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September 4, 2007

ERRATUM

Ms. Marlene H. Dortch
Secretary
Federal Communications Commission
445 12th Street, SW
Washington, DC 20554

Re: Petitions of AT&T Inc., BellSouth Corporation, the Embarq Local Operating Companies, and Qwest Under 47 U.S.C. § 160(c) for Forbearance from Title II and Computer Inquiry Rules with Respect to Broadband Services, WC Docket Nos. 06-125 & 06-147;

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

Dear Ms. Dortch:

On August 31, 2007 Verizon filed an ex parte in the above captioned proceeding. Verizon submits this erratum to include the two attached documents that were omitted in the original filing.

Verizon submits this letter in response to the August 23, 2007 letter from Thomas J. Navin, Chief of the Commission's Wireline Competition Bureau, requesting "market data to enable a 'local market analysis'" for the broadband services at issue in the pending forbearance petitions. As an initial matter, although the letter was issued in WC Docket Nos. 04-440, 06-125, and 06-147, there is no pending forbearance petition in the first docket. Verizon's petition for forbearance was granted by operation of law almost a year and a half ago, and, as explained below, it would be unlawful to issue an order ruling on that petition at this date.

There are, however, pending forbearance petitions in the other two dockets, and those petitioners have shown that there is extensive competition nationwide to provide stand-alone broadband transmission services to the sophisticated, highly lucrative enterprise customers that purchase such services. For several reasons, the Commission should grant the pending petitions and allow petitioners and other providers the full relief requested. First, Verizon's experience over the last year and a half of offering these sophisticated broadband services to enterprise customers on a private carriage basis confirms that the market works and that common carriage regulation is unnecessary. Second, the sophisticated nature of these particular broadband services, as well as the customers who purchase them, removes any need for common carriage regulation. In fact, in light of these characteristics, these are precisely the types of services that the Commission has recognized competitive providers are capable of providing on their own. Third, the Commission

has consistently considered the appropriate regulatory framework for broadband services on a nationwide basis and courts have consistently affirmed that approach. The Commission should continue to address broadband services on that basis. Local data serves no purpose in the context of these sophisticated broadband services. Finally, in no event could or should the Commission do anything at this time to affect the relief that Verizon was granted 17 months ago for its broadband services or to re-regulate those broadband services. Instead, the Commission should grant the pending petitions and provide these competitors and other providers with the full relief requested in these petitions.

1. Verizon's experience over the last year and half confirm that the market for the high-end, broadband services at issue in the pending petitions works, and that outdated common carriage regulation is unnecessary to protect the sophisticated customers who purchase such services. Therefore, the Commission should grant the full requested relief and allow these competitors and any others the flexibility to provide customized, broadband offerings to meet the particularized needs of their customers.

The stand-alone broadband services at issue in the pending forbearance petitions are the same high-end, enterprise services for which Verizon already received relief. These services, which are among the most sophisticated services on the market, include (1) all packet-switched services capable of 200 kbps in each direction and (2) all non-TDM-based optical networking, optical hubbing, and optical transmission services.¹ These services do not include traditional TDM-based special access services, such as traditional DS-1s or DS-3s. *Id.*

Over the last 17 months, Verizon has embraced the deregulatory relief resulting from the grant of its petition for forbearance by operation of law, and has actively engaged with its customers on the transition of these broadband services to private carriage arrangements. Not surprisingly, given the intense competition for broadband services, the market is working. Verizon has already detariffed or grandfathered many of the broadband transmission services for which Verizon obtained regulatory relief through the deemed grant of its petition. Verizon already has entered into private carriage arrangements with approximately two hundred wholesale and retail customers with a value of more than \$1 billion in total. Verizon has also rolled out new and innovative services, such as a bandwidth-on-demand service.² Forbearance has also enabled Verizon to design and offer new, integrated optical IP services without the need to engage in complex regulatory determinations of how to treat the broadband transmission components of

¹ See Edward Shakin Letter to Marlene Dortch, *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, at 2-3 (filed Feb. 7, 2006), attached hereto as Attachment 1.

² The characteristics of these services and customers, and the need to provide innovative and customized offerings, shows why forbearance should not be limited to the particular stand-alone broadband transmission services that a particular carrier is offering while its petition is pending. Requiring incumbent LECs that are rolling out new broadband services to file new petitions for forbearance — and to wait as much as 15 months to obtain the flexibility forbearance provides — would deter carriers from investing in the development and deployment of such new and innovative broadband services, contrary to Congress's goals of promoting advanced services.

those services, or the need to design those integrated services to satisfy regulatory requirements rather than the needs of its customers.³

Verizon's and its customers' successes in moving to private carriage arrangements for broadband services — and the absence of any evidence of harms resulting from the grant of its petition — confirm that the regulations and statutory provisions from which Verizon sought forbearance remain unnecessary to protect consumers or to ensure just and reasonable rates and that enforcement of those rules and provisions is not in the public interest.⁴ Likewise, Verizon's competitors who have filed the pending forbearance petitions should be extended this same relief, so that they too can craft unique and customized offerings to meet their customers' demands.

2. The sophisticated nature of these broadband services, as well the customers who purchase them, confirm that common carriage regulation is inappropriate. The packetized and optical stand-alone broadband transmission services at issue are sold primarily to enterprise customers that purchase those services to connect their locations across the country and around the world. The enterprise customers that purchase these wireline broadband transmission services, moreover, are “highly sophisticated” and can “negotiate for significant discounts.”⁵ This level of sophistication is “significant not only because it demonstrates that these users are aware of the multitude of choices available to them, but also because they show that these users are likely to make informed choices based on expert advice” to “seek out best-price alternatives.”⁶ Indeed, the Commission recently reaffirmed that the “sophistication of the enterprise customers that tend to purchase” stand-alone broadband transmission at issue here, along with the “large revenues these customers generate,” confirms that competition can and will discipline prices for such services, in the absence of regulation.⁷

Moreover, as the Commission has recognized previously, competitive providers are able to offer both categories of high-end broadband transmission services at issue here on their own, and the distinction drawn by the petitions between traditional, TDM-based transmission services and newer, packetized and optical broadband transmission services is consistent with the

³ See, e.g., 47 U.S.C. § 157 note, 230(a).

⁴ See, e.g., *BellSouth Telecomms., Inc. v. FCC*, 469 F.3d 1052, 1060 (D.C. Cir. 2007) (holding that agencies have “no license to ignore the past when the past relates directly to the question at issue” and provides “data against which to test the [relevant] proposition[s]” on which the agency’s decision is based).

⁵ Memorandum Opinion and Order, *Verizon Communications Inc. and MCI, Inc. Applications for Approval of Transfer of Control*, 20 FCC Rcd 18433, ¶ 75 (2005) (“*Verizon-MCI Order*”).

⁶ *Id.* ¶ 76.

⁷ Memorandum Opinion and Order, *Petition of ACS of Anchorage, Inc. Pursuant to Section 10 of the Communications Act of 1934, as Amended (47 U.S.C. § 160(c)). For Forbearance from Certain Dominant Carrier Regulation of Its Interstate Access Services, and for Forbearance from Title II Regulation of Its Broadband Services, in the Anchorage, Alaska, Incumbent Local Exchange Carrier Study Area*, FCC 07-147, WC Docket No. 06-109, ¶ 99 (Aug. 20, 2007) (“*ACS Broadband Forbearance Order*”).

Commission's own prior decisions⁸ and Congress's own policy preference for promoting the deployment and development of broadband facilities.⁹

First, the Commission has made clear that competitive providers can, and should be encouraged to, deploy their own facilities for packet switching and to provide packetized services. For example, in the *Triennial Review Order*, the Commission recognized that “the record shows that a wide range of competitors are actively deploying their own packet switches, including routers and DSLAMs to serve both the enterprise and mass markets.” *Id.* ¶ 538. Likewise, the Commission denied competitive providers unbundled access to any “transmission facility between the central office and the customer’s premises (including fiber feeder plant) that is *used to transmit packetized information.*” *Id.* ¶ 288 (emphasis added). The Commission noted that a contrary rule for packetized services and facilities would “blunt the deployment of advanced telecommunications infrastructure by incumbent LECs and the incentive for competitive LECs to invest in their own facilities, in direct opposition to the express statutory goals authorized by section 706. *Id.*

In any event, as noted above, the pending petitions for forbearance — no different from the Verizon petition that was granted by operation of law — do not cover TDM-based special access facilities, such as DS-1s and DS-3s, which will remain available through federal tariffs, subject to common carrier regulation, even after the Commission grants the full relief sought in the still-pending petitions. As the Commission repeatedly has recognized, competitors are creating and selling their own packetized broadband transmission services by combining these traditional TDM-based “special access facilities” with *their own* “packet switch[es],”¹⁰ as well as by deploying their own facilities or using third-party facilities. The Commission recently reaffirmed its prior findings that competitors can provide stand-alone broadband transmission services “by relying on special access TDM loops (in addition to [their] own facilities).”¹¹

Second, with respect to optical services and facilities, the Commission has recognized that there is “substantial deployment of competitive fiber loops at OCn capacity and competitive carriers confirm they are often able to economically deploy these facilities to the large enterprise customers that use them.”¹² Competing carriers are able to deploy new OCn-level facilities without significant difficulty because these types of facilities “produce revenue levels which can justify the high cost of loop construction, providing the opportunity for competitive LECs to offset the fixed and sunk costs associated with the loop construction.”¹³

⁸ See, e.g., *Triennial Review Order* ¶ 213.

⁹ See 47 U.S.C. §§ 157 note, 230.

¹⁰ Memorandum Opinion and Order, *Petition for Waiver of Pricing Flexibility Rules for Fast Packet Services*, 20 FCC Rcd 16840, ¶ 11 (2005).

¹¹ *ACS Broadband Forbearance Order* ¶ 102.

¹² Order on Remand, *Unbundled Access to Network Elements; Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers*, 20 FCC Rcd 2533, ¶ 183 (2005); see also *Triennial Review Order* ¶ 315.

¹³ *Triennial Review Order* ¶ 316.

To the extent that some commenters continue to oppose the pending petitions, their reasons for doing so likely differ depending on their differing business plans. As explained by independent analysts, some competing providers have chosen to invest heavily to deploy an extensive competing network at the time of their entry into the market and have then focused on attracting customers to fill their network.¹⁴ (Analysts cite Time Warner Telecom as an example. *Id.*) Such facilities-based competitors obtain a relative advantage from keeping incumbents subject to regulations that hamper their flexibility to meet and beat competition by designing and offering service packages and rates that enterprise customers demand. Other providers, however, have taken a “smart build” approach, and lease existing ILEC facilities on a wholesale basis while they build a customer base in an area, and then invest in their own facilities. *Id.* These providers tend to benefit when carriers are afforded the flexibility to negotiate customized arrangements to meet their particular needs. Regardless of the regulatory incentives of competitive providers, the forbearance provision, however, embodies the basic antitrust principle that government regulation of the marketplace is “for the protection of *competition*, not *competitors*” and their particular business plans.¹⁵

3. As did Verizon in the long-since-terminated proceeding on its forbearance petition, the petitioners with pending forbearance petitions have supported their requests for relief by submitting evidence showing the extensive competition nationwide to provide broadband transmission services to enterprise customers. In reviewing the state of competition to provide stand-alone broadband transmission services to enterprise customers with respect to the still-pending petitions in WC Docket Nos. 06-125 and 06-147, the Commission should follow its repeated decisions to review the competitiveness of broadband services at the nationwide level. For example, when the Commission classified cable modem service as an information service and held that the *Computer Inquiry* rules should not apply to cable modem service, the Commission stressed that it was considering “the appropriate *national* framework for the regulation of cable modem service.”¹⁶ The Supreme Court upheld the Commission’s adoption of these nationwide rules based on the Commission’s consideration of national “market conditions.”¹⁷

In the *Triennial Review Order*, the Commission likewise concluded — on a nationwide basis — that incumbent LECs did not have to unbundle certain broadband elements, irrespective of the type of customer served using those elements.¹⁸ The D.C. Circuit upheld the Commission’s decision not to require unbundling of these elements on a nationwide basis.¹⁹ The Commission itself later noted that “the D.C. Circuit upheld the Commission’s findings in the *Triennial Review*

¹⁴ See CIBC World Markets, “Enterprise Outlook Update: Pricing and Volume Continue to Improve,” at 6-7 (July 30, 2007) (describing different business models pursued by CLECs).

¹⁵ *Brunswick Corp. v. Pueblo Bowl-O-Mat, Inc.*, 429 U.S. 477, 488 (1977) (internal quotation marks omitted).

¹⁶ Declaratory Ruling and Notice of Proposed Rulemaking, *Inquiry Concerning High-Speed Access to the Internet Over Cable and Other Facilities*, 17 FCC Rcd 4798, ¶ 56 (2002).

¹⁷ *National Cable & Telecomms. Ass’n v. Brand X Internet Servs.*, 125 S. Ct. 2688, 2711 (2005).

¹⁸ *Triennial Review Order* ¶¶ 210, 241-246, 255-263, 272-280, 285-295.

¹⁹ *United States Telecom. Ass’n v. FCC*, 359 F.3d 554, 578-85 (D.C. Cir. 2004).

Order that it was appropriate to relieve the BOCs from unbundling obligations on a national basis for the broadband elements at issue.”²⁰

Following the analysis in the *Triennial Review Order*, the Commission next granted forbearance, “on a national basis,” from § 271 insofar as it applied to the “broadband elements” as to which the Commission had just refused to require unbundling.²¹ The D.C. Circuit upheld this decision in full as well. The D.C. Circuit held that the forbearance statute permits the Commission to “forbear on a nationwide basis — without considering more localized regions individually” and rejected the argument that the Commission must consider “market conditions in particular geographic markets,” holding further that the forbearance statute “imposes no particular mode of market analysis or geographic rigor.”²² The D.C. Circuit similarly found that the Commission “reasonably eschewed a more elaborate snapshot of the current market in deciding whether to forbear” based on its “view of the broadband market as still emerging and developing” and rejected claims that “competition can only . . . be assessed by focusing on . . . specific . . . geographic markets.”²³ In reaching these rulings, the D.C. Circuit was agreeing with the Commission’s own conclusion that it was appropriate to “evaluate[] the broadband marketplace . . . on a nationwide basis to determine whether the statutory criteria for forbearance were satisfied.”²⁴

In the *Wireline Broadband Order*, the Commission again considered a nationwide broadband marketplace and rejected arguments that it is required to consider narrower geographic areas, because those arguments are “premised on data that are both limited and static,” which is inappropriate in light of the “[c]ontinuous change and development [that] are likely to be the hallmark of the marketplace for broadband Internet access at both the retail and wholesale levels over the next several years.”²⁵ Before the Third Circuit, the Commission is defending the national approach in the *Wireline Broadband Order*, explaining that its decision not to “distinguish[] between specific geographic and product markets” in the context of broadband services was appropriate, because “static marketplace dominance analysis” is not useful in the context of “an emerging market that will likely experience rapid technological and competitive changes before it reaches maturity.”²⁶ And, consistent with all of the preceding orders, the Commission’s most recent orders with respect to broadband over power line and wireless broadband services again used a nationwide analysis, without consideration of narrower geographic regions.²⁷

²⁰ Report and Order, *Appropriate Framework for Broadband Access to the Internet over Wireline Facilities*, 20 FCC Rcd 14853, ¶ 23 (2005) (“271 Broadband Forbearance Order”).

²¹ *Id.* ¶ 12.

²² *EarthLink, Inc. v. FCC*, 462 F.3d 1, 8 (D.C. Cir. 2006) (internal quotation marks omitted).

²³ *Id.* at 9.

²⁴ Brief for Respondents at 21-22, *EarthLink, Inc. v. FCC*, No. 05-1087 (D.C. Cir. Feb. 6, 2006) (emphasis added).

²⁵ *Wireline Broadband Order* ¶¶ 50, 56.

²⁶ Brief for Respondents at 50-58, *Time Warner Telecom v. FCC*, Nos. 05-4769 *et al.* (3d Cir. oral arg. Mar. 16, 2007) (internal quotation marks omitted).

²⁷ See Memorandum Opinion and Order, *United Power Line Council’s Petition for Declaratory Ruling Regarding the Classification of Broadband over Power Line Internet Access Service as an Information Service*, 21 FCC Rcd 13281 (2006); Declaratory Ruling, *Appropriate Regulatory*

The Commission's determination that broadband must be analyzed on a nationwide basis, moreover, is consistent with the manner in which analysts review those services. For example, Time Warner Telecom has recently touted a report by Vertical Systems Group — which Time Warner Telecom states “provides in-depth, accurate, defensible statistics and analysis” on the stand-alone broadband transmission services at issue in the pending petitions — that provides information on the “U.S. Port Share” of “Retail Business Ethernet Service.”²⁸ That report, moreover, shows that Time Warner Telecom saw a 28 percent market share growth in the last six months and that companies other than AT&T, Qwest, and Verizon supply more than 56 percent of Ethernet ports to business customers nationally.²⁹ A recent Lehman Brothers report likewise reviews enterprise data services, such as the broadband transmission services at issue in the pending proceedings, on a nationwide basis, reporting that companies other than AT&T, Qwest, and Verizon currently have won 56 percent of that enterprise business nationally, with these other companies expected to continue increasing their share over the next few years.³⁰ The Commission recently pointed to similar, but older reports in noting that “available data suggest that there are a number of competing providers for [broadband transmission] services and the marketplace appears highly competitive.”³¹

Given the extensive competition nationally to provide broadband transmission services to enterprise customers, it should come as no surprise that data on smaller geographic areas, while unnecessary to consider, shows the same extensive competition. For example, in support of Verizon's forbearance petition that was granted by operation of law, Verizon pointed the Commission to third-party survey results compiled by Harte-Hanks for each of the twelve states (as well as the District of Columbia) in the former Bell Atlantic/NYNEX territories and six different MSAs in the former GTE territory and that Verizon had submitted, and the Commission had relied on, in the Verizon-MCI merger proceeding.³² Just like the national data Verizon had submitted, the Harte-Hanks data confirmed that the degree of competition that Verizon faces warrants forbearance. More recent Harte-Hanks data, which Verizon submitted in a different proceeding and which provide state-specific and MSA-specific data on the broadband transmission services at issue with respect to other carriers' pending forbearance petitions, likewise confirm that

Treatment for Broadband Access to the Internet Over Wireless Networks, 22 FCC Rcd 5901 (2007).

²⁸ See Time Warner Telecom Grows Ethernet Market Share, http://www.twtelecom.com/Documents/Announcements/News/2007/VSG_TWTC_Mid_year07Ethernet.pdf

²⁹ See *id.*

³⁰ See *id.*

³⁰ See Thomas O. Seitz, Lehman Brothers Equity Research, *Telecom Services – Wireline*, at 11 (Oct. 18, 2006) (“*Lehman Brothers Oct. 2006*”).

³¹ *ACS Broadband Forbearance Order* ¶ 98 & n.270.

³² See *Verizon Feb. 7, 2006 Ex Parte* at 12-13; Letter from Dee May, Vice President, Federal Regulatory, Verizon, to Marlene H. Dortch, Secretary, FCC, WC Docket No. 05-75 (FCC filed Sept. 20, 2005); Memorandum Opinion and Order, *Verizon Communications Inc. and MCI Inc., Applications for Approval of Transfer of Control*, 20 FCC Rcd 18433, ¶¶ 70-73 & n.196 (2005).

all segments of the business marketplace are competitive.³³ Therefore, even if the Commission were to depart from its consistent practice of reviewing broadband competition on a nationwide basis — which it should not do — the outcome of that analysis would be no different: there is extensive competition in all areas for the stand-alone broadband transmission services that enterprise customers demand.

The Commission's recent order granting in part ACS's petition for forbearance does not reflect a change in the Commission's consistent nationwide analysis for broadband services. ACS's petition was not a pure "me too" petition related to broadband services, but instead was a more complicated petition involved various types of relief from numerous different services. The petition was not limited to broadband services, but instead also included many services for which the Commission previously has used a different level of analysis. Also, ACS is a rate-of-return carrier that provides service, and operates in a highly unique area, in a small territory that is physically far removed from the lower, contiguous, 48 states. The Commission's analysis, therefore, focused on the unique nature of ACS's requested relief and does not reflect a shift from its consistent approach to analyzing broadband services on a nationwide basis.³⁴

4. Finally, regardless of the relief granted to the petitioners with pending forbearance petitions, in no event could the Commission do anything at this time to affect the relief that Verizon was granted for its stand-alone broadband services or to re-regulate those services.³⁵

In December 2004, Verizon filed its forbearance petition that, as clarified in light of subsequent developments at the Commission, sought for Verizon's stand-alone broadband transmission services the same relief the Commission provided in the *Wireline Broadband Order*³⁶ for broadband transmission services that are used for, or as an input to, broadband Internet access services.³⁷ When the March 19, 2006 statutory deadline for ruling on Verizon's petition for forbearance passed without Commission action, that petition, as clarified, was granted by operation of law, thus terminating the proceedings on Verizon's petition. As Verizon has explained, the Commission therefore lacks authority to issue a belated order on Verizon's petition. At a minimum, the Commission could not re-regulate any broadband services that were the subject of that petition without first initiating a new proceeding and compiling a new record. And that

³³ See Letter from Joseph Jackson, Associate Director, Federal Regulatory, Verizon, to Marlene H. Dortch, Secretary, FCC, WC Docket No. 02-112, at 1-2, Attach. A & Exh. 4.4 (FCC filed Apr. 11, 2007).

³⁴ E.g., *ACS Broadband Forbearance Order* ¶¶ 3, 61.

³⁵ See Opposition of Verizon, *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 (filed Aug. 13, 2007), attached as Attachment 2.

³⁶ Report and Order, *Appropriate Framework for Broadband Access to the Internet over Wireline Facilities*, 20 FCC Rcd 14853 (2005), *petitions for review pending*, *Time Warner Telecom Inc. v. FCC*, Nos. 05-4769 *et al.* (3d Cir. argued Mar. 16, 2007).

³⁷ See Letter from Edward Shakin, Vice President and Associate General Counsel, Verizon, to Marlene Dortch, Secretary, FCC, WC Docket No. 04-440 (FCC filed Feb. 7, 2006) ("*Verizon Feb. 7, 2006 Ex Parte*").

record in any event would not justify a finding of the existence of the type of market failure that would justify regulation in the first instance.³⁸

The statute's forbearance provision states that "[a]ny such petition shall be deemed granted if the Commission does not deny the for failure to meet the requirements for forbearance under section (a) within one year after the Commissions receives it." 47 U.S.C. § 160(c). The Commission has held, in the analogous context of the "deemed lawful" provision in § 204(a)(3), that "the term 'deemed[]' . . . is *not ambiguous*" and "must be read" to mean "conclusive."³⁹ The D.C. Circuit expressly upheld that determination⁴⁰ and the Commission later found that, "[g]iven the Court's conclusion," the Commission "cannot adopt [a] reading" of "deemed lawful" as "ambiguous" and as creating merely a "presumption" of lawfulness that "may be rebutted."⁴¹ These same principles apply to the "deemed granted" language in § 160(c), render the deemed grant of Verizon's petition "conclusive," and preclude the Commission from issuing an order now on Verizon's petition.

Indeed, courts of appeals have previously vacated agency orders purporting to deny an application that "shall be deemed to have been granted" when the agency "fail[ed] . . . to act on" it within a specified time period.⁴²

Nor could the Commission issue an order today as a "reconsideration" of the grant by operation of law of Verizon's petition for forbearance. As the Commission has explained to the D.C. Circuit, when Verizon's petition was granted by operation of law, the Commission did not adopt or issue "a reviewable FCC order," nor did it take "any reviewable agency 'action.'"⁴³ Reconsideration can occur only following "an order, decision, report, or action" by the Commission or by a designated entity within the Commission.⁴⁴ Because the deemed grant of Verizon's petition did not involve any agency action — as the Commission has told the D.C.

³⁸ See Opposition of Verizon, WC Docket No. 04-440 (Aug. 13, 2007) (Exh. A hereto); see also Reply Comments of Verizon at 4-9, WC Docket Nos. 06-125 & 06-147 (Aug. 31, 2006); Reply Comments of Verizon at 1-4, WC Docket No. 04-440 (Aug. 17, 2007) (Exh. B hereto).

³⁹ Memorandum Opinion and Order, *Implementation of Section 402(b)(1)(A) of the Telecommunications Act of 1996*, 12 FCC Rcd 2170, ¶ 19 (1997) ("*Streamlined Tariff Order*") (emphasis added); see also Brief for Respondents at 33, *In re Core Commc'ns, Inc.*, Nos. 04-1368 *et al.* (D.C. Cir. July 25, 2005) ("*FCC Core Communications Brief*") (describing the "deemed lawful" clause in § 204(a)(3) as "an analogous provision" to the "deemed granted" clause in § 160(c)).

⁴⁰ See *ACS of Anchorage, Inc. v. FCC*, 290 F.3d 406, 412 (D.C. Cir. 2002).

⁴¹ Order on Reconsideration, *Implementation of Section 402(b)(1)(A) of the Telecommunications Act of 1996*, 17 FCC Rcd 17040, ¶¶ 4-5 (2002) ("*Streamlined Tariff Reconsideration Order*").

⁴² See, e.g., *Tri-State Bancorporation, Inc. v. Board of Governors of the Federal Reserve System*, 524 F.2d 562, 564, 567-68 (7th Cir. 1975) (quoting 12 U.S.C. § 1842(b)) (internal quotation marks omitted).

⁴³ Brief for the FCC at 16, 21, *Sprint Nextel Corp. v. FCC*, No. 06-1111 *et al.* (D.C. Cir. oral arg. Oct. 15, 2007).

⁴⁴ 47 U.S.C. § 405(a); see 47 C.F.R. §§ 1.106(a), 1.429(a) (providing for reconsideration of "final" agency action only).

