2 NO WAY OUT: THE LACK OF ALTERNATIVES TO SPECIAL ACCESS

Although there is intense competition for interexchange switched voice and dedicated voice and data services, the ILEC monopoly persists largely unchallenged in the case of switched and dedicated access connections between those interexchange carrier networks and individual end-user sites. Some might think that large users' needs are confined primarily to large buildings and commercial centers at which competing services will be readily available. However, many corporate networks involve tens of thousands of small sites – the vast majority of which are in places where the ILEC is the only source of connectivity. Competitive service is available on a very limited basis, and the incumbent local exchange carriers remain the sole source of dedicated ("special") access connectivity at roughly 98% of all business premises nationwide, even for the largest corporate users. The lack of competitive alternatives for high capacity access services is attributable to many well-recognized barriers to competitive entry, especially the very high fixed-costs and risk associated with such investments. These conditions are not likely to change any time soon.

Despite CLEC gains in other market segments, the competitive availability of "last mile" connections for large business users remains very limited

Since the first competitive alternatives in telecommunications appeared nearly half a century ago,[15] large business users have frequently been among the earliest to adopt them and were among the first to

15. In its *Above 890* ruling, 27 FCC 359, 396 (1959), in which the FCC authorized the award of private microwave licenses directly to end users, the Commission declined to require common carriers to interconnect with these private systems. That policy remained in effect until the *Specialized Common Carrier* ruling, when such interconnection between private and carrier networks was required. *Specialized Common Carrier Services, First Report and Order*, 29 FCC 2nd 870, 940 (1971). *Recon. denied*, 31 FCC 2nd 1106 (1971). *Aff'd sub nom. Washington Utilities & Transportation Commission v. FCC*, 513 F. 2d 1142 (9th Cir. 1975).

realize the economic and technological benefits that these new choices had created. Many of these customers regularly make sizable telecommunications purchases and are willing to make volume commitments and enter into long-term contracts, factors that tend to make them particularly attractive to potential suppliers. Nonetheless, while large corporate users have been actively pursuing a broad range of competitive telecommunications choices for several decades, they remain even today *overwhelmingly dependent upon the traditional incumbent local telephone monopolies for the vast majority of locations and service requirements.*

To be sure, there is intense competition in the market for *interexchange* switched voice and dedicated voice and data services, competition that has resulted in extensive capacity expansion and significant reductions in the prices of these services. That is not the case, however, with respect to the switched and dedicated access connections between those interexchange carrier networks and individual end-user sites. There is at best only limited competition for "last mile" connections – so-called "local loops" – between individual customer premises and common carrier networks, whether for conventional "dial-tone" access to the local public switched network, for dedicated access for voice or data private lines, or for Internet access. Even though it has been nearly two decades since competitive access providers made the first, targeted inroads into the access markets, the current availability of special access services from competing providers remains confined to a small number of buildings in an even smaller number of concentrated business districts. While some of large users' requirements fall within those highly concentrated urban areas, many major companies have networks that connect, in some cases, tens of thousands of individual sites – the vast majority of which are areas where the ILEC is the only source of connectivity.[16] It is critically important that policymakers understand that incumbent local exchange carriers remain the sole source of special access connectivity at roughly 98% of all business premises nationwide and that this condition affects even the largest corporate users. In its 2003 *Triennial Review Order*, the FCC found that while competing facilities are available to *some* business customers at *some* of their locations, competitive alternatives are far from universally available:

> ... When competitive LECs self-deploy fiber they predominantly do so at the OCn-level. ... In contrast, the record contains little evidence of self-deployment, or availability from alternative providers, for DS1 loops. As for DS3 loops, evidence of self-deployment and wholesale availability is somewhat greater than for DS1s and is directly related to location-specific criteria. Indeed, competitive LECs agree that at a three DS3 loop capacity level of demand, it is economically feasible to self-deploy ...[17]

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16. For example, a bank network would typically serve hundreds or thousands of branches and thousands or tens of thousands of ATMs. An airline network would have connections to tens of thousands of travel agents. An automobile manufacturer's network would provide service to thousands of auto dealerships. The overwhelming majority of such locations are nowhere near any central business district or concentration of CLEC facilities.

17. *Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carrier*, CC Docket No. 01-338; *Implementation of the Local Competition Provisions of the Telecommunications Act of 1996*, CC Docket No. 96-98; *Deployment of Wireline Services Offering Advanced Telecommunications Capability*, CC Docket No. 98-147, *Report and Order and Order on Remand and Further Notice of Proposed Rulemaking*, FCC No. 03-36, 18 FCC Rcd 16978 (2003) ("*Triennial Review Order*") at para. 298. *See also* paras. 299-307.

CLECs have deployed limited amounts of fiber optic cable along major streets in downtown business districts, but those facilities are physically connected to only a small fraction of the buildings that they pass. This is because the cost to establish each such connection is substantial and is typically incurred by a CLEC only in those limited cases with the actual or potential demand *in a given building* is sufficiently large that these fixed costs can realistically be recovered.[18]

Evidence recently submitted to the FCC by Verizon confirms the extent of enterprise customers' extreme and utter dependence upon BOC-provided special access services, even in what many consider to be the most competitive local service markets in the country (see Figures 2.1 and 2.2). Verizon's maps conclusively demonstrate that throughout both the New York and Washington metropolitan areas, CLECs are required to rely upon overpriced Verizon special access loops to reach enterprise customers.[19] The picture being painted by these two graphics is even more compelling when one considers that the customer locations shown represent only special access facilities provided to CLECs for local service use – they do not include special access services furnished for more traditional uses, such as for access to long distance carrier voice networks, connections to dedicated private lines, connections to frame relay or ATM ports, or facilities used to provide Internet access.

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18. Consider an analogy to mass transit or highway construction. The costliest parts of such projects are stations (in the case of transit systems) or interchanges (in the case of highways). Yet access to such facilities can only be accomplished at these points, so living next to a railroad but miles from the nearest station is no better, in terms of convenient access, than not living near the railroad to begin with.

19. July 19, 2004 *ex parte* filing by Verizon Communications, Inc. in CC Docket No. 01-338, *Section 251 Unbundling Obligations for Incumbent Local Exchange Carriers*. In its filing, Verizon also included maps purporting to display locations of enterprise customers being served by CLEC-owned facilities. However, these "CLEC facility" maps do not offer any information as to the nature of such facilities, nor do they indicate whether these CLEC installations consist primarily (as is likely) of multiple DS-3s or OCn channels. The fact that *some* locations are being served by CLEC-owned facilities in no way diminishes Verizon's absolute monopoly at all locations where no alternative facilities are in place or at locations at which customer demand is insufficient to make CLEC entry economically feasible.

