Before the
Federal Communications Commission
Washington, D.C. 20554

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

REPLY COMMENTS OF
AD HOC TELECOMMUNICATIONS USERS COMMITTEE

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SUMMARY

In its Comments in this proceeding, Ad Hoc urged the Commission to impose regulatory protections on the long distance services of the Bell Operating Companies ("BOCs") and other incumbent local exchange carriers (collectively, the "ILECs") in order to prevent those carriers from impeding or restricting competition in the market for those services. Ad Hoc also urged the Commission to retain, and in many areas repair, its regulation of local exchange and exchange access services to protect competition in both long distance markets and the local markets upon which long distance service competitors depend.

Though the ILECs generally ignore the issue, the initial comments of other parties agree with Ad Hoc that the key structural impediment to full competition in long distance markets once the ILECs can enter those markets is the ILECs' continuing dominance of local exchange and exchange access markets. That dominance, and the ILECs' incentives and opportunities to leverage that dominance into the "downstream" interLATA toll services market, must be addressed by the Commission through, *inter alia*, dominant carrier regulation of the ILECs' long distance services.

Ad Hoc identified in its initial Comments a number of regulatory requirements and non-structural safeguards for both local and long distance services that would protect competition in both markets. In particular, Ad Hoc urged the Commission to re-vamp its regulations for exchange access service to ensure cost-based, economically efficient prices incapable of generating

subsidies for anti-competitive pricing of long distance service by the ILECs. And, as the Commission itself determined in its *LEC Classification Order*, the tariffing and cost support filing requirements imposed by dominant carrier regulation of the ILECs' long distance services can help to detect and prevent predatory pricing of those services.

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REPLY COMMENTS OF THE AD HOC TELECOMMUNICATIONS USERS COMMITTEE

The Ad Hoc Telecommunications Users Committee (the "Ad Hoc Committee") submits these Reply Comments pursuant to the Commission's May 19, 2003 Further Notice of Proposed Rulemaking ("*FNPRM*") in the dockets captioned above.[1]

In its Comments in this proceeding, Ad Hoc urged the Commission to impose regulatory protections on the in-region, interexchange, interstate and

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

international services (hereinafter, "long distance services") of the Bell Operating Companies ("BOCs") and other incumbent local exchange carriers (collectively, the "ILECs") in order to prevent those carriers from impeding or restricting competition in the market for those services. Ad Hoc also urged the Commission to retain, and in many areas repair, its regulation of local exchange and exchange access services as the key regulatory action that would protect competition in both long distance markets and the local markets upon which long distance service competitors depend.

As sophisticated high-volume customers of telecommunications services, with substantial experience negotiating service contracts with carriers, Ad Hoc members expect to benefit significantly from a more competitive and less regulated market for long distance services. But a long distance market that is de-regulated prematurely would offer only short-term gains in return for significant long-term losses for large business users because the development of robust competition would be frustrated, resulting in higher prices, inferior service, and fewer choices for consumers. Rather than succumb to the lure of short-term benefits, Ad Hoc urges the Commission to exercise its regulatory authority and (1) impose pro-competitive, pro-consumer regulatory requirements on the ILECs' long distance activities; and (2) repair and strengthen the regulatory regime applicable to the ILECs' local exchange and exchange access services to eliminate the ILECs' opportunities and incentives to engage in anti-competitive cross-subsidies and price squeezes.

Rulemaking, rel. May 19, 2003, FCC 03-111 ("*Further Notice*").

I. THE ILECS' LOCAL/ACCESS BOTTLENECK REMAINS INTACT

Though the ILECs generally ignore the issue, the initial comments of other parties join Ad Hoc in pointing out the key structural impediment to full competition in long distance markets once the ILECs can enter those markets: the ILECs' continuing dominance of local exchange and exchange access markets. That dominance, and the ILECs' incentives and opportunities to leverage that dominance into the "downstream" interLATA toll services market, remains the elephant in the room that is not going to disappear simply because it is ignored.[2] Ad Hoc agrees with BellSouth that "…rather than expend an inordinate amount of time conducting an extensive and unnecessary market analysis to determine whether BOCs possess market power in the interexchange market, the Commission should focus on addressing its concerns about the BOCs' alleged control in the local exchange and exchange access markets."[3]

The record thus far in this proceeding clearly confirms Ad Hoc's view that the ILECs continue to dominate the markets for local exchange and access. In contrast to USTA, which makes sweeping, unsubstantiated assertions that the local and access markets are fully competitive, citing to *planned* deployments of new technologies,[4] the interexchange carriers have presented quantitative evidence showing that the ILECs continue to control today the vast majority of

[2] SBC devotes a scant two pages to the issue out of its 48 page comments (SBC Comments at 36-37), while the economists sponsored by SBC, Qwest, and Verizon attempt to dismiss in a few sentences the price squeeze problems created by the BOCs' dominance in the access markets. See Carlton-Sider-Shampine Declaration, at para. 53, attached to SBC Comments ("Carlton-Sider-Shampine Declaration").

