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February 5, 2003

*By Electronic Filing*

Marlene H. Dortch, Secretary
Federal Communications Commission
445 Twelfth Street, S.W.
Washington, D.C. 20554

Re: Written Ex Parte of Bridgecom International, Inc. and Metropolitan Telecommunications in CC Docket Nos. 01-338, 96-98, and 98-147

Dear Ms. Dortch:

Bridgecom International, Inc. and Metropolitan Telecommunications (collectively, the "Companies"), by their counsel, and pursuant to Section 1.1206(b)(1) of the Commission's rules, hereby submit this written *ex parte* proposal in the above-referenced dockets.

## I. The Purpose of the Act

Congress passed the Telecommunications Act of 1996[1] (the "Act") "[t]o promote competition and reduce regulation in order to secure lower prices and higher quality services for American telecommunications consumers and encourage the rapid deployment of new telecommunications technologies."[2] Some have misinterpreted this stated goal as expressing a preference for investment in the legacy facilities that comprise the Regional Bell Operating Companies' ("RBOCs") circuit-switched telephone network, a position that in fact stands in stark contrast to Congressional will. While it is certainly true that the Act's pro-competitive provisions extend equally to advanced services and circuit-switched voice services,[3] Congress'

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[1] Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (codified at 47 U.S.C. §§ 151 *et seq.*).

[2] *Id.* at preamble.

[3] *In re Deployment of Wireline Services Offering Advanced Telecommunications Capability*, Memorandum Opinion and Order, and Notice of Proposed Rulemaking, 13 FCC Rcd 24011, 24017 (1998).

only stated preference was to encourage the deployment of *new technologies and facilities* that would promote access to advanced services capabilities for all Americans.[4] To attribute any other intent to Congress would not only be contrary to the plain language of the Act, but also would irrationally suggest that by passing the Act Congress sought to promote investment in outdated technologies and facilities.

As stated in the Act's preamble, Congress sought to procure lower prices and higher quality services for all Americans, which can only be achieved through vigorous competition, and to ensure that all Americans have access to advanced services in an information age. Congress recognized, however, that these aims could only be achieved if there was true competition in the local exchange telecommunications market, which, in turn, could only be possible if the RBOCs opened their networks to competitors. To that end, Congress provided for three paths to local market entry in the Act.

### *A. Congress Expressed No Preference for One Market Entry Strategy Over Another*

In passing the Act, Congress expressly provided for three paths to competitive local market entry – construction of alternative networks, use of UNEs, and simple resale of local services. The Commission most eloquently described Congress' intent in its *Local Competition Order*, in which it stated as follows:

> The Act contemplates three paths of entry into the local market -- the construction of new networks, the use of unbundled elements of the incumbent's network, and resale. The 1996 Act requires us to implement rules that eliminate statutory and regulatory barriers and remove economic impediments to each. We anticipate that some new entrants will follow multiple paths of entry as market conditions and access to capital permit. Some may enter by relying at first entirely on resale of the incumbent's services and then gradually deploying their own facilities . . . . Others may use a combination of market strategies simultaneously . . . . Some competitors may use unbundled network elements in combination with their own facilities . . . other new entrants may pursue a single entry strategy that does not vary by geographic region or over time. Section 251 neither explicitly or implicitly expresses a preference for one particular entry strategy. Moreover, given the likelihood that entrants will combine or alter entry strategies over time, an attempt to indicate such a preference in our section 251 rules may have unintended and undesirable results. Rather, our obligation in this proceeding is to

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[4] 47 U.S.C. § 157 (2001).

establish rules that will ensure that all pro-competitive entry strategies may be explored.[5]

Perhaps most notable in the Commission's discussion of Congress' vision is the Commission's explicit recognition that market conditions and access to capital largely determine the market entry strategy of competitive local exchange carriers or CLECs. It is no secret that the telecommunications sector is in disarray, and that the capital markets are completely shut to CLECs due to the risk and uncertainty surrounding their operations. There are few endeavors that are as capital intensive as the deployment of an alternative telecommunications network, and few if any CLECs have access to the capital necessary to do so at this time. Faced with these market realities, many CLECs have turned to other market strategies. But resale has proven to be a money-losing proposition because the margins established through the avoided cost methodology are wholly inadequate to fund operations. Indeed, resale has not even proved to be a viable temporary market entry strategy. Virtually every CLEC that has attempted to use resale on an interim basis to gain a critical mass of customers until such time as another market entry vehicle could be employed has had to abandon the strategy, as the short term losses associated with resale were too great.[6]

### *B. Recent Entry Through UNE-P*

CLECs, however, have finally begun to successfully enter the local exchange market through the unbundled network element platform or UNE-P. Competitive carriers now serve more than 10 million small business and residential consumer access lines nationwide through UNE-P, thereby affording the nation's consumers nearly $9 billion in annual savings, facts noted

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[5] *In re Implementation of the Local Competition Provisions of the Telecommunications Act of 1996*, First Report and Order, 11 FCC Rcd 15499, 15509 (1996) ("*Local Competition First Report and Order*"), *aff'd in part and vacated in part sub nom.* Competitive Telecommunications Ass'n v. FCC, 117 F.3d 1068 (8th Cir. 1997) and Iowa Utilities Bd. v. FCC, 120 F.3d 753, *aff'd in part and remanded sub nom.* AT&T v. Iowa Utilities Bd., 119 S. Ct. 721 (1999); *In re Implementation of the Local Competition Provisions of the Telecommunications Act of 1996*, Order on Reconsideration, 11 FCC Rcd 13042 (1996); *Implementation of the Local Competition Provisions of the Telecommunications Act of 1996*, Second Order on Reconsideration, 11 FCC Rcd 19738 (1996); *In re Implementation of the Local Competition Provisions of the Telecommunications Act of 1996*, Third Order on Reconsideration and Further Notice of Proposed Rulemaking, 12 FCC Rcd 12460 (1997) (further recons. pending).