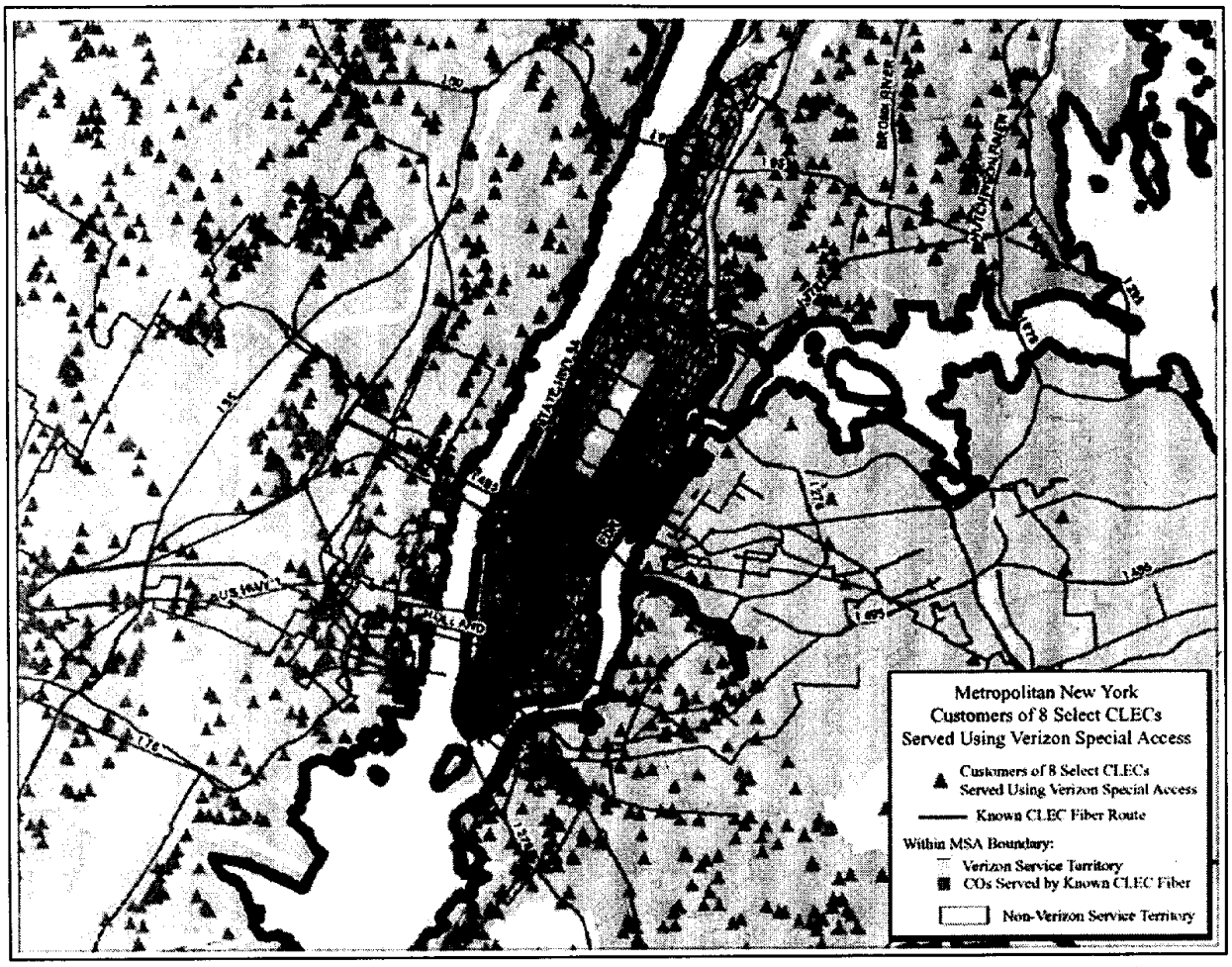

Figure 2.1. Locations of Verizon Special Access services being used by CLECs to provide local service to enterprise customers in the New York Metropolitan area.

Figure 2.2. Locations of Verizon Special Access services being used by CLECs to provide local service to enterprise customers in the Washington Metropolitan area.

All signs point to the continuing lack of competitive alternatives for the large user market

The limited competition for the provision of access services that exists today is not all new. Competitive Access Providers ("CAPs") have been around since the early 1980s. The earliest public utilities commission decisions authorizing local competition pre-date the 1996 Telecommunications Act by more than a decade. Yet, even today, the non-ILEC local service providers – whether they employ

traditional wireline facilities or some inter-modal alternative such as cable or wireless, are still at best marginal players in the local service market.[20]

Competitive intra-modal choices being provided by CLECs and CAPs address only a small portion of the total business market for special access services and other forms of local connectivity.

After reviewing the voluminous record submitted by ILECs, CLECs and IXCs in the FCC's *Triennial Review Order* (TRO) Proceeding, the Commission reported that "between 3% and 5% of the nation's commercial office buildings are served by competitor-owned fiber loops."[21] Even by the most generous of the ILECs' own counts, all CLECs *combined* serve only about 30,000 of the roughly 3-million commercial buildings nationwide.[22] Verizon reported this estimate in response to AT&T's 2002 *Special Access Petition*,[23] and as such, had every incentive to identify and report the largest base of special access competition possible.[24] Table 2.1 below presents the optimistic estimates of "connected" buildings put forth by Verizon, the FCC and CLECs. The Table also includes estimates of commercial building connections via cable and fixed wireless. In not one of the depicted cases in Table 2.1 is the number of "connected buildings" greater than 1% of a conservatively estimated 3-million commercial buildings. Combining the most expansive (Verizon) estimate of "connected" buildings from traditional ILEC special access facilities with the purportedly intermodal competitive alternatives offered by cable and fixed wireless providers, and assuming *no overlap* in the buildings "connected" by these different technologies – all extremely conservative assumptions – provides a *lower bound* estimate of the commercial buildings that have no alternative to ILEC special access at 98%, with the actual figure

20. The March 2, 2004 ruling by the US Circuit Court of Appeals for the District of Columbia Circuit, if not reversed, portends to eliminate the sole telecommunications market segment in which at least *some* non-trivial level of competition has developed – *retail* mass market services. While pejoratively portraying such activity as "synthetic competition," the DC Court has ignored the important service and pricing innovations that are attributable specifically to competing retail service providers, and has also failed to recognize that virtually every other major US industry is structured with a retail segment that does not itself "produce" the underlying product or service. With UNE-P gone, the prospects for any consequential competition for mass market services has all but vanished. *See, United States Telecom Association, Petitioner v. Federal Communications Commission and United States of America, Respondents, Bell Atlantic Telephone Companies, et al., Intervenors*, 359 F.3d 554 (D.C. Cir., 2004).

21. *Triennial Review Order*, at fn. 856.

22. *AT&T Corp. Petition for Rulemaking To Reform Regulation of Incumbent Local Exchange Carrier Rates For Interstate Special Access Services*, RM Docket No. 10593, *Opposition of Verizon*, filed December 2, 2002 ("*RM 10593 Opposition of Verizon*") at p. 13.

23. *AT&T Corp. Petition for Rulemaking To Reform Regulation of Incumbent Local Exchange Carrier Rates For Interstate Special Access Services*, RM Docket No. 10593, *AT&T Corp. Petition for Rulemaking*, filed October 15, 2002 ("*AT&T Special Access Petition*").

24. It should be noted that even using this most optimistic of estimates, in many instances even when a CLEC is able to establish its own facility-based "connection" to a multi-tenant commercial building, it is not given access to all tenants within the building.

likely higher than that. Although the reported data is in some cases up to two years old, there is no reasons to believe that the number of "connected" buildings has increased substantially since 2002. In point of fact, the availability of competitive special access connections may actually be decreasing. As service providers exit the business altogether or scale down operations as part of Chapter 11 proceedings, they frequently scale back their actual connections and/or are forced to admit that their "on net" building connectivity and network deployment claims had been exaggerated.

If competitively supplied loops were widely available, one would expect that the large IXCs would be using them to the maximum extent possible for their special access needs,[25] because special access charges comprise a significant portion of their costs of doing business. However, in a declaration accompanying its 2002 *Petition* AT&T reported that it has been unable to obtain non-ILEC special access services for all but a small fraction of its special access requirements. Specifically, AT&T stated that it serves some 186,000 buildings using special access, yet except in 5% of those cases (9,700 buildings), it must still rely upon the ILECs' special access services.[26] Of the 5% of buildings for which AT&T has been able to obtain an alternative, the majority are self-provided circuits, and only about 3,700 buildings – or 2% of the total – are served using other CLECs' facilities.[27] As a CLEC, AT&T has facilities to only 6,000 of the roughly 3-million commercial buildings in the U.S. – a mere *one-fifth of one percent*!

AT&T's experience is corroborated by statements that Sprint Corporation has made in several FCC proceedings. Back in 1998, Sprint reported that "in 1996, only nine cents of every special access dollar spent by Sprint went to non-ILEC vendors. By January 1998, this figure had increased only slightly, with alternative vendors accounting for only 9.6% of Sprint's total access facility outlays.[28] In comments filed in 2002, Sprint reported that the passage of four years had not improved its ability to obtain special access facilities from ILEC competitors. Filing in the Commission's *Special Access Performance Measurement* proceeding, Sprint states that "Sprint Long Distance ... continues to rely upon the ILECs for approximately 93% of its total special access needs despite aggressive attempt to

25. We recognize that the FCC's "commingling" rules bar the use of unbundled loops solely to provide special access service, but do allow certain combinations of special access and local exchange service on the same loop facility. See 47 C.F.R. 51.318.

26. *AT&T Corp. Petition for Rulemaking To Reform Regulation of Incumbent Local Exchange Carrier Rates For Interstate Special Access Services*, RM Docket No. 10593, *Declaration of Kenneth Thomas on behalf of AT&T*, filed October 15, 2002 as part of the *AT&T Special Access Petition*, (*"RM 10593 Declaration of Kenneth Thomas on behalf of AT&T"*) at p. 1.

27. *Id.*, at p. 1.

28. *Access Charge Reform*, CC Docket No. 96-262; *Price Cap Performance Review for Local Exchange Carriers*, CC Docket No. 94-1; *Petition for Rulemaking of Consumer Federal of America, International Communications Association and National Retail Federation Relating to Access Charge Reform*, RM No. 9210, *Comments of Sprint Corporation*, filed on October 26, 1998, at p. 4.

self- supply and to switch to CLEC-provided facilities wherever feasible."[29] Sprint's estimate of total alternative access provider connections into commercial buildings is larger than AT&T's (Sprint estimates that there are approximately 30,000 connected buildings, and estimates the total number of US commercial buildings at just under 750,000),[30] buts still represents connectivity at less than 5% of commercial buildings in the US. Moreover, Sprint goes on to report that in 12,000 of the buildings (e.g., 40% of the time), the connection is limited to a single customer, and the CLEC is unable to provide access to other customers located in the same building.[31]

CLECs typically seek out opportunities to purchase service from other CLECs (rather than from ILECs) so as to expand the number of buildings where they can "bypass" ILEC facilities. However, the availability of such alternatives continues to be quite limited. AT&T, for example, indicated that looking to the other major CLECs gives it potential access to only an additional 14,000 buildings nationwide (which includes the 3,700 buildings where AT&T actually purchases some CLEC access).[32] Figure 2.3 provides a graphic illustration of the availability of CLEC loops to large business users. The difficulties being experienced by even the largest IXCs in attempting to find alternatives to ILEC special access services underscore the ILECs' continuing dominance of the special access market. Of course, the dearth of competitive alternatives applies just as much to large businesses seeking to obtain those services directly as it does to IXCs that might use special access to provide an integrated package of telecommunications services to large users.

