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FEDERAL COMMUNICATIONS COMMISSION
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Ex Parte Notice

July 9, 2001

Ms. Magalie Roman Salas
Secretary
Federal Communications Commission
445 12th Street, SW – TWB-204
Washington, DC 20554

Dear Ms. Salas:

Re: Use of Unbundled Network Elements to Provide Exchange Access Service, CC Docket No. 96-98

Joint Petition of BellSouth, SBC and Verizon
CC Docket No. 96-98

On June 19, 2001 Steve Brodeur and Ken Martinian of CSMG met with Common Carrier Bureau ("CCB") staff to discuss the CLEC Network Extension Cost Model used in the *Crandall Reply Declaration* filed with USTA's reply comments on April 30, 2001. Attached is a written response to questions raised by the CCB's staff during the June 19 *ex parte* presentation by CSMG.

Should you have any questions regarding this filing please contact the undersigned counsel for USTA at (202) 326-7371.

Sincerely,

Keith Townsend

Keith Townsend
Director Legal and Regulatory Affairs
& Senior Counsel

cc: (See attached)

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Regarding Discussion with the FCC on June 19, 2001-

The FCC asked CSMG to provide further analysis on three issues during the June 19, 2001 discussion: 1) terminal value EBITDA multiples based upon market data; 2) trenching costs over time; and 3) AT&T's discussion in its June 11, 2001 comment on the requirement of additional multiplexing equipment on the existing network.

I. In regard to CSMG's use of a terminal value in its CLEC fiber extension cost model, the FCC inquired as to market evidence of valuations to benchmark the CSMG assumption. CSMG uses the conservative terminal value of a 10x EBITDA multiple, which is at the low end of the standard range in the industry. CSMG has consistently used higher values, usually between 12x and 18x EBITDA multiple valuations for both its CLEC clients as well as its private equity clients evaluating whether to invest in CLECs. Although valuations vary widely from firm to firm and with the business cycle, the CSMG assumption appears to be conservative, even in the current market environment.

Past EBITDA Multiple Valuations. During 2000, there were many CLEC acquisitions that provide insight into valuations when the market was still very strong. Because most of the acquisitions were of CLECs without positive EBITDA and were instead based on revenue multiples, CSMG has applied a modest 20% EBITDA as a percent of revenue assumption to these acquisitions (implied EBITDA multiple). In January of 2000, NEXTLINK acquired Concentric Network at an implied EBITDA multiple of 41x. In February of 2000, SBC acquired Sterling Commerce at an implied EBITDA multiple of 35x. In February of 2000, Global Crossing acquired IXnet at an implied EBITDA multiple of 169x. In February of 2000, Global Crossing acquired IPC at an implied EBITDA multiple of 117x. In April of 2000, McLeodUSA acquired Splitrock Services at an implied EBITDA multiple of 68x. In April of 2000, CoreComm acquired ATX at an implied EBITDA multiple of 25x. In May of 2000, Choice One acquired US Xchange at an implied EBITDA multiple of 98x. In August of 2000, Time Warner Telecom acquired GST at an implied EBITDA multiple of 10x. In October of 2000, McLeodUSA acquired CapRock at an implied EBITDA multiple of 11x. In December of 2000, Hughes acquired Telocity at an implied EBITDA multiple of 257x. The average implied EBITDA multiple valuation of these ten acquisitions was 83x.

Current EBITDA Multiple Valuations. While CLEC valuations by the capital markets are currently depressed, the CSMG assumption is still conservative when compared against the few CLECs with currently positive EBITDA. CSMG examined a set of 40 public CLECs and found only seven are currently EBITDA positive. The average current EBITDA multiple valuation (on June 19, 2001) for these seven CLECs is 17.8x. *Future EBITDA Multiple Valuations.* In January of 2001, Morgan Stanley Dean Witter issued a CLEC industry report, which forecasts EBITDA multiple valuations for four CLECs in 2003 as representative of the CLEC industry as a whole: XO Communications – 38x, McLeodUSA – 17x, CTC Communications – 13x, and Net2000 Communications – 6x.

II. The FCC staff noted that AT&T believed CSMG's trenching cost estimates were too low, citing costs adopted by the Commission in 1998 for use in its universal service model. In fact, applying the FCC's analysis from the universal service model to the actual cities in question shows that the CSMG cost estimates are actually very conservative. CSMG arrived at much higher trenching costs estimates via a different method from the FCC's universal service model. Whereas the FCC method is to estimate costs based on line density and terrain type, CSMG discussed trenching costs with contractors and city officials, and based upon their experience, CSMG was able to estimate a cost for each specific city.

