H. The Presence of One or a Few Competitors Providing Services Without Using UNEs Does Not Prove Lack of Impairment for All Competitors

As noted above, the BOCs argue that if any competitor uses non-incumbent LEC facilities to serve any customer or geographic location, then no competitor should be considered impaired without access to the relevant UNEs with respect to all similar customers or locations.[71] The Commission should reject this argument.

In considering alternatives to incumbent LEC-provided network elements, the Commission should examine entry conditions as a whole, and not rely on the ability of a few carriers to provide service to a handful of large customers in limited geographic areas over non-UNE facilities. The ability of one or more competitors to serve certain customers in a particular location does not prove that competitive LECs without unbundled access to the incumbent LEC's facilities are able to compete for other customers in the same area much less for customers in other areas. A standard that would be satisfied by the existence of a single competitive LEC using a non-incumbent LEC element to serve a specific customer or location would be inconsistent with the Act's goal of creating robust competition for telecommunications services.[72] At best, a single competitor would create a duopoly. And that assumes that the competitor has entered with a sound, sustainable business plan.

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over UNE-P).

[71] *See, e.g.,* Verizon Comments at 44; Shelanski Declaration at ¶ 39.

[72] If the FCC is to err in applying the procompetitive provisions of the Act, it should err in favor of competition and competitors, not in favor of the entrenched monopolists. *See Verizon v. FCC*, 122 S.Ct. at 1661 (Congress did not design the 1996 Act to balance even-handedly the interests of the incumbent LECs and their competitors, but rather to give new entrants "every possible incentive" to compete with the incumbents); *id.* at 1672 (it is reasonable for the FCC to err on the side of promoting competition rather than risking keeping potential entrants out of the market); *see also id.* at 1684.

I. Use Restrictions and Service-Specific Impairment Analyses Are Contrary to the Act and Are Bad Public Policy

The BOCs ask the Commission to place a variety of impermissible restrictions on competitive carriers' ability to use UNEs.[73] For example, the BOCs' seek to limit competitors' use of UNEs to telephone exchange services.[74] The BOCs also support the Commission's ongoing "temporary" restrictions on the use of EELs. As WorldCom explained in its initial comments, such use restrictions are contrary to the plain language of the Act, as are the service-specific impairment analyses required to implement some of the requested restrictions.[75] In addition to being unlawful, a service-specific impairment analysis also would be impractical.[76] In fact, a service-specific analysis would lead to precisely the type of administrative inefficiencies that the incumbent LECs claim they want to avoid.[77]

1. The Use of UNEs May Not Be Restricted to Telephone Exchange Services

Section 251(c)(3) explicitly requires incumbent LECs to provide requesting carriers access to UNEs "for the provision of *a telecommunications service*."[78]

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[73] *See, e.g.*, Verizon Comments at 38-40.

[74] *See* BellSouth Comments at 31; SBC Comments at 22-23.

[75] *See* WorldCom Comments at 52-61.

[76] WorldCom Comments at 58-59.

[77] *Compare* WorldCom Comments at 60 (explaining that a service-specific impairment analysis would needlessly waste administrative resources while providing no offsetting benefit) *with* BellSouth Comments at 28 (arguing that the Commission should give "great weight to the factor of administrative practicality") and Qwest Comments at 16 (urging the Commission to "resist invitations to engage in an increasingly complex unbundling analysis that is operationally difficult to implement and that will lead to uncertainty and invite greater litigation.")

[78] 47 U.S.C. § 251(c)(3) (emphasis added).

"Telecommunications service" is not limited to telephone exchange service.[79] Nor does any other part of the Act support the conclusion that Congress intended that UNEs be used only to provide telephone exchange service, as the BOCs contend.[80] To the contrary, Congress clearly intended to allow competitive carriers to use any capability of a UNE to provide any telecommunications service the competitor seeks to offer.[81] Thus, the plain language of the Act bars the type of limitation the BOCs seek to impose.

2. The Commission Should Eliminate Restrictions on EELs

Now that the Supreme Court has ruled that it is legal to require EELs, either as UNEs or as new combinations,[82] the FCC should clarify that incumbent LECs must convert existing special access to EELs as well as provide EELs where the requesting carrier is not currently relying on special access services.[83] As WorldCom has demonstrated, restrictions on the use of EELs violate the Act, as do all other use

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[79] *See* 47 U.S.C. §§ 153(46) (defining "telecommunications service") and 153(43) (defining "telecommunications").

[80] *See, e.g.*, BellSouth Comments at 29.

[81] *See* WorldCom Comments at 53-54; *Local Competition Order* at ¶ 264 ("Section 251(c)(3) does not impose any service-related restrictions or requirements on requesting carriers in connection with the use of unbundled elements"); 47 C.F.R. § 51.307(c) (requiring incumbent LECs to provide access to UNEs "in a manner that allows the requesting telecommunications carrier to provide any telecommunications service that can be offered by means of that network element"); and 47 C.F.R. § 51.309(a) (prohibiting incumbent LECs from imposing restrictions on requesting carriers' use of UNEs).

[82] *Verizon v. FCC*, 122 S.Ct. at 1682-87.

[83] *See UNE Remand Order* at ¶¶ 478-482 (declining to decide whether rules 51.315(c)-(f) should be reinstated, or whether EELs should be considered a separate network element until the courts completed their review of those issues). The Commission could designate EELs as UNEs or, alternatively, categorize EELs as UNE combinations and require the incumbent LECs to do the combining. *See Verizon v. FCC*, 122 S.Ct. at 1683 (noting that "a predesignated unbundled element might actually comprise items that could be considered separate elements themselves."); *id.* at 1685 (upholding the Commission's "additional combination rules.")

restrictions.[84] The current use restrictions on EELs are administratively cumbersome and fail to provide the predictability necessary to be effective.[85]

EELs promote facilities-based competition by allowing a competitive carrier to connect an end-user customer to the carrier's switch in areas in which customer density is not sufficient to justify collocating at the central office closest to the end user. Current restrictions on the use of EELs – such as the requirement that carriers use EELs to provide a "significant amount of local traffic" in order to qualify for UNE pricing and the restriction on "commingling" – have rendered this potentially valuable combination virtually useless. The Commission therefore should eliminate these restrictions and allow competitive carriers to use EELs to provide any telecommunications service they seek to offer. Unrestricted availability of cost-based EELs would foster competition, and its attendant benefits.

a) The Commission Should Lift Its Prohibition Against Commingling

The Commission's prohibition against "commingling" prevents competitive carriers from using facilities as efficiently as the incumbent LECs do. For example, while the incumbent LECs are free to carry local and long-distance (access) services over the same loop and transport facilities, competitors are barred from realizing the same efficiencies. Instead, competitive carriers are forced to operate two sets of facilities – one

[84] *See* WorldCom Comments at 62.

