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

In the Matter of
Regulatory Treatment of LEC Provision
of Interexchange Services Originating in the
LEC's Local Exchange Area
and
Policy and Rules Concerning the
Interstate, Interexchange Marketplace
CC Docket No. 96-149
CC Docket No. 96-61

SECOND REPORT AND ORDER IN CC DOCKET NO. 96-149
AND THIRD REPORT AND ORDER IN CC DOCKET NO. 96-61

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By the Commission: Commissioner Ness issuing a separate statement.

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## I. INTRODUCTION

1. In February 1996, the "Telecommunications Act of 1996" became law.<sup>1</sup> The intent of this legislation is "to provide for a pro-competitive, de-regulatory national policy framework designed to accelerate rapidly private sector deployment of advanced telecommunications and information technologies and services to all Americans by opening all telecommunications markets to competition."<sup>2</sup> In this rulemaking and related proceedings, the Commission is adopting policies necessary to achieve the pro-competitive, deregulatory goals of the 1996 Act.

2. Upon enactment, the 1996 Act permitted the Bell Operating Companies (BOCs)<sup>3</sup> to provide interLATA services that originate outside of their regions.<sup>4</sup> On March

<sup>1</sup> Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996 Act), codified at 47 U.S.C. §§ 151 et seq. (Hereinafter, all citations to the 1996 Act will be to the 1996 Act as it is codified in the United States Code.) The 1996 Act amended the Communications Act of 1934 (Communications Act).

<sup>2</sup> See Joint Statement of Managers, S. Conf. Rep. No. 104-230, 104th Cong., 2d Sess. Preamble (1996) (Joint Explanatory Statement); see also 47 U.S.C. § 706(a) (encouraging the deployment of advanced telecommunications capability to all Americans).

<sup>3</sup> For purposes of this proceeding, we adopt the definition of the term "Bell Operating Company" contained in 47 U.S.C. § 153(4).

<sup>4</sup> See 47 U.S.C. § 271(b)(2). The Modification of Final Judgment (MFJ), which ended the government's antitrust suit against AT&T, and which resulted in the divestiture of the BOCs from AT&T, prohibited the BOCs from providing interLATA services. See United States v. Western Elec. Co., 552 F. Supp. 131, 214 n.316 (D.D.C. 1982); United States v. Western Elec. Co., 552 F. Supp. 131 (D.D.C. 1982), aff'd sub nom. Maryland v. United States, 460 U.S. 1001 (1983); see also United States v. Western Elec. Co., Civil Action No. 82-0192 (D.D.C. Apr. 11, 1996) (vacating the MFJ). For purposes of this proceeding, we adopt the definition of the term "in-region state" that is contained in 47 U.S.C. § 271(i)(1). We note that section 271(i)

25, 1996, the Commission released a Notice of Proposed Rulemaking initiating a review of its regulation of interstate, domestic, interexchange telecommunications services in light of the passage of the 1996 Act and the increasing competition in the interexchange market over the past decade.<sup>5</sup> Among other things, the Commission asked whether it should modify or eliminate the separation requirements imposed on independent local exchange carriers (LECs) (exchange telephone companies other than the BOCs) as a condition for non-dominant treatment of their interstate, domestic, interexchange services originating outside their local exchange areas.<sup>6</sup> The Commission also sought comment on whether, if it modifies or eliminates these separation requirements for independent LECs, it should apply the same requirements to BOC provision of out-of-region interstate, domestic, interexchange services.<sup>7</sup> The Commission also proposed to revise the relevant product and geographic market definitions for purposes of determining whether a carrier should be regulated as dominant or

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provides that a BOC's in-region services include 800 service, private line service, or their equivalents that terminate in an in-region state of that BOC and that allow the called party to determine the interLATA carrier, even if such services originate out-of-region. *Id.* § 271(j). The 1996 Act defines "interLATA services" as "telecommunications between a point located in a local access and transport area and a point located outside such area." 47 U.S.C. § 153(21). Under the 1996 Act, a "local access and transport area" (LATA) is "a contiguous geographic area (A) established before the date of enactment of the [1996 Act] by a [BOC] such that no exchange area includes points within more than 1 metropolitan statistical area, consolidated metropolitan statistical area, or State, except as expressly permitted under the AT&T Consent Decree; or (B) established or modified by a [BOC] after such date of enactment and approved by the Commission." 47 U.S.C. § 153(25). LATAs were created as part of the MFJ's "plan of reorganization." *United States v. Western Elec. Co.*, 569 F. Supp. 1057 (D.D.C. 1983), *aff'd sub nom. California v. United States*, 464 U.S. 1013 (1983). Pursuant to the MFJ, "all BOC territory in the continental United States [was] divided into LATAs, generally centering upon a city or other identifiable community of interest." *United States v. Western Elec. Co.*, 569 F. Supp. 990, 993 (D.D.C. 1983).

<sup>5</sup> 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, 11 FCC Rcd 7141 (rel. Mar. 25, 1996) (Interexchange NPRM).

<sup>6</sup> *Id.* at 7174, ¶ 61. We use the term "independent LECs" to refer to both the independent LECs and their affiliates.

<sup>7</sup> *Id.* In a recent order addressing BOC provision of interLATA services originating out-of-region, we considered whether, on an interim basis, BOC provision of out-of-region services should remain subject to dominant carrier regulation. See Bell Operating Company Provision of Out-of-Region Interstate, Interexchange Services, CC Docket No. 96-21, Report and Order, FCC 96-288 (rel. July 1, 1996) (Interim BOC Out-of-Region Order) recon. pending. We concluded, inter alia, that, on an interim basis, if a BOC provides out-of-region domestic, interstate, interexchange services offered through an affiliate that satisfies the separation requirements imposed on independent LECs in the Competitive Carrier Fifth Report and Order, we would remove dominant carrier regulation for such services. *Id.* at ¶ 2. Thus, we currently apply the same regulatory treatment to the BOCs' provision of out-of-region, domestic, interstate, interexchange services as we apply to the independent LECs' provision of those services.

non-dominant in the provision of interstate, domestic, interexchange services.<sup>8</sup>

3. The 1996 Act conditions the BOCs' entry into in-region, interLATA service on their compliance with certain provisions of section 271 of the Act. Under section 271, we must determine, among other things, whether the BOC has complied with the safeguards imposed by section 272 and our rules promulgated thereunder.<sup>9</sup> Section 272 requires, among other things, that a BOC provide in-region, interLATA service through a separate affiliate that meets the requirements of section 272(b).<sup>10</sup>

4. On July 18, 1996, we released a Notice of Proposed Rulemaking in which we

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<sup>8</sup> Interexchange NPRM, 11 FCC Rcd at 7164-65, ¶¶ 41-42. In the Interexchange NPRM, the Commission also raised issues relating to: implementation of the rate averaging and rate integration requirements in section 254(g) of the Communications Act; detariffing for domestic services of non-dominant interexchange carriers; and the current prohibition against bundling customer services equipment with the provision of interstate, interexchange services by non-dominant interexchange carriers. On August 7, 1996, we issued a Report and Order implementing the rate averaging and rate integration requirements. See 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, Report and Order, 11 FCC Rcd 9564 (1996) (Rate Integration Order). On October 31, 1996, we issued a Second Report and Order which eliminates § 203 tariff filing requirements for interstate, domestic, interexchange services by nondominant interexchange carriers and orders all nondominant interexchange carriers to cancel their tariffs for those services within nine months from the effective date of the Order. Policy and Rules Concerning the Interstate, Interexchange Marketplace; Implementation of Section 254(g) of the Communications Act of 1934, CC Docket No. 96-61, Second Report and Order, FCC 96-424 (rel. Oct. 31, 1996) (Tariff Forbearance Order), stayed pending judicial review, MCI Telecom. Corp. v. FCC, No. 96-1459 (D.C. Cir. Feb. 13, 1997). See also Policy and Rules Concerning the Interstate, Interexchange Marketplace; Guidance Concerning Implementation as a Result of the Stay Order of the U.S. Court of Appeals for the D.C. Circuit, CC Docket No. 96-61, Public Notice, DA 97-493 (rel. March 6, 1997). In the Tariff Forbearance Order, we stated our intent to issue a Further Notice of Proposed Rulemaking that will address the continued applicability of the prohibitions against the bundling of both CPE and enhanced services with interstate, interexchange services by non-dominant interexchange carriers. Id. at ¶ 118.

