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

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In the Matter of	)	
	)	
Implementation of the Local Competition Provisions in the Telecommunications Act of 1996	)	CC Docket No. 96-98
	)	
Interconnection between Local Exchange Carriers and Commercial Mobile Radio Service Providers	)	CC Docket No. 95-168

COMMENTS
OF THE
UNITED STATES TELEPHONE ASSOCIATION

Lawrence E. Sarjeant
Linda Kent
Keith Townsend
John W. Hunter
Julie E. Rones

1401 H Street, NW
Suite 600
Washington, D.C. 20005
(202) 326-7371

Its Attorneys

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SUMMARY

The Supreme Court's opinion in *AT&T v. Iowa* instructed the Commission to review its decision to impose mandatory unbundling of ILEC network elements ("UNEs") pursuant to Section 251(c)(3) of the Act because the Commission failed to properly apply the limiting provisions in the necessary and impair standards of Section 251(d)(2). Based upon the principles that competition promotes maximization of consumer welfare, not competitor welfare, should guide the Commission's decision-making, USTA recommends a comprehensive process, consistent with the requirements of the Court's review of how the Commission should apply the necessary and impair standards in determining the network unbundling obligations of incumbent local exchange carriers.

Consistent with established intellectual property law, mandatory unbundling of ILEC proprietary network elements would be required only if absolutely necessary for competitors to compete. Under the impairment test, mandatory unbundling of non-proprietary ILEC network elements would be subject to a five part test, based upon antitrust law essential facilities doctrine, where the potential competitor would establish that mandatory unbundling of a particular ILEC network element is required because: (1) unbundling is technically feasible in the relevant geographic market; (2) the ILEC has denied access to the particular UNE; (3) it would be impracticable and unreasonable to a require potential competitor to acquire the UNE elsewhere; (4) the ILEC is a monopoly provider of the particular UNE; and (5) the ILEC can exercise market power in providing telecommunications services by restricting access to the requested UNE.

Regarding the seven network elements previously identified by the Commission for

mandatory unbundling, it is clear that competitive market conditions create situations in which unbundling of all ILEC network elements is unwarranted. Based upon the findings in the attached Huber/Leo *Report on UNEs,* Hausman/Sidak conclude in their affidavit that mandatory unbundling of ILEC switching is unnecessary given the availability of substitutable non-ILEC switching elements. In some markets, ILEC unbundling of loops may not be required depending on the geographic market in which a potential competitor requests loop unbundling. As with loop unbundling, the Commission and state regulators must undertake a comprehensive, geographically specific, market review of the availability of substitutable non-ILEC network elements for the other network elements previously identified by the Commission for mandatory ILEC unbundling - - network interface devices, interoffice transmission, signaling networks and call-related databases, operator services and directory assistance, and operations support systems -- before requiring ILECs to provide these UNEs on an unbundled basis. The recent decision of the Washington State Commission, in declaring directory assistance to be a competitive service because of available non-ILEC substitutes in the state, underscores the importance of regulators focusing on the relevant, geographically specific, market when determining whether mandatory unbundling of ILEC network elements is required, and the significant role state regulators can play in making such findings. Consistent with the *1992 Merger Guidelines* adopted by the Department of Justice and the Federal Trade Commission, mandatory unbundling of ILEC network elements would sunset in two years, or when a facilities-based competitor enters the market.

The Commission should not impose mandatory unbundling of ILEC advanced broadband networks and services. As the affidavit of Jorde/Sidak/Teece make clear, ILECs lack market power over broadband advanced telecommunications services and mandatory unbundling is a disincentive for ILECs to invest in network upgrades and to innovate. In addition, mandatary ILEC unbundling is a disincentive for potential competitors to invest in advanced networks, instead choosing to rely on ILEC investments and innovations, at TELRIC pricing, while bearing no marketplace risks. Consumers benefit when public policy is focused on competition and maximization of consumer welfare, and not the welfare of competitors.

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INTRODUCTION

The United States Telephone Association ("USTA") hereby files its comments in response to the Commission's *Second Further Notice of Proposed Rulemaking*.[1] USTA is the principal trade association of the incumbent local exchange ("ILEC") industry.

