

carrier access services where competitive forces are not sufficiently developed to constrain prices and to lead to eventual deregulation.

Weighing the costs and benefits of implementing regulatory flexibility is much simpler in the abstract than in the real world. Generally, telecommunications markets are neither perfectly competitive nor perfectly regulated, and the correct question is therefore not whether a given firm can exercise excessive control over price in a given market but whether the benefits of a proposed regulatory modification will outweigh the costs in the “imperfect” markets in which telecommunications services are sold and regulated. The question regulators need to answer is not whether ILECs have any market power,<sup>72</sup> but rather how much control over market price is too much and thus requires continued price regulation?

While there is general agreement on the indicia of competition in a market, there is likely to be no agreement in a litigated case concerning the degree of control over price that should trigger reduced regulatory constraints. For example, how much weight should be given to the absence of entry barriers as compared with the absence of entry? To what extent does the threat of potential entry discipline the pricing of a firm with a large market share? Can switched trunk-transport and special access be treated as belonging to the same relevant market? While economists can perform quantitative studies of these issues, the determination of the effect of any proposed change in regulation on price, output, investment and service quality will inevitably require judgement on the part of policymakers. Given that economic theory supplies no clear and unequivocal answers and considering the difficulty involved in measuring competition precisely, especially in an adversarial setting, it is important that readily available and easily verifiable criteria be used by policymakers. The triggers that are used to remove successive regulatory restrictions must be known, measurable, and observable to decrease the likelihood that unneeded asymmetric regulations and regulatory proceedings will distort the competitive process.

---

<sup>72</sup> We generally do not regulate prices in concentrated and imperfectly competitive markets such as soft drinks, even though large firms provide differentiated products and have some control over price.

While economics provides no clear and unequivocal answers to the question at hand, economic theory does provide important insights which, when combined with objective criteria, can be used to determine the pace of regulatory reform. For firms to exercise market power, two conditions must hold: (i) there must be little competition from existing firms producing substitutes for the service in question; and (ii) entry into the market by new competitors must be blocked by significant legal or economic barriers.

Although market concentration is a proper starting point for evaluating alleged market power, care must be taken not to equate market share with market power. Basing an analysis on market share or concentration is likely to lead regulators astray because current market share is fundamentally backward looking and fails to put sufficient weight on current and future developments.<sup>73</sup> While this tends to be the case in general, it is particularly harmful in technologically dynamic markets like telecommunications. As one FCC staff member has observed,

Given the technology of the telecommunications industry, many markets will probably be characterized by the presence of one or more firms with a predominant market share. Under well-accepted precedent, this basic condition alone does not indicate that a market is performing poorly. This is why, in the context of telecommunications, the analysis must always move beyond [market concentration] and toward the evaluation of the elasticities of supply and demand and, in particular, the presence (or lack) of barriers to entry.<sup>74</sup>

More important than market concentration is the requirement that consumers have choices available to them. For this reason, when analyzing market power it is important to look at the productive capacity available from competitors. As recognized by the Commission in its AT&T Non-Dominant Order, the appropriate measure of size for network-based telecommunications markets is generally capacity.<sup>75</sup> For carrier access markets, capacity

---

<sup>73</sup> A more insidious problem is that shares are frequently calculated for things other than markets. For telecommunications services where a small number of customers are responsible for a large fraction of demand, a high average share can conceal low market shares in the economically relevant markets.

<sup>74</sup> L.J. Spiwak, "Reorienting Economic Analysis of Telecommunications Markets After the 1996 Act," *Antitrust*, Spring 1997 at 34.

<sup>75</sup> *In the Matter of Motion of AT&T Corp. to be Reclassified as a Non-Dominant Carrier*, 11 FCC Rcd 3271, (continued...)

measures must be tempered by addressability. That is, if rivals have capacity available that can "address" a significant number of customers and that can be brought on line at low additional cost, the ILEC cannot exercise market power, and therefore, regulatory constraints should adjust accordingly.

