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December 7, 2004

Ex Parte

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

Re: Ex Parte Presentation, *Unbundled Access to Network Elements*, WC
Docket No. 04-313, CC Docket No. 01-338

Dear Ms. Dortch:

I am writing to respond to the October 19, 2004 *ex parte* declaration filed by William Taylor and Aniruddha Banerjee on behalf of BellSouth in the above-captioned proceeding. In this filing, Taylor and Banerjee claim that BellSouth has decreased its special access prices after obtaining pricing flexibility. To support that claim, Taylor and Banerjee purport to examine BellSouth's average special access revenue per voice grade equivalent ("VGE") before and after BellSouth obtained pricing flexibility. As AT&T and others have demonstrated, however, this standard is fundamentally flawed and the results that it generates can be given no weight. Although Taylor and Banerjee attempt to respond to some (but not all) of the shortcomings identified with their methodology, their response remains filled with errors and only confirms that BellSouth enjoys special access market power.

Preliminarily, it is important to understand that Taylor and Banerjee do not attempt to show that BellSouth has decreased special access prices. If true, such an analysis would be easy to do. One merely examines over time how BellSouth changed the price for a particular special access service. Such an analysis would unambiguously refute the claims advanced by BellSouth here. In areas where BellSouth obtained pricing flexibility, BellSouth has either raised special access rates or held those rates roughly constant in the face of rapidly declining costs.¹ This is true both for month-to-month special access rates and term rates under its OPPs.² As a result,

¹ AT&T Reply, Stith Reply Dec., Atts. 1-2.

² *Id.*

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BellSouth's special access rates in areas where it has obtained pricing flexibility are well above what it charges in areas where it remains subject to price caps.³

Taylor and Banerjee instead rely on a contrived metric – average special access revenue per VGE – as an indirect proxy for special access prices. Although the flaws in this approach have been well-documented,⁴ they are largely ignored by Taylor and Banerjee.⁵

First, there is no logical relationship between average revenues per special access VGE and special access price changes. In fact, average revenues per special access VGE can decline even as special access prices increase. There are several reasons why this might occur. The Bells sell special access upon different terms and conditions. Customers that agree to the extra economic burdens entailed by the lengthy term and volume commitments in Bell OPPs can purchase special access at prices lower than the prices the Bells charge for month-to-month rates. Thus, if the Bells increase month-to-month rates (as they have) that will cause more customers to knuckle under to the conditions in the Bell OPPs (as they have). This mere relative shift in demand will cause a decrease in average revenues per VGE – but there indisputably is *no decrease* in price.⁶

Second, the ARMIS data upon which Banerjee and Taylor rely do not segregate revenues earned in pricing flexibility and non-pricing flexibility MSAs. That is critical because the Bells have been forced to lower prices in areas where they remain subject to price caps. These required reductions may cause a drop in overall average revenues per VGE, but in no way show that the Bells have lowered prices in areas where they have pricing flexibility.

Third, average revenue per VGE depends directly upon the *length* of the circuits that the Bells sell. Special access has fixed charges and mileage sensitive charges. The longer the special access circuit, all else equal, the higher the charge for the circuit. Thus, if there is a

³ AT&T, Stith Dec., Atts. 1-2; Loop-Transport Coalition at 48 & n.151 (citing affidavits); MCI at 158; NuVox at 44.

⁴ See generally, AT&T Reply, Selwyn Reply Dec. ¶¶ 59-86; KDW Reply, Pelcovits-Frentrup Reply Dec. ¶¶ 2-19.

⁵ The only justification that Taylor and Banerjee offer for ignoring actual special access prices is the need to capture “discounts” off of BellSouth's tariffed rates. Taylor-Banerjee Ex Parte Dec. ¶ 38. This, of course, is an abuse of the term “discount.” A service is discounted only when its price is less, but the terms and conditions of its provision remain the same. Here, lower prices are granted only when the terms and conditions of purchase are made much more onerous for the buyer, and much more favorable to the seller.

