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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

Via Electronic Filing
Ms. Marlene H. Dortch
Secretary
Federal Communications Commission
445 12" Street, SW, Room TWB-204
Washington, DC 20554

Re: Ex Parte – CC Docket Nos 01-338, 96-98, 98-147 In the Matter of Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers

Dear Ms. Dortch:

Y[illegible] [illegible] James W. Cicconi, General C[illegible] and [illegible] Vice President Law & Government Affairs, [illegible]itted the following letter to Federal [illegible]ti[illegible] [illegible]ss[illegible]on [illegible] [illegible]l K. [illegible], Commissioners Kathleen Q. Abernathy, Mi[illegible]l J Copps and Kevin J. Martin. Please include a copy of this correspondence in the record of the referenced proceedings

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Robert W. Quinn Jr.

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FEDERAL COMMUNICATIONS COMMISSION
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November 13, 2002

The Honorable Michael K. Powell
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The Honorable Kathleen Q. Abernathy
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The Honorable Kevin J. Martin
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Re: In the Matter of Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers, CC Docket Nos. 01-338, 96-98 and 98-147

Dear Mr. Chairman and Commissioners:

In their filings in the referenced proceeding, the Bell Companies have sharply framed the issues before the Commission, dramatically underscoring the ramifications of adopting the incumbents' positions. Indeed, the Bells' proposals and the consequences they foretell make clear the necessity for rules that provide for broad unbundling of network elements in order to promote both competition and investment throughout the telecommunications industry. The choice posed in this proceeding is stark: the Commission can either continue down the road toward all distance competition in the manner and spirit envisioned by the Telecommunications Act of 1996, or it can, as the Bells urge, try improperly to find ways to eliminate the multi-modal competitive model envisioned by the Act and substitute its agenda for the judgments made by Congress nearly seven years ago.

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The incumbents' proposals have four main components. First, they would promptly end competitors' access to unbundled switching and the UNE Platform (UNE-P), which, given the significant impairments CLECs face in the local market, has been **the** principal vehicle for bringing local voice competition to mass-market residential and **small** business customers. Second, they would deny access to facilities essential to enable CLECs to provide competitive broadband services, which are increasingly demanded by consumers. Third, they would generally deny access to high capacity loop and transport UNEs that competitive carriers **use** to provide telecommunications services to medium and large business customers, requiring **carriers** instead to purchase special access services from the **Bells** that are often up to twice as expensive. And finally, they would preempt State commissions – which the Act establishes as key protectors of local competition in their respective jurisdictions -- from mandating any greater unbundling in their **own** markets. In short, adoption of the **Bell** proposals would materially and negatively impact every single customer class being served by CLECs today and in the future. Indeed, for a large segment of the populace, those proposals would eliminate competitive alternatives entirely. AT&T, for one, would have no alternative but to abandon virtually all of **the** approximately ***2.5*** million residential and small business lines it currently **serves** over UNE-P, and both CLEC customers and ILEC customers would lose the benefits that the existence of competition brings to the marketplace.

The **Bell** rhetoric is nothing short of an attack on **the** framework of the Telecommunications Act itself. Having practically achieved all of the benefit that the *Act* provided to the **Bells** – entry into the long distance markets with the potential for billions of dollars in incremental revenue – the **Bells** now seek to reverse **the** Act's requirement that they lease access to their local networks so that local and all distance services **can** become as competitive as long distance services before them. If the Commission elects to go down the road the Bell companies prescribe, it must do so **with** the full knowledge that such action would be a complete, unlawful repudiation of the Act and its competitive goals.

The Act's fundamental goal is to eliminate local and long distance silos and create a competitive environment where customers have multiple choices of providers that sell local, long distance, and all distance services. The framework Congress established reflected the Nation's experience in the long distance marketplace, in which the Commission established resale requirements (with significant discounts available to competitors) and an automated customer migration PIC process that resulted in ***both*** facilities-based competition ***and*** the vibrant wholesale market that exists today. In fact, when the Bell companies enter the long distance market, they do so largely through resale of long distance facilities obtained at steep wholesale discounts – *not through facilities* ***investments.*** The all distance marketplace envisioned by the Act is one in which ILECs and CLECs alike would participate by leasing facilities from their competitors for a portion of their offering and self-providing facilities where it is economically rational to do so. Indeed, all telecommunications carriers provide services in a similar manner. **Wireless** carriers, cable companies, and hundreds of other carriers compete in **the** marketplace by self-providing facilities where **they** have them and leasing other carriers' facilities where they don't. Under the **Bell's** view, all of this competition would have to be dismissed as "synthetic." In reality, however, that is the exact progression towards competitive markets envisioned by the Act.

The same policies that enabled long distance competition were the very foundation for the 1996 Act, which created three entry paths for competitors seeking to compete in the all distance world – facilities builds, UNEs, and resale. The very language of the Act recognized that competitive carriers could not replicate the incumbents' local facilities nationally overnight, just as new long distance competitors were not able to replicate AT&T's national network overnight. The Act was based on the core understanding that competitors would require access to incumbent facilities at cost-based rates in order to compete with the entrenched local monopolies and it is that fundamental tenet that the Bell companies would have this Commission repudiate here. The Act also required non-discriminatory access to local network facilities, just as the equal access requirement before it created a non-discriminatory customer acquisition and provisioning process in the long distance market.

In the end, the Bells' rhetoric is designed to lead the Commission down the path of eliminating the one local entry mechanism that affords competitors the local equivalent to equal access necessary to compete for mass-market residential and small business customers – the UNE-Platform. In the years immediately after the Act was passed, while the **Bells** kept the **bulk** of the Act (and especially UNE-P) tied up in litigation, residential and small business customers saw virtually no competitive alternatives emerge precisely because CLECs faced significant economic impairments in their attempts to address those markets using a facilities-based strategy. Yet the incumbents continue to assert that the presence of CLEC switches alone means that CLECs can effectively serve small business and residential customers, and the elimination of access to the local switching UNE (and UNE-P) would therefore not impair mass-market competition.

But the undisputed facts developed in this proceeding establish that CLECs seeking to connect customers' loops to a CLEC switch inherently incur substantial costs (due to hot cut and backhaul processes and costs) that the incumbent does not, and that CLECs incur significantly higher unit costs than the incumbent over whatever percentage of the market they serve. These cost penalties, together with the degraded service quality associated with the manual hot cut process, erect absolute economic barriers to the provision of mass-market services to small business and residential customers through the use of unbundled loops and self-provisioned switches. By contrast, the only customers that can be economically served through these manual arrangements are generally high volume customer locations served by DSI and higher capacity local loops, and competitive local switches today overwhelmingly serve only those high capacity loops. Indeed, those are the only customer segments that saw any significant competitive alternatives before UNE-P became available.

Recently, however, meaningful opportunities for mass-market competition have emerged through the use of UNE-P. By the end of the year, almost 11 million residential and small business lines will be served by carriers utilizing UNE-P. And these customers are not located only in the high-density urban zones, but they are spread across the market including suburban and rural areas. By SBC's own count, CLECs serve over 1 million lines in the least dense **zone** in SBC's temtory alone.' As a result, residential and **small** business customers are beginning to see the competitive benefits long promised but long denied **after** the Act's passage.

Make no mistake, this competition, along with the lower rates and greater choices it has spawned, will disappear if **UNE-P** is eliminated. AT&T will be unable effectively to **serve** residential and small business markets in the face manual hot cut processes, and **will** be relegated primarily to serving large business customers at the DS1 level **or** above. Indeed, if CLECs are prevented from serving the small business and residential markets, all consumers -- from large business customers to single line rural customers -- will see fewer competitive companies offering alternatives **as the** eroded CLEC customer bases make it more difficult for CLECs to scale their businesses and maintain and expand their competitive presence. And by eliminating AT&T and other CLECs as viable local competitors in the residential and **small** business markets, **the** Bells will also achieve insuperable advantages in the all distance market – the very reason why they were denied entry into the long distance business in the first place.

AT&T has already filed an extensive package of data and economic, legal and policy analyses that highlights the impairment issues and points to the inescapable conclusion that **UNEs** generally, and **UNE-P** in particular, must be retained **until the** Commission resolves the last-mile connectivity and related economic problems that continue to impair competitors' ability to provide the telecommunications services **they** seek to **offer.** This letter reviews this material, but first it addresses why the incumbents' proposal that the Commission preempt the State commissions from maintaining **UNEs** and **UNE-P** is as unlawful as it is bad public policy. Indeed, because States are in the best position to assess these issues, section 251(d)(3) expressly bars the Commission from adopting regulations that preclude enforcement of State unbundling requirements that are in ***addition*** to those that the Commission adopts and reflect the States' views of how best to promote the local competition that is the purpose ***of*** the **Act.**

Next, the letter discusses the record evidence demonstrating that there exists no conflict between unbundling and facilities investment. The development of local competition based on UNEs is beneficial in itself, whether or not it leads to additional investment. But six years of marketplace experience now confirm that UNE-based competition ***also leads io*** greater investment.

