Before the
Federal Communications Commission
Washington, D.C. 20554

In the Matter of

Review of Regulatory Requirements for	)	
Incumbent LEC Broadband	)	CC Docket No. 01-337
Telecommunications Services	)	

COMMENTS OF AD HOC TELECOMMUNICATIONS USERS COMMITTEE

Lee L. Selwyn
Douglas S. Williams
Economics and Technology, Inc.
Two Center Plaza, Suite 400
Boston, MA 02108-1906
617-227-0900

Economic Consultants

Colleen Boothby
Levine, Blaszak, Block & Boothby, LLP
2001 L Street, N.W., Suite 900
Washington, D.C. 20036
202-857-2550

Counsel for
Ad Hoc Telecommunications
Users Committee

March 1, 2002

TABLE OF CONTENTS

SUMMARY i
INTRODUCTION 1
DISCUSSION 5
I. DEFINING THE MARKET FOR BUSINESS SERVICES 6
A. The Broadband Business Services Market Is A Separate Market That Includes Low-Volume Business Locations 6
B. The Commission Must Eliminate Ambiguity In Its Definition Of "Broadband Services" 9
II. THE STATE OF COMPETITION IN THE BROADBAND BUSINESS MARKET DOES NOT JUSTIFY REGULATORY FLEXIBILITY AT THIS TIME 10
A. ILEC Price Increases In Response To Pricing Flexibility Demonstrate The Dearth Of Competition For Broadband Business Services 11
B. The Market Experience of Ad Hoc Committee Members Demonstrates That Competitive Alternatives Are Not Available For Most Broadband Business Service Requirements. 14
C. Cable Modem Service Is Not A Source Of Intermodal Competition For Business Users 17
D. The Development Of Effective Competition From CLEC Services In The Future Is At Risk. 19
E. ILECs Have Not Been A Source Of Competition In Each Other's Markets 20
III. REGULATORY SOLUTIONS TO THE FADING PROMISE OF COMPETITION. 21
A. The Commission Cannot Unreasonably Compromise Other Statutory Objectives In Order to Encourage Broadband Deployment 22
B. The Problem in Business Markets Is Not Deployment But *Competitive* Deployment 22
C. The Commission Should Use The Interstate Interexchange Regulatory Model For Transitioning To A Competitive Broadband Business Services Market 25
CONCLUSION 27

SUMMARY

Ad Hoc's interest in this proceeding is in the competitive provisioning of broadband business services. Because of the significant differences between broadband business services and residential broadband services in terms of available competitive suppliers, potential competition, geographic coverage, and customer characteristics, the Commission must treat the broadband business services market as a separate market from the residential broadband services market.

For a variety of reasons, the broadband business services market is not yet sufficiently competitive to discipline prices and ensure adequate service quality. Therefore, the FCC cannot abdicate its statutory responsibility to protect customers from unjust and unreasonable rates, terms, and conditions by summarily de-regulating the broadband business services market and allowing incumbent local exchange carriers ("ILECs") to exploit their considerable market power.

Moreover, the Commission's existing regime of pricing flexibility for special access services has proven to be premature because of the failure of competition to develop as the Commission had hoped when it adopted that regime for special access services. The ILECs have used the pricing flexibility granted to them under the existing rules to raise prices, confirming that significant countervailing competitive forces that could discipline market prices have simply failed to emerge.

Accordingly, the Commission must not only continue regulation of the broadband business services market but it must re-visit and re-tool its regulatory regime for that market to reflect current competitive realities. In particular, the Commission should re-impose its “price caps”/incentive regulation to ensure just and reasonable prices in the broadband business services market. In addition, the Commission should enforce the non-discrimination, pricing, and tariffing requirements in Sections 201, 202, and 203 of the Act and require the ILECs to make their telecommunications services available to end users, competitors, and information service providers on a stand-alone basis, unbundled from information services or other unregulated services, particularly those telecommunications services used by the ILEC in the provision of its unregulated services.

Before the
Federal Communications Commission
Washington, D.C. 20554

In the Matter of

Review of Regulatory Requirements for	)	
Incumbent LEC Broadband	)	CC Docket No. 01-3337
Telecommunications Services	)	

COMMENTS OF AD HOC TELECOMMUNICATIONS USERS COMMITTEE

The Ad Hoc Telecommunications Users Committee (the "Ad Hoc Committee") submits these Comments pursuant to the Notice of Proposed Rulemaking ("*Notice*" or "*NPRM*") in the above-referenced docket.[1] For the reasons set forth below, the Commission should conclude that the level of competition in the broadband business services market is insufficient to justify deregulation of the broadband services used by business customers.

INTRODUCTION

In this proceeding, the Commission is re-visiting the regulatory requirements for the ILECs domestic broadband telecommunications services. The Commission is seeking a regulatory regime that will serve its objectives of (1) encouraging broadband investment and deployment; (2) fostering competition

[1] *Review of Regulatory Requirements for Incumbent LEC Broadband Telecommunications Services*, CC Dkt. No. 01-337, Notice of Proposed Rulemaking, FCC 01-360 (rel. December 20, 2001), 2001 FCC LEXIS 6852 ("*Notice*").

in the provision of broadband services; (3) promoting innovation; and (4) eliminating unnecessary regulation.[2]

As a general matter, the Commission has requested comment on three issues: (1) "the nature and scope of the market for domestic broadband services;" (2) "the relevant market dynamics – including intermodal competition and the nascent stage of market development for residential broadband services – affecting the provision of domestic broadband services;" and (3) "the appropriate regulatory requirements under Title II of the Act for the provision of broadband services by incumbent LECs given current market conditions."[3]

The Commission must proceed with extreme caution in its efforts to promote the deployment of broadband business services through de-regulation. While the incumbent local exchange carriers ("ILECs") understandably support deregulation as the lynchpin for stimulating investment in broadband-capable infrastructure, a variety of factors indicate that competition in the provision of broadband business services is insufficient to discipline the ILECs if the FCC abandons the regulatory field.

