requirements of section 272 and the Commission's implementing rules."[186] By definition, those safeguards, except for two provisions of section 272(e), would not be available to prevent the BOCs' abuse of market power in circumstances addressed by this proceeding, *i.e.*, "after sunset of the Commission's section 272 structural and related requirements in a state." Notice, ¶ 2. Other regulatory safeguards relied upon by the *LEC Classification Order*, such as price cap regulation to help prevent price squeezes from higher access prices, and the use of UNEs to avoid access charges, have also been reduced or removed since that order was issued. Moreover, the Commission's reliance on these regulatory safeguards to prevent harm to long distance competition from BOC market power over the local bottleneck was itself misplaced, as demonstrated by the subsequent BOC anticompetitive misconduct described above.[187]

Changes in the marketplace since the Commission's 1997 decision, which long predated any grant of section 271 relief, militate against application of nondominant treatment. While the intervening years have brought no meaningful change in the BOC control of the local exchange and exchange access bottleneck, BOCs have now received 271 authority in 42 states and the District of Columbia, and have shown that they can rapidly obtain long-distance market shares over 50 percent even with section 272 separation requirements. BOC competitors are

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innovative IP-based services"); *id.* at 8 ("the Commission's own World Trade Organization ("WTO") commitments compel Commission action to reform special access rates.")

[186] Emphasis added. *See also*, Second Order on Reconsideration and Memorandum Opinion and Order, *Regulatory Treatment of LEC Provision of Interexchange Services Originating in the LEC's Own Local Exchange Area*, 14 FCC Rcd. 10771, ¶ 37 ("We emphasize that the classification of the BOC interLATA affiliates as non-dominant applies *only* to BOC interLATA affiliates that have satisfied the requirements of sections 271 and 272 and the other regulatory requirements relied upon in the LEC Classification Order.") (Emphasis added.)

[187] *See also*, Selwyn Dec., ¶¶ 58 et seq..

greatly diminished in number, weakened in financial strength, and less able than the BOCs to provide the bundled local, long distance, DSL and wireless services for which there is increasing consumer demand. Actual market developments thus provide no substitute for the regulatory safeguards the Commission previously relied upon to prevent BOCs from abusing their local bottlenecks.

Under well-established D.C. Circuit precedents, the Commission is required to conform its former predictive judgment -- that the existence of other safeguards allowed BOC interexchange affiliates to be regulated as nondominant -- to reflect these significantly changed circumstances. It is "settled law that an agency may be forced to reexamine its approach if a significant factual predicate of a prior decision . . . has been removed."[188] An agency has a bedrock obligation to ensure that current facts support its ongoing policy.[189] That duty is also heightened where, as here, the prior decision was based on predictive judgments that in turn were based on the existence of other regulatory safeguards that the Commission has subsequently permitted to lapse. "The Commission's necessarily wide latitude to make policy based on its predictive judgments deriving from its general expertise implies a correlative duty to evaluate its policies over time to ascertain whether they work – that is, whether they actually produce the benefits the Commission originally predicted they would."[190]

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[188] *Bechtel* v. *FCC*, 957 F.2d 873, 881 (D.C. Cir. 1992)

[189] *See, e.g., National Broadcasting Co.* v. *United States*, 63 S. Ct. 997, 1014 (1943) ("If time and changing circumstances reveal that the 'public interest' is not served by application of the Regulations, it must be assumed that the Commission will act in accordance with its statutory obligations").

[190] *Bechtel* v. *FCC*, 957 F.2d at 881 (internal citation omitted).

The Commission itself has acknowledged this obligation.[191] And to the extent that the adoption of different regulatory measures reflecting changed circumstances would arguably entail a "change of mind" by the Commission, such a change does not remotely "render the agency's action arbitrary."[192]

1. The Commission's Prior Nondominant Regulation of BOC Interexchange Affiliates Placed Critical Reliance Upon Section 272.

