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July 29, 2005

Via Electronic Filing

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

REDACTED – FOR PUBLIC INSPECTION

Re: *Special Access Rates for Price Cap Local Exchange Carriers*
WC Docket No. 05-25

Dear Ms. Dortch:

Submitted herewith are Reply Comments of Nextel Communications, Inc. (“Nextel”) in the above-referenced proceeding, including the redacted version of the Declaration of Bridger M. Mitchell and John R. Woodbury (“CRA Decl.”), appended as Attachment 1. The unredacted, confidential version of the CRA Decl. is being filed separately under seal and subject to the Protective Order in the above-referenced proceeding.¹ Arrangements for inspection of the confidential version may be made by contacting the undersigned counsel for Nextel.

If you have any questions, please do not hesitate to contact me.

Sincerely,



Gil M. Strobel
Counsel for Nextel Communications, Inc.

Attachment

cc: Pamela Arluk

¹ *Special Access Rates for Price Cap Local Exchange Carriers*, Order, 20 FCC Rcd 10160 (2005) (DA 05-1635) (“Protective Order”).

**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-10593
)	
)	

REPLY COMMENTS OF NEXTEL COMMUNICATIONS, INC.

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Attachments

Attachment 1: Declaration of Bridger M. Mitchell and John R. Woodbury (“CRA Decl.”)
(Redacted – for Public Inspection)

Attachment 2: Declaration of Steven Sachs (“Sachs Decl.”)

Exhibit 1: Nextel Regression Analysis

Exhibit 2: Nextel DS1 and DS3 Special Access Analysis

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REPLY COMMENTS OF NEXTEL COMMUNICATIONS, INC.

Nextel Communications, Inc. (“Nextel”) submits these comments in reply to the comments filed in response to the Notice of Proposed Rulemaking issued by the Commission in the above-captioned proceedings.¹

I. INTRODUCTION AND SUMMARY

The initial comments filed by Nextel and others in this proceeding reveal a broad consensus that: 1) the Commission must promptly reinstate an effective price cap regulatory regime to restrain the Bell Operating Companies’ (“BOCs”) exercise of market power in the provision of special access; and 2) the current pricing flexibility rules for special access services are deeply flawed and need to be replaced as quickly as possible. Virtually every segment of the telecommunications industry, other than the incumbent local exchange carriers (“LECs”) – including competitive LECs, wireless

¹ *Special Access Rates for Price Cap Local Exchange Carriers*, Order and Notice of Proposed Rulemaking, 20 FCC Rcd 1994 (2005) (“*NPRM*” or “*Notice*”).

carriers, interexchange carriers, consumer advocates and end-user groups² – presented evidence that special access customers rarely have access to realistic competitive alternatives to the BOCs for special access service, even in areas where the BOCs have been granted pricing flexibility.

Indeed, the record shows that the existing pricing flexibility rules have exacerbated the problem by relaxing price cap regulation in areas where the BOCs continue to possess and exercise market power, allowing the BOCs to raise their already supra-competitive prices for special access services in those areas.³ As Ad Hoc and other parties demonstrated through analyses of ARMIS data – analyses further buttressed by additional support provided by Nextel in these reply comments⁴ – the result has been that the BOCs continue to reap exorbitant profits from their overpriced special access services.⁵ The BOCs’ excessive earnings – three of the four BOCs have achieved returns of more than 70% according to ARMIS data – are evidence that the current price cap and

² See, e.g., Comments of the Ad Hoc Telecommunications Users Committee (“Ad Hoc Comments”); Comments of the American Petroleum Institute (“API Comments”); Comments of BT Americas Inc. (“BT Americas Comments”); Comments of CompTel/ALTS, Global Crossing North America, Inc., and NuVox Communications (“CompTel/ALTS Comments”); Comments of Ionary Consulting (“Ionary Comments”); Comments of the New Jersey Division of the Ratepayer Advocate (“NJ Ratepayer Advocate Comments”); Comments of Sprint Corporation (“Sprint Comments”); Comments of T-Mobile USA, Inc. (“T-Mobile Comments”). (Unless otherwise indicated, all comments cited herein were filed in WC Docket No. 05-25 on June 13, 2005.)

³ See, e.g., Sprint Comments at 8-10; Comments of Time Warner Telecom at 21-25 (“Time Warner Comments”).

⁴ See discussion *infra* at 27; Nextel Regression Analysis, attached as Exhibit 1.

⁵ See, e.g., Ad Hoc Comments at 16-21; Comments of ATX Communications Services, Inc., BridgeCom International, Inc., Broadview Networks, Inc., Pac-West Telecomm, Inc., US LEC Corp., U.S. Telepacific Corp. d/b/a Telepacific Communications at 5-10 (“ATX Comments”); Ionary Comments at 1-3; Comments of PAETEC Communications at 4-5 (“PAETEC Comments”).

pricing flexibility regime is flawed. Among the flaws identified by Nextel and other commenters, the current pricing flexibility regime does not focus on the correct product or geographic markets, failing to distinguish between circuits of varying capacities, and treating an entire MSA as a single monolithic market when, in fact, the market for special access services should be defined on a wire center-by-wire center or route-by-route basis.⁶

The vast majority of commenters agreed that the current regulatory scheme has failed and joined Nextel in urging the Commission to reinstate price cap regulation of special access, to overhaul the pricing flexibility rules as quickly as possible, and to adopt interim measures while it considers more permanent reforms.⁷ Nextel, for example, urged the FCC, no later than January 1, 2006, to require the BOCs to adjust their special access price cap indices (“PCIs”) downward to the levels that would have resulted if the BOCs had been required to apply a 5.3% X-factor, net of inflation, as of July 1, 2004 and July 1, 2005.⁸ Under this proposal, the BOCs would be required to make the same adjustments to their PCIs in each future annual access tariff filing until the FCC adopts a new X-factor.⁹ Several other parties, including eTUG and American Petroleum Institute, proposed nearly identical forms of relief.¹⁰ In addition, Nextel urged the FCC to require

⁶ See, e.g., Time Warner Comments at 7; T-Mobile Comments at 5, 15; Comments of WilTel Communications, LLC at 21-22 (“WilTel Comments”).

⁷ See, e.g., Ad Hoc Comments at ii-iii and 52-54; API Comments at 10-12; Comments of AT&T Corp. at 2, 5-6 (“AT&T Comments”); ATX Comments at 2, 13-16, 33-35; CompTel/ALTS Comments at 34-35; PAETEC Comments at 13-16, 22-23; Time Warner Comments at 21-25; T-Mobile Comments at 5-6, 12-18, 21-22.

⁸ Comments of Nextel Communications, Inc. at 2, 25 (“Nextel Comments”).

⁹ *Id.* at 2, 25-26.

¹⁰ See, e.g., Letter from eCommerce & Telecommunications User Group (“eTUG”) and Telecommunications Committee of the American Petroleum Institute, WC Docket

the BOCs, no later than 2006, either to base their tariffed special access rates on forward-looking cost studies, or, alternatively, to retarget their special access earnings to a level that would not exceed a rate of return specified by the FCC (e.g., the 11.25% rate of return previously prescribed by the Commission).¹¹ Several other parties supported similar relief.¹²

Nextel also urged the FCC, at least on an interim basis, to replace the existing pricing flexibility standards with the impairment “triggers” adopted in the *Triennial Review Remand Order* (“TRRO”) to assess whether competitive LECs would be impaired if they were denied access to unbundled loops and transport.¹³ Under this approach, the BOCs would be granted special access pricing flexibility for channel terminations and channel mileage only in those locations where the BOCs can demonstrate that they are not required to provide access to loops and dedicated transport, respectively, of comparable capacity as unbundled network elements (“UNEs”).¹⁴ As part of this filing, Nextel provides an analysis demonstrating the effect of using the impairment triggers with respect to the local special access DS1 and DS3 circuits that Nextel purchases.¹⁵

No. 05-25 (May 10, 2005); API Comments at 12; AT&T Comments at 2; ATX Comments at 2; CompTel/ALTS Comments at 35; T-Mobile Comments at 6.

¹¹ See Nextel Comments at 3-4, 26-27.

¹² See Ad Hoc Comments at 4, 37-43; API Comments at 10; AT&T Comments at 6; ATX Comments at 2, 17-22; PAETEC Comments at 11; T-Mobile Comments at 20-21; WilTel Comments at 16-18; Comments of XO Communications, Inc. at 12.

¹³ *Unbundled Access to Network Elements; Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers*, Order on Remand, 20 FCC Rcd 2533 (2005) (“*Triennial Review Remand Order*” or “*TRRO*”).

¹⁴ Nextel Comments at 2-3, 26.

¹⁵ Nextel DS1 and DS3 Special Access Analysis, attached as Exhibit 2.

In these reply comments and the accompanying declaration by Bridger Mitchell and John Woodbury (the “CRA Declaration”),¹⁶ Nextel shows that the arguments advanced by the BOCs in support of their claims that the special access marketplace is competitive are without merit. Contrary to the BOC allegations that competition for special access services should be assessed on an MSA-wide or even nationwide basis, the evidence shows that what little competition there is for special access services is limited to particular services offered in discrete geographic areas.

As an initial matter, Nextel and CRA demonstrate that the market definitions proposed by the BOCs are overly broad. Because different transmission circuits used for special access perform different functions and have different capacities, those circuits are not interchangeable, as the BOCs allege. In fact, the record demonstrates that DS1 and DS3 channel terminations, DS1 and DS3 channel mileage, and entrance facilities are distinct, non-fungible services, each of which should be defined as a separate special access product market. Contrary to the BOCs’ arguments, moreover, an MSA is far too expansive an area to constitute a relevant geographic market. The availability of transport between two points in an MSA cannot substitute for transport between two different points in an MSA; likewise, the channel terminations provided in an area served by one serving wire center in an MSA cannot substitute for channel terminations provided out of another serving wire center in the same MSA. Therefore, the Commission should define the relevant geographic market on a wire center-specific basis for channel terminations, and on a route-specific basis for channel mileage (interoffice transport).

¹⁶ Declaration of Bridger M. Mitchell and John R. Woodbury, attached as Attachment 1 (“CRA Decl.”).

Based on appropriate market definitions, Nextel demonstrates that the BOCs continue to possess market power in the provision of DS1 and DS3 special access services in the vast majority of locations. Indeed, both the evidence provided by other parties and the attached CRA declaration demonstrate that there is no merit to the BOCs' theories that special access competition is sufficiently robust to constrain the BOCs from charging supra-competitive rates, even in areas where the BOCs have been granted pricing flexibility. Relying on its own experiences, Nextel shows that DS1 and DS3 services generally are not susceptible to competitive entry. For instance, in BOC service areas, Nextel obtains only about 3% of its DS1 to cell site circuits, and only about 8% of its DS1 transport circuits, from non-BOC suppliers.¹⁷ Moreover, approximately 93% of all Nextel DS1 to cell site circuits purchased from BOCs are provided out of wire centers where the FCC would find that carriers are impaired without access to unbundled DS1 loops under the *TRRO*'s impairment triggers.¹⁸ In addition, approximately 84% of the DS1 transport circuits and about 57% of the DS3 transport circuits that Nextel purchases from the BOCs are on routes where the FCC would find that carriers are impaired without access to unbundled transport of comparable capacity.¹⁹ These data confirm that significant competition for special access services does not exist in most markets where Nextel currently purchases such services.

In their initial comments, the BOCs also purported to show that the rates for special access have declined in MSAs where pricing flexibility has been granted. As

¹⁷ "DS1 to cell site circuits" refers to DS1 special access channel termination circuits connecting Nextel's cell sites and the BOC serving wire center.

¹⁸ See Nextel DS1 and DS3 Special Access Analysis.

¹⁹ See *id.*

demonstrated below, however, this claim is misleading because it is based on an unsound methodology that depends on average special access revenues per circuit rather than a straightforward comparison of price cap and pricing flexibility rates for specific circuits offered in particular service areas. Methodologically sound analyses conducted by parties such as AT&T and CompTel/ALTS, *et al.* have consistently demonstrated that special access prices are either the same or higher in Phase II Pricing Flexibility areas than they were under price caps, and much higher than the UNE rates for comparable offerings.

The BOCs also claimed that their rates of return for special access should not be calculated based on ARMIS data because the cost allocations for ARMIS reporting have been frozen during the period in which the BOCs have had pricing flexibility. As Nextel's own regression analysis demonstrates, however, this claim is without merit.²⁰ Other arguments advanced by the BOCs are likewise based on flawed economic analysis and improper measures, as demonstrated below.

Finally, Nextel shows that the BOCs' claims substantially overstate the costs of implementing much-needed reform of the current special access regulations. These costs would be more than offset by the substantial benefits they would bring to special access customers and, ultimately, to consumers. In particular, the Commission can promptly adopt an interim X-factor of 5.3% in order to begin to reduce the BOCs' special access rates to reasonable levels. Further, since the FCC already has established reasonable competitive triggers for determining when incumbent LECs are required to provide access to high-capacity loops and transport as UNEs, the FCC can minimize its

²⁰ See Nextel Regression Analysis.

administrative burden by using those same triggers – at least on an interim basis – as the standards for determining whether and where to grant the BOCs pricing flexibility. The Commission therefore should immediately adopt these and other interim measures outlined in Nextel’s comments while it crafts appropriate longer term special access relief.

II. CURRENT SPECIAL ACCESS MARKET DEFINITIONS SUPPORTED BY THE BOCS ARE OVERLY BROAD FOR DETERMINING WHETHER TO GRANT PRICING FLEXIBILITY RELIEF

A cogent assessment of the state of competition for special access services must begin with reasonable definitions of the relevant product and geographic markets.²¹ Although the BOCs largely sidestep or gloss over this critical first step, their comments, as explained below, advocate overly broad market definitions. The Commission’s analysis must be more rigorous and be based on market definitions that are grounded in the technological and economic realities of today’s special access marketplace.

A. The Relevant Special Access Product Markets Must Be Defined on the Basis of the Function and Capacity of the Transmission Links

As Nextel and other commenters explained in their initial comments, the relevant product markets for special access services must be defined in relation to both the function and the transmission capacity of the relevant circuits.²² Although none of the BOCs proposes actual product market definitions, their comments appear to be based on the assumption that the different transmission links within the network, as well as different circuit capacities, are largely interchangeable, and that therefore the relevant

²¹ See *NPRM* ¶¶ 73, 81-93 (seeking comment on the relevant product and geographic markets).

