offices. Finally, Bell Atlantic provides virtual collocation for those who do not want physical collocation.

Furthermore, Bell Atlantic will ensure that customers will have a choice of xDSL providers, even as Bell Atlantic rolls out xDSL aggressively.

First, Bell Atlantic will offer conditioned loops in accordance with the terms of individual interconnection contracts. Furthermore, Bell Atlantic will disclose technical requirements and network changes affecting interoperability.

Second, Bell Atlantic is working with its xDSL competitors, such as Covad and NorthPoint, in the Universal ADSL Working Group (UAWG) to overcome the problem of conflicting proprietary ADSL offerings by manufacturers (one of the problems that delayed ISDN). "ADSL Gets Access Standards Promised, But Availability is Still Hung Up on Expensive Deployment," LAN Times (Feb. 16, 1998). Adoption of a common standard among other things would minimize interference and incompatibility problems that otherwise is likely to plague competing ADSL services and lead to numerous ill-founded allegations of anticompetitive behavior.

Finally, Bell Atlantic plans to – and indeed must – offer xDSL at prices competitive with cable modems.

3. 706 Relief Will Spur xDSL Competition

Bell Atlantic's requested relief -- from requirements that it unbundle xDSL electronics and from discounted resale, price cap, and other investment-deterring restrictions – will spur real xDSL competition.

First, requiring unbundling of xDSL electronics will discourage facilities-based xDSL investment by making unbundling of Bell Atlantic's electronics at TELRIC prices

more profitable than installing competing equipment, thereby discouraging innovation by Bell Atlantic and competition from others. Comments of NextLevel Communications at 8. Congress rejected the idea that the market for local telephone service remains a "natural monopoly," opting instead for a regime that encourages competitors to build their own physical networks to compete with the incumbents. But some opponents have replaced this vision of robust facilities-based competition with proposed rules that undermine incentives to deploy economically efficient competing facilities. Where Bell Atlantic has not even deployed a technology, it should not be subject to innovation-deterring rules that have already been put in place where facilities already have been built. Compaq Comments at 3.

Second, Bell Atlantic has an incentive to offer xDSL to ISPs, since xDSL deployment will be more cost-effective if rolled out widely and allowing many different companies to market xDSL is a good way to ensure a widespread roll-out.

Third, to the extent that Bell Atlantic raises its own xDSL prices above market cost, then cable modem, satellite, and facilities-based xDSL competitors will gain even more profit by taking cost-based-priced unbundled loops and collocating xDSL equipment. This will spur competition, not lessen it.

Finally, the more Bell Atlantic invests, the more competitors will be forced to invest to compete. Many of the commenters assume a one-way effect of competition – from competitive xDSL to Bell Atlantic – but the reality of all competition is that it spurs everybody to do better.

4. Competitor Complaints Are Meritless

Covad and the DATA Coalition claim that Bell Atlantic could have rolled out xDSL a long time ago but did not because it is a hidebound monopolist. But that cannot account for the fact Bell Atlantic has deployed more fiber than any other carrier and has made ISDN available to nearly every home in its region. As Covad and Northpoint well know, Bell Atlantic did not deploy xDSL in large part because no xDSL standard emerged until recently. Were Bell Atlantic to deploy its own nonstandard flavor of xDSL without consulting with its competitors, Covad and Northpoint no doubt would be complaining about Bell Atlantic's "anticompetitive action."

The DATA coalition and Covad also relate their versions of the interconnection negotiations with Bell Atlantic which occurred under the 1996 Act. Bell Atlantic's recollection of those negotiations is very different, but the important facts are that nearly 400 of interconnection agreements have been negotiated and 300 approved with the active supervision and blessing of state commissions, and Covad and Northpoint are entering Bell Atlantic's market.

Covad and the DATA Coalition also claim that Bell Atlantic has acted anticompetitively by failing to make loops and collocation space available at the instant they were demanded. Bell Atlantic's network and facilities were not built or engineered with xDSL, unbundling or collocation in mind and therefore take time to configure properly. Nonetheless, Bell Atlantic has moved ahead to give these competitors access to Bell Atlantic's network as quickly as possible. Bell Atlantic has committed to provide xDSL-conditioned unbundled loops to its competitors in the interconnection agreements, and will do so just as it has provided ordinary unbundled loops to competitors. Indeed,

Bell Atlantic has complied with its additional market-opening commitments made pursuant to the Bell Atlantic/NYNEX merger. See www.fcc.gov/ccb/Mergers/ Bell_Atlantic_NYNEX/ (quarterly performance reports provided to FCC).

