Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

In the Matter of	)	
	)	
Review of the Section 251 Unbundling	)	
Obligations of Incumbent Local Exchange	)	
Carriers	)	CC Docket 01-338
	)	
Implementation of the Local Competition	)	
Provisions of the Telecommunications Act of	)	
1996	)	CC Docket 96-98
	)	
Deployment of Wireline Services Offering	)	
Advanced Telecommunications Capability	)	CC Docket 98-147

REPLY COMMENTS OF Z-TEL COMMUNICATIONS, INC.

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SUMMARY

The Supreme Court recently stated that local telecom competition "has been slow to materialize," noting that "the incumbents retained a 91 percent share of the local-exchange markets."[1] Competition has been even slower to materialize in the residential and small business mass markets served by Z-Tel. As the incumbents' own figures show, cable operators have been able to attain only about a two percent share of the mass market despite six years of trying.[2] Competitors providing their own switching – the approach the incumbents would like this Commission to mandate – have been able to garner only about one-tenth of one percent of the mass market.[3]

What the comments – even the so-called "facts" asserted by the ILECs – demonstrate is that barriers to entry and expansion by CLECs in local telecommunications markets, especially the residential and small business mass markets, remain gargantuan. The capital requirements of building and bringing into operation any part of a full, duplicate network remain enormous and they are prohibitive for building a full duplicative network. Scale economies in the procurement and operation of alternative network facilities continue to be substantial. ILECs still control access to the "last-mile" transmission – an input essential to any competitor seeking to enter to offer new products and innovative service packages to consumers without constructing its own

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[1] *Verizon Communications Inc. v. FCC*, 122 S. Ct. 1646, 1677 (2002).

[2] *See* "UNE Fact Report 2002," prepared for and submitted by BellSouth, SBC, Qwest, and Verizon, and appended to their comments, Appendix A at A-3 n.10 ("*UNE Fact Report"),* stating, "CLECs serve approximately 3 million residential subscribers today over their own local switches," and *See* FCC 2001 *Trends in Telephone Service*, at 9-5 Table 9.2 (indicating a total of about 146.5 million residential and small business lines in service as of December 2000), *available at* http://www.fcc.gov/Bureaus/Common_Carrier/Reports/FCC-State_Link/IAD/trend801.pdf.

[3] *See* Section II.B.2, *infra*.

"last-mile" facilities. Moreover, a competitor that wants to address the mass market utilizing its own switch and unbundled loops simply cannot do so, because the costs of gaining access to ILEC "last-mile" transmission are too prohibitive, and the volume of "hot cut" transfers too paltry to sustain mass-market entry, and the absolute cost disadvantages in transport too severe to permit successful entry. The evidence presented to the Commission overwhelmingly demonstrates that access to the UNE Platform combination of network elements allows requesting carriers to overcome these barriers, differentiate their products, and address the mass market. For these reasons, it is no surprise that, since the *UNE Remand Order*, the UNE Platform is the fastest-growing method of entry – and that mass-market residential and small-business consumers, previously left behind, are the beneficiaries of this growth.

If the incumbents are allowed to prevail in restricting the availability of network elements used by competitors seeking to serve mass-market customers, the legacy of this Commission will be to kill the competition that mass-market residential and small-business consumers are finally enjoying, and to supervise the potential remonopolization of the local and long distance telecommunications industries. Rolling back access to the UNE Platform will reverse the progress made over the last two years in beginning to bring mass market consumers the competitive benefits that Congress intended the 1996 Act to deliver. Ultimately, the result will be the preservation of the current BOC cartel, and perhaps the restoration of the old Bell System long distance monopoly, both of which were created by excessive government regulation over the century preceding the 1996 Act. Instead of competition and deregulation, the Commission will produce monopoly and perpetual regulation if it adopts the (naturally self-serving) positions advocated by the incumbent LECs.

In these Reply Comments, Z-Tel responds principally to the arguments raised by incumbent LECs that seek to eviscerate mass market competition by undermining the UNE Platform, in particular unbundled local switching. Z-Tel's replies focus on five general areas: (1) recent decisions concerning unbundling, all of which confirm that the Commission must address the impediments to entry in mass markets that are currently overcome only through unbundled switching and access to the UNE Platform; (2) the fallacy, even under the restrictive *USTA* decision, of incumbent LEC arguments that carriers are not "impaired" in serving the mass market without access to unbundled local switching; (3) the failure of incumbent LECs to prove that unbundling to serve the mass market has thwarted or discourages the deployment of network facilities; (4) the proper – and indeed *necessary* – role state commissions should have in making decisions that by definition will affect the level of local competition in their states; and (5) Verizon's attempt to rewrite section 271(c)(2)(B), which explicitly requires Bell operating companies to offer unbundled local switching and the other key elements of the UNE Platform, regardless of the outcome of this *Triennial Review*.

1. The Commission must address all *of the impediments to entry faced by competitors seeking to serve the mass market*. Three important recent decisions all confirm that the Commission must implement section 251(d)(2) so as to make unbundling available to address all impediments to entry and expansion for any requesting carrier. The Supreme Court rejected narrow interpretations of the purpose of the 1996 Act and held that the fundamental goal of the Act is the creation of competitive markets at all levels of the incumbent LEC's vertically-integrated monopoly. The Supreme Court directly rejected the idea that unbundling is merely a transitional tool toward a full facilities-based model for potential competition. Most notably, the

Court explicitly recognized that the 1996 Act rejects regulatory parity; the very purpose of the unbundling provisions is to treat ILEC networks differently from others.

The D.C. Circuit further held that the Commission must ensure that decisions regarding unbundling obligations must be based on granular analysis. This is particularly significant since all of the credible empirical evidence before the Commission supports more rather than less unbundling for the mass market. In fact, the Texas Public Utilities Commission recently performed precisely the type of granular analysis called for by the *USTA* decision. With an extensive record and solid empirical evidence, the Texas PUC found that the UNE Platform is essential to overcome impairment of competitors in mass markets and ordered statewide availability of the UNE Platform, without restrictions. The Commission should do the same.

2. Absent the Platform Combination of UNEs, Entrants Are Clearly Impaired in Providing Mass Market Services. Competitors seeking to serve the mass market of residential and small-business customers are impaired, under any plausible interpretation of that term, without access to all of the elements comprising the UNE Platform. Local networks continue to be constructed today as they were in the monopoly era, with the incumbent LEC's network elements hard-wired to each other. When CLECs seek to provide service using their own facilities in combination with ILEC facilities (such as loops), that hard-wiring must be disconnected manually to separate the elements that the CLEC will continue to use from those elements it will bypass. The incumbents therefore have a structural, pre-engineered advantage that is a direct legacy of their decades as franchised monopolists, resulting in substantial cost differences. Unlike CLECs, the incumbents do not have to pay to assemble local network connections manually – those connections are largely pre-assembled and provisioning can be accomplished electronically. Absent the UNE Platform, new entrants would incur unique and

substantial costs when they assemble their own networks using elements of the network. Imposing those costs would make entry into the mass market financially and operationally impossible.

With regard to unbundled switching, the incumbents have focused their attention solely on the fact that "switches" can be bought and deployed. This argument is misleading; it is akin to arguing that Microsoft Windows is not a monopoly because anybody can write computer code, or that because railroad tracks and ties can be bought, no railroad bridge or yard could ever be an "essential facility." Absent from the ILECs' analysis is *any* focus on market definition, and in particular, on whether switches can be profitably and practically deployed by new entrants to serve the mass market. As Z-Tel showed in its initial comments, for this analysis, it is not the cost of buying switches that is most important; instead, it is the costs sustained in connecting those switches to the loops controlled by the incumbents. One specific and important example is that the incumbents would like to require new entrants to pay them a substantial amount to perform a "hot cut" every time a mass-market customer leaves the incumbent. But the Commission has already rejected the ILECs' similar argument that competitors should be required to bear the costs of porting the phone number when they win a customer. The Commission correctly recognized that the cost of number portability should be borne equally by all customers as a cost of transitioning to a competitive market.

These costs of moving a customer to a competitor are a unique attribute of a telecommunications market in which an incumbent monopolist, the ILEC, controls access to an essential element – the loop – to which competitors must connect in order to provide service, and as to which the ILEC has hard-wired itself into a position of preference. Hot cut costs are thus costs relating to converting a monopoly network into one that supports competition. They are

not "normal" costs of entry incurred by any entrant into any market. In addition, new entrants deploying switches must incur other substantial costs that are not incurred by incumbents because loops and transport are already hard-wired to their facilities. Also, the network architecture urged by the ILECs would impose substantially higher transport costs on competitors. Those additional costs *must* be considered in the impairment analysis required by the statute, and they lead to the same conclusion: for CLECs to serve mass-market customers in the scale and scope needed to compete with the incumbent, switching and the UNE Platform combination of elements must be available.

The true nature of the incumbents' demands becomes clearer if one considers whether a network interface device (NID) should be unbundled. No one in this proceeding seriously argues that loops should be unbundled without access to the NID. Since anybody can buy a NID, however, under the logic of the incumbents' arguments, new entrants should be required to pay the incumbents to send a technician to disconnect the ILEC's loops from its NIDs and have them reconnected to the new entrant's NID. As the Supreme Court recognized in *Verizon*, such a requirement would serve no purpose other than to drive up entry costs and create opportunities for delay and disruption of CLEC service. It would be another example of the incumbents' efforts to impose costs on competitors, "'not for any productive reason, but just to impose wasteful reconnection costs on new entrants.'"[4] NIDs need to be unbundled because a NID is a piece of electronics that provides ready access to an unbundled loop. Failure to unbundle the NID would make access to an unbundled loop economically impracticable for an entrant. The incumbent LEC switch is no different; it is the piece of electronics on the *other* end of the loop that provides ready access to that loop to serve mass-market customers. Failure to unbundle the

[4] *AT&T v. Iowa Utilities Board*, 525 U.S. 366, 395 (1999) (*quoting* Reply Brief for Federal Petitioners at 23).

incumbent LEC switch port would make access to an unbundled loop economically impracticable for a mass-market entrant.

The "evidence" presented by the incumbent LECs actually supports Z-Tel's argument that competitors are not using self-provisioned switching to serve the mass market. Indeed, the incumbents' own "UNE Fact Report 2002" shows convincingly that competitors attempting to use their own switches with ILEC loops have failed to garner any substantial share of the mass market. Indeed, competitors attempting this mode of entry have repeatedly failed to survive, which itself provides clear and convincing evidence of impairment. Even more significant, however, is that carriers that have deployed switches to serve larger business markets also cannot use those switches to serve the residential and small business market, notwithstanding that the costs of the switch itself are already sunk. The impairment resulting from the unique obstacles inherent in attempting to assemble a network that was designed to serve a monopolist is simply too great. Until equal access requirements are implemented in the local markets, new entrants will continue to be impaired without access to the platform of network elements.

3. Unbundling Does Not Discourage Deployment of Facilities. As opposed to the sound economic studies provided by Z-Tel in its initial comments and a new study in these reply comments, the incumbents admitted that they have no evidence, other than a single, highly suspect study, to support their contention that unbundling deters investment in facilities. As SBC stated, the incumbents had long argued that unbundling "diminishes real competition," but had "never before . . . been able to marshal sufficient real-world experience and empirical evidence to back that up."[5] They still lack evidence. The study on which they rely – in addition to improperly using confidential FCC data to which only the study's authors had access – fails to

[5] SBC Comments at 7.

provide that missing evidence. It is a badly flawed study that, among other things, purports to conclude that raising the price for unbundled loops will lead to more competition using unbundled loops, contrary to fundamental economic theory and common sense. Moreover, the study is biased, *inter alia*, by a failure to account for the unique characteristics of the New York market, which significantly distorts the study's results. Z-Tel, on the other hand, submitted reliable econometric evidence showing that regulatory policies that promote the availability of the platform of unbundled network elements spur competition *and* the deployment of facilities.[6]

4. The Commission's Unbundling Rules Should Include a Formal Role for State Commissions. Any "granular" analysis of UNE availability must include Commission deference to the agencies that are on the front-lines of local competition: state public utility commissions. Indeed, if the Commission fails to defer its fact-finding with regard to local competition to agencies that have the tools to make those conclusions, the Commission risks continuing the string of appellate court reversals that has been the unfortunate legacy of Rule 51.319.

State commissions are actively investigating the role that the UNE Platform plays in bringing mass-market competition to their states. Texas and New York, where the UNE Platform has been available to serve residential and small-business customers without restriction, have exceptionally high rates of competitive entry. The unrestricted availability of the UNE Platform in those states accounts for the availability of options that residential and small-

[6] Attachments 8,9 and 10 to Z-Tel Comments: *An Empirical Exploration of the Unbundled Local Switching Restriction*; *Does Unbundling* Really *Discourage Facilities-Based Entry?*; *Facilities-based Entry in Local Telecommunications: An Empirical Investigation*.

business customers find superior.[7] *And*, as stated above, there has been more deployment of facilities where network elements have been available for leasing without restriction.

Earlier this year, both Texas and New York re-confirmed the availability of UNE Platform in their states – regardless of the outcome of this *Triennial Review* – and other states, including Georgia, Tennessee, and Mississippi, are undertaking similar proceedings. The Commission should expand the availability of the platform of network elements in order to give residential customers and small businesses the competitive options promised by the 1996 Act, and reduce the administrative and regulatory cost of state proceedings necessary to eliminate arbitrary restrictions that impede competitive entry. In addition, for any "granular" analysis, the Commission should foster an institutional role for state commissions that takes advantage of the fact-finding tools those commissions command – such as discovery, live testimony, and cross-examination – but the FCC does not. The Commission should not attempt to restrict state efforts to provide competitive alternatives to their residents, which are protected by section 251(d)(3).

5. The Section 271 Checklist Requires BOCs to Provide Unbundled Switching and the Other Components of the UNE Platform. Notwithstanding the elements specified for unbundling under section 251(d)(2)(B), Congress specifically required the BOCs to make unbundled loops, switches, transport, and call-related databases available at cost-based rates as a precondition to long distance entry. Congress foresaw that mechanisms for rapid local entry would be critical to implementing the 1996 Act's *quid pro quo* of Bell long distance entry in return for dropping the legal, economic and operational barriers to local market entry. Congress therefore enacted Section 271, which plainly requires the Bell Operating Companies (BOCs) to unbundle three key

[7] *See* Attachment 7 to Z-Tel's comments, *Without UNE-P, What's Left?* (showing CLEC market shares of nearly 20 and 18 percent in New York and Texas respectively, primarily using the UNE Platform).

network element components of the UNE Platform – loops, transport, and switching – as part of the fourteen-point competitive checklist. Verizon nevertheless contends that this Commission's generic analysis under section 251(d)(2) – which applies to *all* elements and *all* incumbent local exchange carriers – should override Congress's more specific determinations in Section 271. That, of course, is backward.

Apparently recognizing the weakness of its argument that an agency determination under a general statutory provision should trump Congress's explicit direction under a more specific provision, Verizon argues that this Commission should now forbear from application of the competitive checklist's conditions precedent to long distance entry. Its argument is both procedurally defective and substantively meritless. Congress required the steps that were necessary to open the local markets to competition to remain in effect, and any proceeding considering whether to forbear from enforcement of the key market-opening provisions that Congress adopted in 1996 should lie years in the future.

In sum, it is wise to be skeptical of those who appear willing to assist in their own demise. While this advice may appear pedestrian, it has, in the past, often been lost on telecommunications policymakers. In their efforts to promote competition and eliminate monopoly in the local exchange telecommunications marketplace, regulators and other policymakers frequently appear all too willing to heed the counsel of the incumbent monopolists – the Bell Companies. Having incumbent monopolists as advisors for competition policy is like having the hen house guarded by a fox.

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REPLY COMMENTS OF Z-TEL COMMUNICATIONS, INC.

INTRODUCTION

In its initial comments, Z-Tel Communications Inc. ("Z-Tel") pointed out that it was using the combination of all network elements – the UNE Platform or UNE-P – to offer residential and small business mass market consumers an innovative package of local telephone service, long distance service and information services. Z-Tel told the Commission that the UNE Platform was essential to this offering – that Z-Tel could not offer its unique and innovative service bundle by simply reselling ILEC services, and that no other method of entry would permit Z-Tel to offer its service to mass market consumers in a timely manner.

Indeed, Z-Tel demonstrated that the cost of a "hot cut" to transfer a customer from the ILEC to Z-Tel is so high, and the volume of "hot cuts" that ILECs can provide is so low that if Z-Tel had to serve the mass market through a UNE-L offering it simply could not do so today. And, even if Z-Tel could, a UNE-L network architecture would place Z-Tel at a substantial, inherent cost disadvantage to the incumbent, because it would impose on Z-Tel an inefficient

interoffice transport cost structure that the incumbent does not face. In short, absent access to the UNE Platform, there would be no opportunity for companies like Z-Tel to serve mass-market residential and small-business customers.

The comments demonstrate that Z-Tel's experience is typical. ILECs' across the country cannot operationally deliver unbundled loops to switched-based competitors in quantities sufficient to allow mass-market entry, nor – except in a few instances where state commissions have ordered low rates – can they do so at prices that are anything other than prohibitive. In their comments, the ILECs do not even pretend to be able to deliver "hot cuts" in commercially reasonable, mass-market volumes. As the New York Commission noted, Verizon would have to increase its "hot cut" provisioning by 4,400 percent just to connect unbundled loops to CLEC switches for the same number of lines that UNE Platform customers required on average during 2000 and 2001.

The comments confirm that the UNE Platform is the only entry method that attacks the principal sources of barriers to entry in mass-market telecommunications. The late noted antitrust scholar Professor Philip Areeda pointed out that barriers to entry in markets in general arise from four main sources:

1. Blocked Access: *i.e.*, established firms control of the supply of essential raw materials, necessary patents, distribution channels, or other strategic factors makes new entry either impossible or impractical because of a relative cost advantage;

2. Scale Economies: *i.e.*, the minimum size of an efficient firm may be so large with respect to total consumer demand that entry at efficient scale would depress prices so severely as to be unprofitable;

3. Capital Requirements: *i.e.*, efficient entry might require the construction of so large a plant, the entry into so many related fields, the expense of such prolonged start-up costs, and the prospect of such slow acceptance by customers that a vast initial outlay of capital would be needed; and

4. Product Differentiation: *i.e.*, the newcomer must overcome the established firms'entrenched goodwill.[8]

The record shows that forms of each of these barriers to entry are hindering competitive entry and expansion in the residential and small-business mass market. Moreover, these barriers exist because ILECs control access to difficult and costly to duplicate local loop facilities and have largely mechanized and hard-wired their provision of local connections to their mass-market retail customers. The UNE Platform is the only practical means for CLECs to overcome these barriers to entry in the residential and small-business mass market so as to compete with these hard-wired ILEC networks. Without the UNE Platform, approximately 6 million residential and small business customers would lose their choice of local telephone service, innovative new products such as those offered by Z-Tel would be stymied, and Americans across the country would be denied the opportunity actually to *choose* their local service provider. Consequently, the 1996 Act would be thwarted in its principal goal of eliminating the BOC cartel[9] and reversing a century of government-regulated monopoly in local telecommunications markets.

As the Supreme Court recently reaffirmed, the introduction of competition is *the* fundamental goal of the Act. As a means of giving "aspiring competitors every possible incentive to enter local retail telephone markets," Congress provided CLECs the right to lease ILEC network elements at cost-based rates.[10] Facilities-based competition will result, to the

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[8] *See, e.g.,* P. AREEDA & L. KAPLOW, ANTITRUST ANALYSIS: PROBLEMS, TEXT AND CASES §115, at 22-23 (4th ed. 1988).

[9] The BOCs may be properly designated a cartel, since they persistently refuse to compete with each other and instead maintain a rigid division of markets among themselves. Clearly, if this situation had not been created by regulation, it would flagrantly violate section 1 of the Sherman Act. *See* 15 U.S.C. § 1.

[10] *Id*. at 1661.

extent warranted, from competitors' natural desire to control their own destinies to the extent possible. Competitors will naturally seek to avoid the costs of dealing with a critical supplier that is also their largest competitor.[11] At the same time, unbundled access will increase innovation. In particular, unbundling creates markets for wholesale capacity at all levels of the ILEC network and therefore permits entrants to focus on their core competencies – e.g., marketing, customer service, or network operation. Moreover, non-traditional telecommunications providers such as banks, credit card companies, e-mail providers, and Internet access companies will be able to develop whole new ways of integrating voice telecommunications into their products and services, which would not be feasible if they had to replicate parts of the ILEC network from the outset.[12] The Commission's unbundling analysis should consider this strong incentive to service innovation that unbundling creates.

These Reply Comments focus on the following critical points:

1. Recent Supreme Court, D.C. Circuit, and Texas Commission decisions all confirm that the Commission's section 251(d)(2) analysis must ensure that the unbundling rules address *all* of the impediments to entry that competitors face in their attempts to serve the mass market;

2. The record evidence clearly shows that there are significant and substantial impediments to mass-market entry that can be overcome only with the UNE Platform;

3. Unbundling – in particular, unbundled switching and the UNE Platform – does not discourage network facilities deployment;

4. The Commission should enlist the assistance of the state commissions, establish a formal role for state commission fact-finding in proceedings under section 251(d)(2), and respect independent state authority under section 251(d)(3); and

[11] The incentives of the ILEC to sabotage its CLEC customer-rivals are described in T. Randolph Beard, George S. Ford, and Lawrence W. Spiwak, *Why Adco? Why Now? An Economic Exploration into the Future of Industry Structure in Local Telecommunications Markets*, 54 Fed. Comm. L. J. 421-59 (2002) ("Beard, Ford, and Spiwak 2000).

[12] *Cf. Fishman v. Wirtz*, 807 F.2d 520, 540 (7th Cir. 1986) (citing local telephone distribution facilities as the ultimate example of non-duplicable "essential facilities").

5. The section 271 checklist requires the Bell Companies to provide access to unbundled local switching and transport, and Verizon's request that the Commission forbear from that requirement should be rejected on both legal and procedural grounds.

I. RECENT DECISIONS CONFIRM THAT THE COMMISSION MUST ENSURE THAT ITS UNBUNDLING RULES ADDRESS *ALL* OF THE IMPEDIMENTS TO ENTRY FACED BY REQUESTING CARRIERS.

Since the initial comments in this proceeding were filed, three important decisions have been issued: (1) the Supreme Court's ruling upholding the Commission's rules governing the pricing of unbundled network elements and the rule requiring incumbents to combine network elements;[13] (2) the D.C. Circuit's decision remanding the *UNE Remand Order* and the *Line Sharing Order*;[14] and (3) the Texas Public Utility Commission's decision extending access to the UNE Platform in Texas.[15] Those decisions all confirm that, in its section 251(d)(2) review, the Commission must ensure that its unbundling rules address *all* of the impediments to entry that requesting carriers face.

A. The Supreme Court's *Verizon* Decision Confirms the Pro-Unbundling, Deregulatory Nature of the Act.

In the course of upholding the Commission's pricing rules governing network elements and the rules governing combinations of network elements, the Supreme Court extensively discussed Congress' purpose in ordering unbundling. In doing so, the Court rejected incumbent LEC arguments – the same as those advanced by ILECs in this proceeding – that unbundling is

[13] *Verizon Communications Inc. v. FCC*, 122 S. Ct. 1646 (2002).

[14] *United States Telecom Association v. FCC*, 290 F.3d 415 (D.C. Cir. 2002), 2002 U.S. App. LEXIS 9834 ("*USTA*").

[15] *In re Petition of MCIMetro Access Transmission Services, LLC, SageTelecom, Inc Texas UNE Platform Coalition, McLeodUSA Telecommunications Services, Inc., and AT&T Communications of Texas, L.P. for Arbitration with Southwestern Bell Telephone Companies under the Telecommunications Act of 1996*, Arbitration Award, Texas PUC Docket No. 24542 ("*Texas Arbitration Award*").

ostensibly "unfair," that unbundling reduces facilities investment, and that unbundling is not ultimately deregulatory.

The Supreme Court recognized that the incumbents have bottleneck control over "the persistently monopolistic local markets."[16] Because the ILECs own the "feeder wires" that "run into local switches that aggregate traffic into common 'trunks'"[17] – that is, loops, switches, and transport – the Court concluded that the incumbents "have an almost insurmountable competitive advantage" in the provision of local service connections to customers.[18] Moreover, this competitive advantage was not gained as the "consequence of a superior product, [or] business acumen,"[19] but results from a century of heavy-handed government regulation. As discussed in Z-Tel's initial comments and below, that insurmountable competitive advantage remains today for mass-market residential and small-business consumers.

The *Verizon* Court also stated that the basic purpose of the Act is to overcome this insurmountable competitive advantage by giving "aspiring competitors every possible incentive to enter local retail telephone markets, short of confiscating the incumbents' property."[20] Thus, Congress "proceed[ed] on the understanding that incumbent monopolists and contending competitors are unequal"[21] and legislated to create competition in persistently monopolistic

[16] *Verizon*, 122 S. Ct. at 1654.

[17] *Id*. at 1661.

[18] *Id*. at 1662.

[19] *Aspen Skiing Co. v. Aspen Highlands Skiing Corp.*, 472 U.S. 585, 596 (1985) (quoting *United States v. Grinnell Corp.*, 384 U.S. 563, 570-71 (1966).

[20] *Verizon*, 122 S. Ct. at 1661.

[21] *Id*. at 1684.

markets by imposing numerous obligations on incumbents to achieve that goal.[22] This was a deliberate choice by Congress to treat incumbent LEC networks differently, in order to create competition.

The ILECs trotted out before the Supreme Court – virtually verbatim – the same arguments that they raise here regarding the impact of unbundling on "investment" and the purpose of the Act. The Court rejected those arguments, as the Commission should do here. The Court held that "Section 251(c) addresses the practical difficulties of fostering local competition by recognizing three strategies that a potential competitor may pursue."[23] Those three strategies, of course, are resale, leasing network elements, and interconnecting facilities. Recognizing that the ILECs control "costly bottleneck elements," the Court found that "duplication of [those elements] is neither likely nor desired."[24] As a result, according to the Supreme Court, Congress decided to treat incumbent LEC networks differently and require unbundling.

The Supreme Court's decision flatly contradicts the ILECs' contention that network elements are merely a means to a full facilities-based end. The Court understood that Congress was seeking to promote competition at all levels of the ILEC networks rather than mandating vertical integration and seeing if any competitor could manage to replicate the full ILEC network. Indeed, if anything, the *Verizon* Court recognized that duplicating the incumbent LEC networks may not be possible and may, in fact, be unwise.[25] That said, the Court concluded that

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[22] Those obligations are, in effect, property rights in the network designed to offset a century of regulation and replace the BOC cartel with the competitive markets that would have evolved naturally but for government intervention.

[23] *Verizon*, 122 S. Ct. at 1662.

[24] *Id*. at 1675.

[25] This is, of course, precisely the situation in which unbundling is most necessary to maximize consumer welfare. *See* Declaration of Dr. George S. Ford at ¶¶ 14-22 (Attachment 1) ("Ford Decl.").

the Commission's unbundling rules did not discourage facilities deployment and had led to "substantial resort to pure and partial facilities-based competition among the three entry strategies,"[26] which is no doubt due in part to "the desirability of independence from an incumbent's management and maintenance of network elements."[27] As discussed in our initial comments and Section III below, Z-Tel's empirical research confirms the Court's conclusion and shows that where the UNE Platform is available without restriction, there is *more* facilities deployment (*i.e.*, switches) by entrants.

The Supreme Court also emphasized the clear deregulatory purpose of the Act. By "departing from traditional 'regulatory' ways that coddled monopolies,"[28] the Act was designed to put in motion forces of innovation and change that would ultimately lead to greater deregulation of pricing and service quality on the retail level in the same way that unbundled long distance network capacity led to competition, facilities deployment, and the retail deregulation we enjoy today. In the course of explaining the meaning of "deregulatory," the Court referenced Senator Breaux's statement, which was addressed to the BOCs and concerned the meaning of the checklist items requiring them to unbundle loops, transport, and switching. Senator Breaux told the BOCs:

> [T]his legislation says you will not control much of anything. You will have to allow for nondiscriminatory access on an unbundled basis to the network functions and services of the Bell operating companies that is at least equal in type, quality, and price to the access [a] Bell operating company affords to itself.[29]

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[26] *Verizon*, 122 S. Ct. at 1675.

[27] *Id*. at 1670.

[28] *Verizon*, 122 S. Ct. at 1661 n.20.

[29] *Id*. at 1661, quoting 141 Cong. Rec. at S8,153 (daily ed. June 12, 1995) (statement of Senator Breaux).

In short, the *Verizon* opinion articulates the core purpose of the Act, and the Commission is bound to follow that decision. The Supreme Court ratified the important role that unbundling had in Congress's vision of bringing competition to all telecommunications markets, and the Commission help to implement that vision by recognizing the importance of the UNE Platform to the residential and small business mass market.

