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Before the
**FEDERAL COMMUNICATIONS COMMISSION**
Washington D.C.

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| In the Matter of | ) | |
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| United States Telephone Association | ) | RM ____ |
| Petition for Rulemaking -- 1998 Biennial | ) | |
| Regulatory Review | ) | |

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# PETITION FOR RULEMAKING OF THE UNITED STATES TELEPHONE ASSOCIATION

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## SUMMARY

USTA recommends that the Commission initiate a rulemaking proceeding to undertake a comprehensive review of all of its regulations pursuant to Section 11 of the Telecommunications Act of 1996. The Telecommunications Act required the Commission to develop a pro-competitive, de-regulatory national telecommunications policy designed to speed deployment of advanced telecommunications and information technologies and services to all Americans. Section 11 specifies that the Commission must review all regulations every two years to determine whether any such regulation is no longer necessary in the public interest as a result of meaningful economic competition between providers While the Commission has released a number of separate biennial review proceedings on specific rules, its proposals have fallen short of the Congressional mandate and have failed to provide either the comprehensive review anticipated by Congress or the standards under which such a review should be conducted.

USTA has reviewed the entire Part 47 of the Code of Federal Regulations pursuant to Section 11. USTA has developed general principles to guide the public interest analysis that Section 11 requires. USTA has provided matrices depicting the regulations which must be eliminated or modified to meet the statutory requirements as well as the specific rules language reflecting the change. USTA has also provided an economic analysis of the impact of deregulatory initiatives prepared by William E. Taylor National Economic Research Associates and Robert W. Hahn of the American Enterprise Institute. That analysis also provides information regarding the costs and benefits of regulation as experienced in the U.S. telecommunications industry, other U.S. industries and in foreign countries.

In addition to fulfilling the statutory requirements, USTA believes that a rulemaking is required to ensure that regulations keep pace with the evolving nature of the telecommunications market. The public interest will best be served if regulation reflects technology advances, promotes consumer welfare, enhances administrative efficiency and ensures fair and efficient competition. For example, digital technology has rendered many of the rules meaningless and proposed advanced telecommunications networks are oblivious to current regulatory boundaries. Regulation which exacts such costs as higher prices, diminished product variety, slower rates of innovation and productivity growth and reduced job opportunities impedes consumer welfare. The administrative costs of complying with certain regulations must be reduced or eliminated if the regulation no longer serves a valid regulatory purpose.

Regulation should reflect the fact that competitive market forces are far superior to regulation in the determination of efficient levels of output, investment and price. Where market forces can be relied upon, the Commission should do so. In order to avoid incentives for inefficient investment, unnecessary, asymmetric regulatory obligations imposed on only one class of competitor must be eliminated, preferably when markets are first opened to competition. Consumers benefit from policies that foster overall economic efficiency, not policies that protect competitors or technologies. The Commission should promote fair competition by establishing a level playing field for all participants in which the market determines the winners and losers.

USTA recommends that the Commission examine the following factors in conducting its biennial review of regulation: the purpose of the regulation, the relevant market conditions, the economic impact of the regulation on the regulated entity and the public interest benefit in eliminating the regulation. In accordance with a pro-competitive, de-regulatory policy, the presumption should be to eliminate regulation. USTA's recommended rules for the 1998 biennial review are as follows:

Part 1: establish time limits for consideration of waivers, petitions for reconsideration and applications for review of one year to facilitate certainty.

Part 17: avoid duplicative oversight by deleting rules regarding antenna structures which are covered by the Federal Aviation Administration.

Part 32: eliminate the current accounting rules and permit carriers to move to GAAP. As a transition mechanism, permit all carriers to utilize Class B accounting, eliminate subaccounts and subsidiary records as well as jurisdictional difference accounts and streamline property records. This alone would reduce the millions of dollars an incumbent LECs must spend to comply with the outdated Part 32 rules.

Part 36: freeze all jurisdictional allocation percentages and category relationships for price cap LECs and freeze the jurisdictional allocation percentages based on a three year average for rate of return companies to facilitate competitive neutrality, administrative efficiency and to avoid jurisdictional cost shifts.

Part 41: eliminate the rules governing franks as proposed by the Commission in CC Docket No. 98-119 as these rules are outdated and no longer necessary.

Part 42: eliminate the record retention requirements as these rules are superfluous and unnecessary.

Part 43: eliminate the ARMIS reports, or at the very least streamline these reports as recommended by USTA in CC Docket No. 98-117. These reports have outlived their usefulness, pose unnecessary and costly administrative burdens and provide an advantage to competitors of incumbent LECs.

