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

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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BELL ATLANTIC REPLY COMMENTS ON SECTIONS IV, V AND VI

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Affidavit of Robert W. Crandall

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SUMMARY AND INTRODUCTION

As the Commission has recognized, entry of the Bell operating companies into the long distance market is the key to bringing the benefits of true competition to long distance customers. As a result, the Commission should avoid imposing unnecessary regulation on these new entrants. In particular, the Commission should be most suspicious of the incumbents' arguments to impose unique burdens on new entrants while sparing existing providers.

In evaluating both a proposed separation requirement for out-of-region long distance service by the Bell companies, as well as the appropriate market definition to evaluate long distance market power, a number of parties recognized the importance of allowing the new entrant Bell companies to compete without unique encumbrances. Others, however, would have the Commission create

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

market barriers that would discourage long distance price competition. In general, the comments on the specific proposals fell into three groups.

The first group, typified by the Public Service Commission of Florida, new entrant Bell companies and others, recognized that existing regulations provide abundant appropriate safeguards, and that there is no need to impose the burden and cost of a separate subsidiary requirement on a new competitive service. Moreover, these commentators found that the Commission's historical definition of a national interLATA market is appropriate and should not be modified based on the participation of a new entrant in the market.

The second group, typified by AT&T and MCI, argue that while the national market is the right measure, traditional market definition is irrelevant for evaluating market power of the Bell companies. They argue that the Commission should abandon any economic analysis, and instead impose automatic penalties based on allegations concerning the Bell companies' market position for local services.

The third group, typified by Frontier and LDDS Worldcom, would accept a more traditional market power analysis of the Bell companies' long distance services, but would alter the market definition solely for the new entrants in order to reach their predetermined desired result -- namely burdensome regulations imposed exclusively on the new entrant Bell companies. Both the second and third group rely on their claim of in-region market power as justification to seek a separate subsidiary requirement on out-of-region long distance services. The Commission should reject the arguments of the later two groups and apply uniform regulation (and deregulation) of the long distance market, including the Bell companies.

I. The Commission Should Reject Efforts to Impose Unnecessary Regulatory Burdens on New Entrants to the Long Distance Market

Some commentators, including AT&T and MCI, argue that the Commission need not conduct a traditional market power analysis to evaluate the need for burdensome extra regulations on the Bell companies' long distance services.² These arguments are a tacit admission that a legitimate economic market power analysis would demonstrate that the newcomers to the national long distance market do not have greater market power than the incumbents. Because their desired result defies economic reason and common sense, the incumbents don't even attempt the analysis. Instead, they argue that the Bell companies' status as a provider of local exchange and access services is "direct proof" of market power.³ They are wrong, and their arguments ignore post-divestiture changes in regulation, the law, the competitive market and the historical record.⁴

First, the incumbents ignore the changes in the regulation of access services since divestiture. Most fundamentally, the Commission has moved from the perverse incentives of rate of return regulation to price caps, which divorce the level of allowed rates from accounting

² *See e.g.*, AT&T Comments at 7-14; MCI Comments at 7 (filed Apr. 19, 1996).

³ *See, e.g.*, AT&T Comments at 9.

⁴ *See, e.g.*, Comments of MCI at 13 ("There have been no marketplaces changes since [1980] that have appreciably loosened the LECs' bottleneck control").

costs.⁵ As a result, there is no incentive to shift costs from less regulated activities into the more regulated ones, because “the higher costs will not produce higher legal ceiling prices.”⁶ The Commission has also developed detailed cost accounting and allocation requirements since divestiture.⁷ While unnecessary with the advent of “pure” price caps -- which are pricing rules unadulterated by rate of return based sharing requirements -- these additional rules provide a redundant safeguard that the LECs will be unable to improperly shift costs without detection.⁸ In

⁵ ***See Bell Operating Company Provision of Out-of-Region, Interstate, Interexchange Services***, CC Docket 96-21, Affidavit of Robert W. Crandall, ¶ 8 (filed Mar. 13, 1996) (“Crandall 96-21 Aff.”), Reply Affidavit of Robert W. Crandall, ¶¶ 7-8 (filed Mar. 25, 1996) (“Crandall 96-21 Reply Aff.”) (both affidavits were filed as attachments to Bell Atlantic’s initial comments in this docket). ***See also Price Cap Performance Review for Local Exchange Carriers***, CC Docket 94-1, Reply Comments of Bell Atlantic, attached Affidavit of Alfred E. Kahn, ¶ 26 (filed June 29, 1994) (“It is only the presence of rate base/rate of return regulation that creates the possibility of recoupment and therefore of cross-subsidization”). The vast majority of states have made a similar transition. ***See*** Crandall 96-21 Reply Aff., ¶ 8.

