

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

In the Matter of	)	
	)	
Special Access Rates for Price Cap Local Exchange Carriers	)	WC Docket No. 05-25
	)	
AT&T Corp. Petition for Rulemaking to Reform Regulation of Incumbent Local Exchange Carrier Rates for Interstate Special Access Services	)	RM No. 10593
	)	

**REPLY COMMENTS OF BT AMERICAS INC.**

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Exchange Carriers	)	
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AT&T Corp. Petition for Rulemaking to Reform	)	RM No. 10593
Regulation of Incumbent Local Exchange Carrier	)	
Rates for Interstate Special Access Services	)	
_____	)	

**REPLY COMMENTS OF BT AMERICAS INC.**

BT Americas Inc. (“BTA”) and BT Infonet USA (“BT-IUSA”), wholly owned indirect subsidiaries of BT Group plc (“BT”), submit these Reply Comments pursuant to the Commission’s NPRM published in the Federal Register on April 13, 2005.<sup>1</sup>

**INTRODUCTION AND SUMMARY**

While there is disagreement as to the propriety of using ARMIS data, or price cap data, comparisons, all agree to a long run incremental cost (“LRIC”) benchmark for special access pricing – for which UNE TELRIC rates are a reasonable proxy. Indeed that is the rate all parties pay when they purchase special access equivalents (partial private circuits (“PPCs”) from BT in the United Kingdom. Using that benchmark and AT&T’s own analysis of BOC rates, the BOCs’ current special access rates are clearly extremely high with the BOCs earning excessive rates of return and with the economy (and consumers) suffering the effects of the resulting allocative inefficiencies.

<sup>1</sup> 70 Fed. Reg. 19381 (April 15, 2005).

The announced mergers will, if allowed to close without effective conditions, result in the effective monopolization of the special access market, by eliminating the most significant horizontal competitors and creating insurmountable barriers to entry. The pending mergers have also muted the most vocal proponents for regulatory oversight of special access in this proceeding.

It is clear from the record that upon expiration of the *CALLS Order*<sup>2</sup> only re-initializing rates to LRIC, reinstating an X-Factor of at least 5.3% for the interstate special access basket<sup>3</sup> and eliminating pricing flexibility (at least on the basis of the current MSA-based collocation triggers which are not reliable proxies because an MSA is an overly broad geographic market and collocations do not reflect the likelihood of competitive facilities-based competition)<sup>4</sup> will promote allocative efficiency and innovation. The Commission should also clarify that volume and term discounts should not be subject to unreasonable and restrictive conditions.

## **ARGUMENT**

### **I. The Comments Demonstrate Excessive Special Access Rates and Returns As a Result of Insufficient Competition**

#### **A. Using the Concededly Relevant LRIC Benchmark, Special Access Rates and Rates of Return Are Excessive**

Even those disputing the utility of ARMIS data, or comparisons to rates charged in price cap areas, in demonstrating that the BOCs have realized excessive earnings and revenues for

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<sup>2</sup> *Access Charge Reform; Price Cap Performance Review for Local Exchange Carriers; Low Volume Long Distance Users; Federal-State Joint Board On Universal Service*, CC Docket Nos. 96-262, 94-1, 99-249 & 96-45, *Sixth Report and Order in CC Docket Nos. 96-262 and 94-1, Report and Order in CC Docket No. 99-249, Eleventh Report and Order in CC Docket No. 96-45*, 15 FCC Rcd 12962 (2000) (“*CALLS Order*”).

<sup>3</sup> BT in its Comments also supported the proposal for an interim X-factor of 5.3 percent for interstate special access, so long as such interim relief is replaced with permanent relief before any approval of the SBC/AT&T and Verizon/MCI mergers. Comments of BT Americas, WC Dkt. No. 05-25 (June 13, 2005) (“BT Comments”) at 1.

<sup>4</sup> See Comments of Sprint Corporation, WC Dkt. No. 05-25 (June 13, 2005) (“Sprint’s Comments”) at 9-10.

special access, concede the relevance of forward looking economic cost as a benchmark for special access rates. Verizon's expert indirectly notes that the correct measure would "approximate the forward-looking incremental costs of producing another unit of service."<sup>5</sup> SBC agrees, noting that special access pricing should, in a competitive market, go down to the UNE (TELRIC) rates.<sup>6</sup>

Using that benchmark, it is clear that the BOC rates are excessive. As noted in BT's Comments, in the United Kingdom BT is required by the regulator, Ofcom, to charge LRIC prices for special access. Those rates, when compared using an index that allows for transnational price comparisons, demonstrate that special access pricing in the United Kingdom for DS1 and DS3 circuit equivalents (using similar typical mileage) is substantially lower than in the United States. Specifically, BT's PPC prices in the UK are based on LRIC and the weighted average cost of capital ("WACC") that BT is entitled to recover.<sup>7</sup> Initially Ofcom calculated the WACC at 13.5%. Ofcom is currently proposing a WACC of 10.5% for BT overall and a 10.1% WACC for what will become the Access Services Division (that will provide PPC access) and 11.5% for rest of the business lines.<sup>8</sup> A comparison of BT's fully incremental cost-based special

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<sup>5</sup> Declaration of William E. Taylor on Behalf of Verizon, Attachment C to Comments of Verizon, WC Dkt. No. 05-25 (June 13, 2005) ("Verizon Comments") ¶ 43.