Part 61: reorganize the tariffing rules so that this section of the rules only includes tariff requirements, move the rules associated with rate of return regulation to Part 69 and create a new part to include the rules associated with price cap regulation. In addition, the tariff requirements should be streamlined to be consistent with the streamlined tariff provisions of the Telecommunications Act, including reducing the current detailed cost support requirements. Incumbent LECs should be permitted to file contract-based tariffs in order to better respond to customer requests.

Part 62: delete the rules regarding interlocking directorates as such rules are no longer necessary.

Part 63: streamline the rules requiring regulatory approval to extend lines, discontinue lines, and reduce lines. These rules add unnecessary delay in the provision of service, increase administrative costs and create uncertainty.

Part 64: eliminate the rules regarding traffic damage claims, furnishing facilities to foreign governments, the use of recording devices, furnishing enhanced services and CPE, candidates for federal office, and separate affiliates for independent, incumbent LECs. In addition, eliminate the requirement to allocate costs between regulated and nonregulated activities or, at the very least, streamline these rules to eliminate usage forecasts and eliminate quantification of CAM changes, pre-approval requirements, the product matrix and the annual, external audit. Such streamlining will reduce the detail and complexity of the current which serve no public interest benefits and significantly reduce administrative costs.

Part 65: eliminate the rate of return reporting requirements and streamline the calculation.

Part 69: revise this section of the rules so that it only includes rules pertaining to rate of return regulation. Streamline these rules to eliminate the public interest showing for new service tariff filings which only serve to delay new service offerings and streamline the access structure into four elements. Permit rate of return carriers an opportunity for pricing flexibility by establishing a zone pricing plan for the Transport, Switching and Common Line access elements as well as competitive triggers to remove services from regulation as competition develops.

Part XX: by reorganizing Parts 61 and 69, the Commission should create a new section which pertains to price cap regulation. The codified access structure and the public interest showing for new services would be eliminated. These rules would also streamline the price cap basket structure, expand zone pricing to all service categories, simplify the SLC and PICC calculations, and eliminate the CCL. Price cap LECs would be afforded pricing flexibility based on a demonstration that appropriate criteria have been satisfied, including the ability to offer volume and term discounts, contract-based tariffs, as well as promotional and optional service offerings.

These rules changes should be adopted now. These changes reflect the current telecommunications market, enhance consumer welfare, promote administrative efficiency and ensure fair and efficient competition. More important, these rules changes are necessary if the Commission is to fulfill its statutory mandate to provide a framework for a pro-competitive, de-regulatory national telecommunications policy.

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**UNITED STATES TELEPHONE ASSOCIATION**
**PETITION FOR RULEMAKING**

## I. INTRODUCTION AND SUMMARY.

The Telecommunications Act of 1996 was enacted 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."[1] Thus far, the Commission has concentrated its efforts on establishing the conditions to facilitate the development of competition.[2] USTA believes that it is time for the Commission to give equal attention to the

[1]Joint Explanatory Statement of the Committee of Conference at 113.

[2]For example, the Commission has completed proceedings on interconnection, open video systems, electric utility provision of telecommunications, infrastructure sharing, small business entry barriers, number portability, toll rate averaging, Bell Operating Company (BOC) entry into out-of-region interLATA markets, long distance tariff forbearance, payphone service reform, streamlined tariffs for incumbent local exchange carriers (LECs), customer proprietary network information, cost allocations for unregulated services, access reform, universal service, provision of broadband networks and streamlining the formal complaints process. The Commission has pending proceedings on universal service, access reform, Internet traffic, non-accounting safeguards and accounting safeguards for BOC provision of in-region interLATA services, eliminating Section 214 applications for extensions of lines, separations reform, service
(continued...)

implementation of the de-regulatory portion of the policy framework, for as competition continues to develop in all telecommunications markets, there is less need for many of the Commission's rules and regulations. Maintaining such rules on only one class of competitor, the incumbent LEC, is anticompetitive. Therefore, USTA urges the Commission to adopt a rulemaking proceeding, as proposed herein, to review its rules as specified in Section 11 of the Telecommunications Act of 1996.