<sup>9</sup> 47 U.S.C. § 271(d)(3)(B). The Commission also must find that the interconnection agreements or statements approved by the appropriate state commission under section 252 satisfy the competitive checklist contained in section 271(c)(2)(B), and that the BOC's entry into the in-region interLATA market is "consistent with the public interest, convenience and necessity." Id. §§ 271(d)(3)(A), (d)(3)(C). For purposes of section 271, such interconnection agreements must be made with a facilities-based competitor that meets specified criteria. Id. § 271(c)(1)(A). In acting on a BOC's application for authority to provide in-region interLATA services, the Commission must consult with the Attorney General and give substantial weight to the Attorney General's evaluation of the BOC's application. Id. § 271(d)(2)(A). In addition, the Commission must consult with the applicable state commission to verify that the BOC complies with the requirements of section 271(c). Id. § 271(d)(2)(B).

<sup>10</sup> 47 U.S.C. § 272(a)(1).

sought comment on the non-accounting separate affiliate and nondiscrimination safeguards in section 272.<sup>11</sup> We also sought comment on whether we should alter the dominant carrier classification that under our current rules would apply to in-region, interstate, domestic, interLATA services provided by the BOCs' section 272 interLATA affiliates (BOC interLATA affiliates).<sup>12</sup> Further, we sought comment on whether we should modify our existing rules for regulating the provision of in-region, interstate, domestic, interexchange services by an independent LEC.<sup>13</sup> Finally, we invited comment on whether we should apply the same regulatory treatment to the BOC interLATA affiliates' and independent LECs' provision of in-region, international services that we apply to their provision of in-region, interstate, domestic, interLATA services and in-region, interstate, domestic interexchange services, respectively.<sup>14</sup> We recently adopted rules to implement the section 272 non-accounting separate affiliate and nondiscrimination safeguards.<sup>15</sup> On the same day, we adopted rules to implement the accounting safeguards in sections 260 and 271 through 276.<sup>16</sup>

5. This Order addresses the market definition and dominant/non-dominant

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<sup>11</sup> Implementation of the Non-Accounting Safeguards of Sections 271 and 272 of the Communications Act of 1934, as amended; and Regulatory Treatment of LEC Provisions of Interexchange Services Originating in the LEC's Local Exchange Area, CC Docket No. 96-149, Notice of Proposed Rulemaking, FCC 96-308 (rel. July 18, 1996) (Non-Accounting Safeguards NPRM).

<sup>12</sup> Id. at ¶ 142. For convenience, we use the term "BOC interLATA affiliates" to refer to the separate affiliates established by the BOCs, in conformance with section 272(a)(1), to provide in-region, interLATA services. Although we referred to these affiliates as "BOC affiliates" in the Notice, our findings in this Order apply only to affiliates established in conformance with section 272(a)(1).

<sup>13</sup> Id. at ¶¶ 157-58. For purposes of this proceeding, we have defined an independent LEC's "in-region services" as telecommunications services originating in the independent LEC's local exchange areas or 800 service, private line service, or their equivalents that: (1) terminate in the independent LEC's local exchange areas, and (2) allow the called party to determine the interexchange carrier, even if the service originates outside the independent LEC's local exchange areas. Id. at ¶ 4 n.12

<sup>14</sup> Id. at ¶¶ 150, 160.

<sup>15</sup> Implementation of the Non-Accounting Safeguards of Sections 271 and 272 of the Communications Act of 1934, as amended, CC Docket No. 96-149, First Report and Order and Further Notice of Proposed Rulemaking, FCC 96-489 (rel. Dec. 24, 1996) (Non-Accounting Safeguards Order); recon. pending; petition for review pending sub nom., Bell Atlantic v. FCC, No. 97-106 (D.C. Cir. filed Jan. 31, 1997), vacated and remanded in part (Mar. 31, 1997); petition for review pending sub nom., SBC Communications v. FCC, No. 97-1118 (D.C. Cir. filed Mar. 6, 1997).

<sup>16</sup> Implementation of the Telecommunications Act of 1996: Accounting Safeguards Under the Telecommunications Act of 1996, CC Docket No. 96-150, Report and Order, FCC 96-490 (rel. Dec. 24, 1996) (Accounting Safeguards Order).

classification issues raised in the Interexchange NPRM and the Non-Accounting Safeguards NPRM. With respect to market definition, we adopt the approach proposed in the Notices. Specifically, we revise our current product and geographic market definitions in accordance with the 1992 Merger Guidelines.<sup>17</sup> We conclude that we should define as a relevant product market any interstate, domestic, long distance service for which there are no close substitutes, or a group of services that are close demand substitutes<sup>18</sup> for each other, but for which there are no other close demand substitutes.<sup>19</sup> We define the relevant geographic market for interstate, domestic, long distance services as all possible routes that allow for a connection from one particular location to another particular location (i.e., a point-to-point market). We conclude, however, that when a group of point-to-point markets exhibit sufficiently similar competitive characteristics (i.e., market structure), we can aggregate such markets, rather than examine each individual point-to-point market separately. Therefore, if we conclude that the conditions for a particular service in any point-to-point market are sufficiently representative of the conditions for that service in all other domestic point-to-point markets, then we will examine aggregate data, rather than data particular to each domestic point-to-point market. With respect to the BOC interLATA affiliates and independent LECs, however, we conclude that we should analyze point-to-point markets that originate in-region separately from those point-to-point markets that originate out-of-region to determine whether the BOC affiliates' or independent LECs' market power in local exchange and exchange access services results in market power in the interexchange market. We note that, in some cases, it may be necessary to focus specifically on the termination point because the local exchange carrier that serves the end-user customer will necessarily have market power with regard to that customer.

6. We also conclude that a BOC interLATA affiliate should be classified as dominant only if we find that it has the ability profitably to raise and sustain prices of in-region, interstate, domestic, interLATA services significantly above competitive levels by restricting its own output. Dominant carriers are subject to more stringent regulation than non-dominant carriers, including price cap regulation, when specified by Commission order,

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<sup>17</sup> 1992 Department of Justice/Federal Trade Commission Merger Guidelines, 4 Trade Reg. Rep. (CCH) ¶ 13,104, at 20,569 (1992 Merger Guidelines).

<sup>18</sup> Demand substitutability identifies all of the products or services that consumers view as substitutes for each other, in response to changes in price. For example, if, in response to a price increase for orange juice, consumers instead purchase apple juice, apple juice would be considered a demand substitute for orange juice.

<sup>19</sup> In places where we use the term "long distance services," we mean interstate, domestic or international, interLATA services provided by the BOC interLATA affiliates and interstate, domestic or international, interexchange services provided by independent LECs, respectively.

and tariff filing notice periods of 14, 25 or 120 days.<sup>20</sup> In light of the requirements established by, and pursuant to, sections 271 and 272, together with other existing Commission rules, we conclude that the BOCs will not be able to use, or leverage, their market power in the local exchange or exchange access markets to such an extent that their section 272 interLATA affiliates could profitably raise and sustain prices of in-region, interstate, domestic, interLATA services significantly above competitive levels by restricting the affiliate's own output. We also conclude that regulating BOC in-region interLATA affiliates as dominant carriers generally would not help to prevent improper allocations of costs, discrimination by the BOCs against rivals of their interLATA affiliates, or price squeezes by the BOCs or the BOC interLATA affiliates. Although certain aspects of dominant carrier regulation may address these concerns, we conclude that the burdens they would impose on competition, competitors, and the Commission outweigh any potential benefits. As a result, we classify the BOC interLATA affiliates as non-dominant in the provision of in-region, interstate, domestic, interLATA services.

