

expect that a similar requirement for local exchange switchovers that require only a software change will similarly contribute to local exchange competition.

422. We reject the proposal by some incumbent LECs to define unbundled local switching as the facilities that provide a *point of access* to the switch, but that would not actually include switching functionality. Under this definition, the purchaser of the local switching element would not actually obtain local switching, only the right to purchase local switching functionality and other switching features at wholesale rates. We believe that the unbundled local switching element must include the functionality of connecting lines and trunks. The definition proposed by these incumbent LECs would contravene the requirement in section 251(c)(3) that incumbent LECs provide network elements "in a manner that allows requesting carriers to combine such elements in order to provide such telecommunications service."<sup>945</sup> If a competing provider combined its own loops and transport with the local switching element ("point of access"), it would be unable to provide telecommunications service without separately purchasing, at wholesale rates, switching functionality from the incumbent LEC.

423. We also disagree with the proposal to define local switching as a point of access plus basic switching functionality, but that would exclude vertical switching features.<sup>946</sup> As a legal matter, this definition is inconsistent with the 1996 Act's definition of "network element," which includes all the "features, functionalities, and capabilities provided by means of such facility or equipment."<sup>947</sup> In addition, this definition would not fulfill the pro-competitive objectives of the 1996 Act as effectively as the per-line definition we adopt. A competitor that obtains basic and vertical switching features at cost-based rates will have maximum flexibility to distinguish its offerings from those of the incumbent LEC by developing a variety of service packages and pricing plans.<sup>948</sup> Moreover, an upfront purchase of all local switching features may speed entry by simplifying practical issues such as the pricing of individual switching features.

424. We also address the impact on small incumbent LECs. For example, the Illinois Independent Telephone Association and the Rural Telephone Coalition favor rules that

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<sup>945</sup> 47 U.S.C. § 251(c)(3).

<sup>946</sup> Sprint comments at 34; USTA reply at 16-17; SBC reply at 20; NYNEX reply at 31; MECA comments at 29.

<sup>947</sup> 47 U.S.C. § 153(29); *see supra* section V.C., which interprets the Act's definition of "network element."

<sup>948</sup> *See, e.g.*, LDDS comments at 33; AT&T comments at 21.

recognize the differences between larger and smaller LECs.<sup>949</sup> We have considered the economic impact of our rules in this section on small incumbent LECs. In this section, for example, we expressly provide for the fact that certain LECs may possess switches that are incapable of performing customized routing for competitors that purchase unbundled local switching. As noted by Rural Telephone Coalition and the Illinois Independent Telephone Coalition, this approach is necessary to accommodate the different technical capabilities of large and small carriers. We also note that section 251(f) of the 1996 Act provides relief for certain small LECs from our regulations under section 251.

### (2) Tandem Switching Capability

425. We also affirm our tentative conclusion in the NPRM that it is technically feasible for incumbent LECs to provide access to their tandem switches unbundled from interoffice transmission facilities. We note that some states already have required incumbent LECs to unbundle tandem switching.<sup>950</sup> Parties do not contend, pursuant to section 251(d)(2)(A), that tandem switches are proprietary in nature. With regard to section 251(d)(2)(B), we find that competitors' ability to provide telecommunications service would be impaired without unbundled access to tandem switching. Therefore, we find that the availability of unbundled tandem switching will ensure that competitors can deploy their own interoffice facilities and connect them to incumbent LECs' tandem switches where it is efficient to do so.

426. We define the tandem switch element as including the facilities connecting the trunk distribution frames to the switch, and all the functions of the switch itself, including those facilities that establish a temporary transmission path between two other switches. The definition of the tandem switching element also includes the functions that are centralized in tandems rather than in separate end office switches, such as call recording, the routing of calls to operator services, and signaling conversion functions.

### (3) Packet Switching Capability

427. At this time, we decline to find, as requested by AT&T and MCI, that incumbent LECs' packet switches should be identified as network elements. Because so few parties commented on the packet switches in connection with section 251(c)(3), the record is insufficient for us to decide whether packet switches should be defined as a separate network element. We will continue to review and revise our rules, but at present, we do not adopt a national rule for the unbundling of packet switches.

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<sup>949</sup> Illinois Ind. Tel. Ass'n comments at 1; Rural Tel. Coalition reply at 37.

<sup>950</sup> See, e.g., Ameritech comments at 43, Cincinnati Bell comments at 18, GTE comments at 38, AT&T March 21 Letter at 23.

modifications to local transport and special access must wait until the LECs have restructured their local rates.<sup>980</sup>

437. TCC urges the Commission to define dedicated transport as an interoffice transmission path dedicated to a single carrier, including multiplexing and grooming, redundant facilities, and cross-office wiring to a digital cross-connect panel.<sup>981</sup> ACSI argues that the Commission should require incumbent LECs to make both dedicated and switched transport available at the DS-0, DS-1, DS-3 and Optical Carrier levels, which should be offered as completely unbundled links between serving wire centers (SWCs) and interconnector points-of-presence, the central office and the SWC, the end office and the tandem, and the SWC and the tandem.<sup>982</sup> Teleport advocates that interoffice trunking facilities be defined in terms of their underlying transmission characteristics without reference to the use of the facility.<sup>983</sup>

438. ALTS argues that, since there are currently well-defined standards for transport, there should be no impediment to requiring equivalent levels of technical performance among competing carriers, *i.e.*, no meaningful distinctions among the technical performance of different DSIs.<sup>984</sup> Therefore, as in the case with local loops, ALTS contends that competitors should receive the same or better ordering, provisioning, and installation service as the incumbent provides itself and that penalties should be assessed if deadlines are not met.<sup>985</sup>

### c. Discussion

439. We conclude that incumbent LECs must provide interoffice transmission facilities on an unbundled basis to requesting carriers. The record supports our conclusion that such access is technically feasible and would promote competition in the local exchange

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<sup>980</sup> MECA comments at 38.

<sup>981</sup> TCC comments at 38; *see also* NYNEX comments at 63 for a similar definition.

<sup>982</sup> ACSI comments at 41.

<sup>983</sup> Teleport comments at 37.

<sup>984</sup> ALTS comments at 30.

