

# TR's LAST-MILE TELECOM REPORT™



The Convergence of High-Speed Data, Voice, and Video Services

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Incorporating  
*TeleCompetition Report, Video Competition Report,  
Communications Billing Report, &  
The TeleChoice Report on xDSL*

## FCC May Have To Rethink Reciprocal Compensation Again

**T**he FCC's effort to stem the flow of reciprocal compensation payments to competitive local exchange carriers may need some more work. A three-judge panel at the U.S. Court of Appeals in Washington had tough questions Feb. 12 for challengers to and defenders of the FCC's 2001 order setting new rules governing reciprocal compensation for dial-up calls to Internet service providers. But the judges seemed particularly critical of the FCC's reliance on section 251(g) of the Telecommunications Act of 1996, suggesting that the Commission might have to take yet another look at its reciprocal compensation rules.

At issue in *WorldCom, Inc., et al. v. FCC* (no. 01-1218) is the agency's 2001 order to develop new reciprocal compensation rules in response to a remand of its previous rules by the same appeals court in Washington. In that order, the FCC had aimed to respond to the court's concerns and respond to complaints about "regulatory arbitrage" opportunities created by the previous rules. Incumbent local exchange carriers had long complained that competitors were able to collect excessive reciprocal compensation fees for delivering ISP-bound traffic.

In its remand order, the FCC had found that calls to ISPs weren't subject to section 251(b)(5), which obligates local exchange carriers to establish reciprocal compensation arrangements for the transport and termination of telecommunications. The FCC said calls to ISPs were "carved out" of that provision by section 251(g).

Section 251(g) states that after enactment of the 1996 Act each local exchange carrier "shall provide exchange access, information access, and exchange services for such access to

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interexchange carriers and information service providers in accordance with the same equal access and nondiscriminatory restrictions and obligations (including receipt of compensation) that apply to such carrier on the date immediately preceding the date of enactment of the Telecommunications Act of 1996 under any court order, consent decree, or regulation, order, or policy of the Commission, until such restrictions and obligations are explicitly superseded by regulations prescribed by the Commission after such date of enactment."

The FCC said in its order that because calls to ISPs fell within the scope of *information access*, as the term is used in section 251(g), that section should be read to exempt such traffic from section 251(b)(5).

The Commission then found that calls to ISPs were subject to the FCC's general authority under section 201 to regulate the rates and terms of interstate communications services and interconnections. Under that authority, the FCC adopted an "interim" cost recovery rule which requires carriers to recover increasing portions of their costs for delivering calls to ISPs from their own customers rather than from interconnecting carriers.

During the Feb. 12 oral argument, the judges questioned the FCC's interpretation of section 251(g). They were concerned that the FCC's interpretation provided no "limiting principle" for the provision and would give the agency sweeping authority. "I may be obtuse or ill-informed, but I have a very hard time finding the words in section 251(g) that get the Commission to the position" it took, Circuit Judge David Sentelle said.

FCC Deputy General Counsel John Rogovin said the key word in section 251(g) was *policy* because the section specifically allows the agency to continue certain policies that are already in place. Section 251(g), he said, allows the FCC to maintain its "clear policy that information access is treated as interstate for jurisdictional purposes."

Judge Sentelle, however, said section 251(g) "does not look like any grant of power to me. It looks like a grandfathering provision." Mr. Rogovin said the use of the word *policy* meant that the section was "not intended to

have a backward-looking result" by eliminating existing FCC policies.

Competitive local exchange carriers have argued that section 251(g) was enacted solely to preserve the "equal access and nondiscriminatory interconnection restrictions and obligations" contained in the "modification of final judgement" (MFJ)—the consent decrees that broke up the Bell System. Judge Stephen F. Williams seemed to back that view. Section 251(g) "gets you over the hump of the MFJ restrictions, but I'm not sure it gets you any further," he said.

And if the court does find fault with the FCC's interpretation of section 251(g), the case likely will head back to the Commission again. "If the Commission relied on [section] 251(g), and we think 251(g) doesn't get you there, don't we have to remand this case?" asked Judge Sentelle. Mr. Rogovin replied, "I think that's right, as unappealing as that prospect would be."

But the challengers to the FCC's order also endured some tough questioning. The judges took issue with WorldCom's counsel, Darryl M. Bradford, and his characterization of the court's remand of the FCC's previous reciprocal compensation rules. Mr. Bradford suggested that the court had implied that calls to ISPs should be classified as local calls when it rejected the FCC's previous rules, which found that such calls weren't local. At one point in the argument, Judge Sentelle said, "We flatly said [such calls] didn't fit into either category"—local or interstate, he said.

Judge Williams questioned whether WorldCom and its fellow petitioners—which include several competitive local exchange carriers, the Association for Local Telecommunications Services, and the Competitive Telecommunications Association—were really challenging the result of the FCC order or just the "route" that the FCC took to get there.

"Many of your clients seem to believe 'bill-and-keep' fits perfectly as a form of reciprocal compensation," Judge Williams said. "It seems to me that with a bill-and-keep outcome, you seem to be concerned with the route [more than] the end result," he said. If the route is the only concern, then the CLECs may not have standing to challenge the order, he said.

Mr. Bradford, however, said there was a “real difference” between what the FCC found and what the CLEC wanted it to find—specifically, that calls to ISPs are subject to section 252(b)(5) and, as such, qualify for reciprocal compensation at “cost-based” rates.

Not addressed during the argument were other questions about whether the details of the FCC’s interim reciprocal compensation

regime were justifiable. Those details include its “growth cap” provision—which prevents carriers from receiving intercarrier compensation for traffic exceeding a 10% annual growth cap and prevents carriers from receiving compensation in any new geographic markets—and its determination that carriers cannot “opt into” reciprocal compensation provisions from state-approved interconnection agreements.

