



# DEPARTMENT OF JUSTICE

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## **Conditioning the Bells' Entry Into Long Distance: Anticompetitive Regulation or Promoting Competition?**

Address by

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**Abstract.** The Telecommunications Act of 1996 seeks to open local telephone markets to competition and authorizes the Bell companies to offer long-distance services once their local markets have been opened. This paper recaps the reasons for insisting that Bell local markets be opened before authorizing Bell long-distance entry – refuting arguments that this standard needlessly prevents the Bells from competing and constitutes excessive regulation. The Bell incentives which this standard creates will advance the Act’s competitive goals more efficiently and rapidly than other standards, and with less regulation. The standard already is having positive effects in opening local markets.

Over three years since the enactment of the 1996 Telecommunications Act, no regional Bell operating company (“Bell”) has yet been authorized to offer long distance services originating in a state where it offers local service, because none has met the Act’s requirements of taking the actions necessary to facilitate local competition in that state. Some critics have criticizing the Bell entry conditions as superfluous and anticompetitive regulation, and urging their relaxation or elimination. While I, and others, had hoped that a Bell would have met the conditions by now, I believe that these criticisms are misplaced. Adhering to the current process ultimately should produce less not more intrusive regulation, and foster not hinder competition.

I will first briefly recap the logic for conditioning a Bell’s entry on the opening of its local market to competition. I then explain why the conditions for approving Bell entry should not be softened, and discuss suggestive evidence that these conditions have already usefully influenced the Bells’ conduct. Finally, after taking brief stock of developments since the Act, I suggest there is now a basis for cautious optimism.

# **I. THE TELECOMMUNICATIONS ACT OF 1996 AND THE ECONOMIC LOGIC FOR CONDITIONING THE BELLS' ENTRY**

## **A. The Act's Objectives and Key Requirements**

The passage of the 1996 Telecommunications Act<sup>1</sup> marks a watershed in U.S. policy towards competition in telecommunications. Beyond its specific provisions, the Act embodies a Congressional commitment to open *all* telecommunications markets to competition, and move away from the a regime of regulated local monopoly and restrictions, by service or by region, on firms' permissible activities.<sup>2</sup>

**Local Competition.** Of particular significance is the desire to open the so-called "local market" – the local exchange networks and their associated services, historically the domain of regulated franchise monopolists. As a major step, the Act strikes down legal or regulatory barriers imposed by States or local authorities (§ 253). But it also targets artificial entry barriers stemming from incumbents' installed-base advantages, a legacy from the franchise monopoly era. The Act lays out an ambitious agenda for local competition. It envisions entry not only by *facilities based* competitors building their own networks, an entry mode which requires relatively modest cooperation from incumbents – notably, interconnection to exchange traffic. In addition, the Act aims to facilitate entry by competitors who use some or all of the incumbent's *unbundled network elements* (such as unbundled loops), or who *resell* the incumbent's existing retail services ("resale" in fact understates the entrant's role, because the entrant takes over all retailing functions for the customers it acquires). Accordingly the Act mandates all incumbents to extend local competitors this needed cooperation: interconnection; access to unbundled elements of their local networks, at rates based on these facilities' cost;

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<sup>1</sup> Pub. L. 104-104, 110 Stat. 56 (1996) (codified at 47 U.S.C. § 151 *et seq.*).

<sup>2</sup> For a broader discussion of the Act, see Timothy Brennan, "Making Sense of the Telecommunications Act of 1996," *Industrial and Corporate Change*, vol. 5 (1996): 941-61, and Marius Schwartz, "Telecommunications Reform in the United States: Promises and Pitfalls," in Paul Welfens and George Yarrow, eds., *Telecommunications and Energy in Systemic Transformation*, Springer, 1997.

and offering competitors, at discounted wholesale rates, any existing retail services for resale.<sup>3</sup>

**Bell Entry.** The Act also permits the regional Bell operating companies (“Bells”) to offer, under suitable circumstances, long-distance (interLATA) services. The Bells were barred from such services by the 1982 antitrust court order that separated AT&T from the local Bell companies.<sup>4</sup> The Act authorizes the Bells immediately to offer long distance services that originate in a state where the Bell does not offer local service (hence does not control local networks). But to offer long distance services originating in any state where it does offer local service (local exchange and exchange access) a Bell must first obtain approval for that state from the Federal Communications Commission (FCC). The relevant conditions are described in § 271 of the Act: (a) the Bell must have fully implemented a fourteen-point competitive checklist, which largely parallels the obligations imposed on all incumbents (including non-Bells) under § 251, or, in certain limited circumstances, offers all the items in a statement of generally available terms;<sup>5</sup> (b) its long distance services will be provided to comply with the separate

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<sup>3</sup> Section 251 of the Act lists these obligations, while § 252 establishes procedures for negotiations between incumbents and local entrants and for arbitration and oversight by state regulatory commissions. In imposing the unbundling and resale obligations, the Act reflects a view that entrants should not be required to enter on a fully vertically-integrated basis, because competition that relies (in part or even wholly) on the incumbent’s facilities can still yield significant benefits by enabling entrants to share in the efficiencies of incumbents’ established, ubiquitous networks. The benefits can include direct efficiency gains in the entered vertical segments (such as retailing functions, in the case of resale entry); or indirect gains, by allowing an entrant to acquire customers before fully building out its own network, thereby facilitating a transition to facilities-based competition.

<sup>4</sup> *Modification of Final Judgment* (MFJ), U.S. v. AT&T, 552 F. Supp. 131 (D.D.C., 1982).

<sup>5</sup> The FCC must consult with the state commission to verify compliance with the checklist. The Act provides for two tracks, A and B. Track A requires the Bell to have a binding access and interconnection agreement with one or more competitors which are operational, employ exclusively or predominantly their own facilities, and which (individually or between them) serve business and residential customers. The agreement(s) must cover all checklist items, and the FCC must determine that all are in fact being provided (not merely promised on paper). Track B provides a limited exception to the requirements of Track A, to guard against cases where Track A is not implemented solely due to lack of interest by entrants (as evidenced by their failure to request an agreement) or bad faith on their part. To satisfy Track B, when applicable, the Bell must provide a statement of terms and conditions under

subsidiary and nondiscrimination requirements of § 272; and (c) the FCC must find that approving the Bell's application is in the public interest. In making its overall determination, the FCC must consult with the Department of Justice (DOJ) and accord its evaluation "substantial weight." I will discuss later the standard used by the DOJ in its evaluations.

