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*EX PARTE*

July 9, 2004

Ms. Marlene H. Dortch, Secretary  
Federal Communications Commission  
445 12<sup>th</sup> Street, S.W., TW-A325  
Washington, DC 20554

Re: *In the Matter of Section 272(f)(1) Sunset of the BOC Separate Affiliate and Related Requirements*, 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

Dear Ms. Dortch:

On June 9, 2004, Mr. Frank S. Simone, AT&T's Government Affairs Director, submitted a written *ex parte* to the Commission in the above-captioned proceedings concerning the regulatory treatment of BOC interLATA services after Section 272 sunsets.<sup>1</sup> The purpose of this letter is to respond to the lengthy declaration of Lee L. Selwyn, AT&T's economic consultant, which accompanied Mr. Simone's letter. While the Selwyn Declaration largely covers old ground – repeating AT&T's tired price squeeze and cross-subsidization arguments – Qwest feels compelled to respond since for the first time Dr. Selwyn recommends that the Commission significantly modify its affiliate transactions and joint cost rules (*i.e.*, 47 C.F.R. §§ 32.27 and 64.901) to guard against "potential" cross-subsidization by the BOCs. This is in addition to arguing that BOCs should be classified as dominant carriers of interLATA services if BOCs provide these services on an integrated basis rather than through a separate Section 272 affiliate.

Dr. Selwyn and AT&T appear to believe that if they repeat their convoluted arguments for "handcuffing" the BOCs in the provision of interLATA service enough times that these arguments will gain credence. As is demonstrated below, AT&T's arguments for subjecting BOC interLATA services to asymmetrical regulation are neither supported by the facts nor are they compatible with the public interest or the Commission's (and the Act's) goal of encouraging competition wherever possible. Anything but an outright rejection of AT&T's arguments would

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<sup>1</sup> *Ex parte* letter to Ms. Marlene Dortch, Secretary, Federal Communications Commission, WC Docket No. 02-112, CC Docket Nos. 00-175, 01-337 and 02-33, from Frank S. Simone, Government Affairs Director, AT&T, filed June 9, 2004 and its attached *Ex parte* Declaration of Lee L. Selwyn, dated June 8, 2004 ("Selwyn Declaration").

be totally at odds with the Commission's long standing position of "protecting competition, rather than individual competitors."<sup>2</sup>

#### Propositions Underlying AT&T's Position

Selwyn's argument that BOC-provided interLATA services must be subject to pervasive regulation cannot survive close regulatory scrutiny. It is "a house of cards" designed to protect competitors such as AT&T which collapses when the underlying assumptions, predictions and definitions are examined. Selwyn and AT&T's advocacy is based on a number of highly questionable, if not false, propositions, including the following:

- That it is possible to draw conclusions with respect to competition in the market for interLATA services by looking solely at data on landline PIC selections while ignoring actual usage, particularly wireless usage.<sup>3</sup>
- That BOCs have the incentive and the ability to subject interLATA service competitors to an illegal price squeeze.

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<sup>2</sup> See generally *Policy and Rules Concerning Rates for Competitive Common Carrier Services and Facilities Authorizations Therefor, Notice of Inquiry and Proposed Rulemaking*, 77 FCC 2d 308 (1979); *First Report and Order*, 85 FCC 2d 1 (1980) ("*Competitive Carrier First Report and Order*"); *Further Notice of Proposed Rulemaking*, 84 FCC 2d 445 (1981); *Second Further Notice of Proposed Rulemaking*, FCC 82-187, 47 Fed. Reg. 17308 (1982); *Second Report and Order*, 91 FCC 2d 59 (1982) ("*Competitive Carrier Second Report and Order*"); *Order on Reconsideration*, 93 FCC 2d 54 (1983); *Third Further Notice of Proposed Rulemaking*, 48 Fed. Reg. 28292 (1983); *Third Report and Order*, 48 Fed. Reg. 46791 (1983); *Fourth Report and Order*, 95 FCC 2d 554 (1983) ("*Competitive Carrier Fourth Report and Order*"), vacated, *AT&T v. FCC*, 978 F.2d 727 (D.C. Cir. 1992), cert denied, *MCI Telecommunications Corp. v. AT&T*, 509 U.S. 913, 112 S. Ct. 3020 (1993); *Policy and Rules Concerning Rates for Competitive Carrier Services and Facilities Authorizations Therefor*, CC Docket No. 79-252, 98 FCC 2d 1991 (1984) ("*Competitive Carrier Fifth Report and Order*"); *Sixth Report and Order*, 99 FCC 2d 1020 (1985), vacated, *MCI Telecommunications Corp. v. FCC*, 765 F.2d 1186 (D.C. Cir. 1985), affirmed, *MCI v. AT&T*, 512 U.S. 218, 114 S. Ct. 2223 (1994) ("*Competitive Carrier Sixth Report and Order*") (collectively "*Competitive Carrier proceeding*"). Also see *In the Matter of 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, Second Report and Order in CC Docket No. 96-149 and Third Report and Order in CC Docket No. 96-61*, 12 FCC Rcd. 15756 (1997) ("*LEC Classification Order*"). Also see *In the Matter of Motion of AT&T Corp. to be Reclassified as a Non-Dominant Carrier, Order*, 11 FCC Rcd. 3271 (1995) ("*AT&T Reclassification Order*").

