ATTACHMENT 2

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December 5, 2001

EX PARTE – Via Electronic Filing

Ms. Magalie Roman Salas
Secretary
Federal Communications Commission
The Portals
445 12th Street, S.W.
Washington, DC 20554

Re: Response to Verizon Letter of October 19, 2001 on Unbundled Switching, CC Docket 96-98

Dear Ms. Salas:

The attached letter was sent to Chairman Powell today.

In accordance with FCC rules, a copy of this letter is being filed electronically in the above-captioned docket.

Sincerely,

/s/

Thomas M. Koutsky

/krs
Attachment

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Ex Parte

Hon. Michael K. Powell
Chairman
Federal Communications Commission
445 12th St., S.W., Room 8-B201
Washington, DC 20554

Re: Response to Verizon letter of October 19, 2001, on unbundled switching, CC Docket 96-98

Dear Chairman Powell:

In a letter to Chairman Powell dated October 19, 2001, Verizon contended that "[t]he Commission should act now to eliminate, or at a minimum significantly limit, the obligation to provide unbundled local switching."[1] Aside from its brazen attempt to shut down a method of entry that is being utilized to provide millions of residential and small business consumers a choice for local service, this letter is even more remarkable for what it fails to mention.

First, Verizon does not even acknowledge that it is proposing that the Commission now shut off these consumers' service and force them once again to become ILEC customers. Second (and of particular importance to the FCC's upcoming triennial review), Verizon wholly ignores the Supreme Court's decision in *AT&T v. Iowa Utility Board*,[2] which rejected many of the same arguments Verizon recycles here, and also ignores the "material diminishment" standard the Commission adopted to implement the statutory provisions governing unbundling. Third, although the heart of Verizon's contention is that the deployment of switches by some competing carriers demonstrates that CLECs are not impaired without access to unbundled switching, Verizon fails to note that many of those switch-based competitors are now in bankruptcy proceedings, have ceased to offer service, or are losing significant amounts of money. The simple fact that many companies have unprofitably tried to deploy switches to serve large business customers provides absolutely no probative

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[1] Letter from T. Tauke and M. Glover to Chairman Powell, October 19, 2001 ("Oct. 19 letter"), at 1.

[2] *AT&T Corporation v. Iowa Utilities Board*, 119 S. Ct. 721 (1999).

evidence as to whether entrants can now profitably deploy switches to serve mass-market residential and small business consumers. If anything, the many unsuccessful attempts by CLECs to self-provide switching *before* they had established a sufficient customer base ratifies the FCC's decision to mandate access to unbundled local switching.

In this response, we first review the relevant legal standards and respond briefly to Verizon's subsidiary points. We then show that Verizon's reliance on switch deployment by financially-troubled CLECs and CLECs serving sophisticated business customers does not support its contention that CLECs seeking to serve the mass market are not impaired in the absence of access to unbundled switching. In the end, as the Commission prepares for its triennial review, we hope that the Commission will rely upon hard data, econometric evidence and legal analysis – and not the conjecture and rhetoric offered by Verizon.

Verizon Ignores the Relevant Legal Standard. Verizon's letter does little more than recycle arguments continually raised by incumbent LECs since passage of the 1996 Act. The courts and the Commission already have rejected these arguments.

By arguing that CLECs should be required to self-provision switching, Verizon has merely renewed the argument that requesting carriers should be required to own "facilities" in order to avail themselves of any form of unbundled access. In the first round of litigation arising under the 1996 Act, the ILECs argued that, in implementing these provisions, the Commission should have imposed a "facilities ownership" requirement on CLECs lest the Commission "deter investment in competing facilities and technology."[3] Verizon repeats these arguments in its October 19 letter.