Finally, this letter discusses, in detail, AT&T's proposal for analyzing impairment consistent with both the Supreme Court's decision in ***Verizon***[2] as well **as** the D.C. Circuit's decision in *USTA.*[3] In the end, the factual, legal, engineering and economic evidence presented in this record all point to the same result: UNE-P is as essential to competition in the mass-market small business and residential arena **as** wholesale long-distance networks are to the competitive long-distance market. To eliminate access to the former

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[1] **SBC *Ex Parte* (October *30, 2002).***

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

[3] ***United States Telecomm. Ass'n. v. FCC, 290*** **F.3d 415 (D.C. Cir. 2002)**

for CLECs, while allowing the incumbents continued access to the latter would **serve no** purpose but the creation of four enormous all distance wireline monopolies, **setting** telecommunications policy in this Nation back a quarter century and ensuring the need for broad-scale local monopoly regulation for years to come.

State Unbundling Requirements May Not Be Preempted

Recognizing that State commissions vigorously support the broad availability of UNEs and firmly agree that UNE-P is essential to competition for both residential and small business customers: the incumbents' proposal to preempt the states is simply lawless. They contend that the Commission should not only revise its own rules in their favor, but also should preempt State commissions from maintaining or expanding UNE requirements under both Federal and State law. This claim squarely violates the **Act** and defies simple common **sense.**

The issue here is whether there can be ***local*** competition with the incumbents, and while there is a clear federal interest in this matter, State commissions have jurisdiction over these issues as well. In fact, they have exclusive jurisdiction to regulate **the** retail rates, terms, and conditions of the incumbents' local services, and they prescribe whether and to what extent particular ILEC rates provide or receive subsidies. And **just** as critically, the CLECs' ability to provide competitive service depends on the economic and engineering conditions applicable to each local service **office.** States are simply in **a** far better position than the Commission to determine the need for **UNEs** at particular prices in particular places and the effects of access to unbundled network elements **on** competition, on investment, and **on** incumbents.

The **Act** was enacted against the background of the efforts of several States to adopt regulations that would allow local competition to develop, and it expressly relies upon State commissions to implement the federal mandates in accord with local conditions. Under the **Act,** the Commission adopts federal regulations that provide minimum national standards which all incumbents must meet, but the State commissions set UNE rates, apply the federal standards to local conditions, and adopt those additional State law requirements that they believe are necessary and appropriate to allow local competition to **flourish.**[5] By statute, State determinations under the **Act are** *not* reviewed by the Commission, but by a federal district court in that State6

Because of the States' expertise and superior knowledge of local conditions, the Commission's prior regulations have specifically authorized State commissions to apply the "necessary" and "impair" standards and to require incumbents to provide access to

[4] NARUC **UNE-P** Resolution (adopted Nov. 14,2001) (attached to letter from Joan Smith *et al.* to Chairman Powell and Commissioners Abernathy, Copps and **Martin,** CC **Docket** No. **96-98** (December 5,2001)).

[5] 47U.S.C. §§ 251(a) – (d).

[6] *Id.* § 252(e)(6).

UNEs beyond those the Commission has established as national minima. Notably, even when the unbundling requirements of specific Commission regulations were invalidated on direct review by federal appellate courts on the ground that they were unauthorized by $251, the courts held that States can impose the same or greater requirements under state **law.**[7]

But the decisive fact here is that § 251(d)(3) of the Act expressly ***burs*** any attempt by the Commission to adopt regulations that preempt States from adopting unbundling requirements beyond those that the Commission has imposed. This section provides that, in adopting its regulations, the Commission cannot preclude enforcement of any State access and interconnection regulation, order, **or** policy that is "consistent with **the** requirements of Section 25 1" and does not "substantially prevent implementation of the requirements of [§ 251] and the purpose of **[§§** 251-2611 of the Act."

Thus, even if the Commission were to adopt federal regulations that impose lesser unbundling requirements, State rules that require access to UNEs and UNE-P are preserved from preemption. Such measures are obviously consistent with the pro-competitive requirements of § 251 and do not substantially impede their implementation, for additional unbundling requirements neither prohibit nor impede the implementation of the unbundling requirements of **§** 25 1. Rather, they merely require ***additional*** measures that the incumbent must take under state law and for which the incumbent is fully **paid.** It is elementary that where it is "possible to comply with the state law without triggering federal enforcement action," the state requirement "is not inconsistent with federal **law."**[8]

Similarly, State rules that adopt UNE and **UNE-P** unbundling requirements **do not** substantially impede implementation of the purpose of §§ 251-61 of the Act. Their purpose is to promote local competition, and the State unbundling measures have exactly the same purpose. In this regard, it would be entirely beside the point if the Commission were to accept the incumbents' unsubstantiated claim that greater unbundling requirements can reduce facilities investment or impose other costs and that the correct "trade **off** as a matter of federal policy is to limit unbundling in order to foster greater facilities investment.[9] Even if that were a rational policy judgment for the Commission to make – and AT&T maintains it is not given the extensive record here – § 251(d)(3) prohibits the FCC from substituting its judgment on the matter in place of that of the State commissions. Section 251(d)(3) measures the validity of State unbundling **rules** by their consistency with the ***Act's*** purposes, not with the ***Commission's*** purposes in adopting its regulations. Where, as here, there is a reasonable basis for finding that CLECs are impaired without unbundled switching and other UNEs and where a State makes different policy judgments than this Commission on the relationship between unbundling rules and facilities competition and the appropriate "tradeoffs" to address that relationship, the State rule can, at most, be inconsistent with the Commission's regulations. But such a State rule is plainly consistent with the Act and cannot be held substantially to impede implementation of its

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[7] ***US** West Commun. Inc. v. MFS Intelenet, Inc.*, 193 F.3d 1112, 1121 (9" Cir. 1999).

[8] ***Jones v. Rath Packing* Co.,** 430 **U.S. 5** 19, 540 (1977).

[9] ***Accord, USTA,*** 290 F.3d at **424-25.**

purposes. To the contrary, the State **rule** will simply **reflect** measures that a differently constituted Commission could have lawfully adopted and that is thus consistent With the Act and its purposes.

In this regard, the Act otherwise makes clear that unbundling requirements in addition to those imposed by the FCC's § 251 regulations are wholly consistent with the Act's requirements and do not substantially impede implementation of its purpose. The Act authorizes incumbent LECs to voluntarily agree to additional unbundling requirements, and these requirements must be upheld **unless** they are discriminatory **or** contrary to the public interest." Similarly, § 271 independently requires BOCs who **seek** and exercise long distance authority to provide unbundled loops, switching, transport, and signaling, whether or not they are designated as **network** elements that must **be** made available in accord with §§ 251(c) and **252(d)(2)**.[11] Because other provisions of the Act permit or require greater unbundling obligations than the Commission's general unbundling regulations impose, it is patent that additional State unbundling requirements are consistent with the Act, cannot impede implementation of its requirements or purpose, and are immune from preemption under § 251(d)(3).

Finally, while it is clear today that CLECs **will** be impaired if they **are** denied access to UNEs in accord with AT&T's specific proposals, the Commission should now frankly acknowledge that the States are better suited to determine whether and when **these** federal requirements should be modified in the future.[12] **The** Commission simply lacks the **resources** necessary to collect and review the relevant information required efficiently and reliably to determine the extent of the impairments CLECs face in evolving and different local market conditions. Therefore the Commission's new **rules** should mandate the continued availability of UNEs in accord with AT&T's proposals, adopt specific criteria that must be satisfied for delisting any UNEs under federal law, and delegate those delisting determinations to the State commissions – while recognizing the States' right to adopt additional requirements under State law.

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[10] 47 U.S.C. $5 252(a)(1) & (e)(1).

[11] ***Compare*** 47 U.S.C. § 271(c)(2)(B)(ii) (requiring "access to network elements in accord with the requirements of Section 251(c) and 252(d)" ***with id.***, **§§ 271(c)(2)(B)(iv)(v) & (x)** (nondiscriminatory access to unbundled loops, unbundled transport, unbundled switching and databases and signaling). ***See also id.*** § 160(c) (Commission "may not forbear from **enforcing** requirements of Section 251(c) on 271" until they **are** "fully implemented').

[12] NARUC **UNE-P** Resolution (adopted **Nov.** 14,2001) (attached to letter from **Joan** Smith *et al.* to Chairman **Powell** and Commissioners Abemathy, Copps and **Martin,** CC **Docket No.** 96-98 (December 5,2001)); NARUC Reply Comments (July **17,** 2002).