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29. *See, Performance Measurements and Standards for Interstate Special Access,* CC Docket No. 01-321, *Comments of Sprint Corporation*, filed January 22, 2002, at pp. 4-5; *See also, Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carrier*, CC Docket No. 01-338; *Implementation of the Local Competition Provisions of the Telecommunications Act of 1996,* CC Docket No. 96-98; *Deployment of Wireline Services Offering Advanced Telecommunications Capability,* CC Docket No. 98-147, *Comments of Sprint Corporation*, April 5, 2002, at pp. 23-24.

30. *AT&T Corp. Petition for Rulemaking To Reform Regulation of Incumbent Local Exchange Carrier Rates For Interstate Special Access Services*, RM Docket No. 10593, *Comments of Sprint Corporation,* filed December 2, 2002 ("*RM 10593 Sprint Comments*"), at p. 4.

31. *Id.*, at p. 4.

32. As indicated, AT&T uses CLEC facilities at approximately 3,700 of the approximately 14,000 locations where such facilities are available. See, *RM 10593 Declaration of Kenneth Thomas on behalf of AT&T*, at p. 3. According to AT&T, and certainly confirmed by first-hand experience of Ad Hoc members, there are several critical factors that account for AT&T's reluctance to purchase CLEC access facilities, even when they exist. First, major IXCs typically require underlying suppliers to meet criteria for service quality, performance measures and cost effectiveness. *Id.* at p. 2. Some CLECs do not meet these criteria and thus do not provide viable options. Similarly, IXCs that depend upon CLECs for special access often confront a level of uncertainty that threatens to impair their continuing use of such competitive alternatives. According to AT&T, more than half of the buildings for which CLEC special access was available are served by CLECs that have declared bankruptcy. *Id.* at p. 4. Not surprisingly, large users, who cannot afford service disruptions, often direct their principal IXCs to avoid obtaining access links from potentially unstable, bankrupt CLECs. Moreover, CLECs are not always able to secure the building owners' permission to locate equipment in the building's common space, so that in many cases access is limited to a "fiber to the floor" arrangement in which only particular floors in the building can be served. *Id.* at p. 2. Thus, even where there is competitive special access in a building, there is not always competitive special access available to serve all customers in that building.

Table 2.1

Most Optimistic Estimate of Facilities Based Special Access Competition From All Sources

	Traditional Wireline			CATV	Fixed Wireless
	AT&T	CLECs	Verizon	FCC	FCC
Number of Buildings	6,000	14,000	30,000	30,000	25,000
Total % of Commercial Buildings	0.20%	0.47%	1.00%	1.00%	0.83%

Notes: Total number of commercial buildings is estimated to be 3-million; each CATV and fixed wireless line is treated as a separate building/address.

Sources: AT&T estimate reported in RM 10593 Declaration of Kenneth Thomas on behalf of AT&T at p. 1; Verizon estimate reported in RM 10593 Opposition of Verizon at p. 13; CLEC estimate reported in RM 10593 Declaration of Kenneth Thomas on behalf of AT&T, at p. 3; FCC CATV and Fixed Wireless estimates reported in High Speed Services for Internet Access: December 31, 2003, Tables 3 and 5, and Tables 1 and 3, respectively.

The experience of Ad Hoc's own members corroborate this evidence. Despite being among the largest and most technologically sophisticated users of telecommunications services in the country, the members of the Ad Hoc Committee report that they face no competitive alternatives to ILEC services to meet their broadband business services requirements in the overwhelming majority of their service locations. Even where competitive alternatives are nominally "available," members are able to make little use of those competitor services for a variety of reasons.

In 2002, members of the Ad Hoc Committee aggregated their company-specific information regarding the number of customer locations with broadband service needs falling into each of the four following categories:

- Category A: Capacity of 12 DS-0 channels or less (i.e., ½ T-1, 760 kHz, xDSL, etc.).
- Category B: Capacity of at least one but not more than four DS-1 circuits.
- Category C: Capacity greater than four DS-1 circuits, or at a level sufficient to justify the provision of at least one DS-3 facility, other than SONET or Optical Carrier ("OC") service.
- Category D: SONET or OC service.

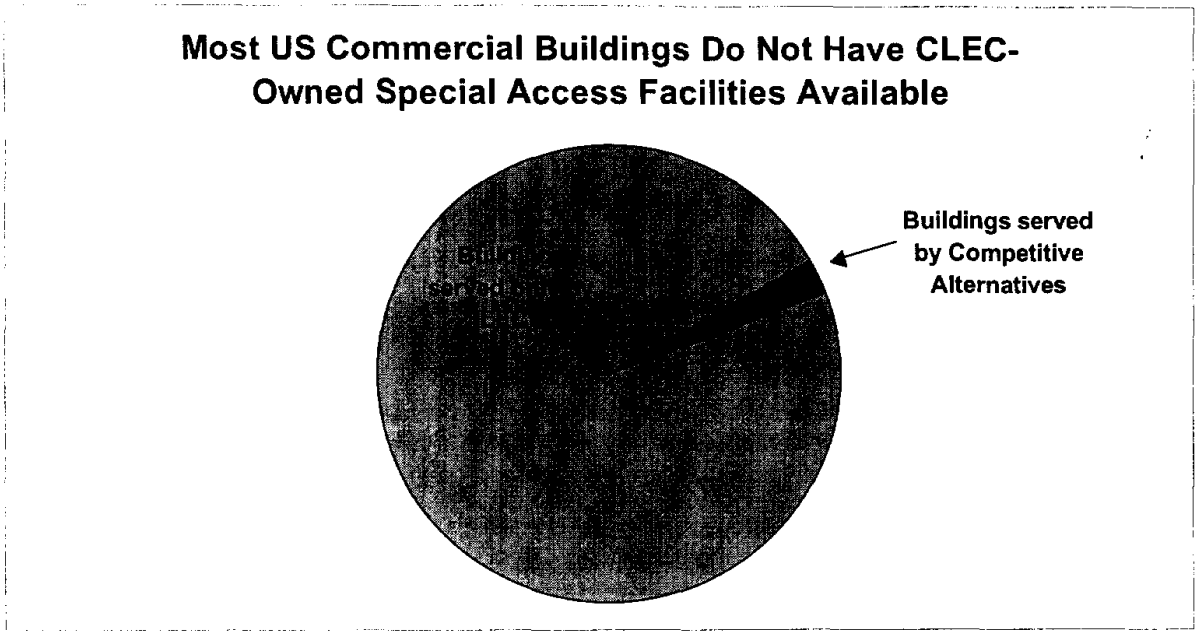

Figure 2.3: Most US Commerical Buildings Do Not Have CLEC-Owned Special Access Facilities Available

Committee members were then asked to provide estimates of the percentage of locations by category for which they were aware of the presence of viable competitive alternatives to ILEC services. Finally, members were asked to estimate the percentage of locations by Category at which they currently used a competitive carrier to satisfy their service requirements. The total number of locations surveyed was about 30,000.[33]

The results of the survey demonstrate that viable competitive alternatives are not frequently available, particularly with respect to smaller business service locations.[34] For the overwhelming majority of Category A and B business service locations, viable competitive alternatives to the incumbent LEC's data service were available at less than 10%. The vast majority of the Category C business service locations also appear to have very few viable competitive alternatives. Although some members indicate the presence of some competitive alternatives for seldom-purchased Category D

33. This data was first reported in Ad Hoc comments filed in CC Docket No. 01-337. *See, Review of Regulatory Requirements for Incumbent LEC Broadband Telecommunications Services*, CC Docket No. 01-337, *Comments of Ad Hoc Telecommunications Users Committee*, filed March 1, 2002 *("CC 01-337 Ad Hoc Comments").*

34. The survey asked respondents to indicate whether there were viable competitive alternatives for each category of service at (a) fewer than 10% of the service locations; (b) between 10% and 25% of the service locations; (c) between 25% and 50% of the service locations; and (d) more than 50% of the service locations.

services, others indicate that viable competitive offerings are no more prevalent for the highest capacity services than for the lowest.

As would be expected, the existence of few viable competitive alternatives has resulted in few actual purchases of competitive data services by Ad Hoc's members.[35] Members indicate that in all Category A locations and nearly all Category B locations, fewer than 10% are served by competitors. The majority of Category C and D locations also are served by competitors less than 10% of the time.

