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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	)	CC Docket No. 96-61
	)	
Implementation of Section 254(g) of the Communications Act of 1934, as amended	)	

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To: The Commission

REPLY COMMENTS OF BELLSOUTH (PHASE II)

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SUMMARY

BellSouth believes that swift BOC entry into the long distance market is necessary to reform the oligopolistic structure that currently characterizes the interexchange marketplace. As BellSouth demonstrated in its initial Phase II comments in this proceeding through expert declarations and related submissions, there is extensive evidence that the incumbent IXCs have long engaged in parallel price increases, and that this "tacit collusion" or "coordinated interaction" among the big three IXCs shows that there is no meaningful competition in the interexchange market. No IXC submitted comments containing any solid price or cost evidence to the contrary.

In fact, the record in this proceeding evidences clear support for BellSouth's position that the interexchange market has not been price competitive. Accordingly, BellSouth agrees with the Commission and commenting parties that the best solution to the problem of tacit collusion is the prompt implementation of the provision in the Telecommunications Act of 1996 allowing for BOC entry into the interexchange market. BellSouth encourages the Commission to facilitate new market entry by BOCs and others by moving quickly to eliminate unnecessary regulation of competitive new entrants. As noted by several of the commenting parties, only effective competition will reduce the incentives of the big three to engage in coordinated pricing behavior.

BellSouth agrees with commenting parties that all competing IXCs, both incumbents and new entrants, should be subject to the same tariff regulations. Accordingly, any detariffing proposals ultimately adopted in this proceeding must be applied at the same time and on an equal basis to all market participants. BellSouth also agrees that BOCs should be treated as non-dominant upon entry into the interexchange market. To do otherwise would create market inequities by favoring incumbent IXCs and creating a potential source of anticompetitive activities.

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REPLY COMMENTS OF BELLSOUTH (PHASE II)

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

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

I. BOC IXC ENTRY IS NECESSARY TO REFORM THE OLIGOPOLISTIC STRUCTURE OF TODAY'S INTEREXCHANGE MARKET

A. BellSouth Demonstrated that the Interexchange Market Is an Inefficient and Uncompetitive Oligopoly, and No IXC Offered Any Real Price or Cost Evidence to Rebut this Position

In BellSouth's Phase II comments in this proceeding, it demonstrated that there is extensive evidence that the incumbent IXCs have long engaged in parallel price increases with respect to residential services and that even their business rates have been less than fully competitive. Following the price leadership of AT&T, MCI and Sprint have repeatedly raised prices in lock step without regard to economic factors. To support this contention, BellSouth provided statements from Professors Jerry Hausman and Paul MacAvoy and a pre-publication copy of Prof. MacAvoy's upcoming book, *The Failure of Antitrust and Regulation to Establish Competition in Long-Distance Telephone Markets*, which together conclusively show that there is no meaningful price competition and that MCI and Sprint repeatedly follow the upward pricing moves of AT&T.[2]

In summary, Profs. Hausman and MacAvoy both showed that the structural prerequisites for "tacit collusion" or "coordinated interaction" in the domestic interexchange market are satisfied and that the big three IXCs, AT&T, MCI, and Sprint, have engaged in "lock-step" pricing with 7 price increases over the past 4 years. They concluded that the fact that MCI and Sprint followed AT&T's price increases is particularly troubling, because AT&T, the dominant price leader, and MCI and Sprint, its two closest competitors, in aggregate control about 85% of the long distance market. Moreover, the fact that the principal cost component of the carriers' service, access charges, have been falling even while the IXCs raise prices is further evidence of oligopolistic market conditions.

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[2] *See* BellSouth Phase II Comments at 3-16 & Attachments.

No IXC submitted any solid price or cost evidence that supports a contrary conclusion. Instead, they offer little more than opinions and arguments that the interexchange market is competitive today. Their largely unsupported arguments cannot be squared with the facts.

