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October 24, 2002

**VIA ELECTRONIC SUBMISSION**

Ms. Marlene H. Dortch  
Secretary  
Office of the Secretary  
Federal Communications Commission  
445 12<sup>th</sup> Street, SW  
Washington, DC 20554

Dear Ms. Dortch:

Re: **Memorandum of Ex Parte Communication**  
*CC Docket No. 01-338, Review of the Section 251 Unbundling*  
*Obligations of Incumbent Local Exchange Carriers*

*CC Docket No. 96-98, Implementation of the Local Competition*  
*Provisions in the Telecommunications Act of 1996*

*CC Docket No. 98-147, Deployment of Wireline Services Offering*  
*Advanced Telecommunications Capability*

On October 23, 2002, representatives of SBC met with Matthew Brill, Acting Senior Legal Advisor to Commissioner Abernathy regarding the Commission's Triennial Review proceeding, including the appropriate regulatory treatment of switching, transport and Broadband facilities. James Smith, Don Cain, Gary Phillips and the undersigned participated in the discussions on behalf of SBC. SBC's presentation focused on the following points:

- CLECs are not impaired without access to unbundled switching.
- The UNE-P obligation should be eliminated. It undercuts investment and is financially unsustainable for ILECs. A reasonable transition for the embedded base is appropriate.
- Competitive deployment of high capacity loops and transport obviates the need for unbundled access to these facilities.
- ILECs are not the dominant provider of Broadband and should not be subject to unbundling for Broadband facilities.
- FCC should create a national pre-emptive framework.

The attached presentation was used during the meeting.

Pursuant to Section 1.1206(b) of the Commission's rules, this letter and the attached presentation are being electronically filed in each of the proceedings identified above.

Please call me should you have any questions.

Sincerely,

A handwritten signature in black ink that reads "Jay Bennett". The signature is written in a cursive style with a large, stylized initial "J" and a horizontal line extending from the end of the name.

Attachment

cc: M. Brill



# **Triennial Review**

October 23, 2002

# Overview



- UNE-P obligation should be eliminated. It undercuts investment and is financially unsustainable for ILECs.
  - A reasonable transition for the embedded base is appropriate.
- CLECs are not impaired without access to unbundled switching.
- Competitive deployment of high capacity loops and transport obviates the need for unbundled access to these facilities.
  - At a minimum, all DS3 and above circuits should not be subject to unbundling requirements and any mandatory unbundling of DS1 circuits must be limited by competitive triggers.
- ILECs are not the dominant provider of Broadband and should not be subject to unbundling for Broadband facilities.
- FCC should create a national pre-emptive framework.

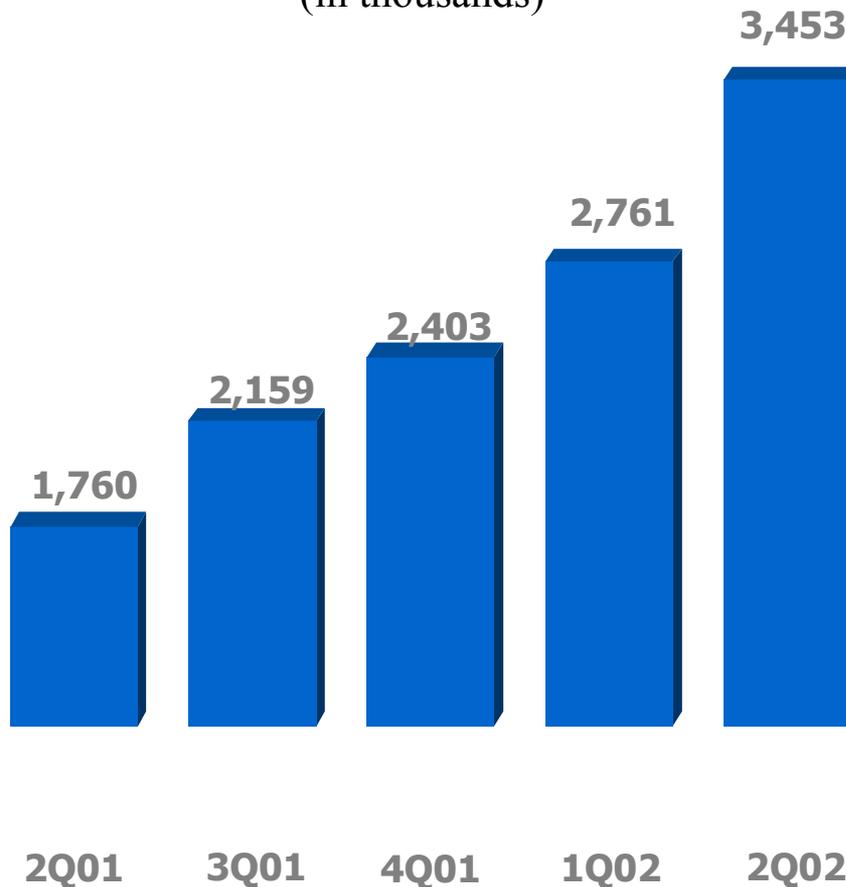
# UNE-P Proliferation



## SBC UNE-P Lines In Service

2Q 2002

(in thousands)

