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November 9, 2004

**Ex Parte**

Ms. Marlene H. Dortch  
Secretary  
Federal Communications Commission  
445 12<sup>th</sup> Street, SW – Portals  
Washington, DC 20554

**Re: AT&T Petition for Rulemaking to Reform Regulation for Incumbent Local Exchange Carrier Rates for Interstate Special Access Services, RM-10593; Unbundled Access to Network Elements, WC Docket No. 04-313; Section 251 Unbundling Obligations for Incumbent Local Exchange Carriers, CC Docket No. 01-338**

Dear Ms. Dortch:

On November 8, 2004, Susanne Guyer and Ed Shakin, representing Verizon, met with Dan Gonzalez of Commissioner Martin's office.

The purpose of the meeting was to discuss how the pricing flexibility rules have worked successfully since the Commission adopted its pro-competitive deregulation of special access prices. As described in the attachments, the facts show that special access pricing flexibility has led to a faster decline in average revenue per special access line than before the Commission took this approach.

Please place this notice in the record of the above proceedings.

Sincerely,

A handwritten signature in black ink, appearing to be "Edwin J. Shimizu".

Attachments

c: Dan Gonzalez

# **ATTACHMENT A**

**Susanne A. Guyer**  
Senior Vice President  
Federal Regulatory Affairs



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October 20, 2004

**Ex Parte**

Marlene H. Dortch  
Secretary  
Federal Communications Commission  
445 12<sup>th</sup> Street, SW  
Washington, DC 20554

**Re: AT&T Petition for Rulemaking to Reform Regulation for Incumbent Local Exchange Carrier Rates for Interstate Special Access Services, RM-10593**

Dear Ms. Dortch:

Please place the attached letter on the record in the above proceeding.

Sincerely,

A handwritten signature in cursive script that reads "Susanne A. Guyer".

Attachment

**Susanne A. Guyer**  
Senior Vice President  
Federal Regulatory Affairs



1300 I Street, NW, Suite 400 West  
Washington, DC 20005

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Fax 202 336-7858  
susanne.a.guyer@verizon.com

October 20, 2004

Honorable Michael K. Powell  
Chairman  
Federal Communications Commission  
445 12<sup>th</sup> Street, SW  
Washington, DC 20554

**Re: AT&T Petition for Rulemaking to Reform Regulation for Incumbent Local Exchange Carrier Rates for Interstate Special Access Services, RM 10593**

Dear Chairman Powell:

One of the success stories for the FCC in recent years has been its pro-competitive deregulation of special access prices. AT&T would now like the Commission to reverse that policy and turn back the clock to the days of now widely discredited rate of return regulation, but its arguments for doing so are misplaced.

The Commission's pricing flexibility rules provide bright line standards that define the circumstances under which special access services may be offered under contract, without being subject to extensive rate regulation. These standards require clear evidence that competitors have entered a given market with their own competitive fiber. The resulting pricing flexibility has allowed carriers like Verizon to compete more aggressively to offer high capacity services both on a wholesale basis to other carriers and to end user customers, including in the enterprise segment of the market that is dominated by AT&T and the other traditional long distance companies.

AT&T's pending petition to re-regulate these services nonetheless claims that special access prices have increased since the Commission adopted its pricing flexibility rules. As we have explained previously, that claim is false. Information recently submitted to the Commission in a parallel proceeding provides further confirmation that the prices customers actually pay for special access have declined substantially under the pricing flexibility rules.

Contrary to AT&T's claims, the facts show not only that special access prices are *declining*, but also that "special access pricing flexibility, together with increasing competition in the market, has led to a *faster* decline in average revenue per special access line during the pricing

flexibility period than before.” Taylor Decl. ¶ 11 (emphasis added).<sup>1</sup> Indeed, AT&T focuses on tariffed month to month rates that few customers use, and ignores the prices that customers actually pay. And an analysis of what customers actually pay demonstrates that Verizon’s special access prices, adjusted for inflation, fell **13.8%** annually from 1996-2000, before pricing flexibility, and by an even greater **22.2%** annually from 2001-2003, once pricing flexibility became available. See Taylor Reply Decl. ¶ 8. AT&T claims that these reductions are solely a function of that fact that customers have shifted to using higher capacity special access services, such as DS-3s or above, that have a lower effective price. Again, that is not true. The fact of the matter is that these reductions in the prices customers actually pay occurred not only for Verizon’s overall special access prices, but also for specific services, including DS1 service. Verizon’s DS1 channel termination prices, adjusted for inflation, fell at an *annual* rate of **6.5%** between January 2001 and April 2004. See *id.* ¶ 21.

AT&T also claims that the returns reflected in regulatory reports also somehow show that the prices for special access are too high. Dr. Taylor and Dr. Kahn explain that the methodology relied on by AT&T and others for calculating BOCs’ net return on special access — the use of fully distributed, or allocated, costs — is “economic nonsense.” *Id.* ¶ 14. This is so because the return figures they cite are based on arbitrary allocations of costs between regulatory jurisdictions and between various categories of services. Indeed, the same reports show that Verizon’s returns on switched access services are only 7.81% percent. Under AT&T’s theory, therefore, the prices for these services would have to be substantially increased to produce a reasonable return. The fact that these reports are economically meaningless is not only what Dr. Taylor and Dr. Kahn conclude, but also what AT&T’s own economists agree is correct. Thus, Dr. Willig has explained that “[f]ully allocated cost figures and the corresponding rate of return numbers simply have *zero economic content.*” *Id.* ¶ 14 (quoting W.J. Baumol, M.F. Koehn, and R.D. Willig, “How Arbitrary is ‘Arbitrary’? – or, Toward the Deserved Demise of Full Cost Allocation,” *Public Utilities Fortnightly*, Vol. 120, No. 5, Sept. 3, 1987, at 21) (emphasis added). And AT&T itself has shared the same view, when it was the carrier subject to regulation, explaining that “determining a cost basis for calculating an economically meaningful rate of return *is impossible.*” *Id.* ¶ 15 (quoting Initial Brief of AT&T Communications of New England, Inc., DPU 91-97, at 42-43 (Mass. DPU filed Apr. 23, 1992)) (emphasis added).

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<sup>1</sup> See Declaration of William E. Taylor Regarding Special Access Pricing (Oct. 4, 2004) (“Taylor Decl.”) (Attachment G to Comments of Verizon, WC Docket No. 04-313 & CC Docket No. 01-338, *Unbundled Access to Network Elements; Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers* (FCC filed Oct. 4, 2004)); Reply Declaration of William E. Taylor (Oct. 19, 2004) (“Taylor Reply Decl.”) (Attachment C to Reply Comments of Verizon, WC Docket No. 04-313 & CC Docket No. 01-338, *Unbundled Access to Network Elements; Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers* (FCC filed Oct. 19, 2004)). For convenience, both of these declarations are attached to this letter. See Attachments 1 and 2.

October 20, 2004  
Page 3

In short, there simply is no justification for repeal of the pricing flexibility relief Verizon has obtained or a return to rate of return regulation AT&T requests.

Sincerely,

A handwritten signature in cursive script, appearing to read "Susan Guyer". The signature is written in black ink and is positioned to the right of the word "Sincerely,".

Attachments

cc: Commissioner Kathleen Abernathy  
Commissioner Jonathan Adelstein  
Commissioner Michael Copps  
Commissioner Kevin Martin  
Scott Bergmann  
Matt Brill  
Dan Gonzalez  
Christopher Libertelli  
Jessica Rosenworcel  
Jeff Carlisle  
Steve Morris  
Tamara Preiss  
John Rogovin  
Austin Schlick

# **ATTACHMENT 1**

**Before the  
FEDERAL COMMUNICATIONS COMMISSION  
Washington, D.C. 20554**

In the Matter of	)	
	)	
Unbundled Access to Network Elements	)	WC Docket No. 04-313
	)	
Review of the Section 251 Unbundling	)	CC Docket No. 01-338
Obligations of Incumbent Local Exchange	)	
Carriers	)	

**Declaration of William E. Taylor  
Regarding Special Access Pricing  
On Behalf of Verizon**

**October 4, 2004**

**DECLARATION OF WILLIAM E. TAYLOR  
REGARDING SPECIAL ACCESS PRICING  
ON BEHALF OF VERIZON**

**SUMMARY**

1. I have been asked to update data presented to the Commission in December 2002 regarding RBOC and Verizon special access revenue per line in the periods before and after limited pricing flexibility was made available to RBOCs in certain areas. Using the most recent ARMIS data, special access prices as measured by special access revenue per line have decreased rapidly over the 1996-2003 period. In addition, special access prices have fallen substantially more rapidly in the recent years (2001-2003) that correspond to the period in which pricing flexibility has been available than in previous years (1996-2000).

2. These data are thus inconsistent with the claim that pricing flexibility has led to price increases for special access services. More importantly, the data support the FCC's view that competitive market forces are sufficient to constrain ILEC special access pricing behavior and have generally forced RBOC prices downward in the aggregate towards cost.

**I. Introduction and Background**

3. My name is William E. Taylor. I am Senior Vice President of National Economic Research Associates, Inc., head of its Communications Practice, and head of its Cambridge office located at One Main Street, Cambridge, Massachusetts 02142.

4. I have been an economist for over thirty years. I earned a Bachelor of Arts degree from Harvard College in 1968, a Master of Arts degree in Statistics from the University of California at Berkeley in 1970, and a Ph.D. from Berkeley in 1974, specializing in Industrial Organization and Econometrics. For the past twenty-five years, I have taught and published research in the areas of microeconomics, theoretical and applied

DECLARATION OF WILLIAM E. TAYLOR  
REGARDING SPECIAL ACCESS PRICING

econometrics and telecommunications policy at academic and research institutions including the Economics Departments of Cornell University, the Catholic University of Louvain in Belgium, and the Massachusetts Institute of Technology. I have also conducted research at Bell Laboratories and Bell Communications Research, Inc. I have appeared before state and federal legislatures, testified in state and federal courts, and participated in telecommunications regulatory proceedings before state public utility commissions, as well as the Canadian Radio-television Telecommunications Commission, the Mexican Federal Telecommunications Commission and the New Zealand Commerce Commission.

