

III. PUBLIC POLICY BASIS FOR LIMITING MANDATORY ILEC UNBUNDLING OF NETWORK ELEMENTS

As described by Hausman/Sidak, USTA's definition of necessary and impair relies on the competitive analysis of demand and supply substitution, essential facilities principles extracted from antitrust litigation, and sound economic principles designed to provide incentives for competition which maximizes consumer welfare.⁴⁰ The Commission, must also consider the adverse impact that TELRIC pricing of ILEC UNEs has on competition and innovation. As Hausman/Sidak conclude:

Regulated prices that are set on the basis of TELRIC confer implicit subsidies to those who purchase unbundled network elements Those highly favorable prices encourage the use and reliance on unbundled network elements of the incumbent and discourage the use of and investment in competitor's own facilities. The availability of those UNEs at inefficiently low prices not only attracts firms that could deploy their own facilities, but also introduces firms that could not have efficiently entered or expanded in the marketplace to do so. The subsidized prices shield inefficient entrants from facing the true economic prices they would otherwise be forced to face.⁴¹

The central tenet of USTA's arguments is that necessary and impair review, conducted by the Commission for the purpose of imposing mandatory network unbundling on ILECs, must be based on defining relevant geographic markets with the intent that unbundling requirements would sunset as competitive developments provide alternative sources for CLECs to purchase

⁴⁰ *Id.* at 71, Part III.

⁴¹ *Id.* at 61; *see also* Jorde/Sidak/Teece Affidavit at 15-35 (mandatory unbundling of ILEC broadband networks raises the ILEC cost of capital and debt, while serving as a disincentive to investment and innovation).

network elements from other than ILECs sources.⁴²

Based upon the Hausman/Sidak review of essential facilities doctrine applied in antitrust cases, the competitor must meet a four-part test: (1) control of the essential facility by a monopolist; (2) a competitor's inability practically or reasonably to duplicate the essential facility; (3) the denial of the use of the facility to a competitor; and (4) the feasibility of providing the facility.⁴³ As Hausman/Sidak explain, the essential facilities doctrine assumes that the owner of the facility "possesses monopoly power".⁴⁴ By analogy, as a limiting principle in interpreting the necessary and impair standards of section 251(d)(2) of the Act, the strength of the essential facilities doctrine is that it screens out unmeritorious claims. "In that respect, the doctrine plainly rejects the notion that the public interest is advanced by the simplistic rule that any compulsory sharing that is technically feasible to order shall be ordered."⁴⁵ Mandatory unbundling, simply because it is technically feasible, has been rejected by the Court, and cannot serve as the basis for the Commission to mandate unbundling of existing ILEC telecommunications services or advanced telecommunications networks and services provided by ILECs.

Section 251(d)(2) does not mandate the unbundling of a proprietary network element unless it satisfies both the impair standard and the necessary standard. Hausman/Sidak correctly

⁴² USTA's proposal in no way limits Section 251(f).

⁴³ *Id.* at 72.

⁴⁴ *Id.* at 73.

⁴⁵ *Id.*

explain that “those two factors are what the Commission shall consider “at a minimum” when deciding whether to mandate unbundling. The Commission’s consideration of additional factors in appropriate cases should tighten rather than expand the focus of this authority to mandate unbundling in the public interest.”⁴⁶ Pursuant to the Court’s mandate, and the principles of essential facilities analysis, the Commission should interpret necessary and impair with geographic specificity and with the view that mandatory ILEC unbundling of network elements should sunset in accordance with the continued growth in competition that leads to non-ILEC UNE substitutes for CLECs. The Commission can usefully identify multiple geographic zones for unbundling purposes without imposing a uniform nationwide unbundling rule—let alone a uniform nationwide presumption or outcome. The absence of limiting criteria, such as the geographically specific market assessment and sunset provisions proposed by USTA, would create an interpretation of Section 251(d)(2) that would be inconsistent with the Court’s expressed opinion that the necessary and impair review conducted by the Commission must bear a relationship to substitutable UNEs available in each geographic market. Clearly, as

Hausman/Sidak argue:

... a single nationwide standard would be in direct contradiction to market definition standards found in the Department of Justice and Federal Trade Commission Merger Guidelines, which the FCC has used in its own recent merger reviews under the public interest standard of the Communications Act. In terms of geographic market definition, the Merger Guidelines ask whether a hypothetical (unregulated) monopolist could impose a “small but significant and nontransitory” increase in price (that is, raise price above competitive levels). That standard is established by

⁴⁶ *Id.* at 77.

determining whether the hypothetical monopolist would have market power or, alternatively, would be constrained by firms outside the market.