Although the Commission recognized in the *LEC Classification Order* that dominant regulation could prevent BOC abuse of market power,[193] it declined to regulate the BOC interexchange affiliates as dominant for this reason, because it concluded that "we believe that *other regulations* applicable to the BOCs and their interLATA affiliates will address the anticompetitive concerns raised in the Notice in a less burdensome manner."[194] In particular, the Commission relied on the fact that the BOCs' affiliates were required by section 272 to be "structurally separate" from the BOCs and to "operate independently" from the BOCs.[195]

However, significant aspects of those "other regulations" cited by the Commission will no longer apply. By definition, section 272 requirements would no longer apply after any sunset of that provision. And, as shown above, the *Pricing Flexibility Order* has

[191] *See, e.g.,* Notice of Proposed Rulemaking, *Reexamination of the Policy Statement on Competitive Broadcast Hearings*, 7 FCC Rcd. 2664, ¶ 4 (1992); *Amendment of the Commission's Rules to Establish Part 27*, Report and Order, 12 FCC Rcd 3977, ¶ 27 (1997) (policy based on "realistic assumptions" which, if shown not to be accurate in practice, "we would of course revisit this issue and make appropriate adjustments").

[192] *Bell Atl. Tel. Cos.* v. *FCC,* 79 F.3d 1195, 1202 (D.C. Cir. 1996). *See also, AFL-CIO* v. *Brock*, 835 F.2d 912, 916-17 (D.C. Cir. 1987) ("courts recognize that agencies must respond to changed circumstances to carry out Congress' purposes")

[193] *LEC Classification Order*, ¶ 87.

[194] *Id.*, ¶ 91 (emphasis added).

removed price cap protection and enabled the BOCs to use increased special access rates to price squeeze their rivals. Thus, the principal safeguards the Commission previously relied upon to prevent the BOCs from "us[ing] their market power in local exchange and exchange access services to engage in anticompetitive conduct in competitive markets" would be absent.[196] Given these different circumstances, different safeguards are necessary to prevent BOCs from using their local bottleneck anticompetitively.

Similarly, the *LEC Classification Order* also considered "whether [the BOCs] can use [market power in the provision of local exchange and exchange access services] to give their interLATA affiliates the ability to raise the prices of in-region, interstate, domestic interLATA services by restricting their own output of those services."[197] The Commission's finding that the BOCs would not be able to leverage their local exchange and exchange access market power in this way was also substantially based on the existence of section 272.

Specifically, the Commission relied extensively on the existence of the structural safeguards, audit requirements and affiliate transaction requirements of section 272 to support its finding that "applicable statutory and regulatory safeguards are likely to be sufficient" to prevent the BOCs from eliminating competing IXCs by engaging in improper cost misallocation.[198] The Commission also found that concerns that the BOCs would harm rivals by "exploiting improper cost allocation to divert business to BOC interLATA affiliates from other, more efficient suppliers," even if those rivals were not driven from the market, were "best

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[195] *Id.* ¶ 91, 112-18.

[196] *LEC Classification Order*, ¶ 91.

[197] *Id.*, ¶ 100.

addressed through enforcement of the section 272 requirements."[199] Further, in finding that "statutory and regulatory safeguards" would prevent a BOC from engaging in discrimination that would allow it to raise interexchange prices by restricting its own output, the Commission substantially relied on section 272 nondiscrimination and structural separation requirements.[200] The Commission also relied on the section 272 biennial audit requirement to help address predatory price squeeze behavior.[201]

Thus, the existence of section 272 was both central and essential to the Commission's 1997 findings that the BOC interLATA affiliates would not be able to abuse their local bottlenecks to raise their rivals' costs or to allow the BOC interLATA affiliate to raise its own prices by restricting its own output. Any sunset of section 272 requirements would eviscerate the basis for granting nondominant treatment to BOC long distance entities.

Other regulatory safeguards cited in support of those *LEC Classification Order* findings have already been removed or shown to be ineffective in preventing BOC bottleneck abuse. As shown above, the *Pricing Flexibility Order* means that price cap regulation cannot "sufficiently constrain[]" a BOC's ability to raise special access prices so that "the BOC affiliate would gain, upon entry or soon thereafter, the ability to raise prices of interLATA services

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[198] *Id.*, ¶¶ 103-05.

[199] *Id.*, ¶ 108. The D.C. Circuit has recently emphasized that anticompetitive conduct may harm the public interest even where competing carriers are not driven from the market. *WorldCom, Inc. v. FCC*, 308 F 3d 1, 10 (D.C. Cir. 2002).

