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BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In re: Petition of Verizon Florida Inc. to Reform Its Intrastate Network Access and Basic Local Telecommunications rates in Accordance with Florida Statutes, Section 364.164	Docket No. 030867-TL
In re: Petition of Sprint-Florida, Incorporated, To reduce intrastate switched network Access rates to interstate parity in Revenue neutral manner pursuant to Section 364.164(1), Florida Statutes	Docket No. 030868-TL
In re: Petition by BellSouth Telecommunications, Inc., To Reduce Its Network Access Charges Applicable To Intrastate Long Distance In A Revenue-Neutral Manner	Docket No. 030869-TL
In re: Flow-through of LEC Switched Access Reductions by IXCs, Pursuant to Section 364.163(2), Florida Statutes	Docket No. 030961-TL Filed Sept. 8, 2004

AARP MOTION FOR EVIDENTIARY HEARING AND MODIFICATION OF COMMISSION ORDERS NOS. PSC-03-1469-FOF-TL AND PSC-04-0456-FOF-TL ON THE BASIS OF SIGNIFICANTLY CHANGED CIRCUMSTANCES AND PUBLIC NEED

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AARP, through its undersigned counsel, pursuant to Rule 28-106.204, Florida Administrative Code and Peoples Gas System, Inc. v. Mason, 187 So.2d 335 (Fla. 1966) and the Florida Supreme Court cases following it, hereby files its motion for additional evidentiary hearing and

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modification of Florida Public Service Commission ("Commission") Orders Nos. PSC-03-1469-FOF-TL (the "Initial Order") and PSC-04-0456-FOF-TL (the "Order on Reconsideration") (or collectively the "Rate Increase Orders") on the basis that the quid pro quo to residential customers – increased residential competition – to be received in exchange for the substantial increases in their basic local rates ordered by the rate increase orders referenced above of increased residential competition is rendered highly improbable, if not impossible. In support of this motion, AARP states:

SUMMARY OF MOTION

On December 24, 2003 this Commission approved over $344 million annually in residential local service rate increases for BellSouth, Sprint and Verizon. The chief statutory and regulatory justification given for the 30 to 90 percent local service rate increases[1] was that they would increase local service competition and, thus, benefit residential customers with both the fruits of enhanced local competition, as well as a reduction in instate toll

[1] Uniform dollar increases were applied to different urban and monthly local rates resulting in varying percentage increases not only between companies, but within each company's service territory as well.

charges. All parties representing the interests of residential customers objected vehemently to the increases.[2]

Potential local service competitors party to the case included long distance companies AT&T and MCI; Sprint, which is both an incumbent local provider and a competitor; and, a relatively small cable television provider, Knology. While these and other competitors were expected to be drawn to the market by the increased profit margins resulting from higher local rates, the evidence, as described in the Commission's 2003 Report on Competition, was overwhelming that recent increases in residential local service competition were almost exclusively the result of the local service competitors having access to the incumbent companies' wire loops and computer switches at Federal Communications Commission (FCC)-mandated, low-cost UNE-P wholesale rates.

However, on March 2, 2004 the FCC's order requiring the low-cost UNE-P rates was reversed by a federal appellate court in an opinion strongly rebuking the FCC for overstepping its jurisdiction. Both the FCC and U.S. Solicitor General declined to appeal. There was no stay mandating the continued availability of the low-cost UNE-P rates for either

[2] In addition to AARP, which has over 2.6 million members in Florida, the Florida Attorney General and the

existing or future customers, and negotiations for new wholesale rates largely failed. Moreover, the interim rates recently unveiled by the FCC, unless overturned, will only extend current wholesale rates until early 2005.

Citing the uncertainty of the ongoing availability of low-cost UNE-P rates as a major factor, the board of the largest potential local service competitor party to these cases, AT&T, on July 22, 2004, announced that it would cease local service competition throughout the nation, including, of course, Florida. AT&T also announced that it would immediately cease its efforts to acquire new residential customers for its long distance services, while focusing instead on its business long distance customers. There are also published reports that both MCI and Sprint are scaling back their efforts to compete for local service customers and that they might completely cease their efforts to compete in the local residential market.

Whatever the "value" of enhanced local service competition would have been to residential customers, the likelihood of it occurring has now been rendered highly unlikely, if not impossible, by the March 2 federal court opinion, AT&T's subsequent decision to cease its local service competitive efforts and the apparent decisions of MCI and Sprint to cease

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Office of Public Counsel opposed any local service rate increases.

marketing their competitive local service offerings. Simply put, the stated quid pro quo for the large residential local rate increases – the "benefits of increased competition" – has now largely evaporated. Worse yet for residential customers, AT&T's decision to abandon its competition for residential long distance customers necessarily means that residential customers, as a group, will receive an even smaller percentage of the flow-back of reduced instate toll rates than currently anticipated by the Commission's orders.

Peoples Gas System, Inc. v. Mason, 187 So.2d 335 (1966), and the cases following it, provide that this Commission may modify its final orders in the face of "changed conditions or other circumstances not present in the proceedings which led to the order being modified," so as to "act in the public interest." AARP believes the March 2 federal court opinion, coupled with the AT&T announcements to abandon residential local service and long distance competition, plus MCI's and Sprint's apparent decisions not to market their local service products, are "changed circumstances" of a most fundamental nature and require modification of the Rate Increase Orders. Simultaneously with the filing of this motion, AARP is moving the

Florida Supreme Court to relinquish jurisdiction of these cases to the Commission for the purpose of holding an evidentiary hearing to determine whether the changed circumstances compel the reversal of the historically large local service rate increases.

AARP believes that such an evidentiary hearing will prove that enhanced local service competition of any meaningful degree is now impossible in Florida and, consequently, that the rate increases can no longer statutorily stand.

THE COMMISSION MAY MODIFY ITS FINAL ORDERS

The Legal Standard

1. In June, 1965, this Commission entered an order by which it attempted to rescind and withdraw its approval of a territorial service agreement between two regulated gas distribution companies it had previously granted in a final order entered in 1962. Upon review by the Florida Supreme Court in the case of Peoples Gas System, Inc. v. Mason, 187 So.2d 335 (1966), the Court found that the Commission could not modify the order in question but enunciated the standard by which the Commission had "the inherent power . . . to reopen or modify a final order

after it has become final by passage of time." Recognizing that the inherent authority was a limited one, the Court discussed the necessity for regulatory agencies to modify final orders with more frequency than courts. In this regard, the Court said:

> We understand well the differences between the functions and orders of courts and those of administrative agencies, particularly those regulatory agencies which exercise a continuing supervisory jurisdiction over the persons and activities regulated. For one thing, although courts seldom, if ever, initiate proceedings on their own motion, regulatory agencies such as the commission often do so. Further, <u>whereas courts usually decide cases on relatively fixed principles of law for the principal purpose of settling the rights of the parties litigant, the actions of administrative agencies are usually concerned with deciding issues according to the public interest that often changes with shifting circumstances and passage of time</u>. Such considerations should warn us against a too doctrinaire analogy between courts and administrative agencies and also against inadvertently precluding agency-initiated action concerning the subject matter dealt with in an earlier order.

<u>Peoples Gas</u> at 339. (Emphasis supplied.)

While the Court found that the order modification under review in <u>Peoples Gas</u> was not "based on any change in circumstances or on any demonstrated public need or interest," it further held as follows:

> Nor can there be any doubt that the commission may withdraw or modify its approval of a service area agreement, or other order, in proper proceedings initiated by it, a party to the

> agreement, or even an interested member of the public. However, this power may only be exercised after proper notice and hearing, and upon a specific finding based on adequate proof that such modification or withdrawal of approval is necessary in the public interest because of changed conditions or other circumstances not present in the proceedings which led to the order being modified. This view accords requisite finality to orders of the commission, while still affording the commission ample authority to act in the public's interest.

Peoples Gas at 339, 340. (Emphasis supplied.)

2. The holding in Peoples Gas was affirmed in Austin Tupler Trucking, Inc. v. Hawkins, 377 So.2d 679 (Fla. 1979) (modification disallowed because "respondents have failed to show any significant change in circumstances or great public interest which would be served by permitting the 1974 proceeding to supersede the finding of dormancy in the 1972 order.") See also Richter v. Florida Power Corp., 366 So.2d 798 (Fla. 2d DCA 1979) (Florida case law recognizes the rule that an administrative agency may alter a final decision under "extraordinary circumstances.")

3. In the more recent case of Mann v. Department of Professional Regulation, Bd. Of Dentistry, 585 So.2d 1059 (Fla. 1st DCA 1991), the Court, citing to Peoples Gas, remanded to the Board of Dentistry an unappealed four-year-old order of suspension following the agency's denial

of the respondent's motion for modification on the basis that the final order in question was ambiguous. Later yet, in Russell v. Department of Business and Professional Regulation, 645 So.2d 117 (Fla. 1st DCA 1994), the Court cited to Peoples Gas, but declined to remand the case because "appellant has failed to demonstrate in his motion to set aside the 'extraordinary circumstances' which are a prerequisite for revisiting a closed case." Ibid. at 119.

4. AARP would submit to the Commission that the legal standard here is that the Commission may, under the appropriate circumstances, modify one of its final orders, as late as four years after the entry of that order, and even if the initial order had not been appealed, so long as there has been "a significant change in circumstances" since the entry of the final order or where there is a "great public interest" which might be served by the modification of such an order.

5. Although the "passage of time" cited by the Peoples Gas court has been relatively short in duration here, AARP believes the "shifting circumstances" since the entry of the final order in these cases have been monumental and fundamentally undermine the basis for the local service

rate increases. It is AARP's position that there is a very great public interest warranting modification of the Rate Increase Orders resulting in denial of the local service rate increases.

SIGNIFICANT CHANGED CIRCUMSTANCES/ PUBLIC INTEREST

Legal and Factual Status Quo At Entry of Rate Increase Orders

6. At the time the Initial Order was entered on December 24, 2003, and during the administrative hearings leading to that order, both the federal and state orders of the day held that Incumbent Local Exchange Companies (ILECs), like BellSouth, Sprint and Verizon, had to make their local loops (the proverbial "last mile" of cooper wiring to the retail customer) and their computer switching facilities (part of the Unbundled Network Element - Platform or "UNE-P") available to their local phone service competitors (Competitive Local Exchange Companies or CLECs) at wholesale rates based upon an FCC pricing methodology called the "Total Element Long Run Incremental Cost" or "TELRIC" method. Pursuant to the FCC's order requiring TELRIC rates, this Commission instituted a generic docket (No. 990649-TP) for the purpose, among others, of conducting a generic UNE pricing proceeding for BellSouth, Verizon (then

GTE Florida, Inc.) and Sprint. The Commission later bifurcated the proceeding and established a separate docket for the purpose of setting Verizon and Sprint UNE rates (Docket No. 990649B). Ultimately, the Commission established TELRIC-based UNE rates for all three local companies, although the implementation of Verizon's rates were stayed pending resolution of its appeal to the Florida Supreme Court. BellSouth's and Sprint's TELRIC-based UNE rates approved by the Commission were not stayed and were available to CLECs at the time of the evidentiary hearing in this case and at the time the final order was entered. The Verizon appeal was decided by the Florida Supreme Court September 2, 2004 in Case No. SC02-2647 in which the Commission's order was upheld.

7. The approval, and availability, of the cost-based UNE-P rates by the Commission were highly significant to the expansion of, and presumed continuation of, local service competition in Florida. The Commission's own 2003 Report on Competition in Telecommunications Markets (2003 Report) to the legislature, which is Exhibit 15 in this case,

repeatedly stresses the criticality of the UNE-P rates to enhanced local service competition in Florida.

Background on the UNE-Ps' Importance to Increased Competition

8. This Commission's 2003 Report addressed the role of the legislature's 1995 Act in helping consumers through enhanced telephone competition, saying:

> In 1995, the Florida Legislature amended Chapter 364, Florida Statutes, to allow for competition in the state's telecommunications industry. The Legislature found that "the competitive provision of telecommunications services, including local exchange telecommunications service, is in the public interest and will provide customers with freedom of choice, encourage the introduction of new telecommunications service, encourage technological innovation, and encourage investment in telecommunications infrastructure."

2003 Report at 4. (Emphasis supplied.) The 2003 Report also addressed the importance of the subsequent Federal Telecommunications Act of 1996 Act (the 96 Act) saying, in part:

> The 96 Act established a national framework to enable CLECs to enter the local telecommunications marketplace. The FCC's Local Competition Order specified that opening the local exchange and exchange access markets to competition was intended to "pave the way for enhanced competition in all telecommunications markets."

Ibid. (Emphasis supplied.)

9. The 2003 Report stated the 96 Act established three methods by which CLECs could enter the local exchange market: (1) resale, (2) leasing of unbundled network elements (UNEs), and (3) investing in their own facilities. Because it found the ILECs dominate the last mile of the local network, the 2003 Report concluded the CLECs must either use the ILEC's local loops or build their own facilities. The 2003 Report also discussed the importance of the TELRIC-based UNE-P rates to both of these strategies, saying, in part:

> *Unbundled Network Elements (UNEs)*
>
> UNEs are the building blocks of ILEC networks used to provide telecommunications services. This method of entry requires ILECs to unbundle their networks and lease the piece parts or elements to CLECs at rates based on a total element long-run incremental cost (TELRIC) methodology.
>
> *Facilities*
>
> Facilities-based CLECs are those that have invested in and built-out their own networks. Frequently, CLECs enter the market using resale or UNE-based services while investing the financial resources necessary to build a telecommunications network and eventually provide facilities-based services independent of the ILECs. Many CLECs have chosen a UNE-P or resale platform, and true facilities-based competition in the local telecommunications market is not yet widespread. Fairly robust intermodal and facilities-based competition currently exists in the advanced communications market primarily through cable companies, wireless providers, and a

handful of other wireline providers that mainly target the high-demand business market.

2003 Report at 5. (Emphasis supplied.)

10. The clear thrust of the 2003 Report, as well as the testimony of the CLECs in this case, is that expanded residential competition in most of Florida depends almost entirely on the continued availability of UNE-P to the CLECs from the ILECs and at the relatively lower rates based on the FCC-mandated TELRIC methodology. The 2003 Report demonstrates this fact by disclosing, for example, that the CLECs' residential customers in 2003 totaled 726,638, up from 366,653 in 2001.[3] However, of that total, 668,261 were taken from BellSouth, while only 32,175 were in Sprint territories, and fewer yet, 23,772, were taken from Verizon. The Rural ILECs lost only 2,430 to competitors. 2003 Report at 8, 9. The over 100 percent increase in CLEC residential customers in less than two years in the BellSouth service territory clearly has a correlation in time to the reduced BellSouth UNE-P rates which were reduced to their lowest levels

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[3] The 2003 Report also showed that while the CLEC's residential market share had increased to 9 percent in 2003 from 7 percent the previous year, the vast number of those new customers were in predominantly urban areas of BellSouth's service territory, with the result that meaningful competition for most Floridians still does not exist.

in September 2002, and seemingly no relation to the large increases in local rates authorized by the Rate Increase Orders, which have yet to be implemented due to the appellate stay.

11. The 2003 Report is replete with other citations to how critical the continued availability of TELRIC-based UNE-P rates have been to the expansion of residential local service competition in Florida. These Report assertions include:

A. Of the top 10 telephone exchanges with the most CLEC providers, all were in BellSouth's territory and largely due to the availability of low-cost UNE-P rates. The Report says, in part:

> CLECs concentrate on larger metropolitan areas for a number of reasons including higher population densities, which improve economics of scale and scope. <u>Lower UNE rates in these higher density zones also attract competitors.</u> Notably, each exchange shown in Table 4 is in BellSouth's territory. <u>One explanation of the greater CLEC presence in these exchanges is that BellSouth has the lowest UNE-P rates among all the ILECs</u> (See Section B for further discussion).

2003 Report at 11. (Emphasis supplied.)

B. While discussing the considerations CLECs face when deciding to compete in a given area, the 2003 Report highlights the importance of UNEs, among other factors, saying:

> Customer acquisition costs can be significant as new entrants attempt to wrest long-time customers away from the incumbent and keep them long enough for payback. Other market entry considerations include collocation availability and cost, adequate and nondiscriminatory access to ILEC operations support systems (OSS), the timeliness and quality of ILEC installations and maintenance, and the availability of UNEs at reasonable (cost-based) prices, especially UNE-P.

2003 Report at 11, 12. (Emphasis supplied.)

C. The 2003 Report observes BellSouth's probable self-interest in seeing the TELRIC-based UNE-P rates established in Florida, at least temporarily, so that it could begin providing expanded long distance service within the state. The report notes that only BellSouth had to obtain FCC approval prior to providing long distance service within its in-region service area. The approval would come only if BellSouth:

> complied with a 14-point checklist showing the local market is sufficiently open to competition. The checklist includes requirements to provide adequate access to OSS and to UNEs at reasonable prices.

2003 Report at 12. (Emphasis supplied.)[4]

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[4] It was fortunate timing for BellSouth that it was able to use the low-cost UNE-P rates to obtain its long distance service approval from the FCC prior to its appellate success in stripping the FCC of its ability to require the continued availability of these same low-cost UNEs. The long distance service approval allowed BellSouth the critical ability to "bundle," which is now effectively denied to its potential competitors in the long distance business, who now do not believe they can afford to provide local service at competitive rates.

D. The 2003 Report observes that BellSouth is the only Florida ILEC to have to obtain this FCC approval, that it has six of the ten most densely populated areas of the state, and the lowest UNE-P rates by far. With respect to the importance of UNE-P availability and price in promoting local service competition, the report continues, saying:

> **3. UNE-P Availability and Price**
>
> An additional factor attracting competitors to BellSouth's territory appears to be the availability of UNE-P at the lowest prices in the state. In short, UNE-P is an unbundled network element platform that provides a CLEC with all of the necessary components to provide end-user service (*i.e.,* loop, local switching, interoffice transport, and tandem switching). A CLEC may add some of its own services to UNE-P, repackage UNE-P, or market UNE-P in a different manner than the ILEC. A CLEC providing end-user service via UNE-P does not require any capital investment by the CLEC in telecommunications infrastructure.
>
> As stated earlier, the availability and price of UNEs, especially UNE-P, are key determinants of CLEC market entry. UNE-P appears to be the entry strategy of choice for many CLECs serving the mass market (i.e., residential and small business customers). This Commission first set UNE rates for BellSouth in 1996. After evidentiary proceedings, the Commission subsequently reduced UNE rates in May 2001, then increased them slightly in October 2001. Finally, after additional evidentiary proceedings, the Commission reduced rates for certain UNE-P components in September 2002 below the levels set in May 2001.

2003 Report at 12, 13. (Emphasis supplied.)

E. The 2003 Report states BellSouth's level of competition is clearly related to its UNE-P rates, which were established much earlier than those for Sprint and Verizon and which are very much lower than those of the other two ILECs in the two largest rate zones. Forty eight percent (48%)of total CLEC access lines are UNE-P lines in BellSouth's territory, while UNE-P comprises only 3% of CLEC lines in Verizon's territory and 5% in Sprint's.

2003 Report at 14.

F. The Report states that the availability of cost-based UNE-P lines from the ILECs has not just led to new competition, but has also dramatically replaced the less desirable resale competitive alternative, the only non capital-intensive method left for competitors if TELRIC-based UNE-P rates are no longer required and available. On this point, the 2003 Report says:

> Moreover, UNE-P lines in BellSouth's territory have increased significantly over the last three years while resale lines have declined. As would be expected, CLECs will replace resale lines if higher margins are available through UNE-P. As of June 30, 2001, 219,907 resale lines were serving customers in BellSouth's territory, nearly twice the number of UNE-P lines. One year later, following the Commission's reductions to BellSouth's UNE rates in 2001, UNE-P lines nearly quadrupled to 420,390, more than a three-to-one ratio over resale lines.

> Resale lines declined by more than 90,000 during this period, with most being converted to UNE-P. As of June 30, 2003, UNE-P lines had increased to 686,242, with growth fueled by the Commission's further UNE rate reductions in September 2002. In this latest reporting period, the ratio of UNE-P to resale lines was more than nine-to-one, and the number of resale lines further declined by almost 57,000.

2003 Report at 15. (Emphasis supplied.)

G. The Report discusses whether CLECs can effectively compete for residential customers without access to UNE-Ps, saying:

> There is an ongoing debate about the appropriate level of UNE-P rates and about whether CLECs are impaired in the market without access to UNE-P. Whatever the outcome of these debates, UNE-P appears to be a significant element in the current business plans of CLECs serving mass market customers. In Florida, 73% of CLEC residential lines are served via UNE-P. The remainder are served in almost equal amounts via resale and subscriber loops that are tied to CLEC switches.
>
> Where UNE-P has become a prevalent method of market entry, proponents of UNE-P argue that UNE-P is critical to ensuring competition in the local telecommunications market and that it must be preserved. The argument on the other side of the debate is that UNE-P is not viable as a long-term competitive strategy. Critics of UNE-P maintain that this strategy is not economically rational and that it serves to drain capital from an industry in dire need of investment. Instead, they argue that regulatory policies should promote facilities-based competitive models – and not business models reliant on market participants leasing the facilities of their competitors.

Ibid. (Emphasis supplied.)

H. The 2003 Report also discusses the FCC's then-continuing procedure for examining the importance of the role of UNE-P in local service competition and this Commission's fact-finding role in that process. On the Triennial Review Order and the FCC's presumption that UNE-P is required to serve residential customers, the report says:

> The FCC is at center stage of the debate, and in August 2003, the agency issued its Triennial Review Order (TRO), <u>which presumptively concluded that CLECs serving mass market customers are impaired without access to unbundled local switching (a key element in UNE-P)</u>. This finding is subject to a more granular determination, which determination must be completed by the states within 9 months of the effective date of the TRO. Whether the FCC's finding of impairment is upheld by the individual state commissions will impact the future of UNE-P as a competitive strategy in those states.
>
> <u>The importance of UNE-P to current CLEC business plans was also illustrated in a recent announcement by Sprint</u>. In the wake of the FCC's Triennial Review Order, Sprint announced that its CLEC arm was launching a portfolio of bundled service offerings, including local, long distance, and wireless, which will be provisioned using UNE-P and available to approximately 80 percent of U.S. households in 36 states and the District of Columbia. Sprint apparently believes that the FCC's finding of impairment will be upheld in most states, thus continuing the availability of UNE-P. Moreover, the expansion of Sprint's local UNE-P based business appears to be a key driver in the company's even more recent decision to restructure in hopes of shedding $1 billion in annual operating costs.

2003 Order at 18. (Emphasis supplied.)

12. While perhaps a bit lengthy, the above discussion of the 2003 Report is intended to demonstrate this Commission's recognition of the criticality of TELRIC-based UNE-P rates in expanding residential local service competition in Florida. When the TELRIC-based UNE-P rates became available, as in the BellSouth service areas, residential local service competition took off, at least in a historically relative sense, in the more urban areas. Where these rates were not available, the 2003 Report shows residential local service competition remained stagnant and the alternative resale and facilities-based service methods were not seen as economically viable by competitors. In short, the relative and recent expansion of residential local service has been almost totally dependent upon TELRIC-based UNE-P rates, and this Commission reported this fact to the Florida Legislature in the 2003 Report. These TELRIC-based UNE-P rates were available when the Commission approved the requested rate increases, but, as described below, they are now a thing of the past.

