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February 13, 2003

BY ELECTRONIC FILING

Marlene H. Dortch, Secretary
Federal Communications Commission
445 12th Street, S.W., Room TWB-204
Washington, D.C. 20554

Re: *Written Ex Parte* Presentation in CC Docket Nos. 01-338, 96-98, 98-147

Dear Ms. Dortch:

Attached for inclusion in the record of the above-referenced proceedings pursuant to 47 C.F.R. § 1.1206(b) is a letter to Daniel Gonzalez from Broadview Networks, Eschelon Telecom Inc., Talk America, Inc., and the PACE Coalition, in response to a question posed by Mr. Gonzalez in a meeting with representatives from those companies today.

Respectfully submitted,

Brad Mutschelknaus

cc: Daniel Gonzalez
Qualex International

DC01/MUTSB/201479.1

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February 13, 2003

VIA ELECTRONIC FILING

Daniel Gonzalez
Senior Legal Advisor
Office of Commissioner Kevin J. Martin
Federal Communications Commission
455 12th Street, S.W.
Washington, D.C. 20554

Re: ***Ex Parte***
CC Docket Nos. 01-338, 96-98, and 98-147

Dear Mr. Gonzalez:

The purpose of this letter is to clarify certain issues and to provide responses to specific questions regarding the relative roles of the States and the Commission in making unbundling determinations that arose today in our meeting with you.

I. THE *NARUC PLAN* IS CONSISTENT WITH THE ACT

You asked us to respond to RBOC contentions that the NARUC Plan lacks an adequate legal predicate. As stated at our meeting, we strongly disagree. The overall legality of the *NARUC Plan* rests on two foundations. One, the Commission has the authority to utilize the expertise and processes of the State Commissions to implement unbundling requirements, including the determination of whether a network element should be, or should remain, unbundled. Two, the *NARUC Plan* addresses the deficiencies with the Commission's earlier unbundling rules found by the U.S. Court of Appeals for the DC Circuit in *USTA*.[1]

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[1] United States Telecom Association v. FCC, 290 F.3d 415 (D.C. Cir. 20002) ("USTA").

A. The Role Envisioned by the *NARUC Plan* for the States Is Consistent with That Set Forth in the 1996 Act and the Commission's Earlier Orders Implementing the 1996 Act

The role for the State Commissions envisioned by the *NARUC Plan* is consistent with the Act and the shared jurisdiction over unbundling decisions envisioned by Congress. As an initial matter, the Act does not preclude the Commission from delegating to State Commissions a critical role in making unbundling determinations. Underscoring the propriety of the State Commissions' involvement in unbundling decisions, the Act preserves for the States the authority to adopt UNEs in addition to any that may be on the Commission's national list. Most significantly, Section 251(d)(3) reveals explicit Congressional intent to preserve State authority to adopt unbundling requirements even in circumstances where the Commission does not. In fact, the Eighth Circuit Court of Appeals held that subsection 251(d)(3) specifically deals with access and interconnection obligations and that it "constrains the FCC's authority" to preempt State unbundling obligations.[2] .In addition, Section 261(c) of the Act expressly permits States to adopt additional requirements under State law that are "necessary to further competition."[3] Section 252(e)(3) explicitly recognizes that that States may establish and enforce requirements of State law when reviewing interconnection agreements under Section 252(e), subject only to review under Section 253 of the Act. In light of such independent State authority to prescribe unbundling, Commission rules as envisioned by the *NARUC Plan* that rely on the States' expertise to make market-specific unbundling decisions through application of federally-mandated criteria would be wholly consistent with the shared federal-state responsibility for implementing the local competition provisions of the Act.

Beyond the statutory provisions, the Commission in its First Report and Order in Docket 96-98[4] and in its Third Report and Order in that docket, the so-called *UNE Remand Order*,[5] as well as its regulations,[6] has consistently recognized and underscored that the State Commissions are to play a major role in administering and implementing the Commission's unbundling regulations. Indeed, the Act puts the State Commissions in this role quite explicitly with respect

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2 *Iowa Utils. Bd. v. FCC*, 120 F.3d 753, 806 (8th Cir. 1997); not at issue in *AT&T v. Iowa Utils. Bd.*, 525 U.S. 366 (1999).

3 Moreover, Section 261(b) of the Act specifically allows States to adopt their own regulations in furtherance of the requirements of the local competition provisions of the 1996 Act. 47 U.S.C. § 261(b).

4 *Implementation of the Local Competition Provisions of the Telecommunications Act of 1996,* 11 FCC Rcd 15499, 15627 (1996) (subsequent history omitted).

