Minimizing Entanglement, Maximizing Competition

Accelerating Local Exchange Competition by Neutralizing Monopolists’ Ability to Control Competitors’ Costs and Capabilities

February 1998

Adapted from Comments of Robert Annunziata, Chairman, President, and CEO of Teleport Communications Group, on The Second Anniversary of the Enactment of the Telecommunications Act of 1996

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Introduction

Two years ago, the Telecommunications Act of 1996 established a national policy to encourage the development of competition for local telecommunications services. Today, many observers are trying to assess whether the Act has been a “success” or a “failure.” From the perspective of TCG, the largest, most experienced, and most successful Competitive Local Exchange Carrier (CLEC), it is premature to make this sort of judgement. There have certainly been positive developments flowing from the Act, but so far it is an “incomplete success” and we are still years away from being able to make a realistic judgement.

The Telecommunications Act was not revolutionary: it simply codified the successful results of the many experiments undertaken by States in the preceding decade to slowly replace local monopolies with competition. TCG, which began offering competitive local telecommunications services in 1985, was heavily involved in these state-by-state experiments.

By 1995, it was clear that the state experiments promoting local exchange competition had been successful. Where states had authorized local competition and required the Incumbent Local Exchange Carrier (ILEC) monopolies to interconnect with CLECs, consumers were beginning to see the benefits of competitive choice. A few larger business users directly benefitted from the early competition because CLECs could serve them directly. But smaller business and residential consumers benefitted indirectly as the monopoly ILECs “woke up” and started to improve the overall quality, performance, and pricing of their services in response to the “pin prick” competition offered by the early CLECs.
In the months leading up to the passage of the Act, Congress correctly determined that three things would be needed to accelerate the development of local competition: 1) CLECs would need to raise billions of dollars from capital markets in order to build the competitive local networks; 2) legal and regulatory barriers to local competition would have to be eliminated; and, 3) the monopolist ILECs' hostility toward competition would need to be neutralized, at least for as long as competitors have no choice but to rely on the ILECs' for essential facilities. It is appropriate, therefore, to judge the “success” or “failure” of the Telecommunications Act on its second anniversary by how well it has achieved each of these essential prerequisites.

Success on Wall Street . . .

It is clear that the Telecommunications Act has been spectacularly successful in encouraging investment in the CLEC industry. By replacing a patchwork of 50 state policies on local competition with a single clear national policy, the Act lowered the perceived risk and increased the perceived potential reward of investing in the fledgling Competitive Local Exchange Carriers (CLECs). This improved investor confidence made it possible for the CLECs to begin raising the billions of dollars that will be needed every year to steadily deploy the competitive networks that competitors must have to compete.

Barriers on Main Street . . .

It is premature to judge, however, whether the other objectives of the Act have been achieved. The 1996 Telecommunications Act, on its face, removed state and municipal legal and regulatory barriers to open telecommunications markets to competition. Since many state legislatures and public utility
commissions were embracing local competition even before the Act became law and other states have moved rapidly to conform to the national law in the past two years, it is fair to say that few state-imposed barriers to entry exist today.

However, it is not at all clear that the Act has done anything yet to eliminate the very substantial barriers to local competition erected by municipal governments. The most unfortunate of these local barriers is the practice of many municipalities to discriminate heavily against competitive local carriers when it comes to CLECs’ access to and payments for use of public rights-of-way. A CLEC will be reluctant to deploy facilities to serve consumers in a municipality if the municipal government demands a substantial share of the CLEC’s revenues -- essentially a tax -- but demands nothing similar from the ILEC. Although Sec. 253 of the Act bars such anti-competitive discrimination by municipalities\(^1\), a final resolution will come only after expensive and time-consuming court battles. Until then, these municipal barriers will remain in place, denying the benefits of competition to many consumers, possibly for many years to come.

... and Entangling Monopolies Everywhere

But the greatest barrier to local exchange competition is the anti-competitive attitude and behavior of the ILECs. Taking advantage of their monopoly position, the ILECs have not hesitated to employ any tactic that would frustrate, delay, or otherwise impose substantial “costs of entanglement” on would-be competitors seeking to interconnect with the ILECs’ networks and to utilize ILEC facilities as part of CLEC service. This “strategy of

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entanglement” has been perfected and shamelessly used by the ILECs to discourage competition since the passage of the 1996 Telecommunications Act. It is a particularly pernicious barrier to competition during the period when CLECs have no practical choice but to use the ILECs’ services and facilities as essential elements of the CLECs’ services.

Even though the Act guarantees that monopolies will be justly compensated for the use of their facilities by competitors and even though, in the case of the Bell companies, they get a coveted quid pro quo for opening up the local exchange bottleneck, monopolies will never want to make it easy or efficient for competitors to use their networks. And one federal statute is not going to make a monopoly politely give up its monopoly power and its ability to frustrate a competitor’s ability to compete.

