

to manage trouble tickets. The LMOS database inventories network facilities throughout SWBT's five state territory, and is used to perform line testing and various maintenance and repair functions. Thus, the LMOS database is intended to record the party serving the line in question (whether SWBT or a CLEC) as the "owner" of the circuit. Willard Decl. ¶¶ 10-12. If the record of a CLEC customer in LMOS is not updated at the time the CLEC submits a local service request to reflect the CLEC as the new "owner" of the circuit, a CLEC will not be able to open a trouble report electronically for that line – because SWBT's LMOS system will still list SWBT as the current "owner." *Id.* ¶¶ 22, 25.

By its own admission, SWBT has not updated LMOS records correctly for all lines served by CLECs. *Id.* ¶¶ 14, 18, 20. As a result, on numerous occasions when CLECs such as AT&T and Birch Telecom have attempted to submit trouble tickets electronically, SWBT's systems have responded that the telephone numbers have been "ported or disconnected" – even though the numbers are active accounts of the CLEC. *Id.* ¶¶ 15, 18-19. Under such circumstances, the trouble report must be made orally by the CLEC, and manually processed by SWBT. *Id.* ¶¶ 22, 25. Although the exact scope of the updating errors are not known, a survey by Birch suggests that 20 to 35 percent of LMOS records for CLECs have not been properly updated. *Id.* ¶ 19.

The LMOS updating problem clearly denies CLECs parity of access to maintenance and repair functions, because it requires them to utilize a manual process for submission of trouble reports that puts them at a competitive disadvantage with SWBT's fully-automated retail operations. Because of the delays inherent in manual processes, CLEC customers will often have their service repaired in a less timely manner than SWBT's retail customers experiencing the same problems. *Id.* ¶ 25. Although SWBT implemented a software

change in late March that is designed to eliminate LMOS updating errors, that change is untested and purely prospective in nature, and will not correct records that were erroneously updated prior to that time. *Id.* ¶ 20. SWBT’s proposed case-by-case manual solution for correcting this “embedded base” of LMOS records simply perpetuates the discriminatory manual system that CLECs have been forced to follow, with little assurance that the problem will ever be fully resolved. *Id.* ¶¶ 21-22.

In addition to denying CLECs parity of access, the failure of SWBT to update LMOS records has affected the accuracy of SWBT’s reported performance data. As SWBT acknowledges, LMOS is used to “register the trouble report[s]” for purposes of performance measurements. *See VanDeBerghe Aff.* ¶ 34; *Willard Decl.* ¶¶ 13, 26. Thus, if a trouble report submitted by a CLEC is improperly recorded in LMOS, or is not recorded in LMOS at all, the report will not be included in SWBT’s reported data for trouble report rates for CLECs – thereby understating the actual rates. *Id.* ¶¶ 26-27. Moreover, because LMOS records that have not been correctly updated list SWBT as the “owner” of the facilities, the trouble report rate for SWBT’s retail operations may be overstated. *Id.* ¶ 27.

The impact of LMOS updating errors on the accuracy of SWBT’s reported data was recognized earlier this month by the Staff of the TPUC, which, after learning of the LMOS problem, indicated that it would recommend to the TPUC that an audit be conducted of all measures affected by LMOS for all five states in SWBT’s region. *Id.* ¶ 28. Whatever the TPUC decides, however, SWBT’s reported data on trouble report rates cannot be considered reliable

evidence of the comparative quality of the maintenance and repair work that SWBT performs for CLECs and its own retail operations. *Id.* ¶ 29.³⁶

B. The Commission Should Not Consider SWBT’s Reported Performance Data As Reliable Evidence of Its Performance.

The Commission has repeatedly emphasized that the most probative evidence that a BOC is providing non-discriminatory access to its OSS, and that the OSS are operationally ready, is actual commercial usage.³⁷ However, the Commission has also stated that “the reliability of reported data is critical,” and “the credibility of the performance data must be above suspicion.” *Texas 271 Order* ¶¶ 428-429. SWBT’s reported data fail to meet that test.

The errors caused by the LMOS updating problem in SWBT’s reported performance data for measurements involving trouble report rates are sufficient cause, by themselves, to raise serious concerns about the completeness, accuracy, and reliability of SWBT’s reported performance data. *See Willard Decl.* ¶ 33. However, disclosures made by SWBT earlier this month demonstrate that its reported data on flow-through rates have also been erroneous, because SWBT has calculated the data using a methodology inconsistent with the applicable business rules. *Willard Aff.* ¶¶ 34-43.

Specifically, at the workshop on performance measures conducted by the TPUC earlier this month, SWBT stated that in calculating the flow-through rates for CLEC orders, it

³⁶ The Commission has long regarded data on trouble report rates as an indication of the quality of the maintenance and repair work that a BOC is performing for itself and for CLECs. *See, e.g., KS/OK 271 Order* ¶ 163; *Texas 271 Order* ¶ 209; *New York 271 Order* ¶ 222; *Louisiana II Order* ¶ 212. *See also Michigan 271 Order* ¶ 212 (requiring submission of data on trouble report rates in future Section 271 applications).