5 *Implementation of the Local Competition Provisions of the Telecommunications Act of 1996,* Third Report and Order,15 FCC Rcd 3696, 3768-69 (1999) ("UNE Remand Order"), *vacated in part, remanded in part sub nom USTA, supra.*

6 47 C.F.R. § 51.317(b)(4).

to arbitrations[7] and approval of interconnection agreements.[8] Further, even the Supreme Court in *Iowa Utilities Board* recognized that "[i]f a requesting carrier wants access to additional elements [beyond the Commission's list], it may petition the state commission, which can make other elements available on a case-by-case basis."[9] The *USTA* Court did not reach a contrary conclusion. The States' role within the *NARUC Plan* would be entirely complementary to the current responsibility they have in implementing federal, in addition to State, laws and regulations regarding local competition.

B. The *NARUC Plan* Overcomes the Deficiencies of the Commission's Unbundling Rules Identified by the Court in *USTA*

At bottom, the Court in *USTA* remanded the Commission's unbundling rules for two reasons. First, the Commission adopted uniform, national rules "mandating [each] element's unbundling in every geographic market and customer class, without regard to the state of competitive impairment in any particular market."[10] The Court found that the Act required a more granular, geographic- or market-based approach to impairment analysis.[11] Second, the Court found that the Commission's rules relied upon cost disparities that were inherent as between new entrants and incumbents in any industry, whether dominated by one company or fully competitive.[12] Rather, the Court concluded, in considering cost disparities in support of a finding of "impairment" under Section 251(d)(2), the Commission must focus on the economies of scale over the extent of the relevant market to determine whether the economies "in some degree" render an element a natural or pure monopoly.[13]

The *NARUC Plan* addresses both concerns of the Court. Through application of the Commission-mandated criteria by State Commissions in individual markets, the *NARUC Plan*

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7 Under Section 252(c)(1) of the Act, 47 U.S.C. § 252(c)(1), State Commissions in arbitrations are charged with ensuring that the resolution of any outstanding issues between the ILEC and the requesting carrier are resolved in a manner consistent with, *inter alia*, Sections 251(c)(3) and 251(d)(2) of the Act (which govern unbundling) and the FCC's unbundling regulations. Thus, the State Commission's are charged with making the underlying determinations pertinent to a carrier's ability to access a particular network element on an unbundled basis, either under the Commission's unbundling rules, or under the Act if the FCC's Rules do not address a particular network element or unbundling scenario.

8 Under Section 252(e)(2)(B), 47 U.S.C. § 252(e)(2)(B), State Commissions, when reviewing and approving arbitrated interconnection agreements, must consider and ensure compliance of the agreements terms with the Act and the Commission's regulations.

9 *AT&T v. Iowa Utils. Bd.*, 525 U.S. at 388.

10 290 F.3d at 422.

11 *Id.* at 424-26.

12 *Id.* at 426-27.

13 *Id.* at 427.

would ensure a proper granular approach. Market-specific variations in competitive impairment will often depend upon local conditions including geography, levels of demand, the nature and extent of infrastructure, and local zoning and property laws. The consideration of such factors cannot be practicably undertaken by the Commission, but the State Commissions are well-suited to address such matters. They are undoubtedly closer to the facts in specific markets, and State regulators have particular expertise and processes for developing a record to complete an impairment analysis in individual markets. As NARUC itself observes, the involvement of the States in these factual and unbundling determinations make it more likely that the *NARUC Plan* will survive any judicial review of whether the Commission's rules incorporate adequate granularity.

Moreover, the *NARUC Plan* is based upon a record developed in this proceeding that new entrants in local markets have been, are, and will continue to be impaired, as a general matter, in most instances by lack of access to the current list of UNEs. The record strongly suggests that, with the possible exception of the highest capacity transport facilities, the current UNEs represent natural monopolies, at least with sufficient confidence to permit a presumption of impairment until a market-specific determination can be made. State Commission determinations in some specific markets may ultimately conclude that there is no impairment for some elements in some markets. However, until State Commissions make their investigations and complete their unbundling analyses, the current list of UNEs should remain in place in each market, even where the presumption is not in favor of impairment. The danger of harm to consumers, competition, and competitors if an element is erroneously removed from the list while the States complete their granular analysis is very real, and any resulting damage if access to that element is, in the end, found to be impaired is likely to be both catastrophic and irreparable. Reinstitution of the UNE will come too late to be of practical benefit. Furthermore, given the independent authority of State Commissions to adopt unbundling regulations under State law, as demonstrated above, the Commission's rules should ensure, as the *NARUC Plan* would, that delisting of UNEs occurs only after the States have the opportunity to conduct their local investigations and conclude their unbundling deliberations.[14]

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[14] *See* discussion *infra* regarding the need for and legality transition periods, as contemplated by the *NARUC Plan*, where a UNE is removed from the list after State examination.

