carriers.[76] In this case, too, state commissions may have an interest in regulating ILEC advanced services affiliates differently than other providers of advanced services. Indeed, Congress directed § 706 not only at the Commission, but at "each State commission with regulatory jurisdiction over telecommunications services." The NPRM offers no basis to abandon the Non-Accounting Safeguards Order's determination that states should be free to impose incumbent-type regulations on ILEC affiliates, and none is apparent.[77]

II. THE COMMISSION SHOULD BUILD ON ITS EXISTING LOOP UNBUNDLING AND OSS RULES TO ADDRESS SPECIFICALLY THE ACCESS TO, AND INFORMATION ABOUT, LOCAL LOOPS THAT NEW ENTRANTS NEED TO OFFER ADVANCED SERVICES.

Regulatory agencies around the world have recognized that the loop is one of the most critical bottleneck facilities, and that mere rights to negotiate for access to it cannot produce meaningful competition. Specific and strictly enforced loop definitions and unbundling regulations (coupled with efficient pricing rules) are essential if CLECs are to receive the nondiscriminatory access to unbundled loop facilities that the Commission has recognized is "critical to encouraging entry."[78]

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76 See Non-Accounting Safeguards Order, ¶ 317.

77 Cf., e.g., Advanced Micro Devices v. CAB, 742 F.2d 1520, 1542 (D.C.Cir.1984) ("[A]n agency changing its course must supply a reasoned analysis that prior policies and standards are being deliberately changed, not casually ignored."). The NPRM states that its discussion of state regulation of advanced services affiliates is limited to their "provision ... of advanced services," and does not address state regulation of these affiliates' provision of "voice services." NPRM, ¶ 117. As the Commission itself has found, however, the Act provides identical treatment for advanced services and circuit-switched voice services, and there is thus no basis for the NPRM's attempted distinction.

78 First Report and Order, Implementation Of The Local Competition Provisions In The Telecommunications Act Of 1996, 11 FCC Rcd 15499, ¶ 377 (1996) ("Local Competition

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ATTACHMENT 3

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

In the Matter of	)	
	)	
Deployment Of Wireline Services Offering	)	CC Docket No. 98-147
Advanced Telecommunications Capability	)	

REPLY COMMENTS OF AT&T CORP.

Pursuant to the Revised Public Notice released on August 12, 1998, AT&T Corp. ("AT&T") respectfully submits these reply comments on the Commission's Notice of Proposed Rulemaking ("NPRM") regarding rules the Commission may adopt to encourage competition in, and timely deployment of, advanced telecommunications capabilities.[2]

INTRODUCTION

In the NPRM the Commission requested the specific data and proposals needed to ensure that its national interconnection, collocation and unbundling standards provide the nondiscriminatory access to network facilities required by the Act and promote real competition in the provision of advanced services over those facilities. As the Commission has recognized, the availability of these new services in a competitive environment promises enormous benefits to all consumers. Notwithstanding their control over virtually all of the relevant facilities and

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2 A list of the commenters and the abbreviations used for them in these reply comments is attached as an Appendix.

information – or, perhaps, because of it – the incumbent LECs have, for the most part, chosen to ignore that request.

The incumbents propose no solutions to the hurdles currently limiting entrant access to remote terminals; they do not even supply the data that might allow others to come up with solutions. Instead, they propose denying their potential competitors access to loops at remote terminals. The incumbents do not disclose the loop characteristic information that is in their possession; rather, they oppose any expansion of existing OSS requirements as "burdensome." And incumbents do not discuss methods of deploying xDSL services to customers served over IDLC configured loops. They simply proclaim that it cannot be done.

Instead of making a constructive contribution to this proceeding, the incumbents raise the same legally and factually bankrupt flag that they have flown in every regulatory proceeding since the passage of the Act: that their local markets are "open" to competition and therefore no regulation of their conduct is required (or, indeed, allowed). The reality is quite different, and the incumbents' comments cannot be taken seriously. As an initial matter, the regulation the incumbents seek to evade is mandated by the plain terms of the Act. In all events, the incumbents' own conduct over the past three years conclusively demonstrates that they can and will exploit any opportunity to impede competition, and that strong pro-competition national rules are therefore imperative. As MCI WorldCom (p. 70) aptly notes, "[n]othing has contributed more to the failure of facilities-based local competition to develop since the passage of the Act than the ILECs' refusal to comply with their statutory obligation to provide reasonable, nondiscriminatory, and cost-based unbundled access to the local loop, including

related OSS." Absent Commission rules that clearly and directly require nondiscriminatory access to the local facilities used to provide advanced services, the same anticompetitive incumbent incentives and abilities can be expected to cripple the competitive provision of those services.

