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1850 M Street, NW
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March 2, 1999

Ms. Magalie Roman Salas
Secretary, Federal Communications Commission
The Portals
445 Twelfth Street, S.W.
Washington, D.C. 20554

EX PARTE

Re: CC Docket 96-98: Interconnection; CC Docket 98-184 GTE Corporation and Bell Atlantic Corporation

Dear Ms. Salas:

On February 26, William Barr, General Counsel of GTE, along with Steve Bradbury and Paul Capuccio of Kirkland and Ellis and me met with Commissioner Powell, Kyle Dixon and Paul Jackson. They discussed the above two matters, specifically materials referred to in two ex parte letters attached hereto.

Please include a copy of this notification into the record of this proceeding in accordance with Section 1.1206 of the Commission's rules concerning ex parte communications. If there are, any questions regarding this matter please contact the undersigned.

Sincerely,

c: Commissioner Michael Powell
Kyle Dixon
Paul Jackson

February 24, 1999

BY HAND

Mr. Thomas Krattenmaker
Federal Communications Commission
1919 M Street
8th Floor
Washington, DC 20554

Re: GTE-Bell Atlantic Merger, CC Docket No. 98-184

Dear Mr. Krattenmaker:

The attached report addresses the long distance issues raised by the pending Bell Atlantic and GTE merger.

GTE and Bell Atlantic also request that the Commission include in its order approving the license transfers for the merger limited, interim relief to allow the merged company to retain GTE Internetworking's existing Internet backbone and related businesses, as further described in the attached report.

Sincerely,

Steven G. Bradbury Counsel for GTE	Michael E. Glover Counsel for Bell Atlantic

Encl.
cc: W. Rogerson
D. Stockdale
M. Carey
M. Kende
T. Troung

Report of Bell Atlantic and GTE
On Long Distance Issues In Connection With Their Merger
and
Request For Limited Interim Relief

At the request of the Commission's staff, Bell Atlantic and GTE respectfully submit this report on the long distance issues raised by their pending merger.

Bell Atlantic continues to pursue vigorously long distance authority for all of its in-region states, and soon will file with the FCC to obtain the first-in-the-nation long distance approval for New York. Once this initial application is granted, applications for other states will follow promptly.

This process will not be completed, however, within the Commission's publicly announced time-frame for completing its review of the merger in June of this year. Consequently, the companies request that the Commission's order approving the license transfers for the merger also grant limited, interim relief as follows:

First, with respect to traditional voice long distance services that GTE provides to residential and business customers originating in any Bell Atlantic in-region states where the long distance approval process has not been completed by the time of closing, the companies request only that the FCC permit a reasonable transition period to allow existing customers to transfer to other carriers. This transition period will ensure that no customers experience a disruption in their long distance service as a result of the merger.

Second, with respect to the Internet backbone and related services provided by GTE Internetworking (formerly BBN), the companies request that the FCC grant limited, interim relief to retain Internetworking's existing businesses while the long distance approval process is completed. This limited relief is critical in order to provide consumers with the significant procompetitive benefits that the merger promises for the Internet and related advanced services.

This limited relief, in the form of approving the temporary establishment of a single LATA for Internetworking's existing businesses, is well within the FCC's express authority to approve LATAs "established or modified by a Bell operating company after [the] date of enactment" of the 1996 Act. *See* 47 U.S.C. . 153(25). It also is directly analogous to relief granted under the AT&T decree to allow new services that did not fit easily into the LATAs established for traditional voice services to be provided over larger (in some instances unlimited) geographic areas. The relief would take effect once Bell Atlantic obtains long distance authority covering at least one-quarter of its lines in its fourteen state region, would remain in effect for a period of no more than two years after closing (unless extended for good cause), and Internetworking would operate as a separate affiliate under the terms of section 272 of the Act. These conditions will ensure that that the local market is (and remains) open and Bell Atlantic is well along the road to obtaining long distance authority regionwide.

1. The projected timing of long distance authority under section 271. Bell Atlantic continues to pursue vigorously long distance relief throughout its 14 state region, and is well on its way to obtaining long distance relief.

Bell Atlantic's FCC application for New York will be filed soon, most likely in early April. As shown by the exhibits included in attachment A, that application is unlike any filed previously and should be granted:

First, the local market in New York is unquestionably and irreversibly open to competition. The best evidence is the actions of competitors themselves. Competing local carriers already have extensive facilities in place, including over 145,000 fiber miles, and already are serving more than 700,000 lines dispersed throughout the state -- including approximately 400,000 served entirely over their own facilities, more than 250,000 served through resale, and approximately 50,000 served using loops and other network elements. In addition, competing carriers are exchanging 1.3 billion minutes of traffic a month over some 250,000 existing interconnection trunks, and have established more than 300 collocation sites in Bell Atlantic's switching centers.

Second, Bell Atlantic has fully implemented the competitive checklist, and is actually furnishing each of the 14 checklist items to one or more competitors. In addition, Bell Atlantic has industry standard interfaces to its operations support systems that are in place and operational, and Bell Atlantic already is handling as many as 2,000 orders per day. It also is in the final stages of an independent third-party test under the supervision of the New York PSC that will demonstrate its ability to handle many more.

Third, the New York PSC has exhaustively monitored Bell Atlantic's activities, and has conducted extensive hearings and amassed a voluminous record to verify compliance. Based upon the terms of its pre-filing commitments with the New York PSC, Bell Atlantic anticipates that both the PSC and the Department of Justice will support its application.