On January 25, 1999, the Supreme Court vacated the Commission's network unbundling requirements in Section 51.319[2] of the Commission's regulations promulgated in the *Local*

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[1] *Second Further Notice of Proposed Rulemaking*, released April 16, 1999, 64 Fed. Reg. 20238 (April 26, 1999).

[2] 47 C.F.R. §51.319.

Competition First Report and Order.[3] The Commission had determined, under its prior analysis of necessary and impair in Section 51.139 of the Commission's rules, that ILECs must unbundle the following network elements ("UNEs"): (1) local loops; (2) network interface devices; (3) local switching; (4) interoffice transmission facilities; (5) signaling networks and call-related databases; (6) operations support system; and (7) operator services and directory assistance.[4] The Supreme Court reversed the Commission's decision, ruling that Section 251(d)(2)[5] of the Act requires 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"[6]

Pursuant to the Supreme Court's opinion, the Commission cannot merely reissue its prior regulations on unbundling. In addition, the Commission may not use this proceeding to arbitrarily expand ILEC network unbundling requirements. As explained in the attached affidavit of Jerry Hausman and Greg Sidak, the Commission should adopt regulations that determine what, if any, ILEC UNEs should be unbundled. According to Hausman/Sidak, the Commission's policy on ILEC unbundling must emphasize consumer welfare and competition

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[3] *First Report and Order, Implementation of the Local Competition Provisions in the Telecommunications Act of 1996*, 11 FCC Rcd 15499(1996), *modified on recon.*, 11 FCC Rcd 13042 (1996), *vacated in part, Iowa Utils. Bd. v. FCC*, 120 F3d 753 (8th Cir. 1997), *aff'd in part and rev'd in part sub nom. AT&T Corp., v. Iowa Utilities Bd.,* 119 S. Ct. 721 (1999).

[4] *Local Competition First Report and Order*, 11 FC Rcd at 15683, ¶¶281-83. The Commission's Order also permited states the power to impose additional unbundling requirements consistent with the Commission's interpretation of Section 251(d)(2).

[5] 47 U.S.C. §251(d)(2).

[6] *AT&T v. Iowa*, 119 S.Ct. at 736.

rather than competitor welfare.

In Part I of their affidavit, Hausman/Sidak review the analysis by the Supreme Court of the "necessary" and "impair" standards of section 251(d)(2). Hausman/Sidak reach the conclusion that by enacting the Telecommunications Act of 1996 ("Act"), Congress did not create a conflict in objectives between that statute and the existing body of antitrust jurisprudence. As Hausman/Sidak explain, antitrust law seeks to maximize the well-being of consumers consistent with the stated purpose of the Act to promote competition and reduce regulation in order to secure lower prices and higher quality services for American telecommunications consumers and encourage the rapid deployment of new telecommunication technologies.[7] Thus, the intent of antitrust law and the principles underlying the purpose and intent of the Act is the promotion and protection of the competitive process, not particular competitors or particular market structures.

In Part II of the affidavit, Hausman/Sidak use economic analysis to explain why the Commission, consistent with the Supreme Court's decision in *AT&T v. Iowa,* must establish limiting principles for the mandatory unbundling of ILEC network elements. As Hausman/Sidak explain: (1) unbundling rules should emphasize consumer welfare and competition rather than competitor welfare; (2) the issue before the Commission is not whether the ILECs will unbundle their network elements for use by competitive local exchange carriers ("CLECs"), but whether the Commission will compel the ILECs to do so at regulated prices based on total element long-

7 *Telecommunications Act of 1996*, Pub. L. No. 104-104, 110 Stat. 56, Joint Conference Committee Explanatory Statement, Senate Report at 113.

run incremental cost ("TELRIC") pricing methodology; (3) the social costs of a particular unbundling regime may outweigh the gains; (4) the Commission should not base its review of the necessary and impair standards on an economic misconception of sunk costs in local telecommunications; and (5) Commission policy, in support of mandatory unbundling, can create uncompensatory pricing of unbundled network elements.