³⁷ *See, e.g., KS/OK 271 Order* ¶ 105; *Texas 271 Order* ¶¶ 53, 98, 102; *New York 271 Order* ¶¶ 53, 89; *Louisiana II Order* ¶¶ 86, 92, 100; *Michigan 271 Order* ¶ 138. *See also Ham Aff.* ¶ 10.

has excluded from the denominator UNE-P orders that, although not designed to flow through SWBT's systems without manual intervention when submitted by a CLEC, would have flowed through SWBT's systems if the same order type had been submitted by SWBT's retail operations. *Id.* ¶¶ 36-38. This methodology is totally contrary to the language of the applicable business rules, and to the interpretation of these rules by the TPUC Staff and AT&T.³⁸ As a result of SWBT's exclusion of UNE-P "orders that would flow through EASE" from the denominator, the reported flow-through rates for CLEC orders submitted via the EDI and LEX interfaces are *overstated* – making SWBT's performance appear better than if it had calculated the rates according to the business rules.³⁹ In addition, evidence presented at the TPUC workshop suggests that SWBT may also have *understated* the flow-through rate for its own retail

³⁸ As SWBT acknowledges, the applicable business rules define the flow-through rate (Performance Measure 13) as "the number of orders that flow through SWBT's ordering systems and are distributed in SORD without manual intervention, *divided by the total number of MOG-eligible orders and orders that would flow through EASE within the reporting period.*" Ham Aff., ¶ 182; Dysart Aff., Att. C at C-36 (emphasis added). CLEC orders are "MOG-eligible" if they are designed to flow through SWBT's systems without manual intervention. Ham Aff., ¶ 182 n.71. EASE is the SWBT proprietary interface used by SWBT's own retail operations, and is also available for submission of resale orders by CLECs. Willard Aff. ¶ 35; Ham Aff. ¶ 137. The business rules include "orders that flow through EASE" in the denominator of the flow-through calculation in order to permit a meaningful parity comparison. Without inclusion of this language in the business rules, the flow-through calculation would measure the flow-through rate only as a percentage of those CLEC orders that SWBT has *designed* to flow-through, while ignoring additional CLEC order types which – although not designed to flow through when submitted by a CLEC – *would* flow through EASE had the same order type been submitted by SWBT's retail operations. Willard Decl. ¶¶ 35-36 SWBT confirmed at the TPUC workshop that it construed the phrase "orders that flow through EASE" as including only *resale* orders, because UNE-P orders do not flow through (and cannot be submitted via) EASE. *Id.* ¶ 37.

³⁹ Willard Decl. ¶¶ 37-39. SWBT's erroneous methodology did not affect the flow-through rates for resale orders submitted by CLECs via its EASE interface, because SWBT included all resale "orders that would flow through EASE" in the denominator. Willard Decl. ¶ 39 n.25. However, as discussed above, SWBT may have understated the flow-through rate for its own retail orders submitted via EASE – an error that might explain why reported flow-through rates for EASE have been higher for CLEC orders than for SWBT orders, even though precisely the opposite would be expected. *Id.* ¶ 40 & n.27.

operations, by improperly including in the denominator retail order types that are not designed to flow through its proprietary EASE interface. Willard Aff. ¶ 40.

SWBT’s misstatement of flow-through rates clearly precludes any reliance on its reported data, particularly in view of the importance of flow-through from the standpoints of parity, competitive impact, and customer impact. *Id.* ¶ 41. Indeed, SWBT’s revelation of its erroneous methodology sent the TPUC Staff “reeling, from the realization that the data collected under [Performance Measure] 13 wasn’t what we thought it was.” *Id.* ¶ 38 & Att. 3 at 220-221. The TPUC Staff therefore indicated that it would recommend a five-state audit of SWBT’s reported flow-through data (along with the five-state audit that the Staff indicated it would recommend regarding performance data affected by updating problems in LMOS). *Id.* ¶ 43.

In view of the demonstrated errors in its reported performance data, SWBT cannot plausibly argue that the data show “that SWBT’s overall performance in Missouri complies with the requirements of section 271,” or even that “SWBT generally provides excellent flow-through performance.” *Dysart Aff.*, ¶¶ 32, 50. SWBT’s data plainly lack the reliability and credibility necessary for it to serve as evidence of SWBT’s actual performance.

Equally importantly, the Commission cannot reasonably rely upon the threat of penalties for non-compliance with performance measure obligations as assurance that SWBT will either improve its performance or not “backslide” into further discrimination in the future. *Cf.* SWBT Application at 93 (asserting that SWBT’s performance plan will “allow CLECs and regulators to confirm that SWBT is providing local facilities and services on a non-

discriminatory basis”). According to a recent analyst report,⁴⁰ SBC has already paid \$23 million in penalties to date, and \$4.6 million as recently as March 2001, for its failure to comply with performance obligations agreed to as part of the merger with Ameritech. According to SWBT’s website for CLECs, SWBT has already paid more than \$8 million in penalties for its 5-State region, including more than \$7.4 million in Texas, where SWBT has already received Section 271 approval.⁴¹ Moreover, the recent analyst report notes that the amount of fines levied against SBC understate the level of non-compliance, because the plans “cap” certain fines and thus preclude any levy of additional fines for below-standard performance.⁴² SWBT’s “Missouri Performance Remedy Plan” is no exception, setting a cap of \$98 million in fines during its first year.⁴³ Because SBC evidently views the prospect of paying fines for non-compliance with performance measure obligations as a mere cost of doing business, the Commission may not reasonably on the presence of a performance compliance plan as a substitute for demonstrated full implementation of SWBT’s duty to provide non-discriminatory access to OSS.

⁴⁰ See Merrill Lynch Global Securities Research, “Telecommunications/Services – Local,” Hoexter’s Broadband Bits, Issue No. 62 (April 13, 2001).

⁴¹ In December 2000 alone, according to SWBT’s website for CLECs, SWBT paid more than \$1.6 million in penalties for Texas. See <https://clec.sbc.com>. Indeed, the monthly penalties that SWBT has paid for Texas have been considerably higher than the amount (approximately \$213,000) that it paid for June 2000 (the month when SWBT’s Texas application was approved). Since July, the monthly penalties paid by SWBT for Texas have ranged from \$289,150 in July to \$1,619,050 for December. In Kansas, SWBT paid more than \$167,000 in penalties in February – the first full month following the Commission’s approval of SWBT’s 271 application for that State.

⁴² Merrill Lynch Global Securities Research, *supra*.

