and will not be able to offer ubiquitous local service throughout South Carolina. See Baseman Decl. ¶ 65. The way to maximize consumer benefits is to let competition for local services develop first so that competition for bundles of local and long distance service can occur. Of course, if BellSouth were allowed into the in-region long distance market now, the likelihood that it would cooperate in making resold and other local services available consistent with the requirements of the Act would approach zero.

5. BellSouth's economic studies are baseless.

BellSouth's brief claims that numerous economic benefits will flow from the approval of its application to provide in-region long distance, including significant decreases in long distance rates and increases in economic activity. See BellSouth Br. at 83-84. Yet the studies on which BellSouth bases its claims are fundamentally flawed. For example, BellSouth relies heavily on a study by WEFA that, among other erroneous and implausible assumptions, suggests that long distance prices have been increasing over time. Quite simply, in the words of Professor Hall, "the WEFA Study has no scientific value." Hall Decl. ¶ 231. The claim advanced by BellSouth that the postponement of BOC long distance entry costs U.S. residential consumers $7 billion each year is equally preposterous. See BellSouth Br. at 67. Most fundamentally, the analysis used to support this claim does not account for the gains to local competition from delaying BOC entry or the harm to long distance competition. In addition, the analysis assumes that all long distance customers are currently paying the relatively higher long distance prices charged by AT&T. See Hall Decl. ¶ 197.

C. Approval of BellSouth's Application Would Create Ample Opportunities for Discriminatory Behavior.

BellSouth contends that a number of factors -- including revised regulations, technological developments, and pricing reform -- will preclude it from engaging in anti-competitive, discriminatory behavior if it is allowed into long distance. See BellSouth Br. at 85-102. Yet none of these factors adequately constrains BellSouth. It is in the interests of BellSouth's shareholders to prevent as much local competition as possible and to leverage its local monopoly into the downstream long distance market. Hall Decl. ¶¶ 56-57. The premise of the Act is that only the establishment of vibrant local competition will operate as a reliable constraint on BellSouth's underlying economic motivations.

1. Effectiveness of Regulation

Regulation, while important in fostering local competition, is not a sufficient constraint on the behavior of the BOCs. Congress rejected any contrary claim when it refused to allow immediate BOC provision of in-region interexchange services once the BOCs implemented the checklist and demonstrated prospective compliance with section 272. The Commission has noted the limitations of regulation, remarking in its discussion of the Bell Atlantic-NYNEX merger that "even while subject to regulation, a firm can exercise market power if, for example, (1) a price cap fails to lower prices for services to competitive levels, (2) a bundled product offering, such as combined local and long distance service, is only partially price-regulated, or (3) quality is difficult to specify and monitor." BA/NYNEX Merger Order ¶ 11.

Moreover, BOCs have many opportunities to frustrate or postpone the impact of regulations. A determined incumbent can significantly delay the onset of competition by raising

numerous meritless challenges to regulatory proceedings and arbitrations;[40] BellSouth appears to have taken exactly this approach in South Carolina.[41] In these circumstances, regulation is not effective, because it takes too long to have an effect and remedies (injunctive as well as compensatory or deterrent) are inadequate. See generally Hall Decl. ¶ 60 (noting delays attendant to remediation proceedings).

The availability of penalties is ineffective as a means of securing competition against a determined monopolist. Revocation of BellSouth's interLATA authority for anticompetitive behavior is extremely unlikely once granted, due to the inconvenience such a step would cause consumers. Imposing the lesser sanction of preventing BellSouth from signing up new long distance customers would not be effective in either deterring non-compliance or securing future compliance. By the time any such sanction were imposed, BellSouth would have been able to build up a substantial customer base, given its ability to provide ubiquitous interexchange service on the day it obtains section 271 authority and the amount of time any revocation proceedings (including appeals) would take.[42] While a penalty time gap may be present in most regulatory proceedings, this delay is especially relevant in proceedings designed to foster local exchange

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[40] In the Michigan Order, the FCC implicitly acknowledged the limitations of regulation when it discussed the need for CLECs to avoid lengthy and contentious negotiations or legal proceedings with BOCs that might result from the absence of adequate performance standards. See Michigan Order ¶¶ 392, 394.

