overall."[205] The Commission found, however, that "price cap regulation of the BOC's access service sufficiently constrains a BOC's ability to raise access prices to such an extent that the BOC affiliate would gain, upon entry or soon thereafter, the ability to raise prices of interLATA services above competitive levels by restricting its own output of those services."[206]

The risk that SBC could acquire market power in advanced services through a price squeeze is even lower. In the mass market, as noted above, SBC's competitors do not even use SBC access services to serve their customers. They have completely separate networks. Thus, as is the case with discrimination, a price squeeze is not even a theoretical possibility in that market. Likewise in the larger business market, SBC's competitors often do not use SBC local access facilities. To the extent they do, however, they use special access services which are subject to far more competition than were SBC's switched access services at the time of the *BOC Classification Order.* In fact, the special access market has become so competitive that SBC has been exempt from price cap regulation in some areas. In those areas, competitive alternatives deny SBC any ability to effect a price squeeze. In all remaining areas, SBC continues to be subject to price cap regulation in addition to growing competition. There is thus no possibility that SBC could acquire market power in advanced services by raising its rival's costs.

VII. THE COMMISSION SHOULD FORBEAR FROM APPLYING TARIFF REQUIREMENTS TO SBC'S PROVISION OF ADVANCED SERVICES.

Section 10(a) of the 1996 Act requires the Commission to forbear from applying any regulation or any provision of the Communications Act of 1934, as amended, to a telecommunications carrier or service if it determines that: (1) enforcement of such regulation or

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205 *BOC Classification Order,* ¶ 125.

206 *Id.,* ¶¶ 125-126.

provision is not necessary to ensure that the charges, practices, classifications, or regulations by, for, or in connection with that telecommunications carrier or telecommunications service are just and reasonable and are not unjustly or unreasonably discriminatory; (2) enforcement of such regulation or provision is not necessary for the protection of consumers; and (3) forbearance from applying such provision or regulation is in the public interest.[207] In a series of decisions spanning twenty years, the Commission has repeatedly recognized that forbearance from tariff requirements is appropriate for services provided on a non-dominant basis. It has held that the application of section 203 tariff requirements to such services offers no public benefits, while imposing significant social costs. Conversely, it has held that detariffing of competitively provided services promotes competition and offers other significant benefits to consumers

These decisions and the reasoning underlying them apply as much to SBC's provision of advanced services as to other competitively provided services.[208] Because SBC lacks market power in the provision of advanced services, it cannot sustain unreasonable rates or practices. Indeed, the past two years prove that to be the case. Throughout that period and up until quite recently, SBC provided advanced services on a detariffed basis. During this time, the advanced services market experienced explosive growth. Moreover, far from acquiring dominance in the

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[207] Section 10(b) provides that in making the public interest determination under section 10(a)(3), the Commission shall consider whether forbearance "will promote competitive market conditions, including the extent to which such forbearance will enhance competition among providers of telecommunications services." 47 U.S.C. § 160(b). A determination that forbearance will promote competition may be a basis, in itself, for concluding that forbearance would be in the public interest.

[208] AT&T agrees that "[p]ublic utility regulation should be confined to relevant markets in which there is a natural monopoly" and Time Warner AOL agrees that "market forces rather than government mandates are the best vehicle to further development and deployment of competitive broadband services." *See respectively* Reply Comments of AT&T and MediaOne Group, Inc. CS Docket No. 99-251, Sept. 14, 1999, Declaration of Janusz A. Ordover & Robert D. Willig, at 31; Reply of America Online, Inc. and Time Warner, Inc. CS Docket No. 00-30, May 11, 2000, at 17.

market, SBC continued to play an unsuccessful game of catch-up with its more dominant competitors.

The fact that these larger competitors are completely deregulated, while SBC is subject to a smothering array of regulations is indefensible. Chairman Powell has recognized as much. Earlier this year he stated that the Commission's task is to *deregulate* the provision of DSL by incumbent LECs in order to level the playing field between broadband technologies, not to add regulations to the incumbents' existing burdens. The Chairman explained that the Commission must move to "some degree of less regulation" in the broadband market that would be "*not so technology centric.*" [209] "We need these things *harmonized,*" he said.[210] "Otherwise, we're penalizing a competitive technology simply because of its legacy."[211]

SBC recognizes that the Commission believes it lacks authority under section 706 to forbear from section 251(c) and 271 requirements until those provisions are fully implemented. But if the section 706 directive that the Commission promote the deployment of advanced services through *inter alia* regulatory forbearance means anything, surely it must apply here, where the Commission clearly has forbearance authority.

The exercise of this authority, in and of itself, would by no means fulfill the Commission's mandate under section 706. If the Commission is to promote the deployment of advanced services as widely as possible, it will have to do far more. Most importantly, it will have to reject its current proposals to extend unbundling requirements to next generation digital loop carrier (NGDLC) technology. If adopted, these proposals would dramatically increase the

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209 "*Cable Bureau Suggests Regulatory Forbearance for New Services,*" COMMUNICATIONS DAILY, Feb. 23, 2001 (emphasis added).

210 *Id.*

211 *Id.*

cost and decrease the revenues available from NGDLC deployment, spelling the difference between profit and loss in many geographic areas. So long as they remain unresolved, incumbent LECs will be hesitant to invest aggressively in widespread DSL deployment.

Nor would the exercise of forbearance authority create complete symmetry in the Commission's regulation of different broadband platforms. In fact, for the most part, it would simply restore the status quo that prevailed at the time Chairman Powell cited the need to achieve greater symmetry through deregulation. It would nevertheless represent an important and essential first step in the right direction. The Commission should take that step as promptly as possible. As shown below, SBC clearly satisfies each of the three prongs of the statutory forbearance test with respect to its provision of advanced services. The Commission therefore must forbear from applying section 203 tariff requirements to those services.

