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

In the Matter of	)	
	)	
Section 272(f)(1) Sunset of the BOC Separate	)	WC Docket No. 02-112
Affiliate and Related Requirements	)	
	)	
2000 Biennial Regulatory Review	)	CC Docket No. 00-175
Separate Affiliate Requirements of Section	)	
64.1903 of the Commission's Rules	)	

REPLY COMMENTS OF THE NEW JERSEY DIVISION OF THE RATEPAYER ADVOCATE

The New Jersey Division of the Ratepayer Advocate ("Ratepayer Advocate") submits these reply comments in response to comments filed by interested parties in the above-captioned proceeding. A review of the initial comments filed by the respective parties in response to the *Further Notice of Proposed Rulemaking* ("*FNPRM*") reveals a glaring dichotomy. On the one hand, there are the Bell Operating Companies ("BOCs") and independent Local Exchange Carriers ("LECs") who assert that they should not be subject to dominant carrier regulation in their provision of in-region, interstate and international, interexchange services because they lack substantial market share in the long distance market. On the other hand, nearly all other commenters, including Interexchange Carriers ("IXCs"), regulatory authorities, and consumer advocates, opine that the BOCs' and independent LECs' continued dominance in the local exchange and exchange access markets in their respective regions allows them to engage in price squeezes, discriminatory practices, and cost misallocation, absent separate affiliate requirements and other effective safeguards.

It is no surprise that all the BOC commenters strongly oppose being treated as dominant carriers in their provision of interLATA long distance services once the Section 272 separate affiliate requirements expires. However, given the fact that in virtually every state in which the BOC has obtained long distance authority, they have managed to gain market share at unprecedented levels despite adherence to Section 272 separate affiliate requirements, BOCs are still able to exert their dominance in the local exchange and exchange access markets. This type of BOC behavior can lead to stifled competition in the long distance market. Therefore, when sunset of the Section 272 requirements occur, the FCC cannot allow the BOCs to provide integrated services without appropriate regulatory scrutiny. The Ratepayer Advocate reasserts its position that BOCs should be treated as dominant carriers unless they voluntarily comply with and are subject to the separate affiliate requirements set forth in the *Competitive Carrier Fifth Report and Order*[1] once the Section 272 requirements expire.

The BOCs and independent LECs pose several arguments why they should not be accorded dominant carrier status in their provision of long distance services to consumers. The Ratepayer Advocate finds none of the BOCs' arguments compelling.

One such argument is that they cannot be regarded as dominant carriers of long distance services because of the competitive nature of the long distance market as evidenced by the services being offered through different avenues, such as wireless,

1 *See Policy and Rules Concerning rates for Competitive Carrier Services and Facilities Authorizations Therefor: Fifth Report and Order*, CC Docket No. 79-252, 98 FCC2d 1191, (1984) ("*Competitive Carrier Fifth Report and Order*"). The *Competitive Carrier Fifth Report and Order* required that interexchange carriers affiliated with independent LECs would be regulated as non-dominant provided that the affiliate providing interstate interexchange services: (1) maintain separate books of account, (2) not jointly own transmission or switching facilities with its affiliated exchange telephone company; and (3) acquire any services from its affiliated exchange telephone company at tariffed rates, terms, and conditions.

Voice over Internet Protocol ("VOIP"), cable, and Internet-based services.[2] The Ratepayer Advocate does not find this argument cogent because the existence of comparable services does not necessarily preclude a BOC from exerting their existing market power in the local exchange and exchange access markets to thwart competition in the long distance market. While it is true that VOIP and cable telephony are growing technologies that are considered alternate providers of long distance services, these technologies have not yet developed to the level of posing a threat to the BOCs' or independent LECs' dominance in their respective markets.[3] As a recent article in the Wall Street Journal explains, the technology is not suitable for primary residential use because of encryption problems, its inability to support 911 calls, and potential problems of providing power to an Internet phone connection because phones that work on VOIP have no independent source of power.[4] The BOCs also claim that the popularity of wireless platforms that include attractive long distance offerings will prevent them from becoming dominant providers of long distance services. However, these wireless platforms are unlikely to replace or impact greatly the BOC dominance in the local and exchange access markets.[5]

SBC Communications cites the FCC's *LEC Classification Order* to support their claim that BOC affiliates have no incentive to restrict their output of long distance services and the elimination of structural separation requirements would not create such

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[2] SBC Comments at 2-3, Verizon Comments at 6-7, BellSouth Comments at 7, Qwest Comments at 13.