Once the New York application is granted, Bell Atlantic will build on its New York experience to file prompt applications for other states, most likely beginning with Massachusetts and Pennsylvania, with other states such as Maryland, New Jersey and Virginia to follow.

These applications too should be granted. While competitors have devoted a significant portion of their effort to the attractive New York market, the local markets in these other states also unquestionably are open to competition. The best evidence again is the actions of competitors themselves, who have invested heavily in competing facilities and are in the market and operational. As shown in attachment B, competitors regionwide have captured an estimated 1.5 million lines, including approximately 800,000 served entirely over their own facilities and more than 600,000 served through resale. In addition, competing carriers are exchanging over 3 billion minutes of traffic a month over 600,000 existing interconnection trunks, and have established more than 1,000 collocation sites in Bell Atlantic's switching centers.

Nonetheless, while Bell Atlantic will continue to pursue vigorously long distance authority for all its states, it has become apparent that the section 271 approval process throughout the Bell Atlantic region will not be completed by the time the FCC plans to conclude its review of the merger in June. Consequently, the following sections outline in detail a proposal for addressing the long distance issues raised by the merger in any states where long distance authority has not yet been obtained.

2. The order approving the merger should allow a reasonable transition for voice customers. GTE currently provides traditional circuit-switched voice long distance service to customers in Bell Atlantic's in-region states. The majority of these long distance customers are located in GTE's local service areas in Pennsylvania and Virginia.[1] A smaller number are located either outside of GTE's local service area in these states or are spread across the remaining Bell Atlantic states, with most of this latter group in New York.

If the Commission grants the limited, interim relief requested for GTE Internetworking (which it should), the companies intend to close the merger once they satisfy the conditions for that relief to become effective and the necessary state regulatory approvals are in hand. Bell Atlantic expects to have long distance authority in one or more of the states where GTE has long distance customers by that time, but it will not have long distance authority in all of the states where GTE has customers. As a result, GTE will cease providing voice long distance services originating in any states where Bell Atlantic has not received long distance authority.

To ensure that no customer suffers a disruption of service, however, GTE will need a reasonable transition period to inform customers and to allow them to move to a new carrier of their choice. This transition is complicated by the fact that GTE will not know precisely which customers need to move until the interim relief becomes effective. To address this problem, the Commission's order approving the merger should establish a reasonable period of no more than 90 days to transition, where required, existing GTE long distance customers to new carriers following the closing.[2]

[1] In addition to its long distance service, GTE also offers local service under extended area service arrangements in Pennsylvania and Virginia that cross LATA boundaries in a limited number of instances. In order to continue these existing arrangements following the merger, the companies also will need approval from the Commission and will file petitions requesting that authority separately.

[2] See Golden West Associates, L.P., 59 Rad. Reg. 2d (P&F) 125 (1985) (transfer granted subject to the condition that Tribune come into compliance with the Act's cable/broadcast cross-ownership restrictions within 18 months); WWOR-TV, Inc., 6 FCC Rcd 193 (1990) (transfer granted subject to the condition that applicants take steps within 90 days to ensure compliance with the alien ownership rules); Cablevision VI, Inc., 5 FCC Rcd 7166 (1990) (the FCC may "delay[] enforcement [of a statutory provision] temporarily to accommodate the exigencies of the marketplace").

3. <u>The order approving the merger should provide limited, interim relief for GTE Internetworking</u>. The Internet backbone and other related businesses of GTE Internetworking present a materially different case, and one where limited, interim relief is warranted.

The core of Internetworking is its Internet backbone service, through which it provides dedicated and ubiquitous Internet service for large business and ISP customers by maintaining a full set of interconnection (or peering) relationships with every major Internet backbone provider. It also provides private network arrangements using IP or other packet-switched technologies that allow customers to connect to its backbone, and for use by customers such as America Online that do not want to transmit their data over the public Internet. In addition, Internetworking provides other closely related services, including Web Hosting, wholesale dial-up Internet service for business and ISP customers who want to offer their own end-users the ability to connect to the Internet, and dial-up Internet service for residential customers.

Internetworking currently is undertaking a major transition to transfer the provision of its Internet and related services away from circuits leased from its competitors (primarily from MCI WorldCom) and onto its own national backbone, known as the Global Network Infrastructure, or GNI. The GNI, which consists of a national OC-192 fiber backbone that links points of presence in more than 70 cities across the United States, will be used to provide each of Internetworking's major product offerings described above.

In its order approving the merger, the Commission should grant limited, interim relief to allow the merged company to retain Internetworking's existing Internet backbone and related businesses while the long distance approval process is completed. Granting this limited relief – rather than extending regulatory restrictions designed for traditional long distance services to the Internet backbone and related services provided by Internetworking – will produce significant public interest benefits and is well within the FCC's express statutory authority.

a. <u>The requested relief will produce significant benefits</u>. As explained in detail in previous filings, the merger of Bell Atlantic and GTE will produce enormous public interest benefits by preserving and enhancing Internetworking's ability to provide services on competitive terms. This result is critical to preserving competition in markets that are becoming increasingly concentrated.

For these public interest benefits to materialize, however, it is essential that the new company be able to operate Internetworking's existing Internet backbone and related businesses that feed traffic onto it without interruption. Indeed, without limited relief to keep Internetworking functioning as a national whole, the market for Internet backbone service will suffer serious competitive injury. As the Commission is well aware, the Internet is a global, interconnected "network of networks" that does not resemble traditional circuit-switched interexchange networks and does not conform (and can not reasonably be conformed) to the LATA structure.

