

support its position on element combination, the order expressly relies on section 47 C.F.R. § 51.315(b), a rule that, as noted above, the Court had not specifically addressed in Iowa Utilities Board.^{8/}

6. Order on Rehearing in Iowa Utilities Board v. FCC. On October 14, 1997, the Court granted the petitions for rehearing filed by the incumbent LECs in Iowa Utilities Board with respect to the combination rule not directly addressed in the Court's original ruling, 47 C.F.R. § 51.315(b). See Iowa Utilities Board, 120 F.3d at 818 n.38. That rule provided that, "[e]xcept upon request, an incumbent LEC shall not separate requested network elements that the incumbent LEC currently combines." In their rehearing petitions, the incumbent LECs had noted the tension between section 51.315(b) and the Court's holding that the 1996 Act requires new entrants to combine unbundled elements.^{2/} They also noted that new entrants AT&T and MCI had seized on the Court's silence regarding section 51.315(b) to argue to state commissions that they were still entitled to get the fully combined "platform" of network elements where those

^{8/} The FCC is also attempting to enforce its new version of "shared transport" in proceedings under section 271 of the 1996 Act. In an order released the day after the Third Reconsideration Order, the FCC announced that Bell Operating Companies must offer the FCC's version of shared transport to secure FCC approval of their applications to enter long distance markets under section 271. See Memorandum Opinion and Order, In the Matter of Application of Ameritech Michigan, CC Docket No. 97-137, FCC 97-298 (rel. Aug. 19, 1997) ¶¶ 298-318 (Appendix at 81-91). Petitioner U S WEST has asked the FCC to reconsider that ruling. Petition for Reconsideration of U S WEST, Inc., CC Docket No. 97-137 (FCC Sept. 18, 1997) at 19-21.

^{2/} Petition for Rehearing of GTE entities, SBC Communications, Inc., BellSouth Corporation, and U S WEST, Inc., Iowa Utilities Board v. FCC, 120 F.3d 753 (8th Cir. 1997) (No. 96-3321 and consolidated cases); Petition for Rehearing of Ameritech Corporation, Iowa Utilities Board v. FCC, 120 F.3d 753 (8th Cir. 1997) (No. 96-3321 and consolidated cases).

elements are already combined in the incumbent's network.^{10/} Ameritech noted to the Court that the FCC in the Third Reconsideration Order had likewise misread the Iowa Utilities Board decision, improperly using the survival of section 51.315(b) to support its requirement that incumbent LECs provide new entrants with the preassembled combination of network elements it dubbed "shared transport."^{11/} On these grounds, the incumbent LECs asked this Court to vacate section 51.315(b).

In its order on rehearing, the Court amended its opinion in Iowa Utilities Board to strike down section 51.315(b) as contrary to the 1996 Act. See Order on Petitions for Rehearing (Oct. 14, 1997) ("Rehearing Order"). Reinforcing its earlier decision regarding network element combinations, the Court explained that "Section 251(c)(3) requires an incumbent LEC to provide access to the elements of its network only on an unbundled (as opposed to a combined) basis," and "does not permit a new entrant to purchase the incumbent LEC's assembled platform(s) of combined network elements (or any lesser existing combination of two or more elements)."^{12/} Rehearing Order ¶ 2 (emphasis added). The Court added that "[t]o permit such an acquisition of already combined elements at cost based rates for unbundled access would obliterate the careful distinction Congress has drawn in subsections 251(c)(3) and (4)" between access to UNEs and the purchase at wholesale rates of an incumbent's retail services. Id. (emphasis added). In accordance with these principles, the Court vacated § 51.315(b), finding the regulation to be

^{10/} Petition for Rehearing of GTE entities, SBC Communications, Inc., BellSouth Corporation, and U S WEST, Inc. at 2, Iowa Utilities Board v. FCC, 120 F.3d 753 (8th Cir. 1997) (No. 96-3321 and consolidated cases).

^{11/} Petition for Rehearing of Ameritech Corporation at 7, Iowa Utilities Board v. FCC, 120 F.3d 753 (8th Cir. 1997) (No. 96-3321 and consolidated cases).

“contrary to § 251(c)(3) because the rule would permit the new entrant access to the incumbent LEC’s network elements on a bundled rather than an unbundled basis.” *Id.* (emphasis added).

SUMMARY OF ARGUMENT

The Third Reconsideration Order should be set aside as contrary to the Telecommunications Act of 1996 and the decision of this Court in Iowa Utilities Board. Under the 1996 Act, two of the three ways provided for new entrants to compete in local markets involve the use of incumbent LEC facilities: resale under section 251(c)(4) and unbundled access to network elements under section 251(c)(3). There are critical differences between the two. With resale, a new entrant gets a wholesale discount off the incumbent’s retail prices and leaves to the incumbent the costs and risks of configuring the service. With unbundled access to network elements, the new entrant often gets a substantially larger discount but must shoulder additional technical and financial responsibilities. The Third Reconsideration Order collapses the statutory distinction between the two options, effectively nullifying the resale provision and giving new entrants the benefits of unbundled access without the accompanying responsibilities.