⁴³ See SWBT Br. at 95-96; Dysart Aff. ¶ 19. The effectiveness of the plans is reduced even further by the recently-revealed errors in SWBT’s reported data. As the Commission has recognized, the adequacy of any performance plan depends on the accuracy and reliability of the performance data that it uses. *SBC Texas Order*, ¶¶ 428-429. Because of these errors, which overstate SWBT’s performance, its actual liability under the performance plan will be less than it should be.

The errors in SWBT's data belie its assertion that the recent "audit" by Ernst & Young "provides further support for the adequacy of SWBT's performance measurements, and for the reliability and accuracy of its reported data." Application at 95.⁴⁴ If anything, the errors show that the Ernst & Young audit was woefully inadequate, since Ernst & Young purportedly "validated" the *same* performance data that has now been shown to be erroneous, without finding any errors in the accuracy of the data or the methodology that SWBT used to calculate it. Willard Decl. ¶¶ 44-45.

In addition, the Ernst & Young audit, and the final Ernst & Young reports on the audit, are fundamentally flawed. First, the highly conclusory, two-page Ernst & Young reports lack the supporting detail and documentation that would be necessary to determine whether the audit was adequate. *Id.* ¶¶ 47-49. Although Ernst & Young indicated that such details could be found in its workpapers, it refused to make them available for inspection, due to spurious objections by SWBT concerning their confidentiality. *Id.* ¶ 49.

⁴⁴ SWBT's reliance on the September 1999 Telcordia report as evidence of the reliability of its reported data is equally misplaced. *See* SWBT Br. at 95; Dysart Aff. ¶¶ 178 n.71, 186. Telcordia's 1999 review was too limited and too subjective to support a conclusion concerning the reliability of SWBT's data for Texas, much less States outside of Texas. Telcordia, for example, conducted no independent testing of the accuracy of the raw data that serves as input to the performance measures, did not document any comparison of SWBT raw input data to independently-collected data, and conducted no review of the accuracy of the data reported for its own retail performance, which is the data used for a parity comparison. Willard Decl. ¶ 44 n.32. As the Department of Justice stated in evaluating SWBT's first Section 271 application for Texas, "Telcordia's review does not provide an adequate basis for determining that presently reported SWBT performance data are reliable." Evaluation of the Department of Justice filed February 14, 2000, in CC Docket No. 00-4, at 6. The Commission itself did not find that the Telcordia review had validated SWBT's performance data, but rather stated that it "agree[d] with several commentators and the Department of Justice that the Telcordia test was limited in scope and depth" - citing, among other things, the criticism that Telcordia "did not evaluate the accuracy of the raw data used by SWBT to calculate the performance measurements." *Texas 271 Order* ¶ 103 & n.263.

Second, the information that Ernst & Young orally provided at the January 30, 2000 technical conference at the MPSC shows that the audit was patently insufficient to determine the accuracy, completeness, and reliability of SWBT's reported data. Ernst & Young revealed that its actual review and testing of performance data was limited to an extraordinarily small number of transactions, with no confirmation that data for major categories of orders (such as UNE-P migration orders) had been reviewed. *Id.* ¶¶ 50-52. Furthermore, Ernst & Young revealed that in conducting its audit, it did not regard errors as "material" unless they altered the results by at least 5 percentage points in one direction or another. This "materiality factor" not only is wholly arbitrary, but also ignores errors that mask discrimination affecting a CLEC's ability to compete. *Id.* ¶ 53.

The inadequacy of the Ernst & Young audit is further confirmed by reports by Telcordia on certain SWBT performance data that were filed by the TPUC Staff in December 2000 – only one month after issuance of issuance of the final Ernst & Young reports. *See id.* ¶¶ 54-60. The reports of the two firms covered similar subject matter areas (such as SWBT's compliance with the applicable business rules in calculating its data) and many of the same performance measurements. Yet, even with their own flaws, the Telcordia reports found numerous problems regarding SWBT's data that the Ernst & Young reports totally fail to mention, much less address. *Id.* For these reasons, the Commission cannot find that SWBT's data were "properly validated." *See Texas 271 Order* ¶ 428.

IV. SWBT'S ENTRY INTO THE INTERLATA MARKET IS NOT CONSISTENT WITH THE PUBLIC INTEREST.

Finally, SWBT cannot satisfy its burden to show that its interLATA authorization would be "consistent with the public interest, convenience, and necessity." 47 U.S.C.

§ 271(d)(3)(C). Notably, checklist compliance alone is *not* sufficient to satisfy the public interest requirement:

“In making our public interest assessment, we cannot conclude that compliance with the checklist alone is sufficient to open a BOC’s local telecommunications markets to competition. If we were to adopt such a conclusion, BOC entry into the in-region interLATA services market would always be consistent with the public interest requirement whenever a BOC has implemented the competitive checklist. Such an approach would effectively read the public interest requirement out of the statute, contrary to the plain language of the section 271, basic principles of statutory construction, and sound public policy. . . .”

Michigan 271 Order ¶ 389. As the Commission has repeatedly confirmed, “the public interest requirement is independent of the statutory checklist and, under normal canons of statutory construction, requires an independent determination”⁴⁵ It requires the Commission “to review the circumstances presented by the applications to ensure that no other *relevant factors* exist that would frustrate *the congressional intent that markets be open*.”⁴⁶ In short, the essence of the public interest inquiry is for the Commission to determine whether, notwithstanding checklist compliance, the BOC applicant’s local markets are irreversibly open to competition.

As shown below, numerous “relevant factors” confirm that the local residential market in Missouri is not open to competition today and – absent significant steps on the part of SWBT – will not be open to competition in the near future. First, SWBT’s own data show that there is virtually no facilities-based and UNE-based competition for residential customers today.