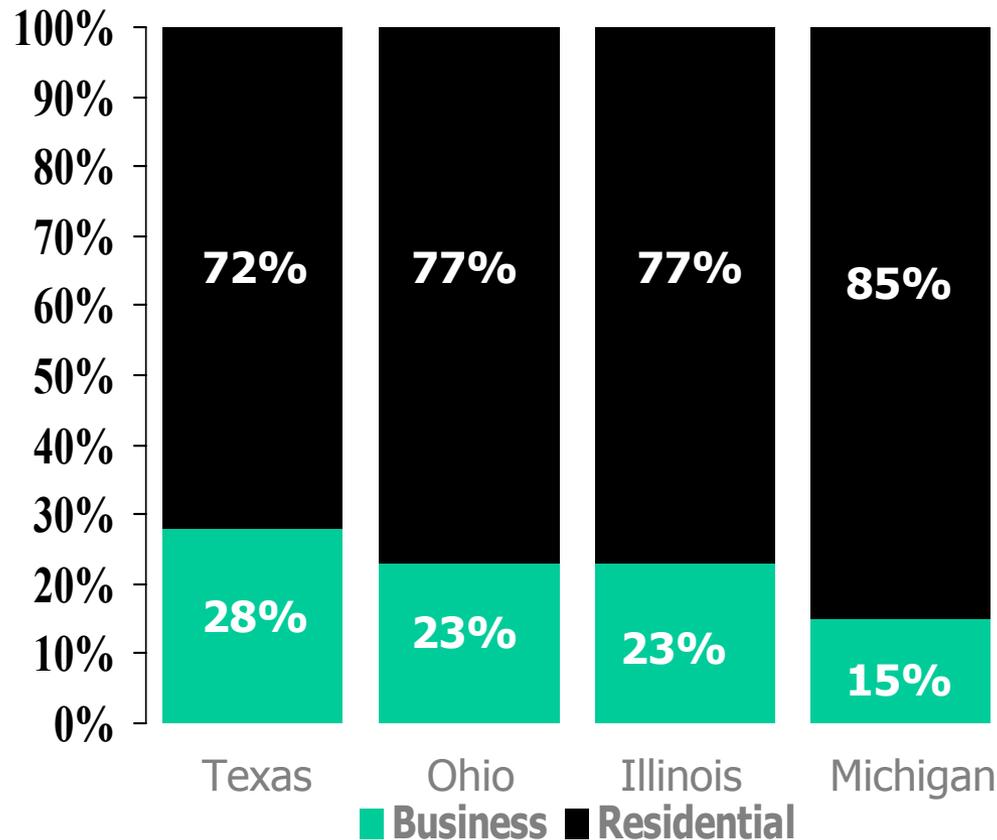


- Over the past year, UNE-P lines in service have doubled.
- As of 3Q02, SBC has lost approximately 4.2 million lines... nearly equivalent to losing the state of Michigan.

