

SPEECHES/PRESENTATIONS

Dynamic Sharing of Spectrum, Presented at Rutgers WINLab Focus '98, June 1998.

Wireless Networks Opportunities — Challenges Ahead. Presented at the 1998 IEEE Workshop on Multiaccess, Mobility and Teletraffic (MMT'98) for Wireless Communications, Washington DC, October 22, 1998

International Approaches to Telecommunications Restructuring. Presented at the Cross-Industry Working Team Plenary Meeting, Washington, DC. November 4–5, 1997.

Expected Patterns of Product Evolution. Presented to the Twenty-Third Annual Rate Symposium, St. Louis, MO. April 28, 1997.

Panelist. *De-Nationalizing the Airwaves*. First Annual Conference of the Federalist Society's Telecommunications Practice Group: Toward a Free and Competitive Communications Industry, Washington, DC. October 18, 1996.

Improving the Regulation of Public Safety Communications. Presented to the 62nd Association of Public-Safety Communications Officials (APCO) International Conference and Exposition, San Antonio, TX. August 1996.

Telecommunications Deregulation. Presented at the Maryland–District of Columbia Utilities Association's Annual Spring Conference, Ellicott City, MD. April 26, 1995.

Participant in the 11th annual Practicing Law Institute/Federal Communications Bar Association Conference on "Telecommunications Policy and Regulation," Washington, DC. December 10, 1993.

How Auctions Will Work. Presented to the TeleStrategies Spectrum Auctions Conference, Washington, DC. November 1, 1993.

Ensuring Efficient Competitive Outcomes. Presented to the "PCS Summit," Washington, DC. October 13–15, 1993

Carrier Perspectives on Government Investment in Public Telecommunications Infrastructure. Presented to the Computer Science and Telecommunications Board workshop on the Changing Nature of Telecommunications Infrastructure, Washington, DC. October 12–13, 1993.

The Impact and Implications of Changing Technology: Competition in LEC Markets. Presented at the United States Telephone Association Congressional Staff Seminar, Williamsburg, VA. June 3–4, 1993.

Regulation of the Spectrum. Presented to the Industrial Liaison Program Symposium of the Massachusetts Institute of Technology on Universal Personal Communications: Technologies and Policies for Seamless, Digital, Wireless Communications, Cambridge, MA. March 30–31, 1993.

Cost Structure of Competitors. Presented to the Pricing and Costing Strategies for a Competitive Environment. A TeleStrategies Conference, Washington, DC. March 9–10, 1993.

Spectrum Allocation for Personal Communications. Presented to the MIT Communications Forum, Cambridge, MA. February 25, 1993.

Ensuring Efficient Competitive Outcomes. Presented to the Personal Communications Services Conference, Dallas, TX. February 2–3, 1993.

Comments on PCS licenses. Presented to the Wireless Datacomm '92 conference, Boston, MA. December 8–9, 1992.

ISDN. Presented to the Information Gatekeepers, Reston, VA. November 19, 1992.

What Can You Do with a Cordless Telephone? Presented to the Nineteenth Annual Telecommunications Policy Research Conference, Solomons Island, MD. September 28–30, 1991.

Participated in the Congressional Budget Office's (CBO) round-table on the budgetary implications of auctioning new radio frequency licenses, Washington, DC. November 20, 1991.

Moderator. *Personal Communications Services in the '90s.* Annual public relations seminar of the United States Telephone Association—"Public Relations Imperatives For the '90s," Washington, DC. September 13, 1991.

LEC Gateways: Provision of Audio, Video and Text Services in the U.S. Presented to the National Economic Research Associates, Inc., Telecommunications in a Competitive Environment Seminar, Scottsdale, AZ. April 15, 1989. Also presented to the 8th Annual ITS International Conference, Venice, Italy. March 1990.

The Evolution of Access. Presented to the Seventeenth Annual Telecommunications Policy Research Conference, Airlie, VA. October 1–3, 1989.

Open Network Architecture: Definition, Benefits and Costs, Impact on Industry Structure and Performance. Speech presented to the Nineteenth Annual Williamsburg Conference, Williamsburg, VA. December 7–9, 1987.

With Harry M. Shooshan III, Jeffrey H. Rohlf, and Susan W. Leisner. *The Negative*

Effects of Tax Reform on the Telephone Industry: Making Up the \$15 Billion Difference. Presented to the Fifteenth Annual Telecommunications Policy Research Conference, Airlie, VA. September 27–30, 1987.

Is Bypass Still a Threat Today? Speech presented to the Telecommunications Policy in a Competitive Environment Seminar, Scottsdale, AZ. March 4–7, 1987.

