

2001

# Controlling Access to Commercial Users by Telecommunications Providers—The FCC's Failure to Separate the Market

Christopher K. Sandberg

Follow this and additional works at: <http://open.mitchellhamline.edu/wmlr>

## Recommended Citation

Sandberg, Christopher K. (2001) "Controlling Access to Commercial Users by Telecommunications Providers—The FCC's Failure to Separate the Market," *William Mitchell Law Review*: Vol. 27: Iss. 4, Article 14.  
Available at: <http://open.mitchellhamline.edu/wmlr/vol27/iss4/14>

This Article is brought to you for free and open access by the Law Reviews and Journals at Mitchell Hamline Open Access. It has been accepted for inclusion in William Mitchell Law Review by an authorized administrator of Mitchell Hamline Open Access. For more information, please contact [sean.felhofer@mitchellhamline.edu](mailto:sean.felhofer@mitchellhamline.edu).

© Mitchell Hamline School of Law

## CONTROLLING ACCESS TO COMMERCIAL USERS BY TELECOMMUNICATIONS PROVIDERS—THE FCC’S FAILURE TO SEPARATE THE MARKET

Christopher K. Sandberg<sup>†</sup>

|   |      |
|---|------|
| I. INTRODUCTION .....   | 2240 |
| II. THE BACKGROUND FOR THE FCC’S ACTION IS AN<br>EMERGING HIGHLY COMPETITIVE MARKETPLACE FOR<br>LOCAL TELEPHONE SERVICES.....           | 2240 |
| III. THE FCC’S RULING ESTABLISHED NEW RULES ON<br>CARRIERS’ ACCESS TO TENANTS IN COMMERCIAL<br>MULTITENANT BUILDINGS AND COMPLEXES..... | 2242 |
| IV. THE FCC’S ASSERTED BASES FOR ITS MTE ORDER<br>MIX POLICY REGARDING ILECS AND CLECS .....  | 2244 |
| V. THE FCC’S IMPOSITION OF LIMITATIONS ON CLECS IS<br>MISGUIDED FROM BOTH A POLICY AND A LEGAL<br>PERSPECTIVE .....                     | 2246 |
| VI. CONCLUSION .....  | 2253 |

---

† Mr. Sandberg is a 1979 graduate of the University of Minnesota Law School, and presently is a partner in the Minneapolis law firm of Lockridge Grindal Nauen P.L.L.P. Mr. Sandberg leads the firm’s Telecommunications and Technology practice area, and works extensively in telecommunications, Internet, and computer law. He advises companies in many parts of the communications industry, including Competitive Local Exchange Companies, long-distance carriers, large telecommunications users, Internet Service Providers, and developers of electronic content. Prior to joining Lockridge Grindal Nauen, Mr. Sandberg spent ten years as a regulator, serving as an Assistant Attorney General in the Minnesota Attorney General’s Office, representing the public in telecommunications and energy matters at the state and Federal levels. Mr. Sandberg is on the Adjunct Faculty of St. Mary’s University of Minnesota, where he teaches law and policy courses as part of the Masters Degree in the Telecommunications program. Mr. Sandberg served on the Minnesota Government Information Access Council, and the State’s Information Policy Task Force, which developed policy recommendations for the State Legislature on electronic data and communications.

Mr. Sandberg gratefully acknowledges the assistance of Rebecca Liethen in the research for this article. Ms. Liethen was an associate at Lockridge Grindal Nauen during 2000, and prepared the materials that form the basis for Section III of this article.

## I. INTRODUCTION

In late October 2000, the Federal Communications Commission (hereinafter "FCC") issued rules limiting the ability of providers of interstate telecommunications services to enter into exclusive contracts to provide their services to tenants in commercial buildings. The FCC supported its decision to adopt these new rules with assertions that it was enhancing competition. These rules, however, may very well produce exactly the opposite of their intended effect.

## II. THE BACKGROUND FOR THE FCC'S ACTION IS AN EMERGING HIGHLY COMPETITIVE MARKETPLACE FOR LOCAL TELEPHONE SERVICES

The first major overhaul of U.S. telecommunications policy in over sixty years became law on February 8, 1996. The Telecommunications Act of 1996 (hereinafter the "1996 Act") made sweeping changes affecting all consumers of telecommunications service and the numerous companies providing those services in the domestic marketplace.

