

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

In the Matter of

Request for Extension of the Sunset Date of the
Structural, Non-Discrimination, and Other
Behavioral Safeguards Governing Bell Operating
Company Provision of In-Region, Inter-LATA
Information Services

CC Docket No. _____

**Request of the
Commercial Internet eXchange Association
and the
Information Technology Association of America**

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The Commercial Internet eXchange Association (“CIX”) and the Information Technology Association of America (“ITAA”) hereby request that, pursuant to Section 272(f) of the Communications Act of 1934, as amended (the “Act”), 47 U.S.C. § 272(f), the Commission extend for two years – until February 8, 2002 – the sunset date of the structural, non-discrimination and other pro-competitive behavioral safeguards governing Bell Operating Company (“BOC”) provision of in-region, inter-LATA information services contained in Sections 272(b), (c), (d), and (g), of the Act, 47 U.S.C. §§272(b), (c), (d), and (g).¹

¹ The Commission has held that the Section 272 competitive safeguards are applicable to BOC provision of both in-region and out-of-region inter-LATA information services. *See Implementation of the Non-Accounting Safeguards of Sections 271 and 272 of the Communications Act of 1934, as amended*, 11 FCC Rcd 21905, 21945-47 (1996). By this filing, CIX and ITAA seek the continued application of the Section 272 safeguards only to inter-LATA information services that the BOCs provide in-region.

I. SUMMARY AND PRELIMINARY STATEMENT

When Congress enacted the Telecommunications Act of 1996 (the “1996 Act”), it struck a careful balance. Congress provided an opportunity for the Bell Operating Companies (“BOCs”) to enter the in-region inter-LATA services market – including the market for inter-LATA information services. At the same time, however, Congress recognized that, until the BOCs’ local telecommunications markets are fully competitive, the BOCs will continue to have the ability and incentive to leverage their market power to obtain an unfair competitive advantage in the market for in-region inter-LATA services, thereby harming both consumers and competing service providers. Congress therefore carefully crafted a three-step process governing the BOCs’ entry into the market for these services.

- First, in Section 271(a) of the Act, Congress barred the BOCs from providing in-region inter-LATA services until they comply with the requirements contained in Section 271(c) designed to open local telecommunications markets to competition.
- Second, because the BOCs will retain significant market power even after they satisfy the Section 271 requirements, Congress provided that the BOCs initially will be required to provide in-region inter-LATA services subject to comprehensive pro-competitive safeguards. These safeguards, codified in Section 272 of the Act, 47 U.S.C. § 272, include the establishment of a separate affiliate, compliance with an absolute prohibition on non-discrimination, and other behavioral safeguards, including a biennial audit that would subject the BOCs’ participation in the inter-LATA market to independent review.
- Third, Congress determined that, once the BOCs’ market power is significantly reduced as a result of the growth of competition, structural and behavioral safeguards no longer will be necessary. Congress anticipated that competition would develop rapidly enough to allow elimination of the Section 272 regime within a few years. At the same time, however, Congress recognized that these critical competitive protections should not be eliminated prematurely. Congress therefore gave the Commission authority to extend the date on which the pro-competitive regime applicable to BOC participation in inter-LATA markets will sunset for as long as the Commission deems necessary. 47 U.S.C. § 272(f).

As the Commission is well aware, the opening of local telecommunications markets to competition has taken far longer than expected. To date, no BOC has demonstrated that any local market is open to competition. Consequently, no BOC has been allowed to enter the in-region inter-LATA services market. Absent Commission action, however, on February 8, 2000, the structural and behavioral safeguards applicable to BOC provision of inter-LATA information services will automatically sunset. As a result, if and when the BOCs – which retain substantial market power – are allowed to enter the in-region inter-LATA information services market, they will be able to do so without *ever* complying with the structural and behavioral safeguards adopted by Congress. Immediate Commission action is needed to avoid this result, which would effectively nullify the three-stage process adopted by Congress in the 1996 Act.

Substantial evidence exists that extending the statutory structural safeguards is necessary to prevent anti-competitive abuses. As shown herein, the BOCs currently are using their control over the local network to thwart the ability of independent ISPs to compete. If the BOCs are allowed to provide inter-LATA information services, they will have an even greater ability and incentive to harm competition in the emerging market for broadband Internet access service.

As the Commission, the courts, and Congress have recognized, non-structural safeguards are not adequate to deter BOC anti-competitive abuses. Rather, the comprehensive regime of structural and behavioral safeguards set forth in Section 272 is necessary to ensure that BOC entry does not harm competition in the market for Internet access and other inter-LATA information services.

In order to effectuate Congress's intent to allow BOC entry without harming competition in the inter-LATA information services market, the Commission immediately should issue an

order extending for two years – until February 8, 2002 – the sunset date for the pro-competitive Section 272 regime applicable to BOC-provided in-region inter-LATA information services.