Indeed, Verizon includes the *same* quote from Professors Areeda and Hovenkamp that it included in its brief to the Supreme Court in *Iowa Utilities Board*. Verizon fails to mention that its argument – law professor quote and all – was extensively briefed by ILECs[4] and was soundly rejected by the Commission, the Eighth Circuit, and the Supreme Court. In particular, the Supreme Court held, in response to the argument that CLECs must be required to self-provision facilities in order to foster facilities-based competition, that "[t]he 1996 Act imposes no such limitation; if anything, it suggests the opposite, by requiring in § 251(d)(3) that incumbents provide access to 'any' requesting carrier."[5]

Verizon's October 19 letter also recycles the incumbent LEC argument that the "impair" standard should be applied by the FCC in the manner of the antitrust "essential facilities" doctrine. As an initial matter, Verizon should be hesitant to raise arguments about the applicability of "antitrust" doctrine to local competition matters

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[3] Reply Brief of Bell Atlantic, BellSouth, and SBC in Sup. Ct. No. 97-926, July 17, 1998, at 19. The ILECs added that CLECs should not be permitted to use "the platform" because, "As Professors Areeda and Hovenkamp have explained, when the government forces a company to 'provide [a] facility and regulat[es] the price to competitive levels, then the [prospective entrant's] incentive to build an alternative facility is destroyed altogether." *Id.*

[4] The ILECs devoted 80% of the argument section of their reply brief to the contention that the FCC erred by requiring them to provide access to "the complete bundle of network elements," which the ILECs called "a complete pre-assembled 'platform' of all the piece-parts needed to provide local service." *Id.* at 5, 11. The ILECs ultimately lost that argument.

[5] 119 S. Ct. at 736.

– because Verizon, like other BOCs, at every opportunity has argued that antitrust law does not apply to local competition matters, citing the Seventh Circuit's decision in *Goldwasser v. Ameritech Corp.*[6]

That said, the Supreme Court explicitly declined to adopt the ILECs' contention that Congress's use of the word "impair" in section 251(d)(2) "codifies something akin to the 'essential facilities' doctrine of antitrust theory."[7] Although the Court reversed and remanded the FCC's application of the "impair" standard, the Commission did not accept Verizon's argument, citing the fact that Congress considered, but did not enact, "essential facilities" language.[8] The Commission observed that instead of codifying the "essential facilities" doctrine, Congress instead created the "necessary" and "impair" standards that plainly call for a lesser showing.

Verizon's analysis does not contest the factual analysis that underlay the Commission's application of the "impair" test in 1999, because Verizon ignores the standard the Commission adopted. In formulating the "material diminishment" standard, the Commission noted the "economies of scale and scope that the incumbents have due to their ubiquitous network," and concluded that "Congress has addressed this problem by mandating that incumbent LECs share their economies of scale and density with competitors."[9] With respect to switching, the Commission concluded that CLECs are at "a significant cost disadvantage relative to the incumbent LEC, particularly at the early stages of entry" on account of the ILECs' economies of scale.[10]

Verizon simply fails to acknowledge these key cost considerations. Verizon does not dispute the costs of collocation, or the additional costs that CLECs that self-provide switching must incur because they lack the economies of scale, scope and density needed to compete against the embedded ILEC local switching mesh. Verizon also does not examine how those costs impact the ability and incentive for CLECs to serve mass-market residential and small business consumers. In short, under the governing standard, the Commission cannot accept Verizon's contention that the obligation to provide unbundled switching should be eliminated or significantly restricted without evaluating in detail the cost of self-provisioning to CLECs seeking to serve mass market customers – and Verizon has provided no evidence regarding that critical factor in the impairment inquiry.

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[6] *See, e.g.*, Motion to Dismiss of Verizon, *Covad Communications Co. v. Verizon Corp.*, Case 1:99-CV-01046 (D.D.C. filed Sep. 12, 2000) (arguing for dismissal of antitrust litigation brought by CLEC against Verizon under Sherman Act on the basis that the 1996 Act contains more prescriptive unbundling and interconnection requirements and thus confers antitrust immunity on incumbent LEC behavior). Verizon cannot be allowed to have it both ways: Verizon argues that the FCC apply "antitrust" principles for its unbundling standard while it tells courts that antitrust law does not apply to its actions.

