BEFORE THE

Federal Communications Commission

WASHINGTON, D.C.

In the Matter of Petition of the Verizon Telephone Companies for Forbearance Under 47 U.S.C. § 160(c) From Title II and *Computer Inquiry* Rules with Respect to Their Broadband Services.	)))))))))))))	WC Docket No. 04-440

COMMENTS OF TIME WARNER TELECOM, XO COMMUNICATIONS, LIGHTSHIP TELECOM AND CONVERSENT COMMUNICATIONS

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February 8, 2005

BEFORE THE

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WASHINGTON, D.C.

In the Matter of Petition of the Verizon Telephone Companies for Forbearance Under 47 U.S.C. § 160(c) From Title II and *Computer Inquiry* Rules with Respect to Their Broadband Services.	))))))))))))	WC Docket No. 04-440

COMMENTS OF TIME WARNER TELECOM, XO COMMUNICATIONS, LIGHTSHIP TELECOM AND CONVERSENT COMMUNICATIONS

Time Warner Telecom, Inc. ("TWTC"), XO Communications ("XO"), Lightship Telecom, LLC and Conversent Communications, LLC, by their attorneys, hereby submit these comments in response to the petition for forbearance[1] filed by Verizon in the above-referenced proceeding.

Verizon's petition is one of a series of recent RBOC petitions seeking relief from common carrier regulations on the theory that *some* retail competition for mass market broadband customers from cable modem service somehow magically eliminates the RBOC's

[1] *See Petition of the Verizon Telephone Companies for Forbearance Under 47 U.S.C. § 160(c) From Title II and Computer Inquiry Rules with Respect to Their Broadband Services,* WC Dkt. No. 04-440 (filed Dec. 20, 2004) *("Petition").*

enduring market power over the facilities used to serve customers outside of the mass market.[2] Verizon is undoubtedly correct that Title II and *Computer Inquiry* requirements have no place in a truly competitive marketplace in which the incumbents' incentives to engage in anti-competitive behavior have been adequately reduced. *See, e.g., Petition* at 14. However, as the Joint Commenters and other parties have shown at length in response to the previously filed petitions for forbearance, the broadband marketplace is *not* fully competitive, and Verizon's powerful incentives to discriminate and engage in cost misallocation remain.

As the Commission only just last Friday reaffirmed, cable modem service does not meet the needs of most customers outside of the mass market,[3] and CLECs cannot economically deploy high capacity loop facilities of their own to the vast majority of the business market.[4] Therefore, the RBOCs continue to exercise a substantial and persisting market power over the transmission inputs used to serve business customers (creating incentives and opportunities for discrimination against competitors) and over regulated local telephone service (creating incentives and opportunities for Verizon to engage in cost misallocation). In such an environment, Title II and *Computer Inquiry* requirements remain necessary to protect consumers and competition from anticompetitive behavior.

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[2] *See Petition of Qwest Corporation for Forbearance Pursuant to 47 U.S.C. § 160(c), Inc. Pertaining to Qwest's xDSL Services*, WC Dkt. No. 04-416 (filed Nov 10, 2004); *Petition of BellSouth Telecommunications Inc, Inc. For Forbearance under 47 U.S.C. § 160(c) From Application of Computer Inquiry and Title II Common-Carriage Requirements*, WC Dkt. No. 04-405 (filed Oct. 27, 2004); *Petition of the Verizon Telephone Companies for Declaratory Ruling or, Alternatively, for Interim Wavier with Regard to Broadband Services Provided via Fiber to the Premises*, WC Dkt. No. 04-242, (filed Jun. 28, 2004); *Conditional Petition of the Verizon Telephone Companies for Forbearance Under 47 U.S.C. § 160(c) with Regard to Broadband Services Provided via Fiber to the Premises*, WC Dkt. No. 04-242 (filed Jun. 28, 2004).

[3] *See Unbundled Access to Network Elements, Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers*, Order on Remand, FCC 04-290, ¶ 193 (rel. Feb. 4, 2005) ("It is therefore reasonable to infer that most of the businesses that cable companies serve, or are likely to serve, are home offices or very small stand-alone businesses, neither of which typically requires high-capacity loop facilities.").

[4] *See id.* n.471 ("The evidence submitted in the record shows that there is *de minimis* deployment of DS1 loops by carriers for their own use, as well as extremely limited availability of wholesale DS1 loops.").

Because of the ILECs' enduring monopoly over bottleneck facilities, it should also be noted that cost-allocation rules remain necessary to protect against anticompetitive cross-subsidies between ILECs' regulated and unregulated services. It is simply incorrect to argue, as the ILECs have, that price cap regulation has "severed the link" between cost and price and therefore eliminated the need for cost-allocation rules. Rather, as the Commission recently confirmed, price caps remain tied to ILEC costs in several important ways.[5] Indeed, the Commission is currently investigating the extent to which ARMIS cost data indicates whether BOC special access rates of return are unreasonable. *See id.* ¶¶ 61-2. Without ARMIS or other similar cost measurements and rules allocating those costs between monopoly and competitive services, it would be impossible to determine whether ILEC rates are unreasonable or not. Therefore, any request for elimination of cost-allocation rules should be denied.

As the Commission has noted, the relief requested in this proceeding is nearly identical to that requested by BellSouth in its recent forbearance petition.[6] Accordingly, we hereby attach and incorporate herein the joint comments and reply comments of TWTC, XO and Cbeyond Communications filed in response to BellSouth's broadband petition for forbearance as appendices A and B respectively. The reasons stated therein for the denial of BellSouth's petition apply equally to the denial of Verizon's present petition as well.

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[5] *See Special Access Rates for Price Cap Local Exchange Carriers, et al.*, Order and Notice of Proposed Rulemaking, FCC 05-18, ¶ 12 (rel. Jan. 31, 2005) ("Although price cap regulation diminished the direct link between changes in allocated accounting costs and change in prices, it did not sever the connection between accounting costs and prices entirely. Rather, because the rates to which the price cap formulae were originally applied resulted from rate-of-return regulation, overall price cap LEC interstate revenue levels continued generally to reflect the accounting and cost allocation rules used to develop access charges. Moreover, earnings remain relevant to price cap regulation [in] several respects.").

[6] *See Comments Invited on Petition for Forbearance filed by the Verizon Telephone Companies With Respect to Their Broadband Services*, Public Notice, DA 04-4049 (rel. Dec. 23, 2004) ("This petition raises issues similar to those in the petition for forbearance filed by BellSouth Telecommunications, Inc. on October 27, 2004.").

Respectfully submitted,

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February 8, 2005

APPENDIX A

BEFORE THE

Federal Communications Commission

WASHINGTON, D.C.

In the Matter of BellSouth Telecommunications, Inc. For Forbearance Under 47 U.S.C. § 160(c) From Application of *Computer Inquiry* and Title II Common-Carriage Requirements	)))))))))))))	WC Docket No. 04-405

JOINT COMMENTS OF TIME WARNER TELECOM, CBEYOND COMMUNICATIONS AND XO COMMUNICATIONS

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December 20, 2004

BEFORE THE

Federal Communications Commission

WASHINGTON, D.C.

In the Matter of	)	
BellSouth Telecommunications, Inc. For Forbearance Under 47 U.S.C. § 160(c) From Application of *Computer Inquiry* and Title II Common-Carriage Requirements	)	WC Docket No. 04-405

JOINT COMMENTS OF TIME WARNER TELECOM, CBEYOND COMMUNICATIONS AND XO COMMUNICATIONS

Time Warner Telecom, Inc. ("TWTC"), Cbeyond Communications LLC ("Cbeyond") and XO Communications Inc. ("XO"), by their attorneys, hereby submit these comments in response to the petition for forbearance[1] filed by BellSouth in the above-referenced proceeding.

I. INTRODUCTION AND SUMMARY

In its petition, BellSouth asks the Commission to forbear from applying the *Computer Inquiry* requirement that it tariff and offer on a stand-alone basis the transmission inputs it uses for "broadband services." In support of this request, BellSouth relies exclusively on the assertions that its "broadband" information services compete with cable modem services, that cable modem offerings have a stronger position in the market, and that cable modem service is

[1] *See Petition of BellSouth Telecommunications Inc, Inc. For Forbearance under 47 U.S.C. § 160(c) From Application of Computer Inquiry and Title II Common-Carriage Requirements*, WC Dkt. No. 04-405 (filed Oct. 27, 2004) ("*Petition*").

not subject to the *Computer Inquiry* tariffing requirement for which BellSouth seeks forbearance. Whatever the merits may be of this argument, it is only relevant to whether forbearance should be granted for regulations applicable to services offered in competition with cable modem service. But BellSouth does not limit its request for relief in this manner. It seems to request forbearance for all of the broadband services it offers, even those that could not possibly be considered in the same product market as cable modem service. In this manner, BellSouth has crudely attempted to leverage whatever claim (however weak) it may have to forbearance in the mass market (services offered in competition with cable modem service) into a request for the freedom to engage in anticompetitive behavior in other markets for broadband information services in which it unquestionably controls bottleneck facilities.

There is simply no basis for forbearing from the *Computer Inquiry* rules as they apply to the small-medium sized business market or the large enterprise business market. In those markets, BellSouth controls the sole access to end user customers in the vast majority of locations. The evidentiary support for this conclusion in the *Triennial Review Remand* proceeding and elsewhere is incontrovertible. In fact, just last week the Commission reached the conclusion that competitors are "impaired" (even under the D.C. Circuit's overly cramped interpretation of that term) without access to DS1 and DS3 loops needed to serve business customers in, as Chairman Powell described it, the "overwhelming majority of markets." Moreover, BellSouth does not even attempt to argue that alternative end user connections are available for serving business customers. Thus, the "core assumption underlying the *Computer Inquiries*,"[2] namely the incumbents' control over bottleneck facilities, remains utterly sound in

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[2] *Appropriate Framework for Broadband Access to the Internet over Wireline Facilities, Notice of Proposed Rulemaking; Universal Service Obligations of Broadband Providers; Computer III Further Remand Proceedings:*

the business markets. The regulations adopted to address this problem must therefore be retained and the instant forbearance petition denied at least for the business markets.