⁴⁵ *KS/OK 271 Order* ¶ 267. See also *Texas 271 Order* ¶ 417; *New York 271 Order* ¶ 423 (“the public interest analysis is an independent element of the statutory checklist.”).

⁴⁶ E.g., *KS/OK 271 Order* ¶ 267 (emphasis added); *New York 271 Order* ¶ 423.

Second, there is no prospect for increased UNE- or facilities-based residential competition in the near future. The only facilities-based provider of residential service is exiting the market, leaving an uncertain future even for its telephony customers, while a margin analysis confirms that UNE-based entry is unprofitable even for a perfectly efficient competitor. None of the CLECs on which SWBT relies is in a position to offer substantial residential competition under current conditions.

Third, the experience in Texas, far from validating SWBT's claim that long-distance relief will serve the public interest, thoroughly belies it. The recent report of the Texas PUC to the Texas Legislature on the "Scope of Competition in Telecommunications Markets of Texas" (January 2001) (att. 1), makes clear that SWBT retains monopoly control of the residential market in Texas and is able to raise prices for local and long distance service. *Id.* at 62-64, 79, 81. CLEC competition for residential customers in Texas, while initially active, has faded, as experience has demonstrated that entry into local residential markets is not profitable. *Id.* at 55-58, 80-81.

There is every reason to believe that the prospects for local competition are far worse today in Missouri than they are in Texas. UNE rates are higher in Missouri than in Texas, and current levels of residential service competition in Missouri are well below the levels present in Texas and New York when this Commission considered § 271 applications for those states. Although CLECs currently serve only 1,228 residential lines via UNEs in Missouri, as described below, CLECs served over 100 times that number of residential lines in both Texas and New York when the § 271 applications for those states were considered, with expectations that they would rapidly gain many more customers.

Thus, granting a 271 application at this time would simply permit SWBT to leverage its existing monopoly over local residential service in Missouri into bundled packages of local and long distance service (*TPUC Report* at x, 79) – creating precisely the harms to consumers and the public interest that Section 271 is designed to prevent. Indeed, in February 2001, SWBT raised its residential long distance rates in Texas by 10 to 33 percent.⁴⁷ Because SWBT has not demonstrated that its monopoly over local services no longer exists, granting interLATA authorization now would conflict with section 271 and with congressional intent that local markets be open, and so SWBT’s application must be denied.

A. SWBT Maintains Monopoly Power Over Residential Service.

There is no meaningful facilities-based or UNE-based competition for residential customers in Missouri. This lack of competition is a factor directly relevant to whether the local market is open. To be sure, the Commission has repeatedly declined to identify a minimum market share that CLECs must capture before the Commission will declare a market to be open. But the Commission need not impose a minimum market share in order to take into account the fact that *no* CLECs today are mounting any kind of competitive threat whatsoever to SWBT’s monopoly control of residential local service in Missouri.

Even the data presented by SWBT show that CLEC penetration in Missouri to date is minimal and, in particular, facilities-based and UNE-based competition for residential service almost non-existent. Using the E911 data presented by SWBT witness David R. Tebeau, Table 1 shows the amount of facilities-based competition in Missouri.

⁴⁷ “SWBT Raises Nonlocal Call Rates: Company Says Prices Better Reflect Costs,” *The Dallas Morning News*, February 2, 2001.

TABLE 1: FACILITIES COMPETITION IN MISSOURI AS OF FEBRUARY 2001

	CLEC LINES⁴⁸	SWBT LINES⁴⁹	CLEC PENETRATION⁵⁰
RESIDENTIAL	23,236	1,752,154	1.31%
BUSINESS	96,224	857,873	10.09%
TOTAL	119,460	2,610,027	4.38%

While the data in Table 1 shows that there is at most, *de minimis* facilities-based competition for residential service – just 1.31% of the residential lines in SWBT’s service territory – even this minuscule number provides an overly optimistic picture of facilities-based competition. Based on a survey of CLECs conducted in August of 2000, the Staff of the MPSC reported that “AT&T is the only competitor in SWBT’s service area providing facilities based service to residential customers.”⁵¹ However, on February 28, 2001, AT&T announced that it had agreed to sell its cable systems in the St. Louis area – the facilities used by AT&T to provide residential service in Missouri – to Charter Communications, Inc.⁵² Charter’s web-site (www.charter.com) does not even mention local telephone service as one of the company’s

⁴⁸ Tebeau Aff., Att. C-1. It should be noted that the number of facilities-based residential lines Mr. Tebeau claims are served by AT&T is substantially overstated.

⁴⁹ Tebeau Aff., Table 5.

⁵⁰ (CLEC lines + SWBT lines)/CLEC lines.

⁵¹ William L. Voight Affidavit ¶ 22 (appended to Staff’s Response Comments to October Question and Answer Session, and to Interim Consultant Report (filed Oct. 26, 2000)).

⁵² AT&T New Release dated February 28, 2001, “AT&T Broadband and Charter Communications Agree to Cable System Transactions.”

products. Accordingly, the prospect of *any* future facilities-based competition for residential service in Missouri is, at best, questionable.⁵³

The picture with respect to UNE-based competition for residential service is also bleak. Just 1,228 UNE-based residential lines – a mere 0.07% of the residential lines in SWBT’s service area – are served by CLECs using the UNE-platform, as reflected in Table 2.

