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

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| 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-10593 |

# REPLY COMMENTS OF BROADWING COMMMUNICATIONS, LLC, AND SAVVIS, INC. (F/K/A "SAVVIS COMMUNICATIONS CORPORATION")


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July 29, 2005

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Broadwing Communications, LLC ("Broadwing"), and SAVVIS, Inc. (f/k/a "SAVVIS Communications Corporation") ("SAVVIS") respectfully submit these reply comments in the above-captioned proceeding.

## I. INTRODUCTION AND SUMMARY

In our opening comments, Broadwing and SAVVIS showed that the BOCs have a "stranglehold" over the special access market that allows them to reap supercompetitive returns.[1] We emphasized that this stranglehold "is substantially attributable to a single fundamental fact: competitive providers of special access cannot economically construct their own special access facilities on an end-to-end basis in the vast majority of locations."[2] In particular, competitors are not economically able to provide DS1s and

[1] Broadwing and SAVVIS Comments at 2.

[2] *Id.* at 2, 10-22.

DS3s to reach the buildings housing end users. We also showed that the BOCs abuse their market power to prevent purchasers of special access services from taking advantage of the limited competition that exists.[3] Accordingly, we urged the Commission to reform special access regulation to adequately constrain the BOCs' overwhelming market power with respect to DS1 and DS3 connections to locations at the "edge" (rather than the "core") of the network.

The BOCs' comments do little to dispel the concerns we identified. In fact, while the BOCs baldly state that the "special access services market is robustly competitive,"[4] they do not seriously suggest that competitors offer DS1 or DS3 connections to a substantial percentage of end user customer premises. Rather, the BOCs observe that "competitors' fiber networks run *close* to a large proportion of . . . DS1 and DS3 customers,"[5] and suggest that competitors therefore *could* deploy fiber to end users. That is simply untrue. The reason why competitors have *not* deployed DS1 and DS3 loops (often called "tails" or "channel terminations") to customer premises, notwithstanding the proximity of their fiber rings, is that it is generally not economic to do so. Until it is, no amount of fiber deployment at the "core" of the network – including infrastructure connecting exceptionally high-traffic points, like data centers, carrier hotels, and service provider points-of-presence – will ensure connections to customer premises.

The BOCs focus much of their fire on AT&T's prior claim that the BOCs' dominance in the special access market has allowed them to earn unreasonable rates of

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3 *See id.* at 22-29.

4 *See, e.g.*, BellSouth Comments at 13.

5 SBC Comments at 13.

return.[6] The BOCs argue, for example, that "ARMIS accounting data is [not] a valid means of assessing the special access market."[7] Notably, however, the BOCs do not indicate what data *should* be used to analyze the special access market, or explain what such data would show. In the absence of better data, it seems quite reasonable to rely on readily available ARMIS data. In any event, the absurdly high rates of return described in AT&T's filing are not the disease itself, but merely a symptom. The same is true of the anticompetitive practices that Broadwing and SAVVIS described in our comments – they are a *sign* of market power, not the problem itself. The root problem is the BOCs' monopolistic hold over access to end user premises. Unless that hold is broken, whether through competition or regulation, it is to be expected that the BOCs will continue to engage in supercompetitive pricing and anticompetitive behavior.

The Commission's current special access pricing flexibility regime does not adequately address the BOCs' dominance in the market for DS1 and DS3 connections to end user premises. Indeed, the special access regulatory framework fails even to account for critical distinctions among special access services – the mere fact that a competitor can economically deploy OC48 fiber, for example, does not mean that it could also economically deploy DS1s. Moreover, the Commission's focus on metropolitan statistical areas ("MSAs") is misplaced – MSAs are far too large to allow appropriately granular analysis of relevant geographic markets for special access competition. Finally, contrary to the BOCs' arguments, competitive collocation in wire centers is *not* an accurate proxy for competitive entry in the market for end-to-end special access circuits.

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6 *See, e.g., id.* at 24-37.

7 BellSouth Comments at 8-9.

For these reasons, the Commission should reject the BOCs' invitation to extend the deeply flawed pricing flexibility regime.