<sup>985</sup> *Id.* at 30-31.

market. We note that the 1996 Act requires BOCs to unbundle transport facilities prior to entering the in-region, interLATA market.<sup>986</sup>

440. We require incumbent LECs to provide unbundled access to shared transmission facilities between end offices and the tandem switch.<sup>987</sup> Further, incumbent LECs must provide unbundled access to dedicated transmission facilities between LEC central offices or between such offices and those of competing carriers. This includes, at a minimum, interoffice facilities between end offices and serving wire centers (SWCs), SWCs and IXC POPs, tandem switches and SWCs, end offices or tandems of the incumbent LEC, and the wire centers of incumbent LECs and requesting carriers. The incumbent LEC must also provide, to the extent discussed below, all technically feasible transmission capabilities, such as DS1, DS3, and Optical Carrier levels (e.g. OC-3/12/48/96) that the competing provider could use to provide telecommunications services. We conclude that an incumbent LEC may not limit the facilities to which such interoffice facilities are connected, provided such interconnection is technically feasible, or the use of such facilities. In general, this means that incumbent LECs must provide interoffice facilities between wire centers owned by incumbent LECs or requesting carriers, or between switches owned by incumbent LECs or requesting carriers. For example, an interoffice facility could be used by a competitor to connect to the incumbent LEC's switch or to the competitor's collocated equipment. We agree with the Texas Commission that a competitor should have the ability to use interoffice transmission facilities to connect loops directly to its switch. We anticipate that these requirements will reduce entry barriers into the local exchange market by enabling new entrants to establish efficient local networks by combining their own interoffice facilities with those of the incumbent LEC.

441. The ability of new entrants to purchase the interoffice facilities we have identified will increase the speed with which competitors enter the market. By unbundling various dedicated and shared interoffice facilities, a new entrant can purchase all interoffice facilities on an unbundled basis as part of a competing local network, or it can combine its own interoffice facilities with those of the incumbent LEC. The opportunity to purchase unbundled interoffice facilities will decrease the cost of entry compared to the much higher cost that would be incurred by an entrant that had to construct all of its own facilities. An efficient new entrant might not be able to compete if it were required to build interoffice facilities where it would be more efficient to use the incumbent LEC's facilities. We recognize that there are alternative suppliers of interoffice facilities in certain areas. We are convinced, however, that entry will be facilitated if competitors have greater, not fewer, options for procuring interoffice facilities as part of their local networks, and that Congress

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<sup>986</sup> 47 U.S.C. § 271(c)(2)(B)(v).

<sup>987</sup> Section V.I. addresses unbundled access to the tandem switching element.

intended for competitors to have these options available from competitors. Thus, the rules we establish for the unbundled interoffice facilities should maximize a competitor's flexibility to use new technologies in combination with existing LEC facilities.

442. We find that it is technically feasible for incumbent LECs to unbundle the foregoing interoffice facilities as individual network elements. The interconnection and unbundling arrangements among the larger LECs, IXCs, and CAPs that resulted from our *Expanded Interconnection* rules confirm the technical feasibility of unbundling interoffice facilities used by incumbent LECs to provide special access and switched transport.<sup>988</sup> As AT&T and Telecommunications Resellers Association point out, IXCs currently interconnect with incumbent LECs' transport facilities pursuant to standard specifications.<sup>989</sup> We also note that commenters do not identify technical feasibility problems with unbundling interoffice facilities.

443. We also find that it is technically feasible for incumbent LECs to unbundle certain interoffice facilities not addressed in our *Expanded Interconnection* proceeding. First, we conclude that an incumbent LEC must provide unbundled access to interoffice facilities between its end offices, and between any of its switching offices and a new entrant's switching office, where such interoffice facilities exist. This allows a new entrant to purchase unbundled facilities between two end offices of the incumbent LEC, or between the new entrant's switching office and the incumbent LEC's switching office. Although our *Expanded Interconnection* rules did not specifically require incumbent LECs to unbundle these facilities, commenters do not identify any potential technical problem with such unbundling. Moreover, some LECs already offer unbundled dedicated interoffice facilities, for example, between their end offices and SWCs for exchange access.

444. In addition, as a condition of offering unbundled interoffice facilities, we require incumbent LECs to provide requesting carriers with access to digital cross-connect system (DCS) functionality. A DCS aggregates and disaggregates high-speed traffic carried between IXCs' POPs and incumbent LECs' switching offices, thereby facilitating the use of cost-efficient, high-speed interoffice facilities. AT&T notes that the BOCs, GTE, and other large LECs currently make DCS capabilities available for the termination of interexchange traffic.<sup>990</sup> We find that the use of DCS functionality could facilitate competitors' deployment of high-speed interoffice facilities between their own networks and LECs' switching offices.

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<sup>988</sup> See, e.g., MCI comments at 32; NCTA comments at 42; GST comments at 24; TIA comments at 13; MFS comments at 47-48.

<sup>989</sup> AT&T comments at 22; Telecommunications Resellers Ass'n comments at 35.

<sup>990</sup> Letter from Bruce Cox, Government Affairs Director, AT&T, to William F. Caton, Acting Secretary, FCC, July 18, 1996.

Therefore, we require incumbent LECs to offer DCS capabilities in the same manner that they offer such capabilities to IXCs that purchase transport services.

445. We disagree with PacTel's assertion that it is not technically feasible for incumbent LECs to provide DCS functionality to competitors that purchase unbundled interoffice facilities.<sup>991</sup> First, contrary to PacTel's assertion, we do not require incumbent LECs to develop new arrangements for the offering of DCS capabilities to competitors. We only require that DCS capabilities be made available to competitors to the extent incumbent LECs offer such capabilities to IXCs. Second, PacTel suggests the provision of DCS capabilities requires physical partitioning of the DCS equipment in order to prevent carriers from gaining control of each other's traffic.<sup>992</sup> We do not require such partitioning for the provision of DCS capabilities. As noted above, we only require incumbent LECs to permit competitors to use DCS functionality in the same manner that incumbent LECs now permit IXCs to use such functionality.

446. Section 251(d)(2)(A) requires the Commission to consider whether "access to such network elements as are proprietary in nature is necessary."<sup>993</sup> Commenters do not identify any proprietary concerns relating to the provision of interoffice facilities that LECs are required to unbundle. We also note that many of these facilities are also currently offered on an unbundled basis to competing carriers. Therefore, the record provides no basis for withholding these facilities from competitors based on proprietary considerations.

447. Section 251(d)(2)(B) requires the Commission to consider whether the failure to provide access to an unbundled element "would impair the ability of the telecommunications carrier seeking access to provide the services that it seeks to offer."<sup>994</sup> We have interpreted the term "impair" to mean either increased cost or decreased service quality that would result from using network elements other than the one sought.<sup>995</sup> Certain commenters contend that unbundled access to these facilities would improve their ability to provide competitive local

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<sup>991</sup> Letter from Alan Ciamporcero, Vice President, PacTel, to William F. Caton, Acting Secretary, FCC, July 17, 1996 (PacTel July 17 *Ex Parte*).