The FCC and other regulators previously have recognized the need to protect against further concentration in the Internet backbone market. For that very reason, the Commission blocked the combination of MCI and WorldCom.s backbone networks -- a combination that would have given two firms (MCI WorldCom and Sprint) control over the great majority of Internet traffic. The Commission based its actions on the need to .ensure that the dynamism that has characterized the Internet will not be undermined,. and to guarantee that Internet services .remain competitive, accessible, and devoid of entry barriers.. MCI WorldCom Order 13 FCC Rcd 18025, . 142 (1998).

Despite these actions, the state of Internet backbone competition remains precarious. Cable & Wireless, MCI.s successor, has had well-publicized problems retaining its customers and faces a serious risk of falling from the top tier.[3] AT&T, on the other hand, is moving rapidly to fill Cable & Wireless.s place -- acquiring IBM.s business-rich Internet backbone operations and consummating transactions with TCI, Time-Warner, and other cable operators that will give AT&T control over cable modem access for more than one-third of the nation.s homes. As a result of these developments, GTE Internetworking, with a small 6 percent share of the backbone business, is the only remaining Internet backbone provider that stands in the way of the Big Three's acquisition of oligopoly control over the Internet.

There is no question that, if Internetworking is unable to continue operating its national backbone network without interruption, it will fall from the top tier of backbone providers. The pace of Internet traffic is growing at an astronomical rate -- doubling roughly every 6-8 months. Internetworking, therefore, must double the amount of traffic carried over its network over the same time period just to maintain its existing competitive position.

The reason that keeping pace is so important is straightforward. Today, major backbone providers exchange traffic through peering arrangements. These arrangements only work so long as the interconnecting backbones exchange roughly comparable traffic volumes and maintain mutual incentives to interconnect. If Internetworking were to fall significantly behind the other major backbone providers, those mutual incentives would break down and Internetworking would become dependent on the larger backbones, which

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[3] E.g., D. Pappalardo, "Ex-MCI Customers Hit by Cable & Wireless Blues," Network World (Jan. 11, 1999).

could refuse to continue the existing peering arrangements and dictate unfavorable interconnection terms.

Yet, if Internetworking cannot provide Internet backbone service or the related services that feed the backbone in the Northeast, it will not be able to market ubiquitous Internet service to customers anywhere in the world. This will cause Internetworking to lose existing customers and stifle or severely hinder its ability to acquire new ones. The net effect will be to materially weaken Internetworking as a competitor of the Big Three, and almost inevitably cause it to fall out of the top tier of providers.

The public interest consequences of this lost competition would be severe. Because the value of each network backbone increases as the number of customers on the network increases, upsetting the delicate balance that exists today between major providers would tip the scales unalterably in favor of the Big Three. As their networks continue to grow relative to other providers, more and more customers will be pushed to those networks, creating a snowball effect that leads to still further concentration. The result will be a decline in competition for backbone services and ultimately higher prices for ISPs and other customers.

In contrast, granting the limited relief requested here -- relief that merely would allow the new company to operate Internetworking as it is operated now – will help to preserve and promote the competitiveness of the Internet. By preserving Internetworking's access to major business customers in the concentrated Northeast market, this limited relief will give it a fighting chance to keep pace with the top tier of providers.

Moreover, by allowing Internetworking to draw on Bell Atlantic's existing marketing channels and established customer relationships, this relief will strengthen Internetworking as a competitor of the Big Three – one of the key benefits of the merger as a whole. As explained in greater detail in previous filings, enhancing Internetworking's ability to attract new customers and to expand the volume of traffic traveling over its backbone network will allow it to reduce its unit costs by at least 10 percent and would make it possible to deploy points of presence in at least 11 new markets, which would expand the geographic coverage of the network by roughly 15 percent. The net effect will be to promote strongly Internet competition as a whole.

b. <u>The requested relief is within the FCC's express statutory authority</u>. The limited, interim relief requested here is well within the FCC's express statutory authority to approve the establishment or modification of LATA boundaries. It also is directly analogous to relief granted on multiple occasions under the AT&T consent decree by creating larger -- in some instances world-wide -- LATAs for services other than the traditional long distance services that were the focus of the restriction.

As an initial matter, the Internet backbone and related services at issue here are, at most, on the periphery of the long distance restriction. In fact, the advanced services at issue here are completely separate from the plain old telephone services (POTS) that the LATA restrictions were originally designed to cover, and are based on new technologies that fundamentally differ from the old circuit switched network. As a result, they bear no resemblance to the core of traditional voice long distance services that Congress had in mind in enacting the restriction.

In fact, a number of the services provided by Internetworking require no relief at all. For example, the Web Hosting service it provides is clearly a permissible information service. The transmission services used in the provision of that information service (by connecting the Web Hosting facilities to the Internet) – presuming they constitute interLATA services at all[4] – are covered by the incidental relief provisions in the Act. 47 U.S.C. . 271(g). This is so both because they permit the storage in and retrieval of information from Internetworking's Web Hosting facilities in distant LATAs, *see* . 271(g)(4), and because the delivery of information from these databases to customers is the very sort of "other programming services" that cable operators routinely offer to their own subscribers today, *see* .. 271(g)(1), 522(14).