A. The Application of Tariffing Requirements and Other Dominant Carrier Regulations to SBC in its Provision of Advanced Services is Not Necessary to Ensure That SBC's Charges, Practices, Classifications, or Regulations are Just and Reasonable and not Unjustly or Unreasonably Discriminatory.

Throughout the past twenty years, the Commission has consistently recognized that the application of section 203 tariff requirements to services provided on a non-dominant basis is wholly unnecessary. For example, in initiating its *Competitive Carrier* proceeding, in 1979, the Commission observed that tariff requirements are not "of any public benefit where firms lacking market power are involved, for [such firms] have no ability or incentive to charge unlawful rates."[212] Based on that finding, the Commission implemented first, a permissive, and then, a

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[212] *Policy and Rules Concerning Rates for Competitive Common Carrier Services and Facilities Authorizations Therefor*, Further Notice of Proposed Rulemaking, 84 FCC 2d 445 (1980) ¶ 41 (*Competitive Carrier Further Notice*).

mandatory detariffing policy for non-dominant carriers.[213] In each case in which the Commission applied this policy it concluded that market forces, coupled with the section 208 complaint process and the Commission's authority to re-impose tariff requirements if necessary, were sufficient to protect the public interest from unjust and unreasonable rates and practices.[214]

Without disputing the merits of the Commission's policy determination, the District of Columbia Circuit subsequently held that the Commission (at the time) lacked the authority to forbear from applying section 203 tariff requirements.[215] The Commission responded to this decision by implementing the most minimal tariff regime that could be justified under the statute and reiterating its view that tariff filings by non-dominant carriers are wholly unnecessary:

> On the basis of the extensive record developed in response to the Notice, we now reaffirm our policy findings, adopted nearly a decade ago in Competitive Carrier, and conclude that, while tariff regulation is required by the Act, traditional tariff regulation of nondominant carriers is not only unnecessary to ensure just and reasonable rates, but is actually counterproductive since it can

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[213] *Policy and Rules Concerning Rates for Competitive Common Carrier Services and Facilities, Authorizations Therefor,* Second Report and Order, 91 FCC 2d 59 (1982) (applying permissive detariffing to resellers of terrestrial common carrier services); Fourth Report and Order, 95 FCC 2d 554 (1983) (applying permissive detariffing to all other resellers and specialized common carriers, including MCI and GTE Sprint); Fifth Report and Order, 98 FCC 2d 1191 1984) (applying permissive detariffing to domestic satellite carriers, miscellaneous common carriers, carriers providing domestic interstate and interexchange digital transmission services, and certain affiliates of exchange carriers offering interstate, interexchange services; Sixth Report and Order, 99 FCC 2d 1020 (1985), (adopting mandatory detariffing for carriers previously subject to permissive detariffing), *vacated MCI Telecommunications Corp. v. FCC,* 765 F.2d 1186 (D.C. Cir. 1985) These decisions are all part of what has been coined the *Competitive Carrier* proceeding.

[214] *See e.g., Sixth Report and Order* at 1029 (Throughout this rulemaking, we have determined that enforcement of Sections 201 and 202 objectives of just and reasonable rates could be effectuated for certain carriers without the filing of tariffs and through market forces and the administration of the complaint process.")

[215] *AT&T. v. FCC,* Nos. 92-1628, 92-1666, 1993 WL 260778 (D.C. Cir. June 4, 1993) (per curiam), *aff'd, MCI Telecommunications Corp. v. AT&T,* 114 S. Ct. 2223 (1994) (reversing FCC determination that permissive detariffing was within its statutory authority). The court had previously vacated and remanded the Commission's mandatory detariffing policy on the ground that the Commission lacked statutory authority to prohibit common carriers from filing tariffs. *MCI Telecommunications Corp. v. FCC,* 765 F.2d 1186 (D.C. Cir. 1985).

> inhibit price competition, service innovation, entry into the market, and the ability of carriers to respond quickly to market trends.[216]

The Commission has continued to adhere to this view in its application of section 10 of the 1996 Act. For example, in the *IXC Forbearance Order*, the Commission found it was "highly unlikely" that carriers lacking market power could successfully charge rates that violate the Communications Act because an attempt to do so would prompt their customers to switch to different carriers.[217] Moreover, the Commission concluded that it could address illegal carrier conduct through the section 208 complaint process. Similarly, in the *CAP Forbearance Order*, the Commission held "[a]s previously determined by the Commission in the *Competitive Carrier Proceeding* and the *IXC Forbearance Order*, tariffing is not necessary to assure reasonable rates for carriers that lack market power. ... [I]f access providers' service offerings violate Section 201 or Section 202 of the Communications Act, we can address any issue of unlawful rates through the exercise of our authority to investigate and adjudicate complaints under Section 208."[218]

This longstanding recognition by the Commission that tariff regulation of non-dominant carriers is unnecessary applies as much to SBC's provision of advanced services as to any other

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[216] *Tariff Filing Requirements for Nondominant Common Carriers*, 8 FCC Rcd 6752 (1993) (*Nondominant Carrier Tariffing Order*) ¶ 2; *vacated on other grounds, Southwestern Bell Corp. v. FCC*, 43 F. 3d 1515 (D.C. Cir. 1995) (finding the range of rates provision violated section 203(a) of the Communications Act). The Commission subsequently eliminated the range of rates provision and reinstated the one-day notice period. *Tariff Filing Requirements for Nondominant Common Carriers* , 10 FCC Rcd 13653 (1995) (*Nondominant Carrier Tariffing Remand Order*).

[217] *Policy and Rules Concerning the Interstate, Interexchange Marketplace, Implementation of Section 254(g) of the Communications Act of 1934, as amended*, 11 FCC Rcd 20730 (1996) (*IXC Forbearance Order*), ¶ 21.