# Residential Customers Are the Primary Target for UNE-P in SBC Territories

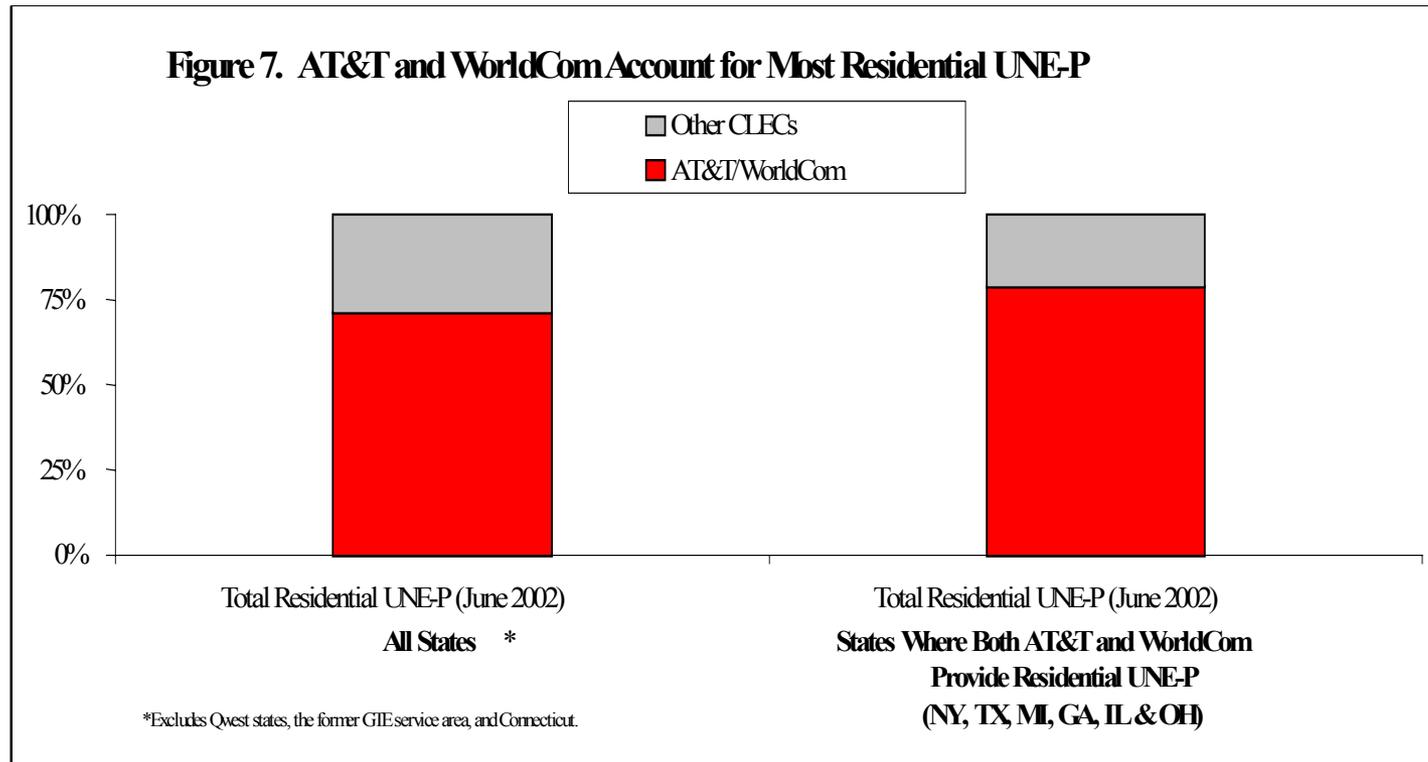


SBC UNE-P Lines In Service  
SBC's Four Largest UNE-P States



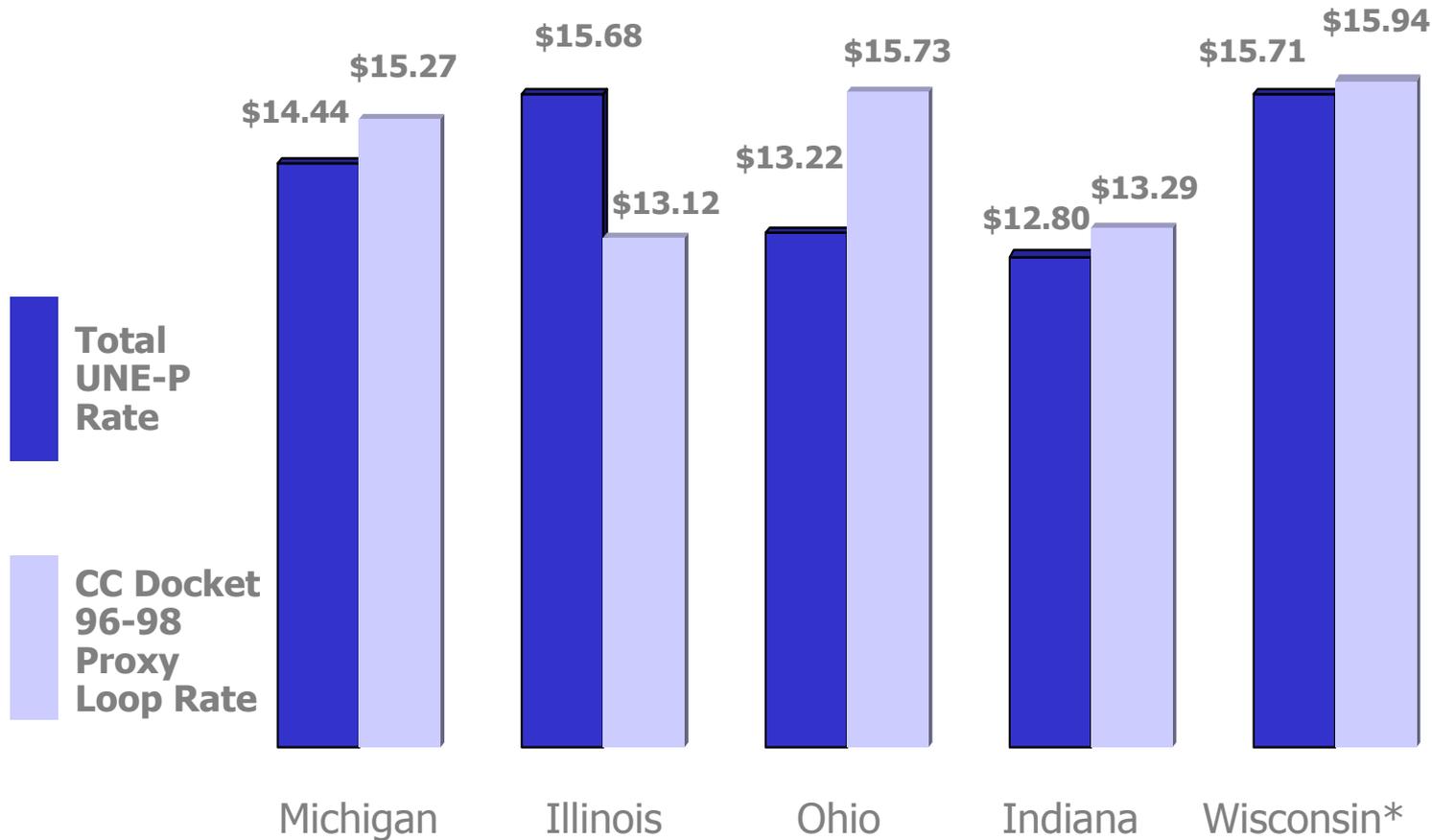
- Across SBC's 13 states, more than 70% of all UNE-P lines are residential
- In SBC's four largest UNE-P states, which have been targeted most aggressively by the large IXC's, residential customers represent an even higher percentage of total UNE-P's.

