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January 24, 2003

**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 January 23, 2003, SBC representatives met with Matthew Brill, Commissioner Abernathy's Senior Legal Advisor regarding the above-listed proceedings. Participating on behalf of SBC were Jim Smith (Senior Vice President - FCC), Don Cain (Managing Director, Federal Regulatory Policy) and Jeff Brueggeman (General Attorney). SBC representatives explained that residential customers can profitably be served using unbundled loops and CLEC-provided switching and the negative impacts of subjecting broadband investment to unbundling obligations. SBC's comments were consistent with its filed materials in the record of these proceedings and the attached materials were used during the meeting.

Pursuant to Section 1.1206(b) of the Commission's rules, this *ex parte* is being electronically filed. I ask that this *ex parte* be recognized with 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, flowing style.

Attachments

cc: M. Brill



Residential Customers Can Be  
Profitably Served Using UNE-L

**January 23, 2003**

# Three Key Questions in Analyzing Impairment



Q. *Do CLECs need unbundled switching in order to provide local service anywhere in the U.S.?*

A. No. The evidence in the record shows that CLECs are providing local service using their own switches in both urban and rural America.

Q. *Are there any operational impediments (e.g., hot cuts) that prevent CLECs from providing local service using their own switches?*

A. No. SBC has demonstrated that it provides the CLECs with timely, cost-effective hot cuts in the volumes necessary for CLECs to serve mass-market customers and that the hot cut process is scaleable.

Q. *Are there economic barriers keeping CLECs from providing local service using their own switches?*

A. No. SBC's analysis demonstrates that CLECs winning 5% to 10% of access lines in wire centers of 5,000 lines or more can profitably serve residential customers using their own switch. Moreover, since the markets served by CLECs contain both large and small offices, even where some smaller wire centers are not profitable, CLECs can still serve the mix of offices profitably.

# SBC's Business Case Analysis



- Financial model constructed to evaluate whether CLECs can profitably serve residential customers using their own switch with loops and transport supplied by SBC
- SBC analyzed wire centers with relatively small numbers of access lines
  - Analyzed various sized wire centers
    - One or more CLECs use their own switches to serve customers in 78% of offices with more than 5,000 lines
    - Two or more CLECs use their own switches to serve customers in 63% of offices with more than 5,000 lines
  - Offices with fewer than 5,000 access lines represent 42% of all SBC wire centers

# CLEC Business Case Model



- The model compares the costs of a UNE loop serving arrangement to the residential revenue opportunity available to competitors
- SBC modeled three states with high UNE-P volumes, one from each of SBC's regions
  - California, Michigan and Texas
  - These three states represent 64% of the residential UNE-P lines in all of SBC

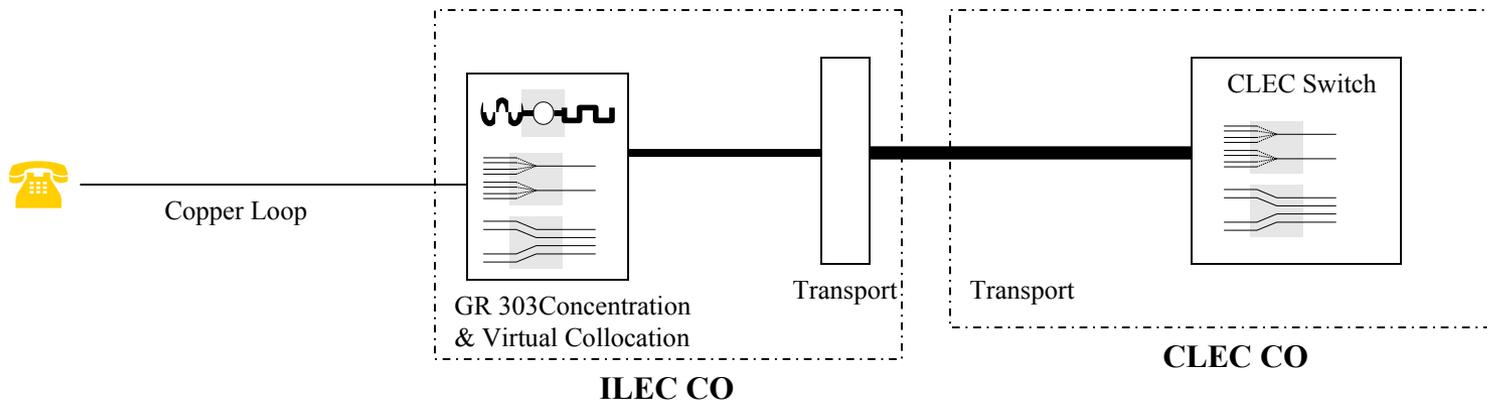
# Conservative Model Assumptions

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- Used residential customer revenues only
  - Business customers provide greater revenue & margin opportunities
- Developed at a wire center level
  - CLECs make entry decisions for a larger market area with greater revenue opportunities and cost savings
- Included using a new switch to serve the wire center
  - CLECs already have numerous switches which can and do serve residential customers
- Included new collocation arrangements
  - CLECs have already established 24,900 collocation arrangements
  - 70% of SBC offices with more than 5,000 access lines have collocation

