TELRIC Rulemaking and Forbearance: A Triumph of Hope over Experience?

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March 8, 2004

Z-Tel Position

There is no evidence that existing FCC TELRIC rules…

…have had adverse investment effects

… are below cost

or

…are too "complex" for state commissions to implement

TELRIC and Investment

An Ideal UNE rate would not be so high as to incent inefficient entry and not so low as to disincent investment

What would economic theory recommend?

Minimum economic cost of reproducing the functionality of the element – TELRIC is reasonable approximation.

Deviations from TELRIC will create distortions. How can you justify such changes if efficient investment is a policy goal.

What do the empirics tell us about current TELRIC rates?

What evidence is there that CLECs have underinvested in switching plant?

None. In fact, there is substantial evidence of over-investment in switching by CLECs.

- Bells claim 1300 CLEC switches deployed – but FCC found over 80% failure rate of Facilities-based CLECs!
- Crandall and Singer on Behalf of BellSouth: switch-based UNE-L is a "non-sustainable business plan[]" that has "resulted in an incredible waste of resources"*
- Beard, Ford & Koutsky, *Mandated Access and the Make-or-Buy Decision*, www.telepolicy.com (2003)
- Beard, Ekelund, Ford, *Pursuing Competition in Local Telephony: The Law and Economics of Unbundling and Impairment,* J. Law, Technology & Policy (upcoming Spring 2004).

* http://www.phoenix-center.org/critiques/CrandallResponse.pdf.

What evidence is there that TELRIC has dis-incented ILEC Investment?

None. In fact, net telecom plant has increased substantially since 1996

Phoenix Center Public Policy Bulletins 5 and 6 (attached to Z-Tel TELRIC Comments)

What evidence is there that TELRIC is below current/embedded cost?

None. In fact, TELRIC provides a healthy return over current/embedded wholesale cost

Beard & Klein, *Bell Companies as Profitable Wholesale Firms* (Nov. 2002); Beard, Ford & Klein, CommLaw Conspectus (2004)

Bells don't even argue "cost" anymore, but focus on differential to retail revenue (aren't wholesale prices always less than retail prices?)

Colloquial Evidence Supports Z-Tel

- SBC CFO Randall Stephenson: at TELRIC UNE-P price of $20/mth in Texas, “there is competition,” “it’s not at such a level we cannot earn money or are disincented to invest”
- BellSouth witness...
  - "The use of a hypothetical network and most efficient, least-cost provider requirements have distorted the TELRIC results and normally understate the true forward-looking costs of the ILEC. .. .These distortions, however, are most evident in the calculation of unbundled loop elements, and they are less evident in the switching and transport network elements that make up switched access. “ Testimony of Robert McKnight in SC Docket 1991-239-C (12/31/03)
- UNE-P costs more than you think!
  - NY: Commerce Capital Markets = $17.17; Z-Tel’s Bill = >$28
  - GA: Commerce Capital Markets = $23.80; Z-Tel’s Bill = >$30

Impact of TRO/*USTA II*

FCC cannot avoid the fact that because of TRO and USTA decision, ILEC "investment" arguments are no longer relevant

Mental Challenge: **Name one network facility a policymaker would want an ILEC to deploy that FCC requires to be unbundled at TELRIC**

(FTT*? NGDLC? Packet switching?)

State Implementation

What evidence is there that TELRIC is "too complex" so that state implementation is a problem?

None.

State variability in rates

- State variability in UNE loop rates generally reflects cost differences between states

  See Phoenix Center Policy Bulletin No. 9 (March 2004).

- Eisenach & Mrozek study submitted by Bells confirms this analysis; Ekelund & Ford study submitted by Z-Tel confirms this analysis

- Evidence supports "learning by doing" hypothesis
  - Over time, state rates have converged toward TELRIC outcomes
  - Mere fact that state UNE rates have "changed" does not support conclusion that those new rates are "wrong" or that the overall methodology is "wrong"

Improving the Accuracy of TELRIC

- Require flat rates for local switching
  - Switches are purchased on a capacity/number of line basis, not by number of minutes
  - Per-minute calculations inject error possibility
  - Per-minute calculations can be manipulated by ILECs (such as mistakes in counting days in a year or usage)
  - Per-minute rates affect CLEC business and entry plans
- Prohibit Forward-Looking-to-Current Cost Factors

Per-Minute Access Charges and UNE-P

Per-minute access charges are substantial revenue source for UNE-P providers

Forbidding UNE-P providers from collecting per-minute access charges would…

- be discriminatory
- require re-examination of Bell 271 entry decisions (which relied upon UNE-P for Track A consideration)
- result in double-recovery of costs to ILECs, and
- be a regulatory taking

UNE-P and Access Charges: Analysis

- Terminating access (incl. 800) is about $8/mth in NY
- Terminating access (incl. 800) is about $5/mth in GA
- Allowing ILEC to recover terminating access in addition to unbundled switching leads to double recovery
  - ULS rate covers costs – per-minute access would be pure gravy for Bells
- Prohibiting UNE-P CLECs from collecting these sums would result in *immediate* and *substantial* decrease in revenue and would impost costs without permitting recovery
- Prohibiting UNE-P CLECs would require FCC to reexamine that impact in any "impairment" analysis

  TRO para. 77: "A firm's ability to enter is affected by the costs incurred, revenues obtained, and risk involved in entering a market…factors that…limit its potential revenues…reduce the likelihood of entry."