II. THE NARUC PLAN PROPERLY INCORPORATES THE USE OF GEOGRAPHIC DENSITY ZONES TO DETERMINE IMPAIRMENT

You also asked whether NARUC's proposed use of geographic density zones is justified as a policy and legal matter. We believe that is.

A. The *USTA* Court's Granularity Requirement Necessitates Geographic Specific Analysis, As The ILECS Have Conceded

In *USTA*, the court noted that "any cognizable competitive impairment would necessarily be traceable to some kind of disparity in cost."[15] The court criticized the Commission's "uniform national rule" rule as overly broad because the impairment standard adopted was "unvarying in scope" and without limitation in any "geographic market."[16]

Echoing these sentiments, the ILECs in this proceeding have repeatedly stated that impairment must have a geographic component. SBC hammered this point home in its comments in this proceeding:

> As the Commission has recognized competitive conditions differ across geographic areas. To the extent those differences translate into differences in the ability of carriers to compete without UNEs, the Commission's unbundling rules should reflect those differences. Indeed, any unbundling analysis that fails to consider relevant geographic differences is not meaningful in the least, since it is nonsensical to address impairment without reference to the market in question.[17]

The United States Telephone Association's comments similarly urged the Commission to use geography as a "limiting standard" for any "impairment analysis" applied on a "granular basis, to all network elements on the current UNE list.[18]

BellSouth also noted that the Commission "took geography into account in formulating the rules for determining under what circumstances incumbent LECs did not have to unbundle switching and for determining special access pricing flexibility."[19] Yet, BellSouth lamented, the Commission in the *UNE Remand Order* "inexplicably" failed to use geographic impairment

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15 USTA, 290 F.3d. at 426.

16 USTA, 290 F.3d. at 422.

17 SBC Comments at 30 (Apr. 5, 2002).

18 USTA Reply Comments at 8 (July 17, 2002).

19 BellSouth Comments at 60.

analysis for other UNEs.[20] Clearly, throughout this proceeding, the ILECs have taken the view that geographic analysis is a critical prong to the development of a "granular" impairment standard consistent with the *USTA* decision.

B. NARUC'S Proposed Use Of Density Zones To Set Impairment Presumptions Is Reasonable And Consistent With Past Commission Practices

In its February 6, 2003 *ex parte* in this proceeding, NARUC recommends that the Commission establish certain impairment presumption according to the geographic zones established by the state commissions to set UNE rates in accordance with Commission's rules. The NARUC proposal is eminently sensible, as it (a) builds on the Commission's existing framework for UNE pricing, which is inextricably linked to UNE availability and (b) is sound policy.

1. The NARUC Proposal Builds on the Commission's Existing Pricing Framework

In the *Local Competition Order*, the Commission recognized that "deaveraged rates more closely reflect the actual costs of providing interconnection and unbundled elements."[21] Indeed, the Commission concluded that geographic cost differences within a state necessitated a Commission finding "that rates for interconnection and unbundled elements must be geographically deaveraged."[22] Implementing this requirement, the Commission promulgated the following rule:

> State commissions shall establish different rates for elements in at least three defined geographic areas within the state to reflect geographic cost differences.
>
> (1) To establish geographically-deaveraged rates, state commissions may use existing density-related zone pricing plans described in § 69.123 of this chapter, or other such cost-related zone plans established pursuant to state law.
>
> (2) In states not using such existing plans, state commissions must create a minimum of three cost-related rate zones.[23]

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20 BellSouth Comments at 60.

21 Local Competition Order, ¶ 764 (emphasis added).

22 *Local Competition Order*, ¶ 764.

23 47 C.F.R. § 51.507(f).

Thus, the Commission required state commissions either to use existing special access pricing zones[24] or develop new zones to reflect "cost-related rate zones."[25]

This Commission has utilized the special access pricing zones set forth in rule 69.123 both to provide ILECs with interstate pricing flexibility and as a part of the "impairment" analysis for local circuit switching.[26] The FCC "froze" these geographic areas in 1999, and they have been fixed ever since.[27] The state commissions, as permitted by the Commission's deaveraging rules, have used the pricing flexibility zones as starting points. Through the myriad UNE cost proceedings that have been conducted since 1996, the state commissions have tailored UNE pricing zones to best reflect ILEC cost differences, based on a granular analysis of conditions within each state. Moreover, the ILECs themselves typically propose the parameters of the geographic deaveraged zones based on their retail cost of providing service. Thus, all interested parties have a substantive role in developing geographic zones for UNE pricing.

