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October 18, 2004

Ms. Marlene H. Dortch, Secretary
Federal Communications Commission
455 12th Street SW
Washington, DC 20554

Subject: CC Docket No. 01-338 and WC Docket No. 04-313

Dear Ms. Dortch:

On October 5, 2004, the California Public Utilities Commission (CPUC) submitted the "Staff Report on Investigation Concerning Competitive Local Carriers' Deployment of Facilities (CPUC Staff Report)" to the Federal Communications Commission (FCC) in response to the FCC's August 22, 2004 Order and Notice of Proposed Rulemaking (Interim Order). In that Interim Order, the FCC called for state commissions to submit summaries of the state proceedings in the Triennial Review Order (TRO)[1], especially highlighting the factual information that would be relevant under the guidance of the March 2, 2004 decision by the U.S. District Court of Appeals for the District of Columbia (USTA II).[2]

As President Michael Peevey's transmittal letter indicates, the CPUC Staff Report expresses the views and conclusions of Commission staff and does not reflect the views of the Commission. As the Assigned Commissioner[3] for the TRO proceeding, I issued a ruling suspending the

[1] Report and Order and Order on Remand and Further Notice of Proposed Rulemaking, In the Matter of Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers (CC Docket No. 01-338); Implementation of the Local Competition Provisions of the Telecommunications Act of 1996 (CC Docket No. 96-989); Deployment of Wireline Services Offering Advanced Telecommunications Capability (CC Docket No. 98-147), FCC No. 03-36, (rel. Aug. 21, 2003) (hereinafter, "TRO").
[2] *United States Telecom Ass'n v FCC*, 359 F.3d 554 (D.C. Cir. 2004)(USTA II.
[3] In California, the "Assigned Commissioner" is responsible for the overall management of a proceeding and for bringing a "proposed decision" before the Californian Public Utilities Commission for consideration by her colleagues. Thus, the "Assigned Commissioner" generally gains a greater familiarity with the record and legal issues surrounding the assigned proceeding and is responsible for case management rulings.

proceeding on June 18, 2004[4] in light of the District Court's vacatur order, until such time as the FCC issued new or interim local competition rules.

In calling for state commissions to submit summaries of their TRO proceedings, the FCC requested that state commissions focus on providing "factual evidence" that may be relevant to the FCC's task under the guidance of the USTA II decision. Unfortunately, the CPUC Staff Report went beyond that invitation and included a number of conclusions. These conclusions would most certainly have been heavily challenged and very likely changed in a final decision had the parties been allowed to comment on the CPUC Staff Report or had the Commission continued the proceeding.

With these comments I hope to highlight some of the conclusions in the CPUC Staff Report that are based on subjective decisions that go well beyond the legal tests set forth in the TRO and, as a result, significantly undermine the usefulness of the CPUC Staff Report and its data analysis in determining the extent of competitors' deployment of local circuit switching in the mass market.

However, the lessons that can be drawn from California's TRO proceeding and the resulting conclusions in CPUC Staff Report are instructive in that they make obvious some of the significant flaws in the FCC's TRO decision. It is my hope that by discussing some of these flaws that these lessons might be taken into consideration as the Commission attempts to write permanent rules in the wake of USTA II.

The express intent of the TRO was to use a "bright line" test as to whether requesting carriers are in fact impaired in a particular market. The FCC adopted "triggers" as a principal mechanism for making this determination, finding that "the presence of facilities-based competitors is the best indicator" of non-impairment.[5] As stated by the FCC, "The use of triggers keyed to objective criteria can avoid the delays caused by protracted proceedings and can minimize subjective burdens."[6] However, in order for such triggers to constitute a "bright line" as intended, discretion on the part of state commissions to interpret or modify the trigger tests must necessarily be severely limited. The FCC acknowledged the concern that states could interpret the tests in "divergent and subjective ways"[7] but proceeded under the belief that it had established "objective, carefully defined criteria" that would "ensure that states undertake the tasks … consistently…"[8]

The CPUC Staff Report provides clear evidence that this faith was misplaced. Not only did the CPUC staff find grounds to ignore the plain language of the TRO where instructions were clear, but because of ambiguity in the language throughout the TRO the opportunities for subjectivity were extensive. As a consequence, the analysis and resulting conclusions rendered the "bright line" test meaningless.