First, as described in the paragraphs that follow, there is scant evidence that the market for broadband business services is in fact competitive, and abundant evidence that it is not. For example, where the FCC has granted pricing flexibility to ILEC's for interstate special access services, based on evidence of some competitive presence, the ILECs have *increased* their prices, indicating that effective competition in those markets has not yet evolved.

---

[2] *Notice*, at ¶ 7.

Moreover, Ad Hoc Committee members report that, in the overwhelming majority of the approximately 30,000 locations at which they require broadband business services, they have few, if any, competitive alternatives to the ILECs. Finally, the general downturn in the capital markets for competitive local exchange carriers ("CLECs") over the past two years, coupled with the recent flood of CLEC bankruptcies and applications to discontinue service, indicate that competition in the market for broadband business services is stunted today and unlikely to thrive in the near future.

Any de-regulatory action the Commission takes with respect to broadband services must carefully distinguish between markets with differing competitive characteristics. Broadband services in residential areas may or may not be competitive as a result of the broadband services provided by cable systems. But the vast majority of broadband *business* service customers are not located in residential areas nor do cable systems typically provide service in business districts. Thus, any conclusions the Commission reaches with respect to broadband services in residential markets have no necessary application to the broadband business services market.

Moreover, no simple demarcation between the "mass market" and the "larger business market" would be adequate to capture these competitive differences since neither of those categories would capture the service needs and practical economic considerations faced by the many low-volume service locations at which large and technically sophisticated business users obtain

---

[3] *Notice*, at ¶ 7.

broadband services. Those locations require higher levels of security and reliability than that available via the broadband service typically provided to residential customers. Thus, the current slate of supposed "mass market" services – including xDSL bundled with Internet access, cable modem, satellite data services, and wireless broadband – does not address business user needs, even if the low-volume business site is located where lower capacity residential services are available.

Of more fundamental concern to business users, the *Notice* evidences an apparent underlying belief that ILEC deployment decisions can be driven solely by changes in regulatory policies and without regard to market forces in the broadband marketplace. Certainly the ILECs' deployment decisions can be heavily influenced by the FCC's regulations. But carriers have an incentive to deploy broadband services and facilities only when two forces coincide: competitive pressure and consumer demand. Of the two, consumer demand is the key. In the absence of demand for a particular service, neither the presence of potential competitors nor de-regulation will necessarily stimulate facility investment by an ILEC. Since current market data confirms that consumer demand for broadband services is low and slowing – even where advanced services are deployed and even where they are deployed in response to competitive pressure from cable providers or one of the rapidly dwindling pool of CLECs – the Commission's concerns regarding the need to stimulate broadband deployment appear to be premature.[4]

---

[4] A variety of reports and public statements from government sources, academia, and even the CEO of an ILEC have been released over the past several weeks regarding broadband

The Commission should resist attempts to establish an industrial policy that forces broadband services down the throats (and pocketbooks) of reluctant consumers. Instead, the FCC should defer to consumer preferences, minimize its regulatory intrusion into the marketplace, and allow marketplace forces – consumer demand and the emergence of competition -- to ensure adequate deployment of broadband business services. But where, as is true of the broadband business services market, competition is too weak to protect consumers from unjust and unreasonable rates, terms, and conditions, the Commission cannot shirk its statutory responsibility to regulate those rates, terms, and conditions.

DISCUSSION

As explained below, the broadband business services market on the whole is not sufficiently competitive to discipline the ILECs' exercise of their market power. Absent competition, the FCC cannot abdicate its responsibility to protect business customers from supra-competitive rates by summarily de-regulating broadband business services in order to stimulate additional deployment of broadband facilities, particularly when there is no under-deployment of facilities in business services markets. The Commission must

---

services, and each has a common denominator: even where broadband services are available, consumer demand is low. *See* "A Nation Online: How Americans Are Expanding Their Use of the Internet," issued by the U.S. Department of Commerce on February 5, 2002, TR Daily, February 5, 2002; "Broadband Success Requires More Than Regulatory Clearance, Says Research," available at www.clec-planet.com/news/02feb2002/18broadband.html, accessed February 25, 2002; "Verizon CEO "Once Again Tells Congress, 'Watch What We Say, Not What We Do,' " February 1, 2002, available at www.voicesforchoices.com/1091/wrapper.jsp?PID=1091-23&CID=1091-020102A, accessed February 27, 2002.

instead adapt its regulatory regime to the competitive realities of the broadband business services market and protect the interests of consumers.