The Internet service providers fear that Bell Atlantic hopes to make Bell Atlantic Internet Solutions the monopoly provider of xDSL and fast internet services. But Bell Atlantic currently plans to make xDSL available on equivalent terms and conditions to all ISPs, including BAIS.

V. Immediate Action Is Needed

Bell Atlantic's petition should be granted now. There is ample Commission precedent permitting company-specific orders to deploy new technology in advance of general rulemaking proceedings. The Commission in the past granted "pioneer preferences" to spectrum-using companies that sought to deploy innovative new technologies pursuant to 47 C.F.R. § 0.241, 1.402, and 5.207. Similarly, the Commission invited cable operators to adopt "upgrade incentive plans," described as a "social contract" between the cable operator and its customers that involves flexibility in the pricing of new service tiers with no increases for current services. Report and Order and Further Notice of Proposed Rulemaking, 9 F.C.C. Rec. 4527, 4677-4680 (1994). The principle of promoting innovation by giving relief to particularly innovative companies is well-established.

The need for speed is clear. Few Americans are anywhere near receiving high-speed broadband capabilities under the current regulatory rules. There is no scenario under which the business-focused competitors who filed in this proceeding will begin to

reach ordinary Americans any time in the near future. That will lead to a two-tiered digital society; those who have, and those who have not. The advocacy groups that filed in support of Bell Atlantic's Petition noted that relief would "provide important incentives for local telephone companies to offer high-speed data services to homes, schools, health care facilities, universities, customers with disabilities, and small businesses in their regions." Comments of United Homeowners Association, et al, at 4.

Many parties counsel the need for thorough study, a transparent delaying tactic. Delay and regulatory uncertainty kill innovation. Compaq and Next Level and Intel and every other great company in the United States would not be where they are today if they had to wait a year every time they wanted to roll out a new product. The Commission has a sufficient record in this proceeding to move ahead; hundreds of pages of comments have been filed. Based on the extensive record in this case, the Commission should act now to ensure that ordinary Americans have a clear path to obtaining greater access to high-speed broadband services.

Respectfully submitted,

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May 6, 1998

CERTIFICATE OF SERVICE

I, NancyAnn Hunt, hereby certify that a copy of "Bell Atlantic Reply Comments" was served this May 6, 1998, by mailing true copies thereof, postage prepaid, to the individuals on the attached service list.

NancyAnn Hunt

* Via hand delivery.

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US OFFICE PRODUCTS

Declaration of Thomas W. Hazlett

1. I am an economist at the University of California, Davis, and have been asked by Bell Atlantic to offer my analysis of their 706 petition and related Comments in the record. I previously filed a declaration in this docket to which my c.v. was attached.

2. The primary area of controversy generated by Bell Atlantic's 706 petition appears to involve the allegation that the deregulation of advanced telecommunications services would render the regulatory safeguards of the 1996 Telecommunications Act moot. As WorldCom writes in its Comments in this matter: "The RBOCs Appear to Demand the Removal of Nearly All Critical Consumer and Competition Safeguards" (p. 7). While it is true that the relief requested involves deregulation in various dimensions, it is highly misleading to characterize the petition as a request to eliminate existing consumer safeguards. Because the regulatory relief solely concerns the provision of new services,[1] there are no existing safeguards in place -- the services do not exist. This is the logic employed by Congress in differentiating regulatory treatment under Sec. 706 for "advanced telecommunications services" from other portions of the Telecommunications Act which leave intact price cap, structural separation, open access and other rules governing the provision of POTS (plain old telephone service). Because the attempt to micro-manage emerging services acts as a tax on the provision of such services, the alleged safeguards now in place "protect" consumers from monopoly pricing by suppressing the supply of such choices to begin with. This, needless to say, is not a net gain for customers.

3. The trade-off between static and dynamic efficiency considerations has long been known to economists. What can maximize consumer welfare at a moment in time (pushing price to marginal cost, for instance) may not maximize consumer welfare *over* time. That is because such regulatory measures as may be enacted to mandate optimization in the static environment may themselves deter risk-taking behavior which will create growth opportunities for the system as a whole: lower costs, more efficient forms of organization, better products motivating higher demands. In the immediate context, this trade-off can be vividly seen, as rules which limit opportunities for new product development can theoretically improve customer satisfaction only if they artfully avoid imposing disincentives on such product development. Because the market for "advanced telecommunications services" features several competitors, and because the market for POTS remains subject to all the existing regulatory constraints, the most reliable path for consumer welfare maximization over time lies with deregulation under the terms of Sec. 706.