⁶ ***National Rural Telecom Ass’n v. FCC***, 988 F.2d 174, 178 (D.C. Cir. 1993). MCI argues that current price cap rules are not adequate protection “since LECs may choose to be subject to sharing each year.” MCI Comments at 25. MCI’s arguments are the embodiment of “*chutzpah*”, given that it is MCI itself that is leading the charge against the LECs in their fight to eliminate sharing in the current review of price cap regulation. ***Price Cap Performance Review for Local Exchange Carriers***, CC Docket No. 94-1, MCI Comments at 19-22. Regardless, once in pure price caps, no company has returned to sharing and the Commission appears ready to end any remaining dispute by eliminating sharing altogether. ***Price Cap Performance Review for Local Exchange Carriers***, 10 FCC Rcd 13659, 13679 (1995).

⁷ ***See*** 47 C.F.R. Parts 32, 36, 64, and 69. Violators of accounting rules are subject to fines and imprisonment. 47 U.S.C. §§ 220 (d) and (e).

⁸ MCI’s citation to audit findings (p. 23) is evidence of yet an additional safeguard. Bell companies’ costs are subjected to multiple audits, not only from the companies’ own independent auditors, but auditors conducted or sponsored by the Commission. ***See Separation of Costs of Regulated Telephone Service from Costs of Nonregulated Activities***, 2 FCC Rcd 1298, 1330-31 (1987).

addition, the equal access rules ensure that customers have complete freedom to choose among all authorized long distance service providers.⁹

Second, the incumbents ignore the changes mandated by the 1996 Telecommunications Act. Before the Bell companies can begin serving even a single in-region long distance customer, they must meet the checklist requirements of Section 271. Section 271's interconnection and access to the network requirements assure that potential competitors will have an open market to compete for local and access services. As economist Dr. Robert Crandall explains in his attached affidavit, once the checklist has been met, the Bell companies will "have no greater ability to restrict competition within their regions than will other market participants."¹⁰

Third, even before the full impacts of the Act are felt, new access and local competition is multiplying at a staggering rate. Indeed, the most recent actions of the Bell companies' largest access customer, AT&T, give an indication of the pace of acceleration in local competition. In March, AT&T announced that it had filed with commissions in all 50 states to provide local services to business and residential customers.¹¹ Last month, AT&T announced alternative access agreements with competitive access providers that would bypass the local phone

⁹ See *MTS and WATS Market Structure, Amendment of Part 67 of the Commission's Rules and the Establishment of a Joint Board*, CC Docket Nos. 78-72, 80-286, Decision and Order, ¶ 2 (rel. Jan. 7, 1986).

¹⁰ Affidavit of Robert W. Crandall, ¶5 ("Crandall Affidavit").

¹¹ AT&T News Release, "AT&T completes initial steps to offer local phone service" (rel. Mar. 4, 1996). AT&T's chairman, Robert Allen indicated that AT&T planned to offer local service using "direct connections between AT&T switches." Other connection methods mentioned by Allen included cable television technology and alternative access providers. *Id.*

companies' networks in 70 cities.¹² "AT&T plans to offer local phone service throughout the country beginning as early as this summer in some areas."¹³ Sprint and MCI have taken their own actions and commitments to offer competitive local service.¹⁴ These companies race ahead with market plans to provide local service, while at the same time they complain to regulators about Bell companies' "bottleneck" control of these same services. The Commission must see through this Orwellian double-speak, and recognize what is actually happening in the marketplace.