The Commission should instead undertake meaningful reform of its special access pricing regime to limit the BOCs' ability to abuse their market dominance. Most importantly, the Commission should refine its approach and cease treating the special access business as a single market within MSAs. In fact, the presence of competitive alternatives on high capacity routes connecting wire centers or other core network buildings in no way demonstrates that competitive alternatives exist for connections to buildings at the DSn level, or that such DSn alternatives can practically be developed. The economics of serving core network buildings with high capacity OCn circuits are fundamentally different from constructing DS1 and DS3 circuits into end user locations and the Commission should recognize this critical distinction in formulating a revised regulatory plan. In doing so, the Commission must take steps to prevent the BOCs from continuing to obtain supercompetitive rates of return from the non-competitive sectors of the special access market. That can be accomplished by defining a price cap basket for DS1 and DS3 circuits, and reinitializing rates to ensure that the ILECs do not earn unreasonably high rates of return for providing special access on those routes where they are dominant.

In sum, as AT&T told this Commission in 2002, it has been "duped" in connection with special access.[8] The FCC erred in "buying" the BOCs' "story" that they "face[d] substantial competition" throughout the special access market, particularly with

[8] *AT&T Petition for Rulemaking*, WC Docket No. 02-250 (Oct. 15, 2002), at 2 ("*AT&T Petition*").

respect to DSn connections to buildings serving end users.[9] The Commission should take this opportunity to correct that error.

## II. THE BOCS HAVE SUBSTANTIAL MARKET POWER OVER WHOLESALE SPECIAL ACCESS SERVICES TO CUSTOMER PREMISES.

As AT&T explained to the Commission in its Petition, "building alternative loop" facilities to connect customer premises to competitors' networks is, "in most instances, fundamentally uneconomic."[10] Due to the tremendous capital investment required, the Commission itself has expressly acknowledged that there are large sunk costs and economies of scale associated with the deployment of loop facilities to enterprise buildings which, along with other operational barriers, prevent competitive carriers from entering the special access market to compete with the BOCs except in a few locations.[11]

Companies seeking to deploy DS1 and DS3 connections to end user premises face important operational hurdles as well, such as limited access to buildings and rights-of-way rendering the deployment of loop facilities a practical impossibility in many circumstances.[12] Deployment typically requires time-consuming and costly cooperation from localities, other carriers, and building owners. As a practical matter, the deployment process requires "many months of pre-construction while the CLEC negotiates and secures (if possible) the necessary rights of way and construction permits

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9 *Id.*

10 AT&T Petition at 25.

11 See Unbundled Access to Network Elements; Review of Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers, Order on Remand, WC Docket No. 04-313 (¶¶ 150, 151) (rel. Feb. 4, 2005) *("Triennial Review Remand Order")*.

12 See Triennial Review Remand Order at ¶ 151; *see also* AT&T Petition at 31.

from the municipality and negotiates terms of building access from the landlord."[13] In the face of these obstacles, the harsh reality is that it rarely makes economic sense today for competitors to construct channel terminations to customer premises and they therefore seldom do so. And in those few cases where a competitor does build in to an end user building, it is economically required to build at the OCn level, not at a DS1 or DS3 capacity.

The BOCs' Comments simply ignore this reality. They do not seriously contend that competitors offer any significant number of DS1 or DS3 channel terminations.[14] Instead, the BOCs emphasize that "competitors' fiber networks run *close* to a large proportion of . . . DS1 and DS3 customers,"[15] and suggest that competitors therefore *could* deploy fiber to end users. That is simply untrue for the reasons summarized above – in reality, fiber rings "close" to customer premises is often the best competitive companies can do. Unfortunately, that is not sufficient for companies like Broadwing and SAVVIS – providing wireline communications services is not like horseshoes:

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13 AT&T Petition at 31. The BOCs – by virtue of the fact that they already have deployed transmission facilities to every customer premises within their footprint – do not have to bear these costs. Indeed, while building owners generally allowed the BOC to enter the building for free to provide tenants with telephone service, the same building owners often charge subsequent providers a sizable fee for entry. Moreover, the BOCs can usually provision a circuit to a customer more quickly than a competitor can. Thus, competitors face enormous difficulties in attempting to deploy loop facilities in competition with the BOCs.