[7] *Id.* at 734.

[8] In re Implementation of the Local Competition Provisions of the Telecommunications Act of 1999, 15 FCC Rcd 3696 (*UNE Remand Order*) ¶ 57, petition for review pending, No. 00-1015 (D.C. Cir.) (to be argued Mar. 7, 2002).

[9] *Id.* at ¶¶ 84, 85.

[10] *Id.* at ¶ 259. "For example," the Commission stated, "competitor's switching costs per minute at a 10% penetration level are slightly more than twice the cost of an incumbent LEC serving the remaining 90% of the market with its own switch." *Id.* at ¶ 260. In addition, "collocation imposes materially greater costs on requesting carriers than use of the incumbent LEC's switching" and the cost of hot cuts "represents a significant cost to those requesting carriers seeking to provide service to the mass market." *Id.* at ¶¶ 263, 266.

Verizon's Subsidiary Arguments Lack Merit. Verizon raises two subsidiary issues in its effort to show that CLECs should be forced to self-provide switching: that collocation and "hot cut" performance are problems that have been "solved." That is simply not the case.

Verizon argues that the Commission's revised collocation rules eliminate the extent to which collocation is a barrier to entry. This argument is incorrect. First of all, it is noteworthy that Verizon has fought implementation of reasonable collocation rules every step of the way, and continues to do so. Verizon led the fight against the collocation rules put in place by the FCC in the *Advanced Services First Report and* Order in *GTE v. FCC.*[11] Verizon is now challenging the *Collocation Remand Order* in that docket. It is unconscionable for Verizon to rely on these rules in its unbundling advocacy while it is simultaneously seeking to undermine and gut these rules at every turn.

In any event, even if the collocation rules were fully and faithfully implemented (which Verizon has not done), the rules at best only begin to mitigate the most extreme ways in which ILECs had abused collocation to create artificial entry barriers. Collocation still costs money and takes time. Both factors are relevant to the FCC's "material diminishment" standard and are of particular importance with regard to serving the mass market efficiently. To serve mass-market customers, an entrant must be able to offer service ubiquitously in literally thousands of central offices. For example, utilizing ULS, Z-Tel can provide service to the *entire state population* that lives in a BOC service territory. As a result, Z-Tel has customers in rural, low density, and residential exchanges.

Verizon also asserts that "concerns about hot cut performance are a thing of the past." [12] Nothing could be further from the truth. There is no evidence that the ILECs can yet provision a sufficient number of hot cuts to permit mass-market local competition. BellSouth recently claimed that it was able to convert more than 1% of its subscriber base in Georgia *in one month* utilizing UNE-Platform arrangements.[13] In fact, the number of UNE-Platform lines installed in *one month* in Georgia (over 48,000 according to BellSouth) is more than the *total number of* stand-alone unbundled loops cut-over by BellSouth in Georgia in the first three years of the 1996 Act.[14]

Servicing competitive entry for the 160 million-plus analog lines possessed by incumbent LECs in the country requires the ability to handle literally millions of installations and change orders on a monthly basis – processes that can only be efficiently supported by automated processes, not the manual "hot cut" process.

In the *UNE Remand Order*, the Commission emphasized that the incumbents "have not successfully provisioned coordinated loop cutovers in the volumes necessary for requesting carriers to serve the mass

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[11] In re Deployment of Wireline Services, CC Docket 98-147 (Aug. 8, 2001) (*Collocation Remand Order*), ¶ 11 petition for review pending, No. 01-1371 (D.C. Cir.), *citing* 205 F.3d 416 (D.C. Cir. 2000).

[12] *Id.* at 5.