[218] *Hyperion Telecommunications, Inc. Petition Requesting Forbearance, Time Warner Communications Petition for Forbearance; Complete Detariffing for Competitive Access Providers and Competitive Local Exchange Carriers*, 12 FCC Rcd 8596 (1997) (*CAP Forbearance Order*) ¶ ¶ 23, 25.

service provided on a non-dominant basis. Because, as shown herein, SBC lacks market power in the provision of advanced services, it is in no position to sustain unjust and unreasonable rates or engage in unreasonable practices against any class of customer. On the contrary, if it attempts to raise rates to unlawful levels, or to engage in unreasonable practices, it will lose customers and revenues to its competitors. Subscribers and potential subscribers to DSL service will turn, instead, to other broadband platforms, including, but not limited to, cable modem service. Likewise, customers and potential customers of SBC's larger business advanced service offerings will choose AT&T, WorldCom, Sprint and other carriers, who already have considerable advantages in that market. Moreover, in the highly unlikely event that SBC did attempt to charge unjust and unreasonable rates or engage in unreasonable practices, the Commission could address the matter through the section 208 complaint process, including, if warranted, accelerated docket procedures.[219] Therefore, the Commission must conclude that tariff requirements are not necessary to ensure that SBC's charges, practices, classifications, or regulations for advanced services are just and reasonable and not unjustly or unreasonably discriminatory.[220]

B. Dominant Carrier Regulation, Including Tariffing, of SBC's Advanced Services is not Necessary for the Protection of Consumers.

Just as dominant carrier regulation, including tariffing requirements, is not necessary to ensure that the rates and practices of SBC in its provision of advanced service are just and reasonable, neither is tariff regulation necessary to protect consumers. Indeed, for purposes of

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[219] *See Nondominant Carrier Tariffing Remand Order,* ¶ 23 ("because by definition nondominant carriers cannot exercise market power, unlawful tariffs should be rare, and in those few instances in which they may occur, remedial action can be taken after the tariffs become effective.")

[220] Although, by definition, a non-dominant provider of a service cannot sustain unjust and unreasonable rates or practices, the question posed by section 10 is not whether SBC theoretically *could* do so, but whether tariff requirements are *necessary* to prevent such actions.

applying section 10 to tariff requirements, there is little difference between the first and second branch of the section 10 test: if tariff regulation is unnecessary to ensure that the rates, practices, classifications, and regulations of a carrier are just and reasonable and not unreasonably discriminatory, then such regulation *necessarily* is not required to protect consumers. The Commission so found in the *CAP Forbearance Order* and it should so find here.

C. Forbearance From Applying Dominant Carrier Regulation, Including Section 203 Tariff Requirements, to SBC's Provision of Advanced Services is Consistent With the Public Interest.

Because subjecting SBC's advanced services to dominant carrier regulation, including section 203 tariff requirements, is wholly unnecessary, forbearance from applying these requirements to SBC's advanced service is *ipso facto* consistent with the public interest. As the Commission stated in the *IXC Forbearance Order,* "it seems inconceivable that Congress intended section 10 to be interpreted in a manner that allows continue compliance with provisions or regulations that the Commission has determined were no longer necessary in certain contexts."[221] And as Chairman Powell stated in an interview last May:

> if we don't have a clear and demonstrable justification of a rule, then the appropriate role of government is to take the rule away or not interfere in the otherwise proper functioning of a market, rather than leave a rule in for good measure. Over history a lot of rules that were left for good measure ... have secondary effects that often harm the welfare of consumers. ... I don't think you've got to prove to me that a rule is not necessary. I think I have to prove that it is necessary. And if I can't do that, I don't think that I should intervene.[222]

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[221] *IXC Forbearance Order*, at 20772. Although the Commission in the *IXC Forbearance Order* was speaking of mandatory detariffing, the Commission held in the *CAP Forbearance Order* that the same rationale applied to permissive detariffing. *CAP Forbearance Order* at ¶ 32.

[222] "Powell defends stance on Telecom Competition," COMMUNICATIONS DAILY, May 22, 2001 at 2-3.

But section 203 tariff requirements are not just unnecessary as applied to SBC's advanced services: their application imposes demonstrable social costs and impedes robust competition. The Commission catalogued these costs and the effect of unnecessary tariff requirements on competition in the *IXC Forbearance Order,* the *CAP Forbearance Order,* and other orders. As the Commission explained in those orders, requiring nondominant carriers to file tariffs: (1) removes incentives for rapid price discounting by giving competitors notice of such discounts; (2) reduces or eliminates carriers' ability to make rapid, efficient responses to changes in demand and cost; (3) imposes administrative costs on carriers, which must prepare and file tariffs and Commission staff, which must review them; and (4) limits the ability of customers to obtain service arrangements that are specifically tailored to their needs.[223]

Each and every one of these costs has been recognized since the *Competitive Carrier* proceeding to be an *inherent* social cost of subjecting firms without market power to tariff requirements. Indeed, in its 1979 Notice of Proposed Rulemaking in that proceeding, the Commission noted that "[t]he advance publication of prices and other terms and conditions – in the context of unregulated industries – has been clearly recognized as anticompetitive."[224]

Significantly, the Commission noted that forbearance is appropriate for *any* firm that lacks market power: "Forbearance discretion, of course, must be exercised upon some well-defined bases which can be measured against the overall statutory goals and mandates of the

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223 *IXC Forbearance Order,* ¶ 53, *citing Competitive Carrier Services and Facilities Authorizations Therefor,* Sixth Report and Order, 99 FCC 2d at 1030 and *Implementation of Section 3(n) and 332 of the Communications Act Regulatory Treatment of Mobile Services*, 9 FCC Rcd 1411, 1479 (1994).

224 *Competitive Carrier Further Notice,* ¶ 87.