TABLE 2: UNE PENETRATION IN MISSOURI

	UNE LINES⁵⁴	SWBT LINES	CLEC %⁵⁵
RESIDENTIAL	1,228	1,752,154	0.07%
BUSINESS	46,182	857,873	5.10%
TOTAL	47,410	2,610,027	1.78%

This microscopic level of UNE-platform-based entry is significantly smaller than the level achieved in other states. As reflected in Table 3, the current level of UNE-based competition for residential service in SWBT’s Missouri service territory is about 1% of the levels of UNE-based residential competition that existed in New York and Texas at the time the Commission considered § 271 applications for those states. Moreover, the Commission then expected that the level of UNE-based residential competition would substantially increase in the

⁵³ Other data also confirm that SWBT’s data overstate the extent of facilities-based competition. If CLEC penetration is measured based on minutes of use, only 0.30 percent of the Missouri local exchange market is being served by CLECs, and only 0.01 percent if the CLECs’ service to Internet Service Providers is excluded. Direct Testimony of Steven E. Turner on Behalf of AT&T Communications of the Southwest, Inc., MPSC Docket TO-99-227, at 5 (filed August 28, 2000), appended hereto as Attachment 2.

⁵⁴ Tebeau Aff., Att. C-2

⁵⁵ (CLEC UNE lines + SWBT lines)/CLEC UNE lines.

immediate months following the grant of the application, which (as Table 3 also shows) in fact occurred.

TABLE 3: COMPARISON OF UNE-BASED RESIDENTIAL SERVICE LEVELS IN MISSOURI, NEW YORK AND TEXAS (number of UNE-based residential lines)

	MISSOURI	NEW YORK	TEXAS
LINES AT TIME OF 271 APPLICATION	1,228 ⁵⁶	137,342 ⁵⁷	236,000 ⁵⁸
LINES SIX MONTHS AFTER 271 APPROVAL	N/A	1,087,000 ⁵⁹	491,000 ⁶⁰

The lack of any significant facilities-based or UNE-based entry into residential services is clearly relevant to the question whether SWBT's local residential markets are open. Of course, "low customer volumes in and of themselves," though highly suggestive of continuing monopoly, may not be conclusive proof, for it is at least theoretically conceivable, as

⁵⁶ Table 2, *supra*.

⁵⁷ *New York 271 Order* ¶14.

⁵⁸ Based on information contained in the Supplemental Affidavit of SWBT witness John S. Habeeb filed in CC Docket No. 00-4 on April 5, 2000, CLECs in Texas provided UNE-P based service to 119,871 residential customers and 83,301 business customers as of February 2000. Supplemental Declaration of A. Daniel Kelley and Steven E. Turner on Behalf of AT&T Corp., Table 2, filed in FCC CC Docket No. 00-65 on April 26, 2000. Accordingly, based on SWBT's own data, about 59% of the UNE-P service in its Texas service territory was provided to residential customers as of February 2000. SWBT now reports that, as of the time of the Commission's June 30, 2000 *Texas 271 Order*, there were 472,249 UNE-P customers in Texas. See SBC Public Affairs Report accessed on April 23, 2001 on SBC's web-site at www.sbc.com/Long-Distance/0,2951,7,00.html. Assuming, about half of these lines served residential customers, yields a total of about 236,000 residential UNE-P customers. On the same web-site, SBC reports there were 983,477 UNE-P customers as of January 2001. Applying the same 50% assumption, yields an estimate of about 491,000 residential UNE-P customers in Texas as of January 2001.

⁵⁹ *DOJ KS/OK Eval.* at 6, n.21 (Dec. 4, 2000) (indicating approximately 950,000 additional UNE-based residential customers as of July 2000).

⁶⁰ See Note 58, *supra*.

the Commission has pointed out, that all CLECs, through the adoption of “individual CLEC entry strategies” (*KS/OK 271 Order* ¶ 268), could have decided independently not to have entered the local residential market in Missouri for reasons unrelated to continuing barriers to entry. But as shown below, “low customer volumes” is only one factor the Commission must consider; other factors leave no doubt that the residential market is not devoid of competition due to CLEC choice, but is closed due to market barriers.

B. The Evidence Of Insufficient Margins Demonstrates That SWBT’s Local Residential Markets Are Closed To Competition.

Another relevant factor is whether, under prevailing UNE rates, competitive entry is economically viable. As the Commission acknowledged in the *Michigan 271 Order*, “efficient competitive entry into the local market is vitally dependent upon appropriate pricing of the checklist items,” (*id.* ¶ 281), and so competitive pricing is obviously “a relevant concern in [the FCC’s] public interest inquiry under section 271(d)(3)(C).” *Id.* ¶ 288. That remains true even where, as assumed *arguendo* here, the Commission has made a finding that UNE rates comply with TELRIC. For the Commission has also made clear that it is prepared to find that a wide range of rates can satisfy TELRIC. Accordingly, where the evidence indicates that UNE rates set at the very upper bound of TELRIC preclude competitors from profitably using UNEs to enter the local market, that fact is clearly relevant to whether the local market is open. In those circumstances, the fact that UNE-based entry is unprofitable need not necessarily entail a review of the applicant’s retail rates, for it would also be open to the BOC and the state commission to set new TELRIC rates at the lower, rather than the upper, reaches of what the Commission’s rules permit

Here, of course, as explained above, SWBT’s Missouri UNE rates are not remotely TELRIC compliant. In fact, its UNE rates for Missouri are among the highest in its five-state region, even though Missouri’s UNE costs are among the lowest. Nevertheless, even if the Commission were to conclude that its TELRIC pricing methodology was elastic enough to accommodate even these Missouri UNE rates, pricing disparities of the type and magnitude present in Missouri simply cannot be ignored. Even relatively small deviations from true forward-looking cost-based prices foreclose widespread competition. *See Clarke Decl.* ¶¶ 5-40.