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## LMTR *Interview*

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### With Fiber on the Horizon, SBC Seeks New Policies

*SBC Communications, Inc.’s highly touted “Project Pronto” effort to deploy advanced services has been a lightning rod for controversy since it was announced in October 1999. Competitors have criticized SBC for blocking competitors’ access to remote terminals and limiting their ability to reach consumers. Meanwhile, SBC, joined by some telecom and tech equipment companies and investors, have blasted regulations that they say are hindering the rollout of broadband services.*

*Wayne Masters, SBC’s senior vice president-network services, recently spoke with LMTR to provide an update on the company’s progress in deploying Project Pronto and its efforts to change rules that it says are preventing further deployment, notably in Illinois. Mr. Masters says SBC is making progress on deployment everywhere except Illinois, where it blames regulations for its decision to halt the advanced-service rollout.*

*Mr. Masters also suggests a slightly different approach toward regulatory treatment of incumbent local exchange carriers’ networks. He recommends an approach similar to the “new wires/new rules” idea championed by Verizon Communications, Inc., while aiming to eliminate some of the guesswork in determining what is a “new” wire and what is an old one.*

**LMTR:** Could you start out by giving us a status report on where you are with Project Pronto—where you’re moving forward with deployments and where you’ve stopped?

**Masters:** Let’s step back. Pronto was a project started before we had a separate affiliate for advanced services. Obviously, we felt that DSL [digital subscriber line service] was critical to our future. The biggest reason for moving forward on Pronto was real simple: We could only reach a certain percentage of our customers with DSL from our central office base. That left about 40%–45% of our customers outside of our reach.

It was unacceptable to us that we would only offer service that addressed 55%–60% of our customers, particularly if you look at the demographics of a lot of our modern cities—Los Angeles, San Francisco—where a lot of the growth is on the outskirts. So we had to address that part of the market, and that’s where Pronto came from.

[The project] had several goals. First of all we wanted to expand the footprint as rapidly as we could, from both central offices and RTs (remote terminals). . . . There are many ways of paying for this. You want to build a common platform and deliver all your services, not just DSL.

That part of Pronto often gets misunderstood. It wasn’t an overlay just for broadband. It was to improve our voice network, our special services, and our regular DS1, DS3, OCN

services, and to put a lot of fiber in the network and take care of the DSL needs along the way. . . .

So that was the goal. We launched [the project], and then went through some hellacious regulatory battles over some of the most insignificant items I've ever seen in my life, like ownership of a plug-in. It delayed us about a year getting started. And we've had the normal amount of new technology introduction problems. We just passed our 6,000th RT. Those 6,000 RTs address about 34,000 subdivisions—our most important 34,000 subdivisions. . . .

So we're building out remote terminals, where we have the regulatory freedoms, at a pretty constant rate. We can talk about Illinois in a minute. That's the only state I'm not building in. We're also expanding some of our central office operations. But mainly we're trying to sell within our capacity right now and mature the product.

This year we actually will finish [the upgrade in] one of our companies—Southern New England Telephone [Corp.]. We'll finish Pacific Bell and Southwestern Bell [Telephone Co.] next year. And Ameritech [Corp.] will linger a little bit into the next year if we ever solve the Illinois regulatory problem.

**LMTR: What kind of transmission speeds are available to the customers?**

**Masters:** We're selling two speeds, and we're fixing to go to five speeds. We basically sell a 384 kilobit-per-second to 1.5 megabit-per-second product. We've also been offering a higher-speed option, 1.5 to 6 Mbps, which frankly we haven't had a lot of takers for.

The goals of the first two years have been to get the technology out, grab as much footprint as we can, get as many customers on the network, and get the kinks out. We've reached a maturity point and can take that next big step.

**LMTR: Let's talk a little bit about the regulatory issues. What is the situation in Illinois, and have you halted deployment anywhere else?**

**Masters:** [In Illinois] they wanted to make the technology an open architecture. They

wanted us to be able to put any manufacturer's plug-in in. They wanted us to agree to deploy any technologies feasible at TELRIC [total-element long-run incremental cost] prices, without any guaranteed recovery. . . .

We've basically taken the approach that advanced services are totally competitive. In a state that cable [broadband service] is winning with 60% of the market, why would I have to deploy hundreds of millions of dollars without any guarantee I can sell the stuff? We've been in that battle, and we've not got it solved, but we're real close.

It's just been a wild ride, probably as a result of the fact that service [quality] got out of hand there right after our merger [with Ameritech]. I'm on the verge of launching a lot of terminals up there, but I can't deploy the technology below my cost, and that's literally what they were forcing me into. What I keep telling them is that I can take those same dollars and put them in the [San Francisco] Bay area and make a return quickly. Why would I not do that rather than deploy in Illinois at a guaranteed loss?

This is a high-risk technology. We're not guaranteed market share. We have to win it. And that view has just not prevailed in all of our states. The real dilemma here is we have federal oversight, but then I have 13 state commissions [with 13 different approaches]. That's just driving us crazy and, frankly, I'm getting a lot of heat from my board about investing hundreds and hundreds of millions of dollars in an unstable environment.

It's a real dilemma in the industry right now, because there is another technology coming—PON [passive optical network], which basically is a techie term for fiber to the home. We think we finally have arrived with that technology. In terms of economics and technology, it's going to be ready in about eight or 10 months. . . . But there's no way I can deploy that technology in this regulatory environment.

So we're putting a lot of emphasis on the regulatory side because we need a regulatory environment that will enable us to deploy this next technology, which we'll start doing 18 months to 24 months from now.

**LMTR:** Would that be deployed in the areas where you've done the Pronto upgrades already?

**Masters:** Yes, but not for years. . . . What we'll start doing is deploying it in new subdivisions. We're doing our first application in Mission Bay, Calif., this year. Then we'll start deploying in new subdivisions and business parks, and as we need to rehab our network, that will be our vehicle of choice. So we'll continue with the Pronto architecture, . . . but this architecture was built knowing I was going to the next step. A lot of the PON architecture is built into my Pronto architecture.

**LMTR:** One thing that seems to complicate the process of setting an appropriate regulatory approach for these new investments is that the new facilities seem to be mixed with the old in the same network. How do you differentiate the old and the new?