²² See Nextel Comments at 4, 8-9; Time Warner Comments at 6; Ad Hoc Comments at 50; CompTel/ALTS Comments at 3; T-Mobile Comments at 16.

product market(s) should be defined broadly.²³ The BOCs' underlying assumption of interchangeability is demonstrably false, however, both in relation to capacity and function. The FCC should adopt product market definitions that reflect marketplace reality and distinguish between each type of special access link as well as between circuits of varying capacity.

Channel terminations (loops), channel mileage (interoffice transport), and entrance facilities each perform separate functions within the network and are not fungible services.²⁴ For instance, channel termination circuits are not substitutes for channel mileage circuits because each connects different points in the network; in Nextel's case, channel terminations connect cell site locations with BOC central offices, and channel mileage connects two central offices or a central office and a tandem office.²⁵ The product market, however, cannot be defined solely on the basis of the discrete functions of each type of circuit. In addition, the product market definition must also reflect the differences between circuits of varying capacities.²⁶ Customers, including Nextel, generally do not view DS1 links as substitutes for DS3 links because the former have a much smaller transmission capacity than the latter. In addition, the economics of

²³ Although Verizon does not proffer a definition, it urges the FCC not to subdivide special access into product markets determined by bandwidth or customer type. Comments of Verizon at 45 n.31 ("Verizon Comments") and Declaration of William E. Taylor, Attachment C to Verizon Comments, ¶ 50 ("Taylor Decl."). The only other BOC that addressed the relevant product markets, BellSouth, also did not proffer any definitions, but simply asserted that it would be difficult or impossible for such markets to be properly defined. Comments of BellSouth at 43-44 ("BellSouth Comments"). All the BOCs appear to agree, however, that special access transmission or service components of different capacities are largely interchangeable. *See, e.g.*, BellSouth Comments at 43 ("DS1 and DS3 loops are sometimes used interchangeably").

²⁴ *See* CRA Decl. ¶ 17 (discussing loops and transport).

²⁵ *Id.*

²⁶ *See* CRA Decl. ¶ 18.

deploying competitive facilities can vary significantly depending on the capacity of the facilities being deployed.²⁷ Thus, it is critical that the Commission's analysis distinguish between DS1 and DS3 capacity circuits as it evaluates the extent of competition in particular geographic markets.²⁸

Both common sense and the record evidence demonstrate that DS1 and DS3 channel terminations, DS1 and DS3 channel mileage, and entrance facilities are each different services that meet different needs, and are not substitutes for one another from the perspective of customers or would-be competitive entrants.²⁹ The Commission should define the product markets for special access accordingly.

B. The Relevant Geographic Market for Channel Terminations Is the Wire Center Serving a Particular Customer Location and the Specific Route for Channel Mileage

The FCC defines the relevant geographic market as “an area in which all customers in that area will likely face the same competitive alternatives for a product.”³⁰

As Nextel explained in its comments, and as the FCC has recognized in prior proceedings, under this criterion the relevant geographic market for loops/channel

²⁷ See, e.g., *TRRO* ¶ 72.

²⁸ CRA Decl. ¶ 18.

²⁹ See, e.g., Time Warner Comments at 6; T-Mobile Comments at 16; ATX Comments at 30; CompTel/ALTS Comments at 3.

³⁰ *Applications of Ameritech and SBC Communications for Consent to Transfer Control of Corporations Holding Commission Licenses and Lines Pursuant to Sections 214 and 310(d) of the Communications Act and Parts 5, 22, 24, 25, 63, 90, 95, and 101 of the Commission's Rules*, Memorandum Opinion and Order, CC Docket 98-141, 14 F.C.C.R. 14712 at ¶ 69, n. 147 (1999); see also *Regulatory Treatment of LEC Provision of Interexchange Services Originating in the LEC's Local Exchange Area and Policy and Rules Concerning the Interstate, Interexchange Marketplace*, 12 FCC Rcd 15756, ¶ 28 (1997) (explaining that the FCC determines the relevant geographic market by considering whether if all carriers raised their prices in a specific area, a customer would be unable to find the same service in another area at a lower price).

terminations is the wire center serving a specific customer location.³¹ The relevant geographic market for interoffice transport/channel mileage is the route between the two central offices being connected.³²

In their initial comments, carriers as diverse as Sprint, T-Mobile, and XO agreed with Nextel, explaining that an MSA-wide market would be far too large to reflect the competitive realities of either channel terminations or channel mileage.³³ Ignoring both these competitive realities and the FCC's recent determinations in the *TRRO*, however, the BOCs argue that the MSA constitutes the smallest relevant geographic market.³⁴ This argument should be rejected.

The first fatal flaw in the BOCs' argument is that it ignores the simple fact that competition in one part of an MSA is unlikely to constrain BOC special access pricing in another area.³⁵ For example, Nextel and other CMRS carriers require special access

³¹ See Nextel Comments at 7-8; *TRRO* ¶ 155.

³² See Nextel Comments at 8; *TRRO* ¶¶ 78-79.

³³ See Nextel Comments at 8; Sprint Comments at 9; T-Mobile Comments at 5, 15; XO Comments at 9, 11; see also Time Warner Comments at 7, 25; WilTel Comments at 22. The FCC relies on the Office of Management and Budget's ("OMB's") definition of Metropolitan Statistical Areas ("MSAs"). As defined by OMB, MSAs consist of one or more counties and can encompass multiple urban areas (e.g., the Miami-Fort Lauderdale-Miami Beach, FL MSA includes the following principal cities: Miami, Fort Lauderdale, Miami Beach, Pompano Beach, West Palm Beach, Kendall, Boca Raton, Deerfield Beach, Boynton Beach, and Delray Beach). See "Metropolitan and Micropolitan Statistical Area Definitions," U.S. Census Bureau, available at: <<http://www.census.gov/population/www/estimates/metrodef.html>>.

³⁴ See Comments of SBC Communications Inc. at 8, 48-50 ("SBC Comments"); Verizon Comments at 44-46. Qwest and BellSouth did not address the appropriate geographic market definition in their comments.

³⁵ See CRA Decl. ¶ 38 ("rivals who can compete with the BOCs in areas like the central business district of the MSA may be unable to do so in other locations within the same MSA"); *TRRO* ¶ 155 ("an MSA-wide [market definition] . . . would require . . . lumping together areas in which the prospects for competitive entry are widely disparate."); see also CRA Decl. ¶ 39.

services to connect their cell sites to BOC central offices, and those cell sites are spread widely throughout an MSA, with many located outside of the central business districts where competition is strongest.³⁶ Whether competitors offer dedicated connections in some parts of an MSA is irrelevant to Nextel if those competitors do not offer dedicated connections between a particular Nextel cell site and the BOC central office serving that cell site.³⁷

Second, an MSA-wide or regional market definition is inconsistent with the economics of providing special access services. For example, serving the entire MSA requires sinking considerable costs throughout the MSA; but competitors generally can reap profits only if they sink those costs exclusively or primarily in targeted areas where the demand and revenues are most concentrated. Competitors therefore typically target their entry to specific central offices where sustained profitability is most likely to allow them to recover the sunk costs needed for entry.³⁸

³⁶ See Nextel Comments at 5-10; Declaration of Steven Sachs, attached as Attachment 2, ¶ 4 (“Sachs Decl.”); *see also* T-Mobile Comments at ii.

³⁷ See CRA Decl. ¶ 36.

³⁸ See CRA Decl. ¶ 52. Notwithstanding the deterrent created by these substantial, up-front sunk costs (particularly in areas outside central business districts), the BOCs argue that the relevant geographic market is at least as extensive as an MSA because competitive LECs are readily able to contest any specific geographic area within an MSA in which a BOC engages in non-competitive pricing. See Statement of Professor Joseph P. Kalt on Behalf of SBC Communications Inc., attached to SBC Comments, ¶ 40 (“Kalt Decl.”). The economic theory of contestable markets, however, requires that competitors not risk the loss of substantial sunk costs in order to enter a market. In order for specific geographic markets to be contestable, competitors must be able to engage in a “hit-and-run” strategy in which they enter such markets rapidly and exit (if necessary) without having to absorb unrecoverable costs. The sunk cost requirements of entry into special access markets preclude such “hit-and-run” entry. CRA Decl. ¶ 37. The potential for “hit-and-run” entry also is limited by contracts obligating BOC special access customers to buy a specified volume of special access services on a region-wide basis for fixed terms of as long as 7 years. See Comments of Broadwing Communications, LLC, and

Third, the fact that a BOC may choose to price its services on an MSA-wide or regional basis does not necessarily mean that the relevant geographic market should be similarly broad.³⁹ How the BOCs choose to price their services should not affect the FCC's definition of the relevant geographic market.⁴⁰ When a BOC prices uniformly across an MSA, that price reflects the variety of competitive conditions that exist across different customer routes within that MSA. As a result, MSA-wide pricing does not preclude the BOCs from charging supra-competitive rates that are very close to monopoly rates.⁴¹

Moreover, to reduce the influence of any competitive areas of the MSA on the uniform price, the BOC with pricing flexibility can offer specialized contract tariffs that selectively target those customers that have ready alternatives to the BOC.⁴² By dealing with these customers through targeted contract offerings, the BOC can exclude them from its uniform price calculation, allowing the BOC to saddle the remaining customers within the MSA with a uniform price that is significantly higher than a competitive rate.⁴³ Thus, the BOCs' decision to offer uniform prices across an MSA does not change the fact

SAVVIS Communications Corporation at 3-4, 22-24 ("Broadwing Comments"); ATX Comments at 35-39.

³⁹ See SBC Comments at 49; Taylor Decl. ¶ 51; see also CRA Decl. ¶ 40.

⁴⁰ CRA Decl. ¶¶ 40-41, 47-48.

⁴¹ For example, if most of the DS1 purchases in an MSA involve routes where there is little competition, then the BOC's uniform price for DS1 links will be close to the monopoly price for those links. Under this scenario, the fact that there is uniform pricing throughout an MSA does not result in a competitive rate in all parts of the MSA. To the contrary, in this example, the BOC will charge all DS1 customers in the MSA a supra-competitive price that is very close to the monopoly rate. See CRA Decl. ¶¶ 42-47.

⁴² CRA Decl. ¶ 48.

⁴³ *Id.*

that the appropriate market for policy purposes must be defined on a much more localized basis.

Consistent with the comments filed in this proceeding,⁴⁴ the Commission should define the relevant geographic market for channel terminations (loops) on a wire center-specific basis, because channel terminations provided in an area served by one serving wire center cannot substitute for channel terminations provided out of another serving wire center. Similarly, the Commission should define the geographic market on a route-specific basis for channel mileage (transport), because the availability of transport between two points cannot substitute for transport between two different points.

III. THE INITIAL COMMENTS CONFIRM THAT THE BOCS CONTINUE TO POSSESS MARKET POWER IN THE PROVISION OF SPECIAL ACCESS, REQUIRING CHANGES TO SPECIAL ACCESS PRICE CAP AND PRICING FLEXIBILITY STANDARDS

A. High Barriers to Entry Limit the Availability of Competitive DS1 and DS3 Services

As Nextel and other commenters demonstrated, DS1 and DS3 services used for special access are characterized by substantial entry barriers that in many or most geographic areas limit the viability of competitive alternatives to the BOCs.⁴⁵ The BOCs' arguments to the contrary are belied both by hard data and the economic realities of the special access marketplace. In fact, carriers such as Nextel continue to rely on BOC special access to meet the vast majority of their special access needs. In addition, there are significant barriers to the emergence of competition for special access services, particularly in areas outside central business districts where demand is most concentrated.

⁴⁴ See, e.g., Time Warner Comments at 7; T-Mobile Comments at 5, 15; WilTel Comments at 21-22.

⁴⁵ See Nextel Comments at 9-12; ATX Comments at 29; Sprint Comments at 13; Time Warner Comments at 8, 18-19.

As discussed above, the provision of loops and transport entails substantial sunk costs that would be stranded if a new entrant were unable to offer service profitably.⁴⁶ These sunk costs alone constitute substantial barriers to entry in many areas. In addition, the provision of special access services exhibits significant economies of scale and scope.⁴⁷ Since the BOCs have already achieved economies of scale and scope in their special access operations that are unmatched by any competitor, they enjoy a sizeable cost advantage over their rivals, making it difficult for new entrants to compete effectively against the BOCs.

The evidence confirms that barriers to entry continue to deter competition for special access, except for the provision of OCn-capacity circuits (particularly those used to create fiber rings) in some areas, and the provision of DS3-capacity circuits along some high-volume routes. For example, competitive LECs do not, and cannot, satisfy the vast majority of Nextel's special access needs. In fact, in BOC service areas, Nextel obtains only about 3% of its DS1 to cell site circuits, and 8% of its DS1 transport circuits, from competitive suppliers.⁴⁸ Moreover, approximately 93% of all Nextel DS1 to cell site circuits purchased from BOCs are provided out of wire centers where the FCC would find that carriers would be impaired without access to unbundled DS1 loops under the *TRRO*'s impairment triggers.⁴⁹ In addition, approximately 84% of DS1 transport circuits and about 57% of the DS3 transport circuits that Nextel purchases from the BOCs serve

⁴⁶ See CRA Decl. ¶¶ 49-52; *TRRO* ¶¶ 72, 150, 152-53. As the FCC found, carriers have greater opportunities for recovering sunk costs in transport than in loop facilities. See *TRRO* ¶ 72, 152-53; CRA Decl. ¶ 54.

⁴⁷ CRA Decl. ¶ 53.

⁴⁸ Nextel DS1 and DS3 Special Access Analysis, Table 1.

⁴⁹ *Id.*

routes where the FCC would find that competitive carriers would be impaired without access to unbundled interoffice transport of comparable capacity pursuant to the relevant *TRRO* triggers.⁵⁰ These data strongly suggest that significant competition for special access services does not exist in most markets where Nextel currently purchases such services.

