THE FUTURE OF CAPS -- IN LIGHT OF TECHNOLOGICAL, ECONOMIC AND LEGAL FACTORS

James Alexander Hall, IV

I. The CAP Dichotomy in Light of the 1996 Telecommunications Act

Competitive Access Providers ("CAPs") are a structural anomaly within the telecommunications industry. As a result, many will not survive into the 21st Century. CAPs have recently been described by the Federal District Court for the District of Columbia as "local service providers" furnishing access services in competition with formerly monopolistic Local Exchange Carriers ("LECs"). However, to survive and benefit in a market driven by the Telecommunications Act of 1996 ("1996 Act"), CAPs will have to provide services at competitive rates in intra-LATA competition.

Congress intended the 1996 Act to promote a "pro-competitive, deregulatory national policy framework" for the telecommunications industry. However, the local loop is affected by additional regulation intended to force competitive growth. Additionally, in order to create a truly competitive marketplace, the appropriate legal, economic, and technological environment must develop. On April 25, 1996, the Federal Communications Commission ("Commission") issued an Notice of Proposed Rule Making ("NPRM") on competition in the local loop. The Commission's cautious behavior leading up to the 1996 Act demonstrates that its details may be more difficult to develop and implement than the nebulous concepts in the 1996 Act itself. Thus, while the seeds of the 1996 Act have been planted for over two years, the Commission has been slow to cultivate the local market. Moreover, further delay may cause the existing CAPs to wither on the vine of competition.

Superficially, the 1996 Act appears to provide CAPs with a near-perfect, pro-competitive legal environment. Section 251 of the 1996 Act generally addressed prohibitive language which restricted CAPs from truly competing with LECs. Indeed, the legislative mandate of Section 251 dictates that incumbent LECs bargain with CAPs in "good faith" toward providing interconnection, number portability, dialing parity and unbundled access at a "reasonable" price. Additionally, CAPs may resell a

LEC's telecommunications services to customers the LEC might not choose to serve directly.

Such changes resulting from the 1996 Act may eventually provide CAPs with the ability to compete locally via a nationally levelled playing field. In the past, some state regulators granted certain CAPs the opportunity to provide service in a number of states. Now, the 1996 Act opens up competition in all states. CAPs are considered by LECs, such as US West, to possess the ability to serve their customers with a complete range of services as a "carrier's carrier."

However, it is unclear whether CAPs have grown into such a competitive force and time is of the essence if the CAPs are to succeed. The 1996 Act remains inceptive to details required for effective, instant implementation. Currently, this regulatory scheme allows those with the power and the ability to question the interpretation of the 1996 Act to gain a permanent advantage over the CAPs. As a first step in providing guidance to the 1996 Act, the duty to negotiate in "good faith" must be defined with parameters which immediately force the LECs to deal fairly with the struggling CAPs. Currently, Section 251(c) of the 1996 Act requires the incumbent LEC to negotiate in good faith with competitors seeking an equal footing within their LATA. Then, if the parties fail to resolve an issue, the state commission is required to arbitrate and issue an order within 9 months of the original notification. However, in Section II(B)(1) of the NPRM, the Commission addresses the parties' duty to negotiate in good faith, and seeks further guidance on the mandatory arbitration process.

This guidance must be the result of federal legislation. The Commission realizes that state-by-state resolutions to arbitrate in good faith would foster inconsistencies within the industry. Thus, the incumbents can take advantage of local rulings and local networking of "de facto monopoly". In this manner, such localism would continue to place an undue burden on the CAPs until a federal procedure was established. Thus, while relying on Congressional intent, any Commission rulemaking must impose serious, punitive repercussions on the LECs for failure to negotiate in good faith.

To interpret the Congressional intent behind the 1996 Act, the Commission should consider adopting a committee similar to the National Labor Relations Board ("NLRB") which exists to
resolve labor disputes between unions and big business.17 Such a committee could provide the Commission with a basis for negotiating, via 60 years of case law related to compulsory arbitration already generated by the NLRA and the Federal Courts.18 An adaptation of labor relations case law works well here because the disadvantage in bargaining between the CAP and the incumbent is similar to that of labor union and employer.

While it might be argued that such a comparison fails to consider the inherent differences in the respective areas of industry and underlying law, such an argument fails to identify the overriding similarities: both industries are fundamentally concerned with economics and the technical ability to operate efficiently.19 Telecommunications competition is simply another business and upper-level decisions are made by those with business-oriented backgrounds not unlike any other major industry. Furthermore, these negotiations would involve economic forces which are Congressionally mandated to "get along."20

Examples of labor cases that could provide guidance are NLRB v. Wooster Div. of Borg-Warner Corp. 21 and the trilogy of Supreme Court Steelworkers cases (the "Trilogy").22 In Wooster, the Supreme Court defined good faith as "the terms and conditions [essential to] employment."23 More so, the Trilogy makes arbitration a mandatory repercussion upon the failure to compromise on a dispute related to the work environment.24 Thus, a Commission ruling reflecting Wooster might then mandate that "good faith bargaining" include those terms. Such a ruling could work conjunctively with Section 251 as essential to telecommunications operations.