### **B.The Economic Logic for Conditioning the Bells' Entry**

The Bells account for about three quarters of the revenues of all local phone companies nationwide, and about the same fraction of all long distance minutes originate in their service areas. Consequently, the 271 process is quite important. A threshold question raised by critics of 271 is, why have any linkage at all between the Bells entry into long distance and the opening of their local markets? The main original basis for keeping the Bells out of long distance was to prevent them from discriminating in access arrangements against competitors that depend on the Bells for local access. But, critics maintain, these access arrangements are by now well established, so there is no risk that the Bells could degrade these arrangements, even if they had an incentive to do so once allowed into long distance. Delaying Bell entry, critics argue, merely prevents enhanced competition in long distance, and the realization of efficiencies from the Bells' provision of integrated services (both cost savings, and the value to consumers of obtaining one-stop-shopping from a single provider).

While there are potential costs of delaying the Bells' entry until the local market is opened, there are also substantial benefits from requiring such linkage – benefits which comfortably outweigh the costs. The benefits fall into two broad categories: preventing longer run harm in long distance, and expediting the opening of the local market.

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which it generally offers the checklist items. The statement must be approved or permitted to take effect by the state commission.

<sup>6</sup> A more complete discussion of these issues is provided in Marius Schwartz, "Competitive Implications of Bell Operating Company Entry into Long-Distance Telecommunications Services," May 14, 1997, ("Schwartz 1<sup>st</sup> affidavit"), available at:

***Safeguarding Longer Run Competition in Long Distance.*** It is quite correct that regulation can do a considerably better job of preventing the degradation of established arrangements than of securing the development of new ones; but it is incorrect to go on and claim that Bell entry can pose no harm to competition in long distance because those access arrangements are well established. As technology and demand conditions change, access arrangement also will require adaptation. If allowed into long distance before the local market is opened – and hence, without a realistic prospect that local competition will take root over a reasonable horizon – the Bells could, over time, pose a serious threat to the cost and quality of local access for their non-integrated long distance rivals, by denying them efficient and timely upgrades to new arrangements.

***Opening the Local Market.*** The second concern – which was not present at the time of the MFJ – is with opening the local market to competition. Allowing premature entry by a Bell into long distance can reduce the Bell's incentives to cooperate in opening its local market. An obvious reason is the loss of the so-called “carrot effect” – that having secured its desired long distance authority, a Bell has less reason to continue cooperation that facilitates local competition.

But there is a second, and less obvious reason why a Bell's pre-mature entry into long distance will make it less cooperative in offering wholesale local services – a magnified incentive to impede competitors from providing *integrated services*. The logic is as follows. A provider's ability to offer both local and long-distance (as well as other) telecommunications services, is believed to be competitively important – because of cost savings enabled by joint provision (e.g., economizing on billing) and because of some consumers' value for one-stop-shopping. A Bell might try to impede competitors' ability to offer integrated services by degrading their *established* access arrangements in long distance – which may be harder to do in the short run – or by denying them the new requisite wholesale *local* services (such as UNEs and discounted retail services for resale). A Bell's authority to sell long distance services (at

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[www.usdoj.gov/atr/statements/Affiwp60.htm](http://www.usdoj.gov/atr/statements/Affiwp60.htm). This affidavit was filed with the FCC in support of the DOJ's evaluations, starting with: Evaluation of the United States Department of Justice, *In the Matter of Application of SBC Communications Inc. et al. Pursuant to Section 271 of the Telecommunications Act of 1996 to Provide In-Region, InterLATA Services in the State of Oklahoma*, FCC, CC Docket 97-121, May 16, 1997 (“DOJ Oklahoma Evaluation”), available electronically at: <http://www.usdoj.gov/atr/public/comments/sec271/sbc/sbc.htm>

substantially unregulated retail rates) increases its gain from impeding competitors' ability to offer integrated services (by denying them local services), in two ways: (a) because competitors are denied cost savings from joint provision, they can put less pressure on the Bell's long-distance prices; and (b) the Bell can charge a greater premium to customers who value one-stop shopping. Thus, authorizing a Bell to offer long distance services before its local market is open, enhances its profit from resisting *local* competition, thereby directly magnifying its resistance to opening its local markets.<sup>7</sup>

Producing worse incentives for a Bell to cooperate in opening the local market will make it significantly harder to foster local competition. The ambitious model of local competition envisioned in the Act rests on extensive "network sharing" with competitors, and this will require establishing a panoply of complex new technical systems, protocols, and business arrangements. (I will return to these issues later.) Because these wholesale local services are complex and new, relying solely on regulatory mandates to foster their development and deployment is especially problematic, as there is no established norm for what is feasible and how fast. Authorizing premature Bell entry into long distance would, therefore, end up spawning a considerably greater need for intrusive regulation to compel the Bells to implement the new local competition arrangements, relative to securing these arrangements up front with greater Bell cooperation by harnessing the incentives created by 271. In a fundamental sense, therefore, 271 is designed ultimately to reduce the need for intrusive regulation.

Two final points support the belief that the cost of delaying a Bell's long distance entry until it opens its local market – as mandated by Congress – is well outweighed by the benefits. First, the local market is much larger, with revenues about twice those from long distance sales net of access payments (which the Bells already collect). Second, the local market is far less

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<sup>7</sup> This analysis demonstrates that it is misleading to argue, as have some critics of 271, that a Bell's long-distance entry can pose no competitive risk and characterize the 271 authority as merely a "hostage" used to pry open a Bell's local market (the traditional "carrot" effect). As I explained, authorizing a Bell's entry before its local market is open will magnify its incentives to deny competitors key wholesale local services, as well as its incentives to try and degrade their long distance access arrangements over time.

competitive than is long distance, leaving more unexploited gains from competition. (I will address later why Bell would, nevertheless, accept the 271 terms of opening its local market to secure entry to long distance.)

## **DO THE 271 INCENTIVES MATTER?**

### **Why The Bar Is *Not* Too High**

The more extreme criticisms of 271 maintain that it cannot hope to affect the pace at which local markets are opened, because the 271 conditions merely duplicate similar cooperation obligations already imposed on all incumbents by other provisions in the Act (principally, sections 251 and 252). Thus, critics argue, 271 is superfluous, and needlessly delays Bell entry. Such a view, it seems to me, defies common sense in holding that regulatory enforcement of obligations is so effective that any incentive effects created for the Bells by 271 necessarily become irrelevant.

More reasoned critics concede that a *properly structured* 271 standard can elicit fruitful cooperation from the Bells, but claim that the 271 bar has been set too high, as evidenced by the Bells' refusal or inability to meet it. They argue that the bar should be lowered, because sticking to the current standard is counter-productive: it will delay Bell entry, without helping to open the local markets. A legal response is that the DOJ's and FCC's interpretation of the 271 standard merely tracks the Act. Not being a lawyer, however, let me articulate two responses based on economic reasoning.

***Commitment and Credibility.*** First, and most important, is the issue of commitment and credibility. To have any chance of ensuring that the local market is truly open before 271 approval, it is crucial that there be a known commitment to the articulated 271 standard. Bell company posturing and testing the waters are inevitable in a process such as this, and an initial reluctance to "deal" may reflect no more than a desire to extract better terms – to force down the bar. A commitment to hold firm to the 271 standard, barring major unforeseen



developments, is therefore crucial.

