Todd F. Silbergeld
Director-
Federal Regulatory

SBC Communications Inc.
1401 I Street, N.W.
Suite 1100
Washington, D.C. 20005
Phone 202 326-8888
Fax 202 408-4806

November 15, 1996

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COMMUNICATIONS
OFFICE OF SECRETARY

EX PARTE

Mr. William F. Caton
Acting Secretary
Federal Communications Commission
1919 M Street, N.W., Room 222
Washington, D.C. 20554

Re: *Implementation of the Non-Accounting Safeguards of Section 271 and 272 of the Communications Act of 1934 and Regulatory Treatment of LEC Provision of Interexchange Services Originating in the LEC's Local Exchange Area, CC Docket No. 96-149*

Dear Mr. Caton:

In accordance with the Commission's rules governing ex parte presentations, please include in the official record in above-referenced rule making docket the attached affidavits of Dr. Richard Schmalensee and Ms. Karol Sweitzer. The affidavits were prepared in response to direct requests by Commission staff. Therefore, the documents will not be counted against the ten-page limitation imposed in this docket.

The affidavit prepared on behalf of SBC Communications Inc. ("SBC") by Dr. Schmalensee addresses the issue of whether the long-distance affiliates of the Bell operating companies ("BOCs") should be regulated as dominant carriers. Dr. Schmalensee concludes that, from an economic and public policy perspective, the classification of BOC long-distance affiliates as dominant carriers (1) would have extremely high costs, resulting in higher prices for consumers and (2) would not provide any protection against any perceived problems some have alleged are present in this context.

In her affidavit, Ms. Sweitzer, the chief financial officer of Southwestern Bell Communications Services, Inc. (SBC's long-distance subsidiary) discusses the various costs dominant carrier classification would impose upon her company. Dominant interexchange carrier classification, Ms. Sweitzer contends, would significantly impair SBCS's ability to compete effectively in the market.

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Pursuant to the Commission's rules, an original and two copies of this letter and the attachments are provided. Please stamp and return the copy provided for that purpose. Should you have any questions concerning this filing, do not hesitate to contact me at (202) 326-8888.

Sincerely,

Todd J. Silberman

Attachments

NATIONAL ECONOMIC
RESEARCH ASSOCIATES
ONE MAIN STREET, CAMBRIDGE, MASSACHUSETTS 02142
TEL: 617.621.0444 FAX: 617.621.0336

nera
Consulting Economists

AFFIDAVIT OF

RICHARD SCHMALENSEE

November 15, 1996

AFFIDAVIT OF RICHARD SCHMALENSEE

I. QUALIFICATIONS AND SUMMARY

1. I am the Gordon Y. Billard Professor of Economics and Management at the Massachusetts Institute of Technology (MIT), Deputy Dean of the MIT Sloan School of Management, and Director of MIT's Center for Energy and Environmental Policy Research. I am also a Special Consultant to National Economic Research Associates, Inc., a Director of the Long Island Lighting Company, and a Member of the EPA's Advisory Council on Clean Air Act Compliance Analysis. I served as a Member of President Bush's Council of Economic Advisers with primary responsibility for domestic and regulatory policy, including environmental and telecommunications policy and for U.S. assistance to Central and Eastern Europe. I served for several years as a consultant to the Bureau of Economics of the Federal Trade Commission.

2. I have done extensive research on aspects of industrial organization and antitrust policy, particularly non-price competition and conditions of entry. I have also studied the telecommunications industry, the electric power sector, and general issues of regulation and regulatory reform. I have testified in federal and state courts, before several Congressional committees, and before the Federal Trade Commission, and have served as a consultant on regulatory and competitive issues to numerous organizations in the United States and abroad.

3. I received an S.B. and Ph.D. degrees in economics from MIT and taught for some years at the University of California, San Diego. At MIT, I teach graduate courses in industrial organization and its applications to management decisions, government regulation and government/business relations. I have published over 60 articles in professional journals, including *The American Economic Review*, *The RAND Journal of Economics*, *The Harvard Law Review*, *The Journal of Econometrics*, *Public Utilities Fortnightly*, *Econometrica*, *The Journal of Law and Economics*, *The Journal of Industrial Economics*, *The Economic Journal*,

The Antitrust Law Journal, *The International Journal of Industrial Organization*, *The Quarterly Journal of Economics*, and *The Journal of Economic Perspectives*.