[6] *See e.g.*, New Paradigm Resources Group., Inc., *1999 Annual CLEC Report* (noting that the bankruptcy of USN, and exit of e.spire and WinStar from resale, signaled the end of resale as a viable strategy) (available from author).

by certain members of Congress in their January 24, 2003 letter to the Commission.[7] In view of CLECs' recent success through this market entry strategy, RBOCs have launched a relentless assault against UNE-P at every conceivable level, including before Congress, before state and federal regulators, and in the courts. Because of the self-serving and pernicious nature of the RBOCs' arguments, it is difficult to imagine that they would resonate in any forum, but they appear to have resonated at the Commission. There have been public indications that the Commission may support the adoption of rules that would significantly undermine CLECs' ability to provide service via UNE-P, and that would require CLECs to deploy their own switched-based networks. As discussed herein, local market entry through switch deployment has not proven to be a viable market entry strategy.

The Commission has stated that it has a responsibility to remove economic impediments to each path of market entry.[8] If the Commission were to undermine UNE-P, a market entry strategy that the Supreme Court has specifically endorsed as reasonable,[9] two of the three paths to market entry, *i.e.*, resale and UNEs, will have been effectively eliminated as stand-alone market entry strategies. This would leave CLECs with the choice of either deploying an entirely new network, or engaging in a hybrid market-entry strategy whereby certain elements of the RBOCs' networks would be used in combination with a CLEC's own facilities. Although both market entry strategies are laudable, virtually no carrier has successfully implemented them, and certainly not at the analog voice grade level. The carriers that have tried have either failed or soon will fail.

The Commission has indicated that it should not adopt rules that favor one market entry strategy over another, lest there be "unintended" and "undesirable" results.[10] While it is unclear what results the Commission would intend or desire to achieve by adopting the rules that are currently being contemplated, the results of doing so are quite foreseeable -- the widespread elimination of the competition that has finally (after seven years) started to take hold in, and the

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[7] Letter from Edward J. Markey, Representative, United States Congress, et al. to Michael K. Powell, Chairman, Federal Communications Commission, et al. 1-2 (Jan. 24, 2003) (on file with author).

[8] *Local Competition First Report and Order* at 15509.

[9] *See* Verizon Communications, Inc. v. FCC, 535 U.S. 467 (2002) ("*Verizon*").

[10] *Local Competition First Report and Order* at 15509.

effective re-monopolization of, the local telecommunications market in contravention of Congress' goals.[11]

## II. The Mere Existence of CLEC Switches in Various Markets Has No Correlation to CLECs' Impairment Absent Access to Unbundled Local Switching

The Companies begin by highlighting some significant events from the past seven years that demonstrate the preposterous nature of any argument that investment in traditional, outdated facilities should be promoted over the availability of UNE-P. There has been significant capital investment in the switch-based approach since the passage of the Act. RBOC arguments that UNE-P creates a disincentive to CLEC investment in facilities ring hollow in view of actual CLEC investment, as CLECs invested more than $55 billion in facilities in the four years after passage of the Act alone. Indeed, the Supreme Court has already summarily rejected RBOC arguments along those lines as specious in view of market facts.[12] To the extent that there is any disincentive to the deployment of a switched-based network, it is this – it has not worked.

Virtually every CLEC that has endeavored to deploy a switch-based network has declared bankruptcy or stands on the verge of bankruptcy. As discussed more fully herein, there have been more than fifty such bankruptcies in the last few years alone. Billions of dollars in investment have vanished as a result of the failure of this market entry strategy. By way of illustration, and as reflected in the chart attached hereto as Attachment A, Allegiance Telecom, perhaps the most prominent of the CLECs that is not one of the three major interexchange carriers, had a market capitalization of nearly $6 billion and a stock price of approximately $50 per share in November of 1999. As of the date of this filing, Allegiance Telecom's stock price is a meager 47 cents per share, and the company's value has fallen to less than $59 million.

The remarkably low market valuations for those few switch-based CLECs that continue to exist reflect the market's expectation that there are only more problems to come. These incredibly low valuations apply equally to switch-based CLECs that have restructured and eliminated substantial debt, such as ITC^DeltaCom or McLeod, which shed approximately 75%

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[11] Stephen Labaton, *Dream Nears Reality: Ease Up at the F.C.C.*, N.Y. TIMES, Feb. 2, 2003, *available at* http://www.nytimes.com/2003/02/02/business/yourmoney/02FCCC.html.

[12] *Verizon* at 554.

of their debt by restructuring, and companies that have managed to survive, such as Allegiance Telecom. Many of these carriers are now urging unrestricted access to UNE-P.[13]

There can be no more compelling evidence of impairment than the empirical evidence currently before the Commission. Against this backdrop, in which the strongest of the switch-based CLECs today stands on the verge of collapse, the RBOCs would have the Commission believe that CLECs can simply purchase a switch and be up-and-running as a switch-based CLEC, a position that founders on market reality. In fact, the majority of CLECs that have declared bankruptcy have these facts in common: 1) they had sufficient access to capital; 2) they employed a traditional switch-based approach to market entry; 3) their business plans involved intensive human coordination with the RBOCs; and 4) they utilized Class 5 local voice switches. Yet they still failed.

CLECs have tried and tested local market entry through the switch-based approach for over seven years and the results are in – there is not a single winner. Deployment of a switch-based network has not proven to be a viable market entry strategy at any point – there can be no more convincing evidence of impairment. Having crushed one segment of its competition, the RBOCs have now turned their attention to UNE-P providers, a group that has attained limited success. And they have done so in a manner that is most insidious – they have duped Congress and the Commission into believing that if UNE-P is eliminated, they will invest in new infrastructure, a position from which the RBOCs have already begun retreating[14] in view of the investment community's dispelling of this notion (*see* the JP Morgan study attached hereto as Attachment B).