Conceivably, some Bells were willing to extend the requisite cooperation, but believed they could instead secure long distance entry by mounting legal challenges to the Act (more on this shortly) and by pressuring the FCC and the DOJ. For this very reason, efforts to soften the 271 standard because it is allegedly unproductive can make it so. They can discourage the Bells from meeting the standard even when the Bells would be willing to do so if convinced that this was their only way to gain long distance entry.

***Bells' Tradeoff Changes Over Time.*** Assume, *arguendo*, that the Bells so far have been genuinely unwilling to accept the terms of the 271 standard. This brings me to the second response. Just because a Bell finds the “terms-of-trade” of 271 unacceptable today, does not imply it would continue to refuse them in the future. As a result of fairly predictable changes in market conditions, one might expect a Bell’s posture to change, leading the Bell to meet the 271 in the future even if it refuses to do so initially.

I can think of two reasons why a Bell’s resistance will soften. First, some local competition is developing in any case to serve the Bells’ more profitable customers, such as large businesses.

<sup>8</sup> Entrants serving such customers are often less dependent on Bell cooperation, because they rely relatively more heavily on their own facilities. Such entry erodes the Bell’s bottleneck over these relatively lucrative customers, and therefore reduces what the Bell stands to lose by opening *all* its local markets as required by 271. A second and related reason for why a Bell’s tradeoff can change is that its inability to offer long-distance services (including international) will become a growing disadvantage in competing to serve large business customers, who demand one-stop-shopping from a single provider, and who can obtain this from other vendors such as

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<sup>8</sup> Useful documentation of the pattern and scope of competitive entry is offered in *Progress Report: Growth and Competition in U.S. Telecommunications 1993-1998*, President’s Council of Economic Advisers, Washington DC, February 8, 1999.

the major long distance companies. This is likely to be of particular concern to those Bells who have national or international aspirations.

Sophisticated critics might attack the second argument – that the 271 standard will be met eventually – by claiming that its logic is incomplete: If a Bell agrees to cooperate because some local competition will have developed anyhow, then the remaining pro-competitive benefits to be had from securing the Bell's cooperation at that point also are lower. This, critics may argue, implies that the delay in long-distance approval will have been undesirable, because the benefits foregone in long distance outweigh the residual benefits from securing cooperation in the local market – benefits which must be small, as revealed by the Bell's willingness to accept the 271 terms at that point.

The last step, however, does *not* follow. Local competition may develop without Bell cooperation sufficiently to erode much of the Bell's profit from large business customers and other lucrative markets – thereby altering the Bell's 271 calculus – yet securing the Bell's cooperation in opening up remaining market segments to competition can still deliver substantial benefits to consumers. In particular, while the residential market contributes a relatively small share of a Bell's profit, in large measure because residential rates are more heavily regulated than rates to large business customers, considerable efficiency gains can be expected from bringing competition to the residential (and small business) market and easing the need for intrusive regulation.

<sup>9</sup> It is therefore wrong logically, and I believe also factually, to presume that if selective entry has eroded local market profit sufficiently for the Bell to accept the 271 terms, then the value to society from attaining the Bell's cooperation also must have diminished correspondingly. Such a zero-sum presumption overlooks the substantial, and well recognized welfare gains to be had

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<sup>9</sup> As an indicator of the Act's concern with the residential market, Track A of the 271 conditions requires an applicant Bell to have an approved agreement with a competitor serving residential customers.

from shifting to competition and away from regulation as the main guardian of consumers' interests.

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### **Evidence of 271's Impact**

As explained above, the reasons for maintaining the 271 standard are firstly, that the Act requires this, and secondly, that it will eventually help to open the local market even if it were not doing so already. Responding to the latter, some critics have argued that 271, as interpreted by the agencies, is asking for the impossible; thus, the Bells will simply abandon all hope of complying and therefore resist cooperating – both now and in the future. This contention is flawed on two counts. Meeting the 271 requirements is well within the Bells' ability. And the Bells themselves recognize this, as revealed by the fact that 271 already appears to be having a beneficial impact.

Because the value to a Bell of obtaining long-distance authority relative to the Bell's loss from opening the local market will vary across states (e.g., with the relative amount of long-distance traffic), one would expect the Bells to find the 271 tradeoff acceptable sooner in some states than others. It is therefore highly revealing that the states in which the Bells have been most serious about undertaking the steps needed to open their local markets are also those states where the Bells have most aggressively sought long-distance authority.

In addition, suggestive evidence comes from comparing the overall behavior of the Bells with that of GTE. Like other non-Bell incumbents, GTE does not require 271 authority to offer

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<sup>10</sup> These welfare gains derive from several sources, including: enhanced responsiveness to consumer choice, stronger incentives to cut costs and to innovate, and reducing direct costs associated with the regulatory process and, more importantly, indirect costs due to intrusive regulation (such as delay, and the setting of an inefficient structure of retail prices). See, e.g., Joseph Farrell, "Creating Local Competition," *Federal Communications Law Journal*, 49:1, November 1996, 201-215.

long-distance services and therefore should be less inclined than the Bells (on average) to cooperate in opening its local markets.

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An interesting study is by Federico Mini;

<sup>12</sup> his findings are consistent with those of a recent FCC study for those issues that both studies examined.

<sup>13</sup> Mini tests whether the Bells have been relatively more cooperative with local entrants than has GTE. This should be viewed as a “one-sided” test. A finding of no difference could mean either: (a) that the § 271 incentives are redundant, because the § 251 obligations already induce maximal cooperation by all incumbents – an implausible interpretation; or (b) that the 271 mechanism has not yet influenced the Bells’ conduct, but will do so in the future – for reasons explained above. Thus, a finding of no difference would not prove that § 271 is irrelevant; but a finding that the Bells have been more cooperative indicates that § 271 incentives *are* relevant.

<sup>14</sup> Mini finds that the Bells have been more cooperative than GTE according to various

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<sup>11</sup> Other incumbents were not barred from long distance in the first place, as were the Bells under the terms of the MFJ.

<sup>12</sup> Federico Mini, “The Role of Incentives for Opening Monopoly Markets: Comparing GTE and RBOC Cooperation with Local Entrants,” Georgetown University, Department of Economics, Working Paper 99-09, July 1999 ([www.georgetown.edu/departments/economics/wk\\_paper/wp\\_list.htm](http://www.georgetown.edu/departments/economics/wk_paper/wp_list.htm)). Mr. Mini is a doctoral student in economics, completing his dissertation under my supervision. (I am serving at the DOJ on leave of absence from Georgetown University, where I am a professor of economics.)

<sup>13</sup> *Local Competition: August 1999*, Industry Analysis Division, Common Carrier Bureau, FCC.