Fortunately, the many other participants in this proceeding have taken the NPRM seriously. And, as discussed below, these parties have reached a general consensus regarding the principal steps the Commission should take to implement the Act's requirements and promote advanced services. Regarding the separate affiliate proposal, the majority of commenters urge the Commission to read Section 251(h)(1) as it should be read – to bar ILECs from evading their obligations under Section 251(c) through a "corporate shell game." Moreover, a number of state commissions, conclude that the proposal would have the unintended effect of incenting ILECs and their affiliates to engage in concerted anticompetitive conduct and to shift network facilities and investments to the affiliate so as to evade the ILECs' unbundling and resale obligations under the Act, underscoring the fatal lack of detail concerning the types of facilities and services that may properly be controlled by the affiliate. Further, the affiliate discussed in the NPRM would nonetheless be subject to ILEC regulation as a "comparable carrier" under Section 251(h)(2).

If the Commission nonetheless determines to proceed with the separate affiliate approach, a broad array of comments, again including the majority of those submitted by state commissions, confirm that the safeguards required under Section 272 are entirely insufficient to limit both the ability and the incentive of ILECs and their affiliates to engage in concerted

anticompetitive conduct. They urge significant strengthening of the proposed separation requirements to ensure sufficient separation and operational independence of the affiliate from the ILEC so that it functions like any other CLEC and derives no anticompetitive and discriminatory advantages from the ILEC. Without these added requirements, the affiliate cannot properly be deemed truly separate from the ILEC such that it can lawfully be exempted from the unbundling and resale obligations of Section 251(c).

In particular, commenters widely call on the Commission to require (i) a prior approval process; (ii) a significant and meaningful amount of outside ownership of the affiliate so as to encourage the affiliate to act in its own corporate self interest rather than simply as an ILEC alter ego. In addition, commenters stress the need to enforce vigorously the nondiscrimination requirement, and, correspondingly, support a bar on the affiliate's use of the ILEC brand, joint marketing and discriminatory access to CPNI, and the affiliate's resale of ILEC services. Commenters also object strenuously to any transfers, de minimis or otherwise, of advanced services facilities to the affiliate.

There is also a strong consensus among non-ILEC comments regarding the rules the Commission should adopt regarding loops. These commenters agree that the Commission should ensure that entrants have nondiscriminatory access to basic, xDSL capable, and xDSL equipped loops, even if a loop must be conditioned or groomed to provide the requested service. Thus, the Commission should establish national rules that prohibit ILECs from impeding entrant access to those loop types and all their features, functions, and capabilities. The comments also demonstrate that the Commission should clarify and expand its existing OSS rules so that

entrants can determine what advanced services could be provided to a particular customer in the same manner that ILECs can make this determination. Further, the Commission should convene a forum to prevent the kind of discriminatory application of spectrum management standards that CLECs have already encountered. And because remote terminals create a strategic opportunity for ILECs to hide loops and discriminate against their potential competitors, the Commission should adopt rules that promote parity of access to remote terminals and the services that ILECs can offer using those facilities. As the demand for advanced services expands, ILECs will place increasing reliance on remote terminal configured loops to achieve higher quality service and transmission speeds. Consequently, in order to prevent ILECs from "hiding" local loops when a loop passes through a remote terminal by raising claims of space exhaustion or technical feasibility, the Commission should require ILECs to provide xDSL equipped loops and require the construction of new remote terminals to take into account the needs of CLECs for collocation.

The comments also evince broad agreement that the Commission has authority to and should expand its collocation rules. ILECs continue to unreasonably restrict access to and use of collocation space thereby significantly undermining local competition. As the comments indicate, these tactics have the potential to be even more devastating for competitive advanced service offerings than for basic services. Thus, most carriers and state commissions agree that the Commission should expand the types of equipment that can be collocated to include, inter alia, remote switching modules and packet switches. In light of rapid technological change, the Commission also should refrain from limiting permissible equipment to particular types of

technology. And many parties like AT&T demonstrated convincingly that the Commission should permit "cageless" collocation, eliminate of POTS Bays, and allow interconnection using copper cables. AT&T and other commenters further demonstrated that the Commission should promote the efficient and nondiscriminatory use of central office and remote terminal space by (i) requiring ILECs to remove equipment that is no longer used or useful, (ii) allowing CLECs who have been denied space to tour central offices and confirm that space is indeed not available, and (iii) limiting the amount of space that the ILEC's separate affiliate may occupy in a central office or remote terminal.

Finally, the incumbents again stand virtually alone in their requests for relief from existing interLATA restrictions, resale obligations, and unbundling requirements. The relief they request would violate the plain language of the Act and seriously undermine competition for advanced services. These requests should be denied.