Pursuant to Section 11, the Commission is required to review all regulations every two years to determine whether "any such regulation is no longer necessary in the public interest as the result of meaningful economic competition between providers of such service."[3] While, as discussed herein, the Commission has initiated many rulemakings under the heading of biennial review, these proposals fall short of the Congressional mandate and do not provide either the comprehensive review anticipated by Congress or the standards under which such a review would occur. USTA has developed general principles which it recommends to guide the Commission's "public interest" analysis and has used those principles to review all of the regulations contained in Section 47 of the Code of Federal Regulations.[4] USTA discusses the statutory requirements of the Telecommunications Act of 1996 and the need for regulatory relief.

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[2](...continued)
and equipment accessibility for persons with disabilities and Section 706 applications for the provision of broadband telecommunications networks

[3]47 U.S.C. § 161(a)(2).

[4]USTA agrees with and has attempted to respond to the issues raised by Commissioner Furchtgott-Roth in his separate statement in *Computer III* Further Remand Proceedings: Bell Operating Company Provision of Enhanced Services, CC Docket No. 95-20 and 1998 Biennial Regulatory Review -- Review of *Computer III* and ONA Safeguards and Requirements CC Docket No. 98-10, *Further Notice of Proposed Rulemaking* (rel. Jan. 30, 1998).

USTA provides a listing of the current regulations which it believes must be eliminated or modified to meet the statutory requirements of Section 11. USTA will list and explain its recommendations in Section V below and in the attached matrices. USTA also provides the new rules incorporating its proposals.

An economic analysis of the impact of deregulatory initiatives is provided in the attached affidavit prepared by William E. Taylor, National Economic Research Associates and Robert Hahn of the American Enterprise Institute. This analysis also provides information regarding the costs and benefits of regulation as experienced in the U.S. telecommunications industry, other U.S. industries and foreign countries. Among the tables provided in the analysis are several which depict the welfare gains from deregulation in the U.S. in 1990 among different industries, an estimate of the annual costs of economic regulation in the U.S. in 1988 and in 1991, and the costs of regulation and the gains from deregulation as a percentage of GDP for different countries. The analysis also discusses ways in which regulation can help or harm consumers and provides guidance on the process of regulatory reform

## II. A RULEMAKING IS NECESSARY TO ENSURE THAT CURRENT REGULATION SERVES THE PUBLIC INTEREST.

The detrimental impact of economic regulations which does not promote consumer welfare has led both Congress and the Executive Branch to continue to search for ways to reform regulation. Efforts to streamline or eliminate regulation, particularly in areas where legal impediments to entry have been eliminated have been ongoing in many industries. Progress has been made in deregulating transportation, financial services and telecommunications. For example, the Civil Aeronautics Board and the Interstate Commerce Commission were eventually eliminated after the airline and trucking industries were deregulated.[5]

The Commission should undertake an examination of its current regulations and determine if such regulations are the most efficient and effective means to serve the public interest. USTA believes that regulations should reflect technological advances, promote consumer welfare, enhance administrative efficiency and ensure fair and efficient competition. This means that regulations must be periodically reviewed and those that do not reflect the present telecommunications environment must be either modified or eliminated.

**A. Regulation Must be Reviewed Periodically to Ensure that it Reflects Evolving Technology.**

The dynamic changes in telecommunications technology are driving the need to reform regulation. USTA strongly agrees with Commissioner Powell that telecommunications can no longer be categorized into separate rules parts, some of which have not been changed since 1934. "Digital technology has liberated information...it is futile to attempt to preserve the balkanized regulatory framework that presently exists. Unquestionably, the dramatic evolution of technology will erode and ultimately eliminate the legal, economic and conceptual boundaries that traditionally have separated the various communications media...If regulation is necessary at all, it should be consistent with competitive markets and sufficiently flexible to accommodate unknowable future technological advances."[6] Commissioner Powell correctly explains that the

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[5]Even though the trucking industry was deregulated in the 1970's, the ICC was not eliminated until 1995. *See*, Kenneth Gordon and Paul Vasington, "The FCC's Common Carrier Bureau: An Agenda for Reform," Citizens For a Sound Economy Foundation Issue Analysis Number 62, September 1997

[6]Remarks of Commissioner Michael K. Powell, Legg Mason Investor Workshop, Washington, D.C., March 13, 1998. [Powell].

flexibility inherent in digital technology will force traditional market barriers to disintegrate. Already, traditionally distinct technologies and services are converging and providers are offering or applying to offer integrated services.