For example, with respect to mass market switching, the CPUC Staff Report applies additional screens beyond the criteria set forth in the TRO to determine whether the presence of a competitively deployed switch counts toward the trigger test. Among other things, the CPUC

[4] Assigned Commissioner's Ruling Suspending Proceedings, in *Order Instituting Rulemaking on the Commission's own Motion into Competition for Local Exchange Service* (R.95-04-043); *Order Instituting Investigation on the Commission's own Motion into Competition for Local Exchange Service* (I.95-04-044), June 18, 2004.
[5] TRO at ¶ 498.
[6] Id.
[7] TRO at ¶ 425, n.1300.
[8] Id. at ¶ 428, notes omitted.

Staff Report excludes from the triggers any switch provider that (1) is a cable company, (2) serves less than 1% of the customers in the defined market, or (3) does not serve residential customers.[9] The CPUC Staff Report concludes that these additional screens are "warranted" and "relevant" as a matter of "public policy."[10]

Nothing in the TRO gave State commissions discretion to modify the TRO trigger tests or employ additional screens. In attempting to preclude subjectivity with regard to the “bright line” test, the TRO instructed the state commissions that the trigger tests were "mandatory and exhaustive"[11] and that "[f]or the purposes of these triggers, we find that states shall not evaluate any other factors . . . ."[12] In fact, the FCC went to great lengths to make clear that it expected states to follow a narrow two-step process in determining whether to find no impairment: “States must first employ triggers that examine actual deployment; only if the triggers are not met must the states apply criteria to assess whether entry is uneconomic.”[13] “If the triggers are not satisfied, the state commission shall proceed to the second step of the analysis, in which it must evaluate certain operational and economic criteria to determine whether conditions in the market are actually conducive to competitive entry.”[14]

In order to protect the integrity and simplicity of the trigger test against exactly the kind of subjectivity employed in the CPUC’s analysis, the FCC also established a separate process for “Potential Deployment” whereby “states may identify specific markets that do not facially satisfy the self-provisioning trigger, but in which operatonal and economic conditions in that market demonstrate a lack of impairment.”[15] The text of the TRO is abundantly clear that the FCC did not intend for the state commissions to engage in this more extensive, qualitative, and subjective analysis until after the “bright line” trigger rules had been applied in a straightforward and objective manner.

But the CPUC Staff Report turns the FCC’s “bright line” test on its head by employing layers of qualifying criteria to a competitively deployed switch ***before*** recognizing its presence in a defined market.

For example, the CPUC Staff Report excludes all "cable providers" from consideration under the triggers, even though Rule 51.319(d)(2)(iii)(A)(1) expressly instructs the states to include "intermodal providers of service comparable in quality to that of the incumbent LEC." The CPUC Staff Report attempts to justify the exclusion of cable providers on the basis that they do not serve mass market customers “ubiquitously” throughout the entire geographic market or that they serve only a portion of their cable footprint. These criteria do not warrant wholesale exclusion of cable providers. At most, they suggest the geographic market should be defined in a manner that reflects the areas actually being served by these providers, as the TRO instructs: "In circumstances where switch providers (or the resellers that rely on them) are identified as currently serving, or capable of serving, only part of the market, the state commission may choose to consider defining that portion of the market as a separate market for purposes of its

[9] CPUC Staff Report, p. 8.
[10] Id. p. 62.
[11] TRO. at ¶ 428, n.1315.
[12] Id. at ¶ 500.
[13] Id. at ¶ 425, n. 1300.
[14] Id. at ¶ 494.
[15] Id. at ¶¶ 506-520.

analysis."[16] The CPUC Staff Report also references the fact that cable providers use a different battery power for 911 services than ILECs as "another reason" to disqualify them as trigger candidates. This type of extremely subjective reasoning is hardly a valid basis for wholesale exclusion of cable providers.