I. INCUMBENT LECS HAVE BOTH INCENTIVES AND ABILITY TO IMPEDE COMPETITION FOR ADVANCED SERVICES.

Incumbents offer two reasons why the Commission should refrain from removing entry barriers to the widespread deployment of advanced services: (1) that despite their control over the bottleneck facilities used to provide advanced services, incumbents have no advantage over entrants in the provision of those services, and (2) that implementation of the Act's interconnection, collocation, and unbundling requirements will rob incumbents of their incentives to deploy new technologies and services. The first argument is refuted by the most basic principles of economic theory and by the record evidence – incumbents can and are using their control over the public network to thwart entrant attempts to offer advanced services. The

second argument has it exactly backwards. If the Commission follows through on its proposals to open local markets to competing advanced services providers, incumbents' incentives to deploy – which to date have been muted by concern over "cannibalization" of their other high margin monopoly retail services – will be significantly enhanced by the realization that if they do not deploy new electronics and services over the existing network, others will.

A. Incumbent LECs' Control Of Bottleneck Local Facilities Gives Them Significant Market Power Over the Provision Of Advanced Services.

Even aside from the fact that the Act's interconnection, collocation, and unbundling provisions apply by their terms to facilities used to provide advanced services, there is no legitimate economic rationale for excusing incumbents from their statutory obligations in this context. While the deployment of advanced services has only recently begun, the ILECs "still own and control the public network, they still have redoubtable market power, and they still have the expertise and the will to place countless obstacles in front of would-be competitors."[3]

The incumbents argue that because they have themselves just begun offering xDSL services, they do not have market power.[4] But this argument confuses market power with market share. Market power is a firm's ability to sustain prices above competitive levels,[5] and

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3 xDSL Networks, p. 3.

4 See, e.g., GTE, p. 3 ("ILECs . . . are the newest among a multitude of rivals in a vigorously competitive market."); BellSouth, p. 30 ("ILECs that provide DSL services do not possess market power in the advanced services market.").

5 See, e.g., American Tobacco Co. v. United States, 328 U.S. 781 (1946) ("the material consideration in determining whether a monopoly exists is not that prices are raised and

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both the courts and the Commission have long recognized that control of bottleneck facilities is direct evidence of market power, regardless of market share.[6] Indeed, as discussed infra (p. 10), the fact that many incumbents have only recently begun to offer advanced services over xDSL technology that have been available for years through modifications to their existing networks, if anything, confirms the existence of market power – a strategy of slow-rolling the implementation of new technologies that compete with existing high margin services is a hallmark of market power. That market power will persist so long as incumbents can inhibit their potential competitors' access to the network facilities used to provide xDSL services.

GTE (p. 3) responds that "[t]he advanced services marketplace is vigorously competitive and does not rely on ILEC telephone networks for essential inputs." GTE points to cable facilities.[7] The reality, however, is that GTE and other incumbents control the only

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that competition actually is excluded but that power exists to raise prices or to exclude competition when it is desired to do so").

6 The Commission has consistently "treat[ed] control of bottleneck facilities as prima facie evidence of market power[.]" First Report and Order, Policy and Rules Concerning Rates for Competitive Common Carrier Servs. And Facilities Authorizations Therefor, 85 F.C.C.2d 1, 21 (1980); see also id. ("An important structural characteristic of the marketplace that confers market power upon a firm is the control of bottleneck facilities"); Memorandum Opinion, Order and Certificate, Application of Iowa Network Access Div. For Auth. Pursuant to Section 214 of the Communications Act of 1934 And Section 63.01 of the Comm'n's Rules and Regulations to Lease Transmission Facilities to Provide Access Serv. to Interexchange Carriers, 3 FCC Rcd. 1468, 1469 (1988) ("One of the indicia of market power is the control of bottleneck facilities, with a concomitant ability to impede competition").

7 Id., pp. 3-4.

facilities that currently can support high speed, two-way data communications for the vast majority of U.S. homes and business. Many rural customers, for example, do not have one-way communications services such as cable or satellite television, but almost all do have telephones that can be converted into advanced services pipelines. Cable and wireless technologies may eventually support affordable, ubiquitous alternatives to the local loop for many customers – and AT&T, for one, is investing heavily to that end – but today the incumbent LEC facilities used to provide advances services will remain bottleneck inputs for the provision of those services to most customers.[8]

Other incumbents claim in circular fashion that the availability of collocation space and unbundled loops eliminates their conceded "technical [and] economic advantages over new entrants in providing advanced services."[9] It is certainly true that nondiscriminatory access to loops and to collocation space are necessary pre-conditions to meaningful competition. But it