CLECs had a right to TELRIC-based UNE-P rates on December 24, 2003

13. During the evidentiary hearings and when the Initial Order was entered on December 24, 2003, the legal and factual status quo was that

the CLEC parties to the case had a legal right to Commission-approved, TELRIC-based UNE-P rates in the service territories of BellSouth and Sprint and an expectation that they would eventually have access to the same type of rates the Commission had approved for Verizon, but which were stayed pending the now resolved appeal. In these cases the Commission heard the testimony of AT&T's witness Fonteix that his company's announced decision to compete for local service customers in two of BellSouth's largest urban areas was based in large part on the fact that the spread between the local BellSouth rates and the approved UNE-P rates were the greatest there, as well as its expectation that the rate rebalancing would take place. There was a clear expectation on the Commission's part that AT&T, the largest of the CLECs in the case, would engage in local service competition to the supposed benefit of residential customers. This Commission noted at page 28 of the Initial Order:

> While it is uncontested that some customers will not receive a direct benefit as a result of the implementation of the ILECs' proposals, we find that Florida consumers as a whole will reap the benefits of increased competition and, ultimately, competition will serve to regulate the level of prices consumers will pay. Increased competition will lead not only to a wider choice of providers, but also to technological innovation, new service offerings, and increased quality of service to the customer. The evidence in this case shows that Knology will

> continue its plans to enter Florida markets if the Petitions are granted, and will consider broadening the number of Florida markets it enters, as demonstrated through the testimony of witness Boccucci. AT&T witness Fonteix has also indicated that AT&T's entry into BellSouth's territory has been largely influenced by the 2003 Legislation and the hope that with the granting of these Petitions, the raising of local rates will make Florida markets more profitable for competitors.

Order No. PSC-03-1469-FOF-TL at 28. (Emphasis supplied.)

14. The Commission also noted in its Initial Order that it expected the increased local service competition would serve to protect Lifeline customers, who, with approval of the rate increases, would receive only limited duration protection from the increases despite the fact that there was no provision for increasing their financial assistance proportionally. This Commission said:

> We agree, and expect that, over time, competition should take care of those protected by Lifeline, in spite of the current limited duration that these customers are protected from the local increases at issue here.

Order No. PSC-03-1469-FOF-TL at 30. (Emphasis supplied.)

Absent significant and actual local service competition, Lifeline customers will not be taken care of and will experience higher local rates without commensurate financial assistance.

15. Again, stressing the expectation that AT&T would provide a part of the competition that would allegedly "benefit" residential customers, the Commission in defending its conclusion that the rate increases would "induce enhanced market entry," said at page 36 of the Initial Order:

> . . . . In addition, AT&T indicated that it has entered the BellSouth territory as a result of the 2003 Act.
>
> We are persuaded that companies like Knology and AT&T provide the empirical evidence of how the ILECs' proposals will increase competition.

Order No. PSC-03-1469-FOF-TL at 36. (Emphasis supplied.)

16. It appears clear from the above that the Commission, and residential customers for that matter, had an expectation that some level of actual increased competition should result from the 30 to 90 percent rate increases being granted and, further, that a portion of that actual competition was to be expected from AT&T per the testimony of its witnesses.

17. As this Commission is aware, the state "granular determination" required by the FCC's August, 2003 TRO, referenced in paragraph 11(H) above, was to be made in this Commission's Docket No. 030851-TP. A hearing was held in this docket in late February, 2004 at which time

BellSouth and Verizon argued generally that UNE-P rates, let alone at TELRIC levels, were not warranted in their service territories.

18. As this Commission is also aware, on March 2, 2004, before the Commission had an opportunity to make its decision in Docket No. 030851-TP, the D.C. Circuit Court of Appeals' reversed the FCC's Triennial Review Order requiring low-cost UNE-P rates in the case of United States Telecom Ass'n v. Federal Communications Commission, 359 F.3d 554 (D.C. Cir. 2004) ("USTA II").[5] In what was widely viewed as a stinging rebuke of the FCC's decision making, the USTA II Court threw out a major portion of the FCC's Triennial Review Order, saying, amongst other things, that the FCC erred when it delegated to state commissions the authority to determine what network elements must be unbundled at discounted rates for use by competitive carriers.

19. The USTA II decision was viewed as a significant victory for the ILECs and a major defeat for the CLECs, who would no longer have a right to TELRIC-based UNE-P rates established by state commissions, but, rather, would have to pay "competitive" rates established unilaterally by the ILECs they were seeking to compete with. Believing USTA II to be a

[5] Opinion attached as Attachment 1

significant change to the status quo, Attorney General Crist, on April 19, 2004 filed his Notice of Supplemental Authority with this Commission, attaching a copy of the USTA II opinion as supplemental authority in support of his Motion for Reconsideration and asserting that the "decision is pertinent to the Attorney General's arguments on reconsideration that the petitions are not in the public interest, do not benefit residential customers, and will not induce enhanced market entry."

20. On reconsideration the Commission rejected the Attorney General's concerns over the impact of the USTA II opinion, stating:

> . . . we conclude that the D.C. Circuit's decision in United States Telecom Ass'n v. Federal Communications Commission does not rise to the level that would necessitate that we reconsider our decision. While the decision does muddy the waters as to the future of certain UNEs, it does not, by itself, automatically remove any UNEs from the national list. Furthermore, the D.C. Circuit's decision is currently stayed, and further appeals are possible. While we are concerned about the uncertain state of the FCC's unbundling rules, even if the D.C. Circuit's decision remains in place, and UNEs are removed from the list as a result, that process will likely take place over an extended period of time. Furthermore, even if the D.C. Circuit's decision remains in place, carriers that compete using their own facilities would not be directly affected.

Order No. PSC-04-0456-FOF-TL at 8.

21. AARP believes the Commission erred in not giving greater weight to the USTA II opinion on reconsideration as requested by the Attorney General. More importantly, since the Order on Motions for Reconsideration was entered on May 4, 2004 a number of significant additional actions have taken place which the Commission could not have had an awareness of when both making its initial decision and its decision on reconsideration, but which definitively signaled the death knell of local service competition in Florida. Specifically, the FCC and the U.S. Solicitor General declined to appeal the USTA II decision to the United States Supreme Court, and that Court has declined to grant a stay in connection with the separate appeals filed by AT&T and others.[6] The chances of success at the U.S. Supreme Court were viewed as slim without the presence of the FCC and Solicitor General on the appeal. Furthermore, negotiations between the ILECs and CLECs over what level of wholesale rates will be charged after the existing TELRIC UNE-P rates expire have apparently had limited success and AARP is not aware of any current settlements that will beneficially impact residential customers in Florida. It has been reported that BellSouth will voluntarily continue honoring its

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[6] See CNET News.com June 14, 2004 article "Chief justice rejects telecom case," Attachment 2.

current UNE-P rates through the end of the year, while Verizon will honor its existing rates (not the lower, but stayed UNE-P rates), but only just past the general election to November 11, 2004. The FCC, apparently in a private vote on July 21, 2004, approved a 6-month extension on the validity of the current UNE-P rates that would leave those rates available to CLECs until early 2005 while the FCC is attempting to draft new permanent rules.[7] However, Verizon and others have already appealed the order granting the extension claiming that the FCC has granted itself an illegal stay in violation of the USTA II opinion. In any event, at this point, the availability of the lower-cost, TELRIC-based UNE-P rates may only be until sometime in early 2005 if the FCC extension is sustained on appeal.

22. While the changed circumstances described in Paragraph 21 above will arguably cause uncertainty in the minds of most CLECs and lead them to think twice about attempting to compete in local service markets in Florida, there are more concrete and specific changed circumstances which AARP believes will necessarily greatly reduce the level of enhanced local service competition to be attained in Florida and, therefore, in turn, reduce, if not eliminate, the "benefits" of competition

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[7] See The Wall Street Journal August 23, 2004 article at Attachment 3.

residential customers are supposed to receive in exchange for paying substantially higher local rates.

23. The most definitive changed circumstance is reflected in the attached (Attachment 4) July 22, 2004 AT&T News Release titled "AT&T Announces Second-Quarter 2004 Earnings, Company to Stop Investing in Traditional Consumer Services; Concentrate Efforts on Business Markets." In connection with reporting greatly reduced second quarter profits as compared to the same period in 2003, AT&T stated that it would cease competing for local service customers, as well as drop attempts to secure new standalone residential long distance customers. The specific language of the release states:

> The company also announced that it is shifting its focus away from traditional consumer services such as wireline residential telephone services, and concentrating its growth efforts going forward on business markets and emerging technologies, such as Voice over Internet Protocol (VoIP), that can serve businesses as well as consumers.
>
> As a result of recent changes in regulatory policy governing local telephone service, AT&T will no longer be competing for residential local and standalone long distance (LD) customers. The company stressed that existing residential customers will continue to receive the quality service they expect from AT&T; however, the company will no longer be investing to acquire new customers in this segment.

(Emphasis supplied.)

24. The consequences of AT&T's decision on enhanced local service competition in Florida are clear cut and undeniable: Any growth in local service competition in Florida from AT&T is out of the question absent a corporate reversal of this decision. Furthermore, it appears reasonable to assume that any existing AT&T local service competition in Florida now will necessarily decline due to normal attrition and customer "churn," coupled with the likelihood that attrition will accelerate if AT&T is forced to increase its local service rates to match the expected UNE-P increases from the ILECs following the expiration of the FCC's interim rules. As reflected in the attached August 4, 2004 NY Times article titled "AT&T Plans to Raise Its Rates for Residential Calling Plans (Attachment 5), AT&T has already announced plans to raise its local service rates by two to three dollars a month in 40 states, specifically including Florida. The article notes the risk of these increases causing AT&T to lose even more local service customers than the existing 10 percent per quarter declines already reported.

Predictably, there can be no benefits to residential customers in Florida from enhanced competition flowing from AT&T's local service competition after the Commission's higher and approved rates become effective because AT&T has said it will not compete.

25. The detriment to residential customers from AT&T's decision doesn't stop with the complete lack of enhanced local service competition, however, although AARP believes this changed circumstance alone is sufficient for this Commission to reverse the planned rate increases. Additionally, however, is the harm to residential customers from AT&T no longer competing for residential long distance customers. The Commission accepted AARP's criticism on reconsideration that the Initial Order overstated the financial benefits that would be received by residential customers from granting the petitions (quantitative financial benefits cannot outweigh the increase in local rates) and modified the text of the order, as reflected on page 16 of the Order on Reconsideration. The Commission did so in recognition of the fact that residential customers will pay for 90 percent of all local service rate increases

(single-line business customers will bear the remaining 10 percent), while multi-line business customers, who pay no local service increases, will receive substantially more than half of the interstate toll reductions. It is now clear that AT&T's newly announced policy of foregoing additional standalone residential long distance customers, while focusing more on large business customers, will necessarily result in residential customers receiving an even smaller percentage of "benefits" from AT&T in the form of reduced instate toll charges. AT&T's percentage of revenues derived from residential long distance versus from large business long distance services was falling even before its decision to abandon new residential accounts, which necessarily will make the ratio skewed more to the benefit of big business customers. Since residential customer benefits in the form of reduced instate toll charges will be based "in proportion to the respective access minutes of use"[8] versus the access minutes used by large business customers, the confidential,[9] but woefully small, percentage testified to in the

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[8] Initial Order at 53, 54.

[9] The confidential exhibit was filed with the Florida Supreme Court by AARP on January 23, 2004 in conjunction with its Original Motion to Relinquish Jurisdiction, but Maintain Stay.

hearing to be returned to residential customers will necessarily decline even more with the fall in AT&T's residential long distance minutes. That residential customers will have to bear 90 percent of the cost of local service rate increases will remain the same. Unless the local service rate increases are reversed or revised due to this additional change in circumstances, Florida's residential telephone customers will get zero benefits from future local service competition from AT&T, while financing an even larger reduction in the instate tolls AT&T's large business customers pay. Here are the rough numbers demonstrating this result from the same July 22, 2004 AT&T News Release cited above:

> **AT&T Consumer**
>
> Revenue was $2.0 billion, <u>a decline of 14.6 percent versus the prior-year second quarter, driven by lower standalone LD voice revenue</u> as a result of the continued impact of competition, wireless and Internet substitution and customer migration to lower-priced products and calling plans, partially offset by targeted price increases.
>
> * * *
>
> According to industry estimates, more than 40% of American households have now migrated to some combination of bundled communications services. <u>Recent regulatory decisions make it financially infeasible for AT&T to offer a competitive bundle of services to</u>

consumers. AT&T has determined that it cannot effectively compete against bundled competition by selling only standalone LD.

(Emphasis supplied.) The fact that the Commission approved ILEC petitions that impose the local service rate increases only on those without bundled services can only serve to exacerbate AT&T's inability to meet bundled competition from ILECs since AT&T cannot "bundle" without offering local services too. The decision exempting ILEC bundled customers from the rate increases will also drive more local service customers to ILEC bundles to avoid the approved rate increases, with the result that the ILECs will acquire a tighter grip on their now near local service monopolies. The end result will be that local service competition will be deterred, not enhanced as required by the statute.[10]

26. While not as definitive and clear-cut as AT&T's departure from local service competition, it appears that the other non-facilities based potential competitors to these cases may also be retreating from local service competition in Florida and throughout the United States. While

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[10] This "anti-competitive" aspect of the rate increases is matched only by the ILECs' "brilliance" in convincing the Commission to approve uniform dollar rate increases for both urban and rural service areas (as opposed to the historic practice of imposing uniform percentage increases), which tends to make the most CLEC desirable urban customers less profitable than they otherwise would be if uniform percentage increases had been approved. Rural customers, who are logically and economically the last

AARP has been unable, to date, to find any "official" company statements from Sprint and MCI on the subject, recent published accounts report that both companies are scaling back their efforts to compete for local service customers and may be thinking of departing completely from such markets. For example, an August 6, 2004 The Washington Times article titled "MCI set to downsize residential service" included the following regarding the company's scaled back residential service plans:

> MCI Inc. said yesterday that it doesn't expect to add new residential calling customers because costs are increasing, the second major phone company in two weeks to announce its exit from residential phone service.
>
> "We anticipate to downsize our [consumer business] effort significantly," said Wayne Huyard, president of MCI's U.S. sales and service division.
> Mr. Huyard didn't offer details about MCI's plans, but the nation's second-largest long-distance provider wants to turn its attention to the more profitable commercial business.
>
> AT&T Corp., the nation's largest long-distance provider, said July 22 that it will stop trying to attract customers but continue to provide long-distance and local service to its 35 million residential customers. AT&T is walking away from the residential-calling business because revenue has fallen owing to increased competition and higher costs.

(Emphasis supplied.) Full article at Attachment 6.

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to be sought by local service competitors, are forced to pay up to 90 percent rate increases (Sprint) from their virtual monopoly ILECs with no competitors to turn to.

27. Still on the subject of MCI's retreat from residential local service competition, an August 9, 2004 article from BusinessWeek/online, titled "At MCI, The Worst May Be Over," reported the following:

> STRATEGIC RETREAT. As arch rival AT&T (T) sounds the siren over asset write-downs and a pullout from the consumer telecom market, MCI's better-than-expected performance could signal that its dog days are on the wane. Indeed, the company, which was wracked by an $11 billion accounting scandal under its former name, Worldcom, produced operating income of $41 million during the quarter.
>
> * * *
>
> The long-distance market remains brutal, with prices falling and new technologies threatening MCI's core voice and data business. The end of cheap rates for access to local telephone customers is expected to cut revenues harshly in MCI's consumer and small-business unit. MCI has 3.6 million local customers and 8.8 million consumer long-distance lines. Meanwhile, regulatory changes are increasingly enabling the Baby Bells to hunt for customers in MCI's long-distance segment. The result: MCI said yesterday that it will reduce efforts to attract new consumer customers and revalue some assets, although it doesn't expect to fully exit the segment, as AT&T has done. "We anticipate downsizing our [consumer] acquisition efforts significantly," says Wayne Huyard, president of MCI's U.S. sales and services unit.

(Emphasis supplied.) Full article at Attachment 7.

28. Sprint, an ILEC in portions of Florida that wants to compete as a CLEC in the service territories of other ILECs and

which is also a long distance carrier throughout the country, is also reportedly cutting back its efforts to compete for residential local service customers. As reflected in a July 29, 2004 article found on the website of Virgo Publishing Inc. titled "Sprint Stops Marketing Residential "Complete Sense" Calling Plans," Sprint, like MCI, will not actively market its local service offerings as a consequence of USTA II. Specifically, the article says in pertinent part:

> Sprint Corp. has stopped actively marketing a number of residential local and long-distance calling plans in 36 states and the District of Columbia known as Sprint Complete Sense, according to company representatives.
>
> The company listed 336,000 Sprint Complete Sense customers at the end of the first quarter, the most recent figure disclosed, according to spokesman Travis Sowders.
>
> Sowders says Sprint never launched a mass marketing campaign to promote the calling plans and primarily sold the packages to existing customers. Sprint will continue to support existing customers, he says, and provide Sprint Complete Sense to people who request it. The decision to stop marketing the calling plans was made in recent weeks, Sowders says.
>
> Sprint introduced the calling plans last year after the FCC released rules that helped foster local-phone competition by requiring BellSouth Corp., Qwest Communications International Inc., SBC Communications Inc. and Verizon Communications Inc. to rent their networks to competitors such as AT&T Corp. and Sprint at government-set rates. Those rules have expired, and numerous telecommunications

companies anticipate a significant spike in the wholesale phone rates beginning next year.

Attributing its decision to regulatory developments, AT&T last week announced plans to stop competing for local and long-distance phone customers in the traditional residential market. Analysts expect other phone companies, including possibly MCI, to scale back their residential services as a result of the regulatory developments. MCI was not immediately available for comment.

(Emphasis supplied.) Full article at Attachment 8.[11]

29. A further indication of Sprint's intention to not actively pursue local service competition anywhere, including Florida, is evidenced in an Associated Press July 30, 2004 article titled "Sprint Corp. stops marketing small local-service plan," which reported the following:

NEW YORK - Sprint Corp. said it would stop marketing a small local-service calling plan called Complete Sense that depends on the company renting equipment from the dominant regional Bells.

Sprint never spent much on marketing the service, which had 336,000 customers at the end of the first quarter. Sprint said it will continue to serve customers who use the service.

Overland Park, Kan.-based Sprint owns its own local service network, with 7.8 million access lines in 18 states, letting the company sell local service to customers without renting equipment from the regional Bells.

[11] http://www.vpico.com/articlemanager//printerfriendly.aspx?article=19770

Complete Sense is the only plan Sprint offers that depends on renting equipment. The price of such rentals is expected to rise following a March federal court decision overturning rules that kept the prices low.

The court decision prompted AT&T Corp., which does not own its own local access lines, to announce last week that it would no longer spent an estimated $1 billion a year to win residential customers. Instead, AT&T will focus on business customers. It, too, said it would continue to serve its existing customers.

(Emphasis supplied.) Full article at Attachment 9.[12]

SIGNIFICANT CHANGED CIRCUMSTANCES COMPEL REVERSAL OF LOCAL SERVICE RATE INCREASES

30. The Florida Legislature clearly intended that residential local telephone service customers receive some measure of actual local service competition if their rates were to be increased by the large amounts requested by the ILECs and now approved by this Commission. Mere theoretical possibilities for competition are not enough to meet either the needs of residential customers or the requirements of law. There were at least three non-facilities based CLECs in these proceedings indicating that they would compete in Florida to a greater extent than they were previously. It was understood by all that AT&T, MCI and Sprint would have to take

[12] http://www.mercurynews.com/mld/mercurynews/business/financial_markets/9284641.htm

advantage of the TELRIC-based UNE-P rates to engage in such competition. However, those rates will soon be gone. Irrespective of the timing of the expiration of these UNE-P rates, each of the three CLECs, AT&T, MCI and Sprint, have indicated in some fashion that they will either cease residential local service competition or curb marketing efforts to obtain new customers in that market. The continued service offerings of cable operator Knology in two relatively small markets in Florida are inadequate to provide to all the customers of BellSouth, Verizon and Sprint the so-call "benefits" of competition promised by this Commission as the quid pro quo of the large local service rate increases approved. AT&T, MCI and Sprint will not compete in this state, so there can be no benefits flowing to Florida's residential customers.

31. Significantly changed circumstances mean that the telephone company parties to these proceedings, and, indeed, this Commission can no longer deliver on the benefits promised to residential local service customers. The public interest requires that the rate increases previously approved by this Commission be

reversed. Pursuant to Peoples Gas this Commission has the authority and, AARP would submit, the obligation to modify its orders to reflect the changed circumstances and the adverse financial impact they will have on Florida consumers absent such a modification.

REQUEST FOR HEARING

32. AARP recognizes Peoples Gas, the Florida Statutes and this Commission's rules would not condone modification of the orders in this case and reversal of the local service rate increases based solely on "evidence" presented through CLEC press releases and news articles. Accordingly, AARP would respectfully request that: (1) this Commission join it in requesting that the Florida Supreme Court relinquish jurisdiction over these cases, (2) for the purpose of the Commission holding an evidentiary hearing to ascertain what level of local service competition is now possible, or likely, in light of the USTA II decision and the announcements of seemingly all major CLECs that they will not so compete, and (3)

whether the public interest and statutes authorizing the increases require that the rate increases be reversed.

NO SUBSTANTIAL HARM TO TELEPHONE PARTIES BY DELAY

33. There should be no harm claimed to result from the telephone parties to these proceedings by the delay occasioned by this Commission holding an evidentiary hearing to determine whether the significant changed circumstances claimed by AARP compel the reversal of the rate increases. As this Commission is fully aware, the ILECs are to be treated in a revenue-neutral fashion by the statute, which means that they cannot keep the revenues associated with the increased local rates, but must, instead, give them over to the long distance companies in the form of reduced access fees. To the extent that the rate increases would result in the ILECs actually losing customers and the revenue associated with them to competitors, as they all claimed would result, the ILECs will actually benefit by such a delay. Likewise, the long distance carriers are charged by the law and this Commission's order with returning all the access fee reductions to their instate toll customers (mostly their big business customers) so that they, too, are held revenue-neutral and cannot gain

financially by the rate increases. The only parties to these proceedings that might be heard to complain about the adverse impact of the delay occasioned by the Commission revisiting this issue are the potential local service competitors, the only one of which is apparently left is Knology, which does not use the ILECs' UNE-Ps and can only claim disadvantage because its rates would look more attractive if the ILECs' customers were forced to pay more for local service. Residential consumers, at least those represented by AARP, the Office of Public Counsel and Attorney General Charlie Crist, never wanted to pay for increased competition and will gladly forego the $344 million in rate increases while the Commission hears evidence on the level of local service competition, if any, that may be expected to result from the rate increases if they are allowed to be charged.

34. The undersigned attorney has contacted opposing counsel and is authorized to represent that the Attorney General of the State of Florida and the Office of Public Counsel do not object to this motion, that the Florida Public Service Commission takes "no position," but that

BellSouth, Verizon, AT&T, MCI, Sprint Corporation, Sprint-Florida, Inc. and Knology are opposed and will file objections.