For example, several incumbent LECs have petitioned the Commission to permit them to deploy advanced telecommunications networks.[7] These petitions fully explain that existing regulation is completely inapposite to the provision of such networks. Existing regulations, designed for the provision of voice-grade services. cannot accommodate the high-speed, broad-band services which will be provided over these networks. Such services are oblivious to LATA boundaries and jurisdictions. There is no reason to require the same unbundling and pricing restrictions on these advanced services as the Commission has imposed on traditional voice-grade services. Advanced data services are already competitive and companies such as AT&T/Teleport/TCI/British Telecom, MFS/WorldCom/MCI, Qwest and Level 3 are building broadband networks to bring voice, video and digitized information into a customer's home or office. AT&T's merger with TCI will provide AT&T with the means to offer "one stop shopping" for customers for local and interLATA telephone, cable, data and wireless services. AT&T will be able to combine its local, long distance and Internet service with TCI's cable, telecommunications and high-speed Internet services. Incumbent LECs should have an equal opportunity to attract the capital necessary to build and deploy broadband networks and to also offer advanced services to consumers.

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[7] *See,* Petitions of Bell Atlantic, U S WEST and Ameritech for Relief from Barriers to Deployment of Advanced Telecommunications Services, CC Docket Nos. 98-11, 98-26 and 98-32 and Petition of Southwestern Bell, Pacific Bell and Nevada Bell for Relief from Regulation Pursuant to Section 706 of the Telecommunications Act of 1996 and 47 U.S.C. § 160 for ADSL Infrastructure and Service

Perpetuating traditional regulatory categories, such as the Commission's proposals in CC Docket No. 95-20 to continue to distinguish enhanced and basic services as well as to differentiate telecommunications and information services, particularly when it is done under the guise of biennial review, is counterproductive.[8] Instead of seeking to maintain such arcane and unnecessary distinctions as well as to expand their application to all incumbent LECs, the Commission should be considering whether such rules are outdated and should be eliminated.

Competitive market forces are far superior to regulation in the determination of efficient levels of output, investment and price. Thus, where market forces can be relied upon, the Commission should do so. Further, delay is costly. In order to avoid incentives for inefficient investment, unnecessary asymmetric regulatory obligations must be eliminated when markets are first fully opened to competitors. Consumers benefit from policies that foster overall economic efficiency, not policies that protect particular competitors or technologies. The Commission must focus on encouraging innovation in accordance with the objectives of the 1996 Act. As Commissioner Powell points out, an industry which is driven by technology, should have every opportunity to provide new services. Regulation which slows the pace of innovation or which confers an advantage on a technology or service must be avoided and all participants should be encouraged to invest in the infrastructure. Given that regulation cannot keep pace with the technological change occurring in the telecommunications industry, greater reliance on competition is the only way the Commission can ensure that it is not standing in the way of

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[8]In the Matter of Computer III Further Remand Proceedings, Bell Operating Company Provision of Enhanced Services, CC Docket No. 95-20, 1998 Biennial Regulatory Review -- Review of Computer III and ONA Safeguards and Requirements, CC Docket No. 98-10, *Further Notice of Proposed Rulemaking*, (rel. Jan. 30, 1998).

innovation.

**B. Regulation Must be Reviewed Periodically to Ensure that it Will Enhance Consumer Welfare.**

The voluminous regulations contained in Section 47 of the Code of Federal Regulations produce too few benefits at excessive costs; costs which are often hidden from the public. Such costs show up indirectly in the form of higher prices, diminished product variety, lower rates of innovation and productivity growth and reduced job opportunities.[9] Estimates of the potential welfare gains to society from deregulating telecommunications -- and actual experience in other industries -- highlight what is at stake before the Commission. Taylor and Hahn, in the attached affidavit, provide many examples of the overall gains for the economy both within the United States and in other countries from economic deregulation. A couple of examples from the telecommunications industry are also provided below.

Under current regulation, incumbent LECs must request permission from the Commission in order to introduce a new interstate service. Of course, competitors of incumbent LECs have an incentive to stop or delay the introduction of the new service in order to enhance their competitive advantage. Thus, while the Commission reviews the request and considers the competing claims, the new service is delayed and consumers are denied the opportunity to purchase the new service from an incumbent LEC. The introduction of new telecommunications services can lead to very large gains in consumer welfare. Dr. Jerry Hausman estimated that the gain in consumer welfare from the introduction of voice messaging services amounted to $1.27 billion per year and that the introduction of cellular telephone service has led to an estimated gain

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[9]"Modernizing Government Regulation: The Need for Action," Policy Statement by the Research and Policy Committee of the Committee for Economic Development 1998.

in consumer welfare of about $50 billion per year.[10]

The delay in the availability of voice messaging services provides a startling example of the magnitude of the loss in consumer welfare resulting from regulatory delay. Voice messaging services were first proposed by AT&T in the 1970's. The Commission delayed its decision and then refused to allow the BOCs to offer these services on an integrated basis with other services. In 1986, the Commission reversed its decision, but the BOCs were forbidden by the Modification of Final Judgment from offering these services. Finally, more than ten years after information services were first introduced, in 1988, the BOCs were permitted to offer information services. The BOCs began providing voice messaging services in 1989. The ten year regulatory delay cost consumers well over $10 billion.