# Modeled cost components



- Included costs for loops, cross-connects, virtual collocation, concentration equipment, transport, switching, long distance and SG&A
- Reflects both non-recurring and recurring costs

# Modeled Revenue Opportunities



- CLECs provide customers with a package of local, long distance and custom calling features
- Revenue opportunities used in SBC's analysis are fully consistent with local and long-distance packages currently provided to residential customers

*“Finally, a place where "unlimited" really means unlimited.  
With The Neighborhood, you're free to call  
anyone, anytime, anywhere in the U.S.  
for one low monthly price.  
So there are no limits on who you can call,  
when you can call, or where you can call.  
Sign up and get the following features  
for one monthly price of \$49.99 - \$69.99.”*

*[www.theneighborhood.com](http://www.theneighborhood.com)*

# UNE-L Competition Generates Positive Margins



California		CLEC Retail Price Points		
		\$40	\$50	\$60
		Margin		
Market Share	5%	-\$2.31	<b>\$5.69</b>	\$13.69
	10%	-\$0.65	<b>\$8.65</b>	\$16.65

Michigan		CLEC Retail Price Points		
		\$40	\$50	\$60
		Margin		
Market Share	5%	-\$0.97	<b>\$8.97</b>	\$16.97
	10%	\$6.48	<b>\$14.48</b>	\$22.48

Texas		CLEC Retail Price Points		
		\$40	\$50	\$60
		Margin		
Market Share	5%	-\$3.25	<b>\$4.75</b>	\$12.75
	10%	-\$0.03	<b>\$7.97</b>	\$15.97

Notes: Based on CO with 5K access lines. Margins reflect SG&A costs estimated as 20% of revenue.

*Our study demonstrates that CLECs can profitably serve residential customers using a facilities-based UNE-Loop serving arrangement*

# Conclusions



- CLECs can profitably serve residential customers in wire centers with 5,000 access lines
  - With a mix of residential and business customers, CLECs can profitably serve customers in wire centers smaller than 5,000 access lines
- CLECs will in fact serve a larger market consisting of both large and small wire centers
  - Even if some smaller wire centers are not profitable, in the aggregate, CLECs can profitably serve the mix of wire centers
  - SBC is also not profitable in all offices, but does not have the luxury of picking and choosing its customers



***Expanding UNE Regulation to Last Mile  
Broadband Investment***

***January 23, 2003***



# *Introduction*

- ***Broadband Investment Should be Encouraged by the Commission.***
  - **Packet/fiber broadband investment in the local loop should be exempt from UNE regulation – with no exceptions.**
    - **UNE regulation constrains broadband investment.**
    - **Tilts the risk/reward balance against mass market deployment.**
    - **Shifts investment risk from CLEC to ILEC.**
    - **Creates insurmountable disparity between cable & ILEC broadband.**
  
- ***CLECs would continue to obtain access to non-packet voice and data UNEs where “impaired”.***
  - **Voice grade UNE loops.**
  - **Non-packet high capacity UNE loops (e.g. DS1s).**
    - **Available today over existing hybrid copper/fiber loop network.**