First, AT&T's allegation that the interexchange industry is not conducive to price coordination is based largely upon consideration of structural factors, such as unequal market shares, the absence of barriers to entry, and complex telecommunications service pricing structures.[3] Such an analysis, however, totally *ignores* actual price data, which is a much more reliable measure for how competitively or anticompetitively the market is performing. Actual performance data is a far more reliable measure of competitiveness. From the perspective of consumers, a market is not competitive if prices are rising in the face of falling costs. The fact that there may be a massive number of resellers says nothing about competitiveness when those resellers cannot push the big three carriers' prices towards costs.

Further, AT&T's statement that "claims of oligopolistic behavior . . . are based entirely on increases in basic schedule rates"[4] is incorrect. BellSouth's Hausman Declaration examined AT&T's average revenue per minute, as used in AT&T's own submission, as well as a random sample of approximately 10,000 telephone bills for an analysis of the *actual amounts* that customers pay.[5] Professor Hausman showed conclusively that while AT&T's costs, including access charges, have decreased significantly, the rates consumers pay for AT&T service — including discounted

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3 *See* AT&T Phase II Comments at 23.

4 AT&T Phase II Comments at 24 n.29.

5 BellSouth Phase II Comments, Ex. A, at 13-17

service — have only barely decreased.[6] AT&T has put forward no analysis showing the contrary to be true.

MCI intimates that claims of tacit collusion are premised upon consideration only of standard rates of interexchange carriers.[7] This claim is also wrong — the Hausman Declaration looked at actual bills, including discounts.[8] Notably, about 64% of customers do not get discounts.[9]

MCI also claims that "stable or rising prices that result either from increasing costs or cost reductions that fail to materialize simply do not indicate a non-competitive market."[10] This statement is simply misleading. Although MCI states that access costs are half of variable costs,[11] MCI has put forward *no data* which demonstrates their costs are increasing; to the contrary, their costs are decreasing, as BellSouth demonstrated in its comments.[12] Or, to utilize MCI's reasoning, rising prices that result despite material decreasing costs *do* tend to indicate a non-competitive market.

Finally, Sprint's statement that allegations of tacit price collusion have never been supported by any reliable evidence, and that the Commission itself has dismissed "evidence" presented by Bell Operating Companies ("BOCs") and others as conflicting and inconclusive,[13] cannot be sustained in light of the detailed evidence presented by BellSouth in its Phase II comments and summarized

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6 BellSouth Phase II Comments, Ex. A, at 3, 9, 14-17.

7 *See* MCI Phase II Comments at 21.

8 *See* BellSouth Phase II Comments, Ex. A, at 12-17.

9 *See* BellSouth Phase II Comments, Ex. A, at 12.

10 MCI Phase II Comments at 22.

11 MCI Phase II Comments at 22 n.32.

12 *See* BellSouth Phase II Comments, Ex. A, at 9.

13 Sprint Phase II Comments at 21-22.

above. Although Sprint claims that the long distance market is competitive, BellSouth's showed in the Hausman declaration submitted with its Phase II comments that Sprint's own witness stated in an affidavit to the Department of Justice as recently as 1995 that competition in the long distance markets is "inadequate."[14]

B. Clear Support Exists for BellSouth's Position that the Interexchange Market is Characterized by Non-Competitive Pricing Practices

Consistent with the evidence submitted by BellSouth in its Phase II comments in this proceeding, Bell Atlantic notes that there is ample evidence already before the FCC demonstrating that the long distance market today is characterized by the lack of competition based on price, in that the gap between AT&T's prices and those of MCI and Sprint is almost zero, that the recent price increases by AT&T have produced significant jumps in the stock prices of both MCI and Sprint, and that entry by the BOCs is the key to ending this tacit price collusion and could produce consumer gains of $24 billion per year.[15] Similarly, NYNEX contended that there is clearly substantial evidence of record that the interexchange market has not been price competitive.[16]

Various state regulators also stated that they believe that non-competitive pricing is present in the interexchange markets. For example, the Louisiana Public Service Commission agreed that the three largest interexchange carriers have a tendency to follow the pricing scheme of each other.[17] Likewise, the Pennsylvania Public Utility Commission acknowledged that tacit price coordination

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14 *See* BellSouth Phase II Comments, Ex. A, at 15.