4. The static/dynamic distinction helps explain much that is confused in the filings opposing the Bell Atlantic petition. For instance, the WorldCom Comments note, "It is more than a little ironic that the RBOCs seek to remove data services from the very same price cap regime that the RBOCs have fought for so hard over the years" (p. 8, footnote 15). Yet it is

[1] That is, granting Bell Atlantic's petition would allow the company to provide services it is not now providing. Some of the services, such as internet backbone transport services, are currently provided by several other firms in the marketplace. Others products, such as high-speed, packet-switched, local internet access lines, are provided on a more limited basis.

hardly ironic when two distinct sets of services are being regulated: POTS and advanced telecommunications services. The former is an established and well-defined product, where price caps yield a reward for progressively lowering the cost of service. For all the real-world complexities involved here, regulators have a fighting chance to improve price/quality offerings to consumers because they can observe the historical pattern of service, demand, and pricing. New services, however, are yet to be introduced (by definition) and regulators have none of the necessary data with which to set realistic prices which cap profits without simultaneously lowering the incentive to innovate. Note that product innovation may *raise* nominal prices -- yet benefit consumers by quality enhancements which are more than offsetting. The threat that the regulator will set a price that does not fully reflect the risks involved in developing, experimenting, and rolling out such a new service line will impinge on investment plans in a manner that is fundamentally different from a price cap which allows the service provider to steadily improve existing products and technologies. (Note that price regulation uncertainty creates nothing but downside risk for the investor in advanced telecommunications services, as setting an overly generous rate will not guarantee a high price.)

5. Subjecting new services to price caps has resulted in dramatic disincentives to develop or upgrade services, as the Commission has learned the hard way in the cable television market. There, the Commission initially took the view expressed by opponents of 706 relief, namely that new services would not be deterred if price regulation merely allowed the service supplier an appropriate rate of return. Pursuant to the 1992 Cable Act, the FCC enacted rate rules in February 1994 which permitted cable TV systems to add new program channels to basic packages so long as they increased customer bills by just the (input or wholesale) cost of the new channel plus a profit mark-up of 7.5%. A channel which cost the cable system 14 cents per subscriber per month could be added, but the customer's bill could only be raised 15 cents. (As an alternative, cable systems were allowed to file for cost-of-service regulations which permitted an 11.25% profit.) The system proved disastrous, decimating demand by cable operators for new programming. At the behest of numerous satellite networks, the Commission quickly reversed its attempt to tightly regulate new services by instituting far more generous "going forward" rules in November 1994 and even greater liberalization in the months that followed. Despite the theoretical implication that carefully enacted price caps on new services would effectively squeeze pricing power in monopolized local cable TV markets, the incentive effects deterred quality enhancements to such a degree that consumers were hurt by the "safeguard." As the NEW YORK TIMES described the measure to ease price caps on new programming in November 1994:

> The FCC giveth and the FCC taketh away. Having ordered cable television companies in February to cut their rates by 17 percent, the Federal Communications Commission today offset that action by giving the companies the right to raise prices when they add new channels...
>
> For weeks, senior agency officials have struggled to reconcile two somewhat incompatible goals. They wanted to preserve the billion-dollar rate reductions they imposed earlier this year. But they also sought to encourage new

programming services and investment in more sophisticated networks by cable operators.[2]

6. While much of the local exchange market has proven more amenable to rate regulation than has cable television, using regulatory forbearance to encourage "advanced telecommunications services" has a great deal in common with the decision by the FCC to relax price controls to "encourage new programming services and investment in more sophisticated networks by cable operators" in cable television. It is important to recall that binding cable rate controls were, by the FCC's analysis, essentially eliminated by mid-1995.[3] That was a product of the fact that the Commission gave up trying to deduce the "optimal" price cap for new services; whatever price was set ran the risk of stifling product upgrades.