In this regard, a simple margin analysis confirms that, at current prices, residential UNE-based competition is not viable in Missouri. In three of the four Missouri UNE rate zones, a new competitor would lose money on each residential line it serves, even if its internal costs of running its business are excluded – *i.e.*, new competitors’ gross margins in those zones are *negative*. *See Lieberman Decl.* ¶¶ 18-19. Moreover, statewide average gross margins for UNE-based competitors in Missouri are *negative*. *See id.* In other words, a new entrant attempting to serve customers on a statewide basis in Missouri would earn no money to offset any of its internal costs of running its local services business.⁶¹

The fact that local entry is unprofitable at prevailing UNE rates is, on its face, precisely the sort of “relevant factor” that “would frustrate the congressional intent that markets be open” before interLATA entry is approved, *New York 271 Order* ¶ 423, particularly since it is obvious that local entry “is vitally dependent on appropriate pricing” of UNEs. *Michigan 271 Order* ¶ 281. Contrary to the Commission’s *KS/OK 271 Order*, ¶¶ 92, 281, the inability of

⁶¹ While the gross margins in Missouri are positive in the metro rate zone, the margins are so small that they are inadequate to support UNE-based entry when customer care and other internal costs are considered. *See Decl.* ¶¶ 18-19.

competitors to enter the local markets profitably using UNEs is highly relevant to the public interest determination required by section 271. That will remain true even in cases where the Commission independently and correctly determines that UNE rates are cost-based in accordance with the competitive checklist. Put simply, regardless of a BOC's checklist compliance, if CLECs cannot profitably enter local telephone markets, then those markets, as a practical matter, are not open to competition. Because the fundamental purpose of section 271 is to bar BOC entry until such time as local markets are open to competition, the profitability of entry is necessarily relevant to the public interest.⁶²

The Commission should therefore consider this quantitative analysis demonstrating that even a perfectly efficient CLEC could not profitably compete to provide local residential service in Missouri. This analysis confirms not only that unduly high UNE rates are helping keep CLEC customer-volumes low, but that the local residential market will remain closed to local competition at least until such time as those rates are substantially lowered.

C. Prospects For Facilities-Based And UNE-Based Residential Competition Are Poor.

The obstacles to UNE-based residential competition are particularly important because neither resale nor facilities-based competition is likely to provide a viable source of competition for SWBT in any foreseeable timeframe. Resale is an inherently limited competitive

⁶² The profitability of entry is also relevant to the competitive checklist because the inability for competitors to enter profitably is a strong indication that UNE prices exceed the incumbent's costs, and thus violate the Act and the Commission's pricing rules. While not conclusive proof of a checklist violation, such evidence is grounds for the Commission to conduct a more rigorous, and in all events, an independent determination as to whether the applicant's UNE prices are cost-based. *See, e.g., DOJ KS/OK Eval.* at 2, 10 (lack of residential competition means FCC "should undertake an independent determination whether these prices conform to the requirements of the 1996 Act and the Commission's rules," and "compel a closer look" at whether SWBT's rates "are properly cost-based").

vehicle, for the competitor cannot alter the nature of the service it is reselling, and thus cannot provide competitors with innovative or improved service. And in any case, resale is priced in a manner that precludes its use in all but the most selectively chosen circumstances.⁶³

The prospects for facilities-based competition are no brighter. As noted above, the principal facilities-based provider of local residential service in Missouri (and only such provider, according to a report of the Missouri PSC), is AT&T, and yet AT&T has now agreed to sell its cable assets to a cable company whose current plans do not clearly include providing local residential telephone service. In addition, as reflected in Table 4, many of the facilities-based CLECs that SWBT identifies as its competitors in Missouri,⁶⁴ have gone, or are going, out of business or otherwise in financial distress at the present time. The anemic financial condition of the CLECs will hamper their ability to make the investments necessary to bring facilities-based competition to Missouri. This further underscores the importance of creating a viable, UNE-based path to providing local residential service in Missouri.

⁶³ The avoided cost discount has proved inadequate to provide CLECs a basis for profitable entry for most consumers. For example, as monopolists, the incumbents do not face (and therefor do not “avoid”) the huge customer acquisition costs that CLECs confront, nor do they face the lack of economies of scale that a new entrant must address. And CLECs providing resale do not benefit from access revenue. For all of these reasons, CLECs seeking to provide a broad-based, significant competitive alternative to the incumbents’ local residential monopoly cannot do so through the resale of local service.

⁶⁴ See Tebeau Aff. Table 3. Mr. Tebeau includes both pure facilities-based and UNE-based CLECs within his definition of “facilities-based” CLECs.

TABLE 4: THE CURRENT FINANCIAL STATUS OF FACILITIES-BASED MISSOURI CLECs IDENTIFIED BY SWBT⁶⁵

<u>Facilities-Based Provider</u>	<u>Change in Mkt. Cap.</u>	<u>Current Financial Situation</u>
Allegiance Telecom	-88.66%	Reported a net loss of \$84.1 million (77 cents per share) on revenue of \$95 million for the fourth quarter of 2000
Alltel Communications	-26.10%	Announced on February 15, 2001 plan to eliminate 1,000 positions (3.7% of its workforce) through early retirements and job reductions and reduce the number of operating regions from five to three.
AT&T	-56.11%	Expect a significant decline in revenue from consumer long-distance customers (15% decrease for first-quarter 2001).
Birch Telecom		Laid off 306 employees on February 23, 2001, and 138 on November 13, 2000 (combined, about 28% of its workforce); forced to cancel IPO because of market value decline.
Bluestar Networks		Acquired by Covad Communications in September 2000.
Broadspan (D.b.a. Primary Network), MCG	-94.21%	Eliminated 339 collocations and delayed expansion into Northeast and Northwest markets; EBITDA loss for 2000 was \$154.0 million.
Connect Communications		ConnectSouth ceased operations in February/March 2001.
Covad	-95.96%	Laid off approximately 800 employees in 2000; closed or closing approximately 260 central offices; suspended applications in progress for approximately 500 additional offices.
DSL Net	-90.11%	Expects first quarter negative earnings before interest, taxes, depreciation and amortization of \$18 million to \$19 million; reported on April 2, 2001 that DSL.net expects operating losses and negative cash flows to continue into at least 2002; reported net loss for 2000 of over \$105 million, or \$1.75 per share.
e.spire Communications (ACSI)	-98.48%	Filed for Chapter 11 bankruptcy on March 22, 2001.
Jato		Ceased all operations as of December 31, 2000.
KMC Telecom		Net losses of \$185.6 million for the first six months of 2000.
Level 3	-84.85%	Posted first-quarter 2001 loss of \$535 million on April 18, 2001; laid off 325 employees (6% of workforce) on April 6, 2001.
Maverix		Ceased operations in December 2000.
McLeod USA	-66.60%	
New Edge Networks		Eliminated 135 jobs (about 30% of its workforce), closed three regional offices, and curbed expansion plans in November 2000; eliminated 55 jobs and scaled back broadband DSL coverage area on February 22, 2001.