2. The NARUC Proposal Is Consistent with USTA and the Act

The NARUC proposal is consistent with *USTA* and the Act. Through the NARUC proposal the Commission would be establishing an overarching national framework while at the same time developing precisely the type of granularity test called for by the D.C. Circuit in the *USTA* decision. Thus, the NARUC proposal is wholly consistent with the federalist structure woven by Congress into the Act, and appropriately continues the battle-tested federal/state cooperative model promulgated by the Commission.

Use of UNE rate zones for applying a geographic impairment test is fully consistent with the *USTA* court's notion of cost disparities. The cost disparities underlying the Commission's UNE rate deaveraging decision are closely related to the notion of "impairment" described in *USTA*. As the USTA court explained, "one reason" for "market-specific variations is the cross-subsidization often ordered by state regulatory commission."[28] The court's focus on this point makes perfect sense, as the state commissions have primary responsibility of setting UNE rates under the Act and sole responsibility for setting retail rates for local exchange service pursuant to state law. The Commission should build on this point and its past practices and support NARUC's proposed use of UNE rate zones to set impairment presumptions.

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24 47 C.F.R. § 69.123.

25 *Id.*

26 UNE Remand Order, ¶ 285

27 UNE Remand Order, ¶ 286 ("we freeze, for unbundling purposes, the incumbent LEC's density zone 1 as it was defined on January 1, 1999).

28 *USTA*, 290 F.3d. at 422.

The NARUC proposal does not attempt the impossible task of resolving each and every substantive issue in play, but rather establishes an appropriate legal and procedural framework for their resolution. The division of labor contained in the NARUC proposal is quite possibly the only way for the Commission to legally determine what elements must be made available in accordance with the Act.

In fact, ILEC assertions that density zones may not be consistent across all of the states is precisely the reason why the state commissions must be given the ultimate decision on the presumptions that would be established by the Commission under the NARUC plan. Where there can be no national presumption, the state commissions are the only ones capable of conducting the granularity test that is now legally required. As noted by WorldCom,[29] the density zones are not the final determinant of whether a particular element must be made available; they are, rather, simply the dividing lines for the creation of presumptions by the Commission that may then be tested by the individual state commissions based on the "state of competitive impairment" in that "particular market."[30]

State commissions have wisely used the density zones required by the Commission in establishing many current rules. The New York Commission has, for example, utilized density zones to resolve the precise question at issue here – where specific elements must be made available. In fact, it is Verizon that has supported their use. As far back as 1998, when Verizon was seeking in-region InterLATA authority in New York, it voluntarily committed to provide UNE-P to competitors on specific terms as determined by the density zones previously set by PSC rate proceedings.[31] It is worth noting that this Verizon commitment was made after the Eighth Circuit had struck down the Commission's combinations rules and there was thus no federal requirement to provide UNE-P or other element combinations.

Just this past year, Verizon again supported the use of density zones in setting regulatory policy when density zones were used as a key component in the price-cap Verizon Incentive Plan (VIP).[32] As part of the Verizon/Staff Joint Proposal submitted to the NY PSC, Verizon proposed to continue the use of the density zones to determine the duration of its offering of UNE-P to residential and business customers (including those with more than four lines).[33]

Since Verizon and other ILECs have already pushed for use of density zones in setting regulatory policy – where it has served their interests – they may not now be heard to complain

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29 WorldCom *ex parte*, CC Docket Nos. 01-338 et al. (Feb. 12, 2003).

30 *USTA*, 290 F.3d at 422.

31 Case 97-C-0271, Pre-Filing Statement of Bell Atlantic-New York, April 6, 1998, at pages 8-9.

32 Cases 00-C-1945 and 98-C-1357, Order Instituting Verizon Incentive Plan, Issued and Effective February 27, 2002 (*VIP Order*).

33 *VIP Order* at pages 4-5, 26-28, and Appendix A.

of that very same use simply because they seek to re-monopolize the telecom market. The Commission must therefore look beyond the ILECs' feigned opposition to the use of density zones and determine that their use is wholly appropriate and entirely consistent with the ILECs' own regulatory policies.

The use of density zones as proposed by NARUC is a reasonable and legal solution to the challenge of establishing a national policy in a nation as expansive and diverse as ours. We urge its adoption.