7. We also classify the independent LECs as non-dominant in the provision of in-region, interstate, domestic, interexchange services, because the independent LECs do not have the ability profitably to raise and sustain prices of in-region, interstate, domestic, interexchange services above competitive levels by restricting their own output of these services. We conclude, however, that the independent LECs' control of local exchange and exchange access facilities potentially enables them to misallocate costs from their in-region, interexchange services, discriminate against rivals of their interLATA affiliates, and engage in other anticompetitive conduct. We therefore require the independent LECs to provide their in-region, interstate, domestic, interexchange services through separate affiliates that satisfy the separation requirements adopted in the Competitive Carrier Fifth Report and Order.<sup>21</sup>

8. In addition, we adopt the same regulatory treatment of the BOC interLATA affiliates' and independent LECs' provision of in-region, international services, as we adopt for their provision of in-region, interstate, domestic, interLATA and in-region, interstate, domestic, interexchange services, respectively. Accordingly, we will classify each BOC interLATA affiliate or independent LEC affiliate as non-dominant in the provision of in-region, international services, unless it (or its parent) is affiliated within the meaning of

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<sup>20</sup> See supra ¶ 12 for more detail on the regulatory distinctions between dominant and non-dominant interexchange carriers.

<sup>21</sup> Policy and Rules Concerning Rates for Competitive Common Carrier Services and Facilities Authorizations Therefor, CC Docket No. 79-252, Fifth Report and Order, 98 FCC 2d 1191, 1198, ¶ 9 (1984) (Competitive Carrier Fifth Report and Order). Nevertheless, we give companies providing in-region, interexchange services on an integrated basis one year from the date of release of this order to comply with the Competitive Carrier Fifth Report and Order separation requirements. See infra section II.B.

section 63.18(h)(1)(i) of the rules, with a foreign carrier that has the ability to discriminate against rivals of its U.S. affiliate through control of bottleneck services or facilities in a foreign market. In that case, we will apply section 63.10(a) of the rules to determine whether to regulate the BOC interLATA affiliate or independent LEC affiliate as a dominant carrier in its provision of service between the United States and that foreign market.<sup>22</sup> We will require the independent LECs to provide in-region international services through separate affiliates that satisfy the Competitive Carrier Fifth Report and Order separation requirements, consistent with the requirements we apply to their provision of in-region, interstate, domestic, interexchange services.<sup>23</sup>

9. Finally, we consider whether we should modify or eliminate the separation requirements imposed on the BOCs and independent LECs as a condition for non-dominant treatment of their provision of out-of-region interstate, domestic, interexchange services. We conclude that those requirements are unnecessary, and we therefore eliminate the separation requirements as a condition for non-dominant treatment of the BOCs' and independent LECs' provision of out-of-region, interstate, domestic, interexchange services.

10. The actions we take in this proceeding will further the pro-competitive, deregulatory objectives of the 1996 Act by eliminating unnecessary regulation that is currently imposed on interexchange carriers affiliated with BOCs and independent LECs. Although we are classifying these carriers as non-dominant with respect to their provision of

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<sup>22</sup> In doing so, we emphasize that there is more than one basis for finding a U.S. carrier dominant in the provision of international services. The separate issue of whether a BOC interLATA affiliate, an independent LEC affiliate, or any other U.S. carrier should be regulated as dominant in the provision of international services because of the market power of an affiliated foreign carrier in a foreign destination market was addressed by the Commission last year in the Foreign Carrier Entry Order. Market Entry and Regulation of Foreign-affiliated Entities, IB Docket No. 95-22, RM-8355, RM-8392, Report and Order, 11 FCC Rcd 3873 (1995) (Foreign Carrier Entry Order), recon. pending. See also Regulation of International Common Carrier Services, CC Docket No. 91-360, Report and Order, 7 FCC Rcd 7331, 7334, ¶¶ 19-24 (1992) (International Services Order). The Foreign Carrier Entry Order maintained a separate framework adopted in the International Services Order for regulating U.S. international carriers (including BOCs or independent LECs ultimately authorized to provide in-region international services) as dominant on routes where an affiliated foreign carrier has the ability to discriminate in favor of its U.S. affiliate through control of bottleneck services or facilities in the foreign destination market. No carriers are exempt from this policy to the extent they have foreign affiliations. Section 63.10(a) of the Commission's rules provides that: (1) carriers having no affiliation with a foreign carrier in the destination market are presumptively non-dominant for that route; (2) carriers affiliated with a foreign carrier that is a monopoly in the destination market are presumptively dominant for that route; (3) carriers affiliated with a foreign carrier that is not a monopoly on that route receive closer scrutiny by the Commission; and (4) carriers that serve an affiliated destination market solely through the resale of an unaffiliated U.S. facilities-based carrier's switched services are presumptively non-dominant for that route.

<sup>23</sup> In the Non-Accounting Safeguards Order, we concluded that the section 272 safeguards apply to the BOCs' provision of in-region, international services. Non-Accounting Safeguards Order at ¶ 58.

in-region and out-of-region long distance services, as summarized above, we recognize that, as long as these carriers retain market power in providing local exchange and exchange access services, they will have some incentive and ability to misallocate costs to local exchange and exchange access services, to discriminate against their long distance competitors, and to engage in other anticompetitive conduct. We conclude, however, that the regulatory structure we adopt today will continue the process of enhancing competition in all telecommunications markets as envisioned by the 1996 Act.

## II. BACKGROUND

11. Between 1979 and 1985, the Commission conducted the Competitive Carrier proceeding, in which it examined how its regulations should be adapted to reflect and promote increasing competition in telecommunications markets.<sup>24</sup> In a series of orders, the Commission distinguished between two kinds of carriers -- those with market power (dominant carriers) and those without market power (non-dominant carriers).<sup>25</sup> In the Competitive Carrier Fourth Report and Order, the Commission defined market power alternatively as "the ability to raise prices by restricting output" and as "the ability to raise and maintain price above the competitive level without driving away so many customers as to make the increase unprofitable."<sup>26</sup> The Commission recognized that, in order to assess whether a carrier possesses market power, one must first define the relevant product and

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<sup>24</sup> Policy and Rules Concerning Rates for Competitive Common Carrier Services and Facilities Authorizations Therefor, CC Docket No. 79-252, Notice of Inquiry and Proposed Rulemaking, 77 FCC 2d 308 (1979); First Report and Order, 85 FCC 2d 1 (1980) (Competitive Carrier First Report and Order); Further Notice of Proposed Rulemaking, 84 FCC 2d 445 (1981); Second Further Notice of Proposed Rulemaking, FCC 82-187, 47 Fed. Reg. 17,308 (1982); Second Report and Order, 91 FCC 2d 59 (1982); Order on Reconsideration, 93 FCC 2d 54 (1983); Third Further Notice of Proposed Rulemaking, 48 Fed. Reg. 28,292 (1983); Third Report and Order, 48 Fed. reg. 46,791 (1983); Fourth Report and Order, 95 FCC 2d 554 (1983) (Competitive Carrier Fourth Report and Order), vacated, AT&T v. FCC, 978 F.2d 727 (D.C. Cir. 1992), cert. denied, MCI Telecommunications Corp. v. AT&T, \_\_\_ U.S. \_\_\_, 13 S. Ct. 3020 (1993); Competitive Carrier Fifth Report and Order, 98 FCC 2d 1191 (1984); Sixth Report and Order, 99 FCC 2d 1020 (1985), vacated, MCI Telecommunications Corp. v. FCC, 765 F.2d 1186 (D.C. Cir. 1985) (Competitive Carrier Sixth Report and Order) (collectively referred to as the Competitive Carrier Proceeding).