<sup>3</sup> Selwyn Declaration at 25-30 ¶ 32.

- That if access charges and other non-tariffed services (provided to BOCs' long distance units) exceed forward-looking costs, BOCs will have the ability to engage in a price squeeze.<sup>4</sup>
- That it is necessary to establish price floors for each individual BOC interLATA service to protect BOC competitors from potential anticompetitive BOC conduct.<sup>5</sup>
- That "service by service" cost imputation is required to ensure that BOCs do not underprice their interLATA services.<sup>6</sup>
- That promotional pricing of competitive interLATA services by BOCs must be severely restricted by requiring BOCs to recover all imputed costs, including installation costs, through promotional rates over a limited period of time (12 months or the contract life).<sup>7</sup>
- That cross-subsidization is defined to occur when nonregulated telecommunications services "are priced below cost *either* (a) by using revenues or profits being derived from [regulated] services [...], or (b) by affording the deregulated or nonregulated services access to assets, resources, facilities and functions of the integrated, regulated firm without bearing a fair share of the costs, or when a provider's deregulated services derive benefits from the regulated operations without the regulated operations receiving just and reasonable compensation from the deregulated operations for the benefits derived."<sup>8</sup>
- That the Commission's affiliate transactions and joint cost rules (*i.e.*, 47 C.F.R. §§ 32.27 and 64.901) are not sufficient to protect regulated ratepayers from cost misallocation.<sup>9</sup>
- That virtually all economies of scope arise from the BOCs' "legacy local service monopolies."<sup>10</sup>

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<sup>4</sup> *Id.* at 5 ¶ 5.

<sup>5</sup> *Id.* at 19-20 ¶ 22.

<sup>6</sup> *Id.* at 17-21 ¶¶ 19-24.

<sup>7</sup> *Id.* at 21-22 ¶¶ 25-26.

<sup>8</sup> *Id.* at 7-8 ¶ 8.

<sup>9</sup> *Id.* at 22-25 ¶¶ 27-30.

<sup>10</sup> *Id.* at 12-13 ¶ 13.

- That dominant carrier regulation of BOC-provided interLATA services is required in order to ensure that AT&T's proposed imputation standards and price floors are "enforced."<sup>11</sup>
- That it is necessary to shackle one group of market participants to guard against "potential" cross-subsidization.<sup>12</sup>
- That costs imposed on consumers, BOCs and the Commission by regulation of BOC-provided interLATA services are outweighed by the benefits of such pervasive regulation.

None of the above assumptions, predictions and definitions are supported by fact, economic theory or judicial/regulatory precedent. These propositions form the foundation of Dr. Selwyn's arguments for classifying BOCs as dominant providers of interLATA service (in addition to his arguments for even greater regulation of BOC interLATA service). If these propositions cannot withstand close scrutiny – and they cannot – then it is not possible for the Commission to rationally conclude that BOCs must be classified as dominant providers of interLATA service, as Selwyn and AT&T advocate.