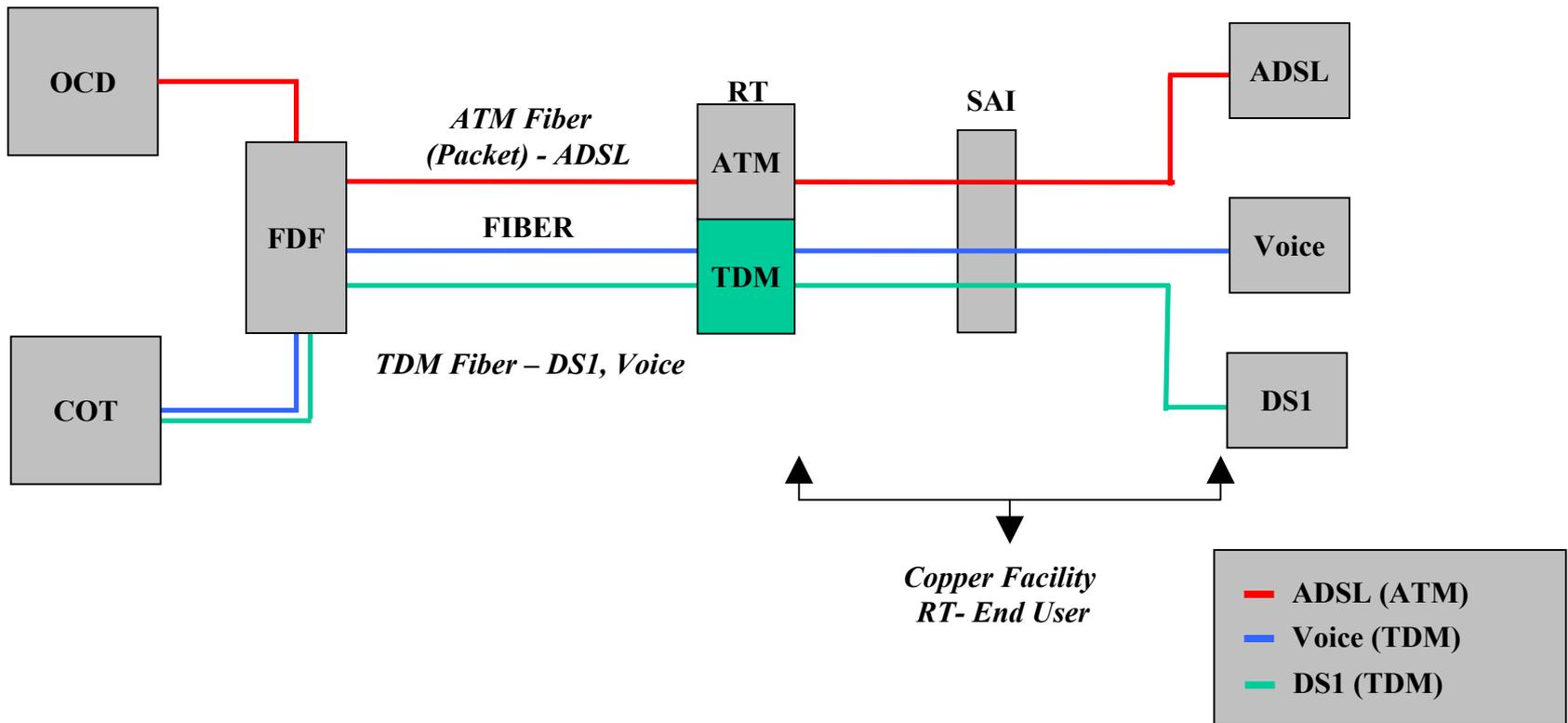


# *Hybrid Copper/Fiber Loop Investment*

- *Goal: Overlay existing network for ADSL to the mass market.*
  
- *Capabilities:*
  - **Non-packet (TDM) = voice and other services (i.e. DS1s).**
  - **Packet (ATM) = ADSL.**
  
- *Regulatory Costs to Date:*
  - **SBC has already spent hundred of millions of dollars to enable competitive access to broadband.**
  - **Insufficient demand to recover costs.**
  
- *Extending UNE Regulation to Packet/Fiber Investment.*
  - **Potential for hundreds of millions of dollars in additional costs.**

# Capabilities Today

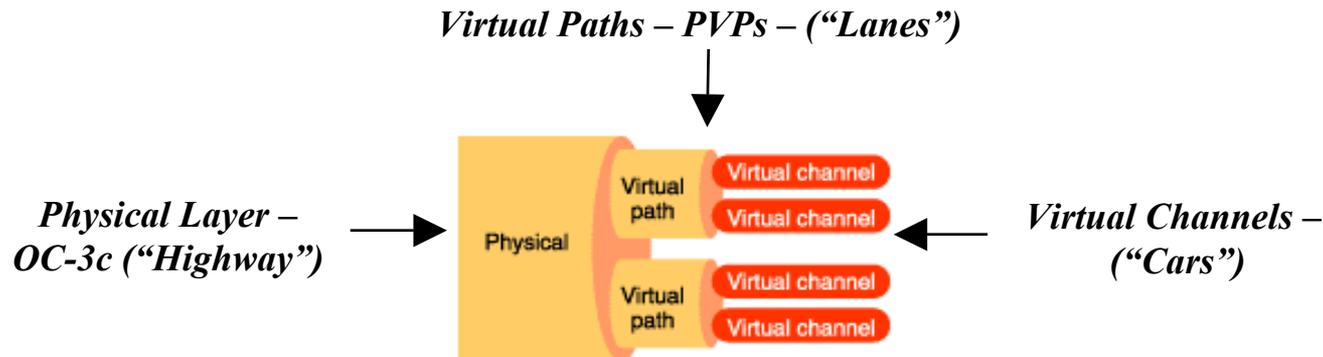
- **UNE Capabilities: Voice, DS1.**
- **Service Capabilities: ADSL.**



# Fundamentals: ATM Networks & Bandwidth

## ➤ Bandwidth Allocation

- Physical facility (OC-3c) – “Highway”.
- Virtual paths (VPs) – “Lanes” on the highway.
- Virtual circuits (VCs) - Individual “cars” on the highway.