[85] The FCC's restrictions on EELs require a circuit-by-circuit analysis and breed impractically complex rules designed to ensure that carriers do not evade the restrictions. Such complexities jeopardize the usefulness of the rules.

for local services and another for long-distance services.[86] As a result, the commingling rule extends the scale advantages enjoyed by the incumbents.[87]

The incumbent LECs fail to articulate any valid reason for prohibiting commingling. According to SBC, for instance, in order to allow commingling, the Commission would have to identify channels on a DS-1 or DS-3 facility as UNEs.[88] This assertion is false. There is no technical reason that a DS-1 loop cannot be connected to a 3:1 multiplexer at an incumbent LEC's serving wire center and multiplexed onto a DS-3 circuit purchased out of the incumbent's interstate special access tariff. All that the Commission would have to do is recognize that such facilities (*e.g.*, the DS-3), when purchased as special access, provide a technically feasible and efficient means to access and aggregate unbundled loop and transport services.[89]

Verizon and the other incumbent LECs are perfectly willing to "commingle" UNEs with access services when a CLEC collocation arrangement is interposed between the UNE and the access service. Verizon has not explained why service and maintenance

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[86] As noted above, although the Supreme Court in *Verizon v. FCC* focuses on TELRIC, it also provides guidance on other issues. In particular, the Court noted that the FCC's requirement that competitors "construct unnecessarily duplicative facilities" results in a "misallocat[ion] of societal resources." *Verizon v. FCC*, 122 S.Ct. at 1672 (*quoting Local Competition Order* ¶ 378).

[87] Verizon's claim that it does not combine UNEs and special access services in its own network misses the point. Verizon Comments at 141. Verizon plainly combines circuits used to serve all customers on a single, unified transport network. Without commingling, competitive LECs are unable to combine circuits and must instead operate separate and necessarily less efficient networks.

[88] SBC Comments at 109.

[89] Likewise, the implementation difficulties alleged by Verizon to result from commingling are meritless. Verizon Comments at 140-141. Any difficulties that arise from an incumbent LEC's decision to create two separate wholesale provisioning departments and systems should be given no weight.

are impossible for circuits that are commingled without passing through a collocation arrangement, but feasible for those that do. There is no practical difference between the two situations. In each, the incumbent LEC is responsible for individual DS-1 loops and an entire DS-3 transport facility.

b) Carriers Should Be Permitted to Convert Special Access to EELs

In addition to lifting the restrictions on EELs, the Commission should allow competitive carriers to convert existing special access circuits to EELs and reject SBC's meritless claim that a carrier using special access services to reach its customers cannot be impaired without access to the underlying UNEs.[90] First, as SBC admits, carriers can lower their costs by converting special access circuits to lower-priced UNEs.[91] This cost-savings can be the difference between profit and loss for the competitive carrier.[92] At best, special access may provide a stop-gap solution for new entrants seeking to establish a foothold in a sector dominated by the incumbent LECs.[93] It does not, however, present a viable long-term alternative to EELs, particularly as the BOCs gain authority to provide in-region interLATA services.[94]

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[90] SBC comments at 105. *See also* Qwest Comments at 34. *But see Iowa Utilities Board 1997,* 120 F.3d at 809 (the fact that a capability may be available as a service does not necessarily preclude that capability from being available as a network element).

[91] SBC Comments at 105.

[92] The fact that a competitive carrier may currently serve a customer at a loss while it seeks to establish itself in a market, does not mean that the carrier is not "impaired" in offering that service.

[93] As the Supreme Court recently recognized, the incumbent LECs' control of local exchange facilities provides them with "an almost insurmountable competitive advantage not only" in the local market but in the market for long-distance calling as well. *See Verizon v. FCC*, 122 S.Ct. at 1662.

[94] A rule prohibiting conversions would also lead to widespread customer churn among competitive providers. If competitive carriers were unable to convert their existing special access circuits, but could serve new customers over cost-based EELs, carriers would be able to win customers away from their current competitive providers simply by using lower priced EELs to offer the customer the same service that their existing carrier

The factual backdrop against which the Commission considers the substitution of EELs for special access has changed substantially in the past few years. In early June 2000, when the *Supplemental Order Clarification* was issued,[95] only Verizon had received interLATA authority and only for one state – New York. By the time the Commission adopts an order in this proceeding, the BOCs will be well on their way to having region-wide interLATA authority. Once the BOCs have interLATA authority for a sufficient number of states, they will be in a position to compete for multi-location enterprise customers. Interexchange carriers (IXCs) like WorldCom, which currently provide service to enterprise customers, rely heavily on incumbent LEC special access as an input. The economic cost of these last-mile facilities for competitive carriers is the price of special access. The economic cost to the incumbent LEC for these last mile facilities is considerably lower, as demonstrated by the differences between the BOCs' tarriffed special access prices and the cost-based UNE rates for EELs.[96] Incumbent LEC control of this input places them in a position to execute a price squeeze by raising the price of special access and/or lowering the price of the business service.[97] Therefore, it is

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would be forced to provide over more expensive special access service circuits.

[95] *Implementation of the Local Competition Provisions of the Telecommunications Act of 1996*, Supplemental Order Clarification, 15 FCC Rcd 9587 (2000).

[96] These price differences also belie SBC's claims of competition in the special access market. SBC Comments at 106. SBC erroneously conflates the granting of pricing flexibility with a finding of competition for special access services. This simply is not the case. *Access Charge Reform*, Fifth Report and Order and Further Notice of Proposed Rulemaking, 14 FCC Rcd 14221, ¶¶ 3, 151 (1999) ("*Pricing Flexibility Order*"); *see also WorldCom, Inc. v. FCC*, 238 F.3d 449 at 460 (D.C. Cir. 2001) ("the FCC did not engage in a thorough competition analysis" of the sort that would be expected in non-dominance proceedings). The lack of competition is evident in the fact that special access prices often are *higher* in areas where the BOCs have been granted pricing flexibility. *See Performance Measurements and Standards for Interstate Special Access Services,* CC Docket No. 01-321, WorldCom's Comments at 34.