UNEs And Investment

Because it is clear on the detailed record here that requesting carriers are indeed impaired if they are denied unrestricted and broad access to the loop, switching, and transport **UNEs** and to combinations of those elements, the Commission should adopt **new** regulations that require these UNEs to be made available without regard to any **other** considerations. Thus, the incumbents' arguments that unbundling reduces investment, even if true, could not be dispositive. Indeed, although ***USTA*** addressed effects of unbundling on investment, it did so only because the court determined that the Commission had ordered unbundling in many markets where the record underlying the *UNE Remand* ***Order*** had not provided a reasonable basis for the court to conclude that competition was suffering from impairment so that the court was addressing whether the national rules could be upheld on other grounds." This analysis is unnecessary and improper here, where it is clear -- based on an extensive factual record of recent market experience -- that CLECs will be impaired if access to UNEs is denied.

But the record now also makes clear that the incumbents' investment claims have no substance. The Supreme Court upheld the features of the TELRIC pricing rule for network elements on the ground that it is a reasonable method to *foster* prudent investment by CLECs and incumbents, and the Court also concluded that the massive CLEC and ILEC investments that occurred in the six years since the unbundling rules were adopted foreclosed any contrary conclusion.[14] Of course, the D.C. Circuit has since held that the mere fact of substantial investment does not provide evidence on investment incentives, and thus whether greater investment may have otherwise occurred. But it is ***undisputed*** today that CLECs massively overinvested and made speculative investments that have indeed been proven to be wasteful. As a result, there can be no legitimate claims at this time that CLECs' right to **UNEs** and UNE-P at TELRIC prices has impaired any efficient investment by CLECs. To the contrary, the record refutes **the** baseless claims that **the** availability of leased facilities (particularly **UNE-P)** has discouraged CLEC **investment.**[15]

Nor does unbundling have any adverse effects on incumbents' investment. ***As*** the Supreme Court has held, TELRIC provides incumbents with a guarantee of recovery of the full economic *replacement* ***cost*** of their network facilities, including depreciation rates and returns on investment that reflect all the **risks** that incumbents face in the marketplace and under the TELRIC regime itself TELRIC thus could not deter investment by incumbents, even if they were used to set all the incumbents' rates. Further, as the Supreme Court has held, because the TELRIC scheme stimulates **CLECs'** investment in alternative facilities, it is "commonsense" that it inherently also fosters investment by **incumbents.**[16]

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[13] ***USTA*****, 290 F.3d** at **424-25.**

[14] ***Verizon*****, 122 S**. Ct. at **1675-76 & n.33.**

[15] **See** AT&T Reply **Comments, pp. 126-36,** Clarke Dec. (July **17,2002);** AT&T Comments, pp. **40-61,** Willig **Dec. (Apr. 5,2002).**

[16] ***Verizon*****, 122 S.** Ct. at **1676 n.33.**

The Bells' claim is also unsound as a matter of economics. Their claim is **that** unbundling deters investments because the unbundling rules compel ILECs to **lease** portions of their local exchange networks to CLECs at returns that are lower than they can earn when they **use** their networks to provide retail services. They assert that because their combined return from their local network investment is diminished, their incentive to invest is also diminished. As Professor Willig has explained, although this argument is "superficially appealing," it is "inconsistent with the basic economics of competition and monopoly."[17]

Whether a **firm** is a monopoly or faces competition, capital investment decisions are based on whether the anticipated incremental revenue that results from the capital investment exceeds the incremental cost of the unit of capital invested. The existence of effective competition may reduce the incumbents' total revenues, but it means that the incumbent's "marginal revenue is greater" and that capital investment is *stimulated*, because it is more likely to lead to increases in net marginal revenues. In **contrast,** a monopolist's incremental investment is more likely to reduce the prices paid by customers for its product, and thereby reduce its revenue on the margin. "The result is that incentives for investment and production of output are greater under the pressures of a competitive environment, and predictably the **firm** invests more."[18]

Critically, actual experience confirms this point. Professor Willig's detailed econometric study determined the actual empirical consequences of more attractive UNE rates on competitive behaviors by CLECs and on network investments by incumbents. It concludes, as an empirical matter, that the more attractive the UNE rates in a State, the greater the incumbent's investment, with 1% ***reduction*** in UNE rates corresponding to a **2.1%** to **2.9%** *increase* in ILEC investment **rates.**[19] This study is an updated version of an earlier study, and it made all the adjustments to the data that the incumbents and other critics of the earlier study suggested.

The Bells have thus now shifted gears yet again. They do not and cannot deny that massive overinvestment occurred in the telecommunications industry in the six years since **the** unbundling **rules** were adopted. But the Bells are now making other claims that **are** highly contrived and ultimately meaningless.

Their main new contention is that even though massive CLEC overinvestment occurred, this investment is not relevant to the Commission's decision, because "most" of the CLEC investment in States with a substantial number of UNE-P customers did not occur after UNE-P based services were rolled out on a significant scale. But the basic assertion is irrelevant, and the specific claims made hy **Mr.** Barr are **erroneous.**

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[17] AT&T *Ex Parte*, Stimulating Investment and **the** Telecommunications **Act** of **1996** ***(Oct* 11,** *2002)* **("*AT&T Investment Incentive Ex Parte'?*** at *5*.

[18] ***Id.*** at **6.**

[19] *Id.* at **23-24.**

First, as the Supreme Court has held, the relevant time frame to assess the-effects of unbundling is ***the*** entire six-year period since the requirements were adopted, ***i.e.***, since August 1996.[20] That is because investment decisions **are** not made based on the services that are being offered at the time of the investment, but rather on the services that **will** be deployed over the investment's useful life. Competitors' rights to use **UNEs** and UNE-P at TELRIC prices were authorized in August 1996. It was then substantially certain that such arrangements would be used, and that assumption became progressively more and more certain **over** the coming years as the Bells' legal challenges to the rules were rejected, and as more and more States independently embraced the use of **UNEs** and **UNE-P** to support competition. Thus the relevant period for assessment begins in 1996, not at the January 1999 commercial introduction of UNE-P based services in New York, or ***the*** subsequent dates at which UNE-P based services were introduced in other States.

Second, even if the dates of commercial UNE-P services rollouts **were** relevant, it is simply meaningless that "*most* of the CLEC investment" in those States occurred before UNE-P was aggressively rolled out. CLECs deployed facilities to serve the customers that they believed could be served *without* UNE-P. Thus, these investments would not be deferred during the three to six year period between the adoption of the unbundling requirements and the rollouts of **UNE-P.**

Beyond that, there **are** finite and well-defined classes of customers that can be more readily and economically served through alternative facilities: ***i.e.***, customers **served** by DS1 and higher level loops and those in the approximately 60,000 buildings in ***the*** nation for which it might be economic to extend alternative fiber loops. Particularly given the absence of significant capital constraints between 1996 and 2000, the most attractive investments (the low hanging fruit) and practically all other investments that appeared feasible were made then. Further, in view of the massive overinvestment that has occurred and the severe capital constraints that apply today, it was inevitable there would be more facility investment in individual States during the first 3-6 years after 1996 than in the last few years.

The Bells also make specific allegations that are both false and **also** refute their claim that UNE-P inhibits facilities-based service to customers for which it would be economic. For example, Verizon's October 16, **2002** letter from William Barr to Chairman Powell (echoing the discredited allegation in ***the*** incumbents' "UNE-P and Investment" document) states that AT&T and WorldCom "invested heavily to deploy their own switches" in New York before the January 1999 rollout of **UNE-P,** but that **this** deployment "declined precipitously" when AT&T and WorldCom began providing **service** through UNE-P in 1999. But that claim is factually false. AT&T's rates of switch deployment in New York *increased* after 1999, and the incumbents fabricated their contrary claim by misclassifying the toll switches that AT&T deployed prior to 1999 as local switches." Indeed, AT&T deployed more switches in New York between 1999 and

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

[21] ***See AT&T UNE-P and Investment Ex Parte*** at *5-7,* **15-16.**

2001 than in it did in other large states (*e.g.*, California) where AT&T was not then able to use UNE-P.[22]

Mr. Barr also notes that AT&T's initial business plan was to serve all business customers through UNE-L, and self-provisioned switching, but that AT&T and nearly all CLECs now use their switches to serve only locations with DSI and higher capacity loops (and certain medium-sized customers who are initially served on UNE-P and moved to AT&T switches on a project basis). Thus, Mr. Barr ignores that AT&T clearly explained exactly why it changed its business plan, *i.e.*, because its actual marketplace experience demonstrated that it could not economically serve other business customers through its own switches due to the incumbents' poor hot cut performance and the financial penalties associated with hot cuts and backhaul.[23] Thus, AT&T and other CLECs have amply documented the undisputed fact that UNE-P is the only practical and economic means to serve the vast majority of customers served by voice grade loops.