With Jeffrey H. Rohlfs. *Improving the Economic Efficiency of NTS Cost Recovery.* Presented to the Fifth Biennial Regulatory Information Conference, Columbus, OH. September 3–5, 1986.

With Jeffrey H. Rohlfs. *Improving the Economic Efficiency of Interstate Access Charges.* Presented to the Fourteenth Annual Telecommunications Policy Research Conference, Airlie, VA. April 27–30, 1986.

Remarks presented to The Council of State Planning Agencies, Lincoln, NE. October 20–21, 1985.

Cable and Public Utility Regulation. Speech prepared for the Reason Foundation Conference on Public Utilities, Washington, DC. September 9, 1983.

“Technology Options in Enhanced Services: Twisted Pair to Videodiscs.” Comments on *Enhanced Services.* NCTA Executive Seminar Series, National Cable Television Association, Washington, DC. 1981.

The Political Climate for Communications: Gusty Winds from All Directions. Presented to the Energy Bureau, Inc., Washington, DC. December 10–11, 1981.

June 15, 1999

REPLY DECLARATION OF ALFRED E. KAHN
CC DOCKET 96-98
JUNE 10, 1999

**Before the
Federal Communications Commission
Washington, D.C. 20554**

In the Matter of)	
)	
Implementation of the Local Competition)	CC Docket No. 96-98
Provisions in the Telecommunications Act)	
of 1966)	

**REPLY DECLARATION OF ALFRED E. KAHN IN RESPONSE TO
SECOND FURTHER NOTICE OF PROPOSED RULEMAKING**

I. INTRODUCTION AND SUMMARY

1. My name is Alfred E. Kahn. My qualifications are set out in my initial submission in this proceeding.

2. The purpose of these comments is to reply to:

- the Affidavit of Professors Hubbard, Lehr and Willig (filed as Exhibit C to AT&T's Comments), and the Declaration of Professor Kwoka (filed as Exhibit C to MCI WorldCom's Comments), previously submitted in this proceeding;
- the demands of Rhythms Netconnections and Northpoint Communications that the subscriber loops the Commission has identified as subject to mandatory unbundling under Section 251 of the Telecommunications Act be themselves subject to additional unbundling, so as to permit them to use only the high-frequency portion of the spectrum; and

- the demand of e.spire Communications, Intermedia Communication and ALTS that ILECs be required to provide them enhanced, expanded loops—“EELS”—in effect “platforms” composed of loops and dedicated transport facilities, at rates set in compliance with the Commission’s TELRIC prescription.

II. MY ORIGINAL DECLARATION

3. In explaining why the statements of the aforementioned economist witnesses are in my opinion not responsive to the instructions of the Supreme Court, in terms of the pertinent economic principles, it will be efficient for me first to summarize my characterization of those principles in my original submission:

- There is an inherent tension between the two generic routes to competitive entry envisioned by the Act—non-facilities based (via resale and lease of UNEs from the incumbent LECs) and facilities-based: the more liberal the definition of UNEs and the more attractive the prescribed prices, the greater the discouragement to facilities-based entry by CLECs and investment by ILECs as well.
- While recognizing the necessity of keeping the former route open, particularly on a transitional basis, it is essential that the Commission keep in mind the primacy of the latter, risk-taking investment, as the superior form of competition.
- This tension is aggravated by the method of pricing UNEs mandated by the Commission:

Why incur the risks of constructing one’s own facilities if one can instead acquire them at a price that regulators ... have determined would be the cost of an ideal efficient provider?” (p. 13)

- These considerations argue for strict application of the competitive principles underlying the essential facilities doctrine—namely, that a firm may not acquire mandatory access to a competitor’s products or facilities unless it cannot compete effectively without them—element-by-element and market grouping-by-market grouping, with the actual experience of CLECs obtaining the UNE elsewhere in a relevant market sufficient to justify exclusion of it from the list and with markets defined both geographically and by class of customers.
- The conflict of this approach with demands for an entire platform: the obligation to offer a “platform” can be justified only if each and every element qualifies under the foregoing criteria.

