July 22, 2004

The Honorable Michael K. Powell
Chairman
Federal Communications Commission
445 12th Street, S.W.
Washington, D.C. 20554

Re: *Automatic Rate Increases in Potential Interim Rules for High Capacity Loops and Transport; CC Docket Nos. 01-338, 96-98, and 98-147*

Dear Chairman Powell:

On behalf of Centennial Ventures, Columbia Capital, Kohlberg Kravis Roberts & Co., M/C Venture Partners, and Madison Dearborn Partners, LLC we are writing to express our concern that competitive carriers continue to receive cost-based access to th incumbent networks as part of any interim rules developed by the Commission. We are private equity firms that have made substantial investments in the telecommunications sector. Our portfolio companies include investments in competitive carriers, including competitive local exchange carriers ("CLECs"). Our portfolio companies serve numerous markets throughout the United States over a mix of their own network facilities and loop/transport facilities leased from incumbent local exchange carriers ("ILECs") as unbundled network elements ("UNEs"). Our portfolio companies include Cavalier Telephone, cBeyond Communications, City Signal Communications, Elantic Networks, Florida Digital Networks, Focal Communications, Grande Communications, Looking Glass Networks, NuVox Communications, and PaeTec, Inc. We are writing today specifically to express our profound concern with certain aspects of potential interim UNE rules under consideration by the Commission-- the automatic rate increases for DS1 loops and EELs pending adoption of permanent rules.

We have a significant amount of experience in capital-intensive, network-based industries. Our firms were instrumental in funding much of our country's wireless, cable TV, and alternative wireline telecommunications networks, including metropolitan area fiber networks. A substantial amount of our recent investments came directly as a result of the Telecom Act of 1996. These competitive telecommunications investments, like our previous investments, were undertaken with a clear understanding of the risks associated with industries characterized by high fixed costs, and network and scale economies.

Accordingly, our experience in competitive wireline telecommunications carriers has not been substantially different from our historical investments in terms of large up-front investments. However, the one characteristic of this industry that is different from the others has been the degree to which our portfolio companies depend on cost-based access to the networks of the ILECs. This is manageable through the gradual investment in, and deployment of, alternative facilities. Indeed, the one constant in the FCC's policies from the beginning has been to encourage carriers deployment of their own facilities. We have taken this government policy seriously and invested accordingly—in both our retail and wholesale competitive carrier business plans. Unfortunately, though, it now appears that our time horizons for deploying these alternative networks—while consistent with the nature of substantial network deployments—are at risk of being thwarted by current political and regulatory inconsistency as well as the substantial lobbying effort of the Bell Operating Companies.

The companies in which we have invested have used the invested capital to purchase and deploy network equipment and facilities in order to compete in the local market. Further, several of our portfolio companies (Looking Glass Networks, Elantic, City Signal) also provide access facilities and services in competition with the wholesale transport services offered by the ILECs. Yet, even though it would seem to be in the interest of these carriers for the FCC to eliminate access to UNEs on some routes, a fact that bears explaining is that even these carriers will readily concede that access to unbundled dark fiber, and lit transport services, must be available to them, as well as their competitive carrier customers, if they are to succeed in continuing to deploy more fiber into local markets. The creation of access to alternative fiber transport infrastructure is critical if your hopes of fostering true "intermodal" competition are ever to be realized. Otherwise, wireless firms and Internet-based communications providers will remain subject to scarcity rents charged by the incumbents for access to an essential input. This evolution cannot continue unless these wholesale competitors have access to retail carrier customers where they have alternative facilities, and access to the incumbent's idle capacity and wholesale services where the competitive wholesalers do not have facilities. Thus, it is essential for the development of a healthy alternative fiber infrastructure that the facilities-based retail CLECs can continue to exist and expand.

The retail CLECs among our portfolio companies tend to focus on serving small and medium-size businesses that are largely ignored by the major incumbent carriers. As a result of this competition, many small businesses for the first time have affordable access to innovative new service offerings, including broadband services. These companies have, in short, brought the facilities-based competition that you have encouraged and championed.

Mr. Chairman, your commitment to facilities-based competition has included carriers, such as those in which we have invested, that bring their own facilities to the table. Nevertheless, these carriers must continue to have cost-based access to some of the incumbent's network in order to compete. As you noted in your statement initiating the Triennial Review, the commitment to facilities-based competition includes "competition from newer entrants who supplement their own facilities with network elements leased from the incumbent. . . I fully support the use of facilities and individual UNEs as means to promote local competition while simultaneously furthering the related goals of encouraging deregulation and innovation."

Following through with this commitment, you joined with all of the Commissioners in adopting provisions that ensured continued access to high capacity (DS1/DS3/dark fiber) loops and enhanced extended loops ("EELs") at TELRIC prices. The reason was clear-- competing carriers simply cannot provide services to business customers without access to these UNEs. With such access, facilities-based competition will continue to thrive, bringing the benefits which you so succinctly identified in your separate statement adopting the Triennial Review Order: service offerings "differentiated from the incumbent"; providing the "real potential for lower prices;" characterized by "less dependen[cy]on the incumbent thereby reducing the need for regulation;" and, stimulating the 'creat[ion] of vital redundant networks that serve our nation if other facilities are damaged by those hostile to our way of life."