<sup>6</sup> Comments of SBC Communications Inc., WC Dkt. No. 05-25 (June 13, 2005) ("SBC Comments") at 23 (the availability of UNEs "as an alternative to special access services exerts significant downward pressure on the price of those services"); SBC Comments at 50 (using the Commission's language in the *Triennial Remand Review Order [In re Unbundled Access to Network Elements, Order on Remand]*, WC Dkt. No. 04-313, CC Dkt No. 01-338, 2005 WL 289015] ¶ 65 that the availability of UNEs "is itself a check on special access pricing [that provides] carriers using special access ... substantial bargaining power when negotiating special access rates").

<sup>7</sup> It should be noted that the WACC is not a profit indicator, but the cost that BT incurs in order to pay back its equity and debt providers via dividend and interest.

<sup>8</sup> The consultation can be found at [http://www.ofcom.org.uk/consult/condocs/cost\\_capital2/](http://www.ofcom.org.uk/consult/condocs/cost_capital2/).

access rates in the UK with the BOCs prices for DS1s and DS3's, using the Purchasing Power Parities Rate analysis is appended hereto as Attachment A.<sup>9</sup>

B. BOC Claims of Competitive Special Access Rates, Revenues and Earnings Are Based on Selective and Non-Credible Assertions

1. The BOCs' Claims of Rate Declines Ignore Documented Rate Increases and Are Based on Selected Aggregate Data

The BOCs suggest that special access rates in the United States have declined since the introduction of Phase II pricing flexibility.<sup>10</sup> The record irrefutably shows that to be incorrect. The declarations of Joseph Stith in 2002 and then again in 2004 setting out the actual tariffed rates,<sup>11</sup> and the Declaration of Dr. Fischer submitted by Comptel/ALTS in this proceeding and based on the same data,<sup>12</sup> demonstrate that those rates have remained the same or *increased* in Phase II areas during that time period, most recently increased after the *USTA II's vacatur* of the Commission's transport rules.

The BOCs are able to charge such high rates because, even within MSAs with Phase II pricing flexibility authority, they maintain overwhelming market power<sup>13</sup> and are very often the

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<sup>9</sup> Likewise in France, the French regulator, Autorité de Régulation des Communications Electroniques et des Postes ("ART"), has chosen LRIC as the basis for PPC pricing with the rate of return set at 10.4%. ART's decision n° 03-1231 dated November 13, 2003 approving France Telecom's 2004 Reference Interconnection Offer (RIO). [www.art-telecom.fr](http://www.art-telecom.fr).

<sup>10</sup> Verizon Comments at 2; SBC Comments at 4 ("the prices customers are actually paying for SBC special access services in Phase II MSAs ... have declined, not risen as some have alleged, since pricing flexibility began").

<sup>11</sup> Declaration of M. Joseph Stith ("*Stith Special Access Declaration*") submitted with AT&T's Petition in *AT&T Corp. Petition for Rulemaking to Reform Regulation of Incumbent Local Exchange Carrier Rates for Interstate Special Access Services*, RM No. 10593 (Oct. 15, 2002) and M. Joseph Stith's Reply Declaration in that proceeding, Exhibit 1 to AT&T's Special Access Reply Comments (Jan. 23, 2003) ("*Stith Reply Special Access Declaration*"); Declaration of M. Joseph Stith submitted with Comments of AT&T Corp. in *In the Matter of Unbundled Access to Network Elements, Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers*, WC Dkt. No. 04-313, CC Dkt. No. 01-338 ("*TRO Remand proceeding*") (Oct. 4, 2004) ("AT&T's TRO Remand Comments"), Exhibit H ("*Stith TRO Remand Declaration*") Atts. 1,2 and Declaration of M. Joseph Stith submitted with AT&T's TRO Remand Reply Comments, Exhibit E (Oct. 19, 2004) ("*Stith Reply TRO Remand Declaration*") Atts. 1,2.

<sup>12</sup> See Declaration of Janet S. Fischer Declaration on Behalf of Global Crossing North America, Inc., WC Dkt. No. 05-25 (June 13, 2005), Tables 4 through 7.

<sup>13</sup> Growth in demand for special access (Verizon Comments at 18) does not negate substantial market power, since factors other than price affect the demand for special access. For example, customers to buy special access

sole facilities-based provider to most (90+%) of the buildings within that MSA.<sup>14</sup> The BOCs, as sole special access facilities providers, are free to refuse to deal with competitive providers at any time and/or to charge above competitive rates for their use.

The BOCs are able to claim that prices have declined by aggregating higher priced rates with the discounted rates for the large volumes purchased by AT&T and MCI pursuant to plans which AT&T has successfully challenged as discriminatory and anticompetitive.<sup>15</sup> Those discounted rates do not include the penalties collected by the BOCs from those purchasers who do not meet the minimum commitments required to obtain those discounts. Those discounted rates are also concededly available only to the largest wholesalers,<sup>16</sup> AT&T and MCI, who are now to be acquired by SBC and Verizon.<sup>17</sup> While AT&T and MCI, as wholesale competitors, may have passed on those discounts to others, with their acquisition by the BOCs, those discounted lower prices are likely to disappear from the marketplace, effectively raising prices for special access even further to the material detriment of third parties and consumers.

