

unlikely to have the incentive or ability to develop equipment that competes "intermodally" against network-based facilities or services.

C. Permitting Interexchange Carriers to Bundle CPE Would be Inconsistent with the Policies Underlying the Telecommunications Act and the Administration's NII/GII Initiative

1. Unbundling

The Commission's rebundling proposal is inconsistent with the Telecommunications Act of 1996, which embodies a strong congressional commitment to CPE unbundling. Section 304 of the Act expressly preserves the Commission's No-Bundling Rule.⁴⁷ This provision further directs the Commission to extend the existing unbundling regime to multichannel video programming systems, such as cable systems and direct broadcast satellite systems.⁴⁸ Pursuant to Section 304, the Commission is to adopt rules that prevent multichannel video programming system operators from requiring a customer to purchase or lease equipment as a condition of receiving service.⁴⁹ The rules also must provide that, in any case in which a system operator seeks to provide CPE, it must offer the equipment on a "stand-alone" basis at a cost-based price. System operators are expressly forbidden from using service revenues to

⁴⁷ Telecommunications Act of 1996, Pub. L. No. 104-104, § 304, 110 Stat. 56, 125, 104th Cong., 2d Sess. (1996) (to be codified at 47 U.S.C. § 549).

⁴⁸ See id.

⁴⁹ Id.; see also H.R. Conf. Rep. No. 458, 104th Cong., 2nd Sess. 181 (1996) ("[O]ne purpose of this section is to help ensure that consumers are not forced to purchase or lease a specific proprietary converter box, interactive device or other equipment from the cable system or network operator.").

cross-subsidize CPE prices.⁵⁰ The Commission proposal to retreat from its long-standing unbundling policy reflects a disturbing disregard for the clear policy choices made by the Congress.

The Telecommunications Act also includes a provision governing the "sunset" of the multichannel video programming system no-bundling rules. In determining when the rules should expire, Congress rejected a proposal that would have linked elimination of the no-bundling requirement solely to the advent of competition in a relevant market.⁵¹ Rather, Congress determined that the no-bundling provision should remain in effect until the Commission finds that the relevant service and equipment markets are competitive and that elimination of the rule would be in the public interest.⁵² The Notice's mechanical reliance on the Commission's prior finding that no interexchange carrier is dominant stands in stark contrast to Congress' direction that the Commission must conduct a public interest analysis before permitting bundling.

2. Interconnection

The Telecommunications Act also seeks to promote interconnection of diverse networks.⁵³ Consistent with that goal, the Act requires all carriers -- including interexchange carriers -- to interconnect "with the facilities and equipment of other telecommunications

⁵⁰ See Telecommunications Act § 304 (permitting operators to provide equipment only "if the . . . charges to consumers for such devices and equipment are separately stated and not subsidized by charges for any . . . service").

⁵¹ See H.R. 1555, 104th Cong., 1st Sess. § 203 (1995).

⁵² See Telecommunications Act § 304.

⁵³ See, e.g., Telecommunications Act § 101(a) (to be codified at 47 U.S.C. § 256(a)(2)) (establishing a congressional policy "to ensure the ability of users and information service providers to seamlessly and transparently transmit and receive information between and across telecommunications networks.").

carriers."⁵⁴ This provision complements the No-Bundling Rule, which requires carriers to interconnect with private networks (such as those that link multiple schools, hospitals, or places of business) and value added networks (which combine data transport service with enhanced services such as protocol conversion), even if those networks choose to provide their own CPE.

Many private and value added networks serve more end-users than many independent local exchange carriers. Under the Notice's proposal, however, an interexchange carrier could refuse to interconnect with a private network or a value added network that chose to deploy competitively provided CPE, while being required to interconnect with a local exchange carrier that uses identical equipment. This anomalous result plainly would thwart Congress' effort to promote widespread interconnection of disparate networks. It also would be inconsistent with the vision that the Administration has advanced as part of its National Information Infrastructure/Global Information Infrastructure Initiative, which seeks to foster an interconnected, interoperable communications infrastructure that will facilitate the transfer of information across the country and the world.⁵⁵

D. Rebundling Would Create Significant Administrative Burdens

Adoption of the rebundling proposal would allow interexchange carriers to provide CPE as part of their regulated transmission service offering. This would result in the reregulation of the bundled CPE. Bundling also would blur the boundary between regulated

⁵⁴ Telecommunications Act § 101(a) (to be codified at 47 U.S.C. § 251(a)).

⁵⁵ See Vice President Al Gore, Address before the International Telecommunication Union (Mar. 21, 1994) ("Today. . . it is not only possible, but desirable, to have different companies running competing -- but interconnected networks . . .").

transmission service and competitively provided CPE, making application of existing rules -- such as Part 68 and the All-Carrier Rule -- far more difficult. The proposal also would create an asymmetric regulatory regime between interexchange carriers and local exchange carriers ("LECs"), requiring the Commission to resolve numerous disputes as to when a given carrier can, and cannot, bundle.