So, if ILECs won’t treat rival CLECs fairly or equally, what are the alternatives? At this stage, there are only two options for the CLEC. The “first-best” alternative is for the CLEC to reduce its reliance on the incumbent’s facilities by deploying its own facilities to serve the customer wherever it is possible and economic to do so. TCG has always said such facilities-based local competition is the only real form of competition.

Unfortunately, “instant install” alternative local telecommunications facilities do not exist. It takes substantial capital, time, and manpower to build competitive facilities. Even under the best of circumstances, it will take many years for local competitors to deploy their own ubiquitous facilities. It will take even longer if, as noted earlier, municipalities continue to maintain barriers that discourage competitive network deployment.

The “second-best” alternative is for the competitor to trust the ILEC enough
to put its brand name, its profitability, and its ultimate destiny in the ILEC’s hands by utilizing the ILEC’s facilities. Unfortunately, the ILECs have yet to earn that trust, and have instead pursued their entanglement strategy with a vengeance: refusing to implement signed and approved interconnection agreements, contesting the terms of the agreements, and refusing to provide service that is “at least equal” in quality to the service the ILECs provide themselves.

Local competition would develop much more quickly if the ILECs themselves reformed their attitude and performance and abandoned their litigious ways so that CLECs would be more willing to risk relying on a competitor’s facilities. If the ILECs are unwilling to reform themselves, however, it is up to state and Federal regulators to reduce the risk and cost of entanglement through swift, strong, and consistent application of the “carrots and sticks” embodied in the Telecommunications Act.

So, as we celebrate the second anniversary of the Telecommunications Act, we need to take a hard businesslike look at what the real possibilities are. Let’s get real.

The Evolution of the CLEC

The goal of the Act is to provide a competitive choice of telecommunications service providers -- particularly for local exchange services -- for everyone. To compete successfully with the ILEC, the competitive provider itself must have economies of scale and scope and, most importantly, the incumbent

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2 A third option provided for in the Act, simple rebranding of the ILEC’s retail service (total service resale -- “TSR”), has proved to be impractical in almost every instance.

monopolist cannot be allowed to ruin the competitor’s business through entanglement.

To achieve the economies of scale and scope that will allow it to compete with the ILEC in all markets, the facilities-based CLEC must evolve through four distinct phases. Each phase takes time and substantial CLEC resources. In addition, each phase exposes the CLEC to ever-increasing risks of entanglement with the ILEC.

In the first phase, a facilities-based CLEC must establish its own broadband backbone local network -- its service area footprint-- and garner large business customers and long distance carriers to act as “anchor tenants” for this initial private line services network. These large customers help pay for the CLEC’s basic local infrastructure. But this also where the facilities-based CLEC starts to become entangled with the ILEC. To serve some large customers, the CLEC must “collocate” its broadband network at an ILEC’s central office and lease a broadband “loop” from the ILEC. Fortunately, for such large customers the CLEC can afford to “brute force” through the difficulties and inefficiencies imposed by the necessary -- and usually temporary -- entanglement with ILEC.

In the second stage, the CLEC starts filling its near-limitless optical fiber and broadband wireless capacity by increasing its range of services -- adding switches for local exchange services and Internet services, for example -- and by selling services to medium sized businesses. But at this stage of development the degree of entanglement with the ILEC -- and the cost of the entanglement -- increases dramatically. Now local telephone calls must be exchanged seamlessly between the ILEC and CLEC switches, 911 calls must be handled flawlessly, and it may be necessary for the CLEC to lease
hundreds of analog loops rather than a few broadband loops because of the location of the smaller customers and their volume characteristics. At this stage, the cost of entanglement starts to become a major factor in the CLEC's business and marketing strategies.

In the third phase, the CLEC has developed sufficient economy of scale and scope on its own network that it can begin to offer services on an incremental cost basis to new groups of customers, such as small business and even residential consumers in apartment buildings and similar high density locations. At this stage, if the CLEC is not careful, the cost of entanglement can be overwhelming. It is these costs of entanglement with the ILECs, rather than the cost of the CLEC's own network operations or any other single factor, that ultimately determine whether a CLEC can serve a particular geographic area or type of customer.

Only after achieving strong financial performance during these first three stages of development will a facilities-based CLEC be in a position to take on the biggest and most costly challenge of the fourth phase -- bringing choice and competitive alternatives to the mass markets. Now more than ever before, the costs of entanglement with the ILEC will determine whether and when a CLEC will be able to take on the "mass market" opportunity, which -- but for the cost of entanglement -- could be a very attractive business.

The duration of the first three phases and the success of the CLEC in the fourth phase depends, ultimately, on the degree of ILEC entanglement and the ability of the CLEC and regulators to minimize entanglement costs. Thus, "complaints" that CLECs seem to be unwilling to serve certain markets reflect the success of the ILECs' efforts to protect those markets by imposing
preemptive entanglement costs on CLECs, not a lack of CLEC intentions or efforts.

