KELLOGG, HUBER, HANSEN, TODD & EVANS, P.L.L.C.
1301 K STREET, N.W
SUITE 1000 WEST
WASHINGTON, D.C. 20005-3317

(202) 326-7900
FACSIMILE:
(202) 326-7999

MICHAEL K. KELLOGG
PETER W. HUBER
MARK C. HANSEN
K. CHRIS TODD
MARK L. EVANS
AUSTIN C. SCHLICK
STEVEN F. BENZ
NEIL M. GORSUCH
GEOFFREY M. KLINEBERG

I COMMERCE SQUARE
2005 MARKET STREET
SUITE 2840
PHILADELPHIA, PA 19103
(215) 864-7270
FACSIMILE: (215) 864-7280

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March 23, 1998

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

Via Hand Delivery

Magalie Roman Salas
Secretary
Federal Communications Commission
1919 M Street, N.W.
Washington, D.C. 20554

Re: *In re LCI Petition for Declaratory Ruling Concerning Bell Operating Company Entry into In-Region Long Distance Markets*
CC Docket No. 98-5

Dear Ms. Salas:

Enclosed for filing is an original and twelve copies of the Comments of BellSouth Corporation on LCI's Petition for Declaratory Ruling.

Please date stamp the extra copy and return it to the individual delivering this package. Thank you for your assistance in this matter.

Sincerely,

Michael K. Kellogg

Michael K. Kellogg Bmm

Enclosures

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MAR 23 1998

FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of LCI Petition for Declaratory Ruling Concerning Bell Operating Company Entry into In-Region Long Distance Markets	CC Docket No. 98-5

To: The Commission

COMMENTS OF BELLSOUTH CORPORATION ON
LCI'S PETITION FOR DECLARATORY RULING

CHARLES R. MORGAN
WILLIAM B. BARFIELD
JIM O. LLEWELLYN
M. ROBERT SUTHERLAND
1155 Peachtree Street, N.E.
Suite 1700
Atlanta, GA 30309-3610
(404) 249-4839

DAVID G. FROLIO
1133 21st Street, N.W.
Washington, DC 20036
(202) 463-4182

MICHAEL K. KELLOGG
AUSTIN C. SCHLICK
Kellogg, Huber, Hansen,
Todd & Evans, P.L.L.C.
1301 K Street, N.W.
Suite 1000 West
Washington, D.C. 20005
(202) 326-7900

Counsel for BellSouth Corporation

March 23, 1998

EXECUTIVE SUMMARY

BellSouth joins LCI in urging the Commission to apply section 271 in a way that promotes competition in local and interLATA services. To that end, the Commission should grant Bell company section 271 applications as soon as local markets are open in accordance with Congress's checklist.

Although BellSouth thus agrees with (and has long encouraged) the purported goal of LCI's petition — speeding local and long distance competition — LCI's specific proposal to divide the Bell companies' local telephone operations into wholesale and retail companies and then to strip the retail operations of their existing customers cannot be taken seriously. In section 271 Congress set forth the local-market criteria for interLATA entry in great detail and instructed the Commission to apply those criteria without additional tests or burdens. The Commission accordingly is powerless to require Bell companies to break apart their local operations and forfeit customer relationships as the price of timely interLATA relief.

Precisely because the Commission may not ignore Congress's criteria, moreover, Bell companies will always have to fulfill the same statutory requirements for interLATA relief regardless of whether they choose to divide their local operations as LCI suggests. The Commission is just as powerless to reduce the checklist requirements as to increase them. LCI's true intention therefore is <u>not</u> to ease Bell company interLATA entry, but to erect a presumption <u>against</u> interLATA relief for those Bell companies that prefer not to abandon their existing retail customer relationships or divide their local businesses. Indeed, LCI argues that where a Bell company does not erect an artificial corporate wall between "wholesale" and "retail" operations, the Commission "would need . . . to test . . . much more rigorously" the facts presented by that company's section 271 application. LCI at 37. Rather than creating a genuine "Fast Track," LCI's proposal would further establish the statutory procedures in section 271 as the "Slow Track."