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[8] See, e.g., U S WEST, p. 3 (acknowledging that loops and collocation are "essential inputs"). Even if the ILECs' network facilities used to provide advanced services were not essential inputs, the Act would still mandate that they be provided to requesting carriers. As the Commission recently argued to the Supreme Court "the antitrust term 'essential facilities' does not appear anywhere in [the Act]. . . . As to most network elements, what the Commission must 'consider' is not whether the element is 'essential,' but whether deprivation of the element 'would impair the ability' of a requesting carrier 'to provide the services that it seeks to offer.'" FCC v. Iowa Utils. Bd., Reply Br. for the Federal Petitioners, p. 43 (filed June 17, 1998) (citing 47 U.S.C. 251(d)(2)(B)) (emphasis in original). In addition, the argument that advanced services-related equipment like packet switches are not essential elements because entrants can buy them from vendors (see, e.g., U S WEST, p. 8) ignores basic economics. That entrants can purchase their own local switches, for example, does not render the incumbent LEC's local switches unessential. See infra, Section V.

[9] U S WEST, p. 3.

is equally true that incumbents do not today provide these inputs on a nondiscriminatory basis.[10] One central purpose of this proceeding is to strengthen interconnection, collocation, and unbundling requirements to discourage this anticompetitive conduct. Both through their conduct and their attempts to evade any regulation of that conduct, the incumbents confirm the need for the requirements proposed by AT&T and others.

B. National Rules That Facilitate Nondiscriminatory Access to Collocation Space and Network Elements Will Enhance Advanced Services Innovation.

Relying on essentially the same arguments that the Commission rejected two years ago in the local competition proceeding, incumbents contend that robust unbundling and resale requirements will, by forcing incumbents to share their "innovations," create a disincentive for them to invest in the facilities needed to provide advanced services.[11] Precisely the opposite is true. As an initial matter, the incumbents' own actions belie their contention that the prospect of competition destroys their incentives to invest in advanced service facilities. "Five of the six largest ILECs are already [offering xDSL services directly], and three of those carriers either initiated or expanded their offerings after the NPRM was released[.]"[12]

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10 See, e.g., AT&T, pp. 13-15; MCI WorldCom, p. 79; MGC, pp. 39-44.

11 See, e.g., U S WEST, p. 9 ("Forced sharing of innovations indisputably undercuts the incentives for all market participants to invest, and thereby retards the deployment of advanced services").

12 Sprint, p. 36 (emphasis added).

The reality is that incumbents have been too slow to promote advanced services because of the absence of the potential competition that nondiscriminatory access to the facilities used to provide advanced services would bring. xDSL technology is not new. HDSL and ADSL were invented in the early 1990s,[13] but the first major incumbent initiatives to offer advanced services using these technologies have come only this year – and only after a CLEC or cable operator has announced its intention to provide a similar service in the ILEC's service territory. Incumbents "have clear incentives to slow-roll high-bandwidth local loop capabilities . . . because these facilities cannibalize their existing higher margin retail offerings."[14] In other words, when an incumbent offers xDSL services, it competes with itself by attracting customers

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13 The DSL Source Book: Plain Answers About Digital Subscriber Line Opportunities, 2d. pp. 12-19, "http://www.paradyne.com/sourcebook_offer/index.html."

14 Qwest, p. 71.

away from existing services such as ISDN, T1, and second lines to homes.[15] It is no surprise, then, that incumbents have been slow to offer xDSL services.[16]

For this reason, by mandating nondiscriminatory access to the facilities used to provide advanced services, the Commission will strengthen, not weaken, incumbent incentives to innovate. Unlike monopolists who are protected from competition, incumbents and other firms in markets open to competition have a tremendous incentive to innovate rapidly. They innovate in order to (i) obtain a temporary jump on their competitors and (ii) protect themselves from their competitors' innovations.

Both factors apply here. First, an incumbent in a competitive market can always obtain a valuable jump on its competitors by moving first. Although entrants may eventually lease the network elements necessary to provide a similar service or resell the incumbent's retail offering, the incumbent almost always will enjoy a first mover advantage. During that period,

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15 See also Ad Hoc, pp. 11-12 ("Given its potential to render their embedded circuit-switched networks obsolete, incumbents have little reason to embrace any policy that will speed the deployment of advanced services, and have every reason to resist policies that will diminish their control over the deployment of such services"); "Telco & Cable Internet Strategies: The Dawn of Carrier-class Access," 1997 Jupiter Strategic Planning Services/IT47, p. 31 ("Currently, the RBOCs have a stranglehold on high-speed Internet access via leased lines by virtue of their ownership of the local loop. The RBOCs will have little reason to invest in ADSL for business use until businesses have options for high-speed access besides leasing T1 and ISDN lines . . . . Moreover, high demand for second phone lines in the residential market – fueled in part by Internet access – provides a strong disincentive for RBOCs to offer ADSL to consumers, because ADSL offers simultaneous voice and data traffic").