Communications Act. The lack of market power is, in our view, clearly a sufficient ground upon which to exercise such discretion."[225]

In recent orders, the Commission has identified still other social costs associated with tariff requirements. For example, in the *IXC Forbearance Order,* the Commission found that tariff filings "may facilitate, rather than deter, price coordination, because under a tariffing regime, all rate and service information is collected in one, central location."[226] In addition, the Commission found, tariffs trigger the application of the filed rate doctrine, thereby effectively denying customers the benefits of state consumer protection and contract laws.[227] In the absence of tariffs, the Commission held, "the legal relationship between service providers and customers will much more closely resemble the legal relationship between service providers and customers in an unregulated environment. Thus, eliminating the filed rate doctrine in this context would serve the public interest by preserving reasonable commercial expectations and protecting consumers."[228]

In short, as the Commission has long recognized, detariffing of services provided by carriers that are non-dominant in the provision of those services offers numerous public benefits, not the least of which is increased competition.[229] Here, no less than in these other contexts, forbearance will eliminate unnecessary cost and expense and promote competition. Accordingly,

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225 *Id.*, ¶ 70.

226 *IXC Forbearance Order,* ¶ 23. *See also id.,* ¶ 61.

227 *Id.* ¶¶ 38, 52, 55.

228 *Id.*, ¶ 55.

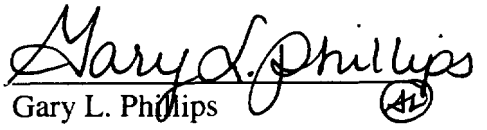
229 This latter benefit can itself be a basis for concluding that forbearance would be in the public interest.

it would be in the public interest for the Commission to forbear from applying dominant carrier regulation, including section 203 tariff requirements, to SBC's provision of advanced services.

VIII. CONCLUSION

As shown above, SBC is non-dominant in its provision of advanced services both for use by mass market customers and by larger businesses. The Commission should thus expeditiously forbear from applying dominant carrier regulation, including tariff requirements, to SBC's advanced services irrespective of whether SBC provides those services through a separate advanced services affiliates. Prompt and favorable action on this Petition will promote competition and consumer welfare and give a much needed boost to the economy as a whole.

Respectfully Submitted,



Gary L. Phillips
Roger K. Toppins
Paul K. Mancini

SBC Communications Inc.
1401 I Street, NW
Suite 400
Washington, D.C. 20005
(202) 326-8910 – phone
(202) 408-8745 - facsimile

Evan T. Leo
Michael K. Kellogg
Kellogg Huber Hansen Todd
& Evans, P.L.L.C.
1615 M Street, NW
Suite 400
Washington, D.C. 20036
(202) 326-7900 – phone
(202) 326-7999 – facsimile

Its Attorneys

October 3, 2001

BEFORE THE
FEDERAL COMMUNICATIONS COMMISSION
WASHINGTON, D.C. 20554

In the Matter of	)
	)
SBC Petition for Expedited Ruling	)
that it is Non-Dominant in its Provision of	)
Advanced Services and for Forbearance	)
from Dominant Carrier Regulation of	)
Those Services	)

DECLARATION OF ROBERT W. CRANDALL AND J. GREGORY SIDAK

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  - 2. Demand Elasticities
  - 3. Supply Elasticities
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Appendix: Output for Nested-Logit Model

INTRODUCTION

1. In this declaration, we present economic evidence relevant to the non-dominance petition filed by SBC Communications Inc. (SBC) with respect to high-speed packet-switched or advanced services.[1] We find that the market for advanced services consists of two relevant sub-markets: services ultimately used by the mass market ("mass-market broadband services") and those ultimately used by larger businesses ("larger-business broadband services"), and that SBC does not have market power in either of these sub-markets.

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1. For purposes of this analysis, we use the FCC's definition of advanced services, as set forth in the *SBC/Ameritech Merger Order*: "wireline telecommunications services, such as ADSL, IDSL, xDSL, Frame Relay, Cell Relay and VPOP-Dial Access Service (an SBC Frame Relay-based service) that rely on packetized technology and have the capability of supporting transmission speeds of at least 56 kilobits per second in both directions." As did the FCC, we exclude from this definition: (1) data services that are not primarily based on packetized technology, such as ISDN; (2) x.25-based and x.75-based packet technologies; and (3) circuit switched services. *See* Application of Ameritech Corp, Transferor, and SBC Communications Inc., Transferee, for Consent to Transfer Control of Corporations Holding Commission Licenses and Lines Pursuant to Section 214 and 310(d) of the Communications Act and Parts 5, 22, 24, 25, 63, 90, 95 and 101 of the Commission's

QUALIFICATIONS

2. Our professional qualifications for submitting this expert report are as follows.

3. My name is Robert W. Crandall. I am the chairman of Criterion Economics and Senior Fellow in Economic Studies at the Brookings Institution in Washington, a position that I have held since 1978. My areas of economic research are antitrust, telecommunications, the automobile industry, competitiveness, deregulation, environmental policy, industrial organization, industrial policy, mergers, regulation, and the steel industry.

4. I have written widely on telecommunications policy, the economics of broadcasting, and the economics of cable television. I am the author or co-author of five books on communications policy published by the Brookings Institution since 1989.[2] In addition, I have published four other books on regulation and industrial organization with the Brookings Institution.[3] My scholarship has been cited on numerous occasions by the federal judiciary and the Federal Communications Commission (FCC).

5. I have been a consultant on regulatory and antitrust matters to the Antitrust Division of the U.S. Department of Justice, to the Federal Trade Commission, to the Canadian Competition Bureau, and to numerous companies in the telecommunications, cable television,

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Rules, CC Dkt. No. 98-141, 14 F.C.C. Rcd. 14,712 (1999) App. C., Merger Conditions, at 1 ¶ 2 [hereinafter *SBC/Ameritech Merger Order*].