[200] *Id.*, ¶¶ 111-119. As discussed above, the requirements of section 272(e)(3) would not be removed but are insufficient to prevent below-cost pricing without dominant carrier cost support requirements to ensure that BOC prices also cover non-access costs. Similarly, as described below, new performance measures are necessary to prevent the non-price discrimination addressed by section 272(e)(1).

above competitive levels by restricting its own output of those services."[202] Price cap regulation also does not prevent cost misallocation. Dr. Selwyn shows that, contrary to the *LEC Classification Order,* price cap regulation in fact has not prevented the cross-subsidization of competitive services, particularly where cost and earnings reporting is reduced as part of the shift to incentive-based regulation.[203]

Similarly, another safeguard against price squeezes relied upon by the *LEC Classification Order* -- "the ability of competing carriers to acquire access through the purchase of unbundled network elements"[204] -- has been largely eliminated by subsequent Commission findings that IXCs may only use UNEs for long distance access to their *own local* customers.[205] Consequently, the availability of UNEs does not enable IXCs to avoid most ILEC access charges or reduce the BOCs' ability to use access charges to price squeeze their rivals. *See* Notice, ¶ 30. Similarly, the use restrictions and ban on commingling that applies to pre-existing combinations of unbundled loops and transport prevents competitors from converting BOCs' special access circuits to UNEs priced at cost-based rates.[206]

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[201] *Id.*, ¶ 128.

[202] *LEC Classification Order*, ¶ 126.

[203] Selwyn Dec., ¶¶ 97-102; *LEC Classification Order*, ¶ 106.

[204] *LEC Classification Order*, ¶ 126. *See also, id.*, ¶ 130 ("As noted, we believe that the ability of competing carriers to acquire access through the purchase of unbundled elements enables them to avoid originating access charges, and thus partially protect themselves against a price squeeze").

[205] Supplemental Order, *Implementation of the Local Competition Provisions of the Telecommunications Act of 1996,* 15 FCC Rcd. 1760, ¶ 2, (1999). (*"Local Competition Supplemental Order"*)

[206] *Local Competition Supplemental Order*; Supplemental Order Clarification, *Implementation of the Local Competition Provisions in the Telecommunications Act of 1996*, 15 FCC Rcd. 9587 (2000). *See also*, AT&T Reply Comments, (filed Jan. 23, 2003), RM No. 10593, at 51-52.

2. Market Developments Assist BOC's Ability to Abuse Their Market Power.

Changes in interLATA markets since 1997 also provide the BOCs with greater ability to exercise market power. The BOCs now have section 271 authority in 42 states and the District of Columbia, and have shown that they can rapidly expand beyond the "zero market share[s]" cited by the *LEC Classification Order* following the grant of section 271 relief.[207] Subsequent experience has clearly demonstrated that the 1997 order was correct that initial low market shares were "not conclusive" in determining whether dominant classification was required for BOC interLATA affiliates because they "potentially could gain significant market share upon entry or shortly thereafter" as the result of "brand identification with in-region customers, possible efficiencies of integration, and the BOC's ability potentially to raise the costs of its affilate's interLATA rivals."[208]

Verizon reported a 20 percent percent long distance market share in New York within twelve months of 271 relief, and a 34.2 percent share at the end of 2001, after just two years of offering long distance.[209] Verizon also reported a more than 20 percent share in Massachusetts after nine months.[210] SBC gained a 21 percent share in Texas within nine months and now claims to have market shares of "43 percent overall and about 50 percent for consumer lines" in the six states where it provides long long distance.[211] Indeed, SBC has advised

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[207] *LEC Classification Order*, ¶ 96.

[208] *Id.*

[209] Selwyn Dec., ¶¶34, 53.

[210] *Id.* ¶ 34.

[211] *Id*; SBC Investor Briefing, 7, http://www.sbc.com/Investor/Financial/ Earning_Info/docs/1Q_03_IB_FINAL.pdf. *See also*, Statement of Edward Whitacre, CEO, SBC Communications, Transcript, April 24, 2003 Conference Call Addressing First Quarter 2003 Earnings (contending
(continued . . .)

investors that market shares can be expected in all its section 271 jurisdictions similar to the 60 percent market share it has obtained in Connecticut five years after SNET (which SBC has since acquired) began marketing long distance services.[212]

This BOC market share growth is unparalleled in the long distance industry -- by 1990, five years after the commencement of interLATA equal access, all non-AT&T IXCs *combined* had collectively acquired only approximately 23 percent of presubscribed lines nationwide.[213] Indeed, the 34 percent share Verizon achieved in New York after two years is *more than twice* the largest share *ever* achieved by any non-AT&T IXC.[214] As noted by Dr. Selwyn, "but for the BOCs' ability to exploit their inbound marketing channel and offer pricing plans ignoring the cost of access, here is no *a priori* reason to expect their rate of market share growth to differ materially from that of OCCs in the years following equal access."[215]

The BOCs also face financially weaker IXC competitors than in 1997. At that time, the Commission found predatory conduct by a BOC interLATA affiliate "unlikely' because "[a]t least four interexchange carriers – AT&T, MCI, Sprint, and LDDS WorldCom" had "nationwide or near nationwide networks," and were "large well-established companies with millions of customers."[216] Those four IXCs are now three, one of which is in

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that SBC has achieved "near 50 percent" penetration of the consumer long distance market in its Southwestern territories).