1. Re-regulation of CPE

Pursuant to the No-Bundling Rule, all customer premises equipment must be offered on a non-regulated basis, separate from the carrier's basic transmission service. If the Commission relaxes the No-Bundling Rule, however, interexchange carriers would be free to offer CPE as part of their regulated transmission service offering. Such CPE "reregulation" plainly is inconsistent with congressional directives and Commission policy.⁵⁶

CPE reregulation also would result in increased administrative burdens. Title II of the Communications Act requires that rates for regulated services be just, reasonable, and not

⁵⁶ Adoption of the proposal contained in the Notice also would be inconsistent with the Commission's policies governing inside wiring. These policies require that carriers unbundle inside wiring and provide it on a non-regulated basis. See Detariffing the Installation and Maintenance of Inside Wiring, Second Report and Order, 51 Fed. Reg. 8498 (rel. Mar. 12, 1986). As the Commission recently explained, "the deregulation of inside wiring, in combination with the deregulation of CPE undertaken in Computer II," was intended to create "unregulated and highly competitive markets for all telephone-related services performed on the customer side of the demarcation point." Telecommunications Services Inside Wiring, Notice of Proposed Rulemaking, CS Docket No. 95-184, at ¶ 41 (rel. Jan. 26, 1996). This policy has been so successful that the Commission is now considering whether to extend it to inside wiring used in conjunction with broadband networks, such as cable systems. See id. at ¶¶ 42-48. CPE and inside wiring are conceptually identical: they are both premises-based products that allow the end-user to connect to, and interact with, the carrier network. If interexchange carriers were allowed to bundle CPE with their regulated transmission service, it would be difficult for the Commission to preserve -- much less expand -- its highly successful, pro-competitive rules allowing customer control over inside wiring.

unreasonably discriminatory.⁵⁷ If carriers are permitted to provide CPE as part of their regulated transmission service offering, the Commission would be required -- for the first time in nearly two decades -- to ensure that CPE prices comply with the Title II pricing requirements.

IDCMA recognizes that the Commission has proposed to eliminate the tariff filing requirement in the interexchange market.⁵⁸ Even if it does so, however, the rates charged by interexchange carriers for regulated services would remain subject to the Title II pricing requirements. In the absence of tariffs, the review of carrier compliance with these requirements will be a difficult task.⁵⁹ Allowing carriers to offer CPE as part of their regulated offerings would make this task even more difficult. In order to determine the legality of a carrier's charges, the Commission presumably would have to allot a portion of the carrier's overall charge to CPE and the remainder to transmission service, and then determine whether each element is lawfully priced.

2. The regulated/non-regulated boundary

The boundary between regulated basic service and non-regulated enhanced service and CPE offerings is critical to the Commission's regulatory regime. For example, the Commission's Part 68 and network disclosure rules apply at the regulated/non-regulated border. Because this boundary is clear and well-established, the Commission's application of these rules has been relatively straightforward. The proposal contained in the Notice, however, would blur

⁵⁷ See 47 U.S.C. §§ 201(b) & 202(a).

⁵⁸ See Notice ¶¶ 27-32.

⁵⁹ Such review will be required in any case in which a customer files a complaint, pursuant to Section 208 of the Communications Act, contesting the lawfulness of a carrier's charges. See 47 U.S.C. § 208. Commission determinations in such matters would remain subject to judicial review.

the boundary by allowing carriers to combine basic service and CPE in a single package. This, in turn, would make application of the existing rules far more difficult.

Part 68. Adoption of the rebundling proposal would substantially complicate administration of the Commission's Part 68 registration program.⁶⁰ This program facilitates consumers' ability to provide their own CPE by assuring that such equipment complies with standards designed to prevent technical harm to the network. Under the Commission's rules, only equipment that directly connects to the "network" is subject to registration.

If interexchange carriers were allowed to bundle CPE into their regulated offerings, the network boundary would change. As a result, equipment that currently is not subject to registration would need to be registered. For example, if an interexchange carrier were allowed to include Channel Service Units/Data Service Units ("CSUs/DSUs") as part of the regulated network service, then premises-based routers, which interconnect the CSUs/DSUs, would become subject to registration under the Part 68 rules. If a carrier also sought to bundle the routers into its regulated offering, then local area network ("LAN") equipment, which interconnects to the routers, would have to be registered.⁶¹ Different carriers no doubt would bundle various levels of CPE into their network offerings, creating continuing uncertainty as to which equipment must be subject to Part 68 registration. The end-result would be an increase in CPE registrations and the resources that the Commission would have to devote to administration of the Part 68 program.

⁶⁰ 47 C.F.R. § 68.1 et seq.

⁶¹ AT&T has sought to offer precisely this kind of package to its packet service and frame relay customers, under the trade names "ACCUWAN" and "Extended Connectivity" service. See, e.g., AT&T ACCUWAN Service Overview ("ACCUWAN service moves the [service] boundaries . . . to the LAN interface on the customer premises.").

Network disclosure. Under the Commission's All-Carrier Rule, all facilities-based carriers must disclose relevant network interface information necessary to allow non-carrier-affiliated manufacturers to design CPE that can interoperate with the network.⁶² If carriers are permitted to offer CPE as part of their regulated network offerings, however, the network interface -- and, hence, the disclosure obligation -- would shift depending on the CPE functionality that a carrier included within its network offering. This would create numerous disputes as to the extent of the carriers' disclosure obligations.⁶³

3. The interexchange/local exchange boundary

While the Notice proposes to allow IXC's to bundle interexchange service with CPE, local exchange carriers would continue to be prohibited from bundling local exchange service with CPE. As carriers begin to enter different service markets and offer combined service packages, implementation of this asymmetric regime would create serious administrative problems.