The UNE Rebuttal Report also offers a contrived comparison that gives new meaning to the concept of lying with statistics. The Bells claim that their figures demonstrate that the presence of UNE-P deters cable providers from offering cable-based telephony. That is nonsense. Only two cable providers (Cox and AT&T Broadband) offer significant facilities-based competition for residential customers. But AT&T and Cox have substantial cable footprints in California, and no significant footprint in New York. Accordingly, the fact that there is relatively little cable-based telephony service in New York can hardly be a surprise, and cannot be attributed to the availability of UNE-P in that State, but rather substantially to the fact that AT&T and Cox have no significant cable footprint there.[24] Further, two States with cable telephony (California and Illinois) also now have growing UNE-P customer bases.

In this regard, the Bells continue to rely on a highly gerrymandered study that purports to show that there is an inverse relationship between UNE-P and network facilities investment by CLECs.[25] But the short answer to this is that the Bells *admit* that if their methodology and data were applied to all States, the conclusion would be that there is *no* significant relationship between CLEC investment and UNE-P.[26] Further, AT&T has already shown that the incumbents can only reach a different result by using a contrived subset of States. And the study is a sham even as applied to that subset, for the results are driven by estimates of CLEC line counts that bear no relation to the Commission's reported data and are derived from "sources" that are not public and methods that are

[22] *Id.*

[23] *See generally* AT&T Comments, Brenner Dec. (Apr. 5,2002).

[24] *See AT&T UNE-P andlnvestment Ex Parte* at *13-14.*

[25] *See id.* at *7-10.*

[26] See *id.*

certain to substantially overstate the CLEC **penetration.**[27] Unsupported repetition of **these** contrived – and false – results cannot make them any more correct.

Finally, it is extremely ironic that the Bells would assert that gutting **the UNE rules** would lead to greater investments by incumbents by "restor[ing] the[ir] financial health."[28] Local voice services are flat or declining, and incumbents have already installed facilities capable of serving 100% of the former demand. Although incumbents will **make** investments that will reduce their costs of providing serving (*e.g.* the Project Pronto loop upgrades that produce operational savings that pay for themselves) or to serve new developments, there otherwise is no prospect of increased investment in the local voice network under any scenario. Similarly, although the ILECs have made and are making substantial investments to offer DSL service;[29] the Commission has correctly found that these investments are being made in response to intermodal competition from cable services and the intramodal competition provided by data and other CLECs. And because there is no demand for fiber to the curb or other higher capacity broadband services, investments to provide these services will not be made under any scenario – as all the panelists at the October **7th** ***en banc*** hearing agreed.

Finally, the incumbents' assertions to the Commission are flatly contrary to **the** presentations that they have made to the financial community. The incumbents' statements to the financial markets show that their investment decisions are ***not*** driven by regulatory rules but by other economic imperatives. Recent Bell statements – particularly those of Verizon itself – provide clear evidence that incumbents can compete successfully in the current unbundling environment, that they themselves recognize they have significant cost advantages over new entrants with respect to local facilities, and that changes in unbundling **rules** will not significantly affect their investment **policies.**[30]

Kev Principles Of Imuairment

The principles that govern the Commission's unbundling determinations **are** straightforward. Because the elements at issue are not "proprietary," the statutory test for unbundling is not whether access is "necessary," but rather **is** merely whether CLECs will be "impaired" in providing local services if access to **a** specific element is denied. Impairment thus requires a showing only that the effectiveness of competitors' entry **will** be materially diminished if **UNEs** are unavailable.

[27] **See** *id.* at 3-5.

[28] **Barr Letter,** at 1.

[29] AT&T Reply Comments at 79-81 (July 17,2002).

[30] **See** *Ex Parte* letter **from** Joan Marsh to Marlene Dortch (Oct. 29,2002).

Natural Monopoly "Characteristics."

As made clear by the Supreme Court, the Act's object is to allow entry by "hundreds of smaller entrants" and that unbundling is thus required even if there are some "large competitive carrier[s]" that can duplicate the element.[31] And in *USTA,* the Court of Appeals stated that it "did not intend to suggest" that the Act requires "use of the criteria of the essential facilities doctrine" and permits unbundling of only those elements that can be provided by only a single firm as a matter of economics.[32] Thus, contrary to the incumbents' suggestion, *USTA* held only that a UNE must have "some degree" of the "characteristics" of a "natural monopoly" and that the question for the Commission is whether "competitive supply" of an element by "multiple" firms would be "wasteful."[33]

In this regard, while *USTA* held that the Commission applied an erroneous impairment standard in the *UNE Remand Order,*[34] this holding was quite narrow. The Court disapproved only *one* aspect of *one* of the kinds of cost disparities that the *UNE Remand Order* had addressed: the presence of economies of scale that apply only during initial stages of entry, that are universal as between incumbents and new entrants in *any* market, and that thus do not constitute entry barriers. By contrast, *USTA* did not disapprove the *UNE Remand Order's* reliance on whether new entrants (1) have to make large investments that are both "fixed" and "sunk" because they will be wasted if entry is unsuccessful[35] or (2) must incur costs that the incumbent does not, such that the new entrant will have higher unit costs than the incumbent over *whatever* range of demand the new entrant experiences.[36]

Indeed, under settled antitrust principles, it is the existence of these latter conditions that mean that facilities have natural monopoly characteristics and multiple competitive supply is wasteful.[37] The reality is that when these conditions exist, entry will *not* occur *unless* new entrants can enter through leasing arrangements that avoid inherent unit cost disadvantages, or that at least allow deferral of such investments until the entrant has acquired sufficient traffic volumes to make the sunk investments rational. In this connection, *USTA* and *Verizon* call for a quite traditional antitrust analysis, analogous to that under the Merger Guidelines. Thus, the question here is whether there are sunk costs or other barriers to facilities-based entry that will prevent the market from attracting

[31] *Verizon,* 122 S. Ct. at 1672 n.27

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

[33] *Id.* These holdings expressly foreclose Mr. Barr's claim (at 3) that an element must be found to be a natural monopoly before impairment can be found, and that the Act requires a showing that average costs are declining throughout the range of the relevant market, such that an entrant with less than full market scale cannot compete.

[34] 15 FCC Rcd. 3696 (1999).

[35] *Id.* ¶¶ 75-77.

[36] *Id.* ¶ 78.

[37] *See, e.g.,* United States Department of Justice and the Federal Trade Commission, Horizontal Merger Guidelines, §§ 12.1, 3.3 & n. 31 (rev. Apr. 8, 1997) (*"Merger Guidelines"*).

multiple competitors and becoming unconcentrated and workably competitive (*e.g.*, with five or more firms) in the near term (*i.e.*, in the next two years) if access to UNEs is denied.[38]

Access to UNEs as a Means to Attain Scale And Time To Build – *USTA* undercuts any claim that scale economics are irrelevant to the Commission's impairment analysis.[39] *USTA* held only that access to UNEs cannot be ordered when new entrants and incumbents face effectively identical costs and when the incumbent's scale advantages are transient and small so that competitive supply by multiple firms would not be wasteful. In this circumstance, there is no entry barrier to facilities-based service and no impairment. By contrast, however, there are obvious entry barriers and impairment when entry requires large sunk investments, when entrants face significant costs that the incumbents do not, or when incumbents have other first mover advantages (*e.g.*, automatic rights of ways and building access rights that competitors must spend time and money to acquire). For example, because they will otherwise be wasteful, sunk investments in transport facilities between two offices simply cannot rationally be made unless the requesting carrier has used UNEs to build up necessary traffic volumes and to serve customers during periods in which rights of way are acquired and construction concluded. Critically, the D.C. Circuit *acknowledged* that a legitimate benefit of UNEs is that they "may enable the CLEC to enter the market gradually by building a customer base up to the level where its own investment would be profitable.'"[40]

In this regard, the Commission should reject any claim that access to UNEs can never be granted on the grounds that CLECs need to build up a customer base and "scale" before construction can be economic or that "time to build" is required thereafter.[41] This is plainly wrong under *USTA*. Mr. Barr's other assertion – that concededly unprofitable resale is the exclusive means of building up the necessary scale – is not only also rejected by *USTA*, but is foreclosed by the Act's terms and structure. As the Commission has stated many times, the Act provides three means of entry – facilities, UNEs, and resale – and intends that each be available and that CLECs may use whichever is most profitable. Resale, moreover, offers no substitute for UNEs. Resale discounts apply only to retail exchange services, not to exchange access services that help fill transport, loop, and other facilities and that are critical to establishing the volumes that can allow carriers to justify and build their own facilities. In addition, resale does not provide CLECs with any information about the distribution of traffic and the traffic volumes on particular routes that is a precondition to a decision whether facilities will be economic to serve particular routes or particular customers. And resale does not permit CLECs to offer innovative new services to differentiate itself from the ILEC.[42] Thus, it is only through the leasing of

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[38] *Cf. id.* § 1.5 (concentration), § 3.2 (to be relevant, entry must occur within two years), § 3.4 (to be relevant, entry must be sufficient to prevent supracompetitive pricing).