I. DEFINING THE MARKET FOR BUSINESS SERVICES

A. The Broadband Business Services Market Is A Separate Market That Includes Low-Volume Business Locations

In addressing the nature of the markets for broadband services, the Commission seeks comment not simply on "which services to include within a particular product market, but also which customer classes to include within a relevant product market."[5] In particular, the Commission seeks comment on "the willingness and ability of end users to purchase other broadband services as substitutes for an incumbent LEC's broadband services."[6]

As a general matter, the two markets for telecommunications services referenced by the Commission in the Notice[7] and supported by SBC in its Petition[8] – the "mass market" and the "larger business market" – are too broad. As defined in SBC's Petition and used in the Notice, the term "mass market" refers to primarily residential users and the term "larger business market" refers to medium and large business users. In the *Notice,* the Commission asks whether services marketed to so-called "small and medium enterprises" ("SMEs")

---

[5] *Notice*, at ¶ 18.

[6] *Notice*, at ¶ 19. The Commission also makes note of its prior determination that the "new approach" for defining the relevant product market "will rely exclusively on demand considerations … rather than supply substitutability." *See Notice*, at ¶ 19, footnote 44, which cites to the *LEC Classification Order*, 12 FCC Rcd at 15782, ¶ 41.

[7] *Notice*, at ¶ 20.

[8] *SBC Petition*, at 19-34.

and “small or home offices” (“SOHOs”) should constitute separate product markets.[9] The Committee urges the Commission to conclude that they do.

As a threshold matter, the notion of “small” needs to be clarified to refer to the amount of broadband service capacity needed at the location, rather than to the size of the corporate or institutional customer maintaining the particular business location. Large corporate telecommunications users, such as the members of the Ad Hoc Committee, by themselves maintain, and/or may have an ongoing need to communicate with, numerous “small” business locations which may properly be classified as SMEs or SOHOs. These include retail stores, automobile dealerships, travel agencies, bank branches, transportation and dispatch facilities, among others. The SME and SOHO designations should therefore be based upon the commercial activity being carried out at each such location and its relatively lower service capacity needs, regardless of the size of the customer of record or the aggregate number of locations maintained on the customer’s enterprise network.

Smaller business locations should not be lumped together with residential customers simply because their geographical location or capacity requirements are the same because they have very different broadband service needs. For example, because communications with small business locations can be critical to the larger company’s operations and commercial success, the same security and reliability levels must be maintained for service to these locations despite their comparatively small scale. Similarly, aside from general privacy concerns,

---

[9] *Notice*, at ¶23.

residential broadband customers typically do not require security measures as stringent as those required by customers conducting sensitive commercial transactions or connecting to an enterprise network rather than the public Internet. The security level that a customer can achieve with a particular data service (or the lack thereof) can be critical to a business customer's choice of service and constitute a "make or break" consideration when a business customer selects a broadband service.

Reliability is another differentiating element of business customers' service needs. For a residential Internet user, a service interruption or outage can be no more than an annoyance; the customer can simply log on later in the evening or the next morning if her internet connection is not working. By comparison, business customers require uninterrupted and secure access to their data services because the very activities of the business itself could be conducted via telecommunications services.

These differences in the customer's "willingness and ability to substitute" services distinguish business users at low volume locations from the more general "mass market" of low-volume residential customers. Accordingly, the Commission's market definitions must recognize the differences between these customer groups regardless of similarities in their capacity requirements.

B. The Commission Must Eliminate Ambiguity In Its Definition Of "Broadband Services"

The Commission's refusal to define the broadband services that will be subject to the rules adopted in this proceeding is problematic.[10] Broadband business services can include everything from a 64,000 bit per second upstream ADSL channel to a 622,080,000 bit per second OC-12 channel. The Commission has introduced an unmanageable level of ambiguity in this proceeding and in its regulatory policy by refusing the specify the services for which it is considering de-regulation and by proposing to define markets according to customer characteristics rather than service characteristics, particularly when the market categories are so broad.

Moreover, the *Notice* introduces additional confusion by distinguishing inconsistently among special access services. On the one hand, the *Notice* states that the Commission is "*not* considering whether traditional special access services belong in the larger-business market for advanced services as these services are governed by the Commission's pricing flexibility regime."[11] Yet the Notice specifically seeks comment on whether to include in the larger-business market services that the ILECs make available pursuant to special access tariffs.[12] In addition, large business customers may use all of these services

[10] *Notice*, at ¶ 17, note 37.

[11] *Notice*, at ¶ 22.

[12] The *Notice* specifically refers to Frame Relay, Asynchronous Transfer Mode, Gigabit Ethernet, Switched Multimegabit Data Service, and Remote Local Area Network services as services that would all fall within a "larger business market for broadband services." *Notice*, at ¶ 22.

interchangeably as a practical matter. The Commission must clarify the services for which it is proposing regulatory change or it may construct different regulatory standards for services that, at bottom, are virtually identical as a technological and competitive matter.

II. THE STATE OF COMPETITION IN THE BROADBAND BUSINESS MARKET DOES NOT JUSTIFY REGULATORY FLEXIBILITY AT THIS TIME

Competition in the broadband business services market is generally insufficient to justify deregulation of those services, as demonstrated by a number of factors described in the following paragraphs:

- The Commission's deregulation of the ILECs' prices for special access services (which include, or may be equivalent to, the broadband business services the Commission has targeted in this proceeding) has resulted in *increased* prices, despite record earnings by the ILECs, a result that is fundamentally inconsistent with the outcome of a market with effective competition.

- Ad Hoc's members – whose combined annual spend in the billions of dollars for telecommunications services makes them the first customers new entrants would seek out – have in fact experienced few competitive alternatives for their broadband service requirements.