WHEREFORE, AARP respectfully requests that the Florida Public Service Commission join AARP in petitioning the Florida Supreme Court for a relinquishment of jurisdiction for the purpose of the Commission holding an evidentiary hearing to determine whether it should modify Order No. PSC-03-1469-FOF-TL as requested in this pleading.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I CERTIFY that a true and correct copy of the foregoing has been furnished by United States mail to the following on this 8th day of September, 2004:

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BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In re: Petition of Verizon Florida Inc. to Reform Its Intrastate Network Access and Basic Local Telecommunications rates in Accordance with Florida Statutes, Section 364.164	Docket No. 030867-TL
In re: Petition of Sprint-Florida, Incorporated, To reduce intrastate switched network Access rates to interstate parity in Revenue neutral manner pursuant to Section 364.164(1), Florida Statutes	Docket No. 030868-TL
In re: Petition by BellSouth Telecommunications, Inc., To Reduce Its Network Access Charges Applicable To Intrastate Long Distance In A Revenue-Neutral Manner	Docket No. 030869-TL
In re: Flow-through of LEC Switched Access Reductions by IXCs, Pursuant to Section 364.163(2), Florida Statutes	Docket No. 030961-TL Filed Sept. 8, 2004

APPENDIX TO

AARP MOTION FOR EVIDENTIARY HEARING AND MODIFICATION OF COMMISSION ORDERS NOS. PSC-03-1469-FOF-TL AND PSC-04-0456-FOF-TL ON THE BASIS OF SIGNIFICANTLY CHANGED CIRCUMSTANCES AND PUBLIC NEED

Notice: This opinion is subject to formal revision before publication in the Federal Reporter or U.S.App.D.C. Reports. Users are requested to notify the Clerk of any formal errors in order that corrections may be made before the bound volumes go to press.

United States Court of Appeals

FOR THE DISTRICT OF COLUMBIA CIRCUIT

Argued January 28, 2004 Decided March 2, 2004

No. 00-1012

UNITED STATES TELECOM ASSOCIATION,
PETITIONER

v.

FEDERAL COMMUNICATIONS COMMISSION AND
UNITED STATES OF AMERICA,
RESPONDENTS

BELL ATLANTIC TELEPHONE COMPANIES, ET AL.,
INTERVENORS

Consolidated with
00–1015, 00–1025, 01–1075, 01–1102, 01–1103, 03–1310,
03–1311, 03–1312, 03–1313, 03–1314, 03–1315, 03–1316,
03–1317, 03–1318, 03–1319, 03–1320, 03–1324, 03–1325,
03–1326, 03–1327, 03–1328, 03–1329, 03–1330, 03–1331,
03–1338, 03–1339, 03–1342, 03–1347, 03–1348, 03–1360,
03–1372, 03–1373, 03–1385, 03–1391, 03–1393, 03–1394,
03–1395, 03–1400, 03–1401, 03–1424, 03–1442

Bills of costs must be filed within 14 days after entry of judgment. The court looks with disfavor upon motions to file bills of costs out of time.

On Petitions for Writ of Mandamus and for
Review of an Order of the
Federal Communications Commission

Michael K. Kellogg argued the cause for ILEC petitioners. With him on the briefs were *Mark L. Evans, Sean A. Lev, Colin S. Stretch, Michael T. McMenamin, James D. Ellis, Paul K. Mancini, Joseph E. Cosgrove, Jr., Gary L. Phillips, James P. Lamoureux, Robert B. McKenna, Charles R. Morgan, James G. Harralson, William P. Barr, Michael E. Glover*, and *Edward Shakin. Donna M. Epps, Daniel L. Poole, John H. Harwood II, William R. Richardson, Jr.*, and *Matthew R. Sutherland* entered appearances.

Donald B. Verrilli, Jr. and *Christopher J. Wright* argued the cause for CLEC petitioners. With them on the briefs were *Mark D. Schneider, Marc A. Goldman, Michael B. DeSanctis, William Single IV, Jeffrey A. Rackow, David W. Carpenter, David L. Lawson, C. Frederick Beckner III, Andrew D. Lipman, Russell M. Blau, Richard M. Rindler, Patrick J. Donovan, Harisha J. Bastiampillai, Dennis D. Ahlers, Steven A. Augustino, Albert H. Kramer, Jonathan E. Canis, Robert J. Aamoth, Carl S. Nadler, Adelia S. Borrasca, Jason D. Oxman, Timothy J. Simeone, Charles C. Hunter, Catherine M. Hannan, Genevieve Morelli, Glenn B. Manishin, Jonathan E. Canis, Teresa K. Gaugler, Jonathan Jacob Nadler*, and *Jonathan D. Lee. Jennifer M. Kashatus, Paul J. Rebey, Eric J. Branfman, Joshua M. Bobeck*, and *Angela M. Simpson* entered appearances.

James Bradford Ramsay argued the cause for State petitioners. With him on the briefs were *Grace Delos Reyes, Jonathan Feinberg, John L. Favreau, John C. Graham, Helen M. Mickiewicz, Gretchen T. Dumas, Maryanne Reynolds Martin, Christopher C. Kempley, Maureen A. Scott, Michael A. Cox*, Attorney General, Attorney General's Office of the State of Michigan, *Thomas L. Casey*, Solicitor General,

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John E. Ingle, Deputy Associate General Counsel, Federal Communications Commission, and *James M. Carr*, Counsel, argued the cause for respondents. With them on the brief were *R. Hewitt Pate*, Assistant Attorney General, U.S. Department of Justice, *Catherine G. O'Sullivan* and *Nancy C. Garrison*, Attorneys, *John A. Rogovin*, General Counsel, Federal Communications Commission, and *Laurence N. Bourne*, *Joel Marcus* and *Christopher L. Killion*, Counsel. *Andrea Limmer*, Attorney, U.S. Department of Justice, and Lisa S. Gelb, Counsel, Federal Communications Commission, entered appearances.

Michael K. Kellogg argued the cause for ILEC intervenors and Catena Networks, Inc. in support of respondents. With him on the brief were *Mark L. Evans*, *Aaron M. Panner*, *Michael T. McMenamin*, *James D. Ellis*, *Paul K. Mancini*, *Joseph E. Cosgrove, Jr.*, *Gary L. Phillips*, *James P. Lamoureux*, *Robert B. McKenna*, *Charles R. Morgan*, *James G. Harralson*, *William P. Barr*, *Michael E. Glover*, *Edward Shakin*, and *Stephen L. Goodman*. *Alfred G. Richter*, *Hope E. Thurrott*, *Lawrence E. Sarjeant*, and *Jonathan E. Canis* entered appearances.

David W. Carpenter argued the cause for CLEC intervenors in support of respondents. With him on the brief were *Donald B. Verilli, Jr.*, *Mark D. Schneider*, *Marc A. Goldman*, *Michael B. DeSanctis*, *William Single IV*, *Jeffrey A. Rackow*, *David L. Lawson*, *C. Frederick Beckner III*, *Teresa K. Gaugler*, *Charles C. Hunter*, *Catherine M. Hannan*, *Andrew D. Lipman*, *Russell M. Blau*, *Richard M. Rindler*, *Patrick J. Donovan*, *Harisha J. Bastiampillai*, *Albert H. Kramer*, *Jonathan D. Lee*, *Carl S. Nadler*, *Adelia S. Borrasca*, *Janson D. Oxman*, *Robert J. Aamoth*, *Genevieve Morelli*, *John T. Nakahata*, *Sara F. Leibman*, *John J. Heitmann*,

Jennifer M. Kashatus, Christopher J. Wright, and *Timothy J. Simeone*. *Roy E. Hoffinger, Charles J. Cooper, Hamish P. Hume*, and *Richard J. Metzger* entered appearances.

Jonathan Feinberg, John L. Favreau, John C. Graham, Helen M. Mickiewicz, Gretchen T. Dumas, Maryanne Reynolds Martin, Christopher C. Kempley, Maureen A. Scott, Michael A. Cox, Attorney General, Attorney General's Office of the State of Michigan, *Thomas L. Casey*, Solicitor General, *David A. Voges* and *Michael Nickerson*, Assistant Attorney Generals, *James Bradford Ramsay*, and *Grace Delos Reyes* were on the brief for State intervenors in support of respondents.

Laura H. Philips, Douglas G. Bonner, Michael F. McBride, Thomas J. Sugrue, Howard J. Symons, Sara F. Leibman, and *Douglas I. Brandon* were on the brief of Wireless intervenors in support of respondent. *Brian A. Coleman* entered an appearance.

Before: EDWARDS and RANDOLPH, *Circuit Judges*, and WILLIAMS, *Senior Circuit Judge*.

Opinion for the Court filed by *Senior Circuit Judge* WILLIAMS.

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WILLIAMS, *Senior Circuit Judge*: The Telecommunications Act of 1996, Pub. L. 104–104, 110 Stat. 56, codified at 47 U.S.C. § 151 et seq. (the "Act"), sought to foster a competitive market in telecommunications. To enable new firms to enter the field despite the advantages of the incumbent local exchange carriers ("ILECs"), the Act gave the Federal Communications Commission broad powers to require ILECs to make "network elements" available to other telecommunications carriers, *id.* §§ 251(c)(3),(d), most importantly the competitive local exchange carriers ("CLECs"). The most obvious candidates for such obligatory provision were the copper wire loops historically used to carry telephone service over the "last mile" into users' homes. But Congress left to the

Commission the choice of elements to be "unbundled," specifying that in doing so it was to

> consider, at a minimum, whether . . . the failure to provide access to such network elements would *impair* the ability of the telecommunications carrier seeking access to provide the services that it seeks to offer.

Id. § 251(d)(2) (emphasis added).

The Act became effective on February 8, 1996, a little more than eight years ago. Twice since then the courts have faulted the Commission's efforts to identify the elements to be unbundled. The Supreme Court invalidated the first effort in *AT&T Corp. v. Iowa Utilities Board*, 525 U.S. 366, 389–90 (1999) ("*AT&T*"). We invalidated much of the second effort (including separately adopted "line-sharing" rules) in *United States Telecom Association v. FCC*, 290 F.3d 415 (D.C. Cir. 2002) ("*USTA I*"). The Commission consolidated our remand in that case with its "triennial review" of the scope of obligatory unbundling and issued the Order on review here. See Report and Order and Order on Remand and Further Notice of Proposed Rulemaking, *Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers*, CC Docket Nos. 01–338 et al., FCC 03–36, 18 FCC Rcd 16978 (Aug. 21, 2003) ("Order"); Errata, *Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers*, CC Docket Nos. 01–338 et al., FCC 03-227, 18 FCC Rcd 19020 (Sep. 17, 2003). Again, regrettably, much of the resulting work is unlawful.

After a brief summary of the legal background, we address first the ILECs' claims, then the CLECs' claims, then the ILEC and CLEC claims relating to a special area, enhanced extended links ("EELs"), and finally a couple of miscellaneous claims.

I. *Legal Background*

Section 251(c)(3) of the Act imposes on each ILEC the duty to provide any requesting telecommunications carrier with

> access to network elements on an unbundled basis at any technically feasible point on rates, terms, and conditions that are just, reasonable, and nondiscriminatory in accordance with . . . the requirements of this section and section 252 of this title.

47 U.S.C. § 251(c)(3).

The statute says that the ILECs may charge a "just and reasonable rate" for these unbundled network elements ("UNEs"), see *id.* § 252(d)(1), and the Commission adopted as its standard "total element long-run incremental cost," or "TELRIC." Under this criterion UNE prices are to be "based on the use of the most efficient telecommunications technology currently available and the lowest cost network configuration, given the existing location of the incumbent LEC's wire centers." 47 CFR § 51.505(b)(1). In litigation over this pricing rule, which the Supreme Court upheld in *Verizon Communications v. FCC*, 535 U.S. 467 (2002) ("*Verizon*"), it appears to have been common ground that, because of ongoing technological improvement (among other things), prices so determined would fall well below the costs the ILECs had actually historically incurred in constructing the elements. *Id.* at 503–04, 508–09. Certainly the ardent preferences of the parties as to the scope of the Act's unbundling requirements—the ILECs seeking a narrow reading, the CLECs seeking a broad one—suggest such a relationship.

In its first effort to interpret the "impairment" standard of § 251(d)(2), the Commission held that lack of unbundled access to an element would "impair" a CLEC's ability to provide telecommunications service "if the quality of the service the entrant can offer, absent access to the requested element, declines and/or the cost of providing the service rises." *Implementation of the Local Competition Provisions in the Telecommunications Act of 1996*, First Report and Order, CC Docket No. 96–98, 11 FCC Rcd 15499, 15643 (1996) ("First Report and Order"), ¶ 285.

The Supreme Court found this reading of "impair" unreasonable in two respects. First, the Commission had irrationally refused to consider whether a CLEC could self-provision

or acquire the requested element from a third party. *AT&T*, 525 U.S. at 389. Second, the Commission had considered *any* increase in cost or decrease in quality, no matter how small, sufficient to establish impairment—a result the Court concluded could not be squared with the "ordinary and fair meaning" of the word "impair." *Id.* at 389–90 & n.11. The Court admonished the FCC that in assessing which cost differentials would "impair" a new entrant's competition within the meaning of the statute, it must "apply *some* limiting standard, rationally related to the goals of the Act." *Id.* at 388.

Responding to the *AT&T* decision, the Commission adopted a new interpretation under which a would-be entrant is "impaired" if, "taking into consideration the availability of alternative elements outside the incumbent's network, including self-provisioning by a requesting carrier or acquiring an alternative from a third-party supplier, lack of access to that element *materially diminishes* a requesting carrier's ability to provide the services it seeks to offer." *Implementation of the Local Competition Provisions of the Telecommunications Act of 1996*, Third Report and Order and Fourth Further Notice of Proposed Rulemaking, 15 FCC Rcd 3696, 3725 (1999) ("Third Report and Order"), ¶ 51 (emphasis added). But in *USTA I* we held that this new interpretation of "impairment," while an improvement, was still unreasonable in light of the Act's underlying purposes.

The fundamental problem, we held, was that the Commission did not differentiate between those cost disparities that a new entrant in *any* market would be likely to face and those that arise from market characteristics "linked (in some degree) to natural monopoly . . . that would make genuinely competitive provision of an element's function wasteful." *USTA I*, 290 F.3d at 427. This distinction between different kinds of incumbent/entrant cost differentials is qualitative, not merely quantitative, which is why the Commission's addition of a requirement that the cost disparity be "material" was inadequate. *Id.* at 427–28.

We also made clear that the Commission's broad and analytically insubstantial concept of impairment failed to pursue the "balance" between the advantages of unbundling (in terms of fostering competition by different firms, even if they use the very same facilities) and its costs (in terms both of "spreading the disincentive to invest in innovation and creating complex issues of managing shared facilities," *id.* at 427), a balance that we found implicit in the *AT&T* Court's insistence on an unbundling standard "rationally related to the goals of the Act," *id.* at 428 (quoting *AT&T*).

We also objected to the Commission's decision to issue, with respect to most elements, broad unbundling requirements that would apply "in every geographic market and customer class, without regard to the state of competitive impairment in any particular market." *USTA I*, 290 F.3d at 422. Though the Act does not necessarily require the Commission to determine "on a localized state-by-state or market-by-market basis which unbundled elements are to be made available," *id.* at 425 (quoting Third Report and Order, 15 FCC Rcd at 3753, ¶ 122), it does require "a more nuanced concept of impairment than is reflected in findings . . . detached from any specific markets or market categories." *USTA I*, 290 F.3d at 426. Thus, the Commission is obligated to establish unbundling criteria that are at least aimed at tracking relevant market characteristics and capturing significant variation.

Finally, we vacated the Commission's decision to require ILECs to unbundle the high-frequency portion of their copper loops to requesting CLECs—a practice known as "line sharing" and used by CLECs to provide broadband DSL service—because the Commission had failed to consider adequately whether intermodal competition from cable providers tilted the balance against this form of unbundling in the broadband market.

In response to *USTA I* the Commission again revised its definition of impairment. This time around, the Commission determined that a CLEC would "be impaired when lack of access to an incumbent LEC network element poses a *barrier*

or barriers to entry, including operational and economic barriers, that are *likely to make entry into a market uneconomic*. That is, we ask whether all potential revenues from entering a market exceed the costs of entry, taking into consideration any countervailing advantages that a new entrant may have." Order ¶ 84 (emphasis added). The Commission clarified that the impairment assessment would take intermodal competition into account. *Id.* ¶ ¶ 97–98.

The Commission responded to our demand for a more "nuanced" application of the impairment standard by purporting to adopt a "granular" approach that would consider "such factors as specific services, specific geographic locations, the different types and capacities of facilities, and customer and business considerations." *Id.* ¶ 118. Where the Commission believed that the record could not support an absolute national impairment finding but at the same time contained too little information to make "granular" determinations, it adopted a provisional nationwide rule, subject to the possibility of specific exclusions, to be created by state regulatory commissions under a purported delegation of the Commission's own authority.

The Commission also resolved to use the "at a minimum" language in § 251(d)(2) to "inform [its] consideration of unbundling in contexts where some level of impairment may exist, but unbundling appeared likely to undermine important goals of the 1996 Act." *Id.* ¶ 173. Specifically, in connection with two broadband elements, "fiber-to-the-home" ("FTTH") and hybrid loops (see below), it brought into the balance the risk that an unbundling order might deter investment in such facilities—contrary, as it saw the matter, to the statutory goal of encouraging prompt deployment of "advanced telecommunications capability." *Id.* ¶ ¶ 172–73 (quoting § 706 of the Act). Additional issues also emerged in the rulemaking and will be addressed below.

The ILECs filed two mandamus petitions with this Court, arguing that the Order violated our decision in *USTA I*, and in addition filed a petition for review here. Various CLECs, state commissions, and an association of state utility consum-

er advocates filed petitions for review in several other circuits; these petitions were transferred to the Eighth Circuit under the random lottery procedure established in 28 U.S.C. § 2112(a)(3), and then transferred to this court by the Eighth Circuit under 28 U.S.C. § 2112(a)(5). We consolidated the petitions for review with the mandamus petitions.

II. *ILEC Objections*

A. *Unbundling of Mass Market Switches*

The Commission made a nationwide finding that CLECs are impaired without unbundled access to ILEC switches for the "mass market," consisting of residential and relatively small business users. This finding was based primarily on the costs associated with "hot cuts" (discussed below), which must be performed when a CLEC provides its own switch. Order ¶ ¶ 464–75. But the Commission, apparently concerned that a blanket nationwide impairment determination might be unlawfully overbroad in light of the record evidence of substantial market-by-market variation in hot cut costs, delegated authority to state commissions to make more "nuanced" and "granular" impairment determinations.

First, the Commission directed the state commissions to eliminate unbundling if a market contained at least three competitors in addition to the ILEC, *id.* ¶ ¶ 498–503, or at least two non-ILEC third parties that offered access to their own switches on a wholesale basis, *id.* ¶ ¶ 504–05. For purposes of this exercise the Commission gave the states virtually unlimited discretion over the definition of the relevant market. *Id.* ¶ ¶ 495–97. Second, where these "competitive triggers" are not met, the Commission instructed the states to consider whether, despite the many economic and operational entry barriers deemed relevant by the Commission, competitive supply of mass market switching was nevertheless feasible. *Id.* ¶ ¶ 494, 506–20. The Commission also instructed the states to explore specific mechanisms to ameliorate or eliminate the costs of the "hot cut" process. *Id.* ¶ ¶ 486–90. The Commission mentioned, for example, the possible use of "rolling" hot cuts, a process in which CLECs

could use ILEC switches for some time after a customer selected the CLEC as its provider, and after an accumulation of such customer changes, the ILEC would make all the necessary hot cuts in one fell swoop. *Id.* ¶¶ 463, 521–24. If a state failed to perform the requisite analysis within nine months, the Commission would step into the position of the state commission and do the analysis itself. *Id.* ¶ 190. Finally, the Order provided that a party "aggrieved" by a state commission decision could seek a declaratory ruling from the Commission, though with no assurance when, or even whether, the Commission might respond. *Id.* ¶ 426; see also 47 CFR § 1.2.

We consider first whether the Commission's subdelegation of authority to the state commissions is lawful. We conclude that it is not. We then consider whether the Commission's nationwide impairment determination can nevertheless survive, even without the safety valve provided by subdelegation to the states. We conclude that it cannot. We therefore vacate the Commission's decision to order unbundling of mass market switches, subject to the stay discussed in Part VI.

1. *Subdelegation of § 251(d)(2) impairment determinations to state commissions*

The FCC acknowledges that § 251(d)(2) instructs "the Commission" to "determine[ ]" which network elements shall be made available to CLECs on an unbundled basis. But it claims that agencies have the presumptive power to subdelegate to state commissions, so long as the statute authorizing agency action refrains from foreclosing such a power. Given the absence of any express foreclosure, the Commission argues that its interpretation of the statute on the matter of subdelegation is entitled to deference under *Chevron U.S.A. v. Natural Resources Defense Council*, 467 U.S. 837 (1984). And it claims that its interpretation is reasonable given the state commissions' independent jurisdiction over the general subject matter, the magnitude of the regulatory task, and the need for close cooperation between state and federal regulators in this area.

The Commission's position is based on a fundamental misreading of the relevant case law. When a statute delegates authority to a federal officer or agency, subdelegation to a subordinate federal officer or agency is presumptively permissible absent affirmative evidence of a contrary congressional intent. See *United States v. Giordano*, 416 U.S. 505, 512–13 (1974); *Fleming v. Mohawk Wrecking & Lumber Co.*, 331 U.S. 111, 121–22 (1947); *Halverson v. Slater*, 129 F.3d 180, 185–86 (D.C. Cir. 1997); *United States v. Mango*, 199 F.3d 85, 90–91 (2d Cir. 1999); *Inland Empire Pub. Lands Council v. Glickman*, 88 F.3d 697, 702 (9th Cir. 1996); *United States v. Widdowson*, 916 F.2d 587, 592 (10th Cir. 1990), vacated on other grounds, 502 U.S. 801 (1991). But the cases recognize an important distinction between subdelegation to a *subordinate* and subdelegation to an *outside party*. The presumption that subdelegations are valid absent a showing of contrary congressional intent applies only to the former. There is no such presumption covering subdelegations to outside parties. Indeed, if anything, the case law strongly suggests that subdelegations to outside parties are assumed to be improper absent an affirmative showing of congressional authorization. See *Shook v. District of Columbia Fin. Responsibility & Mgmt Assistance Auth.*, 132 F.3d 775, 783–84 & n.6 (D.C. Cir. 1998). See also *Nat'l Ass'n of Reg. Util. Comm'rs ("NARUC") v. FCC*, 737 F.2d 1095, 1143–44 & n.41 (D.C. Cir. 1984); *Nat'l Park and Conservation Ass'n v. Stanton*, 54 F. Supp. 2d 7, 18–20 (D.D.C. 1999). (We discuss below some cases that might, mistakenly, be thought to support a contrary view.)

This distinction is entirely sensible. When an agency delegates authority to its subordinate, responsibility—and thus accountability—clearly remain with the federal agency. But when an agency delegates power to outside parties, lines of accountability may blur, undermining an important democratic check on government decision-making. See *NARUC*, 737 F.2d at 1143 n.41; cf. *Printz v. United States*, 521 U.S. 898, 922–23 (1997). Also, delegation to outside entities increases the risk that these parties will not share the agency's "national vision and perspective," *Stanton*, 54 F. Supp. 2d at

20, and thus may pursue goals inconsistent with those of the agency and the underlying statutory scheme. In short, subdelegation to outside entities aggravates the risk of policy drift inherent in any principal-agent relationship.

