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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

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In the Matter of)
)
LCI Petition for) CC Docket No. 98-5
Expedited Declaratory)
Rulings)

AT&T Comments

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Pursuant to the Commission's Public Notice (DA-98-130, released January 26, 1998), AT&T Corp. ("AT&T") submits these comments on the petition of LCI International Telecom Corp. ("LCI") for expedited declaratory rulings relating to Bell Operating Company ("BOC") petitions for in-region interLATA authority pursuant to Section 271 of the Communications Act of 1934, as amended (the "Act"). LCI asks the Commission to declare that, if a BOC elects to restructure its operations into separate wholesale and retail operations that are subject to stringent nondiscrimination and other safeguards, the Commission will grant the BOC a "rebuttable presumption" that it complies with the competitive checklist and public interest requirements of Section 271, and that its retail subsidiary established pursuant to the restructure ("ServeCo") meets the separate subsidiary requirements of Section 272. LCI further proposes that, in these circumstances, ServeCo would not be deemed an incumbent LEC ("ILEC") for purposes of Section 251, and would be treated as a non-dominant carrier

to the same extent as unaffiliated competitive local exchange carriers ("CLECs").

Introduction and Summary

LCI's Petition comes at a pivotal time in the development of local competition. Despite the promise of competition that accompanied the adoption of the Telecommunications Act of 1996, CLECs have been unable to make any meaningful in-roads into the ILECs' monopoly markets. This is due largely to the fact that ILECs have refused to comply with the Act's requirements to provide CLECs nondiscriminatory access to their facilities and services at commercially reasonable rates.

As a result, consumers are frustrated that they have not yet been able to exercise the competitive choices for local services they were promised two years ago. Legislators are also frustrated by the slow development of competition and delays in the consumer benefits they expected would flow from the Act. New entrants are especially frustrated that efforts designed to pry open local markets and enable them to compete on equal footing with the incumbents are tied-up in courts across the country. Nevertheless, regulators -- and particularly this Commission -- must still find a way to provide CLECs with non-discriminatory access to elements and services that are the critical prerequisites for competitive local service markets.

The most important benefit of LCI's Petition is that it returns the focus of the debate back to where it belongs: how to break open the ILECs' local monopolies so that consumers may enjoy the benefits of competition. In particular, the petition focuses upon key obstacles that stand in the way of new entrants' attempts to compete with ILECs through the purchase of ILEC elements or services. And even though incomplete, its proposals also offer the beginning of a new discussion designed to remove those obstacles.

LCI's petition is borne of its own frustration in dealing with incumbent LECs, especially BOCs, that have not taken the required actions to open their local markets to competition. In particular, LCI (p. 2) explains that it faces three fundamental obstacles in its efforts to enter local services markets around the country: (1) inadequate access to ILEC operations support systems ("OSS"); (2) lack of availability of ILEC unbundled network elements, especially combinations of elements; and (3) lack of economically viable pricing for ILEC elements and services. LCI (id.) concludes that these obstacles are "not transitional," but rather "stem from an inherent conflict of interest between [a BOC's] dual role as both network

supplier and [retail] service provider.”¹ To reduce such conflicts, LCI proposes a structural mechanism by which it maintains that a BOC could foster the opening of its local markets, and thereafter could obtain “fast track” approval of a Section 271 application.

Specifically, LCI proposes that each BOC could elect to separate its operations into three entities, generically called “HoldCo,” “NetCo,” and “ServeCo.” The essence of LCI’s proposal is that HoldCo (the parent company) and NetCo (the network services provider) would remain fully owned by the BOC’s current shareholders and remain subject to all of the duties of an incumbent LEC under the Act. In contrast, ServeCo, a newly created retail service supplier, would have independent assets, management and employees, as well as “significant” public ownership. LCI contends that completion of such a restructure, combined with the nondiscrimination duties and other aspects of its proposal, would sufficiently reduce the common interests between HoldCo/NetCo, on the one hand, and ServeCo, on the other, to give local retail competition an opportunity to develop, and

¹ LCI also correctly notes that these conflicts are not limited to the pre-interLATA entry period. See Petition, n.3 (“even after a Section 271 petition is approved, under the current framework these same conflicts of interest will remain,” and, absent significant structural separation, would require “significant regulation to assure that the [BOCs] do not use their monopoly of the only ubiquitous wireline network to perpetuate their retail services monopoly”).

thus permit the Commission to apply a "rebuttable presumption" that the BOC has complied with Section 271.

AT&T shares LCI's frustration with the ILECs' refusal to comply with their statutory obligations to provide CLECs nondiscriminatory and commercially reasonable access to their networks and services for the purpose of providing competing local exchange and exchange access services. AT&T also agrees with LCI that the ILECs' actions have been driven by their mixed incentives, and that such conflicts have prevented -- and continue to prevent -- the emergence of effective local competition. Thus, AT&T applauds LCI's efforts to explore possible "out-of-the-box" solutions to the real-world competitive problems that CLECs face, and it urges the Commission to consider this and other innovative proposals that might further the fundamental goal of the Telecommunications Act of 1996: the development of local competition.