In a given geographic market, the correct question would be whether an (unregulated) ILEC could exercise market power if it were not required to provide its competitors a given unbundled element at cost-based rates. If other CLEC competitors are already providing competing services using the element, or if the element itself is available from non-ILEC suppliers, then an ILEC could not exercise market power. Provision of the unbundled element by the ILEC would not be necessary for competition in telecommunications services in the given geographic area. Nor would competition be impaired if the ILEC were not required to supply the unbundled element at cost-based rates. It is likely, however, that the outcome of that analysis would differ depending on the particular element and the geographical area under consideration.⁴⁷

The Court has instructed the Commission to undertake a review of the ILEC's obligation to unbundle their networks as required by Section 251(c)(3) pursuant to limiting provisions of the necessary and impair requirements of Section 251(d)(2). The Commission should mandate the unbundling of a particular network element in a particular geographic location at a particular time only if such unbundling is necessary to permit the competitive supply of telecommunications services to end users. The correct meaning of impair for purposes of section 251(d)(2) review is whether the ILEC's failure to unbundle a particular network element, at a TELRIC price, in a particular geographic location at a particular time would produce a supply of telecommunications services that is significantly inferior for consumers.⁴⁸

As Hausman/Sidak explain, the price elasticity of demand for unbundled network

⁴⁷ *Id.* at 81.

⁴⁸ *Id.* at 82.

elements must govern the Commission's policy decision when applying the necessary and impair standard in Section 251(d)(2). "In the language of economics, "necessity" and competitive "impairment" are given rigorous economic meaning by deriving the price elasticity of demand for any given unbundled element."⁴⁹ According to Hausman/Sidak:

In the presence of high demand elasticity and high supply elasticity, a firm cannot exercise unilateral monopoly power by attempting to decrease its supply. Demand elasticity is captured by a customer's willingness to switch to competing suppliers as relative prices change. Thus, a broad range of available substitutes would imply a high own-price elasticity of demand. Following the same logic as the market definition criteria, the Merger Guidelines provide a concrete test for evaluating the competitiveness of a market as captured in the idea of market power, which is the ability of a single firm unilaterally to increase price above the competitive level for a significant amount of time.⁵⁰

Market forces are driving competition. These market forces operate to impede the ability of ILECs to engage in anti-competitive pricing. According to Hausman/Sidak:

First, in the face of higher output prices charged by the ILEC, the CLEC could itself also charge more to end-users, and thus could self-supply switches or purchase switches from the ILEC at above-competitive prices. Second, the ILEC must be concerned about customers' fleeing to alternative forms of access such as cable or wireless. With its acquisition of Media One and TCI and its joint venture with Time-Warner, AT&T has positioned itself to serve 95 percent of all households in the United States. Unless - implausibly - AT&T, MCI WorldCom, and Sprint conspired with the ILEC to keep landline access prices artificially high, the "critical share" of deserting customers would likely be reached. Moreover, falling wireless prices will continue to displace traditional wireline users. Those three constraining forces make it implausible that the ILEC

⁴⁹ *Id.* at 83.

⁵⁰ *Id.* at 88-89.

could exercise market power as defined by the Merger Guidelines. If market forces can protect consumers from the harms of monopolization, then the Commission should not impose mandatory unbundling.⁵¹

Based upon these conclusions, Hausman/Sidak proposed a five-part test for the impairment standard under Section 251(d)(2)(B) to determine if a particular ILEC UNE in a particular geographic market must be unbundled, and for what period of time the ILEC should be required to provide the UNE. As this five-part test is applied to the original seven core UNEs set forth in Section 51.319 of the Commission's prior regulation, there is no doubt that competitive developments have made nationwide unbundling of ILEC network elements unnecessary and unworkable in geographic markets throughout the country were substitutable alternatives to ILEC unbundling clearly exists consistent with the requirements of Section 251(d)(2) and the decision of the Court in *AT&T v. Iowa*.

The necessary standard in Section 251(d)(2)(A) applies to proprietary elements. By definition, proprietary elements are those elements which are property rights protected under intellectual property laws. Mandatory unbundling of ILEC proprietary network elements should be required only when access to such element is absolutely essential for competition.

⁵¹ Hausman/Sidak Affidavit at 93.

IV. RECOMMENDATIONS ON APPLYING THE NECESSARY AND IMPAIRMENT TESTS

USTA's proposed standards for Commission review of necessary and impair under Section 251(d)(2) are consistent with the requirements of the Act and the Court's opinion. While USTA's impairment of competition standard is based on the ability of an ILEC to exercise significant market power for a service in the absence of unbundling, in the case of a proprietary element based on intellectual property, USTA recommends a standard that provides for unbundling only if competition is impossible in the absence of unbundling.