### Competition

Today interstate interLATA service prices are set by the competitive market in the absence of tariffs.<sup>13</sup> The primary market participants include wireline telephone companies, wireless carriers, cable companies, resellers of bulk communications, and prepaid calling card providers. Currently, BOCs participate in the market through their Section 272 affiliates. No single market participant has the ability to raise price by restricting output – in fact, it would be a self-defeating maneuver.<sup>14</sup> Even if a large IXC withdrew from the market, the remaining participants would

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<sup>11</sup> *Id.* at 25 ¶ 31.

<sup>12</sup> *Id.* at 1-4 ¶¶ 2-3.

<sup>13</sup> *See In the Matter of Policy and Rules Concerning the Interstate, Interexchange Marketplace, Implementation of Section 254(g) of the Communications Act of 1934, as Amended, Second Report and Order*, 11 FCC Rcd. 20730 (1996), *on recon.*, 12 FCC Rcd. 15014 (1997), *pets. for rev. denied*, *MCI WorldCom v. FCC*, 209 F.3d 760 (D.C. Cir. 2000); the D.C. Circuit lifted its *Stay* of these *Orders* on May 1, 2000 and issued its *Mandate* on June 20, 2000; *Second Order on Reconsideration and Erratum*, 14 FCC Rcd. 6004 (1999).

<sup>14</sup> Even when AT&T had almost a 60% market share, the Commission found that both residential and business customers were highly demand elastic and would switch from AT&T to obtain lower rates. *See AT&T Reclassification Order*, 11 FCC Rcd. at 3305 ¶ 63, 3306 ¶ 65.

have sufficient excess capacity to expand their output without raising prices in most cases.<sup>15</sup> Drs. Carlton, Sider and Shampine note that network capacity has grown at an almost exponential rate in recent years as a result of a massive expansion in the deployment of fiber-optic cable and related electronic developments which allow carriers to derive greater amounts of capacity from a single fiber strand.<sup>16</sup> Furthermore, overall industry capacity would not shrink since most communications investments are “sunk” investments (*e.g.*, fiber, right-of-way, conduit, etc.).<sup>17</sup> The mere existence of unused capacity (that can be quickly “turned on”) puts downward pressure on prices.

As Drs. Carlton, Sider and Shampine have noted, the long distance market is highly competitive and much less concentrated than it was in 1995 when AT&T was found to be a non-dominant provider with a market share of approximately 60%.<sup>18</sup> No single provider has the ability to “dominate” the long distance market. Carlton, *et al.*, also show that wireless providers present a far greater competitive threat to AT&T (and other wireline long distance providers) than the BOCs ever will.<sup>19</sup> They provide data showing that the number of wireless subscribers grew by 400% from 1995-2002 and wireless minutes of use (including interLATA minutes) grew by 1,600% during the same period.<sup>20</sup>

Sunset of Section 272’s separate affiliate requirement should not have an upward impact on long distance prices. Prices have fallen dramatically since 1995, as Carlton, *et al.*, point out,<sup>21</sup> and there is no reason to believe that prices will rise with the expiration of Section 272’s separate affiliate requirement. If anything, the fact that BOCs can reduce their internal costs and organize

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<sup>15</sup> The Commission found this to be the case in 1995 when it found AT&T to be a non-dominant provider with a 60% market share. At the time, the Commission found “AT&T’s competitors have enough readily available excess capacity to constrain AT&T’s pricing behavior – *i.e.*, that they have or could quickly acquire the capacity to take away enough business from AT&T to make unilateral price increases by AT&T unprofitable.” *AT&T Reclassification Order*, 11 FCC Rcd. at 3303 ¶ 58.

<sup>16</sup> See Qwest Comments, WC Docket No. 02-112 and CC Docket No. 00-175, filed June 30, 2003 at its attached Declaration of Dennis W. Carlton, Hal Sider and Allan Shampine, dated June 30, 2003, at 23-25 ¶¶ 38-40 (“Declaration of Carlton, Sider and Shampine”).

<sup>17</sup> “These assets are likely to remain available to a new entrant even if existing long distance companies are driven from the market.” *Id.* at 29 ¶ 55.

<sup>18</sup> *Id.* at 8-9 ¶¶ 13-15.

<sup>19</sup> *Id.* at 16-21 ¶¶ 28-34.

<sup>20</sup> *Id.* at 16 ¶ 29. Carlton, *et al.*, also cite to a Lehman brothers study that estimates that 70% of AT&T’s \$3.5 billion decline in consumer revenues between 2001 and 2002 was due to wireless and Internet (*e.g.*, e-mail) substitution. *Id.* at 20 ¶ 34.