II. DISCUSSION

In its petition, BellSouth essentially argues that it should be relieved of the requirement that it tariff transmission inputs used in information services because that requirement does not apply to cable modem service, the leading broadband service offering among mass market customers. There are numerous reasons why this request is fatally flawed. For example, it makes little sense to try to extend the regulatory framework applicable to cable modem service when the Supreme Court has recently granted *certiorari* to review the Ninth Circuit's decision in *Brand X Internet Services v. FCC* in which the court overturned significant portions of the FCC's *Cable Modem Declaratory Ruling.*[3] The instability of the regulatory regime applicable to cable modem service makes it inappropriate to try to extend equal treatment to other services.

In addition, it is not at all clear that there is a need to adopt further deregulation of even "broadband services" provided by BellSouth to mass market customers because BellSouth seems fully committed to investing in xDSL and fiber facilities to serve such customers under the current regulatory regime. Under the current regime, BellSouth is still able to add hundreds of thousands of xDSL customers each quarter[4] while pricing xDSL well below cable modem

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Bell Operating Company Provision of Enhanced Services; 1998 Regulatory Review -- Review of Computer III and ONA Safeguards and Requirements, Notice of Proposed Rulemaking, 17 FCC Rcd 3019, ¶ 36 (2002).

[3] *Inquiry Concerning High-Speed Access to Internet over Cable and Other Facilities*, Declaratory Ruling and Notice of Proposed Rulemaking, 17 FCC Rcd 4798 (2002) ("*Cable Modem Declaratory Ruling*") *rev'd Brand X Internet Services v. FCC*, 345 F.3d 1120 (9th Cir. 2003), *cert. granted*, 2004 U.S. LEXIS 7980, (U.S. Dec. 3, 2004) (No. 04-281).

[4] *See* Press Release, BellSouth, Investor News: BellSouth Reports Third Quarter Earnings (Oct. 25, 2004), *available at* http://www.bellsouth.com/investor/pdf/3q04p_news.pdf ("*BellSouth Press Release*") (noting that BellSouth added 134,000 net DSL customers in Q4, 2004). The BOCs also project that, under the current rules, the number of DSL subscribers will grow from 8 million in 2004 to 22 million in 2008. *See ex parte* presentation of BellSouth, Verizon, SBC and Qwest, WC Dkt. Nos. 04-313 *et al.* at I-5 (filed Oct. 4, 2004) ("*UNE Fact Report*").

service.[5] Notwithstanding BellSouth's claim that xDSL is losing to cable and other services (*see petition* at 8-12), the BOCs themselves estimate that, by 2008, cable modem and DSL will have approximately the same number of subscribers. *See UNE Fact Report* at I-12. Moreover, the Commission has already granted BellSouth extraordinary regulatory relief in an effort to ensure that there are no constraints on its incentive to invest in broadband facilities. Most recently, the Commission has, at BellSouth's request, extended the unbundling exemption for fiber-to-the-home facilities to fiber-to-the-curb ("FTTC") facilities and, again at BellSouth's request, decided to forbear from applying the Section 271 checklist requirements to broadband network elements.[6] In the wake of the FTTC order, BellSouth announced new investment in extensive fiber deployments.[7] The *Computer Inquiry* costs that BellSouth now asserts are such an impediment to investment do not seem to have been much of a concern.

Furthermore, as TWTC and others have explained at length in the past, the fact that cable operators are not subject to *Computer Inquiry* rules does not mandate that incumbent LECs be

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[5] For customers in Washington D.C., Comcast's "small business" package at 4MB/384k costs $95 per month (*see http://work.comcast.net/smallbusiness.asp*) while Verizon's 3MB/768k business package costs $89.95 per month. *See* http://www22.verizon.com/ForBusinessDSL/Channels/BDSL/DSL/bdsl_landing.asp. On the consumer side, the difference is even more dramatic, where Verizon's entry level DSL service costs $29.95 (*see* http://www22.verizon.com/ForHomeDSL/channels/dsl/forhomedsl.asp ?ID=Res) while Comcast's lowest level of cable modem service costs $42.95 for cable TV subscribers and $57.95 for non-CATV subscribers. *See* http://www.comcast.com/Buyflow/default.ashx?SourcePage =Internet&LocResult&StreetNumber=&StreetName= 1726%2017th%20street%20N.W.&StreetDesignation=&AptNumber=204&City=&State=&Zip=20009.

[6] *See Petition for Forbearance of the Verizon Telephone Companies Pursuant to 47 U.S.C. § 160(c) et al.*, Memorandum Opinion and Order, 19 FCC Rcd 21496 (2004) (forbearing from enforcing the requirements of the Section 271 checklist to broadband elements subject to the unbundling exemption); *Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers*, Order on Reconsideration, 19 FCC Rcd 20293 (2004) (extending unbundling exemption to fiber-to-the-curb).

[7] *See BellSouth Press Release* ("The ruling gives BellSouth the flexibility to redirect investments to FTTC technology and provide the next generation of speeds and services to more customers in a shorter timeframe.").

freed from those rules.[8] As explained in the *Broadband White Paper*, it is well established that the Commission's "primary responsibility" in implementing Title II is to ensure that common carrier offerings, including wholesale offerings, are just and reasonable. *See Broadband White Paper* at 4-8. The *Computer Inquiry* requirements are necessary to meet this requirement. The Commission has been justifiably concerned that the incumbents' provision of unregulated information services would offer ILECs opportunities to degrade and overprice their transmission service offerings. *See id*. at 14-25. In contrast, cable operators generally do not have any common carrier transmission service offerings and the Commission has not concluded that the provision of cable modem service free from *Computer Inquiry* requirements implicates the goals of Title II. *See id.* at 37-40. Absent such a holding, the current treatment of cable modem service has no legal bearing on even the appropriate regulatory treatment of the incumbent LEC mass market broadband services.

While these and other reasons probably justify denial of BellSouth's petition even as to mass market broadband services, these comments focus on the consequences of BellSouth's petition for broadband services demanded by business customers. For although cable modem service is only suitable for mass market (generally residential and home office) customers, BellSouth has not restricted the scope of its petition to that market. It has instead sought forbearance from the transmission input tariffing requirement for all "broadband services," which it defines broadly as "technologies that are capable of providing 200 Kbps in both directions." *Petition* at n.2. Read literally, this definition includes any high speed fiber or

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[8] *See ex parte* presentation of Allegiance Telecom, Time Warner Telecom and Conversent Communications, attached to Letter of Kevin Joseph Jr., SVP Allegiance, *et al.*, to Marlene H. Dortch, Secretary, FCC, CC Dkt. No. 02-33 (filed Jul. 24, 2003) ("*Broadband White Paper*").

copper[9] connection, including those used to serve business customers outside of the mass market.[10] BellSouth never explicitly states whether its petition applies to one or all of these services. In some cases, the discussion in the petition seems limited to the mass market,[11] while at other points it simply refers to "broadband service" without limitation. *See Petition* at 18.[12]

Of course BellSouth knows exactly what is doing here; the sweeping scope of the relief sought is obviously intentional. BellSouth understands perfectly well that there are actually numerous broadband and data product markets. It is fully capable of limiting the relief it requests to one such market. Moreover, it has argued in the past that the Commission should classify all of its "broadband" service offerings in both the mass market and what it called the "enterprise" market (which actually consists of two markets -- the small/medium business market

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[9] It is worth emphasizing that the Commission has applied the *Computer Inquiry* requirements to the ILEC networks as they have evolved. For example, the Commission applied these rules to Frame Relay services that did not exist at the time the *Computer Inquiries* were adopted. *See Independent Data Communications Manufacturers Association, Inc. and American Telephone and Telegraph Company, Petition for Declaratory Ruling That All IXCs be Subject to the Commission's Decision on the IDCMA Petition,* Memorandum Opinion and Order, 10 FCC Rcd 13717, ¶ 35 (1995). BellSouth is therefore clearly wrong in suggesting that the newness of broadband networks, by itself, justifies elimination of the Computer Inquiry requirements. *See Petition* at 7. The real issue is whether BellSouth retains market power over transmission inputs. With regard to business customers, it unquestionably does.

[10] The Commission has held that the services demanded by (1) mass market, (2) small and medium businesses and (3) large businesses comprise separate markets for telecommunications: "We find here that the economic characteristics of the mass market, small and medium enterprise, and large enterprise customer classes can be sufficiently different that they constitute major market segments…These customer classes generally differ in the kinds of services they purchase, the service quality they expect, the prices they are willing to pay, the levels of revenues they generate, and the costs of delivering them services of the desired quality." *Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers,* Report and Order and Order on Remand, 18 FCC Rcd 16978, ¶ 123 (2003) ("*Triennial Review Order*"), *vacated in part, United States Telecomm. Ass'n v. FCC,* 359 F.3d 554 (D.C. Cir. 2004) ("*USTA II*") *cert. denied* 2004 U.S. LEXIS 6711.

[11] *See, e.g., Petition* at 19 (asserting that cable competition has "ensured that consumers have had the benefits of rates that are just, reasonable, and not unreasonably discriminatory.").