- Intermodal competition via cable modem service is not a factor for large business users due to the limited deployment of cable infrastructure in business areas and the severe security and reliability concerns raised by cable-based services.

- Meanwhile, the capital markets for CLECs as a whole have crumbled over the past few years, placing severe restrictions on CLECs' ability to remain in the market, let alone expand their service capabilities.

- By contrast, the financially secure ILECs have refrained from aggressively pursuing out-of-region local markets, notwithstanding the specific "commitments" by both SBC and Verizon to do so in exchange for FCC approval of their respective merger applications.[13]

[13] *In re Applications of Ameritech Corp., Transferor, and SBC Communications Inc., Transferee, For Consent to Transfer Control of Corporation Holding Commission Licenses and*

These characteristics of today's broadband business services market demonstrate that the market is not sufficiently competitive to justify relaxed regulation. And premature elimination or reduction of regulation for these services will almost certainly diminish the small amount of competition that does presently exist.

A. ILEC Price Increases In Response To Pricing Flexibility Demonstrate The Dearth Of Competition For Broadband Business Services

As noted above, "broadband" services include many of the special access services currently provided by ILECs to large business customers or services that support the same functions, albeit somewhat differently and at different prices. The Commission's recent experience with price deregulation of those services via its pricing flexibility rules[14] provides a timely and sobering test bed of the de-regulatory proposals in this docket. Price de-regulation of the broadband services used most frequently by business users has not produced anything close to a "competitive outcome," as prices have risen in those markets where

Lines Pursuant to Sections 214 and 310(d) of the Communications Ace and Parts 5, 22, 24, 25, 63, 90, 95 and 101 of the Commission's Rules, CC Docket 98-141, Memorandum Opinion and Order, 14 FCC Rcd 14712 (1999).

[14] Pursuant to rules adopted in the *Fifth Report and Order and Further Notice of Proposed Rulemaking* in its *Access Charge Reform* proceeding, *Access Charge Reform,* CC Docket Nos. 96-262, 94-1, 98-157 and CCB-CPD 98-63, Fifth Report and Order and Further Notice of Proposed Rulemaking, 14 FCC Rcd 14221(1999), the Commission will grant pricing flexibility to ILECs for special access services in each MSA for which the ILEC can demonstrate the existence of certain specified market conditions. *See, e.g., Verizon Petitions for Pricing Flexibility for Special Access and Dedicated Transport Services,* CCB/CPD Nos. 00-24, 00-28, Memorandum Opinion and Order, DA 01-663 (released March 14, 2001). ILECs to whom "Phase I" flexibility is granted may offer contract-based pricing for special access services, in addition to maintaining generally available pricing for special access customers that have not negotiated contractual arrangements. In MSAs for which ILECs receive Phase II flexibility, the generally available pricing is not regulated under the Commission's price caps rules, nor are the prices constrained by the Part 69 access rate structures or levels.

ILECs received pricing flexibility. The principal reason for these increases is the fact that, notwithstanding the "standards" established by the Commission as threshold qualifications for pricing flexibility,[15] the reality is that mere satisfaction of those standards does not a competitive market make. Similar results can be expected in the broadband business services market if the Commission eliminates its regulatory oversight before actual and sustainable competition has developed.[16]

In fully competitive markets, competition will produce (among other things) reasonable and efficient pricing for services. As discussed in Ad Hoc's initial comments in the Commission's *Performance Standards* proceeding,[17] the ILECs' pricing behavior in markets where they have received Phase II Pricing Flexibility demonstrates that the actual level of competition, even in what appear to be the most competitive markets, has been wholly inadequate to constrain ILEC behavior in a manner consistent with competitive market conditions.[18]

In the *Performance Standards* proceeding, Ad Hoc submitted objective pricing data for the Market Service Areas ("MSAs") in which ILECs have received pricing flexibility on the basis of their demonstration that competing service providers were present. Under the pricing flexibility rules, the price caps and Part

---

[15] *Id.*

[16] The lesson that the special access pricing flexibility experience teaches is that regulatory definitions of "competition" cannot assure a competitive outcome because economic forces will do what they will do, such definitions aside. A definition of "competition" that flies in the fact of economic and market realities has no more validity than an attempt to define *pi* as equal to 3.

[17] *Performance Measurements and Standards for Interstate Special Access Services*, CC Docket Nos. 01-321, 00-51, 98-147, 96-98, 98-141, 96-149, 00-229, Notice of Proposed Rulemaking, 16 FCC Rcd 20896 (2001).

[18] Performance Measurements and Standards for Interstate Special Access, CC Docket No. 01-321, Comments of Ad Hoc Telecommunications Users Committee, January 22, 2002, ("*Ad*

69 rules no longer apply to the generally available pricing for special access in these areas because the Commission had concluded that a Phase II showing by the ILECs of competitive presence meant that market forces would discipline rates.[19] Ad Hoc's review of generally available pricing data for special access services in MSAs where Phase II pricing flexibility has been granted revealed that ILECs are charging higher prices in those MSAs – places where competition is presumably greatest – than in the non-Phase II areas in the same states and density zones, where competition supposedly has not developed. Indeed, this analysis revealed no instance of lower prices for generally available services in the MSAs to which Phase II pricing flexibility applies.[20] Significantly, *no commenting party in that proceeding rebutted the Committee's analysis on reply*.