III. THE FCC HAS DISCRETION TO REQUIRE THAT DE-LISTED UNES BE MADE AVAILABLE FOR A REASONABLE TIME AS PART OF A TRANSITION PLAN

Finally, you have asked us to respond to RBOC suggestions that the FCC lacks authority to implement a rationale transition plan for delisted UNEs. Suggestions by some RBOCs that the Commission lacks authority to create a transition plan that provides for an orderly phase-out of existing UNEs where it is found that impairment no longer exists is plainly silly. First, the 1996 Act itself provides ample authority for the Commission to continue to make UNEs available on a temporary basis even where impairment has dissipated by providing in Section 251(d)(2) that the "necessary" and "impair" standards must be considered "at a minimum" in determining what UNEs to require. Thus, the Commission is free to apply other reasonable considerations, including whether an orderly transition plan designed to avoid crippling competitors and derailing service to CLEC end users, in determining whether and when UNEs should be made available.

Indeed, the Commission has a long history of utilizing its broad discretion to create and implement transition plans when adopting substantial regulatory changes. *See, e.g., National Ass'n of Regulatory Util. Comm'rs v. FCC*, 737 F.2d 1095, 1135 (D.C. Cir. 1984) (stating that "the shift from one type of nondiscriminatory rate structure to another may certainly be accomplished gradually to permit the affected carriers, subscribers and state regulators to adjust to the new pricing system."). The courts have recognized that the Commission has wide latitude in implementing such plans, particularly where the implementation of a new regime might result in an adverse impact on the industry. *See, e.g., Competitive Telecommunications Ass'n v. FCC*, 117 F.3d 1068, 1073-74 (8th Cir. 1997) (upholding the Commission's transition plan and noting that the Commission implemented the plan because "implementation of the requirements of section 251 now, without taking into account the effects of the new rules on . . . existing access charges and universal service regimes may have significant, immediate, adverse effects . . .").

Indeed, the Commission has implemented transitional schemes in furtherance of its obligations under the 1996 Act on numerous occasions.[34] The Commission has noted specifically

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[34] *See MCI Telecommunications Corp. v. FCC*, 750 F.2d 135, 141 (DC Cir. 1984) (stating that an agency has substantial deference in implementing interim relief, and upholding the Commission's interim relief plan

that it "may, where necessary, establish a temporary transitional mechanism to help complete all of the steps toward the pro-competitive goals of the 1996 Act." *See, e.g., Implementation of the Local Competition Provisions of the Telecommunications Act of 1996*, Supplemental Order, 15 FCC Rcd 1760, ¶ 7 (1999). The Commission did just that in the *Supplemental Order*, where it established an interim rule regarding CLECs access to combinations of unbundled loops and transport (an that remains in place to this day—four years later) to address the "legal and economic implications of allowing carriers to substitute combination s of unbundled loops and transport network elements for the incumbent LEC's special access services."[35] The Commission also has implemented interim relief or transitional plans in numerous other contexts, including, *inter alia,* access charge reform, ISP reciprocal compensation charges numbering resources, E-911,.[36]

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noting that the interim plan is particularly appropriate in light of the Commission's goal of maintaining the status quo without frustrating the objectives of a pending rulemaking proceeding).

35 *See, e.g., Implementation of the Local Competition Provisions of the Telecommunications Act of 1996*, Supplemental Order, 15 FCC Rcd 1760, ¶ 7 (1999).

36 "Avoiding unnecessary damage to this growing competition, as likely would result from an immediate transition to the ILEC rate is consistent with our approach in other proceedings, such as the reform of reciprocal compensation that we recently adopted, in which we have sought to reduce the opportunity for regulatory arbitrage but have nevertheless provided a transition mechanism to prevent too great of a revenue shock to a particular group of carriers. This transition period is necessary to permit CLECs to adjust their business plans and obtain alternative sources for the substantial revenues of which the benchmark will deprive them – revenues on which they have previously relied in formulating their business plans because they were not held to the regulatory standards imposed on ILECs." *See Access Charge Reform, Reform of Access Charges Imposed by Competitive Local Exchange Carriers*, CC Docket No. 96-262, 16 FCC Rcd 9923, ¶ 71 (April 27, 2001)

The Commission adopted a three-year ramp-down period in the order governing reciprocal compensation payments for traffic bound for internet service providers. *See Implementation of the Local Competition Provisions in the Telecommunications Act of 1996*, CC Docket No. 96-98, Intercarrier Compensation for ISP-Bound Traffic, CC Docket. No. 99-68, Order on Remand and Report and Order, FCC 01-131 (Apr. 27, 2001).

We hope that you find the foregoing responses to your inquiries helpful. As you deliberate on this important topic, we hope that you feel free to call us with any additional questions or concerns that you may have.

Sincerely,

Brad E. Mutschelknaus
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Eschelon Telecom, Inc.
Talk America, Inc.

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