4. I am the author of *The Economics of Advertising* and *The Control of Natural Monopolies* and co-author of *Markets for Power*. I am also co-editor of the *Handbook of Industrial Organization* and founding editor of the MIT Press Regulation of Economic Activity monograph series. I have served on the editorial boards of *The American Economic Review*, *Zeitschrift fur Nationalokonomie*, *The International Journal of Industrial Organization*, *The Journal of Economic Perspectives*, *Recherches Economiques de Louvain*, and *The Journal of Industrial Economics*. I have served on the Executive Committee of the American Economic Association and am a Fellow of the Econometric Society and the American Academy of Arts and Sciences.

5. I have been asked by SBC Communications Inc. and its subsidiaries ("SBC") to consider the desirability, as a matter of economic policy, of treating the long distance affiliates described in Section 272 of the Act ("272 affiliates") of Bell operating companies ("BOCs") as dominant carriers of interexchange traffic. I conclude that such treatment would be undesirable from an economic and public policy perspective. The main points developed below to support this conclusion are the following:

- Applying to the 272 affiliates the sort of dominant carrier regulation that used to be applied to AT&T would have extremely high costs, resulting in higher prices for consumers.

- Such regulation would not provide any protection against several perceived problems that some have alleged are present in this context. Such protection can only be provided by checks on the BOCs' provision of exchange access service -- in particular, by requirements that all interexchange carriers be treated equally.

- If the 272 affiliates have incentives to be more aggressive competitors than the existing carriers, then this will ultimately benefit consumers. The risk of a price squeeze in the interexchange market is remote.

- The Commission can best respond to any perceived risk by watching to see if a price squeeze actually develops. If it does, the appropriate regulatory response would differ substantially from the dominant carrier regime applied in the past.

II. COSTS OF DOMINANT CARRIER REGULATION

6. The clear intent of the Telecommunications Act of 1996 ("the Act") was to replace regulatory and judicial oversight of telecommunications markets—both local and long distance—with competition. Application of the traditional regulatory apparatus used to control the behavior of dominant firms to the 272 affiliates when it is not necessary is not benign; imposing such regulation on the BOC long distance affiliates would discourage price competition and the introduction of new services, leading to higher prices and slower supply of new services to consumers.

7. According to prior FCC treatment of dominant carriers, that designation has carried with it several types of regulation:

- Price cap regulation, which limits pricing flexibility.
- Tariffing requirements. While classified as a dominant carrier, AT&T was required to file tariffs on either 14, 45 or 120 days' notice, depending upon the type of tariff at issue, instead of the one-day notice required of non-dominant carriers. Tariffs for streamlined services must be filed on 14 days' notice.[1]
- Section 214 filing requirements to obtain FCC approval for new facilities construction or for the discontinuance of any service.

All these requirements are more stringent than they are for non-dominant carriers. Prices of non-dominant carriers are not constrained by price caps and, until recently, non-dominant carriers faced only a one-day delay in filing tariffs. Moreover, in October 1996, the

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[1] Federal Communications Commission, Motion of AT&T Corp. to be Reclassified as a Non-Dominant Carrier, Order ("Non-dominant Decision"), released October 23, 1995, p. 10.

Commission decided to forbear from regulating tariffs of non-dominant carriers altogether,[2] and non-dominant carriers today have streamlined domestic Section 214 filing requirements.[3]

8. When AT&T was pleading for non-dominant status, the FCC summarized AT&T's position as asserting that

> continuing to regulate it as a dominant carrier imposes direct costs on carriers and customers, and does not facilitate a competitive market for interstate, domestic, interexchange services. AT&T claims that, despite loss of market power, it continues to be subjected to 'burdensome and unequal' regulation that unfairly advantages its competitors and deprives consumers of price reductions and innovative service offerings. Regulation of AT&T as a dominant carrier, it argues, also wastes Commission resources that instead could be utilized in areas where regulation may be more appropriate, such as the opening up of local exchange and foreign markets.[4]

In AT&T's view, dominant regulation of a firm that allegedly has lost market power is nonetheless costly to the firm, the competitive process, and ultimately to customers.

