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Unbundling the Local Loop
The FCC Searches for Consensus – Can Other Markets Learn From the US Regulatory Process

By Michael Reede

For much of the last 2 years a debate has been raging within the fixed line telecommunications markets of the United States regarding the status of local loop unbundling, although it has been at the forefront of the telecommunications regulatory agenda for much longer. It began with the introduction of the *Telecommunications Act of 1996* ("Telecommunications Act"). The nature and style of the debate then fluctuated with the politics of US telecommunications markets in the intervening period, but the positions have always been clear. Incumbent local exchange carriers ("ILECs") have opposed all forms of local loop unbundling and the competing local exchange carriers ("CLECs") have just as vigorously argued in favour of access to network elements of all types in all geographic regions on the basis of incremental cost methodologies. Central to the discussion has been the interpretation of a small number of provisions of the Telecommunications Act, and the scope of the FCC's discretion in applying them. Ultimately the regulatory decisions made under the auspices of these provisions will influence the buy/build decisions of ILECs and CLECs in the local loop in the United States, particularly for the deployment of broadband networks.

One reason for the refocusing of the debate in recent times has been that a number of court decisions have played an integral role in influencing the manner in which the Federal Communications Commission ("FCC") exercises its discretion under the Telecommunications Act in relation to unbundled network elements ("UNEs"). As a result the FCC has sought to correct a number of the problems associated with its existing policies, as identified by the courts. However, as is invariably the case in such circumstances in the United States, shifting the status quo involves significant effort and generates considerable lobbying. The FCC's Unbundled Network Element Triennial Review, the outcome of which were announced on 20 February 2003 is the most recent result. However, it has revealed that even the FCC Commissioners are split in relation to the appropriate regulatory policy to be applied, although they have constructed a "majority decision". Some background is required to understand the FCC's latest policy installment.

Section 251(d)(2) of the Telecommunications Act provides that, in determining which unbundled network elements should be made available to the CLECs the FCC shall consider at a minimum whether (i) access to such network elements as are proprietary in nature is necessary; and (ii) if the failure to provide access to such network elements would impair the ability of the telecommunications carriers seeking access to provide the services that it seeks to offer. These concepts of "necessary" and "impairment" have become critical to both the legal and therefore the economic debate regarding local loop unbundling in the United States.

During the incumbency of commissioner Reed Hundt, the FCC issued its 1996 *Local Competition First Report and Order* ("Local Competition Order") in which the FCC defined a "necessary" unbundling to be any technically feasible one and in which it gave the definition of "impairment" very wide scope.

However, in January 1999 the Supreme Court in *AT&T Corp v. Iowa Utility Board* examined two questions. First, the FCC's jurisdiction to set prices for unbundled network elements. Secondly, which such elements did the ILECs have to unbundle at cost based rates for the CLECs. The Supreme Court suggested that the Local Competition Order took an unreasonably broad view of the "necessary" and "impairment" standards and directed the FCC towards considering more appropriate limiting factors that were consistent with the legislation. Some commentators have interpreted this as a direction to consider the essential facilities doctrine and market power analysis.

Then in May 2002 in the US Court of Appeals for the District of Columbia in *US Telecom Assn. v. FCC*, the court overturned the FCC's previous UNE rules. Indicating that the FCC had expressed a belief that, 'more unbundling is better', Judge Stephen William stated that, "To the extent that the Commission orders access to unbundled network elements in circumstances where there is little or no reason to think that its absence will genuinely impair competition that might otherwise occur, we believe it must point to something a bit more concrete."

In combination, these decisions called into question the previous FCC rule makings on UNE and required that it reconsider its position. This reconsideration has now occurred in the context of the Unbundled Network Element Triennial Review during a very different commercial and political phase for telecommunications markets in the United States. The Local Competition Order was written at a time when scope for the telecommunications sector and investment in it seemed limitless. The reconsideration of the UNE rules occurred at a time when the US telecommunications sector faces the reality of a fundamentally different market in which there is far less available capital to invest in deploying new broadband networks. At issue is the nature of those regulatory settings which are consistent with the relevant empowering provisions under the Telecommunications Act and will promote the objectives of the Telecommunications Act in the deployment of broadband networks. A clear difference of opinion has emerged within the FCC.