<sup>992</sup> *Id.*

<sup>993</sup> 47 U.S.C. § 251(d)(2)(A).

<sup>994</sup> 47 U.S.C. § 251(d)(2)(B).

<sup>995</sup> *See supra* Section V.E.

exchange and exchange access service.<sup>996</sup> MCI, for example, argues that its inability to obtain unbundled access to trunks between an incumbent LEC's end offices raises its cost of providing local service.<sup>997</sup> Accordingly, we conclude that the section 251(d)(2)(B) requires incumbent LECs to provide access to shared interoffice facilities and dedicated interoffice facilities between the above-identified points in incumbent LECs' networks, including facilities between incumbent LECs' end offices, new entrant's switching offices and LEC switching offices, and DCSs. We believe that access to these interoffice facilities will improve competitors' ability to design efficient network architecture, and in particular, to combine their own switching functionality with the incumbent LEC's unbundled loops.<sup>998</sup>

448. We reject Cincinnati Bell's argument that existing tariffs for transport and special access services filed pursuant to our *Expanded Interconnection* rules fulfill our obligation to implement the requirements of section 251(c).<sup>999</sup> First, the *Expanded Interconnection* rules require the unbundling of interstate transport services only by Class A carriers<sup>1000</sup> whereas section 251(c) requires network unbundling by all incumbent LECs, except for carriers that are exempt under section 251(f) from our interconnection rules.<sup>1001</sup> Consequently, some non-Class A carriers that were not subject to our *Expanded Interconnection* requirements will be required to comply with the requirements of this Order. Second, we find that the Class A carriers' existing tariffs for unbundled transport elements do not satisfy the unbundling requirement of section 251(c), as suggested by Cincinnati Bell, because such tariffs are only for interstate access services, not for unbundled interoffice facilities. As such, existing federal tariffs for transport and special access exclude *intrastate* transport, and therefore are not equivalent to unbundled interoffice facilities, which we have determined to be nonjurisdictional in nature.

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<sup>996</sup> See, e.g., AT&T Mar. 21 Letter; LDDS Comments at 47.

<sup>997</sup> MCI comments at 46.

<sup>998</sup> See, e.g., MCI comments at 22.

<sup>999</sup> Cincinnati Bell comments at 18.

<sup>1000</sup> Class A carriers are those exchange carriers having more than \$100 million in total company regulated revenues. See *1990 Cost Support Order*, 5 FCC Rcd 1364, (Com. Car. Bur. 1990); *Commission Requirements for Cost Support Material to be Filed with 1989 Annual Access Tariffs*, 4 FCC Rcd 1662, 1663 (Com. Car. Bur. 1988).

<sup>1001</sup> See *infra* Section XII, addressing the exemption for rural LECs.

449. We also disagree with MECA, GTE, and Ameritech that we should consider "pricing distortions" in adopting rules for unbundled interoffice facilities.<sup>1002</sup> Section , below, addresses the pricing of unbundled network elements identified pursuant to section 251(c)(3) as it relates to our current access charge rules. Nor are we are persuaded by MECA's argument that incumbent LECs not subject to the MFJ should not be required to unbundle transport facilities because, according to MECA, such facilities are unnecessary for local competition.<sup>1003</sup> As discussed above, the ability of a new entrant to obtain unbundled access to incumbent LECs' interoffice facilities, including those facilities that carry interLATA traffic, is essential to that competitor's ability to provide competing telephone service.

450. We do not impose specific terms and conditions for the provision of unbundled interoffice facilities. We believe that the rules we establish in this Order for all unbundled network elements adequately address ALTS's concern regarding the provisioning, billing, and maintenance of unbundled transport facilities.<sup>1004</sup> We also decline at this time to address the unbundling of incumbent LECs' "dark fiber." Parties that address this issue do not provide us with information on whether dark fiber qualifies as a network element under sections 251(c)(3) and 251(d)(2). Therefore, we lack a sufficient record on which to decide this issue. We will continue to review and revise our rules in this area as necessary.

451. Rural Telephone Coalition contends that incumbent LECs should not be required to construct new facilities to accommodate new entrants.<sup>1005</sup> We have considered the economic impact of our rules in this section on small incumbent LECs. In this section, for example, we expressly limit the provision of unbundled interoffice facilities to *existing* incumbent LEC facilities. We also note that section 251(f) of the 1996 Act provides relief for certain small LECs from our regulations under section 251.

#### 4. Databases and Signaling Systems

##### a. Background

##### (1) NPRM

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<sup>1002</sup> MECA comments at 38. GTE comments at 38; Ameritech comments at 43.

<sup>1003</sup> MECA comments at 38.

<sup>1004</sup> Section V.G addresses terms and conditions governing incumbent LECs' provision of access to unbundled network elements.

<sup>1005</sup> Rural Tel. Coalition reply at 36.

sense that these costs are incurred as the output level changes by a given increment.<sup>1681</sup> The costs that are considered incremental will vary greatly depending on the size of the increment. For example, the incremental cost of carrying an additional call from a residence that is already connected to the network to its end office is virtually zero. The incremental cost of connecting a new residence to its end office, however, is the cost of the loop. Forward-looking incremental costs, plus a portion of the forward-looking joint and common costs, are sometimes referred to as "economic costs." Embedded or accounting costs are costs that firms incurred in the past for providing a good or service and are recorded as past operating expenses and depreciation. Due to changes in input prices and technologies, incremental costs may differ from embedded costs of that same increment. In competitive markets, the price of a good or service will tend towards its long-run incremental cost.

676. Certain types of costs arise from the production of multiple products or services. We use the term "joint costs" to refer to costs incurred when two or more outputs are produced in fixed proportion by the same production process (*i.e.*, when one product is produced, a second product is generated by the same production process at no additional cost). The term "common costs" refers to costs that are incurred in connection with the production of multiple products or services, and remains unchanged as the relative proportion of those products or services varies (*e.g.*, the salaries of corporate managers). Such costs may be common to all services provided by the firm or common to only a subset of those services or elements. If a cost is common with respect to a subset of services or elements, for example, a firm avoids that cost only by not providing each and every service or element in the subset. For the purpose of our discussion, we refer to joint and common costs as simply common costs unless the distinction is relevant in a particular context.