⁶⁵ Table 4 is derived from Attachment 3 hereto.

NorthPoint	N/A	Operating under Chapter 11 bankruptcy since January 16, 2001; selling substantially all assets to AT&T; laid off over 700 employees on March 30, 2001.
Omniplex Comm. (USA Exchange)		Filed for Chapter 11 bankruptcy as of February 28, 2001.
Prism Communications		Services terminated November 17, 2000.
Rhythms Links	-98.95%	Nasdaq filed a notice to delist its stock; auditor has concluded that company may not have enough cash to continue operating through next year; laid off 450 employees in January 2001.
Sprint Communications, Inc.	-67.13%	Reported 72% drop in earnings for first-quarter 2001.
Teligent, Inc.	-98.95%	Auditors concerned that it may be unable to continue operating as a "going concern"; posted fourth-quarter 2000 net loss of \$270.7 million; fired 200 employees in February 2001; laid off 780 employees (22% of workforce) in November 2000.
Vectris Communications		Filed for Chapter 11 bankruptcy on January 18, 2001; plans to discontinue all services in Michigan, Wisconsin, Ohio, Oklahoma, Missouri, Kansas and Arkansas, as well as parts of Illinois, Indiana and Texas.
Williams Local Network	-87.03%	Williams Communications Group reported \$546.6 million net loss for fourth-quarter 2001.
Winstar	-99.69%	Filed for Chapter 11 bankruptcy on April 18, 2001.
WorldCom Technologies	-60.20%	Laid off 6,000 employees (6-7% of workforce) in February 2001; expects 2001 capital expenditures to be lower than expected; says its depressed stock price prevents new acquisitions.
XO/Nextlink	-92.17%	Informed the SEC that its operations do not generate cash flows, and are not expected to do so in the near future, and that for each period since it was formed, it had substantial and increasing net losses and negative cash flow from operations.

D. The TPUC's Report Demonstrates That It Is Not In The Public Interest To Grant SWBT's Application For Missouri At This Time.

SWBT is well aware that it continues exclusively to provide local service to virtually the entire residential market in Missouri. And SWBT is also well aware that it faces no significant prospect of local residential competition in the foreseeable future. To make its showing under the public interest test, SWBT relies principally on two arguments. It claims first that it is entitled to a presumption that its entry will serve the public interest, and then argues that

the evolution of competition in Texas since its application there was granted confirms the wisdom of such a presumption.⁶⁶

Neither argument has merit. The presumption that SWBT seeks is foreclosed by the statute itself. And SWBT's reliance on Texas is wholly undermined by the recent report of the Texas PUC, which vividly confirms the importance of not granting SWBT's Missouri application until SWBT's local markets are open to competition. Remarkably, nowhere in its lengthy discussion of telecommunications competition in Texas does SWBT even mention the *TPUC Report*.

1. SWBT Is Not Entitled To Any Presumption That Long Distance Entry Will Serve The Public Interest.

As a threshold matter, SWBT asserts that “the benefits of new entry long distance *presumptively* outweigh any risk of harm.” SWBT Br. 86 (emphasis in original). In SWBT's view, the Commission should presume that the public interest will be served by granting SWBT's application, because (in SWBT's view) such approval will spur competitors to enter the local market.

Any such presumption would conflict with the plain language of the statute, which puts the burden on the applicant to show that its entry would be “consistent with the public interest.” *See Michigan 271 Order* ¶ 43 (“Section 271 places on the applicant the burden of proving that all of the requirements for authorization to provide in-region, interLATA services are satisfied”). Indeed, the Commission has flatly rejected the argument that the public interest test can be satisfied by simply presuming that the benefits of additional entry into long distance will outweigh competitive harms arising from premature authorization:

⁶⁶ *See, e.g.*, SWBT Br. i-ii, v, 86-92.

As we have previously observed, ‘the entry of the BOC interLATA affiliates into the provision of interLATA services has the potential to increase price competition and lead to innovative new services and marketing efficiencies.’ Section 271, however, embodies a congressional determination that, in order for this potential to become a reality, local telecommunications markets must first be open to competition so that a BOC cannot use its control over bottleneck local exchange facilities to undermine competition in the long distance market. Only then is the other congressional intention of creating an incentive or reward for opening the local exchange market met.

Id. at ¶ 388.

The reason that SWBT is now attempting to revive a previously rejected presumption is clear: SWBT cannot possibly defend the benefits of premature long distance entry on the merits. Indeed, when a careful look is given to the state of local competition in Texas, the lesson for the public interest is clear: approving a section 271 application before local markets are open will not provoke successful local competition. If CLECs cannot profitably offer local residential service to customers, they cannot and will not effectively compete in the local market. As the Texas experience shows, that is true regardless of whether the incumbent has obtained long-distance authorization.

2. The TPUC Local Competition Report Confirms Congress’s Judgment That Approving A Section 271 Application Before Local Markets Are Open Will Not Produce Successful Local Competition.