The major interexchange carriers are poised to enter various local exchange service markets. Their goal is to offer customers an integrated service package combining both local exchange and interexchange services. If the Commission adopts the bundling proposal set

⁶² Amendment of Section 64.702 of the Commission's Rules and Regulations (Second Computer Inquiry), Reconsideration Order, 84 F.C.C.2d 50, 82-83 (1980).

⁶³ Allowing a carrier to shift the network interface by bundling CPE would enable the carrier to place independent manufacturers at a significant competitive disadvantage. Independent manufacturers expend significant amounts of money to design equipment to interoperate with the interface presented by the carrier's network. If a carrier can change that interface simply by bundling additional CPE, it will have unrestricted ability to render the independent manufacturer's products useless. The end-result would be the elimination of the national market for CPE, which the network disclosure rules have allowed. In its place would be a patchwork of discrete networks, each of which would require CPE designed to interoperate with its unique interface.

out in the Notice, it would have to determine whether an interexchange carrier could bundle CPE with such an offering.⁶⁴

The difficulty of determining the applicability of the No-Bundling Rule will be compounded when incumbent local exchange carriers begin to enter the interexchange market.⁶⁵ If interexchange carriers are allowed to offer packages consisting of interexchange service, local exchange service, and CPE, proponents of "regulatory parity" will argue that local exchange carriers should be allowed to do so as well.⁶⁶ The Commission will have to decide whether incumbent local exchange carriers should be subject to a more stringent bundling rule than interexchange carriers because they remain dominant in their "core" markets. If the Commission were to make such a distinction, it also would have to determine whether other service providers that lack market power -- such as competitive access providers and providers of cable telephony -- should be allowed to bundle CPE in a package that includes both interexchange and local exchange service.⁶⁷

The end result will be a never-ending series of requests to determine when a carrier can, or cannot, bundle. The process is likely to consume scarce significant administrative resources, while leading to a further erosion of the No-Bundling Rule.

⁶⁴ The Commission also will have to determine whether an interexchange carrier can offer a package that bundles CPE with interexchange and international service. This task is complicated by the fact that the Commission continues to classify AT&T as dominant in the international market, while it classifies AT&T's IXC competitors as non-dominant.

⁶⁵ See Telecommunications Act § 151(a) (to be codified at 47 U.S.C. § 271(b)).

⁶⁶ Cf. id. (to be codified at 47 U.S.C. § 271(e)(1)) (providing that an IXC may not jointly market its service with resold BOC local exchange service unless the BOC is authorized to provide in-region interLATA service).

⁶⁷ See id. at § 304 (barring cable operators from bundling CPE used in conjunction with multichannel video programming and "other services" -- such as telephony).

E. Permitting Interexchange Carriers to Bundle Would Violate U.S. International Obligations, and Would Be Inconsistent With U.S. Trade Policy

The Notice specifically requests comment on the impact that allowing CPE bundling in the interexchange market would have on the United States' international commitments.⁶⁸ As demonstrated below, allowing CPE bundling in the interexchange market would violate the binding obligations imposed by the General Agreement on Trade in Services ("GATS") Telecommunications Annex and the North American Free Trade Agreement ("NAFTA"), while undermining U.S. efforts to further open foreign equipment markets to U.S. manufacturers.

1. The GATS Telecommunication Annex

Section 5(b) of the GATS Telecommunications Annex requires signatories -- including the United States -- to ensure that common carriers allow service providers within their borders "to purchase or lease and attach terminal or other equipment which interfaces with the network and which is necessary to supply [their] services."⁶⁹ In addition, Section 5(e) of the Annex requires signatory nations to ensure that carriers impose no conditions on access to, and use of, the public telecommunications infrastructure other than those necessary to safeguard public service responsibilities, protect technical integrity, and ensure against the performance of services not yet liberalized.⁷⁰

⁶⁸ See Notice at ¶ 89.

⁶⁹ See General Agreement on Trade in Services, Telecommunications Annex, Final Act Embodying the Results of the Uruguay Round of Multilateral Trade Negotiations, § 5(b) (1994) (reprinted in H.R. Doc. No. 316, 103d Congress, 2d Sess. 1617 (1994)).

⁷⁰ Id. § 5(e).

At the present time, the United States' commitment to ensure that common carriers in the United States provide these equipment interconnection rights extends to service providers that, under Commission rules, are classified as enhanced service providers ("ESPs").⁷¹ If the Commission were to allow interexchange carriers to bundle CPE, these carriers could require ESPs to attach carrier-provided CPE in order to obtain basic transmission service. Such a restriction would violate Sections 5(b) and 5(e) of the GATS Telecommunications Annex.⁷²

The Commission could allow interexchange carriers to bundle CPE, while ensuring that the United States meets its current obligation under the GATS Telecommunications Annex, by carving out an "ESP exception" to the proposed interexchange rebundling rule. Under this approach, interexchange carriers would be prohibited from requiring ESPs to accept packages of transmission service and CPE. Such a provision, however, would prove very difficult to enforce. It would require the Commission to make difficult distinctions between ESPs and other categories of users (such as private network operators) that presumably could be required to accept IXC-provided premises equipment.