The fact that the subdelegation in this case is to state commissions rather than private organizations does not alter the analysis. Although *United States v. Mazurie*, 419 U.S. 544 (1975), noted that "limits on the authority of *Congress* to delegate its legislative power ... are [ ] less stringent in cases where the entity exercising the delegated authority itself possesses independent authority over the subject matter," *id.* at 556–57 (emphasis added), that decision has no application here: it involved a constitutional challenge to an express *congressional* delegation, rather than an administrative subdelegation, and the point of the discussion was to distinguish the still somewhat suspect case of congressional delegation to purely private organizations.

Two Ninth Circuit cases have invoked *Mazurie* to suggest that limitations on an administrative agency's power to subdelegate might be less stringent if the delegee is a sovereign entity rather than a private group. See *Assiniboine & Sioux Tribes v. Bd. of Oil and Gas*, 792 F.2d 782, 795 (9th Cir. 1986); *Southern Pacific Transp. Co. v. Watt*, 700 F.2d 550, 556 (9th Cir. 1983). But in neither of these cases was this principle necessary to the outcome, and in neither did the court seek to justify the extension of *Mazurie* from its context—the validity of an express delegation of Congress's powers.

We therefore hold that, while federal agency officials may subdelegate their decision-making authority to subordinates absent evidence of contrary congressional intent, they may not subdelegate to outside entities—private or sovereign—absent affirmative evidence of authority to do so.

The Commission's plea for *Chevron* deference is unavailing. A general delegation of decision-making authority to a federal administrative agency does *not*, in the ordinary course of things, include the power to subdelegate that authority beyond federal subordinates. It is clear here that Congress has

not delegated to the FCC the authority to subdelegate to outside parties. The statutory "silence" simply leaves that lack of authority untouched. In other words, the failure of Congress to use "Thou Shalt Not" language doesn't create a statutory ambiguity of the sort that triggers *Chevron* deference. See *Ry. Labor Exec. Ass'n v. Nat. Mediation Bd.*, 29 F.3d 655, 671 (D.C. Cir. 1994) ("Were courts to *presume* a delegation of power absent an express *withholding* of such power, agencies would enjoy virtually limitless hegemony, a result plainly out of keeping with *Chevron* and quite likely with the Constitution as well."); see also *Aid Ass'n for Lutherans v. U.S. Postal Service*, 321 F.3d 1166, 1174–75 (D.C. Cir. 2003); *Motion Picture Ass'n of Am. v. FCC*, 309 F.3d 796, 801 (D.C. Cir. 2002); *Ethyl Corp. v. EPA*, 51 F.3d 1053, 1060 (D.C. Cir. 1995).

The FCC invokes a number of other cases in support of its idea of a presumptive authority to subdelegate to entities other than subordinates. These are inapposite because they do not involve subdelegation of decision-making authority. They merely recognize three specific types of legitimate outside party input into agency decision-making processes: (1) establishing a reasonable condition for granting federal approval; (2) fact gathering; and (3) advice giving. The scheme established in the Order fits none of these models.

First, a federal agency entrusted with broad discretion to permit or forbid certain activities may condition its grant of permission on the decision of another entity, such as a state, local, or tribal government, so long as there is a reasonable connection between the outside entity's decision and the federal agency's determination. Thus in *United States v. Matherson*, 367 F. Supp. 779, 782–83 (E.D.N.Y. 1973), aff'd 493 F.2d 1339 (2d Cir. 1974), the court upheld the decision of the Fire Island National Seashore Superintendent to condition issuance of federal seashore motor vehicle permits on the applicant's acquisition of an analogous permit from an adjacent town. And *Southern Pacific*, 700 F.2d at 556, citing *Matherson*, sustained the Secretary of Interior's conditioning of right-of-way permits across tribal lands on the tribal government's approval. In contrast to these cases, where an

agency with broad permitting authority had adopted an obviously relevant local concern as an element of its decision process, the Commission here has delegated to another actor almost the entire determination of whether a specific statutory requirement—impairment—has been satisfied.

Second, there is some authority for the view that a federal agency may use an outside entity, such as a state agency or a private contractor, to provide the agency with factual information. While *Assiniboine & Sioux Tribes* found that a delegation of decision-making power to a state board would be unlawful, it left open whether reliance by the federal agency on the state board for "nondiscretionary activities such as compiling, hearing, and transmitting technical information might not be permissible and desirable." 792 F.2d at 795. And *National Association of Psychiatric Treatment v. Mendez*, 857 F. Supp. 85, 91 (D.D.C. 1994), upheld a federal certifying agency's decision to hire a private contractor to conduct surveys of residential treatment centers and pass its results on to the agency, which retained final certification authority. While the FCC has sought to characterize the state commissions' role here as fact finding, see Order ¶ ¶ 186, 493, in fact the Order lets the states make crucial decisions regarding market definition and application of the FCC's general impairment standard to the specific circumstances of those markets, with FCC oversight neither timely nor assured. The Commission's attempted punt does not remotely resemble nondiscretionary information gathering.

Our own decision in *Tabor v. Joint Board for Enrollment of Actuaries*, 566 F.2d 705, 708 n.5 (D.C. Cir. 1977), seems to straddle the two above variants of permissible relationships. There the federal Joint Board for Enrollment of Actuaries, exercising its broad discretion to set conditions for certifying actuaries to administer ERISA pension plans, required applicants *either* to pass a Board exam *or* to pass an exam administered by one of the recognized private national actuarial societies. 566 F.2d at 708 n.5. The court found that the process was "superintended by the Board in every respect," and that the Board had not abdicated its decision-making authority but merely created a reasonable "short-cut," contin-

gent on the approval of certain private organizations, to satisfy one of the Board's own regulatory requirements. *Id.* The opinions in both *Southern Pacific* (from our first category) and *Mendez* (from our second) invoke *Tabor*.

Neither *Tabor* nor its progeny relied on any principle that subdelegations to outside parties were presumptively valid, since the result in each of these cases was supportable on the theory that no subdelegation of decision-making authority had actually taken place. To the extent that *Tabor*'s citation of *United States v. Giordano*, 416 U.S. 505, 512–13 (1974), might be thought to suggest that external delegations enjoy the same favorable presumption as internal ones, that suggestion was clearly rejected by our decision in *Shook*, 132 F.3d at 783–84 & n.6.

Third, a federal agency may turn to an outside entity for advice and policy recommendations, provided the agency makes the final decisions itself. Thus in *Shook*, 132 F.3d at 784, we disapproved the D.C. Control Board's delegation of governance powers over D.C. schools to a private Board of Trustees, but we suggested that the Control Board could use an entity of that sort "as an advisory board charged with recommending certain actions and policies to the Control Board." See also *Stanton*, 54 F. Supp. 2d at 19–20 & n.6; *Mendez*, 857 F. Supp. at 91. An agency may not, however, merely "rubber-stamp" decisions made by others under the guise of seeking their "advice," see *Assiniboine & Sioux Tribes*, 792 F.2d at 795, nor will vague or inadequate assertions of final reviewing authority save an unlawful subdelegation, see *Stanton*, 54 F. Supp. 2d at 19, 20–21.

Finally, the Commission's claim that *Diamond International Corp. v. FCC*, 627 F.2d 489, 492–93 (D.C. Cir. 1980), and *New York Telephone Co. v. FCC*, 631 F.2d 1059, 1065 (2d Cir. 1980), uphold "virtually indistinguishable" FCC subdelegations to state commissions, FCC Br. at 25, is (or should be) embarrassing. These cases involved a wholly unrelated issue: whether the FCC properly interpreted the Communications Act when it decided to permit carriers to file state tariffs for local services used in connection with interstate

services. The issue was not delegation of federal authority but rather the scope of federal authority to preempt state authority.

We note that the ILEC petitioners invoke standard *expressio unius* reasoning to attack the delegation. They point out that other provisions of the Act—e.g., the procedures for arbitration and approval of agreements under § 252—expressly specify a state role, and urge us to infer congressional preclusion of such a role under § 251(d)(2). We do not rely on this theory. Our conclusion would be unchanged if no provision of the Act mentioned any role for the state commissions, because the general conferral of regulatory authority does not empower an agency to subdelegate to outside parties. That said, the fact that other provisions of the statute carefully delineate a particular role for the state commissions, but § 251(d)(2) does not, reassures us that the our result is consistent with congressional intent.

We therefore vacate, as an unlawful subdelegation of the Commission's § 251(d)(2) responsibilities, those portions of the Order that delegate to state commissions the authority to determine whether CLECs are impaired without access to network elements, and in particular we vacate the Commission's scheme for subdelegating mass market switching determinations. (This holding also requires that we vacate the Commission's subdelegation scheme with respect to dedicated transport elements, discussed below.) We now turn to whether, without that safety valve, the FCC's national impairment findings for mass market switches can be reconciled with *USTA I*.

2. *Impairment in provision of mass market switching*

Without the (unlawful) innovation of transforming a national impairment finding into a provisional national impairment finding from which state commissions could deviate if they found no impairment under local market conditions, the FCC's Order on mass market switches must stand or fall as a nationwide determination that CLECs are impaired in the mass market without unbundled access to ILEC switches. After reviewing the record, we conclude that we must vacate

the (no longer provisional) national impairment finding as inconsistent with our conclusion in *USTA I* that the Commission may not "loftily abstract[ ] away from all specific markets," 290 F.3d at 423, but must instead implement a "more nuanced concept of impairment," *id.* at 426.

The Commission's national finding of impairment for mass market switches is based on entry barriers related to the need for ILECs to perform "hot cuts" (manual connections) for CLECs if the latter choose to self-provision mass market switches. See Order ¶ ¶ 459, 464–76. A "hot cut" requires an ILEC technician to physically disconnect a customer loop from the ILEC switch (to which the loop was hard-wired) and re-wire the loop to the CLEC switch, while simultaneously reassigning the customer's phone number from the ILEC switch to the CLEC switch. Order ¶ 465 n.1409. A hot cut must be performed every time a CLEC seeks to connect a new customer. In contrast, ILEC connection of a customer generally only requires a software change (unless the customer had already switched to a CLEC switch, in which case the hot cut must be undone via the same physical re-connection). Order ¶ 465. The Commission explains that, according to evidence in the record, the need to perform hot cuts can delay a CLEC in providing service with its own switch and can cause service disruptions, and that these delays and disruptions, even if minor, can damage customer perceptions of CLEC service and impede the CLECs' ability to compete. Order ¶ ¶ 466–67.

Though the Commission in its brief alludes to "other operational and economic factors" that might create barriers to competition in mass market switching, FCC Br. at 36, the Order makes clear that the national impairment finding was based solely on hot cuts. Order ¶ ¶ 459 n.1405 & 476. (The other factors were to be considered by state commissions in the exercise of the unlawfully delegated authority.) There appears to be no suggestion that mass market switches exhibit declining average costs in the relevant markets, or even that switches entail large sunk costs. The Commission nonetheless concluded that hot cut costs are not the sort of cost disparity that a new entrant into any market might face,

since they arise due to the fact that "incumbent LECs' networks were designed for use in a single carrier, non-competitive environment," which means that CLECs face operational costs that the ILECs do not. Order ¶ 465.

Though certain sections of the Order suggest that impairment due to hot cut costs might be sufficiently widespread to support a general national impairment finding even in the absence of more "nuanced" determinations to be made by the state commissions, Order ¶ ¶ 459, 470, 473, the Commission at other points concludes that a national finding, without the possibility of market-specific exceptions authorized by state commissions, would be inconsistent with *USTA I*. See Order ¶ ¶ 186–88, 196, 425, 485, 493. At the very least, these latter passages demonstrate that the Commission's own conclusions do not clearly support a non-provisional national impairment finding for mass market switches, and thus require us to vacate and remand.

Moreover, we doubt that the record supports a national impairment finding for mass market switches. In another context the Commission has already addressed a kindred issue. Under § 271 of the Act, the subset of ILECs that used to be operating companies of AT&T before its break-up (the Bell Operating Companies, or "BOCs") can enter the interLATA market (the market for calls between different local access and transport areas) only by showing, among other things, that they are providing CLECs adequate unbundled access to various network elements, including local loops. See Act § 271(c)(2)(B)(iv). The Commission acknowledges that in that context it has in fact found that the BOCs were doing so "in the quantities that competitors demand and at an acceptable level of quality," see, e.g., Memorandum Opinion and Order, *Application by SBC Communications, Inc., et al., Pursuant to Section 271 of the Telecommunications Act of 1996 To Provide In-Region, InterLATA Services in Texas*, 15 FCC Rcd 18354, 18480 (2000), ¶ 247; Memorandum Opinion and Order, *Application of Ameritech Michigan Pursuant to Section 271 of the Communications Act of 1934, as Amended, To Provide In-Region, InterLATA Services in Michigan*, 12 FCC Rcd 20543, 20601–02 (1997), ¶ 110. In

none of those proceedings did the Commission find the hot cut process inadequate to meet this standard. See Separate Statement of Chairman Michael K. Powell Approving in Part and Dissenting in Part, FCC 03–36 ("Powell Statement") at 4. But it distinguished those cases on the ground of uncertainty about whether ILECs would be able to handle the increases in hot cut demand that would flow from denying CLECs access to switches as UNEs. Order ¶ 469 & n.1435. The ILECs contend that in fact hot cut processes are "scalable," so that existing sufficiency can be projected onto larger-scale usage. See ILEC Br. at 16 (citing Powell Statement at 5; Memorandum Opinion and Order, *Application by Bell Atlantic New York for Authorization Under Section 271 of the Communications Act to Provide In–Region, InterLATA Service in the State of New York*, 15 FCC Rcd 3953, 4114 (1999), ¶ 308).

The record on the matter is mixed, perhaps sufficiently so that the Commission's "provisional" assumption to the contrary might be sustainable as an absolute finding, given the deference we would owe the Commission's predictive judgment and the inevitability of *some* over- and under-inclusiveness in the Commission's unbundling rules. But the Commission implicitly conceded that hot cut difficulties could not support an undifferentiated nationwide impairment finding. Order ¶ ¶ 425, 485, 493. Moreover, we made clear in *USTA I* that the Commission cannot proceed by very broad national categories where there is evidence that markets vary decisively (by reference to its impairment criteria), at least not without exploring the possibility of more nuanced alternatives and reasonably rejecting them. 290 F.3d at 425–26. One can imagine the Commission successfully identifying criteria based, for example, on an ILEC's track record for speed and volume in a market, integrated with some projection of the demand increase that would result from withholding of switches as UNEs. The Commission, however, has made no visible effort to explore such possibilities.

Additionally, the ILEC petitioners suggested several more narrowly-tailored alternatives to a blanket requirement that mass market switches be made available as UNEs. Considering such narrower alternatives is essential in light of our admonition in *USTA I* that the Commission must balance the

costs and benefits of unbundling. 290 F.3d at 429. "Rolling" hot cuts are one such proffered alternative. Under that concept the Commission could require unbundled access to ILEC switching on new lines for 90 days (or some other period of time) in order to give the ILEC time to perform the accumulated backlog of hot cuts simultaneously, Order ¶¶ 463, 521–24, or the Commission could require the ILEC to provide unbundled access to its switch only until it was able to perform the hot cut. The FCC's only real answer to these proposed alternatives, at least the only answer that appears in the Order or the FCC's brief, is that the Commission directed the state commissions to consider these alternatives and to implement them if they would remedy impairment. See FCC Br. at 38–39; Order ¶¶ 463, 521–24. But since we have held such subdelegation unlawful, that response is unavailable.

Moreover, even if the FCC had adopted some lawful mechanism for making exemptions from its general national rule, it could not necessarily rely on the existence of that mechanism as the sole justification for not adopting a more narrowly tailored rule. While a rational rule that would otherwise be impermissibly broad can be saved by "safety valve" waiver or exception procedures, the mere existence of a safety valve does not cure an irrational rule. See *ICORE, Inc. v. FCC*, 985 F.2d 1075, 1080 (D.C. Cir. 1993); *Alltel Corp. v. FCC*, 838 F.2d 551, 561–62 (D.C. Cir. 1988). And a rule is irrational in this context if a party has presented to the agency a narrower alternative that has all the same advantages and fewer disadvantages, and the agency has not articulated any reasonable explanation for rejecting the proposed alternative.

We therefore vacate the FCC's determination that ILECs must make mass market switches available to CLECs as UNEs, subject to the stay discussed in Part VI below, and remand to the Commission for a re-examination of the issue.

3. *The Commission's definition of "impairment"*

The Commission claims that no party in this litigation has challenged the concept embodied in its new interpretation of

"impairment." All the disputes, it says, are about the proper *implementation* of that standard. FCC Br. at 18. Not exactly. For example, although the ILEC petitioners' objections to the Commission's mass market switching provisions are all within the framework of the Commission's subdelegation scheme, a number of them clearly go to the character of the impairment standard embodied in that scheme.

As a general matter the ILECs argue the Commission's impairment standard is so open-ended that it imposes no meaningful constraints on unbundling, and would be unlawful even if applied by the FCC itself. ILEC Br. at 28; see also Separate Statement of Commissioner Kathleen Q. Abernathy Approving in Part and Dissenting in Part, FCC 03–36 at 6–7 & n. 16 (claiming that the Commission's multifactor test is no different from the totality-of-the-circumstances approach struck down in *USTA I*). More specifically, the ILECs claim that the Commission's unbundling test unlawfully permits states to consider as a potential source of impairment retail rates that are held below cost by state regulation against the ILECs' will, and unlawfully precludes consideration of intermodal competition when determining whether a market is suitable for competitive supply.

On the general point about the open-endedness of the Commission's standard, we observe that the Order's interpretation of impairment is an improvement over the Commission's past efforts in that, for the most part, the Commission explicitly and plausibly connects factors to consider in the impairment inquiry to natural monopoly characteristics (declining average costs throughout the range of the relevant market), see Order ¶¶ 75–76 & nn.245, 256, 258–59, ¶ 87 & n.283, or at least connects them (in logic that the ILECs do not seem to contest) to other structural impediments to competitive supply. These barriers include sunk costs (Order ¶ 75 & n.244, ¶¶ 76, 80, 86, 88), ILEC absolute cost advantages (Order ¶ 75 & n.247, ¶ 90 & n.302), first-mover advantages (Order ¶ 75 & n.249, ¶ 89), and operational barriers to entry within the sole or primary control of the ILEC (Order ¶ 91). In contrast to the First Report and Order and the Third Report and Order, the Commission has clarified that

only costs related to structural impediments to competition are relevant to the impairment analysis.

In light of our remand, this is not the occasion for any review of the Commission's impairment standard as a general matter; it finds concrete meaning only in its application, and only in that context is it readily justiciable. A few general observations are pertinent, however.

Relation of "impairment" to the "at a minimum" clause. We note that there are at least two ways in which the Commission could have accommodated our ruling in *USTA I* that its impairment rule take into account not only the benefits but also the costs of unbundling (such as discouragement of investment in innovation), in order that its standard be "rationally related to the goals of the Act." See *USTA I*, 290 F.3d at 428. One way would be to craft a standard of impairment that built in such a balance, as for example by hewing rather closely to natural monopoly features. The other is to use a looser concept of impairment, with the costs of unbundling brought into the analysis under § 251(d)(2)'s "at a minimum" language. The Commission has chosen the latter, and we cannot fault it for doing so. This is especially true as the statutory structure suggests that "impair" must reach a bit beyond natural monopoly. While for "proprietary" network elements the statute mandates a decision whether they are "necessary," § 251(d)(1)(A), for non-proprietary ones it requires a decision whether their absence would "impair" the requester's provision of telecommunications service, § 251(d)(1)(B). Thus, in principle, there is no statutory offense in the Commission's decision to adopt a standard that treats impairment as a continuous rather than as a dichotomous variable, and potentially reaches beyond natural monopoly, but then to examine the full context before ordering unbundling.

That said, we do note that in at least one important respect the Commission's definition of impairment is vague almost to the point of being empty. The touchstone of the Commission's impairment analysis is whether the enumerated operational and entry barriers "make entry into a market uneco-

nomic." Order ¶ 84. Uneconomic by whom? By *any* CLEC, no matter how inefficient? By an "average" or "representative" CLEC? By the most efficient existing CLEC? By a hypothetical CLEC that used "the most efficient telecommunications technology currently available," the standard that is built into TELRIC? Compare 47 CFR § 51.505(b)(1). We need not resolve the significance of this uncertainty, but we highlight it because we suspect that the issue of whether the standard is too open-ended is likely to arise again.

Intermodal alternatives. As for the ILECs' claim that the Commission's impairment standard unlawfully excludes consideration of intermodal alternatives, we observe that the Commission expressly stated that such alternatives are to be considered when evaluating impairment. Order ¶ ¶ 97–98, 443. Whether the weight the FCC assigns to this factor is reasonable in a given context is an question that we need not decide, except insofar as we reaffirm *USTA I*'s holding that the Commission cannot ignore intermodal alternatives. 290 F.3d at 429.

Impairment in markets where state regulation holds rates below historic costs. In the name of "universal service," state regulators have commonly employed cross-subsidies, tilting rate ceilings so that revenues from business and urban customers subsidize residential and rural ones. *USTA I*, 290 F.3d at 422. On remand from our decision in *USTA I*, the Commission decided to consider regulated below-cost retail rates as a factor that may "impair" CLECs in competing for mass market customers. See Order ¶ 518. The ILECs object strenuously, and it appears virtually certain that the issue will recur on remand.

The Commission's brief treatment of the issue makes no attempt to connect this "barrier" to entry either with structural features that would make competitive supply wasteful or with any other purposes of the Act (other than, implicitly, the purpose of generating "competition," no matter how synthetic). The Commission rightly says that if prevailing rates are too low to elicit CLEC entry even with the benefit of UNEs, the unbundling mandate will have no consequences. True

enough. But it is no defense of a rule to say that it is harmless in those cases where it has no effect at all; that presumably is true even of the most absurd rule.

The interesting case is the one where TELRIC rates are so low that unbundling *does* elicit CLEC entry, enabling CLECs to cut further into ILEC revenues in areas where the ILECs' service is mandated by state law—and mandated to be offered at artificially low rates funded by ILECs' supracompetitive profits in other areas. If the scheme of the Act is successful, of course, the very premise of these below-cost rate ceilings will be undermined, as those supracompetitive profits will be eroded by Act-induced competition. In competitive markets, an ILEC can't be used as a piñata. The Commission has said nothing to address these obvious implications, or otherwise to locate its treatment of the issue in any purposeful reading of the Act.

We recognize, of course, that the historic accounting costs relied upon by state regulators are, like TELRIC itself, an artificial construct that may not closely track true economic cost. But that is no justification for the Commission's refusal to evaluate the probable consequences of its approach, and to adopt, in the light of those estimations, a policy that it can reasonably say advances the goals of the Act.