The rosy picture that SWBT paints of flourishing local competition in Texas stands in stark contrast to the January 2001 *TPUC Report* on the “Scope of Competition in Telecommunications Markets of Texas” (Attachment 1). In a nutshell, that report reveals that:

- “monopoly power exists . . . in residential and rural markets in Texas” (*id.* at 83; *see* xiii);
- severe financial problems have caused both large and small CLECs to reduce or eliminate their residential service in Texas (*id.* at 55-58, 80-81);

- this lack of competition has permitted SWBT to extend its monopoly into the provision of bundled combinations of local and long distance services, and to *raise* its prices for local services to both residential and business customers (*id.* at x, 62-64, 79, 81),⁶⁷ and, given this monopoly power,
- “residential and rural customers are better served by existing price cap regulation of traditional nonbasic local service until more viable and sustainable competitive choices become available to them.”⁶⁸

To begin with, the TPUC Report presents a grim picture of the prospects for local competition in Texas. Although SWBT trumpets the alleged competition currently being provided by, in particular, AT&T (SWBT Br. at 89, 91-92), WorldCom (*id.* at 89, 92) and Sprint (*id.* at 92), the *TPUC Report* describes in detail how all three companies have recently have *reduced* their presence in residential voice markets in Texas and de-emphasized local exchange service in the State. *TPUC Report* at 58-61. The *TPUC Report* also describes in detail how market recognition of the continuing barriers to profitable CLEC service have caused many of those competitors to reduce or eliminate their residential service in Texas. *Id.* at 56-57 (“four CLECs that once had a capitalization . . . [of] \$800 million or more in 1998 or 1999 — Covad, ICG, Rhythms, and Teligent — saw their share prices fall more than 95 percent from their 2000 peaks. In contrast, the stock price of the leading ILEC in Texas, Southwestern Bell, was less than 10 percent off its peak in 2000”).

The *TPUC Report* also counters SWBT’s claims that telecommunications prices are falling in Texas. The TPUC describes instead how declining competition from CLECs has permitted SWBT to *raise* its prices for local services to both residential and business customers:

SWBT has significantly increased the prices for a number of nonbasic services, often services that are very popular and for

⁶⁷ As described below, SWBT has also recently raised its rates for long distance service.

⁶⁸ *Id.* at ix.

which competitive alternatives are very limited. In September of 1999, SWBT raised prices on some of its more popular business call-management services in a range of approximately 6% to 42%. In November of 1999, SWBT increased the price of a business extra directory listing by 107% from \$1.45 to \$3.00. In June of 2000, SWBT increased its monthly rates for residential Caller ID services (caller ID name-or-number and caller ID name-and-number, both of which are very popular in Texas) in a range of 22% to 30%. SWBT also raised the following rates: (1) for per-use three-way calling, from \$75 to \$.95, with the \$6.00 monthly cap eliminated; (2) for call return, from \$.50 to \$.95 per use, while eliminating the \$4.00 monthly cap; and (3) for residential call blocker and residential auto redial, from \$2.00 to \$3.00 each per month. In late 2000, SWBT raised its analog private-line rates by an average of 15%.

Id. at 62-63; *see also id.* at 79.⁶⁹

Finally, while SWBT repeatedly boasts about the numbers of long distance customers it has added in Texas, the TPUC's Report makes clear that this phenomenon reflects the fact SWBT has begun to extend its monopoly in the provision of residential services into the provision of "bundled" combinations of local and long distance services:

Because Southwestern Bell can now compete for long distance customers in Texas, the company has made a strong push in 2000 to bundle its offerings to provide residential customers with various options for 'one-stop shopping.' . . . Southwestern Bell also gained a sizeable portion of the long distance market just months after offering long distance service for the first time. Southwestern Bell's largest and strongest competitors have not been offering substantial competition in vertical services or in bundling local residential services with long distance or other services and have lost market share in long distance service.

Id. at x.⁷⁰

⁶⁹ The declining competition from CLECs in Texas and elsewhere has also permitted ILECs to slow down their roll-outs of DSL services. "CLEC Aftermath: Will DSL Become Another BOC Monopoly As Competitive Carriers Die Out," *America's Network*, at 34 (April 1, 2001).

In sum:

By the end of 2000, SWBT's financial position had strengthened relative to the CLECs. SWBT's entry into the long distance market has weakened the ability of CLECs to challenge SWBT in local voice service. Without investor confidence and funding, in the near term CLECs might pose a weaker challenge to SWBT for local wireline voice telephony or in the "one-stop" shopping market than they did in 1998 and 1999. The Commission has noted that in 2000 SWBT raised its prices on a number of vertical services and was successful in rapidly gaining market share in the long distance market, even though it was offering interLATA long distance to only customers who had SWBT as an ILEC.

Id. at 81.

Moreover, there is at least one other highly significant event in Texas that SWBT has neglected to mention. Emboldened by its ability to market bundles of local and long distance services without any competition, in February, 2001, SWBT raised its residential long distance rates in Texas by 10 to 33 percent. SWBT increased its basic rates for long-distance service by more than 10 percent.⁷¹ SWBT also increased the "discounted rate" for customers who buy other services from SWBT by 33 percent.⁷² The rate increase "highlights the fact that SWBT feels like they are in control and they can set the price," said an analyst with Deutsche Banc Alex.

⁷⁰ See also *id.* at 79 ("SB 560 also granted SWBT the ability to competitively bundle its products. An important additional piece in SWBT's 'one-stop' shopping strategy was SWBT's receiving a favorable recommendation from the Commission on its Section 271 application, leading to FCC approval for SWBT to offer long distance service in Texas in the second half of 2000. SWBT at present has very limited competition in providing bundled services in Texas").

⁷¹ "SWBT Raises Nonlocal Call Rates: Company Says Prices Better Reflect Costs," *The Dallas Morning News*, February 2, 2001.

⁷² *Id.*