B. The D.C. Circuit Decision in *USTA* Requires the Commission to Engage in Detailed Fact-Finding in This Proceeding.

Commenters in this proceeding will no doubt focus discussion upon the tension between the Supreme Court's decision in *Verizon* and the D.C. Circuit's subsequent decision in *USTA v. FCC*, which was issued three weeks later. Indeed, the clear inconsistency in these decisions has led the Commission, Covad, AT&T, Sprint, and WorldCom to file motions for re-hearing of *USTA* on July 8, 2002, an action that by federal rule stays the mandate of the *USTA* decision.

While there is no need to reiterate the divergent viewpoints of these opinions in detail here, it is important to note that the D.C. Circuit's decision in *USTA* places a burden upon the Commission's fact-finding processes in this proceeding. The D.C. Circuit held that the *UNE Remand Order* erred by generally issuing unbundling rules of "unvarying scope" that mandate unbundling "without regard to the state of competitive impairment in any particular market."[30] The court explained its conclusion that a more granular approach is required by pointing to "the cross-subsidization often ordered by state regulatory commissions" and reasoning that new

[30] *USTA*, 290 F.3d at 442; *but cf. Verizon*, 122 S. Ct. at 1670 (noting that reviewing court "is in no position to assess" characteristics of a "perfectly functioning market" that "incumbents' criticism assumes").

entrants, "free of any duty to provide underpriced service to rural and/or residential customers," would be drawn to compete for communications-intensive large businesses.[31]

As discussed below, the substantive case presented in this proceeding by the incumbent LECs with regard to the components of the UNE Platform – in particular unbundled local switching – comes nowhere close to satisfying *USTA*. With regard to unbundled switching, the incumbents presented virtually no "granular" analysis at all because they perform no traditional "market definition analysis." Indeed, the ILECs provide no real proof as to whether entrants are able to address the mass market by means of collocation and self-provided switch deployment. A focus on market definition – the "service" the requesting carrier "seeks to provide" – is the predicate analysis under section 251(d)(2).

The comments of Z-Tel and other entrants, on the other hand, *did* put forward a clear and detailed showing that access to the components of the UNE Platform (including switching) was required for entrants adequately to serve the residential and small-business mass market. Z-Tel provided an objective and clear market definition – the 140-million-plus, analog-line mass market – and described in detail what network capabilities a CLEC like Z-Tel needs to provide to be competitive in that market. This "granular" analysis showed that serving the mass market requires comprehensive network coverage, high quality, and low costs of customer acquisition. As a result, any reliance upon manual provisioning processes and any artificial geographic restrictions on availability are a death knell to a mass-market entrant. Z-Tel's granular analysis

[31] *USTA*, 290 F.3d at 422-23; *but cf.* 47 U.S.C. § 254(e) (requiring that all federal universal service support be made "explicit"); 47 U.S.C. § 253(b) (mandating that all state-imposed requirements be "competitively neutral"); *Federal-State Joint Board on Universal Service*, Report and Order, 12 FCC Rcd. 8776, 8944 (1997) (finding that explicit subsidies should be portable); FCC Petition for Rehearing or Rehearing *En Banc* at 14, *USTA v. FCC*, 290 F.3d 415 (D.C. Cir. 2002) (Nos. 00-1012 *et al.* & 00-1015 *et al.*) ("FCC Rehearing Petition").

shows that, to serve this market, availability of the UNE Platform combination is an absolute necessity.

The *USTA* court criticized the Commission's consideration of "cost disparities" that are not "faced by virtually any new entrant in any sector of the economy, no matter how competitive."[32] But the cost disparities described by Z-Tel and other entrants face in attempting to serve the mass market derive from the cost and network advantage the incumbent possesses by virtue of its historic monopoly in the local exchange. They are thus unique to companies like Z-Tel, trying to compete against a company that has an "almost insurmountable advantage" as a result of its historic monopoly.[33] As a result, consideration of these disparities would be consistent with *USTA*.

Specifically, the cost disparities addressed by Z-Tel's comments include the imposition of manual provisioning ("hot cut") costs upon Z-Tel that would not be borne by incumbent LECs in providing a competitive service.[34] They also include an inherently inefficient network architecture that would impose a disproportionately greater level of transport costs on Z-Tel and other new entrants, as compared to the incumbent LEC.[35] Such cost disparities clearly are not faced a new entrant seeking to open a convenience store or a gas station – they arise from the fact that Z-Tel is trying to compete against an incumbent local telephone service provider that has an exclusive, hard-wired physical connection to the entire addressable market. To compete

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[32] *USTA*, 290 F.3d at 426; *but cf. Verizon*, 122 S. Ct. at 1661-62 (noting that incumbents currently have "an almost insurmountable competitive advantage," and that the basic purpose of the Act is to overcome that advantage by "giving competitors every possible incentive to enter local retail markets, short of confiscating the incumbents' property").

[33] *Verizon*, 122 S. Ct. at 1662.

[34] This is because incumbent LECs have hard-wired loop-switch combinations to serve the mass market, while Z-Tel would have to manually provision lines each time.

[35] *See* Ford Decl. at ¶ 83.

in that mass market, Z-Tel must, at a minimum, have equivalent mechanized ability to reach those same customers. Only the UNE Platform offers that opportunity.

C. The Texas PUC's Decision Applied a Comprehensive Impairment Analysis to Order Statewide Availability of the UNE Platform

The Texas PUC's recent decision to order greater availability of the UNE Platform is instructive because it involved consideration of the precise issues pending in this proceeding by an expert body that is closer than the Commission or the courts to the realities involved in implementing the market-opening provisions of the 1996 Act. After weeks of discovery and hearings that generated an extensive record, the Texas PUC performed the sort of granular analysis that the D.C. Circuit faulted the Commission for failing to perform in November 1999. After reviewing that record, the Texas PUC found "compelling evidence that the UNE Platform is the only viable market entry mechanism" that permitted competitors to "gain a foothold"[36] and was "the only viable option for providing competitive analog service to small business customers."[37]

The Texas PUC also appropriately distinguished UNE Platform entry from resale, despite the urging of SBC. The Texas PUC concluded that "[r]esale gives CLECs little or no means to differentiate themselves . . ., while UNE-P provides CLECs with a meaningful opportunity to differentiate their products and services to consumers."[38] UNE Platform entry involves the sale of wholesale capacity, whereas resale under the 1996 Act is simply rebranding the incumbent services. In a competitive market, both the UNE Platform and resale would be available, and they would be chosen by competitors for quite different purposes.

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[36] *Texas Arbitration Award* at 88 (citation omitted).

[37] *Id*. (citation omitted).

[38] *Id*.

The Texas PUC analyzed the utter lack of a wholesale market for switching capacity in Texas. The PUC noted SBC's "clear lack of preparation to integrate in any administratively practical or meaningful way local switching obtained by a CLEC from a third-party with [SBC's] network."[39] The Texas PUC also rejected SBC's argument "that UNE-P would create a disincentive to investment and innovation."[40] To the contrary, the Texas PUC found that lack of access to the platform of network elements "would hinder the rapid deployment of facilities, as well as investment in innovative technologies and product offerings."[41]

The Texas PUC concluded "that the continued availability of UNE-P will allow competitive market forces to provide better guidance and incentive for carriers to make sound and prudent investment decisions regarding the type of technologies to be employed prospectively."[42]

The Texas Commission's Reply Comments in this proceeding reaffirm its view that "CLECs would be impaired without access to [the ILECs'] local switching on an unbundled bases, and that unbundled switching is necessary for CLECs to compete for customers in Texas at this time"[43] Indeed, the Commission observed that "the continued availability of the UNE-P and all of the components of the platform, including local switching, brings the immediate benefit of customer choice in service providers and in service packaging to a larger geographic ubiquitous segment of the population."[44] The Commission also reemphasized that the ILECs' argument that "UNE-P crowds out investment in analog networks is without merit;" rather, "the

[39] *Id*. at 74. (citation omitted)

[40] *Id*.

[41] *Id*.

[42] *Id*. at 89.

[43] Texas Reply Comments at 9.

[44] *Id.* at 13.

presence of competitive forces [including UNE-P provided services] . . . serve[s] as a stronger incentive for carriers to make prudent investment decisions regarding the types of technologies to be deployed."[45]

D. Impact on the Commission's Impairment Analysis.

These three decisions clearly affect the Commission's responsibility in this *Triennial Review* proceeding. First, the Commission must give full and due respect to the purposes of unbundling articulated by the Supreme Court in *Verizon*. Most notably, the Commission should reject out-of-hand the calls for simplistic "regulatory parity" by incumbents, because the Court recognized that the purpose of unbundling *was* to treat incumbent LEC networks differently. Moreover, the Commission must recognize, as the *Verizon* Court did, the fact that incumbent LECs control "persistently monopolistic local markets" and that the unbundling provisions of the Act were to designed to provide "aspiring competitors" with "every possible incentive" to enter the market, short of confiscation.[46]

While there is obvious tension between *Verizon* and the *USTA* decision, the D.C. Circuit's ruling does not contradict Z-Tel's position. Z-Tel has argued that the needs of competitors seeking to provide voice service to residential and small business consumers should be analyzed separately and not be confused with the needs of competitors that seek to provide different services, such as service to medium and large businesses. Viewing granularity from a market-definition perspective is consistent with *Verizon* and ensures that the Commission not run

[45] *Id.*

[46] *Verizon*, 122 S. Ct. 1654, 1661.

afoul of the D.C. Circuit's admonition that unbundling rules not be of "unvarying scope" and instead take into account the level of impairment in a "particular market."[47]

The way that these various pieces properly fit together can be seen in the Texas PUC's decision to require statewide availability of the UNE Platform. The Texas PUC engaged in precisely the type of "granular" analysis demanded by *USTA*, because the Texas PUC focused upon the requirements necessary to allow competitive service to mass-market residential and small-business consumers. In this *Triennial Review* proceeding, the Commission should take its cue from the Texas PUC and recognize that it will have to find ways to enlist the assistance of state commissions in order adequately to conduct granular market analyses.

Like the *Verizon* Court and the Texas Commission, this Commission should reject incumbent LEC arguments that unbundling the UNE Platform undermines the "deployment of facilities." Although the D.C. Circuit admonished the Commission to analyze the effect of unbundling on facilities deployment, it did so on the basis that "the record appear[ed] silent" on this question in that case.[48] In this proceeding, however, the record is far from "silent." As discussed more fully in Section III below, Z-Tel and other CLECs have provided a wide array of record evidence that confirms the Supreme Court's conclusion in *Verizon* that a very considerable amount of investment has occurred under the Commission's broad unbundling rules.[49]

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[47] *USTA*, 290 F.3d at 422-26; *but cf. Verizon*, 122 S. Ct. at 1661-62 (emphasizing that the Act was designed to give "aspiring competitors every possible incentive to enter local retail telephone markets," with no mention of distinguishing particular geographic markets), and 1685 (upholding Commission rules requiring ILECs to offer combinations of UNEs on the ground that the rules were "meant to remove practical barriers to competitive entry into local-exchange markets").

[48] *Id.* at 425.

[49] *Verizon*, 122 S. Ct. at 1675-76.

In fact, four separate attachments to Z-Tel's initial comments show that increased availability of network elements for all mass-market customers, rather than excluding business customers of four or more lines, leads to *more* investment in facilities. AT&T conducted a separate econometric analysis similarly demonstrating that "UNE-P competition leads to greater investment by ILECs as well as by CLECs."[50] These conclusions are consistent with those expressed by the Organisation for Economic Co-operation and Development (OECD), in yet another document released by a distinguished institution that directly undercuts the ILECs' contentions. The OECD concluded that "what constrains investment is lack of competition and factors which restrict the ability of new entrants to compete."[51] The incumbents, in contrast, have conceded that they have no evidence supporting their contrary view other than a single, badly flawed, unpublished study.[52]

Moreover, in addressing the effect of unbundling on investment and innovation, the Commission must consider all kinds of investment and innovation, not just investment in network facilities. That narrow-minded position ignores the potential for investment in software and network capabilities – value-added for the consumer – that are *not* dependent upon facilities ownership but *are* facilitated by broad unbundled access.[53] An ILEC unchallenged by

[50] Attachment F to AT&T Comments, Declaration of Robert D. Willig, at 64 ¶ 122.

[51] OECD Working Party on Telecommunication and Information Services Policies, *Developments in Local Loop Unbundling* (May 2, 2002) at 15 ¶ 49.

[52] *See* SBC Comments at 7 (relying on J. Eisner and D. Lehman, *Regulatory Behavior and Competitive Entry* (2001)). For a detailed rebuttal of that study, *see* Section III.A, *infra*.

[53] Indeed, the Declaration of Robert A. Curtis, attached to Z-Tel's Comments, notes that Z-Tel has been able to invest $100 million in telephone software development – investment that would not have occurred if Z-Tel did not have unbundled access to incumbent LEC networks. *See* Attachment 3 to Z-Tel Comments, Curtis Decl. at 2.

competition has little incentive to develop and implement these other innovations proactively.[54] The benefits of this "above the platform" investment stand in contrast to the type of investment incumbent LECs seem to want the Commission to consider exclusively – investment in duplicative network facilities – which the Supreme Court has characterized as "neither likely nor desired."[55] And in a proceeding to implement new legislation, the Illinois Commerce Commission echoed *Verizon* in rejecting the argument that the availability of unbundled network elements hinders the development of facilities-based competition: "The Commission and the FCC have rejected Ameritech's 'CLECs must build to be competitive' argument on so many occasions that citation is unnecessary. At some point, we are confident that CLECs will undertake the infrastructure investments necessary to serve their clients."[56] In the meantime, the Illinois Commission concluded, "the United States Congress and now, the Illinois Legislature have required a different scheme."[57]

No doubt, a dominant monopolist facing prospective competitors with limited capital would prefer that that limited capital be forced into wasteful duplication of existing facilities rather than in efficient and innovative services and software. The reason is clear – requiring competitors to build facilities before serving customers results in less total competition. Indeed,

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[54] The current edition of *Fortune* notes that as a result of the current "telecom mess," consumers should expect to "pay more." *Fortune* also proclaims, "Welcome to 1995," noting that consolidation and less competition means a "slowdown" in service innovation: "[O]nly the biggest companies with the best balance sheets are likely to survive, front-runners seem to be [RBOCs] Verizon, SBC and BellSouth. . . . Choices will diminish, consumer prices will level off or start to rise, and stuff like caller ID will be what passes for innovation. In other words, the industry might look a lot like it did in 1995 . . ." Stephanie N. Mehta, "Is there a Way Out of the Telecom Mess?," *Fortune* (July 22, 2002), at 83, 84, 86.

[55] *Verizon*, 122 S. Ct. at 1675.

[56] *Illinois Bell Telephone Company Filing to Implement Tariff Provisions Related to Section 13-801 of the Public Utilities Act,* State of Illinois Commerce Commission, Docket 01-0614, at 56 (June 11, 2002).

[57] *Id.*

if it did not, incumbents would argue for the opposite result, because they are economically far worse off with facilities-based competition than they would be with the same level of UNE-platform competition. But the Act flatly rejects the incumbents' efforts to resist competition; as the *Verizon* court recently indicated, the Act was designed to give companies that are bringing competition to the mass market (like Z-Tel) a fighting chance to overcome the incumbents' overwhelming advantages. [58]

II. Z-TEL'S ABILITY TO SERVE MASS MARKET CUSTOMERS WOULD BE IMPAIRED WITHOUT ACCESS TO THE PLATFORM OF UNBUNDLED NETWORK ELEMENTS.

In its opening comments, Z-Tel argued that its ability "to provide the services it seeks to offer" to the mass market would be "impair[ed]" within the meaning of 47 U.S.C. § 251(d)(2)(B) without access to all elements of the UNE Platform.[59] The other comments filed in this proceeding cast no doubt on that argument. Nor does the *USTA* decision.

Numerous commenters, including nearly all of the state commissions participating, support Z-Tel's position that the UNE Platform is necessary for effective mass-market competition.[60] And while the incumbent LECs disagree, their comments inexplicably fail even to meaningfully address the most critical stumbling blocks to UNE-L competition for the mass

[58] *Verizon*, 122 S. Ct. at 1661, 1684 (noting that in adopting the Act, Congress "proceed[ed] on the understanding that incumbent monopolists and contending competitors are unequal," and that "aspiring competitors" should be given "every possible incentive to enter local retail telephone markets, short of confiscating the incumbents' property").

[59] *See* Z-Tel Comments at 42-72. As described in those comments and in Section IV below, Z-Tel believes that access to unbundled switching is legally mandated by its inclusion on the section 271 "competitive checklist." In presenting its arguments and evidence of impairment, Z-Tel in no way concedes its position that unbundled switching is clearly mandated by the clear language of the Act. Z-Tel intends to advocate both its purely legal and its fact-based impairment arguments fully in every appropriate forum.

[60] *See, e.g.*, New York Comments at 1-2 (stating that it is currently "premature" to eliminate unbundling for any of the UNEs that make up UNE-P); California Comments at 20; Indiana Comments at 4; Louisiana Comments at 2; Missouri Comments at 7.

market: the hot-cut bottleneck and other network impediments. The incumbent LEC evidence also fails to focus on the market definition inquiry required by section 251(d)(3) and *USTA*.

Instead, the ILECs recycle their simplistic, tired, and extravagant claim that a requesting carrier cannot be "impaired" without access to a network element if even a single CLEC in that carrier's market is able to provide service without relying on the incumbent's system.[61] As discussed below, the "single competitor" argument makes no sense. Whether, for example, a business-oriented CLEC providing DS3 or OCx service to the large-business market (which has fewer network transmission facilities of larger capacity) can economically self-provision switching is simply irrelevant to whether Z-Tel, which seeks to serve the analog mass market (which has many low-capacity transmission facilities), can do so using unbundled loops and self-provisioned switching. To find otherwise would be irrational.

The ILECs also incant a new mantra: that CLECs would not be impaired in the absence of unbundled local switching because some of them already serve a total of "three million residential customers" through self-provisioned switching. That claim is misleading. As discussed below, only a small fraction of those customers are served by companies other than cable companies or independent ILECs – but the Act clearly did not intend that new entrants would be limited to such companies. And the non-cable, non-ILEC companies serving residential customers – such as Broadview, generally depend on the UNE Platform or resale of ILEC phone service to gain customers in the first place, thus ratifying the need for a continuing commitment to unbundling. Finally, of those few customers that have been served by CLECs

[61] *See Implementation of the Local Competition Provisions of the Telecommunications Act of 1996,* Third Report and Order and Fourth Further Notice of Proposed Rulemaking, 15 FCC 3696, 3726 (1999) ("*UNE Remand Order*") (rejecting this argument).

via UNE-L,[62] most are served by companies that either are not seeking new residential customers, or have gone bankrupt. Taken alone, this degree of business failure is virtually conclusive: the attempt to serve the mass market via UNE-L, and the near-total failure of that attempt is powerful evidence of impairment.

In fact, the total number of residential customers served via UNE-L by companies that continue to pursue that market probably number in the low hundreds of thousands nationwide, amounting to about one-tenth of one percent of mass market customers. That is extraordinarily little to show for six years under the 1996 Act, and certainly no justification for limiting unbundled switching, which today serves close to 6 million lines. The Texas PUC reaffirmed this reality when it found that hot-cut procedures currently used by incumbent LECs do not provide a "viable option" for providing competitive, mass-market service to residential and small-business customers.

Finally, although the D.C. Circuit's recent decision in *USTA* has obviously raised new questions regarding the proper analytical framework for the "impairment" analysis,[63] those questions have little bearing on Z-Tel's arguments. In fact, as set forth below, as a result of the intractability of the hot-cut problems discussed in Z-Tel's opening comments, it is clear that Z-

[62] In these comments, references to "UNE-L" service relate to CLEC business plans that depend upon self-provided switching, collocation in every incumbent LEC central office, and the procurement of unbundled local loops (which can be analog, digital, or high-capacity loops) or special access-type circuits from the customer premises to collocated equipment at the serving wire center. Z-Tel notes that in addition to dependence upon unbundled loops, UNE-L entrants generally are also dependent upon unbundled, dedicated transport (DS1 or DS3 links, usually) obtained from the incumbent LEC. In a real sense, then UNE-L competitors are *utterly dependent* upon ILEC networks. In fact, by designing their networks and deployed fixed capital equipment in and around incumbent LEC wire centers and transport routes, UNE-L competitors are even *more dependent* upon ILECs than Z-Tel, which has not deployed capital in this manner.

[63] The D.C. Circuit's decision is discussed in greater detail in Section II.B.3, *infra*.

Tel's efforts to serve the mass market would be "impaired" in the absence of UNE-P under *any* reasonable understanding of that term.

A. Impairment Exists When Lack of Access to an ILEC Network Element Reduces a CLEC's Output by a Small, but Significant and Non-Transitory Amount.

Section 251(d)(2)(B) establishes the standard for impairment, requiring the Commission to consider, in determining elements to be made available under section 251(c)(3)'s unbundling requirements, whether "the failure to provide access to such network element would impair the ability of the telecommunications carrier seeking access to provide the services it seeks to offer." The Supreme Court in *AT&T v. Iowa Utilities Board* directed the Commission to establish a limiting principle to govern when a carrier requesting access would be considered impaired. The D.C. Circuit reversed and remanded the Commission's first attempt at a limiting principle – the addition of the requirement that cost disparities imposed on the requesting carrier be "material" – as insufficiently specific, and unrooted in any analysis of the Act's "competing values."[64] As set forth in the attached Declaration of Dr. George Ford,[65] a more specific limiting principle, firmly rooted in the Act's pro-competitive values, would be that impairment occurs when lack of access to the ILEC network element would cause a small, but significant and non-transitory decrease in the requesting carrier's output of the services it seeks to provide. In determining whether a decrease in output is significant, the Commission can consider the relative per-line social benefit of the CLEC leasing the ILEC's network element versus supplying the element itself. This

[64] *USTA*, 290 F.3d at 428. Notably, the *Verizon* Court did not appear to observe any "competing values" in the unbundling provisions of the Act. Rather, the Supreme Court noted that the Act "proceeds on the understanding that incumbent monopolists and contending competitors are unequal" and that the purpose of the Act was "to put a competing carrier on an equal footing with the incumbent." *Verizon,* 122 S. Ct. at 1684, 1687. In the view of the Supreme Court, the Act was *not* intended to balance the competing interests of the incumbent against unbundling.

[65] Ford Decl. at ¶¶ 31-34.

framework harmonizes the statutory language, the Supreme Court decision in *AT&T*, and, to the maximum extent possible, the D.C. Circuit's decision in *USTA*.[66]

There are three critical components of this impairment framework: (1) impairment is a carrier-specific, rather than market-wide, evaluation of the services that the requesting carrier seeks to offer; (2) to find impairment, the Commission must conclude that lack of access would reduce the requesting carrier's output of the services it seeks to offer, not just its profitability; and (3) the reduction in output of the firm seeking access to the ILEC network element must be significant and non-transitory.

The requirement of a carrier-specific inquiry is set forth in the plain language of section 251(b)(2)(B). That section requires the Commission to consider whether lack of access impairs "the ability of *the* telecommunications carrier seeking access" from providing its services – a firm-specific reference. As the Ford Declaration notes, "given the different business plans (including target markets), financial resources and service offerings of the various CLECs, it is difficult to imagine how impairment could not be carrier specific."[67] Moreover, in *Verizon*, the Supreme Court recognized that the Commission had to address "the reality faced by hundreds of smaller entrants . . . seeking to gain toeholds in local exchange markets."[68] The D.C. Circuit's decision in *USTA* could not, and did not, alter the statute's explicit focus on the impairment of specific competitors.[69]

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[66] *USTA* remains in substantial tension with the Supreme Court's decisions in both *AT&T* and *Verizon*, and should be reheard or reversed.

[67] Ford Decl. at ¶ 23-34.

[68] Verizon, 122 S Ct. at 1672 n.27. The fact that the Commission must analyze the demands of the "reality faced by hundreds" of competitors confirms the need for enlisting the assistance of the state commissions in this process. *See* Section IV, *infra*.

[69] Even apart from its inconsistency with *Verizon*, the *USTA* court's description (in *dicta*) of Section 251(d)(2)(B)'s reference to "the telecommunications carrier seeking access" as an

As also discussed in the attached Ford Declaration, reading section 251(d)(2)(B) and *AT&T* as establishing an output-based test for impairment also makes sense as a matter of economics.[70] The firm's output is what matters economically. By reducing costs of entry, sunk costs, unbundling increases the number of competitors that the market will sustain. In contrast, depriving a CLEC of access to ILEC unbundled network elements will increase the sunk costs of entry, reducing both the number of sustainable competing firms and the output for competing firms as a whole. In perfectly competitive markets, the cost disparities that would result from withdrawing unbundling would cause outputs of the disadvantaged competitor to fall to zero. Even in markets with less than perfect competition, small cost disparities may have a dramatic effect on output. Focusing on the change in output as a result of lack of access to ILEC network elements tests the result on which the statute and the Supreme Court in *AT&*T focused – whether the firm's "ability . . . to provide the services it seeks to offer" would be reduced, not just its profitability. However, a reduction of output should constitute a cognizable impairment only if the decline in output would be significant and non-transitory.

The Ford Declaration provides a comprehensive analytical and econometric framework for evaluating whether a decline in output would be "significant." Ford proposes that analysis of whether a decline in output is significant should compare the net per-line social benefit produced when a CLEC uses the ILEC unbundled network element against the net per-line social benefit

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"allusion" is mystifying. *See USTA*, 290 F.3d at 429. In fact, that section straightforwardly states that the focus of the impairment inquiry is the competitor, not the end user consumer. The D.C. Circuit has no power to rewrite the law. In addition, the D.C. Circuit's "allusion" comment is in considerable tension with its holding that the Commission erred by writing unbundling rules of "unvarying scope." *See id.* at 422-26. That holding clearly calls for fact-specific findings that, to be consistent with the text of section 251(d)(2)(B), should be carrier-specific as well.

[70] Ford Decl. at ¶¶ 26-28.

produced when the CLEC uses other facilities.[71] If the net social benefits of the CLEC providing the line through other facilities exceeds the net social benefits of providing the line through unbundling, some decline in output from pushing the CLEC from unbundling to facilities can be tolerated without the decline in output becoming "significant." However, this comparison of net per-line benefits of providing the line through unbundling with the net per line benefits of providing the line without unbundling also establishes a threshold of output decline that, when exceeded, is socially intolerable and therefore leads to an unbundling mandate.[72] Moreover, if the net social benefit of the CLEC providing the line through unbundling exceeds the net social benefit of providing the line using facilities – such as would occur in the presence of scale economies across the entire market – then unbundling would always be required and no decline in output would be tolerable.[73]

In addition to causing a significant decline in output, to be cognizable as "impairment," the decline in output should be non-transitory.[74] The market will adjust for transitory declines in output without necessitating regulatory intervention through unbundling, just as the market compensates for transitory increases in price without necessitating an antitrust or regulatory intervention due to finding of market power. The Commission must, however, be careful in defining a transitory decline in output not to confuse a transitory decline – one that is temporary and can be fully made up – with a permanent lag. Permanent lags, such as from insufficient "hot

[71] *Id.* at ¶ 29-34.

[72] *Id*.

[73] *Id*.

[74] This time dimension mirrors the entry analysis of the U.S. Department of Justice and Federal Trade Commission Horizontal Merger guidelines, which regard as "transitory" any market condition that lasts for less than two years. *See* DOJ/FTC Horizontal Merger Guidelines § 3.2, available at www.usdoj.gov/atr/public/guidelines/horiz_book/toc.html.

cut" provisioning capacity, are longer term, non-transitory increases in the requesting carrier's output below the levels that would have existed if the ILEC elements had been unbundled.[75]

While Z-Tel's proposed impairment framework is fully consistent with the text of section 251(d)(2)(B) and *USTA*, the impairment framework and analysis proposed by BOC witness Dr. Howard Shelanski is inconsistent with the Act.[76] As described more fully in Section V of the Ford Declaration,[77] Shelanski's proposition – advanced by ILEC commenters generally – that impairment occur only when there is "no option" to unbundling rewrites the statute to ignore its express focus on the impact on the "carrier seeking access," and to substitute the word "essential" for Congress's choice of "impair." The plain meaning of the statute simply cannot be stretched that far. In addition, as Dr. Ford demonstrates, the condition of natural monopoly is only one subset of the conditions under which unbundling should be mandated in order to prevent a significant and non-transitory decline in the requesting carrier's output.[78]

Moreover, while Shelanski states that he will "examin[e] the empirical evidence" on entry and unbundling, he does no such thing and his proposed "no option" test is not informed by any econometric analysis. Indeed, Shelanski's unsworn statement does not review any circulated and published econometric analysis of unbundling, including Z-Tel empirical evidence discussed in the Ford Declaration and in Section III below, even to support his central claim that entrants

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[75] For example, if a limitation on loop provisioning limits a CLEC's growth to 50,000 lines in a year where the CLEC could have provided 100,000 lines *via* the UNE Platform, that initial 50,000 line difference (the output restriction) is apt to cause a permanent lag in that CLEC's market penetration. In this example, for the output restriction to be transitory, in Year 2, the ILEC would have to "make up" that Year 1 50,000 deficit in addition to serving the CLEC's Year 2 demand. *See* Ford Decl. at ¶ 52 n.34.