Circuit — there is nothing to reconsider. In any event, Congress set a strict 30-day time limit on the filing of petitions for reconsideration, and that time has long since passed, even assuming the deemed grant of Verizon's petition could be treated as an action subject to reconsideration, which it cannot.⁴⁵ Similarly, the Commission's rules establish a 30-day period in which the Commission can grant reconsideration on its own motion.⁴⁶ Again, any such period has long since passed.

Accordingly, the Commission should grant the pending forbearance petitions and allow the petitioners and any other providers the full requested relief from common carriage regulation for the sophisticated broadband services at issue here.

Sincerely,

A handwritten signature in cursive script that reads "Dee May".

cc: T. Navin
W. Dever
W. Kehoe
M. Maher
C. Shewman
D. Stockdale

⁴⁵ See 47 U.S.C. § 405(a).

⁴⁶ See 47 C.F.R. § 1.108.

**Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20544**

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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

OPPOSITION OF VERIZON

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August 13, 2007

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Petition of the Verizon Telephone Companies
for Forbearance Under 47 U.S.C. § 160(c)
from Title II and Computer Inquiry Rules with
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WC Docket No. 04-440

OPPOSITION OF VERIZON¹

The Commission should deny the motion that three CLECs recently filed, requesting that the Commission — sixteen months after Verizon’s petition for forbearance in this docket was deemed granted by operation of law — issue an order ruling on that petition. Contrary to their claims, this proceeding was terminated when Verizon’s petition was deemed granted, and the Commission lacks authority to issue a belated order on that petition. If the Commission sought to impose new regulation on Verizon following the “deemed grant” of its petition, the Commission first would need to initiate a rulemaking, with notice and comment, and could impose such regulation only on a record documenting the type of market failure for broadband services that would justify regulation in the first instance. Because the Commission has not initiated such a proceeding — and because, in any event, the facts would not show a need for such regulation given that the market for these services is competitive and is working well without intrusive regulation — the Commission must deny the CLECs’ motion.

¹ The Verizon companies participating in this filing (“Verizon”) are the regulated, wholly owned subsidiaries of Verizon Communications Inc.

INTRODUCTION AND SUMMARY

On December 20, 2004, Verizon filed a petition for forbearance from the application of Title II and the *Computer Inquiry* rules to Verizon's broadband services, to the extent those requirements might be construed to apply to those services. While that petition was pending, the Commission released the *Wireline Broadband Order*,² in which it held that carriers such as Verizon would no longer be subject to the *Computer Inquiry* rules for broadband services used for, or as an input to, broadband Internet access service.³ The Commission held further that those carriers would be permitted to offer those broadband services on a private-, rather than common-, carriage basis, subject to Title I of the Communications Act.⁴ On February 7, 2006, in light of the *Wireline Broadband Order*, Verizon clarified that its petition for forbearance sought for its stand-alone broadband transmission services the same relief the Commission provided in its order for broadband transmission services that are used for, or as an input to, broadband Internet access services.⁵

In the months leading up to the March 19, 2006 statutory deadline for ruling on Verizon's petition, the Commission had only four Commissioners, rather than its normal complement of five. In these unusual circumstances, a majority of the four Commissioners was unable to agree upon the contents of an order ruling on Verizon's petition. When the statutory deadline passed

² Report and Order and Notice of Proposed Rulemaking, *Appropriate Framework for Broadband Access to the Internet over Wireline Facilities*, 20 FCC Rcd 14853 (2005) ("*Wireline Broadband Order*"), *petitions for review pending, Time Warner Telecom Inc. v. FCC*, Nos. 05-4769 *et al.* (3d Cir. argued Mar. 16, 2007).

³ *See id.* ¶¶ 41-85.

⁴ *See id.* ¶¶ 87-97, 102-106.

⁵ *See* Letter from Edward Shakin, Vice President and Associate General Counsel, Verizon, to Marlene Dortch, Secretary, FCC, WC Docket No. 04-440 (FCC filed Feb. 7, 2006) ("*Verizon Feb. 7, 2006 Ex Parte*").

without Commission action, the petition for forbearance, as clarified, was deemed granted by operation of law, thus terminating the proceedings on Verizon's petition.⁶

Following the deemed grant of Verizon's petition, the competitive broadband marketplace has continued to work well, and the CLECs' provide no evidence to the contrary. Since that time, Verizon has actively engaged with its customers to provide broadband services on the private carriage basis as permitted by its forbearance relief. Verizon is well into the process of transitioning its broadband services — in an orderly manner that prevents disruption or hardship for its customers — away from the tariffed, common-carriage world and into negotiated, private carriage arrangements. Verizon already has reached private carriage agreements for broadband services with more than 100 customers, representing an approximate total value of more than \$1.5 billion.

Now, more than 16 months after Verizon's petition was deemed granted and after Verizon has engaged its customers on a private carriage basis, three CLECs have filed a motion effectively asking the Commission to reconsider the relief that Verizon was granted by operation of law and urging the Commission to issue an order belatedly ruling on Verizon's petition for forbearance.⁷ The CLECs make no substantive arguments on the merits of Verizon's petition on the record before the Commission in March 2006, and point to nothing during the intervening 16 months that suggests that enforcing the statutory and regulatory provisions that were at issue

⁶ Both before that time and since, the Commission has consistently voted to adopt orders ruling on forbearance petitions within the statutory time frame, making clear that its impasse on Verizon's petition was due to the unique circumstances present at that time, rather than a practice of allowing the statutory deadline to run without Commission action.

⁷ The CLECs express a preference that the Commission deny Verizon's petition, but make clear that their primary request is that the Commission issue an order one way or the other on the petition.

in Verizon's petition is currently in the public interest, or necessary to protect consumers or to ensure just and reasonable rates.

Because Verizon's petition was deemed granted by operation of law 16 months ago, the Commission lacks authority to rule on Verizon's petition at this late date. Contrary to the CLECs' claims, and as the Commission and the courts have held with respect to similar language in the Communications Act, a "deemed" grant is not an "interim" grant, but instead is a "conclusive" grant, leaving nothing further for the Commission to do with respect to Verizon's petition. Even if reconsideration motions were permissible in the case of a forbearance petition that has been deemed granted pursuant to Congress' directive — which they are not — the CLECs' belated motion comes far too late.

This does not mean, as the CLECs imply, that the Commission is forever disempowered from addressing issues that Verizon's now-granted petition covered. If evidence of market failure warranted the imposition of regulations, such as those removed by the deemed grant of Verizon's petition, then the Commission could adopt them. But just as the Commission must do any time it seeks to adopt and impose new regulatory requirements, it first would need to initiate a rulemaking proceeding, complete with notice and comment. Then, the Commission could regulate only if the record in such a proceeding provided an adequate basis to conclude that there were a market failure and that regulation were necessary to address that failure. The CLECs have not requested that the Commission initiate any such proceeding and, in any event, have not shown, and would not be able to show, that the adoption of new regulatory requirements is warranted. The CLECs' motion should be denied.

DISCUSSION

I. VERIZON'S PETITION FOR FORBEARANCE WAS GRANTED BY OPERATION OF LAW, AND IS NO LONGER BEFORE THE COMMISSION

When Congress passed the Telecommunications Act of 1996 (“1996 Act” or “Act”), it adopted a national policy of deregulation and competition. The forbearance provision, 47 U.S.C. § 160, is “[c]ritical to Congress’s deregulation strategy” in the 1996 Act. *AT&T Inc. v. FCC*, 452 F.3d 830, 832 (D.C. Cir. 2006). As the Commission recently explained to the D.C. Circuit, Congress, in § 160, not only gave the Commission authority to grant forbearance, but “went further” and, “[t]o ‘improve the [1996 Act’s] deregulatory nature,’ . . . gave telecommunications carriers the ability to compel the Commission to exercise its authority ‘to forbear from regulating.’”⁸ Thus, “Congress expected that this ‘petition driven process’ would spur the Commission ‘to eliminate outdated regulations and to do so in a timely manner,’” by “‘requir[ing] speedy action on . . . petitions for forbearance.’”⁹

But Congress also was concerned that the Commission might not deregulate quickly enough. Therefore, Congress created a default mechanism — in § 160(c) — to ensure that Commission inaction would not frustrate Congress’s deregulatory policy. Any petition for forbearance will be “deemed granted” by operation of law if the Commission does not deny the petition for failure to meet the statutory requirements within one year and 90 days from the date of filing. 47 U.S.C. § 160(c). Congress thus required the Commission, when presented with a

⁸ Brief for the FCC at 4, *Sprint-Nextel Corp. v. FCC*, Nos. 06-111, *et al.* (D.C. Cir. July 5, 2007) (quoting 141 Cong. Rec. S8069-70 (June 9, 1995) (remarks of Sen. Pressler)) (second alteration in original) (“FCC *Sprint-Nextel* Brief”).

⁹ *Id.* (quoting 141 Cong. Rec. S7898 (June 7, 1995) (remarks of Sen. Dole) and 142 Cong. Rec. S700 (Feb. 1, 1996) (remarks of Sen. Burns) (omission in original)).

forbearance petition, to take affirmative action to justify its continued enforcement of those statutory provisions and regulations, in light of the statutory standards.

The deregulatory effect of § 160(c), including relief from regulation as a result of the “deemed grant” of a petition, is a considered choice Congress made in the 1996 Act and is one that directly serves the “Act’s purpose — reduc[ing] regulation in order to . . . encourage the rapid deployment of new telecommunications technologies.” *AT&T Inc.*, 452 F.3d at 836 (internal quotation marks omitted; alteration and omission in original). The language, structure, and purpose of § 160 all demonstrate that Congress intended a forbearance petition to be deemed granted even when — indeed, especially when — the Commission’s inaction is the result of the members’ inability to reach consensus on how to rule on the petition.

Section 160(a) states that “the Commission *shall* forbear” from enforcing against telecommunications carriers any provision of the Communications Act or of the Commission’s own regulations if certain conditions are met. 47 U.S.C. § 160(a) (emphasis added). Forbearance is thus a mandatory duty once the conditions are satisfied.¹⁰ In similarly mandatory language, § 160(c) declares that a forbearance petition “*shall be* deemed granted if the Commission,” within the statutory period, “does not deny the petition for failure to meet the requirements for forbearance.” 47 U.S.C. § 160(c) (emphasis added). Congress’s directive that a petition “shall be deemed granted” establishes a default rule under which a forbearance petition is automatically granted unless the Commission takes timely action to deny it “for failure to meet the requirements for forbearance.” *Id.*

¹⁰ See, e.g., *Akzo Nobel Salt, Inc. v. Federal Mine Safety & Health Review Comm’n*, 212 F.3d 1301, 1303 (D.C. Cir. 2000) (noting the “truth that use of the word ‘shall’ indicates that [a] condition is mandatory”).

Thus, Congress required the Commission, when presented with a forbearance petition, to make a considered decision that enforcement of the statutory provisions and regulations at issue is warranted and can be justified under the specific criteria Congress set forth in § 160(a) and (b), which are comparable to the criteria the Commission applies under § 201(b) when determining whether to promulgate regulations in the first place.¹¹ In other words, the forbearance statute shifts the burden to the Commission to determine affirmatively that continued enforcement of regulation is warranted. If the Commission will not — or cannot — make such a finding, the petition is granted by congressional decision and operation of law.¹² After regulations have been removed pursuant to forbearance — whether by the Commission’s affirmative grant by or the statutory “deemed grant” Congress provided — the removed regulatory requirements could be re-imposed only following the initiation of a new rulemaking proceeding and on the basis of a complete record demonstrating the type of market failure justifying such regulation.

The CLECs acknowledge that Verizon’s petition was deemed granted when a majority of the Commission did not adopt an order denying the petition for failure to meet the statutory

¹¹ See *Cellular Telecomms. & Internet Ass’n v. FCC*, 330 F.3d 502, 512 (D.C. Cir. 2003) (interpreting § 160(a)(2) to “refer[] to the existence of a strong connection between what the agency has done by way of regulation and what the agency permissibly sought to achieve with the disputed regulation”); *Cellco P’ship v. FCC*, 357 F.3d 88, 96 (D.C. Cir. 2004) (explaining that, under § 201(b), “the Commission can adopt rules upon finding that they advance a legitimate regulatory objective”).

¹² In this regard, § 160 is a significantly more muscular version of § 161, which Congress also adopted as part of the 1996 Act. Section 161 requires the Commission, every two years, to review all regulations under the Communications Act that apply to providers of telecommunications to determine “whether the necessity for [those] regulation[s] continues in light of current market conditions” and “to repeal or modify such regulations it determines are no longer necessary in the public interest as a result of current competitive conditions.” *Cellco P’ship*, 357 F.3d at 99. Congress did not “include[] a temporal restriction” in § 161 with respect to the modification or repeal of unnecessary regulations, as it did in § 160(c)’s “deemed granted” provision. *Id.* at 100. This distinction between the two sections provides still further evidence that Congress anticipated and intended the effect of the “deemed granted” provision.

requirements by March 19, 2006. *See* Motion for Expedited Order on Verizon Petition for Forbearance at 6 (filed July 25, 2007) (“Mot.”). Therefore, that petition is no longer pending before the Commission and the Commission cannot, at this late date, adopt an order ruling on that petition — no matter the substance of the order.

In cases involving similar statutory language, courts of appeals have vacated an agency’s attempt to rule belatedly on a petition that had already been deemed granted by operation of law. For example, in *Tri-State Bancorporation, Inc. v. Board of Governors of the Federal Reserve System*, 524 F.2d 562 (7th Cir. 1975), the Seventh Circuit vacated an agency order purporting to deny an application for approval of formation of a bank holding company because that order was adopted and released after the application was “deemed granted” by operation of law. *See id.* at 564, 566-68. Like § 160(c), the “time limitation in the [Bank Holding Company] Act is mandatory in the sense that the statute prescribes the effect of the Fed’s failure to act, *i.e.*, the application is deemed approved.” *Id.* at 565-66. And the court recognized “Congress’s declaration[,] implicit in” adopting the “deemed granted” provision, that it should eliminate the “risk [of] allowing a meritorious application to be delayed by [the] federal bureaucracy for more than” a specified time, even though the result is to preclude the agency from belatedly determining that the application was not meritorious. *Id.* at 567-68; *see North Lawndale Econ. Dev. Corp. v. Board of Governors of the Fed. Reserve Sys.*, 553 F.2d 23, 27 (7th Cir. 1977) (vacating another order purporting to deny an application when the order was adopted and released after the application was deemed granted).

In addition, the Commission has held, in the analogous context of the “deemed lawful” provision in § 204(a)(3), that “deemed” must be interpreted to mean a “conclusive” ruling.¹³ Indeed, the Commission recognized that “[a]ppellate cases . . . have consistently found that the term ‘deemed,’ in this context, is not ambiguous” and “must be read” to mean “conclusive.”¹⁴ The D.C. Circuit upheld the Commission’s interpretation and rejected the Commission’s attempt, with respect to a particular tariff, to create exceptions to the conclusive effect of the “deemed lawful” status of that tariff.¹⁵ Therefore, once a tariff has been “deemed lawful” as a result of the Commission’s failure to issue a suspension order and initiate an investigation under § 204 within the time period Congress specified, the Commission’s only recourse with respect to such a tariff is to conduct a new, separate “section 205 investigation or 208 complaint proceeding based on a preponderance of the evidence presented in either proceeding.”¹⁶

These same principles apply to the “deemed granted” language in § 160(c), render the deemed grant of Verizon’s petition “conclusive,” and preclude the Commission from belatedly acting on Verizon’s petition. Instead, as with a tariff that is “deemed lawful” and as explained above, the Commission may only address the services deregulated through the deemed grant of Verizon’s petition in a new proceeding and based on the new record compiled in that proceeding.

Nor could the Commission grant any “reconsideration” of the deemed grant of Verizon’s petition, as the CLECs’ motion effectively requests. Even if reconsideration were permitted in

¹³ Memorandum Opinion and Order, *Implementation of Section 402(b)(1)(A) of the Telecommunications Act of 1996*, 12 FCC Rcd 2170, ¶¶ 18-19, 21 (1997) (“*Streamlined Tariff Order*”).

¹⁴ *Id.* ¶ 19; *see id.* (“[T]his interpretation is required in order to give effect to the language of the statute.”).

¹⁵ *See ACS of Anchorage, Inc. v. FCC*, 290 F.3d 403, 412, 415 (D.C. Cir. 2002).

¹⁶ *Streamlined Tariff Order* ¶ 23.

this context, the CLECs' motion would be barred as untimely. Congress established a strict 30-day period for filing petitions for reconsideration, and that statutory period — long since passed — cannot be waived.¹⁷ Moreover, although nothing in the statute denies the Commission authority to reconsider the *denial* of a forbearance petition following the 15-month deadline, through which it could extend *additional* deregulatory relief, the statutory deadline precludes Commission from belatedly reconsidering relief that has already been granted, because such a denial would occur after the close of the statutory period, in conflict with the plain language of § 160(c). Otherwise, the Commission could effectively ignore the statutory deadline and defeat Congress's reasons for specifying that petitions would be deemed granted once the deadline passed.

Indeed, if the Commission were able to adopt and release an order at any time after a petition had been deemed granted — which is what the CLECs claim here — it would “gut section 10” by treating “the statutory deadline [as] inconvenient,” which the D.C. Circuit made clear “cannot be correct.” *AT&T Inc.*, 452 F.3d at 836. Petitioners that obtained the benefit of a deemed grant would rightly be reluctant to take advantage of that regulatory relief, for fear that the Commission would — at some future point, without notice, and without consideration of intervening events — issue an order purporting to strip the petitioner of that relief. Such a result would be directly contrary to Congress's intention that forbearance would result in the “eliminat[ion] [of] outdated regulations . . . in a *timely* manner.”¹⁸

¹⁷ See 47 U.S.C. § 405(a). For the same reasons, the CLECs cannot rely on the D.C. Circuit's statement that mandamus could be available to compel the Commission to rule on a timely filed petition for reconsideration of an order a majority of Commissioners adopted denying a forbearance petition in whole or in part. See Mot. at 9.

¹⁸ 141 Cong. Rec. S7898 (June 7, 1995) (remarks of Sen. Dole) (emphasis added).

Over the last 16 months, Verizon has embraced the deregulatory relief resulting from the deemed grant, and has actively engaged with its customers on the transition to private carriage arrangements. Not surprisingly, given the intense competition for broadband services, the market is working. Verizon has already detariffed or grandfathered many of the broadband transmission services for which Verizon obtained regulatory relief through the deemed grant of its petition. In addition, as noted above, Verizon already has entered into private carriage arrangements with more than one hundred customers with an approximate value of more than \$1.5 billion in total. An order issued now based on a record that closed 16 months ago — without meaningful opportunity for consideration of intervening events or the interests of these customers through compilation of a new record in a new proceeding — would disrupt these private carriage arrangements and harm these customers. Indeed, Verizon’s and its customers’ successes in moving to private carriage arrangements for broadband services — and the absence of any claims, let alone evidence, of harms resulting from the deemed grant — demonstrates that, even aside from the Commission’s lack of authority to do so, there is no need for issuance of any order.¹⁹

¹⁹ In a recent letter, NCTA claims that the Commission should “clarify” that the “interconnection and traffic exchange obligations of Section 251” “remain in force with respect to Verizon,” notwithstanding the deemed grant of its forbearance petition. Letter from Daniel L. Brenner *et al.*, NCTA, to Marlene H. Dortch, Secretary, FCC, WC Docket Nos. 04-440 *et al.*, at 7 (Aug. 6, 2007). As an initial matter, the Commission lacks authority to issue such a “clarification” for all the reasons set forth above. In any event, NCTA’s request for clarification is misplaced. Verizon’s petition, as clarified, sought for its stand-alone broadband transmission services the same relief the Commission granted in the *Wireline Broadband Order*, and that order did not grant relief from any existing obligations under § 251(a), (b)(5), or (c)(2). *See, e.g., Wireline Broadband Order* ¶¶ 127 n.400, 145. Indeed, NCTA recognizes (at 5) that Verizon’s petition did not “request[] forbearance from Section 251 interconnection or traffic exchange requirements.” To the extent NCTA is seeking to expand the scope of those sections to impose legal interconnection and traffic exchange mandates on IP networks — thereby regulating for the first time a currently unregulated and highly competitive market segment, contrary to the requirements of the 1996 Act and Commission policy — such radical changes could not be

II. THE CLECS' CLAIMS LACK MERIT

The CLECs raise various arguments in support of their claim that the Commission should issue an order now on a petition that was deemed granted by operation of law 16 months ago. None has merit.

First, the CLECs (at 9) misconstrue the Commission's invocation of § 405(a), in *Qwest Corp. v. FCC*, 482 F.3d 471 (D.C. Cir. 2007), to bar Qwest from arguing on appeal that its petition was deemed granted when Qwest had not presented that argument to the Commission on reconsideration. In that case, the Commission had, by a majority vote, adopted an order within the statutory time frame denying Qwest's petition in part; no such majority vote occurred here. In addition, the fact that Qwest could have used reconsideration to obtain *more* relief through invalidation of the Commission's partial denial of Qwest's petition provides no support to the CLECs, as they attempt here to *reduce* the relief already granted to Verizon by operation of law. Finally, as noted above, even on their own theory, the CLECs' motion comes far too late to be construed as a petition for reconsideration of the deemed grant of Verizon's petition, given the strict 30-day period for filing petitions for reconsideration.

Second, the CLECs suggest (at 9-10, 12-13) that the Commission, in a brief before the D.C. Circuit, "clearly endorsed" the view that it can issue an order with regard to a forbearance petition that has already been deemed granted by operation of law. But, in that case, the Commission was responding to Core Communications, Inc.'s claim that the granting of a petition for forbearance by operation of law is legally equivalent to Congress passing a statute repealing the relevant statutory provisions and regulations, thereby forever precluding the Commission

accomplished through a "clarification" at all, even if the Commission had authority to issue a belated ruling on Verizon's petition, which it does not.

from acting in those areas. After noting that Core’s argument on appeal was barred by § 405(a), because Core had not raised its claims before the Commission, the Commission then noted that “Core’s interpretation . . . is not unambiguously required” and that it may be “open to the agency to conclude the section 160(c) provides for an *interim* ‘deemed’ grant,” with the Commission able to rule on the petition subsequently.²⁰ Far from being a clear endorsement of the CLECs’ position here, the Commission’s brief claimed only that Core’s view — which is not Verizon’s position — is not compelled by the statute. In any event, the alternative interpretation posited in the Commission’s brief is not “open” to the Commission, as it would conflict directly with the Commission’s correct interpretation of the term “deemed” in § 204(a)(3), and the judicial precedent supporting that interpretation.²¹

Third, the CLECs (at 10-11) note that the five-month deadline in § 204(a)(2)(A) for ruling on tariff investigations does not preclude the Commission from completing its investigation after the five-month period has run. But the CLECs are simply wrong in claiming that § 204(a)(2)(A) states that a tariff will be either “deemed granted or lawful” if the Commission does not complete its proceeding within the five-months provided. Mot. at 10. Instead, such a tariff must be permitted to take effect as a merely “legal,” rather than “lawful,” tariff by the end of that five-month period. *See* 47 U.S.C. § 204(a)(1).²² The “deemed lawful”

²⁰ Brief for Respondents at 30-31, *In re Core Commc’ns, Inc.*, Nos. 04-1368 *et al.* (D.C. Cir. July 25, 2005) (emphasis in original).

²¹ In addition, in *Core*, the Commission had unanimously voted to adopt an order denying Core’s petition in part *before* the statutory deadline.

²² *See ACS of Anchorage*, 290 F.3d at 410-11 (explaining the difference between a “legal” tariff and a “lawful” one). For similar reasons, the CLECs’ reliance (at 11) on *Brock v. Pierce County*, 476 U.S. 253 (1986), is misplaced. Like § 204(a)(2)(a), the statute at issue in *Brock* “speaks in mandatory language, [but] nowhere specifies the consequences of a failure to make a final determination within” the statutory period for making the decision. *Id.* at 259. Section 160(c), just like § 204(a)(3), specifies those consequences and *Brock* supports the

language appears only in § 204(a)(3) and, as shown above, the Commission has already interpreted that language to provide a “conclusive” determination that the tariff is lawful, which the Commission can modify only prospectively, and only in a new proceeding on a new record.

Fourth, the remainder of the CLECs’ claims (at 13-20) offer supposed pragmatic reasons why the CLECs prefer that the Commission issue an order at this late date, which are not legal justifications for the Commission’s purported authority to do so. Because the Commission lacks such authority, as shown above, none of the pragmatic reasons could be relevant here. In any event, they, too, are without merit. For example, although the CLECs suggest (at 13-14) that the “public interest” requires a thorough review of Verizon’s petition, they do not point to a single harm to the public interest that has allegedly occurred in the past 16 months. They also ignore the public interest Congress endorsed when it established the forbearance process for removing unnecessary regulations in a timely manner. Similarly, the CLECs complain (at 14-17) about “uncertain[ty]” regarding the relief Verizon received, but provide no basis for their purported confusion about which broadband services were the subject of Verizon’s petition; in fact, the CLECs (at 4) had no difficulty articulating the precise categories of service for which Verizon ultimately sought and received forbearance.²³ Nor is there any reason for the Commission to issue an order so that CLECs can have a final agency order from which to seek judicial review, *see* Mot. at 15-16, as Congress did not intend for there to be judicial review when a petition for forbearance is deemed granted by operation of law, *see* FCC *Sprint-Nextel* Brief at 13-21, 34-44.

decisions, such as those cited in the text, that ensure that agencies and courts adhere to the consequences Congress did specify. *See id.* at 266.

²³ The CLECs suggest (at 17-20) that having a written order on Verizon’s petition would be useful when the Commission rules on the other, similar pending petitions for forbearance. But the Commission is capable of resolving those petitions on the arguments and evidence presented in those dockets without the need to issue a “pre-decision” on Verizon’s petition 16 months after the fact.

CONCLUSION

For the foregoing reasons, the Commission should deny the CLECs' motion.