[12] The discussion of the "RBAN service" confuses matters further. BellSouth argues that its experience with RBAN illustrates the manner in which the *Computer Inquiry* rules cause RBOCs to incur substantial and unnecessary delays and costs in developing new broadband service offerings. It appears that ISPs can use RBAN as an input for information service offerings demanded by both mass market and business customers. BellSouth's request that it be relieved from the *Computer Inquiry* requirements for services such as RBAN thus lends further support for the conclusion that BellSouth is rather ineptly seeking forbearance in all markets based on its plea (however ill-founded) for "parity" with mass market cable modem services.

and the large business market) as non-dominant.[13] It seeks the same outcome here, but it just decided not to say so explicitly.[14]

In any event, the assertion, however expressed, that the Commission should forbear from regulations governing BellSouth's control over bottleneck facilities in the business markets is clearly without merit. BellSouth has not offered a single piece of evidence in its petition to support forbearance from regulating its broadband service offerings to the business markets. Given that BellSouth bears the burden of proving that the requirements of Section 10 are met[15] and that the Commission rejects forbearance petitions where no support is offered for the relief requested,[16] the absence of any factual support for relief supports denial of the petition at least as to services offered to businesses.

Lest there be any doubt about the matter, however, it is worth briefly summarizing the reasons why no facts or policy arguments proffered by BellSouth could support forbearance from regulation of its broadband wholesale transmission services in the business markets. As the Commission has found, competitors seeking to serve enterprise customers over their own loop

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[13] *See* Comments of BellSouth, CC Dkt. No. 01-337, at 4 (filed Mar. 1, 2002).

[14] In this regard, BellSouth's approach resembles Verizon's use of the term "FTTP broadband transmission" in its set of petitions filed earlier this year seeking similar relief. *See Petition of the Verizon Telephone Companies for Declaratory Ruling or, Alternatively, for Interim Wavier with Regard to Broadband Services Provided via Fiber to the Premises*, WC Dkt. No. 04-242, (filed Jun. 28, 2004); *Conditional Petition of the Verizon Telephone Companies for Forbearance Under 47 U.S.C. § 160(c) with Regard to Broadband Services Provided via Fiber to the Premises*, WC Dkt. No. 04-242 (filed Jun. 28, 2004). While Verizon's petitions left hazy the scope of its requested relief, it has "let slip" its true intentions in other dockets. For example, in a recent *ex parte* in the *Triennial Review Remand* docket, Verizon argued that the Commission should find that "fiber loop facilities that are part of a general deployment of an FTTP network are not subject to unbundling, *regardless of the identity of the customer served*, and that any such loop should be considered a 'mass-market' loop." *See ex parte* Letter of Edwin J. Shimizu, Director, Federal Regulatory Affairs, Verizon, to Marlene H. Dortch, Secretary, FCC, WC Dkt. Nos. 04-313 *et al.*, at 4 (filed Dec. 8, 2004) (emphasis added).

[15] *See Petition of Ameritech Corporation for Forbearance from Enforcement of Section 275(a) of the Communications Act of 1934, As Amended*, Memorandum Opinion and Order, 15 FCC Rcd 7066, ¶ 7 (1999).

[16] *See, e.g., Petition of Core Communications Inc. for Forbearance under 47 U.S.C. § 160(c) from Application of the ISP Remand Order*, Order, 19 FCC Rcd 20179, ¶ 16 (2004).

facilities face "steep economic barriers." *Triennial Review Order* ¶ 199. Importantly, "most of the costs of constructing loops are sunk costs." *Id.* ¶ 205. This is true of the huge costs "associated with physically laying the fiber cable." *Id.* ¶ 312. Entities seeking to deploy fiber loops must also overcome the "inability to obtain reasonable and timely access to the customer's premises both in laying the fiber to the location and getting it into the building thereafter, as well as convincing customers to accept the delays and uncertainty associated with deployment of alternative loop facilities." *Id.* (citations omitted).

Because of the barriers associated with investing in new high capacity loops, it is not surprising that such facilities have only been built to a very small fraction of business end-users. For example, BellSouth and the other RBOCs have recently admitted that that CLECs only serve 32,000 (*see* ILEC UNE Fact Report at I-2) buildings out of 739,000 total commercial office buildings[17] (approximately four percent) throughout the U.S. with their own loops. The Commission came to a similar conclusion in the *Triennial Review Order*, in which it noted that only "3% to 5% of the nation's commercial office buildings are served by competitor-owned fiber loops." *Triennial Review Order* at n.856. Accordingly, the Commission concluded that "in most areas, competing carriers are unable to self-deploy and have no alternative to the incumbent LEC [fiber loop] facility." *Id.* ¶ 314.

Evidence supplied by competitors in the *Triennial Review Remand* proceeding confirms that they cannot efficiently self-deploy loops to the vast majority of business customers. TWTC has explained in that proceeding that it must rely on ILEC loop facilities in 75 percent of the

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[17] *See* Sprint Comments, WC Dkt. Nos. 04-313 *et al.*, at 44 (filed Oct. 4, 2004) (noting that this figure is based on Department of Commerce data). As Sprint notes, this figure understates the number of buildings because it excludes heavy users of telecommunications traffic such as hotels, universities, hospitals, smaller buildings, some government and military facilities and other categories of buildings. *See id.*

locations it serves.[18] There are simply not many buildings in which TWTC can generate enough revenue to justify the construction of its own loops. *See TWTC Dec. 1 Letter* at 2-3. Similarly, XO and others have indicated that they must have at least 3 DS3s of committed revenue in a particular building (a rare occurrence) before they can justify deploying loops.[19] Even where the revenue opportunity would justify loop construction, building access, rights-of way issues and the unwillingness of many customers to wait for construction often preclude deployment.[20] It is not surprising therefore that competitors have not been able to overbuild incumbent LEC loops in the vast majority of business customer locations.

Nor do cable operators offer an alternative in the business markets. Even if the hybrid fiber coax ("HFC") networks of cable providers could somehow achieve the geographic scope[21] of the ILECs' facilities, the existing characteristics of cable modem service dictate that it cannot serve as a replacement for DS1 or higher capacity service. The limited upstream capacity[22] of

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[18] *See ex parte* Letter of Thomas Jones, Counsel, Time Warner Telecom, to Marlene H. Dortch, Secretary, FCC, WC Dkt. Nos. 04-313 *et al.,* at 2 (filed Dec. 1, 2004) ("*TWTC Dec. 1 Letter"*); Comments of Time Warner Telecom, WC Dkt. Nos. 04-313 *et al.,* at 5 (filed Oct. 4, 2004).

[19] *See ex parte* Letter of Heather Gold, SVP, Government Relations, XO, to Marlene H. Dortch, Secretary, FCC, WC Dkt. Nos. 04-313 *et al.,* at 2 (filed Dec. 14, 2004); *ex parte* presentation of MiCRA *et al.,* WC Dkt. Nos. 04-313 *et al.,* at 5 (filed Oct. 18, 2004) (citing CLEC filings for the proposition that "KMC will not build laterals unless a customer purchases at least 3 DS3s…XO will not construct laterals unless combined customer demand in a building reaches at least 3 DS3s…Xpedius requires a bare minimum of 3 DS3s in customer demand before constructing laterals…For buildings over 500 feet from its fiber ring, ATI requires that a customer order OC-3 service before building…Echelon and SNiPLink report that it is never economic to self deploy loops to their bases of DS1 service customers.") (internal citations omitted).

[20] *See* Declaration of Graham Taylor and Charles M. Boto at 8-10, attached to *TWTC Dec. 1 Letter.*

[21] Even BellSouth admits that cable networks currently only pass 25 percent of businesses. *See ex parte* Letter of Jonathan Banks, VP Executive and Federal Regulatory Affairs, BellSouth, to Marlene H. Dortch, Secretary, FCC, WC Dkt. Nos. 04-313 *et al.,* at 5 (filed Nov. 8, 2004).

[22] *See* Richard A. Chandler *et. al.,* THE TECHNOLOGY AND ECONOMICS OF CROSS-PLATFORM COMPETITION IN LOCAL TELECOMMUNICATIONS MARKETS, HAI Consulting, at 35 (2002) attachment A to Comments of WorldCom, Inc., CC Dkt. Nos. 01-338 *et. al.,* at 37 (filed Apr. 5, 2002). Offering services similar to a symmetrical T-1 would "quickly exhaust the upstream capacity of even an upgraded cable network." *Id.* at 36.

current cable modem service offerings, HFC's shared architecture that can lead to customer concerns regarding service slowdowns and security problems,[23] and the absence of other features demanded by most business customers make cable modem service unsuitable for most business customers.[24] In fact, 75 percent of businesses subscribing to cable modem service receive the residential version,[25] demonstrating that either the alleged "business centric" features of the business product are not compelling or have not been deployed. Moreover, because HFC networks are shared, Cox and Comcast place bandwidth limitations on their business users.[26] All of these factors make cable modem service unattractive to most businesses. As the Commission recently confirmed: "[c]able modem service is primarily residential service."[27]

The experience of Cbeyond, Conversent and Nuvox confirm that cable modem service for "business" on one hand and services provided via high capacity ILEC loops to small businesses on the other do not compete. An important feature of the products that CLECs provide over DS1 circuits to many small businesses is the integration of voice and data over the

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[23] *See* James Michael Steward, *Facing the security risks of cable modems*, TECHREPUBLIC, July 8, 2002, *available at* http://insight.zdnet.co.uk/hardware/servers/0,39020445,2118716,00.htm.

[24] *See Triennial Review Order* ¶ 129 ("Large enterprises demand extensive, sophisticated packages of services. Reliability of service is essential to these customers, and they often expect guarantees of service quality. The services they might purchase include an internal voice and data network, local, long distance, and international POTS service to one or multiple locations, provisioning and maintenance of a data network such as ATM, frame relay or X.25, and customized billing.").

