

E. Unbundling and Resale

Effective competition depends on widespread entry by numerous carriers into both business and residential markets, in both urban and rural areas. Unbundling and resale are indispensable for this purpose, especially since effective facilities-based competition is unlikely in many areas. When pure retailers (resellers) are given the opportunity to compete effectively, their presence in the market can greatly enhance the public interest. In order to maximize the likelihood that the competition will be truly effective, the Commission should require a high degree of unbundling and mandate reasonable wholesale rates for unbundled basic service functions.

Unbundling

The disaggregation and separate sale of the functional components of telecommunications services (often called BSFs--basic service functions) allows competing carriers to enter the market even though the incumbent may have a monopoly on provision of certain BSFs (e.g., elements of the local loop). Unbundling is an essential part of any effort to reduce barriers to entry and encourage a transition to effective competition.

Incumbent carriers often argue that mandatory unbundling ought to be limited to those BSFs that competing carriers can obtain from no other source. This approach would allow dominant carriers to tightly restrict access to bottleneck facilities, thereby keeping competitors out of the market. While it sounds reasonable, on close examination it is apparent that there are many situations where the dominant carrier is the most practical (e.g. most cost effective, most reliable) source of a BSF, even though other options theoretically exist (e.g. at excessively high cost, or with insufficient reliability).

Some dominant carriers, while accepting unbundling in principle, argue that the cost of conducting the necessary studies to price unbundled services should be borne by the new entrants. This too could impose a significant barrier to entry, especially since the LECs would have no incentive to minimize the cost of preparing the necessary studies. A more reasonable approach would be to allow smaller

carriers to prepare simplified studies, relying in part on generic industry data. Or, a generic statewide unbundled wholesale tariff could be developed that LECs could adopt by reference if they declined to incur the cost of developing cost studies and rate schedules of their own.

It is imperative that the Commission unbundle those basic service functions which are of primary importance to a potential competitor. For example, substantial disaggregation and unbundling should occur in the loop, end office switching, inter-office trunking and tandem switching, to ensure that each competitor is given an opportunity to use the specific functions/facilities that they need, and is free to substitute their own facilities, or provide their own services, where they find this to be more desirable or cost effective. NECs will directly perform most, if not all, of the other functions used in providing basic local exchange service. Therefore, functions such as billing and customer service should be dealt with separately, to ensure that a competitor is not required to pay for activities which are not applicable to them, or are not as costly to perform for wholesale customers.

In order to encourage effective competition, the Commission must ensure that, at a minimum, the loop is unbundled, disaggregated and appropriately priced. The loop should be unbundled from other service functions, and disaggregated to distinguish the following: drop wire/building cable (typically a pair of copper wires running from the customer's premise to the street); copper distribution cable (typically a pair of copper wires running from the end of the drop wire or building cable to the beginning of the feeder cable); copper feeder cable (typically a pair of copper wires running from the end of the distribution cable to the wire center; supporting structures (typically poles or conduit used to support the distribution and feeder cable). Where fiber optic systems are used in providing loops, it becomes important to distinguish between the fiber optic cable (sometimes referred to as dark fiber) and the circuit electronics which are used in deriving multiple communication paths on a copper for fiber optic cable system. Further disaggregation of the loop might be reasonable, but any lesser degree would not be appropriate.

Resale

Since effective facilities based competition is unlikely in many areas, resale is the most important step towards effective competition. When pure retailers (resellers) are given the opportunity to compete effectively, their presence in the market can greatly enhance the public interest.

Most regulatory policy objectives are designed to mimic the results in competitive markets. For instance, effective competition serves to expand consumer choices and encourage technological improvements. It can also lower costs in the long run, as competition forces the competing firms to become more efficient, providing room for price reductions. The development of effective competition in the retail segment of the local exchange market (involving the switching, marketing, customer service, billing and collection and other functions typically performed by resellers) will produce these benefits.

In toll markets the competition provided by resellers has expanded the choices available to consumers in terms of both the number of service providers and the kinds of services available. Consumer choice is an important element of competitive markets. From a customer's perspective, the availability of choices within the retail portion of the market is far more important than the availability of multiple providers of the facilities that carry traffic. Even when there is only one of the latter, consumers benefit from firms that compete by reselling its services.

Furthermore, the competition created by resellers in the long-distance market has proven to be quite significant in promoting innovation in both services and technologies, as resellers have attempted to gain retail market share. Many of the innovations offered by the larger long-distance carriers originated with smaller resellers. These firms try to compete not only on the basis of price but also by their innovative offerings. Some of these new reseller services--such as account codes developed by the customer that list on the bill calls falling within various predetermined categories--have helped businesses cut costs and increase efficiency, to the benefit of their customers. Thus, the benefits of retail competition not only inure to the users of the competitive services but spread out to other consumers as well, increasing the overall public welfare.

Retail competition tends to result in more efficient use of the underlying facilities, even when these

facilities belong to only one monopoly carrier. A large portion of the cost is fixed or sunk once the facilities are installed. Consequently, system costs exhibit sharply declining average costs as the volume of traffic carried on them increases. In most toll markets, retail competition has helped stimulate the overall volume of toll traffic, thereby improving the cost structure of the industry. Similar benefits can be envisioned in the local markets, where resale competition may promote increased volumes of FAX traffic and computer traffic (including higher bandwidth services such as ISDN) as well as ordinary voice traffic. With appropriate unbundling and resale rules, retail competition could promote increased use of the existing facilities, due to the new entrants' promotional efforts, price cutting, and innovations.

A diverse and thriving resale industry is particularly critical if the Commission wants to avoid a pattern of ineffective competition and duopoly. Furthermore, if the Commission wants to spread competitive benefits into rural areas, the most viable opportunity will be to encourage resale competition.

Compared with facilities based operations, entry into the retail end of the telecommunications market is relatively easy, enabling resellers to operate on a very small scale in towns and neighborhoods with densities and volumes too low to support the efficient operation of more than one or two facilities-based carriers. If underlying facilities are available at a reasonable price, potential resellers, could bring competitive benefits even to these small markets; if not, customers in these areas will not enjoy the freedom of choice and other benefits wrought by effective competition.

Furthermore, the Commission's policy towards resale and unbundling will also have a significant impact on the pattern of competition which emerges in the high density markets. In order to provide a complete spectrum of services (perhaps including video dialtone), and to handle calling to and from residential customers in the same city, NECs will need to interconnect with LECs; a policy designed to encourage unbundling and resale competition, will provide NECs with additional options, and potentially reduce the volume of traffic which it must send through a LEC switch.