5. Almost two years ago, A.E. Kahn and I filed with the Commission a joint Declaration concerning an AT&T petition to retract pricing flexibility for RBOC special access services.<sup>1</sup> Among the data we provided was a chart (shown below) of RBOC special access “prices”—actually ARMIS Special Access Revenue per voice grade equivalent circuit—for the 1996-2001 period. From these data, we concluded that

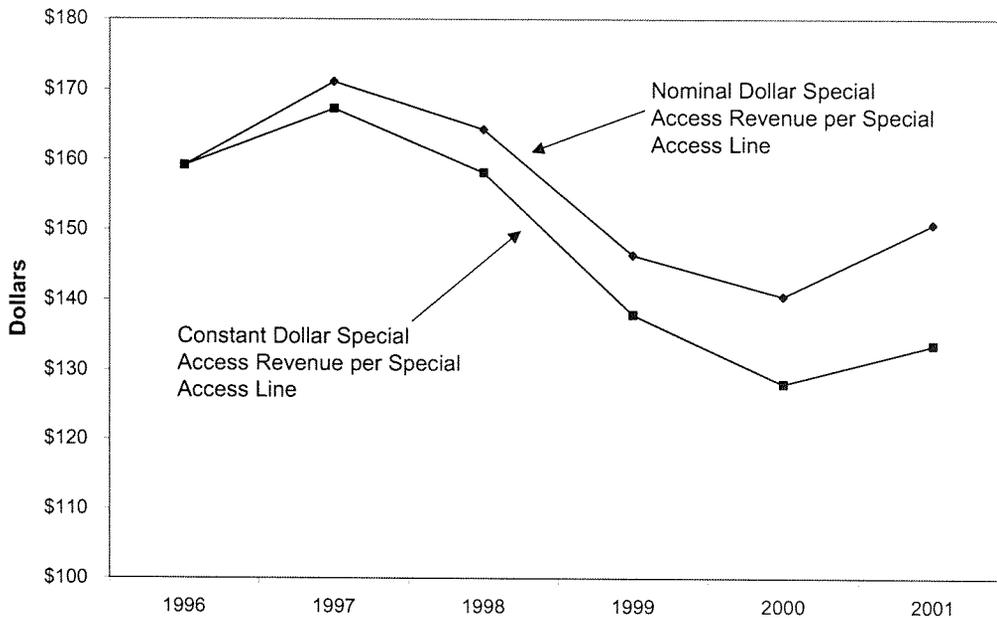
the *growth* in special access lines fully explains the growth in revenue and that the RBOCs’ average revenue per line between 1996 and 2001 decreased by more than 1 percent per year in nominal terms and by more than 3 percent per year in constant dollars. [Footnote: Even these decreases are somewhat understated insofar as special access revenue includes DSL revenue but special access lines do not include DSL lines.]

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<sup>1</sup> Declaration of Alfred E. Kahn and William E. Taylor on Behalf of BellSouth Corporation, Qwest Corporation, SBC Communications, Inc., and Verizon, In the Matter of AT&T Corp. Petition for Rulemaking to Reform Regulation of Incumbent Local Exchange Carrier Rates for Interstate Special Access Services, (RM No. 10593, December 2, 2002).

DECLARATION OF WILLIAM E. TAYLOR  
REGARDING SPECIAL ACCESS PRICING

**RBOC Special Access Revenue per Special Access Line**



Thus, the pricing flexibility exercised by some RBOCs during 2001 had no noticeable effect on their special access revenues per line, and AT&T's dire complaints of massive price increases likewise appear to be belied by the data.<sup>2</sup>

6. The issue of RBOC special access pricing during the period of pricing flexibility has arisen again,<sup>3</sup> and I have been asked by Verizon to update these estimates to give a picture of the effect of pricing flexibility and other market changes on the pricing of special access circuits. This update is particularly relevant because pricing flexibility had only just begun at the end of the data shown above,<sup>4</sup> and thus little information was available to Dr. Kahn and me regarding the effect of the FCC's grant of pricing flexibility on special access prices.

<sup>2</sup> Kahn-Taylor Declaration at 15-16.

<sup>3</sup> See, Ad Hoc Telecommunications Users Committee, "Competition in Access Markets: Reality or Illusion. A Proposal for Regulating Markets," August 2004.

<sup>4</sup> The first grants of pricing flexibility for special access services in some areas took place for BellSouth on December 15, 2000 and for Verizon and SBC on March 14, 2001.

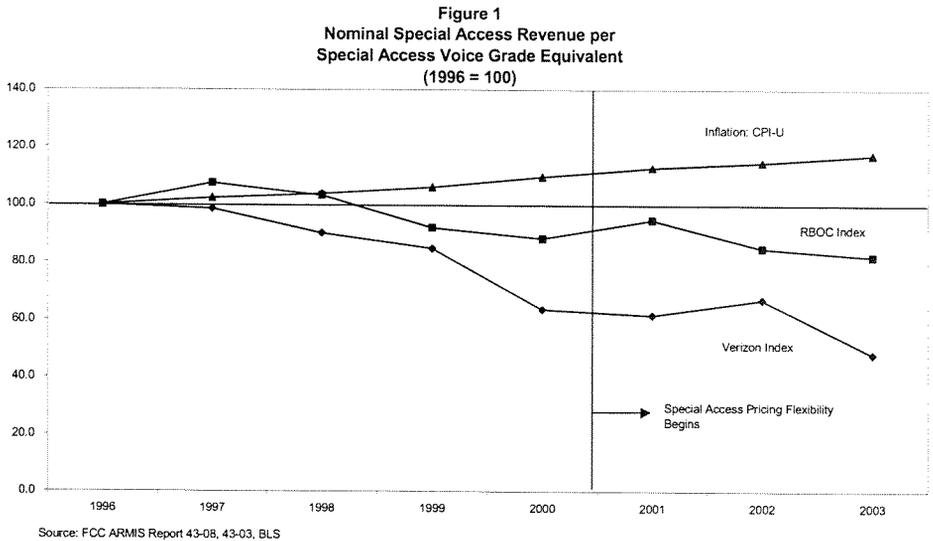
## **II. RBOC Special Access Pricing**

7. Following the calculations and data sources in the Kahn-Taylor Declaration, I took data from the ARMIS Reports as of September 17, 2004. Volumes of analog and digital special access lines, measured in voice-grade equivalents were taken from ARMIS Report 43-08, row 910. Special Access revenue was taken from ARMIS Report 4303, row 5083. I calculated average revenue per special access line for Verizon and for the RBOCs as a whole both in nominal terms and in real terms, using the Bureau of Labor Statistics Urban CPI as the deflator.

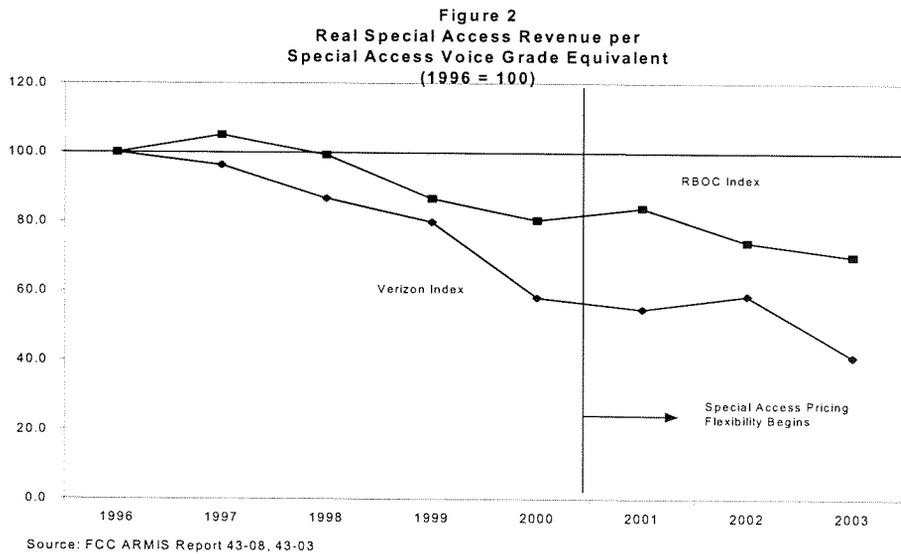
8. Note, as Professor Kahn and I observed in 2002, that ARMIS special access revenue includes DSL revenues, but the ARMIS special access lines do not include DSL lines, which are the high-frequency components of ordinary switched access lines. Moreover, DSL revenues have been growing rapidly, both in absolute terms and relative to special access revenues. Thus, the average revenue per special access line I calculate here *overstates* both the level and growth of special access prices, as measured by average special access revenue per special access line.

9. Indexed to 1996=100, nominal special access prices for Verizon and the aggregate of the RBOCs are shown below for the 1996-2003 period in Figure 1 followed by the same information measured in real terms in Figure 2. In Figure 1, I include the Bureau of Labor Statistics' Consumer Price Index as a measure of inflation. The fact that the CPI-U increased during the period means that special access prices were falling during a period when consumer prices, on average, were rising.

DECLARATION OF WILLIAM E. TAYLOR  
REGARDING SPECIAL ACCESS PRICING



10. Figure 2 takes inflation into account, showing (real) average special access revenue per special access line measured relative to inflation in constant 1996 dollars.