9. The FCC order reclassifying AT&T as a non-dominant carrier stated some of the consequences of applying regulations historically applied only to dominant carriers. To make clear the implications in the present instance, in the relevant paragraph from the FCC order, I have replaced "AT&T" with "an SBC Section 272 affiliate":

> The cost of dominant carrier regulation of an SBC Section 272 affiliate in this context includes inhibiting an SBC Section 272 affiliate from quickly introducing new services and from quickly responding to new offerings by its rivals. This occurs because of the longer tariff notice requirements imposed on an SBC Section 272 affiliate, which allow its competitors to respond to an SBC Section 272 affiliate tariff filing covering new services and promotions even

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[2] Federal Communications Commission, Policy and Rules Concerning the Interstate, Interexchange Marketplace; Implementation of Section 254(g) of the Communications Act of 1934, as amended, Second Report and Order, CC Docket No. 96-61, released October 31, 1996.

[3] Non-dominant Decision, p. 11.

[4] *Ibid.*, p. 13.

> before its tariffs become effective. The longer notice requirements imposed on an SBC Section 272 affiliate thus also reduce the incentive for an SBC Section 272 affiliate to initiate price reductions. In addition, to the extent an SBC Section 272 affiliate were to initiate such strategies, its competitors could use the regulatory process to delay, and consequently, ultimately thwart an SBC Section 272 affiliate's strategies. Furthermore, such regulation imposes compliance costs on an SBC Section 272 affiliate and administrative costs on the Commission.[5]

I agree with that paraphrase of the Commission's order as it would be applied to the interexchange affiliate of SBC.

10. The costs of applying such a regulatory scheme to new entrants into the interexchange market are likely to be substantial. Ironically, declaring the 272 affiliates dominant in the interexchange business may well keep them out of that business entirely. An important component of dominant firm regulation is likely to be cost-justification requirements or other provisions that amount to price floors.[6] The 272 affiliates will be new entrants facing capable, established firms, however, and like other new entrants in unregulated markets, an initial period of aggressive pricing and consequent losses may be the best way to build a viable business. It is hard to see how such a strategy can be executed if prices must be cost-justified. It will clearly be impossible if prices must be made public in advance of their taking effect.[7]

11. The costs of thus inhibiting or even preventing BOC entry into the interexchange market are likely to be substantial. Many economic studies have found competition in this

[5] *Ibid.*, p. 18.

[6] Note that imputation requirements themselves, which are required in the Act (see section 272(e)(3)), will produce price floors without costly "dominant carrier" regulation.

[7] Note that incumbent IXCs would push for 272 affiliates to have "dominant carrier" status even without price floors. They could then intervene in every proposed price decrease or new service, and insist on costly and contentious proceedings every time the 272 affiliate changed a price, including detailed cost support and other data, which, as an added benefit, might reveal information that would be helpful in competing against the 272 affiliates. They would thus increase 272 affiliates' costs, delay or prevent price decreases and new service introductions, gain time to prepare their own competitive responses, gain competitive intelligence, and probably discourage the 272 affiliates from making price reductions or new service introductions.

market to be less than intense, despite the presence of numerous resellers. Reductions in long distance prices since divestiture have not entirely reflected reductions in carrier access charges, let alone reductions in costs through expansion of demand and technological change.[8] Price competition among the three largest IXCs has been less than vigorous, as price changes by AT&T have been followed closely by similar price changes by MCI and Sprint.[9] The cost of imposing dominant carrier regulation may thus be a further reduction in effective competition in a vital, growing market.

III. The Price Squeeze Theory and its Limitations

12. Most of the reasons that have been advanced for imposing some form of dominant carrier regulation on the 272 affiliates do not in fact justify any regulation of those entities. These reasons involve potential exploitation of alleged monopoly power in *access* markets—not long distance markets—and thus should be dealt with by either regulation of access price levels or rigorous enforcement of equal treatment provisions.