Even if the administrative problems could be overcome, however, it would be anomalous to treat enhanced service providers -- who, under existing Commission rules, are just

⁷¹ U.S. Schedule of Specific Commitments, at 45 (reprinted in 30 Uruguay Round on Multilateral Trade Negotiations: Legal Instruments Embodying the Results of the Uruguay Round of Multilateral Trade Negotiations Done at Marrakesh on 15 April 1994 25,299 (1994)).

⁷² Permitting interexchange carriers to bundle CPE also would violate the "standstill" provision of the Decision establishing the Negotiating Group on Basic Telecommunications ("NGBT"). Such an action would constitute a retreat from the liberalized regulatory regime currently governing CPE in the United States. See Decision on Negotiations on Basic Telecommunications, Final Act Embodying the Results of the Uruguay Round of Multilateral Trade Negotiations, at 414 (1994) (reprinted in H.R. Doc. No. 316 at 1706).

another category of communications service customers -- differently from other customers. The legality of such a solution, moreover, might be short-lived: the United States has now offered to extend its commitments under the GATS Telecommunications Annex to all service providers.

2. NAFTA

The Commission's rebundling proposal also would violate Article 1302 of the North American Free Trade Agreement.⁷³ The United States' obligation under this provision is substantially broader than the United States' undertaking in the GATS Telecommunications Annex. Article 1302 requires the United States to ensure that "all persons" -- not just ESPs -- "are permitted to purchase or lease, and attach terminal or other equipment that interfaces with the public telecommunications transport network."⁷⁴ NAFTA also contains a provision, similar to the one in the GATS Telecommunications Annex, that requires the U.S. Government to "ensure that no condition is imposed on access to and use of public telecommunications transport networks or services" other than those necessary to "protect the technical integrity" of the network or fulfill any public service responsibilities.⁷⁵ Because the Commission's rebundling proposal would allow interexchange carriers to deny end-users the right to interconnect competitively provided CPE, it is flatly inconsistent with these binding obligations.

3. Foreign trade

Adoption of the "rebundling" proposal contained in the Notice also would undermine the U.S. Government's efforts to open foreign markets to telecommunications

⁷³ North American Free Trade Agreement, H.R. Treaty Doc. No. 159, art. 1302(2)(a) 103d Cong., 1st Sess. (1993).

⁷⁴ Id.

⁷⁵ Id. at art. 1302(6).

equipment manufactured in the United States. In recent years, foreign regulatory authorities have adopted pro-competitive measures to prevent their telecommunications organizations from discriminating against U.S. equipment manufacturers. For example, Japan,⁷⁶ Korea,⁷⁷ and the European Community⁷⁸ have pursued liberalized policies that permit users to connect foreign manufactured CPE to the public telecommunications network. Due to the rigors of the domestic CPE market, U.S. telecommunications equipment manufacturers have been well-positioned to take advantage of such export opportunities and to compete against their foreign counterparts. As a consequence, exports have increased, and high-skilled jobs have been created for U.S. workers.

If the U.S. Government were to retreat from its long-standing opposition to CPE bundling, however, it would be more difficult to continue to urge other nations to move toward a more liberalized equipment policy. Contrary to the suggestion in the Notice, the United States is unlikely to convince foreign governments that their carriers should be subject to stringent

⁷⁶ As part of the 1990 Market-Oriented Sector-Specific ("MOSS") negotiations with the United States, for example, Japan agreed to allow customers in Japan to purchase digital network channel terminating equipment ("NCTE") from U.S. manufacturers, rather than having to lease such equipment from Japanese suppliers or carriers. See Letter from the Honorable Ryohei Murata, Japanese Ambassador to the United States, to the Honorable Carla A. Hills, U.S. Trade Representative (July 31, 1990).

⁷⁷ In 1992, Korea signed a bilateral agreement with the United States permitting users in Korea to attach any type-approved analog or digital wireline equipment to the public telecommunications network. See Letter from the Honorable Hong-Choo Hyun, Korean Ambassador to the United States, to the Honorable Carla A. Hills, U.S. Trade Representative, Attachment at 19 (Feb. 24, 1992).

⁷⁸ See Commission Guidelines on the Application of EEC Competition Rules in the Telecommunications Sector, 1991 O.J. (C 233) 2, 237 ¶ 134 (1991).

unbundling requirements because they have market power, while U.S. interexchange carriers should be allowed to bundle because they are "subject to competition."⁷⁹

In light of the above, it is clear that adoption of the rebundling proposal contained in the Notice would be both unlawful and not in the public interest. As IDCMA demonstrates below, adoption of the proposal also would impair the pro-competitive, antitrust-based policies that the proposal purports to advance.

