Room Document 25

Agenda Item 5: FCC Presentation on Interconnection

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A Broader Perspective on Interconnection

1. Interconnection policy is a form of resale policy, and is best considered in the context of over-all resale policy.

a. Interconnection is often thought of as the interconnection of multiple competing facilities-based operators so that each can provide ubiquitous service.

b. In a business sense, such interconnection amounts to reselling transport and termination services that are bundled with other (origination and transport) services.

c. The regulatory framework for this form of resale, and other forms of resale, plays a crucial role in promoting and sustaining competition.

II. A minimal, but crucial, policy framework for resale are buyer's rights: a legal right for a buyer to resell any service that a major supplier offers, a legal prohibition against discrimination among buyers based on how they use a service (usage restrictions), and protection of business-sensitive buyer information.

a. Resale rights have been crucial to new entrants in the U.S.
MCI, the second largest facilities-based interexchange carrier, grew by reselling AT&T wide area business service (WATS).

b. Purchasers should have the right to resell services purchased from a major supplier.
The FCC will not approve a dominant carrier's tariffs that include restrictions on resale. Incumbent LEC's are required to offer for resale any telecom service that they provide at retail (to non-teleco customers).

c. Discrimination on the basis of manner of use allows a major supplier to foreclose new markets to competition, i.e. internet service provision, VPN services.
Access providers in the U.S. cannot refuse to provide data calls, i.e. foreclose the internet services market.

d. Competitive safeguards are needed to prevent a major supplier from using information obtained from serving particular customers to further its competitive advantage in other markets, i.e. retail or information service markets.
FCC requires that an operator keeps customer calling information confidential, i.e. the operator cannot identify a reseller's retail customers to its retail unit or anyone else.

III. Additional regulatory support for resale involves supervision of the prices at which a major supplier offers services to resellers.

a. One approach to pricing is retail prices minus avoided costs (costs not incurred in providing the product to a reseller).

This is the resale pricing methodology in the U.S. Telecommunications Act of 1996 for telecommunications services. The FCC has established a default discount range of 17-25%, applicable when cost information is lacking.

b. An alternative approach is to separate network services and retail services, and require a major supplier to provide network services to resellers on the same terms as it provides them to its own retail services unit.

This is the U.S. approach for information services.

IV. Further regulatory support for resale includes regulatory definition of feasible points of interconnection on a major supplier's network and a regulatory requirement to provide services, at these points and under reasonable terms, to other suppliers.

a. New entrants benefit from being able to resell parts of a major supplier's network other than those that the major supplier voluntarily offers to sell.

Under the U.S. approach, incumbent LEC's are required to provide interconnection at the line-side of a local switch, the trunk-side of a local switch, the trunk interconnection points for a tandem switch, central office cross-connect points, out-of-band signaling transfer points, and points of access to unbundled elements. Default price standards have been established to ensure that services offered at each of these points are offered at reasonable terms. The default range for end office termination is 0.2-0.4 cents per minute; switching, 0.2-0.4 cents per minute (0.15 cents per minute for tandem switching).

b. New entrants benefit from being offered appropriately grouped services to resell as part of their service offerings.

The FCC requires incumbent LEC's to provide network services unbundled in terms of at least the following seven elements: network interface devices, local loops, local and tandem switches (including software features), interoffice transmission facilities, signalling and call-related databases, operations support systems, and operator and directory assistance facilities.

V. Granting companies designated as "facilities-based provider" relatively favorable interconnection/resale terms may reduce their incentive to build facilities.

a. A company's decision to expand its operations depends on a wide range of business factors. These factors include competitive environment, regulatory framework, net present value of customer acquisition, marketing significance of geographic scope, etc.

Favorable interconnection/resale terms, *along with weak retail competition or regulation,* can improve new entrant profitability and make financing expansion easier. The policy effect is equivalent to dividing supemormal profits between the incumbent and new entrants. This policy does not help to diminish supemormal profits which are, of course, a transfer from consumers and an indicator of social welfare losses.

b. A regulatory distinction between a "facilities based service provider" and a "non-facilities based service provider" may bear no relationship to the different companies' incentives to build additional facilities.

> The best going forward strategy for a facilities-based provider might be to develop enhanced services on its facilities-based platform. The best going forward strategy for a non-facilities based provider might be to build or buy facilities so that it could exercise more control over its service offerings.

c. Given a decision to expand operations, a company has to choose whether to build facilities or use resale (i.e., a make/buy decision). All else equal, more favorable interconnection/resale terms increase the incentive for a facilities-based provider to choose resale.

d. The FCC does not offer different resale rights to different types of carriers; in particular, the FCC does not distinguish resale rights on the basis of ownership of facilities.

VI. Resale policy should encompass resellers who do not own facilities.

a. Resellers who do not own any facilities can generate large consumer benefits.

> There are over 300 switchless resellers of domestic long distance service in the U.S. They provide are wide range of service and payment options. Through innovative marketing, they increase customer awareness of service alternatives. Overall, the FCC believes that switchless telephony resellers have generated significant consumer benefits in the U. S.

b. Consumers care about lower prices, more choices, and better services rather than about competition itself, or, in particular, about who is building what facilities.

> A consumer is happier about being offered a lower toll rate than about someone digging up the street.

c. Promoting facilities based competition is a key U.S. policy goal. Providing regulatory support for resellers who do not (currently) own facilities is considered to be consistent with this goal.

Conclusion: The U.S. experience suggests that interconnection policy should be considered in the broader context of resale policy. Regulators should provide a policy framework to support resale, but should not make discretionary distinctions among carriers with respect to ownership of facilities. Preferential interconnection/resale terms for carriers designated as facilities based are not measures with a well-reasoned connection to the goal of encouraging facilities build-out.