[3] Sprint states in its comments that cable-telephony lines constituted approximately 1.59% of the total switched access lines in the nation as of December 31, 2002. See Sprint Comments at 4, n.6.

[4] Marcelo Prince, *Dialing for Dollars, Internet Phone Calls Haven't Made Much of a Dent in the Baby Bells' Business*, WALL STREET JOURNAL, May 19, 2003.

an incentive.[6] Contrary to SBC's assertions, the FCC recognized the propensity for the BOC affiliate to gain market share in the long distance market and made reference to this likelihood in the *LEC Classification Order*:

> [T]he fact that each BOC interLATA affiliate initially will have a zero market share in the provision of in-region, interstate, domestic, interLATA services suggests that the affiliate will not initially be able to raise price by restricting its output . . . we find that this factor is not conclusive in determining whether a BOC interLATA affiliate should be classified as dominant, because the affiliate's zero market share results from its exclusion from the market until now, and, *the affiliate could potentially gain significant market share upon entry or shortly thereafter, because of its brand identification with in-region customers, possible efficiencies of integration, and the BOCs' ability potentially to raise the costs of its affiliate's interLATA rivals*.[7] (emphasis added).

Furthermore, the competitive landscape for long distance services has changed dramatically since the release of the *LEC Classification Order* in 1997. The FCC, in deciding that BOC interLATA affiliates would not have the potential to raise prices by restricting their output upon entry into the long distance market was premised on the presence of large, well established interexchange carriers such as AT&T, MCI, Sprint, and LDDS at the time of the Order's release.[8] As we are all aware, these interexchange carriers have undergone their fair share of economic turmoil over the past six years. For example, LDDS is no longer a major interexchange carrier; MCI merged with Worldcom and subsequently filed for bankruptcy amid accounting scandals, and is currently in the process of reorganization; Sprint has been steadily losing market share over the past few years and was most recently surpassed by Verizon Communications as the No. 3 long

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5 Sprint Comments at 4.

6 SBC Comments at 7.

7 *See Regulatory Treatment of LEC Provision of Interexchange Services Originating in the LEC's Local Exchange Area*, CC Docket No. 96-149, Second Report and Order in CC Docket No. 96-149 and Third Report and Order in CC Docket No. 96-611, 12 FCC Rcd 15756, 15810-15811, para. 96. (1997) (*LEC Classification Order*).

distance seller in terms of customers; and AT&T is barely holding on to its No. 1 slot due to constant downgrades to its debt ratings by the major credit rating agencies which makes it more expensive for AT&T to borrow money. The entry of BOCs into the long distance market has affected the market share held by the other interexchange carriers because the BOCs have succeeded in steadily gaining market share within their respective regions and may soon dominate the long distance market altogether. As a result, some form of separate affiliate requirements is necessary. Therefore, the Ratepayer Advocate urges the FCC to adopt the recommendations set forth in our Initial Comments.

Verizon also asserts that BOCs are unable to gain market share by raising rivals' costs or through restricting output through essential control of an essential input to long distance because of the growth of competition in the local exchange and exchange access markets.[9] Verizon's assertions are entirely misplaced and without merit. As MCI accurately explains in its comments, the fact that the local market is considered open to competition when the BOCs receive interLATA authority is by no means equivalent to a finding that the BOCs' local bottleneck control has disappeared. [10]

It is a fact that the local exchange market is still dominated by BOCs, and CLECs have only managed to achieve modest penetration levels, even in those states where the BOCs have achieved long distance authority, such as New York and Texas. The Ratepayer Advocate agrees with MCI's contentions that "the BOCs' continued high local market share is directly relevant to an assessment of the BOCs' market power in the

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[8] *Id.* at 15811, para. 97.

[9] Verizon Comments at 16.