<sup>21</sup> *Id.* at 21-22 ¶¶ 35-36.

more efficiently should allow them to be even more competitive in pricing and packaging their long distance products. Reducing output in an attempt to increase profits would be nonsensical for BOCs or any other market participant in the long distance market where capacity far exceeds demand on most routes. As Carlton, *et al.*, found, competition in the market for long distance service has grown enormously with the widespread availability of low-cost wireless packages.<sup>22</sup>

Using the same analytical framework as the Commission in its *LEC Classification Order*, Drs. Carlton, *et al.*, conclude that “permitting the BOCs and independent ILECs to integrate their long-distance and local exchange operations will not adversely affect competition” and that “there is no economic basis for imposing dominant carrier regulation on BOCs’ in-region long distance service. . . .”<sup>23</sup>

Competition in long distance service is also enhanced by the fact that long distance service has become a commodity. With the advent of dialing parity and equal access, most purchasers view long distance providers as selling essentially the same product rather than differentiated products. The closest thing to the competitive markets of economic textbooks is a commodity market. In such cases it is extremely difficult, if not impossible, for any one market participant to differentiate its product from the products of others and increase profits by restricting output and raising prices.

Dr. Selwyn and AT&T also claim that the BOCs’ bundling of interLATA long distance with local exchange and other BOC services is inherently anticompetitive. Selwyn (and AT&T) is wrong – once again Selwyn refuses to differentiate between harm to competitors and harm to competition.<sup>24</sup> Competitors, including wireless providers, have offered such service packages for

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<sup>22</sup> Many of these wireless packages offer virtually unlimited “free” calling during off-peak and non-business hours. “The emergence of new pricing mechanisms in wireless service plans has contributed to rapid growth in the use of wireless services for long distance calls. These include ‘bucket’ plans (which offer a given number of minutes for a flat monthly rate) [which often include bundles of minutes] that effectively reduce the marginal costs of long distance calls to zero for many consumers.” *Id.* at 17 ¶ 30.

<sup>23</sup> *Id.* at 4 ¶ 8.

<sup>24</sup> Drs. Kahn and Taylor underscored the importance of this point in discussing BOC special access pricing initiatives allowed by the Commission’s *Pricing Flexibility Order*: “The offer of special deals to attract or retain customers, whether justified by differences in cost or actually discriminatory in the technical sense, is an essential way in which price competition takes place in the real world. That they may discommode or injure competitors is an inherent consequence; but one of the most fundamental distinctions in economics generally, and antitrust law specifically, is between the inflicting of harm on competitors, with a resulting net increase in consumer welfare, from weakening or impairment of the competitive process, resulting in an ultimate or net decrease in consumer welfare.” *See* Opposition of Qwest Communications International Inc., RM No. 10593, filed Dec. 2, 2002 at its attached Declaration of Alfred E.

a number of years. The fact that competitors may be harmed as Qwest and other BOCs respond to bundled service offerings of competitors in no way implies that the BOCs' actions are anticompetitive. On the contrary, this is exactly how competition works in practice.<sup>25</sup>

The Commission has found that bundling serves the public interest by fostering competition, reducing prices, reducing transactions costs and encouraging service innovation.<sup>26</sup> In addressing the issue of bundling CPE with local service, the Commission found "that the consumer benefits of bundling outweigh the risk that incumbent LECs can use this power [in the local exchange market] to harm competition."<sup>27</sup> This finding applies equally to bundling local exchange service with interLATA long distance.<sup>28</sup>

Clearly, the market for interLATA services is highly competitive and will remain so after Section 272 sunset – unless the Commission makes the mistake of classifying BOCs providing interLATA service on an integrated basis as dominant providers subject to tariffs and a host of other regulatory requirements.

#### Price Squeeze

Dr. Selwyn and AT&T contend that BOCs will subject their interLATA long distance competitors to an illegal predatory price squeeze by increasing wholesale rates (*i.e.*, switched and special access rates) while decreasing retail rates (*i.e.*, interLATA long distance). They claim that BOCs will sacrifice long distance revenue today in order to drive competitors out of the

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Kahn and William E. Taylor, filed On Behalf of BellSouth Corporation, Qwest Corporation, SBC Communications, Inc., and Verizon, dated Nov. 27, 2002 at 30.

