

facilities to a long distance affiliate, whether they involve newly-constructed or previously-constructed facilities. That is pertinent because the MFJ authorized the BOCs to construct "official service" long distance networks for each BOC's internal communications, but the MFJ prohibited the BOC's use of its own facilities in any interexchange services provided to the public or other carriers.<sup>36</sup> There is some substantial evidence that some or all Regional Bell Companies constructed purported "official networks" that have vast amounts of excess capacity -- at the expense of monopoly exchange and exchange access ratepayers -- in anticipation of their future authorization to provide interexchange services.<sup>37</sup> That would have been improper and anticompetitive.

In all events, until such time as Section 272(a) is sunset, Section 272(a) and 272(e)(4) will allow BOCs to use any official service network facilities only for a BOC's internal official services and will prohibit any provision of these interLATA facilities or services to a BOC's interLATA affiliate or to other carriers. Clearly, that will adversely affect no

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<sup>36</sup> See United States v. Western Elec. Co., 907 F.2d 160, 163-64 (D.C. Cir. 1990); United States v. Western Elec. Co., 569 F. Supp. 1057, 1097-1101 (D.D.C. 1983).

<sup>37</sup> For example, information submitted by BellSouth to the Florida PSC reveals that BellSouth's official services network in Florida has well over 90% excess capacity. See Southern Bell Response to Discovery in FPSC Docket 92-0260. Similarly, in meetings with market analysts Ameritech has touted its ability "to provide in-region long-distance services using its own infrastructure with only \$200-\$300 million in incremental capital expenditures" -- a figure that would only be possible if Ameritech had substantial excess capacity in its official services network at its disposal. See Schelke, C.W., Ameritech Corp -- Company Report, Smith Barney Report No. 1661700 (Nov. 10, 1995).

legitimate interest of any BOC. If the official service networks were in fact not built with excess capacity -- as BOCs have often asserted<sup>38</sup> -- the prohibition will have no effect on any BOC. Conversely, if these monopoly-funded networks were overbuilt in anticipation of future interLATA entry, allowing BOCs to use them to provide interLATA services or facilities to affiliates or other carriers would constitute the discrimination that violates Section 272(c) and (e) and the cross-subsidization of competitive activities that Section 272 and other provisions of the Act (e.g., § 254(k)) were designed to prevent.<sup>39</sup>

At the same time, it could be possible for the BOCs lawfully to make use of even overbuilt official services networks if the Commission permits the provisions of Section 272(a), (b), & (c) to sunset some time after the end of the initial three year period following in-region interLATA relief for a BOC or its affiliate. However, at that time, AT&T submits the Commission will be obligated to investigate the capacity of BOCs' official services networks, and the details of their funding and construction, and

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<sup>38</sup> See Reply of BellSouth Corporation to AT&T's Opposition and MCI's Response to BellSouth's Motion for a Waiver to Allow the State of South Carolina to Use its Facilities in the Event of an Emergency, p. 5, United States v. Western Elec. Co., No. 82-0192 (D.D.C. filed Nov. 12, 1992).

<sup>39</sup> That may not be to say that a BOC could not transfer its official service network to its affiliate without effecting discrimination, but if a BOC did so, the Commission's rules would, and should, require payment of the higher of the "undepreciated baseline cost [plus] . . . interest calculated at the authorized interstate rate of return," or its fair market value. See Accounting Safeguards NPRM, ¶ 31 (quoting Joint Cost Reconsideration Order, 2 FCC Rcd. 6283, 6285 (¶ 17) (1987)). See also Joint Cost Reconsideration Order, 2 FCC Rcd. at 6311 n.32 (defining "baseline cost").

impose conditions to assure that BOC participation in long distance has not been funded and cross-subsidized by monopoly exchange and exchange access subscribers and that no illicit discrimination results.

**D. The Commission Should Establish Specific Procedures For Enforcing The Requirements Of Sections 271 and 272**

Section 271(d)(6) of the Act requires the Commission to establish procedures to enforce the requirements of Section 271 and 272, and the Commission seeks comment (§§ 94-107) on what those procedures should be. In that regard, the Act requires that the Commission act upon a complaint alleging a violation of those provisions within 90 days of the date on which the complaint is filed (see Section 271(d)(6)(B)), a far more compressed period of time than that permitted by Section 208(b)(1) for other complaints.<sup>40</sup> This expedited time frame reflects Congress' recognition that any violation of Sections 271 and 272 in particular must be quickly remedied in order to prevent harm to competition, and requires the adoption of special procedures to ensure that an appropriate record can be assembled, and a fair decision reached, during that abbreviated period.