II. STATEMENT OF INTEREST

Commercial Internet eXchange Association. CIX is a trade association that represents some 150 Internet Service Provider (“ISP”) member networks who handle over 75% of the United States' Internet traffic.² CIX works to facilitate global connectivity among commercial ISPs in the United States and throughout the world.

Information Technology Association of America. The Information Technology Association of America is one of the principal trade associations of the nation's information technology industries. Together with its forty-one regional technology counsels, ITAA represents more than 26,000 companies throughout the United States. ITAA's members provide the public with a wide variety of information products, software, and services. Many of ITAA's member companies provide Internet access and other information services.

III. CONGRESS DID NOT INTEND FOR THE COMMISSION TO ALLOW THE PRO-COMPETITIVE SECTION 272 SAFEGUARDS TO SUNSET BEFORE THE BOCS ENTERED THE INTER-LATA INFORMATION SERVICES MARKET

In enacting the 1996 Act, Congress sought to create a framework for BOC entry into the inter-LATA services market. Allowing the Section 272 pro-competitive safeguards, including the separate affiliate requirements applicable to BOC inter-LATA information services, to sunset before the BOCs are allowed to enter the inter-LATA information services market would upset the balance struck by Congress.

² The views expressed herein are those of CIX as a trade association, and are not necessarily the views of each individual member.

First, Congress provided that the existing prohibition on BOC provision of inter-LATA services – including inter-LATA information services – would continue until the BOCs complied with the requirements, set forth in Section 271 of the Act, designed to open local telecommunications markets to competition.³ This approach reflected Congress’s recognition that, as long as the BOCs enjoy unfettered monopoly power in the local exchange market, the risk of anti-competitive harm to the adjacent inter-LATA markets is too great to allow BOC entry under any circumstances. The nascent state of the dial-up Internet access market and the need to foster competitive development of the Internet backbone made it particularly important to prevent BOCs from leveraging their local exchange monopolies into the market for inter-LATA services.

Second, Congress recognized that, even after they satisfy the Section 271 requirements, the BOCs will continue to have market power in the local telecommunications market and, therefore, the ability to harm competition in the adjacent inter-LATA markets.⁴ Congress therefore provided that the BOCs initially must offer inter-LATA services subject to structural separation⁵ and rigorous accounting⁶ and non-discrimination safeguards.⁷ This regime is codified in Section 272. Significantly, Congress did not seriously consider relying on non-structural

³ Section 601 of the Act provided that conduct prior to February 8, 1996 that was restricted by the AT&T Divestiture Decree (the decree formerly known as the Modification of Final Judgment or MFJ) would henceforth be restricted by the Act. Because the AT&T Divestiture Decree prohibited the BOCs from providing inter-LATA services, including inter-LATA information services, Section 601 made such conduct a violation of the Communications Act.

⁴ See *Implementation of the Non-Accounting Safeguards of Sections 271 and 272 of the Communications Act of 1934, as amended*, 11 FCC Rcd 21905, 21911 (1996) (“*Non-Accounting Safeguards Order*”) (“In enacting Section 272, Congress recognized that the local exchange market will not be fully competitive immediately upon its opening.”).

⁵ 47 U.S.C. § 272(b).

⁶ *Id.* § 272(c)(2).

⁷ *Id.* § 272(c).

safeguards, such as those adopted by the Commission in the *Third Computer Inquiry*, to deter BOC anti-competitive conduct.

Third, Congress recognized that it could not predict the timing of the opening of the BOCs' local markets and the subsequent entry by the BOCs into inter-LATA markets. While Congress established sunset periods for the structural and other safeguards, it expressly granted the Commission authority to extend them.⁸ Thus, under the statutory scheme, structural and behavioral safeguards governing BOC participation in the inter-LATA market should be eliminated only when competition takes root in the local telecommunications market.

At a minimum, Congress did not intend for the Section 272 regime to sunset before the BOCs are allowed to enter the inter-LATA information services market.⁹ The biennial audit provisions of Section 272(d) of the Act offer strong evidence of Congress's intent that BOC participation in the inter-LATA information services market through a separate affiliate be subject to scrutiny *before* allowing BOCs to provide such services on an integrated basis. The audit is to be extensive, and include staff members from 40 state regulatory commissions and the Commission.¹⁰ However, neither Congress nor the Commission anticipated that the BOCs'

⁸ The Act provides that the application of the Section 272 regime to BOC-provided inter-LATA telecommunications services and inter-LATA information services sunsets three years after the date on which a BOC is authorized to offer inter-LATA telecommunications services, and four years after the date of enactment of the Act, respectively. 47 U.S.C. §§ 272(f)(1),(2).