[76] *See* Declaration of Howard A. Shelanski, appended as Attachment D to Verizon Comments, at 4 ("Shelanski Decl.").

[77] *See* Ford Decl. at ¶¶ 65-83.

[78] *See id.* at ¶ 23-55.

will "substitute" unbundled entry for facilities-based entry where unbundling is available.[79] As discussed in the Ford Declaration, that premise cannot be assumed to be true.[80] As a result, much of Shelanski's theoretical discussion is of little, or no, value to the Commission.

Shelanski relies entirely on unsworn and unsupported statements and the anecdotal evidence contained in the "UNE Fact Report," stating that this unsworn "evidence" shows the "feasibility of facilities-based entry."[81] As discussed below, this "fact" report and the conclusions it seeks to draw are significantly flawed.[82] Even when some CLECs have deployed switches in a geographic market, the UNE Fact Report in no way shows that the barriers to use of those switches to serve the mass market are so low that they in fact are elements "availab[le] . . outside of the incumbent's network."[83]

In sum, Z-Tel's proposed impairment framework, in contrast to Shelanski's flawed analysis, is grounded in the text and purpose of section 251. Z-Tel's impairment framework – focused on a small, but significant and non-transitory decrease in the requesting carrier's output – answers the *USTA* court's direction for greater specificity, and responds to its concern that impairment not be based on costs of a type incurred "for any new entrant into virtually any business"[84] without limiting unbundling only to situations of natural-monopoly cost differentials. The framework takes into account the social costs (to the extent that they exist) and benefits of unbundling. It also provides a framework in which impairment turns on the truly relevant effect:

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[79] Z-Tel's empirical analysis – not reviewed by Shelanski – shows that there is no "substitution effect." *See* Section III, *infra*.

[80] *See* Ford Decl. at ¶ 69.

[81] Shelanski Decl. at 3.

[82] *See* Section II.B, *infra*.

[83] *AT&T*, 525 U.S. at 389.

[84] *USTA*, 290 F.3d at 426.

reduction of the requesting CLEC's output, regardless of whether a cost disparity is "large" or "small" in some absolute sense. Indeed, as the Ford Declaration demonstrates, even small cost disparities can have a substantial impact on firm output in a variety of theoretical models of competition, and thus a more flexible and economically rigorous understanding of impairment is required.[85] Nonetheless, as Z-Tel demonstrates in the remainder of this Section II, application of this economically rigorous framework requires that ILECs continue to unbundle switching and the other components of the UNE-P.

B. Z-Tel's Ability to Provide the Services That It Seeks to Offer to Mass-Market Customers Would be "Impaired" Within Any Reasonable Meaning of that Term in the Absence of Unbundled Local Switching.

In its opening comments, Z-Tel emphasized that access to unbundled local switching is particularly critical because of "the problems that result from manual hot cuts,"[86] which currently prevent CLECs from effectively using UNE-L to compete in the mass market. In fact, given the current state of high hot cut costs, dubious reliability, and severely limited availability, the hot-cut bottleneck would, in the absence of unbundled switching, "impose a cap" on "mass market entry . . . at a very low level."[87] And the problem of hot cuts is the tip of the iceberg – forcing mass-market entrants to rely upon self-provided switching would also impose significant, substantial, and non-transitory operational and network design inefficiencies on new entrants like Z-Tel.

Put into Z-Tel's output-reduction framework for analyzing impairment, Z-Tel would clearly suffer an extremely large and non-transitory decline in its output (likely to zero) to the residential and small-business mass market if the Commission were to eliminate unbundled

[85] Ford Decl. at ¶¶ 26-28, 47-49 (discussing the impact of small cost disparities on competition).

[86] *See* Z-Tel Comments, Part III.

[87] *Id.* at 43.

switching as a UNE before ILECs were able to provision hot cuts in large volume and at a sustainable cost comparable to ILEC PIC change fees. Even if there were some greater net social benefits to facilities entry, such a dramatic decline in output would clearly be significant and constitute impairment of the ability of Z-Tel and any other mass-market-oriented CLEC to serve that market.

Z-Tel's opening comments described in detail its analysis of the possibility of self-provisioning switching in New York City through the potential purchase of a bargain-priced switch and accompanying collocations from one of many bankrupt CLECs.[88] That analysis indicated that the cost of the switch itself was relatively insignificant compared to the start-up and collocation expenses, and the non-recurring costs resulting from manual hot cuts.[89] Indeed, Z-Tel concluded that *even if the switch, start-up, collocation, and maintenance were free*, it would never be profitable to deploy a switch to serve mass-market customers in New York if Z-Tel had to pay the "true" hot cut cost of over $185 found by the New York Commission. Even at the current "rebated" rate of $35 offered by Verizon as the result of a settlement with the New York Commission – a rate that Z-Tel could not responsibly employ in analyzing the long-term viability of self-provisioned switching, since the rebated rate will not be in force long enough to fill up even a single switch[90] – Z-Tel's model for analyzing the economic viability of self-

[88] *Id.* at 34-38.

[89] *Id.* at 35-36.

[90] Verizon recently agreed to provide the rebates for two years. *See id.* at 35. Z-Tel calculated that given Verizon's hot cut capacity – discussed further directly below – it would take well over *three years* to bring a single 68,000 line switch up close to capacity. *Id.* at 41. Therefore, offering a two-year rebate has little impact on a long-term decision to invest in switching capacity. Indeed, under Z-Tel's proposed impairment framework, the Commission should ignore these two-year rebate plans, as they are clearly transitory in nature.

provisioned switching indicates that self-provisioning switching in New York would *never* turn cash-flow positive.

Z-Tel's comments also argued that, in addition to the problem of hot cut costs, the ILECs simply cannot perform hot cuts in sufficient quantities to sustain self-provisioned switching in a competitive market.[91] After discussions with Verizon, Z-Tel concluded that it could not expect more than 4,000 hot cuts per month in LATA 132, where Verizon provided an average of only 12,500 hot cuts per month to all CLECs combined. Given Z-Tel's expected churn of four percent per month, merely servicing the churn on Z-Tel's base of well over 100,000 LATA 132 customers would have overwhelmed Verizon's hot-cut capacity. The notion that Verizon could possibly match the over 200,000 UNE Platform conversions it performs each month with hot cuts – as would be necessary if unbundled switching were removed from the UNE list – therefore represents pure fantasy. Indeed, as the New York Commission pointed out in its comments, if all of Verizon's "UNE-P orders were to become UNE-Loop (UNE-L) orders, Verizon's hot-cut performance would have to improve approximately 4400 percent."[92] That is not going to happen.

Finally, Z-Tel pointed out that the mass market has distinctive characteristics that would make it extremely difficult to sustain a fully competitive market using hot cuts, even apart from the problems of hot cut cost and lack of capacity.[93] Forcing competitors to enter this market as UNE-L providers would impose highly inefficient transport network architectures and operational costs on the new entrant that incumbents would not face. Incumbent LECs already

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[91] *Id.* at 38-44.

[92] *See* New York Comments at 3; *see also* Section II.B.4, *infra* (discussing recent New York and Texas commission decisions finding the UNE Platform necessary to serve the mass market).

[93] *See* Z-Tel Comments at 30-34 & 44-47.

have hard-wired direct connections to mass-market customers – service activations and de-activations are mechanized, fast, and reliable. UNE-L CLECs must endure manual provisioning for *each* connection. In addition, while mass-market consumers demand reliable service and headache-free installation, the hot-cut process is notoriously labor-intensive and error-prone.[94] If even a small fraction of hot cuts were to "go bad" in a fully competitive mass market served via UNE-L – assuming, counterfactually, that such a thing would be otherwise possible – hundreds of thousands (even millions) of customers would experience service outages every year. These are classic impediments to entry – the new entrant faces costs that the incumbent does not bear.

1. The ILECs fail meaningfully to address the critical problems of hot cut capacity limitations, costs, and reliability.

Significantly, the ILEC comments do not seriously grapple with the problems competitors would face as a result of the hot cut bottleneck in the absence of unbundled switching.[95] Indeed, the ILECs hardly address hot cuts at all. Verizon's 144-page comments include a single short paragraph on hot cuts, containing two minimalist and inaccurate arguments.[96] First, Verizon claims that "whatever concerns there may have been about hot cuts

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[94] *See id.* at 44-47.

[95] In their replies, the ILECs may attempt to argue that hot-cut problems cannot be understood to prevent CLECs from economically self-provisioning switching because a footnote in the Supreme Court's recent *Verizon* decision describes "digital switches" as "more sensibly duplicable" than loops. *See Verizon*, 122 S. Ct. at 1672 n.27. This is not so. First, that passage is clearly not a holding of the Court, but merely a response to Justice Breyer's dissenting view that firms sharing some existing facilities are not really "competing." Footnote 27 correctly responds that, to the contrary, sharing facilities that cannot practically be duplicated actually *enables* competition in areas where it is practicable. Moreover, as Z-Tel has consistently argued in this proceeding, switches may well be "sensibly duplicable" (at least in some areas) for serving the business market, since hot cuts are not needed to serve that market. Because of the cost, capacity, and reliability problems imposed by the hot cut process, however, the residential market is an entirely different story. Significantly, however, the Court did not need to consider the mass market/business market distinction in order to respond to Justice Breyer.

[96] *See* Verizon Comments at 101-102.

have been directly addressed" because it allegedly "routinely meets 95 percent or more of its installation appointments on time."[97] Even if true, that claim is a non sequitur. It does not explain how a CLEC such as Z-Tel could ever recoup, for example, the $185 allegedly "true" cost of a hot cut in New York from a mass-market customer before losing the customer to churn – to say nothing of paying for switching equipment, collocation costs, maintenance, and so on. Nor does it explain how Verizon, which has struggled to provide hot cuts on the order of tens of thousands per month, could possibly perform the hundreds of thousands per month that would be necessary today in the absence of unbundled switching, or the millions that would be required in a truly competitive local services market. Moreover, Verizon simply ignores the five percent of customers that, even under Verizon's own optimistic assumption, would experience service outages or disruptions as a result of the hot cut process.[98]

Verizon's second claim – that the "best evidence that . . . hot-cut performance [is] not [a] barrier[] to deployment of alternative circuit switching is that CLECs are in fact purchasing and deploying switches on such an impressive scale"[99] – is fundamentally misleading. The ILECs are fond of compiling lists of switches purportedly deployed by CLECs, and they include a new such list as Appendix B to the so-called "UNE Fact Report." Z-Tel does not have the resources

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[97] *Id.* at 102. Qwest's brief discussion of hot cuts in its Comments makes this same argument, even repeating the 95% figure. *See* Qwest Comments at 26-27. Similarly, SBC's only mention of hot cuts is rather imprecise claim that "SBC loop provisioning performance has been outstanding." SBC Comments at 76.

[98] Of course, the BOCs are not really as oblivious to CLEC needs for predictability and reliability as their comments in this proceeding would indicate. On its "CLEC Interconnection" webpage, for example, BellSouth notes that "[a]ny wholesale partner must have predictability, reliability and coverage. A wholesaler has to stay abreast of the latest technologies, invest in innovation, and offer a range of solutions to help you achieve your goals and serve your customers." <http://interconnection.bellsouth.com>.

[99] Verizon Comments at 102.

to determine precisely how each of those switches is being used,[100] but it is certain (as the ILECs well know) that *the overwhelming majority of the switches on the ILECs' list are not used to provide mass market services*.

Indeed, the ILECs' list is dominated by several kinds of companies that obviously do not use their switches to provide services to the mass market through hot cuts. Many are business-oriented CLECs, like Allegiance, Focal, Time Warner Telecom, and Level 3, which offer no mass-market services.[101] As Z-Tel explained in its opening comments, companies providing business services can economically aggregate loops at the customer premises and employ a high capacity line, thus avoiding the need for analog loop hot cuts at the ILEC's central office.[102]

Other companies with large numbers of switches on the ILECs' list, like AT&T and Worldcom, provide mass-market services solely via the UNE Platform, while using their own switches to serve the mid-sized business market.[103] This differentiation in approach by AT&T and WorldCom shows that the small-business and residential mass market is in fact different

[100] Notably, however, when Z-Tel examined a similar list of switches from Verizon in December 2001, it found some curious entries – such as a company whose sole business appeared to be the sale of "collocation space in Tokyo." *See* Letter from Robert Curtis and Thomas Koutsky to Chairman Powell at 5 n.18 (filed December 5, 2001) (appended hereto as Attachment 2). That list of switches also contained switches apparently owned by Gillette, a company that focuses on an entirely different type of hot cut. *See* http://www.gillette.com/products/grooming_men.asp.

[101] Indeed, Level 3 offers no circuit-switched services at all.

[102] Z-Tel Comments at 51-52.

[103] *See* AT&T Comments at 207 ("AT&T and its customers experienced so many difficulties with service implementation when using the coordinated hot cut process to connect loops to its switches that AT&T was forced to cease marketing its switch-based service to all business customer locations that did not have enough traffic to warrant the use of a DS-1 or higher capacity loop."); WorldCom Comments at 33 ("[A]fter a comprehensive evaluation, WorldCom concluded that it did not make economic sense to spend the additional capital necessary to attempt . . . to enter the mass market through end-to-end facilities-based service.") (citation omitted).

from the large-business market – and the distinction falls between those markets that require analog hot cuts and those that do not.[104]

Two other categories of companies that do not require hot cuts also feature prominently on the ILECs' switch list. The first group comprises companies, such as Cablevision Lightpath, RCN, Adelphia, and Western Integrated Networks, that own substantial cable assets. But cable companies already own the "last mile" connection that ordinarily must be cut over in order for a company like Z-Tel to provide local services. As a result, switches belonging to cable companies are entirely irrelevant to the question of whether a non-cable company like Z-Tel can economically provide services to the mass market via UNE-L.

The ILEC list also contains many (now mostly bankrupt) "DLECs" such as Covad, Rhythms, and NorthPoint that had hoped to provide competitive DSL services. These companies, to the extent they still in business at all, provide a different kind of service (with vastly different customer requirements and expectations) from analog dialtone service. Installation of xDSL-capable loops remains a manual process, however, fraught with its own share of ILEC-inspired difficulties, which has doubtless contributed to the economic woes and virtual extinction of the DLEC industry. At any rate, however, it is clearly absurd to suggest that the existence of DLEC switches indicates that there is no hot-cut bottleneck.

Verizon's focus on the number of switches in its region also misses the fundamental point that a switch (or a switch and transport) by itself cannot provide telecommunications service. In order to provide service, the switch must be connected to a loop, which imposes substantial costs

[104] *Cf.* AT&T Comments at 208-09 ("CLEC circuit switches are being used almost exclusively to provide service to very large business customers that connect via DS-1 or higher level facilities, which can be deployed without a coordinated hot cut.").

on CLECs that the ILECs do not face.[105] For ILECs, their switches are hard-wired to their loops, and customers are processed by assigning the customer's telephone number to the appropriate switch and loop. In order for a CLEC to provide service using self-provisioned switching now, the CLEC must pay the ILEC to manually disconnect the ILEC loop from the switch and to "hot cut" the customer's loop to the CLEC switch. Once incurred, the cost of the hot cut is *sunk*, as the customer's line cannot be put to any other use and the investment is lost if the customer once again changes providers or moves. Moreover, the cost is borne equally across all customer acquisitions regardless of the entrant's scale. Accordingly, for self-provisioned switching to be economically viable, the CLEC must recoup not only the cost of the switch itself, and the costs of collocation rental and power, and additional overhead costs (such as maintenance), but also the sizeable costs of the hot cut, all *before* losing the customer to churn.

As demonstrated by Dr. Ford, if the costs of connecting a switch to loops for mass-market service are sufficiently high compared with the revenue opportunity from serving that customer, no entrant will seek to serve that customer.[106] When ILEC hot-cut charges are prohibitive, or the volume of hot cuts so low that working capital costs are substantially increased because of slow provisioning, the increased sunk costs from facilities entry will deter entry that would have occurred via the UNE Platform. This is exactly what Z-Tel found to be the case in New York City, where hot cut costs, along with collocation and related costs of self-provided switching, combined with low hot cut capacity to render UNE-L entry infeasible, even

[105] As the Commission and the D.C. Circuit recently agreed, without a "'switch[] or router, the local loop is merely a transmission medium theoretically capable of carrying telecommunications traffic. To access [that] capability …, a requesting carrier must, as a practical, economic and operational matter, be able to switch or route traffic to or from that loop.'" *Verizon Tel. Cos. v. FCC*, No. 01-1371, 2002 U.S. App. LEXIS 11873, *19 (D.C. Cir June 18, 2002) (quoting *Matter of Deployment of Wireline Services Offering Advanced Telecommunications Capability*, Fourth Report & Order, CC Docket No. 98-147, 2001 FCC LEXIS 4303, *67-*68 (¶ 46) (Aug. 8, 2001).

[106] Ford Decl. at ¶ 10.

if the switch itself was virtually free. In such circumstances, one would expect to find switches deployed to serve markets *other* than the mass market, but with no use of those switches to serve the mass market.

Of course, this phenomenon is exactly what the BOCs have unwittingly documented in their "UNE Fact Report." If hot cut costs are a significant barrier – and they are – then even a CLEC switch already deployed to serve the business market – an investment that is already sunk – will not be used to serve the mass market. In that case, the switch capacity not used to serve the business market will simply remain idle, and the CLEC will use other means of entry not subject to the hot cut bottleneck to enter the mass market. High barriers to connecting the third-party switch to the ILEC loop will also mean that no third-party wholesalers of switching capacity will emerge – notwithstanding the existence of excess switching capacity – because that excess capacity cannot economically be connected to ILEC loops to serve the mass market. This explanation of the fact that some CLEC switch capacity remains idle – as noted in the UNE Fact Report – rather than being used to serve the mass market is far more plausible than the ILEC "explanation" that CLECs are choosing to use UNE switching because TELRIC pricing is too low. After all, for the competitor who has already deployed a switch, the incremental cost of the switch itself is close to zero – far lower than TELRIC rates. The only logical and economical response to these high barriers to self-provided switching is to preserve unbundling for the mass market until the hot cut bottleneck problem and other costs of connecting CLEC switches to ILEC unbundled loops have been addressed.

BellSouth's comments also run to well over a hundred pages, and contain less then a paragraph on hot cuts.[107] BellSouth principally argues that the Commission should give "no

[107] *See* BellSouth Comments at 83-84.

consideration" to the "costs of hot cuts, collocation and other 'additional costs' of putting a switch in service" because they are "inherent costs of doing business in this industry" that would "have to be incurred whether or not the entity the requesting carrier has to deal with is an ILEC."[108] This argument is somewhat inscrutable. Perhaps BellSouth intends to suggest that the Commission need not concern itself with these costs because they are the same for everyone in the industry, including the ILECs, and so CLECs are not disadvantaged by having to incur them. If so, that argument is wildly inaccurate, not to mention irrelevant. It is inaccurate because hot cut costs are *not* the same for ILECs as for CLECs, because ILECs do not need to provide hot cuts for themselves; as AT&T's comments correctly state, "by virtue of the ILECs' prior monopoly status, all voice-grade loops are [already] hardwired to ILEC facilities."[109] It is irrelevant because, as the Supreme Court's recent *Verizon* decision emphasizes, Congress did *not*, in enacting the 1996 Act, intend that ILECs and CLECs should be treated as equals. Rather, "[t]he Act . . . proceeds on the understanding that incumbent monopolists and contending competitors are unequal," and it should therefore be read whenever possible to "remove practical barriers to competitive entry."[110] Accordingly, the notion that the Commission can simply ignore the high costs of hot cuts, collocation, and other switch-activation expenses in assessing impairment in the absence of unbundled switching is misguided, to say the least.

Or perhaps BellSouth intends to suggest that hot cut costs are simply run-of-the-mill start-up costs similar to those costs that any new entrant in any industry would face, and thus that they should not entitle the CLECs to any "special" regulatory treatment. Indeed, the D.C. Circuit recently cautioned the Commission against taking into account "cost disparities" that would be

[108] *Id.* at 83.

[109] AT&T Comments at 210.

[110] *Verizon*, 122 S. Ct. at 1684.

"faced by virtually any new entrant in any sector of the economy, no matter how competitive the sector."[111] Hot cut costs are, however, a far cry from the kinds of costs that are "universal as between new entrants and incumbents in *any* industry." Again, Z-Tel and other commenters have explained, the need for hot cuts in the local phone market arises from the fact that "by virtue of the ILECs' prior monopoly status, all voice-grade loops are hardwired to ILEC facilities."[112] In other words, as the Supreme Court explained in *Verizon*, the ILECs, as a result of their historical monopolies, have control of the "feeder wires" that "run into local switches that aggregate traffic into common trunks."[113] This puts the ILECs' own operations in a superior operational position to any CLEC using unbundled loops, just as, prior to the implementation of equal access, AT&T had a unique and superior advantage in serving the long distance market because it was pre-engineered into the network as the long distance carrier.[114] This is a cost characteristic that is specific to the local telecommunications market.

Qwest and SBC argue that there cannot be a hot-cut problem because the Commission, in its recent examinations of ILEC section 271 applications, has "never found [an applicant's] hot-

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[111] *See USTA*, 290 F.3d at 426; *but cf. Verizon*, 122 S. Ct. at 1684 ("The Act, however, proceeds on the understanding that incumbent monopolists and contending competitors are unequal"). In affirming the Commission's combinations rule, the Supreme Court noted that providing a combination of loop, switch and NID "is justified by the statutory requirement of 'nondiscriminatory access'" because "[t]here is no dispute that the incumbent can make the combination more efficiently than the entrant." *Id.* at 1686.

[112] AT&T Comments at 210.

[113] *Verizon*, 122 S. Ct. at 1661.

[114] Of course, the court and Commission properly imposed "equal access" requirements on AT&T and its progeny so as to make the process of signing up long distance customers equal for all IXCs. *See* Modification of Final Judgment (MFJ) § II(A), adopted in *United States v. AT&T Tel. & Tel. Co.*, 552 F. Supp. 131 (D.D.C. 1982) (subsequent history omitted); *MTS and WATS Market Structure Phase III*, Report and Order, FCC 85-98, 100 F.C.C.2d 860, 877-78, ¶ 59 (1985); *see also Investigation into the Quality of Equal Access Services*, Memorandum Opinion and Order, FCC 86-248, 60 Rad. Reg.2d (P&F) 417 (1986).

cut performance to be unsatisfactory."[115] Like so many of the ILECs' arguments, however, that point is irrelevant to the question now before the Commission. The Commission's section 271 analyses have naturally examined the adequacy of ILEC hot cuts in today's regulatory environment, in which CLECs are entitled to compete using the UNE Platform. But those section 271 analyses dealt with levels of hot cuts not even close to what would be needed to bring mass-market competition. Again, in New York – a state with the most experience in all forms of local competition and with hot-cuts – the PSC has observed that Verizon would have to increase its hot-cut capacity 4400 percent to meet the hundreds of thousands of lines per month that the UNE Platform demands. And other BOC 271s have been granted with far lower levels of hot cut capacity.

Accordingly, the ILECs' claim that hot cut provisioning has been held adequate for a world in which the UNE Platform supplies the lion's share of the limited residential competition that exists is entirely irrelevant to the question whether the ILECs could supply sufficient hot cuts to support competition in a world without the UNE Platform. They unquestionably could not.

The most outrageous of the ILECs' arguments with respect to hot cuts, however, is not in any of their individual comments, but instead appears in their jointly submitted "UNE Fact Report 2002." There, the ILECs argue that "even assuming that hot-cut costs remain significant, substantial numbers of customers that seek phone service are entirely 'new' customers in that they are first-time subscribers at the location at which they are requesting service."[116] Thus, the

[115] Qwest Comments at 26; *see also* SBC Comments at 76. The ILECs cite the Commission's 271 approvals in Rhode Island, Pennsylvania, Arkansas/Missouri, and Massachusetts, to which might also be added the Commission's recent Georgia/Louisiana ruling.

[116] *See* UNE Fact Report at II-19. In essence, families would have to move to enjoy the benefits of competition.

ILECs' response to the problems presented by manual hot cuts is that competitors should content themselves with targeting the "large base of customers" requesting new service each year.[117] This argument is so audacious that it is hard to take seriously. Clearly, Congress did not go to the trouble of enacting the 1996 Act so that CLECs seeking to serve the mass market could compete only for the "new" lines that are added each year. Moreover, even as to "new" customers, the hot cut problem remains. Regardless of whether loops are pressed into service by new customers or old, they nearly all remain hard-wired into the ILECs' networks as a result of the ILECs' position as historical monopolists.

Finally, the UNE Fact Report also appears to argue that if CLEC "cost[s] of migrating the customer" from the UNE Platform to UNE-L are high, CLECs could somehow avoid those costs by not "building their customer base on UNE-P service at all."[118] With this argument, the ILECs appear to admit that they cannot serve as many CLEC lines through hot cuts as they can through the UNE Platform. In itself, this argument thus confirms Z-Tel's position that it would be impaired in the absence of the UNE Platform.

Moreover, for sheer absurdity, the ILECs' suggestion that CLECs could avoid the hot cut bottleneck by eschewing the UNE Platform rivals the suggestion that CLECs should seek to serve only new subscribers. Again, from the perspective of hot cut capacity and costs, it makes no difference whether a customer to be moved to UNE-L was previously being served by the CLEC using leased ILEC facilities (the UNE Platform), by the ILEC itself, or is a "new" customer; in any event, a hot cut must be performed and hot cut costs incurred. Indeed, AT&T's

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[117] *Id.* at II-19 to II-20. In making this argument, the BOCs clearly admit that there is a substantial amount of churn in the market. As Z-Tel pointed out in its opening comments, that churn, combined with limited hot-cut capacity, places a *de facto* cap on UNE-L penetration at levels so low that mass-market competition would clearly be deemed a failure.

[118] UNE Fact Report at II-19.

experience is that it is easier for the CLEC to manage the hot-cut process (and therefore presumably less costly for the CLEC and the ILEC, even if the ILEC does not pass on its cost savings to the CLEC) when migrating larger numbers of UNE-platform lines to UNE-L than in individual hot-cut situations, because the conversions can be project-managed by both entities.[119] As a result, if CLECs were to take the approach of "not build[ing] their customer base on UNE-P at all," that would not lower hot cut costs, or make serving the mass market via UNE-L any more viable. Rather, that approach would – as the ILECs would certainly like – simply prevent the CLECs from building any significant residential customer base at all, reducing their output in the residential and small-business mass market to nearly zero.

In sum, Z-Tel's opening comments explained that as a result of hot cut cost and capacity problems, as well as collocation charges and other significant non-recurring costs, it would clearly be impaired in providing the services that it seeks to offer to the mass market in the absence of unbundled local switching. The ILEC comments fail even to meaningfully address the critical hot-cut bottleneck and other costs of connecting to ILEC unbundled loops. Perhaps that failure was to be expected, given the simple truth: as the Texas PUC concluded earlier this year, the ILECs simply have no mechanism "to integrate in any administratively practical or meaningful way local switching obtained by a CLE from a third party with [the ILEC's] network."[120]

2. THE ILEC claim that CLECs serve three million mass-market residential customers using self-provided switching is misleading.

In addition to repeated general references to the irrelevant list of "CLEC Circuit Switches" discussed above, the ILECs also make the more specific claim that CLECs would not

[119] *Id.*

[120] Texas Arbitration Award at 74.

be impaired in the absence of unbundled local switching because they are purportedly already serving "three million residential lines" through self-provided switching.[121] That argument, however, is as misleading as the circuit switch list. As discussed below, upon closer examination it is clear that only a small fraction of these supposed "three million" CLEC residential customers are actually served via UNE-L. And the few residential customers that *are* being served by CLECs using self-provided switching and unbundled local loops certainly do not suggest that UNE-L entry alone could ever result in a truly competitive local telephone services market for mass market customers nationwide.

Before turning to the details of the ILECs' claim, however, the big picture warrants some attention. There are approximately 140 million mass-market lines in service in the United States.[122] Even if three million of those lines were being served by CLECs through self-provided switching – which they are not – that would be only about two percent of the total number of mass market analog lines. *Six years after adoption of the 1996 Act*, two percent of the mass market served by CLECs self-provisioning switching would be slim support for the notion that relying on UNE-L alone will result in vigorous local competition in that market.

In fact, however, the actual number of mass market lines being served by true, new-entrant CLECs using their own switches is much, much lower than three million. As briefly noted above – and as even the ILECs' otherwise obfuscatory "UNE Fact Report" appears to concede – in determining whether the typical new CLEC that starts with no built-in network assets (such as Z-Tel) would be impaired in the absence of unbundled switching, it is necessary to "[l]eav[e] aside service provided over cable networks."[123] While local telephone service

[121] *See, e.g.,* Verizon Comments at 8, 96; SBC Comments at 69.

[122] *See* Z-Tel Comments, Attachment 1 ("The Local Telecommunications Mass Market (2001)").

[123] UNE Fact Report at II-18.

provided over cable is *one* potential source of competition for the historical monopolist providers, even the ILECs do not have the audacity to argue explicitly that the intent of the 1996 Act was to open the local telephone market to competition *only* by companies that own cable networks. In nearly all of the country, that would leave only a duopoly and both firms would have every incentive to reach a cooperative market outcome that would be far from the competitive market envisioned by Congress in 1996. Z-Tel, for its part, does not own cable assets, and it is certain that being obliged to acquire such assets in order to provide the "services it seeks to offer" would constitute "impair[ment]" within the meaning of section 251(d)(2)(B).