[39] Barr Letter at 3-4, 6-7.

[40] *USTA*, 290 F.3d at 424.

[41] Barr Letter at 3-4, 6-7.

[42] AT&T Comments, Huels Dec. ¶ 25 (Apr. 5, 2002).

UNEs that CLECs can acquire the traffic volumes and information that will allow alternative facilities to be deployed as soon as, and to the extent that, they are justified.

Attempts to analogize[43] local competition to the experience in cellular and PCS competition, which assertedly required large "network" investments and did not achieve profitability for five-to-ten years periods, could not **be** more inapt. ***As*** a threshold matter, wireless service is simply not a full product substitute for local wireline voice service, and there is no evidence that a substantial proportion of wireless **users** have abandoned their wireline service. But more fundamentally, **ILECs** have facilities in places that can service the ***entire existing andforeseeable demand*** in the market. Thus, absent UNEs, new entrants could only enter by making **sunk** investments to create excess capacity, and they would face substantial risks – which the incumbents had not – that the necessary traffic volumes would not materialize, or that the ILEC would respond to their entry by pricing its service at marginal costs." By contrast, when new wireless entry was authorized in the **mid-1990s,** the ILECs were subject to spectrum caps, so that they did not have -- and could not even build – the capacity required to meet the existing market demand, much **less** the rapidly growing future demand for wireless services. Thus, PCS providers could make facility investments secure in the knowledge that they were not creating excess capacity and that their facilities would be filled with traffic at compensatory rates. Indeed, the fact that PCS providers reinvested their net operating income reflected the rapid growth in demand.

The ILECs thus have things backwards in asserting that new entrants have had "six years" to build facilities and cannot claim to need additional "time to build." Local telephony is a market in which large fixed and **sunk** investment cannot even rationally be planned until a carrier has acquired, or is certain to acquire, the necessary customer base to support new construction.[45] And even then it takes significant time for the carrier to obtain the necessary rights of way and/or building access rights and to complete construction. **For** example, AT&T has shown that a carrier cannot rationally construct transport facilities **on a** particular point-to-point route **unless** and until it has achieved the minimum traffic volumes – about **18** DS3s – that make such facilities economic.[46] ***As USTA*** acknowledges, one of the legitimate benefits of UNEs is that they allow gradual entry into markets that require **sunk** investments.

<u>Impacts of Intermodal Competition on the Impairment Analysis</u> – The question under the Act, strictly speaking, is not whether the incumbents' precise facilities can be replicated, but whether there are alternative sources of their *functions* that can be economically used to provide a competitive local service. Intermodal competition is thus

[43] Barr Letter at *3.*

[44] ***See UNE Remand Order,*** ¶¶ 75, 77.

[45] ***See*** AT&T Reply Comments, Willig Reply Dec. ¶¶ 18-36 (July 17,2002); AT&T *Ex* ***Parte,*** Comparing ILEC and CLEC Network Architecture, at 22-23 (Oct. 3,2002) ***("AT&T Network Architecture Ex Parte'?;*** AT&T ***Ex Parte,*** Loop Unbundling and Impairment, at 7-10 (Oct. 7, 2002) ***("AT&T Loop Unbundling Ex Parte").***

[46] ***AT&T Network Architecture*** *Ex* ***Parte*** at 14

potentially relevant to the Commission's analysis. But to be *actually* relevant, the intermodal alternative must be actually available *today*, it must be an exact **or** close substitute for the functions of ILECs' facilities, and there must be sufficient existing alternatives, in aggregate, to satisfy the Act's object of *multiple* competing **firms.**

Against this standard, the Commission must dismiss out-of-hand attempts to rely on satellite technologies that are "in development" or fixed wireless solutions that **are** "promising."[47] **It** must also reject the claims based on mobile cellular and **PCS** services, for they do not remotely provide services of the reliability and quality of landline networks. In this regard, the present substitution of wireless for landline minutes occurs only for marginal traffic, and associated losses do not remotely establish that wireless carriers can or should be treated as providing competitive exchange and exchange access services. In this regard, mobile services could not be offered at close to today's prices if they were engineered to provide landline reliability and quality – even if that were technically feasible.

The Bell arguments on "intermodal competition" boil down to the potential for cable telephony. The Bells may well be correct that cable operators' ability to upgrade facilities that provide video services to offer telephony means that the incumbent facilities are, strictly speaking, "not a natural monopoly."[48] But even if true, that is irrelevant under the Act, and under *USTA.* Even in the limited **areas** where the cable providers have in fact effected the necessary upgrades and provide competing service, that means only that **a** limited number of residential (but not business) service is served by a duopoly. **As** the Commission has held in the past – and reiterated in the very recent Echostar – Direct TV Order – duopolies are insufficient to create the competition that is the object of the Act. **As** Chairman Powell there aptly stated, allowing a duopoly:

> would decrease incentives to reduce prices, increase the risk of collusion, and inevitably result in **less** innovation and fewer benefits to consumers. That is the antithesis of what the public interest demands."

Further, virtually all of the cable telephony available today is provided in only some of the areas served by only two operators (AT&T Broadband and **Cox**),[50] and it is speculative whether **or** when other operators will make the necessary upgrades. NCTA's statistics indicate that cable roviders offer cable telephony to residential customers in only about 30 cities in **15** states?' And as explained at the October *7,2002 En Banc* Hearing on Steps Toward Recovery in the Telecommunications Industry, cable operators can expect to

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[47] **Barr Letter *at 5***

[48] ***Id.* at 4.**

[49] Statement of Chairman Powell, ***Application of Echostar Communications Corporation (Echostar); General Motors Corporation and Hughes Electronics Corporation (DirecTV)***, *CS* Docket No. **01-348 *(Oct.*10,2002).**

[50] **AT&T *Ex Parte,*** Correcting **the RBOCs'** Empirical **Analyses** of the **Linkage Between UNE-P** and Investment, at **14(Oct. 23,2002) *("AT&T UNE-P and Investment Ex Parte").***

[51] *See* www.ncta.com/broadband/broadband.cfm?broadbandID=3.

face severe capital constraints for the next few years, and because their services are under severe attack from satellite services with more channels, the best use of such future capital will likely be to invest in enhancing their video services.[52]

Finally, even the incumbents do not assert that cable telephony facilities are available for lease to competitors – at any price. Thus, the incumbents **are** reduced to claiming that **CLECs** should overbuild cable systems to provide video services in competition with incumbent cable TV systems (and DBS providers) and then invest in upgrades that allow telephony and video to be provided over their cable facilities. **This** is nonsense, because it means that **CLECs** would have to make sunk and potentially wasteful investments on a "field of dreams theory" in two markets, not just one.

Potential Countervailing CLEC Advantages* – *USTA stated that the Commission should consider whether **CLECs** have advantages of their own that offset the ***cost*** advantages that incumbents enjoy and whether there is "net impairment." But the only potential offsetting advantage that the court identified **is** that **CLECs** have theoretical advantages in serving business customers because they have no duty to serve "rural or residential customers" at rates that are below-cost and that are subsidized by above-cost rates to business customers. And the incumbents fail to point out that they are **the** beneficiaries of high-cost support mechanisms for serving such customers. **Further,** even if the existence of implicit subsidies were assumed, **§ 254** of the Act requires that they be eliminated and replaced with explicit subsidy mechanisms, which is why the Supreme Court held that such subsidies are irrelevant to unbundling determinations."

But this is all beside the point. **AT&T** has demonstrated that **CLECs** are impaired in serving business customers through alternative facilities at ***existing*** retail rate levels that include any existing implicit subsidies that have not been eliminated. **For** example, AT&T has shown that **CLECs** cannot overcome the incumbents' scale economies by serving customers from many local serving offices with a single switch, because **the** additional costs of backhaul make the service wholly uneconomic.[54]

Other potential sources of countervailing advantages **are** nonexistent, irrelevant, or both. **The** assertion that **ILECs** "face diseconomies of scale associated with **a** large embedded network"[55] has no empirical basis. **As AT&T's** unrebutted network architecture evidence establishes, the **ILECs'** economies of scope and scale give them inherent cost advantages over **CLECs** over all levels of demands. **AT&T** has demonstrated that even very successful competitors have significantly higher unit costs. **For** example, a **CLEC** that secures even a **30%** market share would have per line loop costs that are **57% higher**

[52] **Oct. 7, 2002 FCC** *En Banc*, **Tr.** at **79-80 (statement** of Lara Warner, CSFB).