Committee members have raised several issues that determine whether or not they can use a competitive carrier in those few locations where one is available. Service quality, reliability, and security are all critical issues that business end users must consider when evaluating competitive alternatives to the ILEC's broadband service offerings. CLEC network ubiquity and price are two other interrelated issues. Because CLEC networks are not as ubiquitous as those of the incumbents, many business service locations seeking broadband services from a CLEC either require (1) additional build-out by the competitor, or (2) "backhauling" of access to the CLEC POP (at the customer's expense). Either outcome increases the cost of service as compared to the ILEC, creating additional barriers for CLEC efforts to penetrate the business end user market. Statistics that focus solely upon the nominal "presence" of competitors, in particular the criteria adopted by the Commission as the threshold standard for Phase II pricing flexibility, fail utterly to account for the practical realities of acquiring and utilizing services from non-ILEC providers.

Indeed, issues of total cost, network integration, reliability, and responsiveness ultimately determine whether a competitor's service is considered by an end user to be a viable alternative in the first place. It is not enough simply to have competitors "operating" in the market – rather, the services provided by carriers other than the incumbent LEC must also satisfy the customer's standards for purchase and use. The survey responses provided by Ad Hoc's members substantiate the fact that even where "available," CLEC services rarely met members' needs in 2002; a recent polling of those same members in the first quarter of 2004 indicated no material change in circumstances since the time of the original survey. As such, it is clear that the business data service market is far from being effectively competitive, and thus continues to require more robust price regulation than the FCC now applies to this sector.

Similarly. current data filed with the FCC also suggests that CLECs have never attained a significant market share using their own loops for *switched* access. CLECs serve about 7-million (approximately 23.5%) of their switched access lines using their own facilities,[36] but roughly just under half of those – 3.22-million – are mass market (mostly residential) services being furnished by cable

35. The survey asked respondents to indicate whether they purchased data services from competitive carriers for each category of service at (a) fewer than 10% of the service locations; (b) between 10% and 25% of the service locations; (c) between 25% and 50% of the service locations; and (d) more than 50% of the service locations.

36. Industry Analysis and Technology Division, Federal Communications Commission, *Local Telephone Competition: Status as of December 31, 2003,* June 2004 ("*Local Competition Report*"), at Table 3.

television operators to their cable subscribers.[37] Even if we assume that *all* of the *non-cable* facilities-based CLEC lines are being used to serve medium and large business customers (and not mass market subscribers), then *at the very most*, CLEC-owned facilities account for only about 8% of the total reported end user switched business access lines[38] and, because medium and large businesses have multiple lines – some in the tens of thousands – the number of *customers* obtaining service from carriers other than ILECs is a far smaller figure.

Intermodal competitive alternatives from Cable and Fixed Wireless are not realistic alternatives for most business applications

As the Commission has often posited, non-wireline ("intermodal") alternatives to traditional ILEC services have the potential to offer viable competitive choices. Regardless of their merits or prospective potential as full-fledged substitutes for plain old telephone service (POTS), the substitutability of these alternatives for most *business* uses is close to nonexistent. As the Commission has recognized, intermodal alternatives are not always reasonable substitutes for ILEC wireline services due to the lack of comparability in availability, quality, price, or the maturity of the alternative provider.[39] Moreover, specific customers (or customer classes) may have specialized requirements (e.g., data security or full-time reliability) that effectively preclude the use of non-wireline substitutes. As detailed below, at least for the present, it is clear that intermodal providers are not capable of supplying a sufficient quantity or quality of service to represent a serious competitive choice for the extensive special access needs of large business customers.

Cable: Cable television companies ("cable") have been portrayed by the ILECs to be a formidable source of competition, and arguably they have been the most significant facilities-based alternative to the ILECs *with respect to mass market (principally residential and "home business") services.* However, cable is not well positioned to meet the connectivity needs of large business users, for several reasons.[40] First, the networks constructed by cable companies are largely designed to reach residential dwellings, not business locations. With the possible exception of local retail shopping areas interspersed within or adjacent to residential neighborhoods, cable infrastructures generally do not "pass" business

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37. *Local Competition Report,* at Table 5.

38. *Local Competition Report,* at Tables 2, 3 and 5: CLEC-owned switched access lines [6,935,000] minus cable telephony lines [3,220,000] divided by the sum of ILEC "other" switched access lines [33,086,052] and CLEC "other" switched access lines [10,841,075].

39. *Triennial Review Order,* at 18 FCC Rcd 17044, at para. 97.

40. The Ad Hoc Committee has discussed these issues in greater detail in its comments in the FCC's broadband services proceeding, CC Docket No. 01-337. See, *01-227 Ad Hoc Comments,* at 17-19; and *Review of Regulatory Requirements for Incumbent LEC Broadband Telecommunications Services*, CC Docket No. 01-337, *Reply Comments of Ad Hoc Telecommunications Users Committee*, filed April 22, 2002, at 4-6.

locations and thus cannot readily serve the vast majority of office buildings and other business sites. In the context of its monitoring of advanced services deployment, the FCC found that:

> Residential and small business subscribers, not surprisingly, account for over 96 percent of the reported high-speed lines delivered over cable systems. This is consistent with our understanding that most cable systems are currently deployed in primarily residential areas.[41]

In addition, because cable companies are primarily oriented towards a mass-market customer base, their telephony and data (*i.e.*, cable modem) offerings generally fall short of ILEC offerings in the areas of service reliability and security. Cable networks do not have the same degree of back-up electrical power as do the ILEC networks, and the "shared platform" nature of cable modem service raises data security and transmission performance issues that are particularly important to business customers, who routinely transmit highly sensitive or mission-critical financial and commercial data.

Given the shortcomings of CATV-provided business services, it is not surprising that cable providers reported supplying fewer than 16,000 coaxial cable connections to medium and large businesses *nationwide* at the time the FCC reached its conclusions in the *Triennial Review* proceeding, and report less than 30,000 such connections today.[42] Considered in relation to the roughly three million commercial buildings, these connections represent less than one percent of potentially addressable business locations. Clearly, cable has thus far had minimal impact upon the ILECs' virtual monopoly on connectivity supplied to large businesses, and this situation appears unlikely to change any time soon.[43]

Fixed Wireless: Fixed wireless service is more easily deployed than cable, but like cable is a wholly inadequate substitute for high capacity wireline access for business customers. Fixed wireless began as yet another highly touted technology of the late 1990s, and like many of the others, it has not lived up to its expectations. Since its inception, the technology has been bogged down with operational

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41. *Inquiry Concerning the Deployment of Advanced Telecommunications Capability*, CC Docket 98-146, *Third Report*, FCC No. 02-33, 17 FCC Rcd 2844 (2002) at 2864, para. 45 (footnotes omitted, emphasis supplied).

42. *Triennial Review Order* at 18 FCC Rcd 17010, para. 41. Citing, Industry Analysis and Technology Division, Wireline Competition Bureau, *High Speed Services for Internet Access: Status as of June 30, 2002*, rel. December 2002. Analysis of the most recent IATD report reveals that for the period ended December 31, 2003, 5-million high speed coaxial cable connections serving new residence and small business cable high speed connections were added, and that only approximately 3,400 new coaxial cable connections were added that served large business subscribers, with the total number of connections to high speed cable connections to large business users still less than 30,000 in total. See, Industry Analysis and Technology Division, Wireline Competition Bureau, *High Speed Services for Internet Access: Status as of December 31, 2003*, rel. June 2004 (*"High Speed Services for Internet Access: December 31, 2003"*); and Industry Analysis and Technology Division, Wireline Competition Bureau, *High Speed Services for Internet Access: Status as of December 31, 2002*, June 2003.