B. *Unbundling of High-Capacity Dedicated Transport Facilities*

1. *Unlawfulness of the delegation to the states and the national impairment finding*

The Commission has made multiple impairment findings with respect to dedicated transport elements (transmission facilities dedicated to a single customer or carrier), varying the findings by capacity level. First, it found that competing providers are not impaired without unbundled access to "OCn" transport facilities (very high-capacity transport facilities or bandwiths within such facilities), Order ¶¶ 359, 372, and all petitioners appear to accept that finding. Second, the Commission found that competitors are impaired without unbundled access to DS1 transport, DS3 transport, and dark

fiber transport, but made this nationwide impairment finding subject to variation by state commissions applying specific "competitive triggers." *Id.* ¶ 359; see also *id.* ¶ ¶ 381–93. Explaining this latter decision, the Commission observed that its nationwide impairment findings for DS1, DS3, and dark fiber were based on "aggregated data" and frankly acknowledged that competitive alternatives are available "in some locations." *Id.* ¶ 398. The Commission declared that it did not need to resolve "the factual identification of where alternative facilities exist.... [B]ecause we recognize that the record is insufficiently detailed to make more precise findings regarding impairment, we delegate to the states, subject to appeal back to this Commission if a state fails to act, a fact-finding role to determine on a route-specific basis where alternatives to the incumbent LECs' networks exist such that competing carriers are no longer impaired." *Id.* ¶ 398.

Specifically, the Commission instructed states to apply two competitive triggers on a route-by-route basis. *Id.* ¶ ¶ 399–401. First, the "self-provisioning" trigger required states to find no impairment if three or more competitors had deployed non-ILEC transport facilities along a specific route. *Id.* ¶ ¶ 400, 405–09. Second, the "wholesale facilities" trigger required states to find no impairment if two or more competing carriers were immediately able and willing to sell transport along a given route at wholesale rates. *Id.* ¶ ¶ 400, 412–16. Even where the triggers were not satisfied, the FCC allowed a finding of non-impairment if a state, applying seven criteria (all quite fluid and none quantified), determined that the route was suitable for multiple competitive supply. *Id.* ¶ 410. If a state believed that there was impairment on a specific route despite facial satisfaction of the self-provisioning trigger, it could petition the Commission for a waiver. *Id.* ¶ 411.

As we explained in the mass market switching context, the Commission may not subdelegate its § 251(d) authority to state commissions. Although the Commission characterizes the states' role as "fact-finding," Order ¶ 394, the characterization is fictitious. It is the states, not the FCC, that determine whether the competitive triggers, or the Commis-

sion's numerous and largely unquantified alternative criteria, are satisfied; it is the states that issue binding orders, subject only to the Commission's discretionary review. And, as with mass market switching, the Order itself suggests that the Commission doubts a national impairment finding is justified on this record. *Id.* ¶¶ 360, 394, 398. We therefore vacate the national impairment findings with respect to DS1, DS3, and dark fiber and remand to the Commission to implement a lawful scheme.

2. *Remaining dedicated transport issues*

The ILECs have raised two additional issues about the Commission's treatment of dedicated transport, and the CLECs yet another. We address the ILECs' objections here, and that of the CLECs (which relates to so-called "entrance facilities") below in the portion of the opinion devoted to their claims.

a. *Route-specific analysis of dedicated transport*

In *USTA I* we expressed skepticism regarding whether there could be impairment in markets "where the element in question—though not literally ubiquitous—is significantly deployed on a competitive basis," giving as a specific example interoffice dedicated transport. 290 F.3d at 422. We also instructed the Commission, as noted above, to apply a "nuanced" concept of impairment connected to "specific markets or market categories." *Id.* at 426. Any process of inferring impairment (or its absence) from levels of deployment depends on a sensible definition of the markets in which deployment is counted.

For dedicated transport elements the Commission decided that the appropriate market was not a geographic market (e.g., a Metropolitan Statistical Area ("MSA"), as the ILECs urged, or general customer class), but rather a specific point-to-point route. Thus, for example, the fact that dedicated transport facilities are widely deployed within one MSA does not, in the Commission's view, necessarily preclude a finding of impairment between two specific points within that MSA, if

deployment has not satisfied the Commission's competitive "triggers" on that route.

We do not see how the Commission can simply ignore facilities deployment along similar routes when assessing impairment. Suppose points A, B, and C are all in the same geographic market and are similarly situated with regard to the "barriers to entry" that the Commission says are controlling. See Order ¶¶ 84 et seq. Suppose further that multiple competitors supply DS1 transport between points A and B, but only the ILEC and one other CLEC have deployed DS1 transport between A and C. The Commission cannot ignore the A–B facilities deployment when deciding whether CLECs are impaired with respect to A–C deployment without a good reason. The Commission does explain why competition on the A–B route should not be *sufficient* to establish competition is possible on the A–C route, Order ¶ 401, but this cannot explain the Commission's implicit decision to treat competition on one route as *irrelevant* to the existence of impairment on the other. Nor does the Commission explain whether, and why, the error costs (both false positives and false negatives) associated with a route-by-route market definition are likely to be lower than the error costs associated with alternative market definitions. While it may be infeasible to define the barriers to entry in a manageable form, i.e., in such a way that they may usefully be applied to MSAs (or other plausible markets) as a whole, the Commission nowhere suggests that it explored such alternatives, much less found them defective.

b. *Wireless providers' access to unbundled dedicated transport*

In addition to their general challenge to the FCC's provisional national finding that competitors are impaired without access to dedicated transport facilities, the ILEC petitioners also attack the Commission's conclusion that providers of wireless service (also known as commercial mobile radio services, or "CMRS") qualify for unbundled access to these facilities. According to the ILECs, the Commission not only failed to conduct the requisite impairment analysis for wireless providers, but in fact found that wireless growth has

been "remarkable": 90% of the U.S. population lives in areas served by at least three wireless providers, 40% of Americans and 61% of American households own a wireless phone, wireless prices have been steadily declining, and 3–5% of wireless customers use wireless as their only phone, treating it as a full substitute for traditional land line service. Order ¶ 53. Although the ILECs implicitly concede that wireless providers would be impaired if they were denied *any* access to ILEC dedicated interoffice transport facilities, they point out that wireless providers have traditionally purchased such access from ILECs at wholesale rates (a transaction classified, since adoption of the Act, under § 251(c)(4)). And the data above clearly show that wireless carriers' reliance on special access has not posed a barrier that makes entry uneconomic. Indeed, the multi-million dollar sums that the Commission regularly collects in its auctions of such spectrum, see, e.g., *Annual Report and Analysis of Competitive Market Conditions With Respect to Commercial Mobile Services*, Seventh Report, FCC 02–179 (July 3, 2002), Table 1B, and that firms pay to buy already-issued licenses, see, e.g., *Annual Report and Analysis of Competitive Market Conditions With Respect to Commercial Mobile Services*, Eighth Report, FCC 03–150 (July 14, 2003), ¶¶ 42–44, seem to indicate that wireless firms currently expect that net revenues will, by a large margin, more than recover all their non-spectrum costs (including return on capital).

The FCC and the wireless intervenors do not challenge the assertion that the current regime has witnessed a rapidly expanding and prosperous market for wireless service. Rather, they rely on the principle that "evidence that requesting carriers are using incumbent LEC tariffed services" is not "relevant to [the] unbundling determination." Order ¶ 102.

The Commission offers several justifications for its decision to treat special access availability as irrelevant to the impairment analysis. None withstands scrutiny. First, the Commission suggests that it would be

> inconsistent with the Act if we permitted the incumbent LEC to avoid all unbundling merely by providing resold

> or tariffed services as an alternative. Such an approach would give the incumbent LECs unilateral power to avoid unbundling at TELRIC rates simply by voluntarily making elements available at some higher price.

Order ¶ 102 (footnote omitted). While the possibility to which the Commission points is undeniable, its implications for the Act's implementation aren't as horrifying as the Commission seems to think. After all, the purpose of the Act is not to provide the widest possible unbundling, or to guarantee competitors access to ILEC network elements at the lowest price that government may lawfully mandate. Rather, its purpose is to stimulate competition—preferably genuine, facilities-based competition. Where competitors have access to necessary inputs at rates that allow competition not only to survive but to flourish, it is hard to see any need for the Commission to impose the costs of mandatory unbundling.

We recognize that, given the ILECs' incentive to set the tariff price as high as possible and the vagaries of determining when that price gets so high that the "impairment" threshold has been crossed, a rule that allowed ILECs to avoid unbundling requirements simply by offering a function at lower-than-TELRIC rates might raise real administrability issues. Those complications might in principle support a blanket rule treating the availability of ILEC tariffed service as irrelevant to impairment. But the FCC hasn't defended its decision in those terms or even tried to explicate these complications. Moreover, where (as here) market evidence already demonstrates that existing rates outside the compulsion of § 251(c)(3) don't impede competition, and where (as here) there is no claim that ILECs would be able drastically to hike those rates, those possible complications recede even farther in the background.

The FCC also suggests that the ILECs' view would effectively read unbundled access out of the Act. Both the Commission and the wireless intervenors argue that this conclusion finds support in *Iowa Utilities I*, which held that ILECs could not avoid unbundling requirements by classifying certain features as "services" rather than "network ele-

ments." 120 F.3d at 809. There the ILECs had argued that the legislative history of the Act suggested that functions offered as services were meant to be governed by the resale provisions of § 251(c)(4) rather than the unbundling provisions of § 251(c)(3). In rejecting this argument, the Eighth Circuit said that the provision "for the resale of telecommunications services ... does not establish resale as the exclusive means through which a competing carrier may gain access to such services. We agree with the FCC that such an interpretation would allow the incumbent LECs to evade a substantial portion of their unbundling obligation under subsection 251(c)(3)." 120 F.3d at 809. Thus the court found that an ILEC offer of functions for sale as services did not preclude classifying these functions as network elements to be unbundled under § 251(c)(3). But that decision in no way supports a claim that the availability of services for sale under § 251(c)(4) is irrelevant to whether there is impairment of the sort that would require unbundling.

The Commission next argues that considering special access availability in the impairment analysis would "be contrary to the Act's requirement that unbundled facilities ... should be priced at cost-based rates and our determination that TELRIC is the appropriate methodology for determining those rates...." Order ¶ 102. This is circular. The question is which facilities must be unbundled, or, more specifically, what the relevant benchmark is for assessing whether entry is "impaired" if non-ILECs don't have access to UNEs (at whatever rate the Commission might choose to prescribe).

Finally, the FCC suggests that tariffed services "present different opportunities and risks for the requesting carrier than the use of UNEs or non-incumbent LEC alternatives." Order ¶ 102. This may well be true in certain cases, and on an appropriate record the Commission might find impairment even when services were available from ILECs outside § 251(c)(3). But this possibility doesn't give the Commission carte blanche to omit consideration of such alternatives in its impairment analysis. And it clearly cannot justify a finding of impairment with respect to wireless, where these different

"opportunities and risks" have obviously not made competitive entry uneconomic.

We therefore hold that the Commission's impairment analysis must consider the availability of tariffed ILEC special access services when determining whether would-be entrants are impaired, and vacate ¶¶ 102–03 of the Order. This of course still leaves the Commission free to take into account such factors as administrability, risk of ILEC abuse, and the like. What the Commission may not do is compare unbundling only to self-provisioning or third-party provisioning, arbitrarily excluding alternatives offered by the ILECs.

C. *Network Modification Requirements*

In *Iowa Utilities I*, the Eighth Circuit struck down an FCC rule that required ILECs to provide interconnection and UNEs superior in quality to those that the ILEC provided for itself. 120 F.3d at 812–13. But the court nonetheless "endorse[d] the Commission's statement that 'the obligations imposed by sections 251(c)(2) and 251(c)(3) include modifications to incumbent LEC facilities to the extent necessary to accommodate interconnection or access to network elements.'" *Id.* at 813 n.33. The line between impermissible "superior quality" requirements and permissible "modification" requirements is not always clear.

In the Order under review, the Commission "require[d] incumbent LECs to make routine network modifications to unbundled transmission facilities used by requesting carriers where the requested transmission facility has already been constructed." Order ¶ 632. The Commission elaborated that "routine network modifications" include "those activities that incumbent LECs regularly undertake for their own customers," but do not include "construction of new wires . . . for a requesting carrier." *Id.* Applying this standard, the Commission determined that when ILECs supply high-capacity loops as unbundled elements, they must "engage in activities necessary to activate loops that are not currently activated in the network." *Id.* ¶ 633. The FCC gave as examples of such necessary loop modifications: "rearrangement or splicing of cable; adding a doubler or repeater; adding an equipment

case; adding a smart jack; installing a repeater shelf; adding a line card; and deploying a new multiplexer or reconfiguring an existing multiplexer." *Id.* ¶ 634.

The ILECs claim that these passages manifest a resurrection of the unlawful superior quality rules. We disagree. The FCC has established a clear and reasonable limiting principle: the distinction between a "routine modification" and a "superior quality" alteration turns on whether the modification is of the sort that the ILEC routinely performs, on demand, for its own customers. While there may be disputes about the application, the principle itself seems sensible and consistent with the Act as interpreted by the Eighth Circuit. Indeed, the FCC makes a plausible argument that requiring ILECs to provide CLECs with whatever modifications the ILECs would routinely perform for their own customers is not only allowed by the Act, but is affirmatively demanded by § 251(c)(3)'s requirement that access be "nondiscriminatory." We needn't reach that claim, however, since the FCC's principle is at the very least reasonable and consistent with *Iowa Utilities I*.

The ILECs further object that the Order unlawfully permits states to find that ILECs are not entitled to compensation for making the requested modifications. We agree with the FCC that this challenge will not be ripe for judicial review until a state actually decides how much an ILEC may charge for a specific network modification.

III. *CLEC Objections*

A. *Unbundling of Broadband Loops*

The Commission declined to require ILECs to provide unbundled access to most of the broadband capabilities of mass market loops. In particular, it decided (subject to certain qualifications) not to require unbundling of the broadband capabilities of hybrid copper-fiber loops, Order ¶ ¶ 288–89, or fiber-to-the-home ("FTTH") loops, *id.* ¶ ¶ 273–77, and it also decided not to require ILECs to unbundle the high-frequency portion of copper loops, a practice known as "line

sharing," *id.* ¶¶ 255–63. The Commission did require ILECs to unbundle the narrowband portion of hybrid loops, Order ¶ 296, but it permitted ILECs to use a different type of technology to connect the fiber feeder loop to the copper distribution portion of the loop than the ILEC itself used, in light of technological and engineering considerations, Order ¶ 297.

The CLEC petitioners attack these decisions as inconsistent with the Act. They argue, first, that CLECs are impaired without access to the broadband capabilities of loops and, second, that the Commission is obligated to unbundle any elements for which impairment has been shown. We consider these claims with respect to each broadband element in question. We then consider the CLECs' claim that their access to the narrowband portion of hybrid loops is impaired by the FCC's decision permitting ILECs to substitute an allegedly inferior connection technology.

1. *Hybrid loops*

The Commission found some degree of impairment from competitors' lack of unbundled access to hybrid loops, Order ¶ 286, but also found that such impairment "at least partially diminishes with the increasing deployment of fiber," *id.*, and that unbundled access to copper subloops "adequately addresses" that impairment, *id.* § 291. Nonetheless, evidently assuming some degree of impairment, it proceeded to invoke the "at a minimum" language of § 251(d)(2) to weigh other statutory goals against that effect. Noting the directive in § 706(a) of the Act that the Commission should pursue "methods that remove barriers to infrastructure investment," it found that the costs of unbundling hybrid loops—stifling investment by both ILECs and CLECs in advanced telecommunications infrastructure—outweighed the benefits of removing this barrier to competition. *Id.* ¶¶ 286, 288, 290.

The CLECs object to this interpretation of the "at a minimum" clause, arguing that the Act prohibits "ad hoc" balancing of the statute's pro-competition goals with an allegedly conflicting goal derived from the uncodified § 706. They interpret the "at a minimum" clause to mean that the FCC

may order unbundling even in the absence of an impairment finding if it finds concrete benefits to unbundling that cannot otherwise be achieved, and that it may refuse to order unbundling in the face of impairment findings if unbundling would conflict with some other unambiguous requirement of the Act, such as funding universal service.

The CLECs offer two main arguments to support their interpretation of the "at a minimum" clause. First, they claim that the Commission's interpretation contravenes the Act's "stated purpose" of promoting competition, CLEC Br. at 18, a goal that is an "end in itself." *Id.* (quoting *Verizon*, 535 U.S. at 476). But in fact the passage from *Verizon* on which the CLECs rely says that eliminating traditional ILEC monopolies "was considered *both* an end in itself *and* an important step toward the Act's other goals," including "boosting competition in broader markets." 535 U.S. at 476 (emphasis added). Section 706(a) identifies one of the Act's goals beyond fostering competition piggy-backed on ILEC facilities, namely, removing barriers to infrastructure investment. The Commission thus acted reasonably in its interpretation of the "at a minimum" clause.

Second, the CLECs contend that failing to impose unbundling in the face of an impairment finding amounts to an unlawful decision to "forbear" from applying the requirements of § 251(c). See §§ 160(a),(d). Here they rely on *Association of Communications Enterprises ("ASCENT") v. FCC*, 235 F.3d 662, 665–68 (D.C. Cir. 2001), in which, rejecting the Commission's argument that the exclusion of ILEC subsidiaries was a reasonable interpretation of the statutory phrase "successor or assign" in § 251(h)(2)(B)(ii), we held that the FCC couldn't exempt an ILEC subsidiary from § 251(c)(3) obligations unless it complied with the statutory forbearance requirements of § 160.

But § 160, prescribing when the Commission may forbear from applying statutory requirements, obviously comes into play only for requirements that exist; it says nothing as to what the statutory requirements are. Thus *ASCENT* turned on our finding that, even under *Chevron*'s forgiving standard,

the Commission's exemption of subsidiaries was inconsistent with the statute. 235 F.3d at 668.

As we noted above in Part II.A.3, there are at least two ways in which the Commission could take into account the frustration of some of the Act's goals—such as encouraging facilities-based competition—that would flow from giving § 251(c)(3) unbundling too broad a scope. It could have built those offsets into its concept of "impairment" by reading that term narrowly, or it could have embraced a relatively broad reading of impairment and then considered, element by element, how an unbundling order might adversely affect the Act's other goals. The CLECs rightly point to *USTA I's* observation that "impairment" was the "touchstone," 290 F.3d at 425, but that opinion, far from barring consideration of factors such as an unbundling order's impact on investment, clearly read the Act, as interpreted by the Supreme Court in *AT&T*, to mandate exactly such consideration, *id.* at 427–28.

We therefore hold that the Commission reasonably interpreted § 251(c)(3) to allow it to withhold unbundling orders, even in the face of some impairment, where such unbundling would pose excessive impediments to infrastructure investment.

But was the Commission's decision on hybrid loops, on this record, a legitimate application of that principle? The Commission explained that its decision would stimulate the infrastructure investment contemplated by § 706 in two ways. First, limiting access to the fiber portion of the hybrid loops would give ILECs incentives to deploy fiber (both feeder fiber and, eventually, FTTH), along with associated next-generation networking equipment, and to develop new broadband offerings for mass market consumers. Because unbundling orders reduce return on investment, such orders would inhibit ILECs from making risky investments in next-generation technology. Second, denying CLECs access to ILEC broadband capabilities will stimulate *them* to seek innovative access options for broadband, including self-deployment of new facilities; unbundling, by contrast, would

be likely to blunt innovation by locking the CLECs into technological choices made by the ILECs. Order ¶¶ 290, 295.

The Commission also identified two additional considerations that would mitigate any negative impact on local competition in broadband. First, CLECs still have unbundled access to other loop alternatives in the ILEC network, including copper subloops, which allow CLECs to compete in the broadband market. Order ¶ 291. Second, intermodal competition in broadband, particularly from cable companies, means that, even if CLECs proved unable to compete with ILECs in the broadband market, there would still be vigorous competition from other sources. *Id.* ¶ 292.

The CLEC petitioners reject all these justifications, and pose a series of objections. First, they argue, the FCC should redress any investment disincentives for ILEC broadband loop investment not by withholding unbundling, but by modifying the UNE pricing rules. But as we have already held, § 251(d)(2)'s "at a minimum" clause allows the Commission to consider the effect on infrastructure investment when determining what elements must be unbundled. And the fact that the Commission and the Court have deemed TELRIC a reasonable methodology for pricing UNEs doesn't require the Commission to blind itself to the fact that TELRIC may itself be imperfect and may be implemented still more imperfectly. While the Commission might modify its UNE pricing rules to adequately reduce the negative impacts that it fears, until it has done so it may reasonably consider real-world risks in deciding what elements to unbundle.

Second, the CLECs insist that the record demonstrates that there is no need for additional incentives for investment in broadband infrastructure. With respect to broadband customers served by hybrid loops, ILECs have already extensively deployed fiber feeder loops, and, the CLECs claim, they would continue to do so even without any incentive from expected broadband revenues, since the narrowband cost savings from fiber feeder deployment alone justify ILEC investment in fiber feeder. Provision of broadband involves

additional electronic equipment, but the CLECs assert that the costs involved are negligible compared to the fiber upgrade, and that in fact most of these additional investments have already been made. As for alternative means of providing broadband service, the CLECs characterize the FCC's assertion that eliminating unbundled access to hybrid loops would stimulate ILEC investment in FTTH loops as pure speculation, inconsistent with record evidence that there is no consumer demand for services requiring such loops. And they say that the Commission may not tolerate an impairment of competition that would benefit consumers of today in order to create incentives for investment in systems for which there is no evidence of demand by consumers of tomorrow.

The Commission says little in the Order or in its brief to respond the assertion that ILECs would invest in fiber feeder even without revenue from broadband. Indeed, the Commission appears to concede that ILECs are already investing heavily in fiber feeder loops, Order ¶ ¶ 224, 290, and offers no specific evidence suggesting that unbundling the broadband capabilities of these loops would have a substantial negative impact on this investment. (Nor, to be sure, do the CLECs offer any sort of sophisticated econometric analysis demonstrating the likely marginal impact on investment.)

But there are at least three other aspects of the Commission's investment incentives argument to which the CLEC response is either inadequate or non-existent. First, the Commission suggested that greater incentives may be needed for ILECs to deploy the additional electronic equipment needed to provide broadband access over a hybrid loop. While the CLECs are correct that the Commission concluded that the deployment of this equipment was far less "costly, complex, and risky" than deployment of the fiber feeder, Order ¶ 244, the Commission also noted that this equipment had not been widely deployed, and suggested that ILECs had been deterred by the "regulatory environment." Order ¶ 290 & n.838.

Second, the Commission noted that deployment of feeder fiber is the first step toward FTTH, and that limiting access to ILEC fiber facilities increases incumbents' incentives to

develop and deploy FTTH. Order ¶¶ 272, 290. Though the CLECs dismissed this as "pure speculation," the Commission relied on submissions in the record that the CLECs have not directly impeached. Order ¶ 290 n.837. While the CLECs may be right that the Commission's judgment entails increasing consumer costs today in order to stimulate technological innovations for which there is not yet sufficient consumer demand, there is nothing in the Act barring such trade-offs. Cf. *Consumer Electronics Ass'n v. FCC*, 347 F.3d 291, 300–03 (D.C. Cir. 2003) (upholding Commission rule that increased television prices in order to stimulate transition to digital TV, for which there is little present demand).