At the same time, as shown below, LCI's proposal permits continued affiliation between BOC wholesale and retail operations, and otherwise fails to eliminate the BOCs' incentives and opportunities to impede competition. Thus, it cannot create reliable and effective incentives for the BOCs fully to cooperate in opening their markets to all forms of competition. Accordingly, AT&T believes that the Commission should encourage the BOCs and other ILECs to comply with the LCI framework and other safeguards specified

below and that it could consider with favor the existence of such arrangements in reviewing Section 271 applications. The Commission could also rely upon such arrangements to facilitate and speed its review of many of the elements of Section 271 applications. However, the Commission should not define a "rebuttable presumption" or factual "safe harbor" for Section 271 compliance, because LCI's proposal cannot -- and, at bottom, does not purport to -- substitute for stringent application of all of the requirements of Sections 251 and 271 of the Act, which is necessary to ensure that local markets have been fully opened to competition.

Argument

LCI's proposal derives from the fact that BOCs "are not voluntarily acting like vendors in a competitive market."² LCI (p. 9) correctly states that "if the [BOCs'] primary function were to provide network elements, and if they faced competition in that role, the [BOCs] could be expected to go out of their way to meet carrier-customer requests." However, that has certainly not been the CLECs' experience. Instead of acting like willing sellers, the BOCs (and other ILECs) have interpreted their statutory duties narrowly, and proposed or established processes and systems that are difficult, if not impossible, to use. The result is that

² Petition, pp. 8-9.

new entrants have been prevented from providing viable competition in the BOCs' lucrative local exchange and exchange access markets.

LCI proposes to break this logjam by holding out a paradigm that is akin to, but necessarily less effective than, the complete separation required by the Bell System divestiture, which was the necessary precondition to the development of interLATA competition.³ Specifically, LCI proposes that a BOC place its retail local exchange operations in a new subsidiary, ServeCo, that would become the full-service telecommunications provider that competes with CLECs in the retail market, and that would be separate from BOC wholesale operations.⁴

Although LCI proposes some well-considered separation requirements,⁵ those requirements do not sever the

³ The Bell System divestiture mandated the complete separation of competitive long distance operations from the essential access facilities upon which all long distance carriers rely.

⁴ Id., p. 14. In contrast, NetCo, the wholesale entity, "would manage the local network and sell it on a 'carrier's carrier' basis to all retailers, including ServeCo, interfacing with every retail service provider on the same basis using the same personnel and systems." Id.

⁵ LCI (pp. 16, 29-31) identifies "seven minimum criteria for adequate separation" including: (i) NetCo and ServeCo would share no facilities, functions, services, employees, and trade names; (ii) NetCo would be barred, except on a grandfathered and transitional basis, from providing retail services; (iii) ServeCo would deal with NetCo only on the same basis as unaffiliated CLECs; (iv) there would be substantial public ownership in ServeCo, creating

affiliation between the BOC's wholesale and retail operations. To the contrary, HoldCo would retain ownership and control of both NetCo (through its 100% ownership of that entity), and ServeCo (through its majority ownership of that entity). As a result, the BOC will retain the incentives and the ability improperly to advantage its retail operations. This discrimination can occur both in the initial establishment of ServeCo, and in transactions between ServeCo and NetCo (and NetCo's other affiliates).⁶ Although these incentives and opportunities would be mitigated by the separation LCI proposes,⁷ it cannot -- and does not purport to -- eliminate such risks. To the contrary, HoldCo still would have strong incentives to use its control of both NetCo and ServeCo to maximize HoldCo's profits. Thus, HoldCo (or NetCo at its direction) could be

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independent fiduciary duties to minority shareholders; (v) independent directors would serve on ServeCo's board; (vi) compensation for ServeCo management would be based solely on ServeCo's performance; and (vii) ServeCo would be barred from providing interLATA services to NetCo's customers, at least until NetCo's OSS that provision and support network elements are capable of processing the same volumes of customer transfers, at the same intervals, as the PIC-change systems used to change long distance carriers.

⁶ See, e.g., Petition, pp. 10, 34.

⁷ For example, a BOC complying with LCI's proposal might have to share some of the benefits of discrimination with the public shareholders of ServeCo, and the separation and nondiscrimination safeguards will improve prospects for detecting and remedying misconduct.

expected to discriminate in ServeCo's favor wherever that would serve HoldCo's interests. Similarly, HoldCo retains strong incentives to blunt any potential efforts by ServeCo to obtain from NetCo (or any other HoldCo affiliate) any service, element, pricing structure or rate, or anything else fundamentally at odds with HoldCo's interests in preserving its local exchange monopoly.⁸

Moreover, as LCI acknowledges (p. 34), the proposed restructure cannot lessen NetCo's incentives to deny CLECs, including ServeCo, access to network elements and combinations of network elements at cost-based rates. Thus, even though some of the risks to retail competition of non-cost-based pricing of network elements might be mitigated by a BOC's implementation of the LCI proposal, fundamental risks to efficient competition would necessarily persist.⁹

⁸ As a facilities-based monopolist, HoldCo would be able design its processes, procedures and pricing to maximize its combined returns in numerous and subtle ways. One simple example is the fact that ServeCo would not be likely to press NetCo for cost-based pricing of network elements, because that would limit NetCo's ability to extract monopoly rents, and allow ServeCo's competitors equally to enjoy the benefits of those rates. Nor would independent management compensation incentives necessarily prevent this type of abuse. HoldCo, through its control of ServeCo, could establish compensation levels and career opportunities to reward "cooperative" ServeCo managers, and discipline "noncooperative" managers, regardless of ServeCo's actual performance.