43. A report issued by Cahners In-Stat Group claims that businesses account for only 5% of cable modem subscribers, and penetration is only expected to increase to 10% by 2005. *See, Review of Regulatory Requirements for Incumbent LEC Broadband Telecommunications Services*, CC Docket No. 01-337, *AT&T Comments*, filed April 22, 2002, at p. 41 (citing Cahners In-Stat Group, *Despite Service Provider Pratfalls, Cable Modem Subscriber Growth Remains Robust*, December 1, 2001, at p. 1).

troubles, including both security and transmission problems. According to Network World Fusion, an on-line network research firm, "[t]here are important issues that network executives will need to resolve before signing up for fixed wireless, including security and possible performance degradation from interference with other service providers."[44] When real-time communication is essential, this technology is a liability. In addition to security and service quality issues, fixed wireless also struggles with connection problems. The technology requires line-of- sight transmission. This means that all of the microwave dishes tend to be set up in the same places, namely on top of towers or hillsides – and the concentration of this equipment with these sites exacerbates the interference problems. In analyzing competitive alternatives available to enterprise customers in the context of its market review for the *TRO*, the FCC all but dismissed fixed wireless as an alternative for enterprise customers, finding that "while there was some fixed wireless entry in the enterprise market, it has been limited."[45]

Due to these problems, fixed wireless has remained a marginal technology for serving the needs of enterprise customers (and the fixed per-customer cost makes it prohibitive for mass market adoption). Current deployment in the enterprise market is minimal – a little over 25,000 lines across the country.[46] Indeed, even if one were (unrealistically) to assume that all of those fixed wireless lines were being used as substitutes for ILEC special access, they would account for *two one-hundredths of one percent* of the 103.8-million special access lines (measured in voice grade equivalents).[47]

Slow and sporadic expansion of alternative loop facilities, including loops for the provision of special access services, is consistent with the Commission's findings that significant barriers to entry continue to exist

The lack of competitive alternatives for high capacity services should come as no surprise given the numerous and well-recognized barriers to entry being confronted by competitors. Chief among these barriers are the enormously high fixed-cost investment required to enter this market and the uncertain return on that investment. The Commission has recognized that CLECs have faced and continue to confront significant economic and operational barriers to the self-deployment of loops. In the *Triennial Review Order*, the FCC concludes, "[b]ased on the record as a whole, for DS1 and some DS3 loops, overbuilding to enterprise customers that require services over these facilities generally does not present

44. Jim Geier, *Fixed Wireless Fills a Niche,* Network World Fusion, October 22, 2001. Available at http://www.nwfusion.com/techinsider/1022broadband/feat.html (accessed June 4, 2004).

45. *Triennial Review Order* at 18 FCC Rcd 17012, fn. 144.

46. *High Speed Services for Internet Access: December 31, 2003*, Table 1 and 3.

47. Industry Analysis and Technology Division, Wireline Competition Bureau, *Statistics of Communication Common Carriers 2002/2003*, March 2, 2004.

sufficient opportunity for competitors to recover their costs and, therefore, may not be economically feasible."[48] In the same vein, the Commission observes:

> Because the cost to self-deploy local loops *at any capacity* is great and the cost to deploy fiber does not vary based on capacity, a competitive LEC that plans to self-deploy its own facilities must target customer locations where there is sufficient demand from a potential customer base, usually a multi-unit premises location, to generate a revenue stream that could recover the sunk construction costs of the underlying loop transmission facility, including laying the fiber and attaching the requisite optronics to light the fiber.[49]

The Commission acknowledges that the decision to deploy loop facilities involves assessment of the economics at "*a particular customer location.*"[50] It also notes that

> [e]ven when the customer demand at a certain location may support self-deployment from a pure cost recovery perspective, however, there are other obstacles that must be overcome before such self-deployment can effectively occur. These other barriers include the inability to obtain reasonable and timely access to the customer's premises both in laying the fiber to the location and getting it into the building thereafter, as well as convincing customers to accept the delays and uncertainty associated with deployment of alternative loop facilities.[51]

CLEC deployment of subscriber loop facilities has indeed slowed. Figure 2.4 illustrates the total quantity of CLEC-owned subscriber lines (including those provided over coaxial cable) from December 2000 to June 2003. As the data demonstrates, the total quantity of CLEC-owned loops has remained relative constant at just over 6-million since June 2003, and in point of fact, the total quantity of non-cable CLEC subscriber lines has declined somewhat during the period June 2002 to June 2003 (most likely as a result of CLEC bankruptcies during that time frame), with growth in lines provisioned over coaxial cable (to mass market customers) accounting for the minimal growth that has occurred.

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48. *Triennial Review Order* at 18 FCC Rcd 17157, fn. 859.

49. *Triennial Review Order* at 18 FCC Rcd 17160, para. 303.

50. *Id.*

51. *Id.* "The record [in the *TRO* proceeding further] reflects that constructing local loops generally takes between 6-9 months without unforeseen delay. ... These delays can be attributable to securing rights-of-way from local authorities which is necessary before competitive LECs can dig up streets to lay fiber. Often, carriers must engage in lengthy negotiations with local authorities over the ability to use the public rights-of-way. Similarly, obtaining building and zoning permits adds further delay as local authorities often conduct extensive inquiries into the planned construction activity of the competitive carrier. Moreover, commenters note that many local jurisdictions impose construction moratoriums which prevent the grant of a franchise agreement to construct new fiber facilities in the public rights-of way." *Triennial Review Order* at 18 FCC Rcd 17161, para. 304., footnotes omitted.

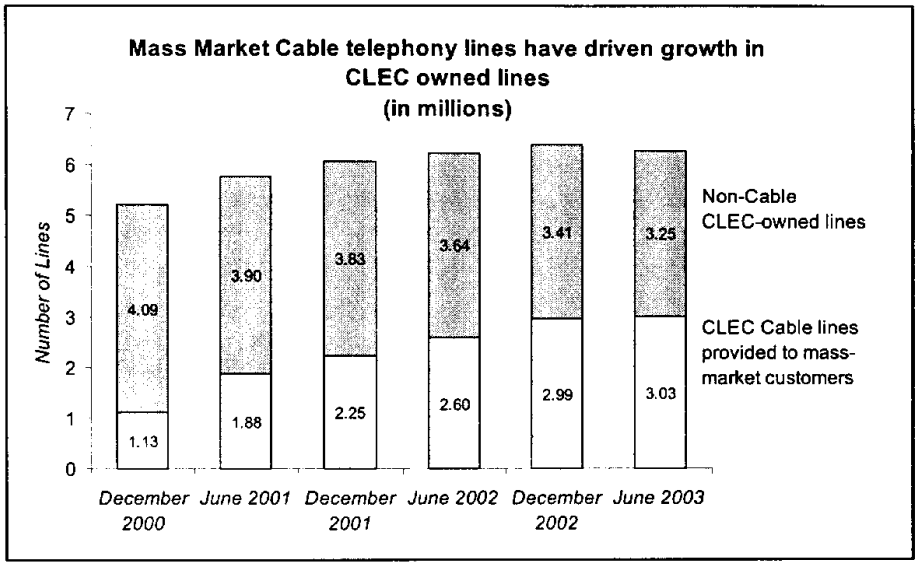

Figure 2.4. Mass market cable telephony lines account for most of the growth in CLEC-owned lines

3 UNDISCIPLINED PRICING AND LIMITLESS EARNINGS IN THE FACE OF ONLY PUTATIVE COMPETITION

Marketplace conduct of the dominant ILECs – extracting higher prices in precisely those geographic areas in which competition is presumed to have materialized – confirms the absence of actual competition. If users confronted actual competitive choices for ILEC switched and special access services, the ILECs would be lowering their prices rather than charging more in purportedly competitive markets, and ILEC earnings would be moving down toward competitive levels, not rising to astronomical heights. But in the markets in which the FCC's pricing flexibility "triggers" have been satisfied, ILEC prices are higher than those in regulated "monopoly" areas, and ILEC profits (as reflected in realized rates of return) for both switched and special access services have risen to high double-digit levels. Contrary to the FCC's expectations at the time it approved the CALLS settlement, competition has not continued to push switched access prices downward toward costs following elimination of X-factor reductions. Thus, affirmative measures are required to get switched access rate reductions back on course, and to bring special access prices back down to reasonable levels.

ILEC rates of return on special access services exceed anything that would be expected from a competitive marketplace

When the FCC adopted its pricing flexibility rules, it expressed the expectation that where actual competition had not yet developed for special access service, potential competition would nonetheless constrain the ILECs' exercise of market power.[52] Experience has shown otherwise. Neither the existing

52. *Access Charge Reform*, CC Docket No. 96-262; *Price Cap Performance Review for Local Exchange Carriers*, CC Docket No. 94-1; *Interexchange Carrier Purchases of Switched Access Services Offered by Competitive Local Exchange Carriers*, CCB/CPD File No. 98-63; *Petition of U S West Communications, Inc. for Forbearance from Regulation as a Dominant Carrier in the Phoenix, Arizona MSA*, CC Docket No. 98-157, *Fifth Report and Order and Further Notice of Proposed Rulemaking*, FCC No. 99-206, 14 FCC Rcd 14221 (1999) *("Pricing Flexibility Order") at 14264, para. 80.*