Additionally, the Commission could draw upon the Trilogy to compel arbitration, rather than allow the LEC to stonewall the CAP. Examples such as those offer ready-made solutions to the inequity which currently exists between most LECs and their competitors. Therefore, the Commission should rely on Federal case law and Congressional mandate to appoint a national committee on bargaining disputes.

A. Interconnection

Interconnection is an additional term which requires definition if the CAP is to survive. Section 251(b) and (c) requires the incumbent LEC to provide interconnection to the competition at "reasonable rates."25 However, without establishing an exacting procedural definition, existing competitors, such as US West, are able to arrange less than optimal connection points based on economic justification or by entirely stalling the process.26

In fact, US West's requirement of a "one-time-bargaining session," addressing interconnection issues set forth in the 1996 Act was arguably timed to leave Electric Lightwave Inc., a West Coast CAP and MCI-Metro, with hundreds of millions of dollars of unusable fiber.27 While this may appear to be merely another case of "lounging bargaining," the end result to such a stalemate will be twofold: US West is allowed to eliminate its competition and the competitive impetus behind the 1996 Act is defeated by example.

Incumbents, such as U.S. West, appear to be relying on Section 251(c)(2)(B) and (D) of the 1996 Act to resist compliance. This section may allow the incumbent some demand for technical and economic preparedness prior to interconnecting with the CAPs. Respectively, subsection (B) allows the incumbent to select an interconnection point which is "technically feasible" to its existing system,28 and subsection (D) allows the incumbent to determine and charge rates that are "just and reasonable."29 Thus, taken together, a conservative interpretation of the statute might allow the incumbent to refuse to bargain until it can determine a fair rate and a mutually beneficial interconnection point. However, this interpretation is contrary to Congressional intent and could prove lethal to CAPs if a national interpretation and enforcement of the 1996 Act is not addressed.

Of all the clarifications needed, the timing of the Commission's reaction remains the most critical. Virtually all of the existing CAPs are engaged in a day-to-day fight for their financial lives. Each day that the incumbent is able to postpone implementing the provisions of the 1996 Act, the CAP will grow deeper in debt. Ultimately, this would allow the incumbent to stockpile revenues and use these very resources to defeat their competition. Moreover, the preexisting disproportion of wealth between CAPs and incumbents only serves to magnify the devastating impact this would have on the CAPs.

The issues of "when" and "how much" to bargain could also be resolved by borrowing from preexisting solutions within the realm of labor law. Public sector employees, or those in positions of ongoing fundamental public importance, such as police or nuclear power plant operators, are forbidden to strike by the Landrum-Griffin Act.30 If issues under negotiation cannot be resolved, arbitration is then compelled by law. This federal mandate ensures that labor disagreements will not affect the greater stream of commerce or public safety. Similarly, CAPs must have a level playing field in which to bargain, and where the LECs are prevented from using stonewalling tactics to defeat the CAPs. Only by supporting the 1996 Act in such an active manner can the Commission guaranty a naturally competitive environment and preserve the maximum number of choices within a LATA.

While deregulation was justified partially on the theory that CAPs could provide effective competition for LECs, the fact that

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17 The power to develop to Constitutionally based within the Commerce Clause as well as under the Due Process afforded to corporations in the Fourteenth Amendment.
18 The National Labor Relations Act was passed in 1935 and upheld by the Supreme Court in NLRB v. Jones & Laughlin Steel Corp., 301 U.S. 1 at 4 (1937).
19 See, e.g., Detroit Fire Fighters v. City of Detroit, 408 Mich. 663 (1980) (Finding that one intent behind the NLRA is to encourage efficiency in the workplace.)
20 Both the 1934 National Labor Relations Act (NLRA) and the 1996 Telecommunications Act were passed to ensure that competing factors within the economy co-exist and provide the greatest good to the people. The NLRA is concerned with promoting competition. Moreover, both legislative acts rely on legislative rulemakings to expedite Congressional intent.
22 The Trilogy was decided by the Supreme Court in order in order to provide the arbitrator with the final say whenever an issue was found to be arbitrable. In sum, this provided the parties with a weapon to use against each other if either side breached the contract or refused to arbitrate.
23 Super note 21 at 349.
25 Super note 6.
26 U.S. West Tells Competitors It's All or Nothing for Interconnection, TELCO BUSINESS REPORT, Wt. 960199 (March 25, 1996).
27 Id.
28 Id.
30 See, 47 U.S.C. §251(d).
CAPs earn less than one percent of local loop revenues hardly supports such a theory. Further, the presidents of MFS Communications ("MFS") and Teleport Communications Group ("TCG") both insist that direct competition with LECs will not be successful. Therefore, the answer to the question, "What was the Commission contemplating when it allowed deregulation, yet only provided vague set of guidelines to implement the provisions?" remains unanswered by the Commission's prior acts.