# UNE-P Predominantly Used by the Two Largest IXC's



In the states where both provided UNE-P as of June 2002, they account for an even larger share of the UNE-P action – nearly 80 percent of residential UNE-P purchases to date.

# UNE-P Rates vs FCC Proxy Loop Rates



\* Estimated impact of pending order.

# Simple Margin Transfer With No Investment



## Ameritech Consumer 5-State Averages

	<u>SBC Retail</u>	<u>SBC UNE-P</u>	<u>IXC Using SBC UNE-P</u>
Revenue	\$36	\$15	\$41
Expenses	*\$25	*\$25	**\$23
Operating Margin	\$11	\$(10)	\$18
Capital Investment	\$1,100	\$1,100	\$0
<i>Capital Investment</i>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input type="checkbox"/>
<i>Service Quality</i>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input type="checkbox"/>
<i>Regulated</i>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input type="checkbox"/>
<i>Universal Service Provider</i>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input type="checkbox"/>

\* Excludes cost associated with data services. Earlier expense amount refined; detailed support on following pages.

\*\* UNE-P plus 20% SG&A.

# Ameritech Expenses (2001)

## \$M



Expense Category *	Examples	Illinois	Indiana	Michigan	Ohio	Wisconsin	Total Ameritech Expense
<b>Plant &amp; Network Operations</b>	Central Office & Plant Maintenance & Provisioning	\$953	\$274	\$741	\$602	\$245	\$2,815
	Network Planning & Engineering						
	Power						
	Land & Buildings						
<b>Customer Operations</b>	Customer Services	\$370	\$123	\$339	\$253	\$128	\$1,213
	Product Management						
<b>Corporate Operations **</b>	Accounting/Finance	\$256	\$105	\$279	\$184	\$101	\$926
	Human Resources						
	Regulatory						
	Corporate Planning						
	Information Technology						
	Procurement						
<b>Depreciation***</b>		\$796	\$238	\$651	\$476	\$224	\$2,385
<b>Uncollectibles</b>		\$109	\$28	\$116	\$56	\$32	\$341
<b>Total Operating Expenses</b>		<b>\$2,484</b>	<b>\$768</b>	<b>\$2,126</b>	<b>\$1,571</b>	<b>\$730</b>	<b>\$7,680</b>

\* ARMIS Data Reported to FCC

\*\* Excluding Extraordinary Pension Adjustment in 2001

\*\*\* Total Capital Expenditures in 2001 = \$3.1B

# UNE-P Pricing in Ameritech is Economically Irrational

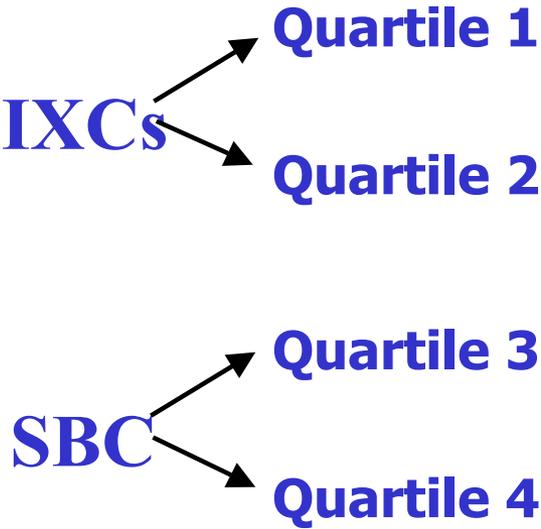


Expense Category	Total Ameritech Expense (\$M)	Monthly Gross Expense/Line	Monthly POTS Expense/Line*
Plant & Network Operations	\$2,815	\$12	\$9
Customer Operations	\$1,213	\$5	\$4
Corporate Operations	\$926	\$4	\$3
Depreciation	\$2,385	\$10	\$8
Uncollectibles	\$341	\$1	\$1
Total Operating Expenses	\$7,680	\$33	\$25
Total # of Access Lines	19,628,158		
UNE-P Revenue			\$15
<b>Shortfall from Operating Expenses</b>			<b>(\$10)</b>
Net Investment/POTS Line			\$499
Return on Investment Per Month @ 11.25%			\$5
Total Monthly Cost Including Return			\$30
<b>Shortfall of UNE-P Revenue from Total Costs</b>			<b>(\$15)</b>
* Excludes Expenses Associated with Data Services			

# SBC Provides Residential Universal Service While IXC's "Cherry Pick" Profits

## Ameritech Residential Customer Spending

IXC offers target premium customers rather than universal service.