As discussed in the Hausman/Sidak Affidavit, "any element embodying a form of legally protected intellectual property, the necessary standard of Section 251 (d)(2) would apply."⁵² Consistent with the Department of Justice and Federal Trade Commission *Antitrust Guidelines for the Licensing of Intellectual Property*, USTA defines intellectual property to include patents, copyrights, trade secrets, and know-how agreements.⁵³ According to the guidelines, "The intellectual property laws and the antitrust laws share the common purpose of promoting innovation and enhancing consumer welfare."⁵⁴ In explaining how the Commission should employ this test, Hausman/Sidak conclude:

While our impairment of competition standard is based on the ability of an ILEC to exercise significant market power for a service in the absence of unbundling, in the case of a proprietary element based on intellectual property we recommend a standard that provides for unbundling only if competition is impossible in the

⁵² Hausman/Sidak Affidavit at 93.

⁵³ *Id.* at 97.

⁵⁴ *Id.* at 946, note 207.

absence of unbundling. Thus, an ILEC might retain some degree of market power based on the intellectual property, as currently happens with respect to intellectual property in the rest of the economy. However, so long as competition is possible without the use of the ILECs intellectual property, economic incentives will exist for ILECs and CLECs to negotiate an agreement over terms, because the ILEC will not be able to control competitive entry into the market for end-user services by means of its control of the intellectual property. We refer to our approach for proprietary elements based on intellectual property as the 'absolute essential' standard because unbundling is appropriate only when the element is truly necessary for competition.⁵⁵

For any element embodying a form of legally protected intellectual property, the necessary standard of section 251(d)(2)(A) would apply. The Commission should recognize that this is a heightened standard of review, beyond impairment of competition, which should apply because of "the importance to consumer welfare of innovation that leads to the creation of intellectual property and because of the uncertainty of successful outcomes that is inherent in the innovative process."⁵⁶

As previously outlined, the Hausman/Sidak impairment analysis involves the following five part test:

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

⁵⁵ Hausman/Sidak Affidavit at 97.

⁵⁶ *Id.* at 95.

regulated price computed on the basis of the regulator's estimate of the ILEC's total element long-run incremental cost;⁵⁷

(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.

In response to the request for comment, this proposed test for the impairment standard provides the Commission with "a mechanism for removing particular elements from the unbundling requirements" while eliminating mandatory unbundling of particular elements where unbundling should not be required.⁵⁸ The order of the requirements are arranged in increasing degree of evidentiary burden. As Hausman/Sidak make clear, the benefits of this approach are unmistakable: "if a CLEC cannot demonstrate that a network element meets the first requirement, then that element is immediately declared inessential, and society is spared the expenditure of the

⁵⁷ As explained earlier, "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." *supra* at 6, note 9.

⁵⁸ *Second Further Notice of Proposed Rulemaking* at 14, ¶¶36-37.

resources needed to perform the more intensive analysis required in the subsequent parts of the test.”⁵⁹

The Commission sought comment on “when we should deem a substitute sufficiently available so as to render access to the incumbent's network element unnecessary.”⁶⁰ As Hausman/Sidak explain, “determining whether a particular network element in a particular geographic area actually is an essential facility requires a close empirical investigation based on the specific facts in that geographic market [and that] demand-side constraints on market power apply to UNEs in general, while supply-side can be analyzed at a UNE-specific level.”⁶¹ In elaborating on the supply-side/demand-side substitution constraints, Hausman/Sidak further explain that “From a supply-side perspective, the correct manner to assess whether an ILEC has the ability to exercise monopoly power is to ascertain the following: If the ILEC attempted to restrict its supply of a given network element to increase the price of end-user services above competitive levels, would other providers increase their supply of that UNE or competing UNEs sufficiently to defeat the attempted price increase?”⁶² Under the circumstances, where competitors have no barriers to expansion or can access the network element from an alternative source, the ILEC cannot exercise market power in the end-user service market by restricting the

⁵⁹ *Id.* at 91.

⁶⁰ *Second Further Notice of Proposed Rulemaking* at 9, ¶21; at 10, ¶ 24 (asking “how the Commission should consider the availability of network elements outside of the incumbent’s network”).

⁶¹ Hausman/Sidak Affidavit at 98.