The fact that ILECs were able to raise prices in MSAs for which they received regulatory flexibility underscores the complete lack of competition in those markets, despite the Commission's confidence that competition was present. There is no evidence to indicate that, if those same services are re-named "broadband services" and subjected to a deregulatory regime in this docket, the outcome would be different. The Commission must consider the results of its de-regulatory experiment with the special access rules and

---

Hoc's Performance Measurements Comments") at 3-6.

[19] *Id*. at ¶ 155.

[20] *See Ad Hoc's Performance Measurements Comments*, Appendix 1, Tables 1-3, which summarize the results of Ad Hoc's analysis of the prices for DS1 and DS3 special access facilities in the tariffs of BellSouth, SWBT and Verizon. As the tables demonstrate, generally available pricing for a large number of pricing elements for DS1 and DS3 special access services is higher in the supposedly more competitive Phase II MSAs than in exchanges for which pricing flexibility has not been granted. While the Phase II prices for all rate elements are not higher -- some are still set at the same levels as regulated services -- the overall prices for high-capacity circuits comprised of these elements are higher.

recognize the perils of de-regulating prior to the development of effectively competitive markets.

B. The Market Experience of Ad Hoc Committee Members Demonstrates That Competitive Alternatives Are Not Available For Most Broadband Business Service Requirements.

Despite being among the largest and most technologically sophisticated users of telecommunications services in the country, the members of the Ad Hoc Committee report that they face no competitive alternatives to ILEC services to meet their broadband business services requirements in the overwhelming majority of their service locations. Even where competitive alternatives are nominally "available," members are able to make little use of those competitor services, for a variety of reasons.

Committee members aggregated their company-specific information regarding the number of customer locations with broadband service needs falling into each of the four following categories:

- Category A: Capacity of 12 DS-0 channels or less (*i.e.,* ½ T-1, 760 kHz, xDSL, etc.).
- Category B: Capacity of at least one but not more than four DS-1 circuits.
- Category C: Capacity greater than four DS-1 circuits, or at a level sufficient to justify the provision of at least one DS-3 facility, other than SONET or Optical Carrier ("OC") service.
- Category D: SONET or OC service.

Committee members were then asked to provide estimates of the percentage of locations by category for which they were aware of the presence of viable competitive alternatives to ILEC services. Finally, members were asked to

estimate the percentage of locations by Category at which they currently used a competitive carrier to satisfy their service requirements. The total number of locations surveyed was about 30,000.

The results of the survey demonstrate that viable competitive alternatives are not frequently available, particularly with respect to smaller business service locations.[21] For the overwhelming majority of Category A and B business service locations, viable competitive alternatives to the incumbent LEC's data service were available at less than 10% of locations. The vast majority of the Category C business service locations also appear to have very few viable competitive alternatives. Although some members indicate the presence of some competitive alternatives for seldom-purchased Category D services, others indicate that viable competitive offerings are no more prevalent for the highest capacity services than for the lowest.

As would be expected, the existence of few viable competitive alternatives has resulted in few actual purchases of competitive data services by Ad Hoc's members.[22] Members indicate that in all Category A locations and nearly all Category B locations, fewer than 10% are served by competitors. The majority of Category C and D locations also are served by competitors less than 10% of the time.

---

[21] The survey asked respondents to indicate whether there were viable competitive alternatives for each category of service at (a) fewer than 10% of the service locations; (b) between 10% and 25% of the service locations; (c) between 25% and 50% of the service locations; and (d) more than 50% of the service locations.

[22] The survey asked respondents to indicate whether they purchased data services from competitive carriers for each category of service at (a) fewer than 10% of the service locations; (b) between 10% and 25% of the service locations; (c) between 25% and 50% of the service locations; and (d) more than 50% of the service locations.

Committee members have raised several issues that determine whether or not they can use a competitive carrier in those few locations where one is available. As discussed in the next section of these comments, service quality, reliability, and security are critical issues that business end users must consider when evaluating competitive alternatives to the ILEC's broadband service offerings. CLEC network ubiquity and price are two other interrelated issues. Because CLEC networks are not as ubiquitous as those of the incumbents, many business service locations seeking broadband services from a CLEC either require (1) additional build-out by the competitor, or (2) "back-hauling" of access to the CLEC POP (at the customer's expense). Either outcome increases the cost of service as compared to the ILEC, creating additional barriers for CLEC efforts to penetrate the business end user market. Statistics that focus solely upon the nominal "presence" of competitors – such as, and in particular, the criteria adopted by the Commission as the threshold standard for Phase II pricing flexibility, cited above, fail utterly to account for the practical realities of acquiring and utilizing services from non-ILEC providers.

Indeed, issues of total cost, network integration, reliability, and responsiveness ultimately determine whether a competitor's service is considered by an end user to be a *viable* alternative in the first place. It is not enough simply to have competitors "operating" in the market – rather, the services provided by carriers other than the incumbent LEC must also satisfy the customer's standards for purchase and use. The survey responses provided by Ad Hoc's members substantiate the fact that even where "available," CLEC

services rarely meet members' needs. As such, it is clear that the business data service market is far from being effectively competitive, and thus does not yet justify the type of deregulation the ILECs seek.