This Court’s decision in Iowa Utilities Board makes plain why this is so. In ruling that a new entrant can serve local customers entirely through UNEs, the Court highlighted two key differences between resale and unbundled access. First, where a new entrant purchases unbundled access from an incumbent LEC, it is the new entrant — not the incumbent — that must “expend[] valuable time and resources recombining unbundled network elements.” 120 F.3d at 815 (emphasis added). Second, a new entrant must “make an up-front investment [in the unbundled elements] . . . without knowing whether consumer demand will be sufficient to cover

such expenditures.” Id. For these reasons, the Court explicitly held that the Act “does not permit a new entrant to purchase the incumbent LEC's assembled platform(s) of combined network elements (or any lesser existing combination of two or more elements).” Rehearing Order ¶ 2. The Court explained that “[t]o permit such an acquisition of already combined elements at cost based rates for unbundled access would obliterate the careful distinctions Congress has drawn in subsections 251(c)(3) and (4) between” unbundled access and resale. Id.

The Third Reconsideration Order obliterates the distinction between UNEs and resale in precisely this manner. As defined by the Order, “shared transport” gives new entrants access to all of the individual network elements in an incumbent LEC's entire interoffice network as a bundled whole. A new entrant need not spend any time or resources combining interoffice facilities with network switching elements; “shared transport” forces the incumbent LEC to provide an existing combination of network elements that the incumbent did the work to assemble. Indeed, a new entrant need not even worry about selecting individual transport links because, again, “shared transport” shifts “all of the work” of doing that job to the incumbent LEC. See Iowa Utilities Board, 120 F.3d at 813. This is contrary to the 1996 Act, the Court’s holding in Iowa Utilities Board, and even the FCC’s own First Report and Order. That order spoke of interoffice transmission facilities as “individual network elements” to be provided separately, not as an entire bundled network of transmission cables, connected to local and tandem switches, that new entrants could use on an undifferentiated basis.

Moreover, “shared transport” relieves a new entrant of any significant risk associated with up-front investments. Instead, the risk of insufficient (or excessive) customer demand is placed on the shoulders of the incumbent LEC. The incumbent LEC must forecast

demand and build facilities to meet that demand, bearing the risk that, if its forecast is inaccurate, its network will turn out to be either overbuilt or overloaded. This runs directly contrary to Iowa Utilities Board, which emphasized that new entrants purchasing network elements must bear the risk that “consumer demand will [not] be sufficient to cover” expenditures on such network elements. 120 F.3d at 815. It also represents a sharp departure from the First Report and Order, which acknowledged that new entrants buying unbundled access would bear the risk that customer demand might not cover costs, and that some new entrants might have traffic volumes too small to take advantage of unbundled access. Having lost in its effort to make incumbents assemble networks for new entrants, the FCC in the Third Reconsideration Order does an abrupt about-face on the risk issue. It asserts that new entrants must be protected from the risk of misjudging demand, and that the impracticability of leasing specific interoffice facilities for small traffic volumes necessitates “shared transport.”

Because “shared transport” cannot be squared with the statute or this Court's decision in Iowa Utilities Board, the Third Reconsideration Order should be set aside.

ARGUMENT

THE THIRD RECONSIDERATION ORDER MISCONSTRUES THE 1996 ACT AND COLLAPSES THE CAREFUL STATUTORY DISTINCTIONS BETWEEN UNBUNDLED NETWORK ELEMENTS AND RESALE.

Both the language and the structure of the 1996 Act require that users of UNEs bear a number of responsibilities. A new entrant that competes using UNEs must obtain individual elements on an “unbundled basis,” must combine those elements itself, and must bear the risk that the elements and capacities it has purchased will not match consumer demand.

These responsibilities are not obstacles to competition; rather, they reflect Congress's intention that, while users of UNEs should enjoy the benefit of leasing incumbent LEC network facilities at cost-based prices, they also should bear the corresponding business risks and costs of investing in and operating a network. As this Court has held, it is this combination of costs and benefits that distinguishes the use of UNEs from resale. See Iowa Utilities Board, 120 F.3d at 815.

The Third Reconsideration Order relieves new entrants of these key responsibilities, and hence obliterates the key differences between competition through resale and competition through UNEs. The FCC's "shared transport" requirement enables new entrants to obtain a preassembled combination of network elements at cost-based prices, giving them an artificial competitive advantage that Congress did not intend. In so doing, the order shifts from new entrants to the incumbent LEC the costs and risks of selecting, combining, and investing in specific transport facilities — in other words, the costs and risks of configuring a network rather than reselling services. In addition, the order undermines existing mechanisms for support of universal service.^{12/} These results are contrary to the 1996 Act as construed by this Court.^{13/}

^{12/} As noted above, incumbent LECs have long been required for public policy reasons to price some services above cost, such as services provided to large business customers or so-called vertical features, and to price other services below cost, such as basic service to residential customers. This system historically allowed the LECs to recover the cost of their ubiquitous networks while promoting universal service. See Federal-State Joint Board on Universal Service, Report and Order, CC Docket No. 96-45 (rel. May 8, 1997), appeal docketed, No. 97-60421 and consolidated cases (5th Cir. Jun. 26, 1997) ¶¶ 10-11 (Appendix at 93). As long as this system is in place, support for universal service will continue to rely on above-cost pricing of certain services solely by incumbent LECs — which will be unsustainable if new entrants are allowed in effect to buy the incumbent's services for resale at prices that avoid the universal service contribution. The new entrants will be enabled to pick off the customers to whom the incumbents have been required to charge above-cost prices. Cf. Competitive Telecommunications Ass'n v. FCC, 117 F.3d 1068, 1074 (8th Cir. 1997) (if new entrants were
(continued...)