[25] *See* Letter of David L. Lawson, AT&T, to Marlene H. Dortch, Secretary, FCC, CC Dkt. Nos. 01-338, *et al.*, at 4-5 (filed Feb. 4, 2003).

[26] *See* http://www.coxbusiness.com/AcceptableUsePolicy.pdf at 1. Cox Business Services' "Acceptable Use Policies" indicates that the "Customer may not use the Services in a manner that places a disproportionate burden on the network or impairs the Service received by other Customers." *Id.* Similarly, Comcast notes in its "High-Speed Internet for Business Acceptable Use Policy," that "You must ensure that your activity… does not improperly restrict, inhibit, disrupt, degrade or impede any other user's use of the Service, nor represent (in the sole judgment of Comcast), an unusually large burden on the network." http://work.comcast.net/legal/aup.asp.

[27] *Availability of Advanced Telecommunications Capability in the United States*, Fourth Report to Congress, 19 FCC Rcd 20540, at 14 (2004).

same circuit. In addition to its other perceived shortcomings, cable modem service generally does not include a voice capability except where the cable operator offers VoIP over its own facilities. For this reason as well, therefore, business customers usually do not perceive integrated DS1 products and cable modem service (or apparently any other cable offering) as substitutes. The available data regarding numbers ported between CLECs and cable operators supports this conclusion. For example, few of Cbeyond's small business customers port their numbers in from cable modem service providers.[28] Nuvox, whose small business customers average 14 lines[29] has asserted that, at most, 23 of its port-outs were to cable modem service providers.[30] Likewise, Conversent has experienced few ports to cable operators and sees little competition from cable modem providers for its "average customer" who has "7 lines."[31] Crucially, all three carriers must rely on the ILECs' DS-1 loops to provide service to their small business customers.[32]

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[28] *See ex parte* Letter of Thomas Jones, Counsel, Cbeyond, to Marlene H. Dortch, Secretary, FCC, WC Dkt. Nos. 04-313 *et al.*, at 4 (filed Nov. 19, 2004) ("*Cbeyond Nov. 19 Letter*").

[29] *Ex parte* presentation of Nuvox Communications at 1, attached to Letter of Michael J. Pryor, Counsel, Nuvox, to Marlene H. Dortch, Secretary, FCC, WC Dkt. Nos. 04-313 *et al.*, (filed Dec. 7, 2004) ("*Nuvox Dec. 7 ex parte*")

[30] *See ex parte* Letter of Michael J. Pryor, Counsel, Nuvox, to Marlene H. Dortch, Secretary, FCC, WC Dkt. No. 04-313 *et al.*, at 4 (filed Nov. 22, 2004).

[31] *Ex parte* Letter from Scott Sawyer, VP Regulatory Affairs and Counsel, Conversent, to Marlene H. Dortch, Secretary, FCC, WC Dkt. Nos. 04-313 *et al.*, at 1 (filed Dec. 1, 2004).

[32] *See ex parte* presentation of Cbeyond at 4, attached to Letter of Patrick Donovan, Counsel, Cbeyond, to Marlene H. Dortch, Secretary, FCC, WC Dkt. Nos. 04-313 *et al.*, (filed Sept. 8, 2004) ("*Cbeyond Sept. 8 ex parte*") ("Cbeyond exclusively uses unbundled DS1 loops and DS1 level EELS to provide service to end user customers"); Reply Comments of Nuvox WC Dkt. Nos. 04-313 *et al.*, at 3 (filed Oct. 19, 2004) ("[n]either NewSouth [Nuvox's affiliate] nor Nuvox have deployed any of their own fiber."); Reply Comments of Conversent, CC Dkt. No. 01-338 *et al.*, at 2 (filed Jul. 17, 2002) ("*Conversent Reply Comments*") ("Conversent has found that it can efficiently provide voice and data service to [its small business customers] by leasing…unbundled local loops.").

The dramatic difference between the prices charged for cable modem and traditional high-capacity wireline services confirm that they are in different product markets.[33] For example, Cablevision's asymmetrical Business Class Optimum Online cable modem service sells for $109.95 per month,[34] while Cbeyond generates an average of $500 per month from its 5-line DS-1 "base-package," ordered by 88% of its customers. *See Cbeyond Sept. 8 ex parte* at 3. Similarly, Nuvox asserts that an average DS-1 generates between $500 and $700 per month in revenue.[35] If cable modem service met the needs of Cbeyond and Nuvox's customer base, these companies would long have been forced into bankruptcy at these price differentials. Yet, Cbeyond is "currently EBITDA positive and is adding new customers every day," (*see Cbeyond Nov. 19 Letter at 5*) while Nuvox has been EBITDA positive since the second quarter of 2002. *See Nuvox Dec. 7 ex parte* at 3. It is clear that cable modem service is not a substitute for DS-1 level service delivered, in large measure, via BellSouth's and other RBOCs' own high capacity wholesale loop facilities to small, medium and large businesses.

To the extent that cable operators attempt to deploy their own high capacity loops, they face the exact same barriers, noted above, that TWTC and other wireline CLECs face. Therefore, they too rely on ILEC loop facilties. The experience of Cablevision's Lightpath division appears to support this conclusion. As Lightpath has explained, "[a]lthough Lightpath is a facilities-

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[33] *See* 2A PHILLIP E. AREEDA, HERBERT HOVENKAMP AND JOHN SOLOW, ANTITRUST LAW: AN ANALYSIS OF ANTITRUST PRINCIPLES AND THEIR APPLICATION ¶ 561 (2d ed. 2002) ("To have separate markets, one must find that a significant price increase beyond the competitive level in the *A* price would *neither* induce customers of *A* to buy *B* instead, nor induce *B* producers to make *A*.") (emphasis in original).

[34] *See* http://www.optimum.com/index.jhtml?pageType=pricing_bcool.

[35] *See* Nuvox Comments, WC Dkt. Nos. 04-313 *et al.*, at 3 (filed Oct. 4, 2004). The importance of symmetrical service to many business users is underlined by Conversent, which notes that business customers are willing to pay 3 times more for Conversent symmetrical DSL service than Verizon's ADSL offering. *See* Declaration of Robert J. Shanahan ¶ 17, attached as ex. 1 to *Conversent Reply Comments*.

based provider, Lightpath relies on special access lines from incumbent LEC facilities, namely Verizon, to supplement its service footprint and provide services to its existing and new customers."[36] Not surprisingly, Verizon has attempted to leverage its control over special access inputs (and no doubt its refusals to make UNEs available as required by law) to harm Lightpath's ability to compete in downstream retail enterprise service markets. For example, Lightpath complains that "Verizon does not provide quality, non-discriminatory access to special access facilities and as a result, inhibits Lightpath's ability to meet its customers' service expectations." *Id.* at 2. Verizon's poor performance is inextricably tied to its market power in special access services: "the evidence in this proceeding on Verizon's performance, in particular, confirms that incumbent LEC provisioning of special access is well below the type of service a company would provide (and indeed could get away with providing) to its customers in a truly competitive market."[37]

There is no reason to believe that other cable operators would escape reliance on RBOC market power in seeking to serve businesses that are outside of the mass market. Although Cox Communications offers DSx and OCn level services in Omaha and other areas, many of these circuits are purchased from Qwest.[38] Even in Manhattan, one of the areas of highest competitive fiber deployment in the country, Time Warner Cable ("TWC") has only built its fiber network to

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[36] Letter from Cherie R. Kiser and Lisa N. Anderson, Attorneys for Cablevision Lightpath, Inc. to Magalie Roman Salas, Secretary, FCC, CC Dkt. No. 01-321 at 1-2 (filed Jan. 22, 2002).

[37] Letter from Cherie R. Kiser and Lisa N. Anderson, Attorneys for Cablevision Lightpath, Inc. to William F. Caton, Acting Secretary, FCC, CC Dkt. No. 01-321 at 2 (filed Feb. 12, 2002).

[38] A discussion with Cox's Omaha Carrier Access sales representative indicated that many of Cox's fiber loops are purchased from Qwest.

neighborhood nodes.[39] It must rely on non-HFC facilities to deliver capacity up to 1 Gbps provided via "fiber connectivity" through TWC's "Dedicated Access Solutions" to "enterprises."[40] Without access to ILEC facilities, when TWC seeks to provide fiber-based services to business customers, it would need to deploy new fiber and, in doing so, would face the obstacles outlined above. In light of these market realities, it is clear that ILECs continue to exercise substantial market power over local bottleneck facilities used by all but the very smallest businesses.

For all of these reasons, last week the Commission reaffirmed that competitors are impaired without access to unbundled high capacity loops in the vast majority of wire centers.[41] As Chairman Powell explained in his separate statement supporting the Commission's decision in the *Triennial Review Remand* proceeding, "the record and our analysis demonstrated that competitors still depend[] significantly on [incumbent loops and transport] in the *overwhelming majority of markets*." *See id*., Separate Statement of Chairman Michael Powell at 2 (emphasis added). Commissioner Abernathy reiterated this point and emphasized that the relevant entry barriers made it "uneconomic" to construct DS1 loops, the most widely used level of connectivity for serving the small and medium business market, in "the vast majority" of cases. *See id*., Separate Statement of Commissioner Kathleen Q. Abernathy at 1.[42]

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[39] *See* http://www3.twcnyc.com/NASApp/CS/ContentServer?pagename=twcnyc/newbusiness&mysect=newbusiness/privatenetwork ("The network is made up of hub sites, which are interconnected with a fiber back bone. These hub sites are in turn connected by fiber rings to Nodes housed on each city block, servicing one or two city blocks or possibly single buildings. Last mile connectivity to the typical user is via coaxial cable runs which terminate at the node.").

[40] http://www.rrbiz.com/RoadRunner/sec_enterprise.asp?TRACKID=&CID=17&DID=22.