II. The Structure of Tomorrow's CAPs

The current actions of the CAPs themselves may provide direct insight toward their future viability. In order to survive, most CAPs have rapidly worked toward establishing a complete menu of customer services to compete with the preexisting infrastructures of LECs. However, this often requires establishing end-to-end services by forming alliances with companies seeking entry into the local loop. Therefore, mergers appear to be the predominant method for CAPs to become a competitive force. Mergers can also provide name recognition as well as a more complete list of services for the customer. Additionally, mergers often provide CAPs with much needed operating capital which allows these new companies to function until their local subscriber base increases to a self-supporting level.

Yet, as these mergers allow the more entrepreneurial CAPs to become financially stable, nationally competitive access providers ("NATCAPs"), the telecommunications industry will become a distillation of several highly integrated organizations. Each will be well-entrenched within the communications industry and will claim a large share of local loop earnings. Moreover, all but a few CAPs are likely to be consumed by these monopolistic companies. Some may even be forced into statistical/competitive insignificance, unable to truly compete with these large mergers. This trend toward larger companies has already begun, as Regional Bell Operating Companies ("RBOCs") and Interexchange Companies ("IXC's") position themselves for expansion.

MFS and TCG represent two distinct examples of how a successful NATCAP could align itself. MFS can be distinguished as a holding company which has interests in various CAPs around the United States, in addition to commercial ATM-based data services in Europe. This type of vertical alignment focuses exclusively on providing telecommunications services. While the MFS structure could allow the company future financial independence, it risks taking too narrow a view of the upcoming technological advances affecting the telecommunications industry.

Several possibilities currently under exploration include a shift from wire-oriented telecommunication services toward coaxial cable or wireless land-line service. In such an event, a MFS-styled company could be left searching for new partnerships at a time when mergers with undiversified CAPs are less attractive.

Alternatively, TCG presents a NATCAP model that has considered future technological shifts. TCG has aligned itself with both an IXC (Sprint), and several cable companies (Cox Enterprises Inc., Time Warner Inc., and Tele-Communications Inc.). This alignment could benefit TCG in several ways: It provides an immediate boost in local competition through name recognition, capital, and potential customers. Additionally, the merger allows TCG the opportunity to expand beyond local telecommunications.

Such a merger moves both horizontally into cable and vertically into long distance. Further, this prepares CAPs such as TCG for any uncertain technological shifts that might occur. For example, if cable were to become a technologically viable alternative to telephone transmissions, the TCG model would already be aligned with national cable companies. Such companies possess a preexisting national coaxial infrastructure and maintenance/engineering crews which could be utilized by CAPs emulating the TCG model.

However, while such mergers allow the TCG model to compete on a national scale, it may require the CAP to relinquish its autonomy and make decisions based on factors other than local loop competition. Thus, the TCG model may be precluded from fulfilling the role it was appointed by the Commission - acting as a competitor in the local loop.

Alternatively, a market may remain for CAPs by competing against LECs that provide poor service or charge exorbitant rates to its customers. These Competitive Local Exchange Carriers ("CLECs") remain dependent on consumer dissatisfaction with the LEC. However, given the competitive nature of market entry, the fate of these CAPs is not as promising as that of the NATCAPs. These companies will eventually either fail or remain relegated to smaller markets - not necessarily smaller geographically, but less desirable from a density or high volume perspective. These markets must be small enough to discourage the competing LEC from improving their service in addition to discouraging entry by a third competitor. If any of these factors are not present within a given LATA, the LEC or a larger competitor will force economically self-sufficient CAPs to fail.