### *A. The Number of CLEC Switches in a Market Says Nothing About CLECs' Ability to Compete*

The RBOCs have suggested that the mere existence of a number of local switches in a LATA is proof that CLECs' ability to provide local service to customers will not be impaired if switching is eliminated as a UNE. This is an uninformed view to say the least, as the mere possession of a switch is only a small part of the equation. Indeed, the record is replete with evidence demonstrating that the costs and operational difficulties associated with deploying a switch-based network are so enormous as to preclude ubiquitous market entry utilizing such a

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[13] Letter from Andrew M. Walker, President and Chief Operating Officer, ITC^DeltaCom, to Kathleen Abernathy, Commissioner, Federal Communications Commission 1 (Jan. 24, 2003) (on file with author) (the "*ITC^DeltaCom Ex Parte*").

[14] Tom Leithauser, *Seidenberg: UNE-P Phaseout Won't Spur Immediate Boost In Verizon's Spending*, TR.COM, Feb. 5, 2003, *available at* http://www.tr.com.

strategy. To be clear, the issue for CLECs is not whether the mere purchase of a switch is possible, but rather whether the deployment of a switched-based network is technically and economically feasible, *i.e.*, whether a requesting carrier would be impaired absent access to unbundled local switching, taking into consideration carrier-specific factors.[15]

The RBOCs have submitted data in this proceeding regarding the number of CLEC switches in existence today as if that, in and of itself, provides any insight into CLEC impairment.[16] It is worth noting that the number of CLEC switches portrayed is woefully erroneous. For example, Metropolitan Telecommunications is credited by Verizon as owning two voice switches when it does not. Moreover, the record reflects that the relevant databases are rarely updated when a CLEC becomes insolvent or otherwise ceases to do business (as the majority of CLECs have), thereby making it appear that there are a host of active switches when in fact many lie dormant.[17] And as for the truly active switches, many are owned by CLECs who were only able to continue operating by virtue of massive debt restructuring.[18] These situations

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[15] *See* Competitive Telecommunications Ass'n v. FCC, 309 F.3d 8, 12-13 (D.C. Cir. 2002).

[16] *See* Comments and Contingent Petition For Forbearance of Verizon Telephone Companies, Review of Section 251 Unbundling Obligations of Incumbent Local Exchange Carries, CC Dkt. Nos. 01-338, 96-98 and 98-147, April 5, 2002 at p. 99.

[17] *See* Attachment to Letter from Thomas M. Koutsky, Z-Tel, to Marlene H. Dortch, Secretary, Federal Communications Commission, CC Docket Nos. 01-338, 96-98, and 98-147 (Dec. 23, 2002), Supplemental Testimony of John M. Ivanuska, Docket No. 24542 (Tex. P.U.C. Jan. 25, 2002) at 1-3 (noting that LERG listed 50 switches in Texas for CLEC Grande Communications and attaching data from stating that it only had 4 switches in Texas). Mr. Ivanuska examined the quality of the LERG for six other CLECs and found that the LERG data "materially overstated the number of CLEC switches in Texas." Mr. Ivanuska stated that the purpose of the LERG database is to route telephone calls and that "[t]he LERG is not necessarily a useful and reliable source for CLEC switching information, particularly when an analysis of the LERG data is not performed thoroughly, yielding implausible results." *Id.*, Ivanuska Supplemental at 4-5. Even SBC's witness that sponsored the LERG data in that Texas proceeding, William L. Fitzsimmons, admitted to its limitations, stating on the stand that the LERG does not indicate which switches are operational, which are utilized to provide only high-speed data services, which are owned by companies in bankruptcy, which are scheduled for deinstallation or decommissioning. *See id.* at Attached Transcript of Texas PUC Hearing in Case No. 24542 at 253-55 (Jan. 28, 2002).

[18] Several CLECs that own their own switches have made filings in this proceeding to that effect. *See, e.g., ITC^DeltaCom Ex Parte.*

cannot be recreated, as the investment community is not interested in again risking billions of dollars in a switch-based business plan only to watch its funds disappear.

In the last two years, more than fifty CLECs have declared bankruptcy, many of which are directly attributable to the enormous debt associated with the deployment of a switch-based network (*see* Attachment C). The few remaining CLECs are either debt-ridden and struggling or have restructured their debt. These market realities lead to the inescapable conclusion that, at least in the present environment, deployment of a switch-based network is not economically or operationally feasible. Put another way, CLECs today would be impaired in their ability to provide local service absent access to unbundled local switching, and thus in their ability to provide service to small business and residential consumers.

Deployment of a switch-based network requires enormous up-front capital expenditures and takes years to construct. In this unstable economy, the capital markets are simply not open to CLECs, thus they do not have access to the capital necessary to construct such networks. It is worth noting that most of the CLEC switches that exist today were procured in one of the greatest growth environments in history, the three years after passage of the Act. For the most part, not even the CLECs who entered the local exchange marketplace during those prosperous times, when their access to capital seemed limitless, have succeeded or significantly penetrated any market, as evidenced by the numerous CLEC bankruptcies.

Finally, merely citing the number of CLEC switches provides absolutely no insight into the manner in which they are used. The vast majority of CLEC switches are used to provide high-capacity services, *i.e.*, service at T-1 levels and above,[19] and few are used to provide voice grade, *i.e.*, DS-0 services to small business and residential end users, which are precisely the customers served by the Companies. Thus, the mass market goes largely unaddressed by CLEC switches, as only the RBOCs have such ubiquitous reach. Any impairment analysis must necessarily take into consideration such factors, which can only properly be done at the state level.

### *B. CLECs Would Be Impaired Absent Access to Unbundled Local Switching*

If the RBOCs were to successfully undermine UNE-P, CLECs would be forced to attempt to deploy their own switch-based networks ubiquitously, irrespective of their business plans or what representations they have made to the investment community, a situation which the investment community has denounced as unreasonable.[20] The issue is further complicated by an

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[19] PACE Coalition, *The UNE-P Fact Report* 3 (Jan. 2003) (on file with author).

