

sufficiently low across a sufficiently broad range of customers that rival firms cannot cover their costs and are therefore driven from the industry.

26. Any evaluation of predation must also include fixed monthly charges (which are often accompanied by lower per-minute charges) that are a standard element in many long-distance pricing plans. Evaluation of an alleged predatory price squeeze must consider both aspects of pricing. For example, an ILEC could charge a fixed monthly charge with no per-minute charges for a fixed bundle of long-distance minutes.¹⁷ If so, it would be inappropriate to conclude that the ILEC was engaged in a price squeeze simply because the per-minute aspect of price was zero and therefore below the per-minute access charge. However, this is precisely what would be implied by AT&T's and Dr. Selwyn's analysis. Instead, the presence of such a plan would more likely be an effort to offer a pricing package that would be attractive to a segment of (presumably high-use) subscribers.

27. Significantly, neither AT&T nor Dr. Selwyn has claimed or presented any evidence that ILECs' long-distance service taken as a whole (including interstate, intrastate and international services) is priced below cost. Given the lack of such evidence and the difficulty of recoupment, the AT&T claim that ILECs are now engaged in predatory price squeezes should be dismissed.

III. AT&T INCORRECTLY SUGGESTS THAT ILEC OFFERS OF LOCAL/LONG-DISTANCE SERVICE BUNDLES ADVERSELY AFFECT LONG-DISTANCE COMPETITION AND REQUIRE DOMINANT FIRM REGULATION

28. AT&T and Dr. Selwyn focus on recent marketing developments in the telecommunications industry to support their argument that ILECs' provision of long-distance services should be subject to dominant carrier regulation after sunset of structural separation

17. We understand that most carriers offer such plans.

rules. Bundled local/long-distance services have been introduced in recent months by both CLECs as well as ILECs (in certain states in which they are authorized to provide long-distance services). Bundled service offerings typically provide local service and a fixed (or even unlimited) number of long-distance minutes for a fixed monthly fee. For example, AT&T's "One Rate USA" plan and MCI's "Neighborhood Complete" plans provide unlimited local and long-distance calling as well as certain vertical services for \$49.95 and \$49.99 per month, respectively, in most states where they are offered. (MCI offers its "Neighborhood Complete" plan for \$39.99 per month in California.) Verizon's "Freedom" plan offers these services for \$59.95 per month.¹⁸

29. Generally, the success of bundled packages reflects the fact that some consumers find them attractive economic alternatives to non-bundled services and there is no basis to view them as anticompetitive devices. Indeed, CLECs themselves began offering bundled packages of local and long-distance service before the BOCs were legally able to do so. Moreover, CLECs continue to aggressively market such packages in the Ameritech region, where SBC has not yet received interLATA authority and thus cannot itself offer similar packages.

30. The FCC has previously recognized in other circumstances that bundled services can result in consumer benefits and that they carry low risk of anticompetitive behavior. In an order permitting ILECs to bundle local exchange service and CPE, the FCC concluded:

[W]e conclude, in light of the existing circumstances in these markets, that the risk of anticompetitive behavior by the incumbent LEC 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

18. These rates may differ between states.

purchase of one component to another, but also because of the safeguards that currently exist to protect against this behavior.¹⁹

31. Dr. Selwyn, however, argues that bundled service offerings “inextricably” link local exchange services and long-distance services, and because local exchange services are regulated this “requires that the BOC long-distance affiliates themselves be classified and regulated as dominant carriers.”²⁰ He further argues that “only IXCs that bundle local and long-distance services together into the same package can compete” with ILEC bundled service offerings.

32. There is no basis for these claims. Bundled local/long-distance services offered by ILECs and CLECs compete not only with each other but also with local services and long-distance services offered on an unbundled basis and with bundled services offered by wireless carriers. The majority of subscribers still obtain local and long-distance services on an unbundled basis. Thus, the prices charged for bundled services are constrained by the prices of the component services. A consumer will choose the bundled service only if it is more attractive than purchases of the component services on an individual basis. Furthermore, since long-distance carriers were legally able to (and did) introduce local/long-distance bundles before BOCs did, it is difficult to see how they can now claim to be disadvantaged when BOCs respond with their own bundles, since, according to AT&T’s logic, only BOCs that offer bundled services could compete with long-distance carriers’ bundled service offerings.

19. FCC, Policy and Rules Concerning the Interstate, Interexchange Marketplace, 23 CR 641, 16 FCC Rcd 7418 (2001), ¶33.

20. Selwyn Declaration, p. 47.

33. AT&T also asserts that (i) local/long-distance bundles facilitate ILECs' ability to engage in a predatory price squeeze; and that (ii) local/long-distance bundles facilitate anticompetitive cost shifting.²¹ There is no basis for these claims.