Minimizing Entanglement: Making the Act Work

TCG has been entangled with the ILECs for more than 10 years and this experience has convinced us that we can be most successful by minimizing our reliance on hostile competitors. However, given the harsh reality that we must interconnect with the ILEC to exchange traffic and to utilize some of their facilities at least temporarily, we had hoped that the Act would have made it possible for TCG to minimize our entanglement costs. That part of the Act that encouraged carrier-to-carrier business deals to exchange traffic and to lease ILEC unbundled elements was indeed very promising.⁴

Unfortunately, most ILECs refused to enter into reasonable, non-entangling business deals. And even those who did negotiate seemingly reasonable interconnection arrangements have fallen short on the implementation.⁵ ILECs -- particularly the Regional Bell Operating Companies (RBOCs) -- continue to protect their monopoly control of the mass market by making entanglement so awkward and costly that it is economically and operationally difficult -- if not impossible -- for any competitor to utilize unbundled ILEC facilities to address the broad local market in the near term. For example, the "cash" costs of collocating at ILEC central offices and of using an ILEC loop to reach a small customer are high enough; but the added, hidden entanglement costs make it impractical to use these unbundled elements except for larger business users.


One way out of this quagmire for a CLEC is to establish seamless interconnection with the ILEC's Operations Support System (OSS). Electronic interfaces between CLEC and ILEC OSS will reduce the ILEC's ability to corrupt a competitor's service, reduce the overall cost of entanglement, and ultimately make it possible to bring a competitive choice to the mass markets.

OSS interconnection must cover five functions: 1) Pre Ordering, 2) Ordering, 3) Installation, 4) Maintenance and Repair, and 5) Billing. So far, only the Ordering processes of OSS have received any attention by the ILECs and this has been limited to the ordering functions associated with the so-called "Total Service Resale" (TSR) of the ILECs' basic service. Unfortunately, "Ordering for TSR" is the simplest part of OSS interconnection and the least useful in terms of promoting facilities-based local exchange competition.

There has been little or no progress on streamlining and improving the OSS processes for any of the five OSS functions needed for efficient facilities-based competition. Efficient, effective OSS interconnection would substantially reduce entanglement costs and make it possible for CLECs to address the mass markets efficiently and economically. If the ILECs will not improve OSS interconnection for real facilities-based competitors, regulators must take this failure into account in considering -- and rejecting -- RBOC petitions for entry into InterLATA services and other premature ILEC petitions for "deregulation."

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Above all, ILECs are unwilling (or are simply unable) to meet the “Performance Parity Principle” embodied in Sec. 251 of the Act. This principle requires ILECs to provide interconnection, facilities, and services to competitors that are at least equal in quality and performance to what the ILECs provide to themselves, to their affiliates, or to their own customers. Because the Performance Parity Principle can be a powerful tool for minimizing the cost of entanglement, it is arguably the single most important pro-competition provision in the Act. If ILECs don’t provide Performance Parity, rivals will always be hostage to the ILECs’ entangling inefficiency and poor quality of service, and hostages make poor competitors.

This then is the pivotal role for regulators if policy makers expect competitive choice to come to the mass market anytime soon: Performance Parity must be enforced vigorously and swiftly. ILEC violators must face swiftly applied and substantial penalties for failing to satisfy the Performance Parity requirement of the Act. Without “swift justice,” the CLECs will naturally be reluctant to rely heavily on unrestrained ILECs.

The Future
The speed with which mass market competition develops depends entirely on the viability of each of the options facing the CLECs. If the ILECs behave (on their own or because of regulatory/judicial intervention) and no longer pursue their strategy of entanglement, the CLECs will eventually gain the confidence to rely on the ILECs and will therefore be able to bring real competitive choice to the mass market relatively quickly. On the other hand,

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if the ILECs continue to pursue the entanglement strategy, mass market competition will have to wait for the CLECs to build their own independent networks.

One thing is clear: no CLEC can allow hostile competitors to dictate its future. TCG will continue to make every effort to make the ILECs live up to their obligations under the 1996 Act so that consumers can have real choices sooner. Because TCG has no illusions that we will ever be able to entrust our destiny to the ILECs -- and unless real world experience convinces us otherwise -- we will continue to rely on ourselves as much as possible and to deploy our own facilities as economically and as quickly as we can.

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If you have questions or comments, please contact Bob Atkinson,
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Other TCG White Papers:

(Titles cited in the text are in boldface.)

- Model Regulatory Procedures for the Enforcement of Interconnection Agreements (November 1997)
- Model Performance Parity Measures for Facilities-Based Competition (November 1997)
- The Performance Parity Principle (July 1997)
- Universal Service Assurance: Act Three of a Four Act Play (April 1997)
- Beyond Cost Models: Managing Interconnection Pricing to Achieve Sustainable Competition (February 1997)
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