After an analysis of current competition, attention generally turns to conditions of entry into the market.<sup>76</sup> Absent barriers to entry, any elevation of price above the competitive level would attract entry, expand market supply and reduce the market price towards the competitive level. Entry barriers, therefore, are a necessary condition for market power. A thorough analysis of entry conditions must include evaluation of the extent of sunk costs of entry. In evaluating market power, sunk costs are key to measuring barriers to entry. If sunk costs are not important requirements of entry, competitors can enter and exit the industry at relatively low costs to take advantage of any profitable opportunities in the market. Therefore, to assess the conditions of entry in the relevant market, the Commission should analyze the extent of legal and regulatory barriers to entry and characterize the degree to which entry (or exit) would entail commitment of sunk costs for potential entrants. If entry has taken place at all, entry barriers could not have been insurmountable.

In implementing these guidelines, two additional considerations should be observed. First, the availability of interconnection agreements, UNEs at cost-based prices, and resale have reduced the level of sunk costs required to enter the local exchange and carrier access markets, and prospective regulatory policy must take into account this reduction in entry barriers. Second, when evaluating the state of potential and actual competition, it is important that measurement be made in a properly defined economic market. For local exchange and carrier access services, geographic markets are generally small, since particular customers cannot travel to obtain services. For practical purposes, market areas can be defined by common

---

(...continued)

(1995).

<sup>76</sup> Of course, if current competition is sufficient to rule out the exercise of market power, it is not necessary to consider barriers to entry.

social, economic and general business characteristics or by ILEC network geography or architecture. The speed and direction of competition will vary geographically, at least initially, and efficient competition will likely be sacrificed if this factor is ignored.

### **B. Triggering Regulatory Relief**

The preceding section reveals that while economic theory provides important and useful insights to assist the Commission, judgment on its part will be required. For this reason, clear and objective triggers that are easily measured and verified can reduce contention and allow regulators to expedite proceedings to provide additional pricing flexibility and reduce regulatory constraints. On the other hand, for some services, e.g., special access and dedicated transport, prices are already sufficiently constrained by market forces so that triggers would be unnecessary.

A well-crafted plan should link regulatory relief—such as volume and term discounts, contract tariffs and forbearance—to objective triggers that measure the availability and use of competitive alternatives to ILEC carrier access. Regulatory relief can be structured in different phases, in which, for example, certain types of triggers may correspond to different forms of regulatory relief. But in general, triggers can be thought of as market symptoms which, combined with the availability of UNEs, makes actual competition more viable and potential competition a greater check on the ability of the ILEC to raise prices above the competitive level. Triggers are a means for regulators to ease regulatory constraints in particular markets—in certain market areas or for certain services and customers—as the ILECs' residual market power is reduced to levels found in unregulated markets. In this sense, triggers work to ensure that once market conditions change, appropriate regulatory constraints immediately follow. Their use ensures that there is a timely process in place that responds to the rapidly-changing market conditions in carrier access and increases the likelihood that efficient regulatory decisions are implemented.

Examples of potential triggers include availability of unbundled network elements, transport and termination charges in place, provision of network elements and services, and the existence of number portability arrangements. These objective and easily verifiable triggers

provide useful information regarding the state of regulatory and legal entry barriers. They also contain information about the economic barriers to entry as well, because the availability of UNEs reduces concerns about sunk costs of entry. Additional possible triggers include answers to questions such as the following: Are competitors collocated in wire centers?; Are competitors deploying facilities and using UNEs in the wire centers?; How many competitors are present in some geographic area?; Do competitors have the ability to provide service to a substantial percentage of the market, using their own facilities or those of the ILEC?

In addition, since the purpose of the triggers is to permit ILECs to move between phases of regulatory reform in a manner that matches market conditions, we believe that movements between whatever phases are eventually chosen by the Commission need not be sequential. Meeting the trigger conditions for a particular phase should be sufficient to grant the associated regulatory relief. For example, market conditions for special access services in most geographic areas are such that immediate regulatory forbearance is warranted, and stepping through sequential phases of deregulation would be an inefficient, time-consuming path to ultimate regulatory forbearance.