	Ave Rev per Line	% of Total SBC Revenue	% of Total SBC Profit
Quartile 1	\$43-\$54	36%	72%
Quartile 2	\$36-\$43	29%	41%
Quartile 3	\$24-\$36	21%	9%
Quartile 4	\$0-\$24	14%	(22)%

SBC's resulting customer base will be unprofitable, with no funds for investment.

# Competitive Switches Are Widely Deployed & Used



- CLECs have deployed 1,300 circuit switches  
(Fact Report, II-1 & Appendix B)
  - 200+ CLECs of all sizes have deployed local circuit switches in the BOC regions (Fact Report, II-1)
- CLEC switches reach customers representing 86% of BOC access lines. (Fact Report, II-6)
- In addition to the circuit switches, more than 9,500 CLEC packet switches provide further competition (ALTS Local Competition Report 2002, page 16)

# Hot Cut Overview



- SBC provisions hot cut orders on a timely basis, with minimal disruption to end users.
- SBC has a proven record of performance as FCC has found in 271 proceedings and as evidenced by data filed in this proceeding.
- Moving forward, SBC has the capacity to meet any reasonably foreseeable increase in demand for stand alone unbundled loops at the same superior level of performance.
  - A small portion of SBC Central Office workforce is involved in the hot cut process. This allows SBC to allocate additional resources, as needed, to meet any spike in demand.
  - SBC maintains flexibility with regard to staffing, making adjustments and reallocations of work force among as necessary to support changes and/or spikes in work load volumes and staffing requirements.
  - Proven historical response to changes/spikes in Hot Cut volumes.
  - SBC can accommodate increases in hot cut activity in individual COs as well as on a regional basis.

# Hot Cut Costs Are Not a Barrier



- In addition to coordinated hot cuts, SBC offers a frame due time (“FDT”) option that eliminates the cutover charge
  - FDT significantly lowers labor costs for SBC, resulting in lower charges to CLECs
- In California, for example, Pacific Bell’s weighted average charge for cutovers this year is less than \$30.00
  - Based on actual charges and line counts from January to September 2002 for both FDT and Coordinated Hot Cuts

# Special Access is Highly Competitive

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- Special access customers are highly concentrated.
  - 80% of SBC's special access revenues are derived from 25% of the wire centers in which it provides special access.
- The special access has been subject to competition for the last 18 years, during which CLECs invested billions to deploy their own fiber.
- Competitive Special access providers have captured 28-39% of the market.

# Alternative Local Fiber is Widely Available

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- All but nine of the top 100 MSAs are served by at least three CLEC fiber networks.
  - In *USTA*, the D.C. Circuit, noting that 47 of the top 50 areas had 3+ transport competitors, questioned how CLECs could be impaired where an element is “significantly deployed on a competitive basis.” Slip Op. 13.
- 1,800 CLEC fiber networks in the 150 largest MSAs, which contain 70% of the US population.
- Competitive carriers have deployed at least 184,000 fiber route miles (much of which is local). ALTS claims the number is 339,000.



# A Vibrant Wholesale Fiber Market Exists

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- Wholesale suppliers provide a real alternative to ILEC fiber. For example:
  - FiberLoops.com, a fiber clearinghouse, lists competitive fiber for 175 cities, identifies fiber hotels, and has developed a directory identifying 2000 local fiber networks from over 100 different companies.
  - American Fiber Systems - offers a ‘turnkey’ fiber solution.
  - Utilities possess one-third of the nation’s fiber infrastructure and rights-of-way, which they supply to carriers. Half of new metro networks are being built by utilities.
- These suppliers connect end users to fiber rings, IXC pops, and ILEC Central Offices.

# AT&T's two stories on Competitive Fiber



- AT&T President David Dorman says that AT&T:
  - has “built 18,000 route miles of fiber in 90 cities and . . . [has] about 7,000 buildings on net and that’s growing every day.”
  - “These 90 cities make up about 70 percent of the jurisdictional local intraLATA service marketplace. We’ve put this network where customers are and that’s what we’re focusing on, small to large.”
  - “[O]ver 20 percent of our T1-equivalent services are on net and we’re growing that every day with a real focus at a grass roots, granular level, building-by-building, address-by-address, of moving customers over.”
- AT&T claims BOCs have market power for special access based largely on rate of return data derived from ARMIS reports
  - AT&T’s data is based on archaic regulatory accounting and cost allocation requirements that do not accurately generate real world returns
  - The same reports show that SBC’s return for switched access is 1.37%
  - Either the data provide a distorted (and therefore meaningless) picture of ILECs’ rate of return or switched access rates are unreasonably low. <sup>17</sup>

# Unlimited Conversion of Special Access to UNEs Conflicts with the Goals of the Act

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- Undermines facilities-based competition where it is most advanced.
- Subjects special access to price regulation more onerous than when it was a monopoly service.
- Windfall for IXC's and large users at expense of basic consumers.
- Unbundling special access facilities in competitive markets (e.g. long distance and wireless) that have developed without UNEs cannot be squared with the DC Circuit's decision in *USTA v FCC*.