2. ROBERT W. CRANDALL & LEONARD WAVERMAN, WHO PAYS FOR UNIVERSAL SERVICE? WHEN TELEPHONE SUBSIDIES BECOME TRANSPARENT (Brookings Institution 2000); ROBERT W. CRANDALL & LEONARD WAVERMAN, TALK IS CHEAP: THE PROMISE OF REGULATORY REFORM IN NORTH AMERICAN TELECOMMUNICATIONS (Brookings Institution 1996); ROBERT W. CRANDALL & HAROLD FURCHTGOTT-ROTH, CABLE TV: REGULATION OR COMPETITION? (Brookings Institution 1996); ROBERT W. CRANDALL, AFTER THE BREAKUP: U.S. TELECOMMUNICATIONS IN A MORE COMPETITIVE ERA (Brookings Institution 1991); ROBERT W. CRANDALL & KENNETH FLAMM, CHANGING THE RULES: TECHNOLOGICAL CHANGE, INTERNATIONAL COMPETITION, AND REGULATION IN COMMUNICATIONS (Brookings Institution 1989).

3. ROBERT W. CRANDALL & PIETRO S. NIVOLA, THE EXTRA MILE: RETHINKING ENERGY POLICY FOR AUTOMOTIVE TRANSPORTATION (Brookings Institution 1995); ROBERT W. CRANDALL, MANUFACTURING ON THE MOVE (Brookings Institution 1993); ROBERT W. CRANDALL & DONALD F. BARNETT, UP FROM ASHES: THE U.S. MINIMILL STEEL INDUSTRY (Brookings Institution 1986); ROBERT W. CRANDALL, HOWARD K.

broadcasting, newspaper publishing, automobile, and steel industries. I have also been a consultant to the Environmental Protection Agency and the U.S. Department of the Treasury.

6. I was an Assistant Professor and Associate Professor of Economics at the Massachusetts Institute of Technology between 1966 and 1974. I also taught at George Washington University. I have twice served in the federal government. I was Acting Director, Deputy Director, and Assistant Director of the Council on Wage and Price Stability in the Executive Office of the President. In 1974-75, I was an adviser to Commissioner Glen O. Robinson of the FCC.

7. I received an A.B. (1962) from the University of Cincinnati and a Ph.D. in Economics (1968) from Northwestern University.

8. My name is J. Gregory Sidak. I am the F.K. Weyerhaeuser Fellow in Law and Economics at the American Enterprise Institute for Public Policy Research (AEI) and the president and chief executive officer of Criterion Economics. I have been a consultant on regulatory and antitrust matters to the Antitrust Division of the U.S. Department of Justice and the Canadian Competition Bureau and to more than forty companies in the telecommunications, electric power, natural gas, mail and parcel delivery, broadcasting, newspaper publishing, recorded music, and computer software industries in North America, Europe, Asia, and Australia.

9. My academic research concerns regulation of network industries, antitrust policy, the Internet and electronic commerce, intellectual property, and constitutional law issues concerning economic regulation. I have directed AEI's Studies in Telecommunications Deregulation since the project's inception in 1992. From 1993 to 1999, I was also a Senior

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GRUENSPECHT, THEODORE E. KEELER & LESTER B. LAVE, REGULATING THE AUTOMOBILE (Brookings

Lecturer at the Yale School of Management, where I taught a course on telecommunications regulation with Dean Paul W. MacAvoy.

10. I served as Deputy General Counsel of the FCC from 1987 to 1989, and as Senior Counsel and Economist to the Council of Economic Advisers in the Executive Office of the President from 1986 to 1987. As an attorney in private practice, I worked on numerous antitrust cases and federal administrative, legislative, and appellate matters concerning telecommunications and other regulated industries.

11. I am the author or co-author of five books concerning pricing, costing, competition, and investment in network industries.[4] I am the editor or co-editor of three books, including two that are relevant to local competition in telecommunications.[5] I am the author or co-author of more than forty scholarly articles in law reviews or economics journals, including the *American Economic Association Papers and Proceedings, California Law Review, Columbia Law Review, Journal of Political Economy, New York University Law Review, Stanford Law Review, University of Chicago Law Review, Yale Law Journal*, and *Yale Journal on Regulation*, as well as opinion essays in the *Wall Street Journal* and other business periodicals. A number of my scholarly articles are directly relevant to the issues posed by this proceeding.[6]

Institution 1986).

4. J. GREGORY SIDAK & DANIEL F. SPULBER, DEREGULATORY TAKINGS AND THE REGULATORY CONTRACT: THE COMPETITIVE TRANSFORMATION OF NETWORK INDUSTRIES IN THE UNITED STATES (Cambridge University Press 1997); WILLIAM J. BAUMOL & J. GREGORY SIDAK, TOWARD COMPETITION IN LOCAL TELEPHONY (MIT Press & AEI Press 1994); WILLIAM J. BAUMOL & J. GREGORY SIDAK, TRANSMISSION PRICING AND STRANDED COSTS IN THE ELECTRIC POWER INDUSTRY (AEI Press 1995); J. GREGORY SIDAK & DANIEL F. SPULBER, PROTECTING COMPETITION FROM THE POSTAL MONOPOLY (AEI Press 1996); J. GREGORY SIDAK, FOREIGN INVESTMENT IN AMERICAN TELECOMMUNICATIONS (University of Chicago Press 1997).

5. COMPETITION AND REGULATION IN TELECOMMUNICATIONS: EXAMINING GERMANY AND AMERICA (J. Gregory Sidak, Christoph Engel & Günter Knieps, eds., Kluwer Academic Press 2000); IS THE TELECOMMUNICATIONS ACT OF 1996 BROKEN? IF SO, HOW CAN WE FIX IT? (J. Gregory Sidak, ed., AEI Press 1999); GOVERNING THE POSTAL SERVICE (J. Gregory Sidak, ed., AEI Press 1994).