Respectfully submitted,

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August 13, 2007

CERTIFICATE OF SERVICE

I, Scott H. Angstreich, hereby certify on this 13th day of August that copies of the foregoing Opposition to Motion for Expedited Order on Verizon Petition for Forbearance were served via first-class mail, postage prepaid, on the following:

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February 7, 2006

Ex Parte via Hand Delivery

Marlene Dortch
Secretary
Federal Communications Commission
445 12th Street, S.W.
Washington, DC 20554

*Re: 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 04-440*

Dear Ms. Dortch:

At the request of the Commission's staff, this letter provides the following information relating to the relationship between Verizon's pending forbearance petition and the Commission's *Wireline Broadband Order*¹: (1) discussion of the types of broadband services for which Verizon is seeking forbearance other than those addressed in the *Wireline Broadband Order*; (2) discussion of the types of Title II regulations that apply to those services and for which forbearance is therefore requested; (3) discussion of how these services meet the same criteria that the Commission identified in the *Wireline Broadband Order* in permitting broadband Internet access and related transport services to be offered on a private-carriage basis, without the burdens of Title II; and (4) the current state of competition for the services at issue.

¹ See *Appropriate Framework for Broadband Access to the Internet over Wireline Facilities*, Report and Order and Notice of Proposed Rulemaking, 20 FCC Rcd 14853 (2005) ("*Wireline Broadband Order*").

REDACTED – FOR PUBLIC INSPECTION

1. Services for Which Verizon² Is Seeking Forbearance

Verizon's petition requests forbearance from traditional common-carriage requirements for all broadband services. The Commission has previously determined that mandatory common-carriage treatment is inappropriate for many broadband services, including broadband Internet access services sold primarily to mass-market customers, and the underlying broadband transmission services that are used to provide Internet access services. The Commission has not yet extended that same flexibility to other broadband transmission services that are not used for Internet access and that are sold primarily to enterprise customers. But given the sophistication of these customers, the flexibility needed to meet their complex and diverse needs, and the vigorous competition for their business, the Commission should forbear from mandatory common-carriage regulation for these broadband services as well and allow Verizon the same option to offer them on either a private-carriage or common-carriage basis.

The Commission has previously defined "broadband" services as those capable of 200 kbps in each direction.³ This definition accordingly provides the baseline for the speed or bandwidth of the services for which we seek relief. In addition, Verizon has consistently maintained – both in the wireline broadband proceedings,⁴ and in this proceeding⁵ – that the Commission could define broadband to exclude TDM-based services. This approach would enable the Commission to address any concerns that granting the requested relief would undermine the availability of traditional TDM-based special access services used to serve business customers.⁶

Consistent with this approach, there are two principal categories of services remaining for which Verizon is seeking relief. The first category is packet-switched services capable of 200 kbps in each direction. These are services that route or forward packets, frames, cells, or other data units based on the identification, address, or other routing information contained in the packets, frames, cells, or other data units. This category includes Frame Relay services, ATM services, IP-VPN services, and Ethernet services.

² Since the time of its original petition, MCI, Inc. merged into MCI, LLC, a wholly owned subsidiary of Verizon Communications Inc. Most MCI, LLC business units, and certain other business owned by Verizon Communications Inc. that serve enterprise and government customers, call themselves Verizon Business. Verizon Business operating units are included in the scope of relief requested here.

³ See Fourth Report to Congress, *Availability of Advanced Telecommunications Capability in the United States*, 19 FCC Rcd 20540, at 10 (2004).

⁴ See, e.g., Verizon Comments in CC Docket No. 01-337, at 9-10 (FCC filed Mar. 1, 2002); Verizon Petition for Limited Reconsideration of Title I Broadband Order in CC Docket No. 02-33, at 2 n.3 (FCC filed Nov. 16, 2005).

⁵ See Verizon Reply Comments in WC Docket No. 04-440, at 8 n.21 (FCC filed Mar. 10, 2005).

⁶ See *Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers*, Report and Order and Order on Remand and Further Notice of Proposed Rulemaking, 18 FCC Rcd 16978, ¶ 294 (2003) ("*Triennial Review Order*"); *Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers*, Order on Reconsideration, 19 FCC Rcd 20293, ¶¶ 20-21 (2004).

The second category includes non-TDM based optical networking, optical hubbing, and optical transmission services. These are very high-speed transmission services – well over the Commission’s 200 kbps definition for broadband – that are provided over optical facilities at OCn speeds (but include no services at DS1 or DS3 speeds). These services are used to support a wide variety of applications used by business customers, and in particular very large enterprise customers. These services are provided both over SONET-based networks, and over Wave Division Multiplexing (“WDM”) or Dense Wave Division Multiplexing (“DWDM”) networks, which are various protocols or standards for transmitting communications signals across fiber-optic facilities. This category includes the following Verizon services: Intellilight Broadband Transport; Verizon Optical Network; Optical Hubbing Service; and Intellilight Optical Transport Service.

With respect to both categories, Verizon offers these various services both to enterprise customers on a retail basis, and to other carriers on a wholesale basis. Verizon is seeking relief for the services at issue regardless of the nature of the customer to whom the service is offered.

Attachment 1 contains a more detailed description of the services that Verizon offers that qualify under each of these two categories. All of these services fall within the Commission’s well-established “broadband” definition, and no traditional TDM-based special access services are included.

2. *Regulations from Which Verizon Is Seeking Forbearance*

Verizon is seeking forbearance from the mandatory application of Title II common-carriage regulation in order to have the flexibility to provide the broadband services at issue on a common-carriage or private-carriage basis. This relief sought here is the same as the Commission already provided for broadband transmission services that are used to provide Internet access service in its recent *Wireline Broadband Order*. As the Commission recognized in that context, this flexibility will enable Verizon to “better accommodate . . . individual market circumstances,” such as permitting Verizon and its customers “to modify their arrangement over time as their respective needs and requirements change without the inherent delay associated with a tariffed offering that must be made available to all” other customers. *Wireline Broadband Order* ¶ 88. This relief gives broadband providers like Verizon “the flexibility to offer these services in the manner that makes the most sense as a business matter and best enables [it] to respond to the needs of [customers] in [its] . . . service areas.” *Id.* ¶ 89. This approach also “will benefit [customers] by making it more likely that they will be offered innovative service arrangements responding to their changing needs.” *Id.* ¶ 92.

To the extent the Commission is concerned that granting the requested relief would potentially remove the services at issue from those contributing to the universal service fund (to the extent the services at issue are subject to such an obligation today⁷),

⁷ For example, because the obligation to contribute to the universal service fund applies to interstate retail revenues, it generally does not apply to services provided on a wholesale basis.

the Commission could exercise its authority under section 254(d) to prevent that result. That section gives the Commission authority to require any “provider of interstate telecommunications . . . to contribute to the preservation and advancement of universal service if the public interest so requires.” 47 U.S.C. § 254(d). The Commission could use this authority to provide for continuing contributions as an interim measure for a six-month period, which would enable the Commission to maintain current universal service funding during the time it would take to complete the pending rulemaking to adopt a new assessment mechanism for the universal service fund. In that rulemaking, Verizon and other parties have proposed comprehensive changes to the current revenue basis for universal service assessment.

3. *The Services at Issue Meet the Same Criteria Used To Justify Forbearance in the Wireline Broadband Order*

The Commission has “on numerous occasions has determined that a particular service can be offered on a non-common carrier or common carrier basis at the service provider’s option.” *Wireline Broadband Order* ¶ 94 & n.280 (citing examples). Most recently, the Commission granted this relief to wireline broadband Internet access services and to the underlying broadband transmission services in the *Wireline Broadband Order*. In reaching that determination, the Commission held that certain characteristics of the services at issue “inform[ed] [its] decision-making.” *Id.* ¶ 32; *see id.* ¶ 79 (listing criteria). As demonstrated below, the broadband services at issue here meet each of those same criteria, and therefore qualify for the same regulatory treatment as the broadband transmission services addressed in the *Wireline Broadband Order*.

First, the technology used to provide the broadband services at issue here “are fundamentally changing” in ways that are “rapidly breaking down the formerly rigid barriers that separate one network from another.” *Id.* ¶ 32. As a result, there are “numerous technologies and network designs that form, or potentially could form, part of the broadband telecommunications infrastructure of the 21st century.” *Id.* ¶ 33. The Commission has already reached this conclusion with respect to enterprise services as a whole, observing that “the use of emerging technologies are likely to make this market more competitive, and that this trend is likely to continue in the future.” *Verizon/MCI Order* ¶ 75.⁸ In the *Wireline Broadband Order*, the Commission found that cable operators, mobile wireless providers, and fixed wireless operators, among others, were all offering broadband services in competition with the broadband services provided over the wireline telephone network. *See Wireline Broadband Order* ¶ 88. Many of these same technologies also are being used to compete for the broadband services at issue here, and in addition new technologies such as IP-VPN and Gigabit Ethernet are rapidly replacing older technologies such as Frame Relay and ATM.⁹ These new technologies are “multi-

⁸ Memorandum Opinion and Order, *Verizon Communications Inc. and MCI Inc., Applications for Approval of Transfer of Control*, 20 FCC Rcd 18433, ¶ 75 (2005) (“*Verizon/MCI Order*”).

⁹ *See Verizon/MCI Order* ¶ 59; *see also* S. Harris, IDC, *U.S. ATM Services 2005-2009 Forecast* at 2 (May 2005) (“ATM, frame, and private lines services are all under pressure from IP VPNs and transparent LAN (Ethernet) services. The migration from one legacy service to another will continue for a minority of customers, but the biggest threat to all traditional services comes from newer IP technologies.”); B. Van

purpose in nature and more application-based, rather than existing for a single, unitary, technologically specific purpose.” *Wireline Broadband Order* ¶ 40. As a result, the emergence of these technologies “will lead to greater capacity for innovation to offer new services and products” and create opportunities for both “the providers of network platforms and those that utilize the platforms . . . to capitalize on these changes.” *Id.* And “as with any evolving technology, new products and providers will continue to emerge to complement existing market offerings and participants; and these offerings will grow over time as consumers demand even more advanced services, with the result that technological growth and development continue on an upward spiral.” *Id.*

Second, changes in the marketplace for the broadband services at issue here require that providers have “the flexibility to respond more rapidly and effectively to new consumer demands.” *Id.* ¶ 79. The Commission has already found that these broadband services are purchased by enterprise customers, “are typically the result of RFPs,” “are individually-negotiated,” and “are generally for customized service packages.” *Verizon/MCI Order* ¶ 79. The Commission also has recognized that wholesale customers purchase high-capacity services in this same manner.¹⁰ Due to these market conditions, carriers require flexibility in their service offerings to compete effectively. Common-carriage regulation does not afford this flexibility but instead imposes “costs, inefficiencies, and delays [that] are significant and substantially impede network development.” *Wireline Broadband Order* ¶ 71. Private contractual arrangements, by contrast, “provide service providers more flexibility in developing a new technology and more incentives to do so.” *Id.* ¶ 72. This is because “a service provider is more likely to invest in technologies if the service provider is able to obtain assurances through private contracts that the technologies will be used.” *Id.*

Third, the current regulatory environment discourages technological innovation with respect to the broadband services at issue here. The Commission has recognized that common-carriage requirements “slow innovation” with respect to wireline broadband Internet access services, “because vendors do not create new technologies with [these] requirements in mind.” *Id.* ¶ 65. This forces service providers into a dilemma: “either they must decide not to use all the equipment’s capabilities, thereby reducing their operational efficiency, or they must defer deployment while the manufacturer re-engineers it to facilitate compliance with the *Computer Inquiry* rules, thereby creating unnecessary costs and service delays.” *Id.* These same considerations apply here. As the Commission has acknowledged, CPE integration is one of the fastest growing segments of the enterprise market, and has enabled equipment suppliers such as Lucent, Nortel,

Dussen & J. Wilson, In-Stat, *Share of Wallet: Telecom Trends and Expenditures in the US Business Market* at 8 (Dec. 2005) (“It is beyond cliché to note the continued decline of legacy revenues; the move to IP is apparent and accelerating. Sprint, for example, announced plans earlier this year to reject new frame relay orders in two years. Furthermore, all of the major service providers continue to report flat or declining wireline data revenues, announcing (as in the case of AT&T) falling volumes and price erosion abated only by improved IP revenues.”).

¹⁰ See *Verizon/MCI Order* ¶ 52 (“Carriers that purchase wholesale special access services, whether Type I or Type II, are sophisticated customers that often rely on a competitive bid process or negotiate individual contracts, and that enter into long-term contracts.”).

Siemens, Cisco and others to compete to provide increasingly sophisticated on-site communications capability to replace services that were previously provided through the network. *See Verizon/MCI Order* ¶ 64.

In sum, the same circumstances that led the Commission to forbear from Title II common-carriage regulation for wireline broadband Internet access services apply with equal or greater force here. Verizon is accordingly seeking relief that is equivalent in scope to the relief granted in the *Wireline Broadband* proceeding.

4. Additional Data on Competition for the Broadband Services at Issue

As the Commission has previously recognized, there is extensive competition for the various broadband services for which Verizon is seeking relief. Verizon is not the largest provider of any of these services, but instead faces stiff competition both from a larger competitor – AT&T – and from a long list of other significant competitors.

- a. *Relief from Title II is appropriate given the nature of the customers at issue and the flexibility needed to serve them*

The broadband services here are purchased predominantly by enterprise customers,¹¹ although Verizon also makes these services available to wholesale customers. The Commission has found that competition for enterprise customers is “strong” and will remain so “because medium and large enterprise customers are sophisticated, high-volume purchasers of communications services that demand high-capacity communications services, and because there [are] a significant number of carriers competing in the market.” *Verizon/MCI Order* ¶ 56. In fact, as noted above, enterprise customers often purchase broadband services through an RFP process that involves competitive bidding, and this process “is often sufficient . . . [to] compel[] the supplier to offer lower prices and improved service to retain the [enterprise] customer.”¹² Moreover, enterprise customers often employ “either communications consultants or . . . in-house communications experts” to help them through this process. *Verizon/MCI Order* ¶ 76. As the Commission recognized, “[t]his is significant not only because it demonstrates that these users are aware of the multitude of choices available to them, but also because they show that these users are likely to make informed choices based on expert advice about service offerings and prices.” *Id.*

The Commission also has found that Verizon competes with a long list of competitors for enterprise customers, “includ[ing] interexchange carriers, competitive LECs, cable companies, other incumbent LECs, systems integrators, and equipment vendors.” *Id.* ¶¶ 64, 74. The Commission concluded that these “myriad providers are

¹¹ *See Verizon/MCI Order* ¶ 57; *id.* ¶ 60 (“larger businesses often contract for more sophisticated services, including Frame Relay [and] virtual private networks”); *Triennial Review Order* ¶¶ 46, 129.

¹² Memorandum Opinion and Order, *SBC Communications Inc. and AT&T Corp., Applications for Approval of Transfer of Control*, 20 FCC Rcd 18290, ¶ 74 n.226 (2005).

prepared to make competitive offers,” and that they therefore “ensure that there is sufficient competition.” *Id.* ¶ 74. These facts all remain true today.

b. There are many competitors offering the broadband services at issue here

Within the enterprise segment, competition for broadband services is particularly intense, with Verizon as just one member of a pack of competitors offering these services, rather than in the lead. It is widely recognized that AT&T is the largest provider for enterprise customers, both with respect to the provision of all communications services, and also with respect to the provision of broadband services to these customers. For example, according to a survey of Enterprise telecom decision makers by Bernstein, the largest “primary” data carrier among enterprise customers is AT&T.¹³ The largest “secondary” data carrier is Sprint, followed by AT&T.¹⁴

In addition, myriad other providers compete to serve this segment of the market as well. Wall Street analysts have noted, for example, that “[a] notable aspect of the enterprise market is the markedly higher share garnered by smaller, niche service providers for data services than for voice services.”¹⁵ Moreover, as noted above, the Commission has acknowledged that “the use of emerging technologies” is transforming the provision of data services, and that this is “likely to make this market more competitive, and that this trend is likely to continue in the future.” *Verizon/MCI Order* ¶ 75.

Just as broadband data services sold to enterprise customers are competitive overall, the same is true of the specific services that are the focus of this petition. The two most widely used services in this category are ATM and Frame Relay, but newer services such as IP-VPN and Ethernet are growing rapidly in importance. *See, e.g., Verizon/MCI Order* ¶ 59. For all of these services, there are multiple competitive suppliers in Verizon’s region. And as with respect to enterprise services as a whole, AT&T is the leading provider of many or all of these services. *See* Attachment 3.

In addition to AT&T, other competitive providers of ATM and Frame Relay services within Verizon’s region include Sprint,¹⁶ McLeodUSA,¹⁷ TelCove,¹⁸ Qwest,¹⁹

¹³ J. Halpern, *et al.*, Bernstein Research Call, *U.S. Telecom: Bells’ Positions Improving in Enterprise As Buyers Shift to Multiple Primary Suppliers* at Exhibit 3 (June 20, 2005) (AT&T 35%, MCI 28%, Sprint 12%, ILEC 7%, Other 19%). *See also* D. Barden, *et al.*, Banc of America Securities, *Merger Monitor XI* at 3 (Oct. 3, 2005) (“SBC’s acquisition of AT&T will catapult SBC to the number one market share position in the large enterprise data, IP and voice long haul market.”).

¹⁴ J. Halpern, *et al.*, Bernstein Research Call, *U.S. Telecom: Bells’ Positions Improving in Enterprise As Buyers Shift to Multiple Primary Suppliers* at Exhibit 4 (June 20, 2005) (Sprint 31%, AT&T 16%, ILEC 16%, MCI 6%, Qwest 6%, Other 25%).

¹⁵ *Id.* at 5.

¹⁶ Sprint, *Domestic ATM*, <http://www.sprint.com/business/products/products/atmSprintlink.jsp> (“Sprint ATM works for sophisticated service providers and enterprises needing high-speed transport up to 10 Gbps

Xspedius,²⁰ Conversent,²¹ Cavalier,²² and Global Crossing.²³ Carriers providing IP/VPN services include AT&T,²⁴ Sprint,²⁵ TelCove,²⁶ Global Crossing,²⁷ SAVVIS,²⁸ XO,²⁹

(higher than DS3) to consolidate intracompany voice, data and video traffic, while maintaining the highest level of network performance.”).

¹⁷ McLeodUSA, *Preferred Advantage Metro Frame Relay*, http://www.mcleodusa.com/ProductDetail.do?com.mcleodusa.req.PRODUCT_ID=340910 (“McLeodUSA Preferred Advantage Metro Frame Relay links multiple office locations through an advanced, secure frame relay network, which works within either public or shared wide area networks.”).

¹⁸ TelCove, *ATM*, <http://www.telcove.com/products/atm.asp> (TelCove’s “ATM and Frame Relay services are able to inter-work to create a hybrid (Frame-ATM) network that best meets a customer’s network application requirements.”).

¹⁹ Qwest, *ATM Service*, http://www.qwest.com/pcat/large_business/product/1,1016,767_4_2,00.html (“Qwest ATM provides high speed, reliability and security for data, video, voice and Internet communications to keep you positioned in the global marketplace.”).

²⁰ Xspedius, *Enterprise Customers: Data ConneX*, http://www.xspedius.com/customersolutions/data_connex.aspx (“Xspedius Communications, Inc. provides managed and unmanaged Frame Relay transport services in over 30 U.S. markets, utilizing its own MPLS backbone with ATM and Frame at the edge.”).

²¹ Conversent, *Conversent Secure Private Networks (ATM)*, <http://www.conversent.com/website/products/index.asp?prodId=24&pId=14&type=data> (Conversent’s “Secure Private Network Solutions leverages proven ATM technology to provide a perfect solution for businesses looking to transmit mission critical information between remote offices and a host location without fear of interception, loss, or corruption of data.”).

²² Cavalier Telephone, *Data Solutions from Cavalier Business Communications*, http://www.cavtel.com/business/data_solutions.shtml (Cavalier offers frame relay with “Secure site-to-site connectivity with ‘best effort’ performance for delay tolerant traffic.”).

²³ Global Crossing, *Frame Relay Service*, http://www.globalcrossing.com/xml/services/serv_data_frame_rel_over.xml (Global Crossing offers “one of the world’s most extensive FR/ATM networks [which] allows you to link sites around the globe free from interoperability concerns.”).

²⁴ AT&T, *IP and IP VPN*, http://www.business.att.com/service_portfolio.jsp?repoint=ProductCategory&repointem=eb_vpn&serv_port=eb_vpn&segment=ent_biz (“AT&T VPN gives you choices in your network design of sophisticated VPN technologies, access, security, voice and WiFi offers, with the flexibility to add on options such as Voice over IP, Video, remote access and hosting.”).

²⁵ Sprint, *IP VPN*, <http://www.sprint.com/business/products/products/hardwareBasedIP-VPN.jsp> (“Sprint IP Virtual Private Network (VPN) services deliver a best-of-both-worlds approach to connectivity, delivering the flexibility and global reach of the public Internet and the security and performance of a private networking solution.”).

²⁶ TelCove, *IP VPN*, <http://www.telcove.com/products/ip-vpn.asp> (“With TelCove’s IP-VPN offerings, critical voice and IT services can be converged using one of the industry’s most scaleable, reliable, and efficient private communications networks.”).

²⁷ Global Crossing, *IP VPN Service*, http://www.globalcrossing.com/xml/services/serv_data_ipvpn_over.xml (“Global Crossing provides one of the most powerful and versatile fully managed IP VPN solutions available today.”).

²⁸ SAVVIS, Inc., *Network Services*, <http://www.savvis.net/corp/Products+Services/Network/> (“SAVVIS operates an integrated global IP and transport network that delivers IP VPN . . . solutions for enterprises and carriers alike.”).

²⁹ XO Communications, *XO VPN*, <http://www.xo.com/products/smallgrowing/data/vpn/index.html> (“XO VPN (Virtual Private Network) is a secure encrypted network solution that secures data traffic via

Equant,³⁰ Level 3,³¹ and BT Infonet.³² Competing providers of Ethernet services within Verizon's region include Time Warner Telecom,³³ TelCove,³⁴ Looking Glass,³⁵ Level 3,³⁶ ICG,³⁷ Cogent,³⁸ and OnFiber.³⁹ In sum, Verizon faces significant and varied competition both nationally and within its own traditional service area. The sophisticated business customers who purchase these types of services have many competitive options.

encryption between your remote employees and your corporate network or among your various office locations. XO VPN is a cost-efficient solution for companies without a heavy investment in infrastructure or personnel.”).

³⁰ Equant, *Equant IP VPN*, http://www.equant.com/content/xml/prod_serv_ipvpn.xml (“Equant IP VPN is a fully managed, business-class service designed to provide a flexible, reliable and cost-effective network infrastructure. It’s backed by the highest levels of performance, quality, data integrity and security – all of which are essential to your e-business.”).

³¹ Level 3 Communications, *(3)Flex Network IP VPN*, <http://www.level3.com/3248.html> (Level 3’s IP VPN “service allows corporations, government entities, and distributed businesses of any size to replace multiple networks with a single, cost-effective solution that greatly simplifies the converged transmission of voice, video, and data.”).

³² BT Infonet, *IP VPN*, http://www.bt.infonet.com/services/internet/ip_vpn.asp (BT Infonet’s “IP VPNs are run over our global IP network for fully meshed, any-to-any connectivity between multiple locations for a lower cost of ownership than a private network.”).

³³ Time Warner Telecom, *Ethernet Internet Service (EIS)*, http://www.twtelecom.com/cust_solutions/services/ethernet_internet.html (Time Warner Telecom offers Gigabit Ethernet, including “[f]ractional, full, or burstable solutions from 20 Mbps – 1000 Mbps (1 Gbps).”).

³⁴ TelCove, *Metro Ethernet and Intercity Ethernet Service*, <http://www.telcove.com/products/ethernet.asp> (TelCove offers Ethernet services with “[b]andwidth from 10 Mbps to 10 Gbps for Metro Ethernet.”).

³⁵ Looking Glass Networks, *EtherGLASS – Ethernet Services*, <http://www.lglass.net/products/etherglass.jsp> (“Gigabit Ethernet services are available on either 1000Base-SX (multimode fiber), or 1000Base-LX (single mode fiber) interfaces, at transmission speeds that are configurable from 10 Mbps to 1000 Mbps, depending on your requirements.”).

³⁶ Level 3 Communications, *(3)Flex Ethernet*, <http://www.level3.com/1505.html> (Level 3 “Ethernet provides scalability from a DS-3 or 100BaseT to multiple Gigabit Ethernet interfaces as well as to OC-48 (2.5 Gbps).”).

³⁷ ICG Communications, *Metro Ethernet*, <http://www.icgcomm.com/products/corporate/metro.asp> (“ICG’s Metro Ethernet is a flexible transport service that provides connectivity across the local metropolitan geography using Ethernet as the core protocol” and is offered at up to “1Gbps (1000Mbps) – Gig-E.”).

³⁸ Cogent Communications, *Ethernet Point-to-Point Services*, <http://www.cogentco.com/htdocs/ethernet.php> (“Cogent’s point-to-point GigE connections are popular solutions for NetCentric customers who need room to grow. Implement a redundant or backup network or access remote storage locations – Cogent’s network has the capacity you need.”).

³⁹ OnFiber Communications, *Ethernet*, <http://www.onfiber.com/content/index.cfm?fuseaction=showContent&contentID=22&navID=22> (“OnFiber Ethernet service provides the ease of Ethernet local area network technology extended across the metro or across the country. It offers a simple, cost-effective, and non-oversubscribed solution for interconnecting locations. With standard LAN interfaces, this service provide customers a highly affordable way to link sites together at speeds ranging from 1 Mbps to 1 Gbps.”).