<sup>14</sup> While it is conceivable that the difference reflects idiosyncratic GTE characteristics, rather than the differential incentives created by 271, Mini notes that GTE was not more aggressive in regulatory proceedings prior to the Act, based on his discussions with industry experts and regulators.

measures, and his statistical tests show that the differences are statistically significant. My intent in reporting Mini's findings is not to single out GTE in any way, but simply to document the apparent impact of 271 incentives.

Mini compares AT&T's negotiations to enter local markets served by GTE and by a Bell, in the 22 states where both GTE and a Bell offer service and where all the relevant data is available. Focusing on states where AT&T negotiated with both GTE and a Bell permits pairwise comparisons while controlling for the potentially important role of the particular state regulatory commission. AT&T is chosen because it has been one of the most active firms seeking access to incumbents' networks in order to become a local competitor, and because it provided data on its negotiations.

<sup>15</sup> GTE is chosen because it is by far the largest non-Bell incumbent, accounting for about eleven percent of access lines nationally at the end of 1996, and because AT&T did not pursue negotiations with the other major non-Bell incumbents, including Cincinnati Bell, Frontier, and Sprint.

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***Litigation.*** To expedite the negotiations for access and interconnection between entrants and incumbents, § 252 of the Act allows parties to file challenges only in federal (not state) court, and only after a state commission has issued an order on an (arbitrated or negotiated) agreement. Mini accordingly classifies litigation as "premature" if it was filed prior to a final commission order (challenging the arbitrator's decisions, or the commission's

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<sup>15</sup> Obtaining such data without the company's assistance would be difficult, as the data is often confidential and comes from disparate, idiosyncratic sources. Indeed, assembling Mini's data proved quite laborious even with AT&T's assistance, as it required combing manually through numerous contracts and other lengthy documents.

<sup>16</sup> AT&T did negotiate with SNET, which provides local service only in Connecticut (SNET has since been acquired by SBC). AT&T's delay in reaching an agreement with SNET is far longer than the average delay Mini finds for the Bells, and therefore is consistent with the pattern he finds when comparing GTE vs. the Bells, as described next.

interlocutory order). In the 22 common states, AT&T filed 3 premature challenges against GTE and 3 against the Bells. The Bells filed 3 premature challenges against AT&T, while GTE filed 16. Mini notes that GTE's premature litigation is likely to have caused only modest delay directly, but might have significant indirect effects – for example, by flagging a wide-ranging set of issues that the incumbent intends to challenge, and thereby signaling an aggressive posture towards entrants.

***Delay.*** As of March 1999, AT&T had failed to obtain approved interconnection agreements with the Bells in only 2 of the 22 sample states, but failed with GTE in 10 of these states. In the 12 states where agreement was reached with both GTE and the local Bell, it was reached first with the Bell 11 times, and only once with GTE. Mini also compares the average delay in reaching an agreement. He constructs this average by computing the interval between AT&T's initial request and either (a) the date when the state commission approved a final agreement, or (b) March 1999, if no agreement had been approved by that date. Observe that step (b) understates the true delay, and that the overall bias this creates is greater for GTE than for the Bells, because GTE failed to reach an agreement ten times to the Bells' two. Even with this bias in GTE's favor, Mini finds that the average delay (equally weighted across all the states) is 457 days with the Bells, and 781 days with GTE – seventy percent longer with GTE.

***Pricing: Parties' Requests and Arbitrators' Awards.*** An especially telling measure of GTE's tougher posture compared to the Bells' is the difference in their pricing *requests*, going into arbitration, for providing access to their networks and services. Mini compares the initial requests for resale discounts and for prices to lease unbundled network elements (UNEs – here, loops and end-office switching). I describe his results for resale discounts; the findings for UNEs are broadly similar.

The Act requires incumbents to offer their retail services to entrants for resale, at wholesale prices discounted off the retail prices by the incumbent's avoided retailing costs (note that a lower discount benefits the incumbent and harms the entrant). These avoided retailing

costs are unlikely to differ significantly between GTE and the Bell (unlike the costs of facilities, which do differ), so a natural measure to compare is the dollar discount offered by GTE and by the Bell in that state.

<sup>17</sup> Of the 18 states for which all the necessary data were available, GTE's resale discount offer for residential customers was lower than the local Bell's in 15 states. These pattern is similar for business customers: GTE's offer was lower in 13 of the 18 states. (In contrast, AT&T's request is not systematically higher to GTE than to the local Bell.)

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As regards magnitudes, Mini estimates the average (across states) residential discount offered by GTE at \$1.20, and by the Bells at \$1.98. This difference is economically significant: relative to their average monthly bills, the discount offers are 8% for GTE and 13% for the Bells, and it is well known that the resale business operates on very narrow margins. Similar results obtain for business discounts.

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<sup>17</sup> Resale discount offers are always expressed as percentages of the retail prices, and these retail prices – which do differ between GTE and the Bells – are not consistently reported, unfortunately. To compare the *dollar* discounts, Mini therefore constructs estimates of the average monthly residential and business revenues per line, for each incumbent by state, and applies the reported percentage offers to these estimates of the monthly bills.

<sup>18</sup> For UNEs, especially for loops, the costs vary considerably between incumbents, according to factors such as customer density and terrain. Mini uses estimates (from the Hatfield Model) of the cost to each company in each state of providing loops and end-office switching, and expresses GTE's and the Bell's pricing request in a state relative to that company's estimated cost. He compares the requested price-cost margins. Combining the data on loops and switching, of the 23 cases where all data were available, GTE's request was higher in 17 cases.

<sup>19</sup> The average residential bill, across states, is \$14.85 for GTE and \$15.41 for the Bells. For business customers, the corresponding average bills are \$51.70 for GTE and \$48.49 for the Bells, and the discounts offered are \$4.11 by GTE (8% off the bill) and \$6.06 by the Bells (12.5% off the bill).

Interestingly, GTE's tougher requests do not result in more favorable arbitration awards to it as compared to the Bells, perhaps because a state commission is reluctant to award very different prices to two incumbents in its state. However, GTE's posture does seem to benefit it and harm entrants, since tougher GTE requests are associated with higher awards to both it and the Bell company in that state.

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**Entry Record.** The above pricing comparisons may only be the tip of the iceberg. They do not capture differences between the GTE and the Bells in their cooperation with entrants on *non-price* dimensions, such as the quality and timeliness with which new arrangements needed by competitors are made available (e.g., operations support systems, discussed later in this paper). Such new arrangements are critical for the success of local competition. Yet measuring incumbents' cooperation in developing and deploying them is hard for an investigator; and imposing such cooperation is hard for regulators – which is why it is so important to provide better incentives for incumbents to cooperate, as the 271 process attempts to do for the Bells. In an attempt to provide at least a crude look at the “total impact” of Bell versus GTE cooperation, Mini analyzes FCC data on the extent of competitive entry (by all firms, not only AT&T). The data come from voluntary responses to a survey

<sup>21</sup> so they should be interpreted with caution; but they are nevertheless suggestive.