Preliminarily, the Commission asks (§ 96) whether "a BOC and its affiliate would be in violation of sections 272(c)(1) and (e) if a BOC provides varying levels of service between its affiliate and third parties as well as between third parties

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<sup>40</sup> Section 208(b)(1) has required that complaints be resolved within 12 or 15 months of their filing. Complaints filed one year or more following the enactment of the 1996 Act will be required to be resolved within 5 months of their filing. See Section 402.

themselves." Sections 272(c)(1) and (e) specifically prohibit the provision of favored treatment by a BOC to its affiliate.<sup>41</sup> That is the most likely form of discrimination the Commission will encounter in this context, and it is the principal focus of Section 272. By contrast, discrimination between third parties does not appear covered by Section 272, but is instead addressed by the more general anti-discrimination requirements of Section 202(a).

Enforcement of the requirement that BOCs not discriminate in favor of their affiliates requires that reporting obligations be imposed on the BOCs with respect to their dealings with those affiliates and unaffiliated entities (see NPRM, ¶ 95). In the absence of such requirements, it will be virtually impossible for unaffiliated entities or the Commission to determine whether the affiliate is receiving favored treatment and whether an enforcement action is required. The Act itself requires that all transactions between the BOC and its affiliate be reduced to writing and available for public inspection (see Section 272(b)(5)). The Commission should further impose the additional reporting requirements previously described in these comments. See supra pp. 36-38.<sup>42</sup>

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<sup>41</sup> See, e.g., Section 272(c) (in "its dealings with its affiliate," BOC "may not discriminate between that company or affiliate and any other entity"); Section 272(e)(1) (BOC must "fulfill any requests from an unaffiliated entity for telephone exchange service and exchange access within a period no longer than the period in which it provides such telephone exchange service and exchange access to itself or its affiliates").

<sup>42</sup> The Commission should also direct that the periodic independent audit of the BOCs' compliance with Section 272, which is required by Section 272(d) of the Act, include an investigation and  
(continued...)

The Commission raises several additional questions regarding enforcement actions. AT&T agrees with the Commission (§ 97) that the enforcement authority granted by Section 271(d)(6) augments, rather than substitutes for, its pre-existing enforcement authority under Sections 206 through 209 of the Communications Act of 1934. Sections 206 through 209 require the Commission to adjudicate complaints alleging violations of "this chapter," which includes newly-enacted Sections 271 and 272. The principal difference between these two provisions is that Sections 206 through 209 permit recovery of damages for injuries suffered by private parties, while Section 271(d)(6) authorizes public remedies such as injunctions, forfeitures, and revocations of interLATA authority that do not remedy private injuries.

Accordingly, a party may simultaneously file complaints under both provisions, and the Commission would then adjudicate the complaints in tandem -- ordering any public remedies or sanctions within the 90-day time frame of Section 271(d)(6), and determining any private damages within the longer period permitted by Section 208. These differing deadlines reflect the special priority Congress assigned to preventing the harms to competition that could follow from violations of Section 271 and 272, as opposed to compensating particular private entities for their injuries.

AT&T likewise agrees with the Commission (§ 98) that remedial action under Section 271(d)(6)(A) can be taken either in

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<sup>42</sup> (...continued)

verification that the procedures used by the BOCs to comply with these reporting requirements generate accurate and complete reports.

response to a filed complaint or on the Commission's own motion. While the 90-day deadline of Section 271(d)(6)(B) applies only to filed complaints, Section 271(d)(6)(A) broadly authorizes the Commission to issue public remedies and sanctions any time it determines, after notice and opportunity for a hearing, that a BOC "has ceased to meet" any of the conditions required for approval of an application for its provision of in-region interLATA services. The Commission is also correct (§ 106) that no live hearing before an ALJ would be required, either in complaint proceedings or in proceedings initiated by the Commission. Section 271(d)(6)(A) does not require a "hearing on the record," and the Commission has generally satisfied the more limited hearing requirements of Sections 204, 205, and 206-209 (similarly worded to Section 271(d)(6)(A)) through written submissions rather than oral testimony.