⁹ The Senate bill that became the basis for the Act would have made the inter-LATA separate subsidiary requirement permanent, while giving the Commission the authority to grant exceptions. *See* S. 652, 104th Cong., 1st Sess., § 102 (1995). The Senate Committee Report made clear, however, that "the Senate [did] not intend that the Commission would grant an exception to the basic separate subsidiary requirement of this section prior to authorizing the provision of inter-LATA service ... by the Bell Operating Company seeking the exception to the requirements of this section." S. Rpt. 104-23, 104th Cong., 1st Sess. at 24 (1995). The Conference Committee melded features of the Senate and House bills. While reflecting the House's deregulatory goals by including a provision "sunsetting" the inter-LATA safeguards, the 1996 Act also reflects the Senate's concern that the pro-competitive safeguards not be eliminated prematurely by giving the Commission authority to extend the sunset periods.

¹⁰ *See Proposed Model for Preliminary Biennial Audit Requirements*, 12 FCC Rcd 13132 (1997). *See also* 47 C.F.R. § 53.209.

intransigence in opening even a single local market to competition would extend four years beyond the Act's enactment. Indeed, in establishing a schedule for auditing the BOCs' subsidiaries established pursuant to Section 272(d), the Commission anticipated that "such a schedule will allow at least one, and possibly two, audits before the sunset provision of Section 272(f) is considered."¹¹

In sum, Sections 271 and 272 were premised on the prompt and orderly opening of the BOCs' local telecommunications markets, and concurrent independent evaluation of BOC entry into inter-LATA information services markets through separate affiliates. Unfortunately, the critical assumption underlying the sunset regime has turned out to be incorrect: forty-five months after the enactment of the 1996 Act, not a single BOC has received Section 271 approval. Rather than opening their markets to competition, the BOCs have initiated numerous – and, for the most part, meritless – judicial challenges to virtually every order adopted by the Commission implementing the local competition provisions of the 1996 Act. Consequently, there has been no opportunity to evaluate BOC entry, with structural safeguards, into the inter-LATA information services market, either through the statutory biennial audit or other means.

Absent agency action, on February 8, 2000, the structural and behavioral safeguards applicable to BOC provision of inter-LATA information services will sunset automatically. As a result, the BOCs will be allowed to enter the in-region, inter-LATA information services market *without ever complying with the structural and behavioral safeguards adopted by Congress*. Whatever else Congress may have intended, it plainly did not want to reward the BOCs' foot dragging in opening their local markets to competition by allowing them to evade a regulatory regime designed to deter competitive abuse in the inter-LATA information services market.

¹¹ *Accounting Safeguards Under the Telecommunications Act of 1996, Report and Order*, 11 FCC Rcd 17539, ¶ 203

IV. THE BOCS HAVE THE ABILITY AND INCENTIVES TO ACT ANTI-COMPETITIVELY IN THE INTER-LATA INFORMATION SERVICES MARKET

There is significant evidence that the BOCs have acted anti-competitively towards independent ISPs. If they are allowed to enter the inter-LATA information market, their incentives to continue such abuses will increase significantly.¹² Such anti-competitive tactics could have an especially adverse impact on competition in the market for broadband Internet access service (e.g., Digital Subscriber Line service).¹³

A. The BOCs Have Engaged in Anti-Competitive Tactics Directed Against Non-Affiliated ISPs

In order for an ISP that is not affiliated with a local exchange carrier to provide broadband Internet access service, it must obtain DSL-conditioned lines. With a virtual monopoly on local lines in their service areas, the BOCs control nearly all access to end users who are the customers and potential customers of independent ISPs.¹⁴

ISPs have been subject to anti-competitive tactics by the BOCs with respect to the provisioning of facilities necessary to offer competitive information services. These tactics include the slow provisioning of and/or excessive pricing of DSL-conditioned lines and improper

(1996) (*Accounting Safeguards Order*).

¹² Non-affiliated ISPs already are at a competitive disadvantage vis-à-vis ILEC-affiliated ISPs for broadband services because interconnection among DSL networks is not yet widespread. Without such interconnection, non-affiliated ISPs are forced to establish separate trunk connections to the network of each data LEC in a given region.

¹³ Digital Subscriber Line (“DSL”) service is a high speed (nearly 10 times as fast as 28.8K dial-up Internet service) data communications service that utilizes the “local loop” and xDSL modems to provide service to end users. DSL service, which uses packet-switched networks, can be provided over existing copper lines that end users currently use for voice telecommunications.

¹⁴ A competitive market for efficient and reasonably priced transport services (e.g., DSL) is critical to the development of a competitive high speed Internet services market. Without competitive services connecting the end-user to the ISP, the BOC-affiliated ISP stands to dominate the market to the detriment of consumer choice. The growth of data CLECs since 1996 has, of course, been a positive development. Unfortunately – as a result of the BOCs’ obstructionist conduct, the CLECs do not yet have the ability to provide a ubiquitous, fully effective substitute for the BOCs’ offerings.

product bundling. Individually and in combination, these tactics have impeded the deployment of advanced services and have seriously threatened the ability of many independent ISPs to continue to offer service. If the BOCs are allowed to enter the inter-LATA information services markets without structural safeguards, their ability and incentive to act anti-competitively in the advanced services market will increase significantly.

