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FEDERAL COMMUNICATIONS COMMISSION
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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Inquiry Concerning the Deployment of	)	CC Docket No. 98-146
Advanced Telecommunications	)	
Capability to All Americans in a Reasonable	)	
And Timely Fashion, and Possible Steps	)	
To Accelerate Such Deployment	)	
Pursuant to Section 706 of the	)	
Telecommunications Act of 1996	)	

COMMENTS OF AMERITECH

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Dated: September 14, 1998

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COMMENTS OF AMERITECH

I. INTRODUCTION AND SUMMARY.

Ameritech submits these comments in response to the Commission's Notice of Inquiry in this proceeding.[1] For the reasons stated below, Ameritech believes that existing regulation is preventing reasonable and timely deployment of advanced telecommunications capability. To solve this problem, the Commission should adopt a "procompetitive, de-regulatory" approach to all advanced capability -- even that which is deployed by incumbent LECs. The presumption should be that traditional regulation is neither needed nor desirable in connection with the deployment of advanced telecommunications capability. Rather, as Congress envisioned, free

[1] *In the Matter of Inquiry Concerning the Deployment of Advanced Telecommunications Capability to All Americans in a Reasonable And Timely Fashion, and Possible Steps To Accelerate Such Deployment Pursuant to Section 706 of the Telecommunications Act of 1996*, CC Docket No. 98-146, Notice of Inquiry, FCC 98-187 (released August 7, 1998) ("NOI").

markets -- not regulation -- provide the best means to ensure deployment of new, advanced services.

A. Statutory Background.

In §706(a) of the Telecommunications Act of 1996 ("the Act"), Congress directed that this Commission "shall encourage the deployment on a reasonable and timely basis of advanced telecommunications capability to all Americans. . . by utilizing. . . regulatory forbearance. . . or other regulatory methods that remove barriers to infrastructure investment." In §706(b) of the Act, Congress directed the Commission to conduct regular inquiries to determine whether advanced telecommunications capability is being deployed "on a reasonable and timely basis." If the Commission determines that such deployment is not occurring, Congress specified that the Commission "shall take immediate action. . . by removing barriers to infrastructure investment and by promoting competition in the telecommunications market."

These specific directives in §706 are intended to implement the overall Congressional goal "to establish a national policy framework designed to accelerate rapidly the private sector deployment of advanced telecommunications."[2] To achieve this goal, Congress has directed the Commission to change regulation -- specifically to utilize deregulation -- by "utilizing . . . regulatory forbearance . . . or other regulating methods that remove barriers to infrastructure investment" if it determines that advanced deployment is not reasonable and timely. Such deployment has not occurred, and the Commission should take the required statutory de-regulatory actions.

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[2] See S. Rep. 104-23 at 27, March 30, 1995. See also, the Joint Explanatory Statement of the Committee of Conference articulating the purpose of the Act: "to provide for a procompetitive, de-regulatory national policy framework designed to accelerate rapidly private sector deployment of advanced telecommunications and information technologies and services to all Americans. . ."

B. Regulatory Proceedings to Date.

Consistent with this statutory mandate, the Commission has expressed its intent "to rely as much as possible on free markets and private enterprise to deploy advanced services. . ."[3] On the other hand, in conflict with the spirit of §706, the Commission has also ominously hinted that it believes that regulatory intervention might be necessary "to promote the availability of telecommunications services generally and advanced services in particular to specific segments of the population. . ."[4] However, Congress prescribed "a procompetitive, de-regulatory national policy. . ." Thus, as Congress envisioned, deregulation -- nor more regulation -- will promote the development and proliferation of advanced telecommunications capability. In fact, regulation in this area has produced results that are exactly the opposite of those envisioned by Congress.

Indeed, regulation -- not the alleged harms of free market incentives -- has created the principal impediments to the achievement of the goals of §706. This was demonstrated in petitions filed by Ameritech, Bell Atlantic, US West, the Southwestern Bell Telephone Companies ("SBC"), and the Alliance for Public Technology ("APT") asking the Commission to implement various deregulatory initiatives under the auspices of §706 to remove barriers to infrastructure investment.[5] For example, Ameritech's 706 petition, describes how current aspects of the regulatory environment discourage investment by BOCs in advanced telecommunications capability. Specifically, the §271 interLATA restrictions and the stringent separate subsidiary

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[3] NOI at ¶5.

