

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

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

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

---

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

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

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

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

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

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

---

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

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

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

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

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

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

---

<sup>86</sup> See Kodak, 541 U.S. at 476.

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

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

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

---

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

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

<sup>89</sup> See Notice at ¶ 80-81.

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

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

Professor Areeda went on to provide the following example:

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

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

---

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

<sup>91</sup> Areeda, IX Antitrust Law ¶ 1704.c.4.

<sup>92</sup> *Id.*

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

**C. Bundling Will Not Provide Competitive Benefits**

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

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

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

---

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

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

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

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

---

<sup>94</sup> Notice at ¶ 89.

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

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

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

---

<sup>96</sup> See supra § II.A.

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

<sup>98</sup> Id. at 4030.

<sup>99</sup> Id. at 4029-30.

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

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

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

---

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

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

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

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

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

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

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

---

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

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

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

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

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

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

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

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

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

this is inadequate, moreover, the Commission retains the authority to provide a carefully circumscribed waiver of the No-Bundling Rule.

This is not the time to jettison one of the Commission's most successful regulatory policies.

### CONCLUSION

For the foregoing reasons, the Commission should retain the current, highly successful, pro-competitive Customer Premises Equipment No-Bundling Rule.

Respectfully submitted,



---

Herbert E. Marks  
Jonathan Jacob Nadler  
Thomas E. Skilton  
Adam D. Krinsky

Squire, Sanders & Dempsey  
1201 Pennsylvania Avenue, N.W.  
P.O. Box 407  
Washington, D.C. 20044  
(202) 626-6600

Counsel for the  
Independent Data Communications  
Manufacturers Association

April 25, 1996



RECYCLED

ALL-STATE\* LEGAL 800-222-0610 ED11

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

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

**Reply Comments of the  
Independent Data Communications Manufacturers Association**

Herbert E. Marks  
Jonathan Jacob Nadler  
Adam D. Krinsky

Squire, Sanders & Dempsey  
1201 Pennsylvania Avenue, N.W.  
P.O. Box 407  
Washington, D.C. 20044  
(202) 626-6600

Counsel for the  
Independent Data Communications  
Manufacturers Association

May 24, 1996

## SUMMARY

Only a handful of commenters supported the Commission's proposal to eliminate the CPE No-Bundling Rule in the interstate, interexchange market. A somewhat larger number of commenters endorsed the Commission's alternate proposal, which would permit interexchange carriers to bundle CPE, provided that they also offer an unbundled service option on a non-discriminatory basis. These commenters, however, provided only the most cursory statement of their position. In contrast, trade associations representing three major industry sectors -- independent equipment manufacturers (IDCMA), consumer electronics retailers (CERC), and enhanced service providers (ITAA) -- submitted detailed comments explaining their strong opposition to the Commission's proposals. As these parties demonstrated, the No-Bundling Rule serves the public interest by fostering the development of a vibrant independent manufacturing sector, which has been a source of innovation and "intermodal" competition.

The "rebundling" advocates have failed to provide any adequate basis for elimination of the No-Bundling Rule. These parties rely principally on the Commission's earlier finding that the interexchange market is "substantially competitive." Even if antitrust considerations were dispositive -- which they are not -- IDCMA has demonstrated that, because interexchange carriers have the ability to dictate their customers' CPE choices, agreements "tying" CPE to interexchange service are per se unlawful.

The only public interest argument advanced by the rebundling advocates is that elimination of the No-Bundling Rule would permit carriers to offer "packages" that include transmission services and CPE. In fact, however, the CPE No-Bundling Rule does not prevent carriers from offering such "packages." The Rule merely requires that -- if a carrier chooses to offer "one-stop shopping" -- it must separately price the service and CPE components, and

offer each component on a stand-alone basis. As a result, elimination of the No-Bundling Rule would neither increase the number of service options available nor lower users' "transaction costs." Rather, elimination of the Rule would reduce the level of CPE innovation, as many independent manufacturers either would be forced from the market or required to shift their focus from directly serving the end-user to acting as a vendor for the carriers.