[20] J.P. Morgan Chase & Co., *Communications Equipment: Potential FCC Ruling a Red Herring for Tech Investors* (Jan. 16, 2003), *available at* http://researchwise.jpmorgan.com.

absurdly unrealistic notion of the time frames required for CLECs to responsibly deploy network facilities even where operational and economic impairments are alleviated. There seems to be an expectation that these nascent enterprises should be able to gain access to capital sufficient to replicate 100 years of infrastructure in the blink of an eye, infrastructure, it might be added, that the RBOCs deployed on the backs of consumers through rate of return regulation. Yet the RBOCs seems strangely offended at the possibility that CLECs might employ a market entry strategy that would allow them to sustain their operations while doing so. Given the stark reality that the capital markets will be unwilling to invest in CLECs who wish to operate in such a poorly conceived and risky environment, virtually all of the remaining CLECs that have managed to survive thus far will fail.[21]

Because of the RBOCs' bottleneck control over "last-mile" facilities (the loop that reaches the customer), CLECs that possess their own switches are forced to deploy their networks in a manner that accommodates ILECs' historical and inefficient network architecture. This means that CLECs must construct interoffice transmission facilities between their switches and each and every ILEC central office serving their customers, must collocate at each such central office, and most notably, must work with ILECs to undergo the mass migration of their customer bases to their newly deployed networks through the hot-cut process, a process riddled with human error, inefficiencies, and exorbitant costs. The time and cost associated with these processes are so enormous as to render them infeasible. And as for the mass migration of CLEC customers from existing ILEC networks to CLECs' newly deployed networks through the hot-cut process, the record reflects that there simply are no mechanisms in place to ensure an orderly and seamless mass migration, at least with respect to small business and residential consumers.

The discourse that is taking place before the Commission largely centers on what hypothetical innovations and improvements are necessary to accommodate the mass migration of CLEC customers from a UNE-P to a so-called UNE-L environment, with many of the proposed innovations having never been tested in the actual marketplace. The Commission then appears prepared to make an extraordinary leap and conclude that since various innovations and improvements are hypothetically possible, a rule should be adopted relying on them to come to pass in the near future, and thus competitors should be deprived of access to RBOC switching based on that unfounded hope. This, of course, is placing the cart before the horse. The only rational course for the Commission to take is to first ensure that technical and operational hurdles faced by CLECs are addressed. Only after the RBOCs have proven that they are able to address CLEC concerns can any meaningful review of the list of network elements RBOCs must make available to competitors be undertaken.

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[21] Sue O'Keefe, *No Relief*, TELECOMMUNICATIONS MAGAZINE, Jan. 9, 2003, *available at* http://www.telecommagazine.com.

Such an approach is at the very heart of *USTA v. FCC*,[22] where the D.C. Circuit criticized the Commission for adopting national rules that failed to take into consideration sufficiently granular and market-specific conditions. If the Commission were to once again adopt national rules in view of the very specific impairments faced by CLECs today in various markets, the Commission will have ignored *USTA's* directive.

The record contains volumes of material discussing the economic and operational impairments associated with competitive entry into the local exchange market through deployment of a switch-based network. As mentioned previously, absent unbundled local switching, CLECs would be forced to deploy switches in each of their markets, to collocate and install interoffice transmission facilities between their switches and each of the central offices where they have customers, and to undergo the hot-cut process, irrespective of any carrier-specific impairments.

Installation and testing of a switch costs several million dollars and can take nearly a year. Not only can collocation cost several hundred thousand dollars per central office, but the process also takes many months, and by their own admission RBOCs can accommodate only limited demand. RBOC provisioning of interoffice transmission facilities has traditionally been plagued by delay, and RBOCs have taken the position in several cases that they have no obligation to deploy such facilities in the first place.[23] Finally, and perhaps most notable, is the hot-cut process, which due to the cost and human error involved constitutes a barrier to entry in and of itself. Indeed, the Companies maintain that until such time as electronic loop provisioning is available, the mass migration of customers from an RBOC to a CLEC network is not operationally or economically feasible.

Collectively, the Companies have customers that are served by literally hundreds of central offices. It would be impossible for the Companies to deploy facilities to each of these central offices in the near future in view of the costs, delays, and inefficiencies associated with the process, and in no event could any migration occur until such time as the operational problems associated with the migration process have been resolved. In short, the Companies' concerns are entirely consistent with the concerns expressed by members of Congress in their letter to the Commission of Friday, January 24, 2003, *i.e.* if the Commission were to remove local switching from the list of network elements that must be made available on an unbundled basis, CLECs would be irreparably harmed (a standard which is much higher than impairment),

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[22] United States Telecommunications Ass'n v. FCC, 290 F.3d 415 (D.C. Cir. 2002).

[23] Letter from Catherine I. Riley, Chairman, Maryland Public Service Commission, et al. to William R. Roberts, President, Verizon Maryland Inc. (Dec. 16, 2002), *available at* http://www.psc.state.md.us/psc.

thereby depriving their customers of competitive service offerings and lower rates. It should be noted that the Companies are the sole providers of competitive local exchange service offerings to many of their customers.

## III. States Should Make Impairment Judgments at a Granular Level, Consistent With USTA

The Companies are particularly supportive of the position shared with virtual unanimity by State PUCs and the competitive telecommunications industry that State PUCs are in the best position to evaluate whether competitors within their states will be "impaired" absent unbundled access to local switching or any other element of the RBOCs' networks. NARUC has intensely argued that the Commission should not usurp its member states' authority[24] because it recognizes the superficial nature of the arguments that are being presented at the Commission, and do not want future competition in their states to be affected by these unsupportable positions.

As mentioned previously, the court in *USTA v. FCC* mandated that the Commission utilize a more granular analysis in making unbundling determinations, taking into consideration specific market conditions. The level of granularity that is called for by *USTA* can only adequately be undertaken by State PUCs. ***USTA did not mandate that the Commission set national standards for unbundling determinations, nor did it mandate that the Commission set forth some roadmap pursuant to which over the next few years RBOCs will be freed of unbundling obligations if certain benchmarks are satisfied.*** To the contrary, the court in *USTA* expressed grave skepticism over the Commission's ability to promulgate national standards that can adequately take into consideration impairment at a granular level. In short, *USTA* mandates that specific determinations be made as to whether CLECs are impaired today, taking into account granular considerations, not whether some hypothetical set of circumstances would alleviate such impairment in the future.