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since functionally equivalent low-priced unbundled network elements (UNEs) are not available for transport from customer sites to ICX POPs. Moreover, demand would be even higher if special access were properly priced at LRIC.

<sup>14</sup> The Declaration of Susan Gately on behalf of Ad Hoc Telecommunications Users' Committee, WC Dkt. No. 05-25 (June 13, 2005) ("Gately Decl.") ¶¶ 16-19; *cf.* Comments of BellSouth, WC Dkt. No. 05-25 (June 13, 2005) ("BellSouth's Comments") at 33, at least conceding it "provides a higher percentage of low capacity services." BellSouth's market share calculation includes special access facilities that they ultimately control and for which, absent Commission action, they can provide at above competitive rates, or even refuse to provide at all.

<sup>15</sup> As AT&T also noted in Reply Comments of AT&T Corp. in the *TRO Remand proceeding*, WC Dkt. No. 04-313, CC Dkt. No. 01-338 (Oct. 19, 2004) (AT&T's TRO Remand Reply Comments"), they also reflect "price reductions for special access rates that are subject to price caps shifts in demand between various Bell special access services." *Id.* at xi.

<sup>16</sup> Taylor Decl. at ¶¶ 25 and 41; Verizon Comments at 22 ("the significant majority of Verizon's special access demand – 85 percent – is satisfied through discount plans that provide substantial discounts off month-to-month rates"). Wholesalers "account for approximately 80 percent of Verizon's special access revenues." Declaration of Quinton Lew, Attachment D to Verizon's Comments, WC Docket No. 05-25 (June 13, 2005) ("Lew Decl."), ¶ 79; SBC Comments at 21 ("the large wholesale and enterprise customers ... provide the bulk of its special access revenues"); BellSouth Comments at 19 ("over 90% of purchasers of DS1 service and 75% of DS3 customers choose to obtain discounts through term of volume and term agreements").

<sup>17</sup> See AT&T's TRO Remand Comments at 99 ("AT&T, the nation's largest special access customer, typically obtains the largest discounts available" under the BOCs' volume discount plans). It is also not differentiated by access speed, including aggregating lower per channel OCN rates with higher DS1 and DS3 rates.

Finally, including those rates would require the Commission to ignore the anti-competitive terms and conditions of those discount plans.<sup>18</sup> Those plans tie purchases of special access where it has significant market power (because it is uneconomic for any rational competitor to provision competing facilities) with special access where there is competition, and although its discounts discriminate in favor of smaller, growing competitors (which in today's market is essentially limited to its affiliated long distance competitor).<sup>19</sup>

The BOCs ultimately concede that special access rates and rates of return may, standing alone, be unreasonably high, but argue that such high rates need to be counter-balanced against what they claim are too low switched access rates.<sup>20</sup> It is the request of these avowed proponents of marketplace competition for an enterprise-based regulatory guaranteed rate of return that is a throwback to the past, not the request of purchasers of special access, such as BT, that the BOCs not be allowed to charge extremely high prices for a bottleneck facility.

## 2. The BOCs' Dismissal of the ARMIS Data is Non-Intuitive

The BOCs further argue that the ARMIS data does not establish unreasonable margins or returns because the cost allocations made in ARMIS are arbitrary.<sup>21</sup> But that is not correct,<sup>22</sup> and as Dr. Selwyn has pointed out, the BOCs have in other proceedings relied on ARMIS data to

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<sup>18</sup> See e.g., *AT&T Corp., Complainant, v. BellSouth Telecommunications, Inc.* 19 FCC Rcd 23898 (2004). Contrary to SBC's suggestion in its Comments at 55, note 183, this decision stands and has not been reversed in any appellate proceeding. In light of this decision, BellSouth's assertion that "where pricing flexibility exists, the marketplace and customer choice have replaced regulators as the determinants of the terms and conditions of special access services," BellSouth Comments at 19 is, to say the least, ironic. If that were the case, AT&T would have obtained the terms it wanted by negotiation rather than litigation.

<sup>19</sup> See Comments of CompTel/ALTS, Global Crossing North America, Inc., and NuVox Communications WC Dkt. No. 05-25 (June 13, 2005) (analysis of the anticompetitive effects of all the BOC discount plans). On the basis of this evidence, the Commission should clarify that volume discounts should not be subject to unreasonable and restrictive conditions.

<sup>20</sup> SBC Comments at 35-36 ("the Commission cannot simply reduce 'high' special access rates unless it allows the ILECs to raise their switched access rates above their depressed levels under CALLS"); Verizon Comments at 19, Table 1 and 22.

<sup>21</sup> SBC Comments at 24-33.