Finally, allowing bundling would not advance the "deregulatory" goals embodied in the Telecommunications Act. To the contrary, the Commission's proposal would allow carriers to provide CPE as part of their regulated transmission service offering, thereby resulting in the reregulation of currently non-regulated CPE. In addition, rebundling would impair implementation of the Commission's universal service mandate.

The comments also confirm that elimination of the No-Bundling Rule would be unlawful and contrary to the public interest. Indeed, AT&T alone argues that adoption of the Commission's proposal would not violate the U.S. obligation under the GATS Telecommunications Annex to ensure that service providers have the right to attach CPE to any common carrier network or service.

The alternate proposal would have similarly adverse consequences. As IDCMA, CERC and ITAA demonstrated, because interexchange carriers retain at least a degree of market power, they are able to sustain prices for transmission service at levels that are at least modestly above cost, thereby generating sufficient of revenue to allow a carrier to provide "free" CPE to their transmission service customers. If the alternate proposal were adopted, customers who purchase stand-alone transmission service would be forced to subsidize customers that purchase

bundled service/CPE. At the same time, independent manufacturers -- who lack the ability to engage in cross-subsidization -- would be placed at an insurmountable competitive disadvantage.

## TABLE OF CONTENTS

SUMMARY .....	i
TABLE OF CONTENTS .....	iv
INTRODUCTION .....	1
I. THE REBUNDLING ADVOCATES HAVE NOT PROVIDED ANY ADEQUATE JUSTIFICATION FOR ELIMINATION OF THE NO-BUNDLING RULE .....	3
A. The Commission's Findings Regarding the Level of Competition in the Interexchange Market Do Not Provide a Basis for Elimination of the No-Bundling Rule; The Commission's Decision Must be Based on a Public Interest Analysis .....	4
B. Elimination of the No-Bundling Rule is Not Necessary to Permit Interexchange Carriers to Offer Packages that Include Transmission Service and CPE .....	7
C. Elimination of the No-Bundling Rule Would Not Advance the "Deregulatory" Goals of the Telecommunications Act .....	11
II. THE COMMENTS CONFIRM THAT ELIMINATION OF THE NO-BUNDLING RULE WOULD BE UNLAWFUL AND NOT IN THE PUBLIC INTEREST ..	13
A. Adoption of the Commission's Proposal Would Violate GATS and NAFTA .....	14
B. Adoption of the Commission's Proposal Would Result in Significant Administrative Burdens and Lead to the Complete Erosion of the No-Bundling Rule .....	17
C. Adoption of the Commission's Proposal Would Allow Interexchange Carriers to Evade the Network Disclosure Rules .....	19
III. SUPPORTERS OF THE COMMISSION'S ALTERNATE PROPOSAL HAVE FAILED TO RECOGNIZE ITS SERIOUS DEFICIENCIES .....	21
CONCLUSION .....	25

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

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

**Reply Comments of the  
Independent Data Communications Manufacturers Association**

The Independent Data Communications Manufacturers Association ("IDCMA"), by counsel, hereby replies to the comments filed in response to the Commission's proposal to allow interexchange carriers to bundle customer premises equipment ("CPE") with interstate, interexchange service.<sup>1</sup>

**INTRODUCTION**

The response to the Commission's request for comments on the bundling issue was surprisingly small. Of the more than one hundred parties that filed initial comments in this proceeding, only 29 addressed the CPE bundling issue. Within this group, only a handful of commenters -- led by AT&T -- supported elimination of the CPE No-Bundling Rule in the interexchange market. A somewhat larger number of commenters supported the Commission's alternate proposal, which would permit interexchange carriers to bundle CPE, provided that they

---

<sup>1</sup> See Policy and Rules Concerning the Interstate, Interexchange Marketplace, Notice of Proposed Rulemaking, CC Docket No. 96-61, ¶¶ 84-91 (rel. Mar. 25, 1996) ("Notice").

also offer an unbundled service option on a non-discriminatory basis. However, commenters supporting this alternative did little more than provide a cursory statement of their position.