A. The Third Reconsideration Order Misapplies the 1996 Act by Forcing Incumbent LECs To Provide Preassembled Combinations of Network Elements to Their Competitors.

It is now firmly established that the 1996 Act requires a new entrant seeking to compete using UNEs to buy elements on an unbundled basis and to combine those elements itself. Section 251(c)(3) gives new entrants the right to purchase “access to network elements on an unbundled basis” and requires incumbent LECs to provide this access “in a manner that allows requesting carriers to combine such elements.” 47 U.S.C. § 251(c)(3) (emphasis added). As this Court held in Iowa Utilities Board, this statutory language “unambiguously indicates that requesting carriers will combine the unbundled elements themselves” and cannot “be read to levy a duty on the incumbent LECs to do the actual combining of elements.” 120 F.3d at 813. Accordingly, the Court vacated FCC rules requiring incumbent LECs to combine elements on behalf of requesting carriers. Id. The Court noted that its ruling that new entrants must combine

^{12/} (...continued)

allowed to avoid paying access charges during the period before universal service reform is complete, “universal service soon would be nothing more than a memory”). This in turn would risk a serious confiscation of the property of incumbent LECs by jeopardizing their ability to recover the costs they are required to incur in providing below-cost residential service.

^{13/} The FCC's actions must be set aside if they were “arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law.” 5 U.S.C. § 706(2)(A). This Court is “empowered to overturn an agency interpretation [of a statute] when the interpretation conflicts with the plain meaning of the statute, when the interpretation is an unreasonable construction of an ambiguous statute, or when an agency acted arbitrarily or capriciously in adopting its interpretation.” Iowa Utilities Board, 120 F.3d at 793 (citations omitted). And where an agency rule “reflects a departure from the agency's prior policies, the agency 'is obligated to supply a reasoned analysis for the change beyond that which may be required when an agency does not act in the first instance.'” Macon County Samaritan Mem'l Hosp. v. Shalala, 7 F.3d 762, 765-66 (8th Cir. 1993) (quoting Motor Vehicle Mfrs. Ass'n v. State Farm Mut. Auto. Ins. Co., 463 U.S. 29, 42 (1983)).

elements themselves was crucial to ensuring that section 251(c) will operate as Congress intended, for at least two reasons. First, it “establishes that requesting carriers will in fact be receiving the elements on an unbundled basis.” Id. at 815. Second, it “makes resale a distinct and attractive option” because, “[w]ith resale, a competing carrier can avoid expending valuable time and resources recombining unbundled network elements.” Id. Congress obviously intended resale to be a meaningful, separate option, or it would not have included the resale provisions in the Act in the first place. Moreover, failure to maintain the distinction between the two options would undermine the universal service support on which incumbent LECs rely to recover their full network costs, thus risking a serious confiscation of incumbent LEC property.

The Rehearing Order in Iowa Utilities Board eliminates any doubt that the FCC may not require incumbent LECs to provide their competitors with preassembled combinations of network elements. The Rehearing Order vacated the FCC rule (47 C.F.R. § 51.315(b)) that entitled new entrants to obtain elements in a combined form if the elements were already combined in the incumbent LEC’s network. The Rehearing Order makes it crystal clear that new entrants may obtain network elements only on an individual, piece-by-piece basis:

Section 251(c)(3) requires an incumbent LEC to provide access to the elements of its network only on an unbundled (as opposed to a combined) basis. Stated another way, § 251(c)(3) does not permit a new entrant to purchase the incumbent LEC’s assembled platform(s) of combined network elements (or any lesser existing combination of two or more elements) in order to offer competitive telecommunications services. To permit such an acquisition of already combined elements at cost based rates for unbundled access would obliterate the careful distinctions Congress has drawn in subsection 251(c)(3) and (4) between access to unbundled network elements on the one hand and the purchase at wholesale rates of an incumbent’s telecommunications retail services for resale on the other.

Rehearing Order ¶ 2 (emphases added). In other words, when a new entrant elects to use UNEs pursuant to section 251(c)(3) rather than constructing facilities itself, the new entrant must combine those elements and assemble its own network, just as a carrier with its own facilities does.

