SIDLEY AUSTIN BROWN & WOOD LLP

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1501 K STREET, N.W.
WASHINGTON, D.C. 20005
TELEPHONE 202 736 8000
FACSIMILE 202 736 8711
www.sidley.com

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BEIJING | GENEVA | HONG KONG | LONDON | SHANGHAI | SINGAPORE | TOKYO

WRITER'S DIRECT NUMBER
(202) 736-8224

WRITER'S E-MAIL ADDRESS
cbeckner@sidley.com

December 6, 2002

Marlene Dortch
Secretary
Federal Communications Commission
445 12th Street, NW
Washington, DC 20554

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 Ms. Dortch:

This letter addresses recent claims by equipment manufacturers that, but for the Commission's unbundling rules, the Bells would invest more in equipment used to provide broadband services.[1] According to recent published reports, the manufacturers have claimed that their "prospective customers" (*i.e.*, the Bells) have informed them that their "revenues could increase to five or ten times what they are today" but for the Commission's unbundling requirements.[2] Likewise, Corning has made a series of filings with the Commission in which it claims that the U.S. fiber industry is in a severe depression that can only be ameliorated by elimination of both unbundling obligations with regard to "fiber to the home" and elimination of the "platform" of unbundled network elements.[3] The notion that the Commission's unbundling

[1] *See, e.g.*, TR Daily, Vendors Renew Push For Broadband Deregulation (Nov. 14, 2002).

[2] *Id.* (quoting Jim Hjartarson, president and chief executive officer of Catena Networks).

[3] *See Ex Parte* Presentation, *Critical Impact of the UNE Decision on the Fiber Optics Industry* (Nov. 27, 2002). The basis for Corning's claim that "[u]nbundling relief will increase FTTH by a factor of 6.2" is the report prepared by Cambridge Strategic Management Group ("CSMG") that was submitted by Corning with its April 5, 2002 comments. AT&T in its reply comments and the accompanying declaration of Dr. Richard Clarke and Mr. John Donovan demonstrated that the CSMG report was riddled with methodological and factual errors. AT&T Reply at 82-85, 121-23 & Clarke-Donovan Reply Dec. ¶¶ 17-29. Correcting these obvious flaws with more realistic assumptions shows that there is no material difference in the rate of FTTH deployment in either a "free" or "regulated" market.

rules impairs the Bells' incentives to invest in network facilities has been conclusively refuted both as a matter of theory and of fact, including, most recently, by the experts who testified at the Commission's October 7, 2002 *En Banc* Hearing. Thus, the equipment manufacturers' assertions offer no basis for the Commission to deny competitors broad unbundled access to network elements that will allow them to offer meaningful alternatives to the Bells.

At the outset, it is critical to stress that the equipment manufacturers appear to have been duped by the Bells. The Bells have, in fact, made *no* commitment to increase broadband investment should they get the relief that they seek – let alone by "five or ten times" current levels. To the contrary, in response to Chairmen Powell's speech urging telecommunications carriers to spend more on equipment in order to help ensure the viability of equipment manufacturers, Verizon responded cavalierly that it has no intention of "reach[ing] in and send[ing] a check to support them."[4] And even where they have committed to make substantial broadband investments, the Bells have history of reneging on those promises.[5] For example, Verizon has backed out of its commitment to deploy fiber-to-the-home ("FTTH") in Pennsylvania in return for regulatory concessions, stating that "giving customers [higher speeds] might even be a waste of bandwidth, or transmission capacity, since few uses of the Internet can fully exploit [them]."[6] Likewise, SBC promised to invest $120 million in new network infrastructure for schools, hospitals and major government centers in Indiana as a *quid pro quo* for an alternative rate regulation plan. That promise was not kept. Instead, SBC made only a fraction of the required investments, and in many instances those upgrades were to serve high-end business customers rather than networks for the governmental organizations it had promised to build.[7]

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[4] Barnaby Feder, *FCC Chief Says Telecom Isn't Doomed By Cutbacks*, N.Y. Times, C1 (Oct. 21, 2002). Notably, Corning has acknowledged that even if its proposals are adopted, "it is unclear whether the ILECs will invest in FTTH." *Ex Parte* Presentation, *Critical Impact of the UNE Decision on the Fiber Optics Industry* (Nov. 27, 2002) at 14.

[5] *See Ex Parte* Letter from H. Russel Frisby to Marlene Dortch, CC Docket No. 01-338 (Nov. 7, 2002).