⁶ Indeed, an analysis that properly accounted for the economic “cost” of the assumed volume and term commitments could well show an economic rate increase.

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relative shift over time in special access demand from longer to shorter circuits, that would manifest itself as a reduction in average revenues per VGE even where there had been no decrease in price. And there is reason to believe this phenomena may have occurred – the record evidence shows that the Bells have consistently price-squeezed competitive carriers purchasing “long” special access circuits, which would result in a relative increase in demand for lower-priced “short” circuits.

Fourth, the average revenue per VGE metric treats mere shifts in the mix of special access purchased as a price decrease. The Bells earn higher revenues per VGE on lower capacity special access services than they do on higher capacity services. For example, the revenue per VGE of an OC12 service is much lower than the revenue per VGE of DS1 service. If there is greater growth in purchases of higher capacity services than of lower capacity services, this would cause a decline in average revenues per VGE even where there had been no price decrease (or indeed, even where there have been price increases).

Although AT&T is confident that a deeper investigation into BellSouth’s pricing flexibility special access prices – and not its average revenue per VGE – will show that these prices have not declined, the Commission need not even resolve this methodological dispute because the data show that BellSouth’s overall average special access revenues per VGE *increased* since obtaining pricing flexibility in 2000. Specifically, using publicly available ARMIS data, AT&T affiant Dr. Lee Selwyn demonstrated in his reply declaration that BellSouth’s average revenues per VGE fell by almost 50% from 1996 to 2000 while BellSouth’s average revenues per VGE *increased* approximately 10% from 2000 to 2003.⁷

In their *ex parte* declaration, Banerjee and Taylor claim to have “enhanced” their analysis in a way that overcomes these criticisms. First, they contend that it is inappropriate to use ARMIS special access revenues in calculating average revenues per VGE.⁸ They contend that ARMIS special access revenue data include revenues from BellSouth DSL services, but that ARMIS-reported special access VGEs do not include DSL lines.⁹ Using undisclosed BellSouth supplied data as to DSL revenues, they then purport to calculate average special access per VGE from 1996 to 2003 using the “correct” data.¹⁰ In addition, they claim to correct for the fact that average revenues per VGE treats relative shifts in demand for different capacities of special access services as a “price” change narrowing some of their analyses to claimed “DS-1 local

⁷ AT&T Reply, Selwyn Reply ¶ 82 (Figure 5).

⁸ Taylor-Banerjee Ex Parte Dec. ¶ 32.

⁹ *Id.*

¹⁰ *Id.* ¶ 33.

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channels.”¹¹ According to Taylor and Banerjee, their “improved” analysis demonstrates that BellSouth’s prices decreased after obtaining pricing flexibility.¹²

Banerjee-Taylor’s newly minted analysis is no better than the one it purports to replace. Most fundamentally, it does not address at all three of AT&T’s major criticisms: (i) that it inappropriately treats mere shifts in relative demand for month-to-month versus more burdensome term services as reflecting price changes; (ii) that it inappropriately combines price changes for price capped special access services with pricing flexibility services and interprets price decreases in special access services subject to price caps as price decreases for services for which the Bells have pricing flexibility; and (iii) that it inappropriately treats mere relative shifts in demand for circuit-mileage as price changes. These points must now be considered conceded.

But even as to the analysis Taylor and Banerjee actually conduct, they can produce their desired result only through secret data, unsubstantiated and unexplained black box calculations and an apparently deliberate misinterpretation of the effective date at which BellSouth special access services were removed from price caps and converted to pricing flexibility. As noted, Taylor and Banerjee claim that ARMIS special access revenues include DSL revenues and thus it is necessary to remove those revenues in order to get an accurate assessment of how special access prices have changed over time. But ARMIS data do not exist that allow for such a reduction. Thus, Banerjee and Taylor claim to use data supplied to them by BellSouth to do this, but of course do not reveal such data or even identify its source with specificity.