⁶² *Id.* at 98.

supply of a given element.⁶³ According to Hausman/Sidak, “ a competitor providing a network element will have no binding capacity constraints, and it will be able economically to increase its supply of a given element at current prices because it already would be supplying the element.”⁶⁴ Additionally, “Since marginal costs are not increasing for provision of network elements, a firm’s current provision of a UNE will demonstrate its ability to expand supply. Thus, for a given UNE in which competitive supply exists, an ILEC will be unable to exercise market power in most situations.”⁶⁵ Consistent with the Court’s opinion that the Commission needed to consider the availability of UNEs from alternative suppliers to the ILEC in determining whether the ILEC’s supply of a particular UNE met the necessary and impair standard, “an economic analysis of the expected supply of a given UNE would be required for the Commission to make a reasoned determination.”⁶⁶ In addition, Hausman/Sidak conclude that “Because of the underlying technology of network elements, where fixed costs are high relative to marginal (or variable) costs, the economic incentives for non-ILECs that have entered the market to expand their supply will be very high. With high supply elasticity from competing firms, the ILEC will not likely exercise market power in the supply of elements.”⁶⁷

With respect to supply-side substitution constraints, Hausman/Sidak recommend that the

⁶³ *Id.* at 98.

⁶⁴ *Id.* at 98-99.

⁶⁵ *Id.* at 99.

⁶⁶ *Id.*

⁶⁷ *Id.*

the Commission incorporate two market characteristics.⁶⁸ Regulators should examine whether a CLEC is self-supplying the element in question in the relevant geographic market. If at least one CLEC is supplying the element in question, “the ILEC could not exercise market power in the end-user services market by restricting access to that element.”⁶⁹ Conversely, if a particular element is not competitively supplied, “regulators should next examine the nature of the costs of the UNE to determine whether the element could be competitively supplied in the short term. In particular, if fixed (as opposed to sunk) costs represent a large share of the total costs of the element in question, then the element should not be unbundled.” Based on their analysis, Hausman/Sidak concluded “as long as the asset can be redeployed in a different geographic market at little cost, the CLEC will face no exit barriers. Because low exit costs encourage entry, the regulator need not rely on unbundling of that UNE to stimulate competition.”⁷⁰ Ultimately, as a UNE becomes competitively supplied, TELRIC pricing better reflects the market value of the UNE.⁷¹ Accordingly, Hausman/Sidak concluded:

The more likely it is that TELRIC accurately approximates the market-determined price of an unbundled network element, the less likely it is that the CLEC will demand mandatory unbundling of that element, because the value of the free option granted to the CLEC by the Commission will be near zero. Conversely, the less likely it is that TELRIC fully compensates the ILEC for the option value of mandatory unbundling of a particular network element when sunk costs are important, the more likely it is that the CLEC

⁶⁸ *Id.* at 97-98.

⁶⁹ *Id.* at 98.

⁷⁰ *Id.*

⁷¹ *Id.*

will demand mandatory unbundling of that element at a TELRIC-based price. This perverse effect flows from the FCC's failure to recognize the substantial option value that is associated with the CLEC's right to compel sharing of the ILEC's sunk investments in network infrastructure.⁷²

**V. THE NECESSARY AND IMPAIR TESTS
APPLIED TO UNBUNDLED NETWORK ELEMENTS**

Whether to mandate ILEC unbundling is a factual determination that must be made on a geographically specific basis. Regulators must bear in mind the need to sunset any mandatory unbundling of ILEC network facilities in accordance with the necessary and impair tests proposed by USTA. Only by limiting ILEC unbundling where absolutely essential to competition when applying the standard for necessary, or when applying the market-power standard in USTA's impairment test, can the Commission promote competition, investment, and innovation which ultimately maximizes consumer welfare. The results of supply-side analysis of mandatory unbundling of the Commission's previously identified UNEs indicate that the Commission must carefully consider the consequences of imposing such requirements on ILECs.

A. Switching

Based on analysis of available data and application of the Hausman/Sidak impairment test, there is no basis on which the Commission should require mandatory ILEC unbundling of local switching. As Hausman/Sidak explain:

The nature of costs for switches and the level of competition in their supply indicate that switches should not be unbundled in any

⁷² *Id.* at 101.

geographic market in the United States. First, switches are already competitively supplied. As of March 1999, over one-third of all RBOC and GTE rate centers in the United States were served by at least one CLEC voice switch, and 17 percent were served by at least two CLEC switches. Even if switches were not competitively supplied, the nature of their costs suggests switches should not be unbundled. In particular, switches are highly substitutable across wide geographic areas. If a local switch is combined with digital loop carrier equipment, the switch can provide service to distant customers. At a certain point, the cost of transporting calls to a distant switch becomes more costly than the benefits achieved from the scale economies of increasing the switch load. According to AT&T, such an arrangement is feasible up to a 125-mile radius from the switch. Consequently, the relevant geographic markets for switching are large. Additionally, it is economical for competitors to self-supply (buy and install) switches across a wide range of geographic areas. As long as a CLEC believes that it can serve the minimum number of access lines needed to operate the switch in an economic fashion, self-supply is a viable alternative. Because there are no barriers to exit in the switch industry, mandatory unbundling of switches would increase competition and therefore could not improve consumer welfare.⁷³