By way of illustration, the record in this proceeding is replete with evidence that the customer migration or hot-cut process is inefficient, prohibitively expensive, and riddled with human error. The New York Public Service Commission, one of the most sophisticated State PUCs in the country on telecommunications competition matters, has only recently instituted a proceeding to investigate the operational problems associated with the hot-cut process, and to develop a solution to such problems for the state of New York. Most other State PUCs have not yet instituted such proceedings, and it would be inappropriate for the Commission to adopt national guidelines governing this and other issues associated with the migration of CLECs from a UNE-P to a UNE-L environment until such time as the states have had an opportunity to do so.

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[24] Letter from David A. Svanda, President, NARUC, et al. to Michael Powell, Chairman, Federal Communications Commission, et al. (Nov. 20, 2002) (on file with author).

It has been suggested that the performance metrics established in RBOC 271 proceedings are sufficient measurements of RBOC performance regarding any future CLEC migration from UNE-P to UNE-L, when in fact those metrics would be wholly inadequate for that purpose. The performance metrics established in RBOC 271 proceedings were designed to determine whether an RBOC's performance was minimally satisfactory such that the RBOCs behavior cannot be said to be anti-competitive. Leaving aside the fact that RBOCs have largely been granted 271 authority without meeting even minimal standards, the level of performance that would be required of RBOCs to promote competition in a UNE-L environment would have to be significantly higher than 271 metrics, and the states should have an unfettered opportunity to make that determination.

Respectfully submitted,

Kemal Hawa

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Counsel for Bridgecom International, Inc., and Metropolitan Telecommunications

cc: Chairman Michael K. Powell
Commissioner Kathleen Q. Abernathy
Commissioner Michael J. Copps
Commissioner Kevin J. Martin
Commissioner Jonathan S. Adelstein
Christopher Libertelli, Esq.
Daniel Gonzalez, Esq.
Matthew Brill, Esq.
Jordan Goldstein, Esq.
Lisa Zaina, Esq.
Jeffrey Carlisle, Esq.

# ATTACHMENT A

# CHART COMPARING CLEC MARKET VALUE BETWEEN NOVEMBER 1999 AND FEBRUARY 2002

# ATTACHMENT A

| | | a | b | c | d | e | f | g | h | i | j | k |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | 1 9 9 9 | | 2 0 0 1 | | @3/30/01 | 2 0 0 2 | | @3/30/02 | 2 0 0 3 | | @9/30/02 |
| | | Stock Price | Market Cap | Stock Price | Market Cap | Current Debt or Debt Carried at time of filing | Stock Price | Market Cap | Current Debt or Debt Carried at time of filing | Stock Price | Market Cap | Debt |
| | Symbol | 11/1/99 | $mil | 7/01/01 | $mil | ($Mil) | 3/18/02 | $mil | ($Mil) | 2/05/03 | $mil | ($Mil) |
| **CLECx** | | | | | | | | | | | | |
| Z-Tel | ztel | $35.00 | $1,155 | $1.06 | $36 | $13 | $2.40 | $82 | $12 | $0.82 | $29 | $11 |
| Choice One* ipo 3/00 | cwon | $30.00 | $1,130 | $6.10 | $232 | $618 | $1.70 | $69 | $514 | $0.20 | $9 | $609 |
| USLEC | clec | $27.50 | $770 | $2.92 | $81 | $130 | $3.40 | $89 | $150 | $2.24 | $60 | $140 |
| RCN Corp | rcnc | $50.00 | $4,925 | $4.24 | $372 | $2,257 | $1.50 | $146 | $1,705 | $0.85 | $93 | $1,740 |
| Allegiance | algx | $50.00 | $5,672 | $14.70 | $1,670 | $576 | $3.50 | $407 | $1,035 | $0.47 | $59 | $1,208 |
| Time Warner Telco | twtc | $29.00 | $3,335 | $29.00 | $3,311 | $585 | $7.60 | $868 | $1,064 | $2.44 | $280 | $1,058 |
| Pac-West | pacw | $20.00 | $720 | $1.00 | $37 | $150 | $0.49 | $18 | $154 | $0.53 | $20 | $118 |
| **Total** | | | $17,707 | | $5,739 | $4,329 | | $1,679 | $4,634 | | $550 | $4,884 |
| **Value Destroyed ($ Millions)** | | | | | -$11,968 | | | -$16,028 | | | -$17,158 | |
| **In and Out of Bankruptcy** | | | | | | | | | | | | |
| McLeod USA * | filed Ch 11 01/31/02 | $15.00 | $9,375 | $2.47 | $1,523 | $2,732 | nm | nm | $3,700 | $0.64 | $177 | 945 |
| Covad | covd.ob | $35.00 | $4,935 | nm | nm | $1,377 | $1.76 | $315 | $50 | $1.24 | $277 | $50 |
| XO Com * | Filed ch 11 June 2002 | $30.00 | $12,900 | $1.40 | $521 | $4,396 | $0.07 | $31 | $5,100 | nm | nm | 500 |
| ITC * | Filed ch 11 June 25, 2002 | $25.00 | $1,550 | $3.02 | $188 | $712 | nm | nm | $715 | $2.00 | $90 | 207 |
| **Total** | | | $28,760 | | $2,232 | $9,217 | | $346 | $9,565 | | $544 | $1,702 |
| **Value Destroyed ($ Millions)** | | | | | -$26,528 | | | -$28,414 | | | -$28,216 | |
| **In Bankruptcy** | | | | | | | | | | | | |
| Net2000 | filed Ch 11 11/01 | $30.00 | $1,200 | $1.00 | $40 | $103 | nm | nm | 95 | nm | nm | nm |
| Teligent | filed Ch 11 5/01 | $56.50 | $3,108 | nm | nm | $1,950 | nm | nm | 1,950 | nm | nm | nm |
| GSTX | Assets acquired by TWTC 1/01 | $10.00 | $375 | nm | nm | $265 | nm | nm | 265 | nm | nm | nm |
| Nettel | na | na | na | nm | nm | na | nm | nm | na | nm | nm | nm |
| ICG Com | Filed ch 11 11/00 | $19.00 | $874 | nm | nm | $1,900 | nm | nm | 1,900 | nm | nm | nm |
| Northpoint | Filed ch 11 1/01 T acquired assets | $28.00 | $3,528 | nm | nm | $404 | nm | nm | 404 | nm | nm | nm |
| Prism | filed Ch 11 | na | na | nm | nm | na | nm | nm | na | nm | nm | nm |
| Rhythms | filed Ch 11 8/01 WCOM acq assets | $35.00 | $2,800 | nm | nm | $832 | nm | nm | 832 | nm | nm | nm |
| Winstar | filed Ch 11 4/01 IDT acq assets | $33.00 | $2,772 | nm | nm | $3,900 | nm | nm | $3,900 | nm | nm | nm |
| E.spire | filed Ch 11 3/01 | $7.40 | $377 | nm | nm | $1,156 | nm | nm | $1,156 | nm | nm | nm |
| Advanced Radio | filed Ch 11 | na | na | nm | nm | $111 | nm | nm | $111 | nm | nm | nm |
| Viatel | filed Ch 11 05/01 | na | na | nm | nm | na | nm | nm | na | nm | nm | nm |
| Global Crossing ** | filed Ch 11 01/28/02 | $40.00 | $35,400 | na | na | $9,200 | nm | nm | $10,700 | nm | nm | nm |
| Network Plus | filed Ch 11 02/05/02 | $18.00 | $1,260 | $2.78 | $179 | $45 | nm | nm | $125 | nm | nm | nm |
| Adelphia Bus Sol | filed ch 11 3/27/02 | $30.00 | $4,032 | $4.04 | $543 | $1,138 | $0.08 | $11 | $1,700 | nm | nm | nm |
| Mpower Com | filed ch 11 4/8/02 | $20.00 | $1,200 | $0.82 | $48 | $477 | $0.05 | $3 | $715 | nm | nm | nm |
| Williams Com | filed ch 11 4/22/02 | na | na | na | na | na | nm | nm | $5,600 | nm | nm | nm |
| Metro Media Fiber | filed ch 11 May 2002 | $20.00 | $12,142 | $0.84 | $510 | $2,671 | $0.09 | $70 | $2,500 | nm | nm | nm |
| Worldcom ** | Filed ch 11 July 2002 | $60.00 | $177,393 | na | na | $24,800 | $6.90 | $20,700 | $30,000 | nm | nm | nm |
| ELEC Com | Filed ch 11 8/2/02 | $1.80 | $30 | na | na | na | $0.11 | $2 | $2 | nm | nm | nm |
| CTC Com | Filed ch 11 10/02 | $10.00 | $268 | $5.86 | $157 | $187 | nm | nm | $333 | nm | nm | nm |
| Focal Com | Filed ch 11 12/02 | $20.00 | $1,250 | $1.60 | $99 | $545 | $4.50 | $21 | $491 | nm | nm | nm |
| **Total (Bankrupt $ Millions)** | | | $248,009 | | $1,576 | $49,684 | | $20,807 | $62,779 | | $0 | $0 |
| **Value Destroyed ($ Millions)** | | | | | | | | -$227,202 | | | -$248,009 | |
| **TOTAL VALUE ($ Millions)** | | | $294,476 | | | | | $22,832 | $76,978 | | $1,094 | $6,586 |
| **TOTAL LOST VALUE ($ Millions)** | | | | | | | | -$271,644 | | | -$293,382 | |