LCI's proposal would hinder competition and hurt consumers regardless of whether a particular Bell company elected to comply with it. If a Bell company were to reject LCI's scheme, a new obstacle would separate consumers from the benefits of Bell company long distance competition. And, in the unlikely event a Bell company elected to implement LCI's plan, customers would still lose. A central goal of the 1996 Act and Commission policy is to allow consumers — especially residential consumers — the benefits of integration across telephony markets. LCI's proposal, in contrast, would rob consumers of the benefits of <u>existing</u> efficiencies in the local telephone business and weaken the Bell companies as competitors in long distance markets. LCI's proposal thus would achieve the opposite of its supposed purpose: it would needlessly handicap the Bell companies and harm consumers.

Finally, LCI's proposal would do nothing to address the real reasons why local residential competition is developing slowly, such as the halting pace of universal service reform and rate rebalancing and the desire of competitors such as LCI to delay Bell company interLATA entry. Those are the issues regulators should be addressing, not schemes such as LCI's plan for further handicapping the Bell companies.

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Before the
FEDERAL COMMUNICATIONS COMMISSION
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To: The Commission

COMMENTS OF BELLSOUTH CORPORATION ON LCI'S PETITION FOR DECLARATORY RULING

The Commission should reject LCI's unlawful and unwise proposal. The scheme would flout Congress's intent, delay Bell company long distance entry, and deprive consumers — especially residential callers — of the benefits of full-blown competition and integrative efficiency. That LCI's proposal would accomplish the opposite of its purported intention should highlight the danger of having the Bell companies' self-interested competitors dictate how the Bell companies should be regulated. Rather than wasting scarce resources pondering CLECs' charlatanry, the Commission should implement Congress's plan for full telecommunications competition.

I. LCI'S PROPOSAL WOULD EXTEND THE CHECKLIST UNLAWFULLY

Congress required a Bell company seeking in-region, interLATA relief to demonstrate that its local telephone markets are open to competitors under the Act's competitive checklist. The fourteen-point "checklist" was Congress's test of "what . . . competition would encompass," 141 Cong. Rec. S7972, S8009 (daily ed. June 8, 1995) (statement of Sen. Hollings), and

Congress forbade the Commission from second-guessing its judgment or modifying its checklist "by rule or otherwise." 47 U.S.C. § 271(d)(4).

In the face of these express limitations on Commission authority, LCI nonetheless proposes an additional local market test, under which Bell companies would first divide their wholesale and retail operations between two structurally separate corporate entities, and then serve up to competitors their local customer base through balloting. LCI at 16-22. Despite Congress's exclusive criteria for opening local markets, LCI argues that its proposed additional requirements would be a permissible exercise of the Commission's supposed "plenary authority to adopt structural approaches to regulatory problems." Id. at 39.

LCI asserts that the Commission's power to go beyond Congress's local market requirements "derives from the Act itself, specifically, from the FCC's statutory power to 'make such rules and regulations, and issue such orders, not inconsistent with this Act, as may be necessary in the execution of its functions.'" Id. at 39-40 (quoting 47 U.S.C. §§ 154(i), 201(b)) (emphasis added). Yet LCI's proposal to substitute or add new requirements to the checklist is "inconsistent" with Congress's express instructions, most particularly section 271(c)(4). Congress decided for itself what is necessary and sufficient to open local markets and it enshrined its conclusions in section 271(c). If LCI believes that Congress should have enacted a different set of local market requirements, or else heaped additional requirements on top of its already stringent checklist, its complaint must be taken to Congress.