[212] Selwyn Dec., ¶ 35.

[213] *Id.*, ¶ 53.

[214] *Id.*

[215] Selwyn Dec., ¶ 54.

[216] *LEC Classification Order*, ¶ 107. *See also, id.*, ¶¶ 97, 129.

bankruptcy.[217] Moreover, as described by Dr. Selwyn, "the interexchange transport cost element of end-to-end long distance service is at this point a relatively minor cost element," that is dwarfed by the other long distance costs of access charge payments to ILECs, billing and collection, advertising, marketing and customer service, and consequently "its subsequent reacquisition and reuse by another carrier (following the bankruptcy of one or more of the existing entities) is neither assured or particularly germane to the future of a competitive marketplace."[218] Accordingly, "[e]ven if a start-up long distance carrier were to obtain an in-place interexchange network essential for free, its savings on network-related transport costs would be far less than the savings that a BOC is able to realize from not having to pay itself originating access charges and the various other integration efficiencies that are available only to the BOC."[219]

The Commission also expected price squeeze risks to be "greatly reduced" by "at or near cost" interLATA access to BOC networks and "as competition develops in the provision of exchange access services."[220] However, interstate access charges remain far above cost-based levels, intrastate access charges are still many multiples of cost, and former optimism about future progress in local competition has now been shown to have been misplaced, with many

[217] Selwyn Dec., ¶ 94.

[218] Id., ¶ 95.

[219] *Id.* Thus, "because interexchange transport capacity is not a factor in limiting the supply of retail long distance service, it is extremely unlikely that any such capacity that might be released by a departing carrier would remain in use." *Id.*

[220] *Id.*, ¶ 130.

CLECs now in bankruptcy or with greatly limited operations.[221] As described above, even in the enterprise market, CLECs provide "last mile" facilities only to a small fraction of commercial buildings. Cable telephony, the primary potential last-mile facilities-based alternative for residential users, remains at *de minimis* levels in most states, as does the number of users using wireless as their only phone.

Additionally, the BOCs' ability to engage in price squeezes has increased since 1997 as a result of consolidation in the industry. The *LEC Classification Order* relied on the fact that in 1997 many long distance calls that originated on one BOC's network terminated on another BOC's network as diminishing the likelihood of a price squeeze.[222] However, the Ameritech-Pacific Telesis-SBC-SNET and Bell Atlantic-GTE-NYNEX mergers have made it much more likely that a call that originates on a particular BOC's network will terminate on that same BOC's network, thereby giving the BOC an insurmountable cost advantage with regard to *both* originating and terminating access.[223]

Other subsequent market developments also facilitate, rather than constrain, the BOCs' ability to exercise market power by leveraging their local bottlenecks. The growing popularity of bundled offerings including local and interLATA services, with unlimited calling, and of similar bundled offerings including DSL services, encourages the BOCs to exploit their

[221] *See, e.g.*, "FCC's Powell Says Telecom 'Crisis' May Allow A Bell To Buy WorldCom," Wall Street Journal, A1, A4, Jul. 15, 2002 (the Commission "tended to over-exaggerate how quickly and how dramatically [the local markets] would become competitive").

[222] *LEC Classification Order*, ¶ 129.

[223] *See SBC-Ameritech Merger Order*, ¶ 207 (finding merger increased incentive of SBC-Ameritech to discriminate against competitors).

local access cost advantage by engaging in prices squeezes and cost misallocation, and to discriminate in other ways.