[97] *See Access Charge Reform*, First Report and Order, 12 FCC Rcd 15982, ¶ 280 (1997) (noting the important role UNEs play in preventing incumbent LECs from engaging in anticompetitive price squeezes against rival long distance providers). Verizon's

essential that the Commission require incumbent LECs to make loop-transport combinations available at TELRIC rates, without use restrictions, and without restrictions on commingling.

c) The Restrictions on EELs Cannot Be Justified by Concerns about Universal Service

The Commission should not be swayed by claims that allowing carriers to use EELs in lieu of special access services would somehow harm universal service.[98] SBC, for example, asserts that allowing the use of UNEs to provide special access services could undermine universal service by reducing IXCs' use of switched access. SBC does not provide any evidence for its speculative claim that the use of EELs would result in carriers abandoning switched access in large numbers, however. Moreover, SBC's argument fails to account for the fact that the Commission has stated that it has removed all universal service subsidies from the incumbent LECs' switched access charges.[99] Thus, universal service considerations should have no bearing on the Commission's determination regarding incumbent LECs' obligation to provide requesting carriers with unfettered access to EELs.

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argument that allowing conversions would prevent incumbent LECs from maintaining the current pace of broadband investment also suggests that the incumbent LECs are receiving supra-competitive returns from special access, and using those returns to subsidize their broadband investments. Verizon Comments at 139.

[98] *See* SBC Comments at 107-108.

[99] *See Access Charge Reform,* Sixth Report and Order in CC Docket Nos. 96-262 and 94-1, Report and Order in CC Docket No. 99-249, Eleventh Report and Order in CC Docket No. 96-45, 15 FCC Rcd 12962, ¶¶ 32, 202 (2002) ("*CALLS Order*"). The Commission had previously recognized that the rates for special access services had never contained implicit universal service subsidies. *See Expanded Interconnection With Local Telephone Company Facilities*, 7 FCC Rcd 7369, 7381, ¶ 16 (1992), *vacated in part on other grounds and remanded, Bell Atlantic Tel. Cos. v. FCC,* 24 F.3d 1441 (D.C. Cir. 1994).

J. The Commission Should Apply a Single Impairment Standard for All Telecommunications Services, Including DSL

There is no merit to the assorted BOC arguments that network elements used for broadband services need not be unbundled. In particular, WorldCom demonstrates below that the BOCs misinterpret the plain language of section 251 (and the relationship between sections 251 and 706), as well as the Eighth Circuit's "superior quality" holding. WorldCom also shows that, contrary to Verizon's claim, the unbundling of broadband services does not violate the First Amendment.

1. The Act Permits Competitive Telecommunications Carriers to Use UNEs to Provide Any Telecommunications Service They Seek to Offer

The BOCs attempt to import a "telephone exchange only" limitation into section 251 that simply does not exist.[100] As explained above, the unbundling obligation of section 251 is not limited to a particular type of telecommunications service. Rather, the statute imposes a legal duty on incumbent LECs to provide requesting carriers nondiscriminatory access to UNEs for the provision of *any* "telecommunications service."[101]

2. Section 706 Does Not Override Section 251

The BOCs attempt to use section 706[102] to override section 251, arguing that section 706(a) allows, and indeed requires, the Commission to forbear from applying the unbundling obligations of section 251 to advanced services such as DSL.[103] According to

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[100] *See* BellSouth Comments at 31.

[101] 47 U.S.C. § 251(c)(3).

[102] 47 U.S.C. § 157 note.

[103] *See* BellSouth Comments at 30 *et seq.*; Qwest Comments at 8-9.

BellSouth, for instance, sections 251 and 706 apply to "two separate and distinct markets": the former applying only to the local exchange "market," and the latter only to the broadband "market."[104]

This argument suffers from three fatal flaws. First, the advanced services offered by the requesting carriers, such as DSL service, clearly fall within the legal definition of "telecommunications service."[105] Because the unbundling obligation of Section 251 expressly applies to network elements used to provide a "telecommunications service,"[106] the Commission has no choice but to consider section 251 when deciding whether an incumbent LEC must unbundle facilities requested by competitive carriers to be used in the provision of DSL.

Second, the Commission has already considered and rejected the BOCs' argument that "section 706(a) constitutes an independent grant of forbearance authority that encompasses the ability to forbear from section[] 251(c)."[107] In reaching this decision, the Commission reviewed "the language of section 706(a), its legislative history, the

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[104] BellSouth Comments at 32.

[105] *See, e.g.*, *Deployment of Wireline Services Offering Advanced Telecommunications Capability*, Second Report and Order, CC Docket No. 98-147, FCC 99-330, ¶ 21 (Nov. 9, 1999); *Association of Communications Enterprises v. FCC*, 235 F.3d 662, 668 (D.C. Cir. 2001).

[106] As WorldCom has previously explained, even if the Commission were wrongly to conclude that incumbent LECs that provide Internet access services are not providing telecommunications services, that ruling would have no effect on the incumbent LECs' continuing obligations under section 251(c)(3) to provide access to bottleneck facilities that competitive carriers intend to use to provide telecommunications and information services. Joint Comments of WorldCom, Inc., the Competitive Telecommunications Association, and the Association for Local Telecommunications Services, CC Docket Nos. 02-33, 95-20, 98-10, at 72-78 (May 3, 2002).

[107] *Deployment of Wireline Services Offering Advanced Telecommunications Capability*, Memorandum Opinion and Order and Notice of Proposed Rulemaking, 13 FCC Rcd 24012, ¶ 68 (1998).

broader statutory scheme, and Congress' policy objectives."[108] These provisions have not changed. In particular, section 10(d) of the Act still expressly forbids the Commission from forbearing from the requirements of section 251(c) "until it determines that those requirements have been fully implemented."[109] No one, not even the BOCs, suggests that section 251(c) has been fully implemented. The Commission therefore should reaffirm its finding that section 706 does not give the Commission an independent grant of authority to forbear from the unbundling requirements of section 251(c).