677. The term "long run," in the context of "long run incremental cost," refers to a period long enough so that all of a firm's costs become variable or avoidable.<sup>1682</sup> The term "total service," in the context of TSLRIC, indicates that the relevant increment is the entire quantity of the service that a firm produces, rather than just a marginal increment over and above a given level of production. Depending on what services are the subject of a study, TSLRIC may be for a single service or a class of similar services. TSLRIC includes the incremental costs of dedicated facilities and operations that are used by only the service in question. TSLRIC also includes the incremental costs of shared facilities and operations that are used by that service as well as other services.

678. While we are adopting a version of the methodology commonly referred to as

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<sup>1681</sup> William Baumol and Gregory Sidak, *Toward Competition in Local Telephony* 57 (1994).

<sup>1682</sup> See, *e.g.*, William Baumol, *Economic Theory and Operations Analysis* 290 (4th ed. 1977) ("The very long run is a period so long that all of the firm's present contracts will have run out, its present plant and equipment will have been worn out or rendered obsolete and will therefore need replacement, etc.").

TSLRIC as the basis for pricing interconnection and unbundled elements, we are coining the term "total element long run incremental cost" (TELRIC) to describe our version of this methodology. The incumbent LEC offerings to be priced using this methodology generally will be "network elements," rather than "telecommunications services," as defined by the 1996 Act.<sup>1683</sup> More fundamentally, we believe that TELRIC-based pricing of discrete network elements or facilities, such as local loops and switching, is likely to be much more economically rational than TSLRIC-based pricing of conventional services, such as interstate access service and local residential or business exchange service. As discussed in greater detail below, separate telecommunications services are typically provided over shared network facilities, the costs of which may be joint or common with respect to some services. The costs of local loops and their associated line cards in local switches, for example, are common with respect to interstate access service and local exchange service, because once these facilities are installed to provide one service they are able to provide the other at no additional cost. By contrast, the network elements, as we have defined them,<sup>1684</sup> largely correspond to distinct network facilities. Therefore, the amount of joint and common costs that must be allocated among separate offerings is likely to be much smaller using a TELRIC methodology rather than a TSLRIC approach that measures the costs of conventional services. Because it is difficult for regulators to determine an economically-optimal allocation of any such joint and common costs, we believe that pricing elements, defined as facilities with associated features and functions, is more reliable from the standpoint of economic efficiency than pricing services that use shared network facilities.

679. *Description of TELRIC-Based Pricing Methodology.* Adopting a pricing methodology based on forward-looking, economic costs best replicates, to the extent possible, the conditions of a competitive market. In addition, a forward-looking cost methodology reduces the ability of an incumbent LEC to engage in anti-competitive behavior. Congress recognized in the 1996 Act that access to the incumbent LECs' bottleneck facilities is critical to making meaningful competition possible. As a result of the availability to competitors of the incumbent LEC's unbundled elements at their economic cost, consumers will be able to reap the benefits of the incumbent LECs' economies of scale and scope, as well as the benefits of competition. Because a pricing methodology based on forward-looking costs simulates the conditions in a competitive marketplace, it allows the requesting carrier to produce efficiently and to compete effectively, which should drive retail prices to their competitive levels. We believe that our adoption of a forward-looking cost-based pricing methodology should facilitate competition on a reasonable and efficient basis by all firms in the industry by establishing prices for interconnection and unbundled elements based on costs similar to those incurred by the incumbents, which may be expected to reduce the regulatory

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<sup>1683</sup> 47 U.S.C. §§ 3(29), 3(46).

<sup>1684</sup> See *supra* Section V.

network element prices were set at efficient competitive levels. The ECPR, however, will serve to discourage competition in these very markets because it relies on the prevailing retail price in setting the price which new entrants pay the incumbent for inputs. While ECPR establishes conditions for efficient entry given existing retail prices, as its advocates contend, the ECPR provides no mechanism that will force retail prices to their competitive levels. We do not believe that Congress envisioned a pricing methodology for interconnection and network elements that would insulate incumbent LECs' retail prices from competition. Instead, Congress specifically determined that input prices should be based on costs because this would foster competition in the retail market. Therefore, we reject the use of ECPR for establishing prices for interconnection and unbundled elements.

711. As discussed above, the record in this docket shows that end user prices are not cost-based. In *Open Video Systems*, in contrast, we did not find that there would be a problem with the determination of end user prices.<sup>1724</sup> We concluded that "[u]se of [an ECPR] approach is appropriate in circumstances where the pricing is applicable [sic] to a new market entrant (the open video system operator) that will face competition from an existing incumbent provider (the incumbent cable operator), as opposed to circumstances where the pricing is used to establish a rate for an essential input service that is charged to a competing new entrant by an incumbent provider."<sup>1725</sup> In addition, in *Open Video Systems*, we concluded that the ECPR is appropriate because it encourages entry for open video system operators and also enhances the availability of carriage for unaffiliated programmers.<sup>1726</sup> The ECPR generally protects the provider's profits and provides opportunities for third parties to use the provider's inputs. The ECPR does not provide a mechanism to drive retail prices to competitive levels, however. In *Open Video Systems*, we wanted to encourage entry by open video system providers and to encourage them to have incentives to open their systems to unaffiliated programmers. Here, our goal is to ensure that competition between providers, including third party providers using interconnection and unbundled elements, will drive prices toward competitive levels and thus use of the ECPR is inappropriate.

712. *Universal Service Subsidies.* We conclude that funding for any universal service mechanisms adopted in the universal service proceeding may not be included in the rates for interconnection, network elements, and access to network elements that are arbitrated by the states under sections 251 and 252. Sections 254(d) and 254(e) of the 1996 Act mandate that universal service support be recovered in an equitable and nondiscriminatory manner from all providers of

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<sup>1724</sup> *Implementation of Section 302 of the Telecommunications Act of 1996 – Open Video Systems*, CS Docket No. 96-46, Second Report and Order, FCC 96-249 (rel. June 3, 1996) (*Open Video Systems*).

<sup>1725</sup> *Id.* at 127.

<sup>1726</sup> *Id.*

telecommunications services.<sup>1727</sup> We conclude that permitting states to include such costs in rates arbitrated under sections 251 and 252 would violate that requirement by requiring carriers to pay specified portions of such costs solely because they are purchasing services and elements under section 251. Section 252(d)(1) requires that rates for interconnection, network elements, and access to network elements reflect the costs of providing those network elements, not the costs of supporting universal service.