- The fact that services are bundled does not alter the fact that a predatory price squeeze would require driving rival long-distance firms from the industry and subsequently raising price. For the reasons discussed in our prior declaration and above, it is highly unlikely that such a predatory strategy would succeed because of the difficulty of recoupment. Both the availability of wireless services (as well as e-mail and instant messaging which are substitutes for certain long-distance calls) and the difficulty of preventing reentry of existing rivals and entry of new firms make it highly unlikely that investments in predation could be recouped.
- The emergence of bundled service would not facilitate cost shifting that would result in predation. As discussed in our prior declaration, there is no basis to conclude that the ability to shift costs facilitates a predatory price squeeze. The fact that some consumers prefer bundles does not alter this conclusion. Moreover, as explained in our prior declaration, there is no basis to conclude that cost shifting would result in greater ILEC revenue for local service in the presence of price caps.

34. Given the benefits of bundles for consumers, the lack of incentive for ILECs to drive efficient long-distance rivals from the industry, and the difficulty of recouping any investment in predation, there is no basis to view bundles as anticompetitive. Under these

21. AT&T Comments, p. 65.

circumstances, the consequence of regulatory proceedings to determine whether tariffed rates for bundles cover relevant costs would be to chill competition and harm consumers.

IV. CHANGES IN LONG-DISTANCE SINCE 1997 PROVIDE NO SUPPORT FOR IMPOSITION OF DOMINANT CARRIER REGULATION ON ILEC LONG-DISTANCE SERVICES

35. In 1997, the FCC found that ILECs' long-distance affiliates should not be classified as dominant carriers simply because ILECs remained significant providers of local services. The Commission also concluded that dominant carrier regulation did not address the potential concerns arising from BOCs' integration in the provision of local and long-distance services, including non-price discrimination against rival long-distance carriers, predatory price squeezes, and cost shifting.²²

36. AT&T now argues that the FCC's conclusions in its 1997 LEC Non-Dominance Order no longer apply due in part to changes in market circumstances, including weakened financial strength of rival long-distance carriers, which AT&T claims leaves them less able than the ILECs to provide bundled service offerings.²³ AT&T also claims that BOCs' success in obtaining wireline long-distance subscribers requires application of dominant carrier regulation. This section shows that there is no merit to either of these claims.

A. ILECS FACE INCREASED, NOT DECREASED, LONG-DISTANCE COMPETITION

37. As discussed in our prior declaration, ILECs face long-distance competition from a number of large national carriers that control vast networks, including several new fiber optic networks that did not exist in 1997. In our prior declaration, for example, we demonstrated that

22. LEC Non-Dominance Order, ¶¶6-7.

23. AT&T Comments, p.57.

the provision of wireline long-distance services is far less concentrated today than it was when AT&T was granted non-dominant carrier status.

38. Moreover, by a variety of measures, the broader telecommunications industry is also more competitive today than in 1997. For example, in recent years not only has the concentration of wireline long-distance services fallen, but new services, including wireless phones and Internet services, have achieved extraordinarily rapid increases in penetration. These new technologies have introduced significant new intermodal competition to the long-distance industry. As a result, wireline long-distance usage and prices have fallen substantially in recent years. While these events have led to weaker financial performance and even bankruptcies among some telecommunications carriers, such events are evidence of increased long-distance competition, not a diminution of competition.

39. AT&T suggests that financial weakness on the part of some companies may make them more vulnerable to predation. However, as we discussed in our prior declaration, even if a company goes bankrupt, its assets will remain in the industry, making recoupment of any investment in predation highly unlikely. Global Crossing, GST and others have been through bankruptcies with their assets remaining in the industry after having been purchased by others at a fraction of their original cost. The same will be true of MCI: either it will emerge from bankruptcy and compete, or its assets will be acquired and used by others to provide similar services.

B. BOCS' SUCCESS IN GAINING LONG-DISTANCE CUSTOMERS DOES NOT JUSTIFY IMPOSITION OF DOMINANT CARRIER REGULATION

40. AT&T and Dr. Selwyn suggest that BOCs' share of wireline long-distance subscribers provides further justification for imposition of dominant carrier regulation.

However, their discussion fails to consider the increased intermodal competition from wireless

and Internet services. They also fail to note the rapid decline in the concentration of wireline services and the fact that BOCs' shares (in states where long-distance authority was granted nearly three years ago) are well below AT&T's at the time that it was declared to be a non-dominant carrier.

41. While AT&T and Dr. Selwyn suggest that BOCs' shares of long-distance will continue to increase, this assertion, even if true, is not necessarily indicative of market power. Indeed, AT&T itself has argued, and the Commission has found, that a high market share is not indicative of market power if elasticities of supply and demand are high. In any event, as discussed in our prior declaration, the share of BOC customers that take BOC-provided long-distance service grows rapidly for roughly two years after the BOC achieves long-distance authority in a state but generally stabilizes after that. That declaration showed that analysts also project that BOCs' share of long-distance subscribers will stabilize at levels far below those projected by AT&T and Dr. Selwyn.