16 See also Qwest, p. 18 ("ILECs are always reluctant to allow competitors to use their last mile facilities. That is the problem that required the Bell System divestiture. That is the problem that required Congress to enact Section 251 in the first place").

the incumbent not only will face no price competition but has the opportunity to build its reputation with customers as a leader in advanced services. Second, if incumbents facing competition do not innovate and offer high quality advanced services, their competitors will. An entrant could lease capable loops, deploy its own advanced services equipment in the incumbent's central office, and offer services that leapfrog the incumbent's basic services. Thus, with entry barriers reduced, incumbents gain both offensive and defensive incentives to innovate and move quickly.

In fact, the effect potential competition will have on incumbent behavior is already evident. Now that some CLECs and cable operators have announced their intentions to provide some advanced services, incumbents finally have begun offering xDSL services. This is precisely what happened when the incumbents were first threatened with competition for video dial tone. They began announcing commitments to offer such services, but as "the threat of cable company entry into telephony diminished over time . . . so did the ILECs' commitment to deploying [video dial tone]."[17] Nor has the ILECs' dismal history in deploying advanced services been restricted to video dial tone. ISDN was a working technology for 20 years before the ILECs made it widely available.[18] Here too, incumbent incentives to innovate will disappear if the Commission does not open local markets with additional unbundling and collocation

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[17] Ad Hoc, p. 16.

[18] See Usage of the Public Switched Network by Information Service and Internet Access Providers, CC Docket No. 96-263, Comments of Internet Access Coalition, filed March 24, 1997, p. 23.

requirements. Hence, instead of rapidly innovating, incumbents will return to their historic practice of protecting their existing services by retarding the deployment of new ones. By contrast, "more competition in the provision of [advanced] services will only increase the urgency [the incumbents] feel to provide these services."[19]

Incumbents nonetheless complain that because competition will constrain their advanced services profits, it must necessarily constrain their incentives to innovate.[20] To the contrary, as the Commission, state commissions and federal courts have all agreed, forward-looking cost-based pricing of network elements, interconnection and collocation, by replicating competitive market outcomes, provides the correct economic incentives for both incumbents and

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19 Time Warner, p. 21.

20 See Ameritech, p. 8.

entrants.[21] The normal profits available in competitive markets provide a reasonable return to investors and strong incentives for efficient innovation.[22]

Nor is GTE's intellectual property protection analogy apt.[23] The intellectual property laws are designed to encourage firms and individuals to undertake research and development activities that may not produce profitable results for many years. For example,

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21 See, e.g., First Report & Order, Implementation of the Local Competition Provisions in the Telecommunications Act of 1996 and Interconnection Between Local Exchange Carriers and Commercial Mobile Radio Service Providers, CC Docket Nos. 96-98 and 95-185, FCC 96-325 ¶ 672 (rel. August 8, 1996) ("Local Competition Order"); GTE South Inc. v. Morrison, 6 F. Supp. 2d. 517, 524 (E.D. Va. 1998); Southwestern Bell Tel. Co. v. AT&T Communications Inc., No.A 97-CA-132-SS, at p. 19 (W.D. Tex. Aug. 31, 1998); accord TNS, p. 7; CWI, p. 13. Under TELRIC or other forward-looking economic pricing arrangements, the ILECs will have similar incentives to invest as a competitive firm. See Local Competition Order ¶ 679 ("Adopting a pricing methodology based on forward-looking, economic costs best replicates, to the extent possible, the conditions of a competitive market."); id. ¶¶ 686-689. ILECs' claim (e.g., Ameritech, p. 8) that they do not have an incentive to invest under such compensation schemes is tantamount to claiming that no competitive firm ever has an incentive to invest.

22 The Commission should reject some ILECs' claim (e.g., Ameritech, p. 8) that TELRIC or other forms of forward-looking economic pricing are not fully compensatory and fail to provide investment incentives. First, the Commission has already concluded that TELRIC is fully compensatory and provides efficient investment signals for entrants and incumbents (see Local Competition Order ¶ 627, et seq.) and state commissions and federal district courts nationwide have echoed this finding. See also supra, n.21. Second, the ILECs' argument highlights their readiness to fault any reasonable pricing scheme. Since passage of the Act, ILECs have contended that they should be reimbursed for their "actual" or book costs. So long as they invest efficiently when deploying facilities to support advanced services, that is exactly what they will receive – plus a risk-adjusted rate of return on their investment. In other words, the forward-looking economic cost of efficient new investments should converge to the total book and capital costs of those investments so long as the ILECs are efficient. Thus, the ILECs' assertion that TELRIC is uncompensatory is nothing more than a thinly veiled attempt to protect their monopoly profits.

