

Upon reconsideration, the FCC took note of the argument of Airsignal International that:

this policy is unwise, because it effectively vests another monopoly . . . and . . . is not supported by the evidence, because it turns on the (unfounded) assumption that no other entity possesses the necessary resources, financial and otherwise, to proceed with cellular systems even on a limited developmental basis. Airsignal points out that if the Commission's factual conclusion is correct, then our policy conclusion is unnecessary, and concludes that, separately or as a member of a consortium, it would be willing and able to test and develop a cellular system in a fair competitive market.

Memorandum Opinion and Order, 51 FCC 2d 945, 953 (1975).

CONGRESS HAS DECREED: LET COMPETITION BE TESTED IN THE MARKETPLACE

Here, too, some regulators are making an unnecessary and unjustified leap of faith. If competition in the local loop is not feasible in some circumstances or in some areas, then the marketplace is where this will be demonstrated. A pre-determination that such competition is not feasible, used to justify inaction on the part of the FCC, will simply foreclose the market test of this proposition, to the ongoing advantage of the incumbent carriers. This foreclosure is inconsistent with the mandate of the Telecommunications Act that competition be fostered throughout the telecommunications industry.

If competition is infeasible in some markets, under some circumstances, the marketplace is the appropriate place for such a determination to be made. Regulatory policy should not presume to foreclose such a test -- or "protect" would-be competitors from the prospect of failure. If the conclusion is correct, the marketplace will prove it. If the conclusion is incorrect, a policy predicated upon it will simply deny the benefits of competition to consumers.

The Existing LEC-Wireless Regime is Intolerably Flawed

Likewise, the proposition that the existing wireless-LEC arrangements are adequate and equitable and consistent with the pro-competitive intent of Congress is unsupported, and indeed is insupportable.

First, the existing arrangements reflect the market power of the incumbent LECs, and are not cost-justified.

Second, the existing arrangements constitute a unilateral, unequal, non-reciprocal, and non-compensatory regime predicated upon perpetuating a continuing market advantage to the incumbent LECs.

Third, the existing arrangements thereby deny the co-carrier status of wireless service providers, and fail to fulfill the mandate of the FCC expressed in the *Declaratory Ruling, The Need to Promote Competition and Efficient Use of Spectrum for Radio Common Carrier Services*, 63 RR 2d (P&F) 7, 22 (1987), *aff'd and clarified on recon.*, 4 FCC Rcd. 2369 (1989).

As the Washington Utilities and Transportation Commission observed last October, in adopting reciprocal termination principles for local competition:

That bill and keep is a fair compensation method is evident from the fact that it is the dominant current practice between adjacent LECs around the country . . . for terminating local (EAS) [Extended Area Service] traffic between adjacent exchanges. Where there is no gain to be achieved from anticompetitive or inefficient behavior, companies have elected bill and keep because of its inherent simplicity and efficiencies. As Dr. Zepp stated: 'This intercompany compensation method has been used . . . to establish intercompany compensation between local co-carriers who are neighbors. It is just as appropriate for local co-carriers who are competitors.'

Washington Utilities and Transportation Commission, et al v. US WEST Communications, Inc., Docket Nos. UT-941464, UT-941465, UT-950146 and UT-950265, October 31, 1995, at 36, *aff'd sub nom US WEST Communications, Inc. v. Washington Util. & Transportation Comm'n*, Case No. 96-2-00177-5 SEA (Wash. Sup. Ct. King County, adopted January 23, 1996).

But even states which have recognized the merits of reciprocal termination for competitive carriers have applied it narrowly to CLECs. Apparently failing to recognize that competition policy should be technologically neutral, states such as Connecticut and Washington have refused to extend this equitable policy to CMRS providers.

TURF DOESN'T JUSTIFY UNDERCUTTING COMPETITION

Why then do these regulators oppose the FCC taking steps to help create a level playing field for wireless-LEC competition? Simply put, some regulators cannot bring themselves to admit that the public interest can be or was served by their surrendering authority over CMRS providers. But turf considerations are not a sound basis for public policy.