<sup>25</sup> It is also consistent with the Commission's goal of protecting competition, not individual competitors.

<sup>26</sup> *In the Matter of Policy and Rules Concerning the Interstate, Interexchange Marketplace, Implementation of Section 254(g) of the Communications Act of 1934, as amended, 1998 Biennial Regulatory Review – Review of Customer Premises Equipment And Enhanced Services Unbundling Rules In the Interexchange, Exchange Access And Local Exchange Markets, Report and Order*, 16 FCC Rcd. 7418, 7424 ¶ 9 (2001).

<sup>27</sup> *Id.* at 7436 ¶ 30.

<sup>28</sup> In permitting ILECs to bundle CPE and local service the Commission stated: "Nonetheless, we conclude, in light of the existing circumstances in these markets, that the risk of anticompetitive behavior by the incumbent LECs in bundling CPE and local exchange service is low and is outweighed by the consumer benefits of allowing such bundling. We view the risk as low not only because of the economic difficulty that even dominant carriers face in attempting to link forcibly the purchase of one component to another, but also because of the safeguards that currently exist to protect against this behavior." *Id.* at 7438 ¶ 33 (footnote omitted).

market with a goal of recouping lost profits (or losses) through higher retail long distance prices in the future. This allegation is not supported by either the facts or economic theory.

Drs. Carlton, Sider and Shampine point out that even if the BOCs were able to raise access prices it is unlikely that they could successfully engage in a predatory price squeeze in the long distance market because: 1) BOCs face numerous well-established wireline and wireless long distance providers; 2) communications assets are largely fixed and will remain available to new entrants at low prices even if existing competitors are driven from the market; 3) any attempt by the BOCs to raise prices in such an environment would invite new entry; and 4) if BOCs were successful in eliminating long distance competition through predatory pricing they, inevitably, would be subject to re-regulation.<sup>29</sup> Drs. Carlton, *et al.*, conclude that it is highly unlikely that a BOC could recoup its investment in predatory pricing and highly unlikely that such a strategy would be pursued by a BOC.<sup>30</sup>

Drs. Carlton, *et al.*, also rebut Selwyn's (and AT&T's) argument that above-cost access charges provide BOCs with both the incentive and the ability to engage in a price squeeze. They point out that not only do higher access charges result in higher costs to all long distance carriers, but higher access charges also represent higher opportunity costs for BOCs when the BOCs win long distance business from other IXC's.

[W]hen ILECs [BOCs] provide long-distance service they gain retail revenue but lose access revenue paid by a subscriber's prior long-distance carrier. The loss in access revenue is a real cost of providing retail long-distance service faced by ILECs which must be considered in any evaluation of the prices charged by ILECs as long-distance carriers.<sup>31</sup>

Drs. Carlton, *et al.*, go on to provide a numerical example demonstrating that BOCs "have no incentive to [lower long-distance prices below the long-run competitive level (*i.e.*, the level at which revenues cover relevant costs) and] drive more efficient long-distance rivals from the industry" in order to provide long-distance themselves.<sup>32</sup> Thus, contrary to the claims of Selwyn and AT&T, above-cost access charges – even if they were true – do not facilitate predation.

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<sup>29</sup> See Qwest Reply Comments, WC Docket No. 02-112 and CC Docket No. 00-175, filed July 28, 2003 at its attached Reply Declaration of Dennis W. Carlton, Hal Sider and Allan Shampine, dated July 28, 2003, at 7-10 ¶¶ 12-17 ("Reply Declaration of Carlton, Sider and Shampine").

<sup>30</sup> The Court of Appeals recognized this in affirming the *Pricing Flexibility Order*: "there is a consensus among commentators that predatory pricing schemes are rarely tried and even more rarely successful." *WorldCom, Inc. v. FCC*, 238 F.3d 449, 463 (D.C. Cir. 2001), citing *Matsushita Elec. Indus. Co. v. Zenith Radio Corp.*, 475 U.S. 574, 106 S. Ct. 1348 (1986).

<sup>31</sup> Reply Declaration of Carlton, Sider and Shampine at 4 ¶ 6.