The Third Reconsideration Order directly contravenes this Court's ruling by requiring incumbent LECs to provide their competitors with preassembled combinations of network elements. Indeed, the then-Chairman of the FCC acknowledged that compelling incumbent LECs to provide such preassembled combinations was a, if not the, central purpose of the order: “[T]his decision highlights the importance we place on incumbents making available to new entrants their network elements on a combined basis — a combination sometimes referred to as the UNE platform.” Third Reconsideration Order at 44 (Separate Statement of Chairman Reed Hundt) (emphasis added). In particular, the Third Reconsideration Order requires incumbent LECs to provide and deliver in combined form a number of different facilities — local switching, tandem switching, and numerous individual interoffice transmission facilities — that the FCC already has classified as network elements in their own right.

1. The Third Reconsideration Order Requires Incumbent LECs To Provide a Combination of Interoffice Transmission Elements.

The Third Reconsideration Order unlawfully requires incumbent LECs to provide new entrants with a preassembled combination of numerous interoffice transmission elements. “Shared transport” requires the incumbent to transport its competitor’s calls using whatever transmission facilities are appropriate and available for each call, thus giving the new entrant access to “all of the incumbent LEC’s interoffice facilities” on an undifferentiated basis and as a

combined package. Third Reconsideration Order ¶ 34 (emphasis in original). In the example of the five-office city described above (p. 5), the new entrant would have as-needed access to any and all channels in all 10 end-office-to-end-office transmission cables and all five end-office-to-tandem cables. Therefore, “shared transport” is not a right to use prereserved channels on specified individual interoffice transmission facilities; rather, it is a right to require the incumbent LEC to provide the use of all of the transmission facilities in the incumbent’s transport network, as needed and on an undifferentiated basis, to transport the new entrant’s calls. See Third Reconsideration Order ¶¶ 35, 43.^{14/}

Each individual interoffice transmission facility included in this new combined package is a network element in its own right. The First Report and Order required incumbent LECs to provide access on an unbundled basis to “interoffice transmission facilities.” 47 C.F.R. § 51.319(d). In concluding that such facilities are subject to the unbundled access provisions of section 251(c)(3), the FCC found that “it is technically feasible for incumbent LECs to unbundle the foregoing interoffice facilities as individual network elements.” 11 FCC Rcd. at 15719 ¶ 442 (emphasis added). The Third Reconsideration Order impermissibly packages these same

^{14/} “Shared transport” is no less a combination of elements because the new entrant requesting it does not specify and does not know what particular transmission facilities will be used to transport its calls. Indeed, the fact that the incumbent LEC must select and combine the transmission facilities needed for each call reinforces the unlawfulness of the FCC’s order. “[A]ll of the work,” to use the Court’s own phrase, is done exclusively by the incumbent LEC. See 120 F.3d at 813.

interoffice transmission facilities into a combination of elements that the FCC has dubbed “shared transport.”^{15/}

The FCC cannot evade the statutory prohibition on preassembled combinations of network elements simply by declaring that an “existing combination of two or more elements” (Rehearing Order ¶ 2) is itself a single element. The 1996 Act “does not permit” new entrants to purchase preassembled combinations of elements, *id.*, and the FCC may not give new entrants that right by a semantic sleight-of-hand. A preassembled combination of network elements remains a preassembled combination regardless of whether the FCC takes the disingenuous step of redefining the combination to be a single element. Plain and simple, the Third Reconsideration Order gives new entrants access to “already combined elements at cost based rates,” *id.*, in direct violation of this Court’s explicit reading of the Act.

2. The Third Reconsideration Order Requires Incumbent LECs To Provide a Combination of Shared Transport and Switching Elements.

The Third Reconsideration Order requires incumbent LECs to combine network elements not only because “shared transport” is itself an amalgam of numerous individual interoffice elements, but also because “shared transport” requires incumbent LECs to provide switching and transport elements as a preassembled package. See Third Reconsideration Order ¶ 44 (ruling that “incumbent LECs may not unbundle switching and transport facilities that are

^{15/} The FCC has asserted to this Court that the various interoffice transmission facilities in the incumbent LEC’s transport network are available only as part of the bundled “shared transport” package. See Opp. of FCC to Motion for Stay Pending Judicial Review at 9, No. 97-3576 (8th Cir. Oct. 14, 1997). As demonstrated in the text above, that litigating position finds no support in the Third Reconsideration Order and is flatly contrary to the First Report and Order and the rules it adopted.

already combined, except upon request”). The FCC expressly based that requirement on its rule forbidding an incumbent LEC to “separate requested network elements that the incumbent LEC currently combines,” 47 C.F.R. § 51.315(b), which this Court has since vacated as inconsistent with the 1996 Act. See Rehearing Order ¶ 2. The FCC’s unlawful requirement that incumbent LECs provide this preassembled combination is central to the Third Reconsideration Order, because “shared transport” cannot function except as part of a preassembled combination with the incumbent’s local and tandem switching.