**Masters:** Unfortunately, technology is not going to make this easier. What you're really seeing is combining the layer-one, -two, and -three areas of the business. [In the OSI (Open Systems Interconnection) reference model, which provides a networking framework for implementing protocols, layer one is the "physical" layer, where bits are conveyed at the electrical and mechanical level; layer two is the "data link" layer, where data

packets are encoded into bits; and layer three is the "networking" layer, which provides routing and switching technologies for directing traffic. —*Ed.*]

There are technologies to combine all three layers that are going to be available within 12 months—just an absolute breakthrough. But I can't deploy that son of a gun in today's regulatory environment and make money with it. . . .

In this Illinois proceeding, we've had months of debates about what technology can actually work in a remote terminal. And the insanity is that the conversation involves a group of 50 lawyers, 50 regulators, and no engineers. You've got something designed by a committee that just can't be built

If you look at our 13 states, you see how each of them takes a different approach, based on their environment or what's important to them and what's not. Some are being very progressive. We've got some regulators like [those in] Oklahoma and Kansas who desperately want the infrastructure, . . . and they're going to get more broadband quicker than anybody else will.

Look what happened in California. California was not exactly viewed as a friendly regulatory environment a few years ago, was

### **TIME WARNER, BROADWING UNITS HALT LOCAL SERVICES**

Time Warner ResCom of New York LLC has asked the FCC for authority to discontinue its circuit-switched local telephone services to about 1,000 residential customers in the New York City area, citing "changed financial market conditions." Meanwhile, Broadwing Local Services, Inc., has filed a similar request, seeking to discontinue its intrastate resold services in three states.

Time Warner ResCom (d/b/a Time Warner Connect) has told the FCC that it has made arrangements with Verizon New York, Inc., to transfer the affected customers to its network. It says it will not "automatically switch customers over to Verizon," allowing customers to switch to other competitive local exchange carriers. In Broadwing's case, the company seeks authority to discontinue its intrastate resold services in Indiana, Kentucky, and Ohio. It says that it is strictly a reseller and that customers will be able to receive services from other carriers, including the incumbent local exchange carriers.

Both applications will be deemed granted 31 days after the release of the Jan. 31 notices, unless the FCC notifies the companies otherwise. The FCC noted that it typically grants such requests to discontinue providing service "unless it is shown that customers or other end users would be unable to receive service or a reasonable substitute from another carrier or that the convenience and necessity is otherwise adversely affected."

it? But their overwhelming desire to get broadband out in Silicon Valley—not because they like us—overpowered a lot of the regulatory in-fighting.

There's this "old wires/new wires" approach that has been suggested [by Verizon Communications, Inc., freeing incumbent telcos from network unbundling and sharing obligations with respect to "new wires," while maintaining those obligations for old "voice" wires]. Something like that has got to occur.

The biggest thing we're seeing is that every vendor is asking us every day what the regulatory environment is going to be so they can start designing hardware. We can't go to our board of directors and make long-term investment decisions when we can't guarantee that we even have a chance to recover our cost of capital in the current regulatory environment. And, at the same time, we're overwhelmed with demands from our consumers to get broadband. . . .

The problem is, as every new technology comes out, people are trying to say that the same rules should apply. [The Telecommunications Act] was never intended to go beyond the bottleneck. You have to draw a line beyond which of those rules don't apply. What incentive would I have to build a national IP [Internet protocol] network, . . . so I can unbundle it and let competitors pay TELRIC prices for it?

**LMTR:** But what's still not clear to me is how, as the network evolves and you mix these new upgrades into your network, you provide access to the old pieces but not the new pieces.

**Masters:** You do it as an IP [Internet protocol] technology split. If you look at the old wires/new wires approach, we think a better way of saying it is that layer-one technologies should be made available.

Layer two and above should be completely competitive. That really makes it easier to get at, because then you're not talking about a physical thing, you're talking about basically an access device.

For instance, we probably deliver POTS [plain-old telephone service] using 25 different technologies, but it's POTS service. It may

be copper here, or it may be a combination of analog carrier and every other device that somebody's come up with in the last 40 years that's somewhere in my network. We have to get back to saying that layer-one services, whatever the technology, are made available to all comers at appropriate rules.

The intent [of the Act] was to make sure that no company had a bottleneck. As long as we unbundle and make layer-one assets available, and layer two and above is considered clearly competitive, to me that's a pretty good dividing line. Then as layers two, three, and four converge, technologywise, which they will, the regulatory model fits.

Look at the PON architecture. There's no RT, no copper wires. My competitors can build that architecture today. AT&T is winning shared tenant services, apartment houses, and new subdivisions right now using a similar technology, and it has no obligation to make it available to anybody else. But if we use exactly the same technology, we have all the obligations. That's obviously, in our perfectly biased position, unfair. That cuts me off from new revenues, new sources of money. At the same time, we have the universal service obligation to provide POTS, and we intend to do that.

The layer-one/layer-two split is very similar to Verizon's message, but they refer to wires because a lot of people don't understand protocol layers.

Basically if you're putting money into services that already are competitive, you should be able to play competitively in that environment. If it's not competitive, like the copper wires, then the facilities should be available for whatever services anybody can dream up to put over it. That encourages manufacturers to develop those things.

We're doing a lot of work internally to determine how we can play in [the current regulatory] environment. You've seen a lot of our frustration. The cost of acquiring a customer on remote terminal is always higher than out of a CO [central office]. That's why this Illinois thing is so negative to us, because it puts us below water. If I deployed the way they wanted me to, I'd be losing money. And I just can't do that.

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# Broadband Policy

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## FCC, Commerce See Strides On Broadband Deployment

Two federal reports issued recently say that deployment of broadband services in the U.S. is progressing rapidly and that the “digital divide” appears to be narrowing.

The documents are the FCC’s third annual report to Congress on the deployment of advanced services and *A Nation Online: How Americans Are Expanding Their Use of the Internet*, a Commerce Department report based on the September 2001 Census Bureau’s current population survey. Although conducted and released separately, the two documents draw similar conclusions.