With respect to the allocation of burdens of proof in complaint proceedings under Section 271(d)(6), the Commission should adopt its proposal (§§ 101-103) to shift the burden to the BOC once the complainant has made out a prima facie case -- i.e., once it has alleged specific facts which, if true, would constitute a violation by the BOC of Sections 271 or 272. Such a requirement is justified in light of the short time frame in which these issues must be resolved, because the relevant information will almost certainly be in the BOC's possession rather than the complainant's. Such a requirement is also consistent with the Act's allocation of

the burden of proof in Section 271 application proceedings to the BOC.<sup>43</sup>

With respect to sanctions (§ 165), the Commission need not at this time limit its remedial flexibility by specifying detailed criteria governing the circumstances under which each type of sanction might be employed. Such determinations are best made on a case-by-case basis, depending on the individual facts. Two general principles, however, should inform all such decisions. First, any sanction must ensure that the penalty for misconduct exceeds whatever illicit competitive benefit a BOC may obtain from the violation, or else the BOC will have no incentive to comply. In that regard, a cease and desist order, while necessary whenever a violation is found, cannot alone be sufficient unless the violation is truly trivial and inadvertent. Second, because a BOC is permitted to provide in-region interLATA service only pursuant to the terms and conditions of Sections 271 and 272, if a BOC is in violation of those provisions in a manner that requires any significant period of time for the violation to be corrected, that BOC should not be permitted to continue to provide in-region interLATA service until that correction is implemented.

Finally, the Commission should establish a procedural schedule for complaints filed under Section 271(d)(6) that would

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<sup>43</sup> See Section 271(d)(3) ("The Commission shall not approve the authorization requested in an application . . . unless it finds that . . .") (emphasis added). For the same reason, there could be no basis for reversing that burden and according the BOC's conduct a "presumption of reasonableness" (see NPRM, § 104).

apply in the absence of specific Commission orders to the contrary in particular proceedings. AT&T recommends the following:

- Day 1: Complaint, including all relevant documentation and discovery requests, filed with Commission and served on Defendant concurrently or by overnight mail.
- Day 15: Answer, including all relevant documentation; responses to plaintiff's discovery request; defendants' discovery requests, filed with Commission and served on complainant by fax and overnight mail.
- Day 20: Status/discovery conference with Enforcement Division; plaintiffs may then make additional discovery requests based on answer.
- Day 30: Plaintiffs' response to discovery requests and defendants' response to supplemental discovery requests due.
- Day 45: Simultaneous filing and service by fax and overnight mail of Initial Briefs.
- Day 55: Simultaneous filing and service by fax and overnight mail of Reply Briefs.
- Day 90: Last day for Commission decision on liability (and equitable relief) phase

Because Section 271(d)(3)(B) requires that the "Commission" act on these complaints within 90 days, the Order adopted by the 90th day should be adopted by the Commission itself, and not by the Bureau under delegated authority. Moreover, in light of Congress' intent that final decisions on these complaints be expedited, the Commission should adopt a rule that it will act on petitions for reconsideration within three months of the filing of such petitions.<sup>44</sup>

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<sup>44</sup> The Commission also seeks comment (§ 107) on possible alternative dispute resolution procedures that might be employed. While the parties are always free to seek alternative dispute (continued...)

**III. THE COMMISSION SHOULD ADOPT RULES IMPLEMENTING THE JOINT  
MARKETING PROVISIONS OF SECTION 272(g)**

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The Act contains three separate provisions addressing the scope of permissible joint marketing activities of interLATA and local exchange services by the larger interexchange carriers, the BOC affiliates, and the BOCs. See NPRM, ¶¶ 90-93. Contrary to the suggestion that these provisions should be interpreted in "parallel" (¶ 91), these three provisions adopt different requirements for these different classes of entities, and the Commission's rules should reflect those differences.