23 See, e.g., GTE, p. 107.

patent protection assures drug companies that if they spend hundreds of millions of dollars to develop a new drug, another drug company cannot immediately manufacture the same product. Similarly, telecommunications equipment manufacturers may be rewarded for their technological innovations with patent protection for the new products they develop. Incumbents, on the other hand, want protection not for inventing revolutionary new equipment, but rather for marketing products using other companies' innovations. That would be like protecting from competition a drug store that is retailing a new product (in addition to giving the inventor of the drug a patent). In short, it is one thing to "acknowledge the importance of protecting and encouraging incentives and innovations,"[24] and quite another to seek, as the incumbents do here, to be immunized from competition. And here, of course, Congress made clear that it did not intend that incumbents be shielded from competition when it ordered them to unbundle their network elements and to allow resale of their retail services.

Finally, the incumbents' claims that cost-based interconnection, unbundling, and collocation will chill entrants' incentives to innovate are equally misplaced. Like incumbents, entrants will have a much greater incentive to invest in infrastructure and offer advanced services if the Commission expands and clarifies its existing loop, collocation, unbundling, and resale rules. An entrant has strong incentives to deploy its own facilities even when it can lease the incumbent's facilities instead. First, and most importantly, remaining dependent on a competitor

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[24] GTE, p. 107 (quoting Commissioner Powell).

leaves the entrant open to various forms of non-price discrimination. Small reductions in service quality, delays in provisioning, and even overt conduct making the maintenance on an entrant's leased loop a lower priority than the maintenance on loops retained by the incumbent all exacerbate the entrant's competitive disadvantages. Second, leasing network elements allows the entrant to build a customer base from which it can justify investing in advanced facilities of its own. In other words, unbundled loop access actually encourages facilities-based competition.[25] Third, an entrant's incentive to deploy facilities that support advanced services is even greater than its incentive to deploy equipment supporting only voice-grade service. Data technology is evolving rapidly and, as a result, companies like AT&T have every incentive to leapfrog their competitors by, for example, developing and deploying state-of-the-art packet switches and DSLAM-type equipment.

Thus, it is clear that "[a]dvanced services are most likely to reach all Americans if incumbents are subject to unbundling obligations to permit additional competitors to provide services. Absent the essential unbundling obligations, ILECs would not have the incentive through competition to invest in the provision of advanced services."[26]

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25 See Local Competition Order, AT&T Comments at Appendix C, Affidavit of William J. Baumol, Janusz A. Ordover, Robert D. Willig ¶ 18 (filed May 16, 1996).

26 CTSI, p. 12; see also RCN, p. 20; Sprint, p. 36; Qwest, p. 71; accord KMC Telecom, p. 24.

II. THE COMMENTS BROADLY URGE THE COMMISSION, TO THE EXTENT IT ADOPTS THE SEPARATE-AFFILIATE PROPOSAL AT ALL, TO EXPAND AND STRENGTHEN THE PROPOSED SEPARATION REQUIREMENTS.

The vast majority of commenters conclude, as does AT&T, that the NPRM's proposed separation requirements are wholly insufficient to justify a finding that the ILECs' advanced services affiliates are non-ILECs under § 251(h).[27] These commenters recognize that, without substantial additional separation obligations, the advanced services affiliate will operate simply as the ILEC's alter ego, with both the incentive, and the ability, to engage in concerted anticompetitve conduct. Indeed, many commenters stress that, absent complete divestiture, an ILEC and its affiliate will never be "truly separate," and the affiliate will never act "like any other CLEC,"[28] which are the fundamental (and appropriate) guideposts the Commission set out in the NPRM.[29]

A. The Advanced Services Affiliate Described In The NPRM Is An "ILEC" Under Section 251(h).

1. The proposed advanced services affiliate is an ILEC "successor or assign."

The majority of commenters recognize the broad reach of § 251(h)'s ILEC definition, and urge the Commission to give the ILEC "successor or assign" provision its

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27 See, e.g., CompTel, pp. 14-33; ALTS, pp. 18-34; Qwest, pp. 22-50; TRA, pp. 30-37; MCI WorldCom, pp. 31-57; Level 3, pp. 4-6; xDSL Networks, pp. 1012; Mindspring, pp. 12-23; Time Warner, pp. 5-6.