Despite the clear mandates of the Act and the Commission's rules that the BOCs provision DSL-conditioned lines to both their competitors and their affiliates on a non-discriminatory basis, ISPs often experience extraordinarily slow DSL-line provisioning, resulting in an inability to serve end-users. In Utah, for example, U S West precluded competitive providers from obtaining DSL-conditioned lines until well after U S West began marketing and rolling out its own DSL Internet services. Even when U S West officially made DSL-conditioned lines available to competing ISPs in Utah, provisioning was extremely slow. The Public Service Commission of Utah, in response to at least complaint, is monitoring U S West's activities regarding the provision of DSL-conditioned lines.¹⁵ In New Mexico, U S West has failed to provide DSL service altogether, largely because its anti-competitive MegaBits DSL tariff has been challenged by competitors.¹⁶ The slow provisioning of DSL-conditioned lines, or the outright refusal to provide such lines, will stymie competition in the provision of DSL transport services. In turn, ISPs will be unable to obtain the cost savings and service quality generally achieved in a competitive market.

¹⁵ See Complaint of Jeff L. Middleton v. Mountain States Telephone and Telegraph Company, dba U S West Communications, Inc., Docket No. 98-049-30, Report and Order (Public Service Commission of Utah, April 13, 1999).

¹⁶ See Borland, John, "U S West Faces State Government Fire," <http://news.cnet.com/news/0-1004-200-121617.html> (September 20, 1999).

The BOCs also have sought to impede competition by unlawfully bundling advanced telecommunications services with information services and customer premises equipment, despite the fact that the Commission “has restricted bundling of CPE and enhanced services with telecommunications services out of a concern that carriers could use such bundling in anti-competitive ways.”¹⁷ These “restrictions not only prevent carriers from offering distinct goods and/or services only on a bundled basis, but also prohibit carriers from offering ‘package discounts,’ which enable ‘customers [to] purchase an array of products in a package at a lower price than the individual products could be purchased separately.’”¹⁸

Notwithstanding these restrictions, when a customer orders Bell Atlantic’s Infospeed DSL service and Bell Atlantic.netSM Internet service in combination, Bell Atlantic charges only \$99 dollars for its DSL modem, and waives the \$99 service charge.¹⁹ If the customer orders Infospeed DSL, but selects a competing ISP, Bell Atlantic imposes the \$99 service charge and charges \$325 for the DSL modem.²⁰ Clearly, Bell Atlantic is violating the Commission’s Rules by offering its DSL modem (in this case absolutely free) in a package at a lower price than the individual products could be sold separately (e.g., \$325 for the DSL modem if not purchased with Bell Atlantic.netSM). Such extreme price disparities appear to violate the Commission’s Rules and are clearly designed to eliminate all meaningful competition.

¹⁷ See *In the Matter of Policies and Rules Concerning the Interstate, Interexchange Marketplace, Implementation of Section 254(g) of the Communications Act of 1934, as amended*, CC Docket No. 96-61; *1998 Biennial Regulatory Review – Review of Customer Premises Equipment and Enhanced Services Unbundling Rules in the Interexchange, Exchange Access and Local Exchange Markets*, CC Docket No. 98-183, *Further Notice of Proposed Rulemaking*, 13 FCC Rcd 21531 (1998), ¶ 2.

¹⁸ *Id.* at ¶ 1

¹⁹ See http://www.bell-atl.com/adsl/more_info/pricing_isps.html (visited November 12, 1999).

²⁰ See http://www.bell-atl.com/adsl/more_info/pricing_isps.html (visited November 12, 1999).

Many BOCs also waive, or heavily discount, fees and charges for installation, activation, and modems.²¹ Some BOCs also have reduced the cost of DSL Internet service when a customer purchases a package of other BOC-provided services. For instance, BellSouth charges \$50 for its FastAccessSM DSL Internet service when a customer orders BellSouth Complete Choice® -- but charges \$59 when the FastAccessSM DSL Internet service is purchased separately.²²

B. If Granted Section 272 Authority, the BOCs' Ability and Incentive to Harm Competition in the Broadband Internet Access Market Will Increase

The discriminatory practices of the BOCs clearly demonstrate that they are attempting to use their existing monopolies as leverage into the market for broadband Internet access services. Deployment of broadband services to all Americans -- which is a key policy goal of Congress and the Commission -- will occur only if the competitive ISP market that exists in the dial-up marketplace extends to the broadband market.

These abuses have occurred at a time when the BOCs are permitted to play only a limited role in the Internet access market. As a result of the continuing prohibition on BOC provision of in-region, inter-LATA services, the BOCs are allowed to provide only intra-LATA connectivity and an intra-LATA gateway to the Internet.²³ If the Commission grants the BOCs Section 271

²¹ See http://www.uswest.com/pcat/for_home/product/0,1084,537_1_3,00.html (visited November 12, 1999) (US West offers a \$75 rebate on activation fees and a free modem); http://www.bellatl.com/adsl/more_info/pricing.html (visited November 12, 1999) (Bell Atlantic offers free service connection and a DSL modem for \$99); <http://www.pacbell.com/products/business/fastrak/dsl/pricing.html> (visited November 12, 1999) (Pacific Bell offers free service activation and free equipment installation).