For example, Section 271(e)(1) imposes a far more limited restriction than Sections 272(g)(1) and 272(g)(2). Section 271(e)(1) prohibits the larger interexchange carriers for a limited period of time from jointly marketing their long-distance service with local exchange service obtained from incumbent LECs for resale pursuant to Section 251(c)(4). But as the Commission notes (¶ 91), this is not a categorical restriction on joint marketing even during the period in which it applies. Section 271(e)(1) does not prohibit any interexchange carrier from jointly marketing within a single, fully-integrated company long-distance service with a local service that is provided (1) through its own facilities, (2) through the purchase of unbundled network elements from the incumbent LEC under Section 251(c)(3), (3) through a combination of

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<sup>44</sup> (...continued)

resolution, the Commission may not adopt any procedures in that regard that would delay a Commission decision beyond 90 days following the filing of a complaint.

such methods, (4) through the purchase of non-BOC services, or (5) through the purchase of BOC services at retail.

At the same time, the Commission's conclusion (§ 91) that the term "market or sell" in Section 272(g)(2) should be construed similarly to the term "jointly market" in Section 271(e)(1) appears correct. In that regard, the Commission should confirm the accepted distinction between "marketing," which encompasses efforts by a firm to persuade a potential customer to purchase or subscribe to its services, and the "customer care" that occurs after the customer has signed up. Any restriction on joint "marketing" will necessarily apply only to activities that take place prior to the customer's decision to subscribe. Such a term would not apply, however, to post-sales efforts to deal jointly with existing customers who have purchased both services by, for example, providing a single bill, or establishing a single point of contact to respond to maintenance and other customer inquiries.

Section 272(g)(1) and 272(g)(2) impose two different sets of restrictions on the activities of BOCs and their affiliates. These comments address the scope of their restrictions separately below, as well as their relationship to the Act's separate CPNI provisions.

**A. Section 272(g)(1)**

Section 272(g)(1) prohibits a BOC affiliate from "market[ing] or sell[ing]" the telephone exchange service of the BOC unless the BOC complies with a non-discrimination rule requiring it to "permit[] other entities offering the same or similar service [as the BOC affiliate] to market or sell its

telephone exchange services." Once a BOC is granted authority to provide in-region interLATA service and this restriction on the BOC affiliate becomes operative, Section 271(e)(1)'s restriction on joint marketing by larger interexchange carriers becomes inoperative. The marketing restrictions that Section 272(g)(1) and the other provisions of Section 272 will then impose upon the BOC affiliate are different from those that will have previously applied to the larger interexchange carriers under Section 271(e)(1) in at least two respects, which the Commission should make explicit in its rules.

First, any joint marketing by a BOC affiliate will be conditioned upon the BOC's compliance with the non-discrimination requirement of Section 272(g)(1) that requires it to enable unaffiliated entities likewise to market or sell its telephone exchange service. In that regard, in order to ensure that any such joint marketing opportunity, if offered at all, is made available to affiliated and unaffiliated providers on a truly non-discriminatory basis, the Commission should require that the BOC announce the availability and terms of any such arrangement at least three months prior to implementing it. In the absence of such a rule, the availability of such arrangements would become known to unaffiliated entities only once the BOC and the BOC affiliate, having previously worked out the terms in secret, actually begin implementing it for themselves. In such circumstances, the BOC affiliate would have a significant and

discriminatory "first mover" advantage over unaffiliated carriers.<sup>45</sup>

Second, unless the BOC chooses to comply with the requirement that it make marketing opportunities for its services equally available to unaffiliated carriers, Section 272(g)(1) will flatly prohibit its affiliate from marketing or selling in any form a local exchange service provided by the BOC -- even if the BOC affiliate seeks to offer that local exchange service separately from the BOC affiliate's interLATA service.

**B. Section 272(g)(2)**

Section 272(g)(2) authorizes a BOC to "market or sell interLATA service" provided by its affiliate after it is authorized to provide such service under Section 271. Section 272(g)(3) provides that the joint marketing authorized by this section cannot constitute discrimination that violates Section 272(c), but the BOCs' joint marketing restrictions are fully subject to the separate requirements of § 272(b) and the nondiscrimination requirements of § 272(e). Thus, the critical issues for the Commission is to what extent and under what conditions and rules a BOC can market an affiliate's interexchange services consistently with the terms and purposes of these other provisions of § 272.