# Competitive Triggers



- No unbundling of high-cap loops and transport at DS3 and above, including dark fiber.
- If the FCC elects not to remove all unbundling requirements for DS1s, a carveout should be developed, such as:
  - No unbundling of DS1 loops and transport at wire centers:
    - with 2 or more fiber-based collocators,
    - with at least 15,000 business lines, or
    - that generate \$150,000 or more in monthly Special Access revenue.

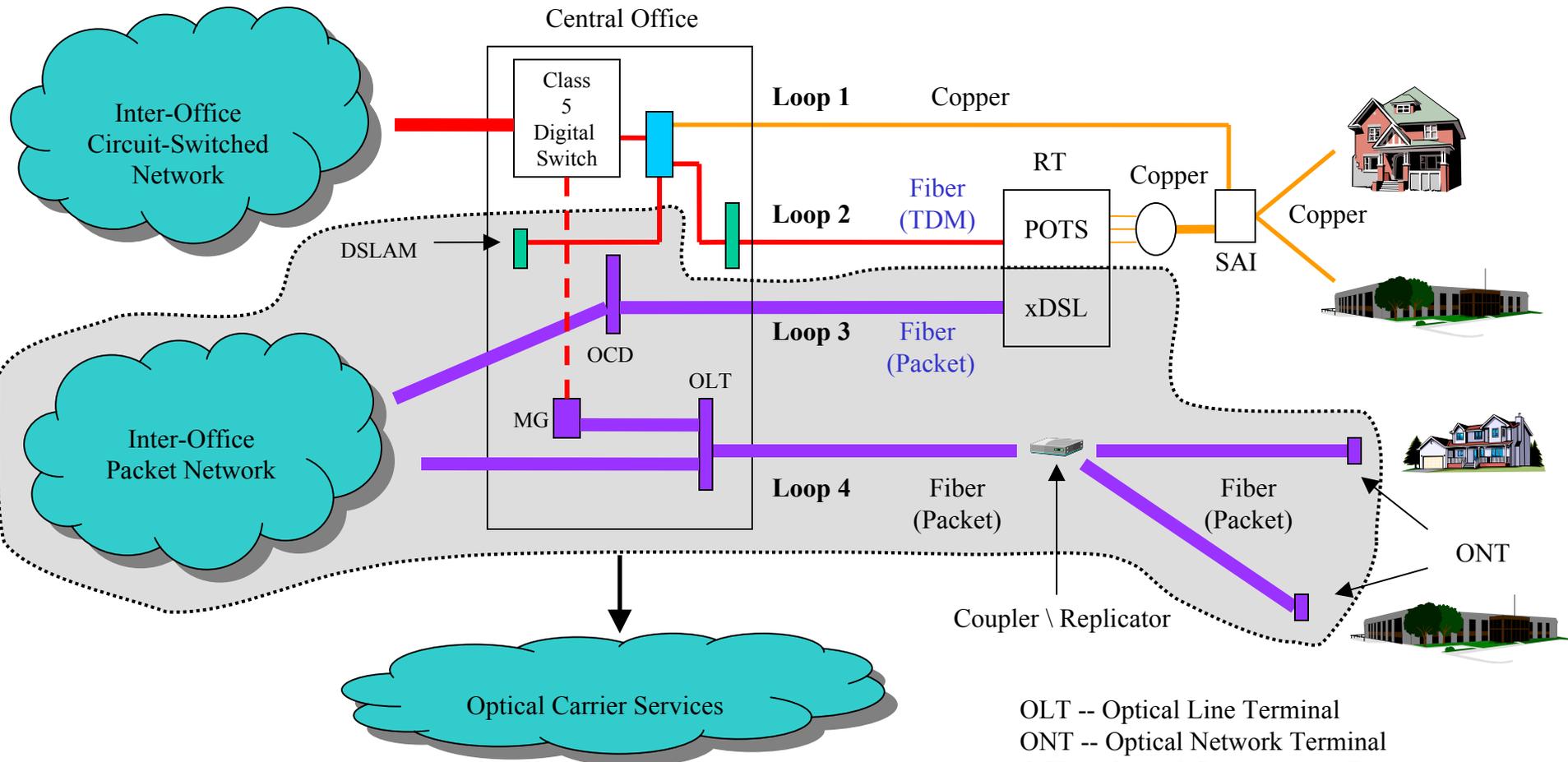
# Broadband Regulatory Framework: Key Issues

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- Unbundling Requirements
  - Do not extend unbundling to packet/fiber facilities
- Dominant Carrier Regulation
  - Classify ILECs as non-dominant in the provision of broadband services and forbear from dominant carrier regulation (e.g., tariffs, CEI)
- *Computer Inquiry* Rules
  - Eliminate outdated rules that interfere with broadband technology integration and innovation (e.g., *Computer II* separation of transmission from information service)
- ISP Access
  - Eliminate mandatory ISP broadband access or adopt uniform cable/wireline ISP broadband access requirement