<sup>22</sup> Gately Decl. ¶¶ 13-15 fully responds to the BOCs complaints about cost allocation.

support their efforts to defend their rates.<sup>23</sup> Indeed the BOCs successfully argued to the Commission that the cost allocation rules it now challenges were sufficiently accurate to prevent any cross-subsidization.<sup>24</sup>

## **II. Re-Regulation is Critical if the Proposed “Mergers to Shared Monopoly” Are Allowed to Proceed Without Adequate Conditions**

Both Verizon and MCI, and SBC and AT&T, in their respective merger proceedings,<sup>25</sup> and several parties filing Comments in this proceeding,<sup>26</sup> have all urged the Commission to consider the impact of the announced mergers in its determination of whether or not to regulate special access rates. As demonstrated in BT’s Initial Comments, and as confirmed by others in the Comments submitted in this proceeding, the proposed acquisitions of AT&T by SBC and MCI by Verizon will result in the elimination of the BOCs’ two largest special access competitors and customers.<sup>27</sup>

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<sup>23</sup> *In the Matter of AT&T Corp. and SBC Communications, Inc. Application Pursuant to Section 214 of the Communications Act of 1934 and 63.04 of the Commission’s Rules for Consent to the Transfer of Control of AT&T Corp. to SBC Communications, Inc.*, WC Docket No. 05-65 (“AT&T/SBC Merger Proceeding”), Reply Declaration of Lee L. Selwyn on behalf of Comptel/ALTS (May 10, 2005) ¶ 49 (The BOCs’ own expert, Debra Aron, has vouched for its validity for the purpose of increasing rates or defending against claims of below cost pricing, and argued that there has not been a misallocation of costs).

<sup>24</sup> SBC’s Petition for Forbearance and Modification, CC Dkt. No. 96-149 (June 5, 2003) at 11-12 (concluding that “Indeed, despite the fact that, for years, the BOCs have provided on an unseparated basis customer premises equipment, enhanced services and other non-regulated services, the Commission has never found any evidence of cross-subsidization by any BOC.”); Letter from Dee May, Assistant Vice President, Federal Regulatory, Verizon, to Marlene H. Dortch, Secretary, FCC, CC Dkt. No. 96-149 (June 24, 2003) at 4-5. This argument was accepted by the Commission in Memorandum Opinion and Order, *In the Matters of Section 272(B)(1)’s “Operate Independently” Requirement For Section 272 Affiliates*, WC Docket No. 03-228 and CC Docket Nos. 96-149, 98-141, 01-337, 19 FCC Rcd. 5102 (2004) ¶ 21.

<sup>25</sup> Merger of SBC Communications Inc. and AT&T Corp., Description of Transaction, Public Interest Showing and Related Demonstrations, WC Dkt. No. 05-65 (Feb. 21, 2005) at 102-105; Verizon’s Public Interest Statement WC Dkt. No. 05-75 (March 11, 2005) at 33, n. 33.

<sup>26</sup> Comments of Qwest Communications International Inc., WC Dkt. No. 05-25 (June 13, 2005) (“Qwest Comments”) at 2-3, Comments of Sprint Corporation, WC Dkt. No. 05-25 (June 13, 2005) (“Sprint’s Comments”) at 7.

<sup>27</sup> BT’s Comments at 7; Qwest’s Comments at 2 (“AT&T and MCI are the largest suppliers of competitive access in the respective SBC and Verizon regions ... AT&T and MCI also influence the special access market directly and indirectly through resale of Verizon and SBC access in their wholesale and retail service products”); Sprint’s Comments at 7 (“the two largest non-ILEC providers of special access services used by Sprint (and presumably by other special access customers as well) are AT&T and MCI”).

As to the elimination of their largest *competitors*, even the highly problematic competitive data submitted by the BOCs in this proceeding,<sup>28</sup> confirm the significance of AT&T and MCI as their largest and most effective facilities based and wholesale competitors.<sup>29</sup> It is also clear from the data submitted by the BOCs and their merging partners that the proposed acquisitions eliminate the two largest *purchasers* of special access. SBC in its Comments noted that it sells more than 90% of its DS<sub>n</sub>-level and 80% of its OC<sub>n</sub>-level special access services to large wholesale customers.<sup>30</sup> Verizon similarly noted that wholesale customers “account for approximately 80 percent of Verizon’s special access revenues.”<sup>31</sup> MCI has previously noted that “AT&T and MCI are the largest special access customers,”<sup>32</sup> AT&T similarly noting just a few months ago that it was “the nation’s largest special access customer, [and] typically obtains the largest discounts available” under the BOCs’ volume discount plans.<sup>33</sup>

A. The Anticompetitive Effect of the Loss of the Two Largest National Competitors

As noted in BT’s Comments, AT&T and MCI are the BOCs largest facilities- based and wholesale competitors, and as to the latter, are able to offer a wholesale price lower than any

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<sup>28</sup> They rely on data compiled by GeoTel and GeoResults, *see* Verizon Comments at 23-28, and the UNE Fact Report, SBC Comments *passim*; Furchgott-Roth and Hausman Declaration appended to BellSouth Comments, Attachment 7 (“Furchgott-Roth/Hausman Decl.”), Table 1 a 15. For the reasons set forth in Reply Comments of AT&T Corp. in the *TRO Remand proceeding*, WC Dkt. No. 04-313, CC Dkt. No. 01-338 (Oct. 19, 2004) at ii and 58-62 (and the Selwyn Decl. ¶¶ 60-62), neither source is reliable. For example, the UNE Fact Report’s list of fiber miles includes an ILEC’s own fiber used by its subsidiary for monopoly services and fiber located in England.