[3] BellSouth Comments at 8.

[4] USTA Comments a 7-8.

the local exchange and the access markets.[5] As it evaluates the record on this point, the Commission should take particular notice of the position of Sprint. Sprint has a foot in both camps, *i.e.,* it has considerable experience operating both as an ILEC and an IXC. Yet Sprint declares unequivocally that the BOCs (1) continue to dominate the exchange and access markets, and (2) have the incentive and ability to discriminate against other interLATA toll services providers; and thus should continue to be subject to structural separation and other regulatory protections.[6]

The record also confirms that the ILECs have been able to leverage their local market power when they enter the long distance market on an integrated basis (*i.e.*, without a requirement that they operate through structurally-separate affiliates). As the BOCs admit – confirming Ad Hoc's observation in its initial comments[7] – they have been able to capture interLATA market share at an unprecedented pace even prior to the elimination of structural separation. SBC, Verizon, and Qwest present in their comments data from SBC which indicates that SBC's share of the Texas toll market shot up from zero to roughly 35 percent in the eighteen months after it gained Section 271 authority to provide in-region interLATA services. [8]

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[5] See, e.g. MCI Comments at 4-5, AT&T Comments at 9-10, and Sprint Comments at 5-9.

[6] Sprint Comments at 2 and 5-11.

[7] Ad Hoc Comments at 16.

[8] Carlton-Sider-Shampine Declaration at para. 24 and Figure 2. SBC claims therein that its Texas market share has stabilized at 35 percent since the end of 2001. But SBC's CEO Edward Whitacre has stated that the company had close to a 50% market share for "consumer" long distance throughout its Southwest territory in the first quarter of 2003. Either the company has achieved considerably greater market penetration than 50% in other Southwest states (to result in a regional average of 50%), or it has understated its recent Texas penetration figures. See Ad

If this unprecedented pace of customer acquisition were due simply to service innovation or competitive skill, other participants in the competitive toll market would have been able to perform as well in the past. Yet that has never occurred. The BOCs' rapid penetration into the market appears largely due to the marketing and cost advantages conferred by joint marketing of interLATA services with their local exchange services. Once the BOCs are permitted to fully integrate their interLATA services into their local operations, those advantages may prove to be insurmountable by the standalone IXCs in the absence of regulatory requirements designed to protect competition from the anti-competitive practices described below.

II. THE ILECS HAVE STRONG INCENTIVES AND UNIQUE OPPORTUNITIES TO ENGAGE IN ANTICOMPETITIVE STRATEGIES

Ad Hoc and other commenters described in their initial Comments in this proceeding the risks of anti-competitive cost-shifting and price squeezes by the ILECs if they are classified as non-dominant in their provision of long distance services and the regulatory regime applicable to their local services is not revised. The ILECs' comments, on the other hand, maintain that the widespread adoption of price caps regulation has eliminated their incentives and opportunities to shift costs improperly, because prices are set independently of underlying costs.[9] But their arguments are substantiated only by theory rather than an examination of actual conditions.

Hoc Comments at 16.

[9] *See, e.g.,* Carlton-Sider-Shampine Declaration, at paras. 63-66; BellSouth at 20.

In fact, price caps plans typically have *not* been implemented in a way that completely severs the BOCs' prices from its costs. State price cap plans most often have a limited term and require periodic review of the ILEC's productivity and cost trends. In addition, while the FCC eliminated earnings sharing in the interstate price cap plans more than a decade ago, several states continue to require earnings sharing. ILECs serving those states would benefit directly by shifting costs from their long distance operations to their price caps services so as to reduce their shareable intrastate earnings. Finally, several states, notably New Hampshire, Oregon, and Washington, continue to apply traditional rate of return regulation, which no party disputes creates an inducement for cost shifting.

Similarly, the BOCs dismiss concerns regarding their ability to impose price squeezes on long distance competitors without looking at actual conditions. Absent competitive sources of local exchange and exchange access services, long distance providers who compete with the ILECs will be vulnerable to price squeezes from over-priced access services and long distance rates subsidized by supra-competitive access revenues. At a minimum, the Commission must review the ILECs' prices for long distance service to ensure that they are set at a level that recovers the costs properly attributable to them. Moreover, under Section 272(e) (3), BOCs must impute to themselves the same access prices that the BOC imposes on unaffiliated long distance competitors. Only dominant carrier regulation of the BOC's long distance service can protect against anti-competitive pricing and ensure compliance with the statutory imputation requirement in a timely and effective manner.