A key element in the 1996 Act was the national policy of opening of local exchange markets—that is, telephone services offered within a toll-free local exchange calling area—to competition for the first time. While the FCC had permitted competition in interstate, interexchange telephone services since the early 1970s,<sup>1</sup> and states had generally followed the FCC's lead for interexchange calling inside their borders, little had changed within local exchanges. The 1996 Act fundamentally restructured those local exchange markets:

Until the 1990s, local phone service was thought to be a natural monopoly. States typically granted an exclusive franchise in each local service area to a local exchange carrier (LEC), which owned, among other things, the local loops (wires connecting telephones to switches), the switches (equipment directing calls to their destinations), and the transport trunks (wires carrying calls between

---

1. *E.g.*, *MCI Telecomm. Corp. v. FCC*, 561 F.2d 365 (D.C. Cir. 1977); *Regulatory Policies Concerning Resale and Shared Use*, 83 F.C.C.2d 167 (Dec. 18, 1980); *Petition of New Ulm Telecom, Inc.*, 399 N.W.2d 111 (Minn. Ct. App. 1987); *Re Summary Investigation Into IntraLATA Toll Access Compensation for Local Exchange Carriers*, MINN. PUB. UTILS. COMM'N, Docket No. P-999/CI-85-582 (1986).

switches) that constitute a local exchange network. Technological advances, however, made competition among multiple providers of local service seem possible, and Congress ended the longstanding regime of state-sanctioned monopolies.<sup>2</sup>

The result of the sea change in telecommunications policy embodied in the 1996 Act has been the rapid emergence of new, competitive carriers in larger metropolitan markets.<sup>3</sup> These new Competitive Local Exchange Carriers, or CLECs, have exploited the provisions of the 1996 Act which permit them to enter the market as equals to the Incumbent Local Exchange Carriers or ILECs (made up of the Regional Bell Operating Companies and the independent local carriers providing local services prior to the 1996 Act), to build their own facilities for handling telecommunications traffic, to rent portions of the ILECs' existing local networks to fill in missing pieces in their own networks, and to exchange traffic with the ILECs on a peer-to-peer basis.<sup>4</sup>

CLECs have gone to considerable lengths to differentiate themselves in the marketplace. Some have pursued both residential and business users in major metropolitan areas, while others have gone after business users with fiber optic facilities connected to interstate backbone network. Some have staked out smaller markets in non-metropolitan areas, some have leveraged their affiliation with cable television and electric power utilities, and still others have developed partnerships with Internet Service Providers to deliver an expanded range of services to consumers, including high-speed Internet access.<sup>5</sup>

One of the ways in which CLECs have tried to reach business customers in the new, competitive arena has been by working

---

2. AT&T Corp. v. Iowa Utils. Bd., 525 U.S. 366, 371 (1999).

3. *Ventura Administration Strategic Plan for Telecommunications* (Dec. 14, 1999). There remain wide variations in the degree to which competition has emerged across the country. In 1999, the Ventura Administration found, "[c]ompetition for local phone service in Minnesota is minimal. There are emerging pockets where smaller, independent competitive telephone companies are overlaying fiber optic facilities in an incumbent telephone company's service territory." *Id.* (on file with author).

4. 47 U.S.C. §§ 251-253 (2000).

5. *E.g.*, *Company Information*, at <http://www.covad.com/companyinfo/>; *Delivering the Promise of Broadband*, at <http://www.northpoint.net/about.asp> *Adelphia Business Solutions*, at <http://www.adelphia-abs.com>; *Who We Are*, at <http://www.crystalcomm.com/whois.html>; *Welcome to AT&T Broadband, About Urban Media* at <http://www.broadband.att.com>; *About Us*, at <http://www.seren.com/about.htm>.

through owners and managers of commercial buildings, seeking partnerships and business arrangements giving the CLEC access to the tenants in the buildings which those owners and managers control.<sup>6</sup> An exclusive access contract is one where the building owner or manager agrees that only one carrier will be able to provide telecommunications services to the tenants of a particular building. One incentive used by some CLECs to obtain exclusive-access arrangements with building owners is a sharing of the revenues generated in the building.<sup>7</sup>

As part of its work implementing the 1996 Act, the FCC initiated a review of the general state of competition in local networks.<sup>8</sup> That inquiry ultimately included an evaluation of the need for the FCC to promote competitive access to multi-tenant environments ("MTEs") such as apartment buildings, office buildings, office parks, shopping centers, and manufactured housing communities.