<sup>32</sup> *Id.* at 5-6 ¶ 9.

In adopting the *LEC Classification Order*, the Commission rejected similar claims finding that the BOCs and their affiliates would not be able “to engage in a price squeeze to such an extent that the BOC interLATA affiliates will have the ability, upon entry or soon thereafter, to raise price by restricting their own output.”<sup>33</sup> The Commission also found that even if the BOCs could subject IXCs to a price squeeze – which they cannot – imposing dominant carrier regulation on BOC long distance affiliates would not be an efficient means of preventing BOCs from engaging in a predatory price squeeze.<sup>34</sup> The same reasoning holds true with regard to the integrated provision of interLATA services by BOCs after sunset of Section 272.

Thus, Dr. Selwyn’s and AT&T’s price squeeze arguments are illusory and find no support in either economic theory or reality and should be rejected.

### Dominance

A carrier must have market power to be classified as dominant under the Commission’s rules. For over two decades the Commission has consistently defined market power as “the ability to raise prices by restricting output” and “as the ability to raise and maintain prices above the competitive level without driving away so many customers as to make the increase unprofitable.”<sup>35</sup> In the *Competitive Carrier* proceeding and thereafter the Commission has defined a dominant carrier to be one that has market power and a non-dominant carrier to be one that is not found to be dominant.<sup>36</sup>

Thus, the Commission must conclude that BOCs providing interLATA services on an integrated basis (*i.e.*, after Section 272 sunsets) will have the ability to increase interLATA prices if BOCs are to be classified as dominant providers.<sup>37</sup> The Commission may not classify the BOCs as dominant providers of interLATA services simply to guard against “potential” unlawful conduct,

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<sup>33</sup> *LEC Classification Order*, 12 FCC Rcd. at 15832 ¶ 129.

<sup>34</sup> *Id.* at 15831-32 ¶ 128.

<sup>35</sup> *Id.* at 15765-66 ¶ 11, citing the *Competitive Carrier* proceeding. “[A] carrier may [also] be able to raise prices by increasing its rivals’ costs or by restricting its rivals’ output through the carrier’s control of an essential input, such as access to bottleneck facilities, that its rivals need to offer their services.” *Id.* at 15802-03 ¶ 83.

<sup>36</sup> See 47 C.F.R. § 61.3(q) and (y). *Competitive Carrier First Report and Order*, 85 FCC 2d at 10 ¶¶ 26-27.

<sup>37</sup> See *LEC Classification Order*, 12 FCC Rcd. at 15804 ¶ 85. “We conclude 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 of those services.” (Emphasis added.)

as Dr. Selwyn and AT&T suggest, or to protect competitors without violating past precedent.<sup>38</sup> In the absence of compelling evidence of market power,<sup>39</sup> BOCs must be found to be non-dominant providers of interLATA services.

Not surprisingly, Selwyn avoids any reference in his lengthy declaration to the Commission's long-standing test for market power (*i.e.*, dominance) in arguing that BOC providers of interLATA service should be classified as dominant. His failure to do so, alone, is sufficient reason to reject his arguments as meritless.

#### Cost Allocation/Cross Subsidization

In an attempt to bolster AT&T's arguments for service-by-service imputation and price floors for BOC interLATA services, Selwyn urges the Commission to adopt a definition of "cross-subsidization" that is entirely self-serving and at odds with conventional economic wisdom regarding cost allocation.<sup>40</sup> Selwyn ignores the fact that "cross-subsidization" is not a meaningful concept except in a regulated "rate-of-return" environment where product prices are based on costs.

Neither local access charges nor interLATA service prices are subject to rate-of-return regulation. Access charges are based on price cap regulation while interLATA service prices are determined by the market. In the *LEC Classification Order* the Commission found that "price

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<sup>38</sup> "We also conclude that regulating BOC in-region interLATA affiliates as dominant carriers generally would not help to prevent improper allocations of costs, discrimination by the BOCs against rivals of their interLATA affiliates, or price squeezes by the BOCs or the BOC interLATA affiliates. Although certain aspects of dominant carrier regulation may address these concerns, we conclude that the burdens they would impose on competition, competitors, and the Commission outweigh any potential benefits." *Id.* at 15762-63 ¶ 6. *See also Competitive Carrier Fourth Report and Order*, 95 FCC 2d at 557 n.2, 582 n.93; *Competitive Carrier First Report and Order*, 85 FCC 2d at 13-14 ¶ 33, and at 50 n.108.