[41] For a list of Commission rulings that BellSouth has challenged, see supra section VII.A.

[42] Similarly, BOCs in Minnesota and Michigan have evaded state regulators' directives to implement one-plus intraLATA dialing parity. The BOCs have appealed the dialing parity orders; during the pendency of the appeals, the BOCs have not implemented the regulators' orders. See Baseman Decl. ¶ 18.

competition. Local competition is still in the developmental stage, and any period during which the incumbent local carrier can evade regulatory requirements yet still provide interLATA services will make it that much more difficult for local competition to take root and flourish, as well as for long distance competition to remain vibrant. This is why Congress designed section 271 to require that local competition become established before the BOCs are permitted to provide in-region long distance services, instead of relying on after-the-fact remedies.

An incumbent local carrier can also frustrate regulation by taking the narrowest possible view of regulatory requirements, thus requiring competitors to contest the incumbent's interpretations on a case-by-case basis. BellSouth has done just this in Georgia, where it first claimed that a particular form of subloop unbundling was not technically feasible. Only after the state commission ruled that the subloop unbundling was feasible did BellSouth admit (via its SGAT) the feasibility of this form of unbundling. See Baseman Decl. ¶ 19 n.12. As discussed further below, the rapid pace of technological change provides BOCs ample opportunities to discriminate against competitors. In short, an incumbent local exchange carrier will have many avenues for thwarting regulation in the course of discriminating against its competitors.[43]

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[43] BellSouth argues that the Commission's decision finding that the merger of MCI and BT is in the public interest somehow requires it to approve this application. BellSouth Br. at 97-98. The Commission analyzed the MCI-BT merger under sections 214 and 310 of the Communications Act, which establish a framework that, among other goals, encourages foreign jurisdictions to adopt procompetitive policies by permitting carriers in competitive foreign markets to enter U.S. markets. Although the Commission did not agree with some of the choices made by regulators in the United Kingdom, the Commission agreed that their policies have made the United Kingdom's telecommunications markets among the most competitive in the world (including interconnection charges that are among the lowest in the world). Mem. Opinion and Order, ¶¶ 177-98, 224-46, Merger of MCI Communications Corp. and British Telecomm. plc, GN Docket No. 96-245 (rel. Sept. 24, 1997) (FCC 97-302). The substantial and increasing facilities-based competition in the U.K. indicates that U.K. markets are irreversibly open to

2. Technical Discrimination

BellSouth argues that reporting requirements and the sophisticated nature of its competitors will make technical discrimination impossible. See BellSouth Br. at 91-95. In the rapidly evolving telecommunications arena, however, technical discrimination with respect to the introduction of new services or equipment is even more likely than ever. See Affidavit of Dale N. Hatfield on Behalf of MCI, filed in CC Docket No. 97-137, at 3-4 (June 5, 1997) (attached as ex. H). Whereas prior to BOC participation in long distance, a BOC would have incentives to cooperate with long distance carriers in introducing new features (as the added traffic would raise its revenues), a BOC that is providing long distance service itself would have every incentive to frustrate efforts by its long distance competitors to introduce new features. See Baseman Decl. ¶ 21. (Obviously, at no time would a BOC have an incentive to cooperate with a CLEC in the introduction of new technologies, especially absent the long distance entry incentive.) Technical collaboration between companies is difficult to monitor and regulate; the uncertainties involved in implementing new technologies create many opportunities for incumbent local carriers to mask anti-competitive discrimination behind claims of technical infeasibility. See Hatfield Aff. at 14-28; Baseman Decl. ¶¶ 21-24.