²² See <http://services.bellsouth.net/external/adsl/cost.html> (visited November 12, 1999) (BellSouth Complete Choice® consists of BellSouth's local telephone service and other optional features).

²³ Pursuant to Commission orders, a subscriber to a BOC's Internet access services must select a non-BOC "Global Service Provider" to allow the user to access information stored at remote Websites. See Bell Atlantic's Offer of Comparably Efficient Interconnection to Providers of Internet Access Services, 11 FCC Rcd 6919 (1996), *Non-Accounting Safeguards of Sections 271 and 272 of the Communications Act, First Report and Order*, 11 FCC Rcd 21905, ¶¶ 55-57 (1996).

authority, they will be able to provide the full range of Internet services – including the provision of end-to-end Internet access services and the provision of Internet backbone capacity. Once the BOCs are allowed into these markets, their incentive to use their remaining market power to thwart competitors in the Internet market will be significantly increased.

The ability of the BOCs to provide inter-LATA information services also will increase the ability of the BOCs to act anti-competitively. The BOCs, for example, will engage in joint planning, joint development of products and joint sales and marketing efforts, including joint product discounts that will extend into the inter-LATA information services arena. BOC integration would make it extremely difficult for regulators to police the cost allocations of joint efforts, and would provide the BOCs with critical information required to offer end-to-end services that would not have to be shared with other competitors.

Finally, the BOCs' ability to act anti-competitively is especially great because of changes in the Internet access market that have occurred since the enactment of the 1996 Act. When Congress adopted the Act, the market for Internet backbone services and dial-up Internet services were immature. The structural and behavioral safeguards applicable to BOC provision of inter-LATA information services reflect, in part, that recognition. At the same time, the sunset period reflects the expectation that the market would develop rapidly – limiting the need for the protection afforded by the Section 272 safeguards.

In the years that have followed, however, consumers have begun to migrate from dial-up to broadband Internet access services. The broadband market is at approximately the same level of development as the dial-up Internet access market was in 1996. Thus, the Section 272 competitive protections for the inter-LATA information services market are as necessary today as they were in 1996.

**V. STRUCTURAL SEPARATION, COUPLED WITH AN
ABSOLUTE PROHIBITION ON DISCRIMINATION,
IS REQUIRED TO PREVENT BOC ANTI-COMPETITIVE ABUSES**

There is only one effective means by which the Commission can reduce the risk that BOC entry will adversely impact competition in the inter-LATA information services market: require that, at least initially, the BOCs provide these services consistently with the structural, non-discrimination, and other behavioral safeguards contained in Section 272 of the Act. Congress designed these safeguards to: prevent cross-subsidization by BOCs of unregulated markets from their monopoly position in regulated markets; prevent discrimination by the BOCs against competitors; and to make transparent the terms and conditions of transactions between BOCs and affiliates.

These protections are essential to achieve Congress's goal of ensuring that BOC entry into the inter-LATA market does not adversely impact competition. Continuation of the safeguards also would be consistent with the Commission's recognition, in numerous contexts, that structural separation is necessary to prevent anti-competitive abuses. The alternative – allowing the BOCs to provide inter-LATA information services on an integrated basis, subject only to *Computer III* non-structural safeguards – is plainly inadequate.

A. Experience Demonstrates that Structural Separation Is the Only Means Proven Effective to Deter Anti-Competitive Abuses

The Commission has repeatedly recognized that structural separation is essential to prevent carriers from using their control of local exchange facilities to impede competition in the information services market. The Commission initially considered the appropriate regulatory regime to govern telephone company participation in the market for information services (then called data processing services) in 1970 in the *First Computer Inquiry*. The Commission ruled that telecommunications carriers – other than AT&T, which the Commission then believed was barred from the market by a 1956 consent decree – could provide information services through a structurally separate affiliate. The agency reasoned that the goal of preventing carriers that possessed monopoly power in the local telecommunications market from engaging in anti-competitive conduct:

[w]ill be achieved best by *maximum separation* of activities that are subject to regulation [i.e., provision of telecommunications services] from non-regulated activities involving data processing. Because of the increasing involvement of interstate communications facilities and services in the provision of data transmission, the need for such separation is apparent and urgent.²⁴

The Commission affirmed the need for structural separation for BOC entry into the information services market in the *Second Computer Inquiry*, which the agency initiated in 1979. The Commission determined that AT&T could provide information services (which the Commission referred to as enhanced services), so long as it did so through a separate affiliate.²⁵

²⁴ *Regulatory and Policy Problems Presented by the Interdependence of Computer and Communication Services and Facilities*, Tentative Decision, 28 FCC 2d 291, 302 (1970); *Regulatory and Policy Problems Presented by the Interdependence of Computer and Communication Services and Facilities*, Final Decision, 28 FCC 2d 267 (1971), *aff'd in part and rev'd in part sub nom. GTE Services Corp. v. FCC*, 474 F.2d 724 (2d Cir. 1973) (emphasis added).