Finally, the Commission itself has provided dispositive evidence that it is indeed possible, in the words of the *NPRM*, to "balance the goals of section 251 and 706" when considering whether to unbundle network elements used to provide advanced services.[110] To date, the Commission has released three annual reports on the deployment of advanced services, each of which concludes that advanced telecommunications capability is being deployed in a reasonable and timely manner.[111] As these reports make clear, the BOCs' ability to roll out DSL services has not been hampered by their need to comply with section 251(c)(3). To the contrary, as WorldCom explained in its comments, the timely deployment of DSL by the BOCs has in large part been spurred by competition,

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[108] *Id.* ¶ 69.

[109] 47 U.S.C. § 160(d). *See* 13 FCC Rcd 24012, ¶ 72.

[110] *NPRM* ¶ 23.

[111] *Inquiry Concerning the Deployment of Advanced Telecommunications Capability to All Americans in a Reasonable and Timely Fashion, and Possible Steps to Accelerate Such Deployment Pursuant to Section 706 of the Telecommunications Act of 1996,* Third Report, 17 FCC Rcd 2844, ¶ 2, n.4 (2002) ("*Third 706 Report*") (citing First and Second 706 Reports released in 1999 and 2000).

including competition from competitive LECs that rely on unbundled network elements.[112]

3. The BOCs Misinterpret the Eighth Circuit's "Superior Quality" Holding

Verizon claims that the Commission lacks the authority to require incumbent LECs to satisfy competitors' requests that it build new loops or condition existing loops to make them DSL-capable.[113] Verizon bases this assertion on a misreading of the Eighth Circuit's holding that section 251(c)(3) requires unbundled access "only to an incumbent LEC's *existing* network – not to a yet unbuilt superior one."[114] According to Verizon, the Commission is therefore barred from requiring incumbent LECs to build a new loop, add capacity to a switch, place new line cards or electronics on a circuit, provide loop conditioning, or eliminate load coils and bridge taps.[115] SBC takes this argument one step further by claiming that the court's "superior quality" holding should be read to allow incumbent LECs to avoid any obligation to unbundle any "new" facilities.[116]

These arguments are based on a misinterpretation of the Court's decision, however. The phrase "unbuilt superior network" refers to a network that is "unbuilt" at the time the competitor requests access, not one that was "unbuilt" at the time of the 1996 Act.[117] In passing the Act, Congress could not have believed that telecommunications

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[112] WorldCom Comments at 96-100.

[113] Verizon Comments at 62.

[114] *Iowa Utilities Board 1997*, 120 F.3d at 813 (emphasis in original).

[115] Verizon Comments at 63.

[116] *See* SBC Comments at 16.

[117] *See, e.g.*, *Iowa Utilities Board v. FCC*, 219 F.3d 744, 758 (8th Cir. 2000) ("*Iowa Utilities Board 2000*").

networks would remain frozen in time, or, for that matter, that competitors would be denied access to improvements made to the incumbents' networks.[118] Clearly, competitive carriers would be impaired if the incumbent LECs could deprive them of access to technological improvements to the existing telecommunications network. Accordingly, if the incumbent chooses to upgrade its network – building fiber loops and connecting them to its existing network, for example – it must provide competitors with unbundled access to those fiber facilities.[119]

Despite Verizon's attempts to style its ongoing network upgrades as "unbuilt superior" networks, the fact is that the incumbent LECs' modifications to their existing networks have taken place slowly, over a period of years, if not decades.[120] Changes in the incumbent's network are the product of incremental upgrades to the existing copper-based, circuit-switched network. Loop technology, in particular, has changed little over time, going "no further than copper twisted-pair wire and fiber-optic cable in the past couple of decades."[121] The current process of replacing copper with fiber and extending

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[118] In fact, one of the benefits of the Commission's decision to reevaluate its UNE rules periodically is that it provides an opportunity to update the UNE list to ensure that the unbundling obligations keep pace with technology.

[119] Although the Eighth Circuit barred the FCC from requiring incumbent LECs from providing competitors with UNEs superior to those the incumbents provide themselves, the Court made clear that it was *not* freeing incumbent LECs from their statutory obligations to provide competing carriers unbundled access to the network elements that the incumbents use to provide their own services. *See Iowa Utilities Board 1997*, 120 F.3d at 812.

[120] Indeed, as Daniel Kelley points out in his attached declaration, the broadband technologies the BOCs refer to when discussing new services "are hardly new." *See* Kelley Declaration ¶ 34; *see also* Stumbaugh/Reilly Declaration ¶¶ 11-18.

[121] *Verizon v. FCC*, 122 S.Ct. at 1677.

fiber closer to the home began long before the 1996 Act was passed.[122] Had Congress wanted to exempt such upgrades from the Act's unbundling requirements, it certainly could have done so.[123]

Moreover, the Act requires incumbent LECs to provide reasonable, nondiscriminatory access to network elements. As the Eighth Circuit recognized, this obligation includes making "modifications to incumbent LEC facilities to the extent necessary to accommodate interconnection or access to network elements."[124] Loop conditioning epitomizes the kind of "modification" to an existing network that the Eighth Circuit recognized is required under section 251(c)(3). Loop conditioning involves the removal of certain facilities, such as load coils and bridge taps, that interfere with the use of that loop for DSL service, whether provided by the incumbent LEC or by a competitor. Incumbent LECs no longer include load coils or bridge taps on newly deployed loops.[125] A request for loop conditioning is thus not a request for superior access, but merely a

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[122] *See* Covad Comments at 33 (discussing the "expansive amount of fiber already deployed" in the incumbent LECs' networks by 1996.)

[123] *See* Covad Comments at 32 (the fact that Congress declined to incorporate a pre/post 1996 Act distinction in the unbundling requirements demonstrates Congress's intent that the unbundling rules would survive changes in technology).

[124] *Iowa Utilities Board 1997*, 120 F.3d at 813, n.33 (emphasis added) (quoting *Local Competition Order* ¶ 198).