<sup>29</sup> Verizon Comments, Lew Decl. ¶ 10; 22(c) (“AT&T reports that it offers these services in 91 cities with approximately 700 points of presence in the continental United States. Its network includes almost 22,000 local route miles, and it reports that it has direct access to nearly 7,000 buildings with over 8,600 metropolitan SONET rings, and reaches almost 180,000 additional buildings through facilities leased from third parties as well as ILEC special access”); Declaration of Dr. William Fitzimmons on Behalf of Qwest Communications International Inc. at 4.

<sup>30</sup> SBC Comments at 49; Declaration of Parley C. Casto on Behalf of SBC Communications Inc. (“Casto Decl.”) at ¶ 11, n. 6.

<sup>31</sup> Lew Decl., ¶ 79.

<sup>32</sup> Declaration of Michael D. Pelcovits on behalf of WorldCom, Exhibit A to WorldCom’s Special Access Comments, RM No. 10593 (Jan. 23, 2003) at 10.

<sup>33</sup> *See* AT&T’s TRO Remand Comments at 99.

other CLEC because only they qualify for the largest discounts under the BOCs' term and volume plans.<sup>34</sup> The loss of AT&T and MCI as competitors will thus have a significant effect on the pricing of special access.<sup>35</sup> As demonstrated by Simon Wilkie in the merger proceedings, elimination of AT&T and MCI as competitors will result in special access prices increasing 100%.<sup>36</sup> With the absorption of AT&T and MCI into the BOCs, SBC's argument that if it were to engage in "exclusionary pricing practices within Phase II MS .... As such practices would invite SBC's *large wholesale customers* to exploit the resulting arbitrage opportunity by reselling their contractually priced special access services to the smaller customers that might otherwise pay the monthly base tariff rates"<sup>37</sup> is no longer true. Those "large wholesale customers" are now gone.

BT similarly noted in its Comments that AT&T and MCI were also the parties most likely to self-supply if the BOCs raised special access prices, and the BOCs likely priced their special access services so as to discourage this potential self-supply.<sup>38</sup> That discipline on pricing will now be lost.

Moreover, AT&T and MCI are unique special access competitors because of their national reach, with large numbers of points of presence ("POPs") throughout the country. Because of the high cost of the variable channel mileage element, AT&T and MCI could provide special access at a much lower cost than even those CLECs with a national presence, but with only a limited number of POPs in the largest U.S. cities.

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<sup>34</sup> BT's Comments at 9.

<sup>35</sup> It will also have significant non-priced effects as the BOCs can degrade provisioning and maintenance of the wholesale circuits they provide and which are critical inputs in services purchased by enterprise customers. Enterprise customers have no tolerance for any delays in provisioning or maintenance.

<sup>36</sup> See Declaration of Simon J. Wilkie, ¶ 27 (Docket 05-65) and ¶ 25 (Docket 05-75).

<sup>37</sup> SBC Comments at 50 (emphasis added).

<sup>38</sup> BT's Comments at 10.

Contrary to the BOCs' mantra about the constraining effects of intermodal competition since the first BOC mergers in the late 1990s, actual market experience has demonstrated that there is no meaningful intermodal competition, especially for the access portion of services sold to the enterprise segment of the market. Indeed the BOCs in their Comments do not seriously dispute that at the present stage in the U.S., fixed wireless and cable, at best, provide competitive alternatives only for residential and small business customers.<sup>39</sup> Nor is wireless a meaningful competitive constraint on pricing, even in the consumer segment, and the BOCs would like that to remain the case, actively supporting legislation designed to limit competitive entry into fixed wireless services.<sup>40</sup> Although the BOCs have claimed that intermodal competition was already sufficiently mature to constrain pricing as early as 1988,<sup>41</sup> clearly it has had no visible effect on special access pricing in the U.S. after Phase II pricing flexibility was granted.

B. The Anticompetitive Effect of the Loss of the Two Largest Purchasers of Special Access

Elimination of AT&T and MCI as the largest *purchasers* of special access will both increase the BOCs market power in the special access market by neutralizing the countervailing power of the largest and most sophisticated special access purchasers, and will create insurmountable barriers to entry by eliminating sufficient demand to justify new entry. As to their countervailing market power, the BOCs concede as much, Verizon's expert, Dr. Taylor,

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<sup>39</sup> Verizon Comments at 28-32; SBC Comments at 16 and Casto Decl. ¶ 8; Furchgott-Roth/Hausman Decl. at 14 and n. 25.

<sup>40</sup> See e.g., Associated Press, *Philly, Verizon strike Wi-Fi agreement, Deal allows city to go ahead with its wireless plans*, Updated: 11:40 p.m. ET Nov. 30, 2004 <http://msnbc.msn.com/id/6622765/> ("regional and long-distance phone companies, who sell broadband Internet to consumers and businesses, have increasingly lobbied for laws to regulate or bar ...municipal competition. Under the Pennsylvania legislation, any political subdivision, such as a city, after Jan. 1, 2006, would have to get the permission of the local telephone company to provide a telecommunications service for a fee, including broadband Internet. If the company rejects the plan, it would have to offer a similar service within 14 months").