LCI's proposal would violate not only the substance of Congress's local market test, but also Congress's division of authority between federal and state regulators. Under section 2(b) of the Communications Act, the structure of a Bell company's local telephone operations —

whether wholesale or retail — is a matter for state regulators that remains outside the Commission's jurisdiction absent an express grant of authority from Congress. 47 U.S.C. § 152(b); see Louisiana Pub. Serv. Comm'n v. FCC, 47 U.S. 355, 370 (1986). While Congress may have granted the Commission authority to supervise the separation of local operations from long distance operations pursuant to section 272, it provided the Commission with no authority to divide a Bell company's local business. Iowa Utils. Bd. v. FCC, 120 F.3d 753, 805 (8th Cir. 1997) ("section 2(b) . . . prevents the FCC from issuing regulations involving telecommunications matters that are fundamentally intrastate in character"), cert. granted sub nom. AT&T Corp. v. Iowa Utils. Bd., No. 97-826 (granted Jan. 26, 1998). Nor does the Commission's supervisory authority over Bell company interLATA entry under section 271 alter the traditional state/federal division of authority. See Order on Motions for Enforcement of the Mandate, Iowa Utils. Bd. v. FCC, No. 96-3321, slip op. at 11 (8th Cir. Jan. 22, 1998). Where a Bell company's local operations are beyond the Commission's jurisdiction under other provisions of the Act, the Commission may not regulate them by the circuitous route of withholding the "carrot" of long distance entry under section 271. Indeed, the Eighth Circuit expressly has forbidden the Commission to "accomplish indirectly" in section 271 proceedings "that which . . . it may not do directly." Id.

LCI wholly ignores these limitations on Commission authority. Indeed, LCI not only urges the Commission to regulate the corporate structure of intrastate activities generally — which would violate the Eighth Circuit's jurisdictional holding in Iowa Utilities Board — but suggests specific federal requirements that directly flout other portions of the Eighth Circuit's decision.[1]

In sum, even if the Commission may have had authority to impose structural separation in the other contexts that LCI cites — regarding enhanced services, customer premises equipment, CMRS services, and the interstate long distance services of independent telcos and foreign entities, see LCI at 38-39 — it has no such authority to regulate a Bell company's core intrastate operations in a manner that contravenes the express terms of section 271.[2]

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1. LCI proposes a reinstatement of two former Commission rules that the Court of Appeals held to violate the 1996 Act: the "pick-and-choose" rule, LCI at 21, and the rule requiring Bell companies to deliver combinations of network elements, LCI at 19. LCI concedes that the Commission would be powerless to impose these requirements on all incumbent LECs, but proposes applying them to Bell companies in exchange for more rapid interLATA entry. LCI at 21 n. 27. This strategy would clearly violate the Eighth Circuit's admonition against "indirect" violations of the 1996 Act in section 271 proceedings. Order on Motions for Enforcement of the Mandate, Iowa Utils. Bd., slip op. at 11.

2. The Commission's regulation of customer premises equipment ("CPE") has been held to fall within the FCC's jurisdiction because of an interstate component. See Computer and Communications Industry Ass'n v. FCC, 693 F.2d 198, 214 (D.C. Cir. 1982) ("exertion of ancillary jurisdiction over carrier-provided CPE was proper under section 2(a) of the Act"), cert. denied, 461 U.S. 938 (1983). CMRS services also have been regulated by the Commission pursuant to 47 U.S.C. § 301 (FCC jurisdiction over radio licenses). But the Commission's regulation of enhanced services has raised difficult jurisdictional issues that LCI ignores. See California v. FCC, 905 F.2d 1217, 1240 (9th Cir. 1990) ("As long as enhanced services are provided by communications carriers over the intrastate telephone network, the broad 'in connection with' language of § 2(b)(1) places them squarely within the regulatory domain of the states.").

II. LCI'S PROPOSAL WOULD NOT RELIEVE BELL COMPANIES OF ANY EXISTING OBLIGATION

Nor can LCI's proposal be salvaged on the ground that it does not "affirmatively mandate[] conduct," but rather simply "clear[s] a path without ordering participation" by Bell companies who are free to choose a "slow[]" and "complex" section 271 process instead. LCI at 40. Whether or not a Bell company is induced to divide its local operations and jeopardize its local customer relationships, the Bell company still needs to satisfy Congress's mandatory criteria in order to receive interLATA entry under the Act. Indeed, under the plain language of the Act, "[t]he Commission shall not approve" a Bell company's application for interLATA relief "unless it finds that" each of Congress's specified criteria are met. 47 U.S.C. § 271(d)(3).