14 AT&T and MCI provide connections to many more buildings than other competitors, though far fewer than the BOCs. That is in part because AT&T acquired Teleport Communications Group, and MCI acquired MFS Communications, Inc., and Brooks Fiber Properties, Inc., in the late 1990s – and there is no reason to think that connections constructed or acquired in that era can be constructed today or in the near future. Moreover, at the time these comments are filed, SBC is seeking to acquire AT&T and Verizon is seeking to acquire MCI.

15 SBC Comments at 13.

"close" doesn't count. For the same reason, the Commission should reject the use of "collocation as a proxy for competitive pressures" in the market for end-to-end wholesale special access.[16] Collocation means only that competitors can reach ILEC wire centers – it says nothing about whether the economics would ever justify extending to customer premises.

The comments filed in this docket by end user customers and communications companies seeking to serve them underscore this point. The Ad Hoc Telecommunications Users Committee ("Ad Hoc") – representing many of the nation's largest corporate consumers of telecommunications services – reports that enterprise customers have no access options in most locations except for the ILECs.[17] More specifically, according to Ad Hoc, "the ILECs … remain the sole source of special access connectivity at roughly 98% of business premises nationwide, even for the largest corporate users."[18] Sprint likewise indicates that despite its aggressive attempts to use competitive providers whenever possible, as of the end of 2004 it was still obliged to rely on the ILECs for almost 95 percent of its DS1 circuits and 83 percent of its DS3 circuits.[19] Similarly, T-Mobile asserts that it purchases 96 percent of the DS1 links from its base stations to central offices from the ILECs.[20]

Figures provided by BellSouth further illustrate the lack of competition for DS1 channel terminations. Specifically, BellSouth indicates that competitors serve a paltry

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16 *Id.* at 58.

17 *See* Ad Hoc Comments at 11.

18 *Id.* at 14.

19 *See* Sprint Comments at 7.

20 *See* T-Mobile Comments at 7-8.

"11% of the market with their own facilities."[21] BellSouth's own data thus flatly contradict its assertion that the special access market is "robustly competitive."[22] BellSouth attempts to deflect attention from this fact by offering a capacity-based analysis of competitors' special access market share, but that analysis is fundamentally flawed.[23] In particular, BellSouth's capacity-based figures do not distinguish between DSn and OCn circuits, nor do they distinguish between core network buildings and enterprise buildings. Broadwing and SAVVIS have never contended that competitors cannot deploy OCn facilities, particularly to core network buildings – only that the ability to do so says nothing about competitors' ability to deploy DSn circuits to end user buildings. A capacity-based measure therefore skews the analysis because it fails to take account of the far greater difficulty of deploying the kind of lower-capacity channel terminations that Broadwing and SAVVIS also need to reach their customers. In those lower-capacity special access markets, the BOCs remain dominant.

As Broadwing and SAVVIS set forth in our opening comments, the BOCs make every effort to reinforce that dominance by using pricing strategies and administrative roadblocks to prevent companies from purchasing competitors' special access services even where they are available. For example, the BOCs often require companies to maintain high special access "buy" rates through "take or pay" contracts – if purchasers attempt to buy special access from competitors on routes where the ILECs face competition and they fail to reach their volume commitment, they must make up the shortfall. As a result, companies frequently do not purchase special access from

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21 BellSouth Comments at 28.

22 *Id.* at 13.