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<sup>45</sup> In that respect, this advance notice requirement would mirror the existing statutory requirement for advance public notice of any technical changes that will be made in an incumbent LEC's network, a requirement that likewise seeks to prevent the LEC from giving affiliates an unfair head start over unaffiliated competitors. See Section 251(c)(5); Second Report and Order and Memorandum Opinion and Order, Implementation of the Local Competition Provisions of the Telecommunications Act of 1996, CC Docket 96-98, FCC 96-333, ¶¶ 165-254 (August 8, 1996).

Foremost, as the Commission correctly notes (§ 92), Section 272(b)'s separate requirements that BOCs and their affiliates operate independently, maintain separate employees, and transact only on an arms-length basis independently restrict the scope of permissible activities that can be implied from Section 272(g)(2)'s prohibition. If a BOC's employees are promoting the services of its affiliate in concert with that affiliate, the BOC and the affiliate cannot be "operat[ing] independently" and must necessarily be sharing the use of employees in violation of Sections 272(b)(1) and 272(b)(3). At a minimum, therefore, as the NPRM proposes (§ 92), a separate affiliate would need to purchase marketing services from the BOC on an arm's length basis. In addition, it may be possible for the BOC and its affiliate each to contract with the same outside marketing entity for any joint marketing of interLATA and local exchange service. See NPRM, § 42. In no event, however, may such arrangements extend beyond marketing, and involve the affiliate and the BOC in joint services development and planning.

Moreover, regardless of the scope of permissible joint marketing in other contexts, the BOCs are independently restricted from such activities when new customers call to order local service, or when existing local customers contact the BOC to advise it that they are switching primary interexchange carriers ("PICs"). The Commission has long relied on equal access and informed customer choice to foster competition, and Section 251(g) provides that the BOCs continue to be subject to the equal access requirements that were in effect under the MFJ. Accordingly, and

at a minimum, when a BOC is receiving orders for local service or PIC changes, it cannot, as one BOC has proposed,<sup>46</sup> turn those communications into marketing opportunities for its long-distance affiliate. The only "marketing" available to it in those circumstances is to list its affiliate's long-distance services as one of the equal access choices available to the customer. Moreover, to the extent the BOC refers customers to its long distance affiliate -- whether by providing the affiliate's telephone number, by way of on-line transfer, or otherwise -- the BOC must do so for all other carriers on reasonable and nondiscriminatory terms and conditions. The Commission should therefore make clear that these equal access and non-discrimination obligations continue to apply, both to the BOCs and to other LECs.

The need to reaffirm the applicability of these rules is sharply underscored by the present conduct of SNET, which has repeatedly abused its position as the incumbent local exchange carrier for Connecticut. For example, SNET has instituted and actively marketed to its own long distance customers a "PIC-freeze" which requires the subscriber to contact it directly when he or she wishes to switch long-distance carriers, rather than permitting the long-distance carrier the customer chooses to advise SNET of the switch. However, SNET has refused to honor identically-worded PIC freeze requests submitted to it by AT&T's long distance customers.

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<sup>46</sup> See Direct Testimony of Daniel O. Jacobsen (Director of Regulatory and External Affairs, Pacific Bell Communications), In re Pacific Bell Communications Applications for a Certificate of Public Convenience and Necessity, Appl. No. 96-03-007, p. 16 (Cal. PUC filed March 5, 1996).

AT&T has also received numerous reports that when customers contact SNET to establish local service and presubscribe to a long distance carrier, the SNET representatives either extol the purported benefits of SNET's long distance service and omit any mention that AT&T is an available carrier choice or, if the customers indicate a preference for AT&T as their long distance carrier, urge the customers to reconsider and proceed to market its own service on the same call.<sup>47</sup> The Commission should reaffirm that such abusive practices are impermissible.