6. *See* Jerry A. Hausman & J. Gregory Sidak, *A Consumer-Welfare Approach to the Mandatory*

12. I have testified before committees of the U.S. Senate and House of Representatives on regulatory and constitutional law matters. My writings have been cited by the Supreme Court of the United States, the lower U.S. federal and state supreme courts, U.S. state and federal regulatory commissions, and the European Commission. In the landmark antitrust decision *United States v. Microsoft Corporation* issued on June 28, 2001, my recent *University of Chicago Law Review* article with Howard A. Shelanski on antitrust remedies in network industries was the first work of legal scholarship that the U.S. Court of Appeals for the District of Columbia Circuit cited as authority in its 125-page opinion.[7]

13. From Stanford University, I received A.B. (1977) and A.M. (1981) degrees in economics and a J.D. (1981). I was a member of the *Stanford Law Review*. Following law school, I served as a law clerk to Circuit Judge Richard A. Posner during his first term on the U.S. Court of Appeals for the Seventh Circuit.

14. We file this declaration in our individual capacities and not on behalf of the Brookings Institution or the American Enterprise Institute, neither of which takes institutional positions with respect to specific legislation, litigation, or regulatory proceedings.

SUMMARY OF CONCLUSIONS

15. We have been asked by SBC to undertake economic analysis to determine whether it would serve the public interest for the FCC to declare SBC's affiliates (hereinafter

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Unbundling of Telecommunications Networks, 109 YALE L.J. 417 (1999); Abbott B. Lipsky, Jr. & J. Gregory Sidak, *Essential Facilities*, 51 STAN. L. REV. 1185 (1999); J. Gregory Sidak & Daniel F. Spulber, *The Tragedy of the Telecommons: Government Pricing of Unbundled Network Elements Under the Telecommunications Act of 1996*, 97 COLUM. L. REV. 1081 (1997); J. Gregory Sidak & Daniel F. Spulber, *Givings, Takings, and the Fallacy of Forward-Looking Costs*, 72 N.Y.U. L. REV. 1068 (1997).

7. United States v. Microsoft Corp., No. 00–5212, slip op. at 11-13 (D.C. Cir. June 28, 2001) (per curiam en banc) (quoting Howard A. Shelanski & J. Gregory Sidak, *Antitrust Divestiture in Network Industries*, 68 U. CHI. L. REV. 1 (2001)).

"SBC") non-dominant in their provision of high-speed packet switched or "advanced" service. We answer that question in this declaration using the analytical framework that the FCC itself has articulated in assessing the regulatory status of other providers of telecommunications services.

16. The remainder of this declaration is organized as follows. In Part I, we review the analytical framework that the FCC has used in previous non-dominance proceedings. FCC rules define a dominant carrier as one that possesses market power (that is, the power to control prices), and a non-dominant carrier as a carrier not found to be dominant.[8] The FCC traditionally has considered four factors in determining whether a firm possesses market power: (1) market share and changes therein, (2) demand elasticity, (3) supply elasticity, and (4) cost and size disparity. In addition to considering these four factors, the FCC also has considered whether a firm classified as dominant that lacks market power in the provision of some services could, through discrimination, cross-subsidization, and/or the effectuation of a price squeeze, quickly acquire market power in those services. The FCC has concluded that if a firm does not now have, and could not quickly gain, the ability profitably to raise the price of a service by restricting its output, it is non-dominant in the provision of that service.

17. In Part II, we explain why SBC is not dominant in the mass-market broadband services market. We begin by defining the relevant market for purposes of our analysis. Using FCC precedent and drawing on generally accepted economic and antitrust principles, we determine that mass-market broadband service constitutes a relevant product market. We conclude that the relevant geographic market is a point-to-point market but that, consistent with FCC precedent, the geographic market should be assumed to be SBC's entire service region.

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8. *See* 47 C.F.R. §§ 61.3(o), 61.3(u).

18. Next, we apply the FCC's analytical framework to the market for mass-market broadband services. These services are used almost exclusively for mass-market access to Internet service providers. With respect to market share, we find that SBC's share of the mass-market broadband services market within its serving area is about 32 percent. This market share is consistent with our finding that DSL providers represent between 28 (according to the FCC) and 38 percent (according to Morgan Stanley Telecom) of the broadband Internet access market nationwide. We find further that in the last quarter of 2000 and the first quarter of 2001, cable modem providers have won more subscribers than have DSL providers. We note that the Commission and the courts have recognized that evidence of low market share, in and of itself, strongly suggests that SBC lacks market power in the provision of DSL services. Because SBC does not represent 100 percent of all DSL revenues, SBC's share of the mass-market broadband services market is presumably smaller.

19. We find further proof that SBC lacks market power in DSL services in our assessment of demand elasticity. We find, in particular, that the own-price elasticity of demand for DSL is very high (between –1.2 and –1.5). We corroborate our demand elasticity analysis with other evidence, including internal SBC data showing extremely high customer-level churn rates and survey data showing that consumers who use broadband services have no strong predisposition to DSL or cable modem service and are likely to choose the platform that offers the best combination of service and price. The FCC has relied heavily on this type of data in its prior analyses of demand elasticity.

20. The evidence on supply elasticity of SBC's mass-market broadband competitors and SBC's relative resources also points toward a finding of non-dominance. SBC competes against numerous mass-market broadband competitors in its region, and SBC's cable modem

competitors alone have sufficient capacity to absorb a significant number (if not virtually all) of SBC's existing DSL subscribers. Moreover, SBC's competitors could readily expand their capacity to absorb additional customers.

20. Finally, SBC does not possess cost or size advantages that confer on it market power in its provision of DSL services. To the contrary, SBC competes against some of the nation's largest companies. Moreover, unlike SBC, these companies are deregulated, not only in their provision of mass-market broadband services, but also in other services (such as multi-channel video programming distribution services) in which they likely have market power. It is not SBC that has advantages over these firms; it is the other way around.