28 NPRM, ¶¶ 86-87.

29 See, e.g., Level 3, pp. 4-6; MCI WorldCom, p. 41; Mindspring, p. 12; Qwest, p. 4; KMC, p. 10.

naturally expansive meaning.[30] Thus, CompTel reasons that "[a]n affiliate who obtains any advantage from its ILEC parent – including any transfer of assets, personnel or goodwill – qualifies as a 'successor or assign' under Section 251(h)(1)(ii)," and that "[w]hen an ILEC creates an affiliate with the same ownership and management, the affiliate is a 'successor.'"[31] The ILECs, of course, argue for a narrow reading of the "successor or assign" provision, claiming variously that it applies only where the affiliate "replaces" the ILEC,[32] or merges with the ILEC, or obtains ownership from the ILEC of "key" local exchange and exchange access services and facilities,[33] or receives the "entire interest of the [ILEC] and the ILEC ceases operations."[34]

At bottom, however, as the Commission already has found, there is no one definition of "successor or assign" that will apply in all legal contexts. Rather, the meaning of

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30 See, e.g., CompTel, pp. 9-11; MCI WorldCom, pp. 11-16; Network Plus, pp. 3-6; Sprint, pp. 4-7; Florida Digital Network, p. 2; Westel, p. 4; TRA, pp. 13-16; McLeodUSA, pp. 2-4.

31 CompTel, pp. 10-11 (emphasis in original). Similarly, MCI WorldCom notes that, even if the ILEC does not transfer any network elements to the affiliate (which plainly would make the affiliate an "assign)" any "affiliate that provide[s] advanced capabilities in [the ILEC's] place would still be succeeding to its role." MCI WorldCom, p. 13. See also Qwest, p. 23 ("any ILEC affiliate that owns local exchange network facilities, equipment, or capabilities is necessarily a 'successor or assign' of the ILEC under any common sense meaning of those terms").

32 Ameritech, p. 51.

33 BellSouth, p. 38-39.

34 Bell Atlantic, p. 26.

this provision must be based on the purpose of this provision and "the particular legal obligation" at issue.[35] Here, a central purpose of the "successor or assign" provision plainly is to bar ILECs from evading their obligations under § 251(c) – the section in which the ILEC definition appears – through a "corporate shell game."[36] In other words, the ILEC cannot avoid these obligations simply by foregoing local network investment (whether involving enhancements or expansion) in its own name, and instead leaving all such investment (and assets) to an affiliated entity acting as the ILEC's alter ego.

ILEC unbundling and resale obligations under § 251(c), a "cornerstone" of the Act,[37] are served only by interpreting "successor or assign" broadly, so as to ensure that movements of local exchange or exchange access functions, facilities, or services among corporate entities within the same ILEC corporate family have no effect on the application of § 251(c) to those functions, facilities, or services (and hence on their availability to all CLECs). Many commenters base their objections to the NPRM's separate affiliate proposal on its undermining of these basic § 251(c) principles. Thus, the Florida Commission expresses great

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35 NPRM, ¶ 104 & n. 202.

36 CompTel, p11. That the "successor or assign" provision was focused on attempted ILEC evasions of their § 251(c) obligations is shown by the fact that the definition applies only to those "successors or assigns" that become such after the Act was enacted.

37 NPRM, ¶ 73. The importance of § 251(c)'s obligations to the overall scheme of the Act cannot be overstated. The importance of these obligations is reflected, in part, by the fact that these obligations have no sunset date, and are included in one of only two sections (§ 271 being the other) placed beyond the Commission's broad forbearance authority under § 10.

concern that the NPRM proposal will encourage ILECs to transfer facilities and investments so as to evade their § 251(c) obligations, concluding "that ILECs would seek ways to move all packet-switching facilities to an unregulated affiliate[,] ... ultimately includ[ing] Signaling System 7 or its successor."[38] Similarly, the Indiana Commission and staff of the Wisconsin Commission conclude that the "NPRM provides RBOCs with an incentive to shift their most lucrative customers to packet-switched networks provided by an advanced services affiliate[, which] network can carry voice, data, and video faster and cheaper than the existing public switched network."[39]

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38 Florida, p. 6. The Indiana Commission and staff of the Wisconsin Commission similarly conclude (p. 11) that the ILEC may shift Signaling System 7 services to the unregulated affiliate. The concern that fundamental components of the current ILECs' networks, like SS7 services, might fall in the hands of an unregulated advanced services affiliate is heightened by the fact that the Commission has not attempted in the NPRM to define in any detail the types of facilities and services that may properly be controlled by the affiliate, consistent with the Act. Plainly, the distinction cannot lie between circuit-switched versus packet-switched technology, because services based on each are rapidly converging.