C. Cable Modem Service Is Not A Source Of Intermodal Competition For Business Users

Much of the optimistic discussion regarding competitive alternatives to incumbent LEC broadband services relies primarily upon the availability of cable modem service as a means for obtaining high-speed access to the Internet.[23] The *Notice* also refers to wireless technologies – both terrestrial and satellite based – as broadband alternatives to ILEC-provided xDSL. Ad Hoc does not here address the suitability of these alternatives for meeting demand for broadband services from residential customers. Regardless of how suitable cable modems and wireless services may be for residential consumers, however, they are not suitable for most business applications, with the possible exception of telecommuting, and thus cannot be considered a source of intermodal competition to incumbent LEC broadband business services offerings.

There are at least three reasons why this is the case. First, the networks constructed by cable service providers are largely designed to reach residential dwellings, not business locations. With the possible exception of local retail shopping areas interspersed within or adjacent to residential neighborhoods, cable TV infrastructures generally do not "pass" business areas. By contrast, ILEC-provided xDSL services are provisioned over existing local telephone feeder and distribution infrastructure. These facilities not only "pass" business

[23] *See, e.g., SBC Petition*, at 20-28.

areas but business locations are, if anything, likely to be in closer geographic proximity to the ILEC central office than many residential subscribers in the same central office serving area, thereby making xDSL an even more efficient serving arrangement for business applications than for residential, where more remote terminals ("RTs") and cross-connect points may be involved.

Second, cable modem-based data service presents serious security and reliability issues that, while also present for residential users, are of far greater concern when used to support business applications, as discussed in Section I.A., *supra*. In addition, service quality for cable modem service is not equivalent to ILEC standards. This is due to both the engineering/architecture of cable systems as well as the economics of the cable TV business. As a threshold matter, cable TV systems were never designed to meet local telephone service reliability standards. Second, where ILEC subscriber infrastructure is powered primarily from the central office, cable networks are powered at various points via electrical interconnections on the same utility poles to which the cables are attached. These arrangements do not have the kind of backup power facilities that are designed into ILEC systems Additionally, cable modem data transmission speeds are not consistent, due to the “shared platform” architecture that the service utilizes; data transmission speeds decrease as the number of users connected to the same network link increases. Again, whereas residential customers may have flexibility with respect to data transmission speeds, business customers typically do not, and are generally unable to tolerate spotty service.

Finally, cable modem platforms do not offer business customers a sufficient level of security. Even the smallest of business customers may transmit data relating to financial transactions or other proprietary or competitively sensitive data, and therefore require adequate security measures with respect to broadband services. While "add-on" computer security can be purchased and installed, these necessarily increase the user's cost for the service and degrade the data transmission speed.

D. The Development Of Effective Competition From CLEC Services In The Future Is At Risk.

The lack of actual competitors for broadband services, as experienced by Ad Hoc Committee members, is not likely to improve in the near future. As Ad Hoc has stated in related proceedings,[24] the capital markets have been particularly unkind to CLECs over the past few years. CLECs, once considered "market darlings" on Wall Street, are now scrambling for cash. Competitive carriers' market capitalization, which reflects their ability to finance continued network construction, has plummeted. As the Table in Appendix 1 of *Ad Hoc's Performance Measurements Reply Comments* demonstrates, the average CLEC market capitalization level has declined over 70% since September, 1999, with many players' stock prices having dropped more than 90%.[25]

The ability of competitive carriers to finance the kind of build-out that is required to translate *potential* competitive capabilities into *actual* competition has

[24] Performance Measurements and Standards for Interstate Special Access, CC Docket No. 01-321, Reply Comments of Ad Hoc Telecommunications Users Committee, February 12, 2002, ("*Ad Hoc's Performance Measurements Reply Comments*") at 10-11.

[25] *Id.* at Appendix 1.

decreased in step with their market capitalization. Moreover, the poor financial position of many of these "competitors" will limit their ability to raise capital in the future. The ever-continuing wave of applications for discontinuance by CLECs per Section 214 of the Communications Act further serves to underscore the fact that CLECs are not simply running out of money that may have previously been earmarked for market expansion; rather, they are running out of money to fund their very *existence*. The recent financial shakeout has all but decimated the CLEC industry, and has had a substantial impact on the CLECs' ability to provide all types of service, from local exchange to special access to broadband services.

E. ILECs Have Not Been A Source Of Competition In Each Other's Markets

As part of the market opening initiatives adopted in the Telecommunications Act of 1996, ILECs were permitted to compete in one another's local service markets. The opportunity for ILECs to operate as CLECs in out-of-region markets has obviously been less than appealing, as is confirmed by their hesitancy over the past six years to do so. Even SBC, which as a condition for approval of its merger with Ameritech had agreed to implement a "National-Local" CLEC entry strategy in the top 30 out-of-region MSAs, has refrained from aggressively pursuing this strategy, choosing instead to incur financial penalties imposed by the Commission.[26] SBC's actions send two very

[26] Since 1999, SBC has incurred about $188-million in penalties for failing to meet competition and service requirements. *See* Rebecca Blumenstein, Yocki J. Dreazen, and Shawn Young, "Familiar Ring: How Effort to Open Local Phone Markets Helped the Baby Bells," *Wall Street Journal*, February 11, 2002, at A1. This total does not include recent fines totaling $3.4-million imposed by the Commission upon SBC related to "carrier to carrier" performance

clear messages: first, the financial "penalties" imposed upon large incumbent carriers have not been steep enough to prevent these carriers from backsliding on regulatory promises. And second, CLEC entry into local markets is not particularly easy nor financially rewarding, else SBC would be clamoring to reap the benefits of becoming a national local service carrier, particularly given the additional out-of-region benefit of providing interLATA services too. The fact that well-funded carriers such as the regional Bells are unwilling to compete in local markets speaks volumes about the potential ability (or inability) of other carriers to compete effectively in these same markets, regardless of whether they are providing local service or broadband services. How can start-up CLECs and their investors be expected to "take on" the RBOC behemoths when these companies would rather pay hundreds of millions in fines and penalties rather than take on each other?