23 *See id.* at 29.

competitors *even when it would, for that particular circuit, be dramatically cheaper to do so*.[24] The BOCs also impose largely arbitrary limitations on the number of circuits that can be migrated to competitors over a specific period, and impose excessive non-recurring charges on such moves.[25] Moreover, companies may not be able to avail themselves of circuits from competitive suppliers because, in contrast to the ILECs' ubiquitous networks, competitors have facilities in far more limited geographic areas.[26] In short, as Broadwing and SAVVIS have explained, the end result is that the BOCs are able to impose unreasonably high prices for special access services – in Verizon territory, for example, Broadwing pays Verizon *more than three times* what it pays competitive carriers for DS1 circuits and about 50% more than it pays carriers for DS3s.[27]

The fact that Verizon's DS1 rates are more excessive than its DS3 rates is no coincidence. Special access competition increases with circuit capacity because higher-usage circuits generate higher returns, helping companies seeking to deploy such circuits to attract capital investment. As a result, many carriers provide high-capacity circuits to connect exceptionally high-usage locations like carrier hotels to wire centers – routes at the "core" of the network. Verizon explains with regard to MCI, for example, that "MCI has focused on providing high-capacity circuits between 'carrier' buildings such as IXC POPs, wireless POPs, ISP POPs, carrier hotels, and incumbent LEC central offices."[28] MCI did not, of course, select this approach whimsically – it did so because it is far more

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24 *See* Broadwing and SAVVIS Comments at 23.

25 *See* Sprint Comments at 6-7.

26 *See id*. at 6.

27 *See* Broadwing and SAVVIS Comments at 26.

28 *Verizon and MCI Joint Opposition*, WC Docket No. 05-75 (May 24, 2005), at 32.

economically justifiable to deploy facilities to the listed locations than it is to deploy facilities to the "edge" of the network (*i.e.*, to the customer premises to which Broadwing and SAVVIS need access). The BOCs' prices are therefore most clearly supercompetitive in the market for special access to customer premises.

Finally, it bears emphasis that a number of commenters echo Broadwing's and SAVVIS' concern that the proposed BOC-IXC mergers will *further expand* the BOCs' dominance of the wholesale special access market by eliminating AT&T and MCI as competitive wholesalers of special access in the SBC and Verizon regions.[29] The direct result will be higher prices for wholesale special access services. As we set forth in our Comments, and as Time Warner and others confirm, AT&T and MCI currently serve as the primary check on the BOCs' special access pricing because of the large scale of their networks.[30] If approved as proposed, the mergers will eliminate that price discipline.[31] Indeed, the likely effect of the mergers will be to render the market for DS3 circuits just as concentrated as the market for DS1s is today.[32] But even if the mergers are not approved, the Commission must reform special access pricing – particularly with respect to DSn connections to enterprise buildings.

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29 *See* Broadwing and SAVVIS Comments at 19-22.

30 *See, e.g.*, Time Warner Comments at 19-20.

31 *See* T-Mobile Comments at 11-12.

32 Broadwing and SAVVIS Comments at 20-21.

## III. THE ILECS ARE ABUSING THEIR SUBSTANTIAL MARKET POWER IN THE SPECIAL ACCESS MARKET TO EARN EXCESSIVE RETURNS AND IMPOSE UNREASONABLE TERMS AND CONDITIONS.

### A. The ILECs are earning excessive rates of return on interstate special access services.

Numerous commenters reinforce AT&T's argument that the ILECs are currently earning unreasonable rates of return on interstate special access services. Ad Hoc, for example, argues that the average special access return has increased to 53.7 percent, with earnings for the individual ILECs ranging from 31.6 percent for Verizon to 81.9 percent for BellSouth.[33] Nextel Communications and several other carriers report the same findings.[34] These returns vastly exceed the Commission's last authorized rate of return for the ILECs, which was 11.25 percent. As AT&T initially set forth and as other parties now confirm, the ILECs' plainly could not earn such extraordinary returns if there were meaningful competition for special access services.

The ILECs attempt to avoid this obvious conclusion by attacking the regulatory accounting data found in the Commission's ARMIS reports, claiming that it cannot reliably be used to calculate earnings results.[35] The Commission should reject that argument. Indeed, as Ad Hoc points out, the ILECs themselves had a larger role in the development of ARMIS than any other party.[36] They should not now be heard to complain that the rules are misleading.[37] In any event, even if ARMIS includes minor cost misallocations at the margins, that would not affect the overall trends in data, since any misallocations would not change from period to period.[38]

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33 Ad Hoc Comments at 16-17.