B. Local Loops

Regarding local loops, the Commission's stated a presumption that loops must be unbundled: "It is our strong expectation that under any reasonable interpretation of the "necessary" and 'impair' standards of section 251(d)(2), loops will be generally subject to the section 251(c)(3) unbundling obligations."⁷⁴ Hausman/Sidak conclude that loops are "less substitutable than switching because a large portion of the facility is dedicated to an individual customer, or at least a specific street or neighborhood, and is costly to redeploy."⁷⁵ Clearly,

⁷³ *Id.* at 102-103 (citing the Huber/Leo *UNE Fact Report*).

⁷⁴ *Second Further Notice of Proposed Rulemaking* at 13, ¶32.

⁷⁵ Hausman/Sidak Affidavit at 103.

however, in many suburban areas there are facilities-based local competitors for business services. As Hausman/Sidak explain, "Supply-side analysis shows that it cannot impair competition to decline to lease unbundled loops to those firms at TELRIC prices. Over time those CLECs should spread to residential customers as well. In some geographic areas, facilities-based competitors already serve residential customers."⁷⁶ The Commission's presumption that loops should be unbundled on a nationwide basis fails to consider the impact of competition in each market. According to Hausman/Sidak: "Given the pace of new technology deployment, suburban and even rural markets need to be analyzed on a case-by-case basis to determine whether and where unbundled loops are essential facilities. Only considering the restraints to market power owing to CLEC supply opportunities, unbundled loops may be essential facilities in some markets and not in others."⁷⁷

C. Other Identified UNEs

As with unbundling of any particular ILEC UNE, the Commission must base its decision on a factual determination whether mandatory unbundling of a UNE, in any geographic market, is required to promote competition. For four of the five remaining elements, including network interface devices (NIDs), interoffice transmission facilities, signaling networks, and operations support systems, the Commission should undertake geographically specific fact finding before concluding whether or not those elements are competitively supplied, and if not, whether they could be competitively supplied in a reasonable period of time. Operator

⁷⁶ Hausman/Sidak Affidavit at 103-104.

⁷⁷ *Id.* at 104.

services and directory assistance need not be unbundled in any geographic market because they are competitively supplied.⁷⁸ Recently, in response to a US WEST petition seeking to have directory assistance declared a competitive service, the Washington Utilities and Transportation Commission granted the relief sought when it determined that: (1) the relevant product market is the directory assistance services market in the state of Washington; (2) there are reasonably available alternative providers of the ... service; (3) there are no regulatory barriers to entry into the relevant market, and entry presently is occurring; and (4) the directory assistance services offered by [US WEST] are subject to effective competition.⁷⁹ The geographically specific market analysis conducted by the Washington State Commission is consistent with the approach advocated by USTA.

D. Advanced Services Unbundling

In terms of broadband networks and the services they deliver, market evidence demonstrates that mandatory unbundling of the ILECs' networks is not required to permit competition. ILECs lack market power in the delivery of broadband services. Thus, the network elements that the ILEC uses to supply those services cannot be essential facilities.

The Antitrust Division of the Department of Justice ("DoJ") approved the MCI/WorldCom merger only after requiring the largest merger divestiture in history. In mandating that MCI divest its estimated \$1.75 billion value Internet business, ultimately

⁷⁸ *Id.* at 104-105.

⁷⁹ *In the Matter of Petition of U S WEST Communications, Inc. for Competitive Classification of Directory Assistance Services*, Dkt. UT-990259, Order at 4 (Apr. 29, 1999).

purchased by Cable and Wireless, the DoJ expressed its concern about the worldwide monopoly over the Internet backbone by MCI/WorldCom:

The merger as originally proposed would have given WorldCom/MCI a significant proportion of the nation's Internet traffic, giving the company the ability to cut off or reduce the quality of Internet services that it provided to its rivals.... This divestiture benefits anyone who relies on the Internet because it preserves competition among major Internet service providers. Consumer will benefit with lower prices, higher quality, and greater innovation⁸⁰

As the Commission's report to Congress concluded, competition in broadband services is well underway without any compulsory unbundling of the ILECs' network elements.⁸¹ In its report, the Commission stated: "Numerous companies in virtually all segments of the communications industry are starting to deploy, or plan to deploy in the near future, broadband to the consumer market. Current providers include cable television companies, incumbent LECs, some utilities, and "wireless cable" companies."⁸² The Commission acknowledged that:

Deployment of broadband, both backbone and last mile, is occurring on a major scale, for both business and consumer markets. American business and the capital markets are obviously betting that broadband will be successful in the business and consumer markets and many companies are rushing to seize part of that success. We expect that this sizeable investment by numerous companies will translate in the near future into significant

⁸⁰ Department of Justice Press Release at 1-2, July 15, 1998, <http://www.usdoj.gov/atr/public/press_releases/1998/1829.htm>.