A further misplaced expectation underlying the *LEC Classification Order* was that "a BOC interLATA affiliate's apparent cost advantage resulting from its avoidance of access charges may be offset by other costs it must incur, such as the cost of interLATA transport, which, at least initially, may be greater than the true marginal cost of interLATA transport for facilities-based interLATA carriers."[224] Dr. Selwyn notes that in fact the BOCs likely would enjoy "a formidable interexchange transport cost *advantage*" following any sunset of section 272, because there would then be no restrictions on their use of the interLATA facilities they were permitted to build for so-called "official" (*i.e.*, intracompany) traffic and transmission of calls to directory assistance and operator services to remotely located centralized facilities.[225] RBOC mergers have expanded the geographic scope of these networks, which were built by the regulated BOC entities with capital outlays much of which have now been recovered through rates charged to BOC monopoly ratepayers.[226]

The predictions and assumptions underlying the Commission's former classification of the BOC interLATA affiliates as nondominant -- that other regulatory safeguards and marketplace developments would prevent abuse of the BOCs' local bottleneck -- therefore provide no support for any similar finding here. Instead, the Commission must address the known, likely anticompetitive effects of the local bottleneck and adopt appropriate regulations to limit the BOCs' ability to exploit them.

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[224] *LEC Classification Order*, ¶ 129.

[225] Selwyn Dec., ¶ 82, n.104 (emphasis added).

IV. DOMINANT CARRIER REGULATION MUST CONTINUE UNTIL THE COMMISSION ADOPTS REFORMS PREVENTING INCUMBENT ABUSE OF LOCAL BOTTLENECKS THROUGH PRICE AND NON-PRICE DISCRIMINATION.

The core problem requiring dominant carrier regulation of BOCs that provide local and interLATA services on an integrated basis is their ability to leverage their local bottlenecks through price and non-price discrimination. With BOCs controlling 87 percent of local mass market customers, 97 percent of local switched access facilities, and the vast majority of last mile special access facilities, BOC market power over local exchange and exchange access will continue for many years.[227]

The BOC's ability to abuse their local bottlenecks will not be eliminated until regulatory actions (1) remove the BOCs' access cost advantage, (2) reduce BOC special access rates to just and reasonable levels, (3) establish and enforce performance measures preventing non-price discrimination, and (4) require independent PIC administration and establish greater limits on joint marketing. These essential reforms, some of which are under consideration in dockets now pending before the Commission, would not provide all the safeguards of section 272 or that would be provided by dominant carrier regulation of BOC long distance services. But once these reforms were fully carried out, they would remove the BOC access cost advantage and limit non-price discrimination, which would provide a basis to revisit the dominant carrier status of BOC interLATA services. Prior to that point, any ruling granting

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[226] *Id.*

[227] As noted above, in applying its section 63.10 dominant carrier rules and the International Settlements Policy, the Commission presumes that foreign carriers possess market power if they have market shares above 50 percent in any relevant market on the foreign end of a U.S. (continued . . .)

nondominant treatment of those services would be highly premature. Moreover, it would merely encourage the BOCs to continue to engage in anticompetitive leveraging of their local bottlenecks and would lead inexorably to the BOCs' remonopolization of U.S. long distance services.

1. The Need for Dominant Carrier Regulation Is Paramount Until and Unless BOC Access Cost Advantages Are Eliminated, Special Access Rates Are Reduced to Reasonable Levels, and Adequate Performance Measures and Imputation Requirements Are Adopted and Enforced.

Intercarrier Compensation Reform. There is a critical need for comprehensive intercarrier compensation reform in order to remove the BOC access cost advantage resulting from the current system of above-cost interstate and intrastate switched access rates, and to reduce the BOCs' ability and incentives to engage in anticompetitive price squeezes, and other anticompetitive cross-subsidization. Now that the BOCs have obtained section 271 authority in 42 states and the District of Columbia, IXCs should no longer be required to subsidize their BOC long distance *competitors* through above-cost switched access charges that also provide the BOCs with an unfair cost advantage in interexchange markets.

The provision of switched access to all LEC networks for all interLATA services at forward looking economic cost-based prices would create a level competitive playing field, as well as encourage efficient facilities investment and use.[228] Indeed, the Commission has long had the objective of reducing switched access charges to TELRIC levels for just this reason.

international route, including local access facilities. *Foreign Participation Order*, ¶ 161 & n. 312.

[228] *See generally,* First Report and Order, *Implementation of the Local Competition Provisions of the Telecommunications Act of 1996*, 11 FCC Rcd. 15499, ¶¶ 672-703 (1996).

However, that goal cannot be fully attained unless access charges for intrastate calls are also reduced to TELRIC levels.