15 Bell Atlantic Comments at 2-3 (citing previous Bell Atlantic submissions in CC Docket No. 79-252 and a 1995 study by Paul W. MacAvoy entitled "The Failure of Antitrust and Regulation to Establish Competition in Markets for Long-Distance Telephone Services," Yale School of Management Working Paper Series C, at 95 (1995)).

16 NYNEX Phase II Comments at 4.

17 Louisiana Public Service Commission Phase II Comments at 7.

is an undeniable and continuing characteristic of the interexchange market place.[18] The Tennessee Attorney General even went so far as to suggest that the Commission take judicial notice of AT&T's current market power behavior.[19] Thus, clear support exists for BellSouth's position regarding non-competitive pricing in the interexchange marketplace.

C. BellSouth Agrees with Commenting Parties that True Competition in the Interexchange Market Will Not Occur Until the BOCs Enter the Market

Many commenters agreed with the FCC's tentative conclusion, seconded by BellSouth in its Phase II comments in this proceeding, that the best solution to the problem of tacit collusion in the interexchange market is the prompt implementation of the 1996 Act's allowance of competitive entry in the interstate interexchange market by facilities-based BOCs.[20] Swift BOC entry into interexchange is the best means to promote true competition and combat tacit price coordination.

Thus, BellSouth agrees with Ameritech's conclusion that the most effective response to address the potential for tacit collusion in the interexchange market would be to take all necessary steps for expeditious approval of in-region long distance applications by BOCs.[21] Likewise, Bell Atlantic and NYNEX concur that BOC entry into the long distance market is the best protection against the existing tacit price collusion.[22] The Pacific Telesis Group also noted that tacit price collusion can occur whether or not tariffs are filed — particularly true where a market exhibits

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18 Pennsylvania Public Utility Commission Phase II Comments at 11.

19 Tennessee Attorney General Phase II Comments at 2-3.

20 *NPRM* at ¶ 81.

21 Ameritech Phase II Comments at 8-9.

22 Bell Atlantic Phase II Comments at 2-3; NYNEX Phase II Comments at 4.

oligopolistic characteristics — and that the only reliable remedy is the introduction of additional facilities-based competition.[23]

BellSouth similarly agrees with the United States Telephone Association ("USTA") that the FCC should encourage new entry to mitigate tacit price coordination in the interexchange market by moving quickly to eliminate unnecessary regulation of competitive new entrants. According to USTA, only effective competition will sufficiently reduce the incentives to engage in coordinated pricing behavior.[24] Finally, BellSouth agrees with the Office of Ohio's Consumer Counsel that increasing the number of facilities-based interexchange carriers, such as the BOCs, will make price coordination more difficult.[25]

Notably, many small and minority businesses also agreed that BOC entry into the long distance market is essential to end the IXC oligopoly, inject needed competition, and reduce rates. For example, the Black Data Processors Association recommended that the FCC should let the BOCs compete with the IXCs as soon as possible, since real competition will only come about in the small business and residential markets when the new markets participants — such as the BOCs — are permitted to compete.[26] Likewise, Chrysler Minority Dealers Association ("CMDA") and the Association for the Study of Afro-American Life and History, Inc. concluded that small businesses have been paying much too much for long distance services, and that this will not change unless real competition exists in the long distance market — that competition will not exist until the

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[23] Pacific Telesis Group Phase II Comments at 9-10.

[24] USTA Phase II Comments at 2-3.

[25] Office of Ohio's Consumer Counsel Phase II Comments at 7-8.