Once cable services are "le[ft] aside," however, the ILECs are able to muster only nine companies nationwide that purportedly "provide facilities-based service to 25,000 or more residential lines" in BOC territories.[124] "Figure 4" of the UNE Fact Report indicates that those nine companies together serve only about 650,000 residential customers, or less than 0.5 percent of the mass market. Again, even if all 650,000 of those customers were being served by CLECs via UNE-L – which they assuredly are not – that would not be much to show for six years of CLEC efforts under the 1996 Act, and would provide little reason for optimism about the competitive prospects of UNE-L entry in the mass market.

But an even closer look at the nine companies listed in Figure 4 clearly shows that those new entrants are not serving anywhere near 650,000 customers via UNE-L.[125] Two of the companies are actually large, independent ILECs with even larger wireless businesses. Specifically, ALLTEL is the country's second-largest independent ILEC, with approximately 3.2 million local customers, and the seventh-largest wireless carrier, with about 7.4 million

[124] *Id*.

[125] The nine companies include: ALLTEL, Broadview, Cavalier Telephone, Intermedia, Knology, McLeodUSA, RCN, TDS, and TOTALink. *See* UNE Fact Report at II-19.

customers.[126] TDS was founded 34 years ago as an ILEC and still derives 80% of its wireline revenues from its ILEC operations. TDS also owns U.S. Cellular, the nation's eighth-largest cellular provider, with 3.5 million customers.[127]

These companies' "CLEC" strategies directly depend on their ILEC resources. ALLTEL describes its CLEC strategy as "leverag[ing ILEC] wireline assets to extend [the] CLEC in wireless markets to small and medium-sized businesses."[128] Similarly, TDS plans to "aggressively grow the [CLEC] business [by] expanding into markets near our existing ILEC" operations.[129] Needless to say, such strategies are not available to CLECs (such as Z-Tel) that are not *also* ILECs. Accordingly, the fact that ILECs such as ALLTEL and TDS may not need unbundled switching to expand their local telephone services into residential areas bordering their ILEC operations is no indication that new entrants such as Z-Tel would not be impaired without access to unbundled local switching.

Like ALLTEL and TDS, Georgia-based Knology, owned by ITC Holding Company, Inc., also operates an ILEC, the Interstate Valley Telephone Company. IVTC, founded in 1896,

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[126] *See* slide entitled "ALLTEL's Communications Business," in ALLTEL's "Company Overview" (March 22, 2002), at *http://www.alltel.com/news_information/presentations/overview/ppframe.htm*.

[127] *See* TDS's presentation from Banc of America Global Telecommunications Media and Entertainment Conference, at *http://www.teldta.com/investor/invpresentation05012002.htm*. ("TDS Banc of America Presentation").

[128] *See* slide entitled "Wireline" in Presentation by ALTEL Communications Group President Kevin Beebe (May 8, 2001), at http://media.corporate-ir.net/media_files/NYS/AT/presentations/50801/sld010.htm.

[129] TDS Banc of America Presentation, at *http://www.teldta.com/investor/invpresentation05012002.htm*. Notably, TDS's presentation also observed that its CLEC operation "is . . . successful due to leveraging [TDS's] existing ILEC capabilities for billing, engineering, regulatory and other operating needs." *Id.*

serves rural and suburban communities in Alabama and Georgia.[130] In 1994, ITC Holdings started Knology to expand its telecommunications business to include providing cable TV. Knology now ranks among the nation's top 25 cable companies,[131] and uses the high-speed fiber and coaxial cable network that it has been constructing since 1994 to deliver not only cable TV, but also telephone and Internet services.[132] Clearly, however, what Knology does *not* do is provide local telephone services to mass market customers using UNE-L, as the ILECs' "Figure 4" misleadingly suggests. Accordingly, Knology's endeavors are irrelevant to the question whether companies like Z-Tel would be impaired in the absence of unbundled local switching.

Like Knology, RCN Corporation – which alone serves more than one-third of the approximately 650,000 residential lines included in Figure 4[133] – does not provide local telephone services via UNE-L. It does, however, serve lines through resale – over 33,000 lines according to its 2001 SEC Form 10K.[134] Indeed, RCN relies in significant part on resale strategies to build its business – of the 1.2 million various "service connections" it reported in 2001 (voice, Internet, cable, etc.), 417,861, or 34%, were "off-net," resold services.[135]

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[130] *See, e.g.,* Knology Press Release "Knology Applies For Franchise In Jefferson County, Kentucky" (November 29, 2000), at *http://www.knology.com/news/index.details.cfm?pkey=108*.

[131] *See* "Top 25 MSOs," Broadcasting & Cable (April 29, 2002), at 36.

[132] It is unclear whether this strategy will succeed in the marketplace – Knology has never achieved a profitable quarter and does not expect one in the foreseeable future. *See* AT&T Comments, Appendix F, Exhibit 1 at 3.

[133] It is impossible to tell from Figure 4 that RCN serves the lion's share of these lines, since the ILECs did not match lines served to the company providing the service. A recent news article, however, stated residential customers constitute about 28% of the approximately 830,000 lines served by RCN, which works out to about 230,000 residential customers. *See* "RCN Improves in Quarter" (February 8, 2008), in BroadbandWeek Direct, at *http://www.broadbandweek.com/news/020204/020208_biz_rcn.htm*.

[134] RCN Corporation, 2001 Form 10K at 4 (filed March 29, 2002).

[135] *Id.* at 5.

Like Knology, RCN is a cable overbuilder, attempting to construct a local fiber network to deliver cable TV, Internet, and telephone services directly to the home without using the ILEC network at all. Once again, however, the 1996 Act clearly was not intended to foster local telephone competition only by companies that own, buy, or build cable assets. And once again, the question whether companies with cable networks can economically provide local telephone services to residential customers over such networks is irrelevant to the question whether companies without cable assets, like Z-Tel, would be impaired in the absence of unbundled local switching.

Moreover, even were RCN's efforts relevant to the viability of UNE-L (which they are not), RCN's reach is small. According to its 2001 SEC Form 10K, RCN's network passes only 1.7 million households – that is, only approximately 1.7% of U.S. households. The ubiquity available under the UNE Platform is substantially greater – Z-Tel can currently provide services throughout 38 states to over 70 million households. Finally, the jury remains decidedly out on the long-term viability of RCN's business plans. RCN has garnered over $5.3 billion in investment capital[136]and was long considered the biggest success story in its business space, but their debt has recently been downgraded by Moody's, which "forecast[ed] a possible default next year."[137]

A fifth company of the nine on the "Figure 4" list, TOTALink, while not initially an ILEC or a cable company, similarly owes its existence to utility company resources unavailable to the typical CLEC. TOTALink is wholly owned by SIGECOM Holdings, Inc., which is in turn owned by Vectren Corporation and Utilicom Networks. Vectren is an Indiana gas and electric

[136] *See* "RCN Company Profile," at *http://www.rcn.com/investor/index.html*.

[137] *See* "RCN Stiffing of Cable Channel Gives Bad Picture" (February 27, 2002), in Chicago Tribune, at *http://www.cantv.org/rcnartic.htm*.

utility; Utilicom is a Massachusetts-based company that partners with utilities to build and operate broadband networks.[138] Utilicom and Vectren also own SIGECOM LLC, a competitive cable TV provider in the Evansville, Indiana market. Like the ALLTEL and TDS CLECs, TOTALink's residential efforts thus clearly depend on leveraging its utility franchises and resources to enter the market for local telephone services. Notably, however, even with the advantage of its utility-parent resources, TOTALink's efforts to enter the mass market appear to have been unsuccessful. Although TOTALink once planned to enter numerous second and third tier markets,[139] it has now "shelved most of its telecom ventures."[140] In fact, "TOTALink" no longer has any independent presence on the Web, and its operations appear to have been merged with those of SIGECOM, the Vectren/Utilicom cable company.[141]

McLeodUSA is also a dubious poster child for successful UNE-L delivery of residential services. In January of this year, McCLeodUSA declared bankruptcy and filed for protection under Chapter 11. It emerged from bankruptcy on April 16, having successfully negotiated the elimination of $3,300,000,000 in debt.[142] It is unclear whether McLeodUSA's market strategy – attempting to reach both residential and business customers – remains unchanged in the wake of that massive restructuring, and it is certainly too early to evaluate McLeodUSA's prospects going forward. For the moment, however, it is fair to say that the possibility that McLeodUSA

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[138] *See, e.g.,* Utilicom Press Release, "TOTALink of Indiana Files Formal Petition With Cable Franchise Board of Indianapolis-Marion County" (April 17, 2000), at *http://www.utilicom.net/press041700.asp?Flash=off*.

[139] *See* Utilicom Press Release, "Utilicom Networks secures $100 million commitment from Blackstone" (February 2, 2000), at *http://www.utilicom.net/press020200.asp?flash=off*.

[140] *See* Bill W. Hornaday, *Comcast Will Publish New Video Service; Cable Company Hopes PR Blitz Entices Subscribers to Try Video-On-Demand*, Indianapolis Star, April 12, 2002, at C5.

[141] Some telecom services are now available at *www.sigecom.com*.

[142] *See* McLeod "Company Info: Our History," at *http://www.mcleodusa.com/company_info/ourhistory.php3*.

may have accumulated 25,000 residential customers during the past six years seems far less significant than the fact that it assuredly accumulated more than $3 billion in debt during that period. That is a whopping $132,000 in debt per residential customer.

Two more of the companies on the ILECs' Figure 4 list either exclusively or primarily target business customers. Intermedia clearly does not sell mass market services. Intermedia's Web site states that "If you are part of a company still searching for the right access services, search no further. . . . Intermedia is your source for reliable products and services focused on meeting the needs of small to mid-sized businesses."[143] Intermedia's site *does not mention residential services at all*. Broadview similarly touts itself as "[o]ne company for all of your business voice, data, and high-speed Internet access" needs,[144] and "[t]arget[s] its plain old telephony, long distance, Centrex, broadband data, virtual private network and VoDSL services to small and medium businesses with four to 25 voice lines."[145] Even more notably, Broadview has also participated in this proceeding as a member of the UNE Platform Coalition.

The final company on the ILECs' Figure 4 list, Cavalier Telephone, sells its services in a limited geographic area and has, notably, sued Verizon in antitrust court for Verizon's utter failures to provide it interconnection, collocation, and loops in a timely manner.[146] The area served by Cavalier includes Richmond, VA, Hampton Roads, VA, Northern Virginia and suburban Maryland (around Washington, DC), the Greater Baltimore, MD area, and the Greater

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[143] *See* Intermedia's "Local Services and Internet Access" Web page, at *http://www.intermedia.com/products/access*.

[144] *See* Broadview Networks home page, at *http://www.broadviewnet.com/Business/Default.asp?scenario=0*.

[145] *See* Peter Lambert, "The Tortoise Wins" (Feb. 1, 2002) in Exchange: The Source for Emerging and Evolving Service Providers, at *http://www.xchangemag.com/articles/221buz&fine.html*.

[146] Cavalier Telephone, LLC v. Verizon Virginia Inc., Civil Action No. 03:01CV736, Complaint (E.D. Va. Nov. 1, 2001) ("Cavalier Antitrust Complaint").

Philadelphia, PA areas.[147] As of the end of August, 2001, Cavalier served a total of 100,000 business and residential lines in those areas. As of the end of August, 2001, Cavalier served a total of 100,000 business and residential lines in those areas.[148] That figure represents 0.80% of the total number of analog mass-market lines in Virginia, Maryland and Pennsylvania. Cavalier notes in its antitrust complaint against Verizon that other CLECs in its service area have filed for bankruptcy, ceased to offer services or cancelled plans to offer service.[149] Cavalier's complaint also states that the prices Verizon charges for access to its unbundled loops "are so high that Cavalier cannot profitably offer Basic Telecommunications Services over those facilities."[150]

In sum, upon close examination, Figure 4 of the UNE Fact Report falls far short of proving its point. If anything, the table is primarily a microcosm of the shattered dreams of the competitive telecom industry since 1996. Of the companies included by the ILECs in Figure 4, nearly all are either primarily ILECs, or cable overbuilders – and nearly all never sought to serve the mass market, or have abandoned plans to do so, or have stated that they cannot do so profitably. Most of the companies in Figure 4 do not even provide service over unbundled loops, and a very generous, best-case scenario examination of this table suggests that CLECs may be

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[147] *See* Cavalier Press Release, "Cavalier Telephone dials up major milestone" (August 30, 2001), at http://www.cavtel.com/news/press/news_press_083001.htm.

[148] A number of these lines were connected by taking advantage of analog loop discounts that Verizon conceded to the Commission as part of the Bell Atlantic-GTE Merger Order. These Cavalier lines risk disconnection in August 2002, when that merger condition expires. *See* Comments of Cavalier Telephone LLC, *In the Matter of Verizon Bell Request for Limited Modification of LATA Boundary to Provide Expanded Local Calling Service Between Certain Exchanges in Virginia*, CC Docket No. 96-159, Attachment A (July 15, 2002) (noting potential of UNE loop rate in Bethia, VA due to expiration of merger condition and possible disconnection of 3000 Cavalier lines as a result.) Unless the Commission acts to make the current (or lower) rates permanent, this entry is the prototypical transitory entry that the Commission should not consider in its impairment analysis.

[149] Cavalier Antitrust Complaint at ¶¶ 144-52.

[150] *Id.* at ¶ 182.

serving somewhere around 200,000 mass-market lines through UNE-L. Two hundred thousand is, of course, a very far cry from 3 million; indeed, it represents only about one-tenth of one percent of the total mass-market lines in the United States. Needless to say, that is remarkably, astonishingly, amazingly little to show for six years under the 1996 Act. Accordingly, what Figure 4 of the so-called "UNE Fact Report" really demonstrates (more eloquently than CLEC protestations ever could) is that UNE-L currently is *not* a viable means of producing a fully competitive local telephone services market for mass market consumers.

3. Z-Tel's argument that it would be "impaired" in the absence of unbundled local switching is fully consistent with the D.C. Circuit's decision in *USTA v. FCC*.

Having failed even to address the critical hot-cut bottleneck in their opening comments, the ILECs' replies will likely make much of the fact that the D.C. Circuit's recent *USTA* decision remanded the Commission's unbundling rules. Specifically, *USTA* rejected the articulation of the "material diminishment" standard for impairment set forth in the *UNE Remand Order*. However, while the court's decision may well – if left unreviewed by the D. C. Circuit and the Supreme Court[151] – complicate the Commission's task in determining whether competitors seeking to serve the large business market would be "impaired" without unbundled access to certain network elements, it poses no such problem I n connection with the mass market services that Z-Tel seeks to offer. As a result of the hot-cut bottleneck and other operational and network impediments, Z-Tel would be "impaired" in its efforts to serve the mass market in the absence of unbundled local switching under *any* reasonable interpretation of that statutory term, and nothing in the *USTA* decision is to the contrary.

[151] It is, of course, far from certain that *USTA* will survive intact. As the Commission recently argued to the D.C. Circuit, "the panel's decision is, at a minimum, fundamentally in tension" with *Verizon*. FCC Rehearing Petition at 1.

a) Market-specific analysis, as required by *USTA*, underscores the impairment that Z-Tel would suffer in the absence of unbundled switching.

The first section of the *USTA* court's analysis faulted the Commission for adopting rules of "unvarying scope" that "mandate unbundling" without regard to the "state of competitive impairment in any particular market."[152] In holding that a more granular impairment analysis is required, the court emphasized that as a result of "cross-subsidization often ordered by state regulatory commissions . . . in the name of universal service," new entrants with no obligation to provide underpriced service in high-cost areas may be drawn to compete only for lucrative large-business customers.[153] The court thus specifically suggested that the large business market and the mass market should be analyzed as separate segments, in which different degrees of unbundling may be necessary to avoid impairment.

Z-Tel wholeheartedly agrees with the court's view that the large business and mass markets – consistent with the Commission's review of major industry mergers – should be distinguished and analyzed separately. Indeed, in its opening comments, Z-Tel made the same point, stating that "a more granular approach to the unbundling rules" is "both welcome and warranted."[154] Significantly, however, Z-Tel itself targets *only* mass-market customers: the very segment that the court apparently feared would be underserved under the Commission's national

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[152] *See USTA*, 290 F.3d at 422.

[153] *Id.* Notably, the D.C. Circuit appeared unaware of both the Act's provisions and the Commission's decisions requiring that such "cross-subsidi[es]" be made explicit and portable. 47 U.S.C. § 254(e) (requiring that all federal universal service support be made "explicit"); 47 U.S.C. § 253(b) (mandating that all state-imposed requirements be "competitively neutral"); *Federal-State Joint Board on Universal Service*, Report and Order, 12 FCC Rcd. 8776, 8944 (1997) (finding that explicit subsidies should be portable). Because of this change (mandated by the Act) to the historical system of implicit subsidies, the court's specific concern that the Commission's impairment analysis ignores (now-prohibited) "cross-subsidization" is likely to prove insubstantial.

[154] Z-Tel Comments at 5.

rules. As Z-Tel urged in its comments, with respect to that market segment, hot cut costs, reliability concerns, and capacity constraints would not merely "impair," but would likely altogether *prevent*, meaningful competition in the absence of unbundled local switching (or any other element of the UNE Platform).[155] Z-Tel's comments acknowledged, however, that hot cuts are not needed when customer traffic reaches a level (generally around 16-20 lines) at which it makes economic sense to purchase multiplexing equipment, to aggregate loops at the customer location, and to provide service using a DS1 interface or higher.[156] The problems of hot-cut costs and capacity constraints may thus disappear in the context of large business customers, because those customers can often be profitably served with manual provisioning (because their monthly bill is higher and they may sign volume and term commitments that mass market consumers will not).[157] As Z-Tel's comments indicated, serving low monthly revenue, mass-market customers requires a high degree of reliance on mechanized provisioning, to a far greater extent than for large business customers. As a result the operational impediments inherent in manual provisioning affect mass-market entrants like Z-Tel far more than they affect entrants that seek to serve large businesses.

In sum, Z-Tel's arguments already take account of the D.C. Circuit's observation that different customer market segments may experience different levels of impairment in the absence of unbundling: Z-Tel has argued that competitors seeking to serve the mass market would be uniquely impaired as a result of failure to unbundle local switching (or any other element of the UNE Platform) because the ability of those competitors to serve the mass market

[155] *Id.* at 20-71.

[156] *Id.* at 52-53.

[157] Of course, even large business customers can be economically served using self-provisioned switching only if they exist in a particular geographic area in sufficient quantity for a CLEC to fill one or more switches.

would beuniquely adversely affected if they were forced to rely entirely on the current inadequate supply of costly and unreliable hot cuts.

The *USTA* decision also suggests that the Commission's unbundling rules should, in addition to taking account of different customer markets, distinguish among different geographic markets.[158] Z-Tel is frankly uncertain how this would work as a practical matter. Certainly it would be difficult for the Commission to undertake fact-finding as to each individual geographic market in the United States. Perhaps, however, at least with regard to mass-market services, market analysis should correspond to the media or advertising market – Proctor & Gamble, for example, does not sell shampoo on a town-by-town basis, and mass market local phone service (marketed through advertisements and billboards such as those attached to Z-Tel's opening comments[159]) is sold much like shampoo.

In any event, it is difficult to see how a granular market analysis could be practicable without enlisting the aid of state commissions, as discussed in Section IV, *infra*. What is clear, however, is that distinguishing among and separately analyzing geographic markets would have no impact on Z-Tel's argument that absent unbundled switching, hot-cut cost, reliability, and capacity concerns would significantly reduce Z-Tel's output and thereby "impair" Z-Tel's ability to serve the mass market throughout its service area. Indeed, Z-Tel is not aware of *any* geographic area in which hot cuts are currently available at low enough cost, in sufficient quantity, and with sufficient reliability to make it economical to serve the mass market using self-provisioned switching and UNE-L. In this situation, in which the ILECs have provided absolutely no evidence of adequate mass market loop provisioning anywhere, a national rule that

[158] The court's discussion of the remanded rules' "unvarying scope" refers, for example, to the "geographic market[s]" as well as "customer class[es]." *USTA*, 290 F.3d at 422.

[159] *See* Attachment 2 to Z-Tel Comments.

unbundled switching must be made available is appropriate, even under the D.C. Circuit's decision in *USTA*.

Z-Tel recognizes that if the ILECs were to upgrade their networks in particular geographic areas to enable mass market customers to change local carriers using a fully mechanized, software-controlled process ("electronic loop provisioning" or "ELP") – similar to the PIC change process that currently enables mass market customers to electronically change long distance providers – instead of via manual cutovers, then the existence of such a process might be relevant to the impairment analysis in those geographic areas.[160] Regulators would, however, have to pay special attention to the substantial impact that scattered availability would have upon competition. To utilize the shampoo analogy once again, assume that a new manufacturer attempts to enter the shampoo market, but all store shelf space is completely taken up by Proctor & Gamble products. The scarcity of shelf space is akin to the hot cut and network capacity arguments discussed above. The fact that shelf space may open up in one or two stores in the U.S. does not mean that the aspiring shampoo company can now "enter the market" in those two stores. Important aspects of the shampoo business – for example, the economies of scale needed in manufacturing, product development, distribution, and (especially) advertising –

[160] Z-Tel noted in its opening comments that the availability of automated hot cuts would change the impairment analysis. Z-Tel Comments at 59-62. Attachment C to the AT&T Comments contains a Declaration by Irwin Gerszberg, an experienced AT&T network engineer, explaining precisely how "ELP can be deployed today using equipment that venders are currently offering." Gerszberg Declaration at 4. Essentially, such deployment involves upgrading the transmission equipment that connects customer loops to the local carrier switches to enable "packetizing" the customer's communications. Packetizing the voice communications that occupy the low frequency portion of the loop would allow that traffic to be electronically routed to a competitor's switch, without the need for a manual hot cut. *Id.* at 8-17. Unfortunately, while the ILECs are certainly aware of the existence of the technology to enable ELP, they "currently deploy this technology in a manner that benefits only their own services, and that in fact significantly hinders the efforts of competing carriers to provide service." *Id.* at 4.

were prevent such an approach. Shelf space would have to open up in many stores for the aspiring shampoo entrant to efficiently produce, market, distribute and sell a product.

Local phone service is not much different. The deployment of a new shelf-space technology like ELP would be a good thing, but it is not an immediate panacea. Mass-market entrants cannot enter the market in a crazy-quilt fashion – recall the evidence presented in Z-Tel's comments of the need to keep costs of customer acquisition and provisioning as low as possible.[161] For the moment, however, ELP is not available anywhere, and the hot cut problems described in detail in Z-Tel's opening comments therefore would, in the absence of unbundled switching and the other elements of the UNE Platform, "impair" Z-Tel's ability to provide the mass market services it seeks to offer without regard to geography.

b) Z-Tel's argument that it would be impaired in the absence of unbundled local switching is consistent with considering only cost disparities other than those faced by any new entrant, in any sector of the economy.

In addition to faulting the Commission for adopting unbundling rules of "unvarying scope," the D.C. Circuit's *USTA* decision also took issue with the scope of "cost disparities" between CLECs and ILECs upon which the Commission relied in adopting its rules. The court's discussion of the cost issue is difficult to follow (quite apart from the apparent conflict with *Verizon*), but it seems primarily to hold that the Commission cannot properly ground a finding of impairment on "cost disparities" that would be "faced by virtually any new entrant in any sector of the economy, no matter how competitive."[162] That holding – like the holding relating to market-specific analysis discussed above – has little bearing on Z-Tel's argument that it would

[161] Z-Tel Comments at 33.

[162] *USTA*, 290 F.3d at 426-28; *but cf. Verizon*, 122 S. Ct. at 1661 (noting that purpose of the Act was to provide "every possible incentive" for new entrants to enter local telephone markets in competition with the incumbent LECs, and making no mention of distinguishing among geographic areas).

be impaired in the absence of unbundled local switching. In the absence of unbundled switching, the hot cut costs and network architecture inefficiencies that would arise from the unique historical monopoly context of local phone servicecould not properly be conflated with typical start-up costs faced by "new entrant[s] in any sector of the economy." They are, instead, costs and inefficiencies uniquely borne by new CLEC entrants.

Indeed, Z-Tel is not aware of *any* other industry in which a new entrant must pay an established monopolist substantial sums merely to enable the monopolists' customers to buy goods or services offered by the new entrant. Indeed, such a situation clearly would – if created by the monopolist itself to perpetuate its monopoly, rather than arising from a history of government regulation – violate section 2 of the Sherman Act, which prohibits a monopolist from acting to extend or preserve its monopoly.[163] In sum, under *USTA*, the Commission's impairment analysis can (and should) take account of the hot-cut costs that CLECs face as a result of the unique historical monopoly legacy of the local telephone market, because those costs are obviously not "faced by virtually any new entrant in any sector of the economy."

Dicta in the *USTA* decision also suggests that the Commission's impairment analysis should, in addition to disregarding cost disparities that new entrants in any industry encounter, recognize impairment (and mandate unbundling) only for elements as to which "multiple, competitive supply is unsuitable."[164] This highly restrictive approach to unbundling was one of the primary motivations for the Commission's recent petition for rehearing of *USTA* before the D.C. Circuit, which aptly pointed out that such a "natural monopoly" rule would import a restriction not contained in the plain text of the Act, inconsistent with *Verizon*, and contrary to

[163] *See, e.g.,* AREEDA & HOVENKAMP at 165 (2000).

[164] *USTA*, 290 F.3d at 427; *but cf. Verizon*, 122 S. Ct. at 1662 (noting that "[a] newcomer could not compete with the incumbent carrier to provide local service without coming close to replicating the incumbent's entire existing network").

the plain terms of section 251(d)(2), which require the Commission to focus on a carrier-specific analysis of impairment.[165] Indeed, as discussed further below, the *USTA* court itself declined to adopt the ILECs' similar argument that the a new entrant is "impaired" only when the facility sought is an "essential facility" under antitrust law. In any event, this discussion in *USTA* would not have any effect on unbundling of local switching (as well as the other elements of the UNE Platform) to serve the mass market.

c) The *USTA* decision properly declined to adopt an "essential facilities" test for impairment, and even if it had done so, unbundling of all elements of the UNE Platform would still be appropriate.

As noted above, the D.C. Circuit's *USTA* decision expressly declined to adopt the ILECs' view that the Commission must incorporate the antitrust "essential facilities" doctrine into its impairment analysis.[166] The court's decision on this issue was clearly correct; the essential facilities doctrine serves a far different, and far narrower, purpose than the market-opening requirements of section 251, and the application of the doctrine here would be inconsistent with text, structure, and legislative history of the Act.

At the same time, however, Z-Tel recognizes that the *USTA* court discussed aspects of the essential facilities doctrine at considerable length, including the doctrine's limitation of "essential" facilities to those that it would "make *no economic sense*" to duplicate due to declining "average costs . . . throughout the range of the relevant market."[167] Indeed, the court

[165] FCC Rehearing Petition at 11-13.

[166] *USTA*, 290 F.3d at 427.

[167] *Id.* at 426 (citing AREEDA & HOVENKAMP at 771-73 (1996), and 2 Alfred E. Kahn, The Economics of Regulation: Principles and Instituttions 119 (1989)); *but cf. Verizon*, 122 S. Ct. at 1686 (in affirming the Commission's UNE combinations rule, the Court noted that the statutory requirement of "nondiscriminatory access" made it reasonable for the Commission to mandate that incumbents combine elements where they "could make the combination more efficiently than the entrant").

appeared to fault the Commission for not engaging in similar discussion,[168] notwithstanding its express holding that the "impairment" test need not incorporate the "essential facilities" analysis. Although Z-Tel is frankly uncertain what this portion of the court's decision was intended to convey, it is clear both that: (1) importing the essential facilities test into the impairment analysis would be inconsistent with the Act; and (2) even if the Commission were to take that unwarranted step, it should still require unbundling of local switching and all other elements of the UNE Platform for the purpose of serving the mass market.

(1) Adopting an "essential facilities" test for impairment would be inconsistent with the fundamental purposes of the Act, as well as its text, structure, and legislative history.

Incorporating the essential facilities doctrine into section 251's impairment analysis would be fundamentally inconsistent with the goals of the 1996 Act, which was intended to serve purposes far broader than that animating the doctrine. Section 2 of the Sherman Act, under which the essential facilities doctrine developed, is targeted to preventing a monopolist from willfully maintaining or extending its monopoly power through wrongful or predatory acts of monopolization, sometimes referred to as "exclusionary conduct."[169] Under the doctrine, a firm with monopoly power may be found to have willfully maintained or extended its monopoly if the firm has exclusive or near exclusive control over inputs that are "essential" for the existence of competition, and refuses to provide reasonable access to those inputs.[170] The essential facilities doctrine is thus a narrow exception to the general rule that the antitrust laws do not impose any

[168] *USTA*, 290 F.3d at 426-28 ("The Commission has in no way focused on the presence of economies of scale "*over the entire extent of the market*.") (quoting 2 Kahn, at 119).

