large extent, the technological revolution in terminal equipment has occurred independent of common carrier transmission services. Non-regulated

⁴² Id. A more recent Commission decision suggests that discounts on non-regulated services are permissible if the "major purpose" of the discount is to promote the non-regulated service or good, rather than to "stimul[ate] the demand for regulated services" and the carrier receives "the full tariffed rate" for its regulated transmission service. BankAmerica Corporation v. AT&T, 8 FCC Rcd 8782, 8785 (Com. Car. Bur. 1992). A CPE discount provided exclusively to customers of a carrier's transmission service fails to satisfy either prong. Such a discount plainly is intended to stimulate demand for regulated transmission service. Moreover, if the Commission chooses to detariff interexchange service, it will no longer be possible to ensure that, despite the discount, the carrier is receiving the "full tariffed rate" for its regulated offering.

equipment vendors have been instrumental in applying computer technology to CPE, and have been the primary leaders in innovation in this area."⁴³

Equipment developed by independent manufacturers also has been an important source of "intermodal" competition. Such equipment often reduces or eliminates the need for end-users to purchase network-based facilities or services. For example, a business that needs to transmit voice and data communications among multiple offices can choose to assemble a private network -- consisting of dedicated lines and premises-based equipment that derives, interconnects, and manages the necessary communications -- rather than relying on the carrier-provided public network. Unlike independent manufacturers, carriers have little, if any, incentive to offer consumers equipment that will decrease demand for network-based facilities and services. To the contrary, because carriers need to recoup often-substantial investments in their networks, they have a strong incentive to limit customers' ability to use such equipment. As a result, carriers often have sought to restrict attachment of CPE or, if that is not feasible, to insist that customers use carrier-provided CPE.

2. Effect of the Commission's proposal

If the Commission were to adopt the rebundling proposal contained in the Notice, interexchange carriers would be able to require transmission service customers to use carrier-provided CPE. This practice would foreclose independent manufacturers from a significant portion of the end-user market. Such a foreclosure might not necessarily rise to the level of an

⁴³ Computer II Final Decision, 77 F.C.C.2d at 440. For example, while Western Electric was asserting that it would never be technically feasible to develop a telephone modem that could operate at a rate greater than 2,400 bits per second, independent manufacturers were developing modems that could operate at three times that speed. Today, the widely available V.34 modem operates at 28,800 bits per second. Cable modems, moreover, promise to offer throughput rates of up to 40 million bits per second.

antitrust violation. However, it plainly would threaten the viability of many independent manufacturers.

Adoption of the Commission's proposal also would allow interexchange carriers to offer deeply discounted (or "free") CPE to induce consumers to commit to a package that includes a long-term transmission service contract.⁴⁴ As Peter Huber has pointed out, "account control" is so important that carriers may offer CPE at below market prices simply to establish a point of contact for the more profitable transmission service. "For AT&T," Huber has observed:

it may well prove profitable to sell PBXs at a loss. . . AT&T has long believed that control of local switching is essential to maintaining customer contact in order to sell . . . long-distance service. AT&T's revenues from long-distance sales completely dwarf its PBX sales (by more than a factor of twenty). Once an AT&T PBX is installed on a customer's premises, the AT&T salesperson will have repeated occasion to peddle AT&T's far more lucrative long-distance service too. Up to a point, AT&T can discount and lose money on PBXs much like cellular companies do with mobile phones; the profit is in the razor blades, not the razor.⁴⁵

⁴⁴ Carriers could do so by imposing proportionately small increases in recurring charges for transmission services, using the revenue generated thereby to cross-subsidize CPE prices. Contrary to the Commission's assumptions, the fact that the agency has classified all interexchange carriers as non-dominant does not mean that they are incapable of any cross-subsidization. "Market power exists in degrees." Phillip E. Areeda, IIA Antitrust Law: An Analysis of Antitrust Principles and Their Application ¶ 501 (1994). Even if interexchange carriers are not able to profitably price transmission service at a level that is substantially above cost, they do have the ability to effect the fairly small price increases necessary to generate the revenues needed to offer CPE at deeply discounted prices.

⁴⁵ P. Huber, M. Kellogg, & J. Thorne, The Geodesic Network II 1993 Report on Competition in the Telephone Industry § 6.61 (1992).

AT&T, of course, plans to divest its manufacturing operations. However, a carrier's ability and incentive to use CPE to obtain account control exists even in situations in which the carrier does not manufacture the bundled equipment. Indeed, AT&T frequently has sought to bundle its service with equipment manufactured by other vendors.⁴⁶ This practice may not necessarily violate the federal antitrust laws. Nonetheless, it places independent CPE manufacturers -- who lack the ability to use basic service revenue to cross-subsidize CPE offerings -- at an insurmountable competitive disadvantage.

If the Commission were to adopt a rebundling policy, one theory suggests that independent manufacturers would "team up" with interexchange carriers to provide service/CPE packages. Such an outcome, however, would deprive consumers of the benefit of a truly independent manufacturing sector. As an initial matter, the major carriers would seek to partner with a small number of CPE vendors. Inevitably, many manufacturers would be without carrier alliances and, as a result, would exit the market. Those that remained, moreover, would be dependent on their carrier-patrons, rather than end-user customers. As a result, they would be

⁴⁶ For example, AT&T has bundled vendor-manufactured routers with its InterSpan Frame Relay Service. See Independent Data Communications Manufacturers Association, Petition for a Declaratory Ruling That AT&T's InterSpan Frame Relay Service is a Basic Service That Must Be Offered Under Tariff, at 26-27 (filed Nov. 28, 1994). AT&T also has sought to offer a bundled package of 800 service and non-AT&T-manufactured computer devices. See Petition for Limited Waiver of the Customer Premises Equipment Unbundling and Detariffing Requirements of the Second Computer Inquiry, DA 93-1036 (filed Aug. 6, 1993). The carrier ultimately withdrew the petition.

The same pattern can be observed in the local exchange market. Pursuant to the terms of the Modification of Final Judgment, the Bell Operating Companies ("BOCs") were prohibited from manufacturing customer premises equipment. See United States v. American Tel. & Tel. Co., 552 F. Supp. 131, 191 (D.D.C. 1982), aff'd sub nom. Maryland v. United States, 460 U.S. 1001 (1983). Despite this restriction, the BOCs repeatedly sought to bundle CPE with their basic service offerings. See supra n.22.