[26] Black Data Processors Association Phase II Comments at 1-2.

big three IXCs are joined by the BOCs in the long distance market.[27] BellSouth agrees with all of these commenters, and the National Association of Development Organizations, *et al.*, that because there is little price competition among the three largest IXCs, allowing new entrants into the market is the best — and perhaps the only — way to promote price competition.[28]

II. TARIFF REQUIREMENTS SHOULD APPLY ON AN EQUAL BASIS TO ALL IXCs, BOTH INCUMBENTS AND NEW ENTRANTS

All competing IXCs, including new interLATA entrants, should be subject to the same regulations. Accordingly, BellSouth agrees with the comments of Bell Atlantic that once the BOCs are allowed market entry, the "regulatory rules of the road" must apply to all participants equally.[29] As noted by Bell Atlantic, detariffing only the incumbents and not the BOCs would hurt competition.[30] This would substantially undermine any competitive benefits of BOC entry by handicapping the new entrants. BellSouth also concurs with the Black Data Processors Association that when the new market participants, particularly the BOCs, are permitted to compete in the interexchange market, any detariffing proposals ultimately adopted must be applied at the same time to *all* market participants.[31]

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27 CMDA Phase II Comments at 1; Association for the Study of Afro-American Life and History, Inc. Phase II Comments at 1-2.

28 *See* National Association of Development Organizations, *et al.* Phase II Comments at 5-7.

29 Bell Atlantic Phase II Comments at 3-4.

30 Bell Atlantic Phase II Comments at 4-5.

31 Black Data Processors Association Phase II Comments at 1-2. The National Association of Development Organizations, *et al.* also believes that when there is sufficient competition in the long distance market, any detariffing proposal should be applied equally to all IXCs, including the BOCs. *See* National Association of Development Organizations, *et al.* Phase II Comments at 5-7.

BellSouth submits that BOCs should also be treated as non-dominant upon entry into the interLATA marketplace.[32] This is consistent with the position of Ameritech that BOCs should be allowed to compete viably by being accorded the same nondominant status enjoyed by incumbent carriers.[33] Therefore, as noted by SBC Communications, Inc. ("SBC"), the FCC should not undertake any piecemeal forbearance action that would serve to lessen competition by exacerbating the regulatory differences among the carriers.

Specifically, SBC maintained that as discussed in the *AT&T Non-Dominance Order*,[34] the potential differences between dominant and non-dominant regulation are significant and extremely important in a competitive market and that "[r]egulations that require a provider to tip its hand to competitors are a source of potentially anti-competitive activities."[35] SBC also stated that regardless of the FCC's determination of whether it should forbear from its regulations requiring non-dominant carriers to file tariffs, the FCC should recognize that, to ensure that consumers receive the full benefits of competition, it must implement or enforce whatever regulations it intends on an even basis for *all* carriers.[36] BellSouth concurs.

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32 The FCC recently found that a significant fact in allowing AT&T to have non-dominant status in the international service market was the fact that its competitors' collective ownership interest in international transmission capacity exceeds AT&T's ownership interest. As potential new entrants into the domestic interexchange market, the BOCs' share of interLATA facilities will be greatly exceeded by the incumbents. Accordingly, this militates strongly in favor of non-dominant status for the BOCs. *See Motion of AT&T Corp. to Be Declared Non-Dominant for International Service, Order*, FCC 96-209, at ¶ 56 (released May 14, 1996).

33 Ameritech Phase II Comments at 8-9.

34 *Motion of AT&T Corp. to be Reclassified as a Non-Dominant Carrier*, 1 Com. Reg. (P & F) 63 (1995) (*AT&T Non-Dominance Order*).

35 SBC Phase II Comments at 4-5.

36 SBC Phase II Comments at 6.

CONCLUSION

For the foregoing reasons, BellSouth reiterates the position advanced in its comments and by numerous other parties that swift BOC entry into the interexchange market is the best method to promote true competition and combat IXC tacit price coordination. Any tariff requirements adopted by the Commission also should be applied on an equal basis to all providers of long distance, both incumbents and new entrants.

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I, Donna M. Crichlow, hereby certify that copies of the foregoing Reply Comments of BellSouth (Phase II) in CC Docket 96-61 were served via first class U.S. mail, postage prepaid, this 24th day of May, 1996, to the parties on the attached list.

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