[10] MCI Comments at 3.

interLATA market . . . because there are a large number of inbound customer contacts inherent in the local exchange service customer relationship and . . . each such contact provides the BOCs with an opportunity to market interLATA service."[11]

Moreover, Verizon's recent Forbearance Petition[12] filed with the FCC in which it requests relief from its obligation to provide UNE-P to competitive carriers, demonstrates Verizon's lack of commitment to furthering competition in the local markets. Verizon's Forbearance Petition is only the most recent in a long series of attempts by the BOCs to weaken or even eliminate FCC rules that provide competitors with the opportunity to compete in the local market. Verizon asserts in this proceeding that they are unable to exert their market power in the long distance market due to existing competition, while at the same time, their Forbearance petition seeks to drastically reduce competition in the local market by limiting the availability of essential inputs relied upon by competitive carriers to provide services to consumers. It is therefore, disingenuous for Verizon to assert that the presence of competition in the local exchange market will successfully prevent them from gaining market share in the long distance market by leveraging control over essential facilities which is precisely what a grant of forbearance from UNE-P obligations will accomplish.

Verizon also asserts that competition in the access market is even better established than in the local exchange market because "competitive carriers are gaining a significant share of revenues from special access."[13] Special access is regarded as the

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[11] *Id*. at 5.

[12] *I/M/O Petition for Forbearance From the Current Pricing Rules for the Unbundled Network Element Platform*, Petition for Expedited Forbearance of the Verizon Telephone Companies, WC 03-157 (July 1, 2003).

[13] Verizon Comments at 18.

backbone of the telecommunications network. Special access refers to high-capacity lines such as T1s, which connect customers directly to long distance carriers. In particular, interexchange carriers rely on BOC special services to provide frame relay, ATM, and integrated voice/data services to their large business customers. Although the FCC declared special access service competitive in the *1999 Pricing Flexibility Order*[14], the experiences of AT&T, MCI, and Sprint paint an entirely different picture. They all claim that BOCs still retain significant market power over the provision of the special access facilities that are a critical input for interexchange carriers.[15] Because of the lack of viable competition in the special access market, the BOCs have essentially taken advantage of the special access pricing flexibility and have increased their rates. The increased special access rates has the effect of raising the costs of interexchange carriers and other carriers that rely on special access services as essential inputs, and allow BOCs competing in these downstream markets to exert price pressure on their rivals.[16]

In fact the BOCs' dominance in the provision of special access services was recently explored in a comprehensive report prepared by the Phoenix Center, a telecommunications "think tank" in Washington D.C. The report reveals that the FCC's regulatory scheme for special access services has produced substantial and sustained price increases, which is a direct consequence of BOC market power. Furthermore, the report states that the BOCs' abuse of market power is a multibillion-dollar annual

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14 *In re Access Charge Reform, Fifth Report and Order and Further Notice of Proposed Rulemaking*, 14 FCC Rcd 14221, FCC 99-206 (rel. Aug. 1999) ("*Pricing Flexibility Order*").

15 AT&T Comments at 31, Sprint Comments at 7-8, MCI Comments at 11.

16 AT&T Comments at 31-32.

overcharge on businesses and consumers.[17] The Ratepayer Advocate submits that it is incumbent upon the FCC to prevent dominant carriers under their jurisdiction from gouging consumers and stymieing competition via the unfettered abuse of their market power, in the special access context in particular and in the long distance market in general.

Bell South, Verizon, SBC, and Qwest all assert that once Section 272 sunsets, existing statutes and regulatory safeguards will still remain in place to prevent BOCs from engaging in price squeezes, discriminatory conduct, and cost misallocation, thereby eliminating the need for additional safeguards.[18] This claim is specious at best.

SBC claims the concern that BOCs have the incentive and ability to discriminate is unwarranted because the BOCs are interested in building goodwill, which will be destroyed by any attempt to provide inferior service to competitors.[19] Furthermore, SBC asserts that if they provide inferior service to other interexchange carriers, the customers of that interexchange competitor will assume that the BOC caused the poor service instead of the competitor.[20] This argument is unpersuasive because a BOC enjoys the benefits of consumer brand loyalty derived from its longstanding monopoly status in the market place. As a result, a BOC who provides inferior service to a competitor does not run the risk of harming its relationship with its core local exchange customers because

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[17] George S. Ford, PhD, Lawrence J. Spiwak,, Phoenix Center Policy Paper Number 18*: Set It and Forget It? Market Power and the Consequences of Premature Deregulation in Telecommunications Markets* at 8-9, Phoenix Center for Advanced Legal and Economic Public Policy Studies. (July 2003).