[125] In addition, to the extent that SBC and other incumbent LECs provide loop conditioning for themselves and/or their affiliates, the Act required that they provide it to competitors as well. *See, e.g.*, Interconnection Agreement Under Sections 251 and 252 of the Telecommunications Act of 1996, Between One or More of [the SBC Telephone Companies] and Ameritech Advanced Data Services of Illinois, Inc., Ameritech Advanced Data Services of Indiana, Inc., Ameritech Advanced Data Services of Michigan, Inc., Ameritech Advanced Data Services of Ohio, Inc. [and] Ameritech Advanced Data Services of Wisconsin, Inc., *available at:* <http://www1.ameritech.com/corporate/regulatory/AADSMPart1of2.pdf>.

request for nondiscriminatory access to the same facilities that incumbent LECs now deploy for themselves.

4. Unbundling of Broadband Services Does Not Violate the First Amendment

Like its policy-based claims, Verizon's strained constitutional argument for deregulating wireline carriers' broadband service is wholly unavailing. Verizon offers no legitimate basis for claiming that the continued regulation of wireline carriers under Title II raises any serious First Amendment concerns.

Even if passive broadband transmission somehow transformed service providers into First Amendment "speakers," the "one-sided burdens" on telephone companies purportedly imposed by "the present regulatory regime"[126] would not threaten any constitutional interests. The Supreme Court has made clear that an asymmetrical burden on First Amendment speakers is not constitutionally suspect where, as here, it is does not "threaten[] to suppress the expression of particular ideas or viewpoints."[127] Current regulation of wireline carriers indisputably places no content or viewpoint limitations on the transmission of broadband service; indeed, telephone companies like Verizon can transmit precisely the same broadband content and services as cable companies regulated under Title I.[128] In addition, unlike the must-carry provisions upheld in *Turner*,[129] the

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[126] Verizon Comments, CC Docket No. 02-33, at 27 (filed May 3, 2002).

[127] *Leathers v. Medlock*, 499 U.S. 439, 447 (1991).

[128] In fact, the Act's definition of "telecommunications," which plainly applies to the provision of stand-alone broadband transmission, *see* Verizon Comments, CC Docket No. 02-33, at 9 (filed May 3, 2002), involves the transmission of information "without change in the form or content of the information as sent and received." 47 U.S.C. § 153(43).

[129] *Turner Broadcasting System, Inc. v. FCC*, 520 U.S. 180 (1997) ("*Turner II*") and

supposed "burden" of the present regulatory regime – including the common carrier and unbundling requirements – creates absolutely no interference with the editorial discretion of wireline broadband providers.[130] At most, such regulations need satisfy only rational basis scrutiny,[131] a burden the current common-carrier obligations surely meet.[132]

In essence, Verizon's constitutional argument against asymmetrical regulation of cable and wireline poses a sweeping challenge to the legal framework governing much of the communications services in this country. In fact, regulation of cable and wireline has always been asymmetrical. Cable service is licensed, regulated, and taxed by municipal governments; telecommunications, on the other hand, are regulated by federal and state agencies. Cable companies traditionally have not offered services to the public on a common-carrier basis; by contrast, local telephone companies historically have been

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Turner Broadcasting System, Inc. v. FCC, 512 U.S. 622 (1994) ("*Turner I*") (collectively referred to as "*Turner*").

[130] *BellSouth Corp. v. FCC*, 144 F.3d 58 (D.C. Cir. 1998), cited in Verizon Comments, CC Docket No. 02-33, at 28 n.66, is similarly inapposite. *BellSouth v. FCC* concerned a challenge to a provision of the Telecommunications Act limiting the *content* of information Bell operating companies can provide. *See id.* at 144 F.3d at 60 (rejecting challenge to Section 274 of Act, which limits the ability of Bell operating companies to provide "electronic publishing," a category that includes disseminating news articles, offering literary material, and providing services similar to the Lexis/Nexis and Westlaw databases).

[131] *See, e.g.*, *Leathers v. Medlock*, 499 U.S. at 449-53 (applying rational basis scrutiny and concluding that extension of sales tax "to cable television services alone, or to cable and satellite services, while exempting the print media, does not violate the First Amendment").

[132] Although rational basis scrutiny plainly would apply, continued regulation of wireline broadband service undoubtedly would survive intermediate scrutiny as well. Such regulation serves important interests similar to those recognized in *Turner* – for example, "promoting the widespread dissemination of information" and "promoting fair competition," *see Turner II*, 520 U.S. at 189 (quoting *Turner I*, 512 U.S. at 662). And, because it does not interfere with any editorial decisionmaking, wireline regulation burdens substantially *less* speech than the must-carry provisions upheld in *Turner*.

required to offer their transmissions as a common-carrier service. Were it successful, Verizon's novel First Amendment challenge to differential broadband regulation would seriously undermine the reasonable asymmetry that pervades most communications regulation.[133]

III. ECONOMIC ISSUES

The incumbent LECs and their supporters generally argue that the availability of UNEs at TELRIC-based rates discourages investment and innovation. These are arguments that the incumbent LECs have made for six years before the Commission and the courts, and which first the Commission and now the Supreme Court have rejected because they are simply wrong. As the Supreme Court succinctly explained, "[a]t the end of the day, theory aside, the claim that TELRIC is unreasonable as a matter of law because it simulates but does not produce facilities-based competition founders on fact."[134] The incumbent LECs' claims are, in the end, unsupported by sound economic analysis. As explained below and in the attached declaration of Daniel Kelley, unbundling: (1) is necessary to bring the benefits of local exchange competition to consumers and preserve downstream competition in markets that rely on local exchange

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[133] If anything, Verizon's argument against asymmetrical regulation falls more appropriately under the rubric of the Equal Protection clause. Verizon, however, wisely has chosen not to raise an Equal Protection claim, which, like Verizon's First Amendment argument, would be frivolous. *See, e.g.*, *Board of Trustees of the Univ. of Ala. v. Garrett*, 531 U.S. 356, 366 (2001) (noting that, where legislation does not regulate suspect or "quasi-suspect" classes, "such legislation incurs only the minimum 'rational-basis' review applicable to general social and economic legislation"); *Vacco v. Quill*, 521 U.S. 793, 799 n.5 (1997) (same); *Gregory v. Ashcroft*, 501 U.S. 452, 470-71 (1991) ("In cases where a classification burdens neither a suspect group nor a fundamental interest, courts are quite reluctant to overturn governmental action on the ground that it denies equal protection of the laws.") (internal quotation marks and citation omitted).