The Commission could undertake such action by adopting a uniform intercarrier compensation rule requiring forward-looking, economic cost-based pricing for all minutes terminated on all networks.[229] Under such an approach, all minutes would be treated identically for transport and termination purposes, whether voice or data, whatever the identity of the called party, whether the call is jurisdictionally interstate or intrastate, and whether the carriers involved are LECs or IXCs.[230] In fact, Congress intended precisely that result when it gave the Commission authority in section 251(g) to establish a reasonable transition period before bringing access charges within the cost-based reciprocal compensation standard that Congress mandated will ultimately apply to the transport and termination of all "telecommunications."[231] The adoption of such a unified approach based on forward-looking economic cost would prevent both bottleneck abuse and the regulatory arbitrage that is encouraged by the present environment.[232]

Meaningful Regulatory Constraints on BOC Special Access Services. Commission action also is required to ensure just and reasonable rates for special access, which the BOCs have raised to excessive levels and have used to create price squeezes for competitors following the *Pricing Flexibility Order*. As requested by AT&T's *Petition for Rulemaking To Reform Regulation of Incumbent Local Exchange Carrier Rates For Interstate Special Access*

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[229] *See* Comments of AT&T, CC Docket No. 01-92, (filed Aug. 21, 2001).

[230] *Id.* at 9.

[231] *Id.*

[232] *Id.* at 1-3.

Services, the Commission should, at a minimum, revoke special access pricing flexibility and reinitialize price caps to levels designed to produce normal, rather than monopoly, returns for the BOCs.[233] Additionally, to prevent further harm while the Commission conducts that rulemaking, the Commission should adopt immediate, interim relief reducing all special access charges for services subject to Phase II pricing flexibility to the rates that would produce an 11.25% rate of return (the last authorized BOC rate of return), make clear that any such rate reductions will not trigger any termination or other liability penalties, and impose a moratorium on consideration of further pricing flexibility applications pending completion of the rulemaking.[234] The Commission also should eliminate the use restrictions and ban on commingling that prevents competitors from converting existing special access circuits to UNEs.[235]

Performance Measures To Limit Non-Price Discrimination. A further necessary reform is the adoption of strong performance measures and standards, supported by meaningful consequences for discriminatory and unreasonable performance, to address longstanding deficiencies in the BOCs' provisioning and support of special access services.[236] The Commission should adopt the Joint Competitive Industry Group ("JCIG") Proposal under consideration in the *Performance Measurements and Standards for Interstate Special Access Services* proceeding, which is the result of an industry consensus among the entire spectrum of special access users regarding the performance measures, measurement calculations, business rules, exceptions, disaggregation levels and performance standards that are necessary to measure

[233] AT&T Petition for Rulemaking (filed Oct. 15, 2002), RM No. 10593, at 39.

[234] *Id.* at 39-40.

[235] *See* AT&T Reply Comments, (filed Jan. 23, 2003), RM No. 10593, at 51-52.

[236] *See AT&T Special Access Comments*

BOC performance in key areas.[237] A separate audit process is also necessary to ensure the reliability of performance reports.[238] As the Commission has recognized, the use of metrics is a "relatively non-intrusive means of implementing pro-competitive policies and rules and of evaluating the incumbents' compliance with such requirements."[239] The Commission also should adopt a meaningful remedy and enforcement plan including maximally self-executing remedies to provide incentives for compliance.[240]

Independent PIC Administration. The BOC abuse of customer preferred carrier choices, changes and freezes described above amply demonstrates the need to ensure that these customer choices are administered in a competitively-neutral manner.[241] Neutral administration of these customer choices would largely eliminate the regulatory burden in resolving preferred carrier disputes (whether between carriers or between carriers and customers and for all services, including local, intraLATA, or interLATA), would facilitate regulatory monitoring of carrier behavior with real-time data while reducing the need for monitoring, and would eliminate the

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[237] *Id.* at 23-28.

[238] *Id.* at 29.

[239] *SBC-Ameritech Merger Order* ¶ 125.

[240] *AT&T Special Access Comments,* at 36-42.

[241] In New York, the Public Service Commission in March 2001 observed that in light of Verizon having received § 271 authorization, "a more neutral system should be considered." *Order to Show Cause, Requesting Comments and Closing Cases,* Case 00-C-0897 et al., (March 23, 2001), at 23. In response, the New York Attorney General recommended that "a competitively neutral PIC freeze system be administered by an independent entity that will treat all competing providers equally." Reply Comments of Eliot Spitzer, Attorney General of the State of New York, (filed June 8, 2001), at 8. Similarly, several State public utility commissions have been considering the use of a Neutral Third Party Administrator to maintain a centralized database and/or a clearinghouse of customer-account information (such as telephone numbers, name and address, and preferred carrier freeze status for each service level) for real-time queries during sales calls and also administering all customer preferred carrier choices, changes, and freezes.