The FCC report was prompted by section 706 of the Telecommunications Act of 1996, which directs the Commission to encourage deployment of advanced telecommunications capability to all Americans on a reasonable and timely basis. The FCC conducts annual reviews and submits reports to Congress to evaluate the progress of deployment of advanced services, which it defines as providing 200 kilobits-per-second transmission speed upstream and downstream. It uses the term *high-speed* to describe services providing at least 200 kbps transmission in one direction.

In each of its first two reports on section 706, the FCC found that deployment of advanced services was “reasonable and timely.” It came to the same conclusion this year, although the Commissioners stressed that they would continue with initiatives to enable further deployment.

The current FCC report cites “appreciable growth in the deployment of high-speed services to residential and small-business consumers in the past 18 months.” The figures show that “high-speed services are available in many parts of the country and suggest that certain factors—such as population density and income—continue to be highly correlated with the availability of high-speed services,” it says.

Subscribers to advanced services were reported in all 50 states, the District of Columbia, Puerto Rico, the Virgin Islands, and in 78% of all the ZIP codes in the U.S. The data also show that 97% of the U.S. population lives in ZIP codes with high-speed Internet subscribership.

“Our data illustrates that advanced services are becoming more available for almost all segments of residential customers, including many of the groups that we previously identified as being vulnerable to not receiving timely access to advanced services,” the FCC report says. “We are encouraged that our data indicate that advanced and high-speed services are becoming more widely available in rural areas.”

In last year’s report, the FCC found at least one subscriber to high-speed services in 65% of its sample of small-town ZIP codes and 20% of the “most sparsely populated outlying areas,” it says. Since then, availability “appears to have increased considerably, and high-speed services are now being reported in 86% of our sample of small town ZIP codes, and 37% of sparsely populated outlying areas,” the report says.

Of the 5.9 million subscribers to advanced services, 3.3 million subscribed to cable modem services, an increase of 52% over the first half of 2001, and 1 million subscribed to ADSL (asymmetric digital subscriber line) service, a 48% increase over the first six months of 2001.

### More Policy Steps Planned

The FCC stressed that it had a number of proceedings under way to accelerate broadband deployment. Those include upcoming actions to determine the appropriate regulatory classification for cable modem services and to launch an examination of the appropriate classification of wireline broadband services. Already under way are the FCC’s “triennial review” of its unbundled network element rules and its examination of the appropriate use of the “dominant/nondominant” regulatory re-

## BROADBAND REPORT

The FCC has released the form and instructions for local competition and broadband reporting (FCC Form 477) for the March 1 filing. The reporting program was adopted by the FCC in March 2000 to determine the extent of local telecom competition and deployment of broadband services.

All providers of local telephone service that serve 10,000 or more voice-grade equivalent lines or wireless channels in a given state must file a Form 477 for that state. The revised form and instructions may be obtained at [www.fcc.gov/formpage.html](http://www.fcc.gov/formpage.html).

game for incumbent local exchange carriers' provision of broadband services.

The FCC added that it was "considering modifications to our collocation rules to ensure competitive access to incumbent LEC remote premises. As fiber is pushed further into the local loop and customers are increasingly served through remote terminals, we recognize the need to ensure that investment is not stifled by the ability of incumbents to control access to remote devices where DSL technology may be installed."

The Commission also said it was considering whether additional steps were necessary to "enhance the ability of service providers to use existing cable wiring to offer traditional and advanced services to residents of multiple-dwelling units." Other steps to improve spectrum flexibility and create secondary spectrum markets could also help in the spread of broadband services, the FCC said.

FCC Chairman Michael K. Powell said he agreed with the report's conclusion that advanced services were being deployed in a "reasonable and timely" manner, "notwithstanding my firm belief that the Commission's central policy-making focus is and should remain the promotion of efficient broadband deployment.

"Although one can easily point to specific communities or categories of customers in which broadband is not yet fully available, the record amply illustrates that the broadband market continues to grow, and that overall availability and subscribership have increased

significantly, despite some slowing investment trends," Mr. Powell said.

Commissioner Kathleen Q. Abernathy said the data showed that the digital divide was narrowing. "The deployment gaps between urban and rural areas and between high-income and low-income households have narrowed significantly since the issuance of our last report."

Commissioner Kevin J. Martin said he was concerned about the FCC's definition of *advanced services*, suggesting the FCC, in its next inquiry, should "ask more in-depth questions on the appropriate transmission speed that should mark advanced telecommunications capability."

Commissioner Michael J. Copps dissented from the FCC's conclusion that deployment was reasonable and timely. Mr. Copps said he was "unable to determine" whether that was true because "we have not gathered data of adequate quality of granularity to fulfill our statutory responsibility under section 706."

U.S. Telecom Association President and Chief Executive Office Walter B. McCormick Jr. said the report "reaffirms what we already know—huge cable companies dominate the market for broadband services by a margin of more than three to one." Meanwhile, AT&T Corp. said the report "underscores the irrelevance of legislation" like HR 1542, the Internet Freedom and Broadband Deployment Act, "that purports to solve a deployment problem. Surprise! There isn't a deployment problem, as today's report shows."

## Commerce Sees 'Rapid' Growth

Meanwhile, a separate study from the Commerce Department also found a "rapid increase" in the use of broadband services over the last year. The Census Bureau surveyed 57,000 households and more than 137,000 individuals across the U.S., providing what Commerce called the "most broadband and reliable data sets that have been gathered on Internet, broadband, and computer connectivity."

In August 2000, only 4.0% of all individuals or 11.2% of all home Internet users said they had broadband service at home, the report says. As of September 2001, 10.8% of

the population had broadband service, and 20.0% of Internet users subscribed to broadband services.

The report says 12.9% of individuals with Internet service at home use cable modem services, 6.6% use DSL services, and 0.5% use other types of connections.