7. The cable rate regulation episode is but a specific, if recent and relatively important, instance of the long-standing realization that setting regulatory pricing constraints on existing products and technologies is a markedly different task than that required to entice risk-taking investors to bring forth innovative products. This is not difficult to see, for the nature of price caps or rate-of-return regulation is to limit upside profit potential. Where investors have already gained confidence in the ability of a given business to generate a regulated rate of return, that regulated rate (provided it is not below the opportunity cost of capital) will not likely deprive customers of demanded services. But where the regulated services are yet to be created and must be discovered out of a process of trial-and-error, investors rationally choose to invest far less when upside potential is truncated by law. Hence, the real irony of continuing to impose strict price regulations or blanket entry restrictions for advanced telecommunications services is that consumers end up "protected" by being denied the opportunity -- the choice -- to access to services which may prove far more valuable in meeting their needs than the regulated (or unregulated) alternatives currently available.

8. Hence, when MCI argues against Bell Atlantic's petition "because it would permit Bell Atlantic to engage in above-cost pricing that is neither a reasonable nor protective of consumers" (p. 20), it reveals a starkly anti-competitive bias. The key question for consumers is not whether Bell Atlantic, MCI, or any other company engages in "above-cost pricing," but whether there are opportunities for lower prices and/or higher quality services which better regulatory rules would permit them to enjoy. By focusing on the profits earned by firms offering innovations to customers, those opposing regulatory forbearance reveal a tendency to ignore consumer interests in favor of a false standard of regulatory cleanliness crafted in an idealized world of static certainty. In a dynamic marketplace, firms which bring new ideas successfully to market are routinely rewarded with "above-cost pricing" even as consumers enjoy progressively declining costs -- and higher quality products -- as a direct result of the process which entices firms to claim such rewards.

---

[2] Edmund Andrews, *F.C.C. Approves New Rate Rises for Cable TV* (NEW YORK TIMES, Nov. 11, 1994, C1).

[3] See: Thomas W. Hazlett and Matthew L. Spitzer, Public Policy Toward Cable Television: The Economics of Rate Controls (MIT Press, 1997; 150-1).

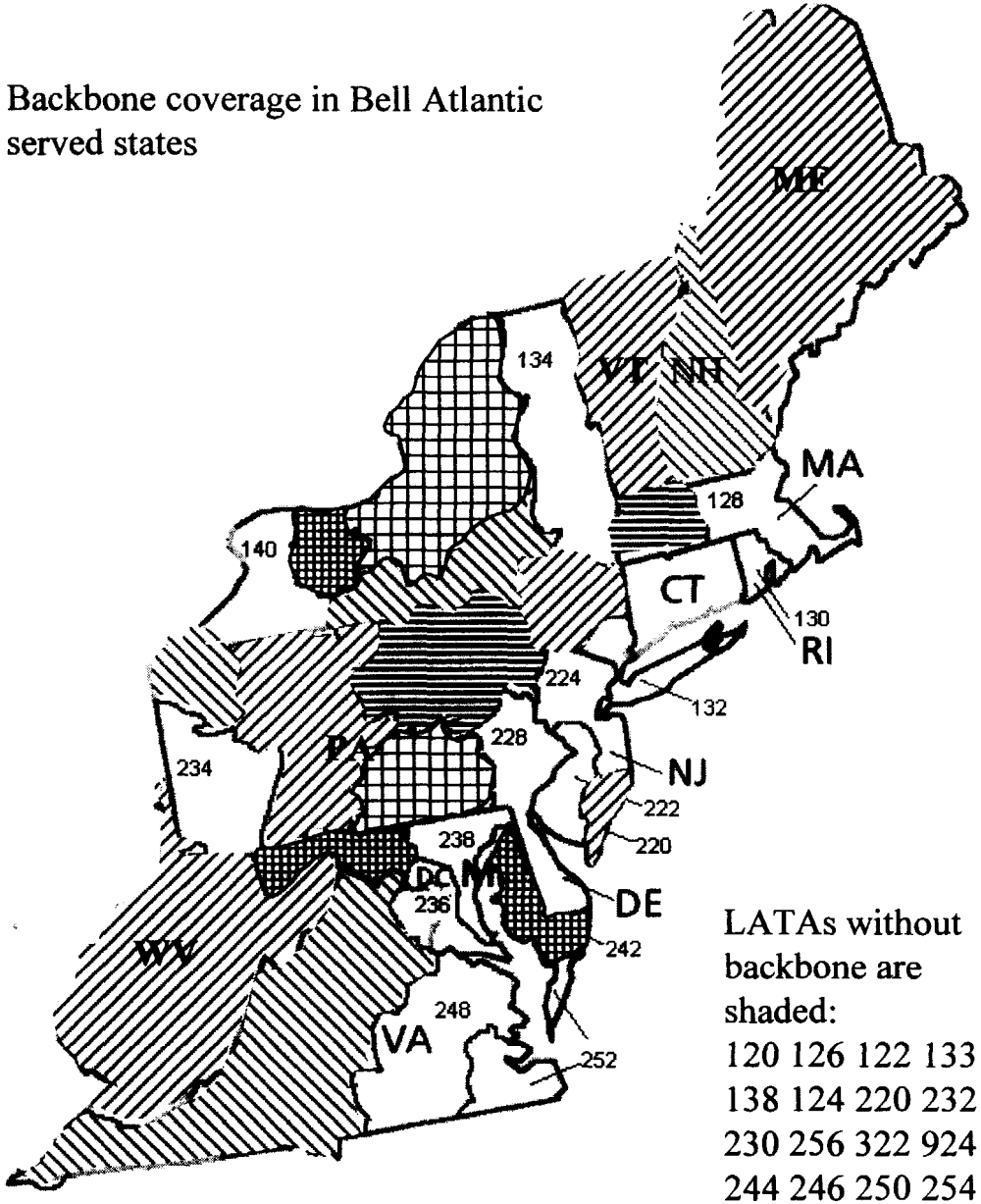
I declare under penalty of perjury that the foregoing is true and correct to the best of my knowledge.