Fourth, the incumbents ignore actual market experience. In fact, they are completely silent on the consistent record of vibrant competition in other markets that both rely on access or other local service, and yet allow Bell company participation. As Dr. Crandall has explained, in areas such as customer premises equipment, cellular, and voice messaging, the Bell companies have successfully participated in the competitive market without causing competitive harm.¹⁵

While their comments are rife with divestiture era complaints of "bottleneck" control, the incumbents have failed to show a realistic problem that would require the drastic "remedies" they advocate. As Bell Atlantic and others have explained, existing rules and market realities eliminate any danger of discrimination or cross subsidy, real or imagined.

¹² AT&T News Release, "AT&T, five companies sign alternative access agreements" (rel. Apr. 11, 1996). According to AT&T's Chairman, "[t]hese agreements demonstrate that AT&T will not limit itself to reselling local service . . ." *Id.*

¹³ *Id.*

¹⁴ *See* G. Naik, "MCI Plans to Buy Equipment to Offer Local Phone Service," *Wall Street Journal* at B6 (Mar. 6, 1995); *Communications Daily*, "Sprint and Cable Partners Spend \$4.4 Billion to Offer Wireline Service," at 2 (Mar. 30, 1995) ("Sprint alliance with TCI, Comcast and Cox will spend \$2.3 billion over next 3 years building competitive local service using cable systems and Sprint brand name").

¹⁵ *See* Crandall Affidavit, ¶ 11; Crandall 96-21 Aff., ¶¶ 12-13.

II. Long Distance Service Operates in a National Market

Despite the major incumbent long distance providers' unwillingness to support any reasoned market analysis, they do agree that the Commission's historic determination of long distance as a national market is correct.¹⁶ Several smaller incumbents, however, argue that the Commission should use one market definition for incumbents, and a separate market definition for the new entrant Bell companies.¹⁷ As the Notice recognizes, however, excess capacity and geographic rate averaging mean that long distance prices are set by a national market.¹⁸ Moreover, customers' purchasing decisions are based on selection of national service, and not any individual point to point connection. To the extent there is concern over a Bell company's market power stemming from its access service, the Florida State Commission correctly suggests that such concerns are addressed through the regulation of the access service, not by distorting the market definition in order to limit the ability of the company to provide competitive long distance service.¹⁹

¹⁶ *See, e.g.*, AT&T Comments at 5.

¹⁷ *See, e.g.*, Comments of LDDS WorldCom at 4-7; Comments of Vanguard Cellular Systems, Inc. at 8-11 (filed Apr. 19, 1996).

¹⁸ *Policy and Rules Concerning the Interstate, Interexchange Marketplace*, CC Docket No. 96-61, Notice of Proposed Rulemaking, ¶¶ 51-52 (rel. Mar. 25, 1996); *see also* Crandall Affidavit, ¶ 4.

¹⁹ "Rather than analyze point-to-point markets to identify the presence of market power, we believe that it would be a better use of resources to allow the price cap mechanism currently in place for interstate, interexchange access services to provide the check on an RBOC or independent LEC's exertion of market power." Comments of the Florida Public Service Commission at 8 (filed Apr. 19, 1996).

III. The Commission Should Reject a Separate Subsidiary Requirement for Bell Operating Company Out-of-Region Long Distance Services

As Bell Atlantic and others have made clear, there is no legitimate reason to hamstring Bell operating companies' out-of-region long distance service by mandating separate subsidiary requirements that have "outlived their usefulness."²⁰ At the same time the Commission is relying on the Bell companies to bring true competition to long distance service, such a requirement limits their service flexibility and increases the cost to consumers of their nascent service. One study estimates that structural separation can increase service costs by 30%.²¹ Parties favoring such restrictions offer no legitimate opposing arguments.

For example, AT&T argues that structural separation is required because it must disclose "future marketing plans and access needs" to LECs through their role as in-region access providers and participants on standard setting bodies.²² In fact, the 1996 Telecommunications Act explicitly forbids a carrier that obtains proprietary information from another carrier to use that information "for its own marketing efforts."²³

²⁰ Comments of the Florida Public Service Commission at 11; see also Bell Atlantic Comments on Sections IV, V and VI at 2-5 (filed Apr. 19, 1996); ***Bell Operating Company Provision of Out-of-Region Interstate, Interexchange Services***, CC Docket 96-21, Bell Atlantic Comments (filed Mar. 13, 1996) and Bell Atlantic Reply Comments (filed Mar. 25, 1996) (both comments were re-filed as an attachment to Bell Atlantic's initial comments in this docket).