3. Cost Shifts, Access Charges, and Price Squeezes

BellSouth additionally argues that it will not be able to discriminate on the basis of cost or price. See BellSouth Br. at 85-91. Nevertheless, it will necessarily possess a number of potent

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competition and helps to explain why no competitor of MCI even alleged that BT has engaged in any favoritism toward MCI during the several years that BT has been vertically integrated into markets for international services while having a substantial investment in MCI.

and discriminatory cost and pricing tools -- including those relating to cost-shifts, access charges, and price squeezes -- at least until local competition is more firmly established in South Carolina.

Even given price cap regulation, cost-shifting is still a potential source of economic inefficiency. Price cap regulation requires reference to some cost standard, and BellSouth will have an incentive to shift costs as long as there is the possibility that regulators will increase the price cap in response to declining profits or maintain a price cap when it should be reduced. See Hall Decl. ¶¶ 62, 115-19. Moreover, the Commission has acknowledged that price cap regulation may fail to create price levels consistent with competition. See BA/NYNEX Merger Order ¶ 11.

As long as access charges have not been reduced to economic costs, BellSouth's long distance affiliate will have a significant competitive advantage. Despite the Commission's access charge reforms, access is still priced well above cost and is likely to remain so, especially absent the development of healthy local competition.[44] Access charges that are above cost automatically give BOCs significant competitive advantages, in that their marginal cost of access for the company as a whole is much lower than the marginal cost of access paid to them by their competitors. Although BOCs are required to impute access charges to their long distance affiliates, imputation is only a bookkeeping measure that does not provide any real protection to competitors. Due to above-cost access charges, BOCs are able to engage in a variety of practices, including non-linear pricing strategies, that distort the marketplace and inhibit competition. See Baseman Decl. ¶¶ 27-36.

Moreover, the Eighth Circuit's July decision invalidating the Commission's pricing

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[44]See Hall Decl. ¶ 95; see also Access Charge Reform Order (FCC 97-158), ¶ 265 (predicting that access charges will be reduced to cost through competition).

regulations for interconnection and unbundled network elements, together with its recent decision on rehearing to invalidate the Commission's rule concerning nondiscriminatory provision of existing combinations of network elements, have increased the potential that incumbent local exchange carriers such as BellSouth will be able to engage in price squeezes (that is, the practice of charging competitors high prices for necessary inputs such as exchange access while offering low prices for competitive services such as long distance, thus forcing competitors to either lose customers or to operate at a loss). In its decision approving Bell Atlantic's merger with NYNEX, the Commission noted that "we are less convinced today that we may generally rely on the availability of interconnection and UNEs to provide alternatives to exchange access services in light of the Eighth Circuit's decision" and to thereby prevent price squeezes. BA/NYNEX Merger Order ¶ 117. The Commission ruled, however, that the additional safeguards agreed to by Bell Atlantic -- safeguards absent from BellSouth's application -- would sufficiently prevent price squeezes. In any event, regulation is no more a panacea for price squeezes than it is for other kinds of anticompetitive abuses.

In sum, regulation is only partially effective, rapid technological evolution provides numerous opportunities to create competitive stumbling blocks, and BOC cost and pricing strategies can easily stifle competition. The surest means to ensure that local competition develops and that interexchange competition remains undiminished is to enforce section 271, including a restriction on in-region interexchange services until local competition has become irreversibly established. At that point, a BOC's customers (both telecommunications consumers and providers) will be able to avoid the BOC's network, should they face discrimination from the

BOC. Also at that point, the BOC will be less likely to discriminate, because it will know that it no longer has the only local exchange service game in town.

D. BellSouth's Premature Entry into Long Distance Would Have Severe Consequences for the Development of Local Competition in South Carolina.

One of BellSouth's most perverse arguments is its claim that it should be allowed to offer long distance now to spur local competition in South Carolina. See BellSouth Br. at 102-03. In fact, approval of BellSouth's application would have exactly the opposite consequence: BellSouth's premature entry into long distance in South Carolina would devastate the incipient local competition in the state and harm the ability and incentive of interexchange carriers to enter local markets.