²⁵ *Amendment of Section 64.702 of the Commission's Rules and Regulations (Second Computer Inquiry)*, 77 FCC 2d 384 (1980) ("*Computer II Final Order*"), *on recon.*, 84 FCC 2d 50, 53 (1980), *further recon.*, 88 FCC 2d 512 (1981), *aff'd sub nom. Computer & Communications Indus. Ass'n. v. FCC*, 693 F.2d 198, 205 n.18 (D.C. Cir. 1982), *cert. denied*, 461 U.S. 938 (1983).

The Commission emphasized that accounting and behavioral safeguards alone would not be sufficient to deter cross-subsidization and discrimination.²⁶

On the eve of the AT&T divestiture, the Commission ruled that, to the extent the divestiture decree permitted the BOCs to provide enhanced services, the *Computer II* structural separation requirements would apply. Once again, the Commission made clear that structural separation is the only viable means of deterring the BOCs from using their local exchange monopolies to dominate the market for enhanced services. As the Commission observed:

[I]f the RBOCs are permitted to market . . . enhanced services on an unseparated basis, there are opportunities to engage in cross-subsidization The provision of enhanced services could rely on the same marketing, installation and maintenance, and operations support organizations [as the BOCs' basic telecommunications operations]. There would be opportunities to place enhanced service software within the network. Identifying these costs would be very difficult. . . . As we have stated previously, accounting alone cannot provide the public as much protection against improper cost shifting as structural separation can. With separate structure, the existence of joint and common operations is limited, reducing the opportunities to shift costs. In addition, separate structure increases the detectability of any cross-subsidization that does occur...

The separate organization requirement should alleviate most concerns about anti-competitive practices by the BOCs against suppliers of enhanced services since the BOCs would enter, if at all, on the same terms and conditions as other suppliers. Anti-competitive conduct directed against enhanced service providers can be controlled by structural separation in a manner that may not be effective with accounting separation alone. If a BOC's separate entity is required to obtain access to the network in the same fashion as would a competing supplier, the provision of inferior access to a BOC rival would be much easier to detect. In addition, the design of the BOCs' own enhanced services would be easier to detect since separate structure could help to reveal any illegal information transfers.²⁷

²⁶ *Computer II Final Order*, 77 FCC 2d at 463-64.

²⁷ *Policy and Rules Concerning the Furnishing of Customer Premises Equipment, Enhanced Services and Cellular Communications Services by the Bell Operating Companies*, 95 FCC 2d 1117, 1125-39 (1983).

The concerns identified by the Commission in the 1980s regarding BOC entry into the market for enhanced services – cross-subsidization, discriminatory treatment of competitors, and the difficulty of deterring these activities through nonstructural safeguards alone – remain valid today.

The Commission’s imposition of structural separation in other contexts provide further support for preserving the structural separation regime that Congress established in Section 272 to govern BOC entry in the inter-LATA information services market. For example, in its recent order approving the merger of SBC and Ameritech, the Commission required that the merged company “provide all Advanced Services through a separate Advanced Services affiliate.”²⁸ The Commission stated that the establishment of an “advanced services separate affiliate will provide a structural mechanism to ensure that competing providers of advanced services receive effective, nondiscriminatory access to the facilities and services of the merged firm’s incumbent LECs that are necessary to provide advanced services.”²⁹

BOC entry into the advanced telecommunications services market raises the very same issues as BOC entry into the inter-LATA information services market. In both cases, the BOC can use its control over local exchange facility to impede competition in an emerging adjacent market. In the case of advanced services, the Commission has recognized the need for structural

²⁸ Application of Ameritech Corp., Transferor, and SBC Communications, Inc., Transferee, for Consent to Transfer Control of Corporations Holding Commission Licenses, Memorandum Opinion and Order, FCC 99-279, CC Docket No. 98-141 (rel. Oct. 8, 1999), Appendix C, p. 5.

²⁹ *Id.* at ¶ 363.

separation to prevent such abuse. The Commission should take the same approach to in-region inter-LATA information services.³⁰

B. Non-Structural Safeguards Are Not Adequate to Deter BOC Anti-Competitive Abuses

If the Commission does not extend the Section 272 sunset period, it presumably will take the position that BOC provision of inter-LATA information services will be subject only to the Commission's *Computer III* non-structural safeguards.³¹ This regime, however, is clearly inadequate.