“In every income bracket, at every level of education, in every age group, for people of every race and among people of Hispanic origin, among both men and women, many more people use computers and the Internet than did so in the recent past,” the report states. Although people who live in low-income households or who have little education still trail the national average, broad measures of Internet use in the U.S. “suggest that over time Internet use has become more equitable,” it says.

Regarding broadband deployment, the report states that the presence of children in a household is associated with “modestly higher rates of broadband connectivity through DSL or a cable modem.” About 11.9% of households with children subscribe to such services, compared with 9.5% of households without children.

The report cites “particularly strong” growth in Internet use in rural households from 1998 to 2001. In rural areas, 52.9% of individuals use the Internet, compared with 49.1% in “central cities” and 57.4% in other urban areas.

## Policy-makers Promise Investors Broadband Action

With the telecom market’s free fall continuing, all eyes are on policy-makers, as institutional investors seek assurance that regulators will provide them with “regulatory clarity” and will, otherwise, just get out of the market’s way. Those were the typical messages from investors gathered at the Precursor Group’s Investment Precursor’s conference, echoing age-old complaints investors have about Washington.

But when asked whether the FCC would provide the “clarity” investors want so badly, Chairman **Michael K. Powell** said constant change in the industry meant that providing clarity might be impossible.

A year ago, “reciprocal compensation is all I would have heard about,” he said. That proceeding was completed last year, and now there is a new list of items investors want resolved. “All you can really ask of us is that we’re constantly working on that list,” Mr. Powell said.

Atop that list this year is an array of broadband-related proceedings. A year from now the Commission “will have made a dramatic contribution to clarifying the regulatory environment for broadband,” Mr. Powell said.

“Right now I’m ashamed to say that the world does not know if [high-speed access] is a telecom service, a cable service, or an information service,” he said. It’s important for the FCC to decide one way or the other, he added, noting that “companies are extremely adaptable.”

Despite continuing struggles and bankruptcies, Mr. Powell insisted that facilities-based competition was still viable. “There are a lot of long-term efficiency, economic, and effective competitive rationales for wanting to incent facilities-based competitive alternatives,” he said.

All panelists during the day-long event were asked to state the top trends investors should be tracking over the next year. During a panel discussion on broadband services, **Thomas J. Tauke**, Verizon Communications, Inc.’s senior vice president-public policy and external affairs, said a big change would come in the number of Bell companies cleared to offer in-region interLATA services. He said Verizon hoped to “complete the process” this year.

Common Carrier Bureau Chief **Dorothy Attwood** said she expected “20 to 30 successful” interLATA service applications this year. “This is a market-altering event,” she said. “It’s also fully contemplated” under the Telecommunications Act of 1996, which allows Bell companies to offer in-region interLATA services in a state once they demonstrate to the FCC that they’ve opened their local exchange service markets to competition.

AT&T Corp. Vice President-government affairs **Len Cali** said recent unbundled network element rate cuts in New York could lead to similar reductions across the country. “We hope this is the beginning of a trend,” he said. But on the other hand, some states are allowing

incumbents to increase “nonrecurring” charges levied when competitors buy unbundled loops, Mr. Cali said.

**John Windhausen**, president of the Association for Local Telecommunications Services, said one trend for the year would be the survival of the CLEC industry. Although some companies will go under, many will “not just survive but in the next year will grow again,” Mr. Windhausen said.

U.S. Telecom Association President and CEO **Walter McCormick** noted recent studies showing that more consumers are using a wireless phone as their only phone. The FCC soon should consider “at what point wireline price regulation sunsets and at what point do we allow this industry to compete like the wireless industry,” Mr. McCormick said.

Mr. Tauke also echoed some of the frustration indicated by investors at the conference. “I believe we’re finally getting to the point where regulators realize they have to stop wringing their hands and do something,” he said. Mr. Tauke added that regulators must recognize that “consolidation is going to be essential” in the telecom market.

### Market Seen Moving on Cable Modems

Some aspects of the FCC’s deliberations over how to classify cable modem service are being rendered moot by events in the cable TV sector, industry leaders said during another panel discussion. The Commission has been pondering the issue since October 2000, and the industry is awaiting the findings from a notice of inquiry (NOI) that will attempt to resolve whether cable modem service should be considered a “telecom” service (general docket 00-185).

If cable modem service is classified as a telecom service, one result would be that cable TV operators could be forced to open their cable modem platforms to unaffiliated Internet service providers (ISPs). But the debate over “open access”—which was so heated in recent years—is becoming irrelevant as cable TV operators voluntarily open their cable modem systems, said **Paul Cappuccio**, AOL Time Warner, Inc.’s executive vice president and general counsel.

Because of conditions on the merger that created AOL Time Warner, the company is a leader in providing what it calls “ISP choice.” But it also has said recently that ISP choice appears to be a financially sound move.

“The cable company makes more money by offering consumers a choice of ISP. . . . Consumer choice drives increased penetration,” Mr. Cappuccio said. “I think it is inevitable that others will follow AOL Time Warner’s lead” in providing ISP choice, he said.

AT&T Broadband has also extolled the financial benefits of ISP choice as a way to generate incremental revenue and increase traffic on its cable modem network.

“Market forces are overtaking the regulatory issue,” agreed **Robert Sachs**, president and chief executive officer of the National Cable & Telecommunications Association. “The trend is clear here. Cable companies’ business plans call for offering their customers multiple ISPs.”

Meanwhile, FCC deliberation on cable modem service is creating a “regulatory cloud” that’s bad for the industry, he added.

### MPOWER BONDHOLDERSTALK DEBT RESTRUCTURING

Competitive local exchange carrier Mpower Holding Corp. says it has begun talks with bondholders on a potential debt restructuring. It recently withdrew previous guidance that its cash reserves would be sufficient to fund its operations through the first quarter of 2003.

“Despite the positive trends in operational and financial results, Mpower still faces liquidity and cash flow concerns,” the company said. Mpower said it was continuing to work with financial adviser Rothschild, Inc., on funding and restructuring strategies.