On February 20, 2003, the FCC announced its new rules on the network unbundling obligations of the ILECs. In an unusual development, separate statements were issued by commissioners, Michael Powell, Katherine Abernathy, Michael Copps and Jonathan Adelstein. These separate statements dissented with each other and did so in different respects. They reflect an ideological split within the FCC on how best to achieve the objectives of the Telecommunications Act.

The new UNE rules can be summarized as follows:

- A CLEC is "impaired" when lack of access to an incumbent ILEC's network poses a barrier to entry likely to make entry into the market uneconomic. In short the decision speaks some of the language of the essential facilities doctrine in attempting to establish limiting principles.

- The FCC will not require unbundling of fibre to the home loops.

- The FCC also elected not to unbundle bandwidth for the provision of broadband services for hybrid loops (i.e. adopting fibre for part of the loop).

- The FCC no longer requires line sharing to be available as an unbundled network element (which will be phased out).

- The FCC provided clarification of its UNE pricing rules, which it has suggested will send more appropriate economic signals to carriers.

- The FCC made a presumptive finding that switching, as a key UNE-P element for business customers served by high capacity loops will no longer be unbundled. However, the States have 90 days to rebut this national finding.

- For mass market customers the FCC set out criteria that the States shall apply to determining whether economic and operational impairment exists in a particular market for UNE-P. The States are to complete these proceedings within 9 months and, if there is a finding of no impairment the FCC has set a 3 year period for carriers to transition off UNE-P.

- The FCC found that CLECs are not impaired without optical carrier level transport circuits.

- The FCC confirmed that it would clarify its Total Element Long Incremental Cost calculation rules to make them more reflective of investment risks and the economic depreciation of assets.

- The FCC confirmed that it was opening a proceeding to re-examine the "pick and choose" rules that allow competitors to take advantage of individual terms of an interconnection agreement without adopting the entire agreement (and tentatively suggesting that the rules should be eliminated.)

The detailed implementation of the rules is still unknown and, if history is any guide, litigation is highly likely (indeed the Commissioners in the minority have expressly contemplated this as an inevitable outcome of the majority decision).The UNE-P decision appears to favor the CLECs, but may now splinter into multiple State decisions and litigation. The exemption of loops including fibre and potential changes to TELRIC and the pick and choose rules may be to the advantage of the ILECs.

In summary, there is material relief from unbundling for all loops that use fibre in whole and part But the FCC has deflected UNE-P issues to the States. Separate regulatory proceedings will take place over the next 12 months to bring these proceedings to a conclusion. Accordingly, there is now clarity regarding local loops that incorporate fiber, which will not to be unbundled. But decisions on copper local loop and UNE-P seem likely to be protracted and ultimately litigated.

The dissenting positions also produced some fascinating commentary. Michael Powell went so far as to suggest that the decision would now require 51 State proceedings to evaluate which network elements would be unbundled which would be litigated through 51 different federal district courts resulting in a variety of decisions and inevitability that the 51 district court cases would be heard by 12 federal courts of appeal and ultimately a decision of the Supreme Court. He went on to conclude that:

I believe this decision will prove too chaotic for an already fragile telecom market. In choosing to abdicate its responsibility to craft clear and sustainable rules on unbundling to the State Public Utility Commissions, the Majority has brought forth a molten morass of regulatory activity that may very well wilt any lingering investment interest in the sector."

So none of the market participants are totally satisfied and neither are any of the Commissioners. A true "compromise outcome".

So what themes can be extracted from the FCC deliberations that rise above the level of this compromise. First, orthodox economic concepts should be a centre piece of any regulatory consideration of access to unbundled network elements, access should not simply be assumed in all cases. Secondly, it is unwise to apply, without further thought, legacy network regulatory tests to the deployment of new technology mediums in the broadband local loop (e.g. loops that include optical fiber). Thirdly, when applying costing methodologies such as TELRIC a more liberal approach may be taken to costs of capital based on the incorporation of competitive risks as well as the economic depreciation profiles of the relevant network elements. Finally, as economic conditions justify, mandated access to certain network elements should be withdrawn (confirming that regulation should not be static in a dynamic market.

Clearly, this chapter of U.S. regulatory decision making is not yet closed, further installments will follow.

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