[134] *Verizon v. FCC*, 122 S.Ct. at 1675.

inputs; (2) increases the ability of competitive LECs to invest in their own facilities; and (3) creates parallel paths for innovation by enabling multiple companies to use monopoly network resources as the foundation for new products and services. Moreover, as explained below, and in the attached report of Janusz A. Ordover, the best available approach to establishing UNE rates is to set them on the basis of forward-looking long-run economic costs estimated in TELRIC models.

A. The Availability of UNEs Is Critical to Fostering Competition and Realizing the Attendant Benefits of Investment and Innovation

The incumbent LECs argue that competition from companies that use only their own facilities is superior to competition that is made possible by unbundling.[135] In terms of policy goals, it is indeed important to break the local exchange bottleneck through facilities competition, but all competition is good. It is also important to recognize that UNE competition can bring enormous benefits to consumers, as well as foster facilities-based entry. As demonstrated in the HAI Report,[136] and as discussed by Richard Clarke,[137] the significant economies of scale and density that the Commission noted in the *Local Competition Order* have not magically disappeared with the passage of time.[138] As long as these economies are present, unbundling will be necessary to bring at least some of the benefits of competition to consumers.

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[135] *See, e.g.,* Verizon Comments at 25-26; *see also*, Alcatel Comments at 7-8; High Tech Broadband Coalition Comments at 3.

[136] HAI Report, Filed as Attachment A to Comments of WorldCom, Inc. in CC Docket No. 01-338 (April 4, 2002).

[137] Clarke Declaration (Attachment B to AT&T Comments).

[138] Kelley Declaration ¶ 13 (citing *Local Competition Order*, 11 FCC Rcd 15499, ¶ 11 (1996)).

In the process of extolling the virtues of end-to-end facilities competition, the incumbent LECs and their economists give short shrift to the benefits derived from the competition that unbundling enables. In a declaration filed as an attachment to the comments of BellSouth, SBC and Verizon, Howard Shelanski claims that the benefits from UNE-based competition are limited to the small amount of value-added associated with retailing local service. That is false.[139] The retailing function that Shelanski disparages is quite significant; competition in retailing improves consumer welfare. Competition for retail regulated local telephone service also will help ensure that competition for unregulated downstream services remains robust. In a world in which services are increasingly bundled, it is important that consumers have a robust choice of retail suppliers. This will help preserve competition for downstream services such as Internet access, long distance and vertical services (*e.g.*, voice mail). Moreover, the ability to add value to unbundled network elements can serve as a platform for innovation. DSL services were introduced to a significant portion of the population not through incumbent LEC retail offerings but through the offerings of the competitive data LECs that combined unbundled loops with their own facilities (such as DSLAMs and ATM switches) to provide DSL services. Absent unbundling, this would not have happened. As monopolists, the incumbent LECs actually have incentives to restrict valuable uses of their networks.[140] Finally, the availability of UNEs reduces barriers to entry for facilities-based competitors. As the Supreme Court noted, "a policy promoting

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[139] *See* Kelley Declaration ¶¶ 4-9.

[140] For instance, the incumbent LECs have used HDSL for T-1 offerings, but have not used it for retail offerings.

lower lease prices for expensive facilities unlikely to be duplicated reduces barriers to entry (particularly for smaller competitors) and puts competitors that can afford these wholesale prices (but not the higher prices the incumbents would like to charge) in a position to build their own versions of less expensive facilities that are sensibly duplicable."[141] As competitive LECs acquire customers through unbundling, they can establish a business case for deploying additional facilities of their own.

It is telling that the incumbent LECs and their economists are the most vocal cheerleaders for facilities competition. By making their networks available on reasonable terms to competitive LECs, it would seem that they could retain better control over their core monopoly. Their reluctance to do so suggests that they recognize that:
(a) unbundling reduces barriers to entry by competitors that use only their own facilities and enhances downstream competition; and (b) end-to-end facilities competition is very difficult, and therefore not a tremendous short-run threat to their revenue streams.[142] The incumbent LECs' evident goal is not to encourage facilities-based competition, but to squelch competition altogether.

The incumbent LECs nevertheless insist that unbundling requirements reduce both incumbent LECs' and competitive LECs' incentives to invest.[143] These points were addressed in detail in the HAI Report. Withdrawal or overpricing of UNEs will not encourage competitive LECs to build facilities that they would otherwise not build. If it is not economically sensible to enter by constructing facilities, then competitive carriers

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[141] *Verizon v. FCC*, 122 S.Ct. at 1668, n.20.

[142] Kelley Declaration ¶ 17.

[143] *See, e.g.,* BellSouth Comments at 12; Qwest Comments at 52-53; SBC Comments at 26.

will not enter.[144] As noted above, denying competitive LECs the opportunity to use elements of the incumbent's network only reduces the incentive and ability of competitive LECs to invest in their own facilities.[145]

Some BOCs and their supporters argue that the FCC should not require unbundling for "green field" investment[146] or new broadband facilities,[147] claiming that any competitor can make a similar investment. Real "green field" investment is extremely rare, however. A new residential or commercial area, unless it is located on some remote island that does not currently have telephone service, is not truly a green field, but is likely to be located near existing plant of the incumbent LEC. The incumbent LEC's ability to extend lines from existing plant enables it to take advantage of the economies of scale that are the basis for the unbundling requirements.

Similarly, WorldCom disagrees with HTBC's claim that "ILEC investment in new, last mile broadband facilities does not constitute a legacy advantage because any competitor could make a similar investment."[148] It is simply not true that a competitor seeking to offer broadband services is in the same position as the incumbent. Competitive carriers offering DSL services use their own facilities wherever they can, but nearly always rely on the incumbent LEC's loop for the last mile.[149] As the Supreme Court noted, "[a] newcomer could not compete with the incumbent carrier to provide

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[144] Kelley Declaration ¶ 18.

[145] HAI Report at 88-90.

[146] SBC Comments at 19; Alcatel Comments at 16.

[147] HTBC Comments at 37.

[148] HTBC Comments at 37.

[149] *See* Graham Declaration ¶ 28.

local service without coming close to replicating the incumbent's existing network, the most costly and difficult part of which would be laying down the 'last mile' of feeder wire, the local loop."[150] The fact that the loop is used for DSL instead of, or in addition to, voice services, does not change the basic problem for new entrants.