“Shared transport” necessarily entails a combination of transport facilities and the incumbent’s local switching because the routing functions of the local switch are what make undifferentiated use of the transport network possible. “Shared transport” requires the incumbent LEC, rather than the new entrant, to “do all of the work” of selecting appropriate transmission facilities for each call and routing the call accordingly. See Iowa Utilities Board, 120 F.3d at 813. The incumbent does this through its local switch. As the FCC admitted in the Third Reconsideration Order, “[r]equesting carriers that purchase shared transport as a network element to provide local exchange service must also take local switching,” id. ¶ 47 (emphasis added), and “shared transport . . . cannot be effectively disassociated from . . . local switching,” id. ¶ 42. Given the nature of “shared transport,” the FCC had no choice but to order incumbent LECs to provide it in a preassembled combination with local switching.^{16/} But mandating that the

^{16/} In fact, as the FCC concedes, “an incumbent LEC that separates shared transport facilities that are already connected to a switch would likely disrupt service to its own customers served by the switch because, by definition, the shared transport links are already used by the incumbent LEC to serve its customers.” Third Reconsideration Order ¶ 44.

incumbent provide such a combination is unlawful under section 251(c) and this Court's ruling in Iowa Utilities Board.^{17/}

That is not all: The incumbent's tandem switches also must be combined with "shared transport." As explained above (p. 5), the incumbent's cables connecting the originating end office directly to the destination end office may be congested at the time of a particular call. The incumbent's local switch then will route the call over a different cable to a tandem switch, which in turn will route it over another cable to the destination end office. "Shared transport," which requires the incumbent to route its competitor's traffic just as it does its own, thus necessarily includes use of the incumbent's tandem switch.

Indeed, the new entrants who successfully lobbied the FCC for "shared transport" frankly admit that it can never be provided except as part of the existing combination of the incumbent's transport facilities and its local and tandem switching that the incumbent uses to provide retail service to its own customers. MCI, for example, recently declared that "shared transport" is "the unrestricted use of the incumbent LEC's public switched network on a call-by-call basis" and entails a combination of interoffice transmission facilities, "switched

^{17/} A new entrant could not obtain the FCC's version of "shared transport" by combining its own switches with the incumbent's transmission facilities. When a new entrant uses its own switches, it assumes the task of choosing which transmission facilities will be used to carry each of its calls. Rather than getting undifferentiated access to the incumbent's entire transport network, the new entrant employs preselected facilities in the manner specified in its own routing tables. This is a perfectly reasonable arrangement and is consistent with the Act, but it is not "shared transport" as envisioned by the Third Reconsideration Order. Indeed, the FCC acknowledged that a carrier using its own local switches would not be obtaining "shared transport" as defined in the order. Third Reconsideration Order ¶ 47 n.127.

transport,” and tandem switching.^{18/} WorldCom (which plans to purchase MCI) has been equally candid, stating that “shared transport” is nothing short of “the preexisting network configuration” in the incumbent’s network, that is, the entire preassembled package of network elements that make up the public switched network.^{19/} And AT&T has conceded that “shared transport is a blended, direct-trunked and tandem-trunked arrangement with tandem switching included.”^{20/}

In short, “shared transport” as established in the Third Reconsideration Order is not a facility, equipment, or function that a new entrant may purchase “on an unbundled basis” and then combine with its own or the incumbent’s switching facilities. Rather, “shared transport” is “already combined” with switching, see Third Reconsideration Order ¶ 44, and indeed can function only where the incumbent has bundled its interoffice transmission facilities with its local and tandem switches, see id. ¶¶ 36, 47. Requiring incumbent LECs to provide “shared transport” inevitably requires them to give new entrants an assembled combination of interoffice transmission facilities, local switching, and tandem switching.

Yet under the FCC’s rules, each of those transport and switching facilities is undeniably itself a network element that may be purchased on an unbundled basis pursuant to section 251(c)(3). See 47 C.F.R. § 51.319(d), (c)(1), (c)(2); First Report and Order, 11 FCC Rcd.

^{18/} Verified Statement of August H. Ankum on behalf of MCI, pp. 2, 12-14, Mich. Pub. Serv. Comm’n Case No. V-11280 (Oct. 20, 1997) (Appendix at 96-99).

^{19/} WorldCom Technologies, Inc. Post Oral Argument Brief, p. 13, Ill. Comm. Comm’n Docket Nos. 96-0486/96-0569 (cons.) (Nov. 3, 1997) (emphasis added) (Appendix at 101).

^{20/} Ameritech Ex Parte Statement, p. 1, CC Docket 96-98 (FCC, filed June 6, 1997) (quoting letter from AT&T’s Bill Davis to Ameritech dated May 14, 1997) (emphasis added) (Appendix at 103).

at 15705-13, 15717-22, ¶¶ 410-26, 439-51. Accordingly, if an incumbent LEC is required to provide all of these elements preassembled in a functioning network — as it must in order to provide “shared transport” — it is providing an “existing combination of two or more elements.” Rehearing Order ¶ 2. This Court held that forcing incumbent LECs to provide such a combination violates section 251(c)(3) of the 1996 Act. *Id.*

B. The Third Reconsideration Order Enables New Entrants To Evade the Investment Risks That the 1996 Act Requires Purchasers of Unbundled Elements To Bear and Shifts Those Risks to Incumbent LECs.