Nextel's dependence on the BOCs for special access is not atypical. Another CMRS carrier, T-Mobile, has stated that it depends on incumbent LECs for over 96% of its base station-to-central office links.⁵¹ Even AT&T, one of the largest competitive suppliers of special access, has stated that as recently as a few years ago, it obtained 93% of its DS1-level transport from incumbent carriers.⁵² As AT&T demonstrated in a 2003 filing, moreover, it is as heavily dependent on incumbent LECs for special access services in MSAs with Phase II pricing flexibility as it is in MSAs with no pricing flexibility – suggesting that the availability of competitive alternatives to the BOC is equally limited in both types of MSAs.⁵³

⁵⁰ *Id.*, Table 2.

⁵¹ T-Mobile Comments at 8 and Declaration of Chris Sykes, Attachment C to T-Mobile Comments, ¶ 5 (“Sykes Decl.”).

⁵² *Special Access Rates for Price Cap Local Exchange Carriers*, Declaration of Janusz A. Ordoover and Robert D. Willig, attached to AT&T Petition for Rulemaking to Reform Regulation of Incumbent Local Exchange Carrier Rates for Interstate Special Access Services, WC Docket No. 05-25, RM-10593, ¶ 30 (Oct. 15, 2002).

⁵³ *See* Declaration of Dr. Lee Selwyn, attached as Exhibit 2 to Reply Comments of AT&T Corp., RM-10593, Table 8 (Jan. 23, 2003) (“Selwyn Decl.”) (in MSAs with some Phase II pricing flexibility, AT&T relies on ILECs for special access in about 94% of the buildings served by AT&T); *id.* Table 7 (citing 2002 tariff filings to show that in MSAs without pricing flexibility, AT&T relies on ILECs for special access in about 97% of the buildings served by AT&T); *see also* PAETEC Comments at 6 (PAETEC depends on incumbent LECs for 95% of special access service lines, even in high-density markets).

The BOCs claim that competitive alternatives to their special access services are particularly plentiful in large metropolitan areas.⁵⁴ However, in the New York MSA, which is generally regarded as one of the most competitive areas in the nation, non-incumbent LEC facilities were available at only a little over 14% of the business locations served by AT&T at the time of the Selwyn declaration.⁵⁵ In Nextel's experience, moreover, BOCs remain the dominant providers of special access even in metropolitan areas with significant competitive entry. For example, in 2004 Nextel issued a request for information ("RFI") soliciting bids from thirteen competitive providers for circuits that had been supplied by the incumbent LEC to connect all of the more than 1,500 New York-area Nextel cell sites with Nextel hub locations (*i.e.*, ring nodes where Nextel aggregates traffic for backhaul).⁵⁶ The RFI specified that service had to be provided over the competitor's own on-net facilities and meet certain service level commitments that Nextel requires to satisfy the needs of its end-user customers.⁵⁷ Only four competitors indicated they could serve any of the locations listed in the RFI, offering to provide service to a total of only 43 cell sites out of the over 1,500 listed in the initial request;⁵⁸ as a result, Nextel had no choice but to continue to rely on the incumbent LEC for the special access facilities Nextel needs to connect its cells sites to its hubs. The fact that competitors bid on fewer than 3% of locations in one of the most competitive

⁵⁴ See Verizon Comments at 3, 23; SBC Comments at 13; BellSouth Comments at 36.

⁵⁵ Selwyn Decl. Table 7.

⁵⁶ Sachs Decl. ¶ 10-11.

⁵⁷ *Id.* ¶ 10.

⁵⁸ *Id.* ¶ 11.

geographic markets in the nation belies the BOCs' claims that competitive alternatives are readily available to special access customers in metropolitan areas.

In Nextel's experience, this lack of competitive alternatives to the BOCs is not limited to the New York area. For example, in response to a Nextel RFI seeking connections between its cell sites and hub locations in the Nextel West Region (including the Seattle, Northern California Bay, Los Angeles/San Diego/Las Vegas, Denver, and Phoenix MSAs), non-BOC providers made viable offers to serve only 76 sites – fewer than 2% of the nearly 4,700 sites identified in the RFI.⁵⁹

The BOCs also argue that the presence of multiple fiber rings in many urban areas is sufficient to constrain any attempt by a BOC to exercise market power in the provision of special access.⁶⁰ That argument is wrong for several reasons.⁶¹ First, the deployment of multiple fiber rings along high volume routes in an urban area does not mean that competitive facilities are deployed ubiquitously throughout an MSA, particularly in areas outside of central business districts.⁶² Second, even at locations where a Nextel cell site is relatively close to a competitive fiber ring, that fact alone does not mean that it is feasible to connect Nextel's cell site directly to the ring.⁶³ A key threshold question is whether Nextel's cell site is near a node that provides access to the ring.⁶⁴ Otherwise, the fact that the ring itself runs past a cell site location provides no benefit to Nextel. Third,

⁵⁹ See *id.* ¶ 12.

⁶⁰ Verizon Comments at 3, 23-28; SBC Comments at 10-16.

⁶¹ See generally Sachs Decl. ¶ 9; CRA Decl. ¶¶ 76-78.

⁶² Sachs Decl. ¶ 9; see also *id.* ¶ 4 (noting that many of Nextel's cell sites are located outside of central business districts).

⁶³ Sachs Decl. ¶ 9.

⁶⁴ *Id.*

even if the cell site is in proximity to a node on the competitive ring, Nextel would still have to determine whether it is cost-effective to connect the cell site to the node, either by having the competitive provider build a new DS1 link between the cell site and the node or, alternatively, by leasing DS1 service between the cell site and the node from the BOC.⁶⁵ Because the costs associated with the new construction needed to connect a cell site to competitive LEC ring are substantial, it is more cost effective to use BOC special access to connect the cell site to the ring.⁶⁶

Perhaps aware that customers have few, if any, actual alternatives to BOC-provided special access services, the BOCs claim that customers can rely on UNEs or alternative technologies in lieu of BOC special access.⁶⁷ This argument does not withstand scrutiny.⁶⁸ As a threshold matter, the BOCs have consistently refused to make UNEs available to Nextel and other CMRS carriers. The Commission in the *Triennial Review Remand Order* ruled that incumbent LECs are not obligated to provide access to UNEs to CMRS providers “for the exclusive provision of mobile wireless services,”⁶⁹ and did not otherwise specify the circumstances in which CMRS carriers are entitled to

⁶⁵ *Id.*

⁶⁶ *Id.* In that event, Nextel would need to consider the disadvantages of using multiple vendor service arrangement at that location. *Id.* Multiple-vendor arrangements typically make the process of rectifying service quality problems more complicated and slower, since Nextel must coordinate with more than one vendor to identify and resolve any such problems. As a result, Nextel must weigh the lower price of using a competitive provider for one part of a circuit against the increased overhead associated with repairs on multiple-vendor circuits. *See id.* ¶ 7.

⁶⁷ Verizon Comments at 3-4, 28-32; SBC Comments at 16-20; BellSouth Comments at 23, 53-54.

⁶⁸ *See* CRA Decl. ¶¶ 32-33.

⁶⁹ *TRRO* ¶ 34.

such access. Consequently, it is unlikely that the BOCs will alter their practice of refusing to offer access to UNEs to Nextel and other wireless providers.⁷⁰

Alternative technologies also are poor substitutes for BOC special access.⁷¹

Although Nextel is very interested in using alternatives to BOC services, it rarely relies on fixed wireless or cable providers because of concerns regarding the costs and reliability of these technologies.⁷² For example, fixed wireless technology often requires direct line-of-sight between the cell site and the fixed wireless transmitter, which may be difficult to achieve in some of the places where Nextel's cell sites are located.⁷³ In addition, the performance of fixed wireless service can be impaired in inclement weather,

⁷⁰ Moreover, under the FCC's current rules, UNEs often are not an effective substitute for special access services. As the FCC explained, unbundling rules apply to only a "minority of special access circuits." *TRRO* ¶ 49. For instance, the FCC's "commingling" and service eligibility rules limit carriers' ability to integrate special access circuits with UNEs in a single network. *See* 47 C.F.R. § 51.318; Petition for Reconsideration of T-Mobile, CC Docket Nos. 01-338, 96-98, 98-147, at 15-16 (Oct. 2, 2003). Another limitation is that the BOCs have no obligation to construct new facilities in order to meet requests for UNEs. *Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers*, Report and Order and Order on Remand and Further Notice of Proposed Rulemaking, 18 FCC Rcd 16978, ¶¶ 632, 636 (2003) ("*TRO*"). Thus, carriers have little choice but to rely on special access to serve locations that require new or "special" construction. In addition, because of provisioning difficulties, even competitive LECs that could acquire UNEs from the BOCs often purchase special access facilities instead. *See, e.g., TRO* ¶¶ 633, 638 (discussing the difficulties that competitive carriers face in accessing UNEs). In short, the Commission's rules currently prevent carriers in many circumstances from using efficiently priced UNEs as substitutes for special access.

⁷¹ *See* CRA Decl. ¶¶ 29-31.

⁷² Sachs Decl. ¶ 13.

⁷³ *Id.* (identifying downtown areas in major cities as one example where line-of-sight is difficult to achieve). Casto claims that WiMax overcomes the line-of-sight restriction. Declaration of Parley C. Casto on Behalf of SBC Communications Inc., attached to SBC Comments, ¶ 45 ("Casto Decl."). Nextel, however, continually explores wireless alternatives to BOC special access but to date has not found an alternative technology that is commercially viable. Sachs Decl. ¶ 13.

and therefore may not provide Nextel with the reliable service its customers demand.⁷⁴ Both fixed wireless and cable alternatives, moreover, are not cost-effective in many instances due to the relatively high cost of the equipment involved and the relatively low bandwidth requirements (typically DS1) of a single cell site.⁷⁵ In addition, cable systems often do not reach the areas where many of Nextel's cell sites are located, and often cannot meet Nextel's service level requirements, including maintenance and repair intervals.⁷⁶ For these reasons, fewer than 1% of Nextel's local DS3s are provided over cable, and only approximately 2% of DS1 circuits between Nextel's cell sites and BOC serving wire centers are provided over fixed wireless.⁷⁷

As the foregoing facts demonstrate, DS-level special access services generally are not susceptible to competitive entry, and even where such entry has occurred, the entrant often cannot reach Nextel's cell sites or provide cost-effective service that meets Nextel's service level requirements. For these reasons, the BOCs are expected to remain dominant in the provision of special access, even in those metropolitan areas where competition is supposedly the most robust. To address this continuing BOC market power, the FCC must modify the current price cap and pricing flexibility rules.

⁷⁴ Sachs Decl. ¶ 13.

⁷⁵ *Id.* ¶¶ 13-14.

⁷⁶ *Id.* ¶ 14.

⁷⁷ *Id.* ¶¶ 13-14. As Mr. Sachs explains in his declaration, Nextel does not rely on cable providers for any DS1 circuits and does not rely on fixed wireless providers for any DS3 circuits. *Id.*

B. The BOCs' Claims that the Provision of Special Access Is Competitive Are Refuted by Evidence of their Price Increases and their Exorbitant Rates of Return

In its initial comments, Nextel summarized the evidence, including the BOCs' own ARMIS data, showing that the grant of pricing flexibility has not driven down BOC special access rates, and in fact has enabled the BOCs to earn ever higher rates of return, including returns above 70% for three of the BOCs in 2004.⁷⁸ A number of other commenters submitted data confirming that the BOCs' special access rates, profits, and rates of return have soared in the years since pricing flexibility was implemented.⁷⁹ The BOCs' attempts to refute this evidence are woefully lacking.

To support their claim that the provision of special access is competitive, the BOCs purport to show that the rates for special access have declined in MSAs where pricing flexibility has been granted.⁸⁰ This showing is based on a flawed approach, however. Specifically, the BOCs persist in an analysis that is based on *average* special access revenues per circuit.⁸¹ These averages reflect a number of factors and disguise the

⁷⁸ See Nextel Comments at 12-17.

⁷⁹ See, e.g., Ad Hoc Comments at 2, 5, 11, 16-19, 26-27; ATX Comments at 7-10; BT Americas Comments at 2, 4-6; CompTel/ALTS Comments at 4, 6-9.

⁸⁰ SBC Comments at 21-24; Verizon Comments at 5-7.

⁸¹ CRA Decl. ¶¶ 98-102. Of all the BOCs, BellSouth appears to be the only one that provides rate data that is service-specific. See BellSouth Comments at 14-19 & Attachment 1; CRA Decl. ¶ 103. Those data are generally consistent with the results of the methodologically sound analyses of Dr. Stith and Ms. Fischer, discussed below. During the period covered by BellSouth, none of BellSouth's special access rates (with one exception) fell, and many were increased. A natural expectation would have been that these rates would fall as a result of the competition in MSAs with pricing flexibility, but that did not happen. And, although BellSouth notes that prices have fallen in real terms (*i.e.*, after adjusting for inflation), one would have expected prices to fall even faster given the scale economies in the provision of special access, the likely higher-than-average rate of productivity increase for special access services, and the substantial gap between UNE rates and the BOC pricing flexibility rates. Indeed, as Nextel indicated in

reality that the prices for specific special access offerings have not declined, and many rates have risen. For instance, a decline in the average revenue per circuit could simply mean that customers have shifted from month-to-month special access arrangements that are relatively costly to contracts that offer volume and term discounts from the month-to-month prices for the same services. Although such a shift would result in declining average revenues per circuit, it would not support a finding that the BOCs have reduced special access prices in an area where they have obtained pricing flexibility.⁸²

A more meaningful analysis of BOC rates requires an examination of the actual rates the BOCs charge for discrete special access services, rather than just an average that masks the true change in price by reflecting differences attributable to variations in volumes purchased, duration of contracts, or aggregation of demand. Because these variations have nothing to do with whether the BOC is pricing competitively, their inclusion in the BOCs' average rate calculations obscures the more relevant changes in the specific prices the BOCs charge for specific services.⁸³ Legitimate analyses that examine non-averaged rates have been performed previously, and in each case the results have shown that special access prices are higher in Phase II Pricing Flexibility areas than they were under price caps, and are far higher than the UNE rates for comparable offerings.⁸⁴

its initial comments, all of the evidence suggests that BOC margins on special access are increasing, not decreasing, an unexpected outcome if special access competition had been growing. *See* CRA Decl. ¶ 103.