The incumbent LECs claim that their incentives to invest are reduced because selling to competitive LECs allegedly exposes them to stranded plant when the competitive LECs build their own facilities or if the competitive LECs do not use the capacity created for them. There is, of course, risk and uncertainty associated with competition. However, as discussed below, the pricing of UNEs can accommodate these factors.[151]

It must be noted that, while the incumbent LECs have been claiming that they are subject to competitive risk for many years, they have continued to invest in their networks, and indeed accelerated those investments after passage of the Act.[152] Building modern, up-to-date networks is likely the best way to handle such risk.[153] Finally, the BOCs ignore the substantial benefits conferred upon them by the 1996 Act. In exchange for opening their networks, they are being allowed to offer interLATA services originating within their own territories, and thereby earn higher revenues. This benefit

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[150] *Verizon v. FCC*, 122 S.Ct. at 1662.

[151] *See* Ordover Report at 28-29; Kelley Declaration ¶ 25. As also discussed below, the incumbent LECs would face various risks – including the risks of stranded or underutilized facilities – even if competitive LECs were not given the right to lease UNEs at TELRIC rates.

[152] Kelley Declaration ¶ 33 (citing HAI Report pp. 96-97).

[153] *Id.*

must be weighed against the risk associated with unbundling, but none of the incumbent LECs' economists mentions this fact.[154]

A related incumbent LEC theme is that unbundling deters innovation.[155] WorldCom addressed this point in its Broadband Non-Dominance Reply Declaration.[156] In general, the incumbent LECs' economists make abstract arguments about the benefits of innovation without looking fully into the nature of the technology and without considering the economic conditions that will best facilitate innovation. For example, Kahn and Tardiff worry about applying regulation to new services[157] while failing to recognize that broadband technologies to which they refer are not new at all. The empirical evidence shows that monopolists, and particularly telecommunications monopolists, have a generally poor history of performance in the area of innovation. Unbundling will create parallel paths of innovation by allowing multiple firms to use the monopoly network resource as the foundation for new products and services.[158]

The BOCs' economists also claim that unbundling is expensive.[159] For example, Shelanski argues that Project Pronto has been hampered by the expense associated with complying with unbundling requirements.[160] No evidence, however, is provided to support Shelanski's allegation that hundreds of millions of dollars are necessary to

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[154] *Id.*

[155] *See, e.g.,* BellSouth Comments at 12; Verizon Comments at 27-29; 35-36.

[156] Declaration of Daniel Kelley, CC Docket No. 01-337, Attachment A to WorldCom Comments (filed March 1, 2002).

[157] Declaration of Alfred E. Kahn and Timothy J. Tardiff, attached to Verizon's Comments.

[158] Kelley Declaration ¶ 35.

[159] *See, e.g.,* SBC Comments at 15.

[160] Shelanski Declaration ¶ 36.

comply with unbundling requirements.[161] Moreover, this allegation is contradicted by SBC's own assertion that Project Pronto will pay for itself in maintenance savings.[162] In any event, the costs of unbundling are legitimately included in the TELRIC of an unbundled network element.[163] It makes eminently good public policy sense to recover certain one-time or set-up costs from the broad group of consumers of the services that will be provided using the facilities. Finally, the BOCs have a long history of making arguments about technical unfeasibility and high compliance costs to oppose opening their businesses to competition. The pre-divestiture Bell system argued that equipment and long distance competition were technically unfeasible and that equal access was impossible to achieve. History demonstrates that their real motives were to protect their monopoly positions against competitive threats.[164]

Another theme in the incumbent LECs' comments is that regulation is bad *per se*. Most economists agree that regulation, including unbundling regulation, imposes costs. But this is where the incumbent LECs' analysis ends. Both economic theory and history show that once established in a network industry, monopoly endures. Affirmative government action is often necessary to allow normal market forces to proceed. The enhanced services, customer premises equipment (CPE) and long distance businesses are all good examples. In each case, interconnection, unbundling and equal access rules were

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[161] Kelley Declaration ¶ 41.

[162] *See* SBC Investor Briefing at 2 (Oct. 18, 1999), *available at*: <http://www.sbc.com>; *see also* discussion below at section IV.A.3(d)(4).

[163] Kelley Declaration ¶ 38.

[164] *Id.* ¶ 43.

required to establish competition. In each case, deregulation was made possible because of the regulation.[165]

An unstated incumbent LEC criticism of unbundling regulation is that it will fail because it is impossible to make the incumbent LECs do what is not in their self-interest – *i.e.*, reduce barriers to entry by cooperating with competitors through unbundling. The 1996 Act includes provisions designed to address with this problem. Specifically, the long distance "carrot" offered by section 271 was supposed to induce the incumbent LECs' cooperation. It should by now be obvious to the Commission that the carrot was not sufficiently enticing to induce the donkey to move, however. By allowing the BOCs into the long distance business (and approving mergers with conditions that the BOCs had no intention of honoring), the Commission has wasted opportunities to fully implement the goals of the Act. But this does not mean that unbundling is hopeless. Given the incumbent LEC litigation-induced delays in implementing unbundling, it is still early in the process. CPE unbundling and interconnection worked because a simple and enforceable interface was developed. Loop unbundling may yet prove to be susceptible to the same dynamic. Reaffirmation of the goals of the Act and active enforcement of the tools provided by the Act are required if the incumbent LECs' reluctance to comply with their regulatory obligations is to be overcome.[166]

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[165] *Id.* ¶ 44.

[166] Kelley Declaration ¶ 56.

B. TELRIC Is the Best Methodology Available

The final theme in the incumbent LEC arguments is that TELRIC-based rates are inappropriate for setting the prices of unbundled elements.[167] The incumbent LECs are wrong as a matter of law,[168] and as a matter of economics. The Supreme Court has now resolved the legal issues by approving the TELRIC methodology and dismissing arguments against it made by incumbent LECs. In his attached Report, Professor Janusz A. Ordover describes why the Supreme Court's conclusion is a sound one from an economic perspective. Ordover explains that forward-looking pricing allows competitors to benefit from the incumbents' economies of scale and scope in the shared facilities, offers proper signals for investments in the network, and allows new entrants to build a customer base that ultimately could lead to more competition. As the Supreme Court noted, new entrants "have invested in new facilities to the tune of $55 billion" between 1996 and 2000, and the "FCC's statistics indicate substantial resort to pure and partial facilities-based competition. . . ."[169] At the same time, TELRIC-based pricing ensures that the incumbents retain the incentive to invest in their networks and earn a reasonable rate of return on their assets.[170] In contrast, allowing the incumbent LECs to charge prices of their own choosing (euphemistically termed "actual costs" by the incumbents) is equivalent to allowing them to refuse to unbundle in the first place.