# ATTACHMENT B

# JP MORGAN STUDY

JPMorgan

**US Equity Research**
J.P. Morgan Securities Inc.
January 16, 2003

# Communications Equipment

## Potential FCC Ruling a Red Herring for Tech Investors

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- We believe the upcoming rulings out of the FCC should have little to no impact on carrier spending at the large integrated equipment vendors and therefore are non-events for any of the 6 companies in our coverage universe (LU, NT, TLAB, CIEN, JNPR and CSCO).
- Of the many rulings likely to come out of the FCC in early '03, the two that have most captured the attention of equipment investors are the new list of UNE requirements - which will likely include definitive sunset provisions for switching - and the reclassification of DSL as an information service.
- We firmly believe that RBOC spending will only increase in response to a re-accleration in revenue growth - an event that we believe is far more dependent on macro and secular issues then on the return of the roughly $2.3B in revenue lost to CLECs from UNEP.
- We also firmly believe that the notion of CLECs being forced to purchase their own switches to continue providing local service offerings in response to an FCC ruling is unreasonable.
- Finally, conversations with key contacts in DC lead us to believe that the new regulatory framework the FCC is purported to present will likely be tested in court almost immediately leading to a prolonged legal battle before any impact could be felt anyway.

**Introduction**

There appears to be much controversy in the investment community over the impact on equipment spending, primarily by the 4 RBOCs, from the outcome of the FCC's triennial review proceedings that we expect to conclude in the late February, early March timeframe. Concurrent with the results from the triennial review, we expect the FCC to present a ruling on the classification of DSL, as either a telecom service falling under Title II of the Telecom Act as it does now, or as an information service falling under Title I. The primary difference between the two is that information service offerings do not fall under the unbundling and resale requirements that telecom services do.
After examining the issues involved in these two proceedings, we strongly believe that the outcomes should have little to no impact on carrier spending at the large integrated equipment vendors and therefore are non-events for any of the six companies in our coverage universe (LU, NT, TLAB, CIEN, JNPR and CSCO). Juniper and Cisco especially do not stand to gain any boost in topline from the FCC rulings since neither IP routers nor Ethernet switches are at the heart of the RBOCs' traditional spending patterns.

We state our specific points below in a point/counter-point format, but we would also note that regardless of the eventual impact of the FCC rulings , we fully expect the UNE ruling to be tested in court by the state PUCs seeking to protect the jurisdiction of their regulatory authorities over the FCC. We would therefore not be surprised to see this

situation leading into a protracted court battle lasting through the end of the year. We treat the two rulings and the ramification from each separately.