III. DISMANTLING THE NO-BUNDLING RULE WOULD ALLOW INTEREXCHANGE CARRIERS TO ENGAGE IN ANTI-COMPETITIVE CONDUCT

The Commission has based its proposal to allow interexchange carriers to bundle CPE solely on antitrust grounds. Yet, the Commission's analysis of the highly complex antitrust issues raised by this proposal is disturbingly cursory. Indeed, the Commission does nothing more than to recite that -- because the interexchange market is "substantially competitive" and the CPE market is "fully competitive" -- it is "unlikely" that interexchange carriers could use "monopoly power" in the transmission service market to "force" customers to purchase carrier-provided CPE and, thereby, "monopolize" competition in the CPE market.⁸⁰

The Notice's invocation of prior Commission findings regarding the level of competition in the interexchange market is not a substitute for a reasoned assessment of the ability of interexchange carriers to dictate their customers' CPE choice. There is good reason to believe that interexchange carriers have such power. The Commission's rebundling proposal

⁷⁹ Notice at ¶ 90 n.193.

⁸⁰ Id. at ¶¶ 86-88.

also raises antitrust concerns because it ultimately would extend to the now-competitive CPE market the oligopoly conditions that exist in the interexchange service market.

A. Bundling By Interexchange Carriers Can Constitute a Per Se Violation of the Federal Antitrust Laws

The proposal contained in the Notice would allow interexchange carriers to require their basic service customers to purchase carrier-provided customer premises equipment. In antitrust law, this practice is referred to as tying.⁸¹ The Supreme Court has made clear that antitrust law seeks to prevent a firm from using its "control over the tying product to force the buyer into the purchase of a tied product that the buyer . . . might have preferred to purchase elsewhere."⁸² For that reason, the Court has held that "when 'forcing' occurs" or is "probable," a tying agreement is per se unlawful under Section 1 of the Sherman Act.⁸³ The

⁸¹ The typical tying case involves an express requirement by the seller of the "tying" product that the buyer also purchase the "tied" product. However, the courts and commentators have recognized that an offer to provide customers who purchase a tying product with a deep discount on a tied product (unrelated to any cost savings resulting from joint provision) also can constitute a tying agreement. See Phillip E. Areeda, IX Antitrust Law: An Analysis of Antitrust Principles and Their Application ¶ 1717.d.3 (1991). Thus, the antitrust law restrictions on tying are applicable if an interexchange carrier either requires a basic service customer to purchase carrier-provided CPE or if the carrier prices CPE at a level so low that the "only viable economic option is to purchase" the transmission service and the CPE "together in a single package." Ways and Means, Inc. v. IVAC Corp., 506 F. Supp. 697, 701 (N.D. Cal. 1979), aff'd, 638 F.2d 143 (9th Cir. 1981), cert. denied, 454 U.S. 895 (1981); see also Amerinet v. Xerox Corp., 972 F.2d 1483 (8th Cir.), cert. denied, 113 S. Ct. 1048 (1993).

⁸² Jefferson Parish Hosp. Dist. No. 2 v. Hyde, 466 U.S. 2, 14-15 (1984).

⁸³ Id. at 16. In many cases, tying also can restrict competition in the market for the "tied" product. Nonetheless, contrary to the suggestion contained in the Notice, see Notice at ¶ 87, it is not necessary to demonstrate that a party is likely to "monopolize" the market for the tied product in order to make out a per se violation of the antitrust laws. See, e.g., Parts and Electrical Motors v. Sterling Electric, 826 F.2d 712, 719 (7th Cir. 1987) ("[T]he requirement that there be a threat of market power in the tied product has not

Court further has made clear that, in determining whether an entity has the ability to "force" a customer to purchase a "tied" product, the analysis must be guided by "actual market realities," rather than "formalistic distinctions."⁸⁴

If the Commission seeks to justify its proposal on antitrust grounds, it must demonstrate that interexchange carriers lack the ability to "force" their customers to use carrier-provided CPE. In conducting this analysis, it not sufficient for the Commission to rely on a "formalistic distinction" between those carriers that it has classified as dominant and those that it has classified as non-dominant in the interexchange market. Rather, the Commission must conduct a fact-specific assessment of the "realities" of the interexchange service and CPE markets, and the relationship between them.⁸⁵

The Supreme Court's decision in Eastman Kodak Company v. Image Technical Services provides useful guidance. In Kodak, the Court found that -- because of the unique structure of the market -- a firm that lacked market power in the photocopier sales market might nonetheless have the ability to force incumbent customers to purchase its copier repair service. This could occur, the Court explained, because customers might make the initial decision to purchase a photocopier/parts/services package without separately assessing the costs and benefits

been endorsed as a requisite for a tying violation by a Supreme Court majority."). Thus, a tying agreement by an interexchange carrier would be unlawful even if it is not likely to result in the creation of a monopoly in the CPE market.

⁸⁴ Eastman Kodak Company v. Image Technical Services, 541 U.S. 451, 466 (1992).