[4] *Id.*

[5] In addition, the Association for Local Telecommunications Services ("ALTS") filed a petition for declaratory ruling asking the Commission to clarify that the obligations of §§251, 252, and 271 of the Act apply fully to digital and broadband services and facilities.

requirements of §272 preclude deployment of advanced telecommunications capability in an economically efficient manner. In addition, §251(c)'s unbundling and resale obligations together with dominant carrier price regulation also constitute significant roadblocks to the efficient deployment of advanced telecommunications capability by incumbent local exchange carriers ("ILECs") generally.

The Commission recently rejected those petitions, but initiated a rulemaking proceeding.[6] In the 706 Order, the Commission seeks comment on criteria under §251(d)(2) applicable to the unbundling of network elements used to provide advanced services, on whether to revise its rules on collocation and sub-loop unbundling, on whether limited LATA boundary modifications in connection with BOC provision of advanced services should be available, and on its tentative conclusion that ILEC separate affiliates providing advanced services should be free from ILEC regulation.

In this NOI, the Commission, as required by §706, takes a broader focus by inquiring into the status of advanced telecommunications capability deployment in all market sectors and by seeking comment on the types of actions it should take -- if it determines that advanced telecommunications capability is not being deployed in a reasonable and timely fashion. Therefore, unlike the 706 Order that is looking at existing inputs used by competitors to deploy advanced telecommunications capability, this NOI is addressing the bigger picture. Is advanced capability being deployed on a reasonable and timely basis, and if not, why not? And, if the reason these capabilities are not being deployed on a reasonable and timely basis is regulation, the Commission must remove the barriers such regulation create.

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[6] *In the Matters of Deployment of Wireline Services Offering Advanced Telecommunications Capability, etc.*, CC Docket Nos. 98-147, et al., Memorandum Opinion and Order and Notice of Proposed Rulemaking, FCC 98-188 (released August 7, 1998) ("706 Order").

C. A De-Regulatory Policy is Needed.

In these comments, Ameritech shows that, although variations of advanced telecommunications capability are being deployed in certain sectors of the marketplace, regulatory distortions prevent this deployment from occurring "on a reasonable and timely basis" as required by the Act. The current regulatory environment -- in particular §§251(c) and 271 --prevent new investment in needed infrastructure so that advanced telecommunications capability can be deployed in an economically efficient manner, i.e., according to priorities that would be established in an open, procompetitive market system. In short, existing regulatory restrictions and requirements hinder the market's ability to direct the allocation of advanced infrastructure in a manner that society values most and as Congress required in §706.

To remedy the situation, the Commission should forbear and deregulate the provision of advanced telecommunications capability in whatever form and by whatever provider. Section 251(c) unbundling and resale requirements, as well as "new service" pricing regulation and LATA restrictions, should not be applied to the deployment of advanced telecommunications capabilities. Any related structural separation requirement should be regarded as, at most, a transition mechanism. Because other vehicles exist for the deployment of advanced telecommunications capability, ILECs cannot reasonably be viewed as being a "bottleneck" or as having an "essential facility" for new, yet to be deployed advanced telecommunications capability. Thus, there is no overriding statutory, legal or public policy reason for imposing legacy-type regulation on the new deployment of advanced telecommunications capability by incumbent LEC's or by any other provider of such capability. Instead, the market should be permitted to work -- to direct the allocation of resources consistent with the express provisions of §706 and well-established

consumer values and open market principles.[7]

II. ADVANCED TELECOMMUNICATIONS SERVICES ARE NOT BEING DEPLOYED ON A REASONABLE AND TIMELY BASIS TO ALL AMERICANS.

No doubt, there are several providers of advanced telecommunications services in the United States today. The Commission has noted the capabilities of xDSL technology, cable modems, high bandwidth terrestrial wireless systems, satellite systems, broadcast, and other vehicles for advanced telecommunications capability.[8] However, all would agree that those services have not been deployed as ubiquitously as Congress expected. Deployment is limited to certain geographic areas and certain types of customers. By way of example, Ameritech submits Attachment B a set of letters of businesses, and governmental entities, and educational institutions that were filed in support of Ameritech's 706 petition. They document the lack of availability of high speed services or of adequate competition in the provision of those services in the upper Midwest.