The key to using objective triggers is that they be easily verifiable and used expeditiously to evaluate ILEC proposals for flexibility. A process that automatically grants ILECs certain regulatory relief when a specific trigger is reached greatly reduces contention, which allows the Commission to administratively expedite ILEC filings. It also prevents the proliferation of ILEC waiver requests, forbearance petitions etc. which could tie up Commission resources. The requirements necessary for regulatory flexibility would have been decided *ex ante*, and thus the Commission's main task would be to verify the fulfillment of the trigger. The importance of moving rapidly to determine the legitimacy of ILEC claims cannot be overstated. Market dynamics are changing the technology and structure of telecommunications at an extremely rapid pace. Having in place quantifiable triggers that correspond to predetermined flexibility reduces uncertainty of the participants and increases the likelihood that competition will not be distorted by unneeded asymmetric burdens.

## V. CONCLUSIONS

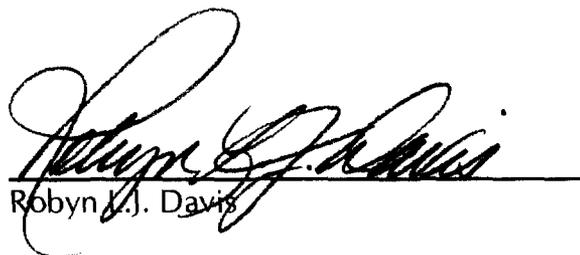
Since competitive market forces are vastly superior to administrative regulation, the Commission should immediately permit the market to constrain ILEC prices in special access and dedicated transport, where such forces are already strong. Doing so would lead to more efficient pricing, production, and investment. As the Commission embarks on the process of moving remaining carrier access markets to eventual forbearance, it should consider the significant costs to consumers and to society as a whole of not relying on market forces. In order to increase the likelihood that efficient competition develops, the Commission must pursue a policy that regulates ILECs and entrants as symmetrically as possible and that does not attempt to guarantee competitors' success in the marketplace. Though market pressures have influenced carrier access pricing since 1984, the recent removal of entry barriers in the carrier access market stemming from implementation of the Telecommunications Act makes regulatory relief imperative. In our experience, four economic principles are particularly important:

- Imperfect competition is generally far superior to imperfect regulation in controlling ILEC prices and service quality. The potential costs of permitting pricing flexibility for incumbent firms prematurely are small and are likely to be swamped by the benefits of competition under symmetric regulatory conditions.
- Delay is costly. The potential costs of permitting pricing flexibility for incumbent firms prematurely are swamped by the potential costs of inefficient entry from opening markets to competition under asymmetric regulation.
- Competition is important; competitors—incumbents and entrants alike—are not.
- Prices cannot be set solely by reference to cost studies performed in litigated proceedings. Prices should approximate their market levels under competitive conditions, in which both cost and demand factors play a role.

In using these abstract policies in a litigious world, regulators would be well-served by setting *ex ante* observable and measurable triggers that provide specific relief from regulatory obligations, as ILEC services move to different phases of regulatory relief and eventual forbearance.

**CERTIFICATE OF SERVICE**

I, Robyn L.J. Davis, do certify that on January 30, 1998 Comments of the United States Telephone Association were either hand-delivered, or deposited in the U.S. Mail, first-class, postage prepaid to the persons on the attached service list.

  
Robyn L.J. Davis

Mark Cooper  
Consumer Federation of America  
1424-16th Street, NW  
Suite 604  
Washington, DC 20036

Cathy Hoika  
National Retail Federation  
325-7th Street, NW  
Washington, DC 20004

Brian Moir  
Moir & Hardman  
2000 L Street, NW  
Suite 512  
Washington, DC 20036

ITS  
1231-20th Street, NW  
Washington, DC 20036