⁸¹ *Inquiry Concerning the Deployment of Advanced Telecommunications Capability to All Americans in a Reasonable and Timely Fashion, and Possible Steps to Accelerate Such Deployment Pursuant to Section 706 of the Telecommunications Act of 1996, Report*, CC Dkt. No. 98-146 (February 2, 1999).

⁸² *Id.* at 7, ¶12.

deployment of broadband capability.⁸³

In the same report to Congress, the Commission determined that cable broadband unbundling was not necessary “see[ing] no reason to take action on this issue at this time.”⁸⁴ Because ILECs are non-dominant providers of broadband services, there is no reason to mandate ILEC unbundling. As Hausman/Sidak conclude: “Because cable companies currently pass more than 95 percent of U.S. homes, it follows that mandatory unbundling of the ILECs’ broadband networks is not necessary for competition in broadband services, nor would competition be impaired if the ILECs’ broadband networks were not unbundled.”⁸⁵ As USTA stressed in a recent letter to Commission Chairman Bill Kennard, AT&T’s direct acquisition of cable broadband local loops, in conjunction with other cable alliances, will allow AT&T to reach about 61 percent of all households.⁸⁶ Yet, the Commission does not require AT&T to unbundle its broadband network facilities, while AT&T is adamant about not permitting access to its facilities, while demanding that ILECs unbundle their networks on demand.⁸⁷ As AT&T has publicly argued “it shouldn’t have to open its network to rivals that aren’t taking the multibillion-dollar risk of buying and upgrading it.”⁸⁸

⁸³ *Id.* at 18, ¶36.

⁸⁴ *Id.* at 52, ¶101.

⁸⁵ *Id.* at 103-104.

⁸⁶ Letter from Roy Neel, President & CEO of USTA to Bill Kennard, Chairman Federal Communications Commission at 3 (May 4, 1999).

⁸⁷ *Id.* at 6.

⁸⁸ *Id.* at 6, note 14.

Chairman Kennard has recognized the importance of removing barriers to ILEC investments in new technology and benefitting from innovations which lead to first-to-market advantages. As the Chairman stated:

I want to get rid of any regulations that are not necessary to promote competition or protect consumers I am particularly interested in eliminating barriers to innovation and investment.

*I, for one, am not afraid of seeing wireline telephone providers have a first mover advantage -- if you make the investments to get to market first*⁸⁹

For the same reasons that AT&T asserts that it should not be required to unbundle its cable-based broadband network, an ILEC is unlikely to invest in the deployment of new broadband networks and services if it knows that the Commission will compel it to sell to its competitors at TELRIC prices the network elements used to supply that service if it proves to be commercially successful. The Commission, however, appears indifferent to the impact that TELRIC pricing would have on ILEC investment in new technologies: As Hausman/Sidak noted, the Commission's belief that "nothing in the statute or the Court's opinion that would preclude us from requiring that loops that must be unbundled must also be conditioned in a manner that allows requesting carriers supplying the necessary electronics to provide advanced telecommunications services, such as digital subscriber line technology ("DSL")"⁹⁰ is contrary to the Court's opinion regarding the limits imposed on the Commission's authority to mandate ILEC unbundling.

⁸⁹ Remarks of Chairman Kennard to *USTA's Inside Washington Telecom*, Washington, D.C. (April 27, 1998).

⁹⁰ Hausman/Sidak Affidavit at 107, quoting the Commission's statements in the *Second Further Notice of Proposed Rulemaking* at 13, ¶3 2.