Advanced data services that do not use ILEC loops, such as private data networks, are available from several providers. Indeed, contrary to the conclusion of some parties in this proceeding, ILECs are neither the dominant -- or even a significant -- providers of these services. Rather, a handful of non-ILEC entities -- specifically the MCI/WorldCom conglomeration -- are

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[7] Consider the introduction of video "players" in the late 1970's and early 1980's. VCRs cost about $1,000 with tapes of movies running about $70 - $80. RCA introduced its video disk player ("VDP") at a price of $500 with movie disks going for $25. There was no regulatory intervention either to force lower VCR prices or to favor VDPs as being in the consumer interest. The market, operating on its own, favored VCRs, despite the initial price, because of their flexibility; and, as demand grew, prices quickly dropped and a booming video rental market developed. RCA lost hundreds of millions of dollars, but the market demonstrated that society valued the flexibility of the VCR more than the temporary price differential that VDPs offered, and "efficiencies" were realized when video rental operations sprang up to solve the "problem" of high priced video tapes.

[8] NOI at ¶¶20, 39, 43, 45, 47, 48-52. The inclusion of these technologies and systems in the scope of advanced telecommunications capability is not, of course, determinative of whether they are Title II telecommunications services.

dominant providers.

Advanced telecommunications services that require local loop access have also not been ubiquitously deployed. Although the Commission's 706 pronouncements focus almost exclusively on traditional ILEC loops. ILEC provided loops are neither the only nor the best method of access to the local loop to provide advanced telecommunications services. The principal technology on which the Commission seems to be focused -- xDSL loop technology has significant technological limitations. That technology cannot work at all for loops that are more than 18 kilofeet from an ILEC central office[9] and requires expensive conditioning or network redesign in may other cases.[10]

Thus, ILEC-supplied loop access should not be the sole -- or even a significant -- hope for ubiquitous advanced telecommunications service deployment. Indeed, as the Commission's NOI notes, other loop access sources, including cable and wireless loops, are also key sources of "last mile" access.[11]

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[9] Ameritech estimates that over 20% of its loops are greater than 18 kilofeet from a central office.

[10] Ameritech estimates that another 25% of loops fall into these categories.

[11] See note 8, *supra*. See also comments of representatives of Winstar, Teledesic, NEXTLINK, and others at the Commission's July 9, 1998, en banc hearing on bandwidth issues. Cox has announced aggressive plans for providing such services using cable modems. See, Cox's website (www.cox.com) where Cox notes that its Cox@Home residential data service has been launched in 7 markets with 1.8 million passed homes and, as of June 30, already had more than 34,000 customers.

III. REGULATORY BARRIERS ARE A PRINCIPAL REASON ADVANCED TELECOMMUNICATIONS SERVICES ARE NOT MORE WIDELY AVAILABLE.

As the attached economic analysis by Dr. Francis X. Pampush[12] demonstrates, contrary to the goals of Congress, the current regulatory environment ensures that advanced telecommunications capability deployment is not occurring either in a reasonable or in a timely manner. It is not "reasonable" because legacy regulation has distorted the incentives facing both ILECs and other providers, directly impeding the offering of advanced telecommunications capability to all Americans. Neither is the deployment timely -- i.e., economically efficient in a dynamic sense. Rather, the timing of deployment is also skewed by regulation which either encourages one segment of the industry/technology or hinders another. Instead, "reasonable" and "timely" deployment must be completely consistent with an open market system, consumer sovereignty, and the economic efficiency that results in firms' ability to freely respond to those stimuli.