Third, the Commission rested its judgment not only on the perceived negative effect of unbundling on *ILEC* investment incentives but also on a conclusion that unbundling hybrid loops would deter *CLECs* themselves from investing in deploying their own facilities, possibly using different technology. Order ¶¶ 288, 290. Although the CLECs argue that this is inconsistent with the Commission's finding that for fiber loops, as for copper loops, "the costs are both fixed and sunk, and . . . deployment is characterized by scale economies," *id.* ¶ 240, that very paragraph, after weighing the various advantages of both ILECs and other entrants, concludes that "the barriers faced in deploying fiber loops, as opposed to existing copper loops, may be similar for both incumbent LECs and competitive LECs." Thus, while declining to unbundle hybrid loops might reduce broadband competition, the Commission reasonably concluded that such a decision might be effective in stimulating investment in all-fiber loops.

We thus believe that, even if the CLECs are correct that unbundling would have no impact on ILEC investment in the fiber feeder portion of hybrid loops, the other investment disincentives the Commission identified are sufficient for us to uphold the reasonableness of the Commission's determination. Reading the Order as a whole, we see little sign that the Commission would have come out otherwise if it had given the CLEC arguments as much credit as they deserve. See *Indiana Muni. Power Agency v. FERC*, 56 F.3d 247, 256

(D.C. Cir. 1995); *Carnegie Natural Gas Co. v. FERC*, 968 F.2d 1291, 1294 (D.C. Cir. 1992).

Nor can we say that the Commission was arbitrary or capricious in thinking that any damage to broadband competition from denying unbundled access to the broadband capacities of hybrid loops is likely to be mitigated by the availability of loop alternatives or intermodal competition. With regard to loop alternatives, we agree with the CLECs that these alternatives are not a perfect substitute for the ILECs' hybrid loops, but we understand the Commission to say only that they are a partial substitute; they will mitigate, not eliminate, CLEC impairment. More important, we agree with the Commission that robust intermodal competition from cable providers—the existence of which is supported by very strong record evidence, including cable's maintenance of a broadband market share on the order of 60%, see Order ¶ 292—means that even if all CLECs were driven from the broadband market, mass market consumers will still have the benefits of competition between cable providers and ILECs. Although the CLECs point to evidence that CLEC broadband competition has played a role in constraining ILEC pricing, see Declaration of Robert D. Willig, ¶ ¶ 206–08, Joint Appendix ("J.A.") 885–87, the evidence itself is hardly rigorous and is offset by conflicting material, see Letter of Susanne Guyer, Vice President, Verizon, at 2 (J.A. 2146), itself not rigorous. Thus the Commission's consideration of past pricing effects was not arbitrary, and in any event, as the discussion above shows, its overall judgment turned on a range of factors.

We therefore hold that the Commission's decision not to order unbundling of the broadband capacity of hybrid loops was based on permissible statutory considerations and supported by substantial evidence.

Although the Commission refused to unbundle the broadband portion of hybrid loops, it required ILECs to unbundle the narrowband portion, Order ¶ 296, and the CLECs raise an issue relating to the details of this unbundling. The Commission said for various technical reasons this would be

more difficult for hybrid loops that used integrated digital loop carrier ("IDLC") equipment to connect the fiber feeder portion of the loop to the copper distribution portion than it would for those that used universal digital loop carrier equipment ("UDLC"). Order ¶ 297 & n.855.

The CLECs protest that the record "unambiguously established that UDLC substantially degrades the speed and quality of dial-up Internet access," CLEC Br. at 30, though they fail to point us to the portions of the record that supposedly establish this. The Commission acknowledges that "UDLC can, in some circumstances, negatively affect data transmission speed," FCC Br. 84 n.37, but it disputes the severity of the impact. Moreover, the Order requires that ILECs "present requesting carriers a technically feasible method of unbundled access." Order ¶ 297. Given the CLEC petitioners' failure to present or highlight evidence that the impact is severe, or to refute the Commission's technical analysis, we have no basis for finding the Commission decision on this issue arbitrary or capricious.

2. *Fiber-to-the-home ("FTTH") loops*

For FTTH loops, the Commission found relatively little impairment except in a specific, limited domain. Although FTTH deployment showed some characteristics in common with copper loops (the costs being "both fixed and sunk, and deployment [being] expensive," Order ¶ 274), the Commission believed that the revenue opportunities of FTTH deployment were great enough to "ameliorate many of the entry barriers." *Id.*; see also *id.* ¶ 276 (same, with respect to FTTH parallel to or in replacement of existing copper plant). With respect to new or so-called "greenfield" FTTH deployments (as for a new subdivision), it denied unbundling without qualification. *Id.* ¶ 275. For the "largely theoretical" scenario in which an ILEC constructed FTTH parallel to or in replacement of its existing copper plant ("overbuild"), it declined to find impairment as to broadband services, *id.* ¶ 276, but agreed with the CLECs' concern that an ILEC might replace and ultimately deny access to the copper loops that CLECs were using to serve mass market customers, *id.*

¶ 277. In the overbuild situations, then, it ruled that the ILEC must either keep the existing copper loop connected after deploying FTTH, or else provide CLECs with unbundled access to the narrowband capabilities of the replacement FTTH loop. *Id.* ¶ ¶ 277, 281–84.

Although not contesting the *concept* that large expected revenue can offset scale economies, the CLECs do object to the Commission's decision that CLECs are not impaired by lack of unbundled access to FTTH. They argue that the Commission ignored two critical considerations. First, they point out that the FCC made a national finding that CLECs are impaired without unbundled access to enterprise market high-capacity DS3 loops (which are made from the same fiber as mass market FTTH loops), finding that "a single DS3 loop, generally, can not provide a sufficient revenue opportunity" to overcome the entry barriers to deployment. Order ¶ 320. This, the CLECs say, contradicts the Commission's conclusion that "the substantial revenue opportunities posed by FTTH deployment help ameliorate many of the entry barriers presented by the costs and scale economies." *Id.* ¶ 274. Second, they argue that ILECs enjoy significant "first mover" advantages due to their existing customer base, rights-of-way, and their existing networks' substantial excess fiber capacity ("dark fiber") that ILECs can readily use for network extensions.

While the CLECs' objections are convincing in many respects, they are ultimately unavailing. Even if the CLECs are impaired with respect to FTTH deployment (a point we do not decide), the § 706 considerations that we upheld as legitimate in the hybrid loop case are enough to justify the Commission's decision not to unbundle FTTH. Although the Commission based its refusal to unbundle on a finding of no impairment, it made clear that its decision was "inform[ed]" by § 706. Order ¶ 278. In particular, it noted that "removing incumbent LEC unbundling obligations on FTTH loops will promote their deployment of the network infrastructure necessary to provide broadband services to the mass market." *Id.* ¶ 278; see also *id.* ¶ ¶ 272, 290 & n.837.

We find that these considerations are sufficient to justify the Commission's decision not to require FTTH unbundling, even if CLECs are to some extent "impaired" in their ability to enter certain segments of the FTTH broadband market. This conclusion is buttressed by the evidence in the record that FTTH deployment is still very limited, Order ¶ 274, that both the costs and potential benefits of deployment are high, *id.*, and, at least in some contexts, ILECs and CLECs face similar entry barriers, Order ¶ ¶ 240, 275 & n.808, ¶ 276. An unbundling requirement under these circumstances seems likely to delay infrastructure investment, with CLECs tempted to wait for ILECs to deploy FTTH and ILECs fearful that CLEC access would undermine the investments' potential return. Absence of unbundling, by contrast, will give all parties an incentive to take a shot at this potentially lucrative market.

3. *Line sharing*

In *USTA I*, 290 F.3d at 428–29, we vacated the Commission's decision to provide CLECs with unbundled access to the high frequency portion of copper loops to provide broadband DSL services, primarily because the Commission had failed to consider the relevance of intermodal competition in the broadband market. On remand, the Commission decided to reverse its earlier position and eliminated this unbundling mandate. The Commission explained its change of heart as follows.

First, the FCC rejected its prior finding that lack of separate access to the high frequency portion would cause impairment. The earlier impairment finding had been based on a notion that broadband revenues would not justify the cost of the whole loop. But now, applying its new decision to focus on *all* the potential revenues from the full functionality of a loop (voice, data, video, and other services), the Commission believes that these revenues would offset the costs associated with purchasing the entire loop. Order ¶ 258. Additionally, the Commission reasons that CLECs interested only in broadband could obtain broadband frequencies from other CLECs through line-splitting, in which one CLEC

provides voice service on the low frequency portion of the loop and the other provides DSL on the high frequency portion. Thus, after taking both costs and revenues into account, the FCC decided that eliminating mandatory line sharing would not impair CLECs' ability to provide broadband service. *Id.* ¶ 259.

The Commission also observed that the difficulties of cost allocation for different portions of a single loop had led most states to price the high frequency portion of the loop at approximately zero. This distorted competitive incentives since CLECs that purchased only the high frequency portion had an irrational cost advantage over both ILECs and CLECs that purchased the whole loop to offer a range of services. Order ¶ 260. The anomalous price differential also skewed CLECs' incentives toward providing only broadband service instead of bundled voice and DSL, discouraged innovative arrangements between voice CLECs and data CLECs, and discouraged product differentiation between ILEC and CLEC offerings. *Id.* ¶ 261. Thus the FCC found the results of mandatory line sharing to be contrary to the Act's goal of encouraging vigorous competition in all local telecommunications markets. *Id.*

Finally, following our mandate in *USTA I*, the Commission noted the substantial intermodal competition from cable companies, which provide nearly 60% of all high-speed lines. Order ¶ 262 & nn.777–78. Although noting that intermodal competition was not "dispositive" in the impairment analysis, the Commission found that it lessened any competitive benefits associated with line sharing. *Id.* ¶ 263. Taking this into account, along with the negative impact of unbundling on competitive incentives, it found that "the costs of unbundling the [high frequency portion of the loop] outweigh the benefits. . . ." *Id.*

As with FTTH, we find that even if the CLECs are right that there is some impairment with respect to the elimination of mandatory line sharing, the Commission reasonably found that other considerations outweighed any impairment. And again we note the ambiguous state of the record on the price-constraining effect of CLEC DSL service. We read the

Commission as concluding that, at least in the future, line sharing is not essential to maintain robust competition in this market, a conclusion based on permissible considerations and supported by evidence in the record. With respect to the skewed incentives from zero pricing of the high frequency portion, it is of course true that alternative cost allocations could have reduced the skew, but any alternative allocation of costs would itself have had some inescapable degree of arbitrariness.

Summary. We therefore uphold the Commission's rules concerning hybrid loops, FTTH, and line sharing on the grounds that the decision not to unbundle these elements was reasonable, even in the face of some CLEC impairment, in light of evidence that unbundling would skew investment incentives in undesirable ways and that intermodal competition from cable ensures the persistence of substantial competition in broadband.

B. *Exclusion of "Entrance Facilities"*

Entrance facilities are dedicated transmission facilities that connect ILEC and CLEC locations. Before the Order, the Commission had defined "dedicated transport facilities" as including entrance facilities. But in the Order it concluded that this definition was "overly broad," Order ¶ 365, and found that "a more reasonable and narrowly-tailored definition of the dedicated transport network element includes only those transmission facilities *within* an incumbent LEC's transport network, that is, the transmission facilities between incumbent LEC switches," *id.* ¶ 366. Thus it held, as a matter of statutory interpretation, that entrance facilities were not "network elements" subject to the statutory unbundling requirements of § 251(c)(3), *id.*, and accordingly required no impairment analysis, *id.* ¶ 367 n.1119. As this is an issue of statutory construction, we review under the *Chevron* standard.

The CLEC petitioners object that the Commission's interpretation is flatly inconsistent with the text of the Act. In particular, the CLECs point out that § 153(29) of the Act defines "network element" as "a facility of equipment used in

the provision of a telecommunications service," and that entrance facilities clearly fall within that definition. Also, the CLEC petitioners continue, the Commission itself, in this Order, addressed the question whether "network element" included only facilities "*actually used by the incumbent LEC* in the provision of a telecommunications service" or also included facilities "*capable of being used* by a requesting carrier in the provision of a telecommunications service regardless of whether the incumbent LEC is actually using the network element to provide a telecommunications service," and expressly adopted the latter definition. Order ¶ 59.

While the Commission's reasoning appears to have little or no footing in the statutory definition, we find the record too obscure to make any final ruling. The CLECs helpfully provide a diagram of various telecommunications network facilities, in which entrance facilities appear as completely stand-alone items linking a CLEC switch with an ILEC office. CLEC Reply Br. at 3. But no party offers an explanation as to why ILECs rather than CLECs construct these facilities. If (as appears) they *exist* exclusively for the convenience of the CLECs, it seems anomalous that CLECs do not themselves provide them, presumably doing so at the costs associated with "the most efficient telecommunications technology currently available," 47 CFR § 51.505(b)(1), i.e., the TELRIC standard. The Commission hints at this consideration in observing that its ruling encourages CLECs to "incorporate those costs within their control into their network deployment strategies." Order ¶ 367. Thus, although the Commission's ruling superficially violates the statutory language, we simply remand the matter for further consideration. If entrance facilities are correctly classified as "network elements," an analysis of impairment would presumably follow.

C. *Unbundling of Enterprise Switches*

The Commission determined, on a nationwide basis, that CLECs are not impaired by lack of unbundled access to switching for the enterprise market at DS1 capacity and above. Order ¶ ¶ 451–53. Though observing that the record

showed no impairment on a national basis in the absence of unbundling, *id.* ¶ 454, and indeed did "not contain evidence identifying any particular markets where competitive carriers would be impaired," *id.* ¶ 455, the Commission went on to note that "a geographically specific analysis could possibly demonstrate that competitive carriers are impaired without access to unbundled incumbent LEC local circuit switching for DS1 enterprise customers in a particular market," *id.* ¶ 454. It therefore permitted state commissions to petition the Commission to waive the "no impairment" finding in particular markets. *Id.* ¶ ¶ 455–58. The operative passages direct the state commissions to "examine" certain issues, and "consider [certain] evidence," and to make "finding[s]." It is obscure what weight the Commission intended to give these findings.

CLEC petitioners argue that the 90–day time limit on this petition procedure is arbitrary and capricious, given that in the mass market switching context the Order gave states nine months to collect and analyze market data. In what appears to be a throwaway sentence, the CLECs say the harm inflicted by this supposed error is "compounded" by the fact that the 90–day state proceedings are voluntary rather than mandatory (i.e., at the option of the state commissions), and that the impairment issue cannot be revisited absent changed circumstances. Order ¶ 455.

Since we have invalidated the FCC's subdelegation scheme with respect to mass market switches, a challenge based on the inconsistency between the nine-month period for mass market determinations and the 90–day period for enterprise market determinations is moot as a practical matter (though not in the strict jurisdictional sense). Cf. *Belton v. Washington Metro. Area Transit Auth.*, 20 F.3d 1197, 1203 (D.C. Cir. 1994). And in any event, we agree with the FCC that the market data states are to analyze under the enterprise switching provisions are significantly different from the data they were supposed to evaluate in the mass market switching context.

Apart from the argument regarding the inconsistency of time limits, the CLECs' argument boils down to a claim that the no impairment finding for enterprise switches (1) is overbroad; and (2) lacks sufficient "safety valve" procedures to cure this overbreadth. But the CLECs do not contradict the Commission's observation about the absence of evidence of impairment either nationwide or in specific markets. Thus, in contrast to the mass market switching context, where the evidence indicated the presence of many markets where CLECs suffered no impairment in the absence of unbundling, here there is no showing of any *need* for a safety valve, except insofar as one may infer a need from the Commission's creation of one (which may in fact have been only an excess of caution).

The CLECs make a rather underdeveloped argument that the vice of the alleged time-limit anomaly is "compounded" by the state proceedings being "voluntary rather than mandatory," and that enterprise switching cannot be re-instated after the 90–day period without changed circumstances. CLEC Br. at 40 (citing Order ¶ 455). But these claims seem ancillary to the now-irrelevant time-limit theory, and without a showing of a need for a safety valve, we see no occasion to reach them.

Finally, we note that our holding regarding unlawful subdelegation of FCC authority to state commissions does not control the limited state commission role contemplated in the portion of the Order dealing with enterprise switching. In this context, state commissions are allowed merely to petition the FCC for a waiver of the unbundling order; the FCC has not granted the states authority to make final decisions on such matters as the existence of impairment. Because no party has challenged the limited state role in the enterprise switching context we have no occasion to rule on whether the role contemplated for the states here is legally problematic.

D. *Unbundling of Call–Related Databases and Signaling Systems*

Call-related databases are used in signaling networks for billing or for transmission, routing, and other telecommunica-

tions services. These databases include, for example, ones that provide name identification for caller ID service and ones that contain information on calling cards. Order ¶ 549. When CLECs have unbundled access to ILEC mass market switches, they also have access to the databases that the signaling network permits carriers to access. *Id.* ¶ 551. Where CLECs provide their own switches, however, they don't automatically have access to the needed databases, and they must either self-provision or purchase databases from the ILEC or a third party. *Id.*

The Commission determined that CLECs are not impaired without unbundled access to ILEC databases (other than the 911 database) because of the abundance of alternative providers. Order ¶ ¶ 551–57. The CLECs object, arguing that the only reason alternatives to ILEC databases exist is that the Commission had previously required ILECs to provide unbundled access to their databases (removing any competitive incentive for the ILECs to withhold the databases from third parties). But the CLECs point to nothing in the record demonstrating that this is so. Even if they did, we doubt that this alone would support a finding of impairment. As it stands, CLECs evidently have adequate access to call-related databases. If subsequent developments alter this situation, affected parties may petition the Commission to amend its rule.

E. *Unbundling of Shared Transport Facilities*

The FCC found CLECs that lease ILEC mass market switches are impaired without unbundled access to so-called "shared transport"—transmission facilities shared by more than one carrier, including the ILEC, running between end office switches, between end office switches and tandem switches, and between tandem switches within the ILEC's network. Order ¶ ¶ 533–34. But the FCC also concluded that, "because switching and shared transport are inextricably linked, if incumbent LECs are no longer obligated to unbundle switching, they should no longer be obligated to unbundle shared transport." *Id.* ¶ 534. In effect, it found that CLECs are entitled to unbundled shared transport only

in cases where mass market switching has also been unbundled. *Id.* The CLECs object to this condition for unbundled shared transport, saying that they are "impaired" without access to shared transport between local tandem switches when they "transit" traffic—that is, when they transport traffic that originates on their network to other carriers' networks. The Commission in fact recognized the claim, saying that it proposed to address the issue in a pending rulemaking on intercarrier compensation. *Id.* ¶ 534 n.1640.

Although the FCC failed to resolve an impairment question pressed by the CLECs in this Order, the Commission "need not address all problems 'in one fell swoop.'" *U.S. Cellular Corp. v. FCC*, 254 F.3d 78, 86 (D.C. Cir. 2001) (quoting *Nat'l Ass'n of Broadcasters v. FCC*, 740 F.2d 1190, 1207 (D.C. Cir. 1984)). The FCC generally has broad discretion to control the disposition of its caseload, and to defer consideration of particular issues to future proceedings when it thinks that doing so would be conducive to the efficient dispatch of business and the ends of justice. See *GTE Service Corp. v. FCC*, 782 F.2d 263, 273–74 (D.C. Cir. 1986) (citing *Nader v. FCC*, 520 F.2d 182, 195 (D.C. Cir. 1975) and *Cellular Mobile Sys. of Penn., Inc. v. FCC*, 782 F.2d 182, 197 (D.C. Cir. 1985)). So long as the FCC's decision to postpone consideration of the transiting issue doesn't result in unreasonable delay or impose substantial hardship on the CLECs—which hasn't been shown here—the Commission's choice to organize its rulemaking docket in this way is lawful.

F. *Section 271 Pricing and Combination Rules*

Section 271 of the Act sets conditions for Bell operating companies (the "BOCs") to enter the interLATA long distance market. These conditions include a "competitive checklist," § 271(c)(2)(B), specifying fourteen conditions that a requesting BOC must satisfy before it may provide interLATA service. Checklist item two requires BOCs to provide "[n]ondiscriminatory access to network elements in accordance with the requirements of sections 251(c)(3) and 251(d)(1)," § 271(c)(2)(B)(ii), while checklist items four, five, six, and ten require the BOC to provide unbundled access to,

respectively, local loops, local transport, local switching, and call-related databases, §§ 271(c)(2)(B)(iv)-(vi),(x). The FCC reasonably concluded that checklist items four, five, six and ten imposed unbundling requirements for those elements independent of the unbundling requirements imposed by §§ 251–52. In other words, even in the absence of impairment, BOCs must unbundle local loops, local transport, local switching, and call-related databases in order to enter the interLATA market. Order ¶¶ 653–55.

But the FCC also found that the BOCs' unbundling obligations under the independent checklist items differed in some important respects from those under §§ 251–52. Two such differences are salient here. First, the Commission determined that TELRIC pricing was not appropriate in the absence of impairment; for elements for which unbundling was required only under § 271, the ruling criterion is the §§ 201–02 standard that rates must not be unjust, unreasonable, or unreasonably discriminatory. Order ¶¶ 656–64. Second, the Commission decided that, in contrast to ILEC obligations under § 251, the independent § 271 unbundling obligations didn't include a duty to combine network elements.

The CLEC petitioners object to both of these differences, arguing that the independent § 271 unbundling provisions incorporate all the requirements imposed by §§ 251–52, including pricing and combination. Because this is an issue of statutory construction, we review under *Chevron* and defer to the Commission unless Congress has spoken to the precise question at issue (*Chevron* step one) or the Commission's interpretation is unreasonable (*Chevron* step two).

With regard to pricing, the CLECs have no serious argument that the text of the statute clearly demonstrates that the § 251 pricing rules apply to unbundling pursuant to § 271 checklist items four, five, six, and ten. The CLECs contend that checklist item two specifies that the § 252(d)(1) pricing rules apply to all unbundled "network elements," but checklist item two says no such thing. Rather, checklist item two by its terms requires only "[n]ondiscriminatory access to

network elements in accordance with the requirements of sections 251(c)(3) and 252(d)(1)"—it says nothing suggesting that the requirements of those sections also apply to the independent unbundling requirements imposed by the other items on the § 271 checklist. The CLECs also claim that it was unreasonable for the Commission to apply a different pricing standard under § 271, but we see nothing unreasonable in the Commission's decision to confine TELRIC pricing to instances where it has found impairment. See generally Order ¶ ¶ 657–64.

As to combinations, the CLECs argue that the Supreme Court decisions in *AT&T* and *Verizon* establish that the nondiscrimination provision in § 251(n)(3), not its reference to "combin[ation]," provides the basis for the rules that ILECs may not separate already-combined network elements before turning them over to competitors, and that ILECs must combine unbundled network elements when requested to do so by CLECs. See CLEC Br. at 42 (citing *AT&T*, 525 U.S. at 394, and *Verizon*, 535 U.S. at 537).

CLEC reliance on *AT&T* and *Verizon* is misplaced for two reasons. First, as we've already held with regard to pricing, § 271 checklist items four, five, six, and ten do not incorporate any of the specific requirements of § 251(c)(3), including the nondiscrimination prohibition specific to that section. Second, neither *AT&T* nor *Verizon* holds that the § 251(c)(3) nondiscrimination requirement *mandates* the combination rules the FCC promulgated under that section; rather, those cases found the nondiscrimination language in § 251(c)(3) ambiguous and deferred to the agency's reading of it. *AT&T*, 525 U.S. at 394–95; *Verizon*, 535 U.S. at 531–38. These holdings don't necessarily establish that a different rule would be unreasonable. Cf. *Rust v. Sullivan*, 500 U.S. 173, 186–87 (1991).