<sup>41</sup> Report of Richard Schmalensee and William Taylor, filed with the Application of SBC Communs. & Ameritech Corp. for Transfer of Control to SBC Communications, CC No. 98-141 (July 24, 1998) ¶¶ 61-62.

noting that, if anyone, it is the large enterprise retail and wholesale carrier customers who affect the competitive price of such services,<sup>42</sup> and SBC asserting that its “customers also can and do leverage their buying power in highly competitive areas and product markets by extracting pricing concessions in areas that are less competitive.”<sup>43</sup> Even if true today, such countervailing market power will disappear after the two largest purchasers, AT&T and MCI, are acquired by those BOCs.

The proposed mergers will also create insurmountable barriers to entry by eliminating sufficient demand to justify new entry. Thus the BOCs’ claim that “if ILECs with Phase II pricing flexibility price special access services high enough to generate outsized returns, ‘competitors will enter the market ... [and] provide additional supply of special access services at (presumably) lower prices than the incumbent’”<sup>44</sup> even if true today, will not be so after the mergers. These parties are only ones closest enough to customers to mount a feasible build out plan but even this has proven illusory to date. Even if prices are too high no one will enter the market, and no “capital will flow” to them from the capital markets, because entry would be uneconomic and irrational. The new entrant could never expect to achieve minimum scale with the removal of the largest purchasers of special access – AT&T and MCI – from the market. Under these circumstances, the availability of “carrier hotels” is similarly irrelevant, since the universe of potential purchasers will be too small to sustain those hotels in the long term and scale will be very difficult for these parties to achieve.

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<sup>42</sup> Taylor Decl. ¶ 56.

<sup>43</sup> SBC Comments at 57.

<sup>44</sup> *Id.* at 39.

C. There Has Been a History of Competitive Forbearance

In light of the past history of BOC reluctance to enter each other's market,<sup>45</sup> it is unlikely that Verizon/MCI will meaningfully compete with SBC/AT&T post-merger. The most likely scenario is mutual forbearance (even by the non-merging BOCs), each serving its "sweet spot" of in-region customers,<sup>46</sup> going out of region only to serve its in-region customers' remote sites. The result will be a shared special access monopoly by the BOCs.

**III. The Record Compels the Commission to Reinitialize Rates at LRIC, Eliminate Pricing Flexibility and Apply an X-Factor of at Least 5.3%**

A. The Record Makes It Clear that Only Reinitializing Rates to LRIC and Reinstating an X-Factor of at Least 5.3% Will Promote Allocative Efficiency and Innovation

As BT demonstrated in its initial Comments, the Commission needs to reset special access rates at LRIC and then annually readjust the rates in accordance with a price cap adjustment mechanism that includes a productivity adjustment ("X-factor"). BT supports the proposed interim X-factor of 5.3 percent for interstate special access, so long as such interim relief is replaced with permanent relief before any approval of the SBC/AT&T and Verizon/MCI mergers.

The BOCs argue that reinitializing rates at long run incremental cost and reintroducing the X-factor will disincent their investment in innovation; essentially, that they need above competitive rates to innovate.<sup>47</sup> But the BOCs' track record is to the contrary; that above competitive rates will be re-invested to further entrench their market position and not for

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<sup>45</sup> Perhaps captured most effectively in a candid moment by Qwest Chairman (and former Ameritech Chairman) Richard Notebaert who stated that competing for local customers currently served by Ameritech "might be a good way [for Qwest] to turn a quick dollar" but that "doesn't make it right," Chicago Tribune, *Ameritech Customers Off-Limits : Notebaert*, October 31, 2002

<sup>46</sup> Joint Opposition of SBC Communications and AT&T Corp. To Petitions to Deny and Reply to Comments, WC Docket No. 05-65 (May 10, 2005) at 137.

<sup>47</sup> Verizon Comments at 39-40; BellSouth Comments at 48-50.

innovation.<sup>48</sup> Reinitializing rates to long run incremental cost will, contrary to the BOCs' assertion, increase, not reduce,<sup>49</sup> allocative efficiency and consumer welfare. Indeed BT, subject to a regulatory requirement that requires it to charge long run incremental cost for special access, will invest substantial sums in its highly innovative Next Generation Network. This is not being done in response to regulatory forbearance or the earnings of monopoly profits but to provide customers' best in class service and in the face of strong competition often driven by regulatory intervention.

The BOCs further argue that the X-factor ought not to be imposed because there is no evidence of either enterprise or service specific productivity enhancements going forward. SBC supports this claim by arguing that, "most of SBC's channel terminations are provided by means of older, copper-based technologies, which are not likely to experience the productivity gains of fiber-based or wireless services."<sup>50</sup> But this is not the case for other BOCs, and probably not for SBC either.<sup>51</sup> Thus, Verizon, in a separate proceeding, asserted that it had conducted a number of studies showing that it uses primarily *fiber* for special access, not copper. Specifically, in Verizon's second Section 272 Audit Report, Verizon sought to explain longer installation and repair special access metrics for non-affiliated entities than for its affiliates on the following basis:

Essentially, all of Verizons' BOC/ILEC interoffice facilities and facilities to carrier points of presence are fiber .... An examination of DS1 services installed in New York during 2002 ... For the section 272 affiliate, during 2002, 100% of the requested special access circuits were requested on routes in locations where Verizon BOC/ILEC

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<sup>48</sup> See e.g., Complaint in *NorthPoint v. Verizon*, California Superior Court (San Francisco), Case No. 317249, filed July 12, 2001 (allegations by NorthPoint regarding anticompetitive purposes of Verizon's investment in that DLEC, which soon thereafter declared bankruptcy).