The Commission's shortsighted statement ignores the intent of the Act and the mandate from the Court. Mandatory unbundling of ILEC networks, absent the fact-based review of competitive alternatives in each geographic market, will create disincentives for ILECs to invest in new technologies that lead to the kind of innovation intended by the Act. Chairman Kennard has championed USTA's bedrock belief in free market forces as the only driver for competition:

*I have an abiding and unabashed faith in the power of the free market to deliver the best, most innovative and cheapest communications services. We cannot legislate or regulate to stop technological change. And we cannot legislate or regulate the power of the market to drive change.*⁹¹

In a companion affidavit, the authors further explain how mandatory unbundling requirements imposed on ILECs deploying advanced telecommunications networks and services create disincentives for investments in network upgrades and innovations.⁹² In explaining the detrimental impacts of Commission policy favoring ILEC unbundling of broadband networks and services, Jorde/Sidak/Teece conclude:

Mandatory unbundling of network elements at total element long-run incremental cost (TELRIC) prices will diminish the incentives of both ILECs and CLECs to invest in existing facilities and new technologies. The Commission must therefore carefully weigh that cost against the putative benefits of any limiting principle that it promulgates to implement the "necessary" and "impair" standards of section 251(d)(2) of the Telecommunications Act. A firm's investment decisions are based on its careful weighing of the expected returns from the investment against the firm's weighted-average cost of

⁹¹ Remarks of William E. Kennard, Chairman, Federal Communications Commission before the Congressional Economic Leadership Institute, June 17, 1998, <<http://www.fcc.gov/Speeches/Kennard/spwek817.html>>.

⁹² Jorde/Sidak/Teece Affidavit.

capital. The mandatory unbundling rules that the Commission tentatively adopts, or hints in the Second Further Notice of Proposed Rulemaking that it will adopt, would decrease the incentives of both ILECs and CLECs to invest in existing facilities and new technologies by lowering the expected returns and increasing the weighted-average cost of capital for each group of firms.⁹³

On August 12, 1998, USTA made an *ex parte* filing in CC Docket Nos. 98-146, and 98-147 in which an exhaustive report by Robert Crandall and Charles Jackson entitled *Eliminating Barriers to DSL Service* was entered into the record.⁹⁴ In their study, Crandall and Jackson discuss current and future competition in Internet access through cable modems, cellular-based Internet service providers, CLECs, through high-speed satellite Internet access and packet radio Internet access. With respect to ILECs deploying DSL, the authors concluded:

Applying retail or universal service regulation to DSL service makes it virtually certain that such investments would become unattractive. Moreover, if wholesale unbundling or resale were allowed in the first six or seven years, the ILEC would find it much more difficult to recover its investment. Indeed, the availability of unbundled copper loops may, by itself, require the ILEC to recover its DSL investment more rapidly than our model allows....

One key step in bringing ... [competition] ... to local telecommunications is to ensure that LECs have the proper incentives to invest in the new data transmission technologies.⁹⁵

Mandatory unbundling of ILEC broadband networks and services leads CLECs to make

⁹³ Jorde/Sidak/Teece Affidavit at 10.

⁹⁴ *Ex parte* letter from USTA's Vice President and General Counsel Lawrence E. Sarjeant to FCC Secretary Margalie Roman Salas, August 12, 1998 in which was attached a letter and the Crandall and Jackson study addressed to Commission Chairman William E. Kennard and Commissioners Susan Ness, Michael K. Powell, Harold Furchgott-Roth, and Gloria Tristani.

⁹⁵ Crandall & Jackson *Eliminating Barriers to DSL Service* at 56 (July 1998).

business decisions that rely on the technological advancements derived from ILEC risk-taking, investments and innovations. By imposing mandatory unbundling of ILEC broadband networks and services at TELRIC prices, CLECs are most likely to “prefer unbundling to building facilities, even if building facilities has a higher net present value.”⁹⁶ Moreover, CLECs are more likely to game the regulatory process for RBOC in-region long distance relief by demanding “bug-free”UNEs, particularly operational support systems, which when unmet leads to complaints that the RBOC has not fulfilled its Section 271 requirements.⁹⁷

With respect to unbundling of switching, loops, DSLAMS and transmission facilities, including fixed and wireless, USTA recommends that the Commission not require mandatory unbundling at TELRIC prices because to do so would jeopardize the continuation of innovations. As Jorde/Sidak/Teece elaborate, investments by ILECs in more efficient routing tables and vertical features, development of loop technology such as DSL, DSLAMs, and wireless transmission facilities would be at risk if ILECs were required to provide access to these network elements on an unbundled basis at TELRIC prices.⁹⁸

E. Combined Elements

The Commission asserts that the “[t]he ability of requesting carriers to use unbundled network elements, including combinations of unbundled network elements, is integral to achieving Congress’

⁹⁶ *Id.* at 37.

⁹⁷ *Id.* at 38-41.