Dr. Hausman has also estimated what would have been the outcome if the Commission had required that cellular prices be set at Total Service Long Run Incremental Cost (TSLRIC).[11] "If cellular carriers had been required to sell their services to competitors (resellers) at a TSLRIC cost-based price, it is unlikely that they would have risked the billions of dollars of investment in cellular networks when the future of cellular was highly uncertain and many industry analysts did not forecast much success for cellular. The consumer welfare gains that have been derived from the success of cellular telephone service would not have existed; indeed a TSLRIC based rule

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[10]Jerry A. Hausman, "Valuing the Effect of Regulation on New Services in Telecommunications," Brookings Papers on Economic Activity, 1997. [Hausman].

[11]The Commission ultimately adopted TSLRIC to determine the price incumbent LECs must charge for unbundled network elements.

would likely have led to tens of billions of dollars of lost consumer welfare."[12] The TSLRIC approach to pricing creates significant negative economic incentives to invest in new services or new infrastructure by any participant.[13]

Finally, Dr. Hausman notes that losses in consumer welfare cannot be regained in subsequent periods. "Regulation, as currently implemented, may well be unable to keep up with the fast-paced changes in telecommunications technology. Consumer welfare losses are likely to be quite large because of regulatory delays and pricing distortions. Past welfare losses have been in the billions of dollars per year, and the FCC's current approach may well lead to comparable consumer welfare losses in the future."[14]

In a 1996 study, Crandall and Waverman estimated that the net gains from telecommunications deregulation that lead to more efficient pricing is almost $30 billion.[15] One example of current inefficient pricing is the geographic averaging of access rates, which causes prices in some areas to exceed economic costs and prices in other areas to be below economic costs. According to Schmalensee and Taylor, such pricing creates two different types

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[12]Hausman at 10.

[13]*See*, also, Statement of Alfred E. Kahn on FCC's Proposed Reforms of Carrier Access Charges, USTA Reply Comments, CC Docket No. 96-262, February 14, 1997 at Attachment 1 and USTA Comments, CCB/CPD 98-12, March 18, 1998 at Attachment 1. Professor Kahn explains that a prescriptive approach to price interstate access is "not confined to its effect on the incentives of both incumbent and competitive LECs to invest in the modernization of our telecommunications infrastructure. Even more directly and obviously, it would inevitably impair drastically the ability of the incumbents to do so."

[14]Hausman at 16.

[15]Robert W. Crandall and Leonard Waverman. *Talk is Cheap: The Promise of Regulatory Reform in North American Telecommunications*, The Brookings Institution (1996).

of inefficiencies: inefficient utilization of telecommunications resources and distorted competitive incentives.[16]

Crandall and Furchtgott-Roth, in a study of the cable television industry found that consumers were $6.5 billion a year better off after deregulation in 1992 than in 1983 and 1984 before deregulation.[17] Clifford Winston analyzed the welfare effects of deregulation in airlines, railroads and trucking and found a total of between $36 and $46 billion in net welfare gains from deregulation.[18]

Clearly, considering the consumer welfare benefits of deregulation and attempting to maximize those benefits should guide the Commission's efforts to establish a de-regulatory telecommunications policy by eliminating current regulations which inhibit consumer welfare benefits. As stated by Commissioner Powell, "...deregulation is a critical pre-condition to competitive conditions because it removes government interference between consumers and producers."[19] Even in cases where regulation is required, the Commission should seek to maximize consumer welfare benefits by ensuring that the costs of the regulation do not outweigh

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[16]Richard Schmalensee and William Taylor, "The Need for Carrier Access Pricing Flexibility in Light of Recent Marketplace Developments: A Primer," USTA Comments, RM No. 9210, at Attachment. [Schmalensee and Taylor].

[17]Robert W. Crandall and Harold Furchtgott-Roth, *Cable TV: Regulation or Competition?* The Brookings Institution (1996).