III. THE POSITIONS OF AT&T’S AND MCI’S ECONOMISTS

4. The assertions of the aforementioned economists essentially ignore the above-described tensions or conflicts and minimize the danger of excessive encouragement of free-riding by CLECs:

- by emphasizing all the asserted inherent disadvantages of CLECs,¹ stemming from the assertedly lesser availability to them of economies of scale and scope. In so doing, they completely overlook comparable and in some respects superior economies available to their clients—e.g., their ability to bundle long-distance with local services, their national brands, their sheer size, their ability to take advantage of more efficient

¹ Fairly consistently the AT&T economists refer to asserted disadvantages of “a CLEC.” Manifestly, the fact that *individual* CLECs may be handicapped is irrelevant to the possibility of *competition* as an effective force in the market.

technologies or network configurations and their already dominant positions in cable, wireless and long-distance service;

- by asserting that the CLECs will typically prefer to use their own facilities—in order to avoid exposure to discrimination and disputes over it, as well as the asserted obligation to disclose competitively sensitive information;
- by asserting that UNEs are an “absolute precondition” to facilities deployment—which is clearly far from true, as I will proceed to document;
- by asserting that entry via UNEs has served, historically, as a transition to facilities-based entry (Kwoka, p. 9). In reality, competition in both local and long-distance service has developed preponderantly through the use of resale, facilities construction and mandatory interconnection with the incumbents. The unbundling required by the Act is unprecedented;
- by simply ignoring the effect of the unprecedented, particular pricing standard for UNEs adopted by the FCC in aggravating the problem. Significantly, Professor Willig in another context explicitly rejected the applicability of TELRIC, as defined by the FCC, as incompatible with risky investment and innovation by AT&T, advocating instead (if—contrary to his urgent advice—it were to be required to share these facilities with competitors) a much more generous standard for the price that that Company would be permitted to charge for access to the broadband facilities it has since acquired from TCI: supply cost plus *full opportunity cost*.² In short, the AT&T

² Declaration of Professors Janusz A. Ordoover and Robert W. Willig, attached to AT&T's and TCI's Joint Reply to Comments and Joint Opposition to Petitions to Deny or to Impose Conditions, *In the Matter of Joint*

and MCI economists in this case—in contrast with the case involving FCC approval of the AT&T/TCI merger—almost completely ignore the prerequisites of risky investment in innovation.

- Moreover, they do not explicitly respond to my central contention—namely, that it doesn't make sense to require availability of UNEs that are in fact being provided or obtained in other ways in the relevant market.

5. In this connection, Hubbard et al. simply *assert* that an inability of CLECs to have access to UNEs would be prohibitive of entry because the CLECs will have an inherent cost disadvantage; and they simply *assert* that

In the long run, unbundled network elements should encourage, and certainly will not discourage, facilities-based competition. (p. 14)

In so doing, they ignore my contention that it is difficult to imagine a pricing standard for UNEs that the FCC could have adopted that would be more likely to encourage free riding and discourage CLECs investing in their own facilities.

Moreover, their explanation of why

in theory, the availability of UNEs at TELRC means that CLECs incur costs similar to those of the incumbent LEC in providing local services. (p. 14)

flatly contradicts itself. In the very next sentence, they go on to explain:

this is because, by its definition, TELRC is supposed to match the incumbent LEC's "economic costs" of providing the network elements necessary to provide local services. (p. 14)

Application of AT&T Corp. and Tele-Communications, Inc. for Transfer of Control to AT&T of Licenses and Authorizations Held by TCI and its Affiliates or Subsidiaries, CS Docket No. 98-178, November 13, 1998. Ordoover and Willig provided a very expansive definition of full opportunity cost. It would account for not only foregone net revenues but also the reduced value of investment consequent on losses in indirect revenues.

Observe the sleight-of-hand exercised here: the FCC's prescribed pricing is said to impose on the CLECs costs "*similar* to those of the incumbent LEC," yet the TELRC-prescribed prices are "supposed to match" not the ILEC's *actual* forward-looking costs but, by design, the putatively lower "economic costs" of providing the network element with maximum efficiency.

6. In short, in this statement these economists fail to explain how the FCC's prescriptions translate into an inherent cost *disadvantage* for the CLECs and on what basis they assure us that the FCC's present rules "certainly will not discourage facilities-based competition." *By design*, the FCC's prescribed pricing method is expected to result in charges *below* the forward-looking costs of the ILECs themselves, on the basis of the expectation that the latter costs incorporate inefficiencies—that is, by the FCC's own reasoning, it is the ILECs that would have the cost disadvantage!³ Hubbard et al., particularly, almost totally ignore the actual market behavior of CLECs generally, and their own client, in particular. They attribute to the Eighth Circuit responsibility for the "fact" that "*no* such competition" in providing services in "local mass markets" "has developed in the ensuing three years." (pp. 4-5) Kwoka is guilty of almost as glaring an oversight: "With isolated exceptions, facilities-based entry is prohibitively expensive and time consuming," with investment costs "staggeringly high" (p. 6).⁴

³ In this connection, also, their assertion that the FCC-prescribed charges would assure the ILEC a competitive return on invested capital (p. 18) ignores that explicit expectation of the FCC: the allowance for return is only on new investment by an ideally-efficient competitor, which, by the assumption of both the FCC and the IXC-advocates of the ideally-efficient-firm TELRIC standard, the ILECs are not. The FCC has suggested in the context of its universal service proceeding that the level of return allowable in TELRIC should be limited to the previously-authorized 11.25 percent and FCC-prescribed depreciation—rather than economic depreciation—rates should be used—the same rates as it applied in the monopoly era and clearly below the rates suitable for investment by CLECs in the new competitive environment.