To the extent that the long distance restriction does extend to other aspects of Internetworking's existing Internet backbone and related businesses, however, granting the limited relief requested here is well within the Commission's express statutory authority to approve the establishment or modification of LATAs. 47 U.S.C. . 153(25)(B).

In fact, the practice of creating larger LATAs for advanced services was well established even prior to the 1996 Act. The court overseeing the AT&T consent decree, or "MFJ," approved a number of modifications that permitted non-traditional services such as wireless and video to be provided over larger geographic areas.[5] These services were

[4] Under the express terms of the Act, the scope of the long distance restriction is established by the express definition of "interLATA services," which means "telecommunications between a point located in a [LATA] and a point located outside such area." 47 U.S.C. . 153(21) (emphasis added). And under the Act, "[t]he term 'telecommunications' means the transmission . . . of information of the user's choosing, without change in the form or content of the information as sent and received." 47 U.S.C. . 153(43). In contrast, the Act defines information services as the mutually exclusive set of services that do involve a change in the form or content: "[t]he term 'information service' means the offering of a capability for generating, acquiring, storing, transforming, processing, retrieving, utilizing, or making available information via telecommunications, and includes electronic publishing." 47 U.S.C. . 153(20). As these definitions make clear, and as the Commission itself has recognized: "[W]hen an entity offers transmission incorporating the 'capability for generating, acquiring, storing, transforming, processing, retrieving, utilizing, or making available information,' it does not offer telecommunications. Rather, it offers an 'information service' even though it uses telecommunications to do so." Federal State Joint Board on Universal Service, Report to Congress, 13 FCC Rcd 11501, . 39 (1998). Consequently, under the express definitions in the Act, the provider of an information service is not providing telecommunications, and cannot be providing an "interLATA service" that is subject to the restriction in section 271.

[5] Modifications of LATA boundaries were granted under the MFJ for specified purposes, particularly to make possible the speedier development of new telecommunications services or increased competition. E.g., United States v. Western Elec. Co., 890 F.Supp. 1 (D.D.C. 1995) (wireless services); United States v. Western Elec. Co., 1986-1 Trade Cas. (CCH) P67,148 (paging

different from the POTS services that existed in 1983 when LATAs were created, and they did not fit comfortably into the LATA boundaries created with those services in mind.

Under the decree, for example, it was clear in the context of wireless (cellular and paging) services that the LATA boundaries for POTS hindered rather than promoted innovation and competition. As a result, the court initially established larger LATAs for cellular services, noting that mobile radio services did not fit easily into voice LATA boundaries, and rigid application of those boundaries to the BOCs cellular services would "substantially inconvenience[]" their customers.[6] The Court also acknowledged that imposing LATA boundaries on mobile services would entail a "substantial loss in the economic efficiencies which could be produced by integrated, multi LATA systems." Later, the court established expanded cellular calling areas in numerous instances. For example, a call on the landline network from Washington to Baltimore was "interLATA," but a call on the cellular network was not. Finally, in 1995, the court permitted BOCs to offer cellular service of any geographic scope under certain conditions,[7] and the 1996 Act removed even those conditions.

The court also established what effectively was a worldwide paging LATA in light of the differences between paging and landline voice technology. In February 1989, the court approved blanket relief permitting all BOCs to provide one-way paging services over any geographic range. The court noted that "in order to compete effectively in the paging market, paging services must be offered on an area-wide basis"; it also noted that paging services were in a "separate market" from traditional landline long distance services.[8]

Likewise, the court established what effectively was a national (and international) LATA for video and audio programming services. For example, the court permitted Bell Atlantic to "provide one-way television and radio services to the extent that the radio signal contours exceed [traditional voice] LATA boundaries."[9]

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services); United States v. Western Elec. Co., 1986-1 Trade Cas. (CCH) P66,987 (D.D.C. 1986) (paging services); United States v. Western Elec. Co., 1987-1Trade Cas. (CCH) .67,452 (cellular services); United States v. Western Elec. Co., No. 82-0192 (D.D.C. Feb. 18, 1993) (cellular services); United States v. Western Elec. Co., No. 82-0192 (D.D.C. Sept. 20, 1994) (video and audio programming by satellite and other means); United States v. Western Elec. Co., No. 82-0192 (D.D.C. Sept. 21, 1993) (cable service); United States v. Western Elec. Co., No. 82-0192 (D.D.C. Oct. 24, 1994) (same); see also United States v. Western Elec. Co., No. 82-0192 (D.D.C. Nov. 14, 1988); United States v. Western Elec. Co., No. 82-0192 (Feb. 15, 1991); United States v. Western Elec. Co., 604 F. Supp. 256, 261 (D.D.C. 1984).

[6] United States v. Western Elec. Co., 578 F. Supp. 643, 648 (D.D.C. 1983).

[7] United States v. Western Elec. Co., No. 82-0192 (D.D.C. Apr. 28, 1995).

[8] Memorandum Order and Opinion, United States v. Western Elec. Co., at 4, No. 82-0192 (D.D.C. Feb. 16, 1989).

[9] Order, United States v. Western Elec. Co., No. 82-0192 (D.D.C. March 22, 1995).

As these examples illustrate, the decree court on a number of occasions granted relief to prevent the LATA boundaries that were established in 1983 for POTS from becoming a straitjacket for new technologies that would hinder innovation and impede competition.