<sup>25</sup> Competitive Carrier First Report and Order, 85 FCC 2d 1; Competitive Carrier Fourth Report and Order, 95 FCC 2d 554; Competitive Carrier Fifth Report and Order, 98 FCC 2d 1191. See also 47 C.F.R. § 61.3(o).

<sup>26</sup> Competitive Carrier Fourth Report and Order, 95 FCC 2d at 558, ¶¶ 7-8 (citing inter alia A. Areeda & D. Turner, Antitrust Law 322 (1978) and W.M. Landes & R.A. Posner, Market Power in Antitrust Cases, 94 Harv. L. Rev. 937, 937 (1981)). The 1992 Department of Justice/Federal Trade Commission Merger Guidelines similarly define market power as "the ability profitably to maintain prices above competitive levels for a significant period of time." 1992 Merger Guidelines, at 20,570.

geographic markets.<sup>27</sup> In the Competitive Carrier proceeding, the Commission relaxed its tariff filing and facilities authorization requirements for non-dominant carriers and focused its regulatory efforts on constraining the ability of dominant carriers to exercise market power.<sup>28</sup>

12. Our 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).<sup>29</sup> Under our rules, non-dominant carriers are not subject to rate regulation, and currently may file tariffs that are presumed lawful on one day's notice and without cost support.<sup>30</sup> Non-dominant carriers are also subject to streamlined section 214 requirements.<sup>31</sup> In contrast, dominant interexchange carriers are subject to price cap regulation, when specified by Commission order, and must file tariffs on 14, 45, or 120 days' notice, with cost support data for above-cap and out-of-band tariff filings, and with additional information for new service offerings.<sup>32</sup> Dominant domestic carriers must also obtain specific prior Commission approval to construct a new line or to acquire, lease or operate any line, as well as to discontinue, reduce, or impair service.<sup>33</sup>

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<sup>27</sup> Competitive Carrier Fourth Report and Order, 95 FCC 2d at 562, ¶ 13.

<sup>28</sup> Id. at 575-80, ¶¶ 31-38; Competitive Carrier Fifth Report and Order, 98 FCC 2d at 1195-1200, ¶¶ 6-11; Competitive Carrier Six Report and Order, 99 FCC 2d at 1028 n.29, ¶ 12.

<sup>29</sup> 47 C.F.R. §§ 61.3(o), 61.3(u).

<sup>30</sup> Tariff Filing Requirements for Nondominant Carriers, CC Docket No. 93-36, Order, 10 FCC Rcd 13,653 (1995). As previously discussed, we adopted mandatory detariffing for nondominant interexchange carriers in the Tariff Forbearance Order, but that Order has been stayed pending judicial review. See supra n. 8.

<sup>31</sup> See 47 C.F.R. §§ 63.71, 63.07(a).

<sup>32</sup> See id. §§ 61.41, 61.58(c). We note that effective February 1997, a local exchange carrier may file with the Commission a new or revised charge, classification, regulation, or practice on a streamlined basis. Unless the Commission takes action under 47 U.S.C. § 204(a)(1), any charge, classification, regulation, or practice shall be deemed lawful and shall be effective 7 days (in the case of a rate reduction) or 15 days (in the case of a rate increase) after the date on which it is filed with the Commission. 47 U.S.C. § 204(a)(3). See also Implementation of Section 402(b)(1)(A) of the Telecommunications Act of 1996, CC Docket No. 96-187, Report and Order, FCC 97-23 (rel. Jan. 31, 1997).

<sup>33</sup> 47 C.F.R. §§ 63.01 et seq. We note that the Commission has simplified this process to permit a carrier to file an annual "blanket" Section 214 application for all construction planned for the year. See id. § 63.06. Moreover, pursuant to section 402(b)(2)(A) of the 1996 Act, the Commission is required to "permit any common carrier . . . to be exempt from the requirements of Section 214 of the 1934 Act for the extension of any line." We are addressing the implementation of section 402(b)(2)(A), including the issue of what constitutes an "extension of any line," in a separate proceeding. See Implementation of Section 402(b)(2)(A) of the Telecommunications Act of 1996, CC Docket No. 97-11, Notice of Proposed Rulemaking, FCC 97-6 (rel.

13. In the Competitive Carrier First Report and Order, the Commission classified LECs and pre-divestiture AT&T as dominant, with respect to both local exchange and interstate long distance services, and therefore subject to the "full panoply" of then-existing Title II regulation.<sup>34</sup> In contrast, the Commission classified MCI, Sprint, and other "specialized common carriers" as non-dominant carriers.<sup>35</sup>

14. In the Competitive Carrier Fourth Report and Order, the Commission determined that interexchange carriers affiliated with independent LECs would be regulated as non-dominant interexchange carriers.<sup>36</sup> In the Competitive Carrier Fifth Report and Order, the Commission clarified that an "affiliate" of an independent LEC was "a carrier that is owned (in whole or in part) or controlled by, or under common ownership (in whole or in part) or control with, an exchange telephone company."<sup>37</sup> The Commission further clarified that, in order to qualify for non-dominant treatment, the affiliate providing interstate, interexchange services must: (1) maintain separate books of account; (2) not jointly own transmission or switching facilities with its affiliated exchange telephone company; and (3) acquire any services from its affiliated exchange telephone company at tariffed rates, terms and conditions.<sup>38</sup> The Commission added that any interstate, interexchange services offered directly by an independent LEC (rather than through a separate affiliate) or through an affiliate that did not satisfy the specified conditions would be subject to dominant carrier

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January 13, 1997). Finally, we note that the Commission has eliminated prior approval requirements to add, modify, or delete circuits on authorized international routes as they apply to U.S. international carriers that are regulated as dominant for reasons other than having foreign carrier affiliations. In addition, such dominant carriers are required to obtain prior Commission approval to discontinue, reduce, or impair service on a particular route and notify the Commission of the conveyance of international cable capacity. See Streamlining the International Section 214 Authorization Process and Tariff Requirements, IB Docket No. 95-118, Report and Order, FCC 96-79, ¶¶ 50, 77, 80-81 (rel. Mar. 13, 1996) (Streamlining Order).

<sup>34</sup> Competitive Carrier First Report and Order, 85 FCC 2d at 23, ¶ 63. In light of increasing competition in the interstate, domestic, interexchange telecommunications market, and evidence that AT&T no longer possessed the ability to control price unilaterally, the Commission reclassified AT&T as a non-dominant carrier in that market. Motion of AT&T Corp. to be Reclassified as a Non-Dominant Carrier, Order, 11 FCC Rcd 3271 (1996) (AT&T Reclassification Order), recon. pending.

<sup>35</sup> Competitive Carrier First Report and Order at 29, ¶ 81.

<sup>36</sup> Competitive Carrier Fourth Report and Order, 95 FCC 2d at 575-79, ¶¶ 31-37.

<sup>37</sup> Competitive Carrier Fifth Report and Order, 98 FCC 2d at 1198, ¶ 9.

<sup>38</sup> Id. The Commission noted that "[a]n affiliate qualifying for nondominant treatment is not necessarily structurally separated from an exchange telephone company in the sense ordered in the Second Computer Inquiry . . . ." Id.

regulation.<sup>39</sup>

15. In the Competitive Carrier Fifth Report and Order, the Commission also addressed the possible entry of the BOCs into interstate, interLATA services in the future:

The BOCs currently are barred by the [MFJ] from providing interLATA services . . . . If this bar is lifted in the future, we would regulate the BOCs' interstate, interLATA services as dominant until we determined what degree of separation, if any, would be necessary for the BOCs or their affiliates to qualify for nondominant regulation.<sup>40</sup>

In this Order, we revisit the question of the appropriate regulatory treatment of BOCs and independent LECs in the provision of long distance services.