[53] *AT&T Corp. v. Iowa Utils. Bd.*, **525 U.S. 366, 393-94 (1999).**

[54] *AT&T Loop* ***Unbundling Ex Parte*** at **12, 13** (showing that in order **to** overcome a **$3/month backhaul** penalty a **CLEC** would have to achieve a 10% market share of business customers **in 38** central offices **of** 25,000 average local VGEs).

[55] **Barr** letter, at ***5***

than the ILEC's if it were to attempt to self-deploy its own loop network and 178% higher costs than the ILEC's if it were to self-deploy its **own** transport **network.**[56]

The assertion that AT&T and other CLECs who are national interexchange carries have "countervailing advantages" that offset the ILECs' cost advantages in providing local services to "enterprise customers" is nonsense. ILECs have been excluded from interexchange markets precisely because their control over essential exchange access facilities would give them immense and uncontrollable advantages in providing interexchange service to these customers, and BOCs that receive **$271** authority have the same ability to acquire capabilities required to provide interexchange services to "enterprise" customers as did Sprint, WorldCom, and AT&T itself Indeed, the Bells have the advantage of being able to take advantage of an existing wholesale market that will enable them to acquire capacity at enormous market-driven discounts to compete for those customers without spending **a** penny on infrastructure investment." Moreover, **as** explained below, unless AT&T and other **IXCs** can obtain loop-transport combinations and other UNEs to serve these enterprise customers at similar cost-based rates, they will be severely impaired in providing ***both*** local *and* long distance services in competition with incumbents, for they can be victims of the types of price squeezes that have enabled incumbents to monopolize the provision of the intraLATA frame relay services.

Comparative Imuairment – AT&T's evidence establishes that incumbents' inherent loop access and cost advantages would erect the barriers to facilities-based service even **for** customers served at prevailing business rates. Thus, it is quite plain that denying access to UNEs would severely impair CLECs' ability to serve residential customers, even if all subsidies **were** eliminated.'*

Market Svecific Variations In Assessing Competitive Imuairment – Finally, ***USTA*** explicitly requires the Commission to consider "market specific variations in competitive **impairment.**"[59] Thus, the Commission cannot decline to require unbundling **by** lumping all classes of customers together and adopting rules of unvarying scope for all that **are** based on factors applicable only to some. But despite the D.C. Circuit's requirement **of** "granularity," the incumbents, as exemplified by Mr. Barr's **letter,** have responded to this mandate by proposing ***national*** markets and relying on national statistics – many **of** which

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[56] AT&T **Comments,** Clarke Dec. ¶ 30 (Apr. *5,2002).*

[57] ***Verizon Expands Voice, Data Services,*** B. Bergenstein, **AP,** November **4,2002**

[58] The Bells are correct **(Barr** Letter at ***5-6)*** that transient burdens that equally apply to incumbents and **new** entrants erect no entry barriers under ***USTA*** and *cannot* be a basis for ***finding*** impairment. But AT&T **has** not relied on any such burdens in making impairment showings here. Indeed, ***even*** if there were actual proof to support **ILEC** assertions that ***overall*** some residential rates ***are*** below cost – and there is none – AT&T's evidence of impairment is not based on such **rates.**

[59] Of course, if impairments exist **for** an entire category **of** customers, ***USTA*** clearly permits the Commission to find impairment for all such customers.

have been shown to be inaccurate[60] – to contend that CLECs will not be impaired in providing local service to any class of customers.

This is flatly improper. The issue under the Act is whether UNEs are necessary to remove barriers to the provision of exchange, exchange access, and other telecommunications services in competition with incumbents. Decisions to offer these services **are** made at the level of individual local serving offices and depend on whether a CLEC can achieve unit costs that are at or near the incumbent's if the CLEC realizes reasonably achievable shares of the relevant classes of customers. This turns on engineering, economic, and operational facts that vary with volumes of traffic generated at specific customer locations and the specific facilities that are used to provide those customers with telecommunications services. These are the sources of "variations" in "competitive impairment," and any impairment analysis **is** required to consider these market-specific variations.

AT&T and others, in conformity with *USTA*'s requirements, have specifically demonstrated how the natural monopoly characteristics that are peculiar to the local exchange business, impair their ability to serve specific classes of customers without access to each of the individual UNE and UNE combination they seek.[61] The incumbents, however, have offered no response to these specific showings other than to cite general statistics regarding CLEC facilities deployment. Since the CLECs' showings are uncontested, they must be accorded dispositive weight.

<u>Application Of The Impairment Standards To Soecific UNEs</u>

The application of the above criteria to the specific facilities at issue is quite straightforward.

Loops - Copper loops (whether voice grade (DS0) or DS1) are quintessential natural monopoly facilities, because they are used to provide low volume telecommunications services. The only loops for which competitive supply is ever economically possible **are** certain very high capacity (DS3 and higher) facilities in limited conditions. But whether a CLEC can provide these facilities at unit costs close to the incumbent's depends on such factors as their capacity, length and proximity to splice points on fiber rings,[62] meaning that competitive supply of these facilities will often be uneconomic. In all events, even when competitive supply may be economic, ILECs

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[60] ***See generally*** AT&T Reply Comments, Pfau Reply **Dec. (July 17,2002).**

[61] ***See*** AT&T Reply, Willig Reply Dec. **¶¶ 37-44** (July **17,2002);** AT&T *Ex* ***Parte,*** Economic Analysis of Impairment, at **4-7** ***(Oct*** **.11,2002);** ***AT&T Network Architecture EX Parte*** at **20-21;** ***AT&T Loop Unbundling*** *Ex* ***Parte*** at **23;** AT&T *Ex* Parte, Transport **UNEs** ***are*** a Prerequisite to **the** Development of Facilities-Based Local Competition, at **3-10** ***(Oct*** **7,2002) (*"AT&T Transport Unbundling Ex Pate").***

[62] ***See*** AT&T Loop Unbundling **Ex** Parte at **23;** AT&T Reply Comments, Fea-Giovanucci Reply **Dec. ¶¶ 24-68** (July **17,2002).**

benefit from significant right of way, building access, and other first mover advantages, and constructing loops requires large fixed investments that are **sunk** and that will **be** wasted if entry is **unsuccessful**.[63] *As* a result, the facilities often cannot be built at all.

In addition, investments in high capacity loop facilities will never be economic **unless** the CLEC can be assured that it will have the committed customer base to **allow** it to recover its substantial **sunk** costs. This often means that carriers must first **use** UNEs to build **up** the required customer base and/or to provide service until rights of way and access rights **are** obtained.

Transport - Transport facilities are dedicated point-to-point facilities that connect one specific office to one other office. In order for a competitive carrier to construct such facilities, it must incur enormous fixed and **sunk** investments to install a facilities-based collocation in a local serving office and to construct transmission **lines** to connect that office to the other specific office. AT&T has shown that it **is** not economic for **a** competitor to incur the costs of connecting a collocation to its own transport facilities **unless** it requires about **18 DS3s** (over **36,000** VGEs) **of traffic**.[64] Self-provisioning transport further requires that CLECs obtain rights of ways that ILECs acquired at **low** (or **no**) cost and **as** matters of course due to their first mover advantages.

The Bells' own data acknowledge that there are two or more facilities-based collocations in no more than ***20%*** of incumbents' wire centers in **the *25*** largest **MSAs**.[65] They also admit that they have **no** data as to whether those collocations **are** equipped to carry **DSO** and **DS1**, as well as **DS3** levels of **traffic**.[66] They further admit that although there are **often** connections between these offices and IXCs' POPs, they have **no** data regarding the existence of fiber transport connections between these offices and any other specific offices that CLECs need to reach in order to **serve** their **own** customers.[67] Carriers that have supplied comments to the Commission, however, have demonstrated that they have no alternatives to ILECs' transport facilities – at any level – in the vast majority **of** cases.[68]

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[63] **See** AT&T **Reply,** Willig **Reply Dec. ¶¶ 37-39 (July 17, 2002).**

[64] *AT&T Network Architecture **EX Parte*** at **14.** Given the amount **of traffic this** represents, a carrier could **not** expect to aggregate such volumes unless it has the ability to **create** "hubs," **which** themselves **will** have higher **unit *costs*** than **the** incumbents unless **they** *can* be obtained **at** TELRIC rates.

[65] ILEC **Fact Report,** at **111-3** (Table **2)** (Apr. 5, 2002) (attached to **comments of** BellSouth, **Verizon,** SBC).