The 1996 Act, in turn, expressly transfers the authority to establish or modify LATAs to the FCC. 47 U.S.C. . 153(25). While the Act could have frozen LATA boundaries for all times, or set strict limits on the Commission's ability to approve the establishment or modification of LATAs, it did neither. Instead, the Act defines the LATAs that may be approved by the FCC only as "contiguous geographic area[s]," without any limitations on the geographic scale of those LATAs. By doing so, it preserved the flexibility that existed under the decree to adapt LATAs to changing technology.

The Commission has exercised its express statutory authority to establish or modify LATA boundaries on a number of occasions since the Act was passed, including at least one case where it modified the LATA boundaries that apply to advanced services.[10] Likewise, in its advanced services proceeding, the Commission has recognized that its statutory authority to approve the establishment or modification of LATA boundaries extends to other circumstances where exercising that authority will promote the development of advanced services.[11]

In prior cases involving the establishment or modification of LATAs, the Commission generally "weigh[ed] the need for the proposed modification against the potential harm from anticompetitive BOC activity, and consider[ed] whether the proposed modification will have a significant effect on the BOC's incentive to open its local market pursuant to section 271."[12] The limited relief requested here easily meets that standard.

First, strengthening the ability of Internetworking to compete with the Big Three is affirmatively procompetitive and is strongly in the public interest. At the same time, because the core of Internetworking's existing services are separate from the public switched telephone network, and will be operated through a separate affiliate that complies with the requirements of section 272, the risk of anticompetitive conduct effectively is non-existent. Second, granting the narrow, interim relief will reinforce Bell Atlantic's already strong incentive to obtain long distance authority under section 271. Indeed, the relief would only become effective once Bell Atlantic has succeeded in obtaining long

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[10] Southwestern Bell Telephone Company Petition for Limited Modification of LATA Boundaries to Provide ISDN at Hearne, Texas, Memorandum Opinion and Order, NSD No. NSD-LM-97-26, DA 98-923 (Com. Car. Bur.)(rel. May 18, 1998).

[11] E.g., Deployment of Wireline Services Offering Advanced Telecommunications Capability, 13 Comm. Reg. (P&F) 1, .194 (1998) ("Advanced Services Order and NPRM") ("We ... tentatively conclude that modification of [rural LATA] boundaries for the purpose of facilitating high-speed access to the Internet would further Congress' goal of ensuring that advanced services are deployed to all Americans").

[12] Advanced Services Order and NPRM at .190.

distance authority for a significant portion of its lines, and by doing so has demonstrated that it is well along the way to obtaining long distance authority regionwide. Moreover, it would be temporary, limited to a period of two years following closing of the merger (unless extended by the Commission), providing still further incentive for Bell Atlantic to complete the section 271 process as quickly as possible. And, even with the limited relief needed to retain Internetworking's existing Internet backbone and related businesses, Bell Atlantic still will have to complete the long distance application process in all of its states in order to enter the traditional long distance business.

The limited relief requested here does not in any sense require the Commission to forbear from applying the requirements of section 271 or any other provision of the Act. On the contrary, the Commission's authority to approve the establishment or modification of LATAs is completely separate from any forbearance authority it has under other provisions of the Act. And, of course, Bell Atlantic still must comply with all of the requirements of section 271 in order to enter the traditional long distance market and provide service across LATA boundaries as they are defined by the Commission.

Likewise, the limited relief requested here would not automatically open the door to relief in other contexts. On the contrary, relief here is uniquely warranted by the need to preserve and strengthen the existing business of GTE Internetworking, and to keep it from falling out of the top tier of Internet backbone providers. And this relief would be tied to the Commission's conclusion here, based on the voluminous record before it, that this particular merger will promote Internet competition and produce potentially enormous public interest benefits. These unique circumstances are unlikely to be replicated in other contexts.

c. <u>The requested relief is consistent with prior FCC practice</u>. Approving the license transfers subject to a requirement that the parties satisfy the conditions for interim relief before closing is consistent with previous FCC practice.

In fact, the FCC routinely grants license transfers where some further (uncertain) event must occur or additional approvals must be obtained before the underlying transactions can be completed. For example, the FCC in the past has conditioned license transfers on a requirement: i) that the parties delay the transfers until they obtain relief from the long distance restrictions in the AT&T decree and until expiration of the statutory waiting period for antitrust review under Hart-Scott procedures;[13] ii) that the transfers at issue be approved by a bankruptcy court and be completed within nine months after that approval;[14] iii) that the transfers not be completed until the Commission acts on license renewal applications for stations involved in the transaction;[15] or iv) that an applicant

[13] <u>Tel-Optik, Ltd.</u>, 2 FCC Rcd 2276 (1987).

[14] <u>MobileMedia Corp.</u>, FCC 99-15, WT Docket No. 97-115 (rel. Feb. 5, 1999).

[15] <u>E.g.</u>, <u>Columbia Montour Broadcasting, Inc.</u>, 13 FCC Rcd 13007 (1998); <u>NewCity Communications, Inc.</u>, 12 FCC Rcd 3929 (1997); <u>Illinois Valley Broadcasters, Inc.</u>, 11 FCC Rcd 13028 (1996).

complete its then pending unsolicited tender offer.[16] Most recently, the FCC approved AT&T's acquisition of TCI even though the parties still have innumerable other regulatory approvals to obtain at the state and local level.[17]

Likewise, the fact that some uncertain period of time would pass before the transaction could be completed has not been a barrier to Commission approval. On the contrary, the Commission has refused to revoke its approval even where the underlying transaction has not been completed several years after the original approval was granted. Here, in contrast, the parties fully expect that the conditions to obtain interim relief will be satisfied, and all other regulatory approvals will be obtained, at the latest by the end of the year -- a matter of months after the FCC plans to act on the license transfer applications.