⁸² *See* CRA Decl. ¶¶ 99-102.

⁸³ *See id.* ¶¶ 89, 98-99.

⁸⁴ *See id.* ¶ 97.

For example, M. Joseph Stith calculated the *pro forma* pricing flexibility rates, the price-capped rates, and the UNE rate in effect for each BOC on July 1, 2004.⁸⁵ This analysis is much more meaningful than the analyses submitted by the BOCs, because it evaluates exactly the same service offered for each capacity evaluated – a stand-alone circuit consisting of two channel terminations, a fixed mileage transport charge, a variable mileage transport charge, and an assumed 10 miles of transport.⁸⁶ Although Dr. Stith’s review shows that there is considerable variation in prices across BOCs, in no instance is the *pro forma* pricing flexibility rate for either a DS1 or DS3 circuit less than the *pro forma* price-capped rate for a comparable circuit either under a comparable month-to-month offering or three-year Optional Pricing Plan (“OPP”).⁸⁷ Moreover, neither the price cap nor the pricing flexibility rates come close to approaching the comparable UNE rates, which represent a reasonable proxy for the prices that would be expected to prevail in a competitive market.⁸⁸ When rates are averaged across all BOCs and across numerous geographic areas, the Stith analysis showed that the BOCs’ month-to-month rates for a representative 10-mile DS1 circuit that were not subject to price caps are 19% higher than the prices for the same circuit under price caps, and are nearly three times higher than the UNE rates for DS1 loops and transport.⁸⁹ Likewise, the average month-to-month price for a representative 10-mile DS3 circuit subject to pricing

⁸⁵ Declaration of M. Joseph Stith, Attachment H to AT&T Comments, WC Docket No. 04-313, CC Docket No. 01-338 (Sept. 30, 2004) (filed Oct. 4, 2004), Attachment 1 at 4 (“Stith Decl.”); *see also* CRA Decl. ¶ 90.

⁸⁶ Stith Decl. ¶ 3. If a BOC has zoned rates, the calculation used the Zone 1 rate.

⁸⁷ CRA Decl. ¶ 91.

⁸⁸ *See id.* ¶ 92.

⁸⁹ *Id.* ¶ 93.

flexibility is 15% greater than the month-to-month price for the same DS3 circuit under price caps and more than three times the UNE rate for a comparable circuit.⁹⁰

Other analyses using the appropriate service and rate comparisons have confirmed that pricing flexibility has not led to declining special access rates. Janet Fischer, for example, compared the price cap and pricing flexibility rates for the same term commitment for a broad cross-section of services in each of the BOCs' service areas, and found that, with the exception of certain BellSouth offerings, the BOCs' June 2005 pricing flexibility rates in Phase II MSAs for DS1 channel terminations are no lower than the price-capped rate in those service areas, and usually are significantly above that rate.⁹¹ For a broad cross-section of services in Qwest service areas, for example, the pricing flexibility rates for DS1 channel termination exceed the price-capped rates by between 22% and 47%, depending on the term commitment. For DS1 channel mileage, the price flexibility rates exceed the price-capped rates by 27% to 48%, depending on the term commitment.⁹²

These data indicate that pricing flexibility has allowed the BOCs to increase special access prices above the level that price caps otherwise would have allowed and far above the comparable UNE rates.⁹³ Moreover, the data suggest that the advent of pricing flexibility is more likely to cause prices to rise rather than to fall, and it appears that very few rates have actually fallen.⁹⁴ This is hardly what one would have expected if

⁹⁰ *Id.* ¶ 93.

⁹¹ Declaration of Janet S. Fischer on Behalf of Global Crossing North America, Inc., Attached to CompTel/ALTS Comments, Table 1 ("Fischer Decl."); CRA Decl. ¶ 95.

⁹² Fischer Decl. Table 1; CRA Decl. ¶ 95.

⁹³ CRA Decl. ¶ 97.

⁹⁴ *See id.*

the supply of special access services were intensely competitive, as the BOCs claim.⁹⁵ Indeed, in a competitive market, one would expect prices to approach incremental costs, which should be close to the UNE rates developed pursuant to the FCC's TELRIC methodology.

The BOCs' supra-competitive rates for special access predictably have led to supra-competitive rates of return. In its initial comments, Nextel used BOC-reported ARMIS data to demonstrate that the BOCs' rates of return for special access grew steadily after the advent of pricing flexibility, reaching levels of over 75% for three of the BOCs in 2004.⁹⁶ These dramatic increases in the BOCs' rates of return reflect the lack of constraints on special access pricing and provide evidence that the BOCs' prices exceed what could reasonably be expected in a competitive market.

Although the BOCs have frequently relied on ARMIS data in the past,⁹⁷ they now attempt to portray such data as deeply "flawed" or "arbitrary."⁹⁸ For instance, the BOCs claim that ARMIS-based rates of return are skewed because during the five years in

⁹⁵ *Id.*

⁹⁶ Nextel Comments at 13-15; *see also* Declaration of Susan M. Gately on behalf of Ad Hoc Telecommunications Users Committee, attached to Ad Hoc Comments, at 6 (June 13, 2005) ("Gately Decl."). Verizon's ARMIS-based rate of return for special access was a healthy 32%. *Id.*

⁹⁷ *See, e.g., Review of the Commission's Rules Regarding the Pricing of Unbundled Network Elements and the Resale of Service by Incumbent Local Exchange Carriers*, Comments of United States Telecom Association, WC Docket No. 03-173, at 10 (Dec. 16, 2003); Comments of Verizon, WC Docket No. 03-173, at 40, 46, 58, 94 (Dec. 16, 2003); Comments of SBC, WC Docket No. 03-173, Exhibit A, "The Economics of UNE Pricing," prepared by Debra J. Aron and William Rogerson, at 29-30 (Dec. 16, 2003).

⁹⁸ *See* SBC Comments at 24; Verizon Comments at 19.

which the BOCs have had pricing flexibility, “the factors used to make cost allocations for ARMIS reporting purposes have been frozen.”⁹⁹

While the BOCs are correct that allocations were frozen, they are wrong to claim that as a result, any rate of return calculations using ARMIS must be flawed and therefore misleading. If that were true, then rates of return based on ARMIS data pre-dating the freeze would not be a very good predictor of rates during the freeze period. Nextel tested this prediction by performing a regression analysis based on the pre-separations freeze period of 1996-2000, and then using that regression to predict what the rate of return would have been in the post-freeze period had the pre-freeze trend in the rate of return continued. As the attached chart demonstrates, the projected rates of return for 2001-2004 rose in virtual lockstep with the actual rates of return.¹⁰⁰

Even taking the allocation factor freeze into account, therefore, the data clearly demonstrate that the BOCs’ rates of return for special access far exceed what one would expect to see in a competitive market. Moreover, even assuming, *arguendo*, that there were a problem with some of the ARMIS data, “the analysis of growth rates and scale economies should not be significantly affected by the cost allocation issues [the BOCs’] raise.”¹⁰¹ Thus, at a minimum, ARMIS data show that there is a trend of ever-increasing special access rates of return. That trend is likely a direct result of the lack of an appropriate productivity factor under price cap regulation and the application of improper pricing flexibility standards.

⁹⁹ SBC Comments at 24; *see also* BellSouth Comments at 10-11; Qwest Comments at 12-13.

¹⁰⁰ *See* Nextel Regression Analysis.

¹⁰¹ *NPRM* ¶ 29.

C. Other Arguments Advanced by the BOCs to Support their Claim that the Provision of Special Access Is Competitive Are Based on Flawed Economic Analysis and Improper Measures

As the comments filed by Nextel and other parties demonstrate, there is little competition for special access services. As a result, the BOCs have been able to charge excessive rates and realize exorbitant profits from special access services. In addition to the arguments described above, the BOCs have advanced a variety of other theories that purportedly support their claims that their special access offerings are subject to effective competition. These claims include contentions that: large customers' purchases protect smaller customers by driving prices down to competitive levels; high sunk costs deter the BOCs from charging excessive rates; and competitive carriers have captured a significant share of the special access market. As explained below, each of these arguments is riddled with flaws and should be summarily rejected.

Large Customers' Purchases. Contrary to Verizon's claim, large customers' purchases do not "drive special access prices to competitive levels even where there may not be multiple competitors from which to choose."¹⁰² Rather, in MSAs in which the BOCs have Phase II pricing flexibility, they are able to use customer-specific contract tariffs that target customers that have access to alternative service providers for some or all of their special access requirements, while discriminating against customers located in areas where there are no competitive alternatives.¹⁰³

Although the BOCs must tariff their special access contracts, they can use specific terms and conditions to limit other customers' ability to avail themselves of contract

¹⁰² See Taylor Decl. ¶ 56.

¹⁰³ CRA Decl. ¶ 80.

tariffs negotiated by large customers.¹⁰⁴ In addition, lower effective rates under contract tariffs do not drive the rates for month-to-month and OPP tariffs to competitive levels.¹⁰⁵ Instead, discounts are usually expressed as a reduction from the generally available tariffed rate. Thus, competition for large customers does not necessarily benefit other customers, as evidenced by the increase in special access rates (or their failure to fall) in MSAs where the BOCs have obtained pricing flexibility, as well as the dramatic increase in the BOCs' special access returns.¹⁰⁶

High Sunk Costs. The BOCs' economists also claim that the high sunk costs of providing special access deter the BOCs from charging supra-competitive prices for these services.¹⁰⁷ This claim is unsupported by marketplace evidence, however.

Because fixed costs constitute a high proportion of the total costs of supplying special access services, the variable profit margin per special access customer (once the fixed costs have been incurred) is relatively high. As the BOCs correctly point out, under such circumstances, the "critical loss" (*i.e.*, the number of customers a BOC must lose to make a price increase unprofitable) is relatively small. The BOCs simply assume, however, without any supporting evidence, that the actual loss that would result from any price increase would equal or exceed the critical loss needed to make a price increase

¹⁰⁴ For example, the BOCs' contract tariffs can be so narrowly tailored to the needs of the large buyers that pricing flexibility essentially allows the BOCs to craft customer-specific solutions in areas where they face competition without having to offer any meaningful reduction to other customers in the MSA that do not have access to competitive alternatives.

¹⁰⁵ See CRA Decl. ¶ 80.

¹⁰⁶ See Fischer Decl. Table 1; Stith Decl. ¶¶ 19-20; CRA Decl. ¶ 80.

¹⁰⁷ See Taylor Decl. ¶ 57; BellSouth Comments at 41 and Declaration of Harold Furchtgott-Roth and Professor Jerry Hausman, attached as Attachment 7 to BellSouth Comments, at 32-33, 37 ("Furchtgott-Roth/Hausman Decl.").

unprofitable. The BOCs ignore the fact that their high margins from special access indicate a low own-price elasticity of demand, meaning that special access customers are relatively insensitive to price changes by the BOCs.¹⁰⁸ Indeed, it is this insensitivity that allows the BOCs to charge high prices and earn high margins for special access in the first place.¹⁰⁹ The actual loss that would result from a price increase therefore may not be as large as the critical loss needed to make the price increase unprofitable. Thus, to the extent that special access is characterized by low elasticity of demand, it is likely that a BOC could profitably increase special access rates above competitive levels (if they are not already charging the profit-maximizing rates).¹¹⁰

Furthermore, the current pricing flexibility regime makes it unlikely that a price increase would cause the BOCs to lose even a relatively small number of special access customers in most markets. Such a loss would require the entry of rivals, entry that is unprofitable in many special access markets, particularly for channel termination service on routes with only limited demand for high-capacity circuits.¹¹¹ Without a credible threat of competitive entry, the potential that a price increase will cause the BOC to lose customers is small and is unlikely to constrain the BOCs' willingness or ability to raise prices above competitive levels or to maintain such supra-competitive pricing.¹¹²

CLEC Shares. As explained above, Nextel and other carriers purchase only a small percentage of special access from competitive LECs. The BOCs' "data" to the

¹⁰⁸ See CRA Decl. ¶ 83.

¹⁰⁹ See *id.* ¶¶ 83-85.

¹¹⁰ See *id.* ¶ 84.

¹¹¹ CRA Decl. ¶ 85; see also *TRRO* ¶ 72.

¹¹² CRA Decl. ¶ 85.

contrary are biased and unreliable. BellSouth's market share calculation, for example, is not reliable for at least two reasons. First, it significantly underestimates the BOCs' share of the *wholesale* special access market because it includes competitive LEC *retail* circuits in the denominator of the market share calculation.¹¹³ Second, BellSouth's data are taken from an *ad hoc* mixture of surveys, each of which likely has different (and potentially inconsistent) methodologies and time frames.¹¹⁴ Further, given this *ad hoc* blend of assumptions and studies, BellSouth should have compared these results to any others that it may have done internally and conducted sensitivity tests to demonstrate that changes in the assumptions, study mix, methodologies, or time periods would not have altered the results.¹¹⁵ Given the flaws in the methodology used by BellSouth, the Commission should attach little, if any, weight to its estimates of market shares.¹¹⁶

IV. REINSTATEMENT OF PRICE CAP REGULATION AND REFORM OF THE PRICING FLEXIBILITY TRIGGERS ARE ESSENTIAL TO CONSTRAIN THE BOCs' EXERCISE OF MARKET POWER

As the evidence described above shows, the BOCs continue to earn excessive returns and continue to possess market power in the provision of special access services, particularly in MSAs where the BOCs have obtained pricing flexibility. Indeed, the record shows that the existing pricing flexibility and price cap rates are deeply flawed and have permitted the BOCs to charge supra-competitive rates and realize exorbitant rates of

¹¹³ *Id.* ¶ 74.

¹¹⁴ *Id.* ¶ 75.

¹¹⁵ *See id.* n.74.