The 1996 Act requires purchasers of unbundled network elements to bear the ordinary business risks associated with investment in specific facilities. This requirement is inherent in the 1996 Act’s establishment of UNEs and resale as two distinct competitive options. One key difference between these two options is that resellers take no active role in the technical or physical aspects of delivering service to end users. By contrast, a new entrant using UNEs invests in and effectively designs and operates its own service network, albeit with rented parts, and therefore must bear the attendant risks.

Indeed, as the Court explained in Iowa Utilities Board, providing service through UNEs is significantly different from resale largely because providing service through UNEs entails risks for the new entrant. A purchaser of network elements invests in specific equipment and takes the risk that the capacity of that equipment will not be well matched to consumer demand. As the Court observed, “[a] carrier providing services through unbundled access . . . must make an up-front investment” in UNEs “without knowing whether consumer demand will be sufficient to cover such expenditures.” 120 F.3d at 815. A reseller, by contrast, avoids any

risk of a mismatch between capacity and demand by buying “on a unit-by-unit basis . . . only as many services (or as much thereof) as it needs to satisfy its customer demand.” Id. This difference was the basis for the Court’s holding that allowing new entrants to assemble services entirely out of UNEs under section 251(c)(3), without building any facilities themselves, would not eliminate resale under section 251(c)(4) as a market entry strategy. See id. This holding echoed the FCC’s assurance that the 1996 Act requires a purchaser of unbundled elements to bear the risk that demand will be insufficient to cover up-front investment costs. In the First Report and Order, the agency noted that a new entrant serving local customers entirely through UNEs faces “greater risks” than a new entrant competing via resale, because “a carrier purchasing unbundled elements must pay for the cost of that facility” and thus “faces the risk that end-user customers will not demand a sufficient number of services using that facility for the carrier to recoup its cost.” 11 FCC Rcd. at 15668 ¶ 334.

The FCC’s new “shared transport” requirement eliminates this crucial distinction between UNEs and resale. It allows new entrants to obtain ubiquitous interoffice transport without bearing any of the investment-related risks that are a core characteristic of competition through UNEs. “Shared transport” involves no up-front commitment to or investment in particular facilities. Buyers of “shared transport” do not lease in advance any specific transport facilities, because “shared transport” is defined as as-needed access to all the facilities in the LEC’s entire interoffice transport network. See Third Reconsideration Order ¶ 35; see also id. ¶ 43 (asserting that a network element need not be “identifiable as a limited or pre-identified portion of the network”). Therefore, buyers of “shared transport” escape the burden of forecasting demand, making specific investment decisions based on those forecasts, and bearing

the risk of being unable to recoup their investment if their forecasts are wrong. As envisioned by the FCC and new entrants like AT&T and MCI, buyers of “shared transport” pay only after the fact and only for what they have used.^{21/} As long as they can get “shared transport,” they never have to worry about forecasting anything.

Indeed, the Third Reconsideration Order astoundingly maintains that the risks associated with forecasting demand — risks that this Court held a new entrant must bear in doing business under section 251(c)(3) — are entry barriers from which new entrants must be protected. The order states that, if “competitive carriers [were required] to use dedicated transport facilities” at this time, “they would almost inevitably miscalculate the capacity or routing patterns.” Third Reconsideration Order ¶ 35. The order concludes that “shared transport”

^{21/} The Third Reconsideration Order acknowledges that, under Iowa Utilities Board, the FCC lacks authority to “establish pricing rules for shared transport.” Third Reconsideration Order ¶ 30. However, the FCC proceeds to express its view that new entrants need not make any up-front investment in shared transport, but rather should be permitted to pay for shared transport after-the-fact, only for the number of minutes they actually use, see Third Reconsideration Order ¶¶ 30, 35. This is precisely the approach that the Court contemplated would apply to resale and not unbundled elements. See Iowa Utilities Board, 120 F.3d at 815. If that were not bad enough, the FCC announces firmly that, where the FCC is required to arbitrate interconnection agreements, “we intend to establish usage-sensitive rates for recovery of shared transport unless parties demonstrate otherwise,” Third Reconsideration Order ¶ 30, and refers subsequently to the obligation of incumbent LECs “to provide access to all of their interoffice transmission facilities on a shared, “usage sensitive basis,” id. ¶ 35 (emphasis added). Moreover, the FCC intends to retain a substantial role in UNE pricing by including UNE pricing among the criteria to be used in the agency’s evaluations of Bell Operating Companies’ applications for authorization to provide long distance service. See Memorandum Opinion and Order, In the Matter of Application of Ameritech Michigan, CC Docket No. 97-137, FCC 97-298 ¶¶ 285-88 (Appendix at 78-79). Petitioners Ameritech, Southwestern Bell Telephone Company, and U S WEST, among others, have in a separate proceeding petitioned this Court to declare that this reassertion of jurisdiction over UNE pricing is a violation of the Court’s holding in Iowa Utilities Board. Petition for Immediate Issuance and Enforcement of the Mandate, No. 96-3321 and consolidated cases (8th Cir. Sept. 18, 1997).

is necessary to protect them from this very risk. *Id.* The FCC also seeks to shield new entrants from the possibility that they “may not have sufficient traffic volumes to justify” purchasing elements that involve a commitment to specific facilities. *Id.* ¶ 51. But, as this Court previously held, Congress provided a very different statutory solution for the problems of uncertain or limited traffic volumes: allowing new entrants to buy finished retail services, on an as-needed basis and at a discount, for resale to end users. See Iowa Utilities Board, 120 F.3d at 815.