We agree with the Commission that none of the requirements of § 251(c)(3) applies to items four, five, six and ten on the § 271 competitive checklist. Of course, the independent unbundling under § 271 is presumably governed by the *general* nondiscrimination requirement of § 202. But as the only

challenge the CLECs have presented to the FCC's § 271 combination rules is grounded in an erroneous claim of a cross-application of § 251, we do not pass on whether the § 271 combination rules satisfy the § 202 nondiscrimination requirement.

IV. *Unbundling of Enhanced Extended Links ("EELs")*

Enhanced extended links ("EELs") are high-capacity loop/transport combinations that run directly between an end user (usually a large business customer) and an IXC/CLEC office. *Supplemental Order Clarification*, 15 FCC Rcd 9587, 9593 (2000), ¶ 10 n.36. EELs can be used to provide local exchange services, but they can also be used to originate and terminate long-distance calls. IXC providers have traditionally purchased these services from ILECs for long distance purposes as a special access service, i.e., under the ILEC's tariff rather than at TELRIC rates.

In its first Order implementing the 1996 Act, the FCC did not impose any limits on the telecommunications services that a CLEC could provide with the UNEs to which it was entitled access. Order ¶ 134 & n.446 (citing Third Report and Order, 15 FCC Rcd at 3911–12 ¶ 484 and First Report and Order, 11 FCC Rcd at 15671–72 ¶ 356). But in 1999 the FCC modified this principle with respect to EELs, and issued (as an interim measure) a supplemental order that limited access to EELs as UNEs to those CLECs that would use unbundled EELs to provide "a significant amount of local exchange service." *Supplemental Order*, 15 FCC Rcd 1760, 1760 ¶ 2. The FCC subsequently clarified and refined this principle, adopting three "safe harbors" that required CLECs to certify sufficient local traffic percentages in order to qualify for unbundled access to EELs, *Supplemental Order Clarification*, 15 FCC Rcd 9587, 9598–60 ¶ 22, and restricting "commingling" by CLECs of EELs and tariffed special access services used for interoffice transmission, *id.* at 9602 ¶ 28. We upheld these rules—which the FCC characterized as "interim restrictions"—in *Competitive Telecommunications Ass'n v. FCC*, 309 F.3d 8 (D.C. Cir. 2002) ("*CompTel*").

In the Order under review, the Commission revised its approach to EELs. First, the Commission generalized the principle underlying its earlier EELs rulings by interpreting the unbundling obligations of § 251(d)(3) to apply only to "qualifying services," defined as "those telecommunications services that competitors provide in direct competition with the incumbent LECs' core services." Order ¶ 139. The FCC also decided that, once a CLEC obtained access to a UNE for a qualifying service, the CLEC could use that UNE to provide additional non-qualifying services. Order ¶ 143. Under these principles, CLECs are entitled to unbundled EELs only if they use these facilities for local exchange service (which counts as a qualifying service), but not for use exclusively for non-qualifying long distance service. Order ¶¶ 591, 595.

The Commission also changed its strategy for enforcing this basic principle and for preventing "gaming" by carriers that, while not bona fide providers of local service, might seek to take advantage of the low (TELRIC) price of unbundled EELs. It abandoned the "safe harbor" approach, agreeing with the CLECs that this regime had proved intrusive, unworkable, and susceptible to abuse by ILECs. Order ¶ 596 & n.1831, ¶ 614. It also lifted the prohibition on "commingling." *Id.* ¶¶ 579–84. In place of the old restrictions, the Commission established new "eligibility criteria" as prerequisites for a competitor to enjoy the access entitlement of a bona fide provider of a qualifying service. *Id.* ¶¶ 591–611. Each applicant would have to show, first, that it had a state certification to provide local voice service and, second, that at least one local number was assigned to each circuit to be acquired as a UNE. *Id.* ¶¶ 597, 601–02. In addition, the Commission imposed a variety of technical requirements aimed at preventing firms from gaming the system. *Id.* ¶¶ 597, 603–11.

While the Commission admitted that none of the anti-gaming requirements by itself would prevent gaming, it concluded that they were "*collectively* sufficient to restrict the availability of these UNE combinations to legitimate providers of local voice service." Order ¶ 600 (emphasis in original).

It justified this conclusion on the logic that "the burdens and inefficiencies for a provider to meet these criteria for non-qualifying service would deter a carrier of non-qualifying service from re-designing its operations to subvert our rules." *Id.* The Commission also allowed CLECs that met the eligibility criteria, but that currently purchased EELs from ILECs as special access services at wholesale rates (i.e., not TELRIC), to "convert" these wholesale services to UNEs. Order ¶ 586. The CLECs object both to the concept of distinguishing between qualifying and non-qualifying service, and to the eligibility criteria used to implement the distinction.

A. *The Qualifying Service/Non–Qualifying Service Distinction*

The CLECs object to the FCC's decision that long distance is not a "qualifying service," claiming that this conclusion is foreclosed by §§ 251(c)(3) and 251(d)(2)(B) of the Act. Long distance services, including the origination and termination functions performed by EELs, are clearly "telecommunications services," and § 251(d)(2) directs the Commission to provide unbundled access to elements where the lack of such an element "would impair the ability of the telecommunications carrier seeking access to provide the services it seeks to offer." (The Commission assumes, as we believe it must, that the reference to "services" in § 251(d)(2) is meant to refer to the "telecommunications services" covered by § 251(c)(3). Order ¶ 138). The CLECs therefore argue that the FCC cannot arbitrarily exclude them from this impairment analysis.

The Commission asserts that "section 251(d)(2)'s reference to the 'services that [the carrier] seeks to offer' is ambiguous as to the question of which services we should analyze in the context of our impairment analysis." Order ¶ 137 (alteration in original). Having thus "conclude[d] that the language of section 251(d)(2) is ambiguous concerning the scope of the impairment inquiry," Order ¶ 138, the FCC looked to the history and purposes of the Act and concluded that "a reasonable interpretation of the statute" would restrict the impair-

ment inquiry to those services offered in direct competition with ILEC core services such as local voice and data services, *id.* ¶ 139.

In *CompTel* we agreed with the Commission that § 251(d)(2) was ambiguous on the question whether the FCC could make impairment decisions on a service-by-service basis. 309 F.3d at 12. That is, we considered a situation where an element could be used to provide services A and B, and a carrier requested unbundling for both. We held that the Commission acted reasonably in disaggregating the *impairment* issue, and in ordering unbundling only with respect to the service for which it found impairment. 309 F.3d at 12–13 (service-by-service impairment analysis permissible); 14 (impairment finding made by FCC as to local service but not as to long distance).

Here the Commission asserts an entirely different sort of statutory ambiguity, namely, whether long distance services are "services" at all and therefore require the Commission, on request, to perform an impairment analysis. We are not persuaded by the Commission's claim that the ambiguity regarding the permissibility of service-by-service impairment determinations extends to whether long distance services (or other telecommunications services that do not compete directly with "core" ILEC services) are "services" within the meaning of § 251(d)(2) in the first place. Even under the deferential *Chevron* standard of review, an agency cannot, absent strong structural or contextual evidence, exclude from coverage certain items that clearly fall within the plain meaning of a statutory term. The argument that long distance services are not "telecommunications services" has no support.

The Commission does suggest that the "impairment" requirement is closely linked to natural monopoly conditions that prevail only with respect to the core ILEC services that the Commission defined as "qualifying services." FCC Br. at 77 (citing *USTA I*, 290 F.3d at 427). But that argument addresses impairment, not the definition of "services." We therefore remand those sections of the Order (¶ ¶ 132–53)

resting the exclusion of "non-qualifying" services on the Commission's reading of the phrase "telecommunications services" in § 251(d)(2)(B).

This does not, of course, necessarily invalidate the Commission's effort to prevent the use of EELs for long distance service. The CLECs have pointed to no evidence suggesting that they are impaired with respect to the provision of long distance services, and in *CompTel* we emphatically held that the Act did not bar a service-by-service analysis of impairment. 309 F.3d at 12–14. The CLECs do not deny that they have been able to purchase use of EELs as "special access." As we noted with respect to wireless carriers' UNE demands, competitors cannot generally be said to be impaired by having to purchase special access services from ILECs, rather than leasing the necessary facilities at UNE rates, where robust competition in the relevant markets belies any suggestion that the lack of unbundling makes entry uneconomic.

On remand, therefore, the Commission will presumably turn to the issue of impairment. Because it may well find none with reference to long distance service, we now turn to the eligibility criteria.

B. *The EEL Eligibility Criteria*

Both the CLECs and the ILECs object to the FCC's eligibility criteria. The CLECs say they are too stringent and are over-inclusive insofar as they preclude access to EELs used to provide services for which CLECs are impaired. The ILECs claim they are too lax and are under-inclusive insofar as they fail to prevent CLECs from using unbundled EELs exclusively for long distance services.

We think that the Commission's eligibility criteria, though imperfect, reflect a reasonable effort to establish an administrable system that balances two legitimate but conflicting goals: the prevention of "gaming" by CLECs seeking to offer services for which they are not impaired, and the preservation of unbundled access for CLECs seeking to offer services for which they are impaired. We accord considerable deference to such administrative determinations, see *WorldCom,*

Inc. v. FCC, 238 F.3d 449, 459 (D.C. Cir. 2001); *Home Box Office, Inc. v. FCC*, 567 F.2d 9, 60 (D.C. Cir. 1977), and find that the proxies the FCC used, though imperfect (as the Commission itself candidly admits, Order ¶ 600), are neither inconsistent with the Act nor arbitrary and capricious. The Commission also satisfactorily explained both the problems with the regime previously in place (which the ILECs thought should be retained), Order ¶ 614, and with the CLECs' proposed alternatives, *id.* ¶ ¶ 615–19.

The ILECs make an independent attack on the Commission's decision to allow "conversions" of wholesale special access purchases to UNEs. As we discussed in the section on wireless carriers, the presence of robust competition in a market where CLECs use critical ILEC facilities by purchasing special access at wholesale rates, i.e., under § 251(c)(4), precludes a finding that the CLECs are "impaired" by lack of access to the element under § 251(c)(3). We realize that this might create anomalies, as CLECs hitherto relying on special access might be barred from access to EELs as unbundled elements, while a similarly situated CLEC that had just entered the market would not be barred. On the other hand, if history showed that lack of access to EELs had not impaired CLECs in the past, that would be evidence that similarly situated firms would be equally unimpaired going forward. Because we have already determined that we must remand to the Commission, given the invalidity of the line it drew between qualifying and non-qualifying services, the Commission can consider and resolve any potential anomaly on remand.

V. *Miscellaneous*

There remain two loose ends, attacks on the Order by the National Association of State Utility Consumers Advocates ("NASUCA") and by a group of state petitioners. We find that NASUCA lacks standing and that the state petitioners' claim is unripe.

A. *NASUCA's Standing*

NASUCA is a non-profit association of offices, each of which has been designated by its respective state govern-

ments to represent the interests of utility consumers in regulatory and judicial proceedings. We agree with the Commission that NASUCA has failed to establish standing pursuant to the requirements of *Sierra Club v. EPA*, 292 F.3d 895, 899–901 (D.C. Cir. 2002), though for different reasons than those advanced by the Commission.

Under *Sierra Club*, "a petitioner whose standing is not self-evident should establish its standing by the submission of its arguments and any affidavits or other evidence appurtenant thereto at the first appropriate point in the review proceeding." 292 F.3d at 900. A petitioner's standing is self-evident only if "no evidence outside the administrative record is necessary for the court to be sure of it." *Id.* at 900. Contrary to the Commission's assertions, we believe that no evidence outside the administrative record is necessary to explain how (on NASUCA's view of the merits) the Order injures the consumers that NASUCA claims to represent. See *NASUCA ex parte letter* (Feb. 13, 2002) at 2–3. On the theories advanced by NASUCA, consumers would enjoy a superior price/quality trade-off in telephone service if the Commission accepted its analysis. But it is not at all self-evident from the record that NASUCA meets the associational standing criteria established in *Hunt v. Washington State Apple Advertising Commission*, 432 U.S. 333, 344–45 (1977), for entities that are not voluntary membership organizations. See also *Fund Democracy, LLC v. SEC*, 278 F.3d 21, 25–26 (D.C. Cir. 2002); *Am. Legal Found. v. FCC*, 808 F.2d 84, 89–90 (D.C. Cir. 1987). Although utility consumer interests are clearly affected by the Order, nothing in the administrative record or NASUCA's opening brief establishes that NASUCA is qualified to represent those interests in federal court. We therefore conclude that NASUCA lacks standing and do not reach the merits of its claims.

B. *Ripeness of the State Preemption Claims*

The state petitioners argue that the Order improperly preempts state unbundling regulations that exist independent of the Commission's federal unbundling regulations enacted pursuant to § 251. Specifically, the state petitioners point to

¶ 195 of the Order, which allows "[p]arties that believe that a particular state unbundling obligation is inconsistent with the limits of section 251(d)(3)(B) and (C)" to seek a declaratory ruling from the Commission, and further predicts that state unbundling requirements for elements that the FCC has determined need not be unbundled under § 251(d)(2) are "unlikely" to be found consistent with the Act.

The state petitioners' challenge to the preemptive scope of the Order is not ripe. The general prediction voiced in ¶ 195 does not constitute final agency action, as the Commission has not taken any view on any attempted state unbundling order. Nor does the states' claim present a purely legal question, as they acknowledge that Commission regulations will lawfully preempt in *some* circumstances. See *Alascom, Inc. v. FCC*, 727 F.2d 1212, 1218–20 (D.C. Cir. 1984); see also *Time Warner Entertainment Co. v. FCC*, 56 F.3d 151, 193–96 (D.C. Cir. 1995). Besides, the state petitioners have not—and probably could not—identify any substantial hardship that they would suffer by deferring judicial review of the preemption issues until the FCC actually issues a ruling that a specific state unbundling requirement is preempted. We therefore hold the challenge unripe.

VI. *Conclusion*

To summarize: We vacate the Commission's subdelegation to state commissions of decision-making authority over impairment determinations, which in the context of this Order applies to the subdelegation scheme established for mass market switching and certain dedicated transport elements (DS1, DS3, and dark fiber). We also vacate and remand the Commission's nationwide impairment determinations with respect to these elements.

We vacate the Commission's decision not to take into account availability of tariffed special access services when conducting the impairment analysis, and we therefore vacate and remand the decision that wireless carriers are impaired without unbundled access to ILEC dedicated transport.

We vacate the Commission's distinction between qualifying and non-qualifying services, and remand (but do not vacate) the decision that competing carriers are not entitled to unbundled EELs for provision of long distance exchange service.

We remand the Commission's decision to exclude entrance facilities from the definition of "network element" for further development of the record to allow proper judicial review.

The petitions for review are otherwise denied, except for NASUCA's petition, which is dismissed for want of standing, and the state commissions' (and that part of the ILEC petitions relating to compensation for modification of elements), which are dismissed as unripe. The ILECs' mandamus petitions are dismissed as moot.

As to the portions of the Order that we vacate, we temporarily stay the vacatur (i.e., delay issue of the mandate) until no later than the later of (1) the denial of any petition for rehearing or rehearing en banc or (2) 60 days from today's date. This deadline is appropriate in light of the Commission's failure, after eight years, to develop lawful unbundling rules, and its apparent unwillingness to adhere to prior judicial rulings.

So ordered.

Chief justice rejects telecom case

By Ben Charny
Staff Writer, CNET News.com
http://news.com.com/2100-1037-5233301.html

Story last modified June 14, 2004, 1:36 PM PDT

The U.S. Supreme Court won't stop local phone competition rules from sunsetting on Tuesday, ending the best chance AT&T, MCI and other long-distance phone companies had of keeping the rules alive.

Chief Justice William Rehnquist's clerk was notifying attorneys involved in the case of his decision on Monday, but nothing had been released yet by the court, according to a source familiar with the situation.

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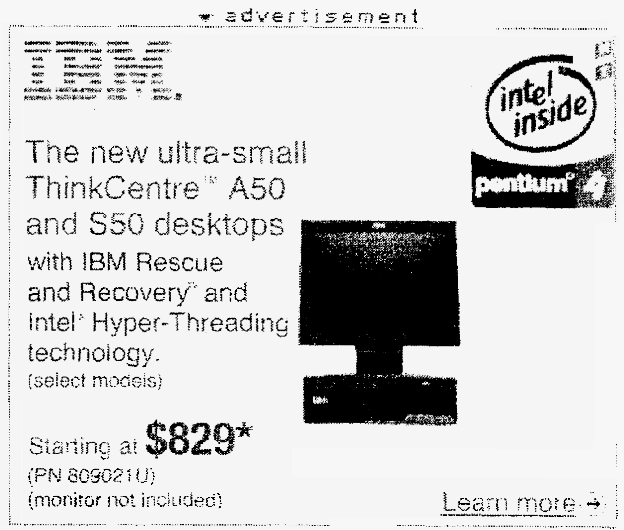

The decision was expected. A spokesman for the National Association of Regulatory Utility Commissions, which filed the stay request alongside AT&T, didn't give the case much hope because it didn't have the backing of the Bush administration, which decided last week not to seek a U.S. Supreme Court review.

The rules required the Bells to lease their local phone lines to competitors at rates set by the government. The FCC imposed the rules eight years ago to open the market for local phone service to competition and lower the cost of a home phone line.

Now that the rules are all but certain to be lifted Tuesday, debate has begun on the aftermath. While it's likely the local carriers will charge competitors more, how much is subject to much disagreement. Some analysts say long-distance companies will be paying $10 more for a local phone line that they can resell, which could trigger a rise of 25 percent to 50 percent in the rates they charge their customers. Others say the effect will be small.

Representatives of the four Bell operating companies--Verizon Communications, Qwest Communications International, SBC and BellSouth--were not immediately available for comment.

The Bells argued that the amount AT&T, Sprint, MCI and other long-distance phone companies were paying for a local phone line was $10 below what it cost the Bells to maintain it. The Bells said they were losing money, along with customers.

Long-distance phone companies argued that, left to their own devices, the Bells would raise fee for access to their networks to uncompetitive levels.

The Bells fought the rules in court, emerging victorious in March when a U.S. Court of Appeals set the rules aside as of Tuesday.

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Rates Bells Charge Rivals Are Frozen

Short-Term Rules Enacted, As FCC Writes Regulations To Undergo Judicial Review

By ANNE MARIE SQUEO
Staff Reporter of THE WALL STREET JOURNAL
August 23, 2004; Page B5

WASHINGTON -- A Federal Communications Commission ruling freezing the rates regional Bell companies can charge rivals to lease parts of their local-phone networks indicates that a flashpoint of the landmark 1996 Telecommunications Act won't be resolved quickly.

The FCC on Friday released short-term rules freezing the rates for six months while the commissioners craft permanent rules that can withstand judicial scrutiny. In a show of good faith, FCC Chairman Michael Powell said he already put a vote on the permanent rules on the agenda for the commission's December meeting, though the six-month freeze would last until at least February.

During the past eight years, the specific rules governing this process have been rejected by federal courts three times, most recently in March, and at least one regional Bell phone company -- Qwest Communications International Inc. -- is expected to go to court possibly as soon as this week to block at least part of the FCC's latest attempt to address this issue, according to people familiar with the company's plans.

The timing of last week's decision isn't coincidental. With a heated presidential election under way, Mr. Powell would like to see the issue resolved before a potential change in power at the FCC if Sen. John Kerry were to prevail, industry analysts said. Also, a change in leadership at the five-member commission could leave the industry in further limbo until at least mid-2005 when a Democratic chairman and other commissioners are appointed and confirmed by the Senate.

The five-member FCC voted 3-2 along party lines in favor of the interim rules. If the FCC doesn't set permanent rules within six months, the Bell companies, which also include Verizon Communications Inc., SBC Communications Inc. and BellSouth Corp., would be allowed to raise the wholesale rates charged to rivals

by 15% for existing customers and higher for new ones. These rates differ by state.

Almost immediately a number of industry participants expressed skepticism that any resolution could be achieved by year end. "The quick turnaround for developing permanent rules presents quite a challenge for the FCC," said H. Russell Frisby, chief executive of CompTel/Ascent, an industry group representing Bell rivals. A spokesman for Verizon, the nation's largest phone company, said: "The FCC must address the issues squarely on in the wake of not one but three court decisions against earlier FCC rules." FCC Commissioner Jonathan Adelstein said the agency's latest rules, which he voted against, would only ensure that "consumer prices will go up and that the telecommunications industry will fight the same old battles come the new year."

The Bell companies made written commitments to the FCC during recent months essentially promising to hold rates in place until year end, though the specific details vary by company. Bush administration officials had been concerned about how rising phone rates could affect the election. But Bell officials have repeatedly said their interpretation of the March appeals-court ruling, which went in their favor, is that they no longer have to lease all the various parts of their networks at discounted prices to rivals. The companies contend that the wholesale rates don't cover their costs for maintaining the networks. Rivals, who repackage the Bells' service and sell it to residential and business customers, have taken more than 19.5 million customers from the Bells through such arrangements during recent years.

Qwest plans to appeal to the D.C. appeals court the part of the FCC rule that requires the company to continue to offer discounted access to high-capacity connections often used by small-business customers, a person familiar with the filing said. It isn't clear whether the other Bell companies will follow suit. A Qwest spokesman declined to comment on whether the company will seek an appeal while it reviews the commission order.

Spokesmen for the other three likewise declined to comment on whether they would appeal the interim rules, saying their lawyers need to review the FCC order before making such decisions.

Write to Anne Marie Squeo at annemarie.squeo@wsj.com

News Release

Editor's note: Note to Financial Media: AT&T executives will discuss the company's performance in a two-way conference call for financial analysts at 8:15 a.m. ET today. Reporters are invited to listen to the call. U.S. callers should dial 888-428-4473 to access the call. Callers outside the U.S. should dial + 1-651-291-0561.

In addition, Internet rebroadcasts of the call will be available on the AT&T web site beginning later today. The web site address is www.att.com/ir. An audio rebroadcast of the conference call will also be available beginning at 12:30PM on Thursday, July 22 through 12:00AM on Tuesday, July 27. To access the audio rebroadcast, U.S. callers can dial 800-475-6701, access code 696623. Callers outside the U.S. should dial +1-320-365-3844, access code 696623.

FOR RELEASE THURSDAY, JULY 22, 2004

AT&T Announces Second-Quarter 2004 Earnings, Company to Stop Investing in Traditional Consumer Services; Concentrate Efforts on Business Markets

- **Second-quarter earnings per diluted share of $0.14**
- **Consolidated revenue of $7.6 billion**
- **Operating income of $348 million**
- **Second-quarter cash from operating activities of $1.1 billion**

BEDMINSTER, N.J. -- AT&T (NYSE: T) today reported net income of $108 million, or earnings per diluted share of $0.14, for the second quarter of 2004. This compares to net income of $536 million, or earnings per diluted share of $0.68, in the second quarter of 2003.

The company also announced that it is shifting its focus away from traditional consumer services such as wireline residential telephone services, and concentrating its growth efforts going forward on business markets and emerging technologies, such as Voice over Internet Protocol (VoIP), that can serve businesses as well as consumers. The shift plays to AT&T's strength as an innovator in communications and a leader in serving the complex

networking and technology needs of businesses.