Advanced data services that do not use local loop access are not as widely available on a reasonable and timely basis because regulatory restrictions prohibit full competition for those services. As a result, the market for such services is controlled by one or two dominant providers. Unlike the market for voice long distance services which was a monopoly that is transitioning to competition, the advanced data service (non-loop) market segment was a non-existent market which regulation caused to become concentrated because it prohibited qualified providers from entering. Specifically, some ILECs, the RBOCs, are prohibited from providing the interLATA

[12] "Economic Analysis of the Federal Communications Commission's Notice of Inquire on Advanced Telecommunications Capability" by Dr. Francis X. Pampush, September 14, 1998 ("Pampush Analysis"), included as Attachment A.

facilities or capabilities that are key components of such services.

Not only do the concentration levels of this market indicate a lack of full competition, it is also compelling evidence that many customers would like to choose providers, like Ameritech, that are regulatorily-prohibited from offering these advanced telecommunications services.[13]

Regulation is also inhibiting the development and proliferation of advanced telecommunications services that require local loop access. First, by focusing regulation on ILEC-provided traditional loops, the Commission is creating economics that will hamper the development of non-ILEC, nontraditional loop technologies. Second, the regulatory regime the Commission applies to ILEC-provided loops and services disincents not only investment by other providers, but also disincents ILEC investment in upgrading facilities to provide such access.

Two principal aspects of current regulation that inhibit the development and proliferation of non-ILEC, nontraditional loop technology are: (1) ILEC unbundling and resale obligations, and (2) misclassification of Internet traffic as local traffic so that ILECs must pay reciprocal compensation on such traffic.[14]

It is fundamental economics that, if one service is artificially priced lower than substitute services, substitute services will not be sufficiently available, if at all, in the marketplace. Exactly the same thing has happened with advanced data services that use loop access. Because unbundling and resale regulations create pricing for ILEC-provided loops that other competing "loop" technologies cannot match, those competing technologies are inhibited. This is exactly why facilities-based providers such as ALTS are arguing in the Supreme Court that these

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[13] See Attachment B.

[14] Ameritech urges the Commission to correct this situation by clarifying that dial-up access to the Internet constitutes interLATA traffic to the extent out-of-state database access or communication takes place.

requirements create a price structure against which facilities-based providers cannot compete.

Similarly, misclassification of Internet traffic as local to require ILECs to pay reciprocal compensation also creates market disincentive to non-ILEC loop technologies. Because state commissions have improperly classified Internet access as local traffic, both CLECs and ISPs have been disincented both from using non-ILEC loops or technologies and from providing their own alternative originating loop technologies, such as packet-switched technologies, which are more efficient for high-speed data services. This is because, if CLECs and ISPs choose such alternatives, they will lose their claim to huge amounts of such reciprocal compensation and, if they provide the originating loop, would subject themselves to the uneconomic payment of such compensation.

These regulations also disincent ILEC investment in loop technologies for the same reasons. As to the unbundling and resale requirement, perhaps former FCC Common Carrier Bureau Chief Kathy Wallman said it best:

> Do we really mean to say that any carrier that is thinking of building a new broadband network should count on being able to recover, from day one of operation, only the forward looking costs of their brand new network? I don't think so. No rational, efficient firm would take that deal. And that would be our collective loss, not just theirs.[15]

The reciprocal compensation issue only furthers exacerbates the problem: why would an ILEC -- or any other economically rational entity invest in developing new technologies as upgrading existing loop facilities for advanced data services if doing so causes the ILEC to pay out more in reciprocal compensation and other costs than it receives for the service? The answer is obvious.

Similarly, regulations that limit pricing of any ILEC-advanced services will not only

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[15] Remarks of Kathleen Wallman to the Annual Convention of the National Association of Regulatory Utility Commissioners, Boston, MA, November 11, 1997 (emphasis is original).

discourage their deployment by ILECs, but also -- to the extent that the price is suppressed below market levels -- discourage the introduction of offering of competitors who will find it difficult to beat the price.

Also, as noted in the 706 petitions, the interLATA restriction on BOC provision of advanced telecommunications capability effectively removes significant potential providers from the innovation and deployment process.