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## Financial News

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### RCN Talks with Lenders, Eyes Scaled-Back Plans

RCN Corp., a provider of bundled phone, cable TV, and high-speed Internet access in major U.S. markets, is holding talks with bank lenders to amend loan agreements and indicated that those discussions involved retrenching RCN's business plans around the company's existing markets.

The bank talks were disclosed as the company released its 2001 financial results. For the full year, RCN reported pro forma revenue of \$536.2 million, up 32% from the prior year. Measured by EBITDA (earnings before interest, taxes, depreciation, and amortization) and not including special charges and write-downs, RCN's losses narrowed to \$232.3 million for the year, down from \$343.7 million in 2000. Operating losses ballooned to \$1.13 billion last year from \$698 million in the previous year.

In the fourth quarter, however, top-line growth was harder to come by. RCN generated \$143.0 million of revenue during the most recent quarter, up only 4.7% from third quarter totals. Leading revenues higher were gains in voice and video service sales, offset by a small decline in data revenues.

EBITDA losses excluding charges improved to \$34.5 million from \$44.1 million in the third quarter, benefiting from deep cost-cutting measures implemented last year. Excluding gains from debt buybacks, fourth quarter net losses amounted to \$198.5 million.

"We improved our results this year in part by significantly reducing discretionary operating expenses and putting programs in place to go after the most profitable revenue," said David McCourt, RCN's chairman and chief executive officer. "Furthermore, we became more cost effective in our marketing effort, cutting acquisition costs in half while still adding more customers onto our network," he said.

Although it generated better profit margins and cut fourth quarter operating cash burn rates to \$111 million from \$496 million earlier in the year, RCN's talks with lenders indicate further changes to come.

RCN said the "ongoing discussions" involved a credit agreement amendment that "would accommodate a modified business plan focused on the development of the company's business plan in existing markets with limited expansion and no new markets."

At the present time, RCN operates in seven of the top 10 U.S. markets—Boston, Chicago, Los Angeles, New York, Philadelphia, San Francisco, and Washington. During a recent conference call, company officials said operations in three of RCN's markets, including Boston, were achieving positive results on an EBITDA basis.

Mr. McCourt was somewhat tight-lipped about the status of the bank talks, saying RCN was "working with the banks on a mutually acceptable plan to lower our trajectory. We know all of our markets can become profitable, and we know we can grow a billion-dollar company with our existing markets."

#### NETWORK PLUS BANKRUPTCY

Network Plus Corp., a Randolph, Mass.-based competitive local exchange carrier, filed for bankruptcy protection at U.S. Bankruptcy Court for the District of Delaware.

Network Plus is in talks to obtain financing to continue operations while it seeks to conduct an auction for the business. Network Plus serves more than 300,000 local access lines and 300,000 long distance lines for about 75,000 customers.

Mr. McCourt added that RCN remained in compliance with existing bank loan covenants and had about \$1.1 billion of liquidity, including \$250 million drawn down from the company's \$1 billion bank facilities last September.

"We are confident that we will get an agreement done," he said. "If we don't receive approval, we'll have to reevaluate our business plan," he said, citing that possibility as a reason for not providing specific financial guidance for 2002. "With the amendment, the company would anticipate a modified business plan that is EBITDA-positive in the first half of 2003 and free cash flow-positive in the first half of 2004," RCN said.

## Time Warner Telecom Unclear on 2002 Forecast

Time Warner Telecom, Inc.'s revenue increased by 51% last year even though many of its customers cut back or went out of business, the company says. But the Littleton, Colo.-based competitive local exchange carrier is unable to provide financial projections for 2002, saying it had no way of knowing what would happen to its current customer base.

When customers disconnect service, they rarely give Time Warner Telecom more than a

few weeks' notice, said Larissa Herda, the company's chairman, chief executive officer, and president. "What happens with disconnects is, they happen," she said. That makes it hard for Time Warner Telecom to provide a forecast, she added.

On the horizon, the CLEC is bracing for the possible loss of business from Global Crossing Ltd., which filed for bankruptcy last week. "Global Crossing is a significant customer," said David Rayner, Time Warner Telecom's senior vice president and chief financial officer. With customers like Global Crossing, disconnects occur over time if they occur at all, he said.

Customer disconnects cost Time Warner Telecom \$4.2 million in recurring monthly revenue during the quarter that ended Dec. 31, 2001. But the company was more than able to replace those revenues. It generated \$174 million in revenue during the quarter, a 30% increase over the figure from the year-ago quarter. The company's net loss, however, widened to \$32.5 million versus \$3.4 million a year ago.

Time Warner Telecom thinks it is well positioned to weather further weakness in the telecom sector. As of Dec. 31, 2001, it had \$384 million in cash and cash equivalents and \$750 million in undrawn financing.

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## Focus on the States

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### Coalition Wants State Role In UNE Review Process

A coalition of carriers that use UNE-Ps (unbundled network element platforms) to provide local exchange service has asked the FCC to ensure that state regulators have a significant say in any steps to scale back unbundling requirements on incumbent local exchange carriers. The Promoting Active Competition Everywhere (PACE) Coalition wants the FCC to consider its proposed process for state involvement as the Commission conducts its "triennial review" of its UNE rules.

PACE told the FCC in a petition in Common Carrier dockets 01-339, 96-98, and 98-147, that proper application of the Telecommunications Act of 1996 "compels retention of all existing UNEs." But to the extent that the FCC scales back its UNE requirements, "state commissions should retain the ability to decide whether those minimum requirements should take effect in their state," PACE said.

Genevieve Morelli, attorney for PACE, explained that under the system, any reduction in unbundling requirements "wouldn't apply in any particular state unless and until" the state public service commission conducted its own

proceeding. The states would examine whether the federal Telecommunications Act of 1996 or any relevant state law justified any reduction in the unbundling requirements, she said.

PACE sees this approach as a perfect fit with the FCC's desire for fact-specific, "granular" determinations on what UNEs should be available and in what circumstances or geographic areas.