⁴ Their fundamental failing, perhaps, is the assumption that entry will come in the form of a duplication of the ILECs' narrowband networks. Real entry, of course, has taken quite a different course. For example, in Dr.

7. Contrast their statements here with what happened during these very years:

- Less than one year ago, AT&T acquired Teleport, one of the largest operating CLECs, at a cost of \$11 billion, upon completion of which acquisition it announced:

Completion of this merger accelerates our entry into the \$21 billion business local service market because we're reducing our dependence on the Bell Companies for direct connections to businesses,' said AT&T Chairman C. Michael Armstrong. ... "We're giving customers simplicity, convenience and choice. It's one-stop shopping for local and long-distance service, just for starters," he said. ...

TCG has more fiber route miles and serves more businesses in more cities than any other competitive local service company," Armstrong said. "The strategic value of this merger...positions AT&T for growth and undisputed leadership in three of the fastest growing segments of the communications services industry—consumer, business and wholesale networking services.

TCG, with more than 10,000 miles of fiber optic cable and 50 local switches, is the nation's premier provider of competitive communications services. Its network encompasses more than 300 communities coast to coast. Armstrong said that AT&T also pledges to devote substantial resources to continue the building of facilities in critical markets.⁵

- MCI made a similar major commitment by entering into a mammoth, \$37 billion merger with WorldCom, which substantially expands its local exchange presence. because of WorldCom's previous acquisition of the largest operating CLEC, MFS. Just as in the case of AT&T, announcement of that merger was accompanied by confident proclamations of the way in which it would strengthen the ability of the partnership to provide local exchange service with its own facilities:

Bryant's Declaration (filed as Exhibit D to MCI WorldCom's Comments), his calculations from the HAI model suggest that loop facilities are uneconomic in high density areas such as Manhattan. Yet, AT&T paid \$11 billion for TCG's loop facilities and switches in these areas.

⁵ "AT&T Completes TCG Merger; TCG Now Core of AT&T Local Services Network Unit," AT&T News Release, July 23, 1998, emphasis added.

The largest expense for MCI, as a long-distance carrier, had been fees paid to local phone companies for beginning and ending calls.

MCI WorldCom now wants essentially to eliminate those fees for business customers who use the company for local and long-distance calling. For a conversation or data message that travels exclusively on MCI WorldCom's network, rates could decrease by as much as 35 percent, the company said.⁶

- These new facilities-based CLECs are by no means limited to the major long distance companies. As of March 1999, over 150 CLECs had installed 724 switches throughout the U.S.: the corresponding figures were 139 at the end of 1996 and 328 at the end of 1997.⁷ In addition, there are at least 31 ventures by private electric utilities into telecommunications, making use of their rights-of-way, excess fiber capacity⁸ and large capital reserves, which make the telephone and/or cable markets appealing to them.⁹ These companies offer both wholesale and retail services: in opposing the designation of dark fiber as an additional UNE, UTC reports that 30 of its members provide dark fiber to third parties, thus offering a direct alternative to ILEC facilities.¹⁰
- As the growth in the number of switches demonstrates, the operations of the CLECs collectively, and of individual CLECs particularly, have been expanding robustly. The president of their trade association at the time informed the FCC that they had provided

⁶ Seth Schiesel, "FCC Blocks Two Bells on Long-Distance Entry," *The New York Times*, September 29, 1998.

⁷ Joan Engebreston, "The New Guys in Town," *Telephony*, June 2, 1997, pp. 98-110. New Paradigm Resources Group, *Review of the Annual Report on Local Telecommunications Competition*, March 1998, p. 2. The March 1999 figures are based on the Bellcore *Local Exchange Routing Guide*.

⁸ For example, SCANA Corp., the parent company of South Carolina Gas and Electric, controlled 2,500 route miles of cable fiber back in 1995 through its subsidiary MPX Systems, Inc., and was planning to double that. "Growing Utility Fiber Market Tempered by Considerable Hesitancy," *Fiber Optics News*, Vol. 15, No. 19, May 15, 1995.