With respect to the optical transmission services at issue here, there is likewise extensive competition. As the Commission has recognized, there is “substantial deployment of competitive fiber loops at OCn capacity and competitive carriers confirm they are often able to economically deploy these facilities to the large enterprise customers that use them.” *Triennial Review Remand Order* ¶ 183.⁴⁰ Competing carriers are able to deploy new OCn-level facilities without significant difficulty, because these types of facilities “produce revenue levels which can justify the high cost of loop construction, providing the opportunity for competitive LECs to offset the fixed and sunk costs associated with the loop construction.” *Triennial Review Order* ¶ 316.⁴¹ Moreover, the “[l]arge enterprise customers purchasing services over OCn loops enter into long-term contracts committing to revenue streams and associated early termination charges that provide the ability for carriers to recover their substantial non-recurring ‘set-up’ or construction costs.” *Triennial Review Order* ¶ 316. Consistent with these findings, “there does not appear to be any evidence of demand for incumbent LEC OCn level unbundled loops,” which further shows that competing carriers are deploying these high-speed optical facilities themselves or obtaining them from third parties. *Id.* ¶ 315. In sum, there is no chance that Verizon could exercise market power with respect to these competitive services, and, hence, no justification for continued application of mandatory Title II regulation.

- c. *There should be no market share test for relief, but such data does provide further evidence of competition for the broadband services here*

Congress did not establish a market share test for forbearance, and the Commission should not adopt one here.⁴² As the Commission has recognized, data on the availability of competitive alternatives are more probative than backward looking market share data. This is particularly true with services provided in a dynamic market, like the broadband transmission services at issue here.

As the Commission recently recognized in the *Verizon/MCI Order*, market share data for enterprise customers is entitled to little weight because it “does not reflect the rise in data services, cable and VoIP competition, and the dramatic increase in wireless,” nor the fact that “myriad providers are prepared to make competitive offers.” *Verizon/MCI Merger Order* ¶ 74. As a result, “market shares may misstate the competitive significance of existing firms and new entrants.” *Id.*

⁴⁰ *Unbundled Access to Network Elements; Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers*, Order on Remand, 20 FCC Rcd 2533, ¶ 183 (2005) (“*Triennial Review Remand Order*”); see also *Triennial Review Order* ¶ 315.

⁴¹ See also *Triennial Review Remand Order* ¶ 182 n.493 (“Despite these costs, the revenue possibilities of dark fiber are great enough to make self-deployment economic.”).

⁴² The Commission adopted a parallel approach in the UNE context, where it expressly “decline[d] to determine impairment based on a certain level of retail competition because section 251(d)(2) requires us to ask whether requesting carriers are ‘impaired,’ not whether certain thresholds of retail competition have been met.” *Triennial Review Order* ¶ 114.

To the extent the Commission does look at market share data, it also has recognized that such data must be interpreted carefully. Any evaluation of competition within a given market must consider “the presence and the capacity of rival carriers in specific markets, rather than simply . . . their current subscriber market shares.”⁴³

These findings are particularly true here, because the services at issue are provided in a dynamic market. *See Verizon/MCI Order* ¶ 57; *AT&T Wireless/Cingular Order* ¶ 118. As described above, technological developments are rapidly changing the nature of services that enterprise customers are purchasing, and thereby creating opportunities for new providers to fulfill these needs. For example, IP-based services are rapidly replacing previous generation of broadband data services like ATM and Frame Relay. This means that legacy market shares are a particularly poor predictor of future industry trends.

With these caveats in mind, Verizon is providing the following types of market share data here. First, the attached Lehman Brothers report (*see* Attachment 2) contains market share estimates for “enterprise” customers, which it defines as a \$152 billion market segment that includes large enterprise customers, wholesale services, and small and medium enterprises.⁴⁴ The Lehman report estimates that, for 2005, Verizon’s and MCI’s combined share of all services provided to enterprise customers was 22 percent.⁴⁵ The Lehman Report also affirms the Commission’s prior findings that for enterprise services as a whole, as well as for various types of those services, there are multiple competitive providers.⁴⁶

Second, Attachment 3 provides the results of Verizon’s internal analysis of national market share for enterprise customers with respect to the following categories: (1) fast-packet services; (2) Frame Relay services; (3) ATM services; (4) IP-VPN services; and (4) Ethernet Services.⁴⁷ These estimates were calculated by analyzing total enterprise demand for these services nationwide, and then comparing that total to Verizon’s retail revenues for the same services.⁴⁸

This analysis confirms that Verizon is only one of many significant providers of these services, none of whom has anything close to a dominant share. For fast-packet

⁴³ Memorandum Opinion and Order, *Applications of AT&T Wireless Services, Inc. and Cingular Wireless Corporation for Consent To Transfer Control of Licenses and Authorizations*, 19 FCC Rcd 21522, ¶ 185 (2004) (“*AT&T Wireless/Cingular Order*”).

⁴⁴ *See* R. Dale Lynch & Blake Bath, Lehman Brothers, *Enterprise Telecom; A Comeback Begins* at 3 (Nov. 11, 2003) (“*Lehman Report*”); *see also Verizon/MCI Order* ¶ 73 & n.219 (relying on this analyst report).

⁴⁵ *See Lehman Report* at 15, Fig. 12.

⁴⁶ *See id.* at 18, Fig. 16.

⁴⁷ Fast-packet services are made up of ATM and Frame Relay services; IP-VPN and Ethernet are separate. This attachment also contains market-share data for enterprise services as a whole, which indicates that Verizon’s market share (including MCI) is lower than what Lehman reports.

⁴⁸ For a more detailed description of the methodology, *see* Attachment 3 and the Declaration of Jeffrey E. Taylor, Attachment 4 to Verizon’s Public Interest Statement, WC Docket No. 05-75 (filed Mar. 11, 2005).

services (which include Frame Relay and ATM), Verizon's nationwide share is approximately [Begin Confidential] [End Confidential] based on pre-merger shares of [Begin Confidential] [End Confidential] for Verizon and [Begin Confidential] [End Confidential] for MCI. This share is smaller than AT&T's, and there are also multiple other providers, many with double-digit or high-single-digit shares, both for fast-packet services as a whole, and for ATM and Frame Relay individually. For IP-VPN and Gigabit Ethernet services, Verizon's nationwide shares are [Begin Confidential] [End Confidential] and [Begin Confidential] [End Confidential], respectively, which likewise indicates the existence of multiple other competing providers.⁴⁹ Verizon has not been able to perform similar market-share estimates for the optical services at issue here because data for those services is available only combined with data for TDM-based high-speed services, and Verizon is unable to separate the two. In sum, these data show that Verizon is just one of many competitive providers for fast-packet services and very high speed transport services.

Moreover, because the bulk of Verizon's market share for these services derives from the former MCI's customer base, which is spread throughout the country, these data indicate that Verizon's share is not significantly different within its own local footprint than for the nation as a whole. Indeed, with respect to the large national customers that were the core of MCI's enterprise business, the Commission found that, without considering MCI, "Verizon is not one of the top five" providers and that its "share of this market is one percent or less." *Verizon/MCI Order* ¶ 73.

Finally, the Commission relied on and included more granular market share data for ATM and frame relay services in the *Verizon/MCI Order*, and may therefore rely on that same data here. As Verizon explained in that proceeding, however, there are a number of important caveats about using these data as a measure of market share.

The data on which the Commission previously relied are based on third party survey results compiled by Harte-Hanks. Harte-Hanks compiles data from telephone interviews of on-site personnel in IT and telecommunications departments for 500,000 customer sites. These data show the percentage of customer sites at which a carrier is a provider for ATM/Frame Relay, but do not reflect the percentage of surveyed customer sites (or customers) for which a carrier is one provider, regardless of whether there are one or more other providers also serving those sites. These data are presented for each of the twelve states (as well as the District of Columbia) in the former Bell Atlantic/NYNEX territories and six different MSAs in the former GTE territory (Dallas-Fort Worth, Long Angeles-Long Beach, Portland-Vancouver, Raleigh-Durham, Seattle-Tacoma-Olympia, and Tampa-St. Petersburg).

The Harte-Hanks "customer share" data treat all customers as equal and do not differentiate between customers who spend more and those who spend less. The data also

⁴⁹ The market share estimates for IP-VPN and Ethernet are based on more recent data collected by Verizon Business, using the same methodology as used for Fast-packet, ATM, and Frame Relay.

do not distinguish among the different providers of a single customer. For example, large business customers often have more than one provider (*e.g.*, a primary provider and a secondary provider that may function as a backup). The Harte-Hanks “customer share” data count the two providers equally. For these reasons, two providers with equal “customer shares” might have very different shares of revenues and or lines. More generally, the Harte-Hanks data were not designed to create a statistically accurate and significant representation of the universe of providers; Harte-Hanks reports disaggregated data from Verizon, even where the results are not statistically significant.

Nonetheless, to the extent the Commission seeks to rely on the Harte-Hanks data as it did in the *Verizon/MCI Order*, these data provide further confirmation that the degree of competition that Verizon faces warrants forbearance. For example, according to the Harte-Hanks data, the HHI for Frame Relay services in each of the geographic study areas is lower than the HHI with respect to wireline broadband Internet access services and related transport, for which the Commission found that the elimination of Title II common-carriage regulations was appropriate.⁵⁰

The Harte-Hanks data also show that Verizon’s shares for ATM and Frame Relay are below the levels at which the Commission found non-dominant treatment appropriate for AT&T. When the Commission declared AT&T to be non-dominant in the provision of domestic interstate interexchange services, AT&T’s market share of such services was estimated to be sixty percent.⁵¹ Likewise, AT&T’s share of the international message telephone service market was estimated to be sixty percent when AT&T was declared non-dominant in the provision of those services, and in a number of countries, AT&T’s market share was significantly higher.⁵² Indeed, all the share data provided here show levels lower than these precedents.

d. None of the findings in the Verizon/MCI Order undermines the competitive showing here

Finally, the Commission should not have the same concern it expressed in the *Verizon/MCI Order* that Verizon may be the only carrier that has deployed fiber to certain buildings within its region. First, the Commission’s concern in the merger proceeding related only to wholesale providers. *See Verizon/MCI Order* ¶ 32. With respect to retail enterprise services, the Commission recognized that the customers who buy these services already have “myriad” choices and “given their size and geographically-dispersed operations, these customers are highly sophisticated and negotiate for significant discounts.” *Id.* ¶¶ 74, 75. Further, the Commission found that

⁵⁰ *See Wireline Broadband Order* ¶ 51 (noting 60.3 percent share for cable modem and 37.2 percent share for DSL).

⁵¹ *Order, Motion of AT&T Corp. to be Reclassified as a Non-Dominant Carrier*, 11 FCC Rcd 3271, ¶ 62 (1995).

⁵² AT&T’s average market share in 76 select countries was 74%, and AT&T faced no competition at all in four countries. *Order, Motion of AT&T Corp. to be Declared Non-Dominant for International Service*, 11 FCC Rcd 17963, ¶ 40 (1996).

“systems integrators and the use of emerging technologies are likely to make this market more competitive, and that this trend is likely to continue in the future.” *Id.* ¶ 75.

Second, with respect to wholesale services, for broadband services that are provided below the very high speeds of the broadband transmission services at issue here, competing carriers can provide service to all locations either by using their own or third party facilities where they exist, or by leasing TDM-based special access facilities (or high-capacity UNEs, where available) from Verizon and connecting their own packet-switching equipment to those facilities. As noted above, the relief that Verizon seeks does not extend to traditional TDM-based special access facilities. Thus, as the Commission has found, “[i]n buildings where a competitive LEC is not directly connected to a building via its own facilities and where customer demand may not justify the construction of competitive facilities (such as where demand is less than the OCn level), competing carriers can either combine competitive transport with special access loops or, where available, high-capacity loop UNEs purchased from Verizon.” *Verizon/MCI Order* ¶ 41; *see also id.* ¶ 45 & n.125; *Triennial Review Remand Order* ¶¶ 161-163. And as the Commission further acknowledged, there are “numerous competitors” already in the market that are capable of competing in this manner. *Verizon/MCI Order* ¶ 52.

Third, with respect to the very high speed broadband services at issue here, there also should be no concern. Competing carriers can provide such services because there is necessarily sufficient capacity at the location to justify new construction for these high-capacity services. By definition, these services will involve customers purchasing OCn-level capacity. When the Commission has previously looked at OCn-level services in isolation, it has consistently held that they “produce revenue levels” that justify loop construction, “providing the opportunity for competitive LECs to offset the fixed and sunk costs associated with the loop construction.” *Triennial Review Order* ¶ 316; *see Triennial Review Remand Order* ¶ 182 n.493. The Commission observed that “[r]ecord evidence reflects competitive deployment of loops at the OCn level and competitive carriers confirm they are often able to economically deploy these facilities to the large enterprise customers which use them.” *See Triennial Review Order* ¶ 315.

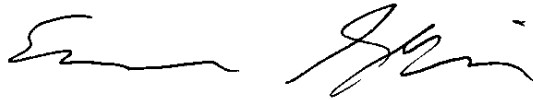
The situation here is accordingly distinct from the one at issue in the Verizon/MCI merger proceeding. There, the Commission was “focuse[d] on special access competition generally,” rather than “on the likelihood of competitive facilities deployment” at any capacity level in particular. *Verizon/MCI Order* ¶ 27 & n.89. As a result, the Commission did not conduct a separate analysis for different capacities of special access services, including OCn-level services. While that may make sense in a merger proceeding where the Commission is trying to gauge the competitive impact to customers whose demand is unknown, here the services at issue are, by definition, only the highest speed services. Thus, the Commission’s conclusions about the likelihood of competitive entry at a building as a general matter “where the capacity demanded is relatively limited” and costs and other barriers could limit deployment – do not apply to the OCn-level services at issue here, for which the Commission has found that competitive supply is not only possible but likely. *Id.* ¶ 39.

* * *

For all the foregoing reasons, the Commission should grant Verizon's petition and provide it with flexibility to offer high-speed packetized and optical broadband services on either a private carriage or common carriage basis so that it can better compete for the business of the sophisticated customers who buy these services.

We would be happy to discuss further the points raised here, and to respond to any questions.

Sincerely,

A handwritten signature in black ink, appearing to read 'Edward Shakin', written in a cursive style.

Edward Shakin

Attachments

REDACTED – FOR PUBLIC INSPECTION

Attachment 1

List of Broadband Services for Which Verizon Is Seeking Forbearance

1. **Frame Relay Service (FRS):** a connection-oriented packet switched data service that allows for the interconnection of Local Area Networks (LAN) or other compatible customer equipment across a wide area for the purpose of interstate access. FRS allows for the transfer of variable length frames (packets).
2. **ATM Cell Relay Service:** a fast-packet, cell-based technology that can support user applications requiring high-bandwidth, high-performance transport and switching. This connectivity is provided via Permanent Virtual Circuits (PVCs) and/or Switched Virtual Circuits (SVCs) that are implemented over access facilities and switches that are dedicated to high-speed telecommunications services.
3. **Internet Protocol – Virtual Private Network (IP-VPN) Service:** a connection-less, packet-based advanced data service that provides connectivity between customer locations. Some uses of IP-VPN Service include enabling business customers to communicate with branch offices, to exchange corporate network traffic, and to establish communication with external partners such as customers, business partners and suppliers.
4. **Transparent LAN Service (TLS):** a high-speed packet-based data service that uses a shared fiber network to allow for the interconnection of Local Area Networks (LANs) across selected metropolitan areas. TLS includes Ethernet TLS (services provided within a LATA) and National TLS (services that allow for interconnection of Ethernet TLS between LATAs).
5. **LAN Extension Service:** service that provides fiber transport connectivity between two customer designated premises, converts an optical signal to an electrical Ethernet signal, and is designed to be connected to the Ethernet switch of the customer. This service transmits packetized traffic.
6. **IntelliLight Broadband Transport (IBT)** (to the extent that the service is not used to provide TDM-based transport): provides high speed synchronous optical fiber-based full duplex data transmission capabilities. IBT is provisioned over the Verizon's shared SONET and WDM networks and provides customers SONET based broadband access transport with the capacities ranging from 152.52 Mbps to 9.953 Gbps.
7. **Custom Connect** (to the extent that the service is not used to provide TDM-based transport): provides high speed synchronous optical fiber-based full duplex data transmission capabilities. Custom Connect is provisioned over the Verizon's

- shared SONET and WDM networks and provides customers SONET based broadband access transport with the capacities ranging from 152.52 Mbps to 9.953 Gbps.
8. ***Verizon Optical Networking***: an Ethernet over SONET technology, providing managed optical transport of data signals of various speeds. The service provides a dedicated path through the network with a guaranteed amount of throughput. Verizon Optical Networking provides a native Ethernet interface at the end user premise.
 9. ***Optical Hubbing Service (OHS)***: provides a dedicated high capacity optical facility for the transmission of up to eight (8) optical connections between a customer's designated premises and an optical hub. An optical hub is a Verizon wire center assigned to OHS where optical connections to OHS occur. The service utilizes high capacity optical facilities configured in a ring architecture or topology that provides survivability. The product includes the option for customers to interface to OHS with a native Ethernet handoff.
 10. ***IntelliLight Optical Transport Service (IOTS)***: uses dense division multiplexing (DWDM) and provides managed optical transport of multiple protocols that are transmitted over a single fiber optic pair. IOTS is configured in a diversely routed ring architecture or topology and can be arranged as a full (closed) ring or as a partial ring. The ring architecture allows for point-to-point optical services of varying bandwidths to be multiplexed on or off of the ring. IOTS allows for the native transmission of multiple high-speed protocols, such as Ethernet, SAN and SONET, with various bandwidths over a single customized network. The wavelengths are arranged in a channelized format such that the protocol transmitted over each channel is independent of every other channel on the IOTS ring.

November 11, 2003

United States of America
Telecommunications
Enterprise Telecom Services

Enterprise Telecom Services

Initiation of Coverage

Enterprise Telecom; A Comeback Begins

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Sector View:

New: 2-Neutral

Old: 2-Neutral

Investment conclusion

□ We initiate coverage of Enterprise Telecom Services and are optimistic regarding the industry's financial and operational streamlining, the consolidation that has occurred to date (and more to come), and cautiously optimistic regarding improving demand and pricing over the next year.

Summary

- We expect a cyclical up-tick, improving operational efficiencies, and industry consolidation to drive stabilizing revenues, improving margins and 10% EBITDA growth in 2004 for the commercial units of our covered Enterprise Carriers.
- We favor Carriers with greater high-end Enterprise exposure, particularly wholesale, and less SME. While competition remains intense across Enterprise telecom, we believe it is poised to improve in 2004 within the wholesale segment, while it is likely to intensify within SME.
- We believe the supply/demand imbalance has finally begun to stabilize. On the supply side, due to recent consolidation and selected bidder-ineligibility among the financially weaker carriers, we believe the bidding-group on a given contract has been reduced by almost 50% from '01's 8-10 bidders. On the demand side, we are seeing the early signs of improvement in key employment, technology sales (chips), and a proprietary Lehman Brothers Fortune 500 Survey.
- Enterprise coverage group valuations hover near 10-year lows - LVLT is our top recovery pick, while T is our best value pick.

Enterprise Telecom Services Launch:

We initiate specialized coverage of the Enterprise Telecom Services sub-sector of the US Wireline Telecom Services market, with an emphasis on carriers specializing in the high-end of the market (Wholesale/Large Enterprise), companies designated as "Enterprise Carriers". We are optimistic regarding the industry's financial and operational streamlining, outlook for 2004 revenue stabilization, margin improvement and EBITDA growth, the consolidation that has occurred to date (and much more to come), and cautiously optimistic regarding improving demand and pricing over the next year. *Please see our companion notes on AT&T, Sprint (FON), and Level (3) for company-specific information, as well as our forthcoming industry report (under the same title as this note) and company reports for extensive details developing the themes outlined in this note. We will be hosting an investor call today at 10:30 a.m. EST; the dial-in numbers: (800) 706-8249 (US), (706) 634-5881 (Intl), and 0(800) 953-0406 (UK toll-free), and the conference ID is 3972920.*

Figure 1: Enterprise Telecom Services Coverage Universe

Company Rating, Target & Enterprise Value						
Company	Ticker	Price	LEH Rating	Price Target	Enterprise Value \$B	Investment Thesis Synopsis
AT&T	T	\$19.08	1-OW	\$24	\$23.5	Dominant Large Enterprise Carrier; Good value & further margin improvement likely; Divs & FCF provide strong value support
Level 3	LVLT	\$5.33	1-OW	\$7	\$8.1	A wholesale leader & consolidator; Strong Gwth opps & dilution manageable; No liq. issues
MCI	MCIAV (when issued)	\$25.26	NR		\$11.7	Restructuring opportunity, with growth upside, but a lot to prove; await audited financials
Sprint	FON	\$15.22	2-EW	\$18	\$13.8	Local business supports FON-Commercial, gwth limited; Strong value support at \$16

PLEASE SEE ANALYST(S) CERTIFICATION(S) ON PAGE 32 AND IMPORTANT DISCLOSURES BEGINNING ON PAGE 33

Investment Thesis: Enterprise Telecom; A Comeback Begins

- We expect a cyclical up-tick, improved operational/financial efficiencies, and industry consolidation to drive stabilizing revenues, materially improved margins and 10% EBITDA growth in 2004 for the commercial units of the Enterprise Carriers in our coverage group. These factors are expected to drive increasing cashflows to equity holders via dividend increases, share buybacks, and operating free cashflow.
- In general, we favor Carriers with greater exposure to the high-end of Enterprise telecom, particularly Wholesale, and less exposure to SME. While competition is intense across the sector, we believe it is poised to improve in 2004 within the Wholesale market, while it is likely to intensify within SME, as the RBOCs aggressively attack that market. We believe Wholesale/Large Enterprise revenue comparisons and margins will improve throughout 2004, while SME revenues and margins remain weak.
- We believe that the supply/demand imbalance has finally begun to stabilize – on the supply side, we estimate that North American fiber route miles could be reduced by up to 30% within 1-2 years (already about 11% reduced) – on the demand side, we are seeing early signs of improvement in commercial bandwidth requirements (our Enterprise Demand Index and Fortune 500 Survey).
- Enterprise coverage group valuations hover near 10-year lows, as investor sentiment remains uniformly abysmal. High-end carriers with the most efficient networks and improving sequential revenues and margins offer compelling cyclical/recovery investments – Level (3) is our top pick in this regard – while AT&T is our best value pick.

Enterprise Carrier – Coverage Group Highlights:

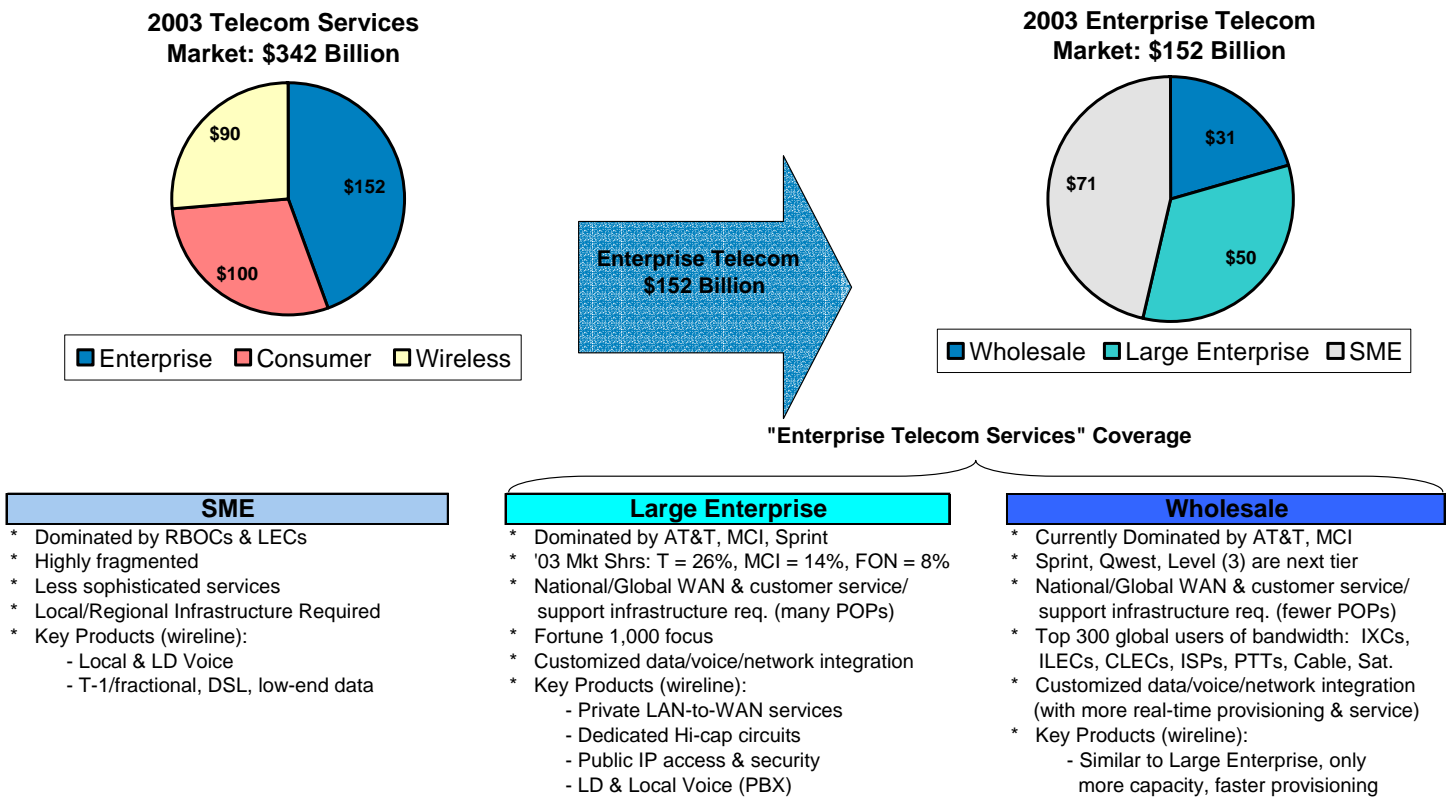
Within our Enterprise Telecom Services coverage universe, we include telecom carriers that derive more than 50% of their total revenues from commercial users, with an emphasis on carriers that specialize in service delivery to Large Enterprises (Fortune 1,000 enterprises) and Wholesale users. This includes the following coverage stocks:

- AT&T (1-OW, PT=\$24): Assumption of coverage with ratings and price target increases from 2-EW and \$22 respectively. AT&T is our top value pick in the group as it trades at a low 3.0x '04 EBITDA, has a 5% dividend yield and a massive \$3.5 billion in expected '04 FCF. We believe BS margins will expand 100 bps in '04, improving BS EBITDA growth to 1% (up from -12% in 2003). While consolidated revenues and EBITDA will still decline in '04, the CS drag is not as much as originally expected. Combined, these factors are driving a greater discounted value of cashflows, driving our upgrade on the stock. Likely further dividend increases or share buybacks in the next few months should also support the stock.
- Level (3) (1-OW, PT=\$7): Initiation of coverage as our top pick in the sector, given its pure-play Wholesale position, operating momentum, liquidity, and improving balance sheet. The company is experiencing sequential revenue growth and delivered 380 bps in sequential Communications EBITDA margin improvement in 3Q. We expect Communications revenues to grow 9% in '04, while EBITDA should grow 29%. Leverage and dilution are less of an issue as the company is FCF-positive, has no material debt maturities until '08, is more modestly 55% debt-to-enterprise value leveraged and no convertible strike prices until \$7.18.
- Sprint-FON (2-EW, PT=\$18): Assumption of joint coverage with its rating maintained at 2-EW, but an increased \$18 price target (up from \$14). We expect FON to cut costs aggressively in '04, which should drive 3% EBITDA growth, despite nearly 3% revenue declines. By 2006 we expect EBITDA margins to expand by more than 400 bps, driving our increased price target. Company has strong value support at \$16, an implied \$1,800 per local access line valuation, and a healthy balance sheet. Revenue growth will remain challenging, however, driving our maintained 2-EW rating.
- MCI (Not Rated): We are initiating coverage on the when-issued equity of MCI Communications, but await audited financials, more insight from management, and an exchange--traded equity before issuing a rating and price target. Operationally, we believe the company has significant upside opportunities, as highlighted in the company's bankruptcy disclosure documents, but also a lot to prove. Facilitating this opportunity is the company's increased financial flexibility, resulting from its restructured and lean balance sheet (approximately \$3.5 billion in net debt).