**C. CPNI Requirements**

Finally, the Commission seeks comments (§ 93) on the relationship between the Act's joint marketing restrictions and its provisions on the use of CPNI. The general rule is stated in Section 272(c)(1): the BOC is prohibited from "discriminat[ing] between [its] affiliate and any other entity" in the "provision" of "information." Accordingly, to the extent a BOC is otherwise permitted to provide customer information to, or access or use such information on behalf of, its affiliate and does so, it must make the same information available to unaffiliated carriers on the same terms. In addition, under the non-discrimination requirement of Section 272(c)(1), the BOC is not permitted, as at least one BOC proposes,<sup>48</sup> to use its databases on, or communications with, its

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<sup>47</sup> Conversely, when a customer calls SNET and seeks to change long-distance carriers from AT&T to SNET, SNET simply makes the change.

<sup>48</sup> See Direct Testimony of Daniel O. Jacobsen (Director of Regulatory and External Affairs, Pacific Bell Communications), In re Pacific Bell Communications Applications for a Certificate of Public Convenience and Necessity, Appl. No. 96-03-007, pp. 16, 18 (Cal. PUC filed March 5, 1996).

customers in order to seek and obtain customer authorization to provide such information to, or use such information for the benefit of, its affiliate, unless it seeks and obtains such authorizations on behalf of unaffiliated entities on the same terms.

**IV. REGARDLESS OF WHETHER THE COMMISSION CLASSIFIES BOCs AS DOMINANT CARRIERS IN THE PROVISION OF INTEREXCHANGE SERVICES, ITS REGULATION SHOULD ADDRESS THEIR STRONG POTENTIAL FOR ABUSE OF MARKET POWER**

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The Commission proposes (§§ 108-162) to reexamine its classification of BOC affiliates as dominant carriers in the provision of in-region interexchange service.<sup>49</sup> It seeks comment on whether, and to what extent, the BOCs would possess market power in the interexchange market, and what regulations and regulatory classifications should be adopted in light of the potential harm they would pose to competition. This section of these comments therefore addresses (1) the appropriate market definitions to be employed, (2) the nature of the BOCs' market power, and (3) the regulatory classifications and rules that should be adopted in light of that market power.<sup>50</sup>

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<sup>49</sup> See Fifth Report and Order, Policy and Rules Concerning Rates for Competitive Common Carrier Services and Facilities Authorizations Therefor, 98 F.C.C.2d 1191, 1198-99 n.23 (1984).

<sup>50</sup> Pursuant to the Commission's Order of August 9, 1996, AT&T will address the issues relating to the proper regulation of long-distance service provided by SNET, GTE, and independent LECs in subsequent comments. See Order, Implementation of the Non-Accounting Safeguards of Sections 271 and 272 of the Communications Act of 1934, CC Docket 96-149, DA 96-1281 (August 9, 1996).

**A. The Commission Is Correct That Its Competitive Analysis Must Focus On Calls Originating In The BOC's Service Area**

As a threshold matter, the NPRM requests comment (¶¶ 115-129) on how it should apply in this proceeding the market definition approaches proposed in the Interexchange NPRM<sup>51</sup> if such approaches are ultimately adopted and, if the Commission does not adopt those approaches, how the relevant product and geographic markets should instead be defined for this proceeding. AT&T set forth its position on the proposed market definition approaches at length in its comments in response to the Interexchange NPRM, and incorporates these comments here by reference.<sup>52</sup>

As AT&T has previously shown, the interexchange market definition is irrelevant to the issue of whether the BOCs could abuse their power in the local market to impede interexchange competition. Settled law establishes that market definitions and market share analyses are unnecessary when the presence of market power can be proven directly -- as it can here, because of the BOCs' control of local bottleneck facilities that are essential to the provision of long-distance service -- or when undisputed power in one market (local services) can be leveraged to impede competition in a second market (interexchange). The proper markets

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<sup>51</sup> See Policy and Rules Concerning the Interstate, Interexchange Marketplace; Implementation of Section 254(g) of the Communications Act of 1934, CC Docket No. 96-61, Notice of Proposed Rulemaking, FCC 96-123 (rel. Mar. 25, 1996) ("Interexchange NPRM").