⁹ See, e.g., Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, CC Docket No. 96-98, released August 8, 1996, ¶¶ 620, 679.

Moreover, NetCo would also retain incentives to undermine prospects for facilities-based competition in other ways, for example, through the establishment of discriminatory, unnecessarily costly, and cumbersome interconnection requirements.

This is not to say that LCI's proposal does not offer a framework that would enhance prospects for local exchange competition. Isolation of the BOC's wholesale operations in a wholesale entity that operates in an identical fashion with all other providers could, as LCI explains (p. 32), foster parity in the provision of access to OSS. It could also mitigate any burdens associated with ongoing regulatory oversight of OSS performance.¹⁰ The separations requirements proposed by LCI also include indicia of independence that could result in more independent operation of ServeCo than would occur without those safeguards. These commendable and wholly appropriate arrangements could -- and should -- be enhanced by applying parallel public ownership and independent management compensation requirements to NetCo, and by vesting control of ServeCo in its independent directors, rather than persons controlled by HoldCo.¹¹

¹⁰ These benefits are not assured, however, because ServeCo might not seek access to the same OSS that unaffiliated CLECs want to use (e.g., for UNE and facilities-based competition).

¹¹ The Commission might also wish to consider whether balloting and allocation should be implemented immediately

As LCI amply demonstrates, its proposal would foster the growth of retail competition, reduce (but not eliminate) opportunities for misconduct, and enhance prospects for detecting discriminatory activity. Accordingly, the Commission should encourage the BOCs and other ILECs to adopt such arrangements. It should also seriously and favorably consider the existence of such arrangements in its review of Section 271 applications, and could rely upon their existence to facilitate and speed the review of many elements of a Section 271 application.

Nevertheless, as shown above, LCI's proposals do not, and cannot, provide BOCs sufficiently reliable incentives to cooperate in fully opening their markets to all forms of competitive entry. Therefore, the Commission should not define any sort of "rebuttable presumption" or factual "safe harbor" for Section 271 compliance based on this framework.

Rigorous application of the competitive checklist and public interest tests of Section 271 is essential to assure that a BOC has irreversibly opened its local markets to effective competition from carriers seeking to provide service using all of the means of competitive entry contemplated by the Act, i.e., the resale of ILEC retail

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upon restructure, or at some specified point shortly thereafter.

services, the use of unbundled network elements, and the use of competing facilities.¹² No single set of circumstances can provide an adequate substitute for such review. Thus, the essential statutory protections should not be presumed away, even on a "rebuttable" basis, because there will be no hope for effective local competition if BOCs do not provide CLECs with what the Act prescribes: nondiscriminatory, commercially reasonable, and cost-based interconnection with, and unbundled access to, the BOCs' local exchange networks.

Conclusion

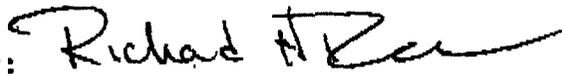
The Commission should encourage the BOCs and other ILECs to comply with the LCI framework and other safeguards specified above. It should consider with favor the

¹² The Section 271 requirements also provide the BOCs unique incentive to open their markets. As Ohio Commissioner Lynn Butler, who also serves as President of the National Association of Regulatory Utility Commissioners, recently testified before the Antitrust Subcommittee of the Senate Judiciary Committee: "For the RBOCs, entry into the long distance markets provides the proverbial 'carrot' for opening its local markets expeditiously. In Ohio, we have seen firsthand just how critical the long distance entry 'carrot' can be in gaining an incumbent's cooperation in opening local markets to competition. It is no accident that almost all of Ohio's forty plus new competitors are competing exclusively in Ameritech's territory. Ohio competitors report that it is much more difficult to work with incumbents who do not have the long distance incentive to open their local markets." Prepared Remarks before the United States Senate, Committee on the Judiciary, Subcommittee on Antitrust, Business Rights and Competition of the Honorable Jolynn Barry Butler, Commissioner Ohio Public Utilities Commission, dated March 4, 1998, p. 4.

existence of such arrangements in its review of Section 271 applications, and could rely upon such arrangements to facilitate and speed its review of many of the elements of Section 271 applications. At the same time, because these arrangements do not -- and cannot-- provide sufficiently reliable incentives for the BOCs to cooperate in fully opening their markets to all forms of competitive entry, the Commission should not define a "rebuttable presumption" for Section 271 compliance.

Respectfully submitted,

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