⁹⁸ *Id.* at 51-57.

objective of promoting rapid competition in the local telecommunications market.”⁹⁹

USTA’s impairment test is designed to be conducted on a “stand-alone basis.”¹⁰⁰ Should any element fail the test, the Commission should not require unbundling of that element at TELRIC pricing. With respect to UNE platforms, the impairment test is applied simultaneously, when each element in the combined UNE platform fails the impairment test, the Commission should not require unbundling of the set of UNEs comprising the UNE platform.¹⁰¹

F. Demand Side Substitution of Elements

From a demand-side perspective, the correct manner to assess whether an ILEC has the ability to exercise monopoly power is to ascertain the following: if the ILEC attempted to raise prices for end-user access while restricting its supply of a given UNE, would customers find an alternative source of acceptable end-user service. Accordingly, where cable, wireless, and voice telephony substitutes exist, the ability of ILECs to exhibit market power is significantly curtailed.

Under the circumstances, it makes no sense to apply the impairment test on a UNE specific level.¹⁰² There is nothing in the Act or the Court’s opinion that would “constrain”¹⁰³ the Commission’s inquiry regarding consideration of cable, wireless, or other substitutes to ILEC unbundling. The inherent fallacy in the Commission ignoring competitive substitutes is reflected in the findings of

⁹⁹ *Second Further Notice of Proposed Rulemaking* at 2, ¶2.

¹⁰⁰ Hausman/Sidak Affidavit at 108.

¹⁰¹ *Id.* at 109.

¹⁰² *Id.*

¹⁰³ *Second Further Notice of Proposed Rulemaking* at 12, ¶28.

Hausman/Sidak:

In contrast, antitrust analysis implies that the relevant product markets for an end product or an essential facility must be continually revised over time. Given those considerations and given the growth of bundled services successfully offered by the ILECs' competitors, the FCC runs the risk of its unbundling policy's being irrelevant to competition before they are even fully implemented—and thus obsolete and harmful to consumer welfare.¹⁰⁴

VI. PROCEDURAL ISSUES

A. State Commissions Role

State regulators should play an active role in the application of any necessary and impair standards adopted by the Commission. As the Washington State Commission decision declaring directory assistance a competitive service indicates, geographically specific, fact-based determinations are required when assessments regarding the availability of substitutable elements are present in the market such that mandatory unbundling of ILEC network elements is unnecessary.

B. Evidentiary Burdens and Sunset Provision

The burden to provide evidence regarding the scope of competition and the availability of substitutes to mandatory unbundling of ILEC network elements must depend upon whether the ILEC or CLEC possesses the best information. The rebuttable presumption should be that mandatory unbundling of any given network element at a TELRIC price is not required. CLECs should bear the burden of establishing the need for a particular ILEC network element in

¹⁰⁴ Hausman/Sidak Affidavit at 113.

a geographically specific market.¹⁰⁵

The Commission also requested comment on the adoption of a sunset provision, "under which unbundling obligations for a particular element or elements would no longer be required, upon the passage of time or occurrence of certain events, without any subsequent action by the Commission."¹⁰⁶ Consistent with the *Merger Guidelines* adopted by the DoJ and the Federal Trade Commission, and discussed at length in these comments, mandatory unbundling of ILEC network elements at TELRIC pricing should automatically sunset within two years, or upon the entry of any facilities-based CLEC into the market. The CLEC would bear the burden of proof that mandatory unbundling of a particular element or elements should continue.¹⁰⁷

CONCLUSION

In *AT&T v. Iowa*, the Supreme Court instructed the Commission to review its decision to impose mandatory unbundling of ILEC network elements 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). USTA has proposed a comprehensive test for both the necessary and impair standards that can assess whether, in specific geographic markets, mandatory unbundling of ILEC network elements is necessary to promote the pro-competitive intent of the Act. State commissions are best able to render decisions on unbundling as the recent decision of the Washington

¹⁰⁵ *Id* at 119-121.

¹⁰⁶ *Second Further Notice of Proposed Rulemaking* at 15, ¶39.

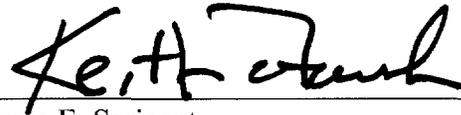
¹⁰⁷ Hausman/Sidak Affidavit at 119-118.

State Commission, finding directory assistance to be a competitive service, indicates.

Mandatory unbundling of an ILEC network element should sunset within two years or when facilities-based competition is present in the market. The Commission should reject requests to impose unbundling requirements on advanced broadband networks and services provided by ILECs because ILECs lack market power and imposition of mandatory unbundling is a disincentive for ILECs to invest in network upgrades and to innovate. The recommendations made by USTA promote consumer welfare, are consistent with the opinion of the Supreme Court, and the pro-competitive deregulatory intent of the Act.

Respectfully submitted,

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