<sup>52</sup> See AT&T Comments on Market Definition, Separations, Rate Averaging and Rate Integration, filed April 19, 1996, in CC Docket No. 96-61, at 2-28 ("AT&T Interexchange Comments"); Reply Comments of AT&T Corp. on Market Definition, Separation, Rate Averaging and Rate Integration, filed May 3, 1996, in CC Docket No. 96-61, at 2-9.

to analyze here, therefore, are the markets for local and access services -- the markets where those bottlenecks exist -- rather than the interexchange market.<sup>53</sup> In this regard, while interexchange services originating in a particular BOC's service area generally could not be a separate geographic market,<sup>54</sup> a determination of the appropriate regulatory treatment of a BOC's (or independent LEC's) in-region interLATA services should focus on these areas.

**B. The BOCs' Monopoly Control Over Essential Facilities In Their Local Markets Would Enable Them To Exercise Market Power In The Interexchange Market**

Under any approach, the BOCs' monopoly control over bottleneck local facilities gives them market power in the interexchange market -- as the Commission tentatively concludes (§ 126).<sup>55</sup> The Commission also identifies two means of exercising

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<sup>53</sup> See AT&T Interexchange Comments, pp. 2-14.

<sup>54</sup> As AT&T explained in its Interexchange Comments (pp. \_\_\_), the Commission's existing market definition is correct in other contexts -- *i.e.*, determining the appropriate regulatory treatment of interexchange carriers that possess no bottleneck power. Moreover, the Commission has properly defined the interexchange market as a single national market because even though there is not perfect demand substitution for interexchange services originating in different regions, there will be perfect supply substitution so long as each LEC will allow any carrier to offer interexchange services to the LEC's customers on nondiscriminatory terms. For example, while a caller that wishes to place a call between two cities will not regard calls between other cities as substitutes (see NPRM, § 123), every market participant has the ability to provide services in every area of the country. Under those circumstances, the Commission's existing "single national market" definition is the only approach that is consistent with settled legal and economic principles, including the Justice Department's Merger Guidelines.

<sup>55</sup> See also United States v. Western Elec. Co. (Opinion), 524 F. Supp. 1336, 1344 (D.D.C. 1981); United States v. Western Elec.

(continued...)

market power -- restricting output and raising rivals' costs -- and suggests, correctly, that the BOCs' market power can potentially be leveraged into interexchange services by their raising of their rivals' costs through acts of discrimination, cost misallocation, the charging of excessive prices for access, and similar abuses (§§ 130-141).

In that regard, the Commission properly recognizes (§ 139) that the BOCs can use their market power in the provision of exchange and exchange access services by discriminating against interexchange competitors in numerous and subtle ways that would be exceedingly "difficult to police, particularly in situations where the level of the BOC's 'cooperation' with unaffiliated interLATA carriers is difficult to quantify." By contrast, however, the Commission appears to suggest (§§ 135, 137) that cost misallocations could harm competition only in the event that they enable the BOC to "drive out its interLATA competitors" and subsequently raise prices to supracompetitive levels in order to "recoup lost revenues." This aspect of the Commission's analysis is seriously flawed.

Preliminarily, discrimination itself merely produces another form of cost misallocation. An affiliate that receives favored treatment should be paying the BOC more than it is in fact paying for the services it receives, and the fact that it is not

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<sup>55</sup> (...continued)  
Co. (Decree Opinion), 552 F. Supp. 131, 167-68 (D.D.C. 1982), aff'd, 460 U.S. 1001 (1983); United States v. Western Elec. Co. (Triennial Review), 673 F. Supp. 525, 567-79 (D.D.C. 1987), aff'd in part, reversed in part, 900 F.2d 283 (D.C. Cir. 1990).

doing so means that costs attributable to the affiliate are being improperly borne by the BOC.

Further, and wholly apart from other potential BOC actions to increase its competitors' costs, misallocations that shift competitive costs to BOC monopoly services mean that the BOC affiliate's interLATA competitors will necessarily be paying excessive rates for access.<sup>56</sup> Consumers are then harmed, both because the BOC affiliate's competitors are forced to charge higher prices for their services, and because the pricing distortions will divert customers to the BOC affiliate regardless of whether it is the more efficient provider. Moreover, contrary to the classic model in which a firm attempting a predatory pricing scheme would be forced to absorb substantial losses in the short run (and is therefore likely to be discouraged from making the attempt in the first place), the predation here is costless to the BOC -- because any diminished revenue from the BOC's competitive services is more than made up by the increase in its revenue from its monopoly services, as even some BOCs have recognized.<sup>57</sup> For all these

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<sup>56</sup> Price cap regulation cannot eliminate the incentive to shift costs to monopoly services, because both the initial caps and subsequent adjustments are generally set at least in part on the basis of the BOCs' returns during the preceding years. See, e.g., Bell Atlantic Tel. Cos. v. FCC, 79 F.3d 1195, 1204 (D.C. Cir. 1996) ("With so many local exchange carriers in the sharing zone, the Commission had good reason to believe that the original X-factor had been too low and therefore adjusted it upward"). Nor do they protect against price squeezes, because the current caps permit the imposition of access charges several times the level of the economic cost of access service.