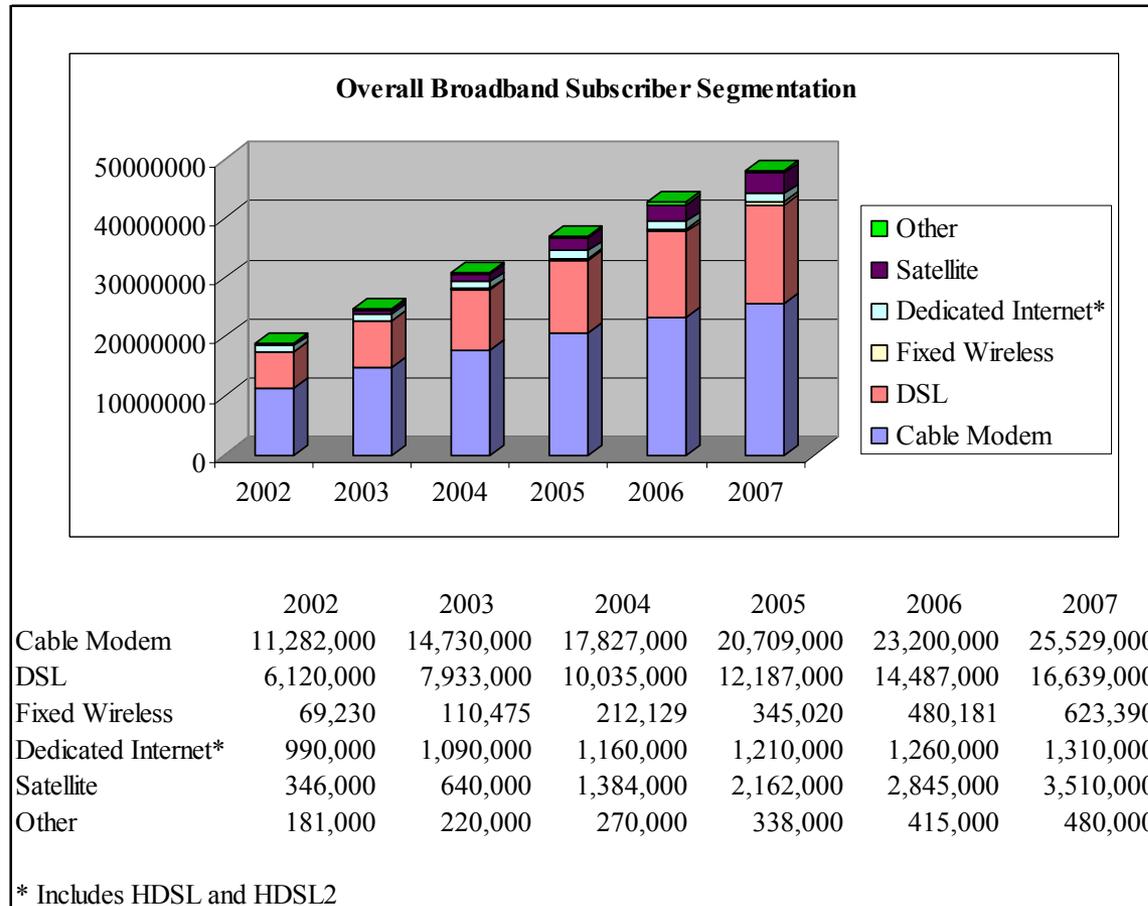
# Regulatory Framework: Packet-Based Services



OLT -- Optical Line Terminal  
 ONT -- Optical Network Terminal  
 OCD -- Optical Concentration Device  
 MG -- Media Gateway

- *At a minimum, packet-based networks and services should be regulated differently from legacy circuit-switched networks*

# Mass Market: Cable Will Continue to Dominate



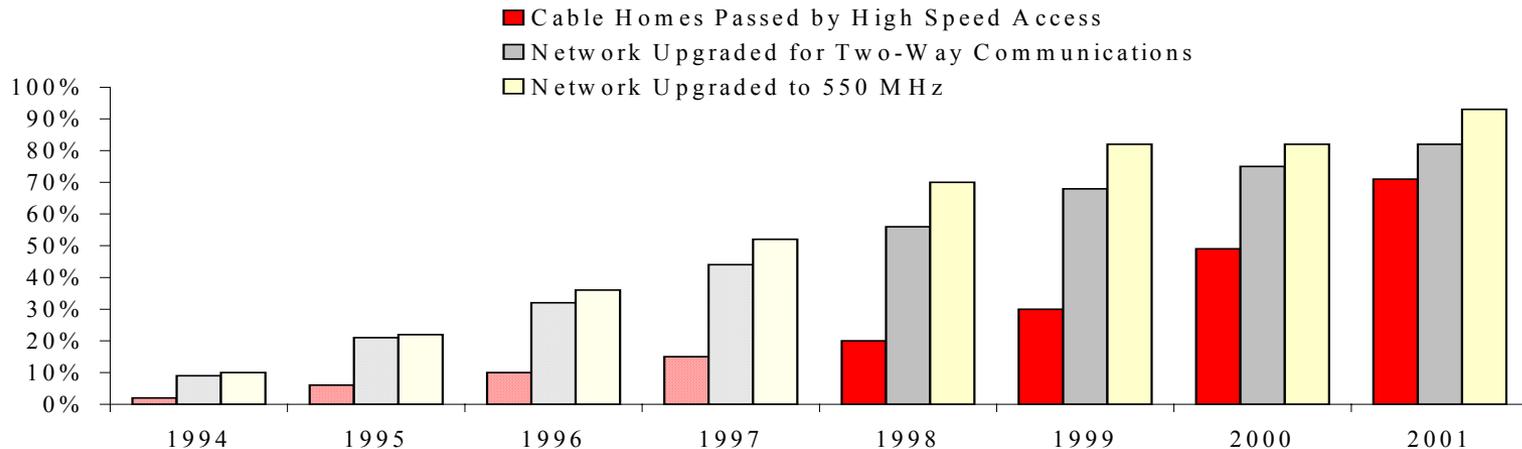
“With over 7 million consumer and 500,000 business subscribers at the end of 2001, cable modem will easily maintain its leadership as the most important broadband connectivity technology in the United States.”