In Part III of the affidavit, Hausman/Sidak examine the limiting principles that are inherent in the essential facilities doctrine and the competitive analysis of demand and supply substitution that are consistent with traditional antitrust analysis of market power which form the basis of their proposal for interpreting necessary and impair standards in Section 251(d)(2). The Commission and state regulators should examine the need for mandatory unbundling in each relevant geographic market for each network element which the Commission proposes that an ILEC unbundle. Any market-power analysis should be based on a specified time horizon, after which time the requirement of unbundling for that network element should sunset unless the CLEC proves that consumer welfare would suffer without the Commission's continuation of such mandatory unbundling. Second, Hausman/Sidak argue that definitions of necessity and impairment should be based upon demand and supply substitution. Accordingly, the necessity of unbundling a proprietary network element, and the extent to which competition would be impaired if a nonproprietary element were not unbundled, should depend on the respective price elasticities of demand and supply in both the input UNE and output (end-user access) markets. As Hausman/Sidak explain, their recommended approach comports with the analysis of unilateral effects in the 1992 *Merger Guidelines* adopted by the Federal Trade Commission and the Antitrust Division of the U.S. Department of Justice ("DoJ").[8] The necessity of unbundling an element, or the likelihood that a failure to provide a network element or elements would impair competition, should be assessed in light of the existence of competition among different bundles of end services. With respect to the impairment test, section 251(d)(2) requires that the focus be on the ability of the telecommunications carrier to provide services. Thus, the interpretation of impair with respect to loops, for example, should reflect the existence of substitution among bundles of services that use different access technologies (such as cable television's coaxial and fiber-optic infrastructure to provide local access for voice telephony, or the wireless one-rate plans that encompass "free" roaming and long-distance calling).

Based upon the Hausman/Sidak analysis, proprietary network elements are protected under well-recognized intellectual property laws. The Commission should limit mandatory unbundling of ILEC proprietary network elements UNE, pursuant to the necessary standard in Section 251(d)(2)(A), to situations in which access to the ILEC UNE is "absolutely essential" for competition. USTA's proposal on how the Commission should conduct its review of access to ILEC proprietary UNEs under the necessary provision of Section 251(d)(2)(A) is a heightened standard of review - - more rigorous than USTA's impairment test under Section 251(d)(2)(B) - - given the importance of intellectual property rights as an incentive to investments leading to innovation, which ultimately enhances consumer welfare.

Regarding the impairment standard for mandatory unbundling pursuant to Section

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8 Department of Justice and Federal Trade Commission, Horizontal Merger Guidelines (1992) ("Merger Guidelines").

251(d)(2)(B), Hausman/Sidak propose the following five-part test that would apply to the ILEC obligation to provide unbundled network elements:

> The FCC shall mandate unbundling of a network element if and only if
>
> (1) it is technically feasible for the ILEC to provide the CLEC unbundled access to the requested network element in the relevant geographic market;
>
> (2) the ILEC has denied the CLEC use of the network element at a regulated price computed on the basis of the regulator's estimate of the ILEC's total element long-run incremental cost;[9]
>
> (3) it is impractical and unreasonable for the CLEC to duplicate the requested network element through any alternative source of supply;
>
> (4) the requested network element is controlled by an ILEC that is a monopolist in the supply of a telecommunications service to end-users that employs the network element in question in the relevant geographic market; and
>
> (5) the ILEC can exercise market power in the provision of telecommunications services to end-users in the relevant geographic market by restricting access to the requested network element.[10]

In Part IV, Hausman/Sidak apply the impairment test to determine whether a particular network element in a particular geographic market requires unbundling. Demand-side

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[9] The second element of the impairment test proposed by Hausman and Sidak asks whether the ILEC has denied the CLEC use of the network element at a regulated price computed on the basis of the regulator's estimate of the ILEC's TELRIC. Of course, if the Eighth Circuit Court were to strike down the Commission's TELRIC pricing methodology, the second element of the Hausman and Sidak test would be restated to reflect the new standard by which regulated prices would be set for network elements subject to mandatory unbundling.

[10] Hausman/Sidak Affidavit at 17.

constraints on the exercise of market power, such as voice telephony over cable television networks and wireless telephony, affect all UNEs equally. According to Hausman/Sidak, network elements with low fixed costs in geographically dense areas should not likely be subject to mandatory unbundling at TELRIC prices.