In contrast, trade associations representing three major industry sectors -- independent equipment manufacturers (IDCMA), consumer electronics retailers (CERC), and enhanced service providers (ITAA) -- provided detailed and well-reasoned comments explaining the basis for their strong opposition to the Commission's "rebundling" proposal.<sup>2</sup> As these commenters demonstrated, the CPE No-Bundling Rule has been one the Commission's most successful policy initiatives and remains an essential regulatory tool.<sup>3</sup>

As IDCMA explained, the CPE No-Bundling Rule ensures that consumers have the ability to obtain CPE from an independent manufacturer. Because independent manufacturers work directly with their end-user customers, they have been the principal source of innovative CPE. In many cases, equipment developed by these manufacturers reduces users' need to purchase network-based services or facilities -- a process often referred to as "intermodal" competition. If the Rule were to be modified or eliminated, IDCMA observed,

---

<sup>2</sup> See Comments of the Independent Data Communications Manufacturers Association (filed Apr. 25, 1996) ("IDCMA Comments"); Comments of the Consumer Electronics Retailers Coalition (filed Apr. 25, 1996) ("CERC Comments"); Comments of the Information Technology Association of America (filed Apr. 25, 1996) ("ITAA Comments"); see also Comments of the Alabama Public Service Commission at 9 (filed Apr. 19, 1996) ("Alabama PSC Comments") (opposing the Commission's rebundling proposal); Initial Comments of the Pennsylvania Public Utility Commission, To the Notice of Proposed Rulemaking Regarding Interstate, Interexchange Service, Sections III, VII, VIII and IX at 11 (filed Apr. 25, 1996) (same).

<sup>3</sup> See CERC Comments at 7 (As a result of the No-Bundling Rule, "American consumers and businesses have had access to the widest variety of affordable CPE in the world."); ITAA Comments at 3 ("If there ever were a Commission policy, the benefits of which are empirically and undeniably verifiable, it is the Commission's prohibition of bundling. ").

carriers would be able to foreclose independent manufacturers from a substantial portion of the end-user market. As a result, many independent manufacturers would exit the market. Those that remained, moreover, would be forced to shift their focus from the end-user market and, instead, would become vendors for the carriers. Carrier-dependent manufacturers, IDCMA further explained, would have far less incentive to continue to develop innovative products that reduce the need for carrier-provided facilities or services.<sup>4</sup>

**I. THE REBUNDLING ADVOCATES HAVE NOT PROVIDED ANY ADEQUATE JUSTIFICATION FOR ELIMINATION OF THE NO-BUNDLING RULE**

The parties that expressed support for the Commission's proposal to allow interexchange carriers to bundle CPE advance three possible justifications for their position. First, they suggest that, because the interexchange market is "substantially competitive," there is no basis for continued application of the Rule. Second, they contend that bundling is necessary to permit carriers to offer "packages" that include transmission service and CPE. And, finally, they assert that elimination of the Rule would advance the "deregulatory" goals embodied in the recently enacted Telecommunications Act. As demonstrated below, none of these purported justifications provides a basis for elimination of the No-Bundling Rule in the interexchange market.

---

<sup>4</sup> See IDCMA Comments at 19-20.

**A. The Commission's Prior Findings Regarding the Level of Competition in the Interexchange Market Do Not Provide a Basis for Elimination of the No-Bundling Rule; The Commission's Decision Must be Based on a Public Interest Analysis**

**1. Antitrust considerations**

The rebundling advocates have distorted the purpose for which the Commission adopted the No-Bundling Rule. These commenters portray the Rule as little more than an effort to codify the restriction -- already contained in the federal antitrust laws -- against "tying" agreements by carriers that possess market power.<sup>5</sup> This myopic view leads these commenters to suggest that the principal issue in this proceeding is whether interexchange carriers possess market power. Because the Commission previously has determined that they do not, the rebundling advocates conclude, the No-Bundling Rule should be eliminated.