⁸⁵ See Digidyne Corp. v. General Corp., 734 F.2d 1336, 1341 (9th Cir. 1984), cert. denied, 473 U.S. 908 (1985) (In a tying case, issue is not whether the defendant has market power in the tying market, it is whether -- because of the market structure -- the defendant has the ability to "force" some of its customers to purchase tied products that they would have preferred not to buy.).

of the parts and service, which account for only a small portion of the total cost of the package. Once they had bought the package, the Court continued, customers might be "locked-in" to the photocopier supplier because of the high cost of purchasing another photocopier. As a result, the Court concluded, the firm could "force" its customers to continue to purchase its repair service.⁸⁶

In a similar manner, the relationship between the interexchange service and CPE markets makes it possible for carriers that do not have market power in the interexchange service market to force customers to purchase carrier-provided CPE. As in Kodak, there are good reasons to believe that customers who purchase interexchange service/CPE packages often do not separately consider the costs and benefits of CPE, which represents a small portion of the total cost of the package. Once a customer has selected an interexchange carrier, the carrier can "lock-in" the customer through the use of long-term contracts and early termination penalties. Such practices are becoming increasingly common, especially in the business services market. Because the customer then lacks the ability to switch carriers easily, the carrier can "force" the customer to meet its future equipment needs using additional carrier-provided CPE. Indeed, once the customer has purchased the initial piece of carrier-provided CPE, it may be required to obtain additional carrier-provided CPE in order to ensure interoperability among premises-based devices.

The ability of interexchange carriers to engage in "forcing" is even greater than that of the photocopier manufacturer in Kodak. While Kodak indisputably lacked market power in the photocopier market, there remain good reasons to conclude that the leading interexchange

⁸⁶ See Kodak, 541 U.S. at 476.

carrier, AT&T, retains at least a degree of market power in the interexchange market. Plainly, under traditional antitrust analysis, a firm with a sixty percent share of a market in which the top three participants account for ninety percent of all sales would be presumed to have a degree of market power. AT&T has repeatedly exercised this power by increasing prices for interexchange service in the face of declining costs.⁸⁷ Moreover, even if AT&T lacks market power in the over-all interexchange market, the Commission now recognizes that AT&T appears to possess market power in several significant submarkets, such the analog private line service market.⁸⁸ Because interexchange carriers have the ability to "force" customers to obtain carrier-provided CPE, preservation of the CPE No-Bundling Rule is necessary to prevent interexchange carriers from engaging in conduct that would constitute a per se violation of the Sherman Act.

B. Even in the Absence of Single Firm Market Power, Bundling Can Have Anti-Competitive Effects

The Notice relies heavily on the Commission's prior finding that the interexchange market is "substantially competitive." However, even if no one firm in the interexchange market has the ability to engage in unilateral anti-competitive conduct, evidence exists that the interexchange service market is an oligopoly, in which three large providers collectively have the ability to establish prices.⁸⁹ At a minimum, under the DOJ-FTC Merger Guidelines, the

⁸⁷ See Comments of the Independent Data Communication Manufacturers Association, CC Docket No. 79-252, at 6-10 (June 9, 1995) ("IDCMA AT&T Reclassification Comments").

⁸⁸ Notice at ¶ 40 ("AT&T might possess the ability to raise and sustain prices for . . . analog private line service above competitive levels without making the price increase unprofitable.").

⁸⁹ See Notice at ¶ 80-81.

interexchange market must be considered highly concentrated.⁹⁰ Indeed, even if several new firms enter the market, such concentration is likely to remain for years to come.

Allowing participants in a concentrated market to engage in bundling can raise serious competitive concerns. As Professor Areeda explained, "oligopolists in a tying market might transfer their concentrated market structure from the tying to the tied market."⁹¹

Professor Areeda went on to provide the following example:

suppose that all users of product B need a product A, which is supplied only by five sellers; each of them supplies A only to those who take their B requirements from him. So long as these tying arrangements continue, they create and maintain an oligopoly in the tied market by denying all potential customers to any new supplier of B. This total denial of potential patronage to others is well captured by the 100% foreclosure that results from adding together the separate foreclosure of each tying seller.⁹²

In the present case, allowing interexchange carriers to bundle CPE could result in a situation in which each of the major IXCs "teams up" with one CPE vendor, and then provides that vendor's CPE as part of its regulated service offering. This would eliminate the current competitive CPE market, in which a large number of manufacturers compete to sell equipment to the vast end-user market. In its place, a new oligopoly/oligopsony market would

⁹⁰ The Merger Guidelines assess the degree of market concentration using the Herfindahl-Hirschman Index ("HHI"), which is calculated by summing the squares of the market shares of the participants in a given market. Under the Guidelines, a market with an HHI above 1,800 is considered to be "highly concentrated." See Department of Justice and Federal Trade Commission, Horizontal Merger Guidelines §§ 1.5-1.51 (Apr. 2, 1992), reprinted in 4 Trade Reg. Rep. (CCH) ¶ 13.104. In 1995 the interexchange market had an HHI of 3,936. See IDCMA AT&T Reclassification Comments at 6. The HHI for the private line sub-market, moreover, stood at 5,320 -- an extraordinarily high level of concentration. Id. These figures have not changed perceptibly in the past year.

⁹¹ Areeda, IX Antitrust Law ¶ 1704.c.4.

⁹² Id.

arise, in which a handful of manufacturers would make equipment sales to a few carrier-purchasers. Such an outcome plainly is at odds with the pro-competitive goals of the antitrust laws.

C. Bundling Will Not Provide Competitive Benefits

Finally, the Notice fails to demonstrate that allowing IXCs to bundle interexchange service and CPE would provide any pro-competitive benefits. Rather, the Notice simply quotes a footnote from the Computer II Final Decision, in which the Commission engaged in a brief theoretical discussion of the possibility of consumer benefits from commodity bundling. In the footnote, the Commission observed that, in a market characterized by "workable competition," bundling might benefit consumers by reducing transaction costs.⁹³ Bundling, however, is not necessary to reduce transaction costs. Under the No-Bundling Rule, carriers may offer consumer packages containing both interexchange service and CPE -- provided that each element also is separately offered and separately priced.