(2002 Broadband Subscriber Forecast, Yankee Group (August 2002))

# Mass Market: Why Cable Will Continue to Dominate



Figure 7. Cable Network Upgrades\*



\*Shaded columns represent estimated status of upgrades.

Sources: See Appendix M.

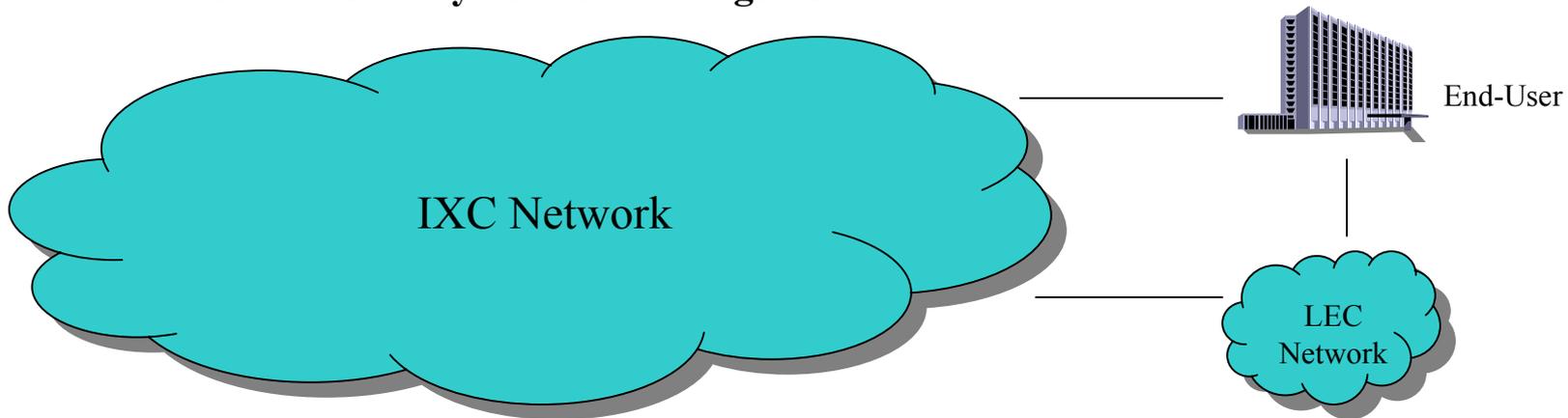
(UNE Fact Report 2002 - V 28 )

- Cable companies *already* have robust broadband networks that can deliver integrated packages of voice, data, and video services
- In order to match this package, ILECs would have to deploy fiber-to-the-home (FTTH)
  - xDSL is merely a transition technology
  - FTTH requires time and huge investment

# Larger Business: IXC's Dominate



## ATM and Frame Relay Service Arrangements



- Customers prefer single provider for “all distance” broadband needs
- Market predominantly served by IXC end-to-end services
  - Evidenced by IXCs’ overwhelming share of ATM and Frame Relay revenues  
(Approximately 85% according to R. Kaplan, IDC Reports 2001-2006 Analysis Forecast (2002))
  - Big 3 IXCs generally avoid interfacing with SBC’s ATM and Frame Relay networks and do not use SBC’s ATM and Frame Relay services as wholesale inputs
- ILECs’ ATM and Frame Relay services have limited interstate application

# Larger Business: IXC's Will Continue to Dominate



- “Bell companies don't present a major threat to WorldCom, Inc.'s business-service group ... [they] don't have the products, systems, or sales forces to attack the middle and high-end segments of the business-service market.”

(Brian Brewer, Chief Marketing Officer for WorldCom - TR Daily May 7, 2002 )

- IXC's are only broadband providers with ubiquitous nationwide networks
  - Easy for IXC's to displace ILEC interstate broadband services
- IXC's have large embedded customer base subject to long-term contracts
- SBC has gained only *de minimis* share of interLATA ATM and Frame Relay market in states where it has obtained § 271 approval

# The FCC Should Develop a National Pre-emptive framework

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- Consistent with judicial precedent and fundamental economics, the FCC should make clear that excessive unbundling imposes societal costs.
- States lack jurisdiction over all inter-modal competitors and thus can not harmonize regulation.
- A patchwork of various state actions create uncertainty and impede investment.
- Rapid financial deterioration of the industry cannot tolerate inevitable process delays of further state proceedings.