III. REGULATORY SOLUTIONS TO THE FADING PROMISE OF COMPETITION.

In the *Notice*, the Commission emphasizes its statutory mandate to encourage the deployment of advanced services[27] and suggests that reduced regulation or regulatory forbearance can foster deployment even in the absence of existing competition.[28] For the reasons discussed below, the Commission's reasoning is deeply flawed.

---

standards, and an additional $84,000 for "willfully and repeatedly" violating the Commission's collocation rules regarding notification of locations that have run out of collocation space. *See* Treasury Gets $3.4M From SBC, $426K From Verizon For Performance, TR Daily, February 25, 2002.

[27] *Notice* at ¶40.

[28] *Notice* at ¶39.

A. The Commission Cannot Unreasonably Compromise Other Statutory Objectives In Order to Encourage Broadband Deployment

The Communications Act charges the Commission with many other goals besides encouraging the deployment of advanced services, none of which should be sacrificed to the broadband bandwagon. In particular, the Act requires the Commission to protect consumers from unjust and unreasonable rates, terms and conditions. If the Commission de-regulates a carrier with market power in the name of encouraging broadband deployment, it would expose consumers to the excessive prices, unreasonable terms and conditions of service, inferior service quality, and technological torpor that results when competition is not present. Given the lack of competition in the market for broadband business services, discussed above, proposals to streamline the ILECs' regulatory regime,[29] re-classify them as non-dominant,[30] or de-regulate them completely, despite the absence of competition,[31] are simply inconsistent with the Act's other statutory goals and lacking in any factual predicate.

Streamlining or eliminating regulatory protections for customers of broadband business services would leave those users unprotected from ILECs' market power. Any belief that users no longer need regulatory protection in the broadband business services market is simply unsustainable after the ILECs responded to special access pricing flexibility with price increases and record earnings, as described in Section II.A, above.

B. The Problem in Business Markets Is Not Deployment But *Competitive*

[29] *Notice* at ¶ 41.

[30] *Notice* at ¶ 42.

[31] *Notice* at ¶ 39-40.

Deployment

Even if the FCC chooses to ignore the Act's other objectives and focus exclusively on fostering the deployment of broadband services, that objective cannot in any case be used to justify a de-regulatory approach to broadband business services for the simple reason that deployment problems have not arisen in that market. Provisioning delays have, as well as unjust and unreasonable prices and poor service quality. [32] But not deployment of the requisite facilities to business districts. Whatever the merit of claims that broadband services have not been adequately deployed to residential markets, no such claims have surfaced in the broadband business services market. Therefore, regulatory changes ostensibly designed to stimulate deployment of broadband business services are simply unnecessary to ensure sufficient deployment to meet broadband business services demand and cannot be justified on that basis.

The only exception to the otherwise adequate deployment of broadband business services is the availability of lower speed broadband services such as DSL for low-volume business locations. But the stumbling block to business use of that service is the ILECs' refusal to unbundle it from Internet access services, not facility deployment.

Business users are interested in using DSL to establish point-to-point broadband connections between a low-volume location, such as an employee's home, and a point on the business user's private network or local area network

[32] *See* notes 17 and 18, *supra.*

("LAN"). Because of security concerns, however, business users can not use a public Internet connection without the added expense of encryption technology. The cost effective solution is a point-to-point DSL connection, de-linked from Internet access services but ILECs refuse to offer stand alone DSL to end users.

As SBC observed in its description of its "RLAN" service, which the *Notice* cited as an example of a broadband business service,

> SBC has one DSL offering designed for business customers – Remote Local Area Network ("RLAN") – that is used principally by businesses to provide their employees with high-speed access from their homes to the corporate LAN. *This service is provided on an extremely limited basis, however, with only about 4600 lines in service. The relatively insignificant scope of this service makes it inconsequential to the analysis here*.

Ad Hoc regretfully agrees.

Since demand stimulates deployment, the FCC can stimulate deployment of these DSL services by requiring the ILECs to offer them in a way that is responsive to demand. That means point-to-point DSL, offered directly to end users, not DSL bundled with Internet access or offered only to ISPs.

As demonstrated in Section II, above, the problem for business users isn't deployment but *competitive* deployment. Only *competitive* deployment will further the statutory goal of just and reasonable rates, terms and conditions. Only *competitive* deployment can produce the technological innovation, cost management, service quality, provisioning standards, downward pricing pressure, and other widely recognized benefits of competition that are missing from today's business services markets. Therefore, the FCC should focus on regulatory measures that stimulate deployment of broadband services by ILEC

competitors, *viz*., the elimination of entry barriers and vigorous enforcement of the market-opening requirements in the Act.

C. The Commission Should Use The Interstate Interexchange Regulatory Model For Transitioning To A Competitive Broadband Business Services Market

Instead of focusing on chimerical deployment issues in the broadband business services market, the FCC should be responding to the lack of competition in that market by re-thinking its preference for weakening or eliminating existing regulatory regimes. Pending the emergence of a competitive market, further de-regulation of ILEC broadband services will simply leave customers and competitors vulnerable to ILEC exploitation of their market power, as evidenced by the excessive MSA rates and record profits discussed in Section II.A.