The FCC’s purported justifications for “shared transport” are inconsistent with even the FCC’s own prior understanding of the Act’s unbundling provisions. In the First Report and Order, the FCC understood and accepted that, for some new entrants, the risks associated with purchasing UNEs would eliminate unbundling as an economically desirable entry strategy: “Some new entrants will be unable or unwilling to bear the financial risks of entry by means of unbundled elements and will choose to enter local markets under the terms of section 251(c)(4).” 11 FCC Rcd. at 15668 ¶ 334. The FCC also recognized that competition through UNEs may not be practical at small traffic volumes:

[S]ome markets may never support new entry through the use of unbundled elements because new entrants seeking to offer services in such markets will be unable to stimulate sufficient demand to recoup their investment in unbundled elements. Accordingly, in these markets carriers will enter through resale of incumbent LEC services.

Id. The FCC’s subsequent attempt to ensure that uncertain demand, poor forecasting, and low traffic volumes — in other words, ordinary business risks — do not dissuade new entrants from using UNEs, see Third Reconsideration Order ¶¶ 35, 51, represents a complete about-face.^{22/} It

^{22/}

The FCC glosses over the plain conflict with its earlier positions by

(continued...)

also undercuts both the FCC's and this Court's rationale for permitting new entrants to serve local customers entirely through UNEs.^{23/}

The Third Reconsideration Order disingenuously argues that, even if new entrants are shielded from the risks associated with transport UNEs, purchasers of “shared transport” still bear some investment risk. But the risks the FCC points to are utterly insubstantial.^{24/} Most of the investment risk involved in competing through unbundled network elements stems from uncertainty about the demand for interoffice transmission capacity. The other major component needed to provide basic service to an end user — the loop — is dedicated to a single customer; a new entrant orders the loop when it wins the customer and cancels it when the customer migrates to another carrier. Investing in individual interoffice transmission elements, by contrast, requires

(...continued)

characterizing its new policy as simply an interim stop-gap measure that may be reversed again in the future. See Third Reconsideration Order ¶¶ 35, 51. But when an agency's rule reverses course, it “is obligated to supply a reasoned analysis for the change.” State Farm, 463 U.S. at 42; see also Sierra Club v. Clark, 755 F.2d 608, 619 (8th Cir. 1985) (“[A]n agency must provide explanations when its rulemaking reflects significant changes in policy.”). The FCC offers no explanation whatsoever for the significant changes in policy and statutory interpretation reflected in the Third Reconsideration Order.

^{23/} The FCC's effort to protect users of UNEs from ordinary business risks also is inconsistent with the FCC's recognition in the Third Reconsideration Order itself that investment risk is a “key distinction” between unbundled access to network elements and resale. Third Reconsideration Order ¶ 47.

^{24/} The FCC asserts that the purchasers of “shared transport” must bear the “risk associated with switching,” including the risk of being unable to sell all of the vertical features included in the switch. Third Reconsideration Order ¶ 47. But, as the FCC fully knows, switching is generally charged on a usage-sensitive basis, so a carrier using the switching element has no stranded investment if usage is lower than expected. And the FCC has stated that the costs of vertical services are trivial. See First Report and Order, 11 FCC Rcd. at 15707 ¶ 414 (citing comments of LDDS (WorldCom) and AT&T).

a carrier to forecast its likely traffic volumes on each of the various end-office-to-end-office routes that the carrier uses to provide service. In short, interoffice transmission links are where the risk is. By enabling purchasers of unbundled elements to avoid the investment risks inherent in these elements, the Third Reconsideration Order effectively eliminates the risk characteristics that distinguish competition through unbundled elements from resale.

Importantly, the investment risk thus lifted from new entrants does not disappear, but is shifted entirely to the incumbent LEC. Under the Third Reconsideration Order, the incumbent LEC must forecast customer demand on behalf of each new entrant, build and maintain interoffice transmission capacity to meet that demand, and bear the risk that its forecasts will turn out to be wrong — all despite the fact that the new entrant plainly is in the best position to anticipate more accurately the demand for its own services.

By relieving purchasers of UNEs from the investment risks the statute requires them to bear and instead shifting those risks to incumbent LECs, the Third Reconsideration Order violates the 1996 Act.

CONCLUSION

For these reasons, the petitions for review should be granted and the Third Reconsideration Order should be set aside as inconsistent with the 1996 Act.