13. For instance, it is true that changes in access prices will affect the overall level of interexchange prices which, in turn, can affect the size of the interexchange market and the number of retail competitors. But changes in access prices are competitively neutral in the interexchange market because all long distance suppliers pay the same tariffed prices for access. Moreover, access prices are regulated at present and will be further disciplined by competition. In addition, there is little danger that SBC would raise access charges to preclude IXC entry—and no substantial harm to competition if it did—because there is already excess capacity in the IXC market. In contrast, regulation of the 272 affiliates as dominant carriers could only affect the markup between access prices and the IX prices charged by a single carrier.

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[8] See, e.g., W.E. Taylor and L.D. Taylor, "Post-Divestiture Long-Distance Competition in the United States," American Economic Review, Vol. 83, No. 2, May 1993, reprinted in E. Bailey, J. Hower, and J. Pack, *The Political Economy of Privatization and Deregulation*, London: Edward Elgar, 1994.

[9] See, e.g., P.W. MacAvoy, *The Failure of Antitrust and Regulation to Establish Competition in Long-Distance Telephone Services*, Cambridge: the MIT Press, 1996 at pp. 69-81.

14. Similarly, dominant carrier regulation is logically inappropriate as a response to concerns about (i) a BOC's charging different access prices to its 272 affiliate and competing IX carriers, (ii) cost-shifting from interexchange to local markets, or (iii) provision of inferior access quality to a 272 affiliate's competitors. All of these concerns relate to the possibility that a BOC will not comply with accounting rules and other regulations that require it to deal with its 272 affiliate and with other IX carriers on equal terms. Experience to date in cellular, information services, intraLATA long distance markets—as discussed below— indicates that such non-compliance is unlikely to be a serious problem.

15. In practice, non-vertically integrated firms have already competed fully with LECs in markets where LECs have been the primary supplier of essential inputs. These markets include cellular, voice messaging services (VMS), and corridor and intraLATA long distance services.

16. LECs have participated in cellular telephony since 1983. The service is organized as a (largely) unregulated duopoly in the United States with entry limited by the availability of only two 25 MHz channels in each geographic market. At its inception, one channel was allocated to wireline carriers (generally a BOC or GTE) and the other to non-wireline providers, though no such restriction is imposed on the licenses once they are awarded. What is significant here is that the wireline licensees (the LECs) have not come to dominate the market, as would have happened if they had been able to subsidize these services from their local telephone services or had they been able to discriminate against their non-wireline cellular rivals. The largest cellular company in the U.S. is AT&T, a non-wireline supplier, and seven of the ten cellular companies with the highest penetration rates are not RHC subsidiaries.[10] Perhaps the best evidence, though, that participation by incumbent LECs in the cellular business does not foreclose competition comes from the wireline carriers themselves. Though presumably most knowledgeable about the real risks of anticompetitive conduct directed at them by the incumbent wireline cellular carriers, the number of territories in which telephone company

[10] *Wireless Telecom Investor*, March 14, 1994, No. 73, p. 10.

cellular affiliates compete with one another has grown rapidly from about 5 in 1986 to more than 30 in 1995.[11] And a company as knowledgeable and sophisticated as AT&T sunk billions into this market through its purchase of McCaw Cellular Communications. This is powerful evidence that concern that LECs might be able to discriminate in favor of their cellular affiliate in their home territory has not been a deterrent to entering into competition with them.

17. Many LECs have long been allowed to provide information services and, in recent years, the BOCs also have been allowed to enter those markets—all without evidence that competition has been undermined. Since the BOCs and GTE began offering VMS, consumer welfare has increased in at least two ways. First, the monthly charge has dropped from $30 in 1990 to $5 to $15 in 1995.[12] Second, the LECs began offering VMS to an unserved market segment—residential and small business customers. In five years, the BOCs' participation in this market increased from zero to over six million subscriptions, yet competitors have thrived, and the BOCs and GTE together account for just over 15 percent of the total VMS revenues nationally.