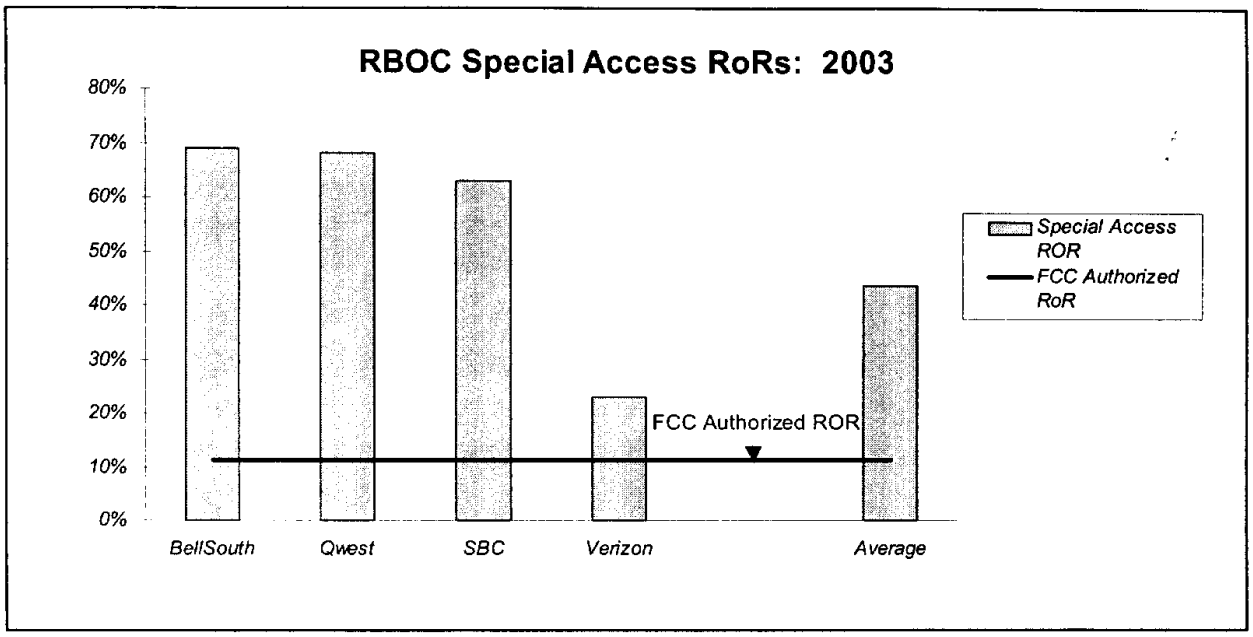

Figure 3.1: Analysis of individual RBOC Special Access rates of return: 2003

level of competition for special access services nor the threat of potential entry has constrained the ILECs' exercise of market power in their local exchange and exchange access markets. Figure 3.1 provides the results of an earnings analysis for each of the RBOCs' special access services category for the year ended 2003, comparing those levels to the FCC's most recently authorized return level for interstate service of 11.25%. The results demonstrate that the RBOCs are earning from two times (Verizon at 23.2%) to six times (Qwest and BellSouth at 68.1% and 69.1% respectively) the last-authorized return level.[53] These earnings averaged a jaw-dropping 43.7% for special access services across all of the RBOCs (i.e., close to four times the most recently authorized return level) and, as the data presented in Chapter 1 showed, those returns have been increasing since pricing flexibility was allowed. While the FCC no longer employs an upper earnings bound as part of its regulatory mechanism, earnings in the 30% to 60% range are clearly excessive by any standard.

Moreover, evidence demonstrates that these earnings levels are not a short-term phenomenon resulting from a one-time change in circumstance. Rather, they are the culmination of a long term trend of increasing profit-taking that has not been limited by competition as it would have been in a well-functioning market. Using the passage of the *Telecommunications Act of 1996* as a starting point (a time widely heralded as flinging open the monopoly gates to competitors) Figure 3.2 below illustrates the steadily increasing average earnings level in the special access category from that date to the present.

53. Rates of Return calculated with data from: FCC ARMIS Report 43-01, Annual Summary Report: Table I YE 1996-2003; FCC ARMIS Report 43-04, Access Report: Table I YE 1996-2003. ("*ARMIS ROR Data*") Available at http://www.fcc.gov/wcb/eafs/ (accessed April 6, 2004).

The average special access category earnings increased from 8.25% in 1996 to the whopping 43.7% at the end of 2003. The significance of this trend in the "average" earnings level is amplified by the fact that it is an "average" and is not simply reflective of a single company's superior performance.[54] Returns of this level simply could not be sustained over a multi-year period in a mature market (such as the market for local telecommunications service) if even a modest amount of *bona fide* competition were present.

The ILECs' primary response to evidence of the extraordinarily high level of profit on special access services has been to claim that the regulatory accounting data found in the Commission's ARMIS reports could not be credibly used for ratemaking purposes.[55] The ILEC criticism of earnings results based on ARMIS data must be dismissed in this instance for a number of reasons.

- *First*, the ARMIS financial results simply document the costing and accounting rules that have been implemented by the Commission over several decades. The ILECs themselves have had as large or larger a role in the development of these rules as any other party. If the rules and reporting requirements do not reflect reality, now is hardly the time to complain.

- *Second*, whether or not ARMIS data includes minor cost mis-allocations at the margins does not affect the overall integrity of *trends* in the data, *since those (arguable) mis-allocations do not change from period to period.* In other words, even if the absolute rate of return developed for the special access category using ARMIS data is off by some percentage, the trend in the data (in this case steadily *up*) should nevertheless be a reliable indicator of the BOCs' ability to increase prices to supracompetitive levels without fear of attracting competitive entry.

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54. The earnings histories of the individual RBOCs, while tracking above and below the "average" are reflective of the same trend. In 1996, the individual RBOC special access earnings ranged between 4% (Verizon) and 16% (BellSouth), as noted above, by 2003 the individual RBOC earnings ranged between 23% (Verizon) and 69% (BellSouth). *See, ARMIS ROR Data.*

55. The ILECs' claims in this area can be found throughout the comment cycles in response to *AT&T's Special Access Petition* to re-regulate special access services (RM 10593) and in response to AT&T's Petition for Writ of Mandamus relative to that proceeding. *See, AT&T Corp. Petition for Rulemaking To Reform Regulation of Incumbent Local Exchange Carrier Rates For Interstate Special Access Services,* RM Docket No. 10593, *Opposition of Qwest Communications,* filed December 2, 2002 at pp. 8-13; *Opposition of SBC Communications,* filed December 2, 2002 at pp. 19-22; *Comments of BellSouth,* filed December 2, 2002 at pp. 4-6; *Opposition of Verizon,* at pp. 21-23. In addition BellSouth and Qwest also suggested that the inclusion of DSL revenues in the Special Access Revenue category skewed results. Dr. Lee Selwyn, in his reply comments on behalf of AT&T calculated that adjusting for DSL revenues would only reduce overall return rates by a couple of percentage points. *See, AT&T Corp. Petition for Rulemaking To Reform Regulation of Incumbent Local Exchange Carrier Rates For Interstate Special Access Services,* RM Docket No. 10593, *Reply Declaration of Lee L. Selwyn on behalf of AT&T Corp, filed with AT&T's Reply Comments, January 23, 2003,* at pp. 46-58.

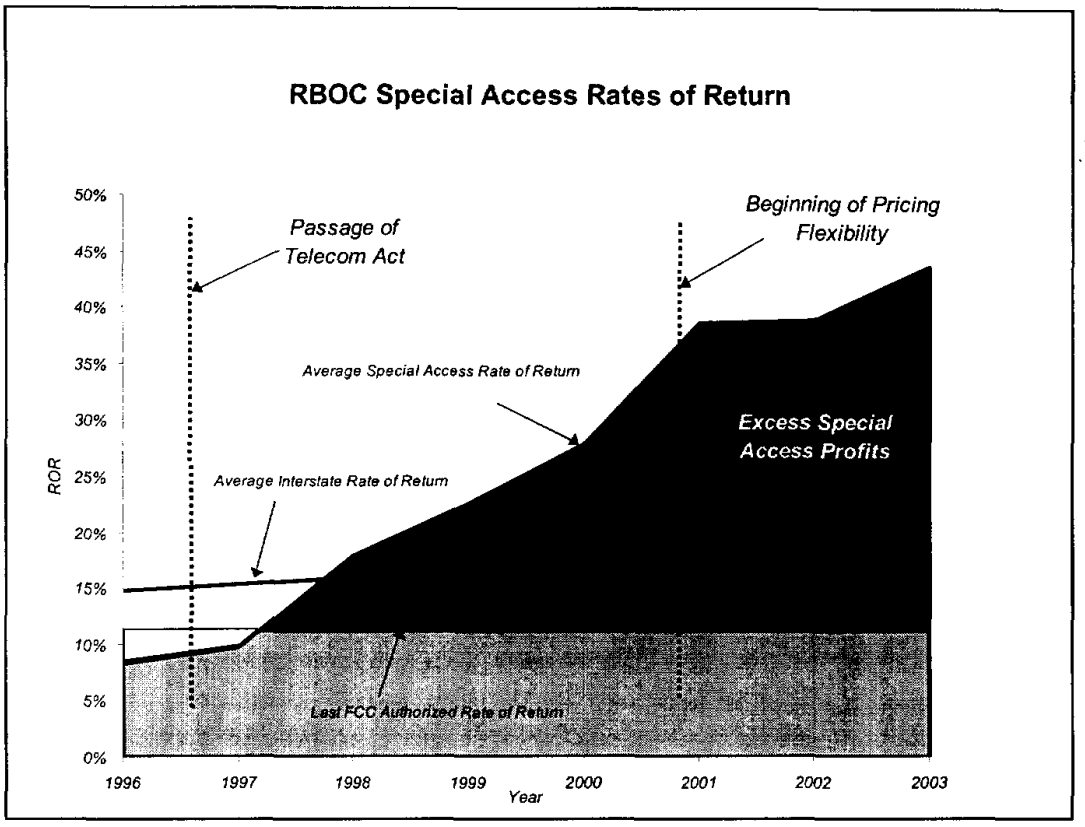

Figure 3.2. Average RBOC Special Access realized rates of return. 1996-2003.