11. These data show that the first conclusion from our December 2002 paper is still valid: special access revenue per line is decreasing steadily. However, our second conclusion changes with the acquisition of additional data after pricing flexibility. Rather than “no noticeable effect” (based on one year of data), the onset of special access pricing flexibility, together with increasing competition in the market, has led to a faster decline

DECLARATION OF WILLIAM E. TAYLOR  
REGARDING SPECIAL ACCESS PRICING

in average revenue per special access line during the pricing flexibility period than before. Table 1 below compares annual growth rates for Verizon and the aggregate of the RBOCs for the 1996-2003 period, divided into the pre-pricing flexibility period (1996-2000) and post-pricing flexibility period (2001-2003).

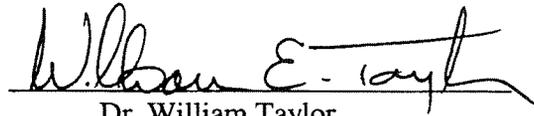
<b>Period</b>		<b>Nominal Annual Growth</b>	<b>Real Annual Growth</b>
All Data 1996 – 2003	RBOC	-2.8%	-5.0%
	Verizon	-9.9%	-12.0%
Before Pricing Flexibility 1996-2000	RBOC	-3.1%	-5.3%
	Verizon	-10.7%	-12.7%
During Pricing Flexibility 2001-2003	RBOC	-7.0%	-8.7%
	Verizon	-11.7%	-13.4%

### III. Conclusions

12. Both RBOC and Verizon special access revenue per line have continued to decline in nominal and real terms and at a faster rate during the period in which limited pricing flexibility has been available to these companies in certain areas. These data are clearly inconsistent with the claims that pricing flexibility has led to price increases for special access services. On the contrary, they support the FCC's view that market forces in special access markets that meet its trigger conditions are sufficient to constrain RBOC pricing and drive special access prices towards cost.

I declare under penalty of perjury under the laws of the United States of America that the foregoing is true and correct.

Executed on October 1, 2004

A handwritten signature in black ink, appearing to read "William E. Taylor", written over a horizontal line.

Dr. William Taylor  
NERA

# **ATTACHMENT 2**

**Before the  
FEDERAL COMMUNICATIONS COMMISSION  
Washington, DC 20554**

In the Matter of

Unbundled Access to Network Elements

Review of the Section 251 Unbundling  
Obligations of Incumbent Local Exchange  
Carriers

WC Docket No. 04-313

CC Docket No. 01-338

**REPLY DECLARATION OF WILLIAM E. TAYLOR  
ON BEHALF OF VERIZON**

**SUMMARY**

1. In my initial declaration, I used ARMIS report data to demonstrate that average revenue per special access line has fallen, and that the drop has accelerated since the ILECs received special access pricing flexibility. In this reply declaration, I refine those calculations and respond to criticisms.
2. First, I remove DSL revenue from the calculation and show that average revenue per voice grade equivalent fell about 21 percent per year during the pricing flexibility period and about 12 percent per year while under price caps. Thus average revenue per voice grade equivalent fell faster after pricing flexibility was in place.
3. Second, I explain that using fully distributed costs and accounting earnings to assess prices flatly contradicts the admonitions of a generation of economists, including those associated with the Commission and with AT&T.
4. Third, I respond to AT&T 's claims that the observed price reduction in special access is due primarily to customer migrations to higher-capacity, lower-priced special access services, rather than to price reductions and customer migrations to discount

contracts. If AT&T were correct, the prices of individual services (such as DS1 or DS3) would not fall, but Verizon has shown that for a single service (DS1), price reductions and migrations to discounts and term and volume contracts did result in significant price reductions during the price flexibility period. As a result, the observed shift in demand towards high-capacity services cannot account for the reduction in average revenue per voice grade equivalent.

**Before the  
FEDERAL COMMUNICATIONS COMMISSION  
Washington, DC 20554**

In the Matter of

Unbundled Access to Network Elements

Review of the Section 251 Unbundling  
Obligations of Incumbent Local Exchange  
Carriers

WC Docket No. 04-313

CC Docket No. 01-338

**I. Introduction and Background**

5. My name is William E. Taylor. I am Senior Vice President of National Economic Research Associates, Inc., head of its Communications Practice, and head of its Boston office located at 200 Clarendon Street, Boston, Massachusetts 02116. I filed a declaration in this Docket on October 4, 2004, which listed my credentials.<sup>1</sup>

6. I have been asked by Verizon to respond to economic allegations made by AT&T regarding my analysis of special access prices and services. In particular, AT&T claims that the fact that average special access revenue per voice grade equivalent (“VGE”) fell does not imply that prices have fallen but “tell[s] a quite different story:” (i) that regulation and price caps contributed to the reduction, (ii) that cost reductions and earnings increases took place and (iii) that a shift in the mix of services towards high capacity services having a lower price per VGE explains the reduction in average revenue per VGE. None of these explanations is correct.

7. In this Reply Declaration, I address these three alleged shortcomings of my average revenue per VGE analysis. In addition, I use Verizon DSL revenue data for 2002 and 2003 to eliminate the problem—identified in my previous Declaration and in my 2002

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<sup>1</sup> Declaration of William E. Taylor on Behalf of Verizon, *In the Matter of Unbundled Access to Network Elements and Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers* (WC Docket No. 04-313, CC Docket No. 01-338), October 4, 2004.

Declaration with Dr. Kahn<sup>2</sup>—that ARMIS data includes DSL revenue but not DSL lines, thus overstating the growth in revenue per line during periods when DSL revenue was growing rapidly.

## II. Removing DSL Revenue from ARMIS Special Access Revenue

8. I took ARMIS data on DSL revenue for Verizon for 2002 and 2003 from row 4012 of the ARMIS Report 43-04. I conservatively assumed that the annual growth rate for those years applied to all previous years.<sup>3</sup> I then subtracted these DSL revenues from ARMIS special access revenue and divided the difference by VGEs. The results are shown in Table 1, where both nominal (current dollar) and real (constant dollar) annual growth rates are calculated for the periods before and after special access pricing flexibility began.<sup>4</sup>

<b>TABLE 1</b>			
<b>VERIZON SPECIAL ACCESS REVENUE PER LINE</b>			
		Nominal Annual Growth	Real Annual Growth
All Data 1996 – 2003	Previous	-9.9%	-12.0%
	Excl DSL	-12.7%	-14.6%
Before Pricing Flexibility 1996-2000	Previous	-10.7%	-12.7%
	Excl DSL	-11.8%	-13.8%
During Pricing Flexibility 2001-2003	Previous	-11.7%	-13.4%
	Excl DSL	-20.7%	-22.2%

9. Removing the DSL revenue from the ARMIS special access revenue corrects the problem noted in my previous Declaration in this docket and my 2002 Declaration with

<sup>2</sup> Declaration of Alfred E. Kahn and William E. Taylor on Behalf of BellSouth Corporation, Qwest Corporation, SBC Communications, Inc., and Verizon, *In the Matter of AT&T Corp. Petition for Rulemaking to Reform Regulation of Incumbent Local Exchange Carrier Rates for Interstate Special Access Services* (RM No. 10593, December 2, 2002) (“*Kahn-Taylor Declaration*”).

<sup>3</sup> The assumption is conservative because (i) DSL is a new service, and annual growth rates would be expected to fall over time and (ii) overstating DSL revenue in the early years has the effect of reducing special access revenue in the early years, which increases its rate of growth over time. In addition, DSL revenue was \$0 before 1998 because Verizon did not provide the service. DSL revenue was also set to \$0 for 2001 because merger conditions required that it be provided through an affiliate and little or no DSL revenue was reported in ARMIS that year.

<sup>4</sup> “Nominal” revenue per line is measured in current dollars and thus includes the effects of inflation. “Real” revenue per line is measured in constant (1982-1984) dollars which removes the effects of inflation—as measured by the Bureau of Labor Statistics Consumer Price Index—from the numbers.

Professor Kahn: that DSL revenue is included in the ARMIS reports as special access revenue, but DSL lines are not included in the ARMIS reports as special access lines. Since DSL revenue and lines have been growing rapidly, including DSL revenue but omitting DSL lines overstates special access revenue and overstates it more in recent years. This overstatement has the effect of understating the rate of reduction of average revenue per line. Excluding DSL revenue then has the expected effects: average revenue per VGE falls faster with DSL revenue excluded and the difference is greater in the later period when DSL revenue is larger.

### **III. AT&T's Criticisms of Average Revenue per VGE are Unfounded**

10. AT&T (at 107-108) offers three arguments why the Commission should not accept the reduction in average revenue per VGE as evidence of price reductions. Each of these arguments is incorrect.

#### **A. Average revenue per VGE declined faster under pricing flexibility**

11. First, AT&T claims that the reductions in price were a result of price cap regulation and predated pricing flexibility in 2002. In fact, between 1996 and 2001, average revenue per VGE fell faster than required by the price cap regime. Moreover, as shown in my previous Declaration, average revenue per VGE fell significantly faster after 2001 than before.

12. The data shown above in Table 1 contradict AT&T's claims. First, the 13.8% real annual reduction in average revenue per VGE before pricing flexibility began for special access (1996-2000) far exceeds the maximum real rate reduction imposed by price cap regulation (6.5% at the end of the period). Thus, even during the price cap period, the annual price cap real rate reductions were not large enough to account for the observed reductions in average revenue per VGE. Second, the data in Table 1—as well as the data in Table 1 of my previous Declaration—show clearly that average revenue per VGE fell much faster in the 2001-2003 period (when special access pricing flexibility was available) than during the 1996-2000 period before pricing flexibility was available.