<sup>49</sup> SBC Comments at 12.

<sup>50</sup> *Id.* at 42.

<sup>51</sup> The Casto declaration qualifies this assertion by stating that "most of the *standalone* DS1 special access circuits it provisions are provided over copper loops." Casto Decl. at ¶ 12, n. 8 (emphasis added).

provisioned DS1 circuits over fiber end to end .... An examination was done of DS1 services as of March 31, 2003 in New York ... For the section 272 affiliate, 79% of the existing base of DS1 circuits were on all-fiber routes, the remaining 21% having a copper local loop segment ... These percentages were confirmed by examining another high-volume state, Massachusetts ... For this sample, 72% of the Section 272 affiliate services were on all-fiber routes.”<sup>52</sup>

Inasmuch as the BOCs concede further productivity gains for fiber networks, an X-Factor is both necessary and appropriate.

B. The BOCs’ Proposals Would Ignore the Lack of Competition in Special Access Today and Would Give Them a License to Engage in Price Squeezes with a Detrimental Impact on Users of Global Telecommunications Services

The BOCs argue that the Commission has irrevocably committed itself to deregulating special access and thus is compelled to further deregulate special access rates even if it is determined that BOC special access prices and rates of return are too high.<sup>53</sup> But the Commission committed itself to deregulation only to the extent that effective competition emerged.<sup>54</sup> And the record is clear that whatever effective competition emerged is now being acquired by the BOCs.

Verizon proposes that the Commission move to negotiated, commercial agreements “outside the current rules, without restriction as to location or type of service.”<sup>55</sup> That, of course, would allow the BOCs to craft special arrangements that favor their affiliates, including (if the mergers are approved) AT&T and MCI.<sup>56</sup> BellSouth’s proposal to “remove all restrain[t]s on the

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<sup>52</sup> Report of PricewaterhouseCoopers LLP, EB Docket No. 03-200(Dec. 12, 2003) Appendix A:73-74.

<sup>53</sup> See e.g., BellSouth Comments at 5-7.

<sup>54</sup> *CALLS Order* at 19977, ¶ 36 (“whether and to what degree it can deregulate price cap LECs to reflect the existence of competition”) (emphasis added).

<sup>55</sup> Verizon Comments at 34-35 and Taylor Decl., ¶ 63.

<sup>56</sup> See, e.g., *Ex Parte* Letter from Aryeh Friedman, Senior Attorney AT&T, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 96-149 (Oct. 1, 2003) at 5-6 (describing BOC’s discounted billing and collection agreement designed to benefit affiliate section 272 affiliate but not available to other competitors); *Ex Parte* Letter from Aryeh Friedman, Senior Attorney AT&T, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 96-149 (Oct. 31, 2003) at

LECs' pricing of special access services in all areas for a period of two years by granting Phase II pricing flexibility" with these services "completely deregulated" at the end of this two year period<sup>57</sup> would require the Commission to ignore the BOCs' pricing in Phase II MSAs for the past four years (where prices have only gone up and the gap between revenues and costs increased dramatically), and to ignore the impact of the proposed mergers on the special access market. SBC's proposal for unlimited downward (Phase I) pricing flexibility for all special access services"<sup>58</sup> while facially attractive, is insufficient, without LRIC pricing, because of the conceded risk for price squeezes in all downstream markets, including the enterprise market, if the proposed mergers are allowed.<sup>59</sup>

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2. Nor should the triggers be based on the BOCs' exaggerated claims of special access competition as proposed by Verizon. VZ Comments at 35-37.

<sup>57</sup> BellSouth Comments at 46; *see generally id.*, at 46-55.

<sup>58</sup> SBC Comments at 8, 60-62.

<sup>59</sup> AT&T's TRO Remand Comments at 121 (once the BOCs, such as SBC and Verizon, get the ability to fully provision enterprise customers, which they will instantly get with their acquisition of AT&T and MCI, "they will have the same incentive and ability to price squeeze these other services as they do for the services that they currently offer").

## CONCLUSION

The Commission should not be put off course by the BOCs' threat of litigation if special access services are re-regulated.<sup>60</sup> The record already compiled makes it eminently clear that the BOCs are already charging extremely high prices for special access, a situation that will only be exacerbated if the proposed mergers are allowed to close without adequate conditions. Reinitializing rates to the BOCs' economic costs and imposing an X-factor of at least 5.3% will save end users millions, if not billions of dollars, and will promote allocative efficiency and innovation.