Mini first reports raw measures of entry. (Observe that entry reflects the joint influence

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<sup>20</sup> Econometric regressions show that GTE's request appears as positive and significant in explaining both the award to it and to the local Bell; whereas the Bell's request is positive and significant in explaining its award, but *insignificant* in explaining the award to GTE. In the regression explaining awards for *loops* (the dependent variable is now the price-cost ratio awarded), GTE's request is again positive and significant throughout, while this time the Bell's request is insignificant in explaining its own award (as well as GTE's). A possible interpretation is that the state commission is more sensitive to GTE, realizing that, unconcerned with § 271 repercussions, GTE is more willing to press its case.

<sup>21</sup> *First Survey on the State of Local Competition*, FCC, Common Carrier Bureau, February 1998. A second survey was published in December 1998, providing updated and expanded information.



of many factors – price and non-price cooperation by incumbents, and the relative interest by entrants.) One entry measure is the number of lines resold to local competitors as a percentage of the incumbent’s total lines in the state. In those states where both Bell and GTE data were reported, the Bell had the higher percent of resold residential lines 12 times out of 15, and 14 out of 14 for business lines. And while the figures were not stellar for the Bells, they were considerably higher than for GTE. The highest residential percentage for GTE was 0.8%, while the Bell highest was 2.1%, with the averages (equally weighted across states) being 0.15% for GTE and 0.53% for the Bells – three times larger. The disparity is even greater for resold business lines. GTE’s maximum is 0.5%, while the Bells’ maximum is 9.3%, followed by 3.2% and 2.3%. The Bells’ average of 1.32% is eighteen times larger than GTE’s average.

Mini also tests if the significantly lesser entry into GTE’s territories, according to the above measure and others, can be explained away by variables that proxy for market conditions that affect the profitability of entry, such as customer density, and incumbents’ price-cost ratio. Controlling for the effect of such factors, he consistently finds that the GTE effect (dummy variable) remains negative and highly significant.

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Finally, the fact that Mini detects significantly greater cooperation by the Bells over his sample period is, in a way, surprising. Until recently, the Bells mounted legal challenges to § 271; thus, the Bells are likely to have discounted somewhat their need to open their local markets before entering long distance. As explained shortly, this legal uncertainty is finally being resolved, so in future the incentive effects of 271 on the Bells’ conduct should be even more pronounced.

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<sup>22</sup> The aforementioned FCC study (*Local Competition: August 1999*) obtains similar statistical findings concerning entry patterns. It notes that “Controlling for demographics, new firms are more likely to enter BOC [Bell operating company] regions than ... independent (that is, non-BOC incumbent) regions ... This empirical evidence leads credence to the view that the BOC long distance prohibition [the need for 271 approval] is effective in facilitating competitive entry into BOC local telephone markets.”

### III. MEETING THE BELL ENTRY CONDITIONS: GROWING PAINS, AND FUTURE PROSPECTS

Recall that the Act vests authority over Bell applications with the FCC, and directs the FCC to accord “substantial weight” to the competitive evaluation of the DOJ. Given this legal guidance, and that the DOJ articulated its standard early in the process and fairly explicitly, the DOJ’s analysis indeed has featured prominently in the FCC’s decisions, which have generally agreed with DOJ’s assessments in turning down the five applications to date.

<sup>23</sup> I therefore first discuss the DOJ standard, then briefly recap the DOJ’s and FCC’s

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<sup>23</sup> The five applications, and the accompanying DOJ Evaluations and FCC Orders, are as follows: 1) SBC in Oklahoma: *Application of SBC Communications, Inc., et al. Pursuant to Section 271 of the Telecommunications Act of 1996 to Provide In-Region, InterLATA Services in the State of Oklahoma*, CC Docket No. 97-121 (filed Apr. 11, 1997)(“SBC Oklahoma Application”); DOJ Oklahoma Evaluation (cited earlier); Memorandum Opinion and Order, *In re: SBC Oklahoma Application*, 12 FCC Rcd 8685 (1997). 2) Ameritech in Michigan: *Application of Ameritech Michigan Pursuant to Section 271 of the Communications Act of 1934, as amended, to Provide In-Region, InterLATA Services in Michigan*, CC Docket No. 97-137 (filed May 21, 1997)(“Ameritech Michigan Application”; Evaluation of the United States Department of Justice, *In re: Ameritech Michigan Application*, CC Docket No. 97-137 (June 25, 1997); Memorandum Opinion and Order, *In re: Ameritech Michigan Application*, 12 FCC Rcd 20543 (1997). 3) BellSouth in South Carolina: *Application by BellSouth Corporation, BellSouth Telecommunications, Inc., and BellSouth Long Distance, Inc., for Provision of In-Region, InterLATA Services in South Carolina*, CC Docket No. 97-208 (filed Sept. 30, 1997)(“BellSouth South Carolina Application”); Evaluation of the United States Department of Justice, *In re: BellSouth South Carolina Application*, CC Docket No. 97-208 (November 4, 1997); Memorandum Opinion and Order, *In re: BellSouth South Carolina Application*, 13 FCC Rcd 539 (1997). 4) BellSouth in Louisiana I: *Application by BellSouth Corporation, BellSouth Telecommunications, Inc., and BellSouth Long Distance, Inc., for Provision of In-Region, InterLATA Services in Louisiana*, CC Docket No. 97-231 (filed Nov. 6, 1997)(“First BellSouth Louisiana Application”); Evaluation of the United States Department of Justice, *In re: First BellSouth Louisiana Application*, CC Docket No. 97-231 (December 10, 1997); Memorandum Opinion and Order, *In re: First BellSouth Louisiana Application*, 13 FCC Rcd 6245 (1998). 5) BellSouth in Louisiana II: *Second Application by BellSouth Corporation, BellSouth Telecommunications, Inc., and BellSouth Long Distance, Inc., for Provision of In-Region, InterLATA Services in Louisiana*, CC Docket 98-121 (filed July 9, 1998)(“Second BellSouth Louisiana Application”); Evaluation of the United States Department of Justice, *In re: Second BellSouth Louisiana Application*, CC Docket No. 98-121 (August 19, 1998); Memorandum Opinion and Order, *In re: Second BellSouth Louisiana*

assessments of the rejected applications, and conclude that, despite these unsuccessful applications, the future of the 271 process looks fairly promising.

**A. The DOJ's Competitive Standard: Local Market Is Irreversibly Open**

While the Act does not set out a specific standard that the DOJ must use in making its evaluation of a Bell's application, the DOJ adopted a standard that it believes reflects the logic of the statute and will help attain its goal of promoting competition as efficiently and expeditiously as possible. The standard requires showing that the Bell's local market in the state for which long distance approval is sought is fully and *irreversibly open* to competition, for all three entry modes envisioned in the Act: construction of new networks interconnected with the Bell's networks ("facilities based" entry), use of the Bell's unbundled network elements, and resale of its discounted retail services.