CSMG has applied the FCC's calculation method to the cities used in the cost study, summarized as follows:

Comparison of Trenching Costs by CSMG and FCC Calculation Methods*

City (Central Business District)	Line Density (Residential and Business Combined)	FCC Estimated Costs per foot**	CSMG Estimated Costs per foot***	CSMG Estimate Relative to FCC Estimate
Akron	1455	$11.90	$22.66	190%
Cleveland	3423	$16.60	$30.94	186%
Dayton	1803	$11.90	$19.21	161%
Greenville	531	$9.22	$18.36	199%
St Paul	3848	$16.60	$25.64	154%
Seattle	4637	$16.60	$31.57	190%
Tucson	405	$9.22	$21.90	237%
Low		$9.22	$18.36	199%
High		$16.60	$31.57	190%
Average		$12.77	$23.80	186%

*Assumes the following terrain composition for each city: Normal: 49.15%, Softrock: 49.15%, Hardrock: 1.7%, based on analysis of CBGs used by the FCC Model showing 1.7% of the 223,322 CBGs have hardrock terrain, and assuming an even split between normal and softrock terrains. CSMG performed a sensitivity analysis on these weighting percentages and found that even assuming an equal mix of all three terrains, CSMG's costs are still higher in general

**Structure calculation includes conduit cost

***CSMG has added a $1.28 per foot conduit cost to its trenching costs for comparison with FCC estimates

The table shows that for all of the cities, the CSMG cost used is actually well above the range yielded by the FCC analysis. On average, CSMG's cost estimates are roughly double those from the FCC's analysis. Furthermore, because the density of a city represents the central business district (CBD), and these areas are likely to be "on-net", one could expect actual costs to be lower as laterals are expanded beyond the CBD.

AT&T apparently misinterprets the range of trenching costs displayed in the FCC density-terrain table as representative of the typical costs across the US. In fact, an application of the FCC methodology to all US cities shows that only about 1.1% of all US cities would see trenching

costs higher than $17 per foot. The majority of these higher cost cities are for the densest parts of New York, Chicago, and Los Angeles. The results of this analysis are as follows:

Estimated Distribution of Trenching Costs per foot for All US Cities
(N=12,380 Cities)

Line Density Range	FCC Weighted Average Cost per foot*	Percent of All US Cities in Density Range
0 to 5	$3.92	11.67%
5 to 100	$3.92	58.82%
100 to 200	$8.48	10.77%
200 to 650	$9.22	9.62%
650 to 850	$10.11	1.53%
850 to 2,550	$11.90	4.50%
2,550 to 5,000	$16.60	1.95%
5,000 to 10,000	$33.75	0.74%
Over 10,000	$52.58	0.40%
Average Weighted Cost for All US Cities:		$6.03

*Assumes the following terrain composition for each city: Normal: 49.15%, Softrock: 49.15%, Hardrock: 1.7%, based on analysis of CBGs used by the FCC Model showing 1.7% of the 223,322 CBGs have hardrock terrain, and assuming an even split between normal and softrock terrains

If the CSMG trenching cost estimates were substantially lower than actual costs, one would expect the total cost per mile of building a lateral, with all the labor and equipment costs involved, to be less than industry benchmarks. In fact, when the total capex cost of the lateral is examined at the fiber distance of one mile, the CSMG results fall within ubiquitous industry benchmarks. CSMG regularly works with clients that budget $100,000 to $200,000 per mile for their 100% underground fiber lateral builds. Multiple articles cite this range as well. The CSMG model calculates the total fiber lateral capex requirements per mile (mixed underground and aerial) for the specific markets studied as follows: Cleveland: $183,000; Dayton: $135,000; Greenville: $113,000; St. Paul: $171,000; Seattle: $199,000; and Tucson: $128,000 (rounded to the nearest thousand).

Additionally, contractors interviewed by CSMG noted that trenching costs had come down in recent months as competition for fewer contracts has heated up. A recent article in the Wall Street Journal sheds even more light on the trenching industry. MICHAEL SELZ, THE WALL STREET JOURNAL, 6/19/01. Arguss Is Digging Its Way Out of Telecom Downturn. The article describes how prices for trenching costs have come down as CLECs are laying less fiber compared to last year given current market conditions. Because the supply of trenchers swelled over the last few years to address the booming demand, there is currently over-supply in the market. This has driven prices down. Notwithstanding the recent costs declines, CSMG's cost estimates are still considerably higher than the FCC's.

III. The FCC raised an issue that AT&T had discussed in its June 11, 2001 comment on the requirement of additional multiplexing equipment on the existing network. AT&T states that splicing off of an existing network requires a multiplexor at the point of the splice. CSMG used the assumption that the CLEC would dedicate an entire strand to the building in its cost model and that there was no need to add multiplexing equipment in addition to the splice box at every splice. In fact, CLECs usually have hundreds of strands available in the existing network as they usually build their networks with 432 or more strands per cable; enough to dedicate a whole strand to hundreds of individual buildings. Furthermore, in practice, a CLEC would use a ring topology and dedicate a whole strand to all the buildings on that ring, thereby spreading the use of one strand across many buildings. CSMG, however, used the conservative assumption that each building would have its own lateral as opposed to utilizing the potential synergies in a ring deployment. Assuming a CLEC was unable to dedicate a whole strand for a lateral or a ring, the additional cost required to add appropriate multiplexing functionality on the network would be minimal. In general, CLECs design their network topology as to optimize the assets deployed. With regard to splicing off of an existing network, there are many ways in which a CLEC can gain synergies from deployed multiplexors. There are at least four methods a CLEC may use to gain these synergies: 1) the CLEC may use the multiplexor in the building off of the lateral itself; 2) the CLEC may use the multiplexor in an on-net building as a hub from which to build laterals; 3) by using a building cluster strategy, the CLEC can spread the cost of a multiplexor across many buildings; and 4) the CLEC can use the existing multiplexor functionality on the network at various points. The last strategy may increase the fiber distance of the lateral depending on the distance between the existing multiplexors on the network. The CSMG cost model, however, calculates costs according to fiber distance and makes no assumptions about the optimal path for a lateral between the existing network and the off-net building.