Likewise, the CPUC Staff Report excludes from the trigger test any switch providers that serve less than 1% of the relevant defined market, on the basis that trigger-eligible carriers must be serving at least a *de minimus* portion of the market. The TRO rules do not set forth any *de minimus* requirement for the trigger test. Indeed, the FCC expressly rejected establishing any impairment test based on a particular "level of retail competition" or on "particular market share."[17] And the fact that the TRO required the presence of three switch providers in the relevant defined market to satisfy the trigger is evidence that the FCC resolved any such "*de minimus'* concerns by setting the threshold at **three** providers. The presence of three providers within a market would mitigate concerns that one or more of them may not be serving a large portion of customers within that market.

State commissions would most assuredly apply the trigger tests in divergent and subjective ways if they were permitted to interject a *de minimus* test, particularly where the TRO provides no guidance in the rule as to what that *de minimus* standard should be. In fact, even the CLECs in this proceeding could not agree on the proposed *de minimus* standard. Moreover, if the CPUC Staff's interpretation of the rule were correct, the FCC's bright-line rules would have simply stated that switch providers will count toward the trigger only if they meet some predetermined market share in the relevant market. But clearly it did not, for the reasons stated above.

The CPUC Staff Report also excludes from the trigger test any service providers that serve only business customers in the mass market. But the FCC clearly delineated that there were only two defined markets: the enterprise market (consisting of small, medium and large enterprises, for which no impairment is presumed) and the mass market (consisting of residential customers and very small businesses, for which impairment is presumed).[18] Under the rules of the TRO, states were given latitude to further define the "contours" of markets on a geographic basis, and to determine the appropriate cutoff between the enterprise market and the mass market; they were not given the discretion to create additional submarkets on a customer-specific basis.

By recognizing only competitively-deployed switch providers that are serving ***both*** residential and very small business customers in the mass market for purposes of the trigger test, the CPUC Staff Report effectively rewrites the test to include residential and business submarkets. The TRO rules very clearly and simply require state commissions to determine whether switch providers "are serving mass market customers," which includes both residential and very small business customers.[19] This single subjective decision on the part of the Staff's analysis eliminated the vast majority of of the competitively deployed switches in California from counting toward the trigger test.

By subdividing the mass market, the CPUC Staff Report again turns the FCC's "bright-line" principle on its head. It ignores the underlying rationale for the test: that the ***presence*** of facilities-based competitors is the best indicator that requesting carriers are not impaired. Indeed,

[16] Id. at ¶ 499, n.1552.
[17] Id. at ¶ 114.
[18] TRO at ¶ 127, ¶ 459.
[19] Rule 51.319(d)(2)(iii)(A)(1).

the FCC makes clear why this principle is the foundation of its decision in its discussion of the Analysis of Potential Deployment. "We find the ***existence*** of switching serving customers in the enterprise market to be a significant indicator of the ***possibility*** of servicing the mass market because of the demonstrated scale and scope economies of serving numerous customers in a wire center using a single switch." (emphasis added) "We choose three self-provisioners and two competitive wholesale providers as the appropriate threshold in order to be assured that the market can support 'multiple, competitive local exchange service providers using their own switch... "[20]

In determining the relevant geographic market, the CPUC Staff Report also subverts the "bright line" principle by relying almost exclusively on actual deployment and discounting any larger geographic areas that CLECs could efficiently serve, unless the evidentiary standards for potential deployment are met. The TRO invited this result by encouraging states to consider "the locations of customers actually being served (if any) by competitors, the variation in factors affecting competitors' ability to serve each group of customers…" The TRO attempts to limit the kinds of factors states should consider in defining the market to those broad conditions that could limit a competitor's ability to economically and efficiently serve a defined market such as zonal loop rates, regional variations in retail rates, and available technologies. However, ambiguous language in the TRO invited states to drill down in search of "precision" based on ***actual*** deployment and, in California's case, essentially reject geographic markets larger than a wire center unless the ILEC also satisfied the potential deployment standard.