²¹ See Crandall Affidavit, ¶ 7 (citing a 1995 study by Professor Jerry Hausman and Timothy Tardiff).

²² AT&T Comments at 25. AT&T also complains that such information is provided to Bellcore. While AT&T's argument is unrelated to a separate subsidiary requirement, it also ignores nondisclosure agreements in place with Bellcore.

²³ 47 U.S.C. § 222 (b). Even before passage of the Act, AT&T maintained proprietary agreements with individual Bell companies that limit the use of confidential information.

AT&T also argues that Bell companies could unfairly leverage their position with in-region customers that have out-of-region locations by bundling out-of-region long distance services with in-region local service. First, such packages would be subject to existing local regulation and could not be coercive or unreasonably discriminatory. Second, a separate subsidiary requirement is unrelated to this supposed harm. Third, as explained in earlier comments, AT&T already plans to offer its own bundled packages,²⁴ and is attempting to use the Commission's regulatory process as a vehicle to limit competition.²⁵

As discussed above, other commentators advocating a separate subsidiary repeat the same generic arguments that ignore the events of the last dozen years. For example, Vanguard Cellular claims that Bell Atlantic could raise its terminating access to CMRS providers to benefit its out-of-region long distance service.²⁶ But this argument simply assumes away the price cap

²⁴ According to AT&T's chairman, AT&T plans to make "bundled offers like the industry has never seen before." AT&T News Release, "AT&T's Allen outlines plans to enter local telephone market" (rel. Feb. 8, 1996).

²⁵ Indeed, some commentators argue that the Commission erect additional separation requirements, including a ban on joint marketing. *See, e.g.*, AT&T Comments at 27; Comments of the Telecommunications Resellers Association at 22-24 (filed Apr. 19, 1996). Such a ban would undermine one of the benefits of new competition and is inconsistent with the intent of the 1996 Act. *See*, 47 U.S.C. § 272(g)(2); *see also Bell Operating Company Provision of Out-of-Region Interstate, Interexchange Services*, CC Docket No. 96-21, Bell Atlantic Reply Comments at 7-8 (filed Mar. 25, 1996).

²⁶ Comments of Vanguard Cellular System Inc. at 4 (filed Apr. 19, 1996). Vanguard also complains that Bell Atlantic, using unfair leverage from its position as a LEC, forced a Philadelphia Sports stadium to preclude Comcast from advertising on the stadium premises. Vanguard Comments at 9-10. But Vanguard cites discredited arguments. The advertising contract related only to competitive businesses (cellular and Yellow Pages) and had nothing to do with Bell Atlantic's LEC services. Indeed, the Commission characterized Bell Atlantic's conduct there as "vigorous competition" and the "kind of conduct in which competitors may engage." *Bell Atlantic Mobile Systems, Inc. and NYNEX Mobile Communications Company, Application for Transfer*, 10 FCC Rcd 13368, 13380 (Wireless Bur. 1995, application for review pending).

restrictions on access prices. Under modern regulation, consumers should be spared the burden of paying for an insupportable separate subsidiary requirement.

IV. Bell Company Entry Into Long Distance is in the Public Interest

Despite AT&T's inability to articulate any potential harm not already addressed by existing regulations, AT&T goes beyond even the issues raised in the Notice and claims that its arguments raise issues that could prevent Bell companies from even offering long distance service in-region under Section 271 of the 1996 Act.²⁷ This is self-serving nonsense. Congress made a judgment on specific steps that must be taken before a Bell Company may provide in-region long distance. The checklist items ensure that the local market is opened to competitors -- in parallel to the opening of the long distance market. And it is the opening of the local market that provides the basis for long distance relief -- whether evidenced by an agreement with a predominantly facilities-based competitor, or in the absence of such a competitor, by a statement of generally applicable terms on which a Bell company has opened its network to use by others.

Ironically, at the same time it claims competitive entry into the long distance business should be blocked, AT&T argues that the Commission should avoid "an examination of the current characteristics of the interexchange market."²⁸ The reason is clear. An "examination of the current characteristics" of the long distance business demonstrates AT&T's price leadership

²⁷ AT&T Comments at 7 ("if a BOC continues to have the ability to use monopoly power in the local market . . . [that fact will] necessarily be critical to the Commission's 'public interest' analysis of any application by that BOC to provide interexchange service"). Bell Atlantic briefly responds to AT&T's misguided comments in this area despite the fact that they go far afield from the issues raised in the Commission's Notice.