### III. MARKET DEFINITION

#### A. General Application

##### 1. Background

16. In order to determine that a particular carrier or group of carriers possesses market power,<sup>41</sup> it is first necessary to define the relevant product and geographic markets. In the Competitive Carrier proceeding, the Commission found, for purposes of assessing the market power of interexchange carriers, that: "(1) interstate, domestic, interexchange telecommunications services comprise the relevant product market, and (2) the United States (including Alaska, Hawaii, Puerto Rico, U.S. Virgin Islands, and other U.S. offshore points) comprises the relevant geographic market for this product, with no other relevant submarkets."<sup>42</sup> In the Interexchange NPRM, the Commission proposed to reexamine and

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<sup>39</sup> Id. at 1198-99, ¶ 9.

<sup>40</sup> Id. at n.23 (citing United States v. Western Elec. Co., 552 F. Supp. 131 (D.D.C. 1982) (subsequent history omitted)).

<sup>41</sup> The 1992 Merger Guidelines define market power as "the ability profitably to maintain prices above competitive levels for a significant period of time." 1992 Merger Guidelines at 20,570-71. "Sellers with market power also may lessen competition on dimensions other than price, such as product quality, service, or innovation." Id. at 20,571, note 6.

<sup>42</sup> Competitive Carrier Fourth Report and Order, 95 FCC 2d at 563, ¶ 13 .

refine the market definitions adopted in the Competitive Carrier proceeding.<sup>43</sup> In the Non-Accounting Safeguards NPRM, the Commission proposed to apply this new approach to market definition in assessing the market power of BOC interLATA affiliates and independent LECs in their provision of interstate, domestic, long distance services.<sup>44</sup>

17. In the Interexchange NPRM, the Commission asked whether it should adopt more sharply focused market definitions than those adopted in the Competitive Carrier proceeding to provide us with a more refined analytical tool for evaluating market power. To establish a more narrowly-focused approach that more accurately reflects the realities of the marketplace and is flexible enough to accommodate unique market situations, the Commission tentatively concluded that it should follow the approach for defining relevant markets contained in the 1992 Merger Guidelines.<sup>45</sup> As the Commission noted in the Interexchange NPRM, the market definition approach taken in the 1992 Merger Guidelines has been recognized increasingly by courts and scholars as an important tool in assessing market power.<sup>46</sup>

## 2. Comments

18. Several commenters agree with our proposal to reexamine the product and geographic market definitions adopted in the Competitive Carrier proceeding.<sup>47</sup> Some emphasize that redefining the market would aid in determining whether BOC interLATA affiliates and independent LECs possess market power with respect to their provision of long

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<sup>43</sup> Interexchange NPRM, 11 FCC Rcd at 7164, ¶ 40.

<sup>44</sup> Non-Accounting Safeguards NPRM at ¶ 115.

<sup>45</sup> Interexchange NPRM, 11 FCC Rcd at 7164, ¶ 41.

<sup>46</sup> Id. at 7164-65, ¶ 41. See, e.g., Werden, Market Delineation Under the Merger Guidelines: A Tenth Anniversary Retrospective, 38 Antitrust Bull. 517, 518-19 (1993) (citing Olin Corp. v. FTC, 986 F.2d 1295, 1299-1301 (9th Cir. 1993); United States v. Country v. Archer-Daniels-Midland Co., 866 F.2d 242, 246 (8th Cir. 1988); United States v. Country Lake Foods, Inc., 754 F. Supp. 669, 672-73 (D. Minn. 1990); FTC v. R.R. Donnelley & Sons Co., 1990-2 Trade Cas. (CCH) ¶ 69,239, at 64,854 (D.D.C. 1990); United States v. Rank Organization Plc, 1990-2 Trade Cas. (CCH) ¶ 69,257 (C.D. Cal. 1990)); Werden, The History of Antitrust Market Delineation, 76 Marq. L. Rev. 123, 199-201 (1992); Pitofsky, New Definitions of Relevant Market and the Assault on Antitrust, 90 Colum. L. Rev. 1805, 1808 (1990).

<sup>47</sup> See e.g., America's Carriers Telecommunications Association (ACTA) April 19, 1996 Comments at 1-3; General Communications, Inc. (GCI) April 19, 1996 Comments at 2; Pennsylvania Public Utilities Commission (PaPUC) April 19, 1996 Comments at 4-5; LDDS WorldCom (LDDS) April 19, 1996 Comments at 2-3; GCI April 19, 1996 Comments at 2; see also GTE April 19, 1996 Comments at 4-5, May 3, 1996 Reply at 3.

distance services.<sup>48</sup> Other commenters recognize the more general benefit in providing the Commission with a more refined and flexible analytical tool to evaluate whether any carrier possesses market power in the long distance marketplace.<sup>49</sup>

19. Although it generally supports a reexamination of the relevant market definitions, Sprint argues that it is not readily apparent whether more particularized definitions would represent an improvement over the broader definitions adopted in the Competitive Carrier proceeding.<sup>50</sup> Sprint urges the Commission to continue to use the definitions adopted in the Competitive Carrier proceeding and to examine the issue, in light of the 1992 Merger Guidelines, on a case-by-case basis only.<sup>51</sup>

20. In general, the BOCs oppose the Commission's proposal to redefine the product and geographic markets adopted in the Competitive Carrier proceeding. They argue that BOC entry into interLATA services should not serve as a basis to reconsider the relevant market definitions and that it would be unreasonable to isolate portions of the national market to analyze the market power of new entrants when a single national market has been used to assess the market power of incumbent interexchange carriers.<sup>52</sup> BellSouth cautions that any change in the market definitions will also require the Commission to reconsider previous decisions based on the existing definitions.<sup>53</sup> SBC and U S West assert that the fast-changing telecommunications marketplace may render modifications in the market definitions quickly obsolete.<sup>54</sup> SBC claims that the 1992 Merger Guidelines were never intended to serve as a basis for determining whether or how to regulate a market or to establish a rationale for

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<sup>48</sup> ACTA April 19, 1996 Comments at 3-4; MCI April 19, 1996 Comments at 6-7; LDDS April 19, 1996 Comments at 3-4.

<sup>49</sup> PaPUC April 19, 1996 Comments at 4-5; Telecommunications Resellers Association (TRA) April 19, 1996 Comments at 31; LDDS May 3, 1996 Reply at 2-3.

<sup>50</sup> Sprint April 19, 1996 Comments at 5-6.

<sup>51</sup> Id. at 6.

<sup>52</sup> See e.g., NYNEX April 19, 1996 Comments at 5-6; BellSouth April 19, 1996 Comments at 9-12, 15-16, BellSouth August 15, 1996 Comments at 47-48; SBC May 3, 1996 Reply at 1-2; Bell Atlantic April 19, 1996 Comments at 5-6; Ameritech May 3, 1996 Reply at 18; Bell Atlantic August 15, 1996 Comments at 12-14.

<sup>53</sup> BellSouth April 19, 1996 Comments at 9.