need for additional regulation to address slamming, cramming, BOC discrimination, and consumer frustrations related to preferred carrier freezes. Indeed, this Commission itself has taken a step toward this solution, endorsing, in its preferred carrier freeze regulations, the use of an "independent third party" to confirm requests for preferred carrier freezes.[242] The Commission accordingly should create a mechanism to ensure that the BOCs no longer dominate customers' preferred carrier choices, changes and freezes.[243]

Joint marketing. Commission action is also necessary to redress the crushing power of the joint marketing made possible by the BOCs' continuing dominance of the bottleneck and of functions related to it -- particularly joint marketing on inbound calls in which customers select a long distance provider. Both the courts and the Commission have acknowledged that BOCs may not discriminate when a customer seeks "new service," defined as "receiv[ing] service from the [particular] BOC for the first time" or "mov[ing] to another location within the BOC's in-region territory."[244] However, local customer service agents may recommend their affiliate's long distance service in such calls so long as they also mention the

[242] 47 C.F.R. § 64.1190(d)(2)(iii). *See also*, 47 U.S.C. § 251(e)(1) (mandating a similar approach for administering telecommunications numbering).

[243] *Notice of Inquiry Concerning a Review of the Equal Access and Nondiscrimination Obligations Applicable to Local Exchange Carriers*, CC Docket No. 02-39, Comments of AT&T, (filed May 10, 2002), at 29-39.

[244] *Non-Accounting Safeguards Order*, ¶292, fn. 761; *U.S. v. Western Electric*, 578 F.Supp 668, 676-77 (D.D.C. 1983)

availability of other providers;[245] they also may market without restriction when customers call to obtain an additional line.[246]

The Commission should, at a minimum, extend nondiscrimination obligations to customer requests for a new telephone line. A customer seeking a new line is not materially different from a customer who "receives services from the particular [BOC] for the first time" or "moves to another location within the [BOC] area." 578 F. Supp. at 677. Just as discrimination by a BOC in providing a first line can thwart interexchange competition, so also can such discrimination in providing additional lines. Requests for second (or additional) lines constitute a significant market for which BOCs should not be permitted to leverage the advantage of an "inbound channel" based upon their continuing dominance over the local telecommunications market.

2. Continuing Dominant Carrier Regulation Until Adequate Safeguards Are Developed to Limit Abuse of the Local Bottleneck is Not Unduly Burdensome.

As described above, the BOCs are properly classified as dominant carriers because of their market power in the provision of local exchange and exchange access. As such, they are not subject to the disciplines of competitive market forces and readily may leverage their market power to advantage their interLATA services by providing local and interLATA services on an integrated basis. Accordingly, following any sunset of the section 272 structural separation requirements upon which the Commission's former nondominant treatment of BOC interLATA

[245] Memorandum Opinion and Order, *Application of BellSouth Corp., et al., Pursuant to Section 271 of the Communications Act etc.*, 13 FCC Rcd. 539, ¶¶ 231-39 (1997), *approved in AT&T Corp. v. FCC,* 220 F.3d 607, 632, (C.A.D.C. 2000)..

[246] *See* Memorandum Opinion and Order, *In the Matter of AT&T Corp.* v. *New York Tel. Co.*, 15 FCC Rcd. 19,997 (2000).

affiliates was predicated, the Commission should require BOC compliance with dominant carrier rules ensuring that their interLATA rates are just, reasonable and nondiscriminatory, until the other safeguards necessary to prevent BOC anticompetitive leveraging of their local bottlenecks are adopted and fully implemented.

This recommended approach would fulfill the objectives stated by the Notice (¶ 40) of "minimiz[ing] regulatory burden on the BOCs" while also "avoid[ing] the potential exposure of both ratepayers in local markets and competitors in interexchange markets to the potential risk of improper cost misallocation and unlawful discrimination." And while the BOCs will no doubt contend that *any* requirement for compliance with dominant carrier rules, even for the limited period proposed here, is "unreasonably burdensome," there is nothing unreasonable about preventing the abuse of market power.[247] Indeed, the Commission is required to take such action in the absence of adequate alternative safeguards. Because the safeguards on which the Commission's former rules on nondominant treatment of BOC interLATA affiliates were premised would no longer apply following the sunset of section 272, the "regulatory benefits" of dominant carrier regulation plainly "outweigh the burdens" pending the adoption of other reforms to prevent the abuse of BOC bottleneck market power.[248] As Chairman Powell has noted, "deregulation for its own sake is not responsible policy."[249]

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[247] *See* Order and Notice of Proposed Rulemaking, *Comsat Corp.*, 13 FCC Rcd. 14083, ¶ 153, (1998) (upholding dominant carrier tariff filing requirements for Comsat services in markets where it had market power and noting that "the public interest in maintaining dominant carrier regulation in these circumstances outweighs the burdens that Comsat might experience by complying with our dominant carrier regulations in these markets").