⁹ In addition, we have identified 24 such ventures by municipally owned electric utilities, preponderantly offering video service.

1.5 million access lines by the end of 1997, reflecting a 2½-fold expansion in that year, and that she anticipated another more than doubling in 1998—an expectation that was actually exceeded by the 4.5 million CLEC lines in service at the end of that year.¹¹ Indeed, in 1998, Salomon Smith Barney reported that the expansion of CLEC access lines for business customers actually exceeded that of the ILECs for the first quarter of that year.¹² At that time it also reported that these firms might well attain a double-digit market share for business access by 1999—approximately the same share as IXCs other than AT&T, MCI and Sprint had attained by 1993, at which time, Professors Hubbard and Lehr have argued, their presence was sufficient to constrain any market power of the “Big 3.”¹³

- Investors clearly have a similarly bullish view of the opportunities for local competition. In the three years since the passage of the Telecommunications Act in

¹⁰ Comments of UTC in this proceeding, May 26, 1999.

¹¹ CLECs reported 1997 revenues of \$2.7 billion, up from the \$0.96 billion reported to the FCC for 1996. Revenues for 1998 were estimated to be about \$5.2 billion (See statement of Heather Gold, FCC *En Banc* on the State of Local Competition, January 29, 1998, FCC’s *Trends in Telephone Service*, February 1998, and Merrill Lynch, *Telecom Services – Local*, March 11, 1999.) The corresponding share of the CLECs in total revenues increased from 1 percent to 2.6 percent to 5 percent.

¹² Salomon Smith Barney, “CLECs Surpass Bells in Net Business Line Additions for the First Time.” May 6, 1998. The article reports that CLECs added 498,000 new lines, compared with 461,000 for the Bells:

To put this in perspective, the non-AT&T long distance competitors did not have more incremental minutes than AT&T until 1986, a full 10 years after MCI carried its first switched long distance minute. What this shows is that the combination of access to low cost capital coupled with a clear regulatory and public policy initiative toward opening up local markets has allowed the CLECs as a group to achieve in less than 2 years after the Telecom Act, what it took MCI and other alternative long distance carriers over 10 years to achieve during the 1970s and 1980s. If one takes the obvious logical extension of this, this means that the 50% loss of market share that AT&T saw from 1986 through 1996 could be replicated in the local market in a much quicker time period.

¹³ Affidavit of R. Glenn Hubbard and William H. Lehr, on behalf of Western Electric Company, Inc., and American Telephone and Telegraph Company, United States District Court for the District of Columbia, Civ. No. 82-0192 (HHG), filed December 5, 1994, Attachment 1: “An Analysis of Competition in U.S. Long-Distance Telephone Service,” pp. 5-6.

1996, CLECs have raised \$30 billion of outside capital.¹⁴ In comparison, the most recent data reported to the FCC show total annual investment by the ILECs has been about \$19 billion.¹⁵ The over \$30 billion that CLECs raised—over a three-year period—was over 12 times the amount of capital they raised in the four years before passage of the Act.¹⁶

8. The AT&T and MCI economists systematically ignore the experience with Canada's very different local competition rules. Based on a strongly articulated preference for facilities-based entry,¹⁷ these rules differ from the FCC's in several ways: (1) UNEs are as a general policy to be made available on a mandatory basis only if they are essential facilities; (2) the few non-essential exceptions are to be made available on a mandatory basis for only a 5-year period; (3) the prices of network elements are based on the ILEC's (not a hypothetically efficient firm's) forward-looking costs plus a 25 percent mark-up; and (4) there is no regulatorily-prescribed resale discount.

9. Yet local competition in Canada is progressing.

- AT&T-Canada merged in March of this year with the largest facilities-based competitive local exchange carrier, MetroNet,¹⁸ which has fiber facilities in 11 large Canadian metropolitan areas. One industry observer now ranks the merged company

¹⁴ Council of Economic Advisors, "Progress Report: Growth and Competition in U.S. Telecommunications 1993-1998," February 8, 1999.

¹⁵ Calculated from data reported in the FCC's *Statistics of Communications Common Carriers*.

¹⁶ Heather Gold, *op. cit.* and Council of Economic Advisors, *op. cit.*

¹⁷ "Local Competition Decision," Telecom Decision CRTC 97-8, Ottawa, May 1, 1997, paras 73-74.