Respectfully submitted,

BT AMERICAS INC. AND BT INFONET USA

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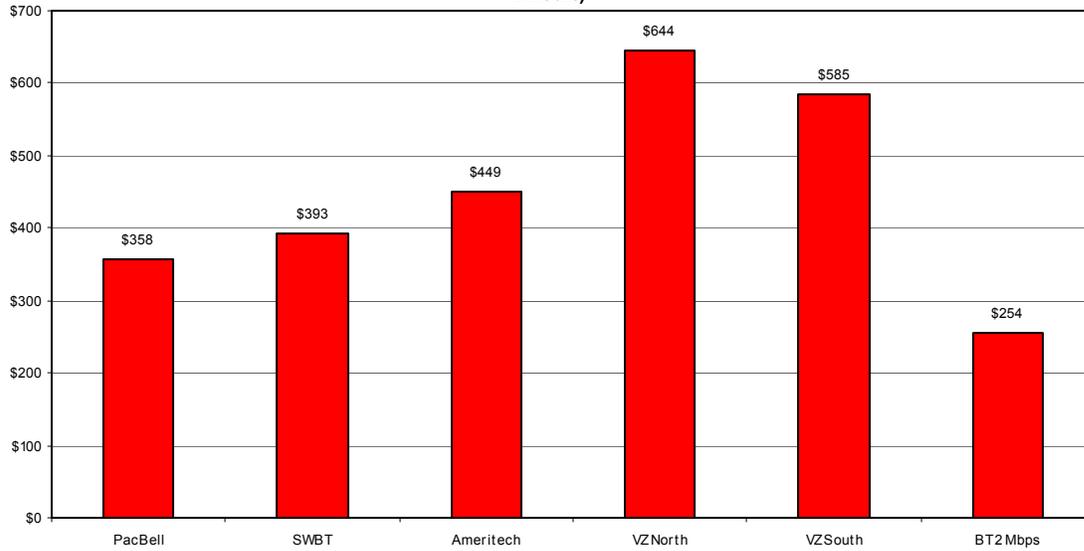
Dated: July 12, 2005

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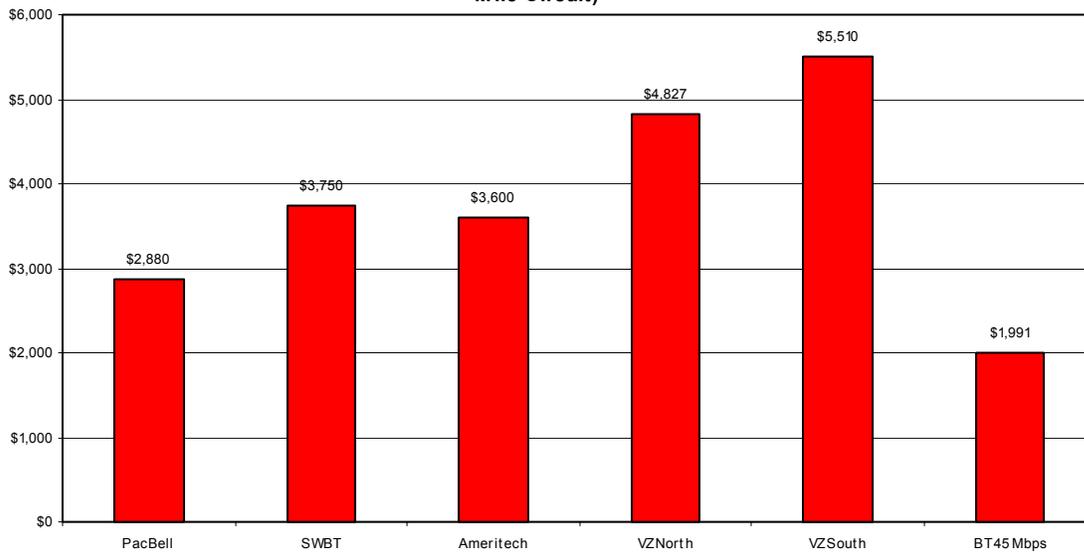
<sup>60</sup> See e.g., SBC Comments at 8.

## ATTACHMENT A

Cost per Month for 3-Year Term for ILEC DS1 (1.544 Mbps) and BT 2 Mbps PPC (10-Mile Circuit)



Cost per Month for 3-Year Term for ILEC DS3 (44.7 Mbps) and BT 45 Mbps PPC (10-Mile Circuit)



Notes:

- (1) For ILEC Rates, Declaration of Joseph Stith, AT&T Special Access Analyst, Submitted on Behalf of AT&T in UNE Remand Proceedings, 9/30/04. The 3-year ILEC rates are taken directly from Attachment 1, pages 11-20. The declaration describes the sources and calculation of the ILEC rates. Note that the ILEC rates are for MSAs where pricing flexibility applies (i.e., they are not price cap rates). Also note that these are discounted rates off of the base rates and are from ILEC optional payment plans. In the Stith's analysis, the ILEC rates were current as of 7/1/04.
  
- (2) For BT Rates, see BT Wholesale web site  
[http://www.btwholesale.com/content/binaries/service\\_and\\_support/pricing\\_information/carrier\\_price\\_list\\_browsable/B8.03.rtf](http://www.btwholesale.com/content/binaries/service_and_support/pricing_information/carrier_price_list_browsable/B8.03.rtf) . Section B8, Part 8.03
  
- (3) BT rates converted at 2004 PPP of \$1.6161 per pound. The web address for the OECD PPP is  
[http://www.oecd.org/statisticsdata/0,2643,en\\_2649\\_34347\\_1\\_119656\\_1\\_1\\_1,00.html](http://www.oecd.org/statisticsdata/0,2643,en_2649_34347_1_119656_1_1_1,00.html).