713. Section 254(f) provides that a state may adopt equitable, nondiscriminatory, specific, and predictable mechanisms to advance universal service within that state.<sup>1728</sup> If a state collects universal service funding in rates for elements and services pursuant to sections 251 and 252, it will be imposing non-cost based charges in those rates. Including non-cost based charges in the rates for interconnection and unbundled elements is inconsistent with our rules implementing sections 251 and 252 which require that these rates be cost-based. It is also inconsistent with the requirement of section 254(f) that telecommunications carriers contribute to state universal service on a nondiscriminatory basis, because telecommunications carriers requesting interconnection or access to unbundled network elements will be required to make contributions to universal service support through such surcharges.<sup>1729</sup> States may not, therefore, include universal service support funding in the rates for elements and services pursuant to sections 251 and 252, nor may they implement mechanisms that have the same effect. For example, states may not fund universal service support by imposing higher rates for interconnection, unbundled elements, or transport and termination on carriers that offer service to different types of customers or different geographic areas. To the extent that New York's "pay or play" system funds universal service in this manner, it violates sections 251, 252, and 254 of the 1996 Act. Nothing in the 1996 Act or in this Order, however, precludes a state from adopting a universal service funding mechanism, whether interim or otherwise, if such funds are collected in accordance with section 254(f) on an "equitable and nondiscriminatory basis" through "specific, predictable, and sufficient mechanisms that do not rely on or burden Federal universal service support mechanisms."<sup>1730</sup>

714. Our decision here does not exempt carriers purchasing elements or services under section 251 from contributing to (or possibly receiving) universal service support. Rather, the recovery of universal service support costs from telecommunications carriers, including carriers requesting unbundled network elements, will be governed by section 254 of the 1996 Act.

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<sup>1727</sup> Joint Explanatory Statement at 131 ("In keeping with the conferees' intent that universal service support should be clearly identified, [section 254(e)] states that such support should be made explicit . . .").

<sup>1728</sup> 47 U.S.C. § 254(f).

<sup>1729</sup> See *infra*, Section VII.D.3., discussing discrimination.

<sup>1730</sup> 47 U.S.C. § 254(f).

**TAB C**



- FINANCIAL SPEAKING
- NEWS STAND
- WORK PLACE
- INSIDE AT&T
- TECHNOLOGY
- EDUCATION & TRAINING
- ABOUT OUR SITE
- TECH BOX
- HELP
- SEARCH
- POST
- WRITE TO US
- SUBSCRIPTIONS
- MORE

# AT&T Investment Community Meeting

Transcript  
March 3, 1997 - A.M. Session

**JOHN ZEGLIS** : Okay. Thank you, John. The subject is public policy. Like it or not, public policy still plays a very large role in AT&T's current operations and particularly its future aspirations. That's pretty much a function of where we've come from as a regulated utility. It's almost equally a function of where we want to go into regulated monopoly markets. It means we've had to seek a lot of change in the public policy arena. And my purpose here this morning is to persuade you that our program for this public policy work is not nearly as heated as the briefs and the counter briefs, charges and counter charges may make you think on a daily basis. We have structured our initiatives in the public policy arena around these four central strategic objectives. Number one, we need to eliminate the unnecessary regulation of AT&T. That means there has been too much of it and it's been lopsided against us and in favor of our competitors. Number two, we need to open monopoly markets to new entry. That means the local exchanges in the United States and just about any other country outside this nation.

Number three, until we get those markets open, we need to enforce monopoly safeguards. The most celebrated here is clearly the MSL like safeguard in the United States, no RBOC long-distance entry until their markets are competitive.

And then the fourth goal, also until we get those monopoly markets made competitive, is to use public policy to bring down this enormous 15 dollar carrier-to-carrier payment bill that we incur globally. We call that access domestically and international settlements globally.

So the modus operandi for this talk is to look at these four objectives. We'll do all of them domestically first. We'll double back and do them internationally at the end.

We're going to talk about where we stand today, where we're going to go, what are the big plays this year and next, and in the end what kind of market framework can we deliver to AT&T for us to execute on our strategy.

All right. Number 1, deregulation of AT&T. This is the most fun because it's essentially done. We have had to seek this relief at two levels, state and federal. State as a practical matter we were done with long-distance regulation of our prices and earnings by

Good news I guess is that the business case for using this unbundled platform is going to turn out to be a lot less sensitive to the pricing results than TSR. And that's where I want to move next. I would like to line up for you the economics of TSR on the one hand and unbundled network elements on the other hand in AT&T's strategy and business case.

We're going to start in the state of Pennsylvania, where like other places, TSR margins are modest. This is a good state for us. This is one where our wholesale discount is 25.9 percent. And when you stack the revenue next to the cost, you see that for a consumer averaging 20 dollars of local exchange service in Pennsylvania, we have a cost of goods sold of \$14.81. Given you a chance to market a combined local and long-distance package to this customer, gives you a fighting chance perhaps of recovering your marketing and billing and customer care costs incrementally to what you're already doing for long-distance. But it's tight. I guess what you say is it's a lot better than it used to be in Rochester where on that trial we have begun to a five percent discount and the pink stack would have been 19 bucks.

But now let's look at the unbundled network element platform in the same state. We'll stay in Pennsylvania. Admit it's a good state for us. We're going to go into a high density, low Uni price zone. We're going to buy all the elements, recombine them to make global service out of the elements and assume we're doing this to a consumer that buys \$25 of long-distance and five dollars of local toll service per month. And now what we end up with, stacked next to it, is quite a different picture. Our cost of goods sold on that platform is \$16.03, slightly above the TSR cost. But our revenue is \$33.50. Consisting of that same 20 dollars in local that we collect and \$3.50 in the interstate subscriber line charge, which under FCC rule comes to the provider under the platform, and 10 dollars worth of access, which was otherwise being paid to the local carrier on the 30 dollars of toll this customer was using. So we have widened our margin on the Uni 2 by more than twelve bucks over what we had on the TSR side.

Where this company assigns this margin, how you assess this business opportunity, depends upon what business you think we're in at AT&T. If you're a division that thinks your business is local exchange service, that is, you're after the 20 dollars, then you say, wow, I've got an all in, net cost of service that is defrayed by that extra revenue I collected, taking that away from the 16 dollars, I'm not paying more than 2 and a half dollars all in for the cost of goods sold to let me go chase the 20 dollars.

