

B. Selective or Unevenly Distributed Entry

Natural monopoly conditions do not necessarily prevail throughout the entire scope of the local exchange market, and therefore some areas are less likely than others to attract NECs. Service at any particular location may or may not be a natural monopoly, depending primarily on the traffic volumes originating and terminating at that location, the overall traffic density in the vicinity, and other variables. For instance, the downtown business district may be more enticing than inner city residential neighborhoods; urban areas may be more attractive than suburban or rural areas.

At the present level of telecommunications activity, one would expect many residential, rural, and suburban areas to continue to be natural monopolies, inimical in the long run to effective facilities-based competition. But prospects for effective competition improve as the traffic densities and associated capacity requirements increase. Thus, locations with high concentrations of traffic (e.g., downtown business districts) are probably capable of sustaining several efficiently operating carriers, all carrying large volumes of traffic on their own networks.

Unfortunately, a great many areas (primarily residential) have not achieved sufficient traffic volume to eliminate or even appreciably diminish the associated natural monopoly characteristics. Nor is it reasonable to expect that these exchanges will approach such volume levels in the foreseeable future. In such areas, the public interest may not be served by facilities-based competition.

Nevertheless, it is quite possible that one or two facilities-based firms will enter the market in each local exchange area--particularly cable television firms, which have an incentive to more intensively use their existing facilities, and/or revamp their system to take advantage of recent technological advances in fiber optic and digital technology. However, it is extremely unlikely that more than one or two new facilities based entrants will be attracted to the residential areas within any one exchange, and thus there is no assurance that customers will benefit from competitive price cutting.

With only one or two entrants, a likely outcome would be a joint attempt to avoid the devastating

consequences of an all-out price war. Therefore, the Commission must take regulatory steps to overcome this problem, and ensure that entrants are attracted to all market segments and all geographic locations. However, the solution is not to force all carriers to serve all customers within a given exchange. Requiring new entrants to offer service to all customers in the exchange may impose unnecessary costs and dilute or limit their ability to follow a unique, focused marketing strategy. In turn, the proposed rule may reduce the number of firms that enter the market, and could potentially inhibit a transition to effective competition. If a new entrant is required to serve everyone within a particular geographic area, firms that do not have the desire or ability to serve an entire existing exchange will tend to be kept out of the market. Unless the proposed rule is revised, smaller firms with more limited capabilities or niche marketing strategies will tend to be precluded, or discouraged, from entering the Ohio market. These problems will be exacerbated if the scope of the "exchange" is controlled by the incumbent LEC. The problems would be reduced, but not eliminated, if the NEC is allowed to define its own "exchange," or serving area, thereby controlling the geographic scope of its operations.

In order to establish a presence in the local exchange market, new entrants should be allowed to focus their efforts, rather than being forced to gear up to offer their services to all potential customers within a large geographic area. Limited entry is likely to eventually lead to widespread competition with multiple providers. All customers will eventually benefit from such competition, because it will ultimately be more effective, and less prone to collusion or co-operation, than the more limited type of competition which would occur in a market that exclusively consists of a relatively large carriers, all having similar entry strategies.

The public interest can best be protected by imposing comprehensive requirements for exchange of traffic between competing networks, mandating adequate unbundling of wholesale services by all carriers (not just incumbents), and limiting or prohibiting resale restrictions. These types of regulatory requirements will help maintain universal service and encourage truly effective competition throughout the entire market.

If the Commission makes appropriate decisions concerning unbundling and interconnection rules, and

establishes appropriate wholesale prices for these services, it can (and should) allow selective entry into narrow markets. While competition may initially be more intense in particular market segments, competitive forces will ultimately spread to all parts of the market, if the unbundling and wholesale pricing decisions have been appropriate. Eventually competition will emerge in all segments of the market, and the resulting pattern of competitive activity will be more effective than if the Commission were to impose restrictions that make niche marketing difficult or impossible.

The mere presence of two or three similar, broad-based firms in an exchange does not guarantee that customers will enjoy the full benefits of effective competition, particularly if there are significant barriers to entry by additional firms. In fact, with a limited number of relatively similar competitors, the market is likely to remain an oligopoly, with results that are little better (and sometimes worse) than those produced by an unregulated monopoly.

Accordingly, Commission policy should encourage maximum competitive entry, at least within the retail side of the business. Moreover, the Commission should retain sufficient involvement in the tariff approval process to protect universal service and encourage a rapid transition to effective competition. If effective competition fails to emerge, the Commission may need to reexamine its policies and requirements to determine, for example, if it has overpriced key bottleneck services thereby deterring entry into particular segments of the market.