42. AT&T and Dr. Selwyn attribute BOCs' success in gaining long-distance subscribers following authorization to provide these services to their "ability to exploit their inbound marketing channel and offer pricing plans ignoring the cost of access ..."²⁴ They argue that these advantages allow BOCs to charge lower prices, which harm the long-distance carriers by taking large numbers of customers from them and forcing them to lower their own prices. However, AT&T confuses harm to competitors and harm to competition.

43. AT&T and Dr. Selwyn mischaracterize the costs faced by ILECs in providing long-distance service and mistake procompetitive efficiencies with anticompetitive behavior.

24. Selwyn Declaration, pp. 52-53.

When providing their own long-distance services, ILECs lose access revenue previously earned from rival long-distance carriers. This reflects a real loss in revenue to ILECs that will be considered in any price determination by a profit-maximizing firm. Thus, it is simply incorrect for AT&T and Dr. Selwyn to claim that ILECs can "ignore the cost of access" in pricing long-distance services.

44. To the extent that ILECs have been successful in gaining long-distance customers due to their ability to market to their existing customer base, then this reflects a procompetitive efficiency. If firms that jointly market both local and long-distance service can realize lower costs of customer acquisition and marketing, then this reflects realization of economic efficiencies. While firms that are less efficient marketers may lose customers as a result, this reflects the results of the competitive process, not harm to competition.²⁵ Both the BOCs' and long-distance companies' experiences in introducing bundled services to the marketplace indicate that consumers often prefer the convenience of a bundled long-distance/local offering.

C. THE FCC'S 1997 CONCLUSION THAT DOMINANT CARRIER REGULATION WOULD NOT ADDRESS POTENTIAL COMPETITIVE CONCERNS REMAINS VALID

45. The FCC concluded in 1997 that dominant carrier regulation of BOC in-region affiliates "generally would not help to prevent improper allocations of costs, discrimination by the BOCs against rivals of their interLATA affiliates, or price squeezes..."²⁶ The FCC's decision

25. Dr. Selwyn complains that long-distance margins are being reduced. However, that is not the issue because competition reduces margins, which is beneficial to consumers. The issue here is whether margins are reduced to predatory levels (in the sense that positive margins would be eliminated).

26. FCC, LEC Non-Dominance Order, ¶6. The FCC notes in ¶111 of this Order that "For purposes of determining whether the BOC interLATA affiliates should be classified as dominant, however, we need to consider only whether a BOC could discriminate against its affiliate's interLATA competitors to such an extent that the affiliate would gain the ability to

holds true even after expiration of structural separation requirements. As discussed in our prior declaration, dominant carrier rules are generally designed to prevent price increases, not attempts to set below-cost prices. They do not affect the ability of consumers, rivals or regulators to detect non-price discrimination, and they do not address predation concerns.

46. Dominant carrier regulation simply does not address the competitive concerns raised by AT&T, including non-price discrimination, cost shifting and predatory price squeezes. AT&T also has presented no evidence that elimination of structural separation rules in related circumstances has resulted in competitive problems.

47. Nonetheless, AT&T argues that imposition of dominant carrier regulation on ILEC-provided long-distance services would impose little if any burden on ILECs.²⁷ However, AT&T and Dr. Selwyn fail to rebut the Commission's prior conclusion that dominant carrier regulation can adversely affect long-distance competition. As we discussed in our prior declaration, the FCC has found, correctly in our view, that dominant carrier regulations can deter competition by, among other things: discouraging the introduction of innovative new service offerings; reducing the ability of firms to engage in price competition, including offering secret discounts; limiting the ability of firms to rapidly respond to changes in market conditions; and deterring firms from developing customer-specific service offerings.²⁸

(...continued)

raise prices by restricting its own output upon entry or shortly thereafter.”

27. AT&T Comments, p. 73.

28. FCC, Policy and Rules Concerning the Interstate, Interexchange Marketplace, 11 FCC Rcd. 20, 730 at ¶23, 53.

V. RESPONSES TO ADDITIONAL POINTS RAISED BY AT&T

A. THERE IS NO BASIS FOR AT&T'S VIEW THAT ILEC PARTICIPATION IN ADJACENT MARKETS IS INHERENTLY ANTICOMPETITIVE

48. AT&T's comments suggest that ILEC provision of telecommunications services such as long-distance that rely on the local exchange is inherently anticompetitive. It argues that "ILEC control of the local bottleneck confers market power in all downstream markets."²⁹ We disagree.