Other regulators cannot bring themselves to concede that competition can provide more efficient incentives and produce more efficient results than regulatory processes. Accustomed to substituting their judgments for those of system operators (without bearing the responsibility and the risk for meeting public demand), they are unable to resist second-guessing the marketplace.

Ironically, in the name of protecting consumers they propose to reduce consumer choice; in the guise of predicting competitive outcomes, they would protect incumbent carriers from competition.

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LEC-CMRS Interconnection WHITE PAPER No. 6 First Series

RECIPROCAL TERMINATION IS ESSENTIAL FOR LEC-CMRS COMPETITION

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RECIPROCAL TERMINATION IS ESSENTIAL FOR LEC-CMRS COMPETITION

For consumers to enjoy the benefits of competition, structural barriers must be eliminated. Congress recognized this in 1993 when it preempted state rate and entry regulation. The FCC affirmed this when it rejected state petitions to reimpose such burdensome regulations. And in its decisions on the size of PCS areas and spectrum, number portability, and the fixed-use of wireless services, the Commission has repeatedly used its authority (including new section 332) to implement its intent that wireless be able to compete directly with local wireline service.¹

In its docket on LEC-CMRS interconnection the Commission has at hand an historic opportunity to remove a critical barrier to competition in the last bastion of telecommunications monopoly: the wireline local exchange.² The Commission should seize upon this opportunity to fulfill its pledge to promote competition between wireless and wireline carriers.

INTERCONNECTION: THE KEY TO CMRS-LEC COMPETITION

John M. Bensché of CS First Boston recently observed that **the key to competition between wireless and wireline carriers lies in bringing down the cost of infrastructure and interconnection.** As he noted: **“competition with landline in the local loop requires the cost of a minute of airtime fall in line with the price A cut in interconnection expenses, via something like Bill-and-Keep, or even a cost based method, will alleviate the pressure on gross margins in a wireless local loop model.”**³

Carriers themselves are addressing the issue of capital expenditures (and are deploying digital technologies in doing so), but only the FCC can really address the other side of the equation: above-cost LEC interconnect rates. This is because the power to impose such rates has been effectively unconstrained at the state level for the past twelve years. The FCC itself admitted in the *LEC-CMRS Interconnection NPRM*, that for CMRS to **“begin to compete directly against LEC wireline services, it is important**

¹See e.g., *First Report and Order and Further Notice of Proposed Rulemaking, Telephone Number Portability*, CC Docket No. 95-116, RM 8535, FCC 96-286, released July 2, 1996, at paras. 155 (the requirement of CMRS number portability “is in the public interest because it will promote competition among cellular, broadband PCS, and covered SMR carriers, as well as among CMRS and wireless providers.”) and 160 (citing decisions favoring local loop competition, and speedy deployment of PCS); see also “FCC Votes to Permit Flexible Service Offerings in the Commercial Mobile Radio Services,” *FCC News Release*, June 27, 1996 (“The rules adopted today replace rules that . . . caused uncertainty among wireless carriers as to the scope of fixed services that were allowed under our rules, and could potentially inhibit development of wireless local loop and other fixed services.”)

²*Notice of Proposed Rulemaking, Interconnection Between Local Exchange Carriers and Commercial Mobile Radio Service Providers*, CC Docket No. 95-185, released January 11, 1996, at para. 2.

³*Bensché-Marks: Wireless Communications*, Vol. 96-01, April 1, 1996, at p.2 (emphasis supplied).

that the prices, terms, and conditions of interconnection arrangements not serve to buttress LEC market power against erosion by competition.”⁴

The FCC recently affirmed that to effectively compete with wireline carriers, “CMRS carriers are likely to change their pricing structures to resemble more closely wireline pricing structures.”⁵ Recognizing its responsibility to remove another barrier to competition, the FCC also adopted number portability as one way of “encourag[ing] CMRS-wireline competition, creating incentives for carriers to reduce prices for telecommunications services and to invest in innovative technologies, and enhancing flexibility for users of telecommunications services.”⁶ But that can only be one step towards promoting competition -- cost control remains essential. As AirTouch Communications has observed, the cost of interconnection is a critical factor, requiring Commission attention.⁷

LEC INTERCONNECTION RATES ARE UNCONSCIONABLY EXCESSIVE

The Commission’s dockets on CMRS-LEC interconnection and on implementing the local competition provisions of the Telecommunications Act of 1996 have revealed facts that should make LECs blush and regulators (and consumers) wince.