[66] Verizon ***EX Parte,*** UNE Rebuttal Report 2002, at 40 **(Oct. 23,2002)** ("ILEC **UNE** Rebuttal **Report").**

[68] **See, *e.g.*,** AT&T **Reply** Comments at **257-67 (July 17,2002)** (citing and **summarizing comments).**

But the Bells claim the ***Special Access Pricing Flexibility Order***[69] establishes that the provision of transport is "competitive" wherever they have met the Commission's standards for pricing flexibility. This contention is extraordinary. The Order adopts triggers that are met in an area if there are collocations in only 15% of the ILEC's offices, or in offices representing only 30% of special access traffic in that area. Thus, the Commission's pricing flexibility rules apply even when **85%** of the offices in an area **or** offices covering 70% of the special access traffic in an area ***face no facilities-based competition*** at all. And critically, the Order specifically states that satisfaction of these triggers does ***not*** establish that incumbents lack market power, and the RBOCs' own data show that they are earning on average a **37.5%** rate of return on special access, even on an embedded cost basis." It would thus be inconsistent both with the Commission's own rulings and actual market experience to support the incumbents' claims that special access services are competitive.

Moreover, the incumbents propose to remove access to **high** capacity transport **as** a UNE when there are competitive facilities at only ***one end*** of the route a requesting carrier needs. Thus, they ***assume*** that the facilities-based competitive carrier would be both willing and able to construct facilities to the location where the requesting carrier needs them without any investigation at all into the economics or practicalities of **such** construction, **or** whether capital is available to support such construction. And in the meantime, the incumbents would relegate the competitor to the use of high priced **and** non-competitive special access services. The Commission thus cannot find here, contrary to its own conclusions in the ***Special Access Pricing Flexibility Order***, that the mere compliance with the pricing flexibility rules means that requesting carriers are not impaired without access to unbundled transport at cost-based rates.

Accordingly, transport plainly must continue to be made available as **a** UNE at cost-based rates. The only possible legitimate carve out would be for point-to-point routes on which (1) a CLEC has sufficient traffic (at least **18** DS3s) to make facilities construction economically feasible and there are no right of way or other practical impediments to such construction or (2) there are at least four competing carriers on **a** specific route with sufficient capacity at the level requested by the CLEC, again assuming that there are no operational or practical hurdles to using such alternatives.

switching - Switching requires significant fixed investments that are largely **sunk:** *e.g.*, collocations and many of the costs of the switch itself, including the cost of installation and engineering it for a specific location. But the clearest source of impairment in providing switching is related to CLECs' inability to connect retail customer loops to competitive switches. The source of this impairment is the CLECs' inability to provide their own loops, the inherently inferior access they have to incumbents' loops, and the high cost of backhauling the traffic on such loops to the competitive switch.

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[69] **14** FCC **Rcd. 14221 (1999).**

[70] **See** Petition of AT&T, RM **No. 10593,** at **7-11** (filed October **15,2002)** ("AT&T Special **Access** Petition").

The incumbent networks are designed so that their loops almost always end in the central **office** where their local serving switch is located. ILEC voice grade loops are connected to ILEC switches through the use of a simple jumper wire pair across their main distribution frame. And in the vast majority of cases, the jumper is already in place. But that is never true for CLECs. **In** order for a competitor to connect an unbundled ILEC voice grade loop to its switch, the CLEC faces two different categories of significant impairments that the incumbent does not. These disadvantages constitute substantial barriers to their ability to enter the market through the use of unbundled loops and non-ILEC **switches.**[71]

The first is the costs **of** "backhaul." To replicate the function of the ILEC jumper, *i.e.*, to connect its customers' loops to a competitive switch, a CLEC must install collocations in each office it serves (unless loop-transport combinations are practically available), install transmission equipment, and **use** transport facilities to route its customers' traffic to the location where its switch is housed." This backhaul "penalty" applies to all customers and all switched services, but it is especially prohibitive for customers served by voice grade loops. These additional costs range from nearly **$7** per month per loop to more than $20 per month per loop, even where a competitor **serves** thousands of loops from the same LSO.

Second, disconnecting voice grade loops from the incumbent's switch and connecting them to the CLEC's network today requires the incumbent to perform a manual hot cut that (1) is time consuming, risks service disruptions, and has caused a **very** significant proportion of AT&T's customers to cancel service before it could provide service and (2) carries a significant fixed (and **sunk**) cost penalty that ***can*** be as high **as** $180 per loop. These hot cut disruptions and costs will continue unless and until an electronic form of loop provisioning is implemented, **so** that CLECs **seeking** to sign up local customers can be on an equal footing with ILECs that enter the long distance business. Moreover, for customers served by DLC loops, there is generally no way to provide the same quality **of** service to a customer using a competitive **switch.**[73]

Whether these undisputed entry barriers are generally surmountable for any class of customer locations depends on the applicable cost disparities and revenue opportunities that such customers represent at today's rates. **For** certain large volume business customers, CLECs can overcome these disparities to serve customer locations that **use** DS1 or higher capacity loops (which do not require hot cuts) and that employ special customer premises equipment such as PBXs. But the combination of the backhaul penalty and the hot cut penalty create significant impairments for competitors that seek to provide voice

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[71] ***See AT&T Network Architecture Ex Parte*** at 19-21. These impairments apply **whether** a **CLEC** uses its own switch or the switch of a third party. Indeed, the presence **of such** impairments largely explains why a competitive market **for** unbundled switching **has never** developed.

[72] Transport equipment and backhaul facilities have very **high** fixed ***costs.*** **Thus,** in order to **be** economic they must have very high capacity.

[73] AT&T Reply Comments at **74** (July 17,2002).

grade service to residential and small business customers through the use unbundled loops and non-ILEC switches.

UNE-P - For the same reasons, CLECs will be severely impaired in providing mass market services to residential and small business customers **unless** they have access to combinations of loop, switching, and shared transport that are referred to as UNE-P. This follows from the facts that ILECs have monopoly control over loops and transport and that there **are** absolute economic and operational barriers to competitors' **efforts** to serve customers by connecting self-provisioned switches to the monopoly loops and transport.[74] Indeed, the record could not be clearer that adoption of the ILECs' proposal **to** end **UNE-P** would devastate the emerging competition for residential and small business customers, nearly all of which is based on **use** of the UNE Platform.

At the same **time,** it is critical to underscore that entry through **UNE-P** requires hundreds of millions **of** dollars of investments that are fixed and **sunk,** and additional fixed and **sunk** investments must be made before **UNE-P** based services **can** be extended to **an** additional state. Accordingly, even UNE-P entry is not economic without sufficient scale to support the significant costs to develop the necessary infrastructure to **serve** local voice customers. In addition to these substantial fixed investments, the provision of **UNE-P** also requires AT&T and other CLECs to lease ILECs' loop, transport, and switching facilities at wholesale rates that have been found by each of the relevant State commissions **to** cover all the incumbents' economic costs, to provide them a reasonable profit and to satisfy the ratemaking method that the United States Supreme Court upheld only last May in *Verizon*.

Because oftheir ability to **use UNE-P,** AT&T and other competitors have been able to offer consumers competitive services. Because incumbents have in many **cases** responded to this competition by cutting their **own** prices, experience also confirms that incumbents' rates have been excessive. Eliminating **UNE-P,** whether immediately or after some transition, would have the effect of depriving consumers of these benefits. AT&T and many other CLECs that rely on UNE-P would then be forced to ***abandon*** the **local** services that they are now providing to millions of residential households and small business customers in many states across **the** country, requiring these customers to **return** to incumbents.

Finally, **UNE-P** is an essential feature of the *quid pro* **quo** embodied in **§ 271** of the Act. The reality is that the intensely competitive wholesale long distance market enables

[74] In their UNE Rebuttal Report (at **16,** 39), the ILECs attempt to refute these points by identifying a ***single*** CLEC (Cavalier) that currently serves residential as well as business customers through combinations of self-provisioned switches and unbundled loops. But Cavalier **offers** residential service only to customers who make **two-year** commitments to obtain packages of Internet **Access,** long distance **and** local. **See** www.cavtel.com/residential/res_9a.php (visited on **Nov. 6,2002).** Thus, it is obvious that Cavalier has **NOT** made a mass market offering. Moreover, **AT&T** believes that even Cavalier's targeted offering to this small subset of higher volume residential customers cannot be profitable, due to **the** backhaul and hot cut ***cost*** penalties. By contrast, **AT&T's *UNE-P*** services are purchased by **all** classes ***of*** residential customers ***in*** high density and low density areas of States. For example, in New **York, AT&T has** comparable penetration rates among customers in all density **zones.**

incumbents to enter the long distance market by obtaining capacity at wholesale and reselling it. And because customers generally desire one stop shopping, BOCs have acquired extraordinary market shares of long distance in each market in which § 271 authority has been granted. In those states where UNE-P is available at economic rates, it has given AT&T and other IXCs comparable opportunities to provide local services and to offer packages of local and long distance.[75] The elimination of UNE-P would thus enable BOCs to leverage local monopolies to foreclose competition in long distance markets, contrary to the whole object of §271.