[18]Clifford Winston, "Economic Deregulation: Days of Reckoning for Microeconomists," *Journal of Economic Literature*, Vol. XXXI (Sept. 1993) at 1263-1289.

[19]Personal Communications Industry Association's Broadband Personal Communications Services Alliance's Petition for Forbearance for Broadband Personal Communications Services, *Memorandum Opinion and Order and Notice of Proposed Rulemaking*, WT Docket No. 98-100, FCC 98-134 (rel. July 2, 1998), Separate Statement of Commissioner Michael Powell Dissenting in Part.

the benefits. Certainly the Telecommunications Act of 1996 provides the Commission with the authority to accomplish both since the Act contemplates that in the long term, competition rather than regulation should be relied upon.

**C. Regulation Must be Reviewed Periodically to Ensure that it Promotes Administrative Efficiency.**

The Commission should also focus on administrative efficiency. As Commissioner Powell noted, timely decision-making, sensitivity to the business decisions of individual companies and shifting resources to enforcement from prescriptive regulation will enhance regulatory efficiency. In recent filings incumbent LECs have estimated the costs of complying with certain regulations. For example, Bell Atlantic notes that it spends more that \$8 million per year to maintain continuing property records as specified in Part 32 and over \$9 million per year to comply with current Part 64 requirements.[20] GTE has stated that up to 25 percent of its total general ledger system implementation costs were solely attributable to customizing its internal systems to meet the Part 32 requirements.[21]

The administrative burden and expense of completing and filing the Automated Reporting Management Information System (ARMIS) reports provides another example of an unnecessary and unjustified administrative burden. On an annual basis, Ameritech estimates that it must spend approximately 26,665 hours, Bell Atlantic estimates 7, 710 hours, Cincinnati Bell estimates 4,100 hours (Cincinnati Bell does not file the ARMIS 43-06), SBC estimates 25,000

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[20]Comments of Bell Atlantic, 1998 Biennial Regulatory Review--Review of Accounting and Cost Allocation Requirements, United States Telephone Association Petition for Rulemaking, CC Docket No. 98-81, ASD File No. 98-64. filed July 17, 1998 at 5,9.

[21]Comments of GTE, CC Docket No. 98-81, filed July 17, 1998 at 6.

hours and U S WEST estimates 6,900 hours to complete and file the ARMIS reports. This does not include the time and resources expended to respond to Commission requests to refile prior year reports. Continuing to impose such administrative burdens on one class of competitor will not promote fair and efficient competition. Compliance with unnecessary administrative burdens forces incumbent LECs to utilize resources which could be directed toward providing service to customers.

**D. Regulation Must Be Reviewed Periodically to Ensure that it Promotes Competition, Not Competitors.**

USTA strongly agrees with Commissioner Powell that the Commission should neither shield incumbents nor new entrants from the competitive marketplace through regulation. USTA has consistently urged the Commission not to adopt asymmetric regulatory requirements which apply only to incumbent LEC's, but to establish a level playing field for all participants and to let the market determine the winners and losers. By speculating as to every possible negative outcome and micro managing incumbent firms to attempt to prevent any such possible negative outcome, the Commission handicaps the market, limits competition and reduces consumer benefits.

Instead of stifling the efforts of incumbents to compete by arbitrarily restricting their business operations, the Commission should shift its focus to enforcing regulations which are necessary to implement the Telecommunications Act of 1996. "Rather than imagining all the dangers that might result if we let a company do what it has asked and then take equally speculative action to meet those speculative dangers, lets instead police conduct and make decisions based on real facts. If there are "teeth" in our enforcement efforts, companies will take heed or pay the price."[22] Conversely, the Commission need not protect incumbents from the presence of new entrants.

USTA fully anticipates that AT&T, MCI and other competitors of incumbent LECs will continue to oppose efforts to relieve incumbent LECs from asymmetrical regulatory constraints since restrictions on incumbent LECs add costs which these competitors do not bear, provide valuable information which these competitors do not divulge and serve to delay incumbent LEC market responses. These factors give the competitors of incumbent LECs an advantage in the marketplace. USTA would remind the Commission that AT&T itself eloquently articulated the problems of this type of asymmetrical regulation:

> The social costs of asymmetric regulation of AT&T's provision of telecommunications services include all the direct, administrative costs of that regulation borne by AT&T, the Commission, AT&T's rivals, and other parties. AT&T bears a differential burden here because it must comply with regulatory requirements from which its rivals have been largely exempted. Moreover, as competition becomes more vigorous and the marketplace more dynamic, AT&T will need to change prices and products more frequently in order to remain competitive. Under the current policy of asymmetric regulation, this will result in more frequent filings with the Commission, and AT&T's differential burden will become more severe.
>
> While the administrative costs of asymmetric regulation are substantial and will grow rapidly as competition intensifies, the most important costs imposed on AT&T and on society as a whole by the current regulatory policy in telecommunications services are not administrative. More important, though perhaps less visible, are the indirect costs that arise from the handicaps and perverse incentives inevitably created by conventional regulation in the presence of competition...
>
> The many differential regulatory burdens discussed above prevent AT&T from using all its substantial assets, both human and tangible, effectively in the competitive arena to meet customer needs. Regulation inevitably reduces incentives to produce efficiently and to innovate vigorously. It does this directly by limiting the allowed returns from efficiency and innovation and indirectly by imposing delays and rigidities that reduce possible returns. Regulation-induced distortions in pricing

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[22] Powell.

distort carrier-specific and market-wide demand patterns and thus distort the utilization of existing capacity. While pricing distortions may benefit some competitors and users, society as a whole loses. Society also loses if AT&T's incentives to deliver services at minimum cost are dulled, so that its costs are higher than they should be.[23]

In a recent article, Alfred E. Kahn discusses the dangers of attempting to micro manage the entry and survival of some competitors by extending to them special regulatory preferences and/or restraining efficient competitive responses by the incumbents.[24] Dr. Kahn lists the factors which should be considered when such regulation is proposed:

--the costs to competition and the inefficiencies that society incurs when supply is not distributed on the basis of the present marginal costs of competitors;

--the encouragement that preferential protections give to competitors to devote their entrepreneurial energies to seeking such protections and ensuring their continuation;

--the preferability of leaving determinations of the long term prospects of new ventures to the market, generally and to financial markets, in particular;

--the need for a hard-headed determination of whether the would-be competitor is indeed a struggling, inexperienced newcomer that both requires and deserves some special preference;

--the lesson of history that, so long as companies are insulated from competition, they are less likely to ever "grow up"; and

--the desirability of putting a strict limit on both the period and extent of the protection.[25]

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[23]Long Run Regulation of AT&T's Basic Domestic Interstate Services, CC Docket No. 83-1147, Comments of AT&T, Attachment 4.

[24]Alfred E. Kahn, "Letting Go: Deregulating the Process of Deregulation, or: *Temptation of the Kleptocrats and the Political Economy of Regulatory Disingenousness*, MSU Public Utilities Papers, 1998 at 16. [Kahn].

[25]*Id.* at 20-22.

Dr. Kahn also debunks the oft repeated claim that incumbents enjoy competitive advantages that must be offset or denied if competition is to thrive. He explains that what

> is clearly *not* justified is the contention that rivals of the ILECs or electric utilities require some special protections or preferences merely because the incumbent companies are in a position to exploit economies that are not available to their challengers...competitive advantages arising out of economies of scale and scope are precisely the kind of efficiency advantages that we expect and *want* to prevail under competition. Integration is fundamentally a *competitive* phenomenon, and such efficiency advantages as it confers on the integrated firms are socially beneficent. The first fundamental competitive principle of freedom of entry means, first and foremost under conditions of real-world competition, freedom of existing firms to integrate into other operations or markets that they think they have special qualifications to serve.[26]

As Dr. Kahn explains, economies of scope and scale permit any provider to supply a number of products and services in combination at lower costs than if it provided them separately.

> If such economies are present, proposals for structural separation of the services using those common facilities--and recommendations of witnesses for competitors and proposed commission rules that all such common uses or personnel be prohibited except as the services (or other inputs) can be transferred at published tariffs and, therefore, made equally available to all applicants--would simply interfere with or totally prevent their achievement. The non-utility operation would have to employ its own trucks and personnel, its own bills and its own computers. All purchasers of its services would be hurt by such mandated separations, preventing the utility companies from taking advantage of such potential economies and passing them on, under pressure of competition--including purchasers of the regulated services, who would lose the possible benefit of sharing those services with unregulated operations."