No weight can be given to this smoke and mirrors. Banerjee and Taylor provide no information whatsoever about what DSL revenue they actually used or the source of the data. Indeed, they do not even provide figures (either publicly or under confidential seal) for the aggregate DSL revenues they have assumed. Such detail is essential for assessing the accuracy of Banerjee and Taylor’s calculation because a substantial portion of BellSouth’s total DSL revenues may not, in fact, be recorded in ARMIS special access accounts. DSL may be provided to so-called Data CLECs (“DLECs”) as UNEs or may be furnished to BellSouth customers bundled together with Internet access. There is no way to ascertain that the DSL “revenues” that Taylor and Banerjee claim to have “removed” from the special access accounts were ever there to begin with. Thus, if the unnamed, unverified, undocumented, undescribed and unquantified DSL revenue data relied upon by Banerjee and Taylor included revenues that were never recorded in ARMIS special access accounts, subtracting those revenues from the ARMIS special access data accounts would have the effect of *understating* BellSouth’s special access revenues per VGE as well as its overall return on special access services in general.

¹¹ *Id.* ¶ 35; *see also id.* (acknowledging that “measuring average special access revenue at the VGE level obscures the differences in unit prices that are charged for special access facilities at different capacity levels”).

¹² *Id.* ¶ 34.

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More fundamentally, Banerjee and Taylor inadvertently make clear that their analysis suffers from yet another fatal problem. DSL revenues are not the only “non-special access service” reflected in ARMIS special access service accounts. Special access services may include services other than DSL that do not generate VGE “lines” in ARMIS 43-08 reports. To the extent that this is the case, inclusion of these revenues likewise can bias the results. For example, to the extent that BellSouth decreased prices for these services and/or experienced reduced demand for them at existing prices, that would reduce BellSouth’s average revenues per VGE even where BellSouth had not reduced any special access prices at all. What Banerjee and Taylor appear to have done is simply to cherry-pick one service (DSL) where revenues have increased over time while ignoring the other services that have declining revenues and that should likewise be removed from their calculation.

But even this sleight-of-hand is insufficient to show that special access prices post pricing flexibility decreased relative to when special access services were fully subject to price caps, so Taylor and Banerjee must resort to misstating the results of their study. Specifically, Taylor and Banerjee claim that the relevant “baseline” for measuring pre- and post-pricing flexibility results is 2001.¹³ In other words, Taylor and Banerjee assert that the revenues that BellSouth earned in 2001 and earlier are revenues earned while BellSouth was subject to price cap regulation, and that revenues earned in 2002 and 2003 are revenues earned while BellSouth was subject to pricing flexibility.

This baseline is wrong. BellSouth pulled its pricing flexibility rates out of price caps on January 10, 2001. That means that virtually all of the special access revenues BellSouth earned in 2001 are properly classified, in Taylor and Banerjee’s nomenclature, as “pricing flexibility.” The reason why the appropriate baseline is critical is because Taylor and Banerjee’s calculations show a substantial *increase* in average special access revenue per VGE from 2000 to 2001.¹⁴ Thus, by using 2001 (rather than 2000), Taylor and Banerjee understate BellSouth’s decrease in revenue per VGE under price caps and overstate BellSouth’s decrease in revenue per VGE under pricing flexibility.

Critically, correcting this flaw produces results the exact opposite of those being claimed by Taylor and Banerjee. According to Figure 1 of the Taylor-Banerjee declaration, average nominal dollar revenue per VGE was approximately \$183 in 1996 and \$90 in 2000 – an annual rate of decrease of 16.26%.¹⁵ In contrast, from 2000 to 2003, average revenue per VGE fell from approximately \$90 to \$73 – an annual rate of decrease of only 6.74%. Thus, BellSouth’s special

¹³ *Id.* ¶ 33 & Figure 1.