"While the PACE Coalition sees potential merit with the concept of a more sophisticated and 'granular' analysis of the ILECs' unbundling requirements, the coalition questions whether the Commission is in the best position to adduce these facts, particularly when they may vary considerably from location to location," PACE said in its petition.

"The states should determine whether any reduction in federal minimums should be implemented in their jurisdiction, because only the states are able to comprehensively consider the effect of any potential reduction in ILEC unbundling obligations on the consumers and small businesses within their borders," PACE said.

PACE wants the FCC to issue a "supplemental public notice" directing parties to address the PACE proposal in their comments in the "triennial review" proceeding. Those comments are due to the FCC March 18.

Whit Jordan, vice president-federal regulatory at BellSouth Corp., told *LMTR* that PACE "seems to think the states are the only place where any expertise resides to look at these UNEs. We think the Commission also has the expertise to look at these issues." PACE is "trying to get a second bite at the apple" by proposing a process under which both federal and state regulators would have to endorse any reductions in unbundling requirements, he said.

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## California PUC Probes SBC Units on DSL, Internet Bills

The California Public Utilities Commission has launched an investigation to determine whether three units of SBC Communications, Inc., "crammed" customers by billing them for digital subscriber line (DSL) or Internet service that wasn't ordered or received.

The PUC's Customer Services Division in March 2001 began to investigate consumer billing complaints against Pacific Bell, SBC Advanced Services, Inc. (ASI), and Pacific Bell Internet. The division found that the companies had done the following:

- (1) Billing consumers for DSL and Internet services that were ordered but never received,
- (2) Billing customers after they asked that service be terminated, and
- (3) Billing consumers for products or services that had been promoted as free or less expensive than the charges placed on consumers' bills.

The PUC's investigation will also examine whether Pacific Bell underreported consumer cramming complaints against its affiliates. From 1999 to 2001, the commission received 753 complaints about the three SBC units for billing unauthorized DSL services. Pacific Bell's three quarterly reports to the commission for 2001, however, showed zero complaints against its affiliate, SBC-ASI.

The CSD said the consumer affairs branch staff tracks consumer contacts in its consumer complaint tracking system database. The CSD staff said it reviewed the database and found 283 complaints lodged against ASI for unauthorized billing in 2001. The commission said it was "appropriate" to investigate whether Pacific Bell failed to maintain accurate and up-to-date records of consumer complaints and failed to report their complaints in its quarterly reports.

A Pacific Bell spokesperson said the billing problems raised by the PUC had been fixed and customer accounts had been credited. In addition, the initial problems were largely due to the FCC's mandate that Pacific Bell transition its advanced services to an affiliate under the merger agreement between SBC Communications and Ameritech Corp., the spokesperson said.

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## Policy Update

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### **GSA: Competition Is Saving Agencies Money on Services**

Despite the bankruptcies of many competitive telecommunications carriers, federal agencies have been able to secure voice and data services at “significantly reduced rates,” thanks to competition among multiple service providers, the General Services Administration has found.

GSA reported its findings in response to the FCC’s request for comments on the state of local and advanced telecom services in multitenant buildings. The agency sought the information as a follow-up to a “competitive networks” order it released in October 2000 in Wireless Telecommunications docket 99-217. In that order, the FCC barred exclusive contracts between commercial building owners and carriers and helped competitive carriers access inside wiring.

In the comments it filed with the FCC, the GSA said federal agencies had saved money on local telecom services through its Metropolitan Area Acquisition (MAA) program. “Benefits of the MAA program have reached 23 cities, with three more planned in 2002,” it said.

GSA also said, however, that “based on the changing state of the telecom industry, these alternatives have not yet become available everywhere.”

GSA said it had drafted a model license agreement clarifying wireless providers’ responsibilities when they gain access to buildings. It said a similar agreement was being drafted to use with incumbent local exchange carriers.

GSA also said it was making progress with regard to telecom access in the private buildings in which it leases space, adding it had taken steps to ensure that those building owners provided agencies access to telecom providers. GSA owns and manages 1,700 buildings and leases space in 6,600 others.

The Texas Public Utility Commission said it adopted a rule in October 2000 to implement 1995 changes to the state Public Utility Regulatory Act that were designed to allow building tenants to pick the telecom provider of their choice. The Texas PUC said that since its building-access rule was adopted, it had received two formal complaints. Both of the cases are pending.

### **CLECs Fault Verizon Rates In Vermont InterLATA Bid**

Competitive local exchange carriers (CLECs) say the FCC should reject Verizon New England, Inc.’s petition to offer in-region interLATA services in Vermont, saying there is almost no facilities-based competition in residential markets. The CLECs also tell the FCC that a recent decision in New York cutting rates for unbundled network elements demonstrates that Verizon’s UNE rates in Vermont are too high.

But the Vermont Public Service Board defended its decision to support the application and said it had set a number of conditions for Verizon to meet. The board said it was concerned with Verizon’s plans to scale back DSL (digital subscriber line) deployment in Vermont but added that it tweaked the carrier’s performance-assurance plan to reflect those concerns.

The Vermont regulators have voted to endorse Verizon’s application, indicating that they believed that the company had complied with the 14-point “competitive checklist” of market-opening mandates in section 271 of the Telecommunications Act of 1996. Under section 271, the FCC must evaluate whether Bell companies have opened their markets and should be allowed to offer in-region interLATA services. In its evaluation, it must consult with the Department of Justice and the relevant state regulators.

Justice’s recommendation in the Common Carrier docket 02-7 proceeding is due Feb. 21,

and reply comments are due March 1. The statutory deadline for the FCC to rule on the application is April 17.

### **CLECs Decry Lack of Competition**

Verizon's rates for unbundled network elements in Vermont are "far above TELRIC [total-element long-run incremental cost] levels and create a price squeeze that makes entry into Vermont economically infeasible," said AT&T Corp.