[169] *See, e.g., United States v. Grinnell Corp.*, 384 U.S. 563, 570-71 (1966).

[170] *See MCI Communications Corp. v. AT&T*, 708 F.2d 1081, 1132-33 (7th Cir. 1983).

duty even on firms with monopoly power to deal with their competitors.[171] Like section 2 as a whole, the doctrine is not specifically directed to eliminating existing, lawfully obtained monopoly power, but rather is targeted to preventing the perpetuation or extension of such power through wrongful or predatory acts.

As the Supreme Court's *Verizon* decision recently explained in no uncertain terms, the 1996 Act is considerably more ambitious with respect to the historical monopoly in local phone services. According to the Supreme Court, the Act is intended affirmatively to foster competition in "the persistently monopolistic local markets" by giving "aspiring competitors every possible incentive to enter [those] markets, short of confiscating the incumbents' property."[172] Indeed, the Court emphasized that the Act, unlike section 2, is intended not merely to guard against the unlawful exclusionary conduct by monopolists, but actually "to reorganize markets" by "uprooting the [local telophone] monopolies that traditional [regulation] had perpetuated."[173] The ultimate goal of the Act is thus clearly far more aggressive than that of either section 2 generally, or the essential facilities doctrine in particular, and it accordingly makes no sense to limit the scope of the Act's market-opening provisions to that of the essential facilities doctrine.

In addition to this basic difference between the ultimate goals of section 251 of the Communications Act and section 2 of the Sherman Act, it is important to note that the provisions also take different approaches to the needs of individual competitors. As the Supreme Court has repeatedly emphasized, the antitrust laws (including section 2) seek to protect "competition, not

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[171] *See Olympia Equipment Leasing Co. v. Western Union Telegraph Co.*, 797 F.2d 370, 376 (7th Cir. 1986).

[172] *Verizon*, 122 S. Ct. 1661.

[173] *Id.* at 1660-61.

competitors."[174] But section 251 *does* seek to empower competitors; as Z-Tel argued in opening comments, that provision directs the Commission to consider whether the failure to provide access to a particular network element would impair that competitor's ability "to provide the services *it* seeks to offer" (emphasis added). The focus of the Act generally and section 251(d)(2) specifically is thus plainly on the requesting carrier and the particular services that it seeks to offer. For this reason as well, importing antitrust principles into section 251 would obviously be ill suited to advancing the aims of the Act.

Adopting the essential facilities test for impairment would be inconsistent not only with the basic purposes of the Act, but also with its plain text and its structure. The ordinary meaning of the term "impair" is to "weaken, to make worse, to lessen in power, diminish, or relax, or otherwise effect in an injurious manner."[175] Given that plain meaning, it would make no sense to interpret the "impairment" standard to require that unavailability of a network element make it *impossible* for any CLEC to provide downstream, retail service. And the fact that the "impairment" standard does not impose an "essential facilities" requirement is further confirmed Congress's choice of a stricter "necessary" standard for those few network elements that are proprietary in nature. Again, as a matter of logic and plain English usage, the "impairment" standard must be more lenient than the "necessary" standard, which is, in turn, more lenient than the standard that an "essential facilities" plaintiff must meet. Accordingly, the text of section 251(c) itself is sufficient to foreclose application of the "essential facilities" doctrine.

Imposing the doctrine would also be inconsistent with the overall structure of the Act. The Act makes clear that Congress specifically intended that it would augment, not replace,

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[174] *See Brunswick Corp. v. Pueblo Bowl-O-Mat*, 429 U.S. 477, 488 (1977) (quoting *Brown Shoe Co. v. United States*, 370 U.S. 294, 320 (1962).

[175] *See, e.g., Humana Inc. v. Forsyth*, 525 U.S. 299, 309-10 (1999) (quoting Black's Law Dictionary 752 (6th ed. 1990)).

traditional antitrust rules. Indeed, Congress expressly preserved new entrants' antitrust remedies through an explicit savings clause that acknowledged the full applicability of the antitrust laws to the local exchange markets: Section 601(b)(1) of the Act provides that nothing in the Act "shall be construed to modify, impair, or supersede the applicability of any of the antitrust laws."[176] Reading the Act to limit the scope of section 251 would thus violate the well-settled rule of statutory construction that courts must give effect to all parts of a statute where possible.[177]

The legislative history of the Act also confirms that Congress did not intend to adopt an "essential facilities" standard. Most obviously, despite Congress's familiarity with the essential facilities standard, Congress did not employ the term "essential" in the Act and, indeed, clearly indicated that the impairment standard was intended to be broader. For example, in debate on an early version of telecommunications legislation, a member of the House of Representatives explicitly noted that the interconnection and unbundling requirements of the bill were not restricted to essential facilities.[178] A later draft of the Act, passed by the Senate, limited the unbundling requirements only to incumbents with "market power," as determined by the Commission, and contained guidance on determining the "relevant market."[179] But neither of those antitrust components – which might have limited the scope of the Act – was included in the final version. In sum, Congress was clearly aware of the essential facilities doctrine and related antitrust requirements, but chose to *supplement* those requirements in the Act rather than merely adopt them.

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[176] *See Law Offices of Curtis V. Trinko v. Bell Atlantic Corp.*, 2002 U.S. App. LEXIS 12233, *49 (2nd Cir. 2002) (holding that this savings clause "unambiguously establishes" that the Act was intended to operate in harmony with the antitrust laws).

[177] *See, e.g., Bowsher v. Merck & Co.*, 460 U.S. 824, 832-33 (1983).

[178] *See* 140 Cong. Rec. at H5,243 (daily ed. June 28, 1994) (statement of Rep. Crapo).

[179] *See* S. 652, 104th Cong. § 101 (1995), as passed by the Senate, reprinted in 141 Cong. Rec. H9,954, H9,956 (daily ed. Oct. 12, 1995) (draft of Section 251(a)(1)).

(2) Even under the essential facilities doctrine, it would be appropriate to unbundle local switching and all other elements of the UNE Platform to enable CLECs to provide services to the mass market.

Although it is clear that section 251 does not permit the Commission to import the essential facilities doctrine into the impairment analysis, it is instructive that even under that restrictive test, it would *still* be appropriate to mandate unbundling of all elements of the UNE Platform, including local switching, for the purpose of serving the mass market. Certainly there is no question that the ILECs would, in the absence of the UNE Platform, exercise market power in the market for local telephone services.[180]

On the question of the difficulty of duplicating the essential facility, it is important to recognize that the ILEC's essential facility is a transmission path to the customer. It is only when the ILEC has a way reliably and cost-effectively to provision the loop separately from other elements such as switching that the other elements even arguably become non-essential. But because the ILEC provisioning systems are inadequate and create the hot-cut bottleneck, the only way Z-Tel or any other CLEC serving the mass market can today feasibly obtain a loop is by purchasing it together with switching. Indeed, Z-Tel believes that the hot cut bottleneck and other operational and network architecture inefficiencies would, in the absence of the UNE Platform, largely "eliminate competition" in the residential local services market, thus meeting even the Ninth Circuit's extremely demanding test for "essentiality."[181] Even the Areeda and Hovenkamp treatise cited by the D.C. Circuit in its *USTA* decision, which takes a very limited

[180] By the ILECs most aggressive (and, frankly, misleading) calculations, non-ILECs currently serve "3 million residential customers." *See* Section II.B.2, *supra*. Even accepting that highly dubious figure, 3 million out of a total of approximately 140 million mass market lines is only about 25 of the market, leaving the ILECs with 98%. A 98% market share would obviously constitute "market power" under any standard.

[181] *See Alaska Airlines, Inc. v. United Airlines, Inc.*, 948 F.2d 536, 544 (9th Cir. 1991).

view of the essential facilities doctrine,[182] acknowledges that the "natural monopolies of the local telephone exchanges" are correctly viewed as "essential" facilities.[183] In sum, while Z-Tel would urge the Commission not to lose sight of the critical fact that incorporating the "essential facilities" into the impairment test would be flatly inconsistent with the Act (and that the D.C. Circuit's *USTA* decision contains no indication to the contrary), Z-Tel also believes (as did Congress) that unbundling all of the elements of the UNE Platform would be appropriate even under that rigorous standard.

4. Recent state commission decisions, including in Texas and New York, recognize the hot cut bottleneck to mass market entry and confirm Z-Tel's need for unbundled local switching.

This Commission should pay close attention to a number of recent determinations by state commissions that ratify the important role of the UNE Platform in bringing competition to the mass market. These state commissions properly focus on the hot cut bottleneck and other operational and network impediments to entry that carriers seeking to enter the mass market face.

In its opening comments, Z-Tel noted that that the New York Commission has recently *expanded* UNE Platform availability by rejecting the FCC's three-line exception to the unbundled switching requirement in New York, and replacing it with an 18-line rule.[184] The NYPSC staff explained that "[t]he expanded availability of the UNE-P for small business

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[182] *See* AREEDA & HOVENKAMP, 3A ANTITRUST LAW 171-73 (1996) (hereinafter "AREEDA & HOVENKAMP") (opining that the "essential facilities" doctrine is inconsistent with the purposes of antitrust law, is "harmful and unnecessary," and "should be abandoned").

[183] *Id.* at 199.

[184] *See Verizon New York*, Order Instituting Verizon Incentive Plan at 27, Case 00-C-1945 (Feb. 2002) ("*Verizon New York*"). Significantly, New York's new rule aligns the cut-off for the availability of unbundled switching with the economics of self-provisioning switching, because it corresponds with the level of traffic at which it makes sense to aggregate lines at the customer premises and provide DS-1 service, thus circumventing the hot cut process. *See Z-Tel Comments* at 55.

customers . . . will introduce greater competition into the small business market and strengthen opportunities for economic development."[185] New York's comments in this proceeding explain its position on the UNE Platform even more clearly, emphasizing many of the same points that Z-Tel made in its comments. Most importantly, the NYPSC argues that "[u]ntil hot-cuts can be performed in much greater volumes, CLECs' lack of access to the UNE-P will materially diminish their ability to provide local service."[186] The New York comments further explain:

> Verizon provisioned an average of approximately 205,000 orders per month via UNE-P in years 2000 and 2001. Those orders should increase in 2002 . . . . Verizon performed approximately 56,000 hot-cut orders in 2001, or an average of approximately 4,700 hot-cut orders per month. Verizon would need to dramatically increase the number of hot-cut orders per month if UNE-P was terminated . . . . In fact, if all of the 205,000 UNE-P orders were to become UNE-Loop (UNE-L) orders, Verizon's hot-cut performance would have to improve approximately 4400 percent.[187]

The New York Commission proceeds to characterize the possibility of a 4400 percent increase in Verizon's hot cut capacity – which would be necessary merely to support the current level of competition in New York in the absence of the UNE Platform – as "unlikely." That is surely a dramatic understatement. And the current level of competition is, of course, minimal; serving a fully competitive market without the UNE Platform would require literally *millions* more hot cuts per month than the ILECs could possibly perform.[188]

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[185] *See Verizon New York*, Prepared Testimony of PCS Staff at 15, Case 00-C-1945, (February 2002).

[186] *See* New York Comments at 3.

[187] *See id.* at 4 (internal footnotes omitted).

[188] *See* Z-Tel Comments at 43.

A recent decision of the Texas Commission similarly reaffirms that CLEC efforts to serve the mass market would be impaired in the absence of unbundled local switching.[189] In fact, the Texas Commission expressly found that "UNE-P is the only viable market entry mechanism that readily scales to . . . serve the mass market," and that "UNE-P is the only viable option for providing competitive analog local service to small business customers."[190] The Texas commissioners emphasized that "non-ILEC [unbundled local switching] is clearly not ubiquitously available"; in fact, "no non-ILEC switch-based provider offers wholesale local switching in any market in Texas."[191] "In addition, the [commissioners] f[ou]nd that the delay and expense associated with deploying facilities and capturing a significant scale of customers using their own facilities remains a time-consuming process for CLECs that takes years." The decision also indicated that, in the absence of unbundled switching, hot cut capacity constraints would be a concern, and, indeed, that "provisioning large numbers of small orders" could even have a "detrimental impact on . . . [the ILEC's] network."[192]

Significantly, the Texas decision also repeatedly rejects the ILECs' argument that the continued availability of the UNE Platform would "create a disincentive to investment and innovation,"[193] or "crowd out investment in the analog network."[194] To the contrary, the Commissioners found that eliminating the UNE Platformwould "hinder the rapid development of

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[189] *See Petition of MCIMetro Access Transmission Services*, *et al.*, Arbitration Award, PUC Docket No. 24542 (April 2002). Although this decision is entitled an "Arbitration Award," the Commissioners of the Texas PUC serve as the arbitrators ("Texas Decision").

[190] *Id.* at 88.

[191] *Id.* at 74.

[192] *Id.*

[193] *Id.*

[194] *Id.* at 89.

facilities, as well as investment in innovative technologies and product offerings."[195] The Commissioners explained – as Z-Tel also emphasized in its opening comments[196] – that the UNE Platform actually "facilitate[s] CLEC creation of innovative product offerings."[197] Rather than obliging CLECs to focus on "continued duplication of the existing legacy analog network," which "may constitute an inefficient use of scarce resources,"[198] the availability of the UNE Platform frees CLECs to pursue true innovation, as Z-Tel has done with the development of its innovative, proprietary software-based services.

In short, as the result of an extensive and searching inquiry, the Texas Commission concluded that "local switching is a vital part of UNE-P, which is in turn an effective vehicle for bringing consumers immediate and long-term benefits of geographically broad-based competition."[199] They therefore "require[d] local switching to be made available as a UNE in all zones in Texas, without restriction."[200] New York's similarly careful analysis of this issue yielded similar results, and no state has yet found that CLECs would not be impaired in the absence of unbundled local switching. This Commission should give careful consideration to the findings of the Texas and New York commissions in analyzing whether CLEC efforts to serve the mass market would be impaired in the absence of unbundled local switching.

As discussed more fully in Section IV, *infra*, the comments of state commissions take the same perspective. The Indiana Commission stated that "eliminating or limiting the availability of certain UNEs and combinations could force CLECs to duplicate many ILEC facilities, plant,

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[195] *Id.* at 74.

[196] *See, e.g.,* Z-Tel Comments Parts IV-V.

[197] Texas Decision at 74.

[198] *Id.* at 89

[199] *Id.*.

[200] *Id.*

or equipment," in a manner that would be "costly and inefficient."[201] As a direct result, "competition would be delayed considerably in Indiana, due to limited access to capital and limited construction budgets for many CLECs, and the sheer amount of time it would take CLECs to replicate many of the ILECs' network components."[202] Although it is much more likely that CLECs would go out of business rather than irrationally create duplicative facilities, Indiana's analysis confirms the basic observation of the Ford Declaration: when ILEC facilities are costly or inefficient to duplicate, CLECs are always impaired.

B. Z-Tel's Ability to Serve the Mass Market Would be Impaired Without Access to the Other Unbundled Network Elements of the UNE Platform.

Although Z-Tel's opening comments focused primarily on explaining why Z-Tel's ability to provide innovative services to mass market customers would be impaired without access to unbundled local switching, we also noted that "switching is, of course, only one element of the UNE Platform that Z-Tel uses to provide the local component of its services."[203] Z-Tel also needs access to the other elements of the platform, such as loops, subloops, network interface devices, local transport, and signaling, to get its services to its mass market customers.

Loops: In their comments, the ILECs argue that unbundling of many UNEs should be eliminated, or severely curtailed. Verizon even has the temerity to maintain that the Commission must "narrowly limit any unbundling" obligation for "analog voice grade loops"[204] in order to "remain faithful to . . . Congress's intent" in adopting the 1996 Act. Specifically, Verizon alleges the existence of "strong" intermodal competition from cable telephony and wireless companies, and urges the Commission to entirely eliminate voice-grade loop unbundling "where

[201] Indiana Comments at 4.

[202] *Id.*

[203] Z-Tel Comments at 66.

[204] *See* Verizon Comments at 122-23.

both cable telephony and digital CMRS service is available"[205] According to Verizon, "the presence of intermodal competition precludes a finding of impairment."[206]

This argument is simply absurd. Although Verizon does not phrase the argument so boldly, because cable and wireless systems are private and proprietary, Verizon's position amounts to a requirement that companies like Z-Tel must either buy or build cable or wireless assets in order to be allowed to compete in the local market. Surely that is not what Congress had in mind in enacting the market-opening provisions of section 251. In fact, the Supreme Court has recently made clear that Congress's intent in adopting the 1996 Act was to "uproot[]the [local telephone] monopolies that traditional [regulation] had perpetuated," not to abandon unbundling at the first sign of intermodal competition.[207] Accordingly, the Supreme Court has rejected Verizon's argument already, by specifically stating that the purpose of the unbundling provisions of the Act were to "provide every possible incentive" for new entrants to enter local markets, short of confiscating incumbent LEC property. Verizon's extremely narrow view of unbundling is inconsistent with that purpose, and the very fact that Verizon would raise it in this proceedings demonstrates to the Commission what lengths the incumbents will stoop to inject uncertainty and confusion into CLEC business plans.

Verizon also argues that the ILECs should not be obliged to unbundle loops in new developments, because ILECs have no competitive advantage in seeking to provide such new facilities to developers. The Commission properly rejected a similar proposal by GTE in the November 1999 *UNE Remand Order*. As Z-Tel pointed out in its opening comments, however, this approach would lead to the anomalous and undesirable result that residents of older

[205] *See id.* at 122-29.

[206] *Id.* at 128.

[207] *Verizon*, 122 S. Ct. at 1660-61.

apartment buildings would have a choice in local service providers, while those in neighboring new buildings would be returned to the historical local service monopoly.[208] In addition, Verizon still fundamentally misunderstands the basic structure of the 1996 Act. As the Supreme Court recently found, Congress did not intend that ILECs and CLECs should be treated as equals under the Act. Rather, "[t]he Act . . . proceeds on the understanding that incumbent monopolists and contending competitors are unequal," and it should therefore be read whenever possible to "remove practical barriers to competitive entry."[209] There is no question that a bar on loop unbundling for new construction would be a "barrier[] to competitive entry," and the Commission should refuse adopt it.

Shared Transport: As Z-Tel set forth in its opening comments, the Commission has found that shared transport is necessary to serve mass market customers with low traffic volumes. In the *Shared Transport Order*, the Commission correctly acknowledged that "dedicated transport is *not economically feasible* at low penetration rates," and that denying unbundled access to shared transport "would create a significant barrier to entry."[210] Although BellSouth, SBC and Qwest all argue at some length that the Commission should revise its analysis of dedicated transport,[211] none of the ILECs addresses the Commission's *Shared Transport Order* findings regarding shared transport for the mass market, or seriously suggests

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[208] *See* Z-Tel Comments at 68.

[209] *Verizon*, 122 S. Ct. at 1652.

[210] *See In re Implementation of the Local Competition Provisions of the Telecommunications Act of 1996; Interconnection between Local Exchange Carriers and Commercial Mobile Radio Service Providers*; Third Order on Reconsideration and Further Notice of Proposed Rulemaking, 12 FCC Rcd 12460, 12482 (1997) ("*Shared Transport Order*") (*emphasis added)*, *aff'd by Southwestern Bell Tel. Co. v. FCC*, 153 F.3d 597, 603-06 (8th Cir. 1998), *vacated and remanded by Ameritech Corp. v. FCC*, 526 U.S. 1142 (1999), *reinstated in part by Southwestern Bell Tel. Co. v. FCC*, 199 F.3d 996 (8th Cir. 1999).

[211] *See* SBC Comments at 84-96; BellSouth Comments at 90-99; Qwest Comments at 32-41.

that CLECs seeking to serve that market would not be impaired without access to shared transport. The Commission should therefore reaffirm its previous holding that access to unbundled shared transport is necessary for CLECs seeking to serve the mass market.

Other UNE Platform Elements: As Z-Tel explained in its opening comments, it seeks to woo mass market customers away from the entrenched monopoly providers of local telephone service by using its own sophisticated software and facilities to introduce innovative vertical services, and then delivering those advanced services in an economical and convenient bundle with traditional local and long distance service.[212] The platform of unbundled network elements offers a dependable method of connecting to the customer and providing the local portion of that bundle. The *NPRM* shows proper awareness of this function of the UNE Platform in suggesting that CLECs "may view the incumbent's switch less as an independent network element than as a dependable method of obtaining access to loops."[213] Indeed, Z-Tel is not particularly interested in any of the elements of the UNE Platform as "independent network element[s]," but rather views the platform as a whole as a dependable way to deliver its innovations "above the platform" – Z-Tel's unique advanced features – to the mass-market consumer. Accordingly, Z-Tel would be impaired without the entire UNE Platform package, which allows Z-Tel to connect its customers to Z-Tel's long distance service and the equipment that provides its advanced features. The Commission therefore should reject the ILECs' calls for limiting unbundling of the other elements of the platform, such as signaling systems, operator services/directory assistance, and OSS.

[212] *See, e.g.*, Z-Tel Comments at 66-67.

[213] *See NPRM* ¶ 59.

III. THE AVAILABILITY OF THE UNE PLATFORM PROMOTES FACILITIES-BASED COMPETITION.

In the *NPRM*, the Commission indicated its concern for the development of facilities-based competition and its preference for data rather than theory.[214] Of course, data itself is useless unless transformed into information through valid empirical analysis. In its initial comments, Z-Tel discussed three empirical studies Z-Tel conducted based on market data collected by the Commission, which show that the availability of the UNE Platform spurs the development of competition *and* the deployment of facilities.[215] The findings of these studies are supported by a fourth study accompanying the Ford Declaration.[216] This new study confirms that the use of unbundled network elements does not discourage full facilities entry by CLECs.[217] Z-Tel's findings are also consistent with a separate analysis performed by AT&T, which showed that "UNE-P competition leads to greater investment by ILECs as well as by CLECs," adding to the wealth of empirical evidence supporting the positive relationship between unbundling and investment.[218]

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[214] *See NPRM* ¶ 17.

[215] These three studies were filed as Attachments to Z-Tel's Comments: *Without UNE-P, What's Left? An Empirical Exploration of the Unbundled Local Switching Restriction*; *Does Unbundling* Really *Discourage Facilities-Based Entry?*; and *Facilities-based Entry in Local Telecommunications: An Empirical Investigation*.

[216] *See* T. Randolph Beard & George S. Ford, *Make or Buy? Unbundled Elements as Substitutes for Competitive Facilities in the Local Exchange Network*, appended hereto as Attachment 3 (hereinafter "Beard & Ford").

[217] *See id.* at 11 ("Most significantly, our empirical model provides no support for a substitution between unbundled and self-supplied switching at current element prices; the estimated cross-price elasticity with respect to loops purchased without switching and the price of unbundled switching is not statistically different from zero.").

[218] Attachment F to AT&T Comments, Declaration of Robert D. Willig, at 64 (¶ 122).

The findings of these empirical studies coincide with the recent decisions by the Supreme Court,[219] the Texas PUC,[220] and the OECD,[221] all of which have freshly considered and rejected the ILECs' argument that the availability of network elements at cost-based rates will lead competitors to lease when they could build. Those distinguished institutions instead adopted the common-sense conclusion: the relevant available evidence shows that the additional competition resulting from the broader availability of network elements will both benefit consumers and spur facilities deployment.

In conflict with the mounting empirical evidence to the contrary, the ILECs admit they have no evidence[222] save a single study conducted by FCC staff member James Eisner (not in his capacity as an FCC employee) and BOC consultant Dale Lehman.[223] Even aside from the fact that the Eisner-Lehman study relies on confidential CLEC data collected by the FCC to which no other party has been granted complete access, that study is seriously flawed, as it conflicts with the most basic tenets of economics and violates numerous rules of empirical analysis.[224] In fact, once the Eisner-Lehman empirical analysis is adjusted to account for the peculiarities of the New

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[219] *Verizon Communications Inc. v. FCC*, 122 S. Ct. 1646 (2002).

[220] *Texas Arbitration Award*, Texas PUC Docket No. 24542 (May 1, 2002).

[221] OECD Working Party on Telecommunication and Information Services Policies, *Developments in Local Loop Unbundling* (May 2, 2002) at 15 (¶ 49).

[222] SBC Comments at 7 (acknowledging that, apart from the Eisner-Lehman study discussed herein, the incumbents have been unable to "marshal sufficient real-world experience and empirical evidence" to "back up" their oft-repeated claim that unbundling diminishes "real" competition).

[223] James Eisner and Dale Lehman, *Regulatory Behavior and Competitive Entry*, unpublished (2001). Z-Tel notes that this study was written based upon unique access the authors had to confidential CLEC information filed twice annually before the FCC on FCC Form 477. As best as Z-Tel can determine, that confidential CLEC data may have been utilized by the study's authors in violation of federal law. Certainly the use of such confidential data was contrary to the Commission's confidentiality rules and procedures.

[224] *See* Ford Decl. at ¶¶ 84-98 (describing Eisner-Lehman as a "case study" in omitted variables bias, among other econometric problems).

York market, their findings vanish entirely,[225] leaving the ILECs' assertions without a shred of empirical support. Quite apart from the clear legal and propriety problems that would ensue if the Commission were to rely on this study, it would, frankly, be irrational to do so rather than on the superior analyses of Z-Tel and AT&T.[226]

In addition, one must question the ILECs' arguments on their face. The ILECs have nothing to gain and everything to lose from competitors' deployment of facilities. Telecommunications network investment is largely sunk, meaning that it cannot be readily transferred to another use once deployed.[227] If competitors move significant traffic onto non-ILEC networks, the ILECs do not save costs. Instead, they must write off their now-stranded investments. Significant competitive network deployment, therefore, will have a material, negative impact on ILEC shareholder value. Accordingly, rational ILECs must be expected to make arguments for policies that will *minimize* overall competitive network investment, as they did when they opposed expanded interconnection throughout the 1980s and 1990s.[228] Clearly, then, despite their pro-competitive rhetoric, current ILEC arguments that unbundling prevents facilities-based investment really only make strategic sense if substantial barriers to actual deployment of alternative facilities – such as Z-Tel has demonstrated to exist – render such

[225] *See id.* at ¶¶ 87-88 (explaining why Eisner and Lehman's failure to account for New York's disproportionately strong competitive local market is responsible for their anomalous results).

[226] In vivid contrast to Eisner and Lehman's reliance on confidential FCC data, the data supporting Z-Tel's econometric analysis are posted on www.telepolicy.com.

[227] *See* Ford Decl. at ¶ 11.

[228] *See Expanded Interconnection with Local Telephone Company Facilities; Amendment of the Part 69 Allocation of General Support Facility Costs*, Report & Order & Notice of Proposed Rulemaking, 7 FCC Rcd 7369, 7377-78 (¶¶ 11-12) (1992) ("*Expanded Interconnection First Order*"); *Expanded Interconnection with Local Telephone Company Facilities, Amendment of Part 36 of the Commission's Rules & Establishment of a Joint Board*, Second Report & Order & Third Notice of Proposed Rulemaking, 8 FCC Rcd 7374, 7381-83 (¶¶ 10-11) (1993) ("*Expanded Interconnection Second Order*").

deployment unlikely. As a result, accepting the ILECs' supposedly pro-competitive arguments regarding facilities deployment would be an extreme case of permitting the fox to determine the best way to guard the chicken coop.

A. Availability of Unbundled Network Elements Does Not Depress Investment in Facilities.

In our comments, Z-Tel presented reliable empirical evidence, consistent with standard econometric practices, showing that unbundling promoted both competition and the deployment of facilities. Because the Commission restricted the availability of the UNE Platform in certain geographic areas (density zone 1 in the top 50 MSAs) and the platform nevertheless was available without restriction in states without and two states with top 50 MSAs (New York and Texas), it was possible to test the effect of restricting the availability of the UNE Platform on the deployment of facilities while holding other factors constant. The ILEC theory that unbundling conflicts with facilities deployment would have credence if the data showed that competitors deployed more facilities where access to the platform was restricted. The evidence, however, showed the opposite. As we summarized: "CLECs are, in fact, all other factors equal, *more* likely to deploy their own switches in areas where unbundled local switching is available on an unrestricted basis," and "making the UNE Platform available without restriction would *increase* switch deployment by 19%."[229] In addition, making the platform available without restriction would "increase the rate of competitive entry by about 50%."[230]

Z-Tel also submitted evidence relating to the effect of UNE prices on the deployment of switching equipment by CLECs. Z-Tel's pricing study showed that, "contrary to the assertions of the ILECs, lower prices for loops and unbundled switching promote, rather than deter, switch

[229] Z-Tel Comments at 80.

[230] *Id*. at 78.

deployment by CLECs."[231] This study also provided further evidence that the three-line restriction reduced, not increased, switch deployment by CLECs.

The studies submitted by Z-Tel on the effects of the three-line restriction were not contradicted by *any* evidence submitted by the ILECs, even though Z-Tel published two of those studies in advance of the comment date and the ILECs were clearly aware of them. SBC, for example, cited the study appended to our comments as Attachment 9,[232] but did not attempt to refute it.