¹¹⁶ *Id.* ¶ 75. In addition, the Commission should not count a competitor's leased special access facilities – *i.e.*, facilities that are not provided over that competitor's own network – as part of that competitor's market share.

return.¹¹⁷ Nextel and other special access users emphasized in their initial comments that the FCC should overhaul its current price cap and pricing flexibility regime in order to constrain the BOCs' ability to exercise this market power.¹¹⁸ There are two principal components to this reform. First, in view of the overwhelming evidence that the BOCs remain dominant in the provision of special access services, the Commission should reinstate an effective system of price cap regulation that ensures that special access prices are set at just and reasonable levels. In particular, as discussed in Nextel's comments, the revised scheme must include a new X-factor that requires the BOCs to share their productivity gains with their customers.¹¹⁹ In addition, no later than 2006, the Commission should require the BOCs either to base their tariffed special access rates on forward-looking cost studies, or, alternatively, to retarget their special access earnings to a level that would not exceed a rate of return specified by the FCC (*e.g.*, the 11.25% rate of return previously prescribed by the Commission).¹²⁰ Second, the Commission should

¹¹⁷ See, *e.g.*, Ad Hoc Comments at 16-21; ATX Comments at 5-10; Ionary Comments at 1-3; PAETEC Comments at 4-5.

¹¹⁸ Nextel Comments at 17-28; *see also* API Comments at 9-12; Ad Hoc Comments at 35-37; ATX Comments at 7; Broadwing Comments at 2-4; CompTel/ALTS Comments at 2-3; PAETEC Comments at 4-6; Time Warner Comments at 15-16; T-Mobile Comments at 7; XO Comments at 4-9.

¹¹⁹ As explained in detail above, the BOCs' claims that their rates have been declining and that, therefore, there is no need for an X-factor are belied by the facts.

¹²⁰ See Nextel Comments at 3-4, 26-27; *see also* Ad Hoc Comments at 4, 37-43; API Comments at 10; AT&T Comments at 6; ATX Comments at 2, 17-22; PAETEC Comments at 11; T-Mobile Comments at 20-21; WilTel Comments at 16-18; XO Comments at 12. Contrary to the BOCs' claims, reinitializing price caps would neither "punish" the BOCs nor reduce their incentives to offer special access service efficiently. See Verizon Comments at 39-41; SBC Comments at 38-39. The BOCs are not entitled to earn excessive rates of return from special access year after year – indeed, the Commission's statutory obligation is to ensure that does not occur and to take corrective action where, as here, existing rates are shown to be unreasonable. Further, the reinstatement of an effective price cap regulatory scheme would create the same

replace the current pricing flexibility triggers with competitive criteria that better reflect the likelihood of actual or emerging (and sustainable) competition in the appropriate geographic markets. One obvious framework that meets the need for more refined criteria is the one the Commission adopted in its recent *TRRO* to determine where competitive carriers would be impaired without access to UNEs. The FCC's UNE impairment standards focus on the appropriate geographic markets, distinguish between loops and transport, and differentiate between circuits of varying capacities. These more refined standards, therefore, are well-suited to the task of determining whether the BOCs are subject to competition in particular markets.

Moreover, as Nextel and others emphasized in their comments, the Commission should not wait until the conclusion of this proceeding before it acts to reduce special access rates to more reasonable levels. Rather, it should immediately adopt interim measures to begin undoing the harms caused by the BOCs' excessive special access prices.¹²¹ These interim measures include, at a minimum, (1) imposing a 5.3% X-factor, as outlined in Nextel's initial comments, to begin driving the BOCs' price cap special access rates to more reasonable levels;¹²² and (2) replacing the current pricing flexibility

incentives to reduce costs and improve efficiency that the FCC's previous rules created. Moreover, reinitialization of price caps would not violate section 205(a) of the Act, as Verizon suggests. Verizon Comments at 40. Because the overwhelming record evidence shows that the BOCs' current rates for special access are unreasonable, "the Commission is authorized and empowered to determine and prescribe what will be the just and reasonable charge." 47 U.S.C. § 205(a).

¹²¹ See, e.g., Nextel Comments at 24-27; Ad Hoc Comments at 52-54; API Comments at 10; Gately Decl. ¶¶ 5-6 (BOC special access rates during the two-year period from 2003 – 2004 generated approximately \$11 billion in excessive special access revenues).

¹²² Nextel Comments at 25 (explaining that the D.C. Circuit has upheld 5.3% as a reasonable X-factor, based on past BOC performance) (citing *Bell Atlantic Tel. Cos. v. FCC*, 79 F.3d 1195, 1201 & 1208 (D.C. Cir. 1996); see also ATX Comments at 13, 17

triggers with the UNE impairment triggers, at least until the FCC is able to promulgate permanent revisions to its pricing flexibility triggers. These interim measures will provide special access customers at least partial relief while the Commission fashions a more permanent reform plan.

Contrary to the BOCs' claims, the special access reforms proposed by Nextel would not necessarily entail high administrative costs, and would bring substantial benefits to consumers. As an initial matter, the BOCs simply ignore the substantial benefits – including lower prices, and greater investment, innovation, and competition – that improved price regulation of special access would confer on consumers.¹²³ The BOCs compound this error by vastly overstating the costs of the proposed regulatory changes. For example, the BOCs cite a litany of evils that would result if rate-of-return regulation were imposed on special access services.¹²⁴ Nextel is not aware of any party, however, that has proposed that rate-of-return regulation apply to special access. Instead, Nextel and other parties have urged the FCC to re-impose price-cap regulation on special access services that currently are provided pursuant to unjustified grants of pricing flexibility. This remedy would provide the BOCs with appropriate incentives to reduce costs, innovate, and modernize their networks, and permit the BOCs to respond to lower

(FCC should immediately adopt interim relief including X-factor of 5.3%); CompTel/ALTS Comments at 35 (supporting interim X-factor of 5.3%).

¹²³ See CRA Decl. ¶¶ 113-115; see also *id.* ¶ 119 (pointing out that the lack of special access competition results in higher input prices to downstream firms; diminishes innovation at the downstream level because of high input costs; allows the monopolist to act inefficiently since investors cannot benchmark the monopolist's performance; and, via the control of bottleneck facilities, allows the monopolist to prevent any downstream competition with the BOC).

¹²⁴ Furchtgott-Roth/Hausman Decl. at 22; Kalt Decl. ¶ 17.

prices that might be offered by a rival in those areas where some competition does exist.¹²⁵

The BOCs also claim that without comprehensive econometric demand studies, accurate cost measures, and a low-cost means of monitoring competitive developments, the FCC should not only forego any new regulations but should abandon all existing special access regulations.¹²⁶ As one BOC economist stated, the “relevant information from the marketplace – products, customers, technology, and costs – is infinitely detailed and variegated,” and unless regulation is “done perfectly,” it will lead to distortions.¹²⁷

These claims are exaggerated at best. In antitrust analysis generally, and in the competitive analysis of communications markets in particular, such comprehensive demand studies are rarely available, and “perfection” is never achieved.¹²⁸ Yet federal and state regulators, policymakers, and courts do not abdicate their responsibilities by throwing up their hands and refraining from all regulation. Instead, they take advantage of numerous other ways of establishing patterns of service and geographic substitution and the extent of competition, including an examination of the functionality and costs of providing alternative services and the way in which customers actually purchase those services.¹²⁹

In this case, the FCC need not expend significant administrative costs to gather relevant data or devise appropriate interim remedies. In the *Triennial Review Remand*

¹²⁵ CRA Decl. ¶ 121.

¹²⁶ Furchtgott-Roth/Hausman Decl. at 30.

¹²⁷ Kalt Decl. ¶ 17; *see also* BellSouth Comments at 39, 42 (regulators must determine “precisely the correct price” for price regulation to work).

¹²⁸ *See* CRA Decl. ¶¶ 127-128.

¹²⁹ *Id.* ¶ 128.

Order, the FCC already has used a wealth of data to estimate the costs of very close functional substitutes for special access services: namely, UNE high-capacity loops and transport.¹³⁰ These estimates (and their periodic revisions) can be used by the FCC to devise meaningful pricing flexibility criteria, at least on an interim basis. Those services that do not meet the revised pricing flexibility criteria should be subject to price caps. As described above, price cap rates, in turn, should be subject to a new X-factor that approximates the BOCs' substantial productivity gains.

¹³⁰ *Id.* ¶ 129.

V. CONCLUSION

For the reasons discussed above, the Commission should reform its existing rules governing the BOCs' provision of special access in accordance with the proposals set forth above and in Nextel's initial comments.

Respectfully submitted,

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July 29, 2005

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ATTACHMENT 1

**DECLARATION OF BRIDGER M. MITCHELL
AND JOHN R. WOODBURY**

REDACTED – FOR PUBLIC INSPECTION

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

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

Declaration of
Bridger M. Mitchell and John R. Woodbury

July 29, 2005

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I. QUALIFICATIONS AND SUMMARY

1. My name is Bridger M. Mitchell and I am a Vice President at CRA International. I am an expert in competition and pricing in the telecommunications industry and have provided expert testimony, litigation support, and economic consulting services to numerous business and government clients. My research on major regulatory issues encompasses the theory and practice of telecommunications pricing, competition, and equal access in local telephone markets, interconnection in telecommunications networks, international telephone rates, and broadcasting and cable television. I have developed pioneering models of the cost structure of a cable television firm and the incremental costs of local telephone networks. I previously taught economics at Stanford University and UCLA and was a senior economist at The RAND Corporation. I have a Ph.D. in Economics from the Massachusetts Institute of Technology.

2. My name is John R. Woodbury and I am a Vice President at CRA International. I am an expert in the economics of antitrust and regulation and I have provided expert testimony, litigation support, and economic consulting services to a large number of business clients, including many in the telecommunications industry. In addition to having been a Brookings Economics Policy Fellow, I have held the following senior positions: Associate Director, Bureau of Economics, Federal Trade Commission; Economics Division Chief, Common Carrier Bureau, Federal Communications Commission; and Research Vice President, National Cable and Telecommunications Association. I currently serve on the editorial board of the *Antitrust Source*. I have a Ph.D. in Economics from Washington University (St. Louis).

3. We have been asked by Nextel to review the comments in this proceeding for the purpose of evaluating the effects of the Commission's triggers for granting the BOCs flexibility in the pricing of special access services. In particular, "the Commission determined that irreversible, sunk investment by competitive carriers in the special access market, as evidenced by the satisfaction of certain

collocation and competitive transport facilities deployment triggers, demonstrates sufficient competitive market entry in specific geographic markets to constrain monopoly behavior, including exclusionary conduct, by price cap LECs.”¹ We also review comments on imposing price regulation in special access markets in which BOC pricing is not effectively constrained.

4. Against the background of the record in this proceeding, we have reviewed the filed comments to assess the extent to which they answer the question of “whether actual marketplace developments support the predictive judgments that underlie the special access pricing flexibility rules.”² Based upon the evidence in the record and the filed comments in this proceeding, we conclude that, in fact, in those Metropolitan Statistical Areas (MSAs) in which the Bell Operating Companies (BOCs) have received pricing flexibility, competition has not emerged or had the salutary effects anticipated by the Commission.³
5. The special access services of principal concern here are channel termination (CT) and channel mileage (CM). CT provides the link between the end customer location and the BOC central office. As we discuss below, CTs have the same basic economic characteristics as a local loop, requiring high fixed and sunk costs to serve an individual customer location. CM provides interoffice transport between two BOC central offices.⁴ For Nextel and other CMRS customers, CTs

¹ Federal Communications Commission, Order and Notice of Proposed Rulemaking, *In the Matters of Special Access Rates for Price Cap Local Exchange Carriers and AT&T Corp. Petition for Rulemaking to Reform Regulation of Incumbent Local Exchange Carrier Rates for Interstate Special Access Services*, WC Docket No. 05-25; RM-10593, (Adopted: January 19, 2005) (Hereafter, “*NPRM in Special Access Proceeding*”), ¶ 69 (Footnote omitted).

² *NPRM in Special Access Proceeding*, ¶ 5 (Footnote omitted).

³ MSAs consist of a population nucleus and surrounding communities that are integrated into that nucleus. MSAs can be quite large in size. For example, the New York MSA spans nearly 7,000 square miles while the Los Angeles MSA spans nearly 5,000 square miles. See Federal Register, Vol. 65, No. 249, December 27, 2004, p. 82228.

⁴ We use CT to refer to the circuit connecting the cell site to the serving wire center, and CM to refer to the circuit connecting the wire center to either another central office or to a point of interconnection. In a BOC tariff, the recurring monthly charge for a CM circuit is comprised of two USOC rate elements: a fixed charge, and a per-mile charge for transport times the mileage between the wire center and the other central office or point of interconnection.

and CMs are required to connect individual cell sites located throughout a MSA to the wireless customer's mobile switching center.

6. In the discussion that follows, we review the analytic steps required to evaluate whether or not the competitive conditions in Phase II pricing-flexibility MSAs have emerged and have successfully constrained the BOCs' rates for these special access services. The first step is to define the relevant markets, both product and geographic. Among other issues, we explain why the arguments that the economists retained by the BOCs have espoused in favor of a broad product market and a broad geographic market are flawed. Instead, for purposes of developing criteria that indicate whether or not competition is supportable, we conclude that the product market should distinguish between the different CTs and CMs (and their capacities), and that the geographic market should be much narrower than the MSA.
7. Having defined the relevant markets, we then briefly consider the barriers to emerging competition in these markets and conclude that such barriers can be substantial, particularly on routes with limited demands for high-capacity circuits. We explain why BOC claims to the contrary are misplaced.
8. The existence of substantial entry barriers leads to the inference that on many routes, the degree of competition in special access is likely to be quite limited. Nextel's own experience in the purchase of special access services (as well as the experience of other parties) provides evidence of the lack of competition. Against the background of this and other record evidence, the BOCs' claim that special access competition is vibrant is wrong.
9. The combination of substantial entry barriers and the general lack of special access competition leads to the prediction that the BOCs can maintain or increase prices of special access to supracompetitive levels in the absence of any regulatory constraint. The evidence that has been provided to the Commission clearly supports such an inference. In those MSAs where the BOCs have been granted pricing flexibility, special access rates have not fallen; in many cases,

they have increased. Moreover, the gap between the price-capped rates and the unconstrained BOC rates under pricing flexibility has typically increased over time, and the price-flexibility rates have remained substantially above the incremental costs of at least one set of comparable offerings: high-capacity unbundled network element (UNE) loops and transport. The BOCs' claims to the contrary—that competition has spurred reductions in special access rates—rely largely on statistically suspect average revenues per circuit. There is no basis for these claims because the BOCs' evidence fails to control for specific services and terms to ensure that any purported rate changes or comparisons are not the result of something other than the actual rates paid. Direct comparisons of rates—comparisons that control for specific services and terms—are the appropriate basis for drawing inferences about the extent to which the current pricing flexibility triggers have resulted in competitive special access prices.