In short, regulation has a significant and disruptive effect on the market. For example, Ameritech's own plans are, for the most part, to deploy only certain limited advanced telecommunications capability applications through vehicles favored with lighter regulation. Specifically, Ameritech has made plans to deploy ADSL technology through an advanced telecommunications capability affiliate of the kind discussed in the Commission's 706 Order. Certainly, the ability to avoid unnecessary §251(c) obligations with respect to advanced telecommunications capability as well as realizing the benefits of non-dominant carrier regulation strongly favor the choice of this vehicle to deploy advanced telecommunications capability (as opposed to a broader deployment through Ameritech's LEC operations).[16]

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[16] That is not to say that Ameritech advocates a separate subsidiary requirement for the deployment of advanced telecommunications capability as either an optimal or a long-term solution. It does not. Ameritech proposed a separate subsidiary of the type established by the Commission in the Fifth Report and Order in its Competitive Carrier Proceeding largely as an expedient rather than as the economic ideal. Under Ameritech's proposal, offering advanced telecommunications capability through such a separate subsidiary would provide more than sufficient justification for the Commission to exempt that subsidiary from §251 and §271 requirements. On the other hand, the Commission has proposed much more stringent requirements including a degree of separateness which would preclude LECs from taking advantage of legitimate efficiencies and economies of scope in the deployment of advanced telecommunications capability. As the attached Pampush Analysis shows, there are inefficiencies associated with the imposition of separate subsidiary requirements. The Commission itself recognized such inefficiencies in its Computer III proceeding when it eliminated the previously-required CI-II fully separate subsidiary to remove a disincentives to BOC deployment of enhanced services. *See, In the Matter of Third Computer Inquiry,* CC Docket No. 85-229, Report and Order, FCC 86-252, 104 FCC 2d 958 (released June 16, 1986) at ¶¶79-81, 89-99.

IV. THE COMMISSION MUST REMOVE REGULATORY BARRIERS TO THE DEPLOYMENT OF ADVANCED TELECOMMUNICATIONS SERVICES.

Because the evidence demonstrates that (1) advanced telecommunications services are not being deployed in a reasonable and timely manner to all Americans, and (2) that regulation is a key reason for that non-deployment, §706 requires the Commission to remove those regulatory barriers.

As the Pampush Analysis notes, the best approach to the regulation of advanced telecommunications capability is a hands-off approach -- procompetitive and de-regulatory. The presumption should be that the deployment of new advanced capabilities should be permitted on an open market basis to encourage competing forms of deployment. The Commission's goal, therefore, should be, within statutory limits, through legitimate statutory interpretation and/or permissible forbearance, to minimize direct regulation of advanced telecommunications capability and, since §706 applies to the states as well, to encourage the states to do the same.

The Commission should, forbear from common carrier regulation of advanced telecommunications capability. The Commission should also eliminate artificial pricing restrictions which encourage reliance on ILEC facilities (which ironically discourage ILEC investment) and disincent alternative deployment by others. And the Commission should act quickly and reasonably on BOC §271 petitions to hasten the removal of the uneconomic LATA constraints on BOC deployment of advanced telecommunications capability.

First, consistent with §251(d)(2), the Commission should refuse to require the unbundling of advanced telecommunications capability by ILECs. Section 251(d)(2) requires the Commission in determining what network elements should be made available pursuant to §251(c)(3) to determine whether failure to provide access to such network element would impair other

competitors from offering services. To the extent the Commission evaluates whether advanced telecommunications investment, such as DSLAMs or other new infrastructure investment, should be considered a network element, it should not require access pursuant to §251(c)(3). Clearly, alternative advanced telecommunications capability mechanisms exist, and are being deployed by non-incumbents. Unbundling of any new similar investment made by an incumbent is neither "necessary" nor would the failure to unbundle unreasonably impair the requester's ability to provide services using such new investment. Accordingly, because of Congress' interest in a market-driven deployment of advanced telecommunications capability, and because of the demonstrated existence of competitive alternatives to such capability, the Commission can and should find that is not necessary to require unbundling of an incumbents advanced capability. This is especially appropriate since an unbundling requirement would actively discourage the deployment of these alternatives as required by §706.

As the Pampush Analysis points out, if unbundling requirements are applied to ILEC provision of advanced telecommunications capability, ILECs would be disincented from innovating or deploying that capability. That is especially true if unbundled capability is required to be made available at rates capped by regulators. In this context, there would be absolutely no incentive for ILECs to engage in the economic risk associated with the development and deployment of new technologies.