4. <u>Request for relief</u>. Accordingly, Bell Atlantic and GTE respectfully request that, in its order approving the merger, the Commission also grant limited, interim relief to allow the merged company to retain GTE Internetworking's existing Internet backbone and related businesses, conditioned on Bell Atlantic's first obtaining long distance authority covering at least one-quarter of its lines. This relief would (1) consist of the establishment of a single LATA for GTE Internetworking's existing businesses, pursuant to the Commission's authority under 47 U.S.C. . 153(25), (2) be subject to the requirement that Internetworking operate as a section 272 separate affiliate, and (3) extend for a period of two years following the closing of the merger, unless extended for good cause by the Commission.

In addition, Bell Atlantic and GTE also respectfully request a reasonable transition period following the closing of the merger to allow traditional voice long distance customers to transfer to other carriers in those in-region states where Bell Atlantic has not obtained long distance authority as of closing.

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[16] <u>HLT Corp. and Hilton Hotels Corp.</u>, 10 CR 716, . 31 (1997).

[17] <u>Applications for Consent to the Transfer of Control of Licenses From Tele-Communications, Inc. To AT&T Corp.</u>, CS Docket No. 98-178, Memorandum Opinion and Order (rel. Feb. 18, 1999).

William P. Barr
Executive Vice President
Government & Regulatory Advocacy,
General Counsel

GTE Service Corporation

1850 M Street, NW
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Washington, DC 20036

March 1, 1999

Lawrence E. Strickling
Chief, Common Carrier Bureau
Federal Communications Commission
1919 M Street, N.W.
Room 500
Washington, D.C. 20554

Re: *Considerations Guiding the Commission's Section 251(d)(2) Remand Proceeding, CC Docket No. 96-98*

Dear Mr. Strickling:

Following up on Alan Ciamporcero's letter to you of February 17 (a copy of which is enclosed), I set out below GTE's general views on the "necessary and impair" analysis, as interpreted by the Supreme Court, to assist the Commission in developing its notice of proposed rulemaking in the UNE remand proceeding.

As the following discussion explains, the Supreme Court has laid down a fundamental proposition to guide the Commission on remand: *The unbundling of any network element must be justified with a convincing showing that CLECs could not effectively compete using potential substitute elements available from sources outside the ILEC's network.*

The Supreme Court's Analysis

In vacating the original unbundling rule, 47 C.F.R. § 51.319, the Court instructed the Commission to "determine on a rational basis which network elements must be made available, taking into account the objectives of the Act and giving some substance to the 'necessary' and 'impair' requirements." *AT&T Corp. v. Iowa Utilities Board*, 119 S. Ct. 721, 736 (1999). In his opinion for the Court, Justice Scalia identified two specific deficiencies in the Commission's previous UNE rule: *First*, contrary to the requirements of section 251(d)(2) of the Act, the Commission had "blind[ed] itself to the availability of elements outside the incumbent's network." *Id.* at 735. "That failing alone," the Court held, "would require the Commission's rule to be set aside." *Id.* *Second*, the Commission had improperly assumed that "any increase in cost (or decrease in quality) imposed by denial of a network element renders access to that element 'necessary,' and causes the failure to provide that element to 'impair' the entrant's ability to furnish its desired services." *Id.* That assumption, according to the Court, "is simply not in accord with the ordinary and fair meaning of those terms." *Id.*

Thus, the Court held that the Commission's unbundling rule must (1) take account of the availability of substitute elements from sources outside the ILEC and (2) rest on a showing that without access to the ILEC's network element, CLECs would effectively lose their ability to compete.

These two prongs of the Court's analysis were fleshed out further by Justice Breyer in his concurrence joining in the Court's "necessary and impair" holding. Justice Breyer made it clear that the Telecommunications Act "requires a *convincing explanation* of why facilities should be shared (or 'unbundled') where a new entrant could *compete effectively* without the facility, or where *practical alternatives* to the facility are available." *Id.* at 753 (emphasis added). As Justice Breyer stated, "[i]ncreased sharing, by itself, does not automatically mean increased competition. It is in the *unshared, not the shared,* portions of the enterprise that meaningful competition would likely emerge." *Id.* at 754 (emphasis added).

In particular, requirements that firms share network elements with competitors "diminish the original owner's incentive to keep up or to improve the property by depriving the owner of the fruits of value-creating investment, research, or labor," and "dissipat[e]" the owner's incentives to "undertake the investment necessary to produce complex technological innovations." *Id.* at 753. Moreover, Justice Breyer reasoned, there is no guarantee that "any added costs imposed by more extensive unbundling requirements [are] necessarily offset by the added potential for competition." *Id.* at 754. Indeed, a rule requiring ILECs to share every major element of their networks without reference to the cost or availability of substitutes would directly *undermine* facilities-based competition, since it would inevitably snuff out any incentive CLECs may have to invest in their own substitute elements. Such a rule would, in other words, create "a world in which competitors would have little, if anything, to compete about." *Id.*

Justice Breyer concluded that, given the overall objectives of the Act, these very real dangers necessarily impose corresponding "limits upon the FCC's power to compel unbundling." *Id.* at 753. Such limits are closely "related," if not identical, to those applicable under the "essential facilities" doctrine of antitrust law. *See id.* (citing Phillip Areeda, *Essential Facilities: An Epithet in Need of Limiting Principles,* 58 ANTITRUST L.J. 841, 852-53 (1989)). Thus, he stated:

> "[T]he statute's unbundling requirements, read in light of the Act's basic purposes, require balance. Regulatory rules that go too far, expanding the definition of what must be shared beyond that which is *essential* to that which merely proves advantageous to a single competitor, risk costs that, in

> terms of the Act's objectives, may make the game not worth the candle." *Id.* at 754 (emphasis added).

