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August 29, 2001

Ms. Magalie R. Salas
Secretary
Federal Communications Commission
445 12th Street, SW
Washington, DC 20554

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

Re: *Ex Parte* Communication in CC Docket No. 96-98

Dear Ms. Salas:

To supplement the record in this proceeding on the circumstances in which CLECs are impaired in their ability to offer telecommunications services to small business customers without access to unbundled ILEC switching as part of the UNE-platform, WorldCom, Inc. ("WorldCom") provides market information presented by neutral market observers on the telecommunications needs of small business customers and on the small business customers targeted by Allegiance, a CLEC that uses its own switches to selectively serve small business customers.

A small business survey by the Yankee Group found that many, if not most, small business customers (and the vast majority of very small business customers) require less than T-1 service. WorldCom urges the Commission to consider this key market information when determining the scope of unbundled ILEC switching availability (for UNE-platform) because that scope will heavily impact whether competition will advance for this important market segment.

Recent Wall Street analyst reports indicate that the focus of Allegiance's business plan is to deploy HDSL2 technology as a substitute for T-1 service. These market data reinforce WorldCom's position that CLECs are not serving small business customers seeking less than T-1 service because CLECs are impaired in their ability to serve these customers using their own switches.

Yankee Group's Small and Medium Business Communications Services Survey, May 2001¹

The Yankee Group performs an annual survey of very small businesses (2-19 employees), small businesses (20-99 employees), and medium-sized businesses (100 to 499 employees). Its May 2001 Survey, with responses from 250 very small, 263 small, and 286 medium-sized

¹ Yankee Group, *Small and Medium Business Communications, Communications Services Survey 2001*, May 2001.

business, provides useful information on the number and distribution of telephone lines that these firms have. Attachment 1 presents the summary data for the responses to the question: “How many telephone lines do you have?”

The Yankee Group survey shows that many, if not most small businesses do not have sufficient demand for telecommunications services to justify purchase of T-1 or equivalent service.

- the *median* number of telephone lines for very small businesses is 3, for small businesses is 7, and for medium-sized businesses is 18. For all three categories, i.e., for all businesses with fewer than 500 employees, the median number of telephone lines is 7.²
- *more than two-thirds of very small businesses have four or fewer lines*; almost 90 percent have nine or fewer lines. Among small businesses, more than one-fourth have four or fewer lines; more than half have nine or fewer lines; more than 80 percent have 20 or fewer lines. Even among medium-sized businesses, almost 10 percent have four or fewer lines; more than a quarter have nine or fewer lines; more than half have 20 or fewer lines.
- Among very small, small, and medium-sized businesses, more than three quarters have 20 or fewer lines.

No matter how the Commission identifies the line count at which it becomes economically feasible to cross-over to T-1 service – whether its as low as 7 or as high as 20 – the Yankee Group survey data suggest that more than half of the businesses with under 500 employees are unlikely to seek, or to be efficiently served by, T-1 service.

Analyst Reports on Allegiance’s Target Customers

Allegiance claims that it uses its own switches to serve many small business customers who have only a few telephone lines and thus require less than T-1 service. It has never responded, however, to the analysis that WorldCom has submitted in this docket³ describing how Allegiance only selectively serves small business customers. Allegiance does not offer service to most small businesses and has no plans to do so in the future.

² Since the proportion of medium-sized firms in the Yankee Group survey sample is larger than the portion of medium-sized firms that exist in the overall business population of very small, small, and medium-sized business firms, these results overstate the median number of telephone lines.

³ *Ex parte* letter to Magalie Roman Salas, Secretary, FCC, from Chuck Goldfarb, Director, Law and Public Policy, WorldCom, Inc., dated March 2, 2001.

Equally important, Wall Street values Allegiance's business plan specifically because the plan selectively targets those small business customers that have relatively large telecommunications needs. Recent analyst reports have focused on Allegiance's plan to deploy HDSL2 technology to serve as a substitute for T-1 lines:

William Blair & Company (report dated 6/29/01)⁴

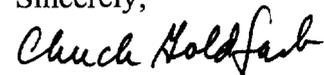
- Blair focuses its analysis on the Allegiance strategy of serving customers "using its high-bit-rate digital subscriber line (HDSL2) technology. HDSL2 equipment currently is deployed in most of the company's central office collocations and will be in all 850 collocations by year-end. Similar to a T-1 circuit, an HDSL2 connection allows the company to provide up to 24 voice and/or data lines over one copper loop." Blair's analysis assumes a customer needs 10 phone lines and both voice and data capabilities – which it takes as Allegiance's target customer. (at p. 13)

Fitch IBCA, Duff & Phelps (report dated 7/10/01)⁵

- According to Fitch, "The company's fastest growing product is its integrated access product, which includes at least eight line provisioned using HDSL2 for voice and data and dedicated access and collocated and dedicated Web hosting." (at p. 2.) Allegiance's "target customer typically has 6-12 lines." (at p. 3) "When serving customers with typically 8-12 lines, the company is utilizing HDSL2 instead of UNE-T1s in the last mile.... Currently, the majority of its lines are UNE loops. This will likely change since the company has been equipping its colos for HDSL2. At March 2001, better than 75% of its colos were HDSL2-equipped." (at p. 3)

Neither Allegiance in its filing with the SEC nor the various Wall Street analysts identify CLEC access to UNE-platform for the provision of service to small business customers as a risk to Allegiance. This is not surprising since Allegiance's business plan does not focus on serving the small business customers who would be served by UNE-platform.

Sincerely,



Chuck Goldfarb
Director
Law and Public Policy

⁴ William Blair & Company, Allegiance Telecom, Inc. Basic Report, June 29, 2001, 37 pp.

⁵ Fitch IBCA, Duff & Phelps, Allegiance Telecom, Inc. Telecom Credit Analysis, July 10, 2001, 6pp.

cc. Dorothy Attwood
Jeff Carlisle
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Michelle Carey
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Attachment 1

YANKEE GROUP SMALL AND MEDIUM BUSINESS
COMMUNICATIONS SERVICES SURVEY, MAY 2001
NUMBER OF TELEPHONE LINES
VERY SMALL, SMALL, AND MEDIUM BUSINESSES

# Lines	Very Small (2-19 empl) N = 250	Small (20-99 empl) N = 263	Medium (100-499 empl) N = 286	Total N = 799
None	0 (0.0%)	2 (0.8%)	7 (2.4%)	9 (1.1%)
1 - 2	83 (33.2%)	17 (6.5%)	13 (4.5%)	113 (14.1%)
3 - 4	88 (35.2%)	50 (19.0%)	13 (4.5%)	151 (18.9%)
5 - 6	36 (14.4%)	49 (18.6%)	26 (9.1%)	111 (13.9%)
7 - 9	14 (5.6%)	37 (14.1%)	22 (7.7%)	73 (9.1%)
10 - 15	17 (6.8%)	40 (15.2%)	50 (17.5%)	107 (13.4%)
16 - 20	4 (1.6%)	18 (6.8%)	17 (5.9%)	39 (4.9%)
21 - 49	3 (1.2%)	30 (11.4%)	55 (19.2%)	88 (11.0%)
50 - 100	2 (0.8%)	10 (3.8%)	35 (12.2%)	47 (5.9%)
> 100	2 (0.8%)	2 (0.8%)	35 (12.2%)	39 (4.9%)
Don't know/ refused	1 (0.4%)	8 (3.0%)	13 (4.5%)	22 (2.8%)
MEAN	7.6	14.7	61.9	61.9
MEDIAN	3.0	7.0	18.0	7.0