LCI's "Fast Track" label is false advertising. LCI's true motivation is not to accelerate the interLATA entry of Bell companies that satisfy LCI's test, as these Bell companies still would have to fulfill all the same congressional criteria that apply today before receiving interLATA relief. Rather, LCI's purpose is to delay the entry of Bell companies that decide not to tear apart their local operations. LCI reveals its true motive when it urges the Commission "to test . . . much more rigorously" any section 271 application submitted by a Bell company that has not erected an artificial corporate distinction between "wholesale" and "retail" operations. LCI at 37.

LCI's plan is merely the latest in a long series of interexchange carrier and CLEC efforts to delay Bell company interLATA entry. Indeed, while LCI argues that separation of wholesale and retail operations should be a precondition for timely interLATA relief under section 271, another long distance carrier/CLEC has urged the Commission to deny interLATA relief to

BellSouth because BellSouth has taken steps in the same direction LCI now urges.[3] The only consistency in the CLECs' positions is their desperation to block long distance competition from the Bell companies.

III. LCI'S PROPOSAL WOULD HARM COMPETITION AND CONSUMERS

Given that the task Congress demanded of the Commission — applying the statutory criteria of section 271 to complicated facts — already strains the Commission's resources,[4] the Commission should focus itself upon fulfilling that responsibility, not discussing wholly new regulatory regimes that have no basis in the statute. Time devoted to fleshing out LCI's scheme would be time lost in the Commission's ongoing effort to provide a clear roadmap for Bell companies in their quest to satisfy Congress's specific criteria.[5] LCI's proposals would require a lengthy rulemaking, parallel state proceedings, and, eventually, lengthy corporate implementation

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3. See Opposition of WorldCom, Application of BellSouth Corporation, et al. Pursuant to Section 271 of the Communications Act of 1934, as Amended, to Provide In-Region, InterLATA Services in South Carolina, CC Docket No. 97-208, at 26 (filed Oct. 20, 1997) (urging the Commission to deny BellSouth's application because BellSouth has established a separate retail CLEC, BellSouth Enterprises).

4. See Memorandum Opinion and Order, Application of BellSouth Corporation , et al. Pursuant to Section 271 of the Communications Act of 1934, as Amended, to Provide In-Region, InterLATA Services in South Carolina, CC Docket No. 97-208, ¶ 45 (rel. Dec. 24, 1997) ("South Carolina Order") ("During the 90-day review period, the Commission has neither the time nor the resources to evaluate a record that is constantly evolving.") (citing Memorandum Opinion and Order, Application of Ameritech Michigan Pursuant to Section 271 of the Communications Act of 1934, as Amended, to Provide In-Region, InterLATA Services in Michigan, 12 FCC Rcd 20543, 20573, ¶ 54 (1997) ("Michigan Order")); see also Statement of Chairman Hundt Regarding Ameritech's Filing to Provide In-Region Long Distance Services in Michigan (rel. Jan. 2, 1997) (noting that the volume of applications that likely will be received and the 90-day statutory deadline will "press [the Commission's] resources very hard").

5. See Separate Statement of Commissioner Michael K. Powell at 1 (attached to South Carolina Order) ("both BOCs and entrants need as much direction as we can possibly provide").

— hardly the "Fast Track" LCI promises. See LCI at 27. Such delays would be worse than pointless, moreover, because LCI's proposal, when finally implemented, would deprive consumers and competitors of significant economic efficiencies without spurring local competition.

Both the Commission and Congress have recognized the efficiencies to be gained from having a single competitor operate across multiple markets. Prior to passage of the 1996 Act, legislators observed that "by removing barriers between distinct telecommunications industries and allowing everyone to compete in each other's business," the Act would allow consumers to benefit from "low cost integrated service with the convenience of having only one vendor and one bill to deal with." 142 Cong. Rec. S687, S713-14 (daily ed. Feb. 1, 1996) (statement of Sen. Harkin). In order to allow such efficiencies — in both operations and marketing — Congress enacted a "a pro-competitive, de-regulatory national policy framework." S. Conf. Rep. No. 104-230, at 1 (1996) ("Conference Report"). For instance, in section 271(g) Congress directly authorized Bell companies to market jointly local and long distance service. Likewise, the Commission has noted that in-region interLATA entry by the Bell companies will be especially beneficial in long distance markets because these companies already have a local customer base to whom they can offer bundled local and long distance services.[6]