- *Third*, the ILECs themselves rely on ARMIS and laud its value in other contexts. While the ILECs reject the use of ARMIS results when these indicate *excessive* earnings, they raise the ARMIS flag to the rooftops when ARMIS results suggest an earnings deficiency or "below cost" pricing.[56] The

56. For example, in May 2003 in Federal District Court in Chicago, Illinois, just five months after having challenged the use of ARMIS data for evaluating the reasonableness of special access prices in FCC RM 10593, SBC relied specifically upon ARMIS results to support its contention that UNE rates were not covering their costs. According to SBC's expert witness:

> SBC Illinois' average revenue per loop (for UNE-L) and revenue per line (for UNE-P) per month is substantially below the costs that SBC Illinois recognizes on its books to provide those UNEs. I used the FCC's financial accounting information as reported in its Automated Reporting Management Information System ("ARMIS") files to obtain the historical cost data specifically for SBC Illinois. These data are reported to the FCC for purposes of tracking the interstate rate of return and are subject to a highly detailed set of reporting guidelines.

See, Affidavit of Debra J. Aron on behalf of SBC in United States District Court for the Northern District of Illinois, Eastern Division, Case No. 03-C3290, filed May 27, 2003.

Several months later, in December 2003 SBC was joined by USTA and other BOCs in lauding ARMIS as the source for the "actual" costs of UNEs in the response to the FCC's *TELRIC NPRM. See, e.g., Review of the Commission's Rules Regarding the Pricing of Unbundled Network Elements and the Resale of Service by Incumbent Local Exchange Carriers,* WC Docket No.

ILECs' claims that ARMIS-based rates of return for special access are inflated by the misallocation of costs to other services (i.e., the Common Line category)[57] are belied by their defense of the accuracy of ARMIS cost allocations to the Common Line category (thus admitting that special access costs are not being misallocated to that category) in other proceedings and venues.[58] In other words, to explain away excessive profit levels for special access, the ILECs assert that in ARMIS, costs associated with special access are being mis-allocated to the Common Line category, but when the shoe is on the other foot, they staunchly defend the use of ARMIS Common Line data as the basis for UNE-Loop prices and claim that prices developed on this basis would include only costs actually attributable to switched access loops (and no others – not even from interstate special access). At least one of these two patently conflicting claims must be false. The Commission cannot ignore ARMIS earnings data on the basis of irreconcilable and patently self-serving claims that ARMIS is (1) reliable for determining the cost of a single disaggregated service element but (2) unreliable for calculating the aggregate (and excessive) rate of return for the entire special

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03-173, *Comments of United States Telecom Association*, December 16, 2003, at p. 10; *Comments of the Verizon Telephone Companies*, at pp. 40, 46, 58, 94; *Opening Comments of SBC Communications, Exhibit A, "The Economics of UNE Pricing," prepared by Debra J. Aron, PhD and William Rogerson, PhD,* December 16, 2003, pp. 28-32.

Then, one month later, in January 2004 , SBC and its sister RBOCs argued to the US Court of Appeals for the District of Columbia Circuit (in opposing AT&T's Petition for Writ of Mandamus) that "ARMIS data 'contain arbitrary allocations that are 'economically irrational.'" See, *In re AT&T Corp. et al.*, No. 03-1397 (D.C. Cir.), *Response of Intervenors in Opposition to AT&T's Petition for a Writ of Mandamus*, filed January 9, 2004, (*"03-1397 BOC Opposition"*) at 13.

However, flip-flopping yet again, in testimony filed with the Illinois Commerce Commission as recently as March 5, 2004, SBC again defended the validity of ARMIS as the correct basis for benchmarking UNE costs. Its witness, Dr. Aron, stated,

> In the final analysis, ARMIS is no better or worse than any cost accounting system for a large, multiproduct firm. It is subject to strict reporting requirements and a consistent set of rules across carriers. Virtually all cost accounting systems will be subject to the criticism that they make allocations, and to the criticism that any full cost estimate (which, as I noted, includes TELRIC-based UNE prices as well) will reflect such allocations. However, the fact nevertheless remains that accounting systems are the basis for decision making in our economy, and that it is reasonable to look at accounting estimates of costs for benchmarking purposes such as this one.

See, Illinois Commerce Commission, Docket No. 02-0864 SBC Illinois Ex. 2.2 (Surrebuttal Testimony of Dr. Debra J. Aron) (*"Illinois - Aron Surrebuttal Testimony"*) filed March 5, 2004, at p. 9.

57. In its Response to AT&T's Petition for Writ of Mandamus, ILECs (including SBC) claimed that the apparently high rates of return on special access arises because ARMIS rules require that certain special access-related costs be assigned elsewhere. See, *03-1397 BOC Opposition* at 14. In fact, in the interstate jurisdiction, the only other place where these costs *could be* allocated is to the Common Line category.

58. For example, in a recent UNE proceeding, SBC submitted testimony that claimed that ARMIS costs for the switched access loop are "fairly straightforward" and reliable indicators of the investment and associated expenses specifically associated with that category (and element)." In this context, SBC's witness stated, "... the costs that ARMIS associates with the loop are fairly straightforward and, except for the shared and common costs of the sort that affect TELRIC costs as well, these costs are reliable indicators of the investment and associated expenses specifically associated with that category (and element). The shared and common costs represent a portion of the costs associated with support assets (and expenses) such as land, buildings, trucks, tools, and personnel, a share of which are appropriately assigned to elements in ARMIS. These costs are also allocated to elements in a TELRIC analysis." *See, Illinois - Aron Surrebuttal Testimony*, at p. 9.

access category. Moreover, as illustrated in Figure 3.2 above, average earnings for the totality of FCC regulated interstate access services are more than 50% above the last authorized rate of return. Table 3.1 illustrates total interstate earnings for each RBOC, ranging from a low of 12.4% (for Verizon) to a high of 23.6% (for Qwest).

Table 3.1
RBOC Interstate Rates of Return

	BellSouth	Qwest	SBC	Verizon	ALL RBOCs
Interstate ROR	19.3%	23.6%	19.8%	12.4%	17.1%

Source: Federal Communications Commission, ARMIS Report 43-04, Access Report: Table I, YE 2003. Available at http://www.fcc.gov/wcb/eafs/ (accessed April 7, 2004).

Source of the huge special access profit levels

Returning to the issue at hand, there are several possible ways in which earnings for a specific service category, such as special access, could have grown to such dizzying heights under the price cap regime that prevails in the federal jurisdiction. Three possible explanations are explored below.

- *Explanation #1: Prices for special access services could have been held constant or increased while the underlying costs of providing these services have decreased.* This is by far the most likely explanation for the ILECs' overearning on special access. As a result of special access "pricing flexibility" adopted by the Commission in 1999,[59] many special access services are no longer subject to any form of price cap or to the so-called "*CALLS*" settlement. As was initially documented by Ad Hoc in comments filed more than two years ago, and is discussed more fully below, in many instances the prices in the non-price caps areas (where Phase II pricing flexibility has been granted) are higher than the prices regulated under price caps.[60] Such pricing behavior has been almost uniformly adopted by price-cap ILECs across the US. In almost every situation in which pricing flexibility has been allowed, the ILECs have either raised their interstate special access rates or, alternatively, have maintained them at the same level while prices for those other services still subject to price caps *have gone down.*

- *Explanation #2: Special access services could be exhibiting rates of productivity growth far in excess of that characteristic of all interstate services as a group.* This explanation, while not

59. *Pricing Flexibility Order*, 14 FCC Rcd 14221 (1999).

60. *Performance Measurements and Standards for Interstate Special Access*, CC Docket No. 01-321, *Comments of the Ad Hoc Telecommunications Users Committee*, filed January 22, 2002 ("*CC 01-321Ad Hoc Comments*").

impossible, is improbable, as there is no *a priori* basis to believe or to expect that productivity growth rates for interstate special access have exceeded the average for all interstate services.[61] However, even if exceptional productivity were initially the basis for such high returns, the fact that prices did not later fall would clearly indicate a lack of competitive pressure. Moreover, if one assumes that the production function for special access services has undergone a radical change and has begun exhibiting extreme productivity growth, that result by itself argues for reviewing the existing price cap system and updating the productivity factor adjustments included in the FCC's price cap plan.