<sup>54</sup> U S West April 19, 1996 Comments at 2-3; see also Missouri Office of Public Counsel May 3, 1996 Reply at 2-3.

disparate regulation of market participants.<sup>55</sup> USTA argues that a market definition based only on demand conditions, omitting supply factors and competitive conditions, could result in an inaccurate finding of significant market power.<sup>56</sup>

21. Although Ameritech does not disagree with the Commission's proposal to use the 1992 Merger Guidelines to define relevant markets, it claims that it would be impractical and unnecessary to define each and every product and geographic market.<sup>57</sup> If the Commission adopts its proposed approach, however, Ameritech asks that the Commission clarify that the 1992 Merger Guidelines will be used to assess market power for other services, including interstate access services.<sup>58</sup>

22. AT&T argues that the definitions adopted in the Competitive Carrier proceeding are appropriate for determining whether carriers, other than those that control the local bottleneck, possess market power in interexchange services because supply substitutability and the widespread pervasiveness of ubiquitous calling plans demonstrate that there is a single, national market for such services.<sup>59</sup> AT&T emphasizes that the 1992 Merger Guidelines provide support for the existing market definitions, rather than the Commission's proposed new approach, because the 1992 Merger Guidelines recognize the importance of supply substitutability in defining relevant markets and advocate aggregate market descriptions where production substitution among a group of products is nearly universal among the firms selling one or more of those products, as is the case in the telecommunications industry.<sup>60</sup>

23. The Department of Justice (DOJ) contends that it is not necessary for the Commission to adopt a precise definition of the relevant markets involved in the provision of a BOC interLATA affiliate's interLATA services and that the Commission should refrain from doing so at this time.<sup>61</sup> To the extent the Commission chooses to define markets in this

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<sup>55</sup> SBC April 19, 1996 Comments at 3-4.

<sup>56</sup> United States Telephone Association (USTA) Aug. 15, 1996 Comments (Hausman Appendix at 5).

<sup>57</sup> Ameritech April 19, 1996 Comments at 12-13.

<sup>58</sup> Id. at 14.

<sup>59</sup> As discussed infra at ¶ 47, AT&T argues that the Commission's current market definitions are irrelevant in assessing the market power of BOC interLATA affiliates or independent LECs because market power can be proven directly through the BOCs' or independent LECs' control of bottleneck facilities.

<sup>60</sup> AT&T April 19, 1996 Comments at 5, 16-17.

<sup>61</sup> DOJ Aug. 30, 1996 Reply at 17-18, 22.

proceeding, however, DOJ urges the Commission to be mindful of the different objectives of defining markets for purposes of regulation and antitrust enforcement.<sup>62</sup> DOJ asserts that, while the approach proposed by the Commission in the Interexchange NPRM for defining relevant markets is "not unreasonable," changes in the telecommunications industry may require the Commission to define markets more precisely in the future and that it may be inappropriate to address this issue at this time.<sup>63</sup>

24. MFS argues that the 1992 Merger Guidelines are too generic to apply to the telecommunications industry and should not be used to redefine the appropriate product and geographic markets.<sup>64</sup> MFS argues, for example, that while the 1992 Merger Guidelines contemplate industries in which goods are substitutable, the telecommunications services market is made up of services that are not substitutes, but rather essential inputs used by competitors.<sup>65</sup> In addition, MFS claims that the 1992 Merger Guidelines are not well-suited to highly segmented industries, such as the telecommunications industry, which is segmented into residential, business, peak, off-peak, local, toll and access services. This market segmentation, MFS claims, makes it possible for dominant firms to engage in predatory cross-subsidization between market segments.<sup>66</sup> MFS further contends that, while the 1992 Merger Guidelines focus on geographic factors and pricing issues, measuring market power in the telecommunications industry requires consideration of such non-pricing issues as physical collocation, interconnection, and the allocation of telephone numbers.<sup>67</sup> Finally, MFS argues that the focus on demand substitutability in the 1992 Merger Guidelines results in an inaccurate measurement of market power in the telecommunications industry because the monopolists or near-monopolists that control the local exchange and exchange access market may foreclose competition by raising the price of an essential facility they provide to competitors without also raising the price of the service they sell to end-users.<sup>68</sup>

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<sup>62</sup> Id. at 18 n.10.

<sup>63</sup> Id. at 20. Although DOJ, like AT&T, believes that the market definition is irrelevant in assessing the market power of BOC interLATA affiliates, its conclusion is based on its assessment that the BOC interLATA affiliates will not be able to exercise, at least in the near term, the type of market power targeted by dominant carrier regulation. Id. at 16-17.

<sup>64</sup> MFS Communications Company, Inc. (MFS) April 19, 1996 Comments at 3-4.

<sup>65</sup> Id. at 4.

<sup>66</sup> Id.

<sup>67</sup> Id. at 5.

<sup>68</sup> MFS May 3, 1996 Reply at 3.

### 3. Discussion

25. We conclude that the 1992 Merger Guidelines provide an appropriate analytical framework for defining relevant markets in order to assess market power in the interstate, domestic, long distance marketplace. We disagree with those commenters that claim that the 1992 Merger Guidelines are inapplicable in a regulatory setting or are based on generalized market concepts that are inapplicable to the telecommunications industry. We find that the 1992 Merger Guidelines are based on fundamental and widely-applicable economic principles, such as principles of demand and supply substitution.<sup>69</sup> Accordingly, we reject MFS's contention that the telecommunications industry is so unique that the 1992 Merger Guidelines are inapplicable.<sup>70</sup> The 1992 Merger Guidelines are intended to guide DOJ and the FTC in their analysis of mergers taking place in any industry, not only mergers in particular industries.<sup>71</sup> The economic principles contained in the 1992 Merger Guidelines are not limited to an analysis of particular types of markets, but rather are broadly drawn to accommodate virtually all marketplace characteristics.<sup>72</sup> In fact, DOJ agrees that "[t]he Commission's market definition, like market definition under the antitrust laws, should be guided by the basic economic principles that inform competitive analysis and market definitions under the DOJ Merger Guidelines."<sup>73</sup> We acknowledge that, in its comments, DOJ notes that the different objectives of regulation and antitrust enforcement may affect the

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<sup>69</sup> Supply substitutability identifies all productive capacity that can be used to produce a particular good, whether it is currently being used to produce that good or to produce some other, even unrelated, good. For example, if a factory that is producing desks could be converted quickly and inexpensively to the production of wheelbarrows, then the owner of that factory should be considered a potential producer of wheelbarrows. That does not mean, however, that desks and wheelbarrows are in the same relevant product market. As previously noted, demand substitutability identifies all of the products or services that consumers view as substitutes for each other, in response to changes in price. For example, if, in response to a price increase for orange juice, consumers instead purchase apple juice, apple juice would be considered a demand substitute for orange juice.

<sup>70</sup> MFS's concern that, by relying on the 1992 Merger Guidelines, the Commission will only consider demand-based factors in assessing market power is unfounded. As discussed supra, although we will rely on demand substitutability in defining relevant markets, market definition is only one component in assessing market power.

<sup>71</sup> "These guidelines outline the present enforcement policy of the Department of Justice and the Federal Trade Commission (the "Agency") concerning horizontal acquisitions and mergers ("mergers") subject to section 7 of the Clayton Act, to section 1 of the Sherman Act, or to section 5 of the FTC Act." 1992 Merger Guidelines at p. 20,569-3.

<sup>72</sup> We note that there is a recognition in the 1992 Merger Guidelines that they will be applied to "a broad range of possible factual circumstances." 1992 Merger Guidelines at p. 20,569-3.

<sup>73</sup> DOJ Aug. 30, 1996 Reply at 18, note 10.

application of the market definition in those contexts.<sup>74</sup> We agree and realize that the markets defined in a particular antitrust suit may reach different results. DOJ does not argue, however, that the fundamental concepts and principles espoused in the 1992 Merger Guidelines apply only in the merger context.