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6. See Michigan Order, 12 FCC Rcd 20741-42, ¶ 381 ("BOC entry into the long distance market will further Congress's objectives of promoting competition and deregulation of telecommunication markets"); id. ¶ 16 (reiterating Commission's "concern[s] . . . that not all segments of [long distance] market appear to be subject to vigorous competition," and "about the relative lack of competition among carriers to serve low volume long distance customers"); South Carolina Order ¶ 26 ("We share the South Carolina Commission's . . . desire to make more choices available to its citizens, including the ability to purchase bundled local and long distance services.").

Yet, at a time when Congress and the Commission are moving telecommunications markets toward competition, beneficial integration, and deregulation, LCI proposes a step in the opposite direction. LCI would — for the Bell companies' purposes — divide an historically integrated local telephone market into separate wholesale and retail operations, depriving consumers of existing efficiencies. See LCI at 17-22. LCI's plan for full-blown structural separation, which would require Bell companies to use new brand names, transform their retail operations into independent CLECs, and accept balloting of their existing customers, is an especially onerous variant on a general approach that the Commission has recognized as inefficient in other contexts.[7] Although Bell companies would be permitted to bundle local and long distance services under LCI's proposal, LCI at 25, they would first have to forfeit (through balloting and default assignments) established local customer relationships that Congress recognized as a key to infusing long distance markets with sorely lacking competition.[8]

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7. See Amendment of the Comm'n's Rules to Establish New Personal Communications Servs., 8 FCC Rcd 7700, 7747-48, 7751-52 (1993) (noting "significant economies of scope between wireline and PCS networks" and deciding that structural separation "would jeopardize, if not eliminate" these benefits and disserve the public interest); Amendment of Sections 64.702 of the Commission's Rules and Regulations (Third Computer Inquiry), 104 F.C.C.2d 958, 964 (1986) (separate affiliate restrictions "impose significant costs on the public in decreased efficiency and innovation that substantially outweigh their benefits), aff'd in relevant part sub nom. California v. FCC, 906 F.2d 1217, 1231 (9th Cir. 1990).

8. See 141 Cong. Rec. S7881, S7889 (daily ed. June 7, 1995) (statement of Sen. Pressler) (long distance market "oligopolistic"); 141 Cong. Rec. S7906 (daily ed. June 7, 1995) (statement of Sen. Lott) (long distance industry displays "at best, limited competition"); 142 Cong. Rec. S713 (daily ed. Feb. 1, 1996) (statement of Sen. Breaux) ("removing all court ordered barriers to competition — including the MFJ interLATA restriction — will benefit consumers by lowering prices and accelerating innovation"); 141 Cong. Rec. S7903 (daily ed. June 7, 1995) (statement of Sen. Burns) (noting that a "full 86 percent of . . . small business owners want one-stop shopping for telecommunications services" and that "[t]wo-thirds of them want to be able to choose one provider that can give them both local and long-distance telephone service").

While LCI and other competitors might hope to benefit from a proposal that robs the Bell companies of existing customer relationships and productive efficiencies, competition and consumers would suffer. The courts recognize that vertical integration in competitive markets offers significant benefits for consumers.[9] There can be no justification — let alone a "compelling" one[10] — for undermining Congress's goal of eliminating regulations that artificially divide telecommunications markets.

To the extent that some division of wholesale and retail operations might be efficient, the Bell companies will move in that direction without any need for regulatory involvement. Moreover, if state regulators were to favor some sort of separation of wholesale and retail functions for reasons other than efficiency, there is nothing to prevent them from working with individual Bell companies toward that end. (State-level negotiations, however, surely would not produce the arbitrary, financially costly provisions proposed by LCI, such as requiring Bell company shareholders to relinquish 40 percent of a newly created retail company to public owners. See LCI at 30.) That LCI's purported goal could be accomplished more quickly on an individualized, truly voluntary, and much lest costly, basis is simply one more reason to reject the rigid, uniform divide that LCI seeks to impose on all Bell companies in every state.