In Part V, Hausman/Sidak discuss the procedures the Commission should employ in administering the impairment test. First, the CLEC bears the burden of proof in demonstrating ILEC market power. Second, any order for mandatory unbundling should automatically sunset within two years of the first unbundling decision, or when any facilities-based competitor enters the market. Third, state commissions should administer a market power test that is both location-specific and fact-intensive.

The opinion of the Supreme Court in *AT&T v. Iowa* [11] suggested that essential facilities and market power analysis in antitrust jurisprudence may well serve the Commission in its application of Section 251(d)(2) to the unbundling requirements of Section 251(c)(3). The Commission was encouraged to consider that body of law as a possible approach to determining when a network element would satisfy the necessary and impair standards of Section 251(d)(2). The Hausman/Sidak Affidavit explains how and why economic analysis and antitrust jurisprudence should be adopted by the Commission as the basis for its statutory interpretation of Section 251(d)(2).

Consistent with the Supreme Court's decision, the Commission must devise a limiting principle for the unbundling of proprietary network elements. The Hausman/Sidak five-part

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[11] *AT&T Corp. v. Iowa Utils. Bd.*, 119 S. Ct. 721 (1999).

"impairment" test focuses on whether competition can be effective in the end-user services market rather than whether a particular competitor can earn profits. This test is concerned with consumer welfare, not competitor welfare. Once the CLEC has demonstrated that the UNE meets the four existing requirements of the essential facilities doctrine, the CLEC must then demonstrate that an ILEC could exercise market power in the provision of telecommunications services to end-users in the relevant geographic market by restricting access to the requested network element.

USTA recommends that the term necessary be interpreted to mean that competition in end-user services would be impossible unless the requested element were unbundled at TELRIC prices. This heightened standard will protect the economic incentives to create the intellectual property embodied in elements that are proprietary in nature. USTA's impairment test is in accord with traditional antitrust analysis. The Commission should apply these standards on geographically specific basis. In addition, the Commission should apply these standards for unbundling only were appropriate, keeping in mind that competitive developments in specific geographic markets may render the need for unbundling unnecessary. Based upon the findings of Hausman/Sidak, USTA finds that switches should not be unbundled in any geographic market, while loops may be unbundled in specific geographic markets where a cable-telephony provider, such as AT&T, or any other facilities-based telecommunications service provider has yet to enter.

A second affidavit explains the adverse impacts of mandatory unbundling of ILEC networks on incentives to innovate telecommunications facilities. In the affidavit of Thomas

Jorde, Greg Sidak and David Teece, it is argued that mandatory unbundling of ILEC network elements at prices computed on the basis of TELRIC adversely affects the ILECs incentives to maintain and upgrade existing network facilities, but also to invest in new facilities. Similarly, competitive carriers have no incentive to invest in innovative upgrades or new technologies, preferring instead to cream skim the ILEC network for upgrades or new facilities and elements at below-market rates. In addition to lowering the expected returns of investment in existing and new facilities, mandatory unbundling at regulated TELRIC rates raises the cost of capital for ILECs. For these reasons, the Commission should forebear from mandatory unbundling of ILEC broadband facilities providing advanced telecommunications services. Recent innovations in several network elements including switches, loops, transmission facilities, and digital subscriber line access multiplexers ("DSLAM") would be at risk under Commission regulations that require mandatory unbundling of ILEC network elements at TELRIC rates for deployment of advanced telecommunications services. Only under circumstances in which the Commission's public policy decisions reflect regulatory forbearance can consumers be assured that the stated policy of the Act to encourage the rapid deployment of new telecommunications technologies will be realized.[12]

Also attached is a market-based study assessing the scope of competition in specific markets, the impact of competition on the need for mandatory unbundling at regulated TELRIC rates, and the availability to competitors from sources other than ILECs of the Commission's

[12] 47 U.S.C. ¶¶157 and 706.