13. Thus, the explanation for the observed decline in average revenue per VGE is not price cap regulation.

**B. Fully distributed costs and accounting earnings cannot be used to assess prices**

14. AT&T (at 107) cites its previous assertions that the average revenue per VGE analysis ignores the fact that average expense per line has fallen and that “the Bells’ net return, on a DS0 equivalent basis, [has] increased enormously.” That this claim has any bearing on the level of Verizon’s special access prices is economic nonsense, as Dr. Kahn and I pointed out almost two years ago:<sup>5</sup>

This is a truly outrageous claim, relying as it does on measures of fully allocated book costs of services whose production in common with others entails a very high proportion of fixed and common costs and significant economies of scope—all the more so coming from a company and specific witnesses who have consistently and correctly decried the basis for such claims in economic terms for many decades...

High or increasing rates of return calculated using regulatory cost assignments for interstate special access services do not in themselves indicate excessive economic earnings reflecting the exercise of market power. Indeed, regulatory rates of return for geographic subsets of single services in multi-product, multi-geographic firms bear no relationship with economic profits and thus can serve no useful purpose in determining whether pricing flexibility has or has not been excessively permissive. ILECs are integrated multi-regional firms and rely on an integrated regional management structure employing the regional physical and human resources to provide a multiplicity of services. The cost allocations required render such a calculation meaningless. ...

The regulatory expedient of assigning fixed costs among categories (e.g., between regulated and unregulated or between interstate and intrastate jurisdictions), in proportion to variable costs or demand volumes, though “reasonable,” is not cost-causative, and the resulting costs are not economic costs. It might be equally reasonable to allocate railroad overhead costs to services by volume, weight or value, but shippers of feathers, coal and diamonds would undoubtedly disagree about the results. In Dr. Willig’s prophetic words some 15 years ago,

Fully allocated cost figures and the corresponding rate of return numbers simply have zero economic content. They cannot pretend to constitute approximations to *anything*. The “reasonableness” of the basis of allocation selected makes absolutely no difference except to the success of the advocates

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<sup>5</sup> *Kahn-Taylor Declaration* at 7-9.

of the figures in deluding others (and perhaps themselves) about the defensibility of the numbers. There just can be no excuse for continued use of such an essentially random, or, rather, fully manipulable calculation process as a basis for vital economic decisions by regulators.<sup>6</sup>

15. Moreover, AT&T's use of accounting earnings here contradicts its previous filings with regulators when asking for regulatory relief for its long distance services. In Massachusetts, AT&T argued that it

... is an integrated, multijurisdictional company providing telecommunications services worldwide using an integrated national management structure and employing the same physical and human resources to provide international, interstate and intrastate services. Because AT&T's services used the same network, computers and other facilities whatever the jurisdiction, determining a cost basis for calculating an economically meaningful rate of return is impossible. Rationally determining the cost basis for purposes of pricing individual state subsets of those services is also an economically impossible task. Yet, Massachusetts ROR regulation requires that a fully-allocated cost basis be established and that the prices for AT&T's intrastate services be modified to reflect such cost allocations. Allocating AT&T's multistate costs to determine AT&T's Massachusetts costs, further allocating those costs between interstate and intrastate services, and yet further allocating the intrastate costs among numerous intrastate services is economically irrational as a basis for setting prices. There is no rational basis for believing that rates based on fully allocated costs are either fair or economically justified.<sup>7</sup>

It is just as "economically irrational" to use accounting earnings and fully distributed costs to assess special access prices as to assess long distance prices.

16. Before the FCC, AT&T addressed assertions of high and increasing price-cost margins in long distance with the argument that "[w]ith respect to the increase in the price-cost margin, ... it should be expected that prices would be above marginal cost in a

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<sup>6</sup> W. J. Baumol, M. F. Koehn and R.D. Willig, "How Arbitrary is 'Arbitrary'? – or, Toward the Deserved Demise of Full Cost Allocation," *Public Utilities Fortnightly*, Vol. 120, No. 5, September 3, 1987 at 21.

<sup>7</sup> Initial Brief of AT&T Communications of New England, Inc., dated April 23, 1992, in the Commonwealth of Massachusetts Department of Public Utilities proceeding DPU 91-79, at 42-43. Citations omitted. Quoted in *Kahn-Taylor Declaration* at 8.

market with high fixed costs.”<sup>8</sup> The technology of special access loops and transport is certainly as subject to “high fixed costs” as that of long distance. AT&T’s (correct) explanation of high and increasing price-cost margins in the long distance market is thus at odds with its complaints in the current proceeding about special access accounting costs and price-cost margins.

**C. The shift in the mix of special access services does not account for the reduction in average revenue per VGE**

17. AT&T claims (at 107-108) that examining average revenue per VGE “is fundamentally misleading,” because any change in average revenue per VGE is “likely due principally to a changing mix of services,” from lower to (relatively cheaper) higher capacity services.

18. First, measuring changes in average revenue per line on a DS0 equivalent basis is hardly “misleading” as evidence of price reductions. For years, AT&T argued that reductions in its average revenue per minute constituted price reductions for long distance for the purposes of (i) assessing competition to support its non-dominance petition and (ii) asserting that it had passed through carrier access charge reductions by lowering prices.<sup>9</sup> These arguments sharply contradict AT&T’s claims in the current case.

19. Surely if reductions in average revenue per minute in the long distance market imply that prices have decreased, then a more dramatic drop in average revenue per VGE in the special access market must do the same. In the long distance markets, competition led to increases in base rates, similar to those of which AT&T complains today in the special access markets. However, in special access—as in long distance—these base rate increases were offset by a proliferation of volume and term discount plans that had the effect of reducing carriers’ average revenue per minute. The fact that some special access tariff rates have risen while term and volume discount plans have caused average revenue per VGE to fall is not an unprecedented event.

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<sup>8</sup> In re: *Motion of AT&T Corp. to be Reclassified as a Non-Dominant Carrier*, Order, released October 23, 1995 at ¶ 76 (footnotes omitted).

<sup>9</sup> *Ibid.*

20. In any event, lower average revenue per VGE represents a lower price that the special access customer pays for the VGE whether or not (i) the carrier has actually reduced the price of some service or introduced a new term and volume discount plan or (ii) the customer has chosen a higher capacity service at a lower price per VGE. If competition or additional consumer choice brings about lower average revenue per VGE for any of these reasons, consumers are better off.

21. Second, there is supporting evidence that contradicts AT&T's claim that the reduction in average revenue per VGE can be attributed principally to a shift in the mix of services purchased. In its initial filing in this proceeding, Verizon undertook such a study for its DS1 service, the service for which AT&T claims (at 106) that prices have increased under pricing flexibility.<sup>10</sup> The Verizon study calculated revenue from DS1 channel terminations, channel mileage and all other rate elements, summed those revenues and divided the sum by the number of DS1 channel terminations. The resulting average revenue per DS1 channel termination fell at an annual rate of about 4.1 percent between January 2001 and April 2004. In real (inflation-adjusted) terms, DS1 prices fell at an annual rate of 6.5 percent. These reduction include the effects of price changes and the migration of customers between tariffed services and volume and term discount contracts, but they do not include any effect of migration to higher-capacity services. As AT&T observed in its Comments (at 108) in criticizing the average revenue per VGE measure, the "more appropriate comparison, however, is to compare rates for the same service." Verizon has done exactly that.

22. Finally, AT&T's criticism that the declining average revenue per VGE is "likely due principally" to the change in the mix of services is pure speculation. In theory, a shift in the mix of services towards higher-capacity, lower price per VGE services would have the effect of lowering average revenue per minute, but AT&T presents no evidence regarding the *magnitude* of the shift towards high capacity services or the effect of that shift on average revenue per VGE.

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<sup>10</sup> Declaration of Judith K. Verses, Ronald H. Lataille, Marion C. Jordan and Lynelle J. Reney, at ¶ 61.

23. In fact, Verizon data imply that the magnitude of the shift towards high capacity services is small. Table 2 shows the change in the distribution of Verizon special access channel terminations (measured in VGEs) across bandwidths from January 2002 to September 2004.

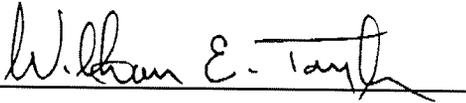
	JAN-02	SEPT-04
DS0-DS1	25.7%	21.9%
DS3-OCn	74.3%	78.1%

The effect of this change is modest, compared with the 21 percent annual drop in average revenue per VGE. If DS3-OCn services were priced at one-tenth that of DS0-DS1 services, the effect of the shift to cheaper services would be a reduction of about 4.0 percent per year in average revenue per VGE. A quick calculation shows that no matter how much cheaper per VGE the higher capacity services might be, the consequential reduction in average revenue per VGE can be no more than 5.9 percent per year. AT&T's unquantified assertion that the observed 21 percent annual reduction in average revenue per VGE is due "principally" to the shift in demand rather than reductions in price is not correct. More to the point, the drop in average revenue per VGE is utterly inconsistent with AT&T's picture of rampant price increases during the price flexibility period, notwithstanding the shift in demand to higher-capacity services.

24. This concludes my declaration.

I declare under penalty of perjury under the laws of the United States of America that the foregoing is true and correct.

Executed on October 15, 2004

A handwritten signature in cursive script, reading "William E. Taylor", is written over a horizontal line.

Dr. William E. Taylor  
NERA

# **ATTACHMENT B**

UNITED STATES COURT OF APPEALS  
FOR THE DISTRICT OF COLUMBIA CIRCUIT

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IN RE AT&T CORP., THE  
COMPTEL/ASCENT ALLIANCE,  
eCOMMERCE AND  
TELECOMMUNICATIONS USERS  
GROUP, AND THE INFORMATION  
TECHNOLOGY ASSOCIATION OF  
AMERICA,

No. 03-1397

Petitioners.