**Unbundled Network Element Reform**

**The Issue:** The Telecom Act of '96 identified the need for the FCC to create a list of network elements that ILECs would be required to lease out to competitors (or CLECs) to help jumpstart the competitors' business models without the need for enormous sums of initial capital. Along with the list, the FCC was mandated to create a pricing framework to be used individually by each state PUC (Public Utility Commission) in order to set the lease prices for each of the network elements specified in the list. The pricing framework developed by the FCC and followed by the states is known as TELRIC (Total Element Long Range Incremental Cost). The states were also given the power to add any new elements to the FCC's master list that they deemed appropriate for their state. The idea was simple. Instead of having to deploy a massive duplicative local network from scratch, competitors could focus on building only parts of their network needs while leasing the others from the incumbent, all the while moving slowly towards a fully facilities based model as the customer bases scaled.

Over the last 2 years, the RBOCs have aggressively raised the issue that many of the CLECs (including especially AT&T and WorldCom) are leasing out all of the network elements on the list at total discounts of 40%+ off of the retail customer price and have little interest in eventually moving to a facilities based system. The practice of leasing all network elements has become known as leasing the UNE-platform, or UNE-P. At the same time, for various esoteric reasons, the FCC's latest list of network elements was vacated (for the 2nd time) by the DC Circuit Court of Appeals and the FCC was given until mid January to draft a new list and to better support its decisions.

In the creation of the new list, we and many others, now expect the FCC to take the opportunity to judiciously remove switching from the list under certain circumstances pertaining to the level of competition in a given area, thereby making it no longer possible for CLECs to avoid the capital outlays involved with deploying their own networks. This naturally has sparked a multi-faceted debate over whether the FCC's actions could trigger a bounce in spending and thereby a boon to vendors. While this conclusion is tempting, we believe the answer is a resounding no. In the paragraphs below, we list the major pro-spending arguments we have heard, followed by our rebuttal to each one.

**Myth 1:** RBOC spending is down because of the current UNE-P and TELRIC regulatory environment that dis-incents investment in new network plant. Therefore, once the regulatory environment changes, RBOC capital spending is free to move back up.

**Our Response:** The first question we ask is back up to where? In our initiation report, we showed that RBOC spending from 1996-2001 rode a wave of excess that was uncharacteristically out of pattern with any historical measure of spending. This myth also presupposes that UNEP and TELRIC are the primary cause of the severe falloff in RBOC CAPX when in fact they are but one of many, many reasons, and a relatively small part of the total picture at that.

We believe that RBOC spending is actually down primarily for the following 4 reasons:

1. It climbed unnaturally high during the bubble period from '96-'01 that the comparisons are now skewed;
2. Revenue, especially data revenue from special access sources such as T1s, T3s and OC-Xs, is down for the first time in well over a decade;

3. Access line counts are also declining for the first time in over a decade and are retracing the gains made in the '90s when fax machines and dial-up internet modems drove 2nd line penetration north of 20%;
4. Wireline long distance minutes, which peaked at 531 billion in 2000 fell 6% in 2001 and are driving down access revenues with them as people migrate their long distance calling minutes over to cheaper wireless calling plans or substitute them entirely by using email.

In truth, RBOC spending in 2003, roughly $19B by the companies' own guidance, will be only 10% below the RBOC spending total in 1995, the year before the Telecom Act was passed and local competition shifted into high gear. It is also interesting to note that RBOC spending had been relatively flat at the $21B level for over 6 years prior to 1995 and this was during an era of over 3% access line growth, and a rate-of-return regulatory environment. Without a return of topline growth, we do not expect RBOC spending to pick up regardless of the outcome of the FCC's proceedings.

**Myth 2:** RBOC revenues could rebound if UNE-P is legislated away leading to a turn around in RBOC spending policies.

**Our Response:** With only 11 million UNE-P customers, RBOC toplines have not been substantially impacted by UNE-P competition. Assuming the average local phone bill is $35/month and the average UNE discount is 50%, we calculate that the cumulative annual revenue loss for the RBOCs thus far has been only $2.3 billion which is 1.8% of aggregate RBOC wireline revenues of $130 billion and 1.5% of total aggregate RBOC revenues of $160B. Furthermore, since the UNE-P is a wholesale service, UNE-P customers are still being switched by the RBOC switches meaning that even if the RBOCs win back the UNE-P customers, the switching ports are already in place to serve them. Hence a transfer of UNE-P customers back to the RBOCs does not drive incremental spending since the RBOCs would not need to buy new equipment. The only change that would occur is the company doing the billing.

**Myth 3:** With the elimination of UNE regulation, the competitive providers, namely AT&T and MCI, would be forced to replicate the switching needed to serve customers and thereby drive industry spending.

**Our Response:** We strongly believe that the RBOCs are willing to "play ball" with the CLECs and continue to offer both switching and a complete wholesale access line service very similar to UNE-P to avoid forcing others into becoming true facilities-based competitors (see Classification of DSL below). They just want to paid more it. SBC's proposal of a single-rate $26/month wholesale charge is the perfect example of this. We believe the RBOCs would much rather lose a portion of customer revenue than lose the customer entirely. Further, it is only economic for a CLEC to buy its own switch in areas where it has significant scale, a situation that we estimate applies in less than 30% of the UNE-P lines in existence today.

**Myth 4:** UNE-P competition has depressed RBOC capex to sales ratios below sustainable levels. This is evidenced by current capex to sales ratios that are far below those from the 1980s and 1990s.

**Our Response:** First, as we outlined in our initiating coverage report, we believe the RBOCs are still working through old spending and equipment inventories acquired through the excessive spending during the last three years. Second, back in the 1980s, the RBOCs were largely regulated under a Rate of Return regulatory regime. Under this type of regulation, the RBOCs were somewhat forced to invest a certain percentage of their profits in order to justify new rate increases. Under the current price-cap regulatory

regime, not to mention the more competitive marketplace, new capital spending is not automatically rewarded through higher rates. Hence, the RBOCs are now incented to improve spending efficiency and are therefore capable of producing capex to sales ratios below historic levels. Furthermore, the technology enhancements implicit in the equipment the RBOCs have deployed over the last several years have created efficiencies allowing the RBOCs to sustain the same level of revenues as they had before at a lower overall level of capex.