18. Evidence concerning the viability of interLATA competition also comes from the intraLATA long distance markets. Nearly all states permit intraLATA toll competition, and in none of them have the LECs been required to divest themselves of their toll businesses or even to create separate subsidiaries. Moreover, if competition in the presence of bottleneck facilities gave rise to uncontrollable discrimination, the intraLATA long distance markets would surely show it. The success of competition for intraLATA long distance is strong evidence that the

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[11] The 1995 number reflects direct competition among the former BOCs except for Pacific Telesis, which spun off its cellular company (now known as AirTouch Cellular).

[12] J.A. Hausman and T.J. Tardiff, "Benefits and Costs of Vertical Integration of Basic and Enhanced Telecommunications Services," April 6, 1995.

theoretical problems of discriminatory treatment of BOC affiliates and their competitors are adequately addressed by existing regulatory safeguards.[13]

19. In sum, there is no need to rely on either *a priori* reasoning or descriptions of regulatory rules to conclude that there is no significant danger of LEC anticompetitive discrimination in these markets. We have now accumulated many years of experience of the LECs operating in associated telecommunications markets in competition with other companies; and there is no evidence that they have succeeded in preventing or suppressing competition as an effective force in any of these markets. Moreover, even if it could somehow be shown that the BOCs are in a position to unfairly advantage their 272 affiliates as against other IX carriers, the solution would clearly be carefully designed constraints on the BOCs' exchange access behavior, not artificial and harmful findings of dominance of the 272 affiliates.

20. We should also keep in mind that the FCC has declared AT&T to be non-dominant, basing its decision on AT&T's share of the interstate, domestic, interexchange market, the market elasticity, and the ease with which competing carriers could expand output and take away AT&T customers. AT&T is the largest telecommunications company in the country, controlling over 50 percent of the interexchange market.[14] SBC's interexchange affiliate will have, for the foreseeable future, a tiny fraction of the interstate, domestic, interexchange market. If AT&T is non-dominant in the interexchange market, surely application of the FCC's own analysis would classify SBC's long distance affiliate as non-dominant.

21. The possibility of a price squeeze is sometimes offered as a rationale for regulating the 272 affiliates as dominant carriers despite their small initial market share. The ordinary price squeeze allegation asserts that the LEC will underprice its affiliate's long distance service

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[13] Additional interLATA long distance competition has taken place successfully since divestiture along the New Jersey-New York and New Jersey-Philadelphia corridors. Bell Atlantic competes with interexchange carriers on these routes under the Commission's rules without incident. It serves only a small fraction of the total demand on these routes, but markets heavily to attract 10XXX calling.

[14] See Non-dominant Decision at ¶ 38 and ¶¶ 67-73.

relative to its carrier access service in order to drive long distance competitors from the market. This type of price squeeze is not a policy concern because:

- the perceived access bottleneck is being dismantled by state and federal regulations;
- the Commission's imputation rules prevent such pricing of long distance; and
- the prospect of increased profit from such a policy is nil. The LEC sacrifices profits in the short run by pricing long distance below its incremental cost (including the opportunity cost from selling carrier access) and has no ability to recoup its lost profits in the long distance market by raising long distance prices (relative to carrier access prices) in the future, because competitive capacity is sunk and will not exit the market.

22. One or more parties to this proceeding have advanced a different price squeeze theory. Suppose that access is priced above its incremental cost and consider a 272 affiliate that attempts to choose its rates to maximize *total* BOC profits: i.e., the sum of access profits and IX profits. Because access is priced above its incremental cost, the BOC's access profits would be increased if the overall level of interexchange rates were reduced, all else equal. This is because lower IX rates would stimulate IX volume at least to some extent, and this would increase access profits. Because access profits increase when IX prices fall, it then follows that the 272 affiliate will charge lower prices than it would if it were interested only in maximizing IX profits. As a logical matter, this theory is correct. In the real world, however, it does not prove that there would be any benefits to dominant carrier regulation of 272 affiliates, especially considering the costs of such regulation, as discussed above.