"AT&T is the leading provider of communications services to business customers, offering a full range of leading-edge networking and communications solutions on a global basis," said David W. Dorman, AT&T's Chairman and CEO, who noted that nearly 75% of AT&T's revenue is now generated by AT&T Business. "We intend to widen the gap between AT&T and our competitors in the business market, while also improving our industry-leading cost structure and financial strength."

As a result of recent changes in regulatory policy governing local telephone service, AT&T will no longer be competing for residential local and standalone long distance (LD) customers. The company stressed that existing residential customers will continue to receive the quality service they expect from AT&T; however, the company will no longer be investing to acquire new customers in this segment.

"This decision means that AT&T will focus on lines of business where we are a clear leader, where we control our own destiny and where we have distinct competitive advantages," said Dorman. "Despite the near-term challenges associated with a difficult industry environment, we are confident that AT&T's cost structure, customer base, strong balance sheet and cash flow give us the flexibility to continue investing for success in the long run."

AT&T reported second-quarter 2004 consolidated revenue of $7.6 billion, which included $5.6 billion from AT&T Business and $2.0 billion from AT&T Consumer. Consolidated revenue declined 13.2 percent versus the second quarter of 2003, primarily due to continued declines in LD voice revenue.

AT&T's second-quarter 2004 operating income totaled $348 million, resulting in a consolidated operating margin of 4.6 percent. Operating income included $54 million of net restructuring and other charges taken during the quarter primarily related to employee separations. This quarter the company also reported that it generated $1.1 billion in cash from operations while spending $0.5 billion on capital expenditures.

AT&T UNIT HIGHLIGHTS

AT&T Business

- Revenue was $5.6 billion, a decline of 12.7 percent from the prior-year second quarter. Pricing pressure and mix shift from retail to wholesale negatively affected the unit's revenue performance.
- Long distance voice revenue decreased 17.6 percent from the prior-year second quarter, driven by continued pricing pressure as well as a continued mix shift in volume from retail to wholesale. Volumes were flat on a quarter-over-quarter basis, with growth in wholesale volumes offset by a decline in retail volumes.
- Local voice revenue grew 5.0 percent from the prior-year second quarter. Local access lines totaled more than 4.6 million at the end of the current period, representing an increase of over 85,000 lines from the end of the first quarter of 2004.
- Data revenue declined 10.4 percent from the prior-year second quarter. Revenue was

negatively affected by pricing pressure, weak demand and technology migration.

- IP&E-services revenue grew 2.3 percent over the prior-year second quarter. The quarter-over-quarter growth was primarily driven by strength in advanced services, including Enhanced Virtual Private Network and IP-enabled frame.
- Outsourcing, professional services and other revenue declined 18.9 percent from the prior-year second quarter, due to customers reducing scope and terminating outsourcing contracts.
- Operating income totaled $152 million in the period, yielding an operating margin of 2.7 percent. Second-quarter 2004 operating income included net restructuring and other charges of $52 million related to employee separations. The operating margin declined from the prior-year second quarter, reflecting the ongoing mix shift from retail LD products toward advanced and wholesale services.
- The sequential increase in second-quarter operating margin was primarily driven by favorable access settlements. In the second half of 2004, we expect the operating margin to be eroded by continuing pricing pressure in the enterprise segment, RBOC share gains in the small and medium business markets and the customary impact of seasonality.
- Capital expenditures were $463 million as AT&T Business continued to invest in its network and systems to drive continued cost efficiencies and expand its customer-focused networking capabilities.
- AT&T Business showed an improvement in market share trends at the high end of the market, consistent with its strategy of keeping and building its enterprise customer base.
- During the second quarter, a number of sizable customer wins and contract extensions were signed with companies including Lockheed Martin, Deutsche Bank and Providea, as well as The United States Army and The Internal Revenue Service, among many others.

AT&T Consumer

- Revenue was $2.0 billion, a decline of 14.6 percent versus the prior-year second quarter, driven by lower standalone LD voice revenue as a result of the continued impact of competition, wireless and Internet substitution and customer migration to lower-priced products and calling plans, partially offset by targeted price increases.
- Operating income totaled $240 million, yielding an operating margin of 11.9 percent. The margin decline from the prior-year second quarter was largely due to ongoing substitution and competition. In addition, increased spending for marketing and new initiatives such as VoIP contributed to the margin decline. Such declines were partially offset by the effects of pricing actions.
- According to industry estimates, more than 40% of American households have now migrated to some combination of bundled communications services. Recent regulatory decisions make it financially infeasible for AT&T to offer a competitive bundle of services to consumers. AT&T has determined that it cannot effectively compete against bundled competition by selling only standalone LD.
- As of June 30, 2004 AT&T Consumer offered its residential VoIP AT&T CallVantageSM Service in 72 major markets throughout the U.S. Recently, the company expanded the availability of its offer to 100 major markets in 32 states and Washington D.C.

OTHER CONSOLIDATED FINANCIAL HIGHLIGHTS

- Free cash flow was $0.6 billion for the quarter. Free cash flow is defined as cash flow provided by operating activities of $1.1 billion less cash used for capital expenditures and other additions of $0.5 billion.
- AT&T ended the quarter with net debt of $7.9 billion, a $0.5 billion decrease from the end of the first quarter of 2004. Net debt is defined as total debt of $11.2 billion less cash of $2.5 billion, restricted cash of $0.5 billion and net foreign debt fluctuations of $0.3 billion.

DEFINITIONS and NOTES

AT&T Business

LD Voice - includes all of AT&T's domestic and international LD revenue, including Intralata toll when purchased as part of an LD calling plan.

Local Voice - includes all local calling and feature revenue, Intralata toll when purchased as part of a local calling plan, as well as Inter-carrier local revenue.

Data Services- includes bandwidth services (dedicated private line services through high-capacity optical transport), frame relay and asynchronous transfer mode (ATM) revenue for LD and local, as well as revenue for managed data services.

Internet Protocol & Enhanced Services (IP&E-services) - includes all services that ride on the IP common backbone or that use IP technology, including managed IP services, as well as application services (e.g., hosting, security).

Outsourcing, Professional Services & Other - includes complex bundled solutions primarily in the wide area/local area network space, AT&T's professional services revenue associated with the company's federal government customers, as well as all other Business revenue (and eliminations) not previously defined.

Data, IP&E-Services - Percent Managed - managed services refers to AT&T's management of a client's network or network and applications including applications that extend to the customer premise equipment.

Data, IP&E-Services - Percent International - a data service that either originates or terminates outside of the United States, or an IP&E-service installed or wholly delivered outside the United States.

AT&T Consumer

Bundled Services - includes any customer with a local relationship as a starting point, and all other AT&T subscription-based voice products provided to that customer.

Standalone LD, Transactional & Other Services - includes any customer with solely a long distance relationship, non-voice products, or a non subscription-based relationship.

Local Customers - residential customers that subscribe to AT&T local service.

Other Definitions and Notes

Restricted cash - $0.5 billion of cash that collateralizes a portion of private debt and is included in "other current assets" on the balance sheet.

Foreign currency fluctuations - represents mark-to-market adjustments, net of cash collateral collected, that increased the debt balance by approximately $0.3 billion at June 30, 2004, on non-U.S. denominated debt of about $1.8 billion. AT&T has entered into foreign exchange hedges that substantially offset the fluctuations in the debt balance. The offsetting mark-to-market adjustments of the hedges are included in "other current assets" and "other assets" on the balance sheet.

- 2Q04 Income Statement (PDF)
- 2Q04 Quarterly Income Statements (PDF)
- 2Q04 Historical Segment Data (PDF)
- 2Q04 Balance Sheet (PDF)
- 2Q04 Cash Flow (PDF)
- 2Q04 Reconciliation of Non-GAAP Measures (PDF)

The foregoing contains "forward-looking statements" which are based on management's beliefs as well as on a number of assumptions concerning future events made by and information currently available to management. Readers are cautioned not to put undue reliance on such forward-looking statements, which are not a guarantee of performance and are subject to a number of uncertainties and other factors, many of which are outside AT&T's control, that could cause actual results to differ materially from such statements. These risk factors include the impact of increasing competition, continued capacity oversupply, regulatory uncertainty and the effects of technological substitution, among other risks. For a more detailed description of the factors that could cause such a difference, please see AT&T's10-K, 10-Q, 8-K and other filings with the Securities and Exchange Commission. AT&T disclaims any intention or obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise. This information is presented solely to provide additional information to further understand the results of AT&T.

About AT&T

For more than 125 years, AT&T (NYSE "T") has been known for unparalleled quality and reliability in communications. Backed by the research and development capabilities of AT&T Labs, the company is a global leader in local, long distance, Internet and transaction-based voice and data services.

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August 4, 2004

AT&T Plans to Raise Its Rates for Residential Calling Plans

By KEN BELSON

T&T Communications plans to reach out and put the touch on its customers.

It has proposed raising its rates on several local calling plans in 40 states to increase revenues from its residential business. AT&T's decision to increase rates for most of its 4.7 million local phone customers comes less than two weeks after it decided not to seek new residential customers or to work to retain them.

The rate increases could prompt its many customers to consider switching their service to another carrier, especially as competitors begin advertising and promotional campaigns to woo AT&T subscribers.

AT&T has notified state public utility commissions, which oversee local phone rates, of its intention to raise rates. It also told its customers of the decision through advertisements in newspapers around the country and on monthly bills.

The increases will affect AT&T customers in states including Florida, New York, Ohio and Texas. Consumers using about half a dozen different local plans will pay two or three dollars more a month, starting in September and October, depending on the state.

California and Illinois are among the 10 states that will not be affected by the rate increases. The District of Columbia also will be excluded.

AT&T hopes the increases will generate more revenue from a part of its business where sales are declining by more than 10 percent a quarter. Its price increase does not apply to its long-distance services. The company said it wanted to bring its local service prices more in line with the prices of its competitors, most notably the

regional Bells like Verizon Communications and SBC Communications, which typically charge 10 to 20 percent more for local phone service.

"The purpose was to put us at closer parity to Verizon's plans," said Bob Nersesian, an AT&T spokesman, who said the company had begun considering whether to raise local phone rates several months ago.

A rival long-distance carrier, MCI, has no immediate plans to raise its local phone rates, though it did increase the prices of some of its long-distance plans in July by as much as $2 a month. Sprint said it also was maintaining its local phone rates, though it no longer actively markets those plans to consumers.

AT&T's decision to stop marketing to consumers was prompted by the government's decision in June not to challenge a court decision that ended subsidies for long-distance carriers. As part of the Telecommunications Act of 1996, regional Bell phone companies were required to connect local phone calls for rival carriers at a discount.

By retreating from the residential phone business it helped create more than a century ago, AT&T has essentially invited its competitors to poach its customers. SBC Communications and Qwest Communications have started advertising campaigns to lure AT&T customers, and several regional Bells have cut their local phone rates in new promotions to attract those customers.

But even after the increase in local calling rates, most of AT&T's local calling plans will be cheaper than those of its competitors. After the rate increase, AT&T will charge consumers in New York $22.95 for its cheapest stand-alone local calling plan that includes unlimited minutes. Local calling plans at Verizon, by contrast, start at $35.95, though the company is offering promotions to entice customers who have switched carriers to return.

Still, by raising its own local calling rates, AT&T gives its customers a reason to jump ship. The move also raises questions about how long the company's consumer business can generate significant amounts of cash. By halting efforts to seek new residential customers, AT&T hopes to reduce costs and use the savings to help finance its much larger business in selling phone services to corporate clients.

Doubts about AT&T's ability to generate cash from its businesses was one reason Standard & Poor's cut the company's credit rating to a noninvestment grade yesterday. S&P, which took the step a week after Moody's Investors Service made

a similar move, now rates AT&T long-term debt at BB+, down from BBB.

"We anticipate that competition will intensify from other large long-distance carriers, the regional Bell operating companies, and cable TV companies in the near-to-intermediate term, further affecting AT&T's weak operating margins," the ratings agency said in a statement.

S&P said the outlook for AT&T's credit rating remained "negative."

Shares of AT&T dipped 6 cents, or 0.4 percent, to close at $15.10 yesterday. With the undoing of the subsidies that helped AT&T offer local phone service, the regional Bells now have the option of raising the fees they charge long-distance carriers to connect their calls.

Most of the Bells have said they would not raise rates until after this November's election.

Nevertheless, in raising its retail residential rates now, AT&T may be anticipating a future connection fee increase by Verizon and other regional Bells, analysts said. The company may also be betting that consumers, comfortable with their current calling plans, will not immediately switch phone providers, analysts said.

"The consumer business is eroding and AT&T needs to do what it can to service its customers but remain as profitable as possible," said Todd Rosenbluth, an analyst at S&P Equity Research. "Until consumers see their phone bills in a couple of months, they won't make a decision" to leave AT&T.

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The Washington Times
www.washingtontimes.com

MCI set to downsize residential service

By William Glanz
THE WASHINGTON TIMES
Published August 6, 2004

MCI Inc. said yesterday that it doesn't expect to add new residential calling customers because costs are increasing, the second major phone company in two weeks to announce its exit from residential phone service.

"We anticipate to downsize our [consumer business] effort significantly," said Wayne Huyard, president of MCI's U.S. sales and service division.

Mr. Huyard didn't offer details about MCI's plans, but the nation's second-largest long-distance provider wants to turn its attention to the more profitable commercial business.

AT&T Corp., the nation's largest long-distance provider, said July 22 that it will stop trying to attract customers but continue to provide long-distance and local service to its 35 million residential customers. AT&T is walking away from the residential-calling business because revenue has fallen owing to increased competition and higher costs.

MCI has 3.5 million residential customers for its local and long-distance phone service, and company officials said revenue from those customers amounts to about $3 billion annually.

"We don't expect [residential phone service] will be a growth engine," MCI spokesman Peter Lucht said after the company outlined its plan in a conference call to discuss second-quarter earnings.

MCI will continue to provide service to existing local and long-distance customers.

"We anticipate that our costs will go up and it will be more difficult to add new [residential] customers," Mr. Lucht said.

MCI, based in Ashburn, Va., also plans to trim its work force to 41,300 by the end of the year. It has 44,800 workers currently, down from 57,300 at the end of 2003.

MCI lost $71 million (22 cents per share) in the second quarter, compared with net income of $8 million a year earlier, as sales fell owing to declining calling prices.

Sales fell from $6.17 billion a year ago to $5.24 billion for the three months that ended in June, the first quarter since it emerged from bankruptcy.

MCI Chief Executive Officer Michael Capellas said the company faces a "challenging industry environment" that has caused "relentless price competition."

"We've made tremendous progress, but recognize that we have work to do," Mr. Capellas said.

MCI also plans to pay a quarterly dividend of 40 cents a share. MCI has about $2.2 billion in excess cash, paving the way for the dividend.

Shares of MCI fell 8 cents to close at $13.84 on Nasdaq.

MCI officials didn't discuss Leucadia Corp., the New York holding firm that wants to buy MCI's outstanding shares of stock. Leucadia needs antitrust clearance under the Hart-Scott-Rodino Act before proceeding with its unsolicited bid because it already owns WilTel Communications Group, in Tulsa, Okla.

MCI has said the review period ends on or about Monday.

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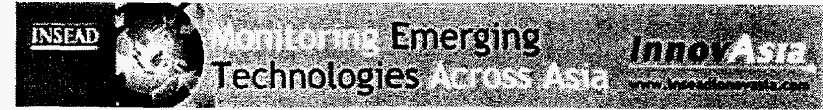

AUGUST 9, 2004

NEWS ANALYSIS :TECH

By Brian Grow

At MCI, The Worst May Be Over

It's still losing money, but second-quarter losses were less than analysts feared, and investors love that dividend

MCI surprises Wall Street with positive earnings report, signaling the worst may be behind it Yet potential suitors in struggling telecom business remain on the sidelines, waiting for company improve further

That happy "Friends & Family" feeling returned to MCI for a time on Aug. 5, when the beleaguered long-distance outfit surprised Wall Street by turning in less-than-horrible second-quarter earnings, announcing a dividend bonanza, and showing solid progress in cost reduction.

While MCI still managed to hemorrhage $71 million in the quarter, that loss beat analysts' estimates and slowed the bleeding, after earnings sank to $388 million in the first quarter. What's more, MCI's board approved a cash dividend of 40 cents per share to begin in September, part of a $2.2 billion plan to return "excess cash" to shareholders, as MCI exits bankruptcy. The payback went over well investors, who lifted MCI by 17.4%, to $16.25, in after-hours trading Aug. 5. The stock lost a little ground in subsequent trading, closing Aug. 6 at $15.94.

STRATEGIC RETREAT. As arch rival AT&T (T) sounds the siren over asset write-downs and a pullout from the consumer telecom market, MCI's better-than-expected performance could signal that its dog days are on the wane. Indeed, the company, which was wracked by an $11 billion accounting scandal under its former name, Worldcom, produced operating income of $41 million during the quarter.

While analysts don't expect MCI to return to profitability until at least the end of 2005, more stable earnings could sweeten takeover interest in the nation's second-largest long-distance company. Already, buyout firm Leucadia National has dipped its toe in the water, last month filing with federal regulators a request for approval to acquire a majority interest in MCI (see BW Online, 7/13/04, "Telecom Frenzy Round 2? Not Yet").

The long-distance market remains brutal, with prices falling and new technologies threatening MCI's core voice and data business. The end of cheap rates for access to local telephone customers is expected to cut revenues harshly in MCI's consumer and small-business unit. MCI has 3.6 million local customers and 8.8 million consumer

long-distance lines. Meanwhile, regulatory changes are increasingly enabling the Baby Bells to hunt for customers in MCI's long-distance segment. The result: MCI said yesterday that it will reduce efforts to attract new consumer customers and revalue some assets, although it doesn't expect to fully exit the segment, as AT&T has done. "We anticipate downsizing our [consumer] acquisition efforts significantly," says Wayne Huyard, president of MCI's U.S. sales and services unit.

"HIGHER-QUALITY REVENUE." Those ailments are forcing MCI to continue slashing costs. During the quarter, MCI cut another 6,200 jobs, trimmed advertising for underperforming businesses such as its 10-10-987 long-distance calling service, and lowered debt levels. The layoffs, part of a plan to reduce MCI's headcount 30% by the end of the year, took its total employee base down to 48,400, from 54,600 at the end of 2003. The cost purge lowered MCI's overhead by 17%, or about $300 million, from the first quarter. Analysts are applauding the results, with JPMorgan's Avi Bennis hailing it as "a really remarkable job."

While substantially lower costs encouraged Wall Street, there were other bright spots for MCI. The company generated $500 million in cash and its EBITDA margin more than doubled to 19%, up from single digits in the first quarter, and just below AT&T's level. MCI executives also crowed that, while rates continue to fall, their outfit won $1.1 billion in new contracts during the quarter from major businesses such as SunTrust Bank (STI) and First Data Corp (FDC). "We're seeing higher-quality revenue," said Capellas, who also announced plans to push wireless voice and data services to corporate clients -- a move made possible by the fact that MCI still holds $4.1 billion in cash.

Indeed, MCI's cash hoard and its stable of big business clients -- Hewlett-Packard (HPQ) and Electronic Data Systems (EDS), to name two -- are appetizing assets for potential suitors. For the moment, most analysts believe potential buyers such as the Baby Bells remain cautious about making a bid until MCI stabilizes. With good reason -- total revenue at MCI is still expected to decline about 14% this year, to about $21 billion, before bottoming out next year at about $20 billion, according to Patrick Guzman, telecom analyst at Variant Research in Miami. Also, competitors aim to pick off MCI's residential customers as it ratchets back efforts to attract new ones.

LOOKING, NOT BUYING. For now, MCI's suitors remain content to sit on the sidelines -- and digest other projects. BellSouth (BLS) and SBC Communications (SBC) are busy closing the $41 billion purchase of AT&T Wireless by their joint-venture cellular unit, Cingular. Indeed, this week, BellSouth CEO Duane F. Ackerman professed to have little appetite for an MCI deal. "We're not in acquisition mode," he said. Another deep-pocketed contender, Verizon (VZ), is busy adding to its industry-leading position in wireless and expanding broadband operation. The upshot: The Bells are reluctant to tinker with their stable margins and steady profitability at a time when MCI is still on the mend, say analysts.

It seems likely, however, that MCI's problems will subside over the next few quarters -- and Capellas and team are managing smartly. Instead of bolting the consumer business *a la*

AT&T for example, MCI plans to milk it "for profitability," while expanding efforts to deliver next-generation, Internet-based services such as data storage, wireless communications, computer security. Given the positive news at MCI, it's easy to understand why investors have decided not to hang up on MCI just yet.

Grow is a writer in *BusinessWeek*'s Atlanta bureau
Edited by Beth Belton

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Sprint Stops Marketing Residential "Complete Sense" Calling Plans

By Josh Long
Posted on: 07/29/2004

PRINT

Sprint Corp. has stopped actively marketing a number of residential local and long-distance calling plans in 36 states and the District of Columbia known as Sprint Complete Sense, according to company representatives.

The company listed 336,000 Sprint Complete Sense customers at the end of the first quarter, the most recent figure disclosed, according to spokesman Travis Sowders.

Sowders says Sprint never launched a mass marketing campaign to promote the calling plans and primarily sold the packages to existing customers. Sprint will continue to support existing customers, he says, and provide Sprint Complete Sense to people who request it. The decision to stop marketing the calling plans was made in recent weeks, Sowders says.

Sprint introduced the calling plans last year after the FCC released rules that helped foster local-phone competition by requiring BellSouth Corp., Qwest Communications International Inc., SBC Communications Inc. and Verizon Communications Inc. to rent their networks to competitors such as AT&T Corp. and Sprint at government-set rates. Those rules have expired, and numerous telecommunications companies anticipate a significant spike in the wholesale phone rates beginning next year.

Attributing its decision to regulatory developments, AT&T last week announced plans to stop competing for local and long-distance phone customers in the traditional residential market. Analysts expect other phone companies, including possibly MCI, to scale back their residential services as a result of the regulatory developments. MCI was not immediately available for comment.

Derek Gietzen, co-founder, president and CEO of privately held Vycera Communications, a phone company targeting the Hispanic market in California and Texas, says he has received calls from three telecommunications providers expressing an interest in selling their residential customer bases. He says one company has 2,000 customers.

"They just didn't have the size to really deal with what is going on," Gietzen says, referring to changes in the federal rules.

Posted on Fri, Jul. 30, 2004

Sprint Corp. stops marketing small local-service plan

Associated Press

NEW YORK - Sprint Corp. said it would stop marketing a small local-service calling plan called Complete Sense that depends on the company renting equipment from the dominant regional Bells.

Sprint never spent much on marketing the service, which had 336,000 customers at the end of the first quarter. Sprint said it will continue to serve customers who use the service.

Overland Park, Kan.-based Sprint owns its own local service network, with 7.8 million access lines in 18 states, letting the company sell local service to customers without renting equipment from the regional Bells.

Complete Sense is the only plan Sprint offers that depends on renting equipment. The price of such rentals is expected to rise following a March federal court decision overturning rules that kept the prices low.

The court decision prompted AT&T Corp., which does not own its own local access lines, to announce last week that it would no longer spent an estimated $1 billion a year to win residential customers. Instead, AT&T will focus on business customers. It, too, said it would continue to serve its existing customers.

Sprint shares fell 34 cents, 1.8 percent, to $18.68 on the Nasdaq Stock Market.

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