34 *See* Nextel Comments at 13-14; ATX Comments at 7-8; XO Comments at 5-8.

35 *See, e.g.*, SBC Comments at 24-37; BellSouth Comments at 7-13; Verizon Comments at 17.

36 *See* Ad Hoc Comments at 29.

37 *See* ATX Comments at 8.

38 *See* Ad Hoc Comments at 29; Nextel Comments at 15; PaeTec Comments at 5.

Moreover, while the ILECs argue that their excessively high special access returns result from the inclusion of DSL revenues in the special access revenue categories,[39] they offer no proof to that effect.[40] In short, whatever the alleged shortcomings of the ARMIS data, it undeniably shows that the ILECs' interstate special access returns have consistently increased over time.

In addition, telecommunications has been a declining cost industry – that is why the Commission applied an X-factor as part of its pricing rules. In such an industry, rates of return will increase if prices remain constant. The BOCs have not been subject to an X-factor greater than the inflation adjustment since July 2004[41] – so there is every reason to think that their rates of return have increased, as analysis of the ARMIS data shows.

At a minimum, it should be the BOCs' burden to come forward with data that is *more* reliable than ARMIS, and that undercuts the clear upward trend in special access returns that ARMIS illustrated. Until they do so, the Commission should rely on ARMIS.

### B. The comments confirm that the ILECs have *increased* rates in those areas where they have been granted pricing flexibility.

Despite the BOCs' assertions to the contrary,[42] the comments confirm that special access rates have *increased* in areas subject to Phase II pricing flexibility relative to the BOCs' rates in price cap areas. Ad Hoc, for example, shows that *all* of the BOCs have implemented price increases for special access services in areas where they have been granted pricing flexibility.[43] Moreover, as Ad Hoc also points out, the "BOCs' Phase II price increases have been sustained for a period long enough to allow alleged competitors ample time to respond in a fashion that

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39 *See, e.g.*, BellSouth Comments at 11.

40 *See, e.g.*, Ad Hoc Comments at 46.

41 *See* Nextel Comments at 18.

42 *See, e.g.*, SBC Comments at 21-24; BellSouth Comments at 15-16.

43 *See, e.g.*, Ad Hoc Comments at 17-24.

would constrain market pricing and force a reversal of the initial price increase."[44] But the price increases have not been reversed "because price-constraining levels of competition do not exist."[45] A number of carriers offer similar evidence – Sprint, for example, demonstrates that its special access bill increased by $103 million under Phase II pricing flexibility.[46] Again, such evidence is simply not consistent with a market subject to robust competition.

SBC claims that its base tariff rates are not an appropriate benchmark because "SBC … aggressively negotiates individual contracts to meet customer demands, generally including price discounts and other favorable terms to customers."[47] Any discounts, however, represent a discount from the base tariff rate. Thus, to the extent that the base tariff rate increases over time, these alleged discounts are illusory.[48] Moreover, the discount comes at a price – to receive discounts, a company must generally agree to volume and term commitments that prevent the company from migrating services to less expensive competitive circuits where they exist.[49]

SBC also claims that DS1 and DS3 UNEs – which can sometimes serve as a replacement for special access circuits – constrain SBC's special access rates. This no longer holds water, if it ever did. First, UNEs cannot be used to provide most of the services Broadwing and SAVVIS offer. Second, the Commission recently greatly limited the availability of DS1 and DS3 UNEs in the Triennial Review Remand Order.[50] Thus, these circuits – once available as UNEs in many markets – must now be purchased as special access. Third, as Broadwing and SAVVIS

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44 *Id.* at 19.

45 *Id*.

46 *See* Sprint Comments at 5; ATX Comments at 10; CompTel Comments at 6-9.

47 SBC Comments at 21; *see* BellSouth Comments at 16-17.

48 *See, e.g.*, Time Warner at 18.