Similarly, mandatory resale of advanced telecommunications services would discourage innovation by ILECs because it would deprive them of the opportunity to offer unique services. The ability to compete in the marketplace through the offering of unique services that are not available elsewhere is one stimulus to innovation. Where that opportunity is foreclosed, that incentive is lost.

Further, the Commission should refrain from regulating rates for advanced services. Requiring that rates for advanced telecommunications services be capped by what regulators deem to be reasonable itself constitutes another disincentive to innovation. The innovative process is a risky one and for every success there are many failures. In order to reward innovation, potential earnings must be sufficient to compensate for the potential losses of failed attempts. If ILEC returns for advanced services are not permitted to be sufficiently high to compensate for the innovative process itself, no innovation will take place. In other words, it will be hard to justify the risk of shareholder investment in the innovative process if returns are not sufficient to compensate for unsuccessful attempts.

In addition, application of the interLATA restriction to BOC provision of advanced telecommunications capability and services denies BOCs the ability to offer innovative service customers want (customers pay no attention to LATA boundaries in fashioning their needs for advanced telecommunications services) and from deploying advanced telecommunications capability in the most efficient manner.

In response to the Commission's inquiry concerning the relationship between §706 and universal service,[17] it is clear that advanced telecommunications capability and advanced services generally must <u>not</u> be considered universal service. Certainly, the language of §254 itself virtually precludes the linkage. Specifically, §254(c)(1) contemplates that the evolving definition of universal service should include only those such telecommunications services which:

> have, through the operation of market choices by customers, been subscribed to by a substantial majority of residential customers.

Thus, advanced telecommunications capability and advanced services should not be considered

[17] NOI at ¶73.

part of universal service, at a minimum, until the market has operated to effect such widespread deployment that they cease to be "advanced" and instead becomes "conventional." This is as it should be. Certainly, including any aspects of advanced telecommunications capability or advanced services in the definition of universal service supported by federal mechanisms prior to that time would, as discussed above, simply result in the deployment of advanced telecommunications capability in a way other than the market might have directed. The text of §254(c)(1) clearly indicates Congress' intent that that should not happen.

Finally, artificial unbundling, resale, and pricing restrictions will actively discourage potential competing providers of advanced telecommunications capability from developing that capability in a way that does not rely on ILECs. If ILEC advanced telecommunications capability is available on an unbundled basis and if ILEC advanced telecommunications services are available at below market rates, there is significant disincentive for competing providers to devote their energies to coming up with a "better" alternative.

Not only has existing regulation impeded investment in new advanced infrastructure, as described above; it has done so without any legal or public policy justification. As the Pampush Analysis points out, there is no need for legacy-type regulation of even ILEC-provided advanced telecommunications capability. The "essential facilities" paradigm extant in the world of conventional telecommunications has no place in the advanced telecommunications capability context. The Commission itself has recognized that advanced telecommunications capability mechanisms are not part of embedded ILEC facilities. Neither cable modems nor any of the high bandwidth spectrum-based vehicles needs the ILEC loop or POTS backbone. On the other hand, in each of these situations, competitive access to the incumbent's new advanced infrastructure investment is neither necessary or reasonably. Thus, ILECs have no "bottleneck" in new

infrastructure investment, and should not be regulated as if they do.

V. CONCLUSION.

In order for the deployment of advanced telecommunications capability to be "reasonable and timely" as required by the Act, the market must be permitted to drive the process so that deployment is effected in an economically efficient manner consistent with marketplace values.

However, advanced telecommunications services are not being deployed on a reasonable and timely basis to all Americans. Regulatory barriers are a principal reason these services are not more widely available. Regulation distorts and hinders that deployment. Unbundling and resale requirements, "new service" pricing regulations and interLATA restrictions on LEC provision of advanced telecommunications capability only skew deployment of advanced telecommunications capability in a way that ironically encourages reliance on ILEC facilities at the same time that it discourages the investment in and the deployment of those facilities. Alternative facilities-based deployment of advanced telecommunications capability is also discouraged.