seven unbundled network elements.[13] What the Huber/Leo *Report on UNEs* demonstrates is that mandatory unbundling of all ILEC network facilities is unsupportable. In addition, geographically specific unbundling must sunset as competitors like AT&T, MCI/WorldCom, and other competitive LECs provide competition and substitutable UNE alternatives. Equally clear from the Huber/Leo *Report on UNEs* is the need for the Commission to conduct a nationwide review of competition in the local exchange to ensure that adequate data exists for the Commission and state regulators to conduct the necessary and impair review required by Section 251(d)(2) consistent with the Court's instructions that the unbundling requirement in Section 251(c)(3) is tempered by the limits impose by Section 251(d)(2). Until such time as the Commission conducts a comprehensive, nationwide review of competition on a market-by-market basis, and assesses the market for non-ILEC UNEs, the Commission cannot impose mandatory unbundling requirements on ILECs consistent with the Court's opinion. Moreover, the Commission should not mandate unbundling obligations for ILEC investments in advanced broadband networks and services. They do not meet any reasonable and conforming necessary and impair test. Such requirements would only serve as disincentives to future ILEC investments, raise the cost of capital for ILECs, deny ILECs the benefits of first-to-the market advantages from innovation, and discourage CLECs from investing in network facilities, while encouraging CLECs to cream-skim ILEC innovations at below market rates. The public interest demands innovation from the Commission in the form of public policy that promotes

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[13] Peter Huber and Evan LEO *UNE Fact Report,* submitted by USTA and prepared for Ameritech, Bell Atlantic, BellSouth, GTE, SBC and US WEST.

competition, not competitors, which is the only way to insure lower prices, and expanded choices for consumers.

I. THE SUPREME COURT'S "NECESSARY" AND "IMPAIR" REVIEW

The Supreme Court's decision in *AT&T v. Iowa* concluded that the Commission's implementation of the network element unbundling provisions in Section 251(c)(3) of the Act contained in Section 51.319 of the Commission's regulations were arbitrary and capricious. According to the Court, the Commission erroneously interpreted the necessary and impair standards of section 251(d)(2) when enacting its unbundling regulations embodied in Section 51.319 of the Commission's regulations.[14] The Court instructed the Commission, on remand, to "determine on a rational basis *which* network elements must be made available taking into account the objectives of the 1996 Act and giving some substance to the 'necessary' and 'impair' requirements."[15]

Section 251(c)(3) requires ILECs to provide CLECs access to their networks. As Section 251(c)(3) provides, ILECs must:

> provide to any requesting telecommunications carrier ... non discriminatory access to network elements on an unbundled basis at any technically feasible point on rates, terms, and conditions that are just, reasonable, and nondiscriminatory ....

Section 251(d)(2) tempers the application of the unbundling requirements in Section

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[14] *AT&T v. Iowa*, 119 S. Ct. at 733-36.

[15] *Id.* at 736.

251(c)(3) by requiring the Commission to apply the necessary and impair standards when deciding which ILEC network elements must be unbundled. As Section 251(d)(2) instructs the Commission to determine:

> at a minimum, whether—(A) access to such network elements as are proprietary in nature is necessary; and (B) the failure to provide access to such network elements would impair the ability of the telecommunications carrier seeking access to provide the services that it seeks to offer.

The Supreme Court's opinion acknowledges that Section 251(d)(2) places limits on the scope of network unbundling that ILECs must provide. As the majority concluded, Section 251(d)(2) imposes clear limits on the Commission's authority to determine whether an ILEC must unbundle a particular network element pursuant to section 251(c)(3) and that the Commission's unbundling regulations in Section 51.319 Rule exceeded the bounds of those clear limits. In the Court's opinion, "the FCC did not adequately consider the 'necessary and impair' standards when it gave blanket access to these network elements, and others, in Rule 319." [16] With respect to the application of the essential facilities doctrine in antitrust law as a limiting principle to be adopted by the Commission the Court concluded:

> The incumbents argue that § 251(d)(2) codifies something akin to the "essential facilities" doctrine of antitrust theory ... , opening up only those "bottleneck" elements unavailable elsewhere in the marketplace. We need not decide whether, as a matter of law, the 1996 Act requires the FCC to apply *that* standard; it may be that some other standard would provide an equivalent or better criterion for the limitation upon network-element availability that the statute has in mind. But we do agree with the incumbents that the Act requires the FCC to apply *some* limiting standard, rationally related

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[16] *Id.* at 734.

to the goals of the Act, which it has simply failed to do.[17]

Regarding the application of the necessary and impair standard of Section 251(d)(2), the Court rejected the Commission's prior definition of necessary under Section 251(d)(2)(A). According to the Court, the Commission ignored whether requesting carriers could obtain the requested proprietary element from a source other than the incumbent, because the Commission erroneously reasoned that "requiring new entrants to duplicate unnecessarily even a part of the incumbent's network could generate delay and higher costs for new entrants," and thereby impede their entry into a specific geographic market in violation of the Act.[18]