Accordingly, as Justice Breyer's analysis makes clear, because the compelled unbundling of network elements under the Act is *no different in substance from, and creates the same significant risks as*, the compelled sharing of a competitor's facilities under the essential facilities doctrine, the Commission's unbundling analysis under section 251(d)(2) needs to mirror in important respects the analysis conducted by courts in essential facilities cases.[18]

The essential facilities doctrine will compel the sharing of a facility only if, among other things: (i) the input is essential to competition and (ii) the input is not practically or reasonably available from another source. *See* 3A Phillip E. Areeda & Herbert Hovenkamp, ANTITRUST LAW ¶¶ 771-773 (1996); *MCI Comms. Corp. v. AT&T Co.*, 708 F.2d 1081, 1132-33 (7th Cir.), *cert. denied*, 464 U.S. 891 (1983). It is well-recognized under the doctrine that requiring an incumbent to share its facilities with a competitor stifles the incumbent's incentive to invest in its facility, "discourages [competitors] from developing their own alternative inputs," and stunts the development of a healthy market for outside substitutes. *See* 3A ANTITRUST LAW ¶ 771b.

For these reasons, application of the doctrine must be carefully cabined. As Professor Areeda wrote in the portion of his seminal article cited by Justice Breyer, "[c]ompulsory access, if it exists at all, is and should be very exceptional." Areeda, *Essential Facilities*, 54 ANTITRUST L.J. at 852. An incumbent's facility, he explained, is "essential" only when access to it is "critical to the [competitor's] competitive vitality," which "means that the [competitor] *cannot compete effectively without it and that duplication or practical alternatives are not available*." *Id.* (emphasis added). Moreover, the incumbent should not be forced to share a facility if doing so will likely "chill desirable activity," such as new investment in facilities or technological innovation, or if it will merely substitute the competitor for the incumbent without producing the benefits of real competition. *See id.*

Application on Remand

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[18] The Court did not decide, "as a matter of law," that the Commission must strictly apply the essential facilities standard. *Iowa Utilities Board*, 119 S. Ct. at 734. "[I]t may be," the Court stated, "that some other standard would provide an equivalent or better criterion for the limitation upon network-element availability that the statute has in mind." *Id.* Our point is that, in substance, the standard applied by the Commission must focus, as does the essential facilities analysis, on whether CLECs can compete effectively without access to the ILEC's facility. That is fully supported both by Justice Breyer's analysis and by the Court's holding that it is not enough to show that denying a UNE will cause CLECs to experience higher costs or diminished quality of service.

At a minimum, the considerations discussed above require the following:

First, on remand the Commission must determine the extent to which substitutes for each element are available to CLECs from sources outside the ILEC's network. That determination should be based on a thorough analysis of the real-world market facts identified in our February 17th letter. In the three years since passage of the Act, CLECs across the United States have deployed hundreds, if not thousands, of switches, laid thousands of miles of fiber for interoffice transport and local access, and deployed myriad other competitive local exchange facilities. Indeed, CLECs continue to announce further plans to deploy local exchange facilities in new markets on an almost daily basis, and appear to have no difficulty attracting capital to fund such strategies. Clearly the Commission has the power to require these telecommunications carriers to identify the facilities they use and the alternative facilities available to them from equipment vendors or other carriers. Under *Iowa Utilities Board*, a failure systematically to examine and inventory such substitutes would doom any new unbundling rule.

Second, because actual facilities deployment by CLECs varies by geographic area, type of customer and type of service, the Commission cannot adopt a single, "one size fits all" national list of UNEs merely for the sake of simplicity and uniformity. The rule must be tailored to accommodate variations in the facilities-based competition that already exists and that is currently possible through the use of available substitutes. It is simply not rational to attempt to determine what is "needed," or what will "impair" a CLEC's ability to compete, on a single, nationwide basis and without taking into account the particular variations associated with different geographic areas and types of service. And the Act clearly establishes a mechanism – individualized arbitrations conducted by state commissions – to take such variations into account. Any departure by the Commission from the localized determination of what elements are essential for unbundling, which the Act's arbitration process enables, must be strictly justified and narrowly tailored.

At a minimum, in order to apply the "necessary" and "impair" standards rationally to the varying availability of substitute elements and other location- and service-specific factors, we believe the Commission must establish multiple geographic zones for unbundling purposes. Establishing multiple zones need not be overly burdensome or time-consuming for the Commission. Indeed, the Commission adopted a similar zone approach in the pricing context. With regard to the availability of effective substitutes for network elements, the undeniable market facts will readily support geographic generalizations that are easy to administer. For example, there are CLEC switches and fiber in all the top metropolitan markets, and there can be no convincing justification for retaining all seven original UNEs in those areas. Similarly, it is well-established that many CLECs have deployed their own facilities specifically to target business customers, as opposed to residential customers, or to offer specific kinds of services, and the unbundling requirements should, and easily can, recognize these realities.