Based on these statements and actions by you and the Commission, we have continued, since release of the TRO, to invest substantial capital in competitive, facilities-based retail and wholesale CLECs. Now, barely one year later and despite your professed commitment to facilities-based competition, we are concerned that you may turn your back on the competitors you once commended. We understand you are considering interim rules that would permit the ILECs to begin charging competitive carriers full special access charges for the loop/transport facilities potentially without any further determination of impairment.

Such a ruling would have potentially disastrous consequences for facilities-based CLECs. Despite the unsubstantiated assertions of the RBOCs, special access services are not an adequate substitute for cost-based UNEs. Our financial analysis of portfolio companies shows that replacement of cost-based DS1 and DS3 loop and transport UNEs with special access services would result in a doubling or tripling (depending upon location) of the critical transmission costs incurred by UNE-L based CLECs. Moreover, those carriers who have expanded network capacity through substantial sunk investments in collocations and the advanced optical electronic equipment necessary to light dark fiber, a heretofore fallow asset, will likely face even greater increases in cost if left to the mercy of the incumbents. All of our portfolio companies operate on thin margins in highly price sensitive markets, and they simply could not absorb such dramatic cost increases or pass them along to customers in the form of increased rates.

As you recognized in the TRO, the *sine qua non* of impairment should be entry barriers. While all of our portfolio companies surmounted extensive barriers to enter the markets they are presently serving—even with access to ILEC UNES—we are concerned that the FCC may not well appreciate another significant barrier to entry: high costs of exit. Replacing cost-based UNEs with retail special access services would very simply turn our capital-intensive CLECs' business plans upside down. By immediately rendering most markets unprofitable for CLECs, the costs of exiting these markets would likely cause the rapid deterioration of the competitive enterprise itself.

One reason for this increased risk to capital-intensive competitors is the way that exogenous negative events can affect a firm's access to capital, especially the ability to access credit. Credit arrangements extended to CLECs typically tie their ability to draw down funds from credit facilities on the achievement of pre-set performance targets (i.e. "covenants"). These covenants are the principle means by which creditors protect themselves from unanticipated risks. A borrower's failure to achieve the performance target can result in immediate cancellation of the credit facility, discontinuance of access to credit lines, and even a demand for immediate repayment of the previously borrowed amount -- a ruinous situation for any business. Our review leads us to conclude that any significant replacement of cost-based UNEs with special access charges could place many CLECs in immediate violation of the financial covenants in their existing credit arrangements. In our experience, once these facilities are revoked, it is virtually impossible to obtain replacement financing.

The adverse financial impact of imposing special access pricing on CLECs would be drastic. A requirement that special access services be ordered for new customers would be likely to shut off new sales. Similarly, an across-the-board 15% increase in the price of the embedded base of high capacity loop and transport UNEs likely would cause some CLECs to violate loan covenants. Moreover, as we previously noted, firms like our portfolio companies—with large amounts of sunk capital committed to each market they serve—cannot quickly or cheaply exit markets made unprofitable overnight, by regulatory flip-flops.

Finally, if any of these risks to competitive carriers were caused by pricing changes for DS1 UNEs, the result would be a disgraceful waste of capital investment. Any such loss in investment capital would be even more shameful since it is not necessary in any legal respect. We understand that there is virtually no record evidence to support the conclusion that competitors are not impaired without access to DS1 loops and transport. In addition, it is our understanding that the DC Circuit did not even address high capacity loops. We also understand that the evidence compiled in the state proceedings would dictate a finding of impairment if included in the rulemaking for the permanent rules. In sum the FCC simply has no basis to adopt interim rules with self-enforcing presumptions of non-impairment for DS1 UNEs.

This is a critical moment in the development of competitive local telecommunications. We have invested in the sector because we believe that our portfolio companies have the ability to compete successfully and deliver value to customers. We also understand and have assumed the business risks of investing in the telecommunications sector. Our assessment of risk, however, has been informed by a strong regulatory commitment to facilities-based competition repeatedly and emphatically expressed by you, and your fellow Commissioners. Our investments were predicated on FCC assurances that the Telecommunications Act and the Commission's rules guaranteed new entrants access to cost-based UNEs so long as impairment exists. Whether our investments prove sound and whether our portfolio companies succeed or fail, should be based on their ability to compete in the marketplace by bringing a valued product to customers, not by regulatory caprice.

We ask you to act quickly and in a manner that shows that our confidence was not ill- placed. Accordingly, we respectfully ask that you issue an order that preserves the status quo for six months, that you issue new permanent rules within that timeframe, and that, to preserve facilities-based competition, you refrain from prescribing UNE price increases for all high capacity transmission UNEs, but at a minimum DS1 loops and EELs, pending adoption of permanent rules.

Sincerely,

_______/s/__________
Peter H. O. Claudy
M/C Venture Partners

______/s/_________
James Fleming
Columbia Capital

________/s/__________
James N. Perry, Jr.
Madison Dearborn Partners, L.L.C.

______/s/_________
Rand G. Lewis
Centennial Ventures

_______/s/______________
James H. Greene, Jr.
Kohlberg Kravis Roberts & Co.

cc: Commissioner Kathleen Q. Abernathy
Commissioner Kevin J. Martin
Commissioner Michael J. Copps
Commissioner Jonathan S. Adelstein
Michael D. Gallagher
Christopher Libertelli
Matthew Brill
Daniel Gonzalez
Jessica Rosenworcel
Scott Bergmann