Enterprise Telecom Services – Defining the Industry:

In evaluating the overall Enterprise Telecom Services market, we include all the assets, financing, revenues and cashflows associated with the units servicing commercial customers. We have constructed our industry compilation using both bottom-up and top-down methodologies, factoring in data from internal sources, company feedback and FCC reports. Importantly, although we include all relevant information from any carrier selling commercial services in our industry compilation, we specifically define “Enterprise Carriers” within this report as carriers that specialize in service delivery to Large Enterprise and Wholesale customers and that receive more than 50% of their revenues from commercial clients. Therefore, the primary Enterprise Carrier segment is comprised of the incumbent IXC group (AT&T, MCI, Sprint), the emerging Network Carriers (Level (3) and its competitors), and the remaining CLECs. We estimate that the broad Enterprise market totals \$152 billion in 2003 revenue, or approximately 45% of the total telecom services market and 60% of the wireline services market. Within Enterprise, we estimate that \$31 billion is Wholesale (20% of Enterprise), \$50 billion is Large Enterprise (33%), and \$71 billion is SME (47%). Our research effort will focus on the Wholesale and Large Enterprise segments, where the Enterprise Carriers are best positioned to create long-term shareholder value. We outline the Enterprise market below.

Figure 22: Enterprise Telecom Services – A Massive Market with Distinct Segments



Expected Enterprise Carrier Improvements:

We expect a cyclical up-tick, significant operational/financial improvements, and industry consolidation to drive stabilizing revenues, materially improved margins and 10% EBITDA growth in 2004 for the commercial units of the Enterprise Carriers in our coverage group. These factors are expected to drive increasing cashflows to equity holders via dividend increases, share buybacks, and growing operating free cashflow (OFCF).

- A modest cyclical up-tick, led by estimated 5% growth in 2004 Fortune 500 telecom service budgets (versus 5% declines in 2003), is expected to stabilize 2004 revenues for our Enterprise Carrier coverage group commercial revenues at -1% (versus -6% in 2003).
- A 25% reduction in headcount from 2000 to current has driven an 18% improvement in productivity per employee. Combined with the benefits of other massive network and systems cost/efficiency initiatives, we expect Enterprise Carriers to improve 2004 EBITDA margins 220 bps and grow EBITDA 10%.
- Industry consolidation, and bidding-ineligibility by weaker players, has reduced the number of bidders per contract from 8-10 in 2001 to 4-6 today. We expect increased financial slack resulting from reduced leverage to help drive ongoing consolidation of weaker, cashflow-negative carriers. Industry debt is down 58% from 2001 to 2003 (\$224 billion to \$95 billion) and debt/EBITDA has declined from 6.8x to 3.1x.

Figure 3: Expected 2004 & 2005 Enterprise Carrier Improvements

	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>2003f</u>	<u>2004f</u>	<u>2005f</u>
<u>Enterprise Industry:</u>						
Revenue Growth	13.7%	1.6%	-7.0%	-4.7%	2.1%	4.6%
bp Change		-1210 bp	-860 bp	230 bp	680 bp	250 bp
# of Bidders per Contract	8-10	8-10	8-10	4-6	3-5	3-4
<u>Enterprise Carrier Coverage Group: Commercial Metrics</u>						
Revenue Growth	6.4%	0.6%	-6.1%	-6.3%	-0.6%	3.6%
bp Change		-580 bp	-670 bp	-20 bp	570 bp	420 bp
Headcount (000)	164	150	129	123	123	123
% Change		-8.8%	-13.8%	-4.9%	0.0%	0.0%
Rev. Productivity/Employee (\$ 000)	\$382	\$421	\$459	\$452	\$449	\$466
% Change		10.3%	9.0%	-1.6%	-0.6%	3.6%
EBITDA Margins	30.1%	25.0%	23.8%	21.2%	23.4%	25.5%
bp Change		-510 bp	-120 bp	-260 bp	220 bp	210 bp
OFCF (\$ bil)	(\$9.8)	(\$11.2)	\$6.2	\$6.2	\$4.6	\$5.2
Leverage (Consolidated Debt/EBITDA)	5.6x	6.8x	3.8x	3.1x	2.7x	2.4x

Favor Exposure to High-End Enterprise:

In general, we favor Enterprise Carriers with greater exposure to the high-end of Enterprise telecom and Wholesale, and less exposure to SME. While competition is intense across the Enterprise market, we believe it is poised to improve in 2004 within the Wholesale market, while it is likely to intensify within SME for Enterprise Carriers, driven by the RBOCs. Early signs of this were evident in Enterprise Carrier 3Q03 earnings reports, as renewed point-of-sale long distance and low-speed private line price declines added a discernable drag to revenues.

- The operational and financial improvements expected for 2004 should flow most directly to the high-end of the Enterprise market, due largely to the core nature of the improvements and to the improving competitive landscape within those segments.
- The 2004 growth and margin outlook is better for Enterprise Carriers within the Wholesale segment, driven ironically by increasing competition within the SME and Consumer market segments by traditional and non-traditional carriers that lack a national backbone and rely on wholesalers to provide the wide area networking.
- Despite the much publicized hyper-competition within the Wholesale market, we believe this segment is the one best positioned to see improving competitive dynamics in 2004, as the number of competitors and network miles are expected to decline.
- While SME has better margins and good long-term growth, to the incumbent Enterprise Carriers it represents the segment expected to most intensify competitively in 2004, as competitive threats emerge from well-funded and aggressive RBOCs. SME revenues are expected to cause 100 bps drags to commercial revenue growth for AT&T and MCI in 2004.
- The following table highlights that AT&T and MCI have the largest long distance SME exposure, while Sprint has materially less and Level (3) has none. Of note, Level (3) derives 100% of its revenues from the portion of the market we expect to perform the best in 2004 (Wholesale).

Figure 4: Enterprise Carrier SME Exposure

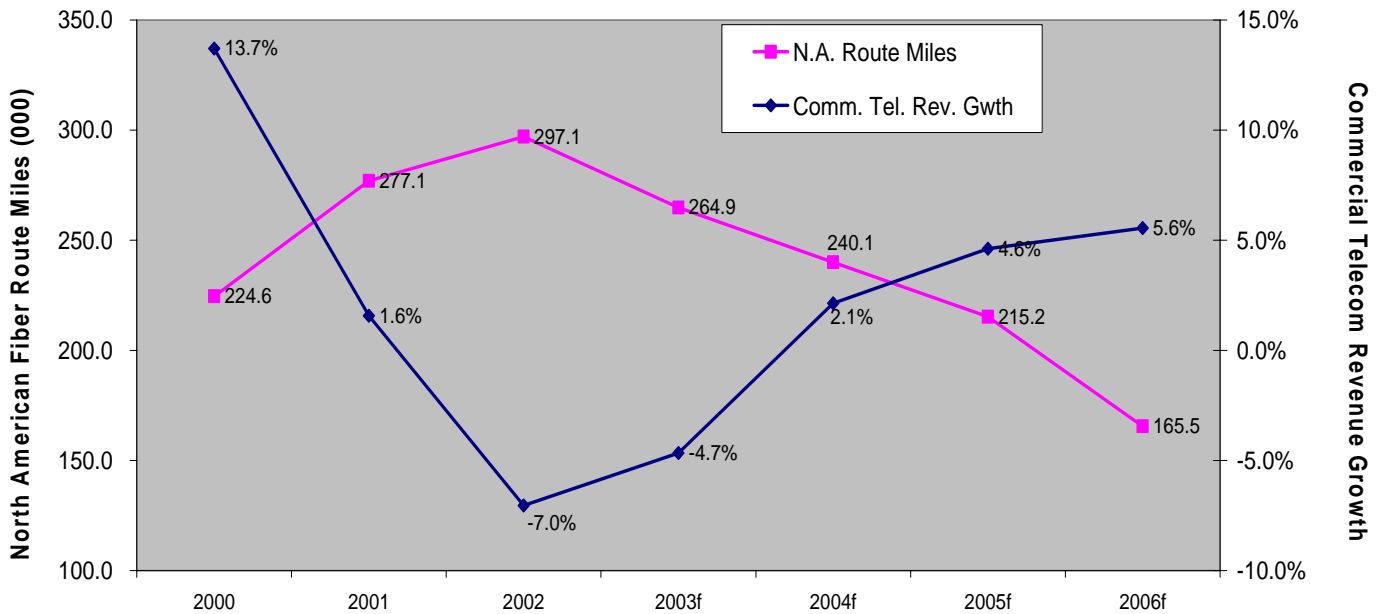
<u>Enterprise Carrier</u>	SME		High-End		
	<u>LD SME</u>	<u>I LEC SME</u>	<u>Total High-End</u>	<u>Wholesale</u>	<u>Large-Enterprise</u>
AT&T Bus. Serv.	24%	0%	76%	24%	52%
MCI Commercial	28%	0%	72%	33%	39%
FON-Commercial	14%	23%	62%	22%	41%
<u>Level (3)</u>	0%	<u>0%</u>	<u>100%</u>	<u>100%</u>	<u>0%</u>
Enterprise Carrier Avg.	23%	2%	75%	30%	45%

Improving Supply/Demand Balance:

We believe that the supply/demand imbalance that has plagued the industry has finally begun to stabilize. On the supply side, we estimate that North American fiber route miles could be reduced by a cumulative 30% within 1-2 years (already about 11% reduced). Additionally, the number of bidders per contract has fallen from 8-10 in 2001 to 4-6 today (and likely 3-5 by 2004). On the demand side, we are seeing the early signs that commercial bandwidth requirements are beginning to improve, as indicated by our Enterprise Demand Index improvements and our Fortune 500 Survey. Currently, we are forecasting a modest recovery, but if job growth and technology sales continue accelerating at current rates there could be upside to our numbers.

- To date, one US-based network carrier has been consolidated and its network decommissioned (Genuity), and a European carrier is scaling back its US operations.
- Another two carriers will likely consolidate within 1-2 years, as they remain cash-flow-negative and have limited access to capital .
- Enterprise telecom is a cyclical business – we believe we have found two reliable leading indicators in terms of forecasting changes in commercial telecom services revenue growth, namely employment growth and semi-conductor revenue growth, and constructed an Enterprise Demand Index (EDI).
- Our EDI score of 0.5 signals an expected moderate improvement to current 4% Enterprise telecom service revenue declines (to begin by 2Q04), while our Fortune 500 Survey indicates an expected 5% increase in 2004 telecom service spending, up from -5% in 2003.

Figure 5: Decreasing Fiber Route Miles Supports Improving Enterprise Telecom Services Industry Revenue Growth

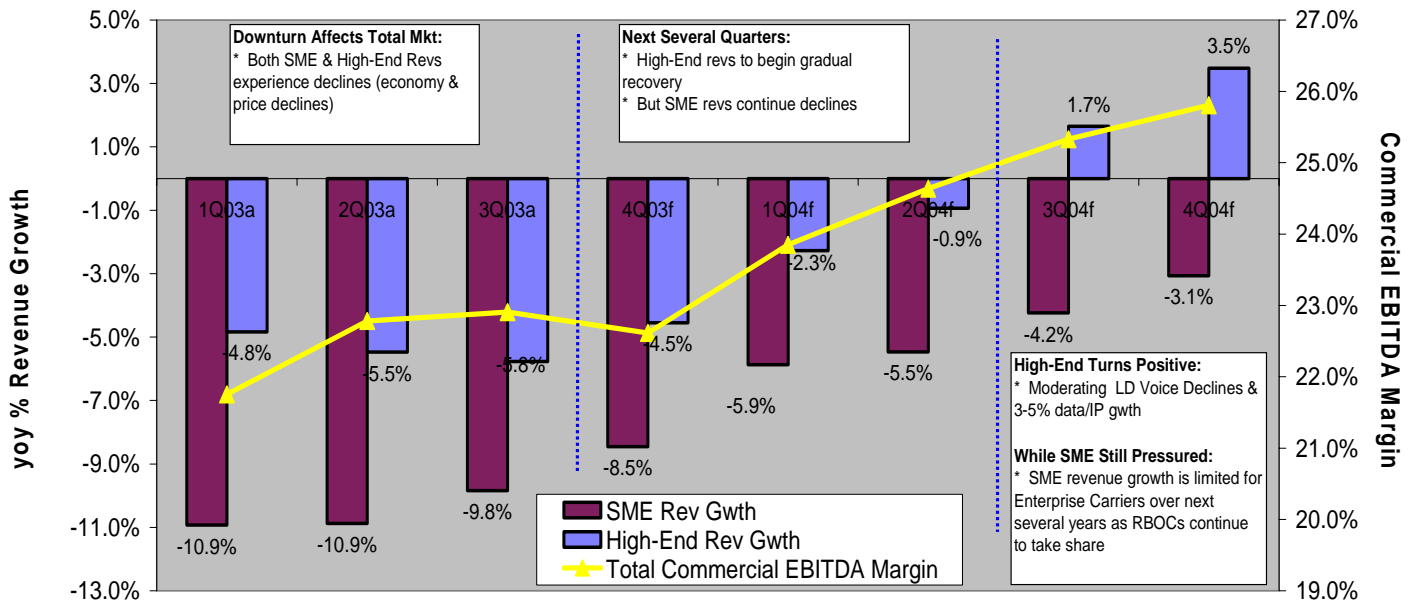


Diverging 2004 Performance – High-End Turning the Corner

While overall revenues for our Enterprise Carrier coverage group are expected to decline 1% in 2004, this masks two diverging trends that we expect to develop throughout the year – improving quarterly Wholesale/Large Enterprise revenue growth and margins versus continued SME revenue declines and pressured margins.

- Expected 1% declines in 2004 Enterprise Carrier revenue masks important underlying trends that favor the high-end of the market, namely improving revenue growth and margins, driven by improving demand and cost reduction initiatives.
- We expect Wholesale/Large Enterprise revenue growth will see improving quarterly yoy growth rates, driven by improving competitive dynamics, better pricing stability and key growth-product opportunities (VoIP and MPLS-enabled LAN-to-WAN services). By 4Q04, we expect high-end revenues will be growing 3.5% yoy for our Enterprise Carriers, while SME is still expected to be declining 3.1%.
- While VoIP does not represent a net growth opportunity to the incumbent market, it does represent a material Wholesale opportunity given that the retail providers of this new service mostly lack a national backbone and will rely on wholesalers.
- Additionally, MPLS-enabled services marketed to enterprises, by RBOCs in particular, provide another such Wholesale growth opportunity .
- We expect Wholesale/Large Enterprise to benefit most from cost-reduction initiatives. Since most of these center around the network core and related systems, the benefits should flow mostly to services that most intensively utilize the core.

Figure 6: Diverging 2004 Performance within Enterprise – High-End Versus SME



Valuations at 10-Year Lows – Provides Targeted Opportunities:

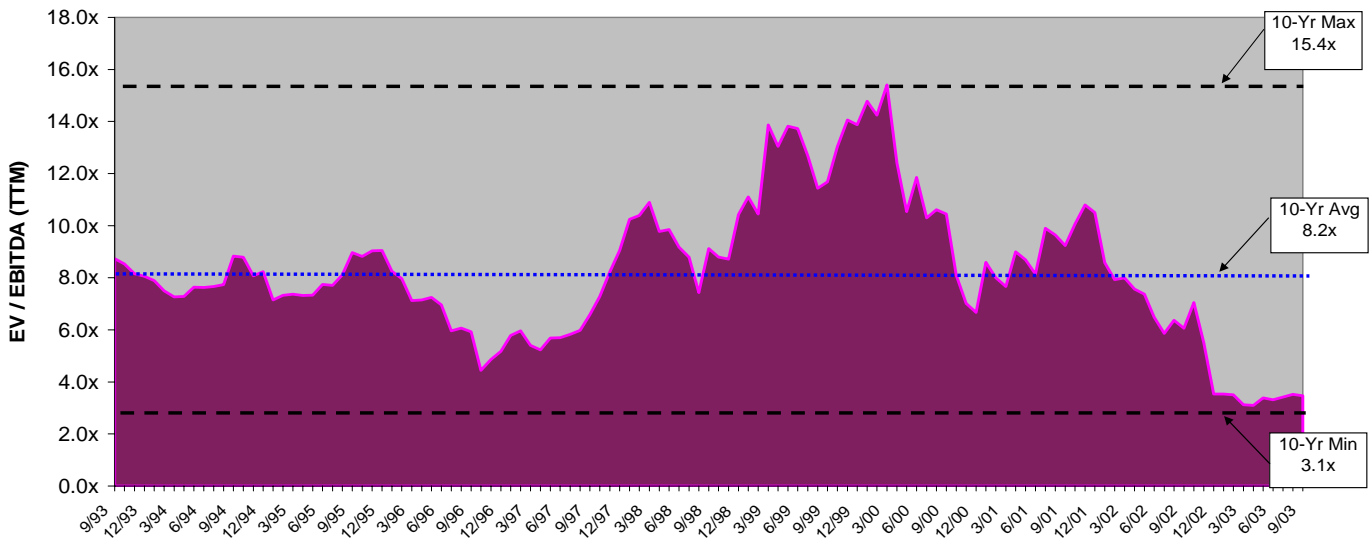
Enterprise coverage group valuations hover near 10-year lows, creating investment opportunities as the entire sector remains tarred with a broad brush. High-end carriers with the most efficient networks and improving sequential revenues and margins, and less exposure to SME, offer investors the chance to buy at a market-bottom values that do not yet reflect their improving underlying fundamentals.

- Level (3) is our top pick in the space, with its Wholesale pure-play model, its industry leading margins (that continue to improve sharply, up 380 bps in 3Q), its FCF-positive status and improving balance sheet. It is most clearly positioned to benefit from the improvements we expect in the Enterprise market in 2004. We believe the bear case valuation is \$6 and buy aggressively below this level.

- AT&T, while exposed to SME, is our top value pick, given its dominant position within Large Enterprise, improving margins, and very cheap valuation at 3.0x 2004 EBITDA. While revenue and EBITDA growth will remain pressured due to Consumer/SME drags, we believe the discounted value of cashflows is worth more than current market prices. A 5%+ dividend yield and potential for additional dividend increases and/or share buybacks should provide strong support for the stock.

- MCI offers strong potential upside, given its vast opportunity for margin improvement. Based on the current when-issued trading levels, the company is trading modestly above AT&T, at 3.4x 2004 EBITDA. We await audited financials and more insight from management in order to fully develop our thesis.

Figure 7: Enterprise Carrier Coverage Group's Valuation Hovering at 10-Yr Lows – EV / EBITDA Multiple



Valuations – Enterprise Carriers Low Vs. Rest-of-Telecom:

We believe that the operating environment is beginning to improve for the carriers within our Enterprise coverage group and that valuations do not yet reflect this, providing an opportunity for patient investors to enjoy a favorable risk/return relationship.

- Fortunately, cycles proceed. We believe valuations and multiples are poised to expand as operational and financial improvements have positioned the stronger Enterprise carriers to benefit in a leveraged fashion from improvements in the commercial economy.
- This process of value-expansion should be greatly enhanced by industry consolidation, which we believe is ripe to occur and should be seen as a catalyst for valuation appreciation in the sector. Other catalysts will be continued improvements in employment and technology and productivity increases (with semiconductor chip sales being a reasonable proxy).
- The following table summarizes our new Enterprise Carrier sector in relation to the other telecom service sector stocks covered by Lehman Brothers. The Enterprise group stands out as the having the lowest market valuation, at 3.5x EBITDA versus the next-nearest group (the RBOCs) at 4.8x. To highlight the disparity, we estimate that Enterprise Carriers comprise 25% of Lehman Telecom Services coverage revenue, and 17% of EBITDA, but only 12% of the market capitalization. Given that we believe fundamentals are poised to improve, we believe the sector has good value at these levels.

Figure 8: Enterprise Carrier Valuation Low Relative to Lehman Telecom Services Coverage Universe

	RBOCs	National Wireless	RLECs	Enterprise Tel.	Small Wireless
	BellSouth Qwest SBC Communications Verizon	AT&T Wireless Nextel Sprint PCS	Alltel Century Tel. Commonwealth Tel. Citizens Comm. US Cellular TDS	AT&T MCI Sprint Level (3)	
\$ Bil					
2003 Revs	\$161	\$37	\$16	\$73	\$9
% of LEH-Cvg	54%	12%	5%	25%	3%
2003 EBITDA	\$61	\$12	\$7	\$16	\$3
% of LEH-Cvg	61%	12%	7%	17%	3%
Market Cap	\$225	\$46	\$27	\$42	\$15
% of LEH-Cvg	63%	13%	8%	12%	4%
EV/EBITDA	4.8x	6.6x	6.6x	3.5x	11.8x

Price Target Methodologies:

FON: Our new \$18 price target is based on an average of DCF and EV/EBITDA multiple, versus expected growth methodologies, and implies a modest multiple expansion to 3.6x 2004 EBITDA, still low versus historical averages.

T: We value AT&T shares based on DCF and EV/EBITDA multiples relative to growth. Based on these metrics, we find strong price support levels for AT&T at \$19 per share, based on the EV/EBITDA multiple versus growth method, with a higher DCF-value, at \$32 per share. Our \$24 price target represents a weighted average of DCF and EV/EBITDA multiple methods, with a \$2 per share haircut to account for variability in valuation driven by different CS assumptions in the out years.

LVL: Our DCF valuation results in a \$7 per-share price target, using a 10.3% WACC and a 4.5% terminal growth assumption. We believe the bear case downside is \$6 per share and the bull case upside is \$8 per share. Our target is based on the assumption that management does not issue significant incremental equity in the near term.

Enterprise Carrier Coverage Group – Improving Commercial Outlook:

We expect a cyclical up-tick, significant operational/financial improvements, and industry consolidation to drive stabilizing revenues, materially improved margins and 10% EBITDA growth in 2004 for the commercial arms of the Enterprise Carriers in our coverage group. These factors are expected to drive increasing cashflows to equity holders via dividend increases, share buybacks, and growing OFCF.

- Estimated 5% growth in 2004 Fortune 500 telecom service budgets (versus 5% declines in 2003) is expected to stabilize 2004 commercial revenues for our Enterprise Carrier coverage group at -1% (versus -6% in 2003). We expect 2005 Enterprise Carrier commercial revenues to grow nearly 4%, and long-term average annual growth of 4%.
- Enterprise Carriers have significantly pared cash operating expenses and are poised to reap meaningful returns as the commercial economy improves. A 25% reduction in headcount from 2000 to current has driven an 18% improvement in productivity per employee. Combined with the benefits of other massive network and systems cost/efficiency initiatives, we expect Enterprise Carriers to improve 2004 commercial EBITDA margins 220 bps and grow commercial EBITDA 10%.
- We expected continued strong margin gains in 2005, at +210 bps, driving expected EBITDA growth of nearly 13%. Between now and 2010, we expect commercial EBITDA will grow at an average annual rate of nearly 9%.
- Capex has also been reigned in and targeted on core efficiency upgrades and success-based spending. We expect it to normalize at 8-10% of revenues, enabling healthy 3-4% commercial OFCF growth rates from 2003 to 2010.

Figure 9: Enterprise Carrier Coverage Group: Improving Commercial Outlook

(\$ Bil)	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004f</u>	<u>2005f</u>	'03 to '10 <u>CAGR</u>
Revenue	\$62.7	\$63.0	\$59.2	\$55.4	\$55.1	\$57.1	3.6%
% Growth	6.4%	0.6%	-6.1%	-6.3%	-0.6%	3.6%	
Opex	\$43.8	\$47.3	\$45.1	\$43.7	\$42.2	\$42.6	1.9%
% Growth	8.0%	8.0%	-4.5%	-3.2%	-3.4%	0.9%	
EBITDA	\$18.9	\$15.8	\$14.1	\$11.8	\$12.9	\$14.5	8.5%
% Growth	20.8%	-16.5%	-10.7%	-16.4%	9.8%	12.6%	
Margin	30.1%	25.0%	23.8%	21.2%	23.4%	25.5%	
Capex	\$22.2	\$17.6	\$6.5	\$5.3	\$5.8	\$6.1	5.9%
% Growth	19.1%	-20.8%	-62.9%	-18.8%	9.8%	4.5%	
% of Rev	35.5%	27.9%	11.0%	9.6%	10.6%	10.6%	
OCF⁽¹⁾	(\$9.8)	(\$11.2)	\$6.2	\$6.2	\$4.6	\$5.2	3.3%
% Growth	16.0%	13.9%	-155.6%	-0.6%	-26.6%	14.9%	
Margin	-15.7%	-17.8%	10.5%	11.2%	8.3%	9.2%	
Commercial Telecom Employees (000s)	164.1	149.6	129.0	122.7	122.7	122.7	n/m

(1) Operating Free Cash Flow is defined as CFFO - capex.