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9. See SBC Communications, Inc. v. FCC, 56 F.3d 1484, 1497 (D.C. Cir. 1995) (affirming the FCC's McCaw decision and noting the procompetitive benefits); see also Tenneco Gas v. FERC, 969 F.2d 1187, 1197 (D.C. Cir. 1992) ("Whenever vertical integration produces new efficiencies, some of the cost savings . . . [will] be translated into a price reduction and . . . [will] save productive resources.") (quoting 3 P. Areeda & D. Turner, Antitrust Law ¶ 725(d), at 201 (1978)).

10. Applications of Craig O. McCaw, 9 FCC Rcd 5836, 5880 (1994), aff'd sub nom. SBC Communications Inc. v. FCC 56 F.3d 1484 (D.C. Cir. 1995).

At the same time that LCI's proposal would affirmatively cause harm, it would fail to solve the core problem that LCI identifies. Competitors have not competed vigorously to serve residential customers, LCI at 2, but this has nothing to do with the structure of Bell company local operations. For instance, a CLEC is able to obtain essentially the same services and facilities from BellSouth, using the same or similar processes, whether it pursues business or residential customers. That CLECs have been able to compete effectively for business customers in BellSouth's region thus proves that BellSouth's corporate organization is unrelated to the pace of local competition.

Delays in residential competition have occurred not because of any action on the part of the Bell companies,[11] but rather because state regulators continue to set residential rates out of line with economic costs[12] and because potential local competitors (most particularly long distance carriers such as LCI) hope to delay Bell company interLATA entry under "Track A."[13]

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11. See, e.g., Order Addressing Statement and Compliance with Section 271 of the Telecommunications Act of 1996, Entry of BellSouth Telecommunications, Inc., into InterLATA Toll Market, Docket No. 97-101-C, Order No. 97-640, at 20, 66-67 (SCPSC July 31, 1997) ("South Carolina Compliance Order") (finding that failure of potential local competitors to move more quickly to launch facilities-based local service in South Carolina — particularly for residential customers — was due solely to their own business decisions).

12. See, e.g., Order, BellSouth Telecommunication, Inc. Application to Restructure Rates, No. 97-074, at 2 (Ky. PSC Sept. 19, 1997) ("the Commission is unable to decide whether the proposed residential rate increases are just and reasonable at this time"); see generally Report and Order, Federal-State Joint Board on Universal Service, 12 FCC Rcd 8776, 8787-88, ¶¶ 18-19 (1997) ("retain[ing]" implicit subsidies, which will be adjusted "[o]ver time . . . to respond to competitive pressures").

13. See Memorandum Opinion and Order, Application by SBC Communications Inc., Pursuant to Section 271 of the Communications Act of 1934, as Amended, to Provide In-Region, InterLATA Services in Oklahoma, 12 FCC Rcd 8685, 8718, ¶ 56 (1997), appeal pending sub nom. SBC Communications Inc. v. FCC, No. 97-1425 (D.C. Cir. argued Jan. 9, 1998) (noting potential

LCI's proposal would do nothing to alter the prevailing incentives of local competitors to cherry-pick profitable business customers while ignoring low-volume residential callers. Secure in the knowledge that Bell companies would have to jeopardize their local customer relationships through balloting and confusing name changes under LCI's plan, LCI at 22, local competitors would continue to focus their energies on more profitable business customers, perhaps hoping to pick up residential subscribers through balloting without doing much to win their business.