¹⁸ See "AT&T Canada – MetroNet Mega-Merger," *Network Letter*, March 8, 1999, pages 1-2.

with other Canadian super carriers—Bell Canada, BCT.TELUS and Sprint-Canada.¹⁹

All of these companies are developing the capability of offering a full range of products on a national scale.²⁰

- MetroNet²¹ alone has acquired 60,000 lines—about one percent of the business lines in Canada—by pursuing a strategy of reselling ILEC Centrex lines²² to acquire customers and then migrating these customers to its own facilities. Between September 1998 and the beginning of 1999, the share of MetroNet's lines served by its own facilities increased from one-third to two-thirds.
- Overall, CLECs (including both facilities-based carriers and resellers) appear to be doing quite well. One industry consultant estimates that they serve about 10 percent of the business market in markets where they operate.²³ As in the US, the potential for residential facilities-based competition appears to be emerging through the medium of telephone over cable television facilities.²⁴ Two of the four largest providers—

¹⁹ The Canadian trade press also reports discussions between Group Telecom, Inc., one of the other two licensed facilities-based carriers, and Sprint Canada. In particular, Group Telecom is interested in offering Sprint loop and transport facilities in the cities in which it is establishing facilities (Vancouver, Calgary, and Toronto) in competition with unbundled elements supplied by ILECs. See "Group Telecom Says AT&T Canada – MetroNet Merger Opens Niche for Local Competition," *Network Letter*, March 22, 1999, pages 4-5.

²⁰ See "The New Balance of Power: National Super-Carriers," *Telemanagement*, March 1999, page 1.

²¹ See John Riddell, "Local Competition Gets Real: MetroNet Offers Service in 11 Cities," *Telemanagement*, January 1999, pages 11-13.

²² Unlike the US, CLECs in Canada purchase retail services targeted for large users from the incumbents, as opposed to services from a wholesale tariff with a regulatory-prescribed avoided cost discount.

²³ See "Montreal Telecom Consultant Predicts CLEC Evolution into Full Service Providers," *Network Letter*, January 18, 1999, pages 3-4.

²⁴ See Lis Angus, "Cablecos Planning Local Service Rollout in 1999," *Telemanagement*, January 1999, pages 14-15.

Videotron²⁵ and Cogesco—have announced plans to upgrade their facilities to provide telephone services to their residential customers.

10. These real world results effectively rebut the grudging acknowledgement of competition shown by the IXCs' economists. By assuming that CLECs will deploy the same narrow-band technology and locate their offices in the same locations as the ILECs, Dr. Byrant "proves" that real companies, such as AT&T's Teleport and MCI-WorldCom's MFS, either cannot exist or do not deserve to. For example, his chart 10 purports to demonstrate that an individual CLEC entering a high density urban area would have loop costs over three times those of the ILECs, even when it attained the rather healthy market share of 10 percent. The history we have surveyed provides a living refutation of his argument.

11. To be sure, all this activity has been concentrated primarily in the densely populated urban areas and sales to medium and large business customers—although even this generalization must be qualified in the light of the documentation of competition in less densely populated areas by the PNR study, attached to GTE's opening comments. The fact remains that their recommendation of "national rules" (Hubbard 20-21)—by which they mean every element must be made available everywhere to serve every customer for all time—necessarily and inherently ignores that experience, which demonstrates conclusively that national rules are simply irrational in the light of the Supreme Court's decision.²⁶ These witnesses representing

²⁵ Videotron also has installed fiber facilities to provide local service to business customers in Montreal.

²⁶ Manifestly, "national rules" are not in themselves unacceptable. GTE and Bell Atlantic, for example, do not object to the FCC's adopting "national rules"—subject, however, to the condition that they be flexible enough to recognize the differing availability of alternatives to ILEC network elements in different parts of the country and in different customer markets.

the IXCs in effect recommend a return to the standard that the Supreme Court explicitly rejected—namely, that if a failure of UNEs to be available would in *any* way impede or handicap competitors (or even, perhaps, a single competitor)—the existence of which handicap would presumably be conclusively inferred from the mere request of a CLEC for a UNE (Hubbard, pp. 7, 8, 21)—the ILEC must be required to offer it, at regulatorily prescribed rates.

12. Moreover, the sponsor of these last two witnesses has now invested upwards of \$100 billion, through its mergers/acquisitions of TCI and MediaOne, precisely in order to enter those “local mass markets,” accompanied by a massive advertising campaign proclaiming its intention to do exactly that.²⁷

IV. THE ISSUE OF LINE SHARING AND SPECTRUM UNBUNDLING

13. Rhythms and North Point are demanding that the mandatory unbundling process be extended to a degree that could scarcely have been contemplated by the initial requirement that ILECs make “unbundled loops” available to their competitors : namely, that they be required to offer applicants use of only the high-frequency portion of the spectrum provided by the loops. Whatever the superficial plausibility of these demands, they would, demonstrably, be destructive of the efficient competition that the Act and FCC have attempted to encourage.