Enterprise Telecom Services Comparables:

Figure 10: Enterprise Comps

Company & Enterprise Value														
Stock Information				Enterprise Value					Investor Returns					
Company	Ticker	Price	Shares Out	Mkt.Cap	Net Debt	Non-Con. Assets	Enter. Value	Book Equity	Current Yields	Stock Performance: % Return				
									Div Yld	ROA	Week	Month	YTD	
AT&T ⁽¹⁾	T	\$19.08	789	15.1	8.5	0.0	23.6	13.6	5.0%	7.6%	1%	-5%	-27%	
T Bus. Serv. ⁽²⁾										4.6%				
MCI ⁽¹⁾	MCAIV	\$25.26	326	8.2	3.4	0.0	11.7	8.4	0.0%	6.5%	1%	-5%	-27%	
MCI Comm. ⁽²⁾										3.6%				
Sprint ⁽¹⁾	FON	\$15.22	903	13.7	0.0	0.0	13.8	13.3	3.3%	8.7%	-6%	-3%	5%	
FON Comm. ⁽²⁾										4.2%				
Level 3 ⁽¹⁾	LVLT	\$5.33	653	3.5	4.5	0.0	8.0	0.3	0.0%	-1.9%	-4%	-1%	9%	
L3 Comm. ⁽³⁾										-5.1%				
XO Comm.	XOCM	\$5.30	95	0.5	0.2	0.0	0.7	0.5	0.0%	-6.6%	-2%	-1%	N/A	
Time Warner	TWTC	\$10.16	115	1.2	0.8	0.0	2.0	0.5	0.0%	-1.8%	-7%	-13%	382%	
Enterprise Avg. (Largecap for Div & ROA)									2.8%	4.2%	-3%	-5%	68%	
S&P 500 Avg.											-1%	1%	19%	

Operating Statistics													
Stock Information		Revenue				EBITDA				EPS			
Company	LEH Rating	2003		2004		2003		2004		2003		2004	
		\$ Bil	% Gwth	\$ Bil	% Gwth	\$ Bil	Margin	\$ Bil	Margin	\$	% Gwth	\$	% Gwth
AT&T ⁽¹⁾	1-OW	34.7	-8.1%	32.9	-5.4%	8.7	25.1%	7.9	24.0%	\$2.28	-17.2%	\$1.73	-24.3%
T Bus. Serv. ⁽²⁾		25.2	-5.3%	24.5	-2.5%	6.8	26.9%	6.8	27.9%				
MCI ⁽¹⁾	NR	24.5	-16.3%	24.0	-1.7%	2.7	11.2%	3.4	14.3%	N/A	N/A	\$2.76	N/A
MCI Comm. ⁽²⁾		18.2	-11.4%	18.3	0.8%	2.0	11.2%	2.8	15.4%				
Sprint ⁽¹⁾	2-EW	14.1	-7.0%	13.8	-2.6%	4.4	31.1%	4.5	32.9%	\$1.45	7.5%	\$1.55	6.4%
FON Comm. ⁽²⁾		9.3	-5.6%	9.3	-0.6%	2.5	26.8%	2.7	28.5%				
Level 3 ⁽¹⁾	1-OW	3.6	26.6%	3.6	-1.2%	0.4	12.1%	0.6	16.4%	(\$1.18)	N/M	(\$0.98)	N/M
L3 Comm. ⁽³⁾		1.6	2.9%	1.8	9.0%	0.4	27.3%	0.6	32.2%				
XO Comm.		1.2	-7.2%	1.2	6.7%	0.0	1.1%	0.0	1.8%	(\$1.28)	N/M	(\$1.08)	N/M
Time Warner		0.7	-7.0%	N/A	N/A	0.2	28.6%	N/A	N/A	(\$1.06)	N/M	(\$0.89)	N/M
Enterprise Ind.		151.6	-4.7%	154.8	2.1%	31.0	20.4%	32.9	21.3%				

Valuation Multiples & Capital Structure												
Stock Information		EV / Revenue		EV / EBITDA		EV / OFCF		P/E Ratio		Leverage Ratios		Coverage Ratios
Company	Price Target	2003	2004	2003	2004	2003	2004	2003	2004	Nt Debt / Capital	Nt Debt / '04 EBITDA	Unlev. '04 OFCF / Int.
AT&T ⁽¹⁾	\$24	0.7x	0.7x	2.7x	3.0x	4.0x	6.9x	8.4x	11.1x	38.5%	1.1x	4.6x
T Bus. Serv. ⁽²⁾		0.9x	1.0x	3.5x	3.4x	5.6x	8.4x					
MCI ⁽¹⁾	NR	0.5x	0.5x	4.3x	3.4x	5.3x	11.5x	N/A	9.2x	29.0%	1.0x	3.4x
MCI Comm. ⁽²⁾		0.6x	0.6x	5.7x	4.1x	5.3x	11.5x					
Sprint ⁽¹⁾	\$18	1.0x	1.0x	3.1x	3.0x	8.0x	6.9x	10.5x	9.8x	0.2%	0.0x	9.0x
FON Comm. ⁽²⁾		1.5x	1.5x	5.5x	5.2x	12.8x	11.5x					
Level 3 ⁽¹⁾	\$7	2.2x	2.2x	18.2x	13.6x	N/A	115.1x	N/A	N/A	93.1%	7.7x	1.1x
L3 Comm. ⁽³⁾		5.0x	4.5x	18.1x	14.1x							
XO Comm.		0.6x	0.5x	53.2x	30.0x	N/A	N/A	N/A	N/A	23.3%	7.4x	No Cash Int.
Time Warner		2.8x	N/A	9.8x	N/A	N/A	N/A	N/A	N/A	61.5%	N/A	N/A
Enterprise Avg. (Largecap)		0.7x	0.7x	3.4x	3.1x	5.8x	8.5x	9.4x	10.0x	22.6%	0.7x	5.7x
S&P 500 Avg.												

(1) Represents consolidated, total company information (for Level 3, reflects recurring items only - excludes any dark fiber, settlement & termination)

(2) Reflects operating statistics for the commercial portion of the company; valuation statistics reflect total company market valuation as a multiple of the commercial operating unit's cashflows.

(3) Reflects recurring Communications Group items only

MCI Company Report on When-Issued Equity:

We are initiating coverage on the when-issued equity of MCI Communications, but await audited financials, more insight from management, and an exchange-traded equity before issuing a rating and price target. Operationally, we believe the company has significant upside opportunities, as highlighted in the company's bankruptcy disclosure documents, but also a lot to prove. Facilitating this opportunity is the company's increased financial flexibility, resulting from its restructured and lean balance sheet. We include our full company report within this industry report since MCI does not yet have an eligible ticker under which to publish research for its new equity. The most important contributor to MCI's value proposition over the next 12 months should be its ability to shed costs while at least stemming market share losses. It is undertaking a massive network and infrastructure overhaul in order to drive more than 500 bps of margin improvement by 2005. We believe these efforts, assuming disciplined pricing, will be successful in driving significant EBITDA improvements over the next two years. If continuing margin improvement can be sustained, driving margins toward industry levels, EBITDA growth could easily exceed 15% annually, materially outperforming the sector. However, we await audited financials and more insight from management in order to fully develop our view on the stock.

Investment Thesis:

- **2004 Outlook:** We believe MCI margins will expand 300 bps in 2004, improving EBITDA growth to positive 26% (up from an estimated 46% decline in 2003), despite forecasted 1.7% revenue declines (improved from a 16.0% decline in 2003). OCF is estimated to be \$1.1 billion in 2004.
- **Productivity & Efficiency:** MCI currently lags the Enterprise industry in most operational metrics, but particularly in EBITDA per employee. At a 2004 forecast of \$68k EBITDA/employee, MCI lags the Enterprise industry average of \$105k by 35% and the AT&T level of \$141k by more than 50%. This is largely due to a redundant cost structure, accumulated through multiple acquisitions and a lack of infrastructure grooming. However, management is keenly focused on achieving 500 bps+ of margin improvement by 2005 (MCI lags the industry by as much as 1,000 bps).
- **Streamlining the Model:** We believe MCI's lower margins are driven by a combination of low pricing and the myriad networks, systems and hierarchical infrastructure built up from its acquisition roll-up/holding-company model over the years. To address this, management is converging its network to a single IP core and eliminating redundant systems. Given the magnitude of the opportunity for improvement, we believe management can achieve its goal of 500 bps+ improvement by 2005, and 50-100 bps per year for some time thereafter.
- **Pricing:** MCI has historically been among the most aggressive in terms of pricing, partially explaining its low margins. However, with 2003 EBITDA margins at a forecast of 10.9%, and approximately \$1 billion in OCF per year thereafter, there is not much room to cut prices further, giving us some comfort against fears of an all-out price war, although some cuts at re-emergence are likely.
- **Capital Structure & Dilution:** At an estimated 326-366 million outstanding shares at re-emergence and \$4.7-\$5.7 billion in debt, MCI will boast one of the best balance sheets in the business. Even at \$5.7 billion in total debt, net debt would only be \$3.5 billion, leaving net debt/EBITDA at a low 1.3x (similar to AT&T). With expected improvements in 2004 EBITDA, we expect leverage to fall to 0.7x and interest coverage to be 3.4x.
- **Consumer:** We expect ongoing revenue and EBITDA losses within Consumer (-5% annually for revenues and -16% annually for EBITDA over next 7 years), but believe a lower proportion of fixed costs within its Consumer unit will allow MCI to maintain positive FCF over time.
- **SME Exposure:** MCI maintains the second-largest SME revenue base, estimated at \$5 billion in 2003, but has the largest relative exposure as a percent of commercial revenues of any of the Enterprise Carriers. We estimate that MCI will lose approximately 25 bps of share annually to the RBOCs in this segment (similar to AT&T), causing an estimated 100 bp drag to commercial revenue growth.
- **Valuation:** Bankruptcy documents value the restructured equity at \$25 per share, however arguments could be made for a range of values, from price support at \$22 per share, to premium-multiple values approaching \$28, for the stock. Fundamental to determining where the stock should trend are assumptions on cost-reduction, pricing and margin-improvement potential over the next 12 months. We await audited financials and more insight from management prior to establishing a price target.

Core Business Model:

MCI is a leading provider of voice and data telecom services to 20 million residential and commercial customers worldwide. The company is structured along customer segment lines, dividing itself primarily into Business, International, and Mass Markets segments. For purposes of this report and our modeling, we have attempted to group revenues and expenses into just two buckets, Commercial (\$18 billion in revenue) and Consumer (\$6 billion in revenue). In this regard, we include International within Commercial since the vast majority of its business involves multinational corporations. While the new corporate structure is not yet totally evident, we believe the Commercial unit will own and operate the fiber network and related POPs and lease capacity to the Consumer unit on a volume basis (we believe that Consumer will own a number of Class 5 voice switches and related network interface devices).

MCI's Commercial unit is second-largest Enterprise telecom services provider in the US and offers a full suite of facilities-based long distance voice and data network services – it maintains a relationship with most of the Fortune 1000 companies and has historically maintained the largest Wholesale business in the US, although estimated share loss due to the bankruptcy process in 2003 has likely driven MCI to a number two Wholesale share spot (below AT&T). As the company re-emerges from bankruptcy, we believe MCI will be particularly focused on regaining share losses within its historic Top 500 accounts (similar to AT&T's increasing focus) and is reconfiguring its network, support and client-facing infrastructure to accommodate this. In this regard, significant network, systems, headcount and bankruptcy-driven restructuring changes are underway in efforts to bring MCI's profitability up to industry levels. This is clearly the number one challenge for management, and without question the central item in MCI's value proposition over the next several years.

Where there is much challenge, there is much opportunity, but the path won't be easy. MCI has historically operated as a holding company that oversees the myriad autonomous companies it has acquired since the 1980s. This has helped lead to the lower margins it maintains versus its peers, due to the layers of inefficient legacy systems, redundancies and parallel network protocols inherent in this structure. By some estimates, MCI maintained at one point more than 400 internal systems (versus AT&T with 140+ at its peak). To address these inefficiencies, MCI announced in April an initiative to overhaul its network, migrate traffic to a single IP core, and streamline its systems. It plans to have 25% of its voice traffic running over its IP core by year-end 2004, but these leaves it somewhat behind the incumbent peers, who are aggressively building out migration paths to a single core in 2003. Nonetheless, success in these areas could lead to significantly faster-than-industry cashflow growth, due to degree of MCI's current margin lag (AT&T Business Services 26.5% 2003 EBITDA margin versus MCI Commercial at an estimated 10.9%).

The Consumer unit is the second-largest provider of residential long distance services in the US and counts an estimated 18 million customers as its client base. The unit is aggressively deploying a non-facilities-based UNE-P local strategy in order to offer a bundled local/long distance, fixed-rate service in efforts to reduce the severity of secular competitive and substitution declines in the mature Consumer long distance voice product. While the local service itself has limited profit potential, its bundled offering with long distance is proving to be effective at reducing competitive losses to RBOCs and substitution to wireless. And while the local/long distance bundle is slowing the rate of customer defection, MCI's smaller overall share within Consumer (versus AT&T), combined with its broader UNE-P scope (48 states versus 35 states for AT&T) is likely to make a thin-margin product even less profitable, making us wonder how long MCI will maintain such a broad deployment. According to our forecasts, MCI's stand-alone UNE-P product will not reach breakeven until 2006 (versus AT&T in 2005), due to its higher costs of service (UNE-P rates), resulting from deployment into less urban areas, and lower effective ARPUs (for similar reasons). Nonetheless, if the product's deployment helps stabilize the overall business in the near-term, we believe it is the best course of action. And if the Consumer infrastructure can be dynamically scaled to match decreasing volumes over time, the current local/long distance strategy may prove the most effective way of maximizing cashflows and harvesting a declining, mature product.

The following table summarizes the relative size of the MCI's Commercial and Consumer units. The table highlights that Commercial revenues (including International) are estimated to be 74% of 2003 MCI total revenues and are expected to grow to 84% of revenues by 2010. Commercial revenues are expected to grow 4% annually over this period, while Consumer revenues are expected to decline approximately 5% annually.

Figure 11: MCI Commercial & Consumer Revenues

Revenue (\$ Bil)	2001		2003f		2005f		2010f	
	Revs	% of Total	Revs	% of Total	Revs	% of Total	Revs	% of Total
Commercial (Inc. Intl)	\$22.7	67%	\$18.2	74%	\$19.1	78%	\$24.1	84%
% Growth	4.8%		-11.4%		4.6%		4.2%	
Consumer	\$11.2	33%	\$6.3	26%	\$5.3	22%	\$4.5	16%
% Growth	-13.6%		-27.9%		-7.2%		-2.1%	
MCI Consolidated	\$33.9	100%	\$24.5	100%	\$24.5	100%	\$28.6	100%
% Growth	-2.1%		-16.3%		1.8%		3.2%	

A Brief Bankruptcy History:

On June 25, 2002, the Company announced that as a result of an internal audit, it was determined that transfers from line cost expenses to capital accounts in the amount of \$3.9 billion were not made according to GAAP. Subsequent announcements over the course of the summer 2002 indicated that additional improperly recorded transfers and accounting we identified and that the ultimate size of the eventual restatements could exceed \$9 billion and involve 1999, 2000, 2001 and 1Q02.

KPMG is the Company's new auditor and conducted this review and restatement process. It also conducted an internal controls audit, which is being relied upon by the Federal government as the guideline as to when MCI may have its current suspension from new GSA business lifted. It has been alleged that the improper transfers at the core of this matter were intentional and done at the direction of various senior management personnel. As such, the entire senior management team of MCI has essentially been removed and replaced, as has the Board of Directors.

There remain outstanding criminal and civil legal challenges to MCI and some of its former senior management related to these matters, as well as other alleged improper access-charge and call-routing practices. Resolution of these matters are uncertain, but they have not impeded the Bankruptcy Court's decision to approve the restructuring transaction, or the creditors agreement to this restructuring, indicating that that outcome of such legal matters is not perceived by the concerned parties as likely to be catastrophic in nature.

On July 21, 2002 WorldCom, Inc. (the "Company") and most of its direct and indirect domestic subsidiaries filed voluntary petitions for relief in the United States Bankruptcy Court for the Southern District of New York under Chapter 11. On November 8, 2002 43 additional, but mostly inactive, subsidiaries filed Chapter 11 and the cases were all consolidated, while the company continued to operate its business as debtors-in-possession. On April 14, 2003 the Company filed a Plan of Reorganization and on May 28, 2003 the Bankruptcy Court approved the Disclosure Statement, allowing solicitation of creditors' approval. Solicitation began on June 13, 2003, but on July 31, 2003 the Bankruptcy Court postponed the expected August 13, 2003 Confirmation Hearing until September 8, 2003 in order to permit the Company to file an additional Disclosure Statement addressing issues relating to the investigation of its call-routing practices by the US Attorney's Office and the impact of the July decision by the GSA to propose debarment of the Company for the purposes of soliciting and contracting new government business.

There remains a current suspension of MCI's ability to gain new government contracts pending on ongoing review of the Company's internal controls improvements and related items. The Company filed this updated Disclosure Statement on August 4, 2003, which was approved by the Court on August 6, 2003. The final Confirmation Hearing began on September 8, 2003 and on September 9, 2003 agreement was reached with the last major group of creditors, clearing the way for a final agreement.

On September 11, 2003, the Company filed a final Disclosure Statement reflecting this agreement. The final creditor vote was completed on October 7, 2003 and the final Confirmation Hearing reinitiated on October 15, 2003, where it was once again delayed until October 30. The Court gave verbal approval for the deal on October 31, and MCI's when-issued stock began trading under the ticker MCI AV on November 3. Re-emergence will become effective at some point just after the beginning of the 2004, when the Company is expected to complete and file its financial restatements and other documents and distribute its new securities. At this point the new equity will begin trading under its official ticker on an exchange to be determined.

Core Markets and Competitors:

MCI is estimated to hold the #3 market share position in terms of total Enterprise revenues, although among carriers that we designate "Enterprise Carriers" (i.e. – carriers that derive more than 50% of their revenues from commercial customers) it is the second largest (behind AT&T). We estimate MCI's 2004 overall Enterprise market share to be 11.8%, down from an estimated 13.3% in 2001, prior to bankruptcy being filed. We estimate that MCI has lost approximately \$2.6 billion in annual market share over the course of its bankruptcy. However, MCI is re-emerging largely intact, with continued strong competitive positions across the Enterprise market, and particularly so within Large Enterprise, where we believe a patient approach to profitable re-acquisition of market share will lead net share gains over the next 7 years. For example, while we expect MCI as an incumbent to experience overall Enterprise share loss of 10 bps annually (through 2010), we expect the company to experience net share gains of 15 bps per year within the Large Enterprise segment of the market. The most intense competition for MCI will come at the upper and lower ends of the market, with strong emerging competition from Level (3) within the Wholesale segment and RBOC long distance entry within SME, driving estimated 10 bps and 25 bps of annual share loss respectively.

Figure 12: The Enterprise Market

Top 10 Enterprise Market Share Carriers⁽¹⁾ - Total Market

Rank	Carrier ⁽²⁾	2004f		2005f		2010f		
		Rev (\$ bil)	Mkt. Share	Rev (\$ bil)	Mkt. Share	7-Yr Rev CAGR	Market Share	Avg. Annual Share Chg.
1	AT&T Bus. Serv.	\$24.5	15.8%	\$25.1	15.5%	2.6%	14.2%	-30 bp
2	SBC	\$20.2	13.1%	\$21.1	13.1%	4.7%	13.1%	00 bp
3	MCI	\$18.3	11.8%	\$19.1	11.8%	4.1%	11.4%	-10 bp
4	Verizon	\$15.2	9.8%	\$16.3	10.1%	5.5%	10.7%	10 bp
5	Sprint	\$9.3	6.0%	\$9.5	5.9%	2.5%	5.2%	-15 bp
6	Qwest	\$8.7	5.6%	\$9.2	5.7%	5.4%	5.8%	05 bp
7	BellSouth	\$8.5	5.5%	\$8.9	5.5%	5.4%	5.7%	05 bp
8	Level 3	\$1.8	1.1%	\$1.9	1.2%	10.3%	1.5%	05 bp
9	XO Communications	\$1.2	0.8%	\$1.4	0.9%	9.7%	1.1%	05 bp
10	Rest of Industry	\$47.1	30.4%	\$49.3	30.4%	6.2%	31.3%	15 bp
Enterprise Industry		\$154.8	100.0%	\$162.0	100.0%	4.9%	100.0%	

(1) Represents commercial local and long distance, voice and data revenues.

Figure 13: The Large Enterprise Market

Top 5 Large Enterprise Market Share Carriers⁽¹⁾

Rank	Carrier ⁽²⁾	2004f		2005f		2010f		
		Rev (\$ bil)	Mkt. Share	Rev (\$ bil)	Mkt. Share	7-Yr Rev CAGR	Market Share	Avg. Annual Share Chg.
1	AT&T Bus. Serv.	\$13.1	25.7%	\$13.5	25.6%	3.5%	25.1%	-10 bp
2	MCI	\$7.5	14.8%	\$8.1	15.3%	5.6%	15.8%	15 bp
3	Sprint	\$3.9	7.7%	\$4.0	7.6%	3.0%	7.0%	-10 bp
4	Qwest	\$2.2	4.4%	\$2.4	4.5%	6.6%	5.1%	10 bp
5	XO Communications	\$0.5	1.1%	\$0.6	1.1%	9.6%	1.5%	05 bp
Rest of LE		\$23.6	46.4%	\$24.1	45.8%	3.8%	45.5%	-15 bp
Large Enterprise		\$50.9	100.0%	\$52.7	100.0%	4.1%	100.0%	

(1) "Large Enterprise" is defined as the "Fortune 1,000" Enterprises; these users generate \$25 million or more annually, with average over \$50 million.

(2) Represents wholesale local and long distance, voice and data revenues.

Figure 14: The Wholesale Market

Top 5 Wholesale Market Share Carriers⁽¹⁾

Rank	Carrier⁽²⁾	2004f		2005f		2010f		
		Rev (\$ bil)	Mkt. Share	Rev (\$ bil)	Mkt. Share	7-Yr Rev CAGR	Market Share	Avg. Annual Share Chg.
1	AT&T Bus. Serv.	\$5.9	18.6%	\$6.2	18.4%	3.6%	16.8%	-30 bp
2	MCI	\$6.0	18.7%	\$6.2	18.6%	4.9%	18.3%	-10 bp
3	Qwest	\$2.6	8.0%	\$2.6	7.9%	3.4%	6.9%	-20 bp
4	Sprint	\$1.8	5.8%	\$1.9	5.7%	2.3%	5.2%	-10 bp
5	Level 3	\$1.8	5.5%	\$1.9	5.7%	10.3%	7.0%	30 bp
	Rest of Wholesale	\$13.8	43.3%	\$14.6	43.6%	7.0%	45.7%	40 bp
	Wholesale Market	\$31.9	100.0%	\$33.5	100.0%	5.6%	100.0%	

(1) "Wholesale" is defined as the "Top 300 Telco Users" worldwide; these users generate at least \$75 million annually in telecom revenues

(2) Represents wholesale local and long distance, voice and data revenues.

Segment Exposure and highlights:

Approximately 26% of consolidated 2003 revenues are Consumer, which are expected to decline 9% in 2004, with EBITDA margins expected to remain steady at 11%, resulting in 9% EBITDA declines. Approximately 21% of 2003 revenues are SME, which are expected to decline 4% in 2004. However, an estimated 260 bp improvement in SME margins, due to the massive cost reduction efforts being undertaken as part of the bankruptcy restructuring, is expected to drive 12% SME EBITDA growth in 2004. We estimate that MCI will lose approximately 25 bps of share annually to the RBOCs in this segment, causing an estimated 100 bp drag to commercial revenue growth. Collectively, the "Drag Revenues" comprise 46% of 2003 revenues and are expected to decline 2% over time, while the "Growth Revenues" comprise 54% and grow 5%.