Thomas W. Hazlett, Ph.D.

B

US OFFICE PRODUCTS

Backbone coverage in Bell Atlantic served states



LATAs without backbone are shaded:
120 126 122 133
138 124 220 232
230 256 322 924
244 246 250 254
927 928 929 932
951 956 921

LATAs with just one backbone are crosshatched: 136 974 240 242 226

City	State	Population	dist to backbone	nearest backbone	In state
Springfield city	MA	149948	82	Albany	NY
Erie city	PA	105270	75	Cleveland	OH
Manchester city	NH	100967	50	Boston	MA
Roanoke	VA	96600	105	Richmond	VA
Scranton	PA	76500	100	Philadelphia	PA
Lynchburg	VA	66600	75	Richmond	VA
Utica	NY	62300	60	Albany	NY
Portland	ME	61700	100	Boston	MA
Charleston	WV	56000	110	Columbus	OH
Huntington	WV	53200	100	Columbus	OH
Altoona	PA	52400	80	Pittsburgh	PA
Burlington	VT	50000	110	Albany	NY
Wilkes-Barre	PA	62478	80	Harrisburg	PA
Williamsport	PA	48935	70	Harrisburg	PA
Hazelton	PA	28866	65	Harrisburg	PA
Cumberland	MD	32792	55	Harrisburg	PA
Atlantic City	NJ	74449	55	Pennsauken	NJ
Harrisonburg	VA	34625	90	Richmond	VA
Charlottesville	VA	40941	50	Richmond	VA
Roanoke-Christians	VA	169741	75	Winston-Salem	NC
Bluefield-Princeton	WV	21442	75	Winston-Salem	NC
Clarksburg-Bridgep	WV	27635	70	Pittsburgh	PA
Beckley	WV	25160	105	Winston-Salem	NC
Parkersburg	WV	36654	100	Columbus	OH
Morgantown-Fairmo	WV	51361	50	Pittsburgh	PA
Jamestown	NY	39556	60	Buffalo	NY
Elmira-Corning	NY	64576	70	Syracuse	NY
Watertown	NY	34381	60	Syracuse	NY
Binghamton-Endicot	NY	94469	70	Syracuse	NY
Plattsburg	NY	24197	110	Albany	NY
Rutland	VT	21178	90	Albany	NY
Montpelier-Barre	VT	19893	100	Albany	NY
Lebanon-Hanover	NH	20281	100	Albany	NY
Concord	NH	36006	50	Boston	MA
Rochester	NH	26630	65	Boston	MA
Portsmouth	NH	25925	50	Boston	MA
Dover	NH	25042	60	Boston	MA
Bangor-Orono	ME	52780	190	Boston	MA
Waterville-Winslow	ME	28913	160	Boston	MA
Augusta	ME	24459	130	Boston	MA
Auburn-Lewiston	ME	64066	110	Boston	MA
Brunswick-Bath	ME	32458	85	Boston	MA
Saco-Biddeford	ME	35891	70	Boston	MA
Presqu-Isle-Caribou	ME	22915	400	Boston	MA

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