10. Thus, the evidence indicates that purchasers of special access services, like Nextel and other CMRS carriers, have been paying prices significantly higher than the levels an effectively competitive marketplace likely would have produced and higher than would have been the case had the FCC's prior price-cap regime remained in force in those MSAs where the BOCs have pricing flexibility. In short, the pricing flexibility triggers did not result in lower special access rates for purchasers.
11. To enable Nextel and others to acquire special access services at more competitive rates, we conclude that the Commission should adopt pricing flexibility rules that reflect product markets distinguished by type of special access service and capacity; geographic markets that are route-specific; and criteria that reflect the extent of sunk costs and the attainment of scale economies required for competitive entry. In addition, the FCC must have reliable standards for determining where competition is sufficient to replace regulation.
12. The Commission's impairment standards that determine where an ILEC must provide a competitive carrier access to UNEs are one example of a regulatory

regime that satisfies all of these requirements, and, consequently, the adoption of this or a similar regime as the competitive test for special access pricing flexibility by the BOCs would advance the interests of consumers. Where competition is not supportable, the Commission should reinstate price cap regulation for special access services.

13. While the BOCs claim that any return to regulation is so costly as to rule it out as a policy option, this assertion greatly overstates the costs associated with the kind of regulation proposed. And, of course, the BOCs see no benefits to regulation, since in their view, the special access markets are competitive. We explain why we believe this view is incorrect.
14. The next section addresses questions of market definition and the subsequent sections examine the extent of entry barriers to new competition, the extent to which competition in the provision of special access services has in fact emerged, the pricing effects of the Commission's pricing flexibility rules, and finally a proposed remedy for the harm experienced by special access customers.

II. MARKET DEFINITION ISSUES

15. The FCC established appropriate market definitions in the *TRRO*,⁵ and there is no reason why those same definitions would not apply to special access services. This section summarizes the special access product and geographic markets that are relevant to CMRS carriers and other purchasers of special access. It also counters claims by the BOCs (or their experts) that the relevant geographic and product markets for special access services should be defined even more broadly than the definitions used under the current pricing flexibility regime.

⁵ Federal Communications Commission, Order on Remand, *In the Matters of Unbundled Access to Network Elements and Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers*, WC Docket No. 04-313; CC Docket No. 01-338, (Adopted: December 15, 2004) (Hereafter, "*Triennial Review Remand Order*" or "*TRRO*"), ¶¶ 78-80.

A. Product Market

1. Channel Termination and Channel Mileage Services Are Distinct Product Markets

16. The definition of a market requires a demand-side analysis, querying whether a hypothetical monopolist of special access services can profitably raise price, holding other things equal, including the number and extent of service supplied by all firms in a market.⁶
17. A channel termination (CT) is required to provide a circuit from a customer's premises (e.g., a Nextel cell site) to the serving wire center. Channel mileage (CM) service is required to extend that circuit from that serving wire center to a more distant wire center or central office, from which it can then be connected to a customer's point of interconnection (e.g., Nextel's mobile switching center). For the customer, CTs (or loops) and CMs (or transport) are not substitutes. A small increase in the price of CMs by a hypothetical monopolist will not lead customers to increase their purchases of CTs so as to render that price increase unprofitable. Similarly, a small increase in the price of CTs will not lead customers to increase their purchases of CMs. This is so because CTs connecting cell sites to serving wire centers cannot substitute for CMs connecting BOC central offices, and *vice versa*. CT and CM services are therefore distinct product markets. Indeed, CT and CM services are more likely complements than substitutes.

⁶ U.S. Department of Justice and Federal Trade Commission, *1992 Horizontal Merger Guidelines* (as revised in 1997), Section 1.0. (Hereafter, "*1992 Horizontal Merger Guideline (as revised in 1997)*"). Note that the implementation of this test assumes that special access prices are not already set at a monopoly profit-maximizing level. If prices were at the monopoly level, then any further price increase would be unprofitable, and so performing the test would then tell little about market definition, only that prices higher than those that maximize profits are less profitable.

2. *Channel Termination Services and Channel Mileage Services Should Be Treated as if DS1 and DS3 Circuits Are in Distinct Product Markets*
18. Special access circuits are also distinguishable by differences in capacity (e.g., DS1 vs. DS3).⁷ The competitive availability of DS1 service and DS3 service will likely differ markedly by geographic area. Distinguishing between DS1 service and DS3 service is critical to evaluating the extent to which competition may or could exist in different geographic areas, and thus these distinctions are critical in adopting revised pricing flexibility triggers that will proxy the availability of likely competition in CTs and CMs.
19. With respect to CTs, competitive supply of stand-alone DS1 CTs is uneconomic.⁸ Instead, when competitive carriers provide DS1 CTs, they do so by channelizing their own DS3 facilities (or by leasing DS1 channelized services from a DS3 provider). When another customer in the same building is already served by competitive fiber, the incremental costs of channelizing a DS3 facility to provide DS1 CTs are minimal.⁹ By contrast, deployment of a fiber lateral to a building in order to serve fewer than seven DS1s would be likely to be uneconomic.¹⁰
20. As a result, the availability of competitive DS1 CTs throughout a particular geographic area will be highly correlated with the availability of competitive DS3 CTs and the level of demand for those services by carriers like Nextel. The availability of competitive DS3 CTs in individual buildings will depend on the demand for DS3 and higher-capacity services in the area served by the relevant serving wire center. A large number of business lines in a wire center service area

⁷ The capacity of one DS3 is equivalent to 28 DS1s. *TRRO*, ¶ 170. Because of this functional equivalence, the application of the hypothetical monopoly test to either CTs or CMs could lead one to a conclusion that for any particular geographic market, DS1 prices would ultimately constrain the prices of DS3s and vice-versa. *1992 Horizontal Merger Guidelines (as revised in 1997)*, Section 1.0. Thus, one could conclude that there is a “high-capacity” CT market comprising both DS1s and DS3 services and similarly a “high capacity” CM market. Yet, for the reasons explained in the text, this does not mean that the Commission should focus only on the availability of “high capacity” special access services.

⁸ *TRRO*, ¶¶ 166, 170-171.

⁹ *TRRO*, ¶¶ 154, 170.

¹⁰ *TRRO*, ¶ 181, Footnote 490.

increases revenue opportunities for DS3 service within the individual buildings located in that area. And collocation of fiber facilities of several competitive carriers in the wire center makes more likely the availability of competitive DS3 services to individual buildings in the area.

21. In areas outside the central business district, the demand for special access services at many locations is likely to be for DS1, but not DS3, levels of capacity. For example, the FCC's record shows that "the majority of small and medium-sized business customers occupy single tenant commercial buildings and that the building of laterals for DS1 services requires many customers at a single location to justify their costs."¹¹ In these areas, there will likely be relatively few business lines and only limited fiber collocation by competitive carriers. Consequently, there is a low likelihood of competitive DS3 facilities at a large proportion of the customer locations. An increase in price by a hypothetical monopolist of DS1 CTs is therefore unlikely to be defeated because it is unlikely that competitive DS3s will be available at those locations. Instead, the BOC is likely to be the dominant provider in markets with limited demand for high-capacity circuits because it can provide stand-alone DS1 CTs over its legacy copper facilities. Other things equal, the more business lines served by a wire center and the greater the number of collocated CLECs, the more likely it is that competitive DS3 capacity will be available to particular business locations that have a demand for only DS1 loops.
22. Now consider a price increase by a hypothetical monopolist of DS3 CTs. Such an increase could be rendered unprofitable if providers of channelized DS1 services were already serving the building served by the DS3 providers and if those providers of DS1 services reconfigured the electronics on their DS3 facilities to provide DS3 services. But, as a practical matter, this means focusing on the availability of DS3 facilities only. It is the availability of sufficient demand to warrant the construction of DS3 facilities in the first place that offers the

¹¹ *TRRO*, ¶ 170, Footnote 469.

possibility of the postulated constraint on DS3 service prices. Many markets outside the central business district may not provide the revenue opportunities to justify sinking the costs of a DS3 facility by a CLEC or other provider, resulting in the ILEC being the dominant provider of DS3 loops over its existing facilities.

23. The same kinds of capacity distinctions should be made with respect to CM markets. On many routes outside the central business district, demands for transport more likely require DS1 rather than DS3 service. But in (for example) less densely populated areas, the transport lengths are likely to be longer than in more densely populated areas, increasing the costs of deploying a DS1 circuit. In these areas, the likelihood that there will be competitive alternatives to the BOCs' transport facilities may be remote. Even if a DS3 could be channelized to offer DS1 transport (so that DS1s and DS3s might be substitutes from a demand/functional equivalence perspective), there will not likely be any DS3 transport providers in these areas, including wholesalers, to constrain a hypothetical monopolist of DS1 transport services. In markets characterized by limited demands for high-capacity transport, competitive DS1 transport may not be profitable and the ILEC is likely to be the dominant provider of DS1 services.
24. On routes with greater demands for high-capacity transport, both DS3 transport services and DS1 transport channelized on a DS3 may be available. In these markets, an increase in the price of DS3 service by a hypothetical DS3 monopolist could result in providers of channelized DS1s using their DS3 capacity to compete with the hypothetical DS3 monopolist; analogously, an increase in the price of DS1 service by a hypothetical DS1 service monopolist could lead DS3 providers to channelize their capacity to provide DS1 service. However, in both cases, it is the availability of sufficient demand to support sinking the costs into DS3 transport capacity that allows such competition. Thus, focusing on the likelihood of actual or emerging DS3 transport competition is appropriate in such markets. In markets with insufficient demand to support DS3 competition, the ILEC will be the sole or dominant provider of DS3 service.

25. These observations echo the conclusions of the FCC in the *TRRO* with respect to high-capacity loops and transport, conclusions that are equally relevant for CTs and CMs, respectively. With regard to CTs, the practical question is whether other competitive carriers have already deployed, or will likely deploy, DS3 facilities throughout the wire center serving area, thereby making (channelized) DS1-level supply of those deployed facilities potentially viable.¹² As the FCC also noted,¹³ where demand for high-capacity loops exists only at the DS1 level of service, there is insufficient traffic for competitive suppliers to enter with DS3 facilities and supply DS1 loops, and the analogous conclusion can be reached for channelized DS1 CTs.¹⁴
26. The Commission reached similar conclusions with respect to interoffice transport that should pertain to CMs as well. For example, in its *Triennial Review Order*, the Commission concluded that “a carrier requiring only DS1-capacity transport between two points typically does not have a large enough presence along a route (generally loop traffic at a central office) to justify incurring the fixed and sunk costs of self-providing just that DS1 circuit.”¹⁵ While the Commission was referring to competitive carriers, the position of carriers like Nextel with respect to self-provisioning is similar to that of a competitive carrier.¹⁶
27. The analysis here highlights the flaws in Dr. Taylor’s assertion that “the products should be broadly defined across specific special access services” because “if a

¹² *TRRO*, ¶ 171.

¹³ *TRRO*, ¶ 171.

¹⁴ A key reason why stand-alone DS1s are not profitable is because at the level of traffic that they carry, the CLEC will invariably have higher unit costs than the BOC. The BOC already has numerous DS1 loops that are provided over copper or hybrid copper-to-fiber facilities. And where the BOC does provide DS1 loops over fiber, it can aggregate that DS1 traffic with other traffic to support deployment of a DS3 facility to the wire center. Similarly, in the *TRRO*, the Commission described its transport impairment test as one that “examines the feasibility of duplicating dedicated transport facilities connecting incumbent LEC wire centers.” *TRRO*, ¶ 91.

¹⁵ *TRRO*, ¶ 126.

¹⁶ To be sure, the prospects for CM competition may be better than for CT competition. In contrast to the generally limited volume of traffic over a CT circuit, the volume of traffic that is aggregated and transported between two wire centers (or central offices) generally requires the capacity of one or more DS3s.

hypothetical monopolist of DS3 services were to attempt to increase the DS3 price above the competitive level, suppliers of DS1 services would reconfigure their electronics and use their fiber networks to provide DS3 services and drive DS3 profits back to a normal level.”¹⁷ As noted above, this may well be true in markets with considerable demand for high-capacity services where, if DS3 prices increase, it is profitable for alternative providers of solely DS1 services to deploy their underlying DS3 capacity to provide DS3 services. Thus, in evaluating the extent of competition in the provision of DS3 service, one only need assess existing DS3 capacity. In markets where the demand for capacity is limited and the competitive deployment of DS3 facilities is unlikely, there will be no competitive DS1 constraint on DS3 prices. In such markets, the BOC may be the only, or dominant, provider of DS3 services.

28. Furthermore, Dr. Taylor’s market definition analysis addressed only one market—that for DS3s—and did not evaluate whether DS1 service was a relevant market. Where the demand for high-capacity services is limited, the rates for DS1 capacity loops and transport will not be constrained by competitive DS3s because competitive DS3 capacity is not likely to be deployed. In these markets, the BOC is likely to be the dominant provider of DS1 and DS3 services. Thus, as a practical matter, in determining appropriate criteria for supportable competition for CTs and CMs, the Commission should distinguish between the viability of competition for DS1 service and for DS3 service.

3. *Cable and Fixed Wireless Are Not Effective Substitutes for Special Access*

29. BOC claims that cable modem circuits and fixed wireless services are good substitutes for DS1 and DS3 circuits are incorrect.¹⁸ As Nextel describes in its

¹⁷ Declaration of William E. Taylor on Behalf of Verizon, *In the Matters of Special Access Rates for Price Cap Local Exchange Carriers and AT&T Corp. Petition for Rulemaking to Reform Regulation of Incumbent Local Exchange Carrier Rates for Interstate Special Access Services*, WC Docket No. 05-25; RM No. 10593, (Hereafter, “*Taylor Declaration in Special Access Proceeding*”), ¶ 50.

¹⁸ See, for example, Declaration of Parley C. Casto on Behalf of SBC Communications Inc., *In the Matters of Special Access Rates for Price Cap Local Exchange Carriers and AT&T Corp. Petition for Rulemaking to Reform Regulation of Incumbent Local Exchange Carrier Rates for Interstate Access Services*, WC Docket No. 05-25; RM-10593, (Hereafter, “*Casto Declaration in Special Access Proceeding*”), ¶ 45.