[6] Akweli Parker, *Verizon Backs Out of Promises in Pennsylvania, Official Charges*, The Philadelphia Inquirer (March 29, 2002). *See also Verizon Pennsylvania, Inc. Petition and Plan for Alternative Form of Regulation Under Chapter 30 2000 Biennial Update of Network Modernization Plan*, P-00930715, at 2 (Penn. PUC March 28, 2002) .

[7] *Petition of Indiana Bell Telephone Company, Incorporated D/B/A Ameritech Indiana For The Commission to Decline to Exercise in Whole or in Part Its Jurisdiction Over, And Regulatory Procedures For, Ameritech Indiana's Provision of Retail and Carrier Access Services Pursuant to I.C. 8-1-2.6 et. seq.*, Cause No. 40849 (Ind. URC April 28, 1999).

In all events, the notion that the Commission's unbundling rules are standing in the way of increased broadband deployment is demonstrably false. Certainly, there is no legitimate claim that the Act's unbundling obligations have impaired deployment of existing NGDLC technology. As the Bells' press statements to Wall Street show, Bell DSL-based services have experienced phenomenal growth.[8] This growth is directly due to the enormous investments that the Bells have *already* made in upgrading their networks, which can now provide broadband services to the vast majority of their subscribers. Indeed, the Commission recently found that "[i]n 2000, [ILECs] invested almost $29.4 billion in infrastructure," and that a "substantial portion" of the investment was to allow "high speed or advanced data services" to be offered more broadly.[9] As a consequence of these and subsequent investments, Verizon now states that high-speed service can be offered on 79% of its access lines,[10] and BellSouth claims that this will also be true for 76% of its customers by year-end, up from 45% in 2000 – a 68% increase in only two years.[11] SBC reports that it expanded its DSL-capable footprint by 37% to 25 million customers in 2001 alone and that currently 60% of its households are DSL-qualified.[12]

Just as implausible is any claim that "new" investment, including next generation broadband services such as FTTH, are imperiled by the Act's unbundling requirements. This is contrary to sound economics. As Professor Willig and his colleagues have explained:

> The increased competition enabled by UNEs can be expected to result in lower retail prices both because of the efficiency improvements induced by competition and because of the pressure competition places on above-cost pricing. Lower

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8 *See* AT&T Reply Comments at 79-81 (documenting Bell statements regarding growth of DSL subscribership and increase in size of DSL footprint).

9 *See Third Section 706 Report,* 17 FCC Rcd. 2844, ¶ 69 (2002).

10 *See* News Release, *Verizon Communications Reports Solid Results for Fourth Quarter, Provides Outlook for 2002* (Jan. 31, 2002).

11 *See* News Release, *BellSouth Captures 620,500 DSL Customers and Deploys Broadband Capabilities to More Than 15.5 Million Lines* (Jan. 3, 2002). BellSouth has widely deployed DSL technology even in relatively rural states. According to recent BellSouth statements, 136 of 140 central offices in North Carolina are now capable of support DSL-based services. *BellSouth Makes Progress on North Carolina High-Speed Internet Service*, The News & Observer, Raleigh, NC Knight Ridder/Tribune Business News, (Apr. 3, 2002). BellSouth also expects to have in place 2,100 remote terminals in North Carolina by the end of the year. *Id.*

12 *EchoStar, SBC Forge Powerful TV-Telecom Alliance*, Satellite News (Apr. 22, 2002). Even Qwest, which has the most rural territory of the mega-ILECs, and has been the slowest to upgrade its network, can now deploy DSL-based services to 40% of households in its region. Jeff Smith, *A Dream Deferred*, Rocky Mountain News (Denver, Co.) (Apr. 1, 2002).

> prices will result in increased demand. The growing demand will induce additional facilities investment by ILECs and CLECs. Additionally, in a competitive environment, both the incumbent and the entrant will face enhanced incentives to improve quality and innovate with respect to services, leading to further investment.[13]

Further, when priced using the Commission's "TELRIC" standard, UNE rates fully compensate the Bells for the economic costs of providing UNEs, including a risk-adjusted return on the Bells' invested capital. Accordingly, TELRIC-based UNE rates approximate the prices that would prevail for UNEs if there were a competitive wholesale market. So long as competitive carriers are paying rates that are at or above TELRIC, "free-riding" simply cannot occur.