Defining the market based solely on actual deployment within each wire center ignores a CLEC's ability to serve adjacent wire centers from the same switch. As a result, qualified switches physically located in adjacent wire centers did not count toward the trigger in that market, and the market was deemed impaired. The CPUC Staff Report recognized this weakness in their analysis noting that that since the ILECs presented a "triggers-only" case: "without a potential deployment analysis, we are limited to mere speculation as to the potential for economies of scale from entering additional wire centers."[21]

What the CPUC Staff Report demonstrates is that, despite the best efforts of professional state commission staff who attempted in earnest to comply with what they believed to be the instructions of the FCC in the TRO, the amount of latitude and subjective interpretation built into the TRO made that task impossible. Certainly it demonstrates that the TRO, as drafted, could not possibly produce results that are interpreted in any consistent and non-subjective manner among various state commissions.

Indeed the CPUC Staff Report shows that the TRO was drafted with so much ambiguity as to allow for absurd results. Witness that after eight years of unbundling under the 1996 Telecommunications Act, and in the face of the incontrovertible fact that competitive local exchange carriers provide service to hundreds of thousands of access lines utilizing well over 100 competitively deployed switches in California, not a single solitary wire center in the State of California was deemed unimpaired under CPUC staff's interpretation of the TRO criteria.

[20] TRO at ¶ 508.
[21] CPUC Staff Report p. 32.

That result speaks volumes. Either the TRO was drafted so poorly as to result in meaningless data from state commissions, or the reliance on unbundling as a means of promoting facilities-based competition has been a total and abject failure.

The FCC is now faced with the unenviable responsibility of writing and issuing its permanent rules. Much has happened since the FCC first voted on the TRO rules in March 2003, and issued its order in August 2003. As daily reports in the media show, carriers have begun to deploy new technologies to compete for local service in ways that were not even recognized in the data states collected just one year ago. Carriers like AT&T and Covad are rolling out voice over Internet protocol (VoIP) on a mass market basis. Cable companies are aggressively seeking to expand their voice services on a stand-alone or bundled basis, with virtually every major cable provider in the nation expected to offer voice service to their entire footprint in the next 12-24 months. Wireless competition continues to thrive and command a significant and increasing share of overall minutes of use.

Perpetuating CLEC reliance on RBOC switches under these circumstances promotes synthetic – not real – competition. It discourages investment in both facilities and new technologies at the expense of facilities-based carriers, including CLECs, who met the challenge of the 1996 Telecommunications Act and invested in their own networks. It does so at the expense of incumbent wireline carriers who are leasing their networks at below cost rates. Ultimately, it does so at the expense of consumers who are spending hundreds of millions of dollars each year subsidizing a 10-year-old concept of competition that focuses on an aging network, instead of driving the advancement of new technologies and new services in the marketplace, where their dollars are the fuel needed to build America’s communications network of tomorrow. New rules should presume non-impairment in mass market switching and eliminate switching as an unbundled network element.

Having said that, the local loop continues to represent a bottleneck through which most facilities-based competitive carriers must rely on the RBOC to access customers. Other technologies, such as cable and wireless, have certainly developed to the point of providing mass market customers with an alternative to voice services delivered over the copper loop, but the deployment of voice services over these technologies has not yet reached a level whereby customers generally view them as a viable substitute for residential service. That time is coming very soon, though, at least for most residential customers. Still, there are areas where wireless and cable are not reliably available to mass market customers today, and these technologies are not considered viable substitutes for the high-capacity loops upon which small to medium-sized businesses still depend. New rules should focus on impairment based on the last mile infrastructure and access to the customer.