November 21, 1997

THEODORE A. LIVINGSTON
JOHN E. MUENCH
CHRISTIAN F. BINNIG
GARY FEINERMAN
Mayer, Brown & Platt
190 South LaSalle Street
Chicago, Illinois 60603
(312) 782-0600

KENNETH S. GELLER
DONALD M. FALK
Mayer, Brown & Platt
2000 Pennsylvania Avenue, N.W.
Washington, D.C. 20006
(202) 463-2000

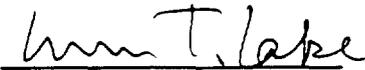
KELLY R. WELSH
JOHN T. LENAHAN
Ameritech Corporation
30 South Wacker Drive
Chicago, Illinois 60606
(312) 750-5000

Counsel for Ameritech Corporation

MADelyn M. DEMATTEO
ALFRED J. BRUNETTI
227 Church Street
New Haven, Connecticut 06510
(203) 771-5200

*Counsel for The Southern New England
Telephone Company*

Respectfully submitted,



WILLIAM T. LAKE
JOHN H. HARWOOD II
DAVID SOHN
TODD ZUBLER
Wilmer, Cutler & Pickering
2445 M Street, N.W.
Washington, D.C. 20037-1420
(202) 663-6000

DAN L. POOLE
ROBERT B. MCKENNA
U S WEST, Inc.
1801 California Street, 51st Floor
Denver, Colorado 80202
(303) 672-2861

Counsel for U S WEST, Inc.

ROBERT M. LYNCH
DURWARD D. DUPRE
MICHAEL J. ZPEVAK
THOMAS A. PAJDA
DARRYL W. HOWARD
One Bell Center, Room 3528
St. Louis, Missouri 63101
(314) 235-2518

PATRICIA DIAZ DENNIS
DAVID F. BROWN
175 East Houston Street, Suite 1200
San Antonio, Texas 78205
(210) 351-3478

STEPHEN B. HIGGINS
JAMES W. ERWIN
Thompson Coburn
One Mercantile Center, Suite 3300
St. Louis, Missouri 63101
(314) 231-7676

*Counsel for Southwestern Bell Telephone
Company*

EDWARD D. YOUNG III
MICHAEL E. GLOVER
JAMES G. PACHULSKI
Bell Atlantic Corporation
1320 North Court House Road
8th Floor
Arlington, Virginia 22201
(703) 974-2944

*Counsel for the Bell Atlantic Telephone
Companies*

WILLIAM P. BARR
WARD W. WUESTE, JR.
M. EDWARD WHELAN
GTE Service Corporation
1850 M Street, N.W., Suite 1200
Washington, D.C. 20036
(202) 463-5200

PAUL T. CAPPUCCIO
STEVEN G. BRADBURY
PATRICK F. PHILBIN
Kirkland & Ellis
655 Fifteenth Street, N.W., Suite 1200
Washington, D.C. 20005
(202) 879-5000

THOMAS B. WEAVER
JORDAN B. CHERRICK
Armstrong, Teasdale, Schafly & Davis
One Metropolitan Square
St. Louis, Missouri 63102
(314) 621-5070

Counsel for GTE entities

MARY McDERMOTT
LINDA KENT
KEITH TOWNSEND
HANCE HANEY
United States Telephone Association
1401 H Street, N.W., Suite 600
Washington, D.C. 20005
(202) 326-7310

*Counsel for United States Telephone
Association*



STATUTORY ADDENDUM

SEC. 251. [47 U.S.C. 251] INTERCONNECTION.

(a) GENERAL DUTY OF TELECOMMUNICATIONS CARRIERS.—Each telecommunications carrier has the duty—

(1) to interconnect directly or indirectly with the facilities and equipment of other telecommunications carriers; and

(2) not to install network features, functions, or capabilities that do not comply with the guidelines and standards established pursuant to section 255 or 256.

(b) OBLIGATIONS OF ALL LOCAL EXCHANGE CARRIERS.—Each local exchange carrier has the following duties:

(1) **RESALE.**—The duty not to prohibit, and not to impose unreasonable or discriminatory conditions or limitations on, the resale of its telecommunications services.

(2) **NUMBER PORTABILITY.**—The duty to provide, to the extent technically feasible, number portability in accordance with requirements prescribed by the Commission.

(3) **DIALING PARITY.**—The duty to provide dialing parity to competing providers of telephone exchange service and telephone toll service, and the duty to permit all such providers to have nondiscriminatory access to telephone numbers, operator services, directory assistance, and directory listing, with no unreasonable dialing delays.

(4) **ACCESS TO RIGHTS-OF-WAY.**—The duty to afford access to the poles, ducts, conduits, and rights-of-way of such carrier to competing providers of telecommunications services on rates, terms, and conditions that are consistent with section 224.

(5) **RECIPROCAL COMPENSATION.**—The duty to establish reciprocal compensation arrangements for the transport and termination of telecommunications.

(c) ADDITIONAL OBLIGATIONS OF INCUMBENT LOCAL EXCHANGE CARRIERS.—In addition to the duties contained in subsection (b), each incumbent local exchange carrier has the following duties:

(1) **DUTY TO NEGOTIATE.**—The duty to negotiate in good faith in accordance with section 252 the particular terms and conditions of agreements to fulfill the duties described in paragraphs (1) through (5) of subsection (b) and this subsection.