[248] Second Order on Reconsideration and Memorandum Opinion and Order, *Regulatory Treatment of LEC Provision of Interexchange services originating in the LEC's Local Exchange Area*, 14 FCC Rcd. 10771, ¶ 37, (1999) (*LEC In-Region Interexchange Order")* ("we believe that dominant carrier regulation should be imposed only where the regulatory benefits outweigh

(continued . . .)

VI. INDEPENDENT LECS SHOULD REMAIN SUBJECT TO EXISTING SAFEGUARDS.

Although there are certainly ample bases for regulating incumbent independent LECs as dominant providers of in-region long distance services in view of their continued control of their local bottlenecks, there is a rational basis for maintaining the independent LECs' *nondominant* status and distinguishing them from the BOCs.

First, and most importantly, independent LECs are geographically dispersed with relatively small service areas and customer bases. Thus, as the D.C. Circuit explained in rejecting the BOCs' claim that section 271 was an unlawful bill of attainder because Congress subjected the BOCs to stricter regulation than the independent LECs, independent LECs simply do not have the same ability to harm long distance competition as the BOCs. Independent LECs originate relatively few calls and almost all independent LECs' customers' long distance calls will terminate on another carrier's network, which greatly reduces the ability of any independent LEC to cost-price squeeze large regional and national long distance carriers.[250]

Moreover, some independent LECs do not even provide long distance services and therefore have no incentive to impede long distance competition. Finally, given their

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the burdens"). *See also*, Selwyn Dec., ¶ 113 ("it is inconceivable, in light of the BOCs' extraordinary success in ramping up their long distance operations, that the BOCs can legitimately claim that dominant carrier treatment would place them at a competitive disadvantage relative to their non-dominant rivals").

[249] *See* Remarks by Michael K. Powell, Chairman, FCC, to Federal Communications Bar Association (June 21, 2001).

[250] *BellSouth Corp. v. FCC*, 162 F.3d 678, 689 (D.C. Cir. 1998) ("[B]ecause the BOCs' facilities are generally less dispersed than [those of other competitors], they can exercise bottleneck control over both ends of a telephone call in a higher fraction of cases than can [other competitors])."

relatively weak brands and marketing presence, independent LECs that attempt to discriminate against rivals are much less likely than the BOCs to gain customers as a result of discrimination.

At the same time, the independent LECs must comply with separate affiliate requirements that, unlike section 272, are not subject to sunset. Specifically, independent LECs are required to provide in-region, interstate interexchange services through a separate legal entity that (i) has separate books of account, (ii) has no joint ownership of switching and transmission facilities with any affiliated local exchange company, and (iii) acquires any services from any affiliated local exchange company at tariffed rates, terms and conditions or on the same basis as requesting carriers that have negotiated interconnection agreements under section 251.[251]

Although these separation requirements are less extensive than the structural separation requirements of section 272 -- and are patently insufficient to constrain the BOCs' market power -- the Commission could rationally determine that they remain appropriate to address the independent LECs' very different incentives and abilities. Those separation requirements will be necessary until the Commission carries out the reforms described above to remove the incumbents' access cost advantage and limit their ability to engage in non-price discrimination.

[251] *LEC Classification Order*, ¶162. The Commission subsequently modified these requirements to allow independent LECs providing in-region long-distance services solely on a resale basis, with no use of their own switching or transmission facilities, to provide these services through a separate corporate division rather than a separate affiliate. *See LEC In-Region Interexchange Order*, ¶ 22.

CONCLUSION

For the reasons described above, the Commission should regulate BOC in-region interexchange services as dominant after sunset of the Commission's section 272 safeguards in a state until the Commission completes all of the following essential reforms to prevent BOC abuse of their local bottlenecks by removing the BOCs' access cost advantage, reducing BOC special access rates to just and reasonable levels, and establishing and enforcing performance measures preventing non-price discrimination. Independent LECs should remain subject to existing separation requirements.

Respectfully submitted,

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