Reply Comments, Nextel's use of both fixed wireless and cable services is limited in the first instance by their small footprint—only rarely are such services available near Nextel's cell site locations. In addition, both fixed wireless and cable have significant performance disadvantages that would reduce the quality of service provided to cellular customers. For example, the performance of fixed wireless services is dramatically degraded by adverse weather conditions, especially snow and rain.¹⁹

30. Cable operators do not offer a “carrier grade” cable modem service, i.e., one that meets the performance and reliability standards for telephony carriers. Any performance-related problems with cable-delivered loop or transport services take a considerable time to resolve, thus reducing the quality of service—sometimes quite dramatically—for CMRS carriers in particular.²⁰
31. In brief, neither fixed wireless nor cable modem service can render unprofitable a price increase by a hypothetical special access monopolist.

4. *Unbundled Network Elements Are Not Effective Substitutes for CMRS Demands for Special Access*

32. The BOCs assert that unbundled network elements (UNEs) provide good economic substitutes for DS1 and DS3 circuits and that the availability of UNEs constrains special access pricing. For example, Drs. Furchtgott-Roth and Hausman claim that “efforts to raise special access service rates are also constrained in most markets by the availability of price-regulated unbundled network elements for high-capacity loops and dedicated transport.”²¹ Similarly,

Statement of Professor Joseph P. Kalt on Behalf of SBC Communications Inc., *In the Matters of Special Access Rates for Price-cap Local Exchange Carriers and AT&T Corp. Petition for Rulemaking to Reform Regulation of Incumbent Local Exchange Carrier Rates for Interstate Access Services*, WC Docket No. 05-25; RM-10593, (Hereafter, “*Kalt Declaration in Special Access Proceeding*”), ¶ 41.

¹⁹ Declaration of Steve Sachs (appended to Nextel's Reply Comments in this proceeding), ¶ 13 (Hereafter, “*Sachs Declaration*”).

²⁰ *Sachs Declaration*, ¶ 14.

²¹ Declaration of Harold Furchtgott-Roth and Professor Jerry Hausman, *In the Matters of Special Access Rates for Price Cap Local Exchange Carriers and AT&T Petition for Rulemaking to Reform Regulation of*

Dr. Kalt claims that “the availability of unbundled network elements allows eligible providers to maintain the same functionality as special access services at TELRIC-based rates if special access rates are higher.”²²

33. Dr. Kalt’s assertion includes the key words “eligible providers.” It is our understanding that the BOCs have consistently maintained that they are under no obligation to provide Nextel (or any CMRS or interexchange carrier) with UNEs. Moreover, it is our understanding that UNEs are available to other carriers as substitutes for only a minority of their special access circuits and in many instances, competitive LECs are prevented from using UNEs as substitutes, even where the FCC has made a finding of impairment, because of limitations on new or special construction, provisioning difficulties, and other restrictions.²³ In any event, as discussed below, UNEs have *not* disciplined special access rates, as evidenced by the substantial difference between special access rates and UNE rates.

B. Geographic Market

1. The Wire Center Is a Useful Approximation of the Relevant Geographic Market

34. In revisiting the standards for requiring access by competitive carriers to unbundled network elements, the Commission posed the demand-side question with respect to the geographic scope of the market and (referring back to earlier decisions) concluded that customers’ demand was route-specific.²⁴ For example, a customer seeking transport between points A and B would not find transport between A and C a good substitute. Similarly, the FCC found that “a loop serves a specific location and cannot economically be transferred to serve another

Incumbent Local Exchange Carrier Rates for Special Access Services, WC Docket No. 05-25; RM 10593, (Hereafter, “*Furchtgott-Roth/Hausman Declaration in Special Access Proceeding*”), p. 33.

²² *Kalt Declaration in Special Access Proceeding*, ¶ 43.

²³ See Nextel Reply Comments in this proceeding, n.70.

²⁴ *TRRO*, ¶¶ 79-80.

customer location.”²⁵ Thus, the FCC appropriately determined that competition at the level of the wire center would be a reasonable proxy for competition for customers seeking services originating, terminating or going through that geographic point.

35. Just as the FCC adopted a wire-center specific approach for determining impairment with respect to access to unbundled network elements, the Commission could use that same analysis to conclude that such a geographic market definition is appropriate for special access as well. Indeed, in the *TRRO*, the Commission soundly rejected the notion that regions at least as large as MSAs are the appropriate geographic market -- finding that “an MSA-wide approach ... would require ... lumping together areas in which the prospects for competitive entry are widely disparate.”²⁶
36. The experience of CMRS carriers in purchasing special access services illustrates the limitations of using the MSA as the relevant market. CMRS carriers don’t just offer service in the central business district—they offer service with a national footprint that includes areas within a MSA with only limited demands for high-capacity circuits. As Nextel has described in its Comments,²⁷ Nextel requires special access services for circuits that connect its cell sites to mobile switching centers and those cell sites are spread widely throughout an MSA.
37. Nonetheless, some economists retained by the BOCs suggest that the relevant market is at least as extensive as an MSA, but their arguments seem both ill-formed and incomplete. For example, Dr. Kalt claims that individual geographic areas within the MSA are contestable—because noncompetitive pricing by the incumbent would make the ILEC an entry target, and such entry is viable and able

²⁵ *TRRO*, ¶ 152.

²⁶ *TRRO*, ¶ 155.

²⁷ Comments of Nextel Communications, Inc., *In the Matters of Special Access Rates for Price Cap Local Exchange Carriers and AT&T Corp. Petition for Rulemaking to Reform Regulation of Incumbent Local Exchange Carrier Rates for Interstate Special Access Services*, WC Docket No. 05-25; RM-10593, (Hereafter, “*Nextel Comments in Special Access Proceeding*”), p. 5.

to discipline the incumbent's pricing.²⁸ In effect, Dr. Kalt is arguing that, for the purposes of competitive analysis, the geographic market spans at least an entire MSA. But contestability in the face of significant sunk costs is an oxymoron—for markets to be contestable, competitors must be able to enter rapidly and exit without requiring the entrant to absorb unrecoverable costs if it decides to abandon that market.²⁹ As noted in greater detail below, the sunk-cost requirements of entry into special access are substantial. In these markets, there is no possibility of “hit-and-run” entry.

38. Drs. Furchtgott-Roth and Hausman claim that “in those markets where these unbundled network elements are not available because of the presence of competitors, those competitors constrain the ability of the ILEC to raise prices.”³⁰ Yet, “those markets” are much smaller than an MSA and rivals who can compete with the BOCs in areas like the central business district of the MSA may be unable to do so in other locations within the same MSA.
39. Dr. Kalt asserts that wholesale customers could buy special access services in the low price area of the MSA, resell it in other areas, and thereby defeat any attempt to raise prices.³¹ This claim is not well founded. CT service is not fungible. Customers with demands in several different geographic areas of the MSA are not able to purchase service in one area so as to satisfy their demands in another: customer demands tend to be for a particular route between two points.
40. Dr. Taylor argues that because Verizon has chosen to price on a regional basis to satisfy the pricing preferences of (presumably, large multi-MSA) customers, the market is broader than even a MSA.³² Therefore, Dr. Taylor suggests state-wide

²⁸ *Kalt Declaration in Special Access Proceeding*, ¶ 40.

²⁹ William Baumol, John Panzar, and Robert Willig, *Contestable Markets and the Theory of Industry Structure*, Harcourt Brace Jovanovich, 1982, p. 292.

³⁰ *Furchtgott-Roth/Hausman Declaration in Special Access Proceeding*, p. 33.

³¹ *Kalt Declaration in Special Access Proceeding*, ¶ 43.

³² *Taylor Declaration in Special Access Proceeding*, ¶¶ 51-52. See also *Casto Declaration in Special Access Proceeding*, ¶ 10; and Declaration of Quintin Lew, *In the Matters of Special Access Rates for Price Cap Local Exchange Carriers and AT&T Corp. Petition for Rulemaking to Reform Regulation of*

and region-wide prices will be driven by the competition in those MSAs in which the BOCs have received pricing flexibility.³³ As we discuss in greater detail below, however, the Commission's pricing flexibility triggers have in fact been set at such a low threshold that many, if not most, MSAs in which the BOCs have complete pricing flexibility do not appear competitive. Thus, far from being forced down to competitive levels, these state-wide and region-wide prices have not fallen or increased as a result of the BOCs' use of their special access pricing flexibility.

41. Nonetheless, even if every BOC currently practices regional pricing, there is no reason why a BOC could not choose an alternative pricing policy to charge different rates in different geographic areas where it has pricing flexibility (including more extensive use of contract tariffs to discriminate between more and less competitive areas). As compared to developing a new product or even a new advertising campaign, pricing policies are among those business strategies that are most easily changed. But even if the BOCs found it profitable to charge a single rate across more than one MSA, that does not make those MSAs a relevant geographic market.
42. To illustrate this point, suppose that the BOC's prices are not uniform across the MSA in which the BOC has pricing flexibility. Suppose also that in area 1, which accounts for half of the MSA, the provision of special access is competitive (because of the presence of CLECs), while in area 2 of the MSA, the BOC has a monopoly. Then the profit-maximizing BOC would set a competitive price in area 1 and a monopoly price in area 2. The lower price that results from the competition in area 1 would not result in lower prices in monopoly area 2. This is because lower-priced special access supplied in one geographic area cannot be used to satisfy demand in a different geographic area where higher prices prevail.

Incumbent Local Exchange Carrier Rates for Interstate Special Access Services, WC Docket No. 05-25; RM No. 10593, (Hereafter, "*Low Declaration in Special Access Proceeding*"), ¶ 79.

³³ Specifically, Taylor notes that because large customers want region-wide pricing, "competition for [large] customers forces prices to competitive market levels in all geographic areas, irrespective of the degree of competition in each wire center." *Taylor Declaration in Special Access Proceeding*, ¶ 52.

Consequently, arbitrage by special access customers or other suppliers (i.e., buying the service at the low price and reselling it at the higher price) cannot take place across the two areas.

43. Continuing with the example, suppose instead that there were no opportunities for price discrimination and a BOC had no choice but to charge the same price in competitive area 1 and monopoly area 2 of the MSA. In addition, suppose (as the BOCs do) that there are quality differences between the BOC special access offerings and the CLEC offerings.³⁴ That is, suppose that there is some product differentiation in the provision of special access so that even with competitive alternatives, an increase in the price of the BOC's special access services will not result in the BOC's loss of all customers to the alternatives. The BOC will then set a uniform price in a way that accounts for the different extent of competition in those areas.

44. Specifically, in setting a uniform price, the BOC will weigh the profits earned from a higher price on those special access customers across the MSA who continue purchasing at the higher price against the lost profits from those customers across the MSA who stop purchasing the special access service from the BOC (i.e., the customers who stop purchasing altogether or who, in area 1 of the MSA, turn to a CLEC). If in raising the price by a particular amount, the BOC realizes incremental profits that exceed the losses, then the price increase adds to the BOC's total profit—the BOC is earning enough additional profits from those special access customers who continue to purchase from the BOC to more than offset the lost profits from those that stop purchasing its special access services. The BOC will continue to raise price until the incremental profits just equal the incremental losses, at which point any further price increase would result in incremental losses exceeding the incremental profits, and total BOC profits would then fall.

³⁴ *Casto Declaration in Special Access Proceeding*, ¶ 57.

45. In calculating the uniform profit-maximizing price for the MSA, the BOC will (other things equal) tend to lose fewer customers (as a fraction of its total sales) in monopoly area 2, whose only alternative is to completely forego the purchase of special access services, than in competitive area 1, where customers can either forgo special access services or purchase them from an alternative (i.e., CLEC) provider. Put differently, other things equal, the elasticity of the BOC's special access demand in monopoly area 2 will tend to be lower than that in competitive area 1. The larger the special access sales in monopoly area 2 relative to those in competitive area 1, the higher the uniform profit-maximizing MSA-wide price will be. A higher uniform price is more profitable in these circumstances than if monopoly area 2 were smaller because higher prices have a smaller effect on discouraging purchasers in monopoly area 2 (where there is no CLEC alternative) than in competitive area 1 (where there are CLEC alternatives).
46. What this means is that a uniform price does not protect consumers in less competitive parts of the MSA from supracompetitive prices. Any uniform price will be infected by the absence of real competition for special access services in some areas in the MSA. Because of the varying extent of competition within the MSA, the uniform price is effectively a blend of the different prices that the BOC would otherwise seek to charge in competitive and non-competitive areas of the MSA. Thus, the consequence of MSA-wide pricing is that while the supracompetitive prices paid by consumers in the non-competitive areas of the MSA are lower than they would otherwise be, the prices paid by consumers who purchase CT and CM services from BOCs in competitive areas are tied to the sales of those products in the non-competitive areas. Consequently, consumers purchasing special access services in competitive areas do not realize the benefit of lower, competitive prices that would obtain if BOCs did not "average" prices across the MSA. And consumers in the non-competitive areas of the MSA continue to pay supracompetitive prices.
47. In brief, then, a uniform price will reflect the range of competitive conditions across the wire centers in the region. To the extent that the BOCs have pricing

flexibility where they face little special access competition, that lack of competition will tend to increase the uniform price that the BOCs will charge across the MSA. Thus, concluding that a uniform price in a larger area implies that the larger area is the relevant market ignores the widely disparate competitive alternatives available to Nextel and other carriers throughout that area.

48. To the extent that the BOCs have the ability to identify those special access customers who do have readily-available competitive alternatives and can use contract tariffs to offer those customers more competitive prices, uniform pricing will not have any of the consumer benefits claimed by these economists for the BOCs. The uniform price available to all other customers that lack competitive alternatives will be set at an even higher supracompetitive level because the customers with the more competitive alternatives have been “removed” by the targeted contracts. Moreover, this entire discussion is only relevant for a price-flexibility MSA where there is significant competition in some substantial area of the MSA. In fact, as discussed below, this is not likely to be the case.