### III. THE FCC'S RULING ESTABLISHED NEW RULES ON CARRIERS' ACCESS TO TENANTS IN COMMERCIAL MULTI-TENANT BUILDINGS AND COMPLEXES

On October 25, 2000, the FCC released its order on Competitive Access Rules for Multi-Tenant Environments ("MTE Order").<sup>9</sup>

---

6. For example, "UrbanMedia collaborates with property owners and managers to deliver comprehensive e-business solutions to today's most under-served market of small and medium-sized businesses. By creating a one stop-shop for voice, data and e-business services, UrbanMedia bridges the gap between large and small businesses .... [P]roperty owners and managers now can provide superior service with our on-site service. UM brings maximized occupancy, increased revenue, and success to today's companies .... UrbanMedia-powered buildings are successful environments." <http://www.urbanmedia.com/company.html>.

7. Brian Ploskina, *FCC Gives Building Providers an Edge, Opens Access*, INTERACTIVE WEEK, Oct. 31, 2000; see also <http://www.zdnet.com/intweek/stories/news/0,4164,26480300.html>.

8. *Promotion of Competitive Networks in Local Telecommunications Markets*, 14 F.C.C.R. 12678 (1999).

9. *In re Promotion of Competitive Networks in Local Communications Markets; Wireless Communications Association International, Inc. Petition for Rulemaking to Amend Section 1.4000 of the Commission's Rules to Preempt Restrictions on Subscriber Premises Reception of Transmission Antennas Designed to Provide Fixed Wireless Services; Implementation of the Local Competition Provisions in the Telecommunications Act of 1996; Review of Sections 68.104 and 68.213 of the Commission's Rules Concerning Connection of Simple Inside Wiring to the Telephone Network*, WT Docket No. 99-217; CC Docket No. 96-98; CC Docket No. 88-57, First Report & Order & Further Notice of Proposed Rulemaking in WT Docket No. 99-217, Fifth Report & Order & Memorandum Opinion & Order in CC Docket No. 96-98, and Fourth Report & Order & Memorandum Opinion & Order in CC Docket No. 88-57, Oct. 25, 2000.

The FCC's MTE Order prohibits both ILECs and CLECs from entering into exclusive contracts with commercial building owners, clarifies the FCC's rules with respect to the location of demarcation points, expands the FCC rules regarding conduits and rights of way in the interior access pathways of MTEs, and extends the FCC rules concerning over the air reception devices to include customers' antennae used for fixed wireless services. The MTE Order also begins the process of requesting additional comments on several issues.

First, the MTE Order prohibits telecommunications carriers from entering into exclusive contracts with commercial building owners, which would limit the tenants of the buildings to receiving telecommunications services from only one provider. The MTE Order only addresses contracts with commercial building owners. The FCC also sought comments on whether the prohibition should be extended to residential buildings. The MTE Order applies to both ILECs and CLECs, but only to those carriers' prospective agreements. Thus, if a carrier has a pre-existing exclusive contract with a commercial building owner, the MTE Order does not preclude enforcement of the contract. The FCC asked for comments on whether the restriction should be extended to pre-existing contracts.

Second, the MTE Order establishes a process under which a building owner can request that the wiring demarcation point be relocated. The demarcation point is the location at which the ILEC's control of the wiring ends and the subscriber's begins. Under current law, the demarcation point may be located at either the minimum point of entry ("MPOE") or further inside the premises. The FCC declined to specify the MPOE as the demarcation point, fearing that such a definition would disfavor competitors who are renting pieces of their network from the ILECs, because those CLECs would be required to enter into independent negotiations with the building owner for access to building wiring to complete their networks. The MTE Order requires ILECs, or CLECs that have control of inside wiring, to relocate or disclose the location the demarcation point to the MPOE at the building owner's request.

Third, the MTE Order requires utilities, including ILECs, to allow telecommunications carriers and cable operators reasonable and nondiscriminatory access to conduits and rights of way inside customer buildings and campuses, if that utility owns or controls the conduits or rights of way. The right-of-way exists where "(1) a

pathway is actually used or has been specifically designated for use as part of its transmission and distribution network and (2) the boundaries of that pathway are clearly defined, either by written specification or by an unambiguous physical demarcation.”<sup>10</sup> The MTE Order encourages utilities to negotiate for rates. The FCC will determine on a case-by-case basis what qualifies as reasonable and just compensation, but it will also consider future proceedings to set appropriate rates.