In addition, the current pricing flexibility regime for broadband business services can no longer be justified, whatever merit it may have had when it was adopted and competition seemed imminent. That competition has not emerged and, based on the virtual tidal wave of discontinuances and bankruptcies among CLECs in the past year, is not likely to emerge soon. Therefore, the FCC must take marketplace realities into account and re-vamp the regulatory approach it adopted so optimistically following passage of the 1996 Act and the first rush of competitive entry into local markets.

Since competition in the broadband business services market has simply not materialized, the Commission should use the same approach for regulating ILEC broadband business services that it used for interstate, interexchange

services to protect business users from an incumbent's market power while waiting for competition to develop. In the interstate, interexchange market, the FCC successfully transitioned to competition through the use of incentive regulation,[33] continued enforcement of non-discrimination and tariffing requirements,[34] and contract tariff authority.[35] These requirements protected consumers and competition while preserving carrier flexibility to respond to competition as it emerged.

To apply the interstate interexchange model to the ILECs' broadband business services, the Commission should:

- Enforce the non-discrimination, pricing, and tariffing requirements in Sections 201, 202, and 203 of the Act
- Revive incentive regulation of ILEC prices for broadband business services
  - Initialize ILEC special access rates at the price cap-regulated levels in place before MSA pricing
  - Initiate and complete an X factor specification before the CALLS plan re-targets the X to GDP-PI in July 2004[36]
- Continue the ILECs' contract tariff authority so that ILECs and customers can negotiate to respond to competition if it emerges

---

[33] *Policy and Rules Concerning Rates for Dominant Carriers*, CC Docket No. 87-313, Notice of Proposed Rulemaking, 2 FCC Rcd 5208 (1987), Further Notice of Proposed Rulemaking, 3 FCC Rcd 3195 (1988) (*Further Notice*), Report and Order and Second Further Notice, 4 FCC Rcd 2873 (1989) (*AT&T Price Cap Order*), Erratum, 4 FCC Rcd 3379 (1989).

[34] *Competition in the Interexchange Marketplace*, Notice of Proposed Rulemaking, 5 FCC Rcd 2627 (1990) (*NPRM*), Report and Order, 6 FCC Rcd 5880, 5908 (1991) (*Interexchange Proceeding*), *recon*., 6 FCC Rcd 7569 (1991), *further recon*., 7 FCC Rcd 2677 (1992), Second Report and Order, 8 FCC Rcd 3668 (1993), *recon*., 8 FCC Rcd 5046 (1993).

[35] *Id.*

[36] *Initiation of Cost Review Proceeding for Residential and Single-Line Business Subscriber Line Charge (SLC) Caps*, CC Dkts. Nos. 92-262, 94-1, DA 01-2163 (released September 17, 2001) at para. 141.

The competitive circumstances of the ILECs differ in one significant respect from those of the interstate interexchange carriers when the Commission transitioned that market to unregulated competition. The ILECs have continuing market power over an essential bottleneck facility, namely, the "final mile" or local loop. Therefore, the Commission's regulatory regime for the ILECs must ensure competitive access to final mile facilities, for both providers of competing telecommunications services who need local loop facilities to establish a network complete enough to compete effectively, and for information service providers or other providers of unregulated services and technologies who are dependent on ILEC transmission services to deliver their services. Accordingly, the Commission must continue to require that ILECs make their telecommunications services available to end users, competitors, and information service providers on a stand-alone basis, unbundled from information services or other unregulated services, particularly those telecommunications services used by the ILEC in the provision of its unregulated services. Finally, the Commission must continue its efforts to eliminate barriers to competitive entry and vigorously enforce the Act's market-opening requirements.

CONCLUSION

As heavy users of broadband services, business customers support the Commission's objective of encouraging robust, competitive deployment of broadband services. But a realistic assessment of current competitive conditions in the broadband business services market cannot justify streamlined regulation

or de-regulation of the ILECs' broadband business services. Where competition is too weak to protect consumers from unjust and unreasonable rates, terms, and conditions, as is the case in the broadband business services market, the

Commission cannot ignore its statutory responsibility to adopt regulations that protect consumers from the carriers' market power.

Respectfully submitted,

AD HOC TELECOMMUNICATIONS
USERS COMMITTEE

By: Colleen Boothby

Colleen Boothby
Levine, Blaszak, Block & Boothby, LLP
2001 L Street, N.W., Suite 900
Washington, D.C. 20036
202-857-2550

Counsel for
Ad Hoc Telecommunications
Users Committee

Lee L. Selwyn
Douglas S. Williams
Economics and Technology, Inc.
Two Center Plaza, Suite 400
Boston, MA 02108-1906
617-227-0900

Economic Consultants

March 1, 2002

Certificate of Service

I, Michaeleen I. Williams, hereby certify that true and correct copies of the preceding Comments of Ad Hoc Telecommunications Users Committee was served this 1st day of March, 2002 via the FCC's ECFS system, and by first class mail upon the following:

Qualex International
Portals II
445 12th Street, NW
CY-B402
Washington, D.C. 20554

Michaeleen I. Williams
Legal Assistant

March 1, 2002

ECFS Filing Confirmation No.: **