Dr. Kahn notes that the most extreme of the protections provided to competitors of incumbent LECs have been the line of business restrictions on the RBOCs, the tariffing requirements and the mandated averaging of costs and prices. The flat prohibition of the line of business restrictions, which prevent the companies in the best position to compete vigorously from

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[26] *Id.* at 23 [footnotes omitted].

competing at all, are inherently anti-competitive. The tariffing requirements give competitors advance notice of services and prices and a legal opportunity to delay new services by opposing the tariff meanwhile preparing their own market responses. The averaging of costs and prices permits competitive undercutting in low-cost markets while incumbents are still required to serve high cost markets at non-compensatory rates. "Whatever one's evaluation of these asymmetrical restraints upon the competitive initiatives and responses of the incumbent companies, there can be no doubt that in essential respects they go beyond the mere preservation of competition in the direction of protecting *competitors from* competition--effectively imposing regimes of cartelization on potentially competitive markets."[27]

## III. THE TELECOMMUNICATIONS ACT OF 1996 AMENDED THE COMMUNICATIONS ACT OF 1934 TO REQUIRE DEREGULATION AND REGULATORY REFORM.

The statutory requirement that the Commission develop a new pro-competitive, de-regulatory national telecommunications policy provides the Commission with the necessary incentive to review all of its rules promulgated before 1996 to ensure that the rules are consistent with that policy and in no way act to impede the development of that policy. Specifically, the Telecommunications Act of 1996 amended the Communications Act of 1934 to require regulatory reform through the addition of two new sections. Section 10 requires the Commission to forbear from applying a provision of the Communications Act or from applying any of its regulations to a telecommunications carrier or a telecommunications service if the Commission determines that enforcement is not necessary to ensure that charges, practices, classifications or regulations for such carrier or services are just and reasonable and not unjustly or unreasonably

[27] *Id.* at 39.

discriminatory, to protect consumers and to protect the public interest. In making its public interest determination the Commission shall consider whether or not forbearance will promote competition. Carriers are permitted to petition for forbearance and these petitions shall be deemed granted if the Commission does not deny such petitions within one year. USTA agrees with Commissioner Powell's interpretation of the statutory language that the presumption is in favor of forbearance.[28] In addition, Section 10 provides that a state may not continue to apply or enforce any provision of the Communications Act that the Commission has forborne.

Section 11 requires the Commission, beginning in 1998 and in every even numbered year thereafter, to review all regulations issued under the Act in effect at the time of the review that apply to the operations or activities of any provider of telecommunications service. The Commission is required to determine whether such regulations are no longer necessary in the public interest as the result of meaningful economic competition between providers of such service. If so, the Commission must repeal or modify any such regulation.

The legislative history of Section 11 clearly shows that this section was intended to require the Commission to perform a complete review of all of its rules and regulations every two years. As stated in the Senate debate, Section 11 "establishes a process that will require

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[28]Separate Statement of Commissioner Michael Powell, Dissenting in Part, Personal Communications Industry Association's Broadband Personal Communications Services Alliance's Petition for Forbearance for Broadband Personal Communications Services, WT Docket No. 98-100, *Memorandum Opinion and Order*, FCC 98-134 (rel. July 2, 1998) "I am increasingly concerned that we are setting up a misguided framework for addressing competition and deregulation questions that will perpetuate regulation, institutionalize government intrusion in markets, and inhibit the full blossoming of competition all in direct contravention to Congress' wishes. Such a framework will go a long way in securing regulators a leading role in telecommunications markets, but will do little to promote the robust, high quality competition that Congress envisioned and from which consumers will really benefit."

continuing justification for rules and regulations each two years. Every two years, in other words, all rules and regulations will be on the table If they don't make sense, there is a process established to terminate them."[29] Section 11 is also characterized as establishing a process "for continuing attic-to-basement review of all regulations on a two year cycle."[30] It is clear that Congress intended the Commission to review all of its rules every two years and eliminate those which no longer make sense as part of its pro-competitive, de-regulatory telecommunications policy.

The Telecommunications Act also contains provisions which provide the Commission with authority to promulgate rules. For example, Section 254(k) states that the Commission, with respect to interstate services, shall establish any necessary cost allocation rules, accounting safeguards and guidelines to ensure that services included in the definition of universal service bear no more than a reasonable share of the joint and common costs of facilities used to provide those services. The Commission also has the authority to ensure that rates for interstate services are just, reasonable and non-discriminatory. The exercise of such authority does not mean, however, that the Commission should not undertake to review its rules to ensure that the methods it employs are consistent with the overall pro-competitive, de-regulatory national policy. In addition, it does not require the Commission to micromanage the business operations of incumbent LECs.

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[29] 141 Cong. Rec. S7881, June 7, 1995.

[30] *Id.*