Since ILECs have no bottleneck or essential facility relevant to the deployment of advanced telecommunications capability there is no need for traditional ILEC regulation. Instead, the Commission must remove regulatory barriers and adopt a procompetitive, de-regulatory policy with respect to the deployment of advanced telecommunications capability in whatever form and by any provider, including incumbent LECs.

It is only in this way that the market can work to drive the allocation of resources to spur innovation so that deployment of advanced telecommunications capability will occur in an economically efficient manner consistent with societal values -- i.e., "on a reasonable and timely basis" as required by the statute. Free markets -- not regulation -- provide the best means to ensure deployment of new, advanced services.

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Attachment A

ATTACHMENT A

ECONOMIC ANALYSIS OF THE FCC'S NOI ON ADVANCED TELECOMMUNICATIONS CAPABILITIES

Frank Pampush, PhD, CFA

September 14, 1998

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1. INTRODUCTION

The FCC's 706 Notice of Inquiry (CC Docket 98-146) (NOI) seeks to address "deployment on a reasonable and timely basis of advanced telecommunications capability (ATC) to all Americans."[1] At paragraph of 8 of the NOI, the Commission seeks to determine "who is able and motivated to deploy advanced telecommunications services (ATS) soon, especially to residential customers." As such, the NOI looks toward a "longer-term" future and seeks to determine the changes in rules that would be necessary to obtain the desirable outcomes.

The purpose of this analysis is to address the economics of some of the policy issues and questions that are posed in the NOI. In particular, this analysis addresses issues related to three key areas: (1) definitions of "reasonable" and "timely" as contemplated by §706 of the Telecommunications Act of 1996; (2) incentives, opportunities, and constraints toward the deployment of ATC by incumbent local exchange companies (ILECs) and by new entrants such as interexchange carriers, cable MSOs, competitive LECs and others; and (3) consistency of current policies and policy models toward ATC/ATS with open markets and a need for innovation. The main conclusions are:

- "Reasonable deployment" should be viewed as meaning that deployment is consistent with an open market system and consumer sovereignty. At this time ATC deployment is not reasonable (optimal) because legacy regulation has distorted the incentives facing both ILECs and new entrants and also directly impedes the offering of ATS to all Americans.
- "Timely deployment" should be viewed as meaning that deployment is economically efficient in a dynamic sense. Timely deployment thereby precludes either force-feeding the ATC market or hindering the rollout of ATC by any party, including ILECs. ATC deployment is not timely because legacy regulation hampers its implementation.
- Incentives and opportunities for ILECs to offer ATC/ATS to all Americans are damaged or limited by (1) unbundling and resale requirements (especially at mandated rates or discounts) that limit profitability and the ability to offer innovative services; (2) federal new-service pricing rules that impose cost-plus pricing on new services that distorts the risk/return relationship that is critical to innovation; (3) interLATA restrictions that reduce the usefulness of advanced services provided by ILECs and which serve to prevent competition from developing in the ATC/ATS marketplace; (4) mandated structural separations that reduce the opportunity to reasonable scale and scope economies; and (5) retail rate imbalances that favor conventional hookups to the Internet and data services (for mass market customers) over advanced telecom capabilities.
- Incentives and opportunities for new entrants in the ATC world are affected by legacy regulation, which is manifested as "dynamic delay" (i.e. keeping their powder dry) in their offerings to residences.

[1] NOI at paragraph 6 and footnote 1.

- Current regulatory models are not consistent with the emerging structure of ATC. Neither the telephone nor the broadcast paradigm as codified in Titles II and III is adequate for addressing the issues of ATC and ATS. The best regulatory model at this time may be to eliminate the regulatory distortions in the conventional telecom marketplace (e.g. narrowband, voice, circuit switched telephony); leave to entrepreneurship the development of the ATC/ATS marketplace; and institute a transition plan to reduce and rescope FCC oversight.

2. DEFINITIONS OF "REASONABLE" AND "TIMELY"

In Section 706 of the Act, Congress directed the FCC and state public service commissions to make regulatory changes necessary to encourage the "reasonable and timely" deployment of ATC. At paragraph 59 of the NOI, the Commission asks how these terms might be used to determine whether ATC deployment is, in fact, reasonable and timely and therefore whether regulatory changes must be made. The Commission further asks whether time-specific schedules or set objectives are needed to meet the goals. The definitions of "reasonable" and "timely" that are provided here can provide a foundation for ATC policy. According to these definitions, neither pro-active time-specific schedules nor set objectives are needed for the reasonable and timely deployment of ATC. Instead, removal of regulations in the conventional telecommunications world is needed to incent optimal deployment of ATC.