First, the average per minute rate demanded by LECs for the termination of wireless calls is 15 times cost. Dr. Gerry Brock, drawing on an earlier study by Dr. Bridger Mitchell, has introduced evidence that the average cost of LEC interconnection is two-tenths of a cent -- even though LECs charge an average per minute rate of 3 cents.⁸ Moreover, it must be understood that **the two-tenths of a cent cost figure is a blended figure, reflecting both end office and tandem interconnection costs.**

The Hatfield Model shows on a state-by-state basis how far out of line the LECs’ interconnection rates are with their costs. The per minute cost of end office switching and tandem switching are consistently far below the rates charged CMRS carriers for those functions by the LECs. **Even LEC-originated figures used in other proceedings demonstrate that their incremental costs are far below the rates charged by LECs for CMRS interconnection.**⁹

⁴ *LEC-CMRS Interconnection NPRM* at para. 2 (emphasis supplied)

⁵ *First Report and Order and Further NPRM, Telephone Number Portability*, at para. 161.

⁶ *Id.* at para. 160.

⁷ See Reply Comments of AirTouch Communications, Inc., CC Docket No. 95-185, March 27, 1996, at p.11.

⁸ See Brock “The Incremental Cost of Local Usage,” CC Docket No. 94-54, March 21, 1995, drawing on Mitchell “Incremental Costs of Telephone Access and Local Use,” (RAND Corporation, 1990), reprinted in Pollard, ed., *Marginal Cost Techniques for Telephone Services: Symposium Proceedings* (NRRI, 1991).

⁹ See e.g., Letter from J.G. Harrington, Dow, Lohnes & Albertson, to William F. Caton, FCC, Docket No. 95-185, June 26, 1996, at Tab 2, pp.3-4 (citing NYNEX submission in Massachusetts showing a blended rate of \$0.0023 per minute for end office/tandem interconnection and Florida PSC staff conclusion (based on GTE testimony) that \$0.0025 per minute would cover end office TSLRIC and tandem LRIC, plus a contribution to common costs).

A NATIONAL PRO-COMPETITIVE POLICY DEMANDS NATIONAL RULES -- THE STATUS QUO IS A BARRIER TO COMPETITION AND CUSTOMER BENEFIT

In its number portability proceeding, the FCC declared: "it is important that we adopt uniform national rules" to avoid the development of policies on a "state-by-state basis [which] could potentially thwart the intentions of Congress . . . and . . . retard the development of competition in the provision of telecommunications services."¹⁰

The truth of this was dramatically borne out in the FCC's proceeding implementing the local competition provisions of the Telecommunications Act of 1996. As AT&T pointed out:

The comments of some state commissions underscore that a comprehensive national requirement of LEC-to-CMRS interconnection is needed. The Commission has been given plenary jurisdiction under Section 332(c) of the Act to order such jurisdiction. More fundamentally, whether under Section 332(c) or under Section 251, **the Commission should act decisively to avoid piecemeal state regulations that impose exorbitant interconnection and 'pay or play' duties on CMRS providers, purport to subject CMRS providers to state entry and rate regulation contrary to the Act, or otherwise erect impermissible barriers to competition.**¹¹

The threat posed by inconsistent state regulations is real and recognized by many parties -- including some state authorities. For example, the Texas Office of Public Utility Counsel warned in their Initial Comments in CC Docket No. 96-98 that:

The greater the degree of uncertainty faced by potential local exchange competitors about regulatory policies across the various jurisdictions, the more difficult it will be for competitors to develop viable entry strategies. . . . the Commission is quite right, therefore, to observe that the absence of consistent pricing policies could constitute a barrier-to-entry.¹²

Even state regulators who have argued for minimal rules have conceded the importance of national guidelines.¹³

¹⁰ *First Report and Order and Further NPRM, Telephone Number Portability*, at para. 37.