49 *See, e.g.*, PaeTec at 9; *see also* infra at 8-9.

50 See Triennial Review Remand Order, ¶¶ 146-195.

explained in our opening comments,[51] UNEs are not a substitute for special access because the ILECs do not offer service level agreements ("SLAs") on UNEs. As a result, CLECs cannot offer SLAs on special access circuits provisioned using UNEs. But end user customers, including those of Broadwing and SAVVIS, demand SLAs, which often prevents the use of UNEs as a substitute for special access.

### C. ILEC Terms and Conditions of Special Access Are Unlawful.

As noted above, the BOCs frequently impose onerous region-wide volume and term requirements as preconditions to receiving discounts off inflated tariff rates. A number of commenters underscore the anticompetitive nature of such conditions. For example, ATX explains: "By requiring a Customer to maintain service level commitments in states in which SBC faces competition in order to obtain substantial discounts in states where SBC faces little or no competition, SBC can effectively eliminate whatever competition it may face by making the choice of competitive service highly unattractive."[52] CompTel correctly states that "[t]he BOCs' pricing structure effectively forces customers into these discount programs because they are the only way customers can avoid the BOCs' exorbitant monthly rates."[53] ATX urges the Commission to "rule in this proceeding that restrictions and conditions for term and volume discounts that require a Customer to obtain similar services from a BOC on a region-wide basis . . . are discriminatory, anticompetitive, and unlawful."[54]

These arguments reinforce the claim made in Broadwing's and SAVVIS' opening comments that the BOCs engage in exclusionary and anticompetitive pricing practices. In

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51 Broadwing and SAVVIS Comments at 18-19.

52 *See* ATX Comments at 38. *See also* CompTel Comments at 11-12.

53 CompTel Comments at 12. CompTel's Comments also set forth examples of exclusionary BOC tariffs. *See id.* at 14-20.

54 *See* ATX Comments at 39.

particular, we noted that to maintain their required volume with a BOC, companies may be obliged to purchase a special access circuit from the BOC *even where a competitor offers the same circuit at a lower rate.*[55] The BOCs may also offer discounts on special access along routes where no competitive facilities are available on the condition that purchasers buy special access services along routes where competitive alternatives do exist.[56] In other words, the only way to receive a discount on the non-competitive route may be to buy from the BOC along the competitive route. These pricing practices are plainly anticompetitive and serve only to bolster the BOCs' dominance in the special access market.

The BOCs argue that imposing volume and term requirements are good for customers. Verizon, for example, notes that some 85 percent of its customers take service through one of its contract plans containing such requirements.[57] Clearly, however, the fact that customers subscribe to plans imposing onerous volume and term commitments says nothing about whether such plans are anticompetitive. As a practical matter, customers subscribe to them because, as discussed above, they generally have no choice but to go with the BOC for most of their special access needs. Given that critical fact, volume and term commitments are the *only* way to obtain discounts off absurdly inflated tariff rates. Certainly that does not mean, however, that this Commission should look with favor on plans specifically designed to prevent companies from taking advantage of competitive alternatives in the limited circumstances where they exist.

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55 Broadwing and SAVVIS Comments at 23.

56 *See, e.g.*, WorldCom Reply Comments on *AT&T Rulemaking Petition*, Declaration of Michael D. Pelcovits, RM No. 10593, at 12-13.

57 *See* Verizon Comments at 11-13.

## IV. THE COMMISSION'S PRICING FLEXIBILITY REGIME IS DEEPLY FLAWED AND SHOULD BE REFORMED, NOT EXTENDED.

The Commission's special access regulatory framework is fundamentally flawed and should therefore be thoroughly reformed. Perhaps most significantly, the Commission's current approach fails to account for important distinctions among special access services.[58] In particular, the special access regime fails to distinguish between DS1 and DS3 channel terminations to enterprise buildings and other special access facilities. In our view, the critical criterion for differentiation is *circuit capacity.* The differing revenue opportunities corresponding to different capacities dictate that in some instances OCn circuits will be suitable for competitive supply while DSn circuits are not. In other words, the revenues associated with providing service at the DS1 or DS3 level generally cannot justify the cost of deploying service to the customer premises, except in the rare instance where a company can serve multiple smaller customers at the same location. Accordingly, this Commission's regulatory regime should acknowledge the reality that a competitive carriers' ability to provide OC48 fiber loops where they are required does not mean that the carrier could also economically deploy DS1s.[59]