Nor does bundling result in production efficiencies. If all network operators are required to disclose customer interface information, then any customer equipment manufacturer will be able to design interoperable products. Packaging transmission service and equipment will only serve to thwart competition from the independent customer equipment sector by providing network-affiliated equipment manufacturers with an artificial advantage in the sale of their products.

Finally, bundling does not lower the total cost to consumers of service/CPE packages. A carrier that provides a deep discount on CPE to customers that buy a service/CPE

⁹³ Computer II Final Decision, 77 F.C.C.2d at 443 n.52.

package still must recover the cost of both components of the package. If the carrier lowers the "up front" purchase or lease price of the CPE, it will have no choice but to recover the costs through service charges. CPE costs are non-usage-sensitive. If these costs are recovered through usage-sensitive transmission service charges, high volume service users will be required to contribute far more than the cost of the CPE they are using, thereby causing significant market distortions.

IV. REQUIRING INTEREXCHANGE CARRIERS TO OFFER AN UNBUNDLED BASIC SERVICE OPTION IS NECESSARY, BUT INADEQUATE

The Commission also has requested comment on an alternate proposal -- modeled on the regulatory regime in the cellular market -- that would allow interexchange carriers to offer bundled interexchange service/CPE packages, provided that they continue to offer interexchange service on an unbundled, nondiscriminatory basis.⁹⁴ As the Commission recognized in the cellular market, Section 202 of the Communications Act requires carriers to unbundle their underlying basic service and make that service available on a non-discriminatory basis.⁹⁵ Nonetheless, compliance with this statutory mandate would not satisfy the requirements of the Communications Act. Under the Commission's alternate proposal, an interexchange carrier still could require a customer to purchase carrier-provided transmission service in order

⁹⁴ Notice at ¶ 89.

⁹⁵ See Bundling of Cellular Customer Premises Equipment and Cellular Service, Notice of Proposed Rulemaking, 6 FCC Rcd 1732, 1775 (1991) ("[F]acilities-based carriers who provide cellular CPE and cellular service on a packaged basis will continue to be required to offer cellular service to agents, resellers, and other customers subject to . . . the nondiscrimination provisions of Section 202(a) of the Act." (footnote omitted)).

to obtain a discount on CPE. As demonstrated above,⁹⁶ this practice violates the non-discrimination requirements contained in Section 202 of the Act. Moreover, even if the Commission had the statutory authority to adopt its alternate proposal, strong policy considerations militate against it.

The Commission's alternate proposal is identical to the regime adopted in the Cellular CPE Bundling Order.⁹⁷ That decision, however, reflected the unique conditions in the relevant markets. In the cellular market, CPE accounts for a significant portion of the cost of a combined service/CPE "solution."⁹⁸ As a result, consumers' primary purchasing decision concerns the equipment they wish to obtain. Moreover, most cellular CPE is sold by independent retailers who also act as agents for the cellular carriers that service their locality.⁹⁹ These retailers typically offer CPE produced by several competing manufacturers. Given these conditions, the Commission concluded that it was unlikely that bundling would result in a situation in which the carriers could dictate customers' choice of equipment. Rather, the Commission believed, bundling would allow independent retailers to assemble packages that combined customer-selected CPE with transmission service.¹⁰⁰

⁹⁶ See supra § II.A.

⁹⁷ See Bundling of Cellular Customer Premises Equipment and Cellular Service, Report and Order, 7 FCC Rcd 4028, 4032 (1992) ("Cellular CPE Bundling Order").

⁹⁸ Id. at 4030.

⁹⁹ Id. at 4029-30.

¹⁰⁰ Id. at 4032. In deciding to allow bundling in the cellular CPE market, the Commission also relied on several public interest factors unique to the cellular market. Id. In particular, the Commission stressed the importance of promoting efficient use of the spectrum by increasing the number of customers subscribing to cellular service. The Commission reasoned that "the high price of cellular CPE" presented a "barrier" to

The structure of the interexchange market differs considerably from that of the cellular market. Most interexchange customers' primary concern is their transmission service, which constitutes the lion's share of the cost of an interexchange service/CPE solution. Moreover, the customer's principal point of contact for this service is the interexchange carrier, rather than an independent vendor. As a result, interexchange carriers have a far greater ability than cellular service providers to dictate their customers' CPE choices.

If the Commission were to adopt the alternate proposal, interexchange carriers likely would offer bundled service/CPE packages at the same -- or nearly the same -- price as the stand-alone transmission service.¹⁰¹ In theory, this approach would allow customers to obtain transmission service from an interexchange carrier, and then purchase the associated CPE from an independent vendor. In reality, however, once customers had obtained transmission service from the carrier, they would be unlikely to seek out an independent vendor and pay market price for competitively provided equipment, when they could obtain "free" equipment

wide-spread use of cellular service. By allowing sellers to provide steep discounts on equipment prices to consumers that agreed to purchase a combined cellular service/CPE package, the Commission hoped to induce more customers to subscribe to this service. Id. at 4031. CPE bundling in the interexchange market is not necessary to provide any of the public interest benefits that the Commission sought to achieve in the cellular market. As the Commission recognized in the AT&T Reclassification Order, interexchange capacity -- unlike spectrum -- is not in short supply. See Motion of AT&T Corp. to be Reclassified as a Non-Dominant Carrier, Order, ¶ 58, FCC 95-427 (rel. Oct. 23, 1995), recon. pending. Moreover, in the interexchange service market, the Commission's goal of widespread service availability has been achieved.