[41] FCC News, FCC Adopts New Rules for Network Unbundling Obligations of Incumbent Local Phone Carriers, FCC 04-290 at 2 (rel. Dec. 15, 2004).

[42] These conclusions are consistent with the Commission's longstanding treatment of the ILECs, including BellSouth, as dominant in the provision of special access. In the *Pricing Flexibility Order*, the Commission found

Nor is there any merit in BellSouth's oft-repeated (though not in the petition) argument that IXCs are dominant in providing end-to-end (largely interLATA) services to enterprise customers, and therefore the Commission should not be concerned about ILEC control of wholesale inputs.[43] This argument confuses *market share* in a downstream market with *market power* in an upstream market. As the Commission has expressly found, BOCs are fully capable of leveraging their control over upstream inputs to harm (and eventually dominate) competition even in downstream markets that they enter for the first time with zero market share.[44] For many years, BellSouth and other BOCs did not have an incentive to discriminate against competitors that used BOC wholesale transmission inputs as part of interLATA services provided to large enterprise customers.[45] This was because sophisticated enterprise customers need multistate access, and without the ability to provide interLATA connections among multiple points in

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that, even where an ILEC has received Phase II pricing flexibility, it may still charge "an unreasonably high rate for access to an area that lacks a competitive alternative." *Access Charge Reform; Price Cap Performance Review for Local Exchange Carriers; Interexchange Carrier Purchases of Switched Access Services offered by Competitive Local Exchange Carriers; Petition of US West Communications, Inc. for Forbearance from Regulation as a Dominant Carrier in the Phoenix, Arizona MSA*, Fifth Report and Order and Further Notice of Proposed Rulemaking, 14 FCC Rcd 14221, ¶ 144 (1999) ("*Pricing Flexibility Order*"), *aff'd, WorldCom, Inc. v. FCC*, 238 F.3d 449 (D.C. Cir. 2001). Therefore, the *Pricing Flexibility Order* retained the dominant classification for ILEC special access (*see id.* ¶ 151) and required ILECs to maintain their tariffed rates to preclude them from "abusing their market power by charging dramatically higher rates to customers that lack competitive alternatives." *Id.* ¶ 79.

[43] *See, e.g.*, Comments of BellSouth Corporation, WC Dkt. Nos. 04-36 *et al.*, at 40 (filed May 28, 2004) ("And in the enterprise market, it is AT&T and other large IXCs that have the lion's share of the business broadband market. As of January 2004, AT&T, MCI and Spring controlled 79% of the frame relay market and 60% of the ATM market…The ILECs thus do not even arguably have 'bottleneck' control of the transmission facilities necessary to offer IP-enabled services, or, for that matter, any other information services offered over broadband facilities.").

[44] *See Regulatory Treatment of LEC Provision of Interexchange Services Originating in the LEC's Local Exchange Area and Policy and Rules Concerning the Interstate, Interexchange Marketplace*, Second Report and Order, 12 FCC Rcd 15756, ¶ 96 (1997) (holding that the fact that BOCs begin with "zero market share" in interLATA services "is not conclusive in determining whether a BOC interLATA affiliate should be classified as dominant because the affiliate's zero market share results from its exclusion from the market until now, and, the affiliate potentially could gain significant market share upon entry or shortly thereafter, because," of, among other things, "the BOC's ability potentially to raise the costs of its affiliate's interLATA rivals.").

[45] *See ex parte* presentation of Verizon at 24, attached to Letter of Michael E. Glover, Verizon, to Marlene H. Dortch, FCC, CC Dkt. Nos. 01-338 *et al.*, (filed Jul. 2, 2004) (describing IXCs' reliance on special access circuits).

multiple states, BOCs could not effectively compete at the retail level.[46] Where a price squeeze was neither possible nor advantageous for ILECs, they would simply sell wholesale service in a profit maximizing fashion. Now that the BOCs have gained Section 271 approval in all 50 states,[47] they have powerful incentives to discriminate.[48] In fact, the Commission recently held that BellSouth has already engaged in unlawful discrimination in favor of its long distance affiliate.[49] Moreover, the continuing sunset of the 272 separate affiliate requirements (without any analysis of the consequences of such action for competition) removes another barrier to BOC unlawful discrimination and price squeezes.[50] Thus, RBOCs, including BellSouth, are increasingly free to act on their incentives to discriminate against providers of interLATA data services, and the removal of *Computer Inquiry* requirements for non-mass market loops would only further invite market power abuses.

In light of BellSouth's powerful incentives to engage in anticompetitive conduct, it is essential that the Commission limit BellSouth's opportunities to act on those incentives. The

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[46] *See id.* at 22 ("Traditionally, local telephone companies have not been major players in this market segment, because they did not have the ability to meet all of the needs of these customers. In particular, the interLATA restriction historically precluded the Bell companies from providing interLATA services, which is a critical component of the package of services that large enterprise customers demand. The Bell Companies have only recently begin to compete seriously for the nationwide and global business of large enterprise customers.").

[47] The final 271 approval was granted only within the last year. *See Application by Qwest Communications International Inc. for Authorization to Provide In-Region, InterLATA Services in Arizona*, Memorandum Opinion and Order, 18 FCC Rcd 25504 (2003).

[48] *See* Marius Shwartz, *The Economic Logic for Conditioning Bell Entry into Long Distance on the Prior Opening of Local Markets*, 18 Journal of Regulatory Economics 247, 265-66 (Nov. 2000).

[49] *See AT&T Corp. Inc. v. BellSouth Telecommunications Inc.*, Memorandum Opinion and Order, File No. EB-04-MD-010 (rel. Dec. 9, 2004).

[50] *See Implementation of the Non-Accounting Safeguards of Sections 271 and 272 of the Communications Act of 1934, as amended*, First Report and Order and Further Notice of Proposed Rulemaking, 11 FCC Rcd 21905, ¶ 160 (1996) ("Together, the prohibition on joint ownership of facilities and the nondiscrimination requirements should ensure that competitors can obtain access to transmission and switching facilities equivalent to that which section 272 affiliates receive."). As of December 15, 2004, RBOC 272 affiliates have sunset in 6 states, eliminating structural separation, affiliate transaction and nondiscrimination requirements.

requirement that BellSouth offer the broadband transmission services underlying its information services as a stand-alone offering subject to common carrier regulation pursuant to the *Computer Inquiry* rules (and as stand-alone unbundled network elements pursuant to sections 251 and 252) is an essential part of the regulatory regime needed to achieve this goal. In the absence of adequate regulation of wholesale transmission services, BellSouth would have the opportunity to upgrade the transmission used for its unregulated offerings while "starving" its regulated, wholesale stand-alone transmission offerings of investment and innovation. Over time, its information service operations would obtain access to more and more efficient transmission capabilities while competitors in the business market would have no choice but to rely on increasingly obsolete transmission services. Such an outcome is squarely at odds with the Commission's statutory duty to ensure that BellSouth's common carrier services are offered on just, reasonable and not unjustly or unreasonably discriminatory terms and conditions.

Tariff filing, as well as unbundling requirements are the means established in Title II to prevent this outcome. In fact, the very existence of a tariff filing requirement can deter a certain amount of anticompetitive behavior because the service provider must justify its prices with cost-based showings and demonstrate that other aspects of its service are reasonable and not unreasonably nondiscriminatory. The tariffing process also assists the Commission in detecting and preventing price squeezes because it makes it easier to determine whether BellSouth has complied with applicable imputation rule requirements, such as Section 272(c)(3). *See* 47 U.S.C. § 272(c)(3). Moreover, the application of the bedrock requirements of Section 201, 202, 271 and 272 to stand-alone tariffed offerings (and the application of sections 251 and 252 to unbundled network elements) offers BellSouth's customers and competitors the opportunity to challenge unreasonable and discriminatory behavior. For all of these reasons, the Commission must retain

the *Computer Inquiry* requirement that BellSouth make available the transmission inputs used for the information services demanded by small, medium and large business customers on a stand-alone, tariffed basis.

III. CONCLUSION

BellSouth's petition should be denied insofar as it requests forbearance from the *Computer Inquiry* requirements applicable to "broadband" services demanded by small, medium and large business customers.

Respectfully submitted,

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*Admitted in Maryland

December 20, 2004

APPENDIX B

BEFORE THE

Federal Communications Commission

WASHINGTON, D.C.

In the Matter of BellSouth Telecommunications, Inc. For Forbearance Under 47 U.S.C. § 160(c) From Application of *Computer Inquiry* and Title II Common-Carriage Requirements	)))))))))))))	WC Docket No. 04-405

JOINT REPLY COMMENTS OF TIME WARNER TELECOM, CBEYOND COMMUNICATIONS AND XO COMMUNICATIONS

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January 28, 2005

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BEFORE THE

Federal Communications Commission

WASHINGTON, D.C.

In the Matter of	)	
BellSouth Telecommunications, Inc. For Forbearance Under 47 U.S.C. § 160(c) From Application of *Computer Inquiry* and Title II Common-Carriage Requirements	)	WC Docket No. 04-405

JOINT REPLY COMMENTS OF TIME WARNER TELECOM, CBEYOND COMMUNICATIONS AND XO COMMUNICATIONS

Time Warner Telecom, Inc. ("TWTC"), Cbeyond Communications LLC ("Cbeyond") and XO Communications Inc. ("XO") (collectively, the "Joint Commenters"), by their attorneys, hereby submit these reply comments in response to the petition for forbearance[1] filed by BellSouth in the above-referenced proceeding.