The Commission's current regulatory approach suffers other flaws as well – in particular, its focus on MSAs as the relevant geographic market is misplaced. As a number of commenters point out, MSAs are far too large to accurately define relevant geographic markets for special access competition.[60] For instance, while there might be competition for high capacity transport in the New York financial district, there likely is no competition at all for DS1 channel

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58 *See* Time Warner Comments at 6.

59 Notably, BellSouth's own analysis, which shows that competitors serve only 11 percent of the DS1 market, as opposed to 79 percent of the OCn market, is entirely consistent with this view. *See* BellSouth Comments at 27-28; *see also supra* at 8.

60 *See, e.g.*, T-Mobile Comments at 13; Time Warner Comments at 7; XO Comments at 11.

terminations to small business premises in the Bronx. But MSA-wide pricing flexibility analysis inappropriately ignores such distinctions, and deregulates the ILECs' special access rates throughout the entire MSA.

As the ILECs now urge, *see infra* at 6-7, the Commission's regulatory approach already appears also to assume that competitors can discipline ILEC prices by deploying their own loop and transport facilities. Again, however, as many commenters emphasize, this is incorrect because of the high entry barriers that prevent competitive carriers from deploying transport and loop facilities in all but the highest density areas.[61] Indeed, as T-Mobile notes, "in MSAs where . . . ILECs have obtained special access pricing flexibility," there is "little or no evidence of new entry by suppliers of special access services other than the ILECs."[62] Rather, competitive companies and end user customers continue to face unreasonably high prices special access prices from the BOCs.[63]

The Commission's reliance on collocation as a proxy for competitive entry repeats the mistake of assuming that competitors can self-deploy access facilities, paralleling the BOCs' claims – discussed *infra* at 6-7 – that the presence of competitive fiber rings "close" to DS1 and DS3 customers suffices to restrain BOC special access pricing. But collocations "close" to end user customers are no more useful to companies like Broadwing and SAVVIS than are nearby fiber facilities. The DS1 and DS3 channel terminations those companies need will not spontaneously generate to customer premises, and we can neither build nor pay someone else to build such facilities economically. Accordingly, the existence of collocations says nothing about

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61 *See, e.g.*, Time Warner Comments at 12; Ad Hoc Comments at 34-35, Sprint Comments at 9-10.

62 *See* T-Mobile Comments at 10.

63 *See infra* at 11.

whether competitive companies will have any economic incentive to extend facilities to customer premises.[64]

The proposed BOC-IXC mergers will further skew the Commission's pricing flexibility analysis if those mergers are approved as proposed. Because AT&T and MCI provide much of the competition that currently exists, and because much of the fiber they acquired or constructed in the late 1990s could not be replicated in today's market, some routes that are currently competitive will not be competitive post-merger.

Based on the foregoing, the Commission should reject the ILECs' invitation to extend the current flawed pricing flexibility regime.[65] The Commission should instead reform the regulation of special access as set forth directly below.

## V. THE COMMISSION SHOULD REFORM ITS SPECIAL ACCESS REGULATORY REGIME.

As we have shown, there are few competitive alternatives for companies seeking to obtain access to enterprise buildings using DS1s or DS3s. The Commission's rules must reflect that reality. Therefore, ILECs should not have flexibility to raise prices for DS1 or DS3 connections to buildings on account of competitive alternatives at the OCn level or competitive alternatives to serve "core" network facilities. As we have stated,

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64 *See* Time Warner Comments at 8-9; Sprint Comments at 9-10; XO Comments at 10.