14. The logic of the demand is, superficially, compelling—even though, I will proceed to demonstrate, it would produce an irrational and anti-competitive apportionment of costs: a CLEC interested in competing only for the business of transmitting massive volumes of data at

²⁷ The question might reasonably be raised whether this huge initiative does not contradict my previous warning that the FCC’s unbundling and pricing rules encourage free riding and discourage facilities-based competition. The answer, I suggest, is that AT&T here is concentrating on developing the next generation of broadband

high speed does not require the entire loop. It is access only to the high frequency portion of the spectrum that is “necessary” for the provision of that service and lack of access to which would “impair” the ability to offer it.

15. The proposal has the additional, intriguing—and, doubtless, not coincidental—implication that while the logic of identifying high frequencies alone as a separate input is questionable, the TELRIC of access to them might in a sense be regarded as close to zero. This could be the result produced by the now-familiar method of measuring the TSLRICs of products supplied in common: where facilities are shared by two or more services, the incremental cost of service B is the difference between the cost of providing A on a stand-alone basis and the cost of providing service A and B together. If, then, a loop is conceived of as making it possible to supply two services—basic dial tone and high speed-high capacity transmission of data—the TSLRIC of *either of them* would turn out to be close to zero if not actually zero, since any system set up to supply the other would already have incorporated the costs of the loop itself. *The same logic that would produce a close to zero total service incremental cost of providing access to the high frequency spectrum, when capacity to do so is added to a loop already providing dial tone, would produce a close to zero incremental cost for the latter as well, if that capacity were added to a system already in place capable of providing access to the high frequency spectrum.*²⁸

facilities not available from ILECs, in further demonstration that the most powerful competition is facilities-based, and particularly when those facilities embody alternative or new technologies.

²⁸ See the exposition of the identical—fallacious—logic as applied to the familiar and long-standing controversies over whether subscriber dial tone is a “separate service,” with its cost to be recovered in a separate charge, or an essential input to the provision, for example, of long-distance and local usage, with its costs properly recovered in the charges for those services. See the exposure of that fallacy in my *Letting Go: Deregulating the Process of Deregulation*, Michigan State University Institute of Public Utilities and Network Industries, 1998, pp. 73-76,

16. Moreover, the logic of separately identifying and costing these two inputs or services is further confounded by the imminent transition from circuit-switched to packet-switched technology and substitution of Voice Over IP (VoIP) for what is now basic service.

17. The simple fact of the matter is that if an incumbent local telephone company is to be required to bear the entire cost of providing a loop, capable of providing a wide variety of services—with the necessity of recovering the common costs from those several services rather than in a lump sum charge for dial tone alone—and is then required to offer the access that the loop provides to competitors for the provision of only some of these services, at—let us assume—zero incremental cost, it may well find itself, under pressure of competition, incapable of recovering any of the common costs from the latter services. CLECs offer the opposing contention that the ILEC does not necessarily impute to itself or to its own xDSL operations and offerings any part of the cost of the loop, presumably because its marginal cost for this new usage is something close to zero; and a similar availability of the loop to them at similarly low-to-zero marginal cost would therefore do no more than put them on an even competitive footing. The response is that in competitive markets sellers do not price on the basis of “imputed” common costs, when those costs must be recovered either in the form of fixed customer charges or on the basis of what the respective services produced with the aid of the inputs will bear. Competitive parity would therefore require that both sets of rivals bear the same loop costs, each recovering them in either of those two ways—not that one set of rivals be

“The TSLRIC Quagmire,” and my allusion, below, to the FCC’s recognition of the proper way to recover loop costs. In this discussion I ignore the possibility, which I am not competent to evaluate, that there would be substantial incremental costs involved in the kind of unbundling being requested here. For my purposes, which is to assess the implications of this demand for efficient competition between ILECs and CLECs, these additional asserted costs are unnecessary: even if the unbundling demanded entailed zero incremental costs, it would decidedly *not* be conducive to efficient competition for that “UNE” to be priced at that level.

totally exempted from them, as the proponents of what is deceptively labeled “line sharing” would have it.

18. As the foregoing characterization of the impossible situation in which the ILECs would find themselves if this demand were granted suggests, essential components of that dilemma are that

- the ILECs have a continuing obligation to supply the basic dial tone services, *and*
- the rates they are permitted to charge for those services are themselves subject to regulatorily imposed ceilings, *and*
- they have been enabled to continue to perform that function, at those regulated rates, in considerable measure because of their ability to extract higher markups on other services provided through the same loops.