¹¹ Reply Comments of AT&T, CC Docket No. 96-98, filed May 30, 1996, at p.8 n.9 (emphasis supplied).

¹² Initial Comments of Texas Office of Public Utility Counsel, CC Docket No. 96-98, May 16, 1996, at p.15 (emphasis supplied).

¹³ See e.g., Comments of Kentucky Public Service Commission, CC Docket No. 96-98, at pp.3-4.

Importantly, residential and business consumer advocates support reciprocal termination. The Consumer Federal of America has stressed that "The current compensation regime for traffic exchange is the most anti-consumer, anti-competitive model and is a remaining vestige of monopoly control over the local network. The Commission has made the appropriate proposal to institute an interim bill and keep regime for wireless services."¹⁴

The Telecommunications Ratepayers Association for Cost-based and Equitable Rates (TRACER) has also criticized the LEC-dominant status quo, correctly noting that **the LECs' high and one-sided interconnect rates represent "an especially high barrier to new entrants" while "[t]he cost savings realized from a bill and keep policy will allow CMRS carriers to better position themselves as competitors in the local exchange market."**¹⁵

Like many potential new entrants and existing CMRS licensees, the Texas Office of Public Utility Counsel also warned that rates involving "[m]ark-ups raise the cost of doing business for new entrants and provide incumbent LECs with a source for anticompetitive mischief."¹⁶ The Texas Office of Public Utility Counsel, for one, urged the Commission to "promulgate rules that give potential entrants the opportunity to operate *viably* in all market segments and all geographic areas"¹⁷

FCC ACTION IS ESSENTIAL TO PROMOTE A FAIR MARKETPLACE

Reciprocal termination constitutes a regime which will promote competition and squeeze out excessive costs. Even a per minute rate of zero is closer to cost than the current LEC interconnection rates. Moreover, the states which have adopted bill and keep have recognized that this policy compensates both the incumbent and the new entrant.¹⁸

But the FCC cannot count on all states to make the right choice, or to adopt consistent rules, and inconsistent rules jeopardize the ability of wireless carriers to compete with the incumbent LECs in the marketplace. The burden of such inconsistent and inequitable rules falls heavily upon consumers, who are thereby deprived of a choice of service providers and of a choice of service options. **Only the FCC can guarantee consistent and equitable interconnection across the nation.** Only the FCC can break the LEC stranglehold on their would-be wireless competitors.

¹⁴Statement of Bradley Stillman, Telecommunications Policy Director, CFA, June 25, 1996.

¹⁵Reply Comments of TRACER, CC Docket No. 95-185, March 22, 1996, at p.4.

¹⁶Initial Comments of Texas Office of Public Utility Counsel at p.20. *See also* Reply Comments of AirTouch, CC Docket No. 95-185, at pp.24-25.

¹⁷Initial Comments of Texas Office of Public Utility Counsel at p.i (emphasis in original).

¹⁸*See e.g., Washington Utilities and Transportation Commission, et al. v. US WEST Communications, Inc.*, Docket Nos. UT-941464, UT-941465, UT-950146, & UT-950265, at 35, *aff'd sub nom US WEST Communications, Inc. v. Washington Util. & Transportation Comm'n*, Case No. 96-2-00177-5 SEA (Wash. Sup. Ct. King County, adopted January 23, 1996).

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RECIPROCAL TERMINATION: A FOUNDATION FOR WIRELESS COMPETITION

July 22, 1996

RECIPROCAL TERMINATION: A FOUNDATION FOR WIRELESS COMPETITION

WIRELESS IS A VIABLE LOCAL LOOP TECHNOLOGY

Throughout the world, wireless local loops have demonstrated that wireless technology offers significant advantages in updating or providing telecommunications services. In central Europe and South America, where older wired infrastructure predominates, wireless systems offer a cheaper and quicker means of providing modern telecommunications. In Africa and Asia and other nations with no installed base wireless systems offer the most modern and cost-effective basis for telecommunications.