65 *See, e.g.*, SBC Comments at 58-60 (Commission should grant Phase II pricing flexibility to all OCN and packet-switched services); BellSouth Comments at 46-48 (Commission should grant Phase II pricing flexibility to all areas over the next two years, and then deregulate all special access rates at the end of this period); USTA Comments at 14-15 (Commission should eliminate pricing flexibility criteria and allow parties to enter commercially negotiated agreements everywhere); Verizon Comments at 35 (Commission should allow ILECs to satisfy the Phase II triggers by submitting evidence of alternative fiber in the area served by specific wire centers).

the existence of competitive alternatives on those fundamentally different sorts of routes simply does not indicate that there are now or ever will be competitive alternatives to ILEC provision of DS1s and DS3s to the edge of the network.

For the same reason, the Commission should create a separate price cap basket for DS1 and DS3 channel terminations to enterprise end user buildings. That is fully consistent with the Commission's long-standing approach of placing like services in a single basket – combining services that are competitive in a basket with services that are not competitive permits ILECs to take advantage of their market power. Having created such a basket, the Commission should then require that special access prices be reduced to reasonable levels for services in that basket. The ideal way to do that would be by means of cost studies, but such studies are complex and expensive. Customers and competitors cannot wait for their preparation, and the ILECs should not be required to prepare cost studies if reasonable alternatives are available. The Commission can provide a reasonable alternative quickly by requiring rates to be reinitialized at the level that would provide a reasonable rate of return based on the ILECs' costs if they had been required to apply an annual X-factor since 2004.

With respect to the appropriate rate of return, many commenters have noted that 11.25% is the last rate or return adopted by the Commission.[66] That level was selected in an era of relatively high inflation, and therefore is too high. As an interim measure, however, it will bring rates down considerably and provide no valid basis for complaint by the ILECs. However, the Commission should initiate a study designed to reduce that level in light of the lower rate of inflation over the last decade.

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[66] *See* XO Comments at 12-13; PaeTec Comments at 10-13; ATX Comments at 22-23; Ad Hoc Comments at 37; API Comments at 10.

With respect to the appropriate X-factor, many commenters have noted that 5.3 percent was the last X-factor approved by a court.[67] That level seems unreasonably favorable to the ILECs. The level last selected by the Commission was 6.5 percent. In the course of vacating and remanding, the court of appeals did not quarrel with the Commission's conclusion that the appropriate range of reasonableness was between 5.2 percent and 6.3 percent plus a consumer productivity dividend. Rather, the court held that the Commission had not adequately *explained* (a) its choice of 6.0 within the range and (b) the use of a consumer dividend of 0.5 percent.[68] There is no reason to think the Commission could not have justified an X-factor much closer to 6.5 percent than to 5.3 percent. Nevertheless, an X-factor of at least 5.3 percent should be used pending further study.

If an ILEC chooses to complain, it should submit its own cost study. But unless and until that happens, ILEC prices for DS1 and DS3 connections to end users should reflect reinitialized rates based on an 11.25 percent rate of return and an X-factor of at least 5.3 percent. That approach – combining the best available estimate of a reasonable rate with the option for the regulated party to submit a cost study justifying a higher rate – is the approach that the Commission adopted and the D.C. Circuit approved when the Commission reduced cable rates.[69] It is entirely appropriate to use that approach in this context, where the evidence shows that the ILECs are using their market power to obtain unreasonably high rates of return. It is certainly fair to ILECs, who would be permitted

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67 *See* PaeTec Comments at 23; CompTel Comments at 35; T-Mobile Comments at 21; API Comments at 12.

68 *See USTA v. FCC*, 188 F.3d 521, 526, 527 (D.C. Cir. 1999).

69 *See Time Warner Entertainment Co. v. FCC*, 56 F.3d 151, 169 (D.C. Cir. 1995).

to submit evidence justifying higher rates. But if the Commission adopts an X-factor of 5.3 percent and a rate of return of 11.25 percent, the Commission is unlikely to be burdened by requests for cost studies: we doubt many ILECs would submit such requests, since they likely would result in lower rather than higher rates.

Respectfully submitted,

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July 29, 2005