26. We conclude that we should revise our product and geographic market definitions to follow the approach taken in the 1992 Merger Guidelines. Most commenters do not appear to articulate serious disagreements with the fundamental economic principles on which we base our revised approach to defining the relevant product and geographic markets. Rather, they appear to focus their concerns on the impact that this new approach may have on specific assessments of market power. We believe that our market power analysis, including our approach to defining the relevant product and geographic markets, should not be formulated by focusing on end-results, but instead should be focused on the application of sound economic principles and analysis. As a result, we conclude that the product and geographic market definitions defined in the Competitive Carrier proceeding should be refined to follow the approach taken in the 1992 Merger Guidelines in order to ensure that our market power assessments are based on the most accurate, up-to-date, and generally accepted economic principles relating to market analysis. As new carriers enter the long distance marketplace and as the telecommunications marketplace changes in the face of increased competition, the flexibility inherent in our new approach to defining the relevant product and geographic markets enables us to make a more accurate measurement of market power than before by accounting for unique carrier characteristics that could impact the dynamics of the marketplace.<sup>75</sup> For example, many new carriers have begun entering the long distance market by targeting particular types of customers or by targeting customers in particular areas, suggesting that carriers do not view the interstate, domestic, long distance market as a single national market or as a single market of interchangeable and substitutable services.

27. In contrast to some commenters,<sup>76</sup> we find that supply substitutability<sup>77</sup> should

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<sup>74</sup> Id.

<sup>75</sup> For example, potential new entrants to the long distance marketplace, such as BOCs, utility companies, and cable companies, possess different characteristics that could impact, inter alia, the types of services offered in the long distance marketplace and the method in which long distance services are priced.

<sup>76</sup> See e.g., USTA Aug. 15, 1996 Comments (Hausman Appendix at 5); AT&T April 19, 1996 Comments at 5, 15-16; BellSouth May 3, 1996 Reply at 3.

<sup>77</sup> As previously noted, supply substitutability identifies all productive capacity that can be used to produce a particular good, whether it is currently being used to produce that good or to produce some other, even unrelated, good.

not be used to define relevant markets, but rather should be used to determine which providers are currently serving, or potentially could be serving, a relevant market only after that market has been identified.<sup>78</sup> We conclude that our market definitions should be based solely on demand substitutability considerations.<sup>79</sup> This conclusion accords with the 1992 Merger Guidelines, which state that, "market definition focuses solely on demand substitution factors - i.e., possible consumer responses. Supply substitution factors - i.e., possible production responses - are considered elsewhere in the Guidelines in the identification of firms that participate in the relevant market and the analysis of entry."<sup>80</sup>

28. Under the 1992 Merger Guidelines, market power is determined by delineating both the product and geographic market in which power may be exercised and, then, identifying those firms that are current suppliers and those firms that are potential suppliers in that particular market. Therefore, in determining whether a carrier is able to exercise market power in the provision of a particular service or group of services or within a particular area, we must consider two issues. First, in the case of the relevant product market, we must consider whether, if all carriers raised the price of a particular service or group of services, customers would be able to switch to a substitute service offered at a lower price. With respect to the relevant geographic market, we must consider whether, if all carriers in a specified area raised the price of a particular service or group of services, customers would be able to switch to the same service offered at a lower price in a different area. Second, with respect to supply substitutability, we must consider whether, if a carrier raised the price of a particular service or group of services, other carriers, currently not offering that service or group of services, would have the incentive and the ability to begin provisioning a substitute service quickly and easily. For example, if we were assessing the market power of a carrier providing long distance service from Miami, and determined that another carrier currently providing service in Los Angeles would also begin providing service from Miami if the price of the service in Miami were to increase, we would consider

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<sup>78</sup> As the 1992 Merger Guidelines note, "[o]nce defined, a relevant market must be measured in terms of its participants and concentration. Participants include firms currently producing or selling the market's products in the market's geographic area. In addition, participants may include other firms depending on their likely supply responses to a 'small but significant and nontransitory' price increase. A firm is viewed as a participant if, in response to a 'small but significant and nontransitory' price increase, it likely would enter rapidly into production or sale of a market product in the market's area, without incurring significant sunk costs of entry and exit. Firms likely to make any of these supply responses are considered to be 'uncommitted' entrants because their supply response would create new production or sale in the relevant market and because that production or sale could be quickly terminated without significant loss." 1992 Merger Guidelines at p. 20,572.

<sup>79</sup> As previously noted, demand substitutability identifies all of the products or services that consumers view as substitutes for each other, in response to changes in price.

<sup>80</sup> 1992 Merger Guidelines at p. 20,571.

the impact of the Los Angeles carrier's potential entry into Miami in assessing the market power of the Miami carrier. This does not mean, however, that customers in Miami consider long distance service offered in Los Angeles as a substitute for service offered in Miami. Therefore, long distance service offered in Miami and long distance service offered in Los Angeles would not be considered as services in the same relevant geographic market. By following the approach taken in the 1992 Merger Guidelines, we will continue to weigh supply substitutability as an important factor in assessing market power, but we will not use it as a factor in defining the relevant product and geographic markets.

29. We acknowledge that the approach to defining relevant markets that we adopt in this proceeding departs from the approach adopted in the Competitive Carrier proceeding and applied in the AT&T Reclassification Order.<sup>81</sup> For the reasons discussed herein, we believe these more refined definitions are now necessary. To the extent that various parties argue that our new approach is contrary to our decision in the AT&T Reclassification Order,<sup>82</sup> it is well-established that the Commission may change approaches as long as it provides a reasoned explanation for doing so.<sup>83</sup> Should any modifications be necessary to decisions reached in the AT&T Reclassification Order, they will be addressed, as necessary, in further proceedings.<sup>84</sup> We emphasize, however, that, because market definition is only one step in assessing market power, changes made in the approach to defining relevant markets will not necessarily produce different assessments of market power.

30. We also reject the argument that we should not revise the product and geographic market definitions because of the dynamic changes taking place in the long distance marketplace.<sup>85</sup> To the contrary, we believe that these changes in the long distance marketplace provide a compelling reason to modify our approach to defining the relevant product and geographic markets. Our new approach to defining relevant markets will be consistently applied, yet contain inherent flexibilities, so that our assessment of market power will always be based on a particular carrier's or group of carriers' unique market situation. For example, in recognition that certain carriers may control discrete facilities in specific

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<sup>81</sup> In the Matter of Motion of AT&T Corp. to be Reclassified as a Non-Dominant Carrier, 11 FCC Rcd 3271 (1995) (AT&T Reclassification Order).

<sup>82</sup> See e.g., BellSouth April 19, 1996 Comments at 9, Aug. 15, 1996 Comments at 43.

<sup>83</sup> See California v. FCC, 39 F.3d 919, 925, 930 (9th Cir. 1994).

<sup>84</sup> In this regard, we note that the State of Hawaii, General Communications, Inc. and Total Telecommunications Services, Inc. have filed petitions for reconsideration of the AT&T Reclassification Order.

<sup>85</sup> See e.g., U S West April 19, 1996 Comments at 2-3; Missouri Office of Public Counsel May 3, 1996 Reply at 2-3; DOJ Aug. 30, 1996 Reply at 20.

geographic areas, target particular types of customers, or provide specialized services, our new market definitions allow us to examine the relevant product and geographic markets at the level of detail necessary to make a more accurate assessment of market power than under the Competitive Carrier definitions. We find that the definitions developed in the Competitive Carrier proceeding would not provide us with sufficient flexibility to account for the impact such unique market situations may have on assessing market power because these definitions are too broad to analyze markets at the necessary level of detail. At the time the Commission defined the relevant product and geographic markets in the Competitive Carrier proceeding, telecommunications services were provided primarily by a single national carrier. Under such a regulatory model, the use of a simplified definition of relevant markets did not significantly hinder our analysis of market power. Today, in light of the dramatic changes that have been occurring in the long distance marketplace, particularly those brought on by the passage of the Telecommunications Act of 1996, with many firms competing to provide more specialized and regionalized long distance services to different types of customers, more detailed market definitions are needed to assess market power more accurately and to pinpoint the particular markets where that power is or could be exercised.