23. What the theory just outlined shows, and all that it shows as a general matter, is that when an IX carrier is affiliated with an access provider charging a price above marginal cost, it will charge lower IX prices than it would if it were an unaffiliated carrier. But lower prices benefit consumers, and more aggressive competition in the interexchange market is most likely to enhance economic efficiency. Thus, the price squeeze argument, if valid in reality, provides another argument in favor of 272 affiliates' entry into the interexchange market and in favor of

eliminating any barriers that would prevent them from helping to make the interexchange market more competitive.[15] As I noted above, competition in the IX market has not been intense. To the extent that the 272 affiliates aggressively push long distance prices down toward competitive levels, consumers benefit. Moreover, large price reductions from current interstate toll prices would not be in the least anticompetitive.[16] There is only a loss compared with the *status quo* if prices are forced substantially below cost, and the 272 affiliates would prefer such an outcome only under rare conditions that cannot be demonstrated to hold here. (For example, overall IX volume must be sufficiently responsive to prices to offset toll revenue losses with higher carrier access revenue).

24. Moreover, it is vital to distinguish between the rates the 272 affiliates would prefer to see prevail in the IX markets and the rates they would be able to bring about in that market. A small firm, particularly a new entrant, cannot lower the price level generally prevailing in a market simply by charging low prices for its own services: it must be able to take sufficient volume from established firms in aggregate to force them to lower prices also. Only by lowering market prices can total IX volume, and thus access volume, be stimulated. The IX market now contains many small carriers that compete primarily on price, but the three or four main carriers have not rapidly lost share in total to the smaller IX carriers and have not generally been compelled to match low prices charged by their small rivals. Thus, even if the 272 affiliates would prefer to price interexchange services below cost, there is no reason to

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[15] The IXC proponents of the price squeeze allegation are essentially asking to be protected from competition. Moreover, many of the unaffiliated IX carriers will also be access providers and local exchange providers with the same incentive to offer attractive "one-stop shopping" options to customers.

[16] At 18 cents average revenue per minute and 6 cents average access charge per minute, AT&T receives 12 cents of revenue net of access. Its incremental costs are roughly 2 cents per minute leaving room for about 10 cents per minute of price reductions above long run incremental cost. (Revenues and access expenses are taken from an AT&T *ex parte* letter in CC Docket No. 94-1, March 21, 1996. AT&T's incremental costs are estimated in L. J. Perl and J. Falk, "The Use of Econometric Analysis in Estimating Marginal Cost," presented at Bellcore and Bell Canada Industry Forum, San Diego, California, April 6, 1989, Table 2 and are independently corroborated in R.W. Crandall and L. Waverman, *Talk is Cheap: The Promise of Regulatory Reform in North American Telecommunications*, Washington, D.C.: The Brookings Institution, 1995, at p. 92).

think that they could bring about such an outcome unless and until their share of the IX market becomes large.

25. When the 272 affiliates are attempting to penetrate the IX market, the BOCs' local exchange businesses already will have been opened to competition, and CAP/CLEC expansion can be expected to continue. Such expansion, perhaps supplemented by access pricing reform, can be expected to push access prices toward incremental cost. The smaller the gap between access price and incremental cost, the lower would be the incentive from this source for the 272 affiliates to be aggressive competitors. (The 272 affiliates may, of course, have other strategic reasons for being more aggressive than the established carriers, particularly when they are trying to build viable market positions, but regulation would have no appropriate role in attempting to address these other reasons.) It is thus entirely possible that this incentive effect will be eliminated by market and regulatory forces before it has any visible effect, desirable or undesirable, on market prices.

IV. Appropriate Regulatory Response

26. I understand that the FCC has the ability to classify any carrier as dominant if market data reveal that it has acquired market power. SBC has not done so in the IX market. Rather than distort competition through dominant firm regulation of the long distance affiliates, it would surely be less costly for the Commission to watch the interexchange market closely and to consider classifying a 272 affiliate as dominant if and only if

- it attains (or is plainly poised to attain) a market share high enough to be consistent with a finding of dominance in antitrust contexts;
- it appears content to compete for traffic at prices that do not cover incremental costs; and
- access prices are and are expected for some time to be substantially in excess of incremental cost.