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***The Standard's Requirements and Logic.*** Before discussing how one determines whether the standard is met, it is useful to clarify what it does and does not entail, and the underlying logic. The standard does *not* require the presence of ubiquitous facilities-based local competition, that is fully effective in eliminating the Bell's market power. Insisting on this would contradict the Act's philosophy that the extent and type of competitive local entry should be determined by market forces;

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*Application*, 13 FCC Rcd 20599 (1998).

<sup>24</sup> This standard is articulated and its logic is explained in the DOJ's Oklahoma Evaluation, May 1997. See also Schwartz 1<sup>st</sup> affidavit, and the subsequent affidavit: Marius Schwartz, "The 'Open Local Market Standard' for Authorizing BOC InterLATA Entry: Reply to BOC Criticisms," ("Schwartz 2<sup>nd</sup> affidavit") available at: [www.usdoj.gov/atr/statements/1281.htm](http://www.usdoj.gov/atr/statements/1281.htm). This 2<sup>nd</sup> affidavit was first filed in support of the DOJ's South Carolina Evaluation, cited above.

precisely for this reason, the Act requires that all three entry modes be made available, but does not express a preference between them (e.g., facilities based competition in some instances may be less desirable than relying, in whole or in part, on the incumbent's facilities).

As regards the risk that the Bells' presence in long distance would lead to their discriminating in local access against long distance competitors, conditions have changed markedly since the time of the MFJ. There are now major established competitors in long distance, and the access arrangements have long been in place. A combination of regulation and some local competition can do a reasonable job of protecting these *established* access arrangements, at least in the near term. And on the benefits side, opting for the DOJ standard, over the stricter one of fully effective local competition, avoids unduly delaying the competitive gains that can arise from Bell entry, and provides the Bells with better incentives to cooperate in opening their local markets.

The DOJ standard does require that the Bells have extended the cooperation needed to ensure that local markets are fully *open*, and that the opening be *irreversible* – it cannot be undone once the Bell obtains long distance authority and naturally becomes less inclined to continue cooperating.

Begin with the issue of opening the market. Securing the Bells' cooperation is so important in large measure because local competition will require the development and deployment of a host of new and complex systems and arrangements to enable efficient network sharing. It is much harder for outside enforcers to mandate the creation of such new systems than it is to prevent degradation of existing ones. For complex new systems, outsiders' information of what is feasible and how fast will be far inferior to that possessed by the firm (here, the Bell), a factor which makes it difficult both to know what to request and to impose

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<sup>25</sup> It also would contradict the intent of Congress: An early bill had required the Bell to face in that state a facilities-based competitor of "comparable scope," but this provision was ultimately dropped.

sufficient penalties. This creates considerable scope for footdragging by the incumbent. By conditioning a Bell's entry on the opening of its local market, the DOJ standard improves the Bell's incentives to cooperate in developing and deploying these systems much more efficiently and expeditiously than can be achieved through regulatory fiat alone.

The second element of the DOJ standard – the market opening is irreversible – requires that performance benchmarks for these new arrangements be in place before authorizing Bell entry. Establishing these benchmarks entails developing performance measures, agreeing on reporting procedures and performance standards, and creating a sufficient track record of performance against which any future degradation can be reliably detected. Once such benchmarks have been established, they help regulators, courts, and competitors to prevent backsliding by the Bell. In short, the DOJ standard seeks to prevent both footdragging and backsliding, and is met by ascertaining that any significant artificial impediments to competition have been durably removed.

***Factual Inquiry.*** Determining whether the DOJ standard is met follows a sensible system of shifting presumptions. The most reliable evidence that the market has been opened is, of course, a record of significant actual entry through all three entry modes. The more widespread and diverse the competition, the greater is one's confidence that the various inputs needed by competitors are available on commercially viable terms – both quality and functionality, and pricing. Moreover, competitors' willingness to invest in the market signals their confidence that the market opening is irreversible; and the presence of competitors with a significant stake will itself make it harder for an incumbent to roll back the process. In short, evidence that significant competition has taken root establishes a presumption that the market is irreversibly open.

Evidence of competition, however, emphatically does not entail a minimum market share test for competitors. For one thing, specifying a high or even moderate market share threshold that local competitors must reach before the Bell in that state receives long distance

entry authority would risk creating perverse incentives for certain potential local entrants to scale back their own entry plans. In particular, the large long distance carriers, which arguably are the most capable of local entry on a large scale, might be induced to pull their punches in order to delay the Bells' entry into long distance. More importantly, the market conceivably may be open even if little or no entry is observed – because this could merely reflect lack of interest by entrants. In the absence of significant competition, however, one requires persuasive alternative evidence that the lack of competition is not due to significant remaining artificial impediments.

This involves showing three main elements. (1) A key is that the new inputs needed by local competitors are meaningfully available, and that their provision could be scaled up to meet growth in demand and extended to additional geographic regions. Performance *benchmarks* must also have been established, as discussed above, preferably via commercial utilization, but if this is not an option then through rigorous testing. (2) The Bell must also demonstrate that it makes these inputs available at prices that are reasonably close to its costs, and that competitors can have sufficient confidence that prices will remain reasonable in future to justify their investments in entry.

<sup>26</sup> (3) Finally, there must be no significant other remaining barriers, such as regulatory or arising from exclusionary private conduct. The DOJ believes that its standard provides the Bells a reasonable roadmap of what they must do in order to satisfy it that their markets are open, and its substantive requirements can be met with the right effort and commitment.

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<sup>26</sup> The Act requires an incumbent's rates for interconnection and access to unbundled network elements to be "just, reasonable, and nondiscriminatory," and "based on the[ir] cost..." The FCC has applied this language and adopted rules requiring costs to be estimated based on the methodology of forward-looking TELRIC (Total Element Long-Run Incremental Cost). The Supreme Court's *Iowa Utilities* decision, discussed below, affirmed the FCC's authority to establish a pricing methodology that states must follow. The TELRIC methodology, if reasonably applied, would satisfy the DOJ's open market standard with regard to the incumbent's prices.

## B. Unsuccessful Bell Applications

In the five applications through July 1999, the DOJ concluded that the applicant Bell's local market was not fully and irreversibly open to competition. The FCC rejected these applications, one on the grounds that the threshold requirements of Track A had not been met, and the rest because they did not satisfy the threshold competitive checklist requirements. Thus, the FCC has not yet had to reach its public interest test,

<sup>27</sup> though the test could become outcome determinative – and properly so – in future applications.

Meaningful implementation of the checklist can be viewed as requiring two steps, neither of which has been met so far. First, *all* checklist items must be provided to competitors, *without undue restrictions* on how they can be used or combined. Second, access must be provided through *wholesale support processes* that allow efficient and rapid interaction between competitors and the incumbent's wholesale arm.