INTRODUCTION AND SUMMARY

The Joint Commenters and other parties that filed comments in opposition to the BellSouth Petition have amply demonstrated that there is no basis for forbearing from the *Computer Inquiry* tariffing or other Title II requirements currently applicable to broadband services offered by BellSouth or other incumbent LECs. As the Joint Commenters explained,

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[1] *See Petition of BellSouth Telecommunications Inc, Inc. For Forbearance under 47 U.S.C. § 160(c) From Application of Computer Inquiry and Title II Common-Carriage Requirements*, WC Dkt. No. 04-405 (filed Oct. 27, 2004) ("*Petition*").

this is especially the case with regard to broadband services demanded by all but the smallest businesses, since the vast majority of businesses have no alternative to the incumbent for broadband end user connections. On these issues, the record in this proceeding speaks for itself, and there is no need to revisit the question of the ILECs' market power over broadband end user connections.

There is one critical issue, however, that has not received adequate treatment by competitors in this proceeding. Specifically, BellSouth argues in its Petition that the Commission should not apply its Part 64 rules to broadband facilities BellSouth uses to provide broadband information services. *See Petition* at 23-24. The Joint Commenters address this issue herein to set the record straight as to both the purpose of proper cost allocation rules and their vitally important role in ensuring that broadband and other services provided by ILECs are offered on just and reasonable rates, terms and conditions. The fact is that, if the Commission refuses (contrary to sound policy) to apply the appropriate level of rate regulation to ILEC broadband services, the ILECs will have powerful incentives to cross-subsidize those services. Existing federal and state rate regulation applicable to the ILECs' regulated services still set prices based on regulated accounting costs. Such rate-of-return regulation inevitably causes the regulated firm to try to pad the rate base as a means of obtaining higher regulated rates in the future. Cost allocation rules are necessary to limit the ILECs' opportunities to engage in this conduct.

DISCUSSION

Accounting requirements are an indispensable regulatory mechanism for constraining ILEC opportunities to misallocate the costs of competitive and/or unregulated services provided on an integrated basis with services subject to some form of rate-of-return regulation. The fundamental concern is that a carrier that provides services over which it has market power and

that are subject to rate of return regulation of some kind has powerful incentives to shift the costs of unregulated and competitive services to the accounting categories associated with the regulated services.[2] Such cost-misallocation or cross-subsidy harms regulated ratepayers, and it distorts competition in the market for the subsidized services. Moreover, the risk that regulated firms will engage in undetected cost misallocation is especially grave where the subsidizing and subsidized services share substantial joint and common costs (*see Non-Accounting Safeguards Order* ¶ 159), as is the case where ILECs provide multiple services subject to varying degrees of competition and regulation over an integrated broadband platform. Where this is the case, the allocation of the joint and common costs among different service categories is essentially the result of value judgments rather than specific accounting principles. The history of accounting regulation essentially consists of attempts to ensure that regulators make those judgments in a manner that protects consumers of regulated services and competition rather than allowing regulated firms to make those judgments in a manner that harms consumers and competition.

The Commission has recognized the importance of proper cost allocation rules over and over in the history of common carrier regulation. Even while most BOC unregulated activity was conducted *via* separate corporate affiliates, the Commission imposed accounting requirements, most importantly the affiliate transaction rules, to ensure that BOCs would not subsidize unregulated service offerings by inappropriately shifting costs from the affiliate to the regulated rate base. But, as BellSouth acknowledges, proper cost allocation rules became an especially critical issue when, in the *Computer III* proceeding, the Commission eliminated the

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[2] *See Implementation of the Non-Accounting Safeguards of Sections 271 and 272 of the Communications Act of 1934, as amended*, First Report and Order, ¶ 10 (1996) (*"Non-Accounting Safeguards Order"*) ("If a BOC is regulated under rate-of-return regulation, a price caps structure with sharing (either for interstate or intrastate services), a price caps scheme that adjusts the X-factor periodically based on changed in industry productivity, or if any revenues it is allowed to recover are based on costs recorded in regulated books of account, it may have an incentive to allocate improperly core business costs that would be properly attributable to its competitive ventures").

requirement that BOCs provide enhanced services through a separate affiliate (which had obviated much of the need for comprehensive accounting safeguards) and instead gave them the chance to offer those services on an integrated basis. As the Commission explained in its initial *Computer III* order, the elimination of structural separation requirements created the risk that, "unless checked in some fashion, [the BOCs] would be able to shift costs properly attributable to their enhanced services offerings to those regulated services for which they still have market power."[3] The Commission correctly observed that "[s]uch cost-shifting can have adverse impacts on ratepayers, by improperly increasing the prices they pay for their use of regulated services, and on competition in unregulated markets, by providing an opportunity for carriers to charge artificially low prices for their unregulated goods and services." *See id.*

To limit the ILECs' opportunities to misallocate the costs of unregulated service offerings, the Commission adopted its Part 64 cost allocation rules. Those rules utilize a fully distributed cost methodology and a hierarchy of cost apportionment rules to separate the costs of regulated and unregulated services. In establishing these rules, the Commission's express intention was to (1) "keep regulated common carriers from using the revenues from their regulated services to subsidize nonregulated enterprises," and (2) "ensure that ratepayers receive their appropriate share of the benefits [in the form of economies of scope] arising from the offering of regulated and nonregulated services on a structurally unseparated basis."[4] The Commission adopted these requirements as the most appropriate means of preventing BOCs from charging unjust and unreasonable rates in violation of Section 201(b) for their *regulated*

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[3] *See Third Computer Inquiry,* Report and Order, 104 FCC 2d 958, ¶ 234 (1986) ("*Computer III Report and Order*").

[4] *See Separation of Costs of Regulated Telephone Service from Costs of Non Regulated Service;* Report and Order, 2 FCC Rcd 1298, ¶ 69 ("*Joint Cost Order*") (1987).

service offerings.[5] It is important to note in this regard that the Commission adopted the Part 64 rules notwithstanding the fact that the market for enhanced services was competitive. The focus of the Commission's concern was the consequences for regulated rates of the BOCs' entry into unregulated, competitive markets.

The Commission has also adopted accounting requirements designed to limit ILECs' incentives to misallocate the costs of competitive, regulated services to cost categories associated with regulated services over which ILECs have market power. In every case, the Commission adopted these requirements notwithstanding the fact that the ILECs lacked market power or any significant market share in the would-be subsidized service. For example, in a situation that is strikingly similar to broadband services at issue here, the Commission established special accounting requirements to prevent ILECs from misallocating the costs of facilities deployed for the purpose of providing video dialtone. Video dialtone was a common carrier video transmission service to be provided *via* facilities that shared substantial joint and common costs with the facilities used to provide local exchange and exchange access services. Then, as now, the ILECs argued that there was no need for detailed accounting regulations because the ILECs had no market power in the provision of video services, a market overwhelmingly dominated by the incumbent cable companies that were (and are) not subject to cost allocation regulations.[6]

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[5] *See id.* ¶ 37 ("protecting ratepayers from unjust and unreasonable interstate rates is the primary purpose behind the accounting separation of regulated from nonregulated activities"); ¶ 39 ("assurance of just and reasonable rates does not stop with assuring that regulated operations do no cross-subsidize nonregulated activities. Rather, if there are savings to be gained from the integration of regulated and nonregulated ventures, those savings must be shared equitably with ratepayers in order to achieve regulated service rates that are just and reasonable.").

[6] *See Telephone Company - Cable Television Cross Ownership Rules Sections 63.54 - 63.58 and Amendments of Parts 32, 36, 61, 64, and 69 of the Commission Rules to Establish and Implement Regulatory Procedures for Video Dialtone Services*, Memorandum Opinion and Order on Reconsideration, 10 FCC Rcd 244, ¶ 159 (1994) (*"VDT Recon Order"*) (describing ILEC arguments that accounting regulation "is unnecessary because LECs offering video dialtone have no market power as new entrants competing against established video monopolies"). *See also id.* ¶ 203 (same).

The Commission rejected these arguments, and found that accounting requirements were necessary to "ensure that telephone ratepayers do not have to bear the costs of video dialtone" and also to "protect cable operators from potential anticompetitive actions by LECs, stemming from LEC incentives and opportunities to price video dialtone service unreasonably low relative to the costs of providing such service." *See VDT Recon Order* ¶ 2.[7]

Accordingly, the Commission required that ILECs establish separate subsidiary accounting categories to capture "the revenues, investments, and expenses wholly dedicated to video dialtone" and to capture the "revenues, investments and expenses that are shared between video dialtone and the provision of other services." *Id*. ¶ 173. *See also id.* ¶¶ 215-220 (explaining the need for these requirements to avoid cross-subsidy). The Commission also required ILECs to seek waivers to establish new Part 69 rate elements for video dialtone ("to help ensure that interstate video dialtone costs are not recovered through charges for access services provided to interexchange carriers" *id*. ¶ 195) and established a separate price cap basket for video dialtone service charges to "prevent potential cross-subsidization"[8]

More recently, the Commission has relied on accounting regulations to ensure that BOCs do not cross-subsidize in-region interLATA services where the costs of facilities and services used to provide such services are not subject to separate affiliate requirements. For example, in order to "protect against improper cost allocations from one regulated activity [*i.e.*, one subject to competition] to another regulated activity [*i.e.*, one not subject to competition]," the

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[7] Notably, the Commission observed that cost misallocation issues were not as serious for video dialtone as they would have been if the ILECs had planned to utilize a "fiber-to-the-home architecture." *See VDT Recon Order* ¶ 163. The obvious point here is that such an architecture (which is of course precisely the architecture ILECs now contemplate) would have included a much higher proportion of joint and common costs and therefore a much greater risk of cost misallocation.

[8] *See Price Cap Performance Review for Local Exchange Carriers; Treatment of Video Dialtone Services Under Price Cap Regulations*, Second Report and Order, 10 FCC Rcd 11098, ¶ 15 (1995) ("*VDT Price Cap Order*").