[13] Letter from Jonathan B. Banks, BellSouth, to Magalie Roman Salas, Secretary, FCC, CC Docket No. 01-277 (filed Nov. 1, 2001).

[14] FCC, *Selected BellSouth Data for its ILEC Operations in Georgia and Louisiana, as reported on FCC Form 477,* http://www.fcc.gov/Bureaus/Common_Carrier/Reports/FCC-State_Link/IAD/477se101.pdf.

market."[15] Aside from hot-cut capacity, the question of the cost of hot-cuts must be considered. Indeed, as Z-Tel will show in future submissions, the costs of ordering and administering "hot cuts" could easily swamp the cost of purchasing and installing the switch itself. Under the "material diminishment" standard, those costs must be considered to be part of the cost of "self-provisioning" switching.[16]

Verizon's Data is Incomplete. Ultimately, Verizon bases its argument that CLECs would not be impaired by the unavailability of unbundled local switching almost entirely on the proposition that "competing carriers have deployed switches in massive and growing numbers."[17] This argument is fatally flawed for two reasons. The fact that some CLECs have deployed switches to serve the large business or "data" market does not support the conclusion that CLECs are not impaired without access to unbundled switching to serve the mass market. In addition, the fact that many of the CLECs that have deployed switches are facing serious financial difficulties contradicts Verizon's argument that CLECs are not impaired absent access to unbundled switching. Yet Verizon barely acknowledges the financial difficulties of the companies it lists as having deployed switches or the fact that most of those companies are serving sophisticated business customers rather than the mass market.

The "list of switches" submitted by Verizon is chock full of entrants that have either closed their doors or are in bankruptcy proceedings. Verizon also provides no evidence whatsoever as to which of these companies or switches are being utilized to provide mass-market residential and small business services. In addition, of the 117 companies listed by Verizon as owning switches, nearly one-half either have no web site (obvious indicia of no intent to offer mass-market services), are in bankruptcy, in significant financial distress (as reported in the press), or otherwise could not be found. And even among the remaining CLECs listed by Verizon, it is readily apparent that mass-market competition is not the focus of those enterprises.[18] Whatever this list shows, it does not show that CLECs seeking to serve residential customers and small businesses are not impaired in the absence of unbundled local switching.

Verizon's list of switches instead reveals the precarious nature of switch-based entry. Many of the CLECs on Verizon's list no doubt took Verizon at its word that they would obtain efficient and effective wholesale services and access to elements. Many no doubt spent thousands, if not millions, of dollars collocating in Verizon central offices, taking Verizon at its word that those collocation costs were all necessary, appropriate, or otherwise justifiable. Their current financial status provides evidence of impairment rather than evidence supporting Verizon's claim that unbundled switching should be eliminated or significantly limited.

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[15] *Id.* at ¶ 271.

[16] See *UNE Remand Order*, 15 FCC Rcd at ¶ 266.

[17] Oct. 19 letter at 2.

[18] Also consider North County Communications Corp. – a company Verizion lists as having switches in California, Washington, and Oregon. A quick visit to the web site of North County, however, shows that the primary – and only – business of North County appears to be the sale of "collocation space in Tokyo." *See* http://www.nccom.com (interested parties are asked to contact "jimmy@nccom.com"). North County has also failed to respond to FCC inquiries regarding its utilization of numbering resources. *See In the Matter of North County Communications Corp.*, Notice of Apparent Liability for Forfeiture, File No. EB-01-IH-0017n, NAL/Acct. No. 2001320080045 (rel. Apr. 24, 2001).