In these circumstances, manifestly, the competition between those two entities would be fatally distorted if spectrum sharing were in fact mandated at the FCC’s TELRIC prices.

19. Such a mandatory spectrum sharing would have the additional, distressing consequence that it would eliminate any incentive on the part of competitive carriers to provide voice services as part of a total package, because to do that they would obviously have to employ—*and pay for*—the entire loop—a cost they could conceivably escape entirely by demanding access only to the high-frequency spectrum.

20. As the FCC has itself recognized, the costs of the loop are not usage sensitive. Efficiency requires that they be recovered, then, in lump-sum charges—not in the prices of the services whose provision they make possible. But where the ILEC is prevented by regulation

from recovering all of those costs in this way and must instead recover some of them from services using the loop, and where a competitor can offer some of those high-margin services, without having to pay any part of the fixed cost of that loop, the result must inevitably be a distortion of competition between the two.

21. Manifestly, fair and efficient competition requires that CLECs and ILECs both be required to bear the full incremental costs of these multi-purpose facilities, the loops—whether by investing in them themselves or acquiring them, unbundled, from the incumbents—competing, then, on an equal footing in providing whatever portions they choose of the entire range of services whose supply the loops make possible.

22. Consider, finally—to advert to our central argument—the fatal effect on the incentive or willingness of competitive carriers to construct their own facilities if they were able, by courtesy of regulators, to acquire the capability of offering the most lucrative, rapidly expanding and most innovation-dependent of their several services from their incumbent owners, at prices equated to the very low (and conceivably zero) marginal costs of adding that capacity to their loops.

V. THE DEMAND FOR ENHANCED, EXPANDED LOOPS (EELS)

23. The demand of some carriers that the FCC require incumbent telephone companies to offer them bundled combinations of loops and dedicated transport facilities, presumably at prices complying with the Commission's TELRIC formula, provides an excellent example of the opposite kind of gaming of the system in which some CLECs are engaging—instead of, as in the previous case, demanding “network elements” narrower than the units for which costs

are incurred, demanding combinations (or “platforms”) of units *broader* than would satisfy the economist’s formulation of the Act’s “necessary” and “impair” standards.

24. The law, the Supreme Court’s interpretation of it and the principles of efficient competition that I have already enunciated all require that mandatory unbundling and provision at Commission-regulated rates be confined to network elements that meet those standards. While I have made no independent study of these markets, the mere fact that, even as of several years ago, every major metropolitan area in the country had its own competitive access provider of special access, along with the recent dramatic emergence and dramatic growth of CLECs in those areas that I have already summarily described (including reference to the facilities AT&T acquired with the purchase of Teleport and those of MFS that went into the MCI-WorldCom combination), clearly demonstrate the absurdity of any pretense that special access could satisfy that requirement. Moreover, as McDermott and Taylor persuasively demonstrate, large customers routinely take advantage of the availability of competition in those urban areas to solicit competitive proposals statewide.²⁹ In these circumstances, the demand that loops bundled with transmission be subject to mandatory “unbundling” and sharing would be laughable even if it were not in a proceeding dictated by an instruction of the Supreme Court to the FCC to give some substance to the statutory “necessary” and “impair” standards.

25. By an illuminating coincidence, the requests of various CLECs for spectrum unbundling, on the one side, and EELs on the other, illustrate the gaming to which the Act’s provision mandating the offer of unbundled network elements is subject. The FCC should

²⁹ Petition of Bell Atlantic for Forbearance (CC Docket 99-24, January 20, 1999, Attachment C).

clearly be wary of both games—the proposed bundling of elements genuinely needed by competitors with elements that do not satisfy that standard, on the one side, and, on the other, the proposed unbundling of what are and clearly must be irreducible elements if the Act's goal of efficient competition is to be achieved.

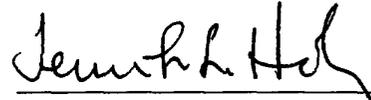
I declare under penalty of perjury that the foregoing is true and correct. Executed on
June 10, 1999.

A handwritten signature in cursive script, appearing to read "Alfred E. Kahn". The signature is written in black ink and is positioned above a horizontal line.

Alfred E. Kahn

CERTIFICATE OF SERVICE

I hereby certify that on this 15th day of June, 1999, copies of the forgoing "Comments of Bell Atlantic" were sent by first class mail, postage prepaid, to the parties on the attached list.



Jennifer L. Hoh

* Via hand delivery.

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ITS*