34 Alternate Access: A Look At the Market, CABLE WORLD, May 23, 1994, at p. 118.
35 See, Teleport Reinvented For New Wireless Era, CRAIN'S NEW YORK BUSINESS, May 8, 1995 at p. 2 (President Robert Annunziata prepares to include wireless services to compete with the LECs). See also, Merger Chaos Opens Door For Competitors To Grab Market Share, TELCO BUSINESS REPORT, No. 10, Vol. 13 (May 6, 1996) (MFS Communications Co. President Royce Holland stating that "someone entering the market just to provide special access in one or two cities is probably really implementing an exit strategy.
36 Lecture by New York Law School Professor Michael H. Botein, February 20, 1996, stating that while local switching fees are currently as much as 45% of a long distance call, this revenue stream is not likely to sustain the CAPs in the long term because the LECs are capable of reducing their fees temporarily, drawing customers away from the CAPs, and forcing the CAPs out of the market.
37 Id.
38 Diaghwall, Craig D., "The Last Mile: A Race For Local Telecommunications Competition Policy", 48 FCLJ 105 at 111 (1995) (citing Economic Strategy Institute "it will be at least five years before a majority of U.S. residents have an alternative to their current LECs offerings.
39 See, Carol Wilson, CLECAPS and COMPLEXES, TELEPHONY, Vol. 226, No. 19, at p. 48 (May 9, 1994) (Rob Annunziata announcing that the COMPLEX is an endangered species which must adapt to survive.
Certain telecommunications consultants appear to favor the "TCG-type" NATCAP model because of its nationwide diversity. Dr. Joseph S. Kraemer, Vice President and head of A.T. Kearney's communications and electronics practice, asserts that it is "obvious that the LEC will cease to exist in its current form within the next five to ten years."[42] Kraemer's position is apparently based on the presumption that the 1996 Act will force consolidation among IXCs and LECs.[43] These mergers will metamorphose into $100 billion conglomerates.[44] In turn, these conglomerates will buy up or bankrupt the LECs and particularly, the CAPs.[45]

At least part of Kraemer's predictions have already occurred. In April 1996, Bell Atlantic and NYNEX announced their intent to merge.[46] In response to this announcement, Commission Chairman Reed Hundt noted that "neither of the proposed Bell mergers is being described by the parties as expanding the possibility of local competition."[47] However, in consideration of the 1996 Act, Chairman Hundt's remarks fell short of suggesting that such mergers were impossible.[48] In fact, the Commission has yet to determine whether it will eventually issue explicit guidance on how these monolithic mergers or local carriers may interact with the local loop.[49] Such inattention to detail leaves the CAPs with little protection from these companies.

Compounding the Commission's inaction on a national level, CAPs are uncertain as to how empowered the state regulators remain after the 1996 Act.[50] If state regulators are allowed to maintain a prominent role in enforcing the 1996 Act, the incumbent LEC might receive favorable treatment with regard to the 1996 Act's ambiguous language. Granting favorable treatment toward the incumbent LEC on the basis of ambiguous language would be inconsistent with the Commission's intent to provide clear and consistent guidance.

However, even if the Commission acts quickly to provide a thorough and detailed interpretation of the 1996 Act, CAPs' efforts to become competitive forces could still be thwarted. That is, agreements which were already negotiated with incumbent LECs could be found to be meaningless; valuable bargaining positions could be exposed without gain; and profits could continue to be stifled.

Assuming that a few CAPs survive the frenzy of mergers and remain as separate corporate entities, they cannot be considered a competitive factor in the local loop. When considering the entire $11.5 billion annual revenues from the local loop, the 26 largest CAPs only claimed $254.3 million, or .01%.[51] Further, of these 26 CAPs, TCG and MFS earned $165 million.[52] That amounts to 61% of the total CAP earnings being generated by two CAPs while the smallest CAPs earned less than $1 million each.[53] Based on these numbers, it is unclear why Congress justified opening the local loop to competition while relying on the CAPs to maintain a competitive force against incumbent LECs.

III. The Functions of CAPs in Today's Marketplace

CAPs have been alleged to play a critical role in both the judicial and legislative endorsement of open market competition within the telecommunications industry. In 1985, the United States Court of Appeals decided in Public Service Commission of Maryland v. Chesapeake and Potomac Telephone Company of Maryland[62] that CAPs could provide effective competition and break up the potential "information bottleneck."[54] Similarly, Congress recognized the potential impact of CAPs when it enacted the 1996 Act, yet CAPs are currently an insignificant source of competition. Moreover, industry competition to expand markets is likely to move slowly due to the need for adequate planning for such substantial risk taking, thus running counter to the predictions of the courts and the legislators.[55] Therefore, it is doubtful that, in the short term, CAPs will satisfactorily fulfill their role as a true competitor in the local marketplace and prevent an information bottleneck. Only if CAPs can successfully avoid both economic pressures and the temptations of merger will they be an effective local force, as has been predicted.

In short, CAPs merely represent a pawn with which the incumbents avoid violating antitrust laws. The 1996 Act decreases the risk that inter-LATA mergers or buyouts between telco competitors would violate the intent behind antitrust laws. However, the conglomerates of tomorrow must have some entity which they can claim creates competition within their LATAs. Currently, it is unclear whether CAPs fulfill such a function.

However, the very presence of CAPs does, technically, appear to create competition within a service area. While competition may be relatively insignificant, the legislative intent of the 1996 Act would consider the presence of a CAP as a sign

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