As an initial matter, the *Computer III* regime does not contain a critical protection found in Section 272: the *absolute prohibition* on BOC discrimination in favor of its own advanced service affiliate. As a result, if the Section 272 regime is allowed to sunset, the BOCs are likely to justify a wide range of plainly discriminatory conduct in the provision of basic telecommunications services – including advanced services – as “not unreasonably

³⁰ The Commission has, on several occasions, relied on modified forms of structural separation in order to prevent carriers from leveraging their power in one market to harm competition in another market. For example, in the *Competitive Carrier* proceeding, the Commission adopted a form of structural separation to guard against "cost-shifting and anti-competitive conduct" by interexchange carriers affiliated with independent local exchange carriers ("LECs"). See *Policy and Rules Concerning Rates for Competitive Common Carrier Services and Facilities Authorization* Therefor, 98 FCC 2d 1191, 1198 (1984). The Commission subsequently extended this regime to all independent incumbent LECs providing in-region, interstate interexchange and international services. See *Regulatory Treatment of LEC Provision of Interexchange Services Originating in the LECs' Local Exchange Area and Policy and Rules Concerning the Interstate Interexchange Marketplace*, FCC 97-142, CC Docket Nos. 96-149, 96-61, ¶¶ 156-69 (rel. Apr. 17, 1997). Structural separation, the Commission explained, was necessary to prevent independent LECs from using their control over bottleneck facilities to discriminate, misallocate costs, or engage in a price squeeze. In the commercial mobile radio services ("CMRS") arena, the Commission has imposed structural separation requirements on all incumbent LECs that provide in-region CMRS in order to guard against discriminatory interconnection practices. See *Amendment of the Commission's Rules to Establish Competitive Safeguards for Local Exchange Carrier Provision of Commercial Mobile Radio Services*, 12 FCC Rcd 15668, 15692-96 (1997). And, for the same reasons that the Commission imposed structural separation in the interexchange and wireless areas – to prevent discrimination, cost misallocation, and the possibility of a price squeeze – the Commission requires U.S. carriers that are affiliated with dominant foreign carriers to comply with a form of structural separation. See *Rules and Policies on Foreign Participation in the U.S. Telecommunications Market*, 12 FCC Rcd 23891, 24003-12 (1997).

³¹ See *Amendment of Section 64.702 of the Commission's Rules and Regulations (Third Computer Inquiry)*, 104 FCC 2d 958 (1986) (subsequent history omitted).

discriminatory” and, therefore, permissible. This would have an adverse impact on ISPs that remain critically dependent on the underlying transport facilities provided by the BOCs. The absence of this important protection, standing alone, is sufficient to justify continuation of the Section 272 regime.

In addition, the *Computer III* regime provides for the use of non-structural safeguards in lieu of structural separation. The Court of Appeals, however, has twice found that this regime is inadequate to prevent BOC anti-competitive abuse in the information (enhanced) services market.

In *California I*,³² the Ninth Circuit rejected the Commission’s first attempt – in the original *Computer III Order* – to eliminate the BOC enhanced services structural separation requirement. While the court held that non-structural safeguards “may be effective” in deterring BOC access discrimination,³³ the court found that the agency had failed to demonstrate that these safeguards were adequate to deter BOC cross-subsidization.³⁴ The court further rejected the agency’s contention that any risk of BOC anti-competitive conduct would be “minimized” by the use of non-structural safeguards. The Commission’s consistent position before *Computer III*, the court observed:

has always been that monitoring and enforcement problems make cost-accounting regulations an ineffective tool in detecting cost-shifting. Should the BOCs be free to integrate their basic and enhanced operations, nothing in the record suggests that the FCC (or state regulators) will have any less difficulty than before in determining whether costs have been misallocated.³⁵

³² *California v. FCC*, 905 F.2d 1217 (9th Cir. 1990) (“*California I*”).

³³ *See id.* at 1232-33.

³⁴ *See id.* at 1233-37.

³⁵ *Id.* at 1237-38 (footnote omitted).

In *California III*,³⁶ the Ninth Circuit again rejected the Commission's conclusion that nonstructural safeguards were sufficient to deter BOCs from acting in an anti-competitive fashion. The Commission has expressed the view that the *California III* decision allows the BOCs to provide telecommunications and information services on an integrated basis, so long as they file "comparably efficient interconnection" ("CEI") plans. As ITAA previously has demonstrated, however, the most reasonable construction of the court's decision is that it struck down the Commission's effort to replace structural separation with non-structural safeguards.³⁷

While the Commission has waived the structural separation requirements,³⁸ the agency's findings in *Computer II* remain legally binding. As a result, the Commission's assessment of the merits of extending the Section 272 safeguards must begin with the assessment, made in *Computer II*, that non-structural safeguards are inadequate to prevent BOC anti-competitive abuse in the information services market.

The *Computer III* regime is even less effective now than at the time of the Court of Appeals decision. The Commission has ruled that the BOCs are no longer required to obtain advanced Commission approval of their CEI Plans, which are designed to ensure that the BOCs provide rival ISPs with equal access to the regulated network services that underlie the BOCs

³⁶ *California v. FCC*, 39 F.3d 919 (9th Cir. 1994) ("*California III*").