- *Explanation #3: The costs of special access services could have been misallocated to other BOC services.* As discussed above, the ILECs' (inconsistently) adopt this explanation. We find this justification uncompelling. In fact, it appears that if any misallocation is occurring, costs from other ILEC services are being improperly assigned *to* special access. Table 3.2 below shows that, for 2003, the net investment allocated to the special access category for the four RBOCs was roughly one third of their total interstate net investment and approximately 40% of their combined Common Line and Special Access investment categories. But there are fewer than 4-million special access loops and associated interoffice transport facilities, compared to more than 158-million Common Line local service loops in the RBOCs' operating territories.[62] Thus, the allocated investment is completely disproportionate to the number of special access loops, as a percentage of total loops in service.[63] The wide discrepancy between the number of loops used for special access and the amount of interstate investment assigned to those loops certainly raises suspicions that costs are being *overallocated* to the special access category. This suggests that the average 43.7% rate of return shown by ARMIS for the combined RBOC interstate special access services would represent the *lower bound* of the actual returns being reaped from these services. [64]

61. In many cases, special access services are still being provisioned on a case-by-case basis, with each circuit requiring circuit-specific engineering and manual cross-connections.

62. While there is no definitive count of Special Access lines, various sources put the count at between 3.2 and 4.5 million lines. A Bellsouth and SBC joint proposal for Assessment and Collection procedures suggests 3.2 million Special Access lines, while data from the FCC's Statistics of Communications Common Carriers puts the value at about 4.5 million. Comments of SBC and Bellsouth, CC Docket Nos. 96-45, 98-171, 90-571, 92-237, 99-200, 96-116, 98-170, 02-33, 95-20, 98-10 and NSD File No. L-00-72, October 10, 2002; Industry Analysis and Technology Division, Federal Communications Commission, *Statistics of Communications Common Carriers 2002/2003*, March 2, 2004 ("*SOCC*") at Table 2.6.

63. This is true even after accounting for the fact that only 25% of Common Line loop investment is allocated to the interstate jurisdiction.

64. However, even if the rate of return for special access were merely equal to the 17% level earned by the RBOCs on their total interstate services, it would be too high.

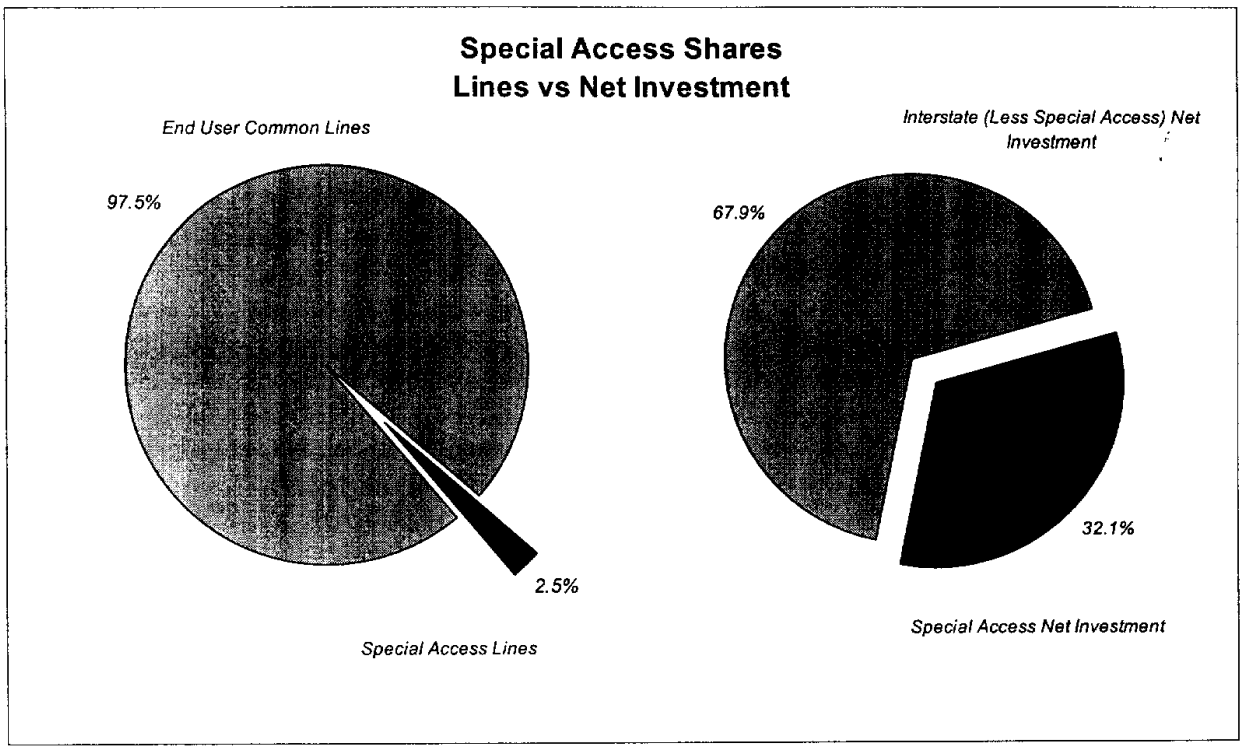

Figure 3.3. Comparison of Special Access lines shares vs. Special Access net investment shares

Table 3.2

Analysis of Special Access Net Investments in Relation to Net Investments Levels for All Interstate Access Services -- 2003

	BellSouth	Qwest	SBC	Verizon	ALL RBOCs
SPAC Net Investment	$ 1,317,121	$ 1,036,069	$ 2,580,419	$ 5,265,290	$ 10,198,899
Common Line Net Investment	$ 3,366,747	$ 2,174,913	$ 4,094,600	$ 6,113,136	$ 15,749,396
Total Interstate Net Investment	$ 5,435,064	$ 3,911,137	$ 8,960,543	$ 13,454,462	$ 31,761,206
SPAC as % of Total Interstate Investment	24.2%	26.5%	28.8%	39.1%	32.1%
SPAC as % of SPAC+Common Line Investment	28.1%	32.3%	38.7%	46.3%	39.3%

Source: Federal Communications Commission, ARMIS Report 43-04, Access Report: Table I, YE 2003. Available at http://www.fcc.gov/wcb/eafs/ (accessed April 7, 2004).

While ARMIS may not be a perfect tool for evaluating the level of special access prices at any individual point in time, it is, in fact, the only tool available. Ideally, access charges (switched and special) – like UNE rates[65] – should be based upon forward-looking economic cost – i.e., TELRIC. This would make embedded ARMIS costs entirely irrelevant. Recommendations to that effect have been made by Ad Hoc[66] and others, and the Commission has indicated its intention to address this matter as part of its forthcoming comprehensive review of all intercarrier compensation issues.[67]

For the present, however, access services are *not* required to be, and are not being, set on the basis of TELRIC or any other forward-looking economic cost standard. Interstate access charges are subject to a price cap form of regulation as modified by the *CALLS* settlement[68] and (in the case of special access services) by the *Special Access Pricing Flexibility Order*.[69] Rates for these services are rooted in *embedded costs* as they existed at the time that the current ILEC price cap regime was put into operation (i.e., 1991).[70] Subsequent modifications to the annual price adjustment mechanism (the so-called "X" factor) were based, in part, upon realized productivity experience as measured *with respect to embedded costs,* as was the timing of revenue changes arising from the CALLS settlement. Whatever its infirmities may be, the reasonableness (or lack thereof) of special access charges needs to be evaluated *with respect to the embedded costs assigned to the special access category.*

Persistent excessive RBOC pricing of Special Access Services in areas where Phase II Pricing Flexibility has been granted demonstrates that the level of competition in those areas is not sufficient to constrain RBOC monopoly pricing practices

Special access services supposedly represent the most competitive segment of last mile connections that have historically been provided on a monopoly basis by the ILECs. Put succinctly, the theory behind the FCC's pricing flexibility rules for special access adopted in mid-1999 was that competition, be it actual or potential, would be sufficient to constrain ILEC pricing behavior once specific

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65. The historic distinction between "access services" and "UNEs" is an anachronism that is no longer valid as a policy matter, now that the RBOCs may themselves enter into and compete in the interLATA switched and private line services markets.

66. *See, for example,* the Ad Hoc Committee's recent reply comments in WC Docket No. 03-173. *Review of the Commission's Rules Regarding the Pricing of Unbundled Network Elements and the Resale of Service by Incumbent Local Exchange Carriers*, WC Docket No. 03-173, *Reply Comments of Ad Hoc Telecommunications Users Committee*, filed January 30, 2004.

67. *Intercarrier Compensation Proposal Will Be Unveiled Soon, FCC Official Says*, TR Daily, May 19, 2004.

68. *CALLS Order* 15 FCC Rcd 12962.

69. *Pricing Flexibility Order* 14 FCC Rcd 14221 .

70. *LEC Price Cap Order*, 5 FCC Rcd 6786 (1990).