While customer confusion might benefit LCI and other new CLECs, it would by no means benefit consumers themselves. Under LCI's plan customers would be forced to change carriers, choosing between "ServeCo" and other CLECs. Customers thus would be deprived of an option that they value greatly today: the ability to stay with the local telephone company that has served them well for years.[14]

Finally, at the same time that LCI's plan would fail to spur new entrants to compete for residential customers, it would strip incumbent carriers of their incentives to invest in new product development and network upgrades to retain their existing customers. Absent LCI's plan, Bell companies will do everything they can to satisfy their residential customers in the hope of retaining those customers and soon winning their long distance business. Under LCI's plan,

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competitors' "incentive to 'game' the section 271 process"); South Carolina Compliance Order at 66 ("[t]he entities with the financial and marketing resources to provide effective [local] competition are the same [interexchange carriers] that have a direct financial interest in delaying [BellSouth's] competing in their long distance market").

[14] Better than three out of four customers rated BellSouth as "very good" in the categories of customer service and service reliability/product quality. Affidavit of Richard Schmalensee ¶ 32, Application by BellSouth Corporation et al. Pursuant to Section 271 of the Communications Act of 1934 as amended, To Provide In-Region, InterLATA Services in South Carolina, CC Docket No. 97-208 (FCC filed Sept. 30, 1997).

however, existing customers would be placed initially with a wholesale entity that could not offer any new services, LCI at 19, could not "engag[e] in any retail marketing, even to its embedded base of local exchange customers," id., and could not retain its existing customers (let alone win their long distance business) under LCI's balloting scheme, id. at 22. Millions of local telephone subscribers would be served by a lame duck carrier. Denying carriers the incentive and ability to provide innovative, high-quality service is no way to promote local competition.

CONCLUSION

LCI's proposal to break apart Bell companies' local retail and wholesale operations is both unlawful and unwise. The Commission should deny LCI's petition.

Respectfully submitted,

Michael K. Kellogg BMM

CHARLES R. MORGAN
WILLIAM B. BARFIELD
JIM O. LLEWELLYN
M. ROBERT SUTHERLAND
1155 Peachtree Street, N.E.
Suite 1700
Atlanta, GA 30309-3610
(404) 249-4839

MICHAEL K. KELLOGG
AUSTIN C. SCHLICK
Kellogg, Huber, Hansen,
Todd & Evans, P.L.L.C.
1301 K Street, N.W.
Suite 1000 West
Washington, D.C. 20005
(202) 326-7900

DAVID G. FROLIO
1133 21st Street, N.W.
Washington, DC 20036
(202) 463-4182

Counsel for BellSouth Corporation

March 23, 1998

CERTIFICATE OF SERVICE

I, Bernadette Murphy hereby certify that on this 23rd day of March, 1998, copies of the foregoing "Comments of BellSouth Corporation on LCI's Petition for Declaratory Ruling" were served on the following by hand (in the case of persons designated with an asterisk) or First Class mail:

William E. Kennard*
Chairman
Federal Communications Commission
1919 M Street, N.W.
Room 814
Washington, D.C. 20554

Susan Ness*
Commissioner
Federal Communications Commission
1919 M Street, N.W.
Room 832
Washington, D.C. 20554

Harold Furchtgott-Roth*
Commissioner
Federal Communications Commission
1919 M Street, N.W.
Room 802
Washington, D.C. 20554

Michael K. Powell*
Commissioner
Federal Communications Commission
1919 M Street, N.W.
Room 844
Washington, D.C. 20554

Gloria Tristani*
Federal Communications Commission
1919 M Street, N.W.
Room 826
Washington, D.C. 20554

Janice M. Myles*
Common Carrier Bureau
Federal Communications Commission
1919 M Street, N.W.
Room 544
Washington, D.C. 20554

International Transcription Services, Inc.*
1231 20th Street, N.W.
Washington, D.C. 20036

Anne K. Bingaman
Douglas W. Kinkoph
LCI International Telecom Corp.
8180 Greensboro Drive, Suite 800
McLean, VA 22102

Peter A. Rohrbach
Linda L. Oliver
Hogan & Hartson, L.L.P.
Columbia Square
555 Thirteenth Street, N.W.
Washington, D.C. 20004-1109

Rocky N. Unruh
Morgenstein & Jubelirer
One Market
Spear Street Tower, 32nd Floor
San Francisco, CA 94105

Eugene D. Cohen
326 West Granada Road
Phoenix, AZ 85003

Bernadette Murphy
Bernadette Murphy