1. Congress required local competition first, then long distance entry.

BellSouth's argument that it should be allowed into the long distance market in South Carolina now is really a disagreement with Congress' refusal in the Act to lift the long distance restriction immediately. While Congress chose to lift certain other restrictions imposed on the BOCs by the MFJ, Congress maintained the restriction on in-region long distance entry pending approval by the Commission of BOC applications on a state-by-state basis. If Congress had intended that the BOCs should be allowed to offer in-region, interLATA services as a means of spurring local competition, it would not have enacted section 271. Under BellSouth's interpretation of the Act, the Commission could simply dispense with all further section 271 proceedings and allow all the BOCs into long distance now.

Of course, such an approach would be directly contrary to Congress' intent. The Act contains elaborate provisions, including the competitive checklist and the public interest test,

designed to ensure that competition in local markets is established before opening the in-region long distance markets to the BOCs. In the words of Representative Forbes, "[B]efore any regional Bell company enters the long distance market, there must be competition in its local market." 142 Cong. Rec. E204 (Feb. 23, 1996). Or, as Senator Hollings phrased it: "[C]ompetition is the best regulator of the marketplace. Until that competition exists, monopoly providers of services must not be able to exploit their monopoly power to the consumer's disadvantage. . . . Telecommunications services should be deregulated after, not before, markets become competitive. 142 Cong. Rec. S688 (daily ed. Feb. 1, 1996). The Act thus requires the establishment of local competition before BOC long distance entry.

Moreover, much of BellSouth's baseless argument that its entry into long distance will spur local competition depends on the purported gamesmanship of the major IXCs, who allegedly have held back from entering the local market in South Carolina to prevent BellSouth from gaining long-distance entry and to thereby protect their long-distance market shares. Yet this argument simply holds no water with respect to non-IXC CLECs, whose successful facilities-based entry could also trigger BellSouth's ability to provide long distance. As further discussed in the Baseman declaration, the first non-IXC CLEC to enter the market on a facility basis would have numerous avenues to profit, even if its entry caused BellSouth to be able to provide in-region long distance. At a minimum, the first non-IXC CLEC could either provide services to or be bought out by the entering IXCs. See Baseman Decl. ¶ 76. Therefore, neither the non-IXC CLECs nor the IXCs have any tactical incentives to hold back from entering the market, once BellSouth truly opens its local market in South Carolina to competition.

2. The benefits, if any, of immediate entry by BellSouth into the South Carolina long distance market are greatly outweighed by the harms to local and long distance competition.

As demonstrated above, the public interest would not be served by the approval of BellSouth's application to offer long distance services in South Carolina. The harm to local competition is both glaring and substantial if BellSouth enters long distance now, while its compliance with the competitive checklist is grossly deficient, and while it, and it alone, can offer ubiquitously in South Carolina a package of local and long-distance service. Only protracted, expensive regulatory proceedings that can offer at best delayed relief of limited effectiveness will stand between it and anti-competitive actions in both the local and long distance markets that are difficult to detect and prove. On the other hand, if the Commission waits to authorize in-region interexchange entry until local competition has become established, the "carrot" of long distance entry will continue to encourage BellSouth to open its local markets to competition. Moroever, the marginal benefits of the addition of one more competitor to the already competitive long distance market are difficult to discern, and all indications are that BellSouth will not offer meaningful price competition to the existing long distance carriers. Premature entry would hurt, not help, both local and long distance competition.

CONCLUSION

For the foregoing reasons, BellSouth's application to provide in-region interLATA services in South Carolina should be denied.

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October 20, 1997

CERTIFICATE OF SERVICE

I, Jerome L. Epstein, hereby certify that I have on this 20th day of October 1997, caused a true copy of the foregoing to be served upon the parties on the attached list by hand, except where noted by Federal Express.

Jerome L. Epstein

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