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Thursday, October 21, 2004

Washington, D.C.

The above-entitled matter came on for oral  
argument pursuant to notice.

BEFORE:

CHIEF JUDGE GINSBURG AND CIRCUIT JUDGES SENTELLE  
AND RANDOLPH

APPEARANCES:

ON BEHALF OF THE PETITIONERS:

DAVID W. CARPENTER, ESQ.

ON BEHALF OF THE RESPONDENT:

JOHN E. INGLE, ESQ.

ON BEHALF OF THE INTERVENOR:

GEOFFREY M. KLINEBERG, ESQ.



C O N T E N T S

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1 on predictions that turned out to be false.

2 In 1999, the FCC ended price caps and effectively  
3 deregulated the rates for special access services in  
4 areas that were shown to have a certain amount of  
5 equipment collocations by competitive carriers. These  
6 collocation triggers establish only the existence of so-  
7 called entrance facilities that run between the nearest  
8 end office or nearest switching center of the incumbent  
9 and an interexchange carrier's switch. And they showed  
10 nothing at all about the existence of alternative  
11 transport or loop facilities. But the FCC predicted that  
12 in the areas where these collocation triggers were met,  
13 nearly all special access customers would have  
14 competitive alternatives not only to transport but also  
15 for the loops that run to the customers' premises and  
16 that in the special access tariffs are referred to as  
17 channel terminations. This prediction turned out to be  
18 wrong.

19 JUDGE SENTELLE: Or would it be possible to  
20 rephrase that as "has not yet proven to be correct?"

21 MR. CARPENTER: Has not proven to be correct.

22 JUDGE SENTELLE: Has not yet proven to be  
23 correct.

24 MR. CARPENTER: Has not yet proven to be  
25 correct, and under the FCC's findings won't be proven to

1 be correct in my lifetime. The FCC has found --

2 JUDGE SENTELLE: Counsel, you cited a parallel  
3 case, the Bechtel decision.

4 MR. CARPENTER: Yes, Your Honor.

5 JUDGE SENTELLE: How long had the predictions  
6 in Bechtel been on the FCC's list before we decided it  
7 had been too long?

8 MR. CARPENTER: I'm not certain, Your Honor,  
9 but --

10 JUDGE SENTELLE: Come close, counsel. You  
11 don't have to be certain.

12 MR. CARPENTER: Several years.

13 JUDGE SENTELLE: Decades?

14 MR. CARPENTER: Could be. Could be. I can't  
15 remember.

16 JUDGE SENTELLE: And how long has this  
17 prediction been outstanding?

18 MR. CARPENTER: Five years. Five years,  
19 leading to alleged overcharges --

20 JUDGE SENTELLE: How long has the --

21 MR. CARPENTER: -- of \$5 billion.

22 JUDGE SENTELLE: How long has the effect of  
23 this been tested on any wide-scale reality? Five years  
24 ago, how many places was this really in effect?

25 MR. CARPENTER: How many years? The first

1 grants of pricing flexibility occurred in 2000, so I  
2 would say four years.

3 JUDGE SENTELLE: So we're down to four years  
4 now.

5 MR. CARPENTER: Four years.

6 JUDGE SENTELLE: So that's one.

7 MR. CARPENTER: Pardon me?

8 JUDGE SENTELLE: That's one. Four years ago  
9 was the first one.

10 MR. CARPENTER: Was the first year, and then  
11 they quickly, they quickly filed thereafter, and they're  
12 now 150.

13 JUDGE SENTELLE: How recent is the most recent  
14 one?

15 MR. CARPENTER: Well, by the end of 2002, there  
16 had been 150. I'm not sure how many have been granted  
17 since.

18 JUDGE SENTELLE: Okay. So two years ago.

19 MR. CARPENTER: But half the country.

20 JUDGE SENTELLE: Thank you, counsel.

21 MR. CARPENTER: Half the population.

22 JUDGE SENTELLE: Thank you.

23 MR. CARPENTER: Yes. But the point, Your  
24 Honor, is that the magnitude of errors here are  
25 considerable. If there are no competitive constraints on

1 the incumbents' special access rates and no regulatory  
2 constraints, they can raise their rates at will, and  
3 that's what's happened. Their rates have gone up. Each  
4 and every rate has gone up for the low-capacity  
5 facilities, the DS1-level facilities, for which  
6 competitive alternatives in the FCC's views are  
7 uneconomic and non-existent. And the rates of return  
8 that they report to the FCC have gone up each year since  
9 they received pricing flexibility. It went up in 2001,  
10 it went up in 2002, it went up more in 2003.

11 JUDGE RANDOLPH: Mr. Carpenter, I'm trying to  
12 get a handle on this, but you're talking with Judge  
13 Sentelle about whether five years or four years, but your  
14 action is predicated on 706 of the APA?

15 MR. CARPENTER: Yes.

16 JUDGE RANDOLPH: Okay. And that permits the  
17 Court to order agency action that's been unlawfully  
18 withheld?

19 MR. CARPENTER: Right.

20 JUDGE RANDOLPH: Or unreasonably delayed, I  
21 think.

22 MR. CARPENTER: Yes.

23 JUDGE RANDOLPH: Whatever it is. But in  
24 determining whether agency action has been unlawfully  
25 withheld, doesn't one measure from the point that the

1 agency was asked to do something? So isn't the relevant  
2 time frame between when you filed your petition for a  
3 rule-making and today?

4 MR. CARPENTER: Well, that's certainly, you  
5 know, a relevant time frame, yes.

6 JUDGE RANDOLPH: You're not claiming they had a  
7 sua sponte, that they violated some law by not sua  
8 sponte?

9 MR. CARPENTER: Well, when the pricing  
10 flexibility grants were sought, we opposed them on the  
11 ground that the application of those rules in those  
12 contexts were irrational and they should be either  
13 reconsidered or waived. But I think it's fair to say  
14 that we most decisively put the FCC on notice that we  
15 regarded it as duty-bound to reconsider these rules when  
16 we filed this petition two years ago. But that wasn't  
17 the first time that we pointed out to the FCC that its  
18 predictions were incorrect.

19 JUDGE SENTELLE: But insofar as withholding a  
20 response to a petition for rule-making, you're talking  
21 about two years, right?

22 MR. CARPENTER: Yes, Your Honor. Withholding -  
23 -

24 JUDGE SENTELLE: And insofar as the basis of  
25 that petition being that the predictions had proven

1 incorrect, you had at most two years from the first  
2 instance of the use of the theory, right?

3 MR. CARPENTER: Well, I mean, you know, the  
4 facts that --

5 JUDGE SENTELLE: You had a four-year span --

6 MR. CARPENTER: The facts that --

7 JUDGE SENTELLE: You told me a while ago you  
8 had a four-year span --

9 MR. CARPENTER: Yes. Yes, Your Honor.

10 JUDGE SENTELLE: -- from the first test of the  
11 predictive theory --

12 MR. CARPENTER: Right.

13 JUDGE SENTELLE: -- until now.

14 MR. CARPENTER: Well, the lack of --

15 JUDGE SENTELLE: Now, if it's two years from  
16 then until, from the filing of the petition until now --

17 MR. CARPENTER: Yes, Your Honor.

18 JUDGE SENTELLE: -- that means there was at  
19 most two years for an examination of some of the  
20 applications of this predictive theory before you filed  
21 your petition, right?

22 MR. CARPENTER: That's true, Your Honor. Of  
23 course, the facts that were the basis for those grants  
24 pre-existed that, and the lack of correlation pre-existed  
25 that. But I want to emphasize --

1           JUDGE SENTELLE: But none of that is at issue  
2 now. You lost that fact. Now you're coming back for a  
3 petition for rule-making in which you say their  
4 predictive judgment was wrong, right?

5           MR. CARPENTER: That's correct, Your Honor.  
6 That's correct, Your Honor.

7           JUDGE RANDOLPH: I'm not even sure that the  
8 two-year figure is the proper measure, because you filed  
9 your petition for a rule-making, and how long after that  
10 did you file in this Court for judicial review?

11          MR. CARPENTER: A year.

12          JUDGE SENTELLE: One year.

13          JUDGE RANDOLPH: One year, right?

14          JUDGE SENTELLE: One year, yes.

15          MR. CARPENTER: A year, yes. A little over a  
16 year, I think.

17          JUDGE SENTELLE: Right.

18          JUDGE RANDOLPH: So at that point if we had  
19 heard the case, your argument would be that 12 months or  
20 13 months, whatever it was, constituted unreasonably  
21 withholding agency action.

22          MR. CARPENTER: That's right, Your Honor. And  
23 I'll defend the proposition that they should have acted  
24 the moment we filed the petition. This is not just a  
25 context where we came in with evidence that their

1 prediction was wrong. We were relying on their own  
2 findings that the prediction was wrong. They said in  
3 their Triennial Review Order that there was no  
4 correlation between these collocation triggers and the  
5 presence of alternative facilities. They found that it's  
6 economic to put in alternative facilities only at very  
7 high capacity levels and that there were no alternatives  
8 and that alternatives would be economic at the low-  
9 capacity levels, the DS1 capacity levels, that represent  
10 the vast bulk of the special access that's used in the  
11 United States. This Court's been quite --

12 JUDGE RANDOLPH: Why would your petition for  
13 rule-making take precedence over any other rule-making  
14 that the FCC's conducting?