## ➤ End User Services

- Assigned a virtual circuit for their respective service.
- Ride the various virtual paths available over the ATM pipe (OC-3c).
- Can be provisioned to function in different ways:
  - *Constant Bit Rate (“CBR”)* – Dedicates bandwidth to a given end user.
  - *Unspecified Bit Rate (“UBR”)* – Best available form of service.

# *UNE Regulation: Inefficient Use of Investment*

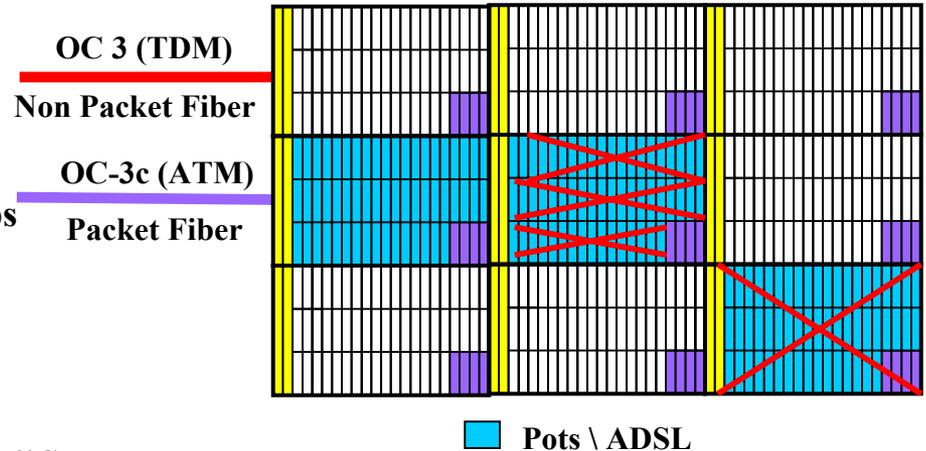


- *DS1 & voice grade equivalent UNE loops over packet.*
  - **Mandates inefficient bandwidth usage inconsistent with system design.**
    - **Voice grade and DS1s require CBR.**
  - **Pronto economics predicated upon UBR (not CBR).**
    - **Takes advantage of the “bursty” nature of data (e.g. internet) traffic.**
    - **Yields high speed ADSL service without dedicated bandwidth.**
    - **Investment for ADSL can reach the largest audience at the lowest cost.**
      - **Design is fundamental to being cost competitive with cable modems.**
  
- *Impact: Limits ROI and the incentive to deploy.*
  - **Increases costs - Additional capital & expense to provide packet UNEs.**
  - **Potentially strands non-packet capacity intended to be used for voice & DS1s.**
  - **Decreases revenues - TELRIC vs. market based rates.**
  - **Deprives ILECs of ability to manage and use their investment as intended.**

# UNE Regulation: Stranded Capacity

## ➤ Key Point

- **Inefficient use of RT capacity**
  - G.SHDSL (ATM): 58 Lines vs. 672
  - G.SHDSL (ATM): Symmetric 2.3 Mbps
  - T1: 87 Lines vs. 672



## ➤ Constant Bit Rate & DS1 Implications

- Impacts ADSL capacity, strands physical ports.
- Current capacity approximately 672 total ADSL end users per RT.
- Maximum DS1 capacity 87 DS1s per OC-3c strands nearly 87% port capacity.

## ➤ Voice Services

- Same potential impacts - coupled with DS1 requirements would drive new capital requirements.



# *Regulation & Investment Impacts*

## ➤ *Incremental Regulatory Costs = Disincentive Investment*

- **Existing requirements have already increased costs and reduced economic attractiveness.**
  - **Disadvantages ILEC broadband compared with cable modem service**
- **Additional requirements would exacerbate the problem by further reducing the economic viability of broadband investment.**
- **Not likely that SBC will move forward with future investments if the same uncertainty exists.**
  - **At a minimum new investment would be targeted and not large scale.**
  - **SBC's March 25, 2002 BPON ex parte estimated at least a 20-50% increase in infrastructure costs for CLEC access.**