21. Having concluded that SBC does not now have market power in the provision of DSL services, we explain why SBC could not leverage its purported market power in the local exchange market into the mass-market broadband services market. We demonstrate why SBC could not engage in discrimination or predatory pricing against unaffiliated rivals.

22. Next, in Part III, we apply the FCC's analytical framework to larger-business advanced services. We present evidence that advanced services for larger businesses constitute a relevant product market. With respect to market share, we determine that SBC has roughly 12 percent of all packet-switching revenues in its region. With respect to demand elasticity, the type of customer for those services—a large, sophisticated business—suggests that the demand is highly price elastic. Moreover, the competitive bidding process for customers ensures that existing customers are insulated from price increases through the duration of the contract. Next, we demonstrate that SBC's largest competitors—the big three IXCs—have sufficient capacity to absorb any customers who would substitute away from SBC in response to a price increase. Finally, we demonstrate that SBC has no advantage over its rivals in the provision of advanced

services. In fact, the interLATA restrictions imposed on SBC place it at a significant disadvantage compared to its rivals in the provision of larger-business advanced services.

23. Having concluded that SBC does not now have market power in the provision of larger-business advanced services, we explain why SBC could not leverage its purported market power in the local exchange market. In particular, we demonstrate why SBC could not engage in discrimination or predatory pricing against unaffiliated rivals.

I. THE FCC'S FRAMEWORK FOR ANALYZING NON-DOMINANCE

24. The FCC defines a dominant carrier as "a carrier that possesses market power" and a non-dominant carrier as "a carrier not found to be dominant (that is, one that does not possess market power)."[9] In the *Fourth Report* in the *Competitive Carrier* proceeding, the FCC defined market power as the "ability to raise and maintain price above the competitive level without driving away so many customers as to make the increase unprofitable."[10] The Commission affirmed this definition in the *BOC Classification Order*, concluding that "the BOC interLATA affiliates should be classified as dominant carriers in the provision of in-region, interstate, domestic interLATA services only if the affiliates have the ability to raise prices of those services by restricting their own output."[11] Notably, in affirming this definition, the FCC rejected arguments that a BOC affiliate should be deemed dominant if it could obtain unfair

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9. 47 C.F.R. §§ 61.3(o), 61.3(t).

10. Policy and Rules Concerning Rates for Competitive Common Carrier Services and Facilities Authorizations Therefor, Fourth Report and Order, 95 F.C.C.2d 554, 558 ¶ 7 (1983) (citing William M. Landes & Richard A. Posner, *Market Power in Antitrust Cases*, 94 HARV. L. REV. 937, 945-52 (1981); Valley Liquors, Inc. v. Renfield Importers, Ltd., 678 F.2d 742, 745 (7th Cir. 1982); H&B Equip. Co., Inc. v. International Harvester Co., 577 F.2d 239, 243 (5th Cir. 1978); ALFRED E. KAHN, THE ECONOMICS OF REGULATION: PRINCIPLES AND INSTITUTIONS 65-66 (MIT Press 1988)).

11. Regulatory Treatment of LEC Provision of Interexchange Services Originating in the LEC's Local Exchange Area and Policy and Rules Concerning the Interstate, Interexchange Marketplace, CC Dkt. No. 96-149, 12 F.C.C. Rcd. 15,756, 15,804 ¶ 85 (1997) [hereinafter *BOC Classification Order*].

advantages over its competitors by virtue of its association with the BOC. The Commission held that dominant carrier status was designed to address anticompetitive pricing by the affiliate, not anticompetitive practices by the BOC and, therefore, should be imposed only when the affiliate would be able to raise its own prices by restricting its own output.[12] The FCC's dominance analysis is grounded in well-accepted antitrust principles of market power.[13]

25. The analytical framework currently used by the FCC to assess market power is based on a framework first articulated in 1991, when the FCC streamlined its regulation of certain AT&T business services.[14] In that order, the FCC identified four primary factors to be used in assessing market power: (1) AT&T's market share and changes therein, (2) the extent to which AT&T's competitors had excess supply capacity, (3) the price elasticity of demand of AT&T's services, and (4) the disparity in size, resources, and cost structures between AT&T and other interexchange carriers (IXCs).[15]

26. The FCC applied this same analytical framework in its 1995 order declaring AT&T non-dominant in its provision of domestic interexchange interstate services.[16] The FCC began its analysis by identifying the relevant product and geographic markets for assessing AT&T's market power. It concluded, based on the market definitions used in the *Competitive Carrier* proceeding and notwithstanding arguments that AT&T maintained market power in discrete services, that all interstate, domestic, interexchange services would be considered a

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12. *Id.* at 15,815 ¶ 103.

13. *See* 2A PHILLIP E. AREEDA, HERBERT HOVENKAMP & JOHN L. SOLOW, ANTITRUST LAW: AN ANALYSIS OF ANTITRUST PRINCIPLES AND THEIR APPLICATION 83-302 (1995); Landes & Posner, *supra* note 10, at 939-52.

14. Competition in the Interstate Interexchange Marketplace, CC Dkt. No. 90-132, 6 F.C.C. Rcd. 5880 (1991) [hereinafter *AT&T Streamlining Order*].

15. *Id.* at 5882 ¶ 10.