Fourth, in order to encourage the development of advanced services, the FCC extended its existing rules regulating over-the-air reception devices to fixed customer-end antennae used for reception and transmission purposes. Therefore, parties with a direct or indirect ownership of leasehold interest in property, including tenants in MTEs, should have the ability to place antennae (one meter or less in diameter) used to receive or transmit fixed wireless service in areas within their exclusive use or control.<sup>11</sup> In effect, the FCC has preempted local and state government laws and regulations that restrict a tenant’s ability to place such an antenna on his or her own property.<sup>12</sup>

#### IV. THE FCC’S ASSERTED BASES FOR ITS MTE ORDER MIX POLICY REGARDING ILECS AND CLECS

In its most significant policy decision in the MTE Order, the

---

10. MTE Order at 82.

11. *Id.* at 94-100.

12. In the MTE Order, the FCC also asked for comments on the following issues:

- whether LECs should be prohibited from serving MTEs whose owners unreasonably prevent competing carriers from obtaining access to potential customers within the MTE;
- the current status of the market for the provision of telecommunications services in MTEs, including the development of new access technologies;
- whether the prohibition on exclusive access contracts for commercial buildings should be extended to residential buildings, and whether the prohibition on future contracts should be extended to pre-existing contracts;
- whether carriers should be prohibited from entering into contracts that grant them other preferences, such as exclusive marketing or landlord bonuses to tenants that use their services;
- the definition of rights-of-way in customer buildings; and
- whether the FCC should extend its cable inside wiring rules to facilitate the use of home run wiring by telecommunications service providers.

*Id.* at ¶¶ 125-175.

FCC imposed the same operational restrictions on ILECs and CLECs: neither class of telecommunications services provider may, on a going-forward basis, "enter into any contract, written or oral, that would in any way restrict the right of any commercial multitenant premises owner, or any agent or representative thereof, to permit any other common carrier to access and serve commercial tenants on that premises."<sup>13</sup>

The FCC justified that decision by noting that ILECs could use exclusive contracts as a device to preserve their existing market power, by barring other providers—CLECs—from offering service to tenants in a building under an exclusive contract, and by increasing the costs of entry for CLECs through excluding large MTEs from their potential market for customers.<sup>14</sup>

The FCC concluded that its rulemaking record did not provide evidence that exclusive contracts in commercial MTEs would have either efficiency-enhancing or pro-competitive effects, and found that such exclusive contracts could be seen as a type of vertical restraint, or a restraint affecting firms in two different markets.<sup>15</sup>

While the FCC admitted that CLECs presently hold only a relatively small share of the local telecommunications market compared to the share held by ILECs, the FCC announced that it was "necessary to prohibit *both* competitive and incumbent telecommunications service providers from entering into exclusive contracts in commercial settings, in order to assure competitive neutrality in the market."<sup>16</sup> The FCC said that CLECs could use exclusive contracts to create market power, and building owners could benefit from exclusive contracts if they have some market power over their tenants.<sup>17</sup>

On the issue of building owners, the FCC admitted that its new rules would affect private contracts, and in particular could have significant effects if applied retroactively to existing exclusive contracts. The FCC pointed to one court decision from the D.C. Circuit as its authority to modify provisions in private contract when "necessary to serve the public interest."<sup>18</sup>

---

13. 47 CFR §64.2500, "Prohibited Agreements."

14. MTE Order at ¶27.

15. *Id.* at ¶28.

16. *Id.* at ¶30 (emphasis added).

17. *Id.* at ¶30-31.

18. *Id.* at ¶36 (citing *W. Union Tel. Co. v. FCC*, 815 F.2d 1495, 1501 (D.C. Cir. 1987)). The *Western Union* case recites the general standard that the FCC can "modify other provisions of private contracts when necessary to serve the public



## V. THE FCC'S IMPOSITION OF LIMITATIONS ON CLECS IS MISGUIDED FROM BOTH A POLICY AND A LEGAL PERSPECTIVE

At a policy level, the FCC's decision to impose the same restrictions on CLECs as on ILECs is fundamentally flawed. As the FCC itself admitted, CLECs have a small share of the local exchange market. In fact, the FCC's own analysis of the local market for advanced services showed that, as of mid-2000, CLECs served only about 7% of the most popular type of high-speed services, known as ADSL, while the ILECs served the other 93%.<sup>19</sup> That was the highest percentage of advanced services provided by CLECs. In total, as of mid-2000, all CLECs together accounted for 6.7% of local service telephone lines, and more than 60% of those CLEC lines were in use by medium and large business subscribers rather than small business or residential users.<sup>20</sup>

The anti-competitive actions ascribed to ILECs in the MTE Order, the denial of access to entire buildings, exorbitant rates charged by ILECs for access to specific buildings, unreasonable conditions and delay, are real and can be readily seen to have negative effects on the entry of CLECs into the local exchange marketplace.<sup>21</sup> FCC action to limit the ability of ILECs, who have the in-place facilities needed to serve commercial buildings, who have long-standing relationships with building owners and managers due to their incumbent status, and who have the most to lose from the growth of CLECs, would be a reasonable and measured response to the facts adduced in the rulemaking record.