<sup>39</sup> Market power should not be confused with market share. A company may have a large market share but little or no market power.

<sup>40</sup> Economists normally define cross-subsidization as "the support of a service priced below its marginal cost by another service priced above its marginal cost." *See Competition and Cross-subsidization in the Telephone Industry*, by Leland L. Johnson, December 1982, The Rand Corporation, at iii. *Also see, In the Matter of Implementation of the Pay Telephone Reclassification and Compensation Provisions of the Telecommunications Act of 1996, Third Report and Order, and Order on Reconsideration of the Second Report and Order*, 14 FCC Rcd. 2545, 2566 ¶ 45 and n.81. In commenting on the fact that "there is no single correct method for allocating common costs among regulated services," the Commission noted that "[a]s long as each type of call recovers its incremental costs, but no more than its stand-alone costs, there is no cross-subsidy."

cap regulation of the BOCs' access services reduces the BOCs' incentives to allocate improperly the costs of their affiliates' interLATA services" because price cap regulation severs the link between regulated costs and rates.<sup>41</sup> InterLATA service prices are unaffected by how many or how few costs are assigned to them since these prices are determined by the market.

Dr. Selwyn also urges the Commission to modify its affiliate transactions and joint cost rules (*i.e.*, 47 C.F.R. §§ 32.27 and 64.901) in order to protect regulated ratepayers when BOCs begin to provide interLATA services on an integrated basis. The Commission should reject Dr. Selwyn's proposals as unneeded and harmful to competition. The joint cost rules were adopted in 1987 specifically to address the joint provision of regulated and nonregulated services by the BOCs (and at the time, AT&T).<sup>42</sup> These rules (and the affiliated transactions rules) are biased in favor of regulated activities to ensure that these activities did not bear more than a fair share of joint and common costs. Furthermore, BOC cost assignments and affiliate transactions are subject to periodic audits (previously annual audits, now biennial) in order to ensure that BOCs comply with the Commission's Part 32 and 64 rules. These rules are more than adequate to protect regulated ratepayers. Dr. Selwyn's claim that these rules need to be changed in order to guard against "potential" cross-subsidization is without merit. Not only would his proposed rule changes be anticompetitive, they would place an extreme burden on both the BOCs and Commission staff.

### Summary

No worthwhile purpose would be served either by classifying the BOCs as dominant providers of interLATA service or the imposition of additional burdensome regulations on the BOCs, as Dr. Selwyn and AT&T propose. The sunset of Section 272's separate affiliate requirement will not change the highly-competitive nature of the interLATA long distance market – as long as the BOCs continue to be classified as non-dominant providers of interLATA service.

However, interLATA customers will be affected significantly (and detrimentally) if the Commission follows the advice of Dr. Selwyn and AT&T and limits BOCs' ability to respond to competition by classifying them as dominant providers and imposing additional restrictions on BOC provision of interLATA service on an integrated basis. Such a result would burden BOCs with unnecessary regulations, disadvantage consumers, and significantly expand the Commission's workload – simply to protect individual competitors. This would be contrary to both the dictates of the 1996 Act and Commission precedent.<sup>43</sup> The Commission should reject

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<sup>41</sup> *LEC Classification Order*, 12 FCC Rcd. at 15817-18 ¶ 106.

<sup>42</sup> *See In the Matter of Separation of costs of regulated telephone service from costs of nonregulated activities, Report and Order*, 2 FCC Rcd. 1298 (1987), *on recon.*, 2 FCC Rcd. 6283 (1987), *on further recon.*, 3 FCC Rcd. 6701 (1988), *aff'd sub nom Southwestern Bell Corp. v. FCC*, 896 F.2d 1378 (D.C. Cir. 1990).

<sup>43</sup> *See note 2, supra.*

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AT&T's self-serving claims and continue to treat the BOCs as non-dominant providers of interLATA service after Section 272 sunsets. Classifying BOCs as dominant carriers would limit their ability to reduce prices and match competitive offers and would be anticompetitive in and of itself.

Respectfully,

/s/ Melissa E. Newman

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