16. Motion of AT&T Corp. to be Reclassified as a Non-Dominant Carrier, 11 F.C.C. Rcd. 3271 (1995) [hereinafter *AT&T Reclassification Order*].

single product market.[17] It concluded, further, that there was a single national geographic market for such services. Having so defined the relevant product and geographic market, the FCC concluded, based on the four factors identified above, that AT&T lacked market power in this market. The FCC subsequently applied this same four-part non-dominance methodology in both the *AT&T International Non-Dominance Order*[18] and the *COMSAT Non-Dominance Order.*[19]

27. In the *BOC Classification Order*,[20] the FCC revised its approach to defining product and geographic markets and amplified its non-dominance analysis to account for firms that could be dominant in the provision of some, but not all, services. With respect to market definition, the Commission adopted the approach taken in the *1992 Merger Guidelines.*[21] Under that approach, a relevant market encompasses any service or group of services for which there are no close demand substitutes.[22] The Commission noted that, under this approach, there could be multiple product markets for domestic, interstate, interexchange services, and that each route that allows a connection from one location to another would be a separate geographic market.[23] Nevertheless, noting that it would be impracticable and inefficient to recognize and analyze every such market, the FCC concluded that it need only do so if there was credible evidence suggesting that there is or could be a lack of competitive performance with respect to a particular

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17. *Id.* at 3285-86 ¶¶ 20-22.

18. Motion of AT&T Corp. to be Declared Non-Dominant for International Service, 11 F.C.C. Rcd. 17,963, 17,977 ¶ 36 (1996) [hereinafter *AT&T International Non-Dominance Order*].

19. COMSAT Corp., Petition Pursuant to Section 10(c) of the Communications Act of 1934, as amended, for Forbearance from Dominant Carrier Regulation and for Reclassification as a Non-Dominant Carrier, 13 F.C.C. Rcd. 14,083, 14,118-19 ¶ 67 (1998) [hereinafter *COMSAT Non-Dominance Order*].

20. *BOC Classification Order, supra* note 11, at 18,042 ¶ 28.

21. Although under the *Merger Guidelines*, markets are defined primarily based on demand elasticity, the FCC will assume that two services are in the same product market if production substitution among these services is nearly universal—that is, if the suppliers of one service also supply the other service. *See* Application of WorldCom, Inc. and MCI Communications Corporation for Transfer of Control of MCI Communication Corporation to WorldCom, Inc., 13 F.C.C. Rcd. 18,025, 18,041 ¶ 27 & n.66 (1998) (citing *1992 Horizontal Merger Guidelines,* 57 Fed. Reg. at 41,557, § 1.32 n.14) [hereinafter *WorldCom/MCI Order*].

22. *BOC Classification Order, supra* note 11, at 18,042 ¶ 29.

service or group of services or in a particular area.[24] Using this approach, the FCC concluded that all domestic, interstate, interexchange services could continue to be treated as a single product market and that a BOC's in-region and out-of-region territory be treated as separate geographic markets.

28. In 1998, the Commission amplified its non-dominance analysis in the *BOC Classification Order*. The Commission began its analysis by applying the four-part test first articulated in the *AT&T Streamlining Order* and then applied in subsequent non-dominance orders. Because the BOCs were new entrants in the long-distance market, the Commission readily concluded that the BOCs would not have market power in the provision of domestic in-region, interLATA services immediately upon entry into that market. Then, theorizing that this initial lack of market power could simply reflect the BOCs' prior exclusion from the market, the Commission went on to address whether a BOC could leverage market power in local exchange and exchange access services to confer market power on its long-distance affiliate upon entry by the affiliate into the market, or shortly thereafter.

29. As noted, though, the Commission specifically rejected claims that a BOC long-distance affiliate should be deemed dominant solely on the basis of a finding that it could derive advantages in the market through discrimination, cross-subsidization, or other anticompetitive actions by the BOC.[25] While acknowledging that such actions could distort the market and result in a misallocation of societal resources, the Commission found that dominant carrier regulation

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23. *Id.* at 18,042 ¶ 30.

24. *COMSAT Non-Dominance Order*, *supra* note 19, at 14,107 ¶¶ 42-43. *See also SBC/Ameritech Merger Order*, *supra* note 1, at 14,746 ¶ 68 ("As we explained in the *WorldCom/MCI Order*, to define relevant product markets we can identify and aggregate consumers with similar demand patterns."). *See also id.* at 14,747 n.147 ("We can consider, as a whole, groups of point-to-point markets where customers face the same competitive conditions. We therefore treat as a geographic market an area in which all customers in that areas will like face the same competitive alternatives for a product.").

of the affiliate was a poor tool for dealing with those risks.[26] Rather, the Commission found, dominant carrier status would only be appropriate if the advantages conferred by leveraging were so great that, upon entry or soon thereafter, the BOC affiliate would be able to raise prices by restricting its own output.[27]

30. We now apply the FCC's four-part test to the relevant market in this proceeding. As we explain more fully below, we examine two markets for advanced services—a mass-market broadband services market and a larger-business services market. Mass-market broadband customers include residential customers and small businesses. Larger-business advanced service customers include medium-sized and larger businesses that require greater speeds, greater security, multiple connections, or other important features that are not offered by mass-market broadband service providers. Although some customers, such as a medium-sized business with one or two offices, might consider mass-market services as substitutes for larger-business advanced services, we follow the FCC's dichotomy and examine those services separately.[28]

II. SBC Is Non-Dominant in the Mass-Market Broadband Services Market

31. Mass-market advanced services are provided by cable providers, telephone companies and their affiliates, direct broadcast satellite (DBS), and other firms that provide mass-market consumers packet switched transport at speeds exceeding 56 kilobits per second in

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25. *BOC Classification Order*, *supra* note 11, at 15,873-77 ¶¶ 206-10.
26. *Id.* at 15,877 ¶ 211.
27. *Id.* at 15,834 ¶ 133.
28. For example, in the *WorldCom/MCI Order*, the FCC said: "We distinguish mass market consumers from larger-business consumers because the record indicates that larger-business users often demand advanced long distance features (advanced features), such as frame relay, virtual private networks (VPN), and enhanced 800 services (E800 services), that differ from the services generally demanded by mass market consumers." *WorldCom/MCI Order*, *supra* note 21, at 18,040 ¶ 26.