Imposing the identical restrictions on CLECs, however, when there are no parallel facts showing any material market power in CLEC hands, no long-standing relationships to exploit, and no financial ability to distort the market with exclusive agreements, is an

---

interest." 815 F.2d at 1501. That case, however, rejected an attempt by the FCC to modify a contractual settlement with a conclusory finding that certain rate disparities were contrary to the public interest. The court found that the FCC had not weighed in any detail the trade-offs made in the contractual provisions, and thus had not justified its abrogation of that contract. *Id.* at 1502.

19. *In re Inquiry Concerning the Deployment of Advanced Telecommunications Capability to All Americans in a Reasonable And Timely Fashion, and Possible Steps To Accelerate Such Deployment Pursuant to Section 706 of the Telecommunications Act of 1996*, CC Docket No. 98-146, FCC 00-290 Second Report at ¶102 (Aug. 21, 2000.)

20. *Federal Communications Commission Releases Data on Local Telephone Competition*, FCC COMMON CARRIER BUREAU, INDUSTRY ANALYSIS DIVISION, Dec. 4, 2000, at [http://www.fcc.gov/Bureaus/Common\\_Carrier/Reports/FCC-State\\_Link/IAD/lcom1200.pdf](http://www.fcc.gov/Bureaus/Common_Carrier/Reports/FCC-State_Link/IAD/lcom1200.pdf).

21. MTE Order at ¶¶17-19.

insupportable administrative decision. The alleged improper activities of the entrenched ILECs do not form a reasoned basis for preventing CLECs from experimenting in the market with new forms of business arrangements with building owners and managers.

The marketplace is proving to be more difficult for CLECs than most observers, including the FCC, had earlier believed. The financial market was troubled during 2000 by the mixed track record of CLECs, and on the last trading day of 2000, slightly more than half of publicly traded CLECs showed declines in price, while only a few had significant increases. Among the largest drops in price were US LEC Corp., which saw a 21% decline, ITC-DeltaCom, which saw an 18% drop, and Focal Communications Corp., which was down nearly 14%. Among the rising stocks were Intermedia Communications, up more than 45%; CoreComm Ltd., up 34%; and NEON Communications, which was up nearly 12%.<sup>22</sup>

Also, on December 29, 2000, Covad Communications—one of the largest independent national CLECs, with potential service coverage for approximately 40-45% of homes and businesses in the U.S. - announced that it was restructuring its Business Solutions division in order to reduce operating costs in 2001 by twenty to thirty percent. The restructuring will reportedly result in a 400-position reduction, or approximately 14% of Covad's employees. The work force reductions are to take place throughout Covad's East and Central regions, and the positions impacted are at all levels of the organization, including sales, operations, marketing and support functions. Coupled with a staff reduction announced on November 27, 2000, Covad's total head count was reduced by approximately 800 people in the latter part of 2000. The costs of the additional restructuring became part of an estimated \$20 million fourth quarter restructuring charge for Covad.<sup>23</sup>

On December 27, 2000, Moody's Investors Service cut its rating of the unsecured debt of Rhythms NetConnections Inc., another major national CLEC that provides broadband communication services in most major metropolitan areas throughout the United States and Canada. Moody's reduced the rating from B3 to

---

22. *Mixed Bag Of Winners And Losers Among CLEC Stocks Today*, (Dec. 29, 2000), at <http://www.clec.com/news.asp?categoryID=11>.

23. *Covad Restructures Direct Channels as Part of Previously Announced Restructuring Initiative*, see [http://www.covad.com/companyinfo/pressreleases/pr\\_2000/122900\\_press.shtml](http://www.covad.com/companyinfo/pressreleases/pr_2000/122900_press.shtml) (last visited Dec. 29, 2000).