The Court also ruled that the Commission had erroneously determined that the impairment standard of Section 251(d)(2)(B) is met if "the failure of an incumbent to provide access to a network element would decrease the quality, or increase the financial or administrative cost of the service a requesting carrier seeks to offer, compared with providing that service *over other unbundled elements in the incumbent LEC's network*."[19] According to the Court, "Since any entrant will request the most efficient network element that the incumbent has to offer, it is hard to imagine when the incumbent's failure to give access to the element would not constitute an 'impairment' under this standard."[20] Moreover, the Court concluded that

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[17] *Id.* at 734–35.

[18] *Id.* at 735 (quoting *Local Competition First Report and Order*, 11 FCC Rcd. at 15,642 ¶ 283).

[19] *Id.* (quoting *Local Competition First Report and Order*, 11 FCC Rcd. at 15,643 ¶ 285).

[20] *Id.*

contrary to the requirements impose upon the Commission under Section 251(d)(2), the Commission's interpretation left CLECs, not the Commission, with the ultimate authority to determine what elements were necessary and how the absence of a particular element would impair competition:

> The Commission asserts that it deliberately limited its inquiry to the incumbent's own network because no rational entrant would seek access to network elements from an incumbent if it could get better service or prices elsewhere. That may be. But that judgment allows entrants, rather than the Commission, to determine whether access to proprietary elements is necessary, and whether the failure to obtain access to nonproprietary elements would impair the ability to provide services.[21]

The Court also criticized the economic reasoning underlying the Commission's interpretation of necessary and impair pursuant to the requirements of Section 251(d)(2). According to the Court, the Commission must consider the availability of network elements outside the incumbent's network:

> The Commission cannot, consistent with the statute, blind itself to the availability of elements outside the incumbent's network. That failing alone would require the Commission's rule to be set aside.[22]

Secondly, the Court emphasized that the impairment standards must embody some threshold of materiality pursuant to Sections 251(c)(3) and 251(d)(2). The Court reasoned:

> [T]he Commission's assumption 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

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21 *Id.*

22 *Id.*

> is simply not in accord with the ordinary and fair meaning of those terms. An entrant whose anticipated annual profits from the proposed service are reduced from 100% of investment to 99% of investment has perhaps been "impaired" in its ability to amass earnings, but has not *ipso facto* been "impaire[d] . . . in its ability to provide the services it seeks to offer"; and it cannot realistically be said that the network element enabling it to raise its profits to 100% is "necessary."[23]

The Court also emphasized that the statutory right of competing telecommunications carriers to receive unbundled access to an ILEC's network element pursuant to the impairment standard in Section 251(d)(2) was not a guarantee of supra competitive profits:

> We similarly disagree with Justice Souter that a business can be impaired in its ability to provide services—even impaired in that ability "in an ordinary, weak sense of impairment"—when the business receives a handsome profit but is denied an even handsomer one.[24]

Relying on the statutory language as a reflection of Congressional intent, the Court rejected the Commission's expansive reading of the unbundling obligations of Section 251(c)(3):

> We cannot avoid the conclusion that, if Congress had wanted to give blanket access to incumbents' networks on a basis as unrestricted as the scheme the Commission has come up with, it would not have included § 251(d)(2) in the statute at all. It would simply have said (as the Commission in effect has) that whatever requested element can be provided must be provided.[25]

In addition, the Court rejected the Commission's reading of Section 251(c)(3) that an ILEC must unbundle its network wherever technically feasible:

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23 *Id.*

24 *Id.* at note 11.