**Classification of DSL**

**The Issue:** For lack of any regulatory clarity in the '96 Telecom Act, DSL has been de facto classified as a standard *telecom service* submitting it to the same unbundling and resale requirements that govern standard access lines. In fact, the primary reason the '96 Telecom Act does not officially classify DSL is that DSL didn't even exist in 1996 (outside of R&D laboratories that is). The primary complaint raised by RBOCs on this issue has been that the main competing technology to DSL, cable modems, has been classified not as a *telecom* service, but as an *information* service, making it not eligible for either unbundling or resale.

While we cannot predict the exact outcome of the FCC proceeding surrounding this issue, we believe it is likely that the FCC could in fact reclassify DSL as an information service, thereby providing a measure of "broadband parity" between DSL and cable modem technology. The issue for equipment investors then is what the incremental spend out of the RBOCs would be under the assumption that DSL gets reclassified. While we agree that a pro-broadband parity ruling out of the FCC would incent the RBOCs to roll out DSL to a greater number of markets and therefore would spur a small spend on remote terminals and DSLAM equipment, we believe the aggregate spend would be measured in the hundreds of millions of dollars, be spread out over multiple years, and not appreciably impact equipment vendor toplines.

**Myth 1:** The RBOCs have delayed spending on broadband access services and have delayed rolling out remote terminals (RTs) and DSLAMs in areas because of ambiguity and uncertainty with unbundling rules.

**Our Response:** As we say above, this one is somewhat true. However, DSL is already available in approximately 63% of SBC's territory and 55% of Verizon's. The RBOCs have long stated that they only intend to rollout service to approximately 75% of their territories, and naturally started with the "sweet spots" with the highest demand. Recalling that wireless penetration in the US stands at approximately 55-60% and PC penetration at 60-65%, we find it unlikely that pushing DSL availability out to 75% of the RBOC's territories will unleash a huge pent up demand for the service that would make a meaningful impact on either backhaul traffic levels or on DSLAM port growth.

**Myth 2:** Once DSL availability increases, adoption should increase, which leads to increased usage and increased traffic on the networks. New network spending by the RBOCs, therefore, would have to increase to match the higher flow of Internet traffic.

**Our Response:** Carrier networks are optimized to carry peak load traffic. DSL is largely a residential technology used mainly on nights and weekends and consumes very little bandwidth relative to the high-capacity data needs of businesses during the day. We therefore do not believe carriers would need to increase backbone spending to support a potential surge in the DSL user population since the additional traffic from millions of off-peak DSL users does not even come close to comparison with the usage needs of corporate America during the peak daytime period. And if the aggregate traffic created

does not push the peak load on the network, no additional network capacity spend is required.

**CIENA Corp(CIEN/$7.09/Underweight) Cisco Systems(CSCO/$15.18/Overweight) Juniper Networks(JNPR/$9.69/Neutral) Lucent Technologies(LU/$1.73/Underweight) NORTEL Networks(NT/$2.44/Neutral) Tellabs(TLAB/$9.52/Neutral)**

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# ATTACHMENT C

# LIST OF CLEC BANKRUPTCIES

ATTACHMENT C

**Telecomm Industry Bankruptcy Filings**

**2001 Bankruptcies**

| | |
|---|---|
| 1/01 Assets acquired by | GSTX |
| 1/16/01 T acquired assei | Northpoint |
| 01/18/2001 | Vectris |
| 02/07/2001 | Vitts Networks |
| 02/28/2001 | Omniplex Comm |
| 03/12/2001 | ConnectSouth |
| 03/22/2001 | Tess Comm |
| 3/22/01 | E.spire |
| 03/30/2001 | ATS Telecomm |
| 04/01/2001 | Natelco |
| 04/02/2001 | Pathnet |
| 04/02/2001 | REAnet |
| 04/11/2001 | Actel Integrated Comm |
| 4/18/01 IDT acq assets | Winstar |
| 04/19/2001 | Convergent Comm |
| 04/20/2001 | Advanced Radio |
| 04/25/2001 | Link Networks |
| 04/27/2001 | Telescape |
| 05/01 | Viatel |
| 05/09/2001 | Broadband Office |
| 05/21/2001 | Teligent |
| 06/25/2001 | 2nd Century |
| 06/28/2001 | 360 Networks |
| 07/01/2001 | Novo Networks |
| 8/1/01 WCOM acq asset | Rhythms |
| 08/07/2001 | Covad |
| 08/16/2001 | PointOne |
| 08/20/2001 | WCI |
| 10/01 | CTC Com |
| 10/11/2001 | Ardent |
| 10/26/2001 | Telergy |
| 11/01 | ICG Com |
| 11/16/2001 | Net2000 |
| 12/31/2001 | Digital Telepart |
| no date | Prism |

**2002 Bankruptcies**

| | |
|---|---|
| 01/28/2002 | Global Crossing |
| 01/31/02 | McLeod USA |
| 02/04/2002 | Network Plus |
| 02/05/2002 | Network Plus |
| 02/28/2002 | Logix |
| 03/13/2002 | WINfirst |
| 03/21/2002 | Yipes Comm |
| 03/27/2002 | Adelphia Bus Sol |
| 4/8/02 | Mpower Com |
| 04/22/2002 | Williams Com |
| 05/01 | Metro Media Fiber |
| 05/02/2002 | Advanced TelCom |
| 06/16/2002 | XO Com |
| 06/25/2002 | ITC Deltacom |
| 06/25/2002 | ITC |
| 7/21/02 | Worldcom |
| 07/30/2002 | Birch Telecom |
| 08/02/2002 | ELEC Com |
| 09/18/2002 | Knology Broadband |
| 12/02 | Focal Com |