AT&T presented an econometric study directly addressing the issue of the incentives unbundling provides to ILEC investment. Contrary to the unsupported assertions of the BOCs, this study concludes that "UNE pricing that encourages entry by CLECs also encourages enhanced investment by ILECs."[233] "Moreover," it continued, "the data provide support for interpreting the latter result as a manifestation of an ILEC competitive response to CLEC entry."[234] That conclusion supports the Supreme Court's "commonsense conclusion," discussed below, that competition will spur the incumbents to invest to improve their services and hold on to their customers.[235]

It is also possible to utilize econometrics to test whether, in fact, the hot-cut bottleneck or other operational and network impediments on UNE Loop entry exists. Econometrics can analyze whether competitors "substitute" UNE-L entry with UNE Platform lines; in other words, if the UNE Platform were restricted or eliminated, would the UNE Loop method of entry

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[231] *Id.* at 81.

[232] *See* SBC Comments at 7 n.10.

[233] Attachment F to AT&T Comments, Declaration of Robert D. Willig, at Exhibit 2, page 14.

[234] *Id*.

[235] *Verizon*, 122 S. Ct. at 1677 n.33.

increase commensurately, or would the overall level of competition in the market decrease? This substitution analysis can be done by estimating the demand curves for UNE-L and UNE-P. From these demand curves, cross-price elasticities of demand are estimated directly, so that the question of the relationship (substitutes or complements) between switching facilities and UNE Platform elements and facilities can be answered using procedures consistent with those employed in a standard antitrust analysis.[236]

Contrary to the self-serving claims of the incumbents, the Beard-Ford study finds that unbundled and self-supplied switching are *neither substitutes nor complements* – the cross-price elasticity between switch deployment and the price of unbundled switching is zero.[237] In other words, while numerous factors contribute to the provision of service over CLEC switches, the price and availability of unbundled switching does not.[238] Eliminating unbundled switching will not, therefore, increase the demand for switching provided over CLEC facilities.

In contrast to these multiple studies, the ILECs rely almost exclusively on Eisner and Lehman's statement that their "findings suggest *that states with lower UNE prices have less facilities-based entry.*"[239] That statement purportedly shows that rules that promote the use of network elements discourage investment in facilities. The ILECs properly conceded that, other

[236] *See* ROGER D. BLAIR & DAVID L. KASERMAN, ANTITRUST ECONOMICS 108-10 (Irwin Publishers 1985).

[237] *See* Beard & Ford at 8.

[238] Switches are sunk investments and, as such, are unlikely to be affected by policies that are potentially interim or short-term in nature. *See* Ford Decl. at ¶ 80.

[239] Eisner & Lehman at B4. At one point, Eisner and Lehman state that "the higher the statewide UNE rate for unbundled loops, the lower facilities-based entry." *Id*. at B11. That statement, which would directly contradict the incumbents' arguments, appears to be a misstatement of the authors' conclusion.

than the Eisner-Lehman study, they have no evidence for their contention that low rates for network elements promote non-facilities-based entry at the expense of facilities-based entry.[240]

The ILECs still have no evidence. As discussed below, the Eisner-Lehman study defines facilities-based competition in a limited manner that undermines the incumbents' reliance on it in this proceeding. In addition, the study contains two crucial, basic flaws: (1) the authors' evidence purportedly shows, contrary to fundamental economic principles and common sense, that *higher* prices for network elements lead to *more* competition using network elements (*i.e.*, demand slopes upward); and (2) the study failed to account for the uniquely competitive New York market, and reworking their statistical analysis to include that omitted variable changes the results to show that UNE loop prices have *no* effect on facilities-based entry (switching prices were ignored entirely by Eisner and Lehman).

As an initial matter, Eisner and Lehman define "'facilities-based' entry to denote lines served *totally* over CLEC facilities."[241] The portion of the study on which the incumbents rely is therefore largely irrelevant to the key issue in this proceeding: whether competitors should be required to self-provision switching. Because competitors using "UNE-L" were not counted as "facilities-based competitors" in the relevant portion of the study, the conclusion that discouraging the use of network elements will increase entry by leasing loops and deploying switches does not – indeed, cannot – follow. Rather, that portion of the study says nothing at all about whether competitors will compete by means of UNE-L if access to the platform is restricted. The portion of the study the incumbents cite suggests, at most, that the *stock* of

[240] "SBC and the other ILECs have long argued . . . that excessive unbundling, compounded by UNE rates that are too low, diminishes real competition by CLECs and ILECs alike. But *never before* have we been able to marshal sufficient real-world experience and empirical evidence to back that up." SBC Comments at 7 (emphasis added).

[241] Eisner & Lehman at B9 n.10.

CLEC-deployed high-capacity circuits and cable telephony plant is larger where *interim* unbundled loop prices are higher. However, as discussed below, there is no basis even for that conclusion, once their data are analyzed properly.

Specifically, as described in detail in the attached Ford Declaration, the Eisner-Lehman study's primary conclusion (*i.e.*, that CLEC facilities-based lines rise with unbundled loop rate increases) disappears once their empirical models are modified to account for the uniqueness of competitive conditions in New York.[242] Eisner and Lehman's results depend solely on a failure to account for the fact that New York has a disproportionate number of facilities-based CLEC lines and an above average loop rate. Once the uniqueness of that market is accounted for in their statistical model, there is no statistically significant relationship between CLEC facilities-based lines and unbundled loop rates. The spurious nature of the correlation touted in the Eisner-Lehman study also disappears if the December-2000 or June-2001 data on facilities-based lines is used, rather than the June-2000 data that was used in their study. In short, the inadequate and invalid statistical model specifications of the Eisner-Lehman study – not legitimate economic relationships – are the sole cause of the study's primary findings.

The most glaring error in the Eisner-Lehman study concerns the portion that is most relevant to the issues in this proceeding: the analysis of the effect of different variables on entry by means of "UNE lines," which the authors define as "[l]ines served with a combination of UNEs and CLEC facilities."[243] The authors' conclusion in this part (which the incumbents ignore in their comments) is that it appears that "higher UNE prices go along with *more* UNE entry."[244] The authors term this a "puzzling result."[245] It is much more than that. As explained

[242] *See* Ford Decl. at ¶¶ 87-88, 91.

[243] Eisner & Lehman at B9 n.10.

[244] *Id*. at B16.

in the attached Ford Declaration, the notion that higher prices lead to increased quantity demanded is contrary to the most basic tenet of economics: that price and quantity demanded are *inversely* related.[246] In other words, demand curves slope downward, not upward. A finding to the contrary is a clear signal that there are serious errors in the empirical model used in the study. An Order relying on such a study would be fatally flawed, since no reviewing court would take seriously the policy prescription that logically flows from the analysis: permitting incumbents to raise the prices they charge for loops will encourage entry by competitors leasing loops.

In fact, as the Ford Declaration explains, the finding that a demand curve slopes upward should have prompted the authors to determine what was wrong with their model.[247] While the authors themselves provided substantial discussion of why their statistical model is incorrectly specified, they did not, but Ford *did*, discover a basic flaw in the study that eliminates this perverse finding: it is, once again, the product of omitted variable bias. As with facilities-based entry by CLECs, Ford's review of the UNE data suggested that New York is different than other states in that area as well.[248] Ford accordingly re-ran the data used by Eisner and Lehman,

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[245] *Id*.

[246] *See* Ford Decl. at ¶ 90.

[247] *See id.*

[248] *See id.* at ¶¶ 91, 94. Pursuant to a request, the Commission provided Z-Tel with a subset of the data used by Eisner and Lehman, with some of the data provided in averaged form for confidentiality reasons. The data show that New York has, by far, the most competitive entry (64% more than the next largest state with respect to competitive entry), no doubt because it was the first state to implement competition (especially UNE Platform entry) in a commercially meaningful way. New York also had above-average UNE rates, but those rates were interim at the time the entry measured in the Eisner-Lehman data was collected. The New York Commission had expressly noted that prices paid by entrants for unbundled switching in New York would be subject to refund – a refund that occurred earlier this year (Z-Tel, for its part, collected over $7 million in refunds). As a result, while Eisner and Lehman assume that CLECs entered the New York market despite relatively high UNE rates, the reality is that all New York entrants had a reasonable expectation (later fulfilled) that UNE rates would decrease dramatically. This combination of characteristics makes New York a potential outlier, and

controlling for the uniqueness of New York. The results, provided in Table 2 in the Ford Declaration, show that, once the unique characteristics of the New York market are controlled, the finding on which the incumbents rely disappears and no empirical finding of any significance remains intact.[249]

Thus, the finding on which the incumbents rely really reflects only the fact that there was more facilities-based and UNE entry in New York, along with an above-average loop rate in that state, *prior to* and during the period studied by Eisner and Lehman. In other words, if Eisner and Lehman had included statistics on the number of Yankees fans in their model, they would, presumably, have found more Yankee fans in New York than elsewhere, and the model would have shown that more Yankee fans leads to more deployment of telecommunications facilities. But, of course, that is not so – that finding, too, would be merely a result of the uniqueness of New York.

In short, the New York market presents unusual features for which Eisner and Lehman failed to control, and their study is fundamentally flawed as a result. Z-Tel's studies and AT&T's study are the *only* reliable evidence in the record, and that evidence supports the conclusion that restricting the availability of the platform not only retards the development of competition but discourages CLEC investment in facilities. There is no sound evidence to the contrary.

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econometric analysis confirms that, as a statistical matter, New York is, in fact, unusual. *See id.* Notably, however, once the unique characteristics of New York are controlled in the model, the demand curve for UNE loops is found to slope downward, not upward. Clearly, the impact of omitted variables bias in the Eisner-Lehman models is considerable.

[249] *See* Ford Decl. at ¶ 98 & Table 2.

B. The Supreme Court, the Texas PUC, and the OECD Have Rejected the ILECs' Contention that the Availability of Network Elements Will Deter Investment.

In the brief period since the opening comments in this proceeding were filed, the Supreme Court, the Texas Public Utility Commission, and the Organisation for Economic Co-operation and Development (OECD) have each rejected the argument that access to network elements should be restricted in order to promote the deployment of facilities. The Commission should rely on the findings of those distinguished organizations.

Indeed, the same theoretical arguments that the ILECs present to the Commission in this proceeding were presented by the ILECs to the Supreme Court in its first decision arising from the Commission's 1996 *Interconnection Order*. In that case, as in its more recent decision, the Court rejected ILEC arguments based on the theory that the broad availability of network elements at cost-based rates would deter facilities-based competition. Rather, the Court upheld what it termed the "all elements rule" – the rule authorizing competitors to lease the Platform. Contrary to the ILECs' arguments, the Court held that the Act was not written to prohibit access to the Platform, but instead requires incumbents to "provide access to 'any' requesting carrier."[250]

In its recent *Verizon* decision, the Court considered and rejected ILEC arguments that TELRIC rates are inappropriate because they will deter facilities-based entry. As the Court bluntly stated, that claim "founders on fact."[251] The Court credited evidence that new entrants "have invested in new facilities to the tune of $55 billion since the passage of the Act (through

[250] *AT&T*, 525 U.S. at 392.

[251] *Verizon*, 122 S. Ct. at 1652.

2000)" and FCC statistics indicating "substantial resort to pure and partial facilities-based competition among the three entry strategies" authorized by the Act.[252] As the Court put it:

> [I]t suffices to say that a regulatory scheme that can boast such substantial competitive capital spending over a 4-year period is not easily described as an unreasonable way to promote competitive investment in facilities.[253]

In fact, it is hard to see how there could have been more investment; this period saw one of the largest network deployments in history. The Court also rejected the contention that the widespread availability of network elements at TELRIC rates would stifle investment by the ILECs. It instead affirmed "the commonsense conclusion that so long as TELRIC brings about some competition, the incumbents will continue to have incentives to invest and to improve their services to hold on to their existing customer base."[254]

The Court also emphasized that the ILECs control "costly bottleneck elements, duplication of which is neither likely nor desired."[255] That is the same point Z-Tel made in its initial comments. Z-Tel has invested more than $100 million in software development and that investment has yielded tangible benefits for consumers in the form of Z-Tel's innovative advanced features. The ILECs' proposal – that competitors should instead be required to invest in duplicative facilities – "is neither likely nor desired," as the Court put it.[256]

We anticipate that the incumbents will argue that the Supreme Court's *Verizon* decision should be given little weight in this proceeding because it concerned rules governing the pricing of network elements rather than the availability of network elements. That is both wrong and

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[252] *Id.* at 1675.

[253] *Id*. at 1652.

[254] *Id*. at 1676 n.33.

[255] *Id*. at 1675.

[256] *Id.*

contrary to their reliance on the Eisner-Lehman study. It is wrong because price and availability are two sides of the same coin. The empirical study appended to these reply comments shows, not surprisingly, that as prices increase, the quantity demanded of elements declines, and declines rapidly according to the estimated elasticities of demand, which are all in the elastic region of demand (the percentage change in quantity exceeds the percentage change in price).[257] At some price, the quantity demanded is effectively zero. In other words, a right to lease an element at an unreasonably high price is the same as no right to lease the element.[258] Eisner and Lehman agree with this basic principle, in that they viewed the price at which network elements are provided as just another sort of regulatory action affecting the availability of network elements, like the unbundling rules issued under section 251(d)(2). Moreover, the fact that the incumbents made virtually identical arguments to the Supreme Court and the D.C. Circuit on the effects of the rules at issue in those proceedings on investment in facilities shows that they recognize that the issues are the same at bottom.

The Texas PUC – which studied the effect of the rules at issue in this proceeding – agrees with Z-Tel's position. In its recent decision making the platform available without restriction, it stated that it was "not convinced by SWBT's [Southwestern Bell Telephone Company's] argument that the availability of UNE-P will crowd out investment in the analog network."[259] "Moreover," the Texas commission added, "continued duplication of the existing legacy analog network may constitute an inefficient use of scarce industry resources," which "is not in the

[257] *See* Beard & Ford at 7-8.

[258] *Verizon*, slip op. at 38 ("the difference between such a higher rate and the TELRIC rate could be the difference that keeps a potential competitor from entering the market") and 44 ("high lease rates for these elements would be the rates most likely to deter market entry").

[259] *See Texas Arbitration* Award at 89.

public interest."[260] The Texas PUC further concluded "that the continued availability of UNE-P will allow competitive market forces to provide better guidance and incentive for carriers to make sound and prudent investment decisions regarding the type of technologies to be deployed prospectively."[261] For those reasons, together with its conclusion that competitors would be impaired without access to the platform, the Texas PUC "determine[d] that local switching is a vital part of UNE-P, which in turn is an effective vehicle for bringing consumers immediate and long-term benefits of geographically broad-based competition."[262] "Therefore," it ordered "local switching to be made available as a UNE in all zones in Texas, without restriction."[263]

The Organisation for Economic Co-operation and Development also recently considered arguments that "incumbents will have little interest in upgrading their existing facilities if they have to open them to competitors," and concluded "that this argument does not hold."[264] The OECD explained that "what constrains investment is lack of competition and factors which restrict the ability of new entrants to compete."[265] That conclusion is a variation on the Supreme Court's commonsense conclusion that competitors with customers will invest in facilities and the incumbents will invest to respond to competition.[266] As stated above, AT&T reached the same conclusion, on the basis of an econometric study. Recent empirical evidence on the wireless

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[260] *Id.*

[261] *Id.*

[262] *Id.*

[263] *Id.*

[264] OECD Working Party on Telecommunication and Information Services Policies, *Developments in Local Loop Unbundling* (May 2, 2002) at 15 (¶ 47).

[265] *Id*. (¶ 49).

[266] *Verizon*, 122 S. Ct. at 1677 n.33

telecommunications industry also supports the conclusion that innovation is brought to consumers more rapidly in competitive markets.[267]

C. Promoting Competition Will Promote Sensible Investment in Facilities.

Emphasizing rhetoric rather than evidence, the incumbents contend that the only alternative to their approach is "UNE-P forever." That is not so, and the assertion entirely misses the point. At present, UNE-L is not a viable alternative for serving residential and small business customers, primarily because of the problems associated with manual hot cuts, collocation, and high transport costs which the ILECs do not incur. If the incumbents develop an automated cutover process that is as efficient and reliable as the process for changing presubscribed interexchange carriers, these barriers to entry and expansion will be reduced and some competitors will choose to deploy switches or to use already deployed switches to serve the mass market.[268] Moreover, given what the Supreme Court aptly called "the desirability of independence from an incumbent's management and maintenance of network elements,"[269] competitors will tend to move off the incumbents' networks as soon as it is possible to do so.

However, as discussed in the accompanying Declaration of Dr. Ford, given the cost structure of providing local exchange service on a facilities basis, the equilibrium industry structure in the facilities-based, wholesale segment of the industry will be highly concentrated even under the best of circumstances.[270] The retail segment, on the other hand, can support a

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[267] Harold Gruber, *Competition and Innovation: The Diffusion of Mobile Telecommunications in Central and Eastern Europe*, 13 INFO. ECON. & POL'Y 19-34 (Mar. 2001).

[268] In its comments, AT&T described how "electronic loop provisioning" could be used in upgraded networks to eliminate manual hot cuts. *See* Attachment C to AT&T Comments (Declaration of Irwin Gerszberg).

[269] *Verizon*, 122 S. Ct. at 1670.

[270] Ford Decl. at ¶¶ 16-18.

larger numbers of firms competing for customers.[271] This industry structure, a more-concentrated wholesale and less-concentrated retail market, is exactly the industry structure observed today in the domestic long distance industry. At present, there are hundreds of long distance retailers (including Z-Tel) relying on the networks of seven wholesale providers of nationwide, facilities-based interexchange service.[272] Because local exchange networks require more fixed and sunk costs than do interexchange networks per dollar of potential revenue, industry concentration in the local, the facilities-based wholesale market will be even more concentrated than in the long distance industry.[273]

Thus, to expect every new entrant to the local markets to deploy their own network would ignore the basic economics of the local exchange telecommunications industry. If deploying local exchange network was as easy as the ILECs want the Commission to believe, there would be no need for a Telecommunications Act of 1996. While the local exchange natural monopoly may be vulnerable in particular geographic segments, the local exchange is not and likely will never be a contestable market with easy entry and exit. Breaking the wholesale monopoly in the local exchange is a very, very difficult task.[274]

In today's financial climate, as should be the case in any rational financial climate, it is clear that capital markets are extremely reluctant to fund the construction of local telecommunications facilities in advance of evidence that there are customers for those facilities.

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[271] *Id.* at 18.

[272] *Id.* at ¶ 16. The bankruptcies of most of these wholesale carriers suggests that the equilibrium number of firms in that segment of the industry has been exceeded.

[273] *Id.* at ¶ 17; *See generally Beard, Ford & Spiwak 2002* at 421-59.

[274] The Supreme Court noted that there are some "expensive facilities unlikely to be duplicated," *Verizon*, 122 S. Ct. at 1668, and it may be that alternative networks will be slow to develop in some areas.

Bearing in mind that carriers, and not end users, directly "demand" those alternative facilities,[275] the factor that would be most likely to justify investment in alternative facilities would be competing retailers (like Z-Tel) anxious to move large numbers of customers off the ILECs' networks to both improve their product and ensure that they would no longer be dependent on a hostile supplier. As Dr. Ford also points out, a single wholesale provider of facilities could respond to the aggregate demand of many retailers, using that combined demand to justify the investment in wholesale facilities.[276] As a practical matter, this is likely to happen in local markets on a timetable much slower than the development of alternative long distance facilities, which have more favorable cost characteristics for multiple firm supply.[277] But it will happen sooner rather than later, as the OECD concluded, if there are opportunities for new retail entrants to compete and gain market share, thereby reducing the risk related to the sunk investments required to provide local service on a facilities basis.[278]

As Dr. Ford points out, the retail factors are operationally distinct from the wholesale network operations factors.[279] Some carriers, such as Z-Tel, are likely to be more adept at performing the many operational steps necessary for successful retail operations, including back office tasks, marketing, customer relations, E911, operator services, directory assistance, and carrier relations. Other carriers, such as cable companies, may have substantial experience and expertise in operating network facilities, but considerably less at carrying out the retail

[275] Ford Decl. at ¶ 17.

[276] *Id.*

[277] *Id.* at ¶ 20.

[278] OECD Working Party on Telecommunication and Information Services Policies, *Developments in Local Loop Unbundling* (May 2, 2002) at 15 (¶ 49); *see also* Ford Decl. at ¶ 19.

[279] Ford Decl. at ¶¶ 16-19.

telecommunications service functions.[280] The CEO of Cox Communications, for example, recently called design and maintenance of its network the "easy part" compared with retail telecommunications operations, which he described as a "very complex business, with a steep learning curve."[281]

The Commission should therefore recognize that unbundling policies need to be designed to foster a wholesale market for local telecommunications capacity. Since the ILECs are the dominant (and often the sole) owners of this capacity at the moment, they should be required to make their capacity available to competitors. As competitors become established, some will develop and offer competing capacity for themselves and for other firms. Others will focus on retail operations and serve primarily as consumers of local capacity. Still others may focus entirely on wholesale network functions. Over time, the industry will become organized more like a competitive industry and less like the regulated monopoly that has persisted since the Bell System drove out competition in the first decades of the Twentieth Century.

As has been long recognized in the antitrust laws, competitive entry is far more difficult if it must occur at multiple levels simultaneously, as would be the case if a CLEC had to both build network and market services at the outset. Not only are both activities capital intensive, they require fundamentally different resources and capabilities. That is why it is common in modern economies for businesses to focus on their "core competencies" rather than vertically integrate throughout the entire value chain (as do the ILECs). In fact, the ILEC business model is quite rare and may be more an artifact of regulatory history than an efficient form of organization. In any event, vertical integration is effective as a tool to protect monopoly and the 1996 Act aims to remove the need for vertical integration.

[280] *Id.* at ¶ 15.

[281] *Id.*

A review of history in telecommunications markets demonstrates that the mandated provision of wholesale capacity, like unbundling, has never prevented the deployment of competitive facilities. To the contrary, every major competitive telecommunications market – long distance, wireless, satellite, and undersea cable – has had the regulated sale of wholesale capacity from the outset. Conversely, telecommunications markets that have not contained mandatory sale of wholesale capacity – cable, and local telecommunications prior to 1996 – have had very little deployment of competitive facilities. Moreover, when taken to its logical conclusion, the argument that competitive facilities will flourish if only competitors are denied access to existing facilities is plainly absurd; it implies that we would have seen competitive telecommunications networks spring forth if only the 1996 Act had not been passed.

While claiming that the competitors support "UNE-P forever," the incumbents in fact advocate "no analog mass-market competition ever." If the Platform of network elements is not available to serve residential and small-business customers, at best those customers will be presented with competitive options at roughly the pace at which facilities-based options have been available to them for the last six years. In six years, only about two percent of the residential market has been presented with a competitive choice from a facilities-based competitor,[282] and the cable operators have stated clearly that their deployment of cable telephony will be geographically limited.[283] The incumbents, of course, profit from the fact that,

[282] The BOCs seem to think that a two percent market share for competitors after six years is a remarkable intrusion into their monopoly. *See* UNE Fact Report at II-10 ("As of year-end 2001, CLECs were serving approximately *three million* residential lines using their own switches").

[283] *See, e.g.*, RCN Corporation, 2001 Form 10K at 1 (filed Mar. 29, 2002) ("Our primary business is delivering bundled communications services to residential customers over our own network to 7 of the 10 most densely populated areas of the country.").

as the Supreme Court stated, competition "has been slow to materialize in local-exchange retail markets."[284]

D. Any Effort to Limit Unbundling to Spur Investment Will Backfire.

Although the Supreme Court concluded that "it suffices to say" that there had been "substantial competitive capital spending"[285] under the Commission's rules, the D.C. Circuit faced a record that "appears silent" on the question of how much investment would have occurred under different rules.[286] Although it stated that "a lack of multiple regression analyses is not ipso facto arbitrary and capricious," the court directed the FCC to "point to something a bit more concrete than its belief in the beneficence of the widest unbundling possible."[287]

In this proceeding, Z-Tel has not only provided concrete evidence, it has provided numerous multiple regression analyses supporting its conclusions.[288] The incumbents have chosen to rely on one flawed empirical study and have admitted that it is the only evidence they can muster.[289] As explained above, the Eisner-Lehman study is much too flawed to provide any basis at all for agency action. The concrete evidence in this record therefore permits only one conclusion in response to the D.C. Circuit's inquiry: unbundling both promotes competition *and* investment in facilities.

The Commission should not restrict the availability of the UNE Platform in a misguided effort to stimulate the deployment of facilities by regulatory fiat; such a policy is supported by no

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[284] *Verizon*, 122 S. Ct. at 1677. In describing competition as arriving slowly, the Court noted that competitors had only a nine percent market share. *Id*. Of course, that market share largely represents service to large businesses.

[285] *Id*. at 1652.

[286] *USTA*, 290 F.3d at 425.

[287] *Id*.

[288] Ford Decl. at ¶¶ 88-93.

[289] *See* SBC Comments at 7.

reliable evidence and will fail. The Commission instead should make the platform of network elements available to competitors seeking to serve residential and small business customers, and let the market sort out when and where facilities can be deployed. The relevant empirical evidence – like the conclusions of the Supreme Court, the Texas PUC, and the OECD – shows that the continued availability of the platform will stimulate competitive entry and appropriate investment in facilities.

IV. THE COMMENTS UNDERSCORE THE NEED FOR STATE COMMISSION AUTHORITY TO ESTABLISH ADDITIONAL UNBUNDLING OBLIGATIONS.

State public utility commissions have consistently been on the front lines in developing local competition, beginning well before the 1996 Act and certainly after its passage. Through a variety of tools – such as imposing price cap or alternative regulation plans, establishing initial concepts of unbundling, collocation and the Platform, arbitrating section 251 interconnection agreements, and establishing rates for UNEs and interconnection pursuant to section 252(d) – state commissions must continuously review and assess the level of competition in their states.

It is therefore telling that *state commissions have overwhelmingly filed comments that recognize the importance of the UNE Platform in bringing competition to the mass market*. These comments follow on the November 2001 NARUC resolution, which supported the UNE Platform method of entry. The Commission should heed this advice and preserve the tool that is bringing real competition to real mass-market consumers. Indeed, the Commission should formally include state fact-finding processes into this *Triennial Review* and future unbundling policy decisions.

A. State Commissions Support the UNE Platform for Mass-Market Consumers.

As noted in Z-Tel's initial comments, many states have already implemented the UNE Platform as a matter of state law, because they see the key role that the Platform plays for mass-

market consumers. In doing so, state commissions confirm that they understand the details concerning the development of competition in their respective states in a way that this Commission could never do with respect to all fifty states and the District of Columbia. State commissions have implemented the UNE Platform as part of price cap or alternative regulation plans (as in New York), as part of telecommunications "global settlements" (as in Pennsylvania), pursuant to state statute (as in Illinois), or after conducting an independent "impairment" and state-law analysis (as in Texas).

State commissions generally understand the *real* impediments to mass-market entry. The New York commission, for example, recently performed an in-depth analysis of Verizon's hot cut capabilities. After noting that "Verizon provisioned an average of approximately 205,000 order per month via UNE-P in years 2000 and 2001," the commission pointed out that "if all of the 205,000 UNE-P orders were to become UNE-Loop (UNE-L) orders, Verizon's hot-cut performance would have to improve approximately 4400 percent."[290] The commission added that, at its current rate of performing hot cuts, "it would take Verizon over 11 years to switch all the existing UNE-P customers to UNE-L."[291] And that assumes that competitors would not add a single new customer.

Thus, the New York commission already understood the key facts concerning the realities of serving mass-market customers in New York that Z-Tel made in its initial comments. As the commisison stated, eliminating the UNE Platform "is premature" because there "are still major issues that hamper the development of facilities-based competition." In light of those problems, "CLECs' lack of access to the UNE-P will materially diminish their ability to provide

[290] New York Comments at 4.

[291] *Id*. at n.11.

service."[292] The New York commission therefore "opposes eliminating any of the elements that make up the UNE-P at this time."[293]

Other state commenters also emphasized particular competitive circumstances that must be taken into account when making unbundling decisions, and underscored that state commissions themselves are in the best position to do so. The Louisiana commission pointed out that entry through unbundled elements, including switching, "provides the most successful mode of market entry for competitive carriers in Louisiana."[294] The Louisiana commission noted that, in part because much of the state consists of historically "underserved and geographically dispersed markets," the "unbundled switching UNE is absolutely critical to the continued development of competition in Louisiana."[295] As a result, the Louisiana Commission concluded unequivocally that any action by the Commission to "restrict, or further restrict CLEC access to unbundled switching at TELRIC rates will retard the further development of competition in Louisiana."[296]

Illinois went so far as to emphasize that it "opposes any [FCC] action which would weaken currently existing unbundling requirements as premature and potentially damaging to the [nascent] competitive market" in Illinois, and that "[n]otwithstanding any revisions that the FCC

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[292] *Id*. at 3.

[293] *Id.* at 8.