The BOCs have also argued, in reliance on the Carlton-Sider-Shampine Declaration attached to or referenced in their comments, that price predation, *i.e.,* setting prices for long distance services below their costs in order to drive competitors from the market, generally is rare and unlikely to succeed.[10] But this view does not reflect the current consensus among mainstream economists, as detailed in the Selwyn declaration attached to AT&T's Comments. Driven by developments in game theory, the more recent consensus in mainstream economics is that predatory pricing does occur and can succeed, so that it should be taken seriously. [11]

III. REGULATORY PROTECTIONS ARE NECESSARY TO PRESERVE COMPETITION IN LONG DISTANCE MARKETS AND PROTECT END USERS IN LOCAL EXCHANGE AND EXCHANGE ACCESS MARKETS

Ad Hoc identified in its Comments a number of regulatory requirements and non-structural safeguards for both local and long distance services that would protect competition in both markets. The bulk of these requirements was directed at what Ad Hoc believes to be the core competitive issue in current telecom markets, namely, the ILECs' continuing dominance in local markets. Pending improvement in the competitive conditions in local markets, the Commission must classify the ILECs' long distance activities as dominant and impose regulatory requirements that will prevent the ILECs from leveraging their power in local markets and impeding competition in long distance markets.

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[10] Carlton-Sider-Shampine Declaration at para. 55; SBC Comments at 46, citing *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209, 226 (1993).

[11] *See generally* Selwyn Declaration, attached to Reply Comments of AT&T.

As Ad Hoc noted in its Comments, dominant regulation of the ILECs' long distance service is an imperfect tool for stimulating the behavior – and replicating the conditions – that characterizes a fully competitive market. But it is a necessary tool for the ILECs' long distance services, along with improved reporting of key market data, until such time as the Commission (1) revamps its regulation of access prices to eliminate the potential for price squeezes; and (2) modifies its cost allocation rules so that the BOCs' local exchange and access services are not saddled with costs (such as marketing and customer acquisition costs) attributable to the ILECs' interLATA services.

Ad Hoc recognizes that dominant carrier regulation imposes some costs on the carriers and can impact competition at the margin, as the BOCs emphasize. [12] Many of the specific concerns of the BOCs regarding the burden of regulation are unfounded, however. For example, while they point to the FCC's prior finding that tariffing may promote tacit collusion through the exchange of pricing information,[13] that concern is misplaced since, as previously discussed in Ad Hoc's Comments, the BOCs have almost entirely refrained from providing their interLATA services outside of their home regions and thus do not compete head-to-head in any event. More importantly, even the (minor) costs that may result from regulatory oversight are outweighed by the potential harm to the competitiveness of the market, and ultimately to end users, from a lack of regulatory oversight. .

[12] Carlton-Sider-Shampine Declaration at para. 73, SBC at 2-3, BellSouth at 23-25.

[13] Carlton-Sider-Shampine Declaration at para. 80, BellSouth at 26.

As the Commission itself determined in its *LEC Classification Order*,[14] the tariff and cost support filings required under dominant carrier regulation might help to detect and prevent predatory pricing of the ILECs' long distance services.[15] In fact, that cost data, in combination with the opportunity for regulatory review and potential intervention by affected parties, constitutes one of the few means available to police that anticompetitive behavior before it occurs. In contrast, reliance on the *ex post facto* mechanisms suggested by the BOCs, such as complaints brought by competing IXCs suspecting a price squeeze or predatory pricing, would introduce unnecessary delay and could not undo the market damage caused in the interim.

CONCLUSION

Ad Hoc recognizes that this proceeding is not intended to address some of the access pricing issues that the commenters have identified as crucial to the preservation of competition in the long distance market if structural separation requirements are no longer applied to the ILECs. Nevertheless, the most effective tool for eliminating the potential for anti-competitive cost-shifting and price squeezes is to reduce over-priced access charges (for both switched and special access) to economic cost. The Commission itself observed this more than six years ago. [16] Until these problems are eliminated from local markets, the Commission must retain its ability to detect and expeditiously correct anti-

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[14] *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*, 12 FCC Rcd 15,756 (1997) ("*LEC Classification Order*").

[15] *LEC Classification Order* at para. 87.

competitive pricing in long distance markets by classifying ILEC long distance services as dominant.

Respectfully submitted,

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[16] *LEC Classification Order* at para. 130.

Certificate of Service

I, Algerlynn Gill, hereby certify that true and correct copies of the preceding Comments of Ad Hoc Telecommunications Users Committee were served this 28th day of July, 2003 via the FCC's ECFS system, and by email upon the following:

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