THE NORTH AMERICAN OPPORTUNITY

In North America, the viability of wireless local loops has been debated. In high cost rural markets, the FCC has -- through Basic Exchange Telecommunications Radio services (BETRs) -- permitted wireless local loop systems because they are cheaper than wired systems. However, because current cellular airtime charges are too high to allow head-to-head competition with LECs, and because the federal government has, through the Rural Telephone Bank and other mechanisms, subsidized the deployment of wired landline systems in much of rural America, some critics have suggested that wireless local loop competition is infeasible.

This assertion misses two central facts about wireless local loop competition and the FCC's role. First, when wireless competes with LECs it will not look like today's cellular systems. Second, it is entirely inappropriate for the FCC to decide market structure and participants, particularly based on current events, costs and technologies. **Rather, the FCC is responsible for establishing the foundations upon which wireless competition can evolve and strengthen over time** (as did wired services generally). Stated differently, it is the job of the FCC to remove regulatory barriers to wireless competing with LECs -- not to decide whether or how wireless entrepreneurs will be successful in doing so.

Until very recently, the Commission appeared clearly committed to this role. In its decisions on the size of PCS license areas and spectrum, number portability, and the fixed-use of wireless services, the Commission has repeatedly used its authority (including Section 332) to implement its intent that wireless be able to compete directly with local wireline service.

Consumer, business user, and industry commentators have pointed out that the current LEC interconnection charges to CMRS customers are an insuperable barrier to wireless local loop competition. For some to argue against the Commission's "bill and keep" interconnection proposal "because wireless won't be able to compete anyway" is

an inappropriate position at best. And mobile wireless has already taken on a particularly central role in general communications in rural areas.

A MODEL FOR WIRELESS LOCAL LOOPS IN AMERICA --

(1) PATTERNS FROM THE PAST

Much as cable television initially constituted a service at the margins of broadcast television (*e.g.*, in areas of marginal reception), some wireless services are initially providing competition at the margins of wired communities. Thus, for example, wireless may constitute the technology of choice in areas where *exurban* growth has outstripped the capabilities of landline companies to deploy wired services.¹

Likewise, much as cable television has become a medium for the delivery of more diverse forms of products and services, altering the nature of television overall, wireless local loops may constitute a redefining force in telecommunications more generally. Thus, existing wired landline facilities may be converted into data delivery media, while voice telephony shifts to wireless media.²

A MODEL FOR WIRELESS LOCAL LOOPS IN AMERICA --

(2) THE KEY IS CONTROLLING COSTS

Industry and financial market analysts like John M. Bensché of CS First Boston have concluded that **the key to CMRS competition with LECs is cost reduction, both by the industry itself, and by the Government reducing excessive interconnection costs.** Bensché stresses that: **“competition with landline in the local loop requires the cost of a minute of airtime fall in line with the price A cut in interconnection expenses, via something like Bill-and-Keep, or even a cost based method, will alleviate the pressure on gross margins in a wireless local loop model.”**³

As Bensché points out, there are two parts to that cost reduction: wireless carriers' own costs, and what they are forced to pay LECs for interconnection. The FCC itself stated in the *LEC-CMRS Interconnection NPRM*, for CMRS to **“begin to compete directly against LEC wireline services, it is important that the prices, terms, and conditions of interconnection arrangements not serve to buttress LEC market power against erosion by competition.”**⁴

¹See *e.g.*, Order, *In the Matter of Request of U S WEST Communications, Inc., for a Limited Waiver of Section 22.903 of the Commission's Rules*, DA 96-605, released April 17, 1996.

²This may be described as a “Negroponte switch” writ small, but all data applications will *not* migrate to wired networks. Wireless networks and media will become access points to the Internet and other networks.

³*Bensché-Marks: Wireless Communications*, Vol. 96-01, April 1, 1996, at p.2 (emphasis supplied).