AT&T added that Verizon had asked the Vermont board to approve its rates because they were comparable to rates the New York Public Service Commission set in 1997, AT&T noted. The PSC recently cut those rates because it found that they were "unwarrantedly high" and would "impede the development of competition." This is "powerful evidence that the Vermont rates also could not be reflective of today's costs," AT&T said.

AT&T also rejected Verizon's claim that it was subject to self-executing enforcement mechanisms under a Vermont performance assurance plan (PAP). "The Vermont PAP provides no compensation to CLECs for performance failures . . . [and it] cannot detect discrimination effectively because it employs a flawed statistical methodology that is strongly biased in Verizon's favor," it said.

AT&T also said the board couldn't have rationally determined that Verizon's cost studies complied with TELRIC principles. What information is available is riddled with "very significant TELRIC errors," AT&T added.

WorldCom, Inc., echoed AT&T's comments and also complained about inflated rates for unbundled switching. "Until its switching rates are reduced to TELRIC and the price squeeze is eliminated," the FCC must not allow Verizon to offer interLATA services, it said.

WorldCom said the rates were inflated because they were based on weekday usage, even though the charges apply to weekends and holidays. That methodology was rejected in New York and Massachusetts, WorldCom said. Verizon also "double charges" for originating and terminating intra-switch calls that pass through the switch only once, it added.

"Although Verizon claims that meaningful competition exists, its argument is seriously flawed," said Sprint Communications Co. L.P. Verizon's application notes that competitors serve about 21,500 lines in Vermont, Sprint said. Of those lines, 74% are provided by resale, it noted. "The lack of facilities-based service clearly indicates that these competing carriers are not willing to make a sizeable investment to serve this market."

National Mobile Communications Corp. (d/b/a SoVerNet Communications) said Verizon's application was premature because of the lack of competition. SoVerNet said it had collocated its own facilities in Verizon central offices in eight cities and planned to expand to six more cities in Vermont by the end of March. It expects it will take two years to duplicate Verizon's footprint in the state. "A more robust showing of actual competition of local residential competition is warranted," it said.

"We are aghast that Verizon may rely solely or largely on this company's presence in the local residential market to support a showing of local competition," SoVerNet said. "As far as we know, SoVerNet is the only CLEC in Vermont offering local residential phone service over UNEs." As of Jan. 30, the company had 78 local residential lines provisioned, it said. "That is the full extent of actual competition" for residential facilities-based competitors, it said.

### **Board Tweaks Performance Plan**

The Vermont Public Service Board said that in reviewing Verizon's compliance with the market-opening provisions of section 271, it found a few deficiencies in several competitive checklist items and portions of the carrier's performance-assurance plan.

In its comments, the board assured the FCC that steps had been taken to fix those deficiencies and that Verizon had already implemented the recommended changes. It adopted a revised PAP Jan. 28, the board said.

The board said it was disappointed that Verizon had "elected not to expand its DSL services offerings, despite evidence of significant demand." To allay those concerns and to make it attractive for other carriers to deploy DSL, the board adopted changes to the PAP

that would (1) reduce certain nonrecurring charges for DSL services by 25%, (2) add several performance measures for DSL services, and (3) reallocate potential penalty dollars to DSL failures.

To account for the small sample size in the state, the board also adjusted the PAP methodology to penalize primarily “significant and commercially substantial breaches of parity.” It didn’t adopt specific changes for “Type II” errors—errors in which Verizon’s failures affect competitors—but said it was considering such changes in a wholesale service quality proceeding.

The board also adjusted the “dollars-at-risk” amount for performance shortfalls to \$14.98 million, representing 39% of Verizon’s net Vermont revenue. That percentage has been used in neighboring states, the board said. Verizon is also required to write a check for money owed to CLECs until its wholesale

billing systems can reflect billing credits, it added.

To address potential “significant problems for competitors” from Verizon’s billing process, the board will require the carrier to retain all internal and external communications about wholesale billing disputes for five years for each complaint. The board also added to the PAP a “special provision” category for CLEC billing metrics that would make \$100,000 available annually for delays.

The board is also requiring Verizon to create a database—the Central Office Remote Terminal inquiry—that will enable competitors to locate remote terminal information. In the meantime, Verizon must supply a report with the remote terminal information in February. Verizon also agreed to notify all CLECs collocated in its central offices of the database’s availability and amend the form that CLECs use to request the information. □

#### **CARRIERS EYE AUDITS TO CHECK SPECIAL-ACCESS PERFORMANCE**

The FCC should require annual audits of incumbent local exchange carriers’ performance in providing special-access services to competitors and should establish a “special task force” to monitor that performance, according to a coalition of competitive telecommunications carriers, trade associations, and large business users of telecom services.

Those suggestions were submitted to the FCC by the Joint Competitive Industry Group Feb. 12. They were part of a list of “essential elements” that the group thinks should be part of any remedy plan to address ILECs’ performance failings. The group came together last month to offer a joint proposal for performance measures, performance standards, and reporting requirements for ILECs’ special-access services. The FCC recently launched a proceeding to consider whether to adopt such rules.

In its *ex parte* filing, the group said remedies should include both payments to the U.S. Treasury and to special-access customers. The filings, it said, must be of a “magnitude sufficient to deter anticompetitive behavior.” The penalties should “increase with the magnitude of the performance failure and should increase for repeated performance failure, it said.

The group also recommended that the FCC rules should allow for “self-executing payments to customers” for performance failings and should allow customers to seek damages either through the FCC complaint process or through a failing in federal district court. The FCC should require each ILEC to undergo an “annual independent audit of its performance reporting,” the group added, and competing carriers should “have the right to audit the ILECs’ performance reports.”

The Joint Competitive Industry Group consists of AT&T Corp., Broadview Networks, Cable & Wireless, Choice One Communications, Inc., Focal Communications Corp., Global Crossing Ltd., NewSouth Communications, Time Warner Telecom, WorldCom, Inc., XO Communications, Inc., the Association for Telecommunications Services, the Competitive Telecommunications Association, and the eCommerce & Telecommunications Users Group.