[294] Louisiana Comments at 2. The Louisiana Commission strongly criticized the Commission's current restriction on unbundled switching. "Under the FCC rules, even in New Orleans—the largest market in Louisiana—circuit switching is available at cost-based rates to serve only the smallest customers (those with three or fewer lines). Competitive carriers need unrestricted access to UNEs at TELRIC rates in the most densely populated areas of the state in order to economically provide services to consumers in the less populated areas of the state." *Id.*

[295] *Id.*

[296] *Id.*

may make to the federal list of UNEs," the states must "continue to . . . take proactive measures when barriers to entry frustrate the pro-competitive provisions of the 1996 Act."[297]

The Georgia Public Service Commission also strongly opposed any "rigid unbundling rules that dictate, for instance, geographic areas and/or classes of customers for which unbundled local switching is and is not required." Such a "rigid, one-size-fits-all standard could not and would not recognize the myriad variables that determine whether or not unbundled local switching is necessary to the survival and further development of competition within individual states and within specific regions within those states."[298]

Any effort by this Commission to restrict the UNE Platform while also seeking to limit the authority of the state commissions to add to federal unbundling requirements would – in addition to being unlawful under section 251(d)(3) – spark a direct and unnecessary conflict between the Commission and these states. Last year, the Illinois General Assembly passed a state law that ensured access to the UNE Platform. The Texas commission recently "decline[d] to rely" on any determination that the FCC may make in this proceeding regarding unbundled local switching.[299] The Texas commission emphasized that "even if in its Triennial UNE Review proceeding the FCC were to remove local switching from the national list, or create a new exception standard, [we] nonetheless find that on this specific final record CLECs in Texas

[297] Illinois Comments at 3-4. NARUC also emphasized that "maximum State flexibility" is particularly needed "with respect to a UNE-P requirement." NARUC Comments at 9. NARUC argued that "the FCC should not constrain State authority to determine if 'UNE-P' should be made available in certain markets," and reemphasized its resolution that "State commissions should support the implementation of universal availability of UNE-P, on the basis that one form of entry should not be favored over another." *Id.*

[298] Georgia Comments at 3-4.

[299] *Texas Arbitration Award* at 73.

would be impaired without the availability of local switching on an unbundled basis."[300] Similarly, the New York commission recently approved a settlement pursuant to which Verizon will make the UNE Platform available without restriction, regardless of the outcome of the *Triennial Review*, to serve the mass market. Verizon, in turn, was given pricing flexibility.[301]

As discussed in Z-Tel's initial comments, those state activities are specifically permitted by section 251(d)(3) of the Act. However, any attempt by this Commission to restrict unbundled switching and the UNE Platform would no doubt undercut those independent state efforts to develop competition. Rather than undercut those efforts, the Commission should specifically recognize that initiatives such as those undertaken by Illinois, Texas and New York are entirely consistent with both the letter and the spirit of the 1996 Act.

B. State Fact-Finding Tools Are Superior to Current FCC Processes.

State commissions are important sources of fact-finding that the Commission should not ignore. Because they are close to the action, state commissions know which entrants are succeeding where, and they are not apt to be led astray by unsworn and misleading "evidence" like the ILEC UNE "Fact" Report.

NARUC commented that "[s]tate regulators have access to the detailed real-world information that is essential to reasoned decision-making" concerning what network elements should be unbundled in a particular state, "employ procedures (such as discovery and cross examination) that are most compatible with fact-finding and verification, and are in the best position to balance competitive policies with the regulatory/deregulatory framework that governs

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[300] *Id.*

[301] *See Verizon New York*, Case 00-C-1945, Order Instituting Verizon Incentive Plan, at 27 (Feb. 2002) ("*Verizon New York*").

the ILECs operating within their jurisdictions."[302] NARUC correctly argued that state commissions should therefore be permitted to apply their unique knowledge of local market conditions to require additional unbundling where appropriate: "While national standards provide a useful floor to the competitive experiment," "NARUC strongly supports State commission authority to impose unbundling requirements *that exceed those imposed by the FCC*."[303]

Nearly every individual state commission filing comments made similar points. Illinois, for example, wrote that the "unique position of the State Public Utility Commissions grants them a singular expertise to evaluate the status of competition in their respective jurisdictions, as well as the availability of network elements to competitive carriers within their states."[304] Louisiana opined that "[t]he LPSC is uniquely situated to know the needs of its citizens and to fairly balance the needs of both the incumbent local providers and the competitive carriers."[305] Massachusetts observed that "[s]tates are better able to judge the appropriateness of a particular UNE in light of local market conditions and can be more responsive to change in those conditions. Each state [also] has a unique interest in the availability of UNEs in that state because of the effect on competition and investment in that state and ultimately the state's economy."[306] Georgia suggested that "the GPSC . . . is uniquely situated to evaluate Georgia-

[302] NARUC Comments at 7.

[303] *Id.*

[304] Illinois Comments at 3.

[305] Louisiana Comments at 2.

[306] Massachusetts Comments at 3.

specific factual issues in order to make decisions about the degree to which local switching and other network elements should be unbundled by the incumbent LECs in Georgia."[307]

The foregoing is just a sampling of the state views. While there were many ways to say it, the same message emerges: the states should be permitted to add additional unbundling requirements where appropriate not only because section 251(d)(3) says they can, but also because, as a practical matter, they are best situated to determine the needs of competitors in their respective jurisdictions.

The fact that state regulators are better situated to evaluate the status of competition on a more granular level takes on particular significance in light of the D.C. Circuit's recent decision in *USTA*. The principal objection to the Commission's unbundling rules laid out by the *USTA* was that the Commission did not engage in sufficiently detailed fact-finding. The court indicated that the impairment inquiry should be more market-specific and not be of "unvarying scope."[308]

In the wake of *USTA*, it is time for the Commission to take a long and hard look at its processes in this proceeding. Absent comprehensive evidence, discovery, cross-examination, and complete briefing, this Commission is not nearly as well situated as each state commission to undertake such "granular" fact-finding with respect to every element for every state in the country.[309] And although localized analysis is not necessary in connection with UNEs that are

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[307] Georgia Comments at 3.

[308] *See USTA,* 290 F.3d at 422.

[309] Of course, as discussed in Z-Tel's opening comments and Section V, *infra*, certain elements do not need any granular examination – particularly those outlines in the section 271 "checklist," like loops, transport and switching. It is also noteworthy that the Commission's lone effort at granular analysis in the *UNE Remand Order*, the so-called "three-line rule," has been criticized by both CLECs and ILECs, and continues to require the Commission's attention. *See* Z-Tel Comments at 50-56. Notwithstanding the D.C. Circuit's suggestion that the Commission could similarly develop "partial rules" for other elements and other markets, *see USTA*, 290 F.3d at 423, the Commission's experience with the three-line rule certainly suggests that any attempt to

crucial to mass-market service – because companies seeking to serve the mass market would clearly be impaired in *any* geographic market in the absence of the UNE Platform, as a result of the hot-cut bottleneck and other network impediments discussed in Section II above – individual market data may well be relevant to the impairment analysis for UNEs needed to serve large-business consumers.

Z-Tel believes that more formal reliance upon state fact-finding processes will help the Commission write unbundling rules that will survive appeal. In the recent Texas UNE Platform proceeding, the parties generated several boxes of documents, transcripts and testimony – all devoted to whether a single element (unbundled local switching) should be made available in a single state. Similar record gathering on the status of local competition occurs virtually every week before a state commission somewhere in the nation. These state processes often include discovery and cross-examination – fact-finding tools that the Commission *has not* made available to parties in this *Triennial Review* proceeding. The Indiana commission warned bluntly that the Commission not "arbitrarily reduce" the "competitive options" of entrants.[310] The Commission would be foolhardy, perhaps arrogant, to arbitrarily decide that it could do a "better job" in gathering the facts sufficient for a granular market analysis than its state colleagues.[311]

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develop rules on a market-by-market basis without the benefit of substantial state commission participation would prove impracticable.

[310] *Id.*

[311] *See generally Texas Arbitration Award* at 70-71. Indeed, in that decision, the Texas commission explicitly stated that, while the FCC implemented the three-line rule pursuant to unsworn *ex parte* evidence, the Texas commission's determination was made on the basis of discovery, sworn testimony, and cross-examination. *See id.* at n.379 (also noting that the basis for the three-line rule was an Ameritech letter filed "very late in the proceeding, without verification or attestation, and the validity of the claims in the letter were not tested through any cross-examination").

C. The Commission Should Explore a Formal Role for State Commissions.

The Texas commission urges the FCC to engage in "full collaboration" with state commissions in this proceeding.[312] The Louisiana commission suggests that the Commission create a UNE base line to be made available nationally and that the State commissions should be allowed to "assume the responsibility for applying local conditions to ensure that competitive services are widely available" in their state.[313] Z-Tel agrees.

To that end, the Commission should actively explore formal procedural mechanisms for such state involvement. Z-Tel believes that, with regard to network elements in addition to those specifically listed in the section 271 checklist, the Commission should consider convening a Federal-State Joint Conference, as endorsed by NARUC and CompTel, to decide the appropriate process for assessing and applying local conditions on the nature and scope of unbundling. This Conference would focus not upon "defining UNEs" *per se*, but upon establishing process and fact-finding standards under which the FCC and state commissions could cooperate to establish unbundling policies on a going-forward basis. That fact-finding process could – and should – replace the FCC's current plan of reviewing "every UNE" *sui generis* every three years.[314]

D. Independent State Authority under Section 251(d)(3) Must Be Recognized and Specifically Preserved.

Z-Tel's comments argued that section 251(d)(3) of the Act, entitled "preservation of state access regulations," expressly prohibits the Commission from limiting the states' right to

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[312] Texas Comments at 7.

[313] Louisiana Comments at 2.

[314] Z-Tel submits that continuing the process of triennial reviews *ad infinitum* could seriously destroy investor confidence in the competitive telecom sector and would be counterproductive. Serious investors (especially in capital-intensive industries like telecom) generally have 5-10 year investment horizon. Attempting to assess the risk of a telecom investment when that business plan may have to survive three "triennial" reviews is virtually impossible.

establish additional unbundling requirements. Z-Tel also pointed out that the Commission's 1996 effort to preempt state unbundling rules inconsistent with the Commission's regulations was rejected by the Eight Circuit's decision in *Iowa Utilities Board v. FCC*,[315] which held that a state policy inconsistent with an FCC regulation is not necessarily also inconsistent with the statute itself. After *Iowa Utilities Board*, the Commission appeared to acknowledge that, under section 251(d)(3), the states must be given considerable leeway to decide whether to order additional unbundling.[316] Z-Tel's comments urged the Commission to "adhere to its conclusion that state commission may add to, but may not subtract from, the [UNE] list."[317]

State commissions strongly agree.[318] For example, the Illinois Commission urged the Commission not to "weaken the authority of individual states as it pertains to unbundling rules."[319] The Illinois Commission strongly stated that removing or revising UNE list "would undermine the competitive progress the ICC has achieved to date and frustrate the continuing efforts to foster a competitive local exchange market in Illinois."[320] As the Illinois Commission

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[315] 120 F.3d at 807.

[316] Specifically, the regulation concerning state authority adopted in 1999 indicated that state commissions may "require the unbundling of additional network elements." 47 C.F.R. § 51.317(b)(4). The regulation provides that state commissions must "comply with the standards of this § 51.317" when exercising the authority delegated to them. When state commissions are acting under authority granted by state law, however, the Commission lacks authority to constrain their consideration to those enumerated by the Commission. Rather, as the Eighth Circuit held, under section 251(d)(3) state unbundling requirements are preserved except in limited circumstances.

[317] Z-Tel Comments at 91-92.

[318] *Resolution Concerning the States' Ability to Add to the National Minimum List of Network Elements*, adopted Feb. 13, 2002 ("*NARUC UNE Resolution*"). *See, e.g.,* Comments of NARUC at pages 4-6, Indiana Comments at 5, Illinois Comments at 3, Kentucky Comments at 1, Michigan Comments at 6, Mississippi Comments at 1, New Jersey Comments at 1, Oklahoma Comments at 5, South Dakota Comments at 1, and Texas Comments at 3.

[319] Illinois Commission Comments at 3.

[320] *Id.* at 2.

concluded: "The unique position of State Public Utility Commissions grants them a singular expertise to evaluate the status of competition in their respective jurisdictions as well as the availability of network elements to competitive carriers within their states. States must continue to have the authority to respond to developments in the local marketplace through State Commission and State Legislative actions."[321]

Likewise, the California Commission noted that "given current market conditions, it may be appropriate to require more, not less, unbundling."[322] And the Georgia Public Service Commission urged the Commission "not to attempt to limit the ability of individual state regulatory commissions to impose unbundling obligations upon the incumbent LECs within their jurisdiction" as long as those obligations are consistent with the Section 251 of the Act and the policy framework established by the Commission in its *UNE Remand Order*.[323] "Any attempt to constrain a state commission's ability to require unbundling where the factual circumstances demonstrate its necessity would clearly undermine the pro-competitive goals of the Act."[324]

The Commission should recognize that section 251(d)(3) of the Act specifically preserves state authority to implement interconnection and access regimes beyond the Commission's rules. Any attempt by the Commission in this proceeding to restrict these state efforts would violate section 251(d)(3) and the Eighth Circuit's decision in *Iowa Utilities Board*. Rather than spark that controversy, the Commission should instead enlist the assistance of state commission in applying the Commission's unbundling rules.

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[321] *Id.* at 3-4.

[322] California Comments at 5.

[323] *Id.*

[324] *Id.*

V. THE CHECKLIST REQUIRES THE BOCS TO UNBUNDLE LOOPS, TRANSPORT, AND SWITCHING, AND THERE IS NO BASIS FOR FORBEARANCE FROM ITS REQUIREMENTS AT THIS TIME.

In our initial comments, we addressed the Commission's question concerning the relationship between the unbundling obligations in section 251 and the competitive checklist in section 271.[325] We showed that the checklist requires the BOCs to unbundle loops, transport, and switching, as the Commission has concluded.[326] We also showed, contrary to the Commission's prior conclusion, that BOCs seeking to provide long distance service must unbundle those network elements at the cost-based rates required by section 252(d)(1).

Given the clarity of those statutory commands, we noted that "the BOCs have not had the audacity to argue that they are not required to unbundle loops, transport, and switching."[327] That is no longer so. Verizon now contends, contrary to the plain terms of the statute, that BOCs are not required to unbundle the network elements listed on the checklist if the Commission decides not to require other ILECs to unbundle those elements under the standard of section 251(d)(2).[328] Recognizing that it is asking the Commission to ignore the clear requirements of the checklist, Verizon alternatively argues that the Commission should forbear from their application.[329] There is no merit to either contention.

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[325] *See* Z-Tel Comments at 7-20, responding to *NPRM* ¶ 72.

[326] The fourth checklist item states that BOCs must provide "Local loop transmission from the central office to the customer's premises, unbundled from local switching or other service." 47 U.S.C. § 271(c)(2)(B)(iv). Checklist item five states that BOCs must provide "Local transport from the trunk side of a wireline local exchange carrier switch unbundled from switching or other services." 47 U.S.C. § 271(c)(2)(B)(v). Checklist item six states that BOCs must provide "Local switching unbundled from transport, local loop transmission, or other services." 47 U.S.C. § 271(c)(2)(B)(vi).

[327] Z-Tel Comments at 16.

[328] Verizon Comments at 66-67.

[329] Verizon Comments at 68-69.

A. The BOCs Are Required to Unbundle Loops, Transport, and Switching Regardless of How Sections 251(c)(3) and 251(d)(2) Are Applied to Other ILECs.

Verizon first argues that, if the Commission decides that a network element need not be unbundled by all ILECs under section 251(d)(2), "the most reasonable reading of the statute is that . . . the corresponding facility is no longer considered a UNE."[330] Verizon's contention that loops, transport, and switching may somehow be deemed not to be "UNEs" is plainly wrong.

1. The plain language of the checklist requires BOCs to unbundle loops, transport, and switching.

Loops, transport, and switching are "network elements" under any plausible reading of the statute. They do not cease to be "network elements" if the Commission decides under section 251(d)(2) that ILECs other than BOCs need not provide unbundled access to them.[331] Loops, transport, and switching remain loops, transport, and switching regardless of non-BOC regulatory decisions, and the checklist lists each of those elements by name and specifically requires each to be unbundled. Verizon's contention is plainly contrary to the terms of the statute.[332]

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[330] Verizon Comments at 67.

[331] That is so, moreover, whether the network element at issue is a "facility" or a "capability." For example, a loop is a loop whether it is a twisted copper pair or the capability of providing a voice-grade equivalent over an upgraded network. The statutory definition is very broad and includes "features, functions, and capabilities" as well as "a facility or equipment." *See* 47 U.S.C. § 153(29). Verizon nevertheless speaks only of "facilities." But it litigated that issue and lost. After reviewing the statutory definition of "network element," the Supreme Court held, "[g]iven the breadth of this definition, it is impossible to credit the incumbents' argument that a 'network element' must be part of the physical facilities and equipment used to provide local phone service." *AT&T*, 525 U.S. at 387.

[332] The Supreme Court also focused on loops, transport, and switching as the key elements of the bottleneck possessed by the ILECs. At the beginning of its 1999 decision, the Court stated that, because "States typically granted an exclusive franchise in each local service area," the incumbent LECs own "the local loops (wires connecting telephones to switches), the switches (equipment directing calls to their destination), and the transport trunks (wires carrying calls between switches) that constitute a local exchange network." *Id*. In its recent decision, the Court

Likewise, the conclusion that loops, transport, and switching are "network elements" that BOCs must unbundle pursuant to the checklist is entirely consistent with section 251(d)(2), whether or not *all* ILECs must provide unbundled access to those elements under section 251. As we have previously explained, section 251(d)(2) is a general provision relating to all ILECs and network elements.[333] General provisions do not override specific ones, and therefore section 251 cannot reasonably be construed to trump the checklist's specific commands governing one subset of ILECs (BOCs) and one subset of network elements (loops, transport, and switching).

Congress has made clear that BOCs must unbundle the key elements of the platform. Congress also authorized – but did not require – the Commission to require other ILECs to provide access to those elements, depending in part on the Commission's consideration of whether CLECs would be impaired without access to those elements. If the BOCs continue to believe that Congress should not have treated them differently than other ILECs, they may renew their equal protection challenge or their bill of attainder challenge to section 271. But the D.C. Circuit correctly held that "[b]y no stretch of the imagination can it be found that § 271 violates equal protection," even though Congress treated the BOCs differently than other ILECs.[334] The court similarly concluded that "it is hard to imagine how § 271 inflicts injury" on the BOCs – a prerequisite to succeeding on a bill of attainder claim.[335] The BOCs' imaginative challenges to

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described the "physical incarnation" of the ILECs' bottleneck, which gives them "an almost insurmountable competitive advantage," as "feeder wires, collectively called the 'local loop,'" that "run to local switches that aggregate traffic into common 'trunks.'" *Verizon*, 122 S. Ct. at 1661, 1662.

[333] Z-Tel Comments at 15-17.

[334] *BellSouth Corp. v. FCC*, 162 F.3d 678, 692 (D.C. Cir. 1998).

[335] *Id*. at 691.

section 271 do not pass muster "as a matter of constitutional law . . . or as a matter of common sense."[336] This Commission should not accept those recycled arguments.

The second checklist item, which requires the BOCs to provide "network elements in accordance with the requirements of sections 251(c)(3) and 252(d)(1),"[337] illustrates the fact that Congress knew how to cross-reference other provisions of the statute; indeed, Congress did so repeatedly in the checklist. But nowhere did Congress cross-reference section 251(d)(2) or provide any other indication that it overrides the clear requirements of the checklist. The inescapable conclusion is that it does not.

Congress also recognized that a right of access to unbundled network elements is worthless in the absence of a statutory pricing rule. It therefore adopted section 252(d)(1), which requires network elements to be provided at cost-based rates. As the cross-reference to section 252(d)(1) in the second checklist item (quoted above) makes clear, BOCs must provide loops, transport, and switching *at cost-based rates*. In explaining the relevant provisions, the congressional drafters said that they intended "the competitive checklist to set forth what must, at a minimum, be provided by a Bell operating company in any interconnection agreement approved under section 251 to which that company is a party."[338] Of course, the cost-based pricing rule in section 252(d)(1) applies to network elements provided pursuant to an interconnection agreement.[339]

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[336] *Id*.

[337] 47 U.S.C. § 271(c)(2)(B)(ii).

[338] S. REP. NO. 104-23, at 43 (1995).

[339] Section 252(d)(1) governs "[d]eterminations by a State commission . . . of the just and reasonable rate for network elements." The D.C. Circuit recently overturned the Commission's attempt to regulate reciprocal compensation rates under section 201 rather than section 252(d)(1). *WorldCom, Inc. v. FCC*, 288 F.3d 429 (D.C. Cir. 2002). As explained in Z-Tel's

Moreover, the cross-reference in the checklist to the statutory pricing provision was the product of considered deliberation. The Senate bill – on which the checklist was based – did not contain a specific cross-reference to the pricing provision, but merely a general cross-reference to section 251.[340] During debate on the Senate floor, Senator Hollings, the ranking Democrat on the Commerce Committee and one of the Senate Managers, noted that although there was "no explicit reference" in the checklist "to the charges that the RBOC's may assess," he interpreted the general reference to section 251 as being intended to incorporate the cost-based pricing rules contained in the bill.[341] The statute as enacted after conference committee reconciliation made that understanding explicit by cross-referencing the statutory pricing provision.

The plain language of the checklist, therefore, requires the BOCs to provide unbundled access to loops, transport, switching, and any other elements the Commission selects, and to do so at the cost-based rates mandated by section 252(d)(1). That is also how the drafters explained the checklist. Congress is rarely so clear. The BOCs must unbundle loops, transport, and switching at cost-based rates.

2. Reading the statute coherently as a whole confirms that the BOCs must provide unbundled access to the key elements of the Platform.

Verizon does not attempt to provide any statutory basis for its position that BOCs need not unbundle loops, transport, and switching if the Commission deletes them from the national

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initial comments, there is no basis for regulation of network element prices under section 201 rather than section 252(d)(1) either. Z-Tel Comments at 11-12.

[340] *See* Telecommunications Competition and Deregulation Act of 1995, S. 652, 104th Cong. § 255(b)(1) (1995).

[341] 141 Cong. Rec. S8,469 (daily ed. June 15, 1995) (statement of Sen. Hollings). The pricing rule contained in section 101 of the Senate bill ("based on the cost (determined without reference to a rate-of-return or other rate-based proceeding) of providing the unbundled element") was essentially the same as the pricing rule contained in section 252(d)(1)(A)(i) as enacted ("based on the cost (determined without reference to a rate-of-return or other rate-based proceeding) of providing the interconnection or network element (whichever is applicable)").

list implementing section 251(d)(2). Verizon instead suggests that its reading of the checklist ought to be adopted in order to "advance[] Congress's intent to promote facilities-based competition and treat UNEs as transitional devices," and adds that "the various provisions ought to be read as a whole, in a coherent fashion, to promote the stated objective of the statutory scheme."[342]

The second contention – that a statute ought to be read coherently as a whole – is correct. But it supports Z-Tel's reading of the statute, not Verizon's. Congress legislated "on the understanding that incumbent monopolists and contending competitors are unequal," and "sought to bring competition to local-exchange markets, in part by requiring incumbent local-exchange carriers to lease elements of their networks at rates that would attract new entrants when it would be more efficient to lease than to build or resell."[343] Thus, the principal goal of the Act was the introduction of competition to "persistently monopolistic local markets, which were thought to be the root of natural monopoly in the telecommunications industry."[344] Indeed, the Act was "designed to give aspiring competitors every possible incentive to enter local retail telephone markets, short of confiscating the incumbent's property."[345]

Verizon's contention – that Congress's overriding goal was to promote facilities-based competition and that UNEs are merely transitional devices to that end – is made without citation[346] and without any basis in the text of the statute. Congress provided three modes of competitive entry, including the use of unbundled network elements, as the Supreme Court has

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[342] Verizon Comments at 67.

[343] *Verizon*, 122 S. Ct. at 1687.

[344] *Id*. at 1654.

[345] *Id*. at 1661.

[346] *See, e.g.*, Verizon Comments at 67.

reiterated. In its *Verizon* decision, the Court described the "three strategies that a potential competitor may pursue:" pure facilities-based entry, reselling, and leasing network elements.[347] With respect to the purposes underlying the three modes of entry and the use of UNEs in particular, the Court stated that the ILECs control "expensive facilities unlikely to be duplicated."[348] It accordingly approved a "policy of promoting lower lease prices" for access to those bottleneck facilities, which is essential "particularly for smaller competitors" like Z-Tel.[349] Verizon's belief that the purpose of the Act is to favor facilities-based competition even when the likely result is no mass-market competition is incompatible with the recent pronouncements of the Supreme Court, and common sense.[350]

Verizon's contention is contrary to the Supreme Court's earlier decision in *AT&T* as well. In that case, citing sections 251(c)(2), (3), and (4) in reverse order, the Court stated that "a requesting carrier can obtain access to an incumbent's network in three ways: It can purchase local telephone services at wholesale rates for resale to end users; it can lease elements of the incumbent's network 'on an unbundled basis'; and it can interconnect its own facilities with the incumbent's network."[351] And *AT&T* shows that Congress did not favor any of those modes of

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[347] *Verizon*, 122 S. Ct. at 1662.

[348] *Id*. at 1668 n.20.

[349] *Id*.

[350] As stated previously, Z-Tel does not contend that consideration of the effects of unbundling rules on the deployment of facilities is misguided. Z-Tel Comments at 72-73. Moreover, the D.C. Circuit clearly instructed the Commission to continue to take that factor into account. However, promoting the deployment of facilities is not the only consideration relevant to unbundling decisions, and any interpretation of section 251(d)(2) that treated it as such would be contrary (a) to the Supreme Court's ruling, which emphasized Congress's purpose in opening markets to competition, and (b) to the language of the statute, which does not mention facilities deployment, but instead focuses on the needs of requesting competitors. In any event, as discussed in our opening comments and below, unbundling the network elements that are important to Z-Tel would not deter useful investment in facilities. Z-Tel comments at 72-85.

[351] *AT&T*, 525 U.S. at 371.

entry over the others.[352] To the contrary, when the BOCs argued to the Supreme Court that "a facilities-ownership requirement" should be inferred in order to promote the deployment of facilities by CLECs, the Court flatly disagreed.[353]

Moreover, the Court adopted a position of neutrality between the three methods of competitive entry at the urging of the Commission, which successfully defended its decision not to impose a facilities-ownership requirement on competitors leasing network elements by arguing that "nothing in Section 251 compels new entrants to pick one entry option over another when either, by its terms, is available. Nor should the Commission, much less the federal courts, create artificial limitations on one option to encourage greater use of another."[354] The Commission should adhere to the conclusion that the Supreme Court rightly adopted at the Commission's request.[355]

"Facilities-based" competition *does* have a statutory basis in the Communications Act, of course; it is mentioned in "Track A" of section 271.[356] But as Z-Tel already pointed out in our comments, the Commission has concluded – *at the urging of the BOCs* – that, under section 271,

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[352] As we showed in our comments, however, CLECs will deploy facilities whenever it is reasonable to do so in order to avoid relying on the facilities of their primary competitor, which imposes a host of "soft costs" on competitors. Z-Tel comments at 62. The Commission made the same point to the Supreme Court. *See* Reply Brief for the Federal Petitioners, No. 97-826 *et al*. (June 1998), at 34-35 ("Moreover, the incentive to build new facilities will often be enhanced because new entrants will wish to reduce the burdens of negotiating with, and relying on, their chief competitors – the incumbent LECs –in order to do business. *See, e.g.*, D. CARLTON & J. PERLOFF, MODERN INDUSTRIAL ORGANIZATIONS 501 (2d ed. 1994)."). The Supreme Court agreed in its recent decision, citing "the desirability of independence from an incumbent's management and maintenance of network elements." *Verizon*, 122 S. Ct. at 1670.

[353] *AT&T*, 525 U.S. at 392.

[354] Reply Brief for the Federal Petitioners, No. 97-826 *et al*. (June 1998), at 37.

[355] Moreover, as Z-Tel explained in its initial comments and above, restricting the availability of the platform would not lead to more facilities deployment. *See* Z-Tel Comments at 76-83.

[356] 47 U.S.C. § 271(c)(1)(A).

a competitor using the platform of unbundled network elements is a "facilities-based competitor."[357] Indeed, in the recent Vermont 271 decision, the Commission concluded that Verizon "satisfies the requirements of Track A in Vermont" on the basis of competition from Z-Tel and SoVerNet after noting that "Z-Tel provides services to residential subscribers over the UNE-Platform."[358] Given that conclusion, if the Commission were to retreat from the position that a competitor using the platform is a "facilities-based" competitor, it would call into question all of the section 271 applications that have been approved.