Caal.<sup>24</sup> The trade press reported that Rhythms' stock was down more than 11% at mid-day on the 27th. At least part of that downgrade was believed to be due to concerns about the ability of Rhythms' large ISP customers to pay their bills, and Rhythms quickly announced that one of its two largest ISP customers - Telocity - was being acquired by Hughes Electronics Group. Rhythms suggested that the acquisition should eliminate any concerns regarding the Telocity's future funding. At the same time, Rhythms acknowledged that its other large ISP customer had signed an agreement with Rhythms to transition approximately 7,000 of its customers directly to Rhythms' network, thus placing collection issues on Rhythms' shoulders.<sup>25</sup>

On December 14, 2000, Digital Broadband, a regional CLEC with approximately 1,000 customers located throughout Massachusetts, New Hampshire, Rhode Island, Connecticut, New York, Pennsylvania, and Maryland, announced it would lay off a substantial portion of its workforce due to adverse market conditions and its inability to attract sufficient additional financing to fund its business plan in the "extremely challenging" capital environment.<sup>26</sup> On January 12, 2001, Digital Broadband filed for bankruptcy protection after informing its customers that it had been unable to attract sufficient additional financing to maintain its growth or to secure "strategic alternatives."<sup>27</sup>

An additional demonstration of the tenuous nature of CLECs' business prospects was the November 30, 2000 announcement that Verizon Communications—the major ILEC formed from the merger of two Regional Bell Operating Companies (NYNEX and Bell Atlantic) and GTE—had canceled its merger agreement with data CLEC NorthPoint Communications, due to "the recent deterioration in NorthPoint's finances and operations." NorthPoint subsequently filed a \$1 billion civil lawsuit against Verizon in California state court alleging breach of contract.<sup>28</sup>

---

24. See [http://www.moodys.com/moodys/cust/qckSearch/qckSearch\\_rhistory.asp?n\\_id=600042550&r\\_id=10244638&fr\\_ref=C&PB2\\_nam=Rhythms+NetConnections+Inc%2E&searchQuery=rhythms&search=1&searchIdent=qcksearchportid=&frameOfReference=corporate&ratg\\_cls\\_num=700750](http://www.moodys.com/moodys/cust/qckSearch/qckSearch_rhistory.asp?n_id=600042550&r_id=10244638&fr_ref=C&PB2_nam=Rhythms+NetConnections+Inc%2E&searchQuery=rhythms&search=1&searchIdent=qcksearchportid=&frameOfReference=corporate&ratg_cls_num=700750).

25. Wayne Kawamoto, *Rhythms' Customers Grow Stronger*, at <http://www.clec-planet.com/news/0012/01226rhythms.html> (last visited Dec. 26, 2000).

26. *Market Slowdown Compels Digital Broadband to Reduce Workforce*, at <http://www.digitalbroadband.com/news/pr12142000.htm> (last visited Dec. 14, 2000).

27. See *Letter to Digital Broadband Customers*, at <http://www.digitalbroadband.com> (last visited Jan. 15, 2001).

28. *NorthPoint To Sue Verizon For \$1 Billion*, at <http://www.isp-planet.com>

Taken together, these negative developments show that CLECs are far from fearsome market-controlling entities, but rather are a fragmented group of independent businesses, all trying to compete with heavily-capitalized ILECs who far outmatch any CLEC in assets, revenues, personnel, or market penetration. The FCC's attention should properly have been on the ILECs alone, not on CLECs.

Against this factual background, all the FCC could say in support of its decision to limit the competitive options available to CLECs to enter the MTE market through innovative arrangements with building owners and managers was that it was necessary to "ensure competitive neutrality in the market," and that a CLEC might be able to use an exclusive contact as "a device to create market power."<sup>29</sup> As the dissent to the MTE Order notes, "the question is not whether there is sufficient evidence of ... pro-competitive benefits [of exclusive contracts] to warrant rejection of the proposed rule ... but whether there is enough proof of harmful effects to justify its adoption. I submit the record is devoid of such empirical support."<sup>30</sup>

The FCC is not an agency with primary antitrust enforcement jurisdiction. Nevertheless, when the FCC attempts to base its policy decisions on antitrust grounds, it should be reviewed on the same basis as an antitrust enforcer. In the MTE Order, the FCC generally noted that an exclusive contract between a building owner and a carrier, if viewed as a form of vertical restraint, might either increase or decrease consumer welfare. Looking to one article in "the economic literature," the FCC observed that vertically related firms might enter into long term or exclusive contracts that inefficiently deter or foreclose entry to a market and thus harm consumers. With no further analysis, the FCC stated, "[w]e believe that exclusive contracts between building owners and telecommunications providers fit this model."<sup>31</sup> Indeed, all the FCC found in the record was a lack of evidence of benefit to competition or consumer welfare from the use of exclusive contracts in commercial settings, and the support of four of the largest carriers—AT&T and three ILECs (Bell Atlantic, GTE, and Sprint)—for a prohibition on exclusive