³⁷ See, e.g., Comments of the Information Technology Association of America, CC Docket Nos. 95-20, 98-10 (filed Mar. 27, 1998).

³⁸ The Commission has held that "to the extent that the effect of *California III* might be regarded as returning regulation of BOC enhanced services to the *Computer II* framework . . . we grant any necessary waivers, pending the completion of the remand proceedings, so that BOCs" can provide information services on an integrated basis." *Bell Operating Companies Joint Petition for Waiver of Computer II Rules*, 10 FCC Rcd 1724, 1730 (1995). Nearly five years later, these waivers remain in effect.

information service offerings.³⁹ The Commission, moreover, is considering further weakening the *Computer III* regime by completely eliminating the CEI Plan requirement.⁴⁰

In addition to departing from decades of regulatory treatment of BOC provision of enhanced services, the abandonment of structural safeguards for non-structural protections would have particularly harmful effects in the Internet services market. Through joint cost allocation, the BOCs will be able to extend their local monopolies into the potentially competitive high speed Internet services market by allocating costs in a manner that makes it impossible for ISPs to offer their services at competitive rates. The significant possibility of cross-subsidization between BOC telecommunications inputs and the BOC Internet offerings could have the effect of severely limiting the ability of non-affiliated ISPs to compete. In turn, the innovation and competition that exist in the ISP market, in large part responsible for the development of the Internet, would be at risk. While constituting violations of the Joint Cost Order,⁴¹ without structural separation, these activities would be exceedingly difficult for the Commission to detect.

³⁹ See *Computer III Further Remand Proceedings: Bell Operating Company Provision of Enhanced Services; 1998 Biennial Review of Computer II and ONA Safeguard Requirements*, 14 FCC Rcd 4289, 4295 (1999).

⁴⁰ See *Computer III Further Remand Proceedings: Bell Company Provision of Enhanced Services, Notice of Proposed Rulemaking*, 10 FCC Rcd 8360, 8362 & n.5 (1995).

⁴¹ See *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).

**VI. THE COMMISSION SHOULD EXTEND THE SUNSET DATE
FOR THE SECTION 272 STRUCTURAL, NON-DISCRIMINATION,
AND OTHER BEHAVIORAL SAFEGUARDS GOVERNING BOC PARTICIPATION
IN THE IN-REGION, INTER-LATA INFORMATION SERVICES MARKET**

In light of the above, CIX and ITAA urge the Commission to issue an order extending for an additional two years the sunset date for the pro-competitive safeguards governing BOC provision of in-region inter-LATA information services contained in Sections 272(b),(c), (d) and (g) of the Communications Act, 47 U.S.C. §272(b),(c), (d) & (g).⁴²

Grant of a two-year extension is the best means to achieve Congress's goal of ensuring that adequate safeguards are in place at the time the BOCs enter the inter-LATA information services market, while providing the Commission adequate opportunity to assess the competitive effects of BOC entry into inter-LATA information services. In effect, this approach gives effect to the sunset regime established by Congress, while reflecting the fact that the advent of local competition – and the accompanying BOC entry into the in-region inter-LATA market – has taken substantially longer than Congress anticipated.

In addition to the requested extension, CIX and ITAA further urge the Commission to initiate an inquiry, not later than August 8, 2001, to assess both the level of competition in the intra-LATA telecommunications market and the impact that BOC entry has had on the currently competitive information services market. This inquiry will provide a foundation for the Commission to determine, prior to February 8, 2002, whether competition has developed to a point at which the congressionally crafted structural and behavioral safeguards applicable to BOC provision of in-region, inter-LATA information service are no longer necessary.

⁴² Because the BOCs lack market power outside of their service regions, CIX and ITAA do not believe it is necessary for the Commission to continue to apply the Section 271 regime to BOC provision of out-of-region inter-LATA information services.

The Commission plainly has legal authority to grant this request. Section 271(f)(2) states unambiguously that the Commission may extend the four-year sunset period applicable to BOC provision of inter-LATA information services “by rule or order.” Thus, while the Commission may want to seek public comment, it need not initiate a rulemaking proceeding.⁴³ Nor is the Commission precluded from modifying the Section 272 regime – for example, by continuing to apply it only to BOC provision of in-region inter-LATA information services. Section 272(f)(3) makes clear that the Commission retains the full measure of its pre-existing authority “to prescribe safeguards consistent with the public interest, convenience, and necessity.”⁴⁴

⁴³ Should the Commission determine that a rulemaking proceeding is necessary, however, it should extend the sunset of Section 272(f)(2) until such time as the proceeding has been completed.

⁴⁴ 47 U.S.C. § 272(f)(3).

VII. CONCLUSION

For the foregoing reasons, the Commission should issue an order extending until February 8, 2002 the sunset date of the structural, non-discrimination and other behavioral competitive safeguards governing BOC provision of in-region, inter-LATA information services contained in Sections 272(b), (c), (d) and (g), of the Communications Act.

Respectfully submitted,

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