Indeed, this reality calls into direct question the Commission's decision in 1999 – at time when CLEC Wall Street fortunes were close to their peak – that CLECs could self-provide switching in the largest cities to customers with more than three lines. In the *UNE Remand Order*, the Commission stated that "to the extent the market shows that requesting carriers are generally providing service in particular situations with their own switches, we find this fact to be probative evidence that requesting carriers are not impaired without access to unbundled local circuit switching."[19] After examining the evidence available at that time, the Commission concluded that "marketplace developments suggest that competitors are not impaired in their ability to serve certain high-volume customers in the densest areas" of the largest cities.[20] In doing so, though, the Commission cautioned that "a significant number of requesting carriers currently self-provisioning switches are not generating net income (*i.e.*, profits)," and that "it is too early to know whether self-provisioning is economically viable in the long run, although capital markets appear to be supplying requesting carriers with access to capital in the absence of demonstrated profitability."[21]

It is no longer "too early to know" the answer to the Commission's query. The evidence of the current financial status of those CLECs that deployed switches is sufficient to overcome what in 1999 may have been a reasonable inference. In addition, as shown by Z-Tel in its November 21, 2001 *ex parte* presentation, residential and small business consumers in states where access to ULS is restricted enjoy *significantly less* competitive entry than consumers in states where access to ULS is unrestricted. In other words, consumers in restricted areas have unnecessarily had to wait two years during the Commission's experiment in forcing switch self-provisioning.

Conclusion. Verizon's letter does not offer the hard data that the Commission needs as it commences its triennial review of UNEs. Z-Tel has provided, and will continue in the coming weeks to provide, substantive econometric analysis of the importance of unbundled local switching and the UNE-Platform to competition for mass-market, residential and small business customers.

Verizon wants the Commission to adopt an industrial policy that would force the ILECs' competitors to own a particular form of network technology in order to offer service. This proposal would micromanage market entry to the point that entry would be strangled. Verizon may not support unbundling in any manifestation.[22] But unbundling is the law of the land and the Commission is bound to implement Congress's intent.

Congress put unbundling in place – and specifically put unbundled switching in the Section 271 "competitive checklist" – because it understood that waiting for pure, parallel facilities-based entry would take far too long (if ever) to bring the benefits of competition to consumers. Congress's approach was recently reaffirmed by a recent study by the Organization for Economic Co-operation and Development. The OECD

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[19] *UNE Remand Order*, ¶ 276.

[20] *Id.* at ¶ 297.

[21] *Id.* at ¶ 256.

[22] *See* Verizon's press release of Dec. 3, 2001, at newscenter.verizon.com, reporting on a speech by Verizon co-CEO Ivan Seidenberg and contrasting Verizon's preferred approach with "the current regulatory model based on resale and unbundling."

concluded: "To date the major criticism of unbundling or line sharing are that such policies allegedly discourage investment in new infrastructure. No evidence has been forwarded to substantiate this claim. By way of contrast there are huge investments being made by new entrants in local access markets, where unbundled elements are available, to provide broadband services."[23]

Unbundling, and, in particular, unbundled local switching, is a crucial step in developing a vibrant and competitive environment. Z-Tel's analyses show that there is more competition in states where access to unbundled local switching is unrestricted than in states where the FCC rule restricts access. Entrants like Z-Tel are utilizing unbundled local switching and the UNE-Platform to deploy new and innovative local services to millions residential and small business consumers. This marketplace success of the UNE-Platform has happened in spite of a hostile capital market environment embroiling the entire telecom industry. Adopting Verizon's proposal would sacrifice those customers and trample this local competition success story.

Sincerely,

/s/
Robert A. Curtis
Sr. Vice President, Strategic Planning

/s/
Thomas M. Koutsky
Vice President, Law and Public Policy

c: Commissioner Kathleen Q. Abernathy
Commissioner Michael Copps
Commissioner Kevin J. Martin
Dorothy Attwood
Jeffrey Carlisle
Kyle Dixon
Paul Jackson
Jordan Goldstein
Samuel Feder
Matthew Brill
Chris Libertelli
Brent Olson
Jonathan Reel

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[23] Working Party on Telecommunications and Information Service Policies, *The Development of Broadband Access in OECD Countries* (Oct. 29, 2001), at 15.