15 MR. CARPENTER: Well, in all these mandamus  
16 applications you apply a rule of reason and you have to  
17 make a judgment about how central the issues that are  
18 raised --

19 JUDGE RANDOLPH: That is one of the factors.  
20 That's why I asked you.

21 MR. CARPENTER: Yes, Your Honor. And you look  
22 at the consequence of the delay, the importance of the  
23 issues, the burden on the Commission from acting. In  
24 this case, the burden on the Commission is very modest.  
25 There's no heavy lifting. It's simply instituting a

1 rule-making, asking a question, not answering it. The  
2 consequences of delay are immense. I just reiterate, we  
3 alleged --

4 JUDGE SENTELLE: What's the closest precedent  
5 in which we've granted a mandamus to not necessarily FCC,  
6 any agency to what you're asking for here?

7 MR. CARPENTER: Well, in the American Rivers  
8 case last year, you said that to decide the merits of an  
9 issue, you know, an extreme case would require two years.  
10 Generally months or years.

11 JUDGE SENTELLE: What was the procedural  
12 posture of Rivers?

13 MR. CARPENTER: The procedural posture was a  
14 request for action that had been pending for a much  
15 longer time. I freely --

16 JUDGE SENTELLE: What was the procedural  
17 posture, though? Where was it in the process?

18 MR. CARPENTER: Where was it in the --

19 JUDGE SENTELLE: Yes.

20 MR. CARPENTER: I'm not sure I understand.  
21 There was a petition --

22 JUDGE SENTELLE: I think you understand. That  
23 was not the case that somebody had filed a petition for  
24 rule-making and one year later they came in and asked us  
25 to mandamus the agency and we did it, was it?

1 MR. CARPENTER: Yes, Your Honor.

2 JUDGE SENTELLE: It was?

3 MR. CARPENTER: But I just go back to the  
4 proposition that you apply a rule of reason and that the  
5 application of it is context-specific. If you're not  
6 persuaded that the agency has an obligation to respond  
7 when it's shown that predictions are false and it's found  
8 that predictions are false, and the result is \$5 billion  
9 of overcharges and a \$12 billion adverse effect on the  
10 national economy, then obviously we lose the case. But  
11 you do focus on the significance of the interests that  
12 are at stake, the burden on the FCC, and here the burden  
13 is very, very slight. It's simply initiating a rule-  
14 making. It's not rendering the kinds of final decisions  
15 on the merits that were involved in these other  
16 decisions, and the consequences of delay are immense.

17 JUDGE GINSBURG: Excuse me. Is the burden  
18 initiating a rule-making or deciding whether to initiate  
19 a rule-making?

20 MR. CARPENTER: They can do either one. They  
21 can do either one.

22 JUDGE GINSBURG: Okay, it's really just  
23 deciding.

24 MR. CARPENTER: But they have to under your  
25 precedents, when they're presented with substantial

1 evidence that the premises of their rules are wrong, they  
2 have to respond in some fashion, either instituting a  
3 rule-making or explaining why a rule-making is not  
4 justified, and confronting the evidence. And I keep  
5 going back to the fact that it's their own findings as  
6 well as our evidence that supports the proposition that  
7 the prediction is wrong. This is a context where under  
8 any view that their findings in 2001 had rendered their  
9 Pricing Flexibility Order arbitrary and capricious.

10 JUDGE SENTELLE: What's the full, if you know,  
11 the citation of that American Rivers decision?

12 MR. CARPENTER: It's fairly recent, Your Honor,  
13 372 F.3d 413. But what I was relying on was, you know,  
14 admittedly dicta, quoting another decision of this Court  
15 that said that in terms of deciding the merits, a  
16 reasonable time for the Commission is usually a month,  
17 sometimes years --

18 JUDGE SENTELLE: How much time had elapsed in  
19 that case?

20 MR. CARPENTER: Pardon me?

21 JUDGE SENTELLE: How much time had elapsed in  
22 that case?

23 MR. CARPENTER: Oh, it was a number of years,  
24 Your Honor. It was six or seven years.

25 JUDGE SENTELLE: Six, wasn't it?

1 MR. CARPENTER: Yes.

2 JUDGE SENTELLE: Yes. So how is that case  
3 parallel to this one?

4 MR. CARPENTER: What's parallel is, well,  
5 there's the quote I just read you, and applying it in the  
6 different context where the agency is not being asked to  
7 decide something on the merits but merely to initiate a  
8 proceeding and to rule. So as I say, you apply a rule of  
9 reason, and if you're considering the burden on the  
10 agency, the magnitude of the harms affected by delay,  
11 then this is a very easy case. If you're going to close  
12 your eyes to those things and apply a per se rule in  
13 which there has to be a six- or seven-year delay, then we  
14 obviously lose. But I would submit that that would not  
15 be an example of this Court exercising its judicial  
16 powers in the utmost wisdom, because you have to be  
17 practical in responding to these things. The agency has  
18 the duty of reasoned decision-making that requires that  
19 it monitor its predictions. When it's found that the  
20 predictions are invalid and the erroneous prediction is  
21 having immense adverse consequence, then I submit that  
22 granting, that the agency has a clear duty to act and  
23 immediately. It can't wait for one year, two years, and  
24 now it's been two years, and at this point enough is  
25 enough. The agency is quite assiduous in trying to take

1 the minimum steps necessary, trying to avoid mandamus,  
2 while maintaining maximum latitude to keep stringing this  
3 thing out and delaying something that they should have  
4 done two years ago.

5 JUDGE GINSBURG: You're into your rebuttal  
6 time, Mr. Carpenter.

7 MR. CARPENTER: Thank you, Your Honor.

8

9 ORAL ARGUMENT OF JOHN E. INGLE, ESQ.

10 ON BEHALF OF THE RESPONDENT

11

12 MR. INGLE: Good morning. My name is John  
13 Ingle. I'm representing the FCC in this case.

14 We're going to try to keep ourselves from talking  
15 about the merits of the petition for rule-making, because  
16 we don't think that's what's before this Court. We think  
17 what's before this Court is whether there is  
18 justification for issuing a writ of mandamus requiring  
19 the FCC to act on that petition.

20 We think, we sort of have two points to make here.  
21 Mr. Carpenter has said both in his briefs and here this  
22 morning that he's not arguing the merits of his case,  
23 although he seemed to be talking an awful lot about it,  
24 his case before the Commission. He said, though, in his  
25 reply brief that all they were asking was for the Court

1 to direct the FCC to rule on its request. Now, the FCC,  
2 perhaps bullied by this petition for rule-making, perhaps  
3 influenced by the fact that the Court called for a  
4 response and then called for briefing and then called for  
5 oral argument on the mandamus petition, has made  
6 significant movement in the direction of ruling on the  
7 request. As we told the Court in our motion filed two  
8 weeks ago asking that this argument be deferred, the  
9 Commission staff has drafted an order that would dispose  
10 of all of the issues raised in the petition for rule-  
11 making, that is, whether to initiate a rule-making and  
12 whether to grant the interim relief that was required or  
13 that was asked for. That draft order is now before the  
14 commissioners in the voting process that's known as  
15 circulation, and the voting has begun. In those  
16 circumstances, it seems to us that this is a case very  
17 much like the TRAC case itself and very much like other  
18 circumstances in which action by the Commission is  
19 clearly forthcoming if not imminent and that the Court  
20 should simply require perhaps a status report from the  
21 Commission at an appropriate time and stay its hand on  
22 acting on the merits of the mandamus petition.

23 JUDGE RANDOLPH: Is there any requirement  
24 regarding the time that a commissioner has to vote on?

25 MR. INGLE: There is not. There is not. I can

1 tell you that the voting has started and that there are  
2 votes that have been recorded, and there are five  
3 commissioners. It shouldn't take an awful long time.  
4 What we proposed in our motion to defer was that the  
5 Court --

6 JUDGE RANDOLPH: How many votes does it take to  
7 grant or deny?

8 MR. INGLE: A majority would be sufficient, but  
9 the Commission's process is don't permit a cessation of  
10 the vote when a majority has been achieved as to one  
11 outcome or another. All five of the commissioners have  
12 to vote before there's a release of an order.

13 JUDGE RANDOLPH: So one could just not vote and  
14 that would hold it up for a year?

15 MR. CARPENTER: That's right.

16 JUDGE RANDOLPH: A year or two years, three  
17 years?

18 MR. CARPENTER: That could happen. That could  
19 happen. And what we have proposed in our motion to defer  
20 the argument was that the Court entertain a status report  
21 from the FCC on December the 1st of this year. We think  
22 -- we hope -- that this matter will be resolved within a  
23 matter of weeks now that the draft order is before the  
24 Commission.

25 Now, I have to add to that that the Commission's

1 disposition of the proposal that's before it now could be  
2 to reject that proposal, in which case it would be  
3 somewhat analogous to a recommittal of a bill, and there  
4 would be further staff work to prepare another version of  
5 a proposed order that would dispose of the matter in  
6 accordance with instructions that the Commission gives.  
7 I don't know whether that's going to happen here. I  
8 simply don't know.

9 But in any event, if we file a status report with  
10 the Court on December 4th, December 1st, rather, we can  
11 accompany that with some recommendation as to whether it  
12 should go ahead and deal with the merits of the mandamus  
13 petition or whether the status report is sufficient for  
14 us to make a suggestion of mootness on the mandamus  
15 petition. We think that's an appropriate resolution here  
16 that doesn't require the Court to vote up or down on  
17 whether to grant the mandamus.

18 Now, if the Court doesn't do that, we think that Mr.  
19 Carpenter's case for mandamus is really a very lame case.

20 As the Court pointed out this morning through its  
21 questions, the time frame, the relevant time frame for  
22 deciding whether the Commission has delayed unreasonably  
23 can't start any earlier than October of 2002, when Mr.  
24 Carpenter filed his petition for rule-making, and perhaps  
25 it shouldn't even start then, because when the Commission

1 got the petition for rule-making, it put the petition out  
2 on notice and asked for comment. Those comments came in  
3 in December of 2002, and the reply comments, I believe,  
4 were filed in the early part of 2003, so that arguably,  
5 at least, the petition for rule-making was not even ripe  
6 for Commission action until after those comments had come  
7 in.