49. As noted in our prior declaration, there is ample history that contradicts this blanket claim and shows that AT&T's claimed distrust of ILEC participation in downstream markets is unwarranted. The FCC has previously concluded that ILEC provision of a variety of ancillary services, including customer premises equipment (CPE), various enhanced services (such as voice mail), and information services did not adversely affect competition and further found that structural separation requirements were not necessary to preserve competition. When ILECs are efficient suppliers and their participation does not harm competition, restricting ILECs as competitors by subjecting them to dominant carrier regulation would only adversely affect competition.

50. AT&T's general condemnation of ILEC provision of non-local services also ignores the variety of other regulatory safeguards in place. As discussed in our prior declaration, ILECs have long been subject to nondiscrimination requirements in their provision of access services, and they have developed systems, procedures and processes to ensure that they comply with their nondiscrimination obligations. They also face established, sophisticated long-distance competitors who presumably monitor the quality of the access services they receive. The

29. AT&T Comments, p. 18.

elimination of structural separation will not alter these realities, nor would dominant firm regulation address any perceived risk of increased discrimination. Nor, for that matter, does AT&T explain how ILECs could keep rivals from the market if they attempted to raise long-distance price and thus recoup investments in a predatory price squeeze. AT&T also fails to explain how ILECs would benefit from shifting costs from unregulated to regulated activities given the widespread reliance on price-cap regulation and establishment of interstate access fees based on factors other than ILECs' costs (through the CALLS order).

51. Thus, there is no basis for AT&T's suggestion that ILECs' provision of non-local services is inherently anticompetitive. Rather, the heightened competition in long-distance services that has resulted from BOC entry, experience in other markets that BOCs have been permitted to enter, such as CPE and enhanced services, and price regulation, where necessary, of access and local services provide ample evidence that ILECs' provision of non-local services benefits consumers and promotes competition.

B. DR. SELWYN INCORRECTLY SUGGESTS THAT STRUCTURAL SEPARATION REQUIRES THAT ILECS BE DENIED ANY ADVANTAGES OF VERTICAL INTEGRATION. HOWEVER, RESTRICTIONS ON ILEC ACTIVITIES CAN REDUCE THEIR EFFECTIVENESS AS SUPPLIERS OF NON-LOCAL SERVICES AND HARM CONSUMERS

52. Dr. Selwyn claims that the separate subsidiary requirements of Section 272 require affiliates to ignore any efficiencies from their affiliation with a BOC.³⁰ He claims that:

[L]ower long distance prices arising solely or primarily from BOC exploitation of integration efficiencies and joint profit maximization is clearly not what Congress had in mind. ... If the BOCs are the *only* downstream providers that are permitted

30. Selwyn states that Section 272 reflects "an attempt to force the affiliate (the provider of the downstream product) to set its retail prices so as to maximize its own profits, just as any non-affiliated IXC, which is operating in the (same) downstream product market, would be expected to do." (Selwyn Declaration, p. 62)

to benefit from these types of integration efficiencies, then they will ultimately be the only downstream providers to survive in the retail long distance mass market. And that outcome is clearly *not* what Congress intended, and will surely result in less competition and higher prices overall.³¹

53. Dr. Selwyn's fear that ILECs will displace all other long-distance carriers appears to be based on his failure to consider the costs ILECs face in terms of foregone access revenue in providing long-distance services. When these costs are properly considered, there is no reason to conclude that ILECs' provision of local services gives them any inherent access cost advantage that would enable them to supplant all other competitors. The history of ILEC provision of long-distance services to date fails to support Dr. Selwyn's proposition.

54. While we offer no opinion on Congress' intent in drafting Section 272 of the 1996 Act, Dr. Selwyn's interpretation would be expected to result in significant consumer harm. As noted above, market activities by CLECs as well as ILECs indicate that many consumers prefer obtaining local and long-distance services from the same supplier. That is, it often is economically efficient to provide these services jointly. Dr. Selwyn's interpretation would surely interfere with ILECs' ability to exploit these and other potential efficiencies that ILECs could realize by integrating their local and long-distance operations.

VI. CONCLUSION

55. ILECs have no ability to engage in non-price discrimination against rival long-distance carriers, a predatory price squeeze against long-distance rivals or cost shifting that adversely affects long-distance competition, whether or not they offer long-distance services through a separate affiliate. Accordingly, there is no basis for imposing dominant carrier regulation on the ILECs' provision of in-region, interstate, interLATA services.

31. Selwyn Declaration, p.63.

I declare under penalty of perjury that the foregoing is true and correct to the best of our knowledge and belief.

Dennis W. Carlton

Dennis W. Carlton

Hal Sider

Hal Sider

Allan Shampine

Allan Shampine

July 28, 2003