39 Indiana and Wisconsin, p. 11. These commenters also provide a stark example of how one ILEC, Ameritech, manipulated "ownership" of advanced services facilities to shield them (and their related services) from § 251(c). Id. at 7. Ameritech created an advanced services affiliate ("AADS"), which it identified as the owner of frame relay switches. This affiliate sells Ameritech switching services (at unknown contract rates), which Ameritech then combines with its own plant and sells back to the affiliate. The affiliate, in turn, resells these frame relay services to end users. Id. Through this "Byzantine relationship," id., Ameritech successfully has evaded its unbundling and resale obligations regarding these advanced services, claiming at various times that, because an affiliate was the "owner" of these frame relay switches, Ameritech was not obligated to allow CLECs to interconnect with them, and that, if it were called on to resell such frame relay switching services to CLECs, the resale rate would be the rate at which Ameritech paid the affiliate for these services, which Ameritech identified as its "actual cost." See Intermedia, pp. 16-19. The relationship between Ameritech and this advanced services

(footnote continued on following page)

Far from answering these concerns, the ILECs ignore them. The ILECs do not even suggest that their narrow interpretations of the "successor or assign" provision serve the purposes of § 251(c), and instead argue (wrongly) that such interpretations serve other interests under the Act, that is, the deployment of advanced services under § 706.[40]

(footnote continued from previous page)

affiliate thus gave each the ability to engage in price squeezes as well as the ability to artificially inflate the costs underlying these services.

40 See, e.g., BellSouth, pp. 21-22; GTE, pp. 34-39; Ameritech, pp. 57-58; Bell Atlantic, pp. 21-23. The ILECs no doubt will attempt to rely on a recent decision by a Connecticut district court, MCI Telecommunications v. Southern New England Telephone Co., Civ. Nos. 97cv1596, 97cv1601 (Dist. Conn. Sept. 29, 1998), in support of their cramped interpretation of the "successor or assign" provision in § 251(h). In that Connecticut decision, the district court held that an affiliate could never be considered an ILEC under § 251(h)(1), even though it admittedly was a "successor or assign," unless the affiliate also was a provider of local exchange service at the time of the Act's enactment. Id., slip op. at 29-30. This incredible conclusion – which even the ILECs have not proffered to date – effectively reads out the successor or assign provision altogether. Moreover, the decision is in direct conflict with the Non-Accounting Safeguards Order, ¶ 309, because, in the Connecticut court's view, transfers of network elements to an affiliate would not make the affiliate subject to ILEC regulation except in the unlikely event that this affiliate also was a provider of local exchange service on February 8, 1996. The district court did not even consider the reasoning of the Non-Accounting Safeguards Order, let alone refute it. This Connecticut decision is plainly wrong, and is due no deference. If the Commission nonetheless chooses to follow this decision, it is imperative that a rulemaking be initiated on the appropriate scope of the "comparable" carrier provision in § 251(h)(2), which provides an independent basis for finding that an ILEC affiliate is subject to ILEC regulation, and which expressly was left undisturbed by the Connecticut court. Cf. Indiana and Wisconsin, p. 15 ("strongly recommend[ing] that the FCC undertake a rulemaking to adopt standards for when and how section 251(h)(2) ... could be applied to an advanced services affiliate").

2. The proposed advanced services affiliate is a "comparable" carrier under section 251(h)(2).

As many commenters have established,[41] even ignoring the advanced services affiliate's status as a "successor or assign," the affiliate described in the NPRM would nonetheless be subject to ILEC regulation as a "comparable" carrier under § 251(h)(2). The Commission has sweeping authority to treat "comparable" local exchange carriers as ILECs, where the carrier "occupies a position in the market within area that is comparable to the position of [the ILEC]," has "substantially replaced" the ILEC, and "such treatment is consistent with the public interest.[42]

Contrary to the suggestion of some ILECs, this comparable-carrier provision does not require that an affiliate supplant the ILEC for all services over the entire LATA before it becomes subject to ILEC regulation.[43] Indeed, such a formulation would allow an ILEC to avoid § 251(h)(2) altogether through the simple expedient of employing multiple affiliates within its LATA, each providing its own local exchange or access services within its own service area.

Instead, such ILEC treatment a comparable carrier is appropriate where an affiliate has received any exclusive benefits (such as use of the ILEC brand) owing to its corporate relationship with the ILEC (and thus is not "truly separate") (from the ILEC), and provides local telecommunications services (here, advanced services) in the same LATA as the

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41 See, e.g., CompTel, pp. 12-13; TRA, pp. 13-16; MCI WorldCom p. 16.

42 Section 251(h)(2).

43 See, e.g., Ameritech, p. 53.