A little more accurate way of looking at our local business might say it's not local exchange. It's local network. We're going to change all the revenues that move over local network facilities. In that case I just bought a \$33.50 revenue stream for \$16.03 cost of goods sold, a discount of 52 percent. Or if you're in one of our sister divisions, say Gail McGovern's consumer long-distance, she might look at it differently. She might say, Good. For the same \$16 that Harry Beason paid to earn his 23.50 of end user collection, I just had my access reduced by \$10. I improved my

**TAB D**

## FCC Out of Bounds on Pricing Rules For Local-Phone Markets, Court Finds

By LESLIE CAULEY  
And JOHN R. WILKE

Staff Reporters of THE WALL STREET JOURNAL

A federal court ruled that the Federal Communications Commission again overstepped its bounds in laying out pricing rules for local-phone competition, further slowing long-distance carriers' plans to invade the nation's local-phone markets.

The Eighth Circuit Court of Appeals in St. Louis ruled that the FCC could not force the Bells to lease and then "recombine" network parts at discounts of up to 70% for rivals. The agency's plan was intended to permit rivals to more easily use Bell-network equipment to offer local-phone services. Long-distance carriers, including AT&T Corp., had favored that approach because it required far less of an investment to get into the local-phone business.

But the Bells had argued that, under the FCC's complex plan, long-distance companies would essentially be reselling the Bells' service, not building their own networks, and therefore didn't qualify for the steep discounts. The Bells argued that the long-distance companies should have to order network parts individually and then maintain the leased equipment themselves in order to get the big discounts.

The court's ruling, the latest in a series of challenges to the FCC, was immediately hailed as a victory by the Bells, and further casts a cloud over the agency's efforts to set rules for local-phone service.

FCC Chairman Reed Hundt said the agency would appeal to the Supreme Court. He warned that the court's finding, if left to stand, would "have the effect of significantly delaying — perhaps preventing — many Americans from being able to have more than one choice for their local-telephone service."

Taking a dig at the Bells, which have become vocal critics of the FCC and its efforts to bring competition to the nation's local-phone markets, Mr. Hundt asserted that the ruling allows local telephone monopolies "to subvert competition."

The Bells see it differently, blaming what they see as unreasonable demands by federal regulators for the holdup.

Ameritech Corp., Chicago, told analysts it doesn't expect to be in long-distance business for at least another year, amounting to an about-face for the Bell, which has long promised that it would soon strike an agreement with the agency to enter long distance.

Ameritech, which also reported third-quarter earnings in line with expectations, contends the FCC is seeking to impose a number of conditions that are at odds with last year's federal telecommunications legislation, aimed at encouraging local and long-distance carriers to enter each other's markets.

The court, in part, agreed with that assessment. In its ruling, the court found that the FCC was trying to reinstate pricing

rules that the appeals panel had thrown out earlier this year. The court hinted in a separate ruling that it is considering taking enforcement action against the FCC for not following its earlier orders.

Long distance carriers were unhappy with the latest decision. AT&T said in a statement that the ruling, if it stands, would raise the costs of competing in the local-phone market and "increase disputation for customers who seek to exercise a choice." The Bells countered that they wouldn't be denying choice to customers, nor access to their networks, but they believe long distance carriers should be required to pay their way.

Scott Cleland, a policy analyst with Legg Mason Wood Walker in Baltimore, labeled the ruling a big disappointment for long-distance carriers, saying it would force them to build their own local networks rather than resell those of the Bells under their own names. If the ruling stands, long-distance carriers could only expect to get discounts of 17% to 24%, the range set by the FCC for basic resale, instead of the deeper discounts of 50% and higher that the carriers had been looking for.

Mr. Cleland said the court's ruling was also a big letdown for the FCC, which "was essentially trying a back-door resurrection of their phone rules."

Ameritech had been one of several Bells that had challenged the FCC's pricing scheme. Left on the table, for Ameritech, is a series of technical requirements that the agency is seeking to impose as a condition of allowing the Bell to offer long-distance services in Michigan. Ameritech says some of those requirements are inconsistent with what last year's telecommunications bill calls for, and technically impossible, to boot.

Among other things, the FCC wants Ameritech to set up its network so that rivals leasing piece-parts could more closely track calls, offering up such details as the identity of other carriers that originate calls. "No one can do that," said John Lenahan, Ameritech's assistant general counsel.

The FCC listed these and other conditions in turning down the Bell's request to offer long-distance services in Michigan. Now it is up to Ameritech to rework its application and come back to the agency. Based on the FCC's latest directives, Mr. Lenahan said he has "no idea" when that might be.

So far, the FCC has turned down both long-distance applications it has received, from Ameritech and SBC Communications Inc. The agency had been expected to turn down a third application, from BellSouth Corp., Atlanta, for South Carolina, in part because its pricing didn't comport with what the FCC had wanted. Now that those rules have been thrown out by a federal court, it isn't clear what will happen.

**TAB E**

Before the  
Federal Communications Commission  
Washington, D.C. 20554

In the Matter of )  
 )  
 )  
Application of Ameritech Michigan ) CC Docket No. 97-137  
Pursuant to Section 271 of the )  
Communications Act of 1934, as amended. )  
To Provide In-Region, InterLATA Services )  
In Michigan )

**MEMORANDUM OPINION AND ORDER**

**Adopted: August 19, 1997**

**Released: August 19, 1997**

By the Commission: Chairman Hundt and Commissioners Quello, Ness, and Chong issuing separate statements.

**TABLE OF CONTENTS**

	Paragraph
I. INTRODUCTION .....	1
II. BACKGROUND .....	5
A. Statutory Framework .....	5
B. The Purpose of Section 271 .....	10
C. History of Ameritech's Efforts to Obtain In-Region, InterLATA Authorization for Michigan .....	24
III. CONSULTATION WITH THE MICHIGAN PUBLIC SERVICE AND THE UNITED STATES DEPARTMENT OF JUSTICE ...	30
A. State Verification of BOC Compliance with Section 271(c) .....	30
B. Department of Justice's Evaluation .....	35
IV. STANDARD FOR EVALUATING SECTION 271 APPLICATIONS .....	43
A. Burden of Proof for Section 271 Applications .....	43
B. Compliance with Requirement that Application Be Complete When Filed .....	49
1. Weight Accorded to New Factual Evidence .....	49
2. Obligation To Present Evidence and Arguments Clearly .....	60

ultimately, the Supreme Court will resolve the issue of what the statutory requirement that rates be cost-based means. This litigation will take years, however, and inevitably will run the risk of impeding or significantly delaying the development of competition in the local exchange market, and, consequently, delaying the deregulation of the telecommunications markets that Congress envisioned.