8 In addition to that, there have been further ex  
9 parte presentations made, some as recently as in 2004,  
10 going to the merits of the rule-making petition.

11 JUDGE GINSBURG: Mr. Ingle, when you say only  
12 after the reply comments was it ripe for action, do you  
13 mean to say that the Commission had to seek comments and  
14 replies before it could have acted?

15 MR. INGLE: No. No. No, I do not mean that.

16 JUDGE GINSBURG: No? All right. Just the way  
17 they proceeded --

18 MR. INGLE: I mean as a practical matter, this  
19 is the way the Commission proceeds normally with rule-  
20 making petitions.

21 JUDGE GINSBURG: Okay.

22 MR. INGLE: It allows comment, and only after  
23 receiving comments does it typically vote to open a rule-  
24 making or not.

25 JUDGE GINSBURG: Okay. Okay.

1           MR. INGLE:  There's more to it than that,  
2  though, as far as the timing is concerned.  It seems to  
3  us that there are two time frames that are relevant here.  
4  The first is the one I've just discussed, the time from  
5  the petition for rule-making to now.  The other is the  
6  time that passed between the adoption and the affirmance  
7  and the implementation of the Commission's pricing  
8  flexibility rules and the filing of the petition for  
9  rule-making, which alleged that the whole thing was a  
10 failure.  Now, in our judgment, it seems that there was  
11 not a fair amount of time given for anybody to make a  
12 proper evaluation of whether the Commission's predictive  
13 judgment was a valid one.  This Court held that it was a  
14 reasonable predictive judgment, and we think that when  
15 that has occurred, when the agency has adopted rules,  
16 there at least has to be some reasonable time in which  
17 those rules can be implemented and evaluated.

18           JUDGE GINSBURG:  Well, isn't that a reason for  
19 the Commission if it agreed with you to have rejected the  
20 petition or deferred it but not to have put it out for  
21 comment?

22           MR. INGLE:  I think the Commission could have.  
23 I don't think that would have been a useful thing to do.

24           JUDGE GINSBURG:  But by putting it out for  
25 comment, they opened that question, right, and --

1 MR. INGLE: I think that's right.

2 JUDGE GINSBURG: I mean, they took it, were  
3 open-minded about the matter that you're suggesting is  
4 closed. That is to say --

5 MR. INGLE: Well, I'm making --

6 JUDGE GINSBURG: -- you're saying, well, it was  
7 premature, and they said let's hear what people have to  
8 say.

9 MR. INGLE: Okay, I'm making an argument of  
10 counsel here in defense of the Commission as against the  
11 petition for mandamus. I'm not arguing that the  
12 Commission could not have either granted or denied  
13 immediately the petition that Mr. Carpenter filed on  
14 behalf of AT&T back in 2002. I think the Commission, and  
15 this is sort of inside baseball and the way things work  
16 at the Commission rather than a discussion of what the  
17 Commission is required to do under the law. The  
18 Commission often gets petitions for rule-making. They  
19 come in all the time. The Commission doesn't necessarily  
20 act on those rule-making petitions either to grant them  
21 or to deny them. The Commission often does not. The  
22 Commission sometimes will accumulate a record on rule-  
23 making proceedings, and then the staff will go over them  
24 to decide which ones look promising, which ones look like  
25 something the Commission ought to address itself to, and

1 at some time down the road several of those rule-making  
2 petitions may be incorporated into a single rule-making.

3 But some of them may be several years old by the time  
4 that occurs.

5 Now, getting back to Mr. Carpenter's argument here  
6 this morning, the Commission was affirmed by this Court  
7 in the WorldCom case on the basis in large part of its  
8 predictive judgment as to what the result of this policy  
9 was going to be. And we don't deny that the Commission  
10 has a continuing obligation to look at the results of the  
11 policies and rules that it has adopted over time. The  
12 Court has said that in a number of cases. The Bechtel  
13 case, Judge Sentelle, as it turns out, I read it the  
14 other day to see what the time frame was, and it was 26  
15 years.

16 JUDGE SENTELLE: Twenty-six? Yes.

17 MR. INGLE: This doesn't approach that. We do  
18 have that obligation. The question --

19 JUDGE GINSBURG: Well, that, we don't --

20 JUDGE SENTELLE: Bechtel was not a mandamus to  
21 begin with.

22 MR. INGLE: No, it was not. No, it was not.  
23 And --

24 JUDGE GINSBURG: That wasn't meant to set a  
25 standard within which anything is okay, you know?

1           MR. INGLE: We take what we can. No, the --  
2 I've sort of lost my train here. The --

3           JUDGE SENTELLE: You were probably about to say  
4 that you do not concede that the Commission has found  
5 that its predictive judgment was incorrect and it's  
6 having disastrous consequences.

7           MR. INGLE: Well, I certainly hope I was going  
8 to say that. That's --

9           JUDGE SENTELLE: That seemed to be the  
10 direction in which you were moving.

11          MR. INGLE: Yes, sir. Yes, sir, it was. In  
12 any event, we do have the obligation to make that  
13 evaluation over time as to whether our predictive  
14 judgments have been valid, but we certainly don't have an  
15 obligation after just having completed a five-year rule-  
16 making and just having been affirmed by this Court on  
17 judicial review to go back and grant a do-over on the  
18 basis of claims that the agency's rule has not proven to  
19 do exactly what it was supposed to do within a very, very  
20 short time. We think that if the Court doesn't take us  
21 up on our offer to send a status report in on December  
22 1st that the Court nonetheless should deny the mandamus  
23 petition outright.

24          JUDGE GINSBURG: If we do take you up on that  
25 or some variant of that, Mr. Ingle, we would be issuing

1 an order shortly. Otherwise, the matter will just be  
2 under submission.

3 JUDGE RANDOLPH: They don't need an order from  
4 us to give us a status report, do they?

5 MR. INGLE: No. No, we don't.

6 JUDGE GINSBURG: No, no.

7 MR. INGLE: We'll be happy to do that  
8 voluntarily.

9 JUDGE GINSBURG: But if we want one.

10 MR. INGLE: Thank you.

11 JUDGE GINSBURG: Thank you, Mr. Ingle.

12

13 ORAL ARGUMENT OF GEOFFREY M. KLINEBERG, ESQ.

14 ON BEHALF OF THE INTERVENOR

15

16 MR. KLINEBERG: Thank you, Chief Judge  
17 Ginsburg, and may it please the Court.

18 I certainly agree for all of the reasons that Mr.  
19 Ingle described that this is not an appropriate case for  
20 mandamus. But I would like to take the few minutes I  
21 have to make one additional point, and that is that the  
22 evidence before the FCC in this proceeding demonstrates  
23 that the Commission's Pricing Flexibility Order is  
24 working in precisely the way the FCC predicted it would  
25 work back in 1999. I say this not to urge the Court to

1 rule on the merits but rather to --

2 JUDGE SENTELLE: Yes, are they even before us?

3 MR. KLINEBERG: Well, no, they're not, Your  
4 Honor, and I simply say this to just urge the Court to,  
5 really to emphasize that the FCC has no reason to believe  
6 that there is a some emergency here that justifies  
7 launching a rule-making to consider the wholesale  
8 abandonment of a deregulatory policy that is barely five  
9 years old.

10 The Pricing Flexibility Order is working for all of  
11 the reasons we have spelled out in our brief, but I would  
12 like to emphasize just three of them quickly here.

13 First, the Bell companies have provided concrete  
14 evidence that special access rates have declined since  
15 pricing flexibility went into effect. Verizon, for  
16 example, has shown the FCC that between 2001 and 2003,  
17 which really are the first two years under pricing  
18 flexibility, its revenues for special access line have  
19 declined by over 21 percent.

20 Second, there is no evidence at all that the Bell  
21 companies have engaged in any form of discriminatory  
22 conduct in the provision of special access services. And  
23 this is precisely what both the FCC and this Court  
24 predicted. Indeed, as you, Judge Sentelle, wrote for the  
25 Court in WorldCom, collocation can reasonably serve as a

1 measure of competition in a given market and predictor of  
2 competitive constraints upon future LEC behavior  
3 precisely because the presence of substantial sunk  
4 investment and the resulting potential for entry into the  
5 market can limit anti-competitive behavior. This is  
6 exactly what has happened, and petitioners have provided  
7 no evidence at all that the Bell companies have engaged  
8 in any anti-competitive behavior.

9       And third, the market for high-capacity services of  
10 which special access is an essential part is dominated  
11 not by the Bell companies but by the long-distance  
12 carriers, who control approximately 75 percent of the  
13 market for high-capacity services to large business  
14 customers. In other words, the Bell companies are way  
15 behind in this business market, given that they've only  
16 recently been able to provide long-distance services  
17 throughout their entire regions.

18       So in conclusion, there is no emergency here, and  
19 the FCC's conduct has been entirely reasonable, and when  
20 the FCC ultimately does address the underlying petition,  
21 it should simply deny it as entirely inadequate to  
22 justify the re-regulation of special access rates. It  
23 has been less than five years since the FCC initiated the  
24 modest deregulation reforms reflected in the Pricing  
25 Flexibility Order, and there is every reason to believe

1 that this order is working precisely as the FCC  
2 predicted.