---

/news/northpoint\_sues\_verizon.html (Dec. 11, 2000); see also *Verizon Ends Merger With Northpoint*, at <http://www.clec-planet.com/0011/01130northpoint2.html> (last visited Nov. 30, 2000).

29. MTE Order at ¶30.

30. *Id.*, Dissenting Statement of Commissioner Harold Furchgott-Roth at 1.

31. *Id.* at ¶28.

contracts.<sup>32</sup>

Amazingly, the FCC concluded that it should not make any distinction among exclusive contracts based upon the length of the contract, nor upon the market position of the carrier entering into the contract.<sup>33</sup> This failure to consider the underlying facts—even though those facts were used in the economic literature cited by the FCC—would not pass muster in a traditional antitrust review.

The Seventh Circuit presented a clear framework for analysis of exclusive contracts in its rejection of a claim by a smaller newspaper that exclusive licensing agreements between larger newspapers and news services/feature syndicates were violative of the anti-trust laws.<sup>34</sup> The court observed:

Competition-for-the-contract is a form of competition that antitrust laws protect rather than proscribe, and it is common. Every year or two, General Motors, Ford, and Chrysler invite tire manufacturers to bid for exclusive rights to have their tires used in the manufacturers' cars. Exclusive contracts make the market hard to enter in mid-year but cannot stifle competition over the longer run, and competition of this kind drives down the price of tires, to the ultimate benefit of consumers. Just so in the news business—if smaller newspapers are willing to bid with cash rather than legal talent. In the meantime, exclusive stories and features help the newspapers differentiate themselves, the better to compete with one another. A market in which every newspaper carried the same stories, columns, and cartoons would be a less vigorous market than the existing one.<sup>35</sup>

A key element of the Seventh Circuit's analysis was the duration of the exclusive contract under review. Looking to the United States Supreme Court's earlier decision in an exclusive dealing case,<sup>36</sup> the Seventh Circuit noted that even exclusive dealing contracts (such as the exclusive contracts between carriers and building owners/managers) are lawful if limited to a year's duration, because "exclusivity can promote competition by making it feasible for firms to invest in promoting their products ... with year-long

---

32. MTE Order at ¶32.

33. *Id.*

34. Paddock Pub'ns Inc. v. Chicago Trib. Co., 103 F.3d 42, 47 (7th Cir. 1996).

35. *Id.* at 45.

36. FTC v. Motion Picture Adver. Serv. Co. 344 U.S. 392 (1953).

contracts, the entire market is up for grabs."<sup>37</sup>

This is, at its core, the same for CLECs trying to crack open the local exchange market: if a CLEC can gain an exclusive contract for a building for a period of time, the CLEC is much more likely to be able to persuade investors to make the necessary capital investment to purchase and emplace the equipment needed to provide new, competitive services in that building. Particularly in the case of independent CLECs serving small businesses in commercial buildings, the risk of getting an acceptable return on that investment is high and an exclusive arrangement with the building owner/manager may be the only way to bring the risk down to a level that permits market entry by the CLECs.

At the very least, the FCC had the obligation to develop a record demonstrating the terms of exclusive contracts that it found to be objectionable, and the negative effects of contracts over certain duration. The FCC noted in passing one party's comments that commercial leases last five to fifteen years.<sup>38</sup> Even if this one party's representation were accepted as true and universally accurate, it would not shed any light on the duration of carrier-to-building owner contracts, nor the effects of various lengths of such contracts. Only if CLECs are given the ability to experiment in the market with varying forms of exclusive access arrangements will there ever be a basis on which to conclude that a particular length of exclusive contract is short enough to increase consumer welfare, while a longer term overpowers that benefit with an effective "lock out" of competitors. The FCC's blanket rejection of all exclusive contracts makes it impossible for the market to try out various forms of arrangements and learn their impact.