Any doubt on this score was put to rest by the independent economists and analysts that testified at the Commission's October 7, 2002 *En Banc* Hearing. At the hearing, there was a consensus among the experts that that any perceived lack of broadband deployment is *not* due to the Commission's unbundling rules; rather, it is due to the lack of consumer demand for greater bandwidth.[14] That is because, as Professor Nalebuff explained, the future broadband applications that are being discussed are primarily for business – which already are served by high-capacity facilities – and would not spur demand for residential services like FTTH.[15] Indeed, at the hearing, Professor Varian discussed the results of an empirical study he undertook that demonstrated, except for telecommuters, consumers are simply unwilling to pay substantial sums for high bandwidth services.[16] Thus, the experts concluded that the most significant

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[13] Willig, Bigelow, Lehr and Levinson, *Stimulating Investment and the Telecommunications Act of 1996*, at ii (Oct. 11, 2002) (attached to *Ex Parte* Letter from Joan Marsh to Marlene Dortch, (Oct. 11, 2002)).

[14] October 7, 2002 *En Banc* Hearing, Tr. at 51 (Nalebuff) ("The problem with broadband is simply there aren't any good killer applications. We had one. It was called Napster, and it was unfortunately illegal."); *id*. ("So we don't have any existing [killer applications], nor is it clear that there are any obvious applications coming up in the future. I read a report from Brookings which said there would be $500 billion in productivity gains from broadband. I think if you believe that, I have dot com stock to sell you."); *id.* at 61 (Varian) (lack of demand for broadband because touted applications "never materialized").

[15] *See, e.g.*, *id.* at 51-53 (Nalebuff) (discussing why forecasted broadband applications are for business that already have high capacity, and would not drive demand for greater bandwidth to residences).

[16] *Id.* at 63-64 (Varian).

impediment to greater broadband penetration today is not the Commission's unbundling rules, but the high prices that the Bells are charging for their DSL services.[17]

The *En Banc* Hearing also made clear that any lack of broadband deployment by the Bells is not due to "a chicken and egg problem."[18] To the contrary, "there are 24 million people who have access to [broadband] at home, plus countless millions more who have access to it at work or at school. And so if there is some great application that's ready to go, people can find it. That's a big enough market out there for people to make the application for."[19]

Finally, the experts explained that the Commission should *not* be setting policies to maximize "investment." As Professor Naleboff explained, investment is not a goal unto itself; rather, the goal of sound regulatory policy is maximize consumer welfare.[20] There was universal agreement among the economists at the *En Banc* that the best way to promote consumer welfare was to take measures to facilitate competition that reduce prices.[21] And because it is undisputed that the markets are now hesitant to fund deployment of facilities by new entrants,[22] the best way to accomplish this is to ease existing barriers to intramodal competition.[23]

In sum, it is easy to understand why equipment manufacturers would like to believe that the Bells would spend more on their products if only they were freed of unbundling obligations.

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[17] *Id.* at 64 (Varian) ("And if you look at prices in the U.S., they're going the wrong direction. They're going up. Last year price – average price of residential broadband has gone up from $50 to $55.").

[18] *Id.* at 53 (Nalebuff).

[19] *Id.*

[20] *Id.* at 104 (Nalebuff) ("I'd like to challenge the question in the sense of I don't care if ther's less investment. We've had too much investment. Our problem is not getting more investment. Actually, the goal of competition is to bring down prices, and that's actually something that needs to happen and hasn't happened."); *see also id.* at 56-57 (Nalebuff) ("There is a question of whether or not adding competition will lead to more investment. I think I come down on the view that it does because that's the only way to protect yourself. . . . . [C]onsumers have not gained enough from competition.").

[21] *Id.* at 56-57 (Nalebuff); *id.* at 64, 106 (Varian); *id.* at 106 (White).

[22] *See id.* at 79 (Warner) ("In my opinion, the market will be reticent to fund any additional capital for facilities-based competition."); *see also id.* at 79-80 (explaining that cable operators are unlikely to invest substantially in cable telephony for the next several years).

[23] *See id.* at 106 (White) (stressing the importance of intramodal competition); *id.* (Varian) (stressing the fact that competition will reduce the incumbents' profits is not a reason for shielding them from competition).

However, those beliefs are simply unfounded, as the Bells' statements to the financial community and the panel's testimony confirm. Indeed, as the distinguished panelists – all of whom came from "outside the industry" – agreed, the best course for the Commission is to adopt unbundling rules that that will bring the benefits of competition to consumers.

Sincerely,

/s/ C. Frederick Beckner III

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