Put another way, there is no threat of a price squeeze and thus no rationale for applying dominant firm regulation to a 272 affiliate if any of the following conditions are satisfied: (a) the 272 affiliate is a new entrant, (b) the 272 affiliate has a small market share, (c) the access prices of the 272 affiliate's BOC are not substantially above incremental cost, or (d) the access prices of the 272 affiliate's BOC are set in the face of effective competition.

27. Finally, much of the dominant carrier apparatus applied to AT&T would have no value in dealing with a perceived threat of a price squeeze. There is no reason to require cost justification on a service-by-service basis or to require that a 272 affiliate sell only on the basis of published tariffs. A price squeeze of the sort at issue here means that total revenues do not cover total costs in the long run; if a 272 affiliate is proceeding along a course that can be reasonably expected to yield at least a competitive rate of return on invested capital, there is no price squeeze problem. Thus, any price floors should be flexible and broad.

# # #

Before the
Federal Communications Commission
Washington, D.C. 20554

In the Matter of	)	
	)	
Implementation of the Non-Accounting Safeguards of Section 271 and 272 of the Communications Act of 1934 and Regulatory Treatment of LEC Provision of Interexchange Services Originating in the LEC's Local Exchange Area	))))))	CC Docket No. 96-149

AFFIDAVIT OF KAROL SWEITZER

I. Statement of Karol Sweitzer

1. My name is Karol Sweitzer. I am the Chief Financial Officer of Southwestern Bell Communications Services, Inc., which will do business in-region as Southwestern Bell Long Distance. I am responsible for the accounting, finance, and regulatory functions of Southwestern Bell Long Distance.

2. We are currently in the process of attempting to establish a high quality, low cost, competitive long distance company. On July 17, 1996, the Federal Communications Commission ("Commission") initiated a proceeding to implement rules for the provision of interLATA long distance services in-region by Bell Operating Company ("BOC") affiliates. In its Notice, the Commission solicited public comment on whether the long distance affiliates of the BOCs should be classified and regulated as "dominant carriers." There are a number of issues in that proceeding which, if decided incorrectly from Southwestern Bell's perspective, could seriously harm its ability to compete effectively in the domestic interexchange market. The following is a synopsis of the detrimental characteristics of a dominant carrier classification.

II. Dominant Carrier Status Would Create Competitive Disadvantages

3. To the extent that Southwestern Bell Long Distance is prevented by regulatory constraints from offering services in a timely manner or at prices in parity with its competitors, Southwestern Bell Long Distance will be at a competitive disadvantage. Delays caused by the tariff-approval process will prevent Southwestern Bell Long Distance from meeting customer demands. Customers often have the expectation of an immediate response to their needs, and will be unlikely to wait lengthy periods for Southwestern Bell Long Distance to obtain regulatory approval, particularly if other companies are able to offer the price or service immediately. In a competitive market, a dominant carrier would appear sluggish and unwilling to respond to its customer's needs. This is not the image that Southwestern Bell Long Distance can portray if it expects to succeed in the market.

4. Furthermore, the public nature of tariff filings will result in the release of pricing and sensitive cost information to competitors. Southwestern Bell Long Distance will be at a competitive disadvantage if its competitors learn in advance of new prices or services, the costs of providing those services, and demand forecasts for those services. For example, when AT&T announces a $0.15 per minute rate, Southwestern Bell Long Distance could not respond until after seeking regulatory approval, yet AT&T's other competitors could respond immediately. Furthermore, in order to have obtained any "first-mover" advantage, Southwestern Bell Long Distance would had to have tariffed the rate much earlier than its competitors. In addition to the obvious advantages of seeing a competitor's plans in advance, competitors are free to contest the tariff filings,

potentially prolonging the approval process even further. Southwestern Bell Long Distance will never appear to be an innovative leader if competitors are given the opportunity to see and challenge Southwestern Bell Long Distance's plans in advance.

5. Finally, dominant carrier status will impose price cap regulation on Southwestern Bell Long Distance. Price caps force restrictions on pricing flexibility by limiting certain price increases and decreases. No other interexchange carrier exists with such restrictions -- they are free to alter prices as the market dictates. Certainly in a market where the Commission is seeking to enhance competition, all companies should be free to set market-based rates and consumers should be able to enjoy the benefits of real price competition.