Similarly, it is fundamental in any analysis of an "essential facilities" antitrust issue, which the FCC appears to be relying upon for its determinations, that there be (1) control by a monopolist of an essential facility serving the monopolist's market, (2) a competitor's inability practically or reasonably to duplicate the essential facility, (3) the denial of the use of that facility to a competitor, and (4) the feasibility of providing access to the facility.<sup>39</sup> The FCC has not made the very first of these necessary determinations. The FCC acknowledges that CLECs are not monopolists, and finds only that

---

37. *Paddock*, 103 F.3d at 47.

38. MTE Order at ¶31.

39. *MCI Communications Corp. v. AT&T Co.*, 708 F.2d 1081, 1132 (7th Cir. 1983), *cert. denied* 464 U.S. 891 (1983).

building owners “*may* possess ... market power ...”<sup>40</sup> Without a starting-point basis for a finding of who the monopolist in this market is, the FCC’s analysis founders.<sup>41</sup>

The paucity of reason behind the FCC’s decision to treat all exclusive contracts by all carriers identically, to bar them all without any “rule of reason” analysis—is further shown by two aspects of its MTE Order. First, the FCC declined to bar exactly the same exclusive access agreements in *residential* MTEs, declaring that it did not have “enough information in this record to determine if we should forbid exclusive contracts under some or all circumstances.”<sup>42</sup> The FCC decided that the “predominant use” of an MTE would be the determining factor in assessing whether the MTE is residential or commercial.<sup>43</sup> As a result, two buildings, side by side, differing only by the fact that one building is 51% residential and the other 49% residential use, would have exactly the opposite rule in effect: the 51% residential building could be served by a carrier under a contract that excluded all other carriers, while the 49% residential building could not. This absurd result is not the product of reasoned decision-making by the agency.

Second, the FCC announced that it viewed the need for a prohibition of exclusive contracts as “primarily a temporary one designed to address a transitional problem ... once competition is well established in commercial markets, it is unlikely that contracts with building owners that are harmful to tenants would be sustainable ... [O]ver time the market power that building owners may take advantage of today will diminish, as tenants’ existing lease arrangements expire ...”<sup>44</sup> This admission turns the entire exclusive contracts decision on its head. On one hand, the FCC says that it needs to bar exclusive contracts to ensure competitive neutrality in the market, and to avoid CLECs creating market power. But on the other hand, the FCC concludes that any such contracts that harmed end-users would not be sustainable anyway. Further, the

40. MTE Order at ¶31 (emphasis added.)

41. *E.g.*, *Discom, Inc. v. NYNEX Corp.*, 93 F.3d 1055, 1061-62 (2d Cir. 1996), “To state a claim for monopolization, [plaintiff] must allege, among other things that the defendants possess monopoly power in a relevant market. [Citations omitted.] In this case, none of the NYNEX defendants competes in the relevant market for removal services .... Thus, [plaintiff’s] claim of monopolization must fail, since it is axiomatic that a firm cannot monopolize a market in which it does not compete.” *Id.*

42. MTE Order at ¶33.

43. *Id.*

44. *Id.* at ¶34.

FCC recognizes that timing in the market is vitally important in gauging the need for or vitality of exclusive contracts, but refuses to make that very same distinction in its rules!

## VI. CONCLUSION

It appears that the FCC, recognizing the lack of support in the record for its decision on commercial MTEs, has attempted to hide the harmful effects of its ruling in a claim that those effects will not be long lasting. Not only is this approach to decision-making disingenuous, it points out the need for an utter rejection of the ruling. The practical effect of the FCC's logical inconsistencies and refusal to apply standard antitrust analysis is likely to be exactly the opposite of the result it claims to want.

CLECs are now struggling in the financial and business markets. If they are denied the ability to use exclusive contracts where the benefits outweigh any potential harm to end-users, the CLECs may never get to the nirvana of "well established" competition that the FCC foresees in the MTE Order. Unless the investment community sees a fair likelihood of returns, that community will not regain its faith in CLECs.

It will be the cruelest of ironies if the FCC's decision to bar all exclusive contracts—regardless of the duration of the contract, the market power of the participants, or their effect on consumers—is the straw that breaks the back of many a CLEC camel. CLECs may fail, in part, because they could not use short-term and investment-protecting exclusive contracts to wrest commercial MTEs away from ILECs and use those buildings as sheltered beachheads in a long-term assault on the ILECs. If they do fail, the FCC will have done a grave disservice not only to the owners and employees of the CLECs, but to the users of business telecommunications services in MTEs and elsewhere—that will see their competitive options wither away under the FCC's overly simplistic and undifferentiated rule.



\*\*\*