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[167] *See, e.g.,* Qwest Comments at 3-4; Verizon Comments at 32-33.

[168] *See Verizon v. FCC.*

[169] *Id.*, 122 S.Ct. at 1675.

[170] *See id.* at 1676, n.33.

1. The TELRIC Pricing Methodology is Grounded in Sound Economics

TELRIC is based on the universally accepted principle that the "economic" cost of a facility is the cost of replicating the facility's functions using the most efficient technology presently available.[171] No one seriously disputes that the marketplace values assets at this forward-looking replacement value, or that a firm will recover no more than the full economic costs of its operations in a fully competitive market. An appropriate application of TELRIC ensures a recovery of all pertinent forward-looking economic costs. Just as retail rate regulation is designed to mimic a competitive market rate, so too should wholesale prices mimic the prices that would prevail in the face of competition.[172]

In particular, and contrary to claims that have been made by some critics of TELRIC, the TELRIC costing and pricing methodology allows for a full recovery through UNE prices of a reasonable risk-adjusted return on capital and a reasonable share of common costs. TELRIC presents a comprehensive cost estimate that includes all of the incremental fixed and variable costs of constructing and operating an efficient telephone network at a wholesale level, including the cost of capital, depreciation, and the impacts of fill factors (how much capacity will be used over time).[173] To estimate the forward-looking cost of a telecommunications network, engineering-economic models, such as the FCC's Synthesis model and the HAI model, are used to determine the quantities of service demanded and the locations at which demand must be served. Once the locations to be served are determined, the models use algorithms that mimic the

[171] Ordover Report at 10.
[172] *Id.*
[173] *Id.* at 11.

process followed by telephone company engineers in designing and engineering the telephone network. The current TELRIC models produce estimates of the cost of each component of an efficient network, designed to serve current demand at current customer locations, using engineering and economic techniques similar to those employed by telephone company engineers in designing "real world" networks. TELRIC models are open in the sense that all of the data inputs and calculations are exposed to public scrutiny.[174]

TELRIC produces conservative estimates of the cost of each component of an efficient network because it "does not assume a perfectly efficient wholesale market or one that is likely to resemble perfection in any foreseeable time."[175] Instead, by assuming the placement of existing incumbent LEC wire centers, by modeling only currently available equipment, and by leaving prices static for three or four years, TELRIC contains certain built-in rigidities that assure that TELRIC-based rates are above those that would exist in a frictionless, perfectly competitive market.[176] Because TELRIC models do not assume that costless and perfect adjustments can be made to changing conditions, there is no merit to the incumbent LECs' argument that TELRIC rates are too low either to encourage competitors to construct their own facilities, or to fully account for the incumbent LECs' real costs of capital.[177]

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[174] *Id.* at 13-18.

[175] *Verizon v. FCC*, 122 S.Ct. at 1669.

[176] *Id.* at 1669-70; Ordover Report at 22.

[177] *Verizon v. FCC*, 122 S.Ct. at 1668-69; Ordover Report at 33-38.

There is likewise no merit to the incumbent LECs' argument that TELRIC is flawed because it makes use of "hypothetical" or "fictionally ideal" networks.[178] To be sure, TELRIC, like any sound economic model, relies on certain simplifying assumptions that render the model useful to regulators.[179] Far from relying on "fictional" assumptions or data, however, TELRIC remains firmly grounded in real network operations. As Ordover explains, TELRIC models make use of real-world inputs and engineering assumptions, much of it provided by the incumbent LECs themselves, including demand and network architecture.[180] Moreover, the embedded cost models that the incumbents favor are every bit as complex as TELRIC models, rely every bit as much on simplifying modeling assumptions, and would engender precisely the same kinds of "battles of the experts" that are a feature of any contested cost case.[181]

2. The TELRIC Pricing Model Includes Proper Assumptions Regarding Depreciation and Risk

Professor Ordover explains in his report why the forward-looking TELRIC pricing model is currently the best methodology available for determining prices for unbundled network elements. As the Supreme Court concluded, setting prices on the basis of TELRIC offers the best way to balance the goals of competitive entry and the legitimate needs of the incumbents to earn economic returns in efficient investments.[182] The incumbent LECs' criticisms of TELRIC do not withstand scrutiny. In particular, the incumbent LECs repeatedly ignore or mischaracterize the extent to which existing

[178] *See* Verizon Comments at 58; SBC Comments at 34.
[179] Ordover Report at 23.
[180] *Id.*
[181] *Id.*
[182] *See id.* at 7-8.

TELRIC models permit proper allowances to be made for economic depreciation and risk.

According to the incumbent LECs, TELRIC models set unfairly low rates based on the assumption that competition would drive rates to costs that would be incurred by a carrier that installs the newest and most efficient technology that is currently available.[183] This criticism ignores both a fundamental feature of market-driven pricing and the role of depreciation in TELRIC models. In competitive markets, all firms are forced to price at the level of an efficient new entrant, regardless of when they built their facilities and regardless of what technology they are using. As the Supreme Court observed, a merchant is likely to charge its customers current market prices for its inventory, regardless of the prices at which that inventory was acquired.[184] For example, the eBay price of a two-year-old laptop is not determined by the purchase price of that laptop, but by the price of a new and comparable laptop.[185] Although firms do not change their equipment every time technology or input prices change, they do change the prices they charge in recognition of the fact that competitors using the new technology would take away their customers if they did not do so.[186]

a) Economic Depreciation

Contrary to incumbent LECs' arguments, the TELRIC models in use today do in fact properly reflect economic depreciation. That is, they assume that the value of equipment declines both because of wear and tear, and also because newer, more efficient

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[183] *E.g.*, Verizon Comments at 58.

[184] *Verizon v. FCC*, 122 S.Ct. at 1666.

[185] Ordover Report at 20.

[186] *Id.* at 21.