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Federal Communications Commission
Office of Secretary

EX PARTE

William F. Caton
Acting Secretary
Federal Communications Commission
Mail Stop 1170
1919 M Street, N.W., Room 222
Washington, D.C. 20554

Dear Mr. Caton:

Re: Non-Accounting Safeguards, CC Docket No. 96-149;
Out of Region Authority, CC Docket No. 96-21

Today, Michael Yourshaw and Carl Frank of Wiley, Rein & Fielding, and I met with John Nakahata, Senior Legal Advisor to Chairman Hundt to discuss matters summarized in the attachment, as well as questions concerning the interpretation of Section 271(e)(1) and 272(e)(4). Please associate this material with the above-referenced dockets. We are submitting two copies of this notice, in accordance with Section 1.206(a)(1) of the Commission's rules.

Please stamp and return the provided copy to confirm your receipt. Please contact me should you have any questions.

Sincerely yours,

Attachment

cc: J. Nakahata

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Non-Accounting Safeguards
Nondominant Status
International Services

Ex Parte CC Docket No. 96-21 & 96-149
December 13, 1996

PBCOM Should Be Regulated As a Nondominant Carrier

- PBCOM will have zero initial market share and no market power
  - PBCOM cannot raise prices by restricting its own output
  - PBCOM cannot raise prices by raising rivals' costs
- PBCOM cannot gain market power by cost misallocation, predation, or discrimination
- Dominant regulation will harm competition
- The U.S. Department of Justice recommends: *"The Commission should not apply its dominant carrier regulations to BOC affiliates."*

PBCOM Has No Market Power To Raise Prices by Restricting Its Own Output

- PBCOM has zero initial market share for interstate, domestic (or international) interLATA telecommunications services
  - It cannot quickly increase its market share to the point where it could raise prices by restricting output because it will be competing with large, established carriers like AT&T and MCI
- Substitutable supply capacity exists — customers can easily change providers if PBCOM's prices are not competitive
- PBCOM would not have market power under any narrower market definition

PBCOM Has No Market Power To Raise Prices by Raising Rivals' Costs

- Pacific Bell cannot exercise any "bottleneck" control
  - The Commission has determined that the Act allows competitors to provide exchange access using unbundled network elements, shattering the "bottleneck" and any competitive advantage
  - Pacific Bell must provide exactly the same treatment to CLECs that it provides to itself
- Pacific Bell's local exchange services and facilities are price controlled, precluding exercise of market power
  - Exchange access is subject to price caps
  - Unbundled elements must be priced at TELRIC

PBCOM Cannot Use Cost Misallocation, Predation, or Discrimination To Gain Market Power

- The Act's structural and accounting safeguards prevent cost misallocation and cross-subsidies
- Predation cannot be successful
  - The low marginal cost of interLATA traffic would lead to huge financial losses by a would-be predator
  - Because of the substantial sunk cost in competitors' existing networks, there is no barrier to market re-entry
- Competition cannot be distorted by discrimination
  - Discrimination cannot be effective and undetectable at the same time
  - The Act's specific nondiscrimination safeguards will be effective

Dominant Regulation Will Harm Competition

- No tariff requirement— like PBCOM's competitors
- No cost support — like PBCOM's competitors
- No 214 approval process — like PBCOM's competitors
- No price cap regulation — like PBCOM's competitors

Tariff Requirements Will Harm Competition

- No tariff requirement— like PBCOM's competitors
  - Enables PBCOM to match price changes of its competitors over an identical time period
  - Speeds new services to customers
  - Long notice periods could harm consumers by reducing price discounts and other forms of price competition among incumbent long distance carriers

Other Elements of Dominant Regulation Will Harm Competition

- No cost support — like PBCOM's competitors
  - PBCOM will compete in markets the Commission has already declared competitive — PBCOM should not be required to disclose its costs to its competitors
- No 214 approval process — like PBCOM's competitors
  - The streamlined 214 process allows rapid introduction of new services
- No price cap regulation — like PBCOM's competitors
  - Price cap regulation of PBCOM would interfere with market pricing and result in less efficient investment and service decisions

PBCOM Must Be Regulated As a Nondominant Carrier Internationally

- PBCOM Has No Market Power To Raise Prices by Restricting Its Own Output
  - PBCOM has zero initial market share for international telecommunications services
  - The market is dominated by an "oligopoly" of the big three carriers
  - Substitutable supply capacity exists — customers can easily change providers if PBCOM's prices are not competitive
- PBCOM Has No Market Power To Raise Prices by Raising Rivals' Costs
  - Pacific Bell's local exchange services and facilities are price controlled, precluding exercise of market power
  - PBCOM will not control a bottleneck—it will be required to obtain capacity from its competitors, especially AT&T, which own the cables
- Nimble U.S. Competitors Will Increase Competition in U.S.-International Markets
  - The streamlined 214 process allows rapid introduction of new services
  - Filing tariffs on 1 day's notice enables PBCOM to match price changes of its competitors over an identical time period

Grooming* Is Lawful

- FCC has already determined that flexible accounting rate arrangements are in the public interest (Docket No. 90-337, Phase II)
- Grooming is non-discriminatory
  - Nothing would prevent any carrier from negotiating similar deals
- MCI concedes legality by arguing for "reverse grooming"
- Grooming issue should be resolved as soon as possible

* Obtaining geographically enhanced mix of international return traffic

Geographic enrichment is in the public interest

- Enhances efficiency by saving costs of unnecessary long haul transmission
- Could substantially lower prices to American consumers
- Creates an economic incentive for a LEC to charge lower prices for international calls
- Leads to greater use of the network and thus increased economic efficiency
- Accords with recent International Settlements Policy (ISP) decision objectives of "allowing U.S. carriers ... to ... reduce their call termination costs and ... provide for lower calling prices for U.S. consumers"

Terminating In-Region International Return Traffic Is Legal

- The 1996 Act permits terminating traffic in-region before grant of Section 271 approval
- No policy reason to prevent it
  - No U.S. local exchange customer chooses the carrier
  - There can be no abuse of the local exchange
- If terminating in-region were forbidden
  - No BOC could offer facilities-based services out-of-region before grant of Section 271 approval
  - Proportionate return forces a carrier to terminate such traffic by operation of law
  - This result would be contrary to the clear intent of Congress.

Summary

- PBCOM should be regulated as a nondominant carrier both domestically and internationally
- Grooming is in the public interest
- Terminating in-region international return traffic before Section 271 approval is lawful