We are committed to working with the Commission to develop a rule that adequately takes into account what substitutes are available in particular geographic locations and for particular types of customers or services. One thing is certain, however: a single uniform rule for all locations, customers and services, particularly one that presumptively requires unbundling, will not satisfy the Act.

Third, it is clear from the Supreme Court's opinions in *Iowa Utilities Board* that *the burden rests with those seeking unbundling* to establish, with respect to each particular UNE, that CLECs *could not compete effectively without unbundled access*. As Justice Breyer explained thoroughly in his concurrence, competition occurs only on the *unshared* elements, not the shared ones, and thus unbundling necessarily stifles genuine facilities-based competition for any element that is unbundled. Unbundling is therefore permitted only where the Commission, or the CLEC seeking access through arbitration, provides a "convincing explanation" that the CLEC could not effectively compete using a substitute for that element. *Id.* at 753 (Breyer, J.). The bottom line is that any rule that establishes a *presumption* that elements will be made available – or otherwise places the burden on ILECs to avoid unbundling – would violate the unmistakable teachings of the Supreme Court and the goals of the Act. The presumption must be *against* unbundling, and this presumption should govern both the Commission and state arbitration proceedings.

Fourth, the Commission should reject any suggestion that a CLEC cannot be a viable facilities-based competitor unless it can immediately serve the incumbent's entire customer base. In its recent white paper addressing the "necessary and impair" issues, AT&T argues that any unbundling rule must give CLECs the ability to serve an ILEC's entire territory instantaneously. *See* AT&T White Paper at 20-21. That approach is plainly unrealistic and inconsistent with the thrust of the Supreme Court's ruling. In the real world, most facilities-based CLECs effectively compete by initially targeting business centers or pockets of high-value customers within the ILEC's territory. Although scale economies can be a significant competitive factor for CLECs, certain network elements, such as switching modules, are fully scalable and are well-suited to an efficient incremental entry strategy. In addition, CLECs can gain economies by serving several widely dispersed areas from a single remote switch. The Commission's rule must recognize as much. Moreover, the rule should also take account of the fact that the *ILEC's* network, in contrast to the CLEC's, may be saddled with significant *diseconomies* precisely because of the incumbent's obligation to serve all customers in a given territory – an obligation that does not fall on new entrants.

Fifth, the unbundling rule should recognize the existence and likely further development of a wholesale market for substitute elements. AT&T suggests that the Commission should largely disregard this market, *see* AT&T White Paper at 20, but again AT&T's approach would turn a blind eye to economic reality. Many CLECs with excess capacity in their facilities – for example, fiber transmission facilities – have strong economic incentives to sell that capacity to other CLECs, and these wholesale supply markets will assuredly grow and develop along with demand. The Commission should not artificially stamp out the demand for wholesale capacity by adopting a rule that assumes there can be no such supply market.

Sixth, the Commission should not impose unbundling requirements on the equipment used to implement new technologies, including xDSL equipment for high-speed data services. Once again, AT&T advocates as much in its white paper. AT&T White Paper at 25-26. It would throttle ILECs' incentives to invest in new data, video and other advanced services if they must share such equipment with competitors through unbundling, even though CLECs can acquire similar technologies off the shelf. One can only assume that stifling ILEC incentives to invest in these new technologies is precisely the result AT&T must hope to achieve, now that it will control through TCI and Time Warner the only broadband access lines currently available for millions of American homes.[19]

Finally, it is imperative that the Commission periodically reevaluate its UNE rule or that it sunset particular unbundling requirements within a reasonable period, such as two years. As Chairman Kennard stated just this past week, "The telecom market is changing, changing fast, and changing for the better." "Moving On," Remarks of Chairman Kennard Before NARUC Winter Meeting (Feb. 23, 1999) (as prepared for delivery). Given the extraordinary dynamism and technological evolution of this industry, it is a near certainty that elements that may be appropriate candidates for unbundling today may not be appropriate UNEs one or two years from now. For example, it is now widely recognized that wireless service is or soon will be a viable competitor to wireline loops for many customers. The Commission needs to monitor these developments and continually

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[19] More generally, given that AT&T is now implementing a multi-billion dollar *cable-based* strategy for local entry, its effort to reinstate a "soup to nuts" blanket unbundling requirement can only be intended to achieve one goal – undermining ILEC investment in traditional wireline telephone networks. Why else would a competitor like AT&T that has chosen to invest heavily in its own alternative networks wish to advocate a rule that is designed to serve CLECs who do *not* have their own facilities? After all, AT&T well recognizes that a sharing obligation undermines the investment incentives of the incumbent. Thus, when it was recently suggested that the AT&T-TCI cable networks should be subject to parallel unbundling and resale obligations, AT&T Chairman C. Michael Armstrong protested that "[n]o company will invest billions of dollars to become a facilities-based broadband services provider if competitors who have not invested a penny of capital, nor taken an ounce of risk, can come along and get a free ride on the investments and risks of others." *Armstrong Fires Back at Critics of TCI Deal*, TR Daily.

reassess its unbundling rule to ensure, as always, that the rule adequately reflects market realities.

Thank you for your attention in this matter and please feel free to contact me if you have any questions or would like to discuss these issues further.

Respectfully submitted,

William P. Barr

Enclosure

c: Chairman Kennard
Commissioner Ness
Commissioner Furchtgott-Roth
Commissioner Powell
Commissioner Tristani
Christopher Wright, General Counsel