²⁸ AT&T Comments at 8.

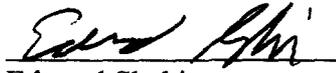
and the total lack of price competition among the leading incumbents.²⁹ By shattering that paradigm, Bell company entry will provide consumers the benefits of additional competition and serve the public interest.

CONCLUSION

Commentors that advocate special restrictions on the Bell operating companies long distance services ignore regulatory and market realities. The Commission should recognize a national long distance market for all providers, including the Bell companies. The Commission should also reject a burdensome separate subsidiary requirement for Bell company out-of-region long distance service.

²⁹ *See Policy and Rules Concerning the Interstate, Interexchange Marketplace*, CC Docket No. 96-61, Comments of BellSouth (Phase II), Declaration of Prof. Jerry A. Hausman at 3-4 (“AT&T, MCI and Sprint have engaged in ‘lock-step’ pricing with 7 price increases over the past 4 years”); Paul W. MacAvoy, *The Failure of Antitrust and Regulation to Establish Competition in Long-Distance Telephone Service Markets* at 180 (1996) (“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”).

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Edward Shakin", written over a horizontal line.

Edward Shakin

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Affidavit of Robert W. Crandall¹

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

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

2. I have been asked by Bell Atlantic to provide an analysis of certain issues raised by the Commission's Notice of Proposed Rulemaking and the comments filed in this proceeding. My analysis supplements affidavits that I prepared for submission with Bell Atlantic's Comments in Docket 96-21, dealing with BOC out-of-region provision of interexchange services, and which were appended to Bell Atlantic's Comments in this proceeding filed on April 19, 1996.

My curriculum vitae was attached to the initial affidavit.

Summary

3. In this affidavit, I concur with those commenters who suggest that the Commission continue to view the interstate interexchange market as a national market. Nothing would be gained by attempting to provide narrower definitions for dealing with one set of competitors, the BOCs or the LECs, while continuing to define the market as national for others. However, I differ with many of the IX commenters who want the Commission to require their nascent BOC competitors' interstate interexchange operations to be structurally separate from their intrastate networks so as to deprive the BOCs of operating and marketing economies that they -- the IX carriers -- are free to exploit. Given the advent of mandated unbundling of the BOCs' network elements, the increased entry into local markets that will result, the states' and the Commission's increasing reliance on rate caps, more than a decade of experience with equal access, and the sheer size of many of the IX carriers, the BOCs have neither the incentive nor the ability to use their in-region positions to impede interstate interexchange competition. Moreover, I believe that while the interstate interexchange market has become more competitive since the 1984 AT&T

divestiture, interstate rates are still likely to fall with the entry of additional national or regional competitors. The Commission should clearly weigh the benefits of such additional competition against the declining risk of any abuse of local-market position by the BOCs as it establishes the ground rules for interstate competition in the wake of the Telecommunications Act of 1996.

The National Interstate Interexchange Market

4. In antitrust analysis, a geographic market is defined by determining the smallest area or set of areas in which a single firm, if it were to gain control of all sales in a given region, could successfully raise price without suppliers from other regions increasing their sales into that market and defeating the price increase. In the case of interstate interexchange services, all of the large IX carriers and the BOC commenters in this proceeding appear to agree that the interstate interexchange market is national in scope.² Even though most interstate customers would not view a call from another location to be a substitute for the call he or she wishes to make, the IX carriers are able to use their national networks and general excess capacity to shift their output to city pairs in which any other carrier attempts to raise rates, thereby defeating any price increase over that city pair or in any region smaller than the entire country. Because most customers want to be able to reach other subscribers throughout the country, most facilities-based IX carriers have built national networks that are capable of reaching all other telephone lines in the country. If any carrier were to attempt to raise rates on any given route or in any given region, other carriers

² See Comments of AT&T at 4; Comments of MCI at 4. However, the Comments of LDDS WORLDCOM at 6 argues for the use of a regional-market definition for RBOCs.

would be able to respond by offering lower rates through their networks. This fungibility in supply clearly makes the interstate interexchange market national in scope.