¹⁴ *Id.*, Figure 1.

¹⁵ Because Taylor and Bannerjee do not provide their actual data, these figures are determined from a visual examination of the data points plotted in Figure 1.

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access revenues per special access VGE (even assuming its data are accurate) declined much more slowly after it was granted pricing flexibility than before.

Taylor and Banerjee also fail to prove that even the modest decrease in average revenue per VGE they calculate is not attributable entirely to the relative increase in purchase of high capacity circuits relative to low capacity circuits.¹⁶ As noted, Taylor and Banerjee candidly acknowledge that a relative shift in demand to higher capacity circuits will decrease revenues per VGE even if there is no price decrease. Taylor and Banerjee, however, attempt to control for this relative shift by examining whether “average DS-1 revenue per local channel” decreased at a greater rate post-pricing flexibility than pre-pricing flexibility.

This “analysis” of DS-1 specific revenues suffers from many of the same problems as Taylor and Banerjee’s analysis of all special access revenues. Again, Banerjee and Taylor obscure the details of their analysis. They provide no explanation as to where they obtained DS-1 revenues and line counts (such data are not reported in ARMIS) or even what the aggregate numbers were so that one could at least double check their math.¹⁷

The labels employed by Taylor and Banerjee suggest that they have made significant alterations to their basic approach without any explanation or justification for those changes. While their basic calculation claims to have measured average revenue per special access VGE line, Taylor and Banerjee’s DS-1 specific analysis is stated to measure “average DS-1 revenue per local channel.”¹⁸ This is not standard terminology. Indeed, this difference in terminology suggests that they may *not* have examined DS-1 *interstate special access service* – the relevant service. Instead, their revised wording suggest that their DS-1 revenue data could include revenues derived from non-interstate or non-special access services. Potentially, this could include DS-1s circuits sold as UNEs, local private line services or other retail services. In addition, Taylor and Banerjee *sub silento* changed the denominator. Instead of using special access VGEs as reported in ARMIS (as they did in their initial calculation), they instead use “local channels” for their DS-1-specific measure. But they provide no explanation as to what they mean by that term. Is it channel terminations? How does it handle circuits that include

¹⁶ Of course, as noted, BellSouth does not even attempt to show that the decline in average revenue per VGE is not driven by (i) shifts in demand for month-to-month and term rates as price changes; (ii) decreases in special access services subject to price caps as price decreases for services for which the Bells have pricing flexibility; and (iii) relative shifts in demand for circuit-mileage as price changes.

¹⁷ This is not a quibble. As AT&T demonstrated, Dr. Taylor made substantial mathematical errors in performing a similar analysis for Verizon. 11/08/04 AT&T Ex Parte, Att. at 2 & Selwyn Ex Parte Dec. ¶ 11.

¹⁸ Taylor-Banerjee Ex Parte Dec. ¶ 36 & Figure 2.

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channel mileage?¹⁹ These are critical issues because Taylor and Banerjee's claimed DS1-specific analysis proves nothing if they used a different denominator than they used in their basic analysis.

Finally, and in all events, Taylor and Banerjee's calculations prove nothing because they failed to examine higher capacity services. As Dr. Selwyn previously explained, there has been a relative increase in purchase of OC-n level services that generally have the lowest revenue per VGE of all special access services.²⁰ Thus, in order to determine the extent of the error in Taylor and Banerjee's base calculation, one must conduct a service-specific analysis of these higher capacity services, not the lower capacity services measured by Taylor and Banerjee.

Very truly yours,

/s/ C. Frederick Beckner III
Counsel for AT&T Corp.

¹⁹ Finally, their results critically rely on use of the wrong 2001 baseline. And, again, if the appropriate baseline of 2000 were used, Banerjee and Taylor's conclusions are repudiated.

²⁰ 11/08/04 AT&T Ex Parte, Selwyn Ex Parte Dec. ¶ 16.