[18] BellSouth Comments at 9-12, SBC Comments at 42, Qwest Comments at 18, Verizon Comments at 18-21.

[19] SBC Comments at 43-44.

[20] *Id*. at 43.

they are not adversely affected by the discriminatory conduct of the BOC towards the interexchange competitor. However, a competitor's goodwill can be severely harmed when the BOC provides them with inferior services, because the customer of the competitor in turn receives poor service, and those customers invariably assign blame on the competitive carrier, and not on the BOC.

Other BOCs such as Verizon assert that price-cap regulation reduces the BOCs' incentive to allocate improperly the costs of their affiliates' interLATA services.[21] This argument is unconvincing as well and as MCI duly noted in their comments, the FCC has recognized that a price squeeze can occur whenever BOC access charges are above cost, even if they are limited by price caps.[22] Furthermore it no longer holds true that price cap regulation can effectively deter BOCs from increasing the access charges that competing interLATA carriers have to pay the BOCs. For example, the deregulation of the special access market demonstrated that BOCs began increasing special access rates as soon as they were freed from price cap regulation. It is therefore apparent that price-cap regulation does not sufficiently control prices for key services such as special access that have remained well above cost, and has created a substantial risk of a price squeeze for frame relay, ATM, and other data services that rely on special access services.

It is quite ironic that BellSouth asserts in its comments that there is no need to impose any new or modified requirements on BOCs in their provision of interLATA services outside of a separate affiliate in order to prevent anticompetitive behavior, when it has been the subject of recent FCC investigations for non-competitive conduct in violation of the Section 272 requirements. BellSouth has recently entered into a consent

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[21] Verizon Comments at 19.

decree with the FCC and have agreed to make a voluntary payment of $1.4 million to the U.S. Treasury and have also agreed to abide by the separate affiliate requirements for longer than is required. The consent decree resolved two investigations by the FCC, the first focused on allegations that BellSouth had marketed, sold or provisioned long distance services in six states from May through December 2002 before receiving FCC approval to do so. The second investigation centered around allegations that BellSouth Long Distance refused to provide long distance service to CLEC end users because it did not have operational agreements with the CLECs.[23] BellSouth's violation of the Section 272 requirements reinforces the need for continued structural safeguards to limit similar BOC abuses.

The fact that all the BOC commenters have been guilty of noncompliance with various local competition obligations, both at the federal and state level, and have been assessed fines totaling millions of dollars, highlights the need for separate affiliate requirements and other effective safeguards. These tools give the FCC and state commissions the ability to monitor market behavior and detect misbehavior. Without these monitoring tools, there is no reason to assume that the BOCs will police themselves. Furthermore, the benefits afforded consumers through vibrant competition far outweighs the burdens that the BOCs supposedly endure in order to satisfy these requirements. Sprint, an independent LEC, stated in its comments that their experience in complying with separate affiliate requirements were not nearly as burdensome and costly

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[22] MCI Comments at 17.

[23] Telecommunication Report's State News Wire, *BellSouth to pay $1.4M to resolve FCC probes*, July 18, 2003.

as the BOCs have alleged.[24] The Ratepayer Advocate reasserts its position that BOCs should be treated as dominant carriers unless they voluntarily comply with and are subject to the separate affiliate requirements set forth in the *Competitive Carrier Fifth Report and Order* once the Section 272 requirements expire.

CONCLUSION

For the reasons set for the herein and in its Initial Comments, the Ratepayer Advocate respectfully submits that both BOCs and independent LECs, must be subject to the structural safeguards currently in place for independent LECs. The FCC must not ignore the fact that BOCs' have committed numerous violations of federal and state requirements and the structural safeguards were instrumental in detecting and punishing BOC misbehavior. Without these structural safeguards, BOCs and independent LECs will have the ability to engage in anticompetitive conduct. The FCC simply cannot allow BOCs and independent LECs to operate in an unbridled manner without regulatory oversight. Adoption of the Ratepayer Advocate's recommendations set forth in our Initial Comments will provide appropriate regulatory oversight and protect the public interest.

Respectfully Submitted,

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24 Sprint Comments at 15.