5. There is simply no reason to attempt to define the interstate interexchange market differently for LECs or BOCs than for other participants. However, some commenters in this proceeding, particularly the IX carriers, argue for a regional market definition for the BOCs because they contend that the BOCs could successfully raise rates within their regions without inviting a competitive supply response from other carriers. But for this to happen, the BOCs would have to be able to restrict access to their local customers or otherwise restrain their rivals' competitive response. As I show in the next section, there are now ample safeguards, such as rate caps, equal-access provisions, unbundling, and local-market open entry to prevent such potential abuses. Under the new Telecommunications Act, the BOCs will have to satisfy a number of criteria (the "checklist") before they can enter the interstate market with in-region services. Once these criteria are satisfied, they will clearly have no greater ability to restrict competition within their regions than will other market participants. Outside their own regions, they are no different from these other carriers. Thus, the market is national because even the LECs or BOCs will have no ability to monopolize any geographical subdivision of this market.

6. The IX carriers argue for a national market because they argue that market definition should not affect the regulation of the BOCs. They simply wish to define the BOCs as bottleneck monopolists regardless of regulatory or market changes and to relegate the BOCs to a more rigorous standard ad infinitum. As I show below, conditions have changed, and there is now no

reason to treat the BOCs differently from other market participants once they have satisfied certain regulatory requirements.

Structural Separations

7. All participants in the telecommunications industry now recognize the desirability of being able to offer customers "one-stop shopping" for their local, intrastate, and interstate services as well as for basic and enhanced services. Most of the large IX carriers are pursuing policies of integrating into local telecommunications markets through landline facilities, the purchase of network elements from incumbent LECs, investment in wireless networks, or a combination of these strategies. AT&T has acquired the nation's largest cellular carrier and is also preparing to enter a number of local markets as a reseller or a facilities-based carrier. Sprint has recently bid successfully with a number of cable-television partners for a large number of PCS licenses and has begun to roll out its PCS service. MCI has announced that it will invest as much as \$2 billion in local facilities. Each will be offering customers a complete package of services from a single marketing entity. Clearly, these companies will have a substantial advantage over the BOCs if they can persuade the Commission to require the BOCs to maintain separate subsidiaries, including separate marketing organizations, for their intrastate and interstate activities. Not only will the BOCs not be able to engage in joint marketing of local and interstate interexchange services, but

their costs will be raised substantially by the separate-sub subsidiary requirement.³ As a result, the BOCs will be forced to charge higher prices to consumers and will be unable to compete as vigorously with other market participants.

8. Under the new Telecommunications Act, the BOCs will have to maintain temporarily separate subsidiaries for marketing their in-region interstate interexchange services. The IX carriers seek to require structural separations for both in-region and out-of-region interexchange BOC services,⁴ but they offer no new arguments for such a extending such a quarantine to out-of-region services or for indefinitely continuing the quarantine for in-region services. Rather, they invoke the same arguments -- the potential risks of cross-subsidies and discrimination in providing access -- that motivated the MFJ nearly 15 years ago. As I showed in the affidavits submitted in Docket 96-21, the regulatory landscape has changed dramatically since then. Rate caps and equal-access requirements now reduce the ability and the incentives for the BOCs to engage in such activities.

9. More important, the new Telecommunications Act has opened up the local market to competitive entry and required substantial unbundling. The BOCs and other LECs know that this change in regulatory environment will unleash new facilities-based entry and entry through the

³ A 1995 study prepared by Professor Jerry Hausman and Timothy Tardiff estimated that the requirement of a separate structural subsidiary for enhanced services could raise the cost of these services by 30 percent. See Jerry A. Hausman and Timothy J. Tardiff, "Benefits and Costs of Vertical Integration of Basic and Enhanced Telecommunications Services," submitted as Attachment A to Comments of Bell Atlantic in CC Docket 95-20, April 7, 1995.

⁴See, for example, the Comments of AT&T at 24-28 and the Comments of MCI at 8-26.

resale of LEC services or through a combination of new facilities and unbundled elements. As I pointed out in the reply affidavit filed in Docket 96-21, the BOCs would be foolhardy to attempt to degrade their access services in this environment for they would only invite more rapid entry into their local markets. A rational firm does not respond to entry threats by offering lower and lower quality services.