Loop-Transport Combinations (EELs) and Special Access - The Commission's existing rules adopt (1) use restrictions that prohibit requesting carriers from using loop-transport combinations (also referred to as enhanced extended links or EELs) solely to provide the equivalent of special access services that connect IXCs to their end user customers and (2) commingling restrictions that have meant that these combinations generally cannot be used to serve local customers with DS1 or higher capacity facilities. Indeed 98% of AT&T's DS1 facilities that it uses to provide local services are today obtained at inflated special access rates.[76] These restrictions have severely impaired the provision of both interexchange and local service.

First, it has led to price squeezes that have already foreclosed competition to large enterprise customers. Specifically, when BOCs were barred by § 271 from offering interexchange Frame Relay and similar services, IXCs had immense – and legitimate -- advantages of scope economies in providing intraLATA Frame Relay Services. But by denying them access to loop-transport combinations and requiring the use of special access instead of UNEs, incumbents imposed price squeezes that have allowed BOCs to acquire 90% shares of intraLATA and local Frame Relay Service – as AT&T has documented elsewhere.[77] Where BOCs have been granted § 271 authority, they are using the same price squeezes to obtain illicit advantages in providing interexchange frame relay services. For example, despite the absence of investment in national facilities in this market, Verizon has recently touted the successes it is attaining in this market.[78] But share gained through illicit use of monopoly facilities is anticompetitive – and is precisely what § 251 is designed to prevent.

As the Commission and the Supreme Court have concluded, TELRIC represents the economic costs that the ILECs incur using their facilities to provide their own services, and the ILEC price their own services based on these economic costs.[79] By forcing IXC competitors to obtain these essential inputs at special access rates that are substantially higher than UNE rates, the incumbents have created price squeezes that severely impair

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[75] *See AT&T Corp. v. FCC*, 274 F.3d 549,554-56 (D.C. Cir. 2001) (FCC must address whether UNE-P rates provide sufficient margins to allow IXCs to'offer competing local services).

[76] *AT&T Transport Unbundling Ex Parte* at 10.

[77] See, *e.g.*, Comments of AT&T Corp. CC Docket No. 01-337, at 24-25 (March 1,2002).

[78] *Ex Parte* letter from Joan Marsh to Marlene Dortch (Oct. 29,2002).

[79] *Local Competition Order*, 11 FCC Rcd. 15499, ¶¶ 679-93 (1996); *Verizon*, 122 S. Ct. at 1668-73.

IXCs' ability to compete on the merits. In this regard, it is besides the point that the Commission's existing **§ 272 rules** require BOCs to provide service through separate affiliates that must "purchase" access services at generally applicable tariffed rates. While the separate affiliate requirements prevent some forms of blatant price discrimination, the access charges that a BOC's interexchange subsidiary pays to its affiliate **is** a "left pocket-to-right pocket" intracorporate transfer payment, and the retail interexchange prices of the BOC are unregulated and set based on the overall costs of the service to the BOC enterprise.

Similarly, the commingling restrictions have had the practical effect of barring AT&T from using loop-transport combinations to connect its local service customers served by DS1 and higher capacity loops to AT&T's switches and to **require** the **use** of special access that costs up to twice as much. **This** significantly inflates AT&T's costs of serving its local customers and has meant that AT&T cannot economically serve many other local customers, and plainly means that denials **of** access to loop-transport combination impairs AT&T's provision of local service.

In addition, AT&T has shown that the imposition of **use** and commingling limitations limits the growth of facilities-based competition – the very type of competition the incumbents claim to support. In particular, these limitations make it significantly more expensive for camers to aggregate customer traffic and create efficient "hubs" where they can afford to create additional facilities-based competition.[80] Thus, rather than provide incentives **for** other carriers to construct new facilities, the **use** and commingling restrictions simply create additional roadblocks to the deployment of efficient competitive networks.

Indeed, the Commission has previously recognized that loop-transport combinations can reduce competitors' backhaul penalty (by eliminating the need to collocate in every end office where a com etitor wishes to compete) and **are** critical to support competitive switch-based service.[81] Yet as the ILECs admit, the incumbents generally chose to refuse to provide these combinations and instead provide unbundled switching. Given the incumbents' staunch opposition to the unbundling of local switching and **UNE-P,** the only rational basis for this refusal would appear to be that the benefits **of** keeping such combinations from competitors were even greater than the **effects** of competition from UNE-P.

Finally, it is ironic in the extreme that the incumbents would contend that the availability of tariffed special access services has any effect at all on the incumbents' obligation to provide loop-transport combinations as **UNEs.** ***As*** AT&T has elsewhere demonstrated, the incumbents' special access services are today priced at exorbitant levels that are up to two times the costs of UNEs under **TELRIC**.[82] More generally, because

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[80] AT&T Reply Comments, Fea-Giovanucci Dec. ¶¶ 69-76, Willig Reply Decl. **747** (July 17, **2002).**

[81] ***UNE Remand Order* ¶ 278** (existing exception from the requirement to provide unbundled switching ***carve*** out applies only if "cost-based" loop-transport Combinations are available).

[82] AT&T Special **Access** Petition at 10.

§ 251(c)(3) of the Act requires that UNEs be available at TELRIC-based rates, it is patent that incumbents cannot avoid their statutory obligations by offering the capabilities of UNEs in wholesale services that are available under tariff at higher rates. The Commission first rejected this contention in its ***Local Competition Order*** (¶ 287), and the Eighth Circuit "agree[d]" that relieving incumbents of UNE requirements on the ground that a UNE's functionality could also be obtained in a tariffed wholesale service "would allow the incumbent LECs to evade a substantial portion of their unbundling obligations under subsection 251(c)(3)."[83]

NGDLC Loops - Finally, the record clearly reflects the substantial impairments that new entrants face because of the incumbents' current ability to bar CLECs From accessing the high frequency portion of NGDLC loops in ILEC central offices. CLECs can no more afford to deploy NGDLC loops than they can afford to deploy any other type of loop, and the record shows that the costs and technical impediments associated with constructing remote collocation facilities are prohibitive. Moreover, the incumbents' efforts to paint the remote electronics used in NGDLC loops as "packet switching" are utterly wrong. NGDLC loops – as all other loops – provide no switching functionality.[84] Moreover, it is undisputed that CLECs that wish to provide competitive DSL service must use their own packet switches, so any attempt to call access to NGDLC loops a form of "data UNE-P" is simply wrong. Finally, AT&T has demonstrated that the incumbents' ability to wall off access to NGDLC loops has given them enormous advantages in their efforts to compete for local voice services as well.[85] Indeed, incumbent executives have proudly pronounced that their abili to offer DSL service has substantially reduced customer "churn" for local voice services? The case for impairment is clear and the only result of accepting the incumbents' arguments would be to lock up broadband services for small business customers as an ILEC monopoly and to relegate retail residential broadband services to a duopoly between the ILECs and cable providers.

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In sum, the record shows that removal of access to UNEs and restrictions on UNE use will not encourage new entrants to construct their own facilities. Indeed, it shows just the opposite. CLECs will only be encouraged to construct their own facilities by rules that *foster* their use of UNEs, so they can develop sufficient scale to support additional facilities deployment, and so that the incumbents' unit cost advantages arising From their closed network architectures may be somewhat neutralized.

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[83] *Iowa Utilities Bd. v. FCC*, 120 F.3d 753, 809 (8" Cir. 1997), *aff'd in part and rev'd in part on other grounds, AT&T Corp. v. Iowa Utilities Bd.*, '525 U.S. 366 (1999).

[84] AT&T Reply Comments, Gerszberg Reply Dec. ¶¶ 3-6 (July 17, 2002).

[85] AT&T Reply Comments at 102-08, 191-92, 220-23 (July 17, 2002).

[86] See http://www.isp-planet.com/cplanet/tech/2002/prime letter 020729 verizon.html ("SBC just reported DSL customers have a remarkable 75 percent lower chum rate for voice lies.")

For these reasons, the Commission should **reject** the incumbents' proposals. Instead, it should adopt **rules** that (1) maintain its existing national list **of** UNEs; **(2)** modify the switching carve-out **so** that it applies to all customer locations served by DS1 and higher capacity loops; **(3)** eliminate the **use** and commingling restrictions on **loop-**transport combinations; and **(4)** eliminate the restrictions on access to **NGDLC loops.**

Very truly **yours,**