To the extent state commissions are responsible for collecting or interpreting data on the impairment in the future, the lessons learned from California’s TRO proceeding lead me to the following recommendations:

1. **The FCC should establish a clear and unambiguous definition of a competitor’s facilities-based presence**. If the FCC chooses to use a “bright line” test in the future, there should be no question as to when “a switch is a switch.” The test should not be construed to exclude recognition of a CLEC switch providing service only to business customers, or enterprise customers, when the decision not to serve residential customers

is a business decision made by the CLEC absent clear and insurmountable barriers to market entry that make serving residential customers unfeasible or uneconomic.

2. **Establish a national standard for the definition of "mass market" versus "enterprise market."** There is no public policy served by giving states the latitude to determine the crossover point between mass market and enterprise customers. One state, such as California, could choose 15 lines as a statewide DS1 cut off, while other states choose 3 or 4 lines. This latitude, which is influenced more by the politics of the parties than by actual differences in the competitive landscape from state to state, could produce significant disparity between states in what constitutes impairment. Any granular nuance captured by applying a particular cut off in one market would be lost by applying that same cut off statewide.

3. **Intermodal competition should be recognized in any market analysis**. The qualification that intermodal services must be "comparable in quality" is vague, outdated, myopic and impossible to interpret with any consistency among the states. Few things are as subjective as the definition of "comparable" when it comes to the quality of phone service. Indeed a state could easily determine that if cable telephony does not provide the same level of uninterruptible 911 service as traditional wireline service, its service is not of "comparable quality." Other states could easily decide otherwise. Likewise, as VoIP providers such as Vonage continue to make strides in market share, there is no definition of "comparable quality" that would guide states in making the determination with anything remotely resembling consistency. ***Competition should be measured by its impact on consumers, not carriers.*** The viability of intermodal competition should be determined by a threshold level of substitution occurring in the market, or a traditional economic test of whether the competitor has a discernible impact on the prices of other carriers within the market.

4. **Establish a national standard for the definition of a market.** The geographic contours of a particular market may legitimately vary between and within each state. However, permitting states to define markets without clear national standards allows for too much granularity in defining what constitutes a "market" for purposes of determining impairment. Too much latitude produces inaccurate results and undermines consistency in the application of national rules. The definition of a market must be broad enough to encompass potential deployment. While wire centers may provide the most granular definition as to the ***actual*** deployment of a CLEC within an area, a wire center is not a "market" by any stretch of the imagination. It is too myopic to capture obvious economies of scale available to CLECs and necessary for efficient deployment. Even AT&T's witness in California's proceeding conceded that it is unlikely that an efficient CLEC would enter a state intending to serve only a single wire center. To define the market so narrowly, as California did in focusing on wire centers, results in a "least common denominator" approach to measuring competition instead of potential deployment. It measures barriers to entry by the least efficient competitor which, in effect, discourages investment. The market definition should encompass, at a minimum, clusters of wire centers within the reach of mass media advertising aimed at a particular geographic area. Barriers to deployment should not be considered in conjunction with

the geographic boundaries of a market, but should be considered as part of an impairment analysis of that market.

5. **Potential deployment should be embedded in all levels of an impairment test**. There should be no question as to whether potential deployment should be considered either at the market definition level or with an impairment test. Technology is changing the competitive landscape so fast that making a decision about the extent of competition based upon a snapshot of the market as it exists at a particular moment in regulatory time will undoubtedly be in error by the time the ink dries on new rules.

6. **Any new rules requiring unbundling should automatically sunset in three years, subject to revision and extension**. Unbundling is the most onerous tool regulators could possibly impose on a competitive industry. As such, it is the heaviest weight regulators could place on a company's investment decisions. And, as we've seen with the tumultuous debate over unbundling rules in the TRO, many market participants based their business models on ***long term*** access to unbundled network elements, regardless of the transitional purpose of unbundling spelled out in federal regulations. These companies now live or die based on slight changes to the status quo, regardless of whether we've achieved the goal of facilities-based competition. Market entrants must be forced to assume that unbundled elements will cease to be available as a transitional tool within a reasonable period of time or we will face this controversy again and again with no benefit to the public.

I appreciate the opportunity to convey these recommendations to the Commission.

Very truly yours,

SUSAN P. KENNEDY
Commissioner

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