285. While the question of what constitutes cost-based pricing under section 252(d) wends its way through the courts, the Commission, pursuant to section 271, must determine whether the BOCs have fully implemented the competitive checklist, which incorporates the section 252(d) cost-based standard. The BOCs will file section 271 applications in the meantime, and the Commission is obligated by section 271 to issue a written determination approving or denying the authorization requested not later than 90 days after receiving an application.<sup>743</sup>

286. The cost-based standard is contained in a federal statute. It is, therefore, presumed to have a uniform meaning nationwide.<sup>744</sup> As the Supreme Court has often stated, "federal statutes are generally intended to have uniform nationwide application."<sup>745</sup> Moreover,

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commission's use of forward looking cost methodology); *AT&T v. BellSouth, et al.*, Civ. No. 97-130 (N.D. Fla. filed April 18, 1997) (alleging, *inter alia*, state commission erred in not deaveraging prices for unbundled network elements); *AT&T v. U S WEST, et al.*, Civ. 97-917 (D. Minn. filed April 16, 1997) (same); *Southwestern Bell Telephone Co. v. McKee, et al.*, Civ. No. 97-2197 (D. Kan. filed April 11, 1997) (challenging, *inter alia*, state commission's resale price discount); *Southwestern Bell Telephone v. Zobrist, et al.*, Civ. No. 97-0140 (W.D. Mo. filed Feb. 6, 1997) (alleging, *inter alia*, state commission improperly relied on TELRIC methodology); *MCI Telecommunications Corp. v. Southwestern Bell Telephone Co., et al.*, Civ. No. 97-132 (W.D. Tex. filed Feb. 28, 1997) (alleging, *inter alia*, state commission erred in not using forward looking cost methodology). GTE has filed suits in numerous states, including Michigan, alleging, *inter alia*, that the rates established by state commissions in arbitrations for unbundled network elements and interconnection improperly preclude GTE from recovering historical costs. See, e.g., *GTE v. Strand, et al.*, Civ. No. 97-20 (W.D. Mich. filed Feb 25, 1997); *GTE v. Johnson et al.*, Civ. No. 4:97CV26 (N.D. Fla. filed Jan. 31, 1997); *GTE v. Naito, et al.*, Civ. No. 97-00162 (D. Haw. filed Feb. 14, 1997); *GTE v. Miller, et al.*, Civ. No. 96-1584 (C.D. Ill. filed Dec. 19, 1996); *GTE v. Mortell, et al.*, Civ. No. 97-0066 (N.D. Ind. filed Feb. 20, 1997); *GTE v. Breathitt, et al.*, Civ. No. 97-7 (E.D. Ky. filed Jan. 29, 1997); *GTE v. Zobrist, et al.*, Civ. No. 97-0193 (W.D. Mo. filed Feb. 19, 1997).

<sup>743</sup> 47 U.S.C. § 271(d)(3).

<sup>744</sup> See, e.g., *U.S. v. Phipps*, 68 F.3d 159, 161 (7th Cir. 1995) ("Language in federal statutes and regulations usually has one meaning throughout the country").

<sup>745</sup> See, e.g., *Mississippi Bank of Choctaw Indians v. Holyfield*, 490 U.S. 30, 43 (1989) (citations omitted); see also *Jerome v. United States*, 318 U.S. 101, 104 (1943). Occasionally, the federal courts have concluded that an ambiguous federal statutory term was to be given meaning by reference to state law. See, e.g., *De Sylva v. Ballentine*, 351 U.S. 570 (1956); *Reconstruction Finance Corp. v. Beaver County*, 328 U.S. 204 (1946). But that approach has been applied only in cases in which the ambiguous federal statutory term is a familiar state law term with a history of state law jurisprudence interpreting it. Indeed, it is only in such cases that the issue of

there is nothing in section 271 to suggest that the Commission's bases for determining checklist compliance should be vary throughout the country. The Commission, pursuant to its responsibility under section 271, therefore must apply uniform principles to give content to the cost-based standard in the competitive checklist for each state-by-state section 271 application.

287. Such a reading of our responsibilities under section 271 is also sound policy. Determining cost-based rates has profound implications for the advent of competition in the local markets and for competition in the long distance market. Because the purpose of the checklist is to provide a gauge for whether the local markets are open to competition, we cannot conclude that the checklist has been met if the prices for interconnection and unbundled elements do not permit efficient entry. That would be the case, for example, if such prices included embedded costs. Moreover, allowing a BOC into the in-region interLATA market in one of its states when that BOC is charging noncompetitive prices for interconnection or unbundled network elements in that state could give that BOC an unfair advantage in the provision of long distance or bundled services.

288. We believe that Congress did not intend us to be so constrained in conducting our prescribed assessment of checklist compliance in section 271. We conclude that Congress must have intended the Commission, in addressing section 271 applications, to construe the statute and apply a uniform approach to the phrase "based on cost" when assessing BOC compliance with the competitive checklist. We will consider carefully the state commission's assessment of pricing contained in its checklist compliance verification, the methodology used to derive prices for checklist items, and the allegations of interested parties in the section 271 proceeding. It is our understanding that a large majority of state commissions have stated that they have adopted or intend to adopt forward-looking economic cost approaches. Our ultimate objective, for the purpose of section 271 compliance, is to determine whether the BOC's prices for checklist items in fact meet the relevant statutory requirements. We note, moreover, that even if it were decided that we lacked authority to review BOC prices as an aspect of our assessment of checklist compliance under section 271(d)(3)(A), we would certainly consider such prices to be a relevant concern in our public interest inquiry under section 271(d)(3)(C). We discuss below our conclusions concerning the appropriate pricing for these checklist items.

289. TELRIC-Based Pricing of Interconnection Services, Unbundled Network Elements, and Transport and Termination. In ascertaining whether a BOC has complied with the competitive checklist regarding pricing for interconnection, unbundled network elements, and transport and termination pursuant to section 251, it is critical that prices for these inputs be set at levels that encourage efficient market entry. New entrants should make their

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conditions such as non-recurring charges. We believe that we have authority to impose such conditions pursuant to sections 271(d)(6) and 303(r) of the Communications Act.<sup>753</sup>

## 2. Unbundled Local Transport

### a. Introduction

298. Section 271(c)(2)(B)(v) of the competitive checklist requires Ameritech to provide "[l]ocal transport from the trunk side of a wireline local exchange carrier switch unbundled from switching or other services."<sup>754</sup> The checklist further requires Ameritech to provide [n]ondiscriminatory access to network elements in accordance with the requirements of sections 251(c)(3) and 252(d)(1).<sup>755</sup> In the *Local Competition Order*, the Commission required incumbent LECs to provide requesting telecommunications carriers with access to both dedicated and "shared" interoffice transmission facilities as an unbundled network element pursuant to section 251(c)(3).<sup>756</sup>

299. There was significant controversy in this proceeding concerning whether Ameritech's shared transport offerings satisfy the requirements of section 251(c)(3) and our

<sup>753</sup> 47 U.S.C. §§ 271(d)(6), 303(r); *see also infra* Section IX (discussing the Commission's authority to impose conditions).