25 *Id.*

> The FCC was content with its expansive methodology because of its misunderstanding of § 251(c)(3), which directs an incumbent to allow a requesting carrier access to its network elements "at any technically feasible point." The Commission interpreted this to "impos[e] on an incumbent LEC the duty to provide all network elements for which it is technically feasible to provide access," and went on to "conclude that we have authority to establish regulations that are coextensive" with this duty.[26]

As the Court reasoned, "[s]ection 251(c)(3) indicates 'where unbundled access must occur, not which [network] elements must be unbundled.'"[27] The Court ruled that the Commission's "premise was wrong" and that "[s]ection 251(d)(2) does not authorize the Commission to create isolated exemptions from some underlying duty to make all network elements available."[28] The Court ruled that Section 251(d)(2):

> requires the Commission to determine on a rational basis which network elements must be made available, taking into account the objectives of he Act and giving some substance to the "necessary" and "impair" requirements. The latter is not achieved by disregarding entirely the availability of elements outside the network, and by regarding any "increased cost or decreased service quality" as establishing a "necessary" and an "impairment" of the ability to "provide ... services.[29]

The Commission is precluded from adopting regulations that are inconsistent with its obligations under Section 251(d)(2) to determine if unbundling of a particular element is necessary

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[26] *Id.* at 736 (quoting *Local Competition First Report and Order*, 11 FCC Rcd. at 15,640 ¶ 278; see also ¶ 286 ("we conclude that the statute does not require us to interpret the 'impairment' standard in a way that would significantly diminish the obligation imposed by section 251(c)(3)").

[27] *Id.* (quoting *Iowa Utils. Bd. v. FCC*, 120 F.3d at 810).

[28] 119 S. Ct. at 736.

[29] *Id.* at 736.

and whether the absence of unbundling of an ILEC network element would impair a CLEC's ability to compete. As Hausman/Sidak explain:

> In short, the Court held that the FCC's interpretation of "necessary" and "impair" must reflect the procompetitive goals of the 1996 legislation, that the interpretation must embody an assessment of competitive substitution in the supply of network elements, and that the interpretation must not trigger mandatory unbundling of network element[s] on the basis of insignificant differences between the cost or service quality of the network elements used by the ILEC and the cost of service quality of the network elements that the ILEC supplies an entrant.[30]

Consistent with the Court's opinion, antitrust principles and the requirements of the Act, USTA recommends a reasonable approach that the Commission and state regulators can pursue in determining the scope of unbundling obligations ILECs must provide that comport with the requirements of Sections 251(c)(3) and 251(d)(2), and which recognizes the increased level of competition since the Act was implemented in 1996. By tailoring the unbundling requirements to geographically specific markets, the Commission and state regulators can accurately assess the level of competition in each market, and the potential for future competition from a variety of sources including wire line, terrestrial wireless, and satellite providers of telecommunications services. This market-based, market power review will permit the Commission and state regulators to determine what available substitutes, other than ILEC network elements, exists in a geographically specific market, require ILEC unbundling of network elements consistent with the competitive market conditions, and terminate mandatory ILEC unbundling of network elements under the two year provision in the *Merger Guidelines*, or when a single facilities-based competitor enters a given

[30] Hausman/Sidak Affidavit at 31.

geographic market. USTA's recommended approach to mandatory unbundling meets the requirements of the Act, recognizes the alternative sources for network elements from other than ILEC networks,[31] and is consistent with the limiting principles on Commission mandated unbundling of ILEC networks set forth in the Court's opinion.

II. THE SCOPE OF MANDATORY ILEC NETWORK UNBUNDLING MUST BE LIMITED AND REFLECT THE INTEREST OF CONSUMER WELFARE

Contrary to the Court's opinion, antitrust principles, and the intent of the Act, the Commission appears to suggest its willingness to continue its protection of competitors at the expense of consumers and consumer welfare. In the *Second Further Notice of Proposed Rulemaking* the Commission asks for comment on whether "the requesting carrier's particular market entry strategies should be considered as part of the 'necessary' and 'impair' analysis."[32] Similarly, the Commission opines "Section 251(d)(2)(B) requires us to consider whether the failure to provide access to an element would 'impair' the ability of a new entrant to provide a service it seeks to offer."[33]

As Hausman/Sidak explain, the Commission's interpretation of the necessary and impair provisions of Section 251(d)(2) must be limited in application and based on standards that are rationally related to the purposes of the Act.[34] Foremost among those limiting principles is the

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31 *See* Huber/Leo *UNE Fact Report.*

32 *Second Further Notice of Proposed Rulemaking* at 11, ¶27.

33 *Id.* at 8, ¶17.