Implementing workable definitions of "reasonable" and "timely" should recognize that there are alternative claims on society's resources and that these claims should be mediated in a way that promotes social welfare. Accordingly, both terms should be grounded in the concept of economic efficiency. The term "reasonable" would be connected with the amount and mix of ATC, while the term "timely" would be connected with the timing of the ATC deployment.

Whether the amount and mix of advanced telecommunications capabilities are reasonable or not depends on whether the resources so dedicated reflect the social desires for the use of those resources in an alternative capacity. A reasonable amount and mix of ATC would satisfy consumer desires, consistent with willingness to pay. Technically (and somewhat ideally), this condition is satisfied when the tradeoffs, at the margin, that consumers face are equalized and also equal the tradeoffs in production. From a policy viewpoint, this means that prices generated by the free market are likely to ensure that a reasonable amount and mix of ATC is produced and that no further intervention is required.

The term "timely" should mean that the amount and mix of resources devoted to ATC is efficient in the dynamic sense. Because ATC involves emerging technologies, and because there is a good chance that successive generations of ATC will supplant others, efficiency in a dynamic sense might require less immediate investment than that which the usual static analysis would suggest. For example, a consumer who opts to use a dial-up modem rather than invest in a cable or DSL modem even when these higher speed technologies are available (and presuming that the anomalous retail pricing system has been corrected) may not do so as a result of policy failure but could do so out of the belief that a newer technology is just over the horizon and that it is better to wait. Consequently,

the efficient path (in a dynamic sense that accounts for the impact that technological uncertainty has on the optimality of investing today) results in the most social welfare and should be the basis defining the term "timely."

By grounding the definitions of "reasonable" and "timely" in the economic concept of dynamic efficiency the Commission ensures that resources are used optimally and that the maximum social welfare is generated by the actions taken to promote ATC. These definitions argue against time-specific schedules and objective targets that are described at paragraph 59 of the NOI. As is described below (in Section 3.G), policies that force-feed ATC deployment create social losses, just as do policies that hinder ATC development. The implications that flow from the above definitions of "reasonable" and "timely" say that, as a first step, the Commission should eliminate regulations that damage or distort the incentives to deploy ATC.

3. INCENTIVES, OPPORTUNITIES, AND CONSTRAINTS IN THE DEPLOYMENT OF ATC AND ATS

In paragraph 66 of the NOI, the Commission asks that respondents who believe that ATC is not being deployed in a reasonable and timely fashion state the reasons why. A response to this interrogatory therefore requires an investigation into those circumstances that would interfere with dynamic economic efficiency and the generation of maximum social welfare. This section provides a number of examples where legacy regulations on ILECs affect the incentives of ILECs and new entrants to deploy ATC/ATS in a reasonably and timely manner. The major themes of this analysis is that this Commission, and state commissions, should (1) use as the null hypothesis, or regulatory paradigm, that special industry-specific economic regulations (i.e. beyond general law, identification and defense of property rights, and anti-trust) are unneeded for ATC unless a market failure is demonstrated that cannot be otherwise addressed; and (2) use the legal and institutional tools available to them to remove the impediments described below from the conventional telecommunications capability world when they impinge on the development of ATC. Seven examples are provided where legacy regulation damages the incentive to deploy ATC in a reasonable and timely manner:

A. The impact that unbundling (generally, or especially at administered rates) would have on the incentive to deploy ATC;

B. The impact that resale (at avoided-cost rates) would have on the incentive to deploy ATC;

C. The impact of the FCC's "New Service" pricing rule on the deployment of ATS;

D. The impact that the interLATA restriction has on the deployment of ATC;

E. The impact of a separate subsidiary requirement for ATC on the deployment of ATC;

F. The impact that regulated retail intrastate service prices have on the incentive of customers to buy ATS and, derivatively, of ILECs to supply ATC;