Moreover, a retreat from the UNE Platform would destroy the potential for parity of local and long distance entry that Congress intended. Given the existence of a competitive wholesale market for long-distance capacity and the ease with which end users may change their long-

[357] *See* Z-Tel Comments at 83-85. The conclusion that competitors leasing the platform are facilities-based competitors makes sense. As we showed in our opening comments, Z-Tel has invested more than $100 million in software to provide advanced features. It could not use those features if it provided the local component of its service by means of resale. *Implementation of the Local Competition Provisions in the Telecommunications Act of 1996*, First Report and Order, 11 FCC Rcd 15499, 15667 (¶ 332) ("[R]esellers cannot offer services or products that incumbents do not offer," whereas new entrants using network elements may "offer services that are different from those offered by incumbents."). Moreover, as we also showed, investment in software designed to provide distinctive offerings is more productive than investment that does nothing more than replicate the functions of basic network elements. *See generally* 47 U.S.C. 214(e)(1)(A); *Federal State Joint Board on Universal Service*, Report & Order, 12 FCC Rcd 8776, 8862 (1997) (similarly construing "own facilities" in section 214 to include UNEs).

[358] *See Application by Verizon New England Inc., Bell Atlantic Communications, Inc. (d/b/a Verizon Long Distance), NYNEX Long Distance Company (d/b/a Verizon Enterprise Solutions), Verizon Global Networks Inc., and Verizon Select Services Inc., for Authorization To Provide In-Region, InterLATA Services in Vermont*, Memorandum Opinion & Order, 2002 FCC LEXIS 1905, FCC No. 02-118, at ¶ 11 (2002) ("*Vermont 271 Decision*"). The Commission noted that there was a dispute as to whether Adelphia should also count as a facilities-based provider of service to residential customers, but concluded that it "need not resolve this question." *Id*. at n.28. The Commission also relied on competition from UNE-P CLECs in approving BellSouth's applications for Georgia and Louisiana. *See Joint Application by BellSouth Corporation, BellSouth Telecommunications, Inc., And BellSouth Long Distance, Inc. for Provision of In-Region, InterLATA Services in Georgia and Louisiana*, Memorandum Opinion & Order, 2002 FCC LEXIS 2484, FCC No. 02-147, ¶ 12 (Georgia), ¶ 15 (Louisiana) (2002) ("*Georgia and Louisiana 271 Decision*").

distance carrier, entry into the long-distance market by the BOCs is simple once they receive their 271 authorizations. A consumer's presubscribed interexchange carrier may be changed electronically and the cost is typically less than $5.[359] The UNE Platform allows for similar entry into local markets without significant investments in reengineering the ILEC's local network. But without the UNE Platform and in the absence of an automated cutover procedure (which ILECs have no incentive to develop or deploy), competitors seeking to serve residential and small-business customers over unbundled loops would have to rely entirely on manual hot cuts. As we showed in our comments, requiring competitors to rely on time-consuming, manual hot cuts would cap competitive entry at a very low figure, and would do so for no productive purpose, but merely to impose wasteful costs on new entrants.[360] Accordingly, under the Platform-less regime the BOCs propose, they will be able to continue efficiently to enter the long distance market, but CLECs (other than cable companies) would have no means of offering broad-based, mass-market service to residential and small-business customers.

This, of course, is not the competitive "bargain" that Congress envisioned in passing the Act. Rather, Congress anticipated that "[*w*]*hen we open local service exchanges to competition*, then the Bell operating systems will want to go out and compete in the long distance market."[361] Or as Senator Breaux put it, "You can get in my business when I can get in your business."[362] In fact, however, the BOCs want to "go out and compete in the long distance market" *without* opening local exchange services to competition. Congress expressly rejected such unbalanced

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[359] Indeed, the Commission recently initiated a rulemaking in response to claims that the $5 "safe harbor" adopted in the 1980s is too high. *Presubscribed Interexchange Carrier Charges*, Order & Notice of Proposed Rulemaking, 17 FCC Rcd 5568, 5568 (¶ 1) (2002).

[360] *See* Z-Tel Comments at 63-66.

[361] 141 Cong. Rec. S8,135 (daily ed. June 12, 1995) (statement of Sen. Dorgan).

[362] 141 Cong. Rec. S8,153 (daily ed. June 12, 1995) (statement of Sen. Breaux).

proposals during the legislative process, and it is not the Commission's role now to rewrite the laws to reflect the statute that the BOCs wish had passed.[363]

In addition, the drafters of the checklist made clear on the Senate floor that BOCs would have to provide loops, transport, and switching for "the reasonably foreseeable future."[364] Senator Pressler, the sponsor of the Senate bill and the Chair of the Senate Commerce Committee, explained the purpose of the checklist in the Senate bill, which required BOCs to unbundle loops, transport, and switching. He said that the checklist included "those things that a telecommunications carrier would need from a Bell operating company in order to provide a service such as telephone exchange service or exchange access service in competition with the Bell operating company. This competitive checklist could best be described as a snapshot of what is required for these competitive services now and in the reasonably foreseeable future."[365] It is therefore clear that Congress correctly anticipated that competition in local telephone services for residential and small business customers would not develop overnight – and they took care to ensure that the key elements of the BOCs' technological stranglehold over such competition would be unbundled for "the reasonably foreseeable future."[366] Given the extensive

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[363] *See, e.g.,* S.Amdt. 1261, 104th Cong. (1995).

[364] 141 Cong. Rec. S8,469 (daily ed. June 15, 1995) (statement of Sen. Pressler).

[365] *Id.*; *see also* Telecommunications Competition and Deregulation Act of 1995, S. 652, 104th Cong. § 151 (1995), as codified at 47 U.S.C. § 271(c)(2)(B)(iv-vi).

[366] During debate on the 1996 Act, Senator Kerrey observed that "[t]here is much in this legislation . . . that will benefit the American consumer, and that will benefit the American household. But let no one be mistaken …. It may take 9 or 10 years, which is what happened with divestiture. It took us 10 years before people began to say, 'Wait a minute. This is working. Competition is bringing the price down. The quality is going up.'" 141 Cong. Rec. S7,909 (daily ed. June 7, 1995) (statement of Sen. Kerrey). Unfortunately, six years after passage of the Act, so little local exchange competition has emerged for the "American household" that Senator Kerrey's nine- or ten-year time frame now looks optimistic. An important reason for the delay, as the Fifth Circuit concluded, was that "potential entrants were stymied . . . by the uncertainty over the FCC's jurisdiction to implement its local competition

delays in implementation caused by BOC litigation up to and including today, the "reasonably foreseeable future" has hardly begun.

Senator Breaux, a "leading backer of the Act in the Senate,"[367] put it more colloquially. He told the BOCs: "Now, this legislation says you will not control much of anything," but instead "will have to allow for nondiscriminatory access on an unbundled basis to the network functions and services of the Bell operating companies network."[368] Almost immediately after telling the BOCs "you will not control much of anything," Senator Breaux ticked off the three checklist items we have emphasized: "local loop transmission from the central office to the customer's premises, unbundled from local switching or other services; and next, local transport from the trunk side of local exchange carrier switch, unbundled from switching or other services. Finally, local switching unbundled from transport, local loop transmission, or other services."[369]

The only construction of the statute that reads it coherently as a whole, in light of its text and its purpose, is the one that respects what the section 271 checklist plainly states: BOCs must unbundle loops, transport, and switching at cost-based rates.

B. There Is No Basis for Forbearance from the Requirements of the Checklist at This Time.

Verizon alternatively contends, with respect to the network elements listed in the checklist, that "the Commission should forbear from applying these checklist items once the

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order" until the Supreme Court issued its 1999 decision. *Texas Office of Public Utility Counsel v. FCC*, 183 F.3d 393, 436 n.78 (1999), *cert. granted*, 530 U.S. 1213 (2000), *cert. pet. dismissed*, 531 U.S. 975 (2000). Further uncertainty retarded competitive entry until the Supreme Court rejected the ILECs' challenges to the Commission's pricing rules in the *Verizon* decision. The D.C. Circuit's *USTA* decision may have upset the certainty that prevailed for ten days following the Supreme Court's decision.

[367] *Verizon*, 122 S. Ct. at 1662.

[368] 141 Cong. Rec. at S8,153 (daily ed. June 12, 1995) (statement of Sen. Breaux).

[369] *Id*.

related facilities no longer satisfy the Section 251(d)(2) standard."[370] Recognizing that section 10(d) states that the Commission may forbear from enforcement of section 271 only after it has been "fully implemented," Verizon contends that section 271 should be deemed "fully implemented" "once a BOC has proven that it satisfies the checklist."[371] That argument is circular and contrary to the terms of the statute, its implementation by state and federal authorities, and common sense. Indeed, Verizon's forbearance request is as implausible and as premature as SBC's argument that the Oklahoma residential market was open to competition because four employees of a CLEC were obtaining competitive service on a test basis.[372]

1. The anti-backsliding provision shows that forbearance is not warranted merely because a section 271 application has been approved.

The statute does not contemplate relieving a BOC of its unbundling obligations once its section 271 application has been approved. To the contrary, section 271(d)(6) – the "anti-backsliding" provision – provides for a range of penalties if "the Commission determines that a Bell operating company has ceased to meet any of the conditions required for such approval." The statute authorizes remedies in the nature of injunctive relief, fines, or suspension or revocation of long-distance authority if, for example, a BOC fails to unbundle switching after its section 271 application has been approved. So it is absolutely clear, contrary to Verizon's statement, that section 271 has not been "fully implemented" simply because the checklist has

[370] Verizon Comments at 68.

[371] *Id*. at 69.

[372] *See SBC Communications Inc. v. FCC*, 138 F.3d 410, 416 (D.C. Cir. 1998) ("We do not think much of appellant's argument that the Commission was obliged to conclude that Brooks was a 'competing provider' in the local residential market merely because four Brooks employees were provided free residential service"), *cert. denied*, 525 U.S. 1113 (1999).

been satisfied and an application has been approved. Section 271 specifically contemplates continuing compliance with the requirements that are prerequisites to approval.[373]

The state commissions have understood that section 271 imposes continuing obligations on the BOCs. Every state commission for which a section 271 application has been granted has adopted a "performance assurance plan" "to protect against backsliding after BOC entry in the long distance market."[374] The Commission routinely applauds those efforts, as it did recently with respect to Vermont.[375] And the Commission recognizes its own duty to prevent backsliding. For example, the Commission recently stated: "Working in concert with the Vermont Board, we intend to monitor closely Verizon's post-approval compliance for Vermont to ensure that Verizon does not 'cease[ ] to meet any of the conditions required for [section 271] approval.'"[376] In short, Verizon's contention that forbearance is appropriate once the checklist

[373] A proposed – and rejected – version of the statute might have provided some basis for Verizon's claim, if it had been enacted. The Senate version of the bill included a forbearance provision that required full implementation of section "255(b)(2)" – the provision that became the checklist. S. 652, 104th Cong., 1st Sess. (1995), § 260(c). But that provision was broadened in the statute as enacted to require that section 271 in its entirety be "fully implemented." Thus, it plainly is *not* sufficient under the forbearance provision for a BOC merely to have implemented the checklist, because the forbearance provision as enacted requires full implementation of all of section 271, including the anti-backsliding provision as well as the checklist. Nor did the Senate bill have a provision comparable to the "anti-blacksliding" subsection (section 271(d)(6)) of the statute as enacted. The Conference Committee added the anti-backsliding provision to section 271 in addition to changing the language of the forbearance provision. Those changes clearly indicate that forbearance is not appropriate until the checklist has been implemented.

[374] *Vermont 271 Decision* at ¶ 74 n.256.

[375] *Id*. at ¶ 3 ("[B]y diligently and actively conducting proceedings beginning in 1997 to . . . develop a Performance Assurance Plan . . . the Vermont Board has laid the necessary foundation for our review and approval.").

[376] *Id*. at ¶ 81 (quoting section 271(d)(6)). The Commission made the same point in its order granting BellSouth's applications for Georgia and Louisiana. *See Georgia and Louisiana 271 Decision* at ¶ 307.

has been satisfied is plainly contrary to the terms of the statute and the manner in which it has been consistently implemented by the states and the Commission.

Verizon's contention also defies common sense. When a BOC satisfies the checklist and gains entry under section 271, it usually relies substantially on competition provided using unbundled switching, particularly via the UNE Platform. If the BOC were then able to take away unbundled switching and the UNE Platform, it would instantly create a much less competitive environment (one in which the sole competition would be from cable, thereby creating a duopoly and one can simply look at wireless markets to see how poorly duopoly serves customers). In fact, the BOC often would not have been able to obtain 271entry without the competition using unbundled switching. It is inconceivable that such a "bait-and-switch" approach to competition is permissible under section 271.

Opening the local phone markets to competition is an extraordinarily difficult task.[377] As the Supreme Court recognized, local phone service was regulated as a natural monopoly until recently.[378] As the Court also noted, the incumbent LECs own a vast network of bottleneck facilities – including loops, switches, and transport facilities – as a result of their prior status as franchised monopolists.[379] They also controlled, until recently, nearly 100 percent of the customers in their markets, and telecommunications markets are characterized by "network effects," where the value of service is highly dependent on being able to reach large numbers of other subscribers. As the Supreme Court stated: "It is easy to see why a company that owns a

[377] The D.C. Circuit recognized "the extraordinary complexity of the Commission's task" in opening local markets to competition, and added that Congress "plainly believed that merely removing affirmative legal obstructions would not do the job." *USTA,* 290 F.3d at 421-22.

[378] *AT&T*, 525 U.S. at 371.

[379] *Id*.

local exchange . . . would have an almost insurmountable competitive advantage."[380] In light of those formidable barriers to entry, Congress required ILECs to provide unbundled access to network elements and to permit resale. Those steps were needed so that competitors could enter the market by means other than constructing fully redundant networks and interconnecting them.

As we have shown, most of the existing competition for residential and small business, mass-market customers relies on the availability of the platform.[381] NARUC has recognized that any reduction in the availability of the network elements comprising the platform will reverse the progress that has been made to open the local phone markets to competition and has resolved that the platform should continue to be made available.[382] And this Commission told the Supreme Court last year that "the UNE Platform has been the most important vehicle for competitive entry into local markets for residential and small business customers."[383] It would not make sense to relieve the BOCs of the obligations that have permitted competition to begin to take hold.

In addition, Verizon's forbearance request is procedurally defective. The Commission's rules require a forbearance petition to be filed as a "separate pleading."[384] Verizon's request, made at pages 68-69 of its comments, obviously is not in compliance with that requirement. The rule provides that "[a]ny request which is not in compliance with this rule is deemed not to constitute a petition pursuant to 47 U.S.C. 160(c), and is not subject to the deadline set forth

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[380] *Verizon*, 122 S. Ct. at 1662.

[381] Z-Tel Comments at 76-79.

[382] NARUC's *Resolution Concerning the UNE Platform* was appended to Z-Tel's initial comments.

[383] Brief for Petitioners Federal Communications Commission and the United States, No. 00-511 *et al.*, *Verizon Communications, Inc. v. FCC* and related cases 44 (April 2001).

[384] 47 C.F.R. § 1.53.

therein."[385] Verizon's forbearance request therefore must be disregarded under the Commission's rules.

2. Forbearance is not warranted because the standards of section 10 have not been satisfied.

Verizon's argument also is contrary to the language and structure of the forbearance provision. Section 10(a) requires a showing that a provision: (1) is not necessary to ensure that the charges and practices of carriers "are just and reasonable and not unjustly and unreasonably discriminatory;" (2) is not needed "for the protection of consumers;" and (3) can be forborne in a way that is otherwise "consistent with the public interest." Since the incumbents control bottleneck facilities in an industry characterized by network effects by virtue of their prior status as government-sanctioned and protected monopolies,[386] a great deal is needed to protect competitors and consumers and otherwise to show that enforcement of the statute Congress enacted is not in the public interest. As the Supreme Court stated, the BOCs "have an almost insurmountable competitive advantage" on account of their control of loops, transport, and switching.[387]

In addition, section 10(d) specifically provides that "the Commission may not forbear from applying the requirements of section 251(c) and 271 under subsection (a) of this section until it determines that those requirements have been fully implemented." Section 10(d) thus imposes a test for those two provisions, above and beyond the three requirements for forbearance that apply to every other provision of the Act. That is appropriate, because those are the two key market-opening provisions of the Act.

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[385] *Id*.

[386] *UNE Remand Order*, ¶ 86.

[387] *Verizon*, 122 S. Ct. at 1662.

The Commission has not yet had to grapple with application of the standards of section 10(a) to the requirements set forth in the checklist or with the precise meaning of "fully implemented" in section 10(d). There is no need to do so at this time, since Verizon's forbearance request is so obviously premature.

The AT&T non-dominance proceeding provides some relevant guidance into what should be required before the Commission forbears from enforcement of section 271.[388] In that proceeding, which culminated in an order in 1995 declaring AT&T to be non-dominant, the Commission carefully examined whether consumers and carriers would be damaged by AT&T's exercise of market power. Both of those factors are relevant under section 10(a).

Focusing first on supply elasticity, the Commission emphasized that "MCI and Sprint can absorb overnight as much as fifteen percent of AT&T's total 1993 switched demand at no incremental capacity cost" and, "within twelve months, AT&T's largest competitors could absorb almost two thirds of AT&T's total switched traffic for a combined investment of $660 million."[389] There is no evidence that any CLEC in any market could absorb 15 percent of an ILEC's traffic overnight or 67 percent of its traffic within a year. To the contrary, as our discussion of the problems associated with manual hot cuts demonstrates, making the platform unavailable would impose a severe cap on competitors' ability to serve residential and small business customers. Indeed, as we have shown, even in Manhattan a competitor relying on manual hot cuts would need about three years to fill a single 68,000-line switch.[390] The

[388] *In re Motion of AT&T to be Reclassified as a Non-Dominant Carrier*, 11 FCC Rcd 3271 (1995) ("*AT&T Non-Dominance Order*").

[389] *Id*. at ¶ 59.

[390] Z-Tel Comments at 41.

differences between this state of affairs and those that justified declaring AT&T to be non-dominant are exponential.

In addition, in the AT&T non-dominance proceeding the Commission "closely considered the commenters' claims that AT&T possesses market power with respect to resellers," but emphasized in that respect that "AT&T had only 25.6 percent of the resale market segment in 1994."[391] That is, nearly three-quarters of resellers used the facilities of a carrier other than AT&T, showing that "adequate alternative sources of supply exist for resellers."[392] This fact illustrates that competitors will choose to use the facilities of any carrier other than the dominant carrier whenever they have a reasonable option. It also illustrates how different the current local competition situation is from the state of the long distance market in 1995. Z-Tel would prefer to use the facilities of carriers other than the incumbent LECs to provide the local component of its service, but it has no reasonable alternative.

The Commission also analyzed market share figures before it declared AT&T non-dominant. It noted that it had classified AT&T as dominant when it had a 90% market share, and reclassified AT&T as non-dominant only after its market share fell below 60 percent.[393] Incumbent LECs currently have about a 91% share of the local markets and a higher share of the residential and small business markets.[394] Of course, it took more than twenty years from the initiation of long-distance competition to the date AT&T was declared non-dominant. The Telecommunications Act is only six years old and the local bottleneck is more difficult to open to competition than was the long-distance market.

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[391] *AT&T Non-Dominance Order* at 3341 (¶ 129).

[392] *Id*.

[393] *AT&T Non-Dominance Order* at 3307 (¶ 67).

[394] *See Verizon*, 122 S. Ct. at 1677; UNE Fact Report 2002, at II-10.

Moreover, the factors the Commission considered in 1995 in the AT&T non-dominance proceeding align with the inquiry mandated by section 10(a): whether enforcement of the dominant carrier regulations were necessary to protect consumers and other carriers and were otherwise in the public interest.[395] Significantly, however, Congress – which enacted the 1996 Act shortly after AT&T was declared non-dominant, and thus was likely aware of the Commission's analysis – required more, with respect to sections 251(c)(3) and 271. With respect to those two provisions, Congress also required a showing that they had been "fully implemented." Accordingly, Congress required that *more* needs to be shown to forbear from enforcement of sections 251(c)(3) and 271 than was shown before AT&T was declared non-dominant. Any construction of section 10(d) that does not add a requirement on top of what is minimally necessary to protect consumers and other carriers by section 10(a) would be faulty as a legal matter because it would render section 10(d) superfluous.

In our view, sections 251(c) and 271 should not be considered "fully implemented" in a geographic area until there is a functioning wholesale market in which competitors may obtain what they need to serve end-users and there is some assurance that the wholesale market will continue to function.[396] A mature wholesale market not only will protect consumers and other

[395] The D.C. Circuit in *USTA* was not, of course, considering any issue involving section 10. In reviewing the *Line Sharing Order*, however, it held that the Commission must explain the relevance of intermodal competition. *USTA v. FCC,* 290 F.3d 415 (D.C. Cir. 2002). Under the plan of the Act Congress adopted, intermodal competition is relevant under section 10, but not under section 251(d)(2). That provision plainly focuses on the needs of competitors. Only *after* competitors have been afforded the extraordinary opportunities Congress provided for entry into local markets is a broader analysis warranted. The competitive choices available to consumers are thus relevant in a forbearance proceeding, and not in this proceeding, and are but one of three factors for consideration under section 10(a).

[396] Since new entrants need access to the platform to serve residential customers, they need a wholesale market in which they may obtain the entire local component of telephone service, not just a wholesale market for the different elements comprising the platform. For example, given

competitors, but also will ensure that each mode of entry that Congress authorized in sections 251(c) and 271 will continue to be viable in the absence of enforcement of that provision. That construction follows from the terms of the provision. The ability of competitors to lease network elements at cost-based rates is set forth – indeed, reiterated – in those two provisions.[397] So are interconnection and resale rights.[398] Thus, the common denominator between the two provisions that Congress singled out for heightened forbearance scrutiny is their repeated emphasis on the availability of each of the three modes of entry. As a matter of textual analysis, it therefore makes sense to conclude that those provisions have not been fully implemented until competition has taken root so that the market will provide for entry by each mode in the absence of regulatory oversight.

Our proposed interpretation of section 10(d) also is consistent with the conclusions of the Supreme Court. The Court emphasized that Congress provided three modes of competitive entry, gave "aspiring competitors every possible incentive to enter local retail telephone markets, short of confiscating the incumbents' property," and noted that duplication of some bottleneck facilities "was neither likely nor desired."[399] The market-opening provisions of the Act will not be "fully implemented" in a particular local market until competitors may enter and continue to

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the problems caused by manual hot cuts, a wholesale market for switching unconnected to loops is not sufficient.

[397] Section 251(c)(3) requires ILECs to provide unbundled access to network elements on nondiscriminatory terms and in accordance with the requirements of section 252. The checklist in section 271 requires BOCs to provide unbundled access to loops, transport, and switching at cost-based rates in accordance with the pricing rules in section 252(d)(1). 47 U.S.C. § 271(c)(2)(B)(ii), (iv), (v), & (vi).

[398] Interconnection rights are established in section 251(c)(2) and the first checklist item. Resale rights are established in section 251(c)(4) and the fourteenth checklist item. 47 U.S.C. § 271(c)(2)(B)(i) & (xiv).

[399] *Verizon*, 122 S. Ct. at 1661, 1675.

provide service in any of the three ways provided by Congress without regulatory oversight, and only a functioning wholesale market provides that assurance.

The Commission similarly has described the long-term goal of the Telecommunications Act as "creating robust competition in telecommunications," which it aptly described as "competition among multiple providers of local service that would drive down prices to competitive levels."[400] Competition among multiple facilities-based competitors, as exists in the long distance market and will develop over time in at least some local markets, is likely to lead to the creation of a wholesale market, as also exists in the long distance market.[401] Such a wholesale market is a prerequisite to achievement of the robust competition that the Commission's has properly described as the long-term goal of the Act. But until that goal is achieved, the market-opening provisions of the Act will not have been "fully implemented."[402]

An interpretation of section 10(d) requiring the existence of a robust wholesale market also makes sense because competitors entering new markets in the future will continue to need to use resale or to lease network elements to gain a foothold. As the Supreme Court stated, some

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[400] *UNE Remand Order* at 3727 (¶ 55).

[401] As explained in our discussion of facilities-based competition in Section III, *supra*, the relevant empirical evidence shows that increased competitive entry by means of network elements will lead to investment in facilities where it is warranted.

[402] In the *UNE Remand Order*, the Commission declined to accept the argument of some CLECs that section 251(d)(2) should be construed such that competitors would be deemed to be impaired in the absence of a wholesale market. *UNE Remand Order* at 3727 (¶ 56). Unlike those CLECs, we do not contend that a competitor in not impaired within the meaning of section 251(d)(2) if it can self-provision an element without materially diminishing its ability to provide the services it seeks to offer. But whether sections 251(c) and 271 has been "fully implemented" is a different question than whether a CLEC is impaired, and the standard for determining whether section 10 has been satisfied plainly is higher than the standard for determining whether any particular provision of the Act has been satisfied; otherwise all of section 10 would be surplusage.

"expensive facilities" owned by the BOCs are "unlikely to be duplicated,"[403] and certainly not by more than a few competitors. It would not make sense, either from the perspective of a particular company or from the perspective of the public interest, for every competitor to construct a redundant network in every market. If a functioning wholesale market for local service exists, as currently exists for long distance service, market forces can guide the decisions of new entrants. But until then, enforcement of the statutory provisions Congress enacted is necessary to foster robust competition.

Verizon, on the other hand, apparently envisions forbearance from section 271 once a cable operator or an overbuilder enters a market to a significant extent. Such a construction of section 10 would kill off other competitors and, at best, consign residential and small business customers to "competition" from duopolists rather than permitting the development of robust competition.[404] The existence of a duopoly would not satisfy the requirements of section 10(a), much less the additional requirement of section 10(d).

Z-Tel's interpretation of section 10(d) would permit full deregulation on a sensible schedule. The existence of a functioning wholesale market would ensure fulfillment of Congress's goals in enacting "a pro-competitive, de-regulatory national policy framework designed to accelerate rapidly private sector deployment of advanced telecommunications and information technologies and service to all Americans by opening all telecommunications

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[403] *Verizon*, 122 S. Ct. at 1668.

[404] A duopoly is unlikely to result in vigorous competition, as the Commission has recognized with respect to the wireless market. *See 2000 Biennial Regulatory Review Spectrum Aggregation Limits For Commercial Mobile Radio Services*, 16 FCC Rcd 22668, 22685-86 (¶ 35) (2001) (describing the benefits to consumers resulting from the abolition of the wireless duopoly). The reason is easy to understand. As the president of Trump Shuttle once remarked, at a time when it and Pan Am were the only airlines offering shuttle service between New York and Washington, "There are only two of us in the market – what do you think Pan Am is going to do if I cut prices?" M. KATZ & H. ROSEN, MICROECONOMICS 532 (2d ed. 1994).

markets to competition."[405] Any lesser construction of "fully implemented" would deregulate the incumbents before competition had fully and irrevocably taken hold.

Congress did not intend for deregulation of carriers that continue to possess market power. Indeed, deregulation of carriers with market power is wholly inconsistent with Section 10's statutory prerequisites. As the Supreme Court recently explained, the Act is deregulatory "in the intended sense of departing from traditional 'regulatory' ways that coddled monopolies."[406] It would go beyond coddling to forbear from the requirements of sections 251(c) and 271 at this time. Congress instead mandated full implementation of sections 251(c)(3) and 271 prior to forbearance from enforcement of those provisions. Verizon's forbearance request is plainly premature, in addition to being procedurally defective.

CONCLUSION

Many residential and small-business customers prefer Z-Tel's service because of the advanced features Z-Tel provides through its innovative software, and Z-Tel could not provide that service without access to the UNE Platform. Utilizing the UNE Platform, Z-Tel can now, after only a few years' operation, sell its advanced features and voice software in 38 states, reaching more than 70 percent of the U.S. population. No other method of competitive entry would have allowed Z-Tel to serve this mass market.

The comments in this proceeding ratify the fact that Z-Tel – along with almost all other new entrants – would be impaired in providing service to mass-market customers if it did not have broad and ubiquitous access to the UNE Platform. The arguments and "evidence" presented by the incumbents are sparse, incomplete and overwhelmingly rhetorical. Most

[405] *Joint Explanatory Statement of the Committee of Conference on Public Law No. 104-104*, 104th Cong., 2d Sess. 113 (1996).

[406] *Verizon*, 122 S. Ct. at 1668 n.20.

importantly, the evidence presented by the incumbents fails to provide any "granular" analysis – mandated by section 251(d)(2) – that focuses upon the ability of CLECs to serve the analog mass market.

The evidence presented by Z-Tel, AT&T, the UNE Platform, and other entrants vividly shows the real-world operational, network efficiency, and cost disparity impairments that would face carriers seeking to serve the mass market if the UNE Platform were not available. And even though the Supreme Court in *Verizon* articulated a broad conceptual framework for unbundling, the evidence presented by CLECs in support of the UNE Platform would survive even the strictest of "impairment" tests.

The Commission must also respect the provisions of the section 271 competitive checklist, which requires the BOCs to make the key elements of the platform – loops, transport, and switching – available without any restriction. In addition, the Commission must respect the vital role of state commissions, pursuant to section 251(d)(3) and their front-line involvement in implementing local competition. State commissions have fact-finding tools – including discovery, sworn live testimony, and cross-examination – that the Commission has not established in this *Triennial Review* proceeding. Z-Tel submits that, absent rigorous fact-finding tools, the Commission would have difficulty establishing *any* "granular" rules on UNE availability that could survive appeal. The Commission should instead formally enlist the assistance of state commissions in this proceeding.

Respectfully submitted,

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