Regarding the first issue, unencumbered access to all checklist items, some of the applicant Bells made elements available only in a way that materially impeded competitors' ability to use them,

<sup>28</sup> or simply refused to provide certain items.

<sup>29</sup> An especially important and contentious issue in this regard has been whether incumbents

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<sup>27</sup> The FCC gave some indication of its thinking on the public interest test in its Order that turned down Ameritech's application in Michigan, but has not had to say much on the subject since then.

<sup>28</sup> For example, the DOJ and FCC found that in South Carolina, BellSouth's statement of generally available terms (used under Track B) failed to describe adequately what elements it will provide, the method in which it will do so, or the terms. Such vagueness naturally hampers competitors.

<sup>29</sup> For example, the DOJ and FCC found that Ameritech in Michigan refused to provide shared local transport, and provided trunking facilities whose quality was insufficient to ensure nondiscriminatory interconnection with competitors (as compared to the interconnection quality

must provide the so-called UNE “platform” – all the elements of the network, in their pre-existing combination, at cost-based prices as required by the Act, or whether competitors must supply some of their own elements in order to qualify for these cost-based prices. Incumbents argued that the platform is merely a backdoor way to obtain retail services for resale, but at lower prices.

<sup>30</sup> They sought to break up existing combinations of unbundled elements sought by competitors. Competitors countered that: (a) the Act does not require them to provide their own elements in order to qualify for UNE pricing; and (b) that the platform enables them not only to qualify for a different pricing methodology, but also to provide services not available through resale – notably, exchange access for long-distance carriers (such access is sold by incumbents only to long-distance carriers, not end users, hence is not a “retail service” eligible for resale), but potentially also new services that could be generated from the existing capabilities of the incumbent’s network but have not yet been offered by the incumbent.

Second, even if the incumbent places no explicit or technical restrictions on access to UNEs and to retail services for resale, such access must be provided in a manner that allows competitors to compete effectively with the incumbent’s own retail arm. This requires that a competitor receive parity compared to the incumbent’s retail arm in service dimensions such as obtaining items in large quantities, expeditiously, and without encountering quality problems. (If there is no retail analogue to a particular wholesale service, the FCC has said that the access must be sufficient to allow an efficient competitor a meaningful opportunity to compete.)

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between its own networks).

<sup>30</sup> Prices can be lower because the Act requires different methodologies to calculate prices for UNEs and for resale. UNEs are to be priced “bottom up” -- based on the incumbent’s costs of providing these elements. In the case of resale, wholesale prices are calculated “top down” -- starting from the existing retail prices and discounted by the estimated costs which the incumbent can avoid as a result of delegating these retailing functions to the reseller entrant. If retail prices exceed the incumbent’s overall costs (including both facilities and retailing expenses), the top down methodology will produce higher prices for competitors than bottom up.



Incumbents, however, have traditionally operated as retailers (and as wholesalers of a limited set of services, notably, local access for long distance carriers), and were not set up to operate as large-scale wholesalers of various inputs to local competitors. In order for incumbents to become efficient wholesale providers of such inputs, as sought by the Act, it will therefore be necessary to develop and deploy new systems, which the DOJ has termed *wholesale support processes*, that enable smooth and timely communication and interaction between competitors and the incumbent's wholesale operations. In many cases, this involves procedures for granting competitors nondiscriminatory access to the incumbent's internal *operations support systems* (OSS) – those systems used by the incumbent for functions such as obtaining pre-ordering information about a customer or about available services, ordering, installation, repair and maintenance, and billing. Providing competitors efficient access to OSS requires, among other things, the development of electronic interfaces between competitors and the incumbent, because manual processing is both inherently slower and much more prone to error. In other cases, the functionality needed by a competitor may not yet exist, so the issue of parity is moot, but adequate new arrangements would be needed. None of the applications so far had demonstrated adequate access to OSS.

### **C. Hopeful Signs**

The absence of a successful application so far has, understandably, bred frustration and disappointment all around. Some critics have decried the 271 process as dysfunctional and a failure, urging the DOJ and the FCC to throw in the towel. Perhaps acknowledging that the agencies are merely following the roadmap laid in the Act, some critics have called for revising the Act itself. Although I too would have hoped that the 271 conditions would have been met by now, I believe that departing from today's policy would be a serious mistake. Attaining the vision of local competition articulated in the Act is difficult, and the incentives created by section 271 can play an substantial role in inducing the Bells to do what does not come naturally to any incumbent.

While there can be no guarantees, there are promising signs that adhering to the current process will help advance Act's goals of promoting competition in all markets, and in a reasonably timely manner. There are two bases for this optimism: the cloud of legal uncertainty over the Act is clearing, and real progress is being made to resolve the difficult technical challenges of creating the new systems needed to allow efficient network sharing by local competitors.

*Clarifying the Legal Rules.* A major reason for the relatively slow progress thus far has been the Bells' understandable reluctance to open up their markets before they have explored what they perceived as promising legal challenges to the mandates of the Act. Like any other company, a Bell does not wish to act against its own self interest by making things any easier for competitors. This is precisely why mechanisms such as 271, and the obligations on all incumbents contained in the other sections of the Act, are necessary. Given the enormous stakes involved, and charges of ambiguities in the Act, it was predictable that incumbents would litigate to test the limits of these obligations.

And litigate they did. The issues taken to the courts ranged from the terms of particular agreements between incumbents and new entrants, to the meaning of various provisions of the Act, to the reasonableness of the FCC's implementing regulations, and the scope of the FCC's regulatory authority. Some went so far as to challenge the constitutionality of the Act, as bill of attainder, on the grounds that the § 271 obligations single out the Bells versus other incumbents.

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Fortunately, the courts have now resolved most of the fundamental disputes and have upheld the Act and, for the most part, the FCC's implementing regulations. In January 1999, the Supreme

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<sup>31</sup> At least to a non-lawyer, this argument is a bit hard to swallow, considering that the Bells alone were subject to the MFJ and its line of business restrictions, and that the Bells generally supported the Act because it voided the MFJ and replaced it, inter alia, with the 271 obligations. I find it strange that such a fundamental challenge was mounted a year and a half after the passage of the Act. In any event, the courts have rejected these arguments.

Court affirmed the FCC's broad authority to adopt regulations implementing all substantive provisions of the 1996 Act and upheld on the merits all but one of the specific regulations whose validity was at issue.<sup>32</sup> The Court's decision in this unusually complex case reinstated the FCC's vital and central role in telecommunications regulation.