Figure 15: MCI Segment Exposure & Outlook Highlights

Revenue: \$ Bil	2003	2004	2005	2006	2010	'03 to '10 CAGR
"Drag Segments"						
Consumer	\$6.3	\$5.7	\$5.3	\$5.1	\$4.5	-4.7%
% Growth	-27.9%	-9.1%	-7.2%	-4.4%	-2.1%	
% of Consolidated Revs	26%	24%	22%	20%	16%	
SME	\$5.0	\$4.8	\$4.8	\$4.9	\$5.3	0.7%
% Growth	-10.1%	-3.9%	0.3%	1.5%	1.8%	
% of Consolidated Revs	21%	20%	20%	20%	19%	
Total "Drag Segments" (Cons+SME)	\$11.3	\$10.6	\$10.2	\$10.0	\$9.8	-2.1%
% Growth	-20.9%	-6.8%	-3.8%	-1.6%	0.0%	
% of Consolidated Revs	46%	44%	42%	40%	34%	
"Growth Segments"						
Wholesale & Large Enterprise	\$13.1	\$13.5	\$14.3	\$15.2	\$18.8	5.3%
% Growth	-11.8%	2.7%	6.1%	6.2%	4.9%	
% of Consolidated Revs	54%	56%	58%	60%	66%	
MCI Consolidated Revenue	\$24.5	\$24.0	\$24.5	\$25.2	\$28.6	2.3%
% Growth	-16.3%	-1.7%	1.8%	3.0%	3.2%	
EBITDA: \$ Bil						
"Drag Segments"						
Consumer	\$0.7	\$0.6	\$0.5	\$0.4	\$0.2	-16.1%
% Growth	-53.1%	-9.4%	-18.5%	-15.5%	-15.9%	
% of Consolidated EBITDA	25%	18%	13%	10%	4%	
Margin	11.0%	11.0%	9.7%	8.5%	4.5%	
SME	\$0.8	\$0.9	\$1.0	\$1.0	\$1.2	6.1%
% Growth		12.1%	8.6%	5.2%	4.0%	
% of Consolidated EBITDA	30%	26%	25%	24%	22%	
Margin	16.2%	18.8%	20.4%	21.2%	23.3%	
Total "Drag Segments" (Cons+SME)	\$1.5	\$1.5	\$1.5	\$1.5	\$1.4	-0.7%
% Growth		2.2%	-2.5%	-1.9%	0.6%	
% of Consolidated EBITDA	55%	45%	38%	34%	25%	
Margin	13.3%	14.6%	14.8%	14.7%	14.7%	
"Growth Segments"						
Wholesale & Large Enterprise	\$1.2	\$1.9	\$2.5	\$2.9	\$4.3	19.6%
% Growth		55.9%	28.8%	16.9%	8.3%	
% of Consolidated EBITDA	45%	55%	62%	66%	75%	
Margin	9.3%	14.1%	17.2%	18.9%	22.8%	
MCI Consolidated EBITDA	\$2.7	\$3.4	\$4.0	\$4.3	\$5.7	11.1%
% Growth	-45.6%	26.2%	14.8%	9.8%	6.2%	

Core Products and Competitors:

As shown in the following table, MCI maintains strong product positions across the Enterprise space, but particularly strong positions within the retail Large Enterprise market, a market totaling an estimated \$50 billion in 2003 and representing about 33% of the total Enterprise market. In long distance voice, MCI is the second-largest US carrier, behind AT&T; when including local voice revenues, MCI's estimated share position is 6th. Across the legacy data products such as private line, FR, and ATM, MCI generally maintains the second market share position. Historically, MCI held a lead in Large Enterprise DIA, but we believe the disruption of the past few years, both in terms of its client base being particularly hard hit from the Internet crash, as well as the company's own bankruptcy filing, has pushed AT&T into the lead spot in this product. Conversely, this decline leads to opportunity going forward. We believe network overhauls to migrate toward a single IP core as well as intense sales focus within Large Enterprise will drive faster-than-industry growth for MCI in these core products, with IP-LAN/WAN driven products such as IP-VPNs and MPLS-enable services leading the way

Figure 16: The Core MCI Products and Competitors

Core MCI Wholesale-Focused Markets & 2003 Estimated Sizes - \$31.0 b													
Voice - \$13.8 b	DIA - \$3.6 b	Dial & DSL Wholesale - \$2.0 b											
<ol style="list-style-type: none"> 1 AT&T 2 MCI 3 Qwest 4 Sprint 5 RBOCs 	<ol style="list-style-type: none"> 1 Sprint 2 Level 3 3 MCI 4 AT&T 5 Qwest 	<ol style="list-style-type: none"> 1 Level 3 2 MCI 3 Sprint 4 Qwest 5 Regional Players 											
Core MCI Retail-Focused Markets & 2003 Estimated Sizes - 121.0 b*													
<table border="1" style="width: 100%; border-collapse: collapse;"> <thead> <tr style="background-color: #e0ffe0;"> <th style="width: 33%; padding: 5px;">Voice - \$55.7 b</th> <th style="width: 33%; padding: 5px;">Packet Svcs⁽¹⁾ - \$26.0 b</th> <th style="width: 33%; padding: 5px;">Private Line: Retail⁽²⁾ - \$16.0 b</th> </tr> </thead> <tbody> <tr> <td style="padding: 5px;"> <ol style="list-style-type: none"> 1 SBC 2 AT&T 3 Verizon 4 Sprint 5 BellSouth 6 MCI 7 Qwest </td> <td style="padding: 5px;"> <ol style="list-style-type: none"> 1 AT&T 2 MCI 3 Sprint 4 Qwest 5 RBOCs (in-region) <p style="font-size: small; margin: 0;">(1) FR, ATM & IP LANs, WANs and VPNs</p> </td> <td style="padding: 5px;"> <ol style="list-style-type: none"> 1 AT&T 2 MCI 3 RBOCs 4 Sprint 5 Network Carriers <p style="font-size: small; margin: 0;">(2) DS-3 & below; market includes ILEC/IXC last-mile links since most end-users are retail-based</p> </td> </tr> </tbody> </table>	Voice - \$55.7 b	Packet Svcs ⁽¹⁾ - \$26.0 b	Private Line: Retail ⁽²⁾ - \$16.0 b	<ol style="list-style-type: none"> 1 SBC 2 AT&T 3 Verizon 4 Sprint 5 BellSouth 6 MCI 7 Qwest 	<ol style="list-style-type: none"> 1 AT&T 2 MCI 3 Sprint 4 Qwest 5 RBOCs (in-region) <p style="font-size: small; margin: 0;">(1) FR, ATM & IP LANs, WANs and VPNs</p>	<ol style="list-style-type: none"> 1 AT&T 2 MCI 3 RBOCs 4 Sprint 5 Network Carriers <p style="font-size: small; margin: 0;">(2) DS-3 & below; market includes ILEC/IXC last-mile links since most end-users are retail-based</p>	<table border="1" style="width: 100%; border-collapse: collapse;"> <thead> <tr style="background-color: #e0ffe0;"> <th style="width: 33%; padding: 5px;">DIA - \$4.6 b</th> <th style="width: 33%; padding: 5px;">Managed Svcs⁽³⁾ - \$9.0 b</th> <th style="width: 33%; padding: 5px;">Network Integration⁽⁵⁾ - \$18.5 b</th> </tr> </thead> <tbody> <tr> <td style="padding: 5px;"> <ol style="list-style-type: none"> 1 AT&T 2 MCI 3 Qwest 4 Network Carriers 5 Regional Players </td> <td style="padding: 5px;"> <ol style="list-style-type: none"> 1 AT&T 2 Network Integrators⁽⁴⁾ 3 Qwest 4 MCI 5 RBOCs <p style="font-size: small; margin: 0;">(3) Includes network management outsourcing fees, hosting, e-services & colocation revenue. (4) The large network design integrators such as IBM, EDS & others.</p> </td> <td style="padding: 5px;"> <ol style="list-style-type: none"> 1 Network Integrators⁽⁶⁾ 2 AT&T 3 Regional/Other Consultants 4 RBOCs <p style="font-size: small; margin: 0;">(5) Includes outsourced network design and integration (6) The large network design integrators such as IBM, EDS & others.</p> </td> </tr> </tbody> </table>	DIA - \$4.6 b	Managed Svcs ⁽³⁾ - \$9.0 b	Network Integration ⁽⁵⁾ - \$18.5 b	<ol style="list-style-type: none"> 1 AT&T 2 MCI 3 Qwest 4 Network Carriers 5 Regional Players 	<ol style="list-style-type: none"> 1 AT&T 2 Network Integrators⁽⁴⁾ 3 Qwest 4 MCI 5 RBOCs <p style="font-size: small; margin: 0;">(3) Includes network management outsourcing fees, hosting, e-services & colocation revenue. (4) The large network design integrators such as IBM, EDS & others.</p>	<ol style="list-style-type: none"> 1 Network Integrators⁽⁶⁾ 2 AT&T 3 Regional/Other Consultants 4 RBOCs <p style="font-size: small; margin: 0;">(5) Includes outsourced network design and integration (6) The large network design integrators such as IBM, EDS & others.</p>
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* \$130 b of gross Retail Large Enterprise & SME revenues less \$9 b of intercarrier eliminations

Bold = A dominant market share position

Competitive Advantages:

MCI's core competencies are anchored by its top-tier market share position and reputation within Large Enterprise, its rejuvenated balance sheet and its product mix, which has the heaviest weighting in favor of data revenues of any incumbent carrier. MCI has established itself, in conjunction with AT&T, as one half of the dominant "duopoly" in terms of the retail Large Enterprise telecom services market. The merging of WorldCom and its leading Internet business, UUNet, with MCI's corporate customer list pushed the company to years of accelerated growth, as it was successful in penetrating the old MCI commercial customers with increasing amounts of IP-centric products. While the Internet downturn was particularly impactful to UUNet, which had a heavier than average exposure Internet-centric companies, we believe MCI's established reputation and corporate customer list will continue to be its number one competitive advantage, with the share loss of the last two years ironically providing upside opportunity over the next several years. Additionally, thanks to the fresh-start procedures of bankruptcy, MCI is eliminating more than \$28 billion in term debt, leaving it with only \$4.7-\$5.7 billion of total debt at re-emergence, and only \$2.5-\$3.5 billion of net debt. This leaves its estimated 2004 leverage at only 0.7x net debt/EBITDA and its interest coverage at 3.4x (somewhat lower than AT&T's due to MCI's lower margins). This increased slack should give the company more flexibility to invest capital in efficiency-improving areas. Finally, MCI maintains a revenue mix that is easily the most data-weighted among the incumbent carriers. We estimate that 53% of its 2004 revenues will be data/IP, versus an industry average of 45%, and AT&T's weighting of 40%. We believe this weighting differential alone gives MCI an average 100 bp total revenue growth advantage versus AT&T.

Figure 17: Competitive Advantage – Product Mix Favors Data

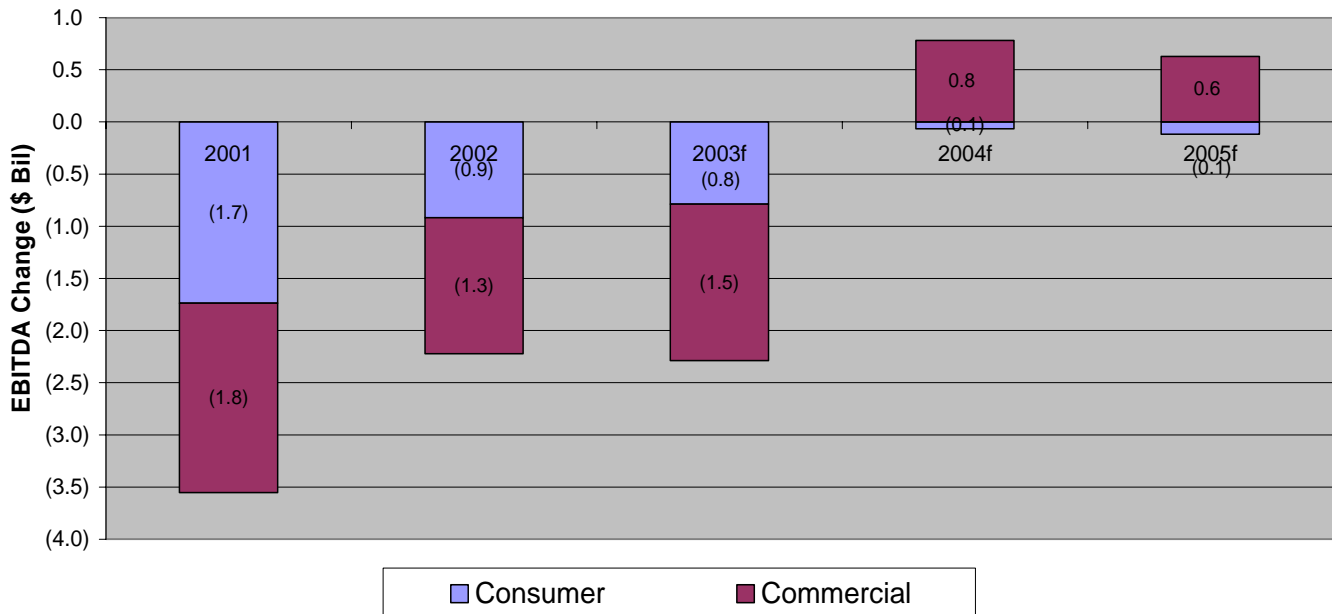
Mix Weighted in Favor of Data			
<u>2004f Revenues (\$ Bil):</u>	<u>MCI</u> <u>Commercial Serv.</u>	<u>Enterprise Coverage</u> <u>Group Average</u>	<u>MCI Mix Vs.</u> <u>Enterprise</u> <u>Group Average</u>
Voice	\$5.3	\$24.3	
Growth	-5.3%	-3.9%	
% of Total	29%	44%	-1500 bp
Data	\$9.7	\$24.8	
Growth	3.8%	3.2%	
% of Total	53%	45%	800 bp
Other (Inc. Intl)	\$3.3	\$6.0	
Growth	2.9%	-1.3%	
% of Total	18%	11%	
Total	\$18.3	\$55.1	
Growth	0.8%	-0.6%	

Competitive Challenges:

MCI is facing a number of challenges as it re-emerges from bankruptcy, including low margins (large cost structure and low pricing), continuing drag from its Consumer unit and some technical volatility that is likely to impact the stock upon initial trading. We believe MCI's low margins are driven by a combination of lower pricing and the myriad networks, systems and hierarchical infrastructure built up from its acquisition process over the years. MCI has historically operated as a holding company that oversees the numerous autonomous companies it has acquired since the 1980s. This has helped lead to the lower margins it maintains versus its peers, due to the layers of inefficient legacy systems, redundancies and parallel network protocols inherent in this structure. Additionally, MCI faces ongoing drag from its Consumer unit as it suffers under technological substitution losses to wireless and Internet, as well as competitive losses to RBOCs. Over the past two years, despite the fact that Consumer is only approximately 25% of revenues, it has accounted for approximately 45% of total EBITDA declines (shown in the following figure). We expect ongoing declines in this unit, estimated at 5% annual revenue declines over the long run, and 16% annual EBITDA declines. Additionally, we estimate that due to its broader deployment of UNE-P, the margins on its local product are lower, and will take longer to reach breakeven than AT&T's.

Finally, we expect there to be technical volatility in both the when-issued share price, as well as the initial exchange trading of the stock due to issues of dilution-concern and ownership redistribution from restructuring (credit) investors into new equity investors.

Figure 18: Competitive Challenge – Consumer Drag



While MCI's low margins represent a current disadvantage, costs are one thing that management can truly control. Therefore, we believe this actually represents tremendous upside for the company – the key will be management's dedication to *ongoing* margin improvements. The drag from Consumer revenue declines is more problematic, but we believe MCI benefits from a lower proportion of fixed costs within its Consumer unit, which should allow the company to better eliminate expenses as volumes decline, allowing cashflows to remain positive strategically, albeit at very low margins. This is highlighted by the fact that we estimate that SG&A as a percent of revenues in 2003 is 33% for MCI, but 43% at AT&T.

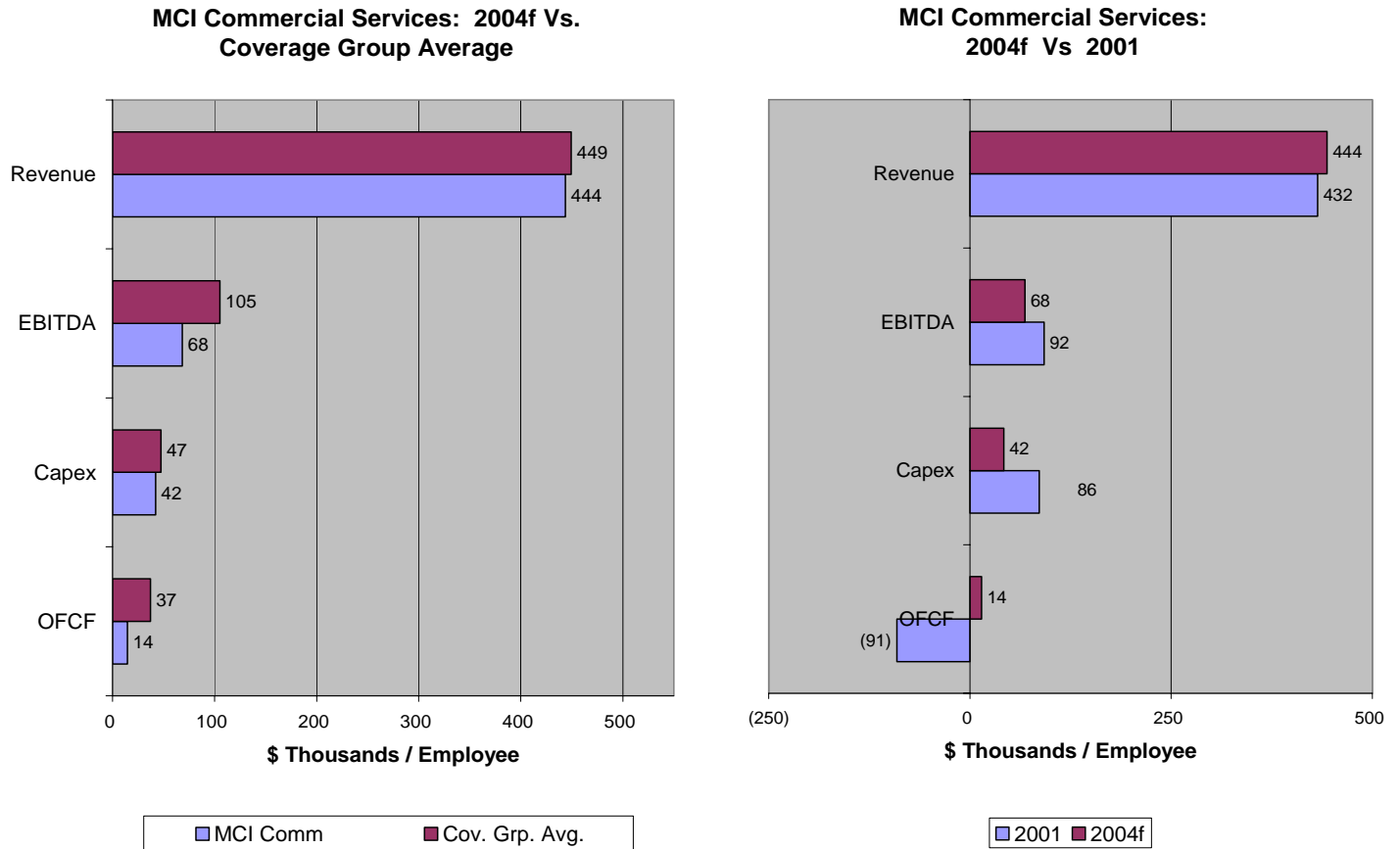
Network:

MCI owns and operates an estimated 75,000 global route-mile (ex-undersea), IP-MPLS over DWDM at the core fiber backbone reaching an estimated 4,500 IP POPs in 130 markets in 65 countries worldwide. It represents one of the most extensive networks in the US and claims the most dial IP modems of any US carrier (3.2 million). Management is aggressively overhauling the legacy components of this network, consolidating its protocols to a single IP core and deploying MPLS switching throughout as part of its initiative to improve network efficiency and performance, and lower costs. This initiative will allow MCI to significantly reduce its estimated 400+ total systems as well as eliminate redundant overlay networks and consolidate all traffic (including voice) to a single IP core. Management intends to migrate approximately 25% of its voice traffic to this core by the end of 2004, leaving it somewhat behind incumbent competition, which spending the bulk of their 2003 capital budget to begin a migration of traffic to a single packet-switched core this year. We believe this "lost year" in terms of capital spending as a result of the bankruptcy process is the likely to be the largest friction to the company as it recovers from its financial distress. Having said that, MCI's market share, reputation and scale provide strong assets to carry it while such efficiencies are achieved, and we believe there are material opportunities for improved cashflows deriving from such improvements.

Productivity and Efficiency:

MCI is estimated to lag the Enterprise industry in most operating metrics, but particularly in EBITDA per employee. At a 2004 forecast of \$68k EBITDA/employee, MCI lags the industry average of \$105k by 35% and the AT&T level of \$141k by more than 50%. We believe this is driven by a combination of lower pricing and a redundant cost structure accumulated through multiple acquisitions. However management is keenly focused on achieving 500 bps+ of margin improvement by 2005 (MCI lags the industry by as much as 1,000 bps), which we believe is achievable given the magnitude of opportunity for improvement, the network and systems overhaul and hierarchical restructuring taking place.

Figure 89: Operating Metrics Per Employee



OFCF is defined as CFFO - Capex; All metrics reflect commercial telecom services operating information divided by estimated commercial telecom services employees.

Capital Structure and Financial Strength:

MCI should re-emerge from bankruptcy with 326-366 million shares of new equity and \$4.5-\$5.5 billion in new senior term debt (plus \$275 million in capitalized leases). Of the 15 classes of claimants to MCI's assets, five can or will be receiving equity in the newly reorganized company, including the following classes:

	<u>Est. Claim Amount (\$ bil)</u>
■ Class 5 WorldCom Senior Debt Claims	\$27.3
■ Class 6 WorldCom General Unsecured Claims	n/a
■ Class 11 Intermedia Senior Debt Claims	\$0.9
■ Class 12 Intermedia General Unsecured Claims	n/a
■ Class 13 Intermedia Subordinated Debt Claims	\$0.3

Of these classes, we estimate that Class 5, the WorldCom Senior Debt Claims, will receive nearly 90% of the new stock, with Class 11 receiving approximately 8%, with the balance spread among the rest, representing 100% equity ownership of the company at the moment of reorganization. However, management has established a restricted stock and options program through which shares and options on shares will be distributed, diluting the re-emergence owners over time. Our analysis makes no assumptions or estimations regarding such dilution from restricted stock or options. We have assumed the bankruptcy plan capital structure of 326 million in new equity shares, valued at \$25 per share, to yield an initial \$7.2 billion market cap, and \$5.7 billion of total debt (\$3.5 billion in net debt), resulting in an initial enterprise value of \$11.6 billion. This represents a 4.4x multiple of our 2003 MCI EBITDA forecast and 3.4x multiple of our 2004 forecast, which is in-line with current trading levels of AT&T). The following table highlights various potential prices and implied EV/EBITDA multiples.

Figure 20: MCI Stock Price & Implied EBITDA Multiples

Assumed NewCo Share Price	NewCo Total Enterprise Value	EBITDA & Multiples			
		2003	2004		
		<u>\$2,731</u>	<u>\$3,250</u>	<u>\$3,448</u>	<u>\$3,690</u>
\$22.50	10,772.7	3.9x	3.3x	3.1x	2.9x
\$23.00	10,935.7	4.0x	3.4x	3.2x	3.0x
\$23.50	11,098.7	4.1x	3.4x	3.2x	3.0x
\$24.00	11,261.7	4.1x	3.5x	3.3x	3.1x
\$24.50	11,424.7	4.2x	3.5x	3.3x	3.1x
\$25.00	11,587.7	4.2x	3.6x	3.4x	3.1x
\$25.50	11,750.7	4.3x	3.6x	3.4x	3.2x
\$26.00	11,913.7	4.4x	3.7x	3.5x	3.2x
\$26.50	12,076.7	4.4x	3.7x	3.5x	3.3x
\$27.00	12,239.7	4.5x	3.8x	3.5x	3.3x
\$27.50	12,402.7	4.5x	3.8x	3.6x	3.4x
\$28.00	12,565.7	4.6x	3.9x	3.6x	3.4x

At our base case assumptions of the maximum debt and minimum equity (\$5.7 billion in debt and 326 million equity shares), MCI will still boast one of the best balance sheets in the business. The following table highlights this strength. At re-emergence, we expect MCI to have leverage of 1.3x (net debt/EBITDA). With expected improvements in 2004 EBITDA, we expect leverage to fall to 0.7x and interest coverage to be 3.4x. This financial slack should give MCI the flexibility to invest capital in efficiency-improving areas.

Figure 21: MCI Capital Structure Outlook – Pre & Post Restructuring

MCI Capital Structure & Cashflow Outlook: 2003 Pre & Post Reorg. & Forecasts								
(\$ bil):	2003		Proforma Projections - Reorganized Company					
	Pre-Reorg.	Reorganized Company	2004	2005	2006	2007	2008	2009
Cash Balance	\$4.7	\$2.3	\$3.1	\$4.2	\$5.1	\$6.1	\$7.2	\$8.3
Total Assets	\$20.0	\$20.9	\$21.8	\$23.1	\$24.5	\$26.2	\$28.0	\$30.0
Total Debt	\$34.2	\$5.7	\$5.6	\$5.5	\$5.5	\$5.5	\$5.5	\$5.5
Net Debt (Net of Adjustments)	\$29.4	\$3.4	\$2.5	\$1.3	\$0.4	(\$0.6)	(\$1.7)	(\$2.8)
Debt Mat./Paid-down this Period ⁽¹⁾		\$28.4	\$0.1	\$0.1	\$0.0	\$0.0	\$0.0	\$0.0
OFCF ⁽²⁾		\$2.2	\$1.0	\$1.2	\$0.9	\$1.0	\$1.1	\$1.1
Total Incremental Financing Required		\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0
Portion Assumed as Debt		\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0
Portion Assumed as Equity		\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0
<hr/>								
Leverage (Net Debt / EBITDA)	10.3x	1.3x	0.7x	0.3x	0.1x	-0.1x	-0.3x	-0.5x
Coverage (Unlev. OFCF /Cash Int.)	not paying coupons in '03		3.4x	4.0x	3.5x	3.8x	4.1x	4.3x

Comments

Represents the least levered, large-cap telecom services company

(1) 2003 debt reduction represents the debt forgiven as part of fresh start accounting under Chapter 11.

(2) Operating Free Cash Flow is defined as CFFO - capex.

MCI as a Consolidation Play?

Upon re-emergence from bankruptcy, MCI will present itself as an extremely attractive commercial telecom services company, with minimal debt, strong coverage ratios and the second-leading market share among the Enterprise carriers, but slowed by a high cost structure and a consumer unit that is in sharp decline. If a potential suitor could solve the consumer overhang by somehow selling off the consumers that are out of the suitor's local footprint (if it has any), and get comfortable with its ability to materially rationalize MCI's commercial cost structure, MCI could be attractive at its estimated \$10-\$12 billion valuation upon re-emergence. There is significant execution risk however in such a transaction, as paring off the unwanted portions of the consumer arm could be highly complex, require extensive regulatory approvals, receive very low valuations and take a long time.