## B. Product Market Definition

### 1. General Approach to Product Market Definition

#### a. Background

31. In the Competitive Carrier proceeding, the Commission defined the relevant product market as "all interstate, domestic, interexchange telecommunications services . . . with no relevant submarkets."<sup>86</sup> In the Interexchange NPRM, we tentatively concluded that we should refine our analysis and define as a relevant product market any domestic, interstate, interexchange service for which there are no close demand substitutes or any group of services that are close substitutes for each other but for which there are no other close demand substitutes.<sup>87</sup> Recognizing, however, that delineating all relevant product markets would be administratively burdensome and that the Commission has previously found that there is substantial competition with respect to most interstate, domestic, interexchange services, the Commission tentatively concluded that we generally should address the question of whether a specific domestic, interstate, interexchange service, or group of services, constitutes a separate product market only where there is credible evidence suggesting that there is or could be a lack of competitive performance with respect to a

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<sup>86</sup> Competitive Carrier Fourth Report and Order, 95 FCC 2d at 563, ¶ 13.

<sup>87</sup> Interexchange NPRM, 11 FCC Rcd at 7167, ¶ 46.

particular service or group of services.<sup>88</sup> We asked commenters to evaluate this new approach and to suggest any other possible approaches.<sup>89</sup>

**b. Comments**

32. Several commenters support the proposed approach to redefining the relevant product market.<sup>90</sup> Many commenters agree that the Commission should rely on demand substitutability in defining relevant product markets.<sup>91</sup> A number of commenters argue, however, that the Commission should continue to recognize supply substitutability in defining the relevant product market and, therefore, should not modify the relevant product market definition adopted in the Competitive Carrier proceeding.<sup>92</sup>

33. GTE concedes that the definition proposed in the Interexchange NPRM would provide the Commission with the flexibility to accommodate a rapidly-evolving, technology-driven environment and would enable the Commission to assess a particular service provider's ability to exert market power over new products.<sup>93</sup> GTE claims, however, that the certainty of the Commission's standard would diminish if different market evaluations were applied to particular carriers or groups of carriers absent a relatively strong basis for distinguishing them.<sup>94</sup> Although it generally supports the revised approach to defining the relevant product market, the Florida Public Service Commission warns that logical sets of substitutable services will likely intersect with one another, which could render the Commission's approach to defining relevant product markets unworkable in practice.<sup>95</sup>

34. AT&T opposes the approach proposed in the Interexchange NPRM. It emphasizes that the 1992 Merger Guidelines support an aggregate product market definition

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<sup>88</sup> Id., ¶ 47.

<sup>89</sup> Id.

<sup>90</sup> GTE April 19, 1996 Comments at 4; PaPUC April 19, 1996 Comments at 4-5; TRA April 19, 1996 Comments at 32.

<sup>91</sup> PaPUC April 19, 1996 Comments at 7-9; TRA April 19, 1996 Comments at 32; cf. Sprint April 19, 1996 Comments at 6-7.

<sup>92</sup> See, e.g., NYNEX April 19, 1996 Comments at 5-6; SBC May 3, 1996 Reply at 1-2.

<sup>93</sup> GTE April 19, 1996 Comments at 4-5.

<sup>94</sup> GTE May 3, 1996 Reply at 3-7.

<sup>95</sup> Florida Public Service Commission (Florida PSC) April 19, 1996 Comments at 7-8.

where "production substitution among a group of products is nearly universal among the firms selling one or more of the products," as in the telecommunications industry.<sup>96</sup> AT&T claims that, due to pervasive supply substitutability, a product market defined by a single service would yield the same market share and market power results as the single product market approach adopted in the Competitive Carrier proceeding.<sup>97</sup> Because there is no difference between the facilities used to provide different services, AT&T argues that there is ample capacity for carriers to attract customers from any carrier that attempts to exercise market power with respect to a particular service.<sup>98</sup> AT&T further claims that the Commission's recent analysis of AT&T's 800 directory assistance and analog private line offerings provide no basis to abandon the single product market definition.<sup>99</sup> AT&T contends that the Commission recognized that AT&T's pricing of 800 directory assistance is constrained by supply substitutability principles, and that the migration of analog private line customers to digital and virtual private line services demonstrates that these services are substitutable and, therefore, in the same market.<sup>100</sup>

35. The BOCs generally oppose the product market definition proposed in the Interexchange NPRM.<sup>101</sup> BellSouth supports retention of the current product market definition on the grounds that there is high cross-elasticity of demand among virtually all interexchange services, most of which are interchangeable services that are packaged differently, and that the distinctions between services can be easily erased by entities such as resellers.<sup>102</sup> For example, BellSouth argues that, if a sole supplier of any particular interexchange service raised its prices by five percent or more, most customers would turn to

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<sup>96</sup> AT&T April 19, 1996 Comments at 16 (quoting 1992 Merger Guidelines at p. 20,573-4 n.14). AT&T, as noted supra at ¶ 47, claims that market definition is irrelevant in analyzing the market power of BOCs and argues against modifying the current product market definition. It further claims that supply substitutability considerations lead to the conclusion that there is a single product market in interexchange services.

<sup>97</sup> AT&T April 19, 1996 Comments at 17-18.

<sup>98</sup> AT&T May 3, 1996 Reply at 7-8.

<sup>99</sup> AT&T April 19, 1996 Comments at 21.

<sup>100</sup> Id. at 21-23.

<sup>101</sup> See, e.g., NYNEX April 19, 1996 Comments at 5-6; U S West April 19, 1996 Comments at 2-6; BellSouth April 19, 1996 Comments at 9-12, 20; SBC May 3, 1996 Reply at 1-2; Bell Atlantic April 19, 1996 Comments at 5.

<sup>102</sup> BellSouth April 19, 1996 Comments at 13-14.

a different service as an alternative.<sup>103</sup> BellSouth disputes the Commission's suggestion that market power over discrete fringe services may warrant redefinition of the relevant product market.<sup>104</sup> It further asserts that delineating relevant product markets would be administratively burdensome and might cause carriers without market power to be regulated as dominant carriers.<sup>105</sup> BellSouth claims that the Commission's proposed approach would be inconsistent with the Commission's decision in the AT&T Reclassification Order, in which AT&T was classified as nondominant even though it was found to control two discrete services in the overall product market.<sup>106</sup> BellSouth also contends that the Commission's proposed approach seems to signal a return to the "all-services" methodology of assessing dominance, which was expressly rejected in the AT&T Reclassification Order.<sup>107</sup>

36. PacTel agrees that the product market definition turns on whether there are sufficiently close substitutes for a product or group of products. PacTel contends, however, that because services, such as MTS, discount plans, WATS, 800 service, foreign exchange service, wireless and even "carrier" access services, are highly substitutable options for consumers to place or receive long distance calls, the relevant product market should include all interstate, long distance services.<sup>108</sup> USTA questions the Commission's use of a demand-elasticity methodology to define the relevant domestic product market, especially when the Commission proposes to continue to emphasize supply substitutability in defining the international product market.<sup>109</sup> USTA asserts that the Commission has consistently and continually recognized a single relevant product market, and contends that the Commission should not abandon this long-settled definition in favor of numerous, fragmented submarkets.<sup>110</sup>

37. A number of commenters support our proposal in the Interexchange NPRM to delineate separate product markets only if there is credible evidence demonstrating that there is or could be a lack of competitive performance with respect to a particular service or group

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<sup>103</sup> Id. at 14.

<sup>104</sup> BellSouth Aug. 15, 1996 Comments at 43 (citing its April 19, 1996 Comments at 12-15).

<sup>105</sup> BellSouth April 19, 1996 Comments at 14-15.

<sup>106</sup> Id. at 12-13.

<sup>107</sup> BellSouth Aug. 15, 1996 Comments at 43-44.

<sup>108</sup> Pacific Telesis Group (PacTel) Aug. 15, 1996 Comments at 50.

<sup>109</sup> USTA Aug. 15, 1996 Comments at 41-42.

<sup>110</sup> Id. at 40-42.