Commission has required BOCs to treat in-region interLATA services provided on an integrated basis as non-regulated services under Part 64.[9] Furthermore, just last year, when the Commission eliminated the prohibition against sharing by BOCs and their Section 272 affiliates of operating, installation, and maintenance functions, the Commission explained that applicable affiliate transaction and cost allocation rules would "protect against cross-subsidization of section 272 affiliates by the BOCs' local customers."[10] Indeed, precisely because of the likelihood that the BOCs would engage in cross-subsidy if left unchecked, the Commission required that BOCs modify their cost allocation manuals to address specifically the allocation of OI&M services shared with Section 272 affiliates. *See id.* The Commission also pointed out that cost allocation issues would be subject to a biennial audit. *See id*. ¶ 21. None of this would of course have been necessary if the Commission had been unconcerned about the BOCs' incentive to engage in cost misallocation.[11]

As explained in the Joint Commenters' initial comments, BellSouth and other ILECs remain dominant in the provision of broadband services demanded by business customers. The appropriate way to address these services would be to reimpose appropriate and effective rate

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[9] *See Accounting Safeguards Under the Telecommunications Act of 1996,* Report and Order, 11 FCC Rcd 17539, ¶ 75 (1996) (*"Accounting Safeguards Order"*).

[10] *See Section 272(b)(1)'s "Operate Independently" Requirement for Section 272 Affiliates,* Report and Order, 19 FCC Rcd 5102, ¶ 20 (2004) (*"OI&M Order"*).

[11] Moreover, Congress has fully embraced the ineluctable logic of the cross-subsidy threat by adopting numerous express prohibitions in the Telecommunications Act of 1996 against cross-subsidy. Most obviously, Section 254(k) states that incumbent LECs may "not use services that are not competitive to subsidize services that are subject to competition." 47 U.S.C. § 254(k). Many other provisions of the Act also address this issue. *See e.g.,* 47 U.S.C. §§ 260(a)(1) (stating that a LEC "shall not subsidize its telemessaging service directly or indirectly from its telephone exchange service or its exchange access"); 271(h) ("[t]he Commission shall ensure that the provision of services authorized under [section 271(g)] by a Bell operating company or its affiliate will not adversely affect telephone exchange service ratepayers or competition in any telecommunications market"); 272(e)(4) (permitting a BOC to provide services or facilities to its interLATA affiliate "so long as the costs are appropriately allocated"); 276(a)(1) ("any Bell operating company that provides payphone service shall not subsidize its payphone service directly or indirectly from its telephone exchange service operations or its exchange access operations").

regulation (including unbundling requirements) to limit the ILECs' opportunities to raise their rivals' costs and engage in price squeeze tactics. Unfortunately, many, perhaps even all, of the services that would qualify as broadband using BellSouth's expansive definition (*i.e.*, any service that delivers at least 200 Kbps in both directions, *see* Petition at n.2), including special access services in areas where BellSouth has received Phase II pricing flexibility and xDSL service, have been removed from rate regulation. Those services share very substantial joint and common costs with transport and common line rate elements that remain subject to rate regulation at the federal and state levels and therefore create substantial opportunities for undetected cross-subsidy.[12] If the Commission fails to apply adequate rate regulation directly to ILEC broadband services, it must at the very least apply appropriate accounting regulations to ensure that ILECs do not have the opportunity to misallocate the costs of those services.

BellSouth, however, asserts in its petition that existing price cap regulation severs the link between costs and prices of ILEC telephone exchange and exchange access services, thus obviating the need for cost-allocation rules as applied to broadband service.[13] This is clearly wrong. The link between cost and price that has caused the Commission to consistently apply cost accounting requirements in the past remains in full force today.

Price caps on both the state and federal levels remain tied to cost in numerous direct and indirect ways. To begin with, as the Supreme Court has recognized, price cap plans enacted by

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[12] *See e.g., Access Charge Reform et al.,* Sixth Report and Order, 15 FCC Rcd 12962, ¶ 172 (2000) ("*CALLS Order*") (recognizing ILEC incentives to cross subsidize special access with regulated trunking basket services).

[13] *See Petition* at 24 ("Unlike rate of return regulation, under price cap regulation there is no link between cost and price. Indeed, the purpose of price cap regulation was to adopt an incentive-based pricing theory that promoted ILEC efficiencies as opposed to cost-plus pricing. For price cap ILECs, rates are driven by changes in the price cap formula, which incorporates changes in inflation and other non-accounting factors, such as demand changes. The price cap system was intentionally designed to prevent cross-subsidy between services, and thus, obviates the need for Part 64 cost allocation.").

the states and the FCC all use a cost of service formula as a starting point for determining rates and then apply inflation and productivity adjustments to determine the cap.[14] Both federal and state price cap plans generally expire within a certain set amount of time.[15] Upon expiration, the regulators investigate whether the ILEC's rates continue to be reasonable in light of its costs and overall productivity. ILECs are often required to submit cost-data to ensure that their prices are at least reasonably related to their costs.[16] In this way, price caps often operate as rate-of-return regulation with a time lag.

The FCC's price cap regime for incumbent LEC switched access charges illustrates this point. In fact, the ILECs' cost of service has *always* formed the basis for the rates set under federal price caps. In the FCC's first price caps order, the rates as of July 1, 1990 (established by cost-based rate-of-return regulation) were the starting point for applying the cap methodology.[17] Going forward, the ILECs were at first essentially guaranteed a rate-of-return over 10.25 percent, but were required to "share" (*i.e.*, give back) all of their earnings in excess of a 16.25 percent or 17.25 percent rate-of-return, depending upon the productivity factor selected. *See Price Caps Order* ¶ 163-165. The Commission required the submission of detailed cost data if prices fell below a certain level to prevent "any LEC attempts to engage in predation or cross-

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[14] *See Verizon v. FCC*, 535 U.S. 467, 487 (2002) ("The price-cap scheme starts with a rate generated by the conventional cost-of-service formula, which it takes as a benchmark to be decreased at an average of some 2-3 percent a year to reflect productivity growth…subject to an upward adjustment if necessary to reflect inflation or certain unavoidable 'exogenous costs.'").

[15] *See e.g., Price Cap Performance Review for Local Exchange Carriers; Access Charge Reform*, Fourth Report and Order and Second Report and Order, 12 FCC Rcd 16642, ¶ 166 (1997) ("*Price Cap Performance Review*") (holding that the Commission will review its price cap rules within 3 years.).

[16] *See e.g., CALLS Order*, ¶ 57 (stating that price cap LECs have the option of submitting "a cost study based on forward looking economic cost that will be the basis for reinitializing rates to the appropriate level.").

[17] *See Policy and Rules Concerning Rates for Dominant Carriers*, Second Report and Order, 5 FCC Rcd 6786, ¶ 230 (1990) ("*Price Caps Order*").

subsidization." *Id.* ¶ 36. These "backstops" were created because the Commission recognized that it might not have a full understanding of the ILECs' productivity, and therefore, their costs. *See id.* ¶ 120. If an ILEC wanted to file rates above the cap, it had to make extensive cost-based showings that the rates were justified. *See id.* ¶ 303. Rates filed below the cap would have to be in excess of average variable cost, or else they would be subject to a presumed finding of predation. *See id.* ¶ 310. Moreover, for new services to be included within the price caps, cost information would first need to be filed. *See id.* ¶ 321.

In later orders, the Commission increased the X-Factor in part because it had underestimated the ILECs' costs in previous orders. For example, in the 1997 *Price Cap Performance Review*, the Commission increased the X-Factor to 6.5 percent "based on a total factor productivity analysis of the impact that LEC productivity growth and the *change in LEC input prices* have had on LEC industry unit costs over a ten-year period." (emphasis added) *Price Cap Performance Review* ¶ 145. The Commission also applied this new X-Factor prospectively as if it had applied at the higher rate previous years (resulting in a large one-time rate reduction) to ensure that the previously "understated productivity" would not leave current rates too high. (*id.* ¶179). To calculate the appropriate X-Factor, the Commission undertook a detailed analysis of the historical costs of three key LEC cost inputs: capital, labor and materials. *See id.* ¶ 91.[18] Although the Commission eliminated the sharing requirement, it kept the "low end adjustment" to ensure that LECs would be able to retain at least a 10.25 percent rate of return. *Id.* ¶ 127.[19]

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[18] This analysis was necessary because, "LEC unit costs are also affected by the prices they pay for inputs, an input price differential should be included in the X-factor. " *Id.* ¶ 95.

[19] The low end adjustment was later eliminated in the *Pricing Flexibility Order* for those carriers that opt for pricing flexibility. *See Access Charge Reform et al.*, Fifth Report and Order, 14 FCC Rcd 14221, ¶ 163 (1999). Yet, the Commission justified the elimination of this requirement in part by asserting that it retained the ability to monitor costs. *See id.* n.419.

As the Commission recognized, "the fact that an incumbent local exchange carrier subject to the Commission's price cap regulation does not currently have a potential sharing obligation does not obviate the need for rules governing their allocations of costs between regulated and nonregulated activities." *Accounting Safeguards Order* ¶ 271.

In the *CALLS Order* the Commission conducted an even more explicit review of carrier costs to determine the appropriate rate for ILEC access services. In fact, the *CALLS Order* essentially establishes a rate-of-return framework. ILECs electing[20] *CALLS* have no pricing discretion on a number of services; prices must meet target rates, which are in turn tied to the ILEC's costs.[21] For example, the X-Factor was set so as to push switched access charges closer to cost.[22] Importantly, price reductions were targeted only at those baskets with excessive rates-of-return.[23] The 15 percent rate-of-return earned by the ILECs on the common-line basket was not targeted for reduction since the Commission believed that this was a reasonable rate of

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[20] Those ILECs who do not elect CALLS would be subject to a cost-study proceeding to accomplish of the longstanding Commission goal that "interstate access charges [would] reflect the forward looking economic costs of providing interstate access services." *See CALLS Order* ¶ 60. The price cap index of LECs opting out of *CALLS* would be "set at forward looking economic costs." *Id.* ¶ 150.