Additionally, the only deal structures that are likely to receive regulatory approval are the ones that are the most economically unattractive. For example, in order for an RBOC to win regulatory approval for an MCI acquisition, it would likely have to divest the consumer business in-region (which would be the only customers the RBOC would want to keep to begin with) and agree to do one of the following: (1) operate MCI's consumer long distance and local UNE-P business out of region, or (2) sell it intact to another company that would. All of this makes for an especially messy transaction with unattractive economics. The only consumers that are efficient for an RBOC to keep would be the in-region ones, which they'd have to divest. And the out of region ones, served with low-margin UNE-P would be extremely unattractive and dilutive. Additionally, we do not see many other buyers out there that would be interested in owning and operating the consumer business – there simply aren't enough local customers for it to make sense for a cable company to buy (and the cable companies would likely have the same incentives to divest the out-of-footprint consumers and keep the in-footprint ones, again flying exactly in the opposite direction of what would likely gain regulatory approval). In our opinion, all of this makes an acquisition unlikely in the near term.

Business Units and Forecasts:

As the following table shows, we believe that 2004 will mark the last consolidated revenue decline for MCI as it pulls itself out of bankruptcy and the economy stabilizes and begins to improve. We expect total revenues to decline approximately 1.7% in 2004, but EBITDA to grow a material 26%+, driven by the significant cost reduction efforts discussed previously and the forecast 310 bp improvement in EBITDA margins. Operating free cashflow declines are also expected to bottom out in 2004 at around \$1 billion, and then grow approximately \$100-200 million per year. As the Commercial unit refocuses its efforts on regaining profitable market share, and demand begins at least a modest recovery, we expect consolidated revenue growth to approach the 2-3% range. However, we believe EBITDA can grow at more healthy rates due to the significant cost reduction opportunities and management's intense focus in this area – we expect to see consolidated EBITDA grow approximately 11% annually through 2010.

Figure 22: MCI Consolidated Summary Forecasts

(\$ Bil)	2001	2002	2003f	2004f	2005f	2010	'03 to '10 CAGR
Commercial (Inc. Intl)	\$22.7	\$20.5	\$18.2	\$18.3	\$19.1	\$24.1	4.1%
% Growth	4.8%	-9.7%	-11.4%	0.8%	4.6%	4.2%	
Consumer	\$11.2	\$8.7	\$6.3	\$5.7	\$5.3	\$4.5	-4.7%
% Growth	-13.6%	-21.8%	-27.9%	-9.1%	-7.2%	-2.1%	
Corp.	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	#DIV/0!
Total Revenue	\$33.9	\$29.2	\$24.5	\$24.0	\$24.5	\$28.6	2.3%
% Growth	-2.1%	-13.7%	-16.3%	-1.7%	1.8%	2.4%	
EBITDA	\$7.2	\$5.0	\$2.7	\$3.4	\$4.0	\$5.7	11.1%
% Growth	-32.9%	-30.7%	-45.6%	26.2%	14.8%	6.2%	
Margin	21.4%	17.2%	11.2%	14.3%	16.2%	20.0%	
Operating Income	\$5.5	\$3.4	\$1.3	\$1.8	\$2.1	\$3.5	15.8%
% Growth	-41.8%	-38.2%	-62.9%	40.8%	18.3%	8.6%	
Margin	16.4%	11.7%	5.2%	7.4%	8.7%	12.4%	
Net Income	\$2.7	\$1.5	\$1.2	\$0.9	\$1.1	\$2.0	7.9%
% Growth	-49.3%	-42.2%	-25.0%	-24.6%	24.6%	10.2%	
Margin	7.9%	5.3%	4.7%	3.6%	4.4%	6.9%	
Capex	\$4.8	\$1.5	\$1.2	\$1.8	\$2.0	\$2.8	13.1%
% Growth	-30.3%	-69.5%	-18.6%	48.9%	13.7%	5.1%	
% of Rev	14.1%	5.0%	4.9%	7.4%	8.2%	9.8%	
OFCF⁽¹⁾	(\$5.3)	\$3.4	\$2.2	\$1.0	\$1.2	\$1.1	-9.3%
% Growth		-163.7%	-35.0%	-53.7%	17.0%	1.9%	
Margin	-15.6%	11.5%	9.0%	4.2%	4.9%	3.9%	

(1) Operating Free Cash Flow is defined as CFFO - capex.

Commercial:

We believe the ability for MCI management to strip away significant cost structure is the most important value driver for the company over the next 1-2 years. In this regard, given its importance, the vast opportunity (MCI Commercial's estimated margins lag the industry by 1,000 bps and AT&T's by as much as 1,500 bps), and management's focus and current initiatives, we believe MCI - Commercial will be successful in driving more than 680 bps of EBITDA margin improvement over the next 2 years, with approximately 420 bps of this coming in 2004 and 260 bps in 2005. This would still leave MCI Commercial's estimated EBITDA margins at only 18% in 2005, which would still represent a 450 bp disadvantage versus the industry forecast and a 1,000 bp discount to AT&T Business Services' margins. A key question in forecasting margin improvements of this magnitude is pricing. As we've discussed earlier, given the already slim margins at the company, we believe aggressive across-the-board price cuts are not in store, but would clearly wipe out forecasted margin improvements if they were to occur.

The following table summarizes our Commercial forecasts, which are characterized by recovering but still-moderate revenue growth and but sharply improving margins and EBITDA. Commercial revenues are expected grow 0.8% in 2004, driven by 4% growth in data revenues, moderated by a 3% decline in voice revenues. We expect EBITDA to grow 38% in 2004 as margins are expected to improve by approximately 420 bps. We believe 2004 should also mark the low-mark in terms of OFCF at approximately \$0.6 billion, which should begin healthy growth from that point forward. Strategically, we expect the Commercial unit will grow revenues 4% annually, due to a greater weighting of data revenues (53% of 2003 MCI Commercial revenues versus an industry average of 45%) and market share recapture-opportunities within Large Enterprise. With ongoing improvements in margins, back toward the low end of industry averages, we believe EBITDA will grow 15% annually, on average, through 2010.

Figure 23: MCI Commercial Summary Forecasts

(\$ Bil)	2001	2002	2003f	2004f	2005f	2010	'03 to '10 CAGR
Total Voice	\$7.9	\$6.6	\$5.6	\$5.3	\$5.3	\$5.7	0.3%
% Growth	-16.0%	-17.1%	-15.0%	-5.3%	-0.8%	1.9%	
Data & IP	\$11.8	\$10.4	\$9.4	\$9.7	\$10.4	\$14.3	6.2%
	19.6%	-11.6%	-10.1%	3.8%	7.6%	5.4%	
Other	\$3.0	\$3.5	\$3.2	\$3.3	\$3.4	\$4.1	3.7%
Total Revenue	\$22.7	\$20.5	\$18.2	\$18.3	\$19.1	\$24.1	4.1%
% Growth	4.8%	-9.7%	-11.4%	0.8%	4.6%	4.2%	
EBITDA	\$4.8	\$3.5	\$2.0	\$2.8	\$3.4	\$5.5	15.3%
% Growth	-27.3%	-26.9%	-42.4%	38.4%	22.3%	7.3%	
Margin	21.3%	17.3%	11.2%	15.4%	18.0%	22.9%	
Capex	\$4.5	\$1.4	\$1.1	\$1.7	\$1.9	\$2.7	13.3%
% Growth	-27.9%	-69.9%	-18.5%	57.1%	10.1%	9.2%	
% of Rev	19.9%	6.6%	6.1%	9.5%	10.0%	11.0%	
OCF⁽¹⁾	(\$4.8)	\$1.7	\$1.3	\$0.6	\$0.9	\$1.2	-1.5%
% Growth	129.8%	-136.7%	-26.4%	-53.5%	50.9%	-2.8%	
Margin	-21.0%	8.5%	7.1%	3.3%	4.7%	4.8%	

(1) Operating Free Cash Flow is defined as CFFO - capex.

Consumer:

MCI faces ongoing drag from its Consumer unit as it faces technological substitution losses to wireless and Internet, as well as competitive losses to RBOCs. Over the past two years, despite the fact that Consumer is only approximately 25% of revenues, it has accounted for approximately 45% of total EBITDA declines. We expect ongoing declines in this unit, estimated at 5% annual revenue declines over the long run, and 16% annual EBITDA declines. Additionally, we estimate that due to its broader deployment of UNE-P, the margins on its local product are lower, and will take longer to reach breakeven than AT&T's. For example, we believe MCI's 2003 local UNE-P EBITDA margins are -30%, while AT&T's are -26%. This should improve over the next several years, but at slow rates and with limited profit potential. On the plus side, we believe MCI benefits from a lower proportion of fixed costs within its Consumer unit, which should allow the company to better eliminate expenses as volumes decline, allowing cashflows to remain positive strategically, albeit at very low margins. This is highlighted by the fact that we estimate that SG&A as a percent of Consumer revenues in 2003 is 33% for MCI, but 43% at AT&T. We summarize our MCI local UNE-P forecasts in a subsequent table.

The following table summarizes our Consumer forecast, which is characterized by 7-9% annual revenue declines losses through 2005, easing to mid-single single digit declines longer-term as wireless substitution matures, RBOC penetration slows, voice-rate declines ease, and UNE-P local bundling helps boost customer retention. On average, we are expecting revenues to decline nearly 5% annually through 2010, with EBITDA staying positive throughout. Ultimately, the Consumer unit should shrink to a size that is small relative to the Commercial arm, such that its ultimate resolution would not have dramatic effects. The challenge for MCI in the interim is to build wholesale replacements for the network volume that Consumer currently uses, which should be aided by a gradual migration of voice to VoIP.

Figure 24: MCI Consumer Summary Forecasts

							'03 to '10
(\$ Bil)	2001	2002	2003f	2004f	2005f	2010	CAGR
Stand-Alone LD Voice	\$7.1	\$5.0	\$2.8	\$1.5	\$0.7	\$0.1	-37.9%
% Growth	2.1%	-29.3%	-43.2%	-46.4%	-55.9%	n/m	
Bundled Voice	\$0.2	\$1.0	\$2.4	\$3.2	\$3.9	\$4.0	7.9%
	n/m	576.1%	125.6%	37.4%	18.5%	-1.8%	
Other	\$4.0	\$2.7	\$1.1	\$1.0	\$0.8	\$0.4	-14.5%
Total Revenue	\$11.2	\$8.7	\$6.3	\$5.7	\$5.3	\$4.5	-4.7%
% Growth	-13.6%	-21.8%	-27.9%	-9.1%	-7.2%	-2.1%	
EBITDA	\$2.4	\$1.5	\$0.7	\$0.6	\$0.5	\$0.2	-16.1%
% Growth	-42.0%	-38.2%	-53.1%	-9.4%	-18.5%	-15.9%	
Margin	21.5%	17.0%	11.0%	11.0%	9.7%	4.5%	
Capex	\$0.3	\$0.1	\$0.1	\$0.0	\$0.1	\$0.2	10.1%
% Growth							
% of Rev	2.4%	1.1%	1.3%	0.5%	1.8%	3.5%	
OFCF⁽¹⁾	(\$0.5)	\$1.6	\$0.9	\$0.4	\$0.3	(\$0.0)	-165.7%
% Growth		-402.6%	-44.2%	-53.8%	-31.3%	n/m	
Margin	-4.8%	18.6%	14.4%	7.3%	5.4%	-1.1%	

(1) Operating Free Cash Flow is defined as CFFO - capex.

Figure 25: MCI Consumer Local UNE-P Forecasts

MCI Consumer - Stand-Alone Local UNE-P Forecasts				
Subscribers: (000)	<u>2003f</u>	<u>2004f</u>	<u>2005f</u>	<u>2006f</u>
Eligible Consumer HHs	96,513	93,394	92,221	91,396
% of US	78.0%	85.0%	85.0%	85.0%
Gross Adds	3,496	3,829	3,704	3,574
<u>- Churn (Annual)</u>	<u>50.2%</u>	<u>47.2%</u>	<u>39.6%</u>	<u>37.4%</u>
Net Adds	2,041	1,496	1,153	733
Year-End Subs	4,941	6,437	7,590	8,322
Penetration of Eligible HHs	5.1%	6.9%	8.2%	9.1%
Revenue:				
Effective ARPU/Mo.	\$29.6	\$28.2	\$27.6	\$27.6
Local UNE-P Revenue (\$mil)	\$1,411	\$1,941	\$2,333	\$2,646
% Growth	115%	38%	20%	13%
Expenses:				
CGS: UNE-P Rate/Sub/Mo.	\$18.2	\$19.0	\$19.3	\$19.3
Gross Margin	38%	32%	30%	30%
SG&A (Inc. Acq. Costs)/Sub/Mo.	\$20.7	\$13.4	\$9.7	\$8.0
EBITDA (\$mil)	(\$419)	(\$273)	(\$107)	\$36
Margin	-30%	-14%	-5%	1%

Valuation – Bankruptcy Plan Capital Structure:

We have assumed the bankruptcy plan base-case capital structure of 326 million in new equity shares and \$5.7 billion of total debt (\$3.5 billion of 2003 net debt). The following table summarizes our estimation of the impact of higher amounts of equity (and thus lower amounts of debt) in the initial capital structure. We estimate that for each incremental 20 million shares of equity issued at the time of reorganization, the dilution per share is estimated to be \$0.50. Therefore, if the maximum amount of 366 million shares is issued, we believe the equity value would be \$1.0 less than if the minimum 326 million shares are issued. The table also shows that no matter what the ultimate blend of debt and equity are under the reorganized capital structure, the leverage of the company is extremely modest. Additionally, even under the maximum 366 million share scenario, the implied P/E on estimated 2004 EPS is still a modest 10.0x, below the 2004 industry average of 11.5x.

Figure 26: Capital Structure & Value Implications

MCI - Valuation & Balance Sheet Effects of Different Re-emergence Capital Structures					
Debt Scenario	Bankruptcy Base Plan	Range of Bankruptcy Plan Debt Scenarios		Versus Bankruptcy Plan Base Case	
	Maximum of Possible Debt	Mid-Range of Possible Debt	Lowest-End of Possible Debt	Mid-Range Vs. Base Case	Lowest-End Vs. Base Case
(\$ bil):					
Total Assets	\$20.9	\$20.9	\$20.9		
Total Debt	\$5.7	\$5.2	\$4.7	(\$0.5)	(\$1.0)
Debt / Assets	27.5%	25.1%	22.7%	-240 bp	-479 bp
Book Equity	\$8.4	\$8.9	\$9.4	\$0.5	\$1.0
Debt / Equity	0.7x	0.6x	0.5x	-0.1x	-0.2x
"New-Co." Shares (mil)	326	346	366	20.0	40.0
"New-Co." 2004 EPS	\$2.76	\$2.64	\$2.50	(\$0.12)	(\$0.26)
Implied P/E (on Assumed \$25 Price)	9.1x	9.5x	10.0x	0.4x	0.9x
Unlevered FCF / Share	\$4.41	\$4.15	\$3.93	(\$0.25)	(\$0.48)
Implied \$25 Share Price / FCF	5.7x	6.0x	6.4x	0.3x	0.7x
DCF- Value / "New-Co." Share	\$25.1	\$24.6	\$24.1	(\$0.5)	(\$1.0)

(1) Consolidated tracking stock information reflecting the current capital structure for Sprint. Corp.

Potential Trading Range:

The following table outlines what we believe to be a potential trading range for the new stock, given three views on the company. Our Base Case assumes that the stock's value is viewed on a discounted cashflow, as well as on relative EV/EBITDA multiple basis, and that management is reasonably successful in achieving its stated EBITDA goals for 2004. At an assumed maximum number of 366 million new shares, we believe a Bull-Case premium valuation could be \$27-\$28. Our Bear Case analysis assumes that only a EV/EBITDA multiple valuation gets applied and that the 10-year industry low multiple value is assigned to a 2004 MCI EBITDA amount that is only 50% as improved as management forecasts. This results in a \$22 value per share. We believe the near-term equilibrium range should be between these two points, roughly in the \$24-\$26 range.

Figure 27: Potential Trading Range

MCI Potential Trading Range Arguments			
New MCI Equity Valuation:	Bear Case	Base Case	Bull Case
Market Assumptions	Stock gets valued at the 10-yr low-tick of industry EV/EBITDA multiples and market believe 2004 MCI EBITDA will only improve 50% of mgmt's forecasted \$1 billion amount. No intrinsic value (DCF) credit is given.	Stock gets valued both intrinsically and by peer EV/EBITDA target multiples. Market believes 2004 MCI EBITDA will achieve 80% of mgmt's forecasted improvement, reaching \$3.5 b.	Stock gets valued both intrinsically and by peer EV/EBITDA target multiples. Market believes 2004 MCI EBITDA will achieve 100% of mgmt's forecasted improvement, reaching \$3.7 b.
Valuation Metrics: \$ Bil			
Intrinsic Value:			
DCF - Public Equity Value	No Credit	\$8.2	\$8.2
EV / EBITDA Valuations:			
10-yr Low Industry Multiple	3.0x		
Industry Target Multiple		3.4x	3.4x
2004 EBITDA	\$3.2	\$3.4	\$3.7
Enterprise Value	\$9.5	\$11.8	\$12.6
- Net Debt	<u>\$2.5</u>	<u>\$2.5</u>	<u>\$2.5</u>
Equity Value	\$7.1	\$9.3	\$10.2
Equity Value Per Share⁽¹⁾ at...			
326 million shares (lowest)	\$22	\$27	\$28
346 million shares (mid-range)	\$22	\$27	\$28
366 million shares (max)	\$22	\$26	\$27
Assumes 366 million Shares:			
Potential Trading Range:			
	Price Support	Mid-Range Equilibrium	Premium Multiples
	\$22	\$24 - \$26	\$27 - \$28

(1) Equity Value per Share represents an equal weighted average of the DCF and EV/EBITDA multiple values for the Base Case and the Bull Case. For the Bear Case it only represents the EV/EBITDA multiple value.

Enterprise Telecom Services Comparables:

Figure 28: Enterprise Carrier Comparables

Company & Enterprise Value													
Stock Information				Enterprise Value					Investor Returns				
Company	Ticker	Price	Shares Out	Mkt.Cap	Net Debt	Non-Con. Assets	Enter. Value	Book Equity	Current Yields	Stock Performance: % Return			
									Div Yld	ROA	Week	Month	YTD
AT&T ⁽¹⁾	T	\$19.08	789	15.1	8.5	0.0	23.6	13.6	5.0%	7.6%	1%	-5%	-27%
T Bus. Serv. ⁽²⁾										4.6%			
MCI ⁽¹⁾	MCI AV	\$25.26	326	8.2	3.4	0.0	11.7	8.4	0.0%	6.5%	1%	-5%	-27%
MCI Comm. ⁽²⁾										3.6%			
Sprint ⁽¹⁾	FON	\$15.22	903	13.7	0.0	0.0	13.8	13.3	3.3%	8.7%	-6%	-3%	5%
FON Comm. ⁽²⁾										4.2%			
Level 3 ⁽¹⁾	LVL T	\$5.33	653	3.5	4.5	0.0	8.0	0.3	0.0%	-1.9%	-4%	-1%	9%
L3 Comm. ⁽³⁾										-5.1%			
XO Comm.	XOCM	\$5.30	95	0.5	0.2	0.0	0.7	0.5	0.0%	-6.6%	-2%	-1%	N/A
Time Warner	TWTC	\$10.16	115	1.2	0.8	0.0	2.0	0.5	0.0%	-1.8%	-7%	-13%	382%
Enterprise Avg. (Largecap for Div & ROA)									2.8%	4.2%	-3%	-5%	68%
S&P 500 Avg.											-1%	1%	19%

Operating Statistics													
Stock Information		Revenue				EBITDA				EPS			
Company	LEH Rating	2003		2004		2003		2004		2003		2004	
		\$ Bil	% Gwth	\$ Bil	% Gwth	\$ Bil	Margin	\$ Bil	Margin	\$	% Gwth	\$	% Gwth
AT&T ⁽¹⁾	1-OW	34.7	-8.1%	32.9	-5.4%	8.7	25.1%	7.9	24.0%	\$2.28	-17.2%	\$1.73	-24.3%
T Bus. Serv. ⁽²⁾		25.2	-5.3%	24.5	-2.5%	6.8	26.9%	6.8	27.9%				
MCI ⁽¹⁾	NR	24.5	-16.3%	24.0	-1.7%	2.7	11.2%	3.4	14.3%	N/A	N/A	\$2.76	N/A
MCI Comm. ⁽²⁾		18.2	-11.4%	18.3	0.8%	2.0	11.2%	2.8	15.4%				
Sprint ⁽¹⁾	2-EW	14.1	-7.0%	13.8	-2.6%	4.4	31.1%	4.5	32.9%	\$1.45	7.5%	\$1.55	6.4%
FON Comm. ⁽²⁾		9.3	-5.6%	9.3	-0.6%	2.5	26.8%	2.7	28.5%				
Level 3 ⁽¹⁾	1-OW	3.6	26.6%	3.6	-1.2%	0.4	12.1%	0.6	16.4%	(\$1.18)	N/M	(\$0.98)	N/M
L3 Comm. ⁽³⁾		1.6	2.9%	1.8	9.0%	0.4	27.3%	0.6	32.2%				
XO Comm.		1.2	-7.2%	1.2	6.7%	0.0	1.1%	0.0	1.8%	(\$1.28)	N/M	(\$1.08)	N/M
Time Warner		0.7	-7.0%	N/A	N/A	0.2	28.6%	N/A	N/A	(\$1.06)	N/M	(\$0.89)	N/M
Enterprise Ind.		151.6	-4.7%	154.8	2.1%	31.0	20.4%	32.9	21.3%				

Valuation Multiples & Capital Structure													
Stock Information		EV / Revenue		EV / EBITDA		EV / OFCF		P/E Ratio		Leverage Ratios		Coverage Ratios	
Company	Price Target	2003	2004	2003	2004	2003	2004	2003	2004	Nt Debt / Capital	Nt Debt / '04 EBITDA	Unlev. '04 OFCF / Int.	
AT&T ⁽¹⁾	\$24	0.7x	0.7x	2.7x	3.0x	4.0x	6.9x	8.4x	11.1x	38.5%	1.1x	4.6x	
T Bus. Serv. ⁽²⁾		0.9x	1.0x	3.5x	3.4x	5.6x	8.4x						
MCI ⁽¹⁾	NR	0.5x	0.5x	4.3x	3.4x	5.3x	11.5x	N/A	9.2x	29.0%	1.0x	3.4x	
MCI Comm. ⁽²⁾		0.6x	0.6x	5.7x	4.1x	5.3x	11.5x						
Sprint ⁽¹⁾	\$18	1.0x	1.0x	3.1x	3.0x	8.0x	6.9x	10.5x	9.8x	0.2%	0.0x	9.0x	
FON Comm. ⁽²⁾		1.5x	1.5x	5.5x	5.2x	12.8x	11.5x						
Level 3 ⁽¹⁾	\$7	2.2x	2.2x	18.2x	13.6x	N/A	115.1x	N/A	N/A	93.1%	7.7x	1.1x	
L3 Comm. ⁽³⁾		5.0x	4.5x	18.1x	14.1x								
XO Comm.		0.6x	0.5x	53.2x	30.0x	N/A	N/A	N/A	N/A	23.3%	7.4x	No Cash Int.	
Time Warner		2.8x	N/A	9.8x	N/A	N/A	N/A	N/A	N/A	61.5%	N/A	N/A	
Enterprise Avg. (Largecap)		0.7x	0.7x	3.4x	3.1x	5.8x	8.5x	9.4x	10.0x	22.6%	0.7x	5.7x	
S&P 500 Avg.													

(1) Represents consolidated, total company information (for Level 3, reflects recurring items only - excludes any dark fiber, settlement & termination)

(2) Reflects operating statistics for the commercial portion of the company; valuation statistics reflect total company market valuation as a multiple of the commercial operating unit's cashflows.

(3) Reflects recurring Communications Group items only

Attachment 3

Verizon's Internal Share Estimates for Fast-Packet Services, ATM, Frame Relay, IP-VPN, and Ethernet

The attached revenue share estimates were prepared by the Market Strategy & Intelligence group within Verizon Business. These results are obtained by first sizing total revenues for the services at issue using both “tops down” and “bottoms up” methods. The “tops down” method forecasts total business revenue for enterprise customers, and then breaks the total business down into service-specific segments. In contrast, the “bottoms up” method forecasts specific products and services and uses the individual forecasts to build the total business size.

Each method uses a combination of primary research and financial or industry analyst secondary research. For the tops-up method, Verizon assesses total business forecasts from all relevant sources that have been recently published, such as broker analyst reports that provide company specific forecasts for industry players as well as overall industry reviews. Verizon also uses information from secondary research vendors, such as the Gartner Group and the Yankee Group. Verizon then constructs a weighted-average growth rate forecast for the large enterprise and mid-sized business in total based on broker analyst views of approximately 40 major industry players (carriers, equipment providers, systems integrators, and IP applications providers). This growth rate forecast provides a check to the “bottoms up” approach.

For the “bottoms up” method, Verizon builds product-specific forecasts. Verizon uses at least three information sources to triangulate an industry-consensus estimate. Verizon then checks the results from this “bottoms up” sizing against the results from the overall business total and growth forecast from the “tops down” method and from our internal modeling and analysis of the actual performance of major industry players.

The sizing work described above forms the “denominator” for determining share calculations. The “numerator” for non-affiliated carriers is Verizon's estimate of revenue for relevant industry participants. This estimate is derived by running a company's publicly available data through an analysis developed for MS&I in 2002 by the Yankee Group. Those revenue calculations, as stated above, are then compared to the total sizing to determine each company's national revenue share.

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