NORTEL NETWORKS
TELECOM PUBLIC POLICY POSITION

About Nortel Networks: Nortel Networks is an industry leader and innovator focused on transforming how the world communicates and exchanges information. The company is supplying its service provider and enterprise customers with communications technology and infrastructure to enable value-added IP data, voice, and multimedia services spanning metro-and-enterprise networks, wireless networks, and optical long-haul networks. Nortel Networks is a global company, doing business in more than 150 countries.

Background: Telecommunications was a driving force behind the rapid economic growth of the late 1990s. Between 1996 and 2000, the telecom sector grew at twice the rate of the U.S. economy and, during the first quarter of 2001, telecom share of GDP had risen to almost six percent.

While the economic growth of the late nineties was to a great extent telecommunications driven, by the same token, the economic downturn of the early 2000s in large part is a consequence of the unprecedented collapse of the telecom sector. There have been over 60 bankruptcies to date and surviving companies are carrying a collective debt load of nearly one trillion dollars. Half-a-million people in the industry have already lost their jobs and two trillion dollars have been lost in market capitalization. New investment capital, vital for innovation, has been reduced significantly with consequences not only for telecom but for business investment generally and for economic growth in the U.S. and other global economies.

The New Dynamics: Telecom appears to be confronted with a “new normal.” After nearly a century, the rate-of-return era and mindset are over. The days of a guaranteed rate of return and the liberal spending and benefits that mindset created are assuredly a thing of the past. The days of "build it and they will come" are gone. From now on, the “every dollar counts” model is in the ascendant, and current regulatory pricing regimes are inconsistent with the new model.

One inescapable conclusion is that we can no longer have artificial competition kept on life support by a telecom regulatory system that has created competitors at the expense of competition. Government price mandates have drained profits from the sector’s strong players by handicapping the ILECs in the interest of subsidizing new entrants. ILECs are compelled to sell their assets for less than they paid for them in perpetuity as per the TELRIC and UNE-P regime. The cold, hard fact is that without the ability to earn a decent return on investment, the ILECs will be forced to pull back the resources they have committed to the sector.

How to Revive the Sector: It is widely recognized that the key to reviving the telecom industry is stimulating the growth and rollout of the broadband connections that are widespread in business but have only incrementally made their way into consumers' homes.

- Unleashing broadband would spark investment in hardware, software, and infrastructure, with a dramatic impact on the nation's long-term economic growth and its ability to compete on the global stage.

Today's Climate for Investment: Telecommunications infrastructure is costly to the carriers deploying it and the equipment suppliers creating the technology.

- Nortel Networks commits more than $2 billion annually in creating technological innovation, an investment that's predicated on the success of our customers.
- Investors will not fuel the next telecommunications investment cycle unless service providers and equipment suppliers can demonstrate viable business cases.
- Telecom service providers will not invest in infrastructure when regulatory burdens adversely affect the viability of business cases and shareholder return on investment.
- Without such investment, the equipment suppliers and solutions providers that create innovation will be unable to sustain their research-and-development efforts. The present unbundling and pricing rules result in disincentives to investment on both sides of the issue---for ILECs because they're required to unbundle and for CLECs because they have much to gain by waiting for ILECs to construct facilities instead of building their own.

A Vicious Cycle: Like every other business, carriers need the freedom to earn a market-based return on their investment.

- Unreasonably low, regulated pricing of network elements by definition prevents a market-based rate of return, inevitably resulting in less infrastructure investment.
- This, in turn, leads to less spending with technology suppliers, which leads to less money available for technology companies to invest in developing new technology, resulting in a negative impact on innovation.
- Productivity and the overall economy are adversely affected.
- This is the vicious cycle we are facing today.
- This cycle must be interrupted.

A Matter of Global Competitiveness: There is a great deal of urgency to interrupting this cycle and proceeding with a new regulatory regime.

- US economic expansion of the late twentieth century was largely powered by investments in research and development, especially in information technology.
- The sector that led that growth and productivity depends on upgrades to the telecommunications infrastructure to serve as the highway to global economic prosperity in the twenty-first century.
- It is imperative that we remove disincentives to technology investment in order for the U.S. to continue to demonstrate leadership in the global economy.

A Rational Investment Environment: We request the support of government to create a telecommunications policy that restores the health of the sector by creating a proper and rational investment environment that recognizes new realities.

- In today's post-bubble environment, getting regulation right is more important than ever.

OUR POLICY RECOMMENDATIONS

We advocate policies that reflect the following principles:

1. **Marketplace competition is good for consumers, service providers, solutions providers, and the general economy.**

2. **In the provision of telecommunications services, facilities-based competition should be the ultimate policy goal.**
   - Facilities-based competition provides consumers with a choice of providers and ensures market-based pricing of services.
   - Facilities-based competition also encourages infrastructure investment by carriers and incentives for technology innovation by solutions providers and equipment suppliers.
   - Facilities-based competition enhances homeland security by providing multiple facilities options.

3. **Government policies should emphasize appropriate regulation that is equitable, minimal, and certain.**

Equity

- Government policies should be technologically neutral, rather than try to pick winning and losing technologies.
- Current FCC rules on the unbundling of local networks and the pricing of unbundled network elements have a negative impact on infrastructure investment.
- The FCC must ask itself whether the unbundling of each network element is encouraging investment and innovation and whether it is rationally related to the goals of the *Telecom Act* and the transition to facilities-based competition.
- Consistent with the goals of the Telecom Act, Nortel Networks recommends that current UNE/UNE-P users be required to transition to facilities-based investments

through the use of a sunset mechanism of the FCC's current regulatory regime that would provide certainty to the UNE-based carriers and their customers while providing clarity to the UNE providers in terms of assessing returns on their investments.

- Current state and federal pricing policies are uneconomic and serve as a deterrent to facilities-based investment.
- The decision to provide telecommunications services on leased infrastructure rather than providing them based on the providers' own investment in infrastructure should be financially neutral and not driven by artificially low prices imposed by regulators to jump start competition.
- UNE/UNE-P users must transition to facilities-based competition in accordance with the goals of the *Telecom Act*.
- The FCC should, however, avoid flash cut changes, determine the length of transition and ensure that it takes into account the needs of UNE providers, UNE users, and consumers of UNE based services.

Minimal Regulation

- A legacy regulatory framework should not be applied to new technologies.
- Nortel Networks recommends that the current UNE, UNE-P, and TELRIC pricing regime not be applied to new infrastructure investment.
- Current FCC rules generally declining to unbundle packet switching on the basis of furthering the Telecom Act's goals of encouraging facilities-based investment and innovation should be extended to recognize the distinction between packet networks delivering next-generation services and circuit-switched networks delivering telecommunications services.

Certainty

- Clear rules are imperative in order to build and sustain viable business cases.
- Regulatory uncertainty inhibits rational investment decisions.

4. Considering the crisis in the telecommunications sector, regulatory policies need to be adopted carefully and as expeditiously as possible.

- Such policies should be carefully considered and drafted to enable it to withstand the inevitable court challenges that increase uncertainty.