3 Unless there are any questions, I will sit down.

4 JUDGE GINSBURG: Thank you, Mr. Klineberg.

5 MR. KLINEBERG: Thank you very much.

6 JUDGE GINSBURG: How much time does Mr.  
7 Carpenter have?

8 THE CLERK: One minute (indiscernible).

9

10 REBUTTAL ARGUMENT OF DAVID W. CARPENTER, ESQ.

11 ON BEHALF OF THE PETITIONERS

12

13 MR. CARPENTER: Three points. First, the FCC  
14 didn't dispute in its brief and Mr. Ingle didn't dispute  
15 today that the FCC's findings in the Triennial Review  
16 Order establish that the '99 prediction won't ever come  
17 true, that it's uneconomic to put in low-capacity DS1-  
18 level loops because there's insufficient demand to  
19 justify the fixed and sunk investments that's required.  
20 So conceding that a reasonable time is required to  
21 evaluate whether rules predictions are valid, here the  
22 FCC has made findings that establish the predictions  
23 aren't true and won't ever come true.

Second, Mr. Ingle has acknowledged that the voting  
that's occurring on circulation won't produce a guaranteed

order at any point in time. Our position is that the FCC was required to act two years ago. It's required to act now. What we submit you should do is put out an order tomorrow or soon giving the FCC a certain amount of time, 30 to 60 days, to act or at a minimum to commit to a schedule, not to continue to try to string this out by making commitments that don't mean anything at all and that won't result in actions that we submit the FCC was required to take long ago and is certainly required to take now.

I see my time is up.

JUDGE GINSBURG: Thank you, Mr. Carpenter. Mr. Ingle, Mr. Klineberg, thank you all. Case is submitted, and the Court will take a brief recess.

(Recess.)

#### CERTIFICATE

I certify that the foregoing is a correct transcription of the electronic sound recording of the proceedings in the above-entitled matter.

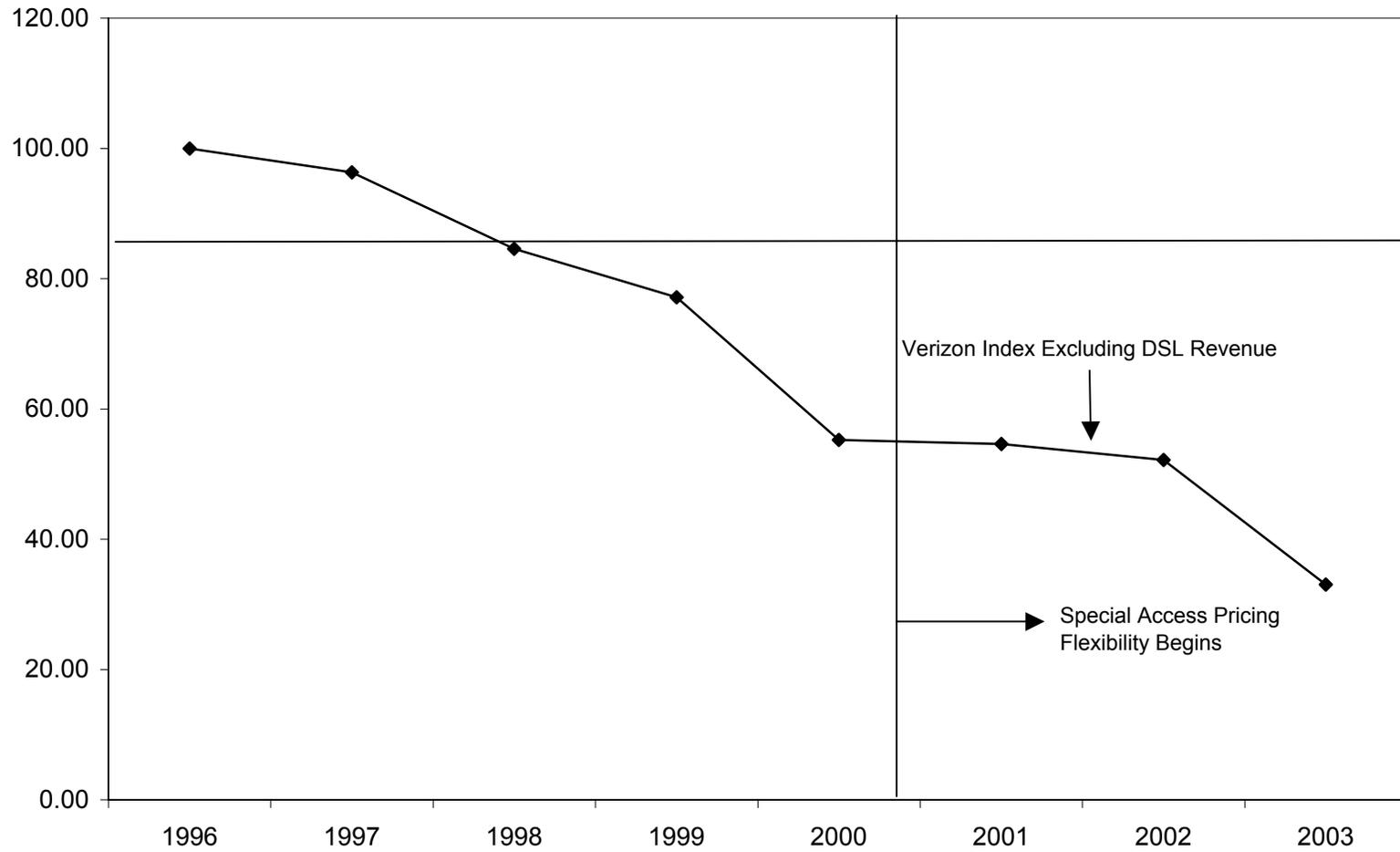
Carol Schlenker

Date

DEPOSITION SERVICES, INC.

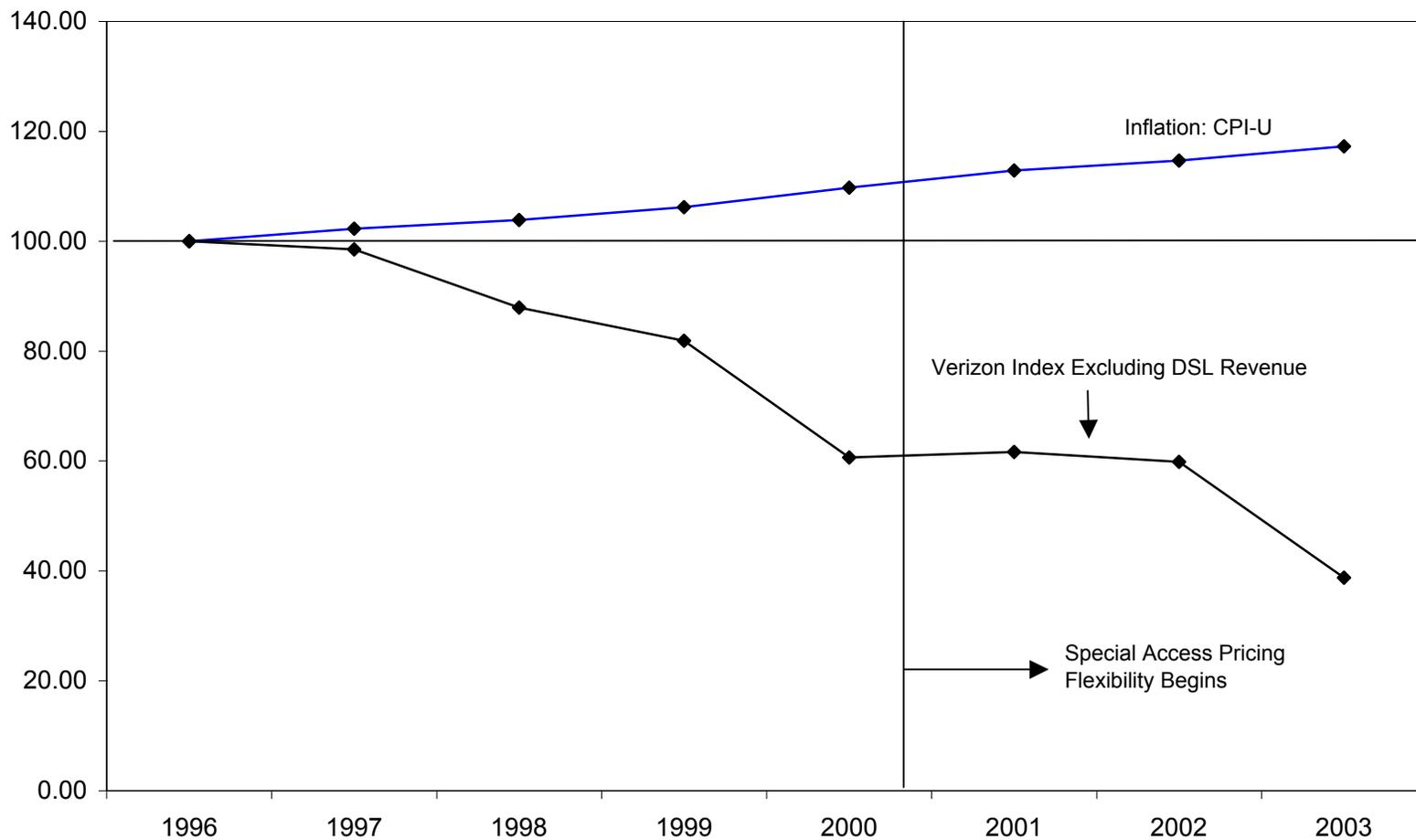
# **ATTACHMENT C**

**Real Special Access Revenue per  
Special Access Voice Grade Equivalent  
(1996 = 100)**



Source: FCC ARMIS Report 43-08, 43-03, 43-04, BLS

### Nominal Special Access Revenue per Special Access Voice Grade Equivalent (1996 = 100)



Source: FCC ARMIS Report 43-08, 43-03, 43-04, BLS