Even if antitrust considerations were dispositive -- which they are not -- the rebundling advocates would be obliged to do more than incant the Commission's prior findings regarding the level of competition in the interexchange market. If interexchange carriers have the ability to "force" customers to purchase carrier-provided CPE, then any effort to tie the provision of transmission service to the provision of CPE would constitute a per se violation of Section 1 of the Sherman Act. Therefore, if the rebundling advocates are to justify elimination

---

<sup>5</sup> See Comments of the American Petroleum Institute at 14 (filed Apr. 25, 1996) ("API Comments") ("Since no carrier in the domestic interstate, interexchange market exerts market power, the Commission need not retain a regulatory requirement intended to constrain that power."); accord Comments of AT&T Corp. at 26 (filed Apr. 25, 1996); Comments of Excel Telecommunications, Inc. at 5 (filed Apr. 25, 1996); Comments of Frontier Corporation at 7 (filed Apr. 25, 1996); Comments of the Florida Public Service Commission at 17 (filed Apr. 19, 1996) ("Florida PSC Comments"); Comments of the United States Telephone Association on Price Collusion and CPE Bundling at 3-4 (filed Apr. 25, 1996) ("USTA Comments").

of the Rule on antitrust grounds, they must demonstrate that interexchange carriers do not have the ability to dictate their customers' CPE choices.

The rebundling advocates have not even attempted to assess this critical economic issue. AT&T's comments epitomize the approach taken by these parties. AT&T baldly asserts that, because it is subject to competition in the interexchange market, it does not have the ability to dictate its customers' choices in the CPE market.<sup>6</sup> AT&T's conclusory assertion is flatly inconsistent with the analytic approach mandated by the Supreme Court's Kodak decision.<sup>7</sup> In that case, the Court squarely rejected the suggestion that a firm that lacks market power in its principal market should be presumed incapable of engaging in unlawful tying in an adjacent market. Rather, the Court concluded, it is essential to consider the "realities" of the relevant markets in order to determine whether the firm has the ability to "force" its customers to purchase an unwanted product.

Unlike the rebundling advocates, IDCMA has carefully analyzed the "realities" of the interexchange and CPE markets, and the relationship between them.<sup>8</sup> Based on this analysis, IDCMA demonstrated that the Commission's basic assumption is incorrect: interexchange carriers do retain the ability to dictate users' CPE choices.<sup>9</sup> IDCMA further demonstrated that carriers have every incentive to use their power to "force" customers to obtain

---

<sup>6</sup> See Comments of AT&T Corp. at 26.

<sup>7</sup> See Eastman Kodak Co. v. Image Technical Services, 541 U.S. 451, 466 (1992).

<sup>8</sup> See IDCMA Comments at 35-36.

<sup>9</sup> See id. at 36.

carrier-provided CPE.<sup>10</sup> Therefore, even if antitrust principles were dispositive, the Commission would be obligated to reject its proposal to eliminate the No-Bundling Rule in the interexchange market.

## 2. Public interest considerations

Contrary to the suggestion of the rebundling advocates, antitrust principles do not control the Commission's decision in this proceeding. As IDCMA demonstrated in its comments, "the Commission did not adopt the CPE No-Bundling Rule solely to codify the Sherman Act proscription against tying by firms with market power."<sup>11</sup> To the contrary, IDCMA explained, "adoption of the Rule was the culmination of a generation-long effort" to advance the public interest by "ensur[ing] that users have the right to use the premises equipment that best meets their needs -- regardless of whether they obtain such equipment from a carrier or an independent manufacturer."<sup>12</sup> For that reason, IDCMA observed, the Commission has consistently applied the No-Bundling Rule to all carriers, not just those with market power.<sup>13</sup>

---

<sup>10</sup> As IDCMA explained in its comments, in a competitive market a carrier has an incentive to bundle CPE in order to obtain complete "account control." This incentive exists regardless of whether the carrier actually manufactures the bundled CPE. See id. at 18-19.

<sup>11</sup> Id. at 4.

<sup>12</sup> Id.

<sup>13</sup> See id. at 7; see also CERC Comments at 3 (Prevention of "anticompetitive conduct . . . was not the Commission's primary reason for adopting the antibundling rule."); Comments of America's Carriers Telecommunication Association ("ACTA") at 17 (filed Apr. 25, 1996) ("Beyond the specific concerns for applying the tenets of the antitrust laws...the Commission must also be assured that . . . its rules [do] not . . . violate other public interests.").