34 Hausman/Sidak Affidavit, Part II at 43-71.

proposition that the FCC's unbundling rules should regard the public interest as primarily determined by consumer welfare, which in turn is determined by competition rather than competitor welfare. According to Hausman/Sidak:

> Whether it is "necessary" for the FCC to mandate, at TELRIC prices, the unbundling of a particular proprietary network element in a particular location at a particular time should depend on whether such unbundling is necessary to permit the competitive supply of telecommunications services to end users. Similarly, the correct meaning of "impair" for purposes of section 251(d)(2) is whether the ILEC's failure to unbundle, at TELRIC prices, a particular nonproprietary network element in a particular location at a particular time would produce an equilibrium supply of telecommunications services that was, relative to the competitive equilibrium, significantly inferior for consumers. Here, "inferior" can mean not only higher prices, but also lower quality services or less innovation in new telecommunications services, the consumer welfare losses from which have been shown empirically to be enormous.[35]

An emphasis on consumer welfare, over the interest of a single competitor, is consistent with the public interest standard. In addition, the approach to mandatory unbundling proposed by Hausman/Sidak is consistent with antitrust analysis which has the goal of maximizing consumer welfare. Thus, the public interest is consistent with increased competition and innovation. Moreover, an emphasis on economic efficiency and consumer welfare maximization has a related benefit: it harmonizes economic regulation and antitrust law. The benefits of applying this analysis to the Commission's review of ILEC unbundling requirements in Section 251(d)(2) of the Act are clear. As Hausman/Sidak reason:

> First, the same basic tools of microeconomic analysis can be em-

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[35] *Id.* at 43-44.

> ployed in one as in the other. There can be little disagreement that the economic sophistication of antitrust law has enriched the regulatory analysis of natural monopoly. Second, changes in technology or other circumstances that permit natural monopoly to give way to competition impart continuity to the relationship between economic regulation and antitrust. Third, many of the thorniest problems in antitrust law—such as judicial enforcement of injunctive remedies under the [Modification of Final Judgment] or the essential facilities doctrine—are fundamentally regulatory in nature, involving issues such as entry or the pricing of intermediate goods sold to competitors. Thus, the economic scholarship on regulation can in many instances enrich antitrust jurisprudence.[36]

Clearly, this standard of review regarding the scope of mandatory unbundling proposed by USTA looks to the effect on competition, rather than the interests of a given CLEC, and comports with the Supreme Court's instructions that the Commission must take into account the availability of substitutes for ILEC network elements outside ILEC networks. If substitutes outside the ILEC networks are available, that availability occurs because some firms have made the rational economic decision that they can efficiently provide services that employ those elements. The conclusions which follow from this analysis are self-evident: (1) the element as provided by the ILEC cannot be essential for competition because competition is already occurring without ILEC provision, and the network element, unbundled by government decree at TELRIC prices, cannot be labeled an essential facility, or "necessary" to competition, or an element for which the decision not to mandate unbundling would "impair" the competitive supply of telecommunications services; and (2) competition will not be adversely affected if a given CLEC cannot procure the unbundled

[36] *Id.* at 45.

element from the ILEC since other firms are providing substitutes outside the ILEC network.[37] As Hausman/Sidak explain: "the 'limiting principle' demanded by the Court naturally emerges when one uses the effect on competition, rather than the effect on individual competitors as in the Commission's past and present formulations of the "necessary" and "impair" standards." [38]

Commission policy which imposes mandatory ILEC unbundling at TELRIC rates is nothing more than compulsory sharing which serves as disincentives to investment and innovation. According to Hausman/Sidak, "Disincentive effects on incumbents are substantial because those firms are continuing to make large and sunk investments in their existing networks. As ... Justice Breyer explained ... Nor can one guarantee that firms will undertake the investment necessary to produce complex technological innovations knowing that any competitive advantage deriving from those innovations will be dissipated by the sharing requirement."[39] The central principle that should guide the Commission's interpretation of the necessary and impair review required by the Court's opinion is the impact of unbundling on competition and market power, and not how any given network element may impact a particular competitor.

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[37] *Id.* at 46-47.

[38] *Id.* at 46.

[39] Hausman/Sidak Affidavit at 57, *citing* Justice Breyer's Concurring Opinion in *AT&T v. Iowa*, 119 S. Ct at 721.