¹⁰¹ This scenario is not speculative. To the contrary, experience in the cellular market demonstrates that, if bundling is allowed, customers are likely to be offered CPE for "free" if they agree to enter into a long-term service contract. Because the cost of CPE accounts for a smaller proportion of the cost of the services/CPE "solution" in the interexchange market than it does in the cellular market, interexchange carriers are even more likely than cellular carriers to offer artificially low CPE prices as an inducement to customers to enter into long-term service contracts.

from the carrier.¹⁰² The end-result would be no different than if the carrier were permitted to offer all service on a bundled basis: customers would accept carrier-provided CPE, even if it was not the equipment that best met their needs.

V. AT A MINIMUM, THE COMMISSION SHOULD DEFER CONSIDERATION OF ANY CHANGE IN THE NO-BUNDLING RULE FOR THREE YEARS

The Commission's proposal to allow interexchange carriers to bundle interstate, interexchange service and CPE is deeply flawed. The evidence, IDCMA believes, demonstrates that this proposal would impede competition in the CPE market and harm the public interest. Nonetheless, IDCMA recognizes that the Commission may take a different view as to the cost and benefits of CPE bundling. Even if the Commission disagrees with IDCMA's analysis, however, a compelling reason exists to defer action on this radical proposal.

This is a time of considerable uncertainty in the telecommunications industry. As demonstrated below, actions taken by the Congress and the Commission -- as well as on-going international developments -- are likely to transform the telecommunications market in as-yet-unimaginable ways. In light of this substantial uncertainty, IDCMA believes the appropriate course of action is for the Commission to defer consideration of the rebundling proposal for at least three years.

The basis of the Commission's proposal is the increase in competition in the interexchange market. Yet, the extent to which the Telecommunications Act will promote competition by permitting the Bell Operating Companies to enter this market has yet to be seen.

¹⁰² The CPE, of course, is not free; the cost is recovered over time through higher transmission service charges. Bundling merely serves to conceal the true costs to consumers. See supra § III.C.

At present, there are reasons for concern. On the day the President signed the Telecommunications Act, commentators predicted that elimination of the Modification of Final Judgment would result in seven significant new entrants into the long distance market. Soon after the Notice was released, the merger of SBC Communications and Pacific Telesis reduced the potential to six. By the time these comments were filed, the Bell Atlantic-Nynex merger had reduced the number of potential BOC entrants to five. Moreover, it may be some time before any of the surviving BOCs obtain the state and federal regulatory approvals necessary to enter the in-region interexchange market.

There also are substantial questions as to whether BOC entry into the CPE manufacturing market will promote competition by increasing the number of market participants, or will impede competition by allowing the BOCs to use their substantial market power to disadvantage their rivals. At a minimum, it seems likely that several currently independent manufacturers will soon become BOC-affiliates. The future role of Bellcore, and the effect that a possible BOC divestiture will have, also remain unknown.

Actions taken by the Commission also have increased market uncertainty. The Commission's recent AT&T Reclassification Order has eliminated many regulatory constraints on the nation's largest interexchange carrier. In this proceeding, moreover, the Commission has proposed a mandatory forbearance regime which -- for the first time in the Commission's history -- would result in the provision of all interstate, interexchange service on a non-tariffed basis.

Future proceedings at the Commission will doubtless bring more changes. For example, the major interexchange carriers have asserted that Section 251 of the Telecommunications Act allows them to obtain cost-based, unbundled access service at prices

as much as 80 percent lower than current carrier access charges. How the Commission -- and, ultimately, the courts -- decide this question will profoundly affect the competitive structure of the interexchange market. Commission proceedings governing a wide range of additional issues -- from universal service to the revision of the customer proprietary network information rules -- also lie ahead. At the present time, it is simply not possible to predict how the Commission will resolve the difficult issues presented in these dockets, let alone what effects these decisions will have on the relevant markets.

Finally, the international telecommunications regulatory environment remains in flux. In particular, the extent to which the United States will bind itself to unbundle CPE as part of the on-going NGBT negotiations remains uncertain. The Commission should be wary of taking any action that would be inconsistent with, or which could undermine, the Government's international negotiating position.

In light of this substantial market uncertainty, the prudent course of action is for the Commission to defer consideration of this matter until the effect of the changes now under way can be determined. IDCMA believes that a three-year deferral period -- beginning upon adoption of the decision in this proceeding -- would be appropriate. At the end of that period, the Commission will be in a far better position than it now is to assess the costs and benefits of any alteration in the No-Bundling Rule.

There is little cost to this approach. Interexchange carriers currently have the right to provide "one-stop-shopping" for their customers, so long as they separately offer and separately price each element of the services/CPE package. Should any carrier make a case that