10. In addition, the notion that a BOC operating in, say, the Great Lakes states, could cross-subsidize competitive forays in, say, Arizona without inviting immediate regulatory detection defies credulity. Surely, these companies will not be able to confuse regulators that the expenses in Arizona were undertaken to connect local customers in Michigan. Nor is such a cross-subsidy even possible in an environment of rate caps. As long as states employ rate caps in constraining local service rates, these rates cannot be influenced by cost allocations anywhere.

11. It is altogether too facile to argue that structural separations are the sine qua non of the development of competition in interstate interexchange services as AT&T does in its comments. It is true that the rate at which AT&T's market power declined accelerated after the implementation of the divestiture required by the MFJ. But equal access requirements have clearly also been conducive to the development of competition. Indeed, such access arrangements have worked well in other telecommunications markets, such as cellular services and voice messaging., as I demonstrated in my earlier affidavit in Docket 96-21. In addition, the BOCs' provision of limited "corridor" interLATA service without structural separations has not resulted in anticompetitive abuses. Finally, AT&T must be aware that its subsidiary in Canada, Unitel, has

succeeded in gaining market share at a rate even more rapid than that achieved by MCI in the United States after 1984 despite the fact that the Stentor companies in Canada were not forced into a vertical divestiture. To suggest that such separations are a necessary condition for competition is simply an example of post hoc, ergo propter hoc reasoning.

The Benefits of Further Competitive Entry

12. The Commission should recognize the substantial potential benefits from additional market entry into interstate interexchange services. While the Commission has decided to view AT&T as "nondominant," this does not mean that interstate interexchange rates have been reduced to fully competitive levels or that further entry would not provide an improvement in the diversity and quality of services. The empirical literature on the interstate interexchange market does not suggest that current rates have been pressed down to competitive levels.⁵ Surely the continuing interest in new entry into this market suggests otherwise.

13. Given the price elasticity of demand for interstate interexchange services, the potential for gains in consumer welfare through lower rates is considerable. Leonard Waverman and I have estimated that the cost to the economy of excessive long-distance rates may be as much as \$30 billion per year⁶ If the BOCs are handicapped through expensive and cumbersome structural-

⁵For a review of these studies, see Robert W. Crandall and Leonard Waverman, Talk is Cheap: The Promise of Regulatory Reform in North American Telecommunications. Brookings, 1996, Chapter 5 and Appendix to Chapter 5.

⁶ Crandall and Waverman, op. cit., Chapter 8.

separation requirements, they may not be able to compete with the IX carriers or other telecommunications service providers with a full array of customer services. This will reduce their ability place downward pressure on interLATA rates and to induce greater network use by customers. The resultant loss in consumer welfare from thus constraining the BOCs must be compared with the costs, if any, of allowing the BOCs to offer all services without the "protection" of structural separations immediately from out-of-region locations and after no more than three years from in-region locations. As I indicated above, there is no indication that the BOCs can or will use their local-market positions to impede competition in a world of rate caps, equal-access provisions, open entry, and unbundling of local network elements.

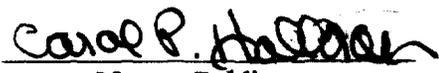
Conclusion

14. The Commission should encourage the entry of the BOCs into interstate interexchange services by not responding to their prospective rivals' pleas to saddle them with cumbersome requirements for structural separations. The Telecommunications Act of 1996 has opened up the local market to competition and vacated the 1982 MFJ. The Commission does not need to re-impose structural separations to promote competition. Indeed, such a requirement will actually impede the development of competition at a time when the joint marketing economies in telecommunications are becoming more and more apparent to all market participants.

Further than this, affiant sayeth not.


Robert W. Crandall

Subscribed and sworn before me this 1st day of May, 1996.

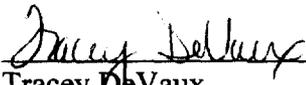

Notary Public

My commission expires:

My Commission Expires October 31, 1998

CERTIFICATE OF SERVICE

I hereby certify that on this 3rd day of May, 1996 a copy of the foregoing "Bell Atlantic's Reply Comments on Sections IV, V and VI" was served on the parties on the attached list.


Tracey DeVaux

* Via hand delivery.