<sup>57</sup> See David J. Teece, The InterLATA Restriction in Light of Changing Technology, Increased Competition, Strengthened Regulation and Ameritech's Customer First Plan, Dec. 7, 1993, pp. (continued...)

reasons, cost misallocations represent just as serious a form of monopoly leveraging as discriminatory practices.<sup>58</sup>

C. The Commission Should Adopt Appropriate Regulations To Check The BOCs' Abuse Of Market Power

The Commission's rules "define a dominant carrier as one that possesses market power, and a non-dominant carrier as a carrier not found to be dominant (i.e., one that does not possess market power)." See NPRM, ¶ 114 & n.205 (citing 47 C.F.R. §§ 61.3(o), 61.3(t)). Because the BOCs' ability to leverage their control over essential local facilities would enable them to raise their interexchange rivals' costs, they plainly possess market power and the Commission should apply dominant carrier regulation to any in-region, interstate, domestic interLATA services provided by a BOC affiliates.

The Commission is correct, however, in questioning (¶ 132) whether all aspects of current dominant carrier regulation should be applied to the BOCs. Some such aspects -- more stringent Section 214 requirements and price ceilings, for example -- are not designed to address the leveraging problems presented by BOC entry into competitive markets, and the different risks they were meant

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<sup>57</sup> (...continued)  
10-11 (Submitted as Attachment 1A to Ameritech's Motions to Remove the Decree's Interexchange Restriction).

<sup>58</sup> The NPRM also inquires (¶ 148) about the effect of a merger on two BOCs' ability to exercise market power. A merger of, or joint venture between, two or more BOCs would increase the BOCs' market power even further by extending the area over which they control access, and by increasing the number of instances in which they control access at both ends of the interexchange call -- thus further enhancing the ability of the BOCs to subject their interexchange competitors to a price squeeze.

to address appear to have little application here. At the same time, however, the Commission is mistaken insofar as it tentatively concludes (id.) that dominant carrier regulation is addressed solely to the exercise of market power through the restriction of a firm's output, rather than through the raising of rivals' costs. Some features of dominant carrier regulation -- such as price floors, and advance notice and cost support requirements for tariff filings -- seek to inhibit predation by, for example, giving the Commission and competitors the opportunity to determine whether a carrier's pricing properly reflects its costs.

In all events, the classification of BOC affiliates as dominant or non-dominant should not obscure the central issue in this proceeding: what combination of regulatory safeguards should be established in light of the market power they possess. The Commission should adopt a set of regulations properly addressed to the risks of monopoly leveraging. However they are classified, the BOCs and their interexchange affiliates should be subject to advance tariff filing and cost support requirements, stringent separate affiliate and non-discrimination requirements (see supra pp. 15-34), and periodic reporting requirements (see supra pp. 36-38). Such regulations, while necessarily limited in their scope and effectiveness, can at least check some of the more blatant forms of anticompetitive conduct, or make it at least somewhat more feasible to enforce the rules against them.<sup>59</sup>

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<sup>59</sup> The Commission should also adopt its proposals (§§ 150, 160) to apply the same regulatory treatment for the BOC affiliates' provision of in-region, international services as it applies for (continued...)

Respectfully submitted,

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<sup>59</sup> (...continued)

their provision of in-region, interstate, domestic interLATA services. The relevant issue is whether the BOC can leverage its market power in the exchange and exchange access markets to raise the costs of its rivals in the long-distance market. The ability and incentive of a BOC to use its market power for that purpose does not depend on whether its competitors are domestic or international. Consequently, different regulation approaches to domestic and international service would be unwarranted.