<sup>754</sup> 47 U.S.C. § 271(c)(2)(B)(v).

<sup>755</sup> *Id.* § 271(c)(2)(B)(ii).

<sup>756</sup> *Local Competition Order*, 11 FCC Rcd at 15718. 47 C.F.R. § 51.319(d)(2) states:

The incumbent LEC shall:

(i) Provide a requesting telecommunications carrier exclusive use of interoffice transmission facilities dedicated to a particular customer or carrier, or use of the features, functions, and capabilities of interoffice transmission facilities shared by more than one customer or carrier;

(ii) Provide all technically feasible transmission facilities, features, functions, and capabilities that the requesting telecommunications carrier could use to provide telecommunications services;

(iii) Permit, to the extent technically feasible, a requesting telecommunications carrier to connect such interoffice facilities to equipment designated by the requesting telecommunications carrier, including, but not limited to, the requesting telecommunications carrier's collocated facilities . . . .

47 C.F.R. § 51.319(d)(2) (emphasis added).

implementing regulations, as mandated by sections 271(c)(2)(B)(ii) and (v) of the Act.<sup>757</sup> In light of our conclusions in this Order that Ameritech has failed to satisfy other checklist requirements of section 271(c)(2)(B), we need not reach this issue. As discussed below, we believe, however, that Ameritech is not in compliance with the requirements that were established in the *Local Competition Order*.

300. Since the release of the *Local Competition Order*, moreover, the Commission has, on reconsideration, clarified the incumbent LECs' obligation to provide shared transport pursuant to section 251(c)(3) of the Act. Although the *Local Competition Order* clearly required incumbent LECs to provide shared transport between incumbent LEC end offices and the tandem switch, the order was not clear on all other portions of the network to which the shared transport obligation applied. As discussed below, the Commission, on reconsideration in the *Local Competition Third Reconsideration Order*, concluded that incumbent LECs are required to provide "shared transport among all end offices or tandem switches in the incumbent LEC's network (i.e., between end offices, between tandems, and between tandems and end offices)."<sup>758</sup> We also concluded that "a requesting carrier may use the shared transport unbundled element to provide exchange access service to customers for whom the carrier provides local exchange service." In this Order, we are not evaluating Ameritech's application against the requirements the Commission established in the *Local Competition Third Reconsideration Order*. We note, however, that all BOCs, including Ameritech, are now on notice as to the clarified shared transport obligations and are required to comply with the revised rules prior to filing any future applications for interLATA entry pursuant to section 271 of the Act.<sup>759</sup>

#### b. Background

301. Section 251(c)(3) of the Act requires incumbent LECs to "provide, to any requesting telecommunications carrier . . . nondiscriminatory access to network elements on an unbundled basis."<sup>760</sup> In the *Local Competition Order*, the Commission identified seven network elements that incumbent LECs were required to provide to requesting carriers on an unbundled basis. These network elements included unbundled local switching and interoffice transmission facilities. In *Iowa Utilities Board v. FCC*, the United States Court of Appeals for the Eighth Circuit, while vacating certain provisions of the *Local Competition Order*,

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<sup>757</sup> Section 51.319(d) of the Commission's rules requires that incumbent LECs provide access on an unbundled basis to interoffice transmission facilities shared by more than one customer or carrier. 47 C.F.R. § 51.319(d). In this Order, we refer to such shared interoffice transmission facilities as "shared transport."

<sup>758</sup> *Local Competition Third Reconsideration Order*, FCC 97-295 (rel. August 18, 1997).

<sup>759</sup> *Id.* at paras. 24-25, 31-34, 39-49.

<sup>760</sup> 47 U.S.C. § 251(c)(3).

affirmed the Commission's authority to identify network elements to which incumbent LECs must provide access on an unbundled basis.<sup>761</sup>

302. In the *Local Competition Order*, the Commission defined "interoffice transmission facilities" as:

incumbent LEC transmission facilities dedicated to a particular customer or carrier, or shared by more than one customer or carrier, that provide telecommunications between wire centers owned by incumbent LECs or requesting telecommunications carriers, or between switches owned by incumbent LECs or requesting telecommunications carriers.<sup>762</sup>

The Commission stated that "[f]or some elements, especially the loop, the requesting carrier will purchase exclusive access to the element for a specific period," and for "other elements, especially shared facilities such as common transport, carriers are essentially purchasing access to a functionality of the incumbent's facilities on a minute-by-minute basis."<sup>763</sup> The Commission found that "the embedded features and functions within a network element are part of the characteristics of that element and may not be removed from it. Accordingly, incumbent LECs must provide network elements along with all of their features and functions, so that new entrants may offer services that compete with those offered by incumbents as well as new services."<sup>764</sup>

303. Ameritech contends that the Act defines "network element" as "a facility or equipment" used to provide a telecommunications service.<sup>765</sup> Ameritech states that a network element also includes features, functions, and capabilities that are provided by "such facility or equipment."<sup>766</sup> Ameritech claims, however, that, in order to obtain a feature, function, or capability of a network element, the requesting carrier must first designate a discrete facility or piece of equipment, in advance.<sup>767</sup>

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<sup>761</sup> *Iowa Utils. Bd.*, 1997 WL 403401, at \*27-28.

<sup>762</sup> *Local Competition Order*, 11 FCC Rcd at 16210-11; 47 C.F.R. § 51.319(d)(1).

<sup>763</sup> *Local Competition Order*, 11 FCC Rcd at 15631.

<sup>764</sup> *Id.* at 15632. That determination was affirmed by the Eighth Circuit. *Iowa Utils. Bd.*, 1997 WL 403401, at \*18-22.

<sup>765</sup> Ameritech Application, Vol. 2.3, Edwards Aff. at 46.

<sup>766</sup> *Id.*, Vol. 2.3, Edwards Aff. at 46.

<sup>767</sup> *Id.*, Vol. 2.3, Edwards Aff. at 46.