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<sup>32</sup> *AT&T Corp. v. Iowa Utilities Board*, 119 S. Ct. 721 (1999). The FCC's *Local Competition Order* of August 1996, among other things, had: (a) required prices of unbundled elements to be based on the forward-looking TELRIC methodology, and not on "historic" costs; (b) specified the network elements that incumbents must provide; and (c) prohibited an incumbent from separating network elements that it currently combines, over the objection of a new entrant requesting access to combinations of network elements (to avoid unnecessary costs for entrants and consumers). Many incumbent phone companies and states filed petitions for judicial review of the FCC Order; the cases were consolidated in the U.S. Court of Appeals for the Eighth Circuit. In a 1997 ruling, *Iowa Utilities Board v. Federal Communications Commission*, 120 F.3d 753, the Eighth Circuit held that the FCC lacked jurisdiction to promulgate pricing rules and therefore vacated the pricing rules without considering their substance. The Eighth Circuit also addressed various arguments concerning unbundled elements, ruling for the FCC on some issues and for the incumbents on others. The government and many of the private parties asked the Supreme Court to review the Eighth Circuit's rulings.

In its *Iowa Utilities* decision, the Supreme Court held that the FCC's general jurisdiction to implement the Communications Act extends to the local competition provisions added by the 1996 Act. The state commissions' authority to "establish rates" under § 252 does not displace the FCC's authority to promulgate pricing rules; rather, state commissions are to apply the FCC's rules in setting specific prices. (The issue of the substantive propriety of the FCC's pricing rules, which was briefed but not decided in the Eighth Circuit, was not presented to Supreme Court, and is now before the Eighth Circuit on remand.)

On unbundled elements, the Supreme Court held the FCC has broad discretion in interpreting and implementing the requirements of the Act and that the regulations, with one exception, reasonably interpret and apply the Act. Accordingly, the Court affirmed the Eighth Circuit's holdings that the FCC properly construed and applied the statutory definition of "network element," and that the FCC reasonably declined to impose a requirement that carriers seeking to use the incumbent's unbundled elements must also own some facilities. The Court also upheld Rule 315(b), which prohibits incumbents from separating already-combined network elements. Reversing the Eighth Circuit, the Court held this important rule to be a reasonable interpretation of the statute, consistent with generally accepted definitions of "unbundled" and rationally based on the Act's nondiscrimination requirement. The Court also addressed challenges, which the Eighth Circuit had rejected, to the FCC's Rule 319, which requires an incumbent to provide requesting carriers with access to a minimum of seven specified network elements. The Court held that the FCC failed adequately to consider the Act's "necessary" and "impair" standards when it identified the network elements which must be made available to requesting carriers. Accordingly, the FCC must reconsider Rule 319 and articulate and apply a standard rationally related to the goals of the Act.

The D.C. Circuit and Fifth Circuit have now held that the Act's restriction on the Bell companies' provision of in-region long distance services is constitutional,<sup>33</sup> and the Supreme Court denied certiorari. The United States Court of Appeals for the D.C. Circuit, which hears all challenges to the FCC's rulings on Bell applications under § 271, also upheld the FCC in both appeals from its decisions denying Bell applications.<sup>34</sup> In addition, the D.C. Circuit has upheld the Commission and the Act in several cases addressing the scope and interpretation of the § 271 prohibition, holding, for example that certain so-called "marketing" arrangements between Qwest and the Bells violated that prohibition.<sup>35</sup>

The vast majority of federal district courts and all of the courts of appeals that have entered judgments in cases seeking review of state agency decisions under section 252(e)(6) of the Act also have upheld the Act and the FCC's regulations. The courts have rejected state agency contentions that the constitutional prohibition on suits against the states in federal courts bars such review, and they have required states to conform agreements to the Act and the FCC's regulations.

To be sure, some significant issues do remain.

<sup>36</sup> But while litigation will surely continue, and while I hesitate to underestimate the creativity of

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<sup>33</sup> *SBC Communications, Inc. v. FCC*, 154 F.3d 226 (5th Cir. 1998); *Bell South Corp. v. FCC*, 162 F.3d 679 (D.C. Cir. 1998).

<sup>34</sup> *SBC Communications, Inc. v. FCC*, 138 F.3d 410 (D.C. Cir. 1998); *Bell South Corp. v. FCC*, 162 F.3d 678 (D.C. Cir. 1998). (Ameritech did not appeal the denial of the Michigan application; BellSouth voluntarily dismissed its appeal from the denial of its Louisiana application, No. 98-1087 (D.C. Cir.).

<sup>35</sup> *US West v. FCC*, 177 F.3d 1057 (D.C. Cir. 1999).

<sup>36</sup> On remand from the Supreme Court's decision upholding the FCC's authority to adopt pricing rules, the Eighth Circuit is now considering challenges to the substance of those rules. Specifically, it will determine whether FCC's decision that access to unbundled network elements and interconnection should be priced on the basis of forward looking costs – using the total element long-run incremental cost ("TELRIC") methodology – is reasonable and consistent with the Act. The Eighth Circuit also is considering arguments as to the effect, if any, of the Supreme Court's decision on the FCC's requirement that the incumbents provide shared transport, which the court of appeals previously upheld. *Southwestern Bell v. FCC*, 153 F.3d 597 (8th Cir. 1998). Also on remand from the Supreme Court, the FCC is reconsidering its

lawyers in conjuring new arguments, my learned lawyer colleagues inform me that the major legal overhangs are finally being resolved. This is a key reason for believing that the Bells become more willing to cooperate in meeting the 271 requirements for their long distance entry.

*Implementing the Complex New Systems.* It would be quite unfair, however, to blame the slow progress solely on recalcitrance by the Bells. The framework for local competition required by the Act places heavy demands for complex network sharing with competitors. Even with the best intentions, it would take considerable expense, effort, and time to develop the myriad of complex new systems called for by the Act, and to iron out the kinks.

However, significant progress is being made. For example, in evaluating the latest application, of BellSouth in Louisiana, the FCC found that several checklist items had been met, and several more would have been had those items been provided through adequate OSS. Serious efforts have been underway in some states, such as New York and Texas, to develop and test the new systems of providing access to OSS, with the close involvement of state commissions and some participation by third-party testers.

In conclusion, we at the Antitrust Division are mindful that our role is not to prescribe the evolution of local competition, but to help establish conditions that will allow market forces to operate with minimal impediments. This means doing the hard work of applying the facts to the law. We know that we are ill equipped to be regulators, nor is this our mandate or desire. The 271 process can help greatly in securing the market opening measures needed to permit competition to evolve, and minimize the need for intrusive regulation. Predictably, the road has not been easy. But promising signs are emerging, and the right policy is to give these efforts a chance to work. To paraphrase Mark Twain, I believe that rumors of 271's death are greatly exaggerated.

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rule 319 – which specifies the unbundled network elements incumbents must provide – in light of the Court's holding that in adopting the rule it had failed appropriately to consider certain statutory standards. The Commission is expected to reissue a UNE rule in the near future; various parties likely will seek further court of appeals review.