⁴*LEC-CMRS Interconnection NPRM* at para. 2 (emphasis supplied)

THE BUSINESS SIDE OF WIRELESS LOCAL COMPETITION

Wireless carriers today generally compete only for a mobile market. In that separate market, airtime is priced efficiently. Even if current costs allowed it, offering unlimited wireless usage at anywhere near LEC local prices would overwhelm current network capacity. Getting to price competition with the LECs will require a major change and expansion of CMRS investment, but the key business pieces of it are already clear, and some are already being implemented:

More spectrum: PCS has more than tripled the amount of spectrum committed to CMRS.

Better spectrum usage: The various digital technologies will allow 4-10 times the amount of calls in the same spectrum as analog currently uses. The shift to digital is already in high gear.

Far more re-use of frequencies, i.e., much smaller cells: The first wave of this is moving fast; microcells will be the second wave required for competition with LECs in urban areas.

More competition: With seven or more wireless competitors in each market (which we will have in short order), the pressure will be on these competitors to expand out of mobile into the much larger local, fixed service market.

All of these factors mean that wireless can acquire and use spectrum and networks that allow them to compete head-to-head with LECs. Indeed, a variety of new PCS entrants have announced exactly that goal.⁵ **But wireless carriers will have little incentive to charge at this goal if they will still be unable to compete because of inappropriate LEC interconnection charges.**

INTERCONNECTION: THE INSUPERABLE REGULATORY BARRIER TO LOCAL COMPETITION

The current LEC practice of applying an excessive surcharge on CMRS-originated traffic, while refusing to make reciprocal compensation (at any level) to CMRS providers, constitutes both a burden on the wireless user and a barrier to direct LEC-CMRS competition. Any reduction in current LEC-CMRS interconnection fees will be welcomed by current wireless customers. As importantly, such a reduction, and making interconnection payments reciprocal, will encourage the growth of the mobile industry. But this does not address the key issue of what level of interconnection payment will allow wireless to compete with the LECs for local service.

⁵See Remarks of Daniel Riker, CEO of Pocket Communications, National Press Club, June 25, 1996.

The FCC is engaged in the crucial task of addressing the barrier of excessive LEC interconnection rates. It initially proposed an interim bill and keep mechanism; more recently a reciprocal per call charge of less than one cent is being discussed. One cent sounds small, but that would be a \$7 per month surcharge on the competitive service provider's average bill.

Indeed, any per call charge represents a tax on competition. This is because in the initial stages of competition, the wireless provider will have relatively few local service customers and the LEC will have the vast majority. Most of the wireless company's traffic will originate or terminate on the LEC network, and bear the LEC interconnection "tax," while none of the traffic originating and terminating on the LEC network bears this tax.

Thus, all else being equal, it will be more expensive to use the new competitive service than to stay with the monopoly, since the LEC interconnection fee constitutes a special tax on the competitive network which doesn't apply to most calls on the LEC network.

Though it may be suggested that if actions are taken to equalize traffic flow, the wireless company will be getting a payment from the LEC which could be used to balance out payments (i.e., a back-door version of bill-and-keep), this misses the point.

The reality is that if the FCC sets a per call charge or formula by which such charges are to be derived, both LEC and CMRS providers will pass through the charges to consumers. These are costs that consumers can avoid if they don't subscribe to the wireless competitor or call its customers.

The central problem is that a usage sensitive charge system by itself discourages competition. Reciprocal termination, as the FCC proposed it in December, avoids all of these problems, along with the long delays that negotiations and state proceedings would entail.

A number of states have approved compromise agreements for LEC-CLEC interconnection, instituting "bill and keep" for a period and then adding an after-the-fact settlement in the event that the aggregate traffic/dollar flow is out-of-balance by more than a specified percentage. This stimulates competition in the near-term, avoids delay, is fair, and most importantly, does not impose a usage sensitive burden on new local service.

Wireless technology already constitutes a valuable service for over 40 million Americans, and holds out the promise of increased competition, and increased variety in telecommunications services for millions more Americans. Much as MCI was once viewed as an inconsequential and peripheral player in the long distance marketplace, so too do some critics view wireless telecommunications. But the FCC should remember: *history is the story of experts who said it couldn't be done, just before someone did it.*