6. With the difference in the regulatory rules, a "dominant" Southwestern Bell Long Distance will not be able to match or beat competitors price changes with any agility. The disparity between dominant and non-dominant carriers will become more acute when non-dominant interexchange carriers stop filing tariffs.

7. The following are examples of regulatory filing disparities between dominant and non-dominant carrier classifications.

DOMINANT CARRIERS	*NON-DOMINANT CARRIERS*
Price Cap Regulation	No rate regulation
14, 45, or 120 day's Notice for Tariff Filing	No tariffs required
Cost Data Required in Tariff Filing	No requirements
For domestic facilities, required to obtain approval to construct, extend, acquire, lease, or operate any line, or to discontinue or reduce service.	Streamlined Section 214 process
Not permitted to include in contract-based tariffs: MTS, operator services, credit card, special construction, and other services.	No restrictions

III. Dominant Carrier Status Would Cause Increased Costs

8. It is the objective of Southwestern Bell Long Distance to operate as an efficient company offering high quality service at competitive prices to consumers. Southwestern Bell Long Distance will not be able to compete under equal conditions and consumers will not benefit, if Southwestern Bell Long Distance costs are higher than its competitors due to stricter regulatory oversight. Examples of costs that Southwestern Bell Long Distance will incur if it is regulated as a dominant carrier, which would not be borne by its competitors, include:

- Southwestern Bell Long Distance will be required to create and submit competitively-sensitive cost support data and will be obliged to create numerous reports not required of its competitors. This could add a significant cost component to Southwestern Bell Long Distance, which will translate into higher consumer rates.

- Non-dominant interexchange carriers are no longer required to file tariffs. If declared dominant, Southwestern Bell Long Distance will be required to expend resources to satisfy this regulatory requirement. Therefore, while competitors will be able to reduce staff not used for this purpose, Southwestern Bell Long Distance will be in a position of having to add employees.

9. At this time, I cannot quantify precisely the cost of compliance with the regulatory requirements for dominant carriers. However, Southwestern Bell Long Distance's BOC affiliate, Southwestern Bell Telephone Company, consumes enormous human and financial resources to sustain these activities. These are activities that Southwestern Bell Long Distance is not currently staffed to handle and had not anticipated in its business planning.

10. In order to comply with dominant carrier regulatory requirements, Southwestern Bell Long Distance would have to hire people, create databases and

engage in other costly activities for the sole purpose of satisfying rules which are not imposed on any other carrier. Regardless of what it would cost, it will be an amount not spent by any competitor. The bottom line is that extra expenses must be taken into account, and that may be in the form of less competitive prices. Lessening competition in this manner benefits no one but the incumbent interexchange carriers.

IV. Historical Basis for Dominant Carrier Status Does Not Apply to Southwestern Bell Long Distance

11. Dominant carrier status may or may not have been appropriate for AT&T. In any event, there is no similarity, even remote, between the circumstances of AT&T at divestiture and Southwestern Bell Long Distance in the present. AT&T started out with the majority of customers, and there existed at the time a goal to expand telecommunications competition. When it enters the market, Southwestern Bell Long Distance will not have a single customer, and hundreds of competitors will be in the market competing. Simply put, Southwestern Bell Long Distance does not fit the mold that caused the dominant carrier rules in the first place.

To impose these inappropriate rules would unjustly penalize Southwestern Bell Long Distance, result in fewer choices for consumers, and protect incumbent interexchange competitors for increased competition.

FURTHER AFFIANT SAYETH NOT.

Karol Sweitzer

Executed this 15th day of Nov., 1996.

Before me, the undersigned, a Notary Public, on this day personally appeared Karol Sweitzer, known to me, to be the person whose name is subscribed to the foregoing instrument and acknowledge to me that the same was the act of the said Karol Sweitzer, and that she has executed the same of his own free will.

Sworn to and subscribed before me this 15th day of November 1996.

Notary Public

My Commission expires:
April 14, 1998