[21] The ILECs themselves have openly acknowledged that periodic reviews of price cap levels based on cost assessments give them the incentive to engage in cost misallocation. *See* Comments of Bell Atlantic and NYNEX, CC Dkt. No. 96-262, at 7 (filed Jan. 29, 1997) ("If the Commission were to use a regulatory cost measure to lower rates, which it should not, it would upset that delicate balance. Regardless of whether it were to rely on forward looking costs or actual historical costs to set rates, there could be no return to true price cap incentives. A LEC (and the investment community) would know that the regulatory promise of potential profits for new investment is a sham. The LECs would be taught by example that any real success will be rewarded by a change in the rules that takes away potential profit. Once a regulator turned its back on the promises underlying price cap regulation, it could not go back.").

[22] *See CALLS Order* ¶ 158 (noting that the CALLS plan will drive "switched access usage charges closer to their *actual costs*…"); *id*. ¶ 167 ("Targeting the X-factor reductions to switching and switched transport charges will more quickly reduce charges for these services *towards cost-based levels* than would be possible under the existing price cap methodology.") (emphasis added).

[23] *See CALLS Order* ¶ 171 ("…price cap LECs' basket earnings are significantly higher for traffic-sensitive services than for common line services…Therefore we find it reasonable to target reductions to traffic-sensitive services rather than to common line services.").

return.[24] The Commission found that target rates chosen for switched access were "within the range of estimated economic costs of switched access that have been presented to the Commission," (*id.* ¶ 176) by, among others, Bell Atlantic and GTE.[25] Finally, the terms of the global CALLS rate settlement are no longer binding as of the middle of this year, leaving the ILECs with the prospect of a likely imminent review of access charge rates in light of cost.

Like the FCC, many states tie their price caps closely to cost. This is a critical fact, because the majority of the regulated rate base is allocated to the intrastate category. As the Commission has recognized, "because . . . incumbent local exchange carriers' intrastate services may be subject to cost-of-service regulation or to a form of price cap regulation that involves potential sharing obligations or periodic earnings reviews, the incumbent local exchange carriers may still have an incentive to assign a disproportionate share of costs to regulated accounts." *Accounting Safeguards Order* ¶ 271.

Virtually every state rate regulation regime contains some, and in many cases several, of these rate-of-return attributes. For example, as the FCC did in its *Price Caps Order*, Maine's initial price caps were "set by the Commission following a traditional revenue requirement inquiry."[26] The plan is reviewed every five to ten years (*id.* .at 836) at which time the

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[24] *See CALLS Order* n.376 ("Based on 1999 ARMIS data, Commission staff calculated approximate rates of return of 85 percent for the traffic-sensitive basket, 20 percent for the trunking basket, and 15 percent for the common line basket."). A fifteen percent rate of return is within the range held to be reasonable in the first price caps order. *See Price Caps Order* ¶ 165.

[25] *See CALLS Order* n.387 ("*See* Bell Atlantic/NYNEX Comments, CC Docket No. 96-262 at 22 (Jan. 29, 1997) (cost study supporting traffic sensitive switching costs of approximately one cent a minute); Letter from Joel E. Lubin, Vice President, Federal Government Affairs, AT&T to Magalie Roman Salas, Secretary, FCC, CC Docket No. 96-262 (Feb. 25, 1999) (estimating the economic cost of a switched access minute at $0.00255 for RBOCs and $0.00272 to $0.00544 as a potential proxy for interstate switched access costs); GTE Comments, CC Docket Nos. 96-262, 94-1, 97-250 at 7 (Oct. 26, 1998); GTE Comments, CC Docket Nos. 96-262, 94-1, 97-250 at 7 (Oct. 26, 1998) (estimating universal service support using a switched access rate of $0.008/minute).").

[26] *See Office of the Pub. Advocate v. PUC*, 816 A.2d 833, 838 (Me., 2003).

commission can order a change to the productivity factor, (*id*. at 838) to ensure that rates remain lower than they would be under a rate-of-return system. Therefore, the Maine commission must provide "some reliable estimate, based on objective data, of what local rates would be" under a rate-of-return system. *Id*. at 843. The Vermont commission was even more explicit in linking its price cap methodology to ILEC costs. In its reevaluation of the state's price cap plan, the Vermont commission held that parties must be able to submit cost of service information into the record. In determining how to structure its price regulation going forward, "cost-of service information is relevant to any comparison between alternative and traditional regulation."[27] It would be "unfair," argued the commission, for "Verizon [to be] able to seek rate adjustments due to low earnings, but the Department and others unable to advocate for rate reductions due to high earnings." *Id.* *10.

Other states followed a similar pattern of adjusting their cap plans to reflect ILEC costs. In reviewing its three year price cap plan in 2004, Indiana required SBC to "submit cost studies to support price decreases for existing services and introductory prices for new services…."[28] Cost studies were also necessary for bundled pricing plans. *See id.* *68. In Arizona, at the expiration of its 3 year price cap plan, Qwest must submit an application containing, among other things, an analysis of Qwest's productivity changes and return-on-investment.[29] As a part

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[27] *See Investigation into a Successor Incentive Regulation Plan for Verizon New England Inc., d/b/a Verizon Vermont*, Order Re: Motion to Clarify Proceeding and Motion to Compel, Docket No. 6959, 2004 Vt. PUC LEXIS 165, *11 (2004).

[28] *Petition of Indiana Bell Telephone Company, Incorporated ("SBC Indiana") For the Commission to Exercise its Statutory Authority Under IC. 8-1-2.6 Et. Seq. to Decline to Exercise its Jurisdiction, in Whole or in Part, and use Alternative Regulatory Procedures and Standards and Approve SBC Indiana's Alternative Regulation Plan for the Pricing and Other Regulation of SBC Indiana's Retail and Carrier Access Services, et al.*, Cause No. 42405, 2004 Ind. PUC LEXIS 253, *18 (2004).

[29] *See Application of US West Communications, Inc. a Colorado Corporation, For a Hearing to Determine the Earnings of the Company, the Fair Value of the Company for Ratemaking Purposes, to Fix a Just and Reasonable*

of its three-year long price cap review, an audit by the California PUC determined that SBC had "significantly overstated the expenses it had reported" during the late 1990's.[30] The commission will take that cost finding into account in determining how to revise its price-cap plan. *See id.* at *257-8.

All of this demonstrates that existing federal and state rate regulation retains a strong connection between cost and prices of regulated ILEC services. Moreover, it is difficult to see how it could be any other way, since the federal and most state statutes governing rate regulation require that ILECs charge prices that are just and reasonable. Regulators cannot ensure that price cap levels comply with these requirements without relying on some measure of cost.

Nor is there any basis for concluding that BellSouth or other ILECs have lost the market power over exchange and access services that allows them to raise the price of regulated services. To begin with, the Commission has concluded that switched access service represents a bottleneck service characterized by market failure that allows any LEC, even a CLEC with negligible market share, to exercise monopoly power over the termination and even origination of traffic to and from its customers.[31]

Moreover, BellSouth, like other ILECs, continues to dominate the local exchange service market. In its most recent local competition report, CLECs held a 17.8 percent share of end-user

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Rate of Return Thereon and to Approve Rate Schedules Designed to Develop Such Return, Opinion and Order, 2001 Ariz. PUC LEXIS 3, *57-8 (2001).

[30] *Order Instituting Rulemaking on the Commission's Own Motion to Assess and Revise the New Regulatory Framework for Pacific Bell and Verizon California Incorporated*, Interim Opinion Regarding Selected Issues Related to the Audi of SBC Pacific Bell Telephone Company, 2004 Cal. PUC LEXIS 55, *1 (2004).

[31] *See Access Charge Reform et al.*, Seventh Report and Order and Further NPRM, 16 FCC Rcd 9923, ¶¶ 30-31 (2001).

switched access lines.[32] But even this small percentage greatly overstates the CLECs' share going forward because of the imminent elimination of UNE-P. Fully 60.5 percent of CLECs' switched access lines are provided via UNE-P, with 16.1 percent purchased as resale and 23.4 percent self-provisioned. *See id.* at Table 3. This means that CLECs only provide 4.1 percent of all switched access lines over their own facilities. In fact, the percentage of CLEC owned switched access lines has declined from 5.9 percent since 1999 (*see id.*), clearly demonstrating that it is not economically efficient for CLECs to deploy their own local exchange facilities in the vast majority of markets. Moreover, any increased market pressure the ILECs may feel from competitive VoIP offerings is likely to be far in the future and of uncertain scope (especially since a customer must obtain a broadband connection in order to receive the service).

For all of these reasons, therefore, the ILECs continue to have powerful incentives to misallocate the costs of unregulated broadband service. At the very least, the Commission must address this problem with appropriate cost allocation rules designed to limit BellSouth's and other ILECs' opportunities to act on their powerful incentives to engage in this conduct.

CONCLUSION

BellSouth's petition should be denied insofar as it requests forbearance from the *Computer Inquiry* requirements applicable to "broadband" services demanded by small, medium and large business customers. Moreover, the Commission must affirm that appropriate cost allocation rules apply to broadband services that remain free of rate regulation.

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[32] *Local Telephone Competition: Status as of June 30, 2004*, Industry Analysis and Technology Division, Wireline Competition Bureau, Table 1 (rel. Dec. 22, 2004).

Respectfully submitted,

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