III. THERE ARE SIGNIFICANT BARRIERS TO THE EMERGENCE OF COMPETITION IN THE PROVISION OF SPECIAL ACCESS SERVICES

49. The ability of BOCs to raise and maintain special access prices above competitive levels depends critically on the profitability of entry by new competitors and the profitability of expansion by existing competitors. However, sunk costs and the need to achieve economies of scale and scope constitute significant barriers to profitable entry and expansion by competitors and thus to effective competition in most of the markets for DS1 and DS3 special access services. Nextel's experience in purchasing special access services reflects this lack of competition.
50. The Commission, in its extensive examination of competition in loops and interoffice transport in its *TRRO*, has already found that there are significant barriers to competitive supply of loop and transport services (analogous to CTs and CMs, respectively). The FCC found that loop investments require large sunk costs and therefore pose substantial barriers to competition for high-capacity loops.³⁵ This conclusion is consistent with an AT&T analysis that quantified the importance of sunk costs and found that competitive carriers must have at least three DS3s of demand at the potential location to justify deploying CTs.³⁶
51. Similarly, Drs. Ordover and Willig find that the lion's share of the cost of transmission facilities required by a competitive carrier is sunk and would be stranded and lost if it is unable to offer service profitably.³⁷ And AT&T's analysis finds that deployment of transport facilities to a particular point of aggregation is only economic when there are at least 18 DS3s of traffic available.³⁸

³⁵ *TRRO*, ¶¶ 150, 152-153.

³⁶ Reply Declaration of Janusz A. Ordover and Robert D. Willig on Behalf of AT&T Corp., *In the Matters of Special Access Rates for Price Cap Local Exchange Carriers and AT&T Petition for Rulemaking to Reform Regulation of Incumbent Local Exchange Carrier Rates for Special Access Services*, WC Docket No. 05-25; RM 10593, (Hereafter, "*Ordover/Willig Reply Declaration in Special Access Proceeding*"), ¶ 29.

³⁷ *Ordover/Willig Reply Declaration in Special Access Proceeding*, ¶ 26.

³⁸ *Ordover/Willig Reply Declaration in Special Access Proceeding*, ¶ 29.

52. Moreover, as discussed previously, CLEC investments in the most profitable areas of a MSA do not enable competitors to provide CT or CM service in many or most of the other areas within the MSA. Consequently, in the great majority of the areas, sunk costs constitute a sufficient barrier to entry to make the BOC an effective natural monopoly in CT service. Moreover, Drs. Ordover and Willig find that sunk costs and limited traffic concentration also provide the conditions for what is effectively a natural monopoly in many interoffice CM markets.³⁹
53. In addition to significant sunk costs, special access services are supplied under conditions of economies of scale and scope. Fixed costs of trenching and laying cable, combined with lower unit costs of both higher-capacity fiber and electronics, provide the supplier who achieves greater aggregate demand in a geographic market with a significant cost advantage over competitors with lesser demand. BOCs enjoy economies of scale by aggregating the demands of customers located along a route. In addition, they achieve economies of scope on high-capacity transport facilities by combining special access traffic with traffic from other BOC-supplied services (local telephone, long-distance, DSL, etc.).⁴⁰
54. Nonetheless, it may well be that the opportunities for the emergence of competition in DS3 transport is greater than in CTs or DS1 CMs. In particular, while the FCC found that interoffice transport is characterized by substantial sunk costs, the FCC also found that carriers have greater opportunities for recovering sunk costs in transport than in loop facilities because interoffice transport facilities carry numerous customers' traffic and in some instances, CLECs have

³⁹ *Ordover/Willig Reply Declaration in Special Access Proceeding*, ¶¶ 26-27.

⁴⁰ The FCC's record in the *TRRO* established that "the cost of construction does not vary significantly by loop capacity" and "the most significant portion of the costs incurred in building a fiber loop results from deploying the physical fiber infrastructure into underground conduit to a particular location, rather than from lighting the fiber-optic cable...For these reasons, LECs do not typically construct fiber loop facilities at lower capacity levels, such as DS1 or DS3, but rather install high-capacity fiber-optic cables and then use electronics to light the fiber at specific capacity levels, often "channelizing" these higher-capacity offerings into multiple lower-capacity streams." *TRRO*, ¶ 150.

the flexibility to replace a decrease in traffic from the loss of one customer's demand with traffic from other customers.⁴¹

55. In their analysis, Drs. Furchtgott-Roth and Hausman overlook the variation in entry barriers across an MSA, observing only that “many CLECs offer facilities-based special access services even in MSAs with pricing flexibility.” They then leap to the mistaken conclusion that “[s]pecial access services consequently do not appear to be natural monopolies in which only one firm can survive.”⁴² Similarly, Dr. Taylor incorrectly asserts that the extent of sunk investment in facilities *in an MSA* is the appropriate standard for pricing flexibility.⁴³ As discussed earlier, these characterizations are incorrect because the MSA is far more extensive than the relevant geographic market in which special access services are supplied. The next section demonstrates that in many of those markets—and nearly all of those in which Nextel has cell sites—sunk costs and limited demand combine to restrict efficient supply to a single firm.

IV. AS A RESULT OF BARRIERS TO ENTRY, THERE IS LITTLE COMPETITION IN THE SUPPLY OF SPECIAL ACCESS SERVICES

56. The barriers to entry by competitive suppliers of special access services reviewed above have resulted in only limited competition in the supply of special access services. In this section we test the BOCs' claims that competition is extensive against the evidence of the actual extent of competition.
57. Nextel's nationwide CMRS network encompasses the majority of MSAs.⁴⁴ Nextel has purchased over 30,000 DS1s to cell sites and about 3,400 local DS3s.⁴⁵ Overall, 22% of DS1 CTs and 61% of DS1 CMs purchased by Nextel from the BOCs are on routes where the BOCs have Phase II price flexibility; for DS3

⁴¹ *TRRO*, ¶ 72.

⁴² *Furchtgott-Roth/Hausman Declaration in Special Access Proceeding*, p. 31.

⁴³ *Taylor Declaration in Special Access Proceeding*, ¶ 55.

⁴⁴ *Sachs Declaration*, ¶ 4.

⁴⁵ See Exhibit 2 (appended to Nextel's Reply Comments in this proceeding). (Hereafter, “*Exhibit 2*”).

transport, the corresponding percentage is 71%.⁴⁶ Nextel does not purchase DS3 CTs.

58. In the *TRRO*, the FCC found that requesting carriers are not impaired without access to DS1-capacity loops to provide service to any location served by an incumbent LEC wire center containing at least 60,000 business lines and at least four fiber-based collocators.⁴⁷ For DS1 transport, the Commission found that requesting carriers are not impaired on routes connecting a pair of wire centers if the wire centers on both ends of the route have at least 38,000 business lines or at least four fiber-based collocated CLECs.⁴⁸ Our understanding is that by these standards, 93% of Nextel's DS1 CTs and 84% of Nextel's DS1 CMs purchased from BOCs are provided over routes where a requesting carrier would be considered "impaired" without access to unbundled DS1 loops or transport.⁴⁹
59. Similarly, the FCC found that with respect to DS3 loops, requesting carriers are not impaired in their ability to provide service to any location served by an incumbent LEC wire center containing at least 38,000 business lines and at least four fiber-based collocated CLECs. With respect to DS3 transport, the FCC found that requesting carriers are not impaired on routes connecting a pair of wire centers if the wire centers on both ends of the route have at least 24,000 business lines or at least three fiber-based collocated CLECs. Our understanding is that by these standards, 57% of Nextel's DS3 CMs purchased from BOCs serve routes that fail to meet these criteria.⁵⁰
60. Of the BOCs' DS1 facilities purchased by Nextel in MSAs that satisfy the Commission's current Phase II pricing flexibility triggers, we understand that 87% are on CT routes where the Commission would find that competitive carriers are impaired without access to unbundled DS1 UNE loops and 63% are on CM

⁴⁶ See *Exhibit 2*, Table 2.

⁴⁷ *TRRO*, ¶ 146.

⁴⁸ *TRRO*, ¶ 146.

⁴⁹ See *Exhibit 2*, Table 2.

⁵⁰ See *Exhibit 2*, Table 2.

routes on which a competitive carrier would be considered to be impaired without access to DS1 UNE interoffice transport.⁵¹ Also, in MSAs that satisfy current pricing flexibility triggers, a third of all Nextel's DS3 CMs serve routes on which a carrier would be considered to be impaired without access to DS3 UNE transport.⁵²

61. Thus, most of the markets in which Nextel requires special access services in fact have only very limited competitive alternatives. Indeed, Nextel obtains only about 4 percent of its DS1s from non-BOC suppliers.⁵³ In a 2005 filing, another CMRS carrier, T-Mobile, similarly reports that it has depended on ILECs for over 96% of its CT links.⁵⁴ Even AT&T, one of the largest CLEC suppliers of special access, obtained 93% of its DS1-level transport from incumbent carriers, according to a 2004 Declaration submitted by AT&T.⁵⁵
62. Nextel recently issued a Request for Information (RFI) for the provision of high-capacity CTs and CMs in the New York City metropolitan area. Our understanding is that the responses provide further evidence of the lack of competitive alternatives. Nextel has over 1,500 cell sites that were the focus of the RFI. Even though New York City is arguably the most fertile ground for the development of special access competition, CLECs responded by offering to provide special access for only 43 of those 1,500 cell sites.⁵⁶
63. Nextel's experience is not atypical. In this proceeding, there has been no dearth of reliable data on the lack of competition in special access. The most substantial

⁵¹ See *Exhibit 2*, Table 3.

⁵² See *Exhibit 2*, Table 3.

⁵³ See *Exhibit 2*. These data exclude purchases of DS1s and DS3s from non-BOC ILECs and purchases for which the provider could not be identified.

⁵⁴ Declaration of Chris Sykes, *In the Matters of Special Access Rates for Price Cap Local Exchange Carriers and AT&T Petition for Rulemaking to Reform Regulation of Incumbent Local Exchange Carrier Rates for Special Access Services*, WC Docket No. 05-25; RM 10593, (Hereafter, "*Sykes Declaration in Special Access Proceeding*"), ¶ 5.

⁵⁵ *Ordovery/Willig Reply Declaration in Special Access Proceeding*, ¶ 30.

⁵⁶ *Sachs Declaration*, ¶ 10-11.

evidence has been developed by ETI. In a 2003 declaration on behalf of AT&T, Lee Selwyn determined that in MSAs that have some Phase II pricing flexibility, AT&T relied on ILECs for special access services in about 94% of the buildings served by AT&T.⁵⁷ In MSAs where there is no pricing flexibility, the percentage rose to 97%.⁵⁸ Thus, AT&T's reliance on ILECs was nearly the same in both categories of MSAs, suggesting that the availability of competitive alternatives to the BOC is equally limited in both types of MSAs. Even in what is arguably the most promising metropolitan area for CLEC competition, the New York MSA, no non-ILEC facilities were available at nearly 86% of the business locations served by AT&T.⁵⁹ And in New York City, only 900 of 220,000 buildings (mixed use, commercial, industrial, and public) were served by CLEC fiber at the time of the Selwyn Declaration in 2003.⁶⁰ Indeed, as the subsequent ETI study highlights, non-ILEC provide facilities-based service to no more than 1% of the commercial buildings in the United States.⁶¹

64. And if transport services are supplied in competitive markets (conditions that may occur more frequently than conditions for CTs), the BOCs may still be able to capture the monopoly profits from the sale of price-capped CTs. Specifically, Nextel typically (but not always) purchases CTs and CMs for the same circuit

⁵⁷ Declaration of Lee L. Selwyn, *In the Matters of Special Access Rates for Price Cap Local Exchange Carriers and AT&T Petition for Rulemaking to Reform Regulation of Incumbent Local Exchange Carrier Rates for Special Access Services*, WC Docket No. 05-25; RM 10593, (Hereafter, "*Selwyn Declaration in Special Access Proceeding*"), Table 7.

⁵⁸ *Selwyn Declaration in Special Access Proceeding*, Table 7.

⁵⁹ *Selwyn Declaration in Special Access Proceeding*, Table 8.

⁶⁰ *Selwyn Declaration in Special Access Proceeding*, ¶ 48, citing *Proceeding on Motion of the Commission to Investigate Methods to Improve and Maintain High Quality Special Services Performance by Verizon New York, Inc., Opinion and Order Modifying Special Services Guidelines for Verizon New York, Inc., Conforming Tariff, and Requiring Additional Performance Reporting*, NY PSC Case 00-C-2051, pp. 7-8 (June 15, 2001).

⁶¹ Economics and Technology Incorporated, *Competition in Access Markets: Reality or Illusion*, (August 2004), (Hereafter, "*ETI Competition in Access Markets*"), Table 2.1. Updated data for New York and Washington metropolitan areas, Denver, San Francisco, Dallas, Oakland and Florida are consistent with this picture. Declaration of Susan M. Gately on behalf of Ad Hoc Telecommunications Users Committee, *In the Matters of Special Access Rates for Price Cap Local Exchange Carriers and AT&T Petition for Rulemaking to Reform Regulation of Incumbent Local Exchange Carrier Rates for Special Access Services*, WC Docket No. 05-25; RM 10593, (Hereafter, "*Gately Declaration in Special Access Proceeding*"), ¶¶ 17-19.

from a single vendor and at separate prices for CTs and CMs. We understand that Nextel does this because (among other reasons) if it were to purchase CTs and CMs from separate vendors, it would incur greater difficulties in fault-tracing/restoration when there is an outage on a circuit provided by more than one carrier.⁶²

65. Nextel uses CT and CM in combination to provide a circuit from a cell site to a wire center and then continuing on to a more distant wire center or BOC central office. Dr. Taylor characterizes the special access purchases generally in these terms: “[F]or nearly all transactions, special access is sold as a bundle of CTs, CMs and other services.”⁶³ As a result of these complementary purchases, even when the BOCs have Phase II pricing flexibility only for CTs but not for CMs, and even though Nextel purchases those services separately at separate prices, the BOCs may be able to set the unconstrained rate of CM to extract the monopoly profit from CTs. Thus, the sum of the two prices that Nextel pays for CT and CM will equal the sum of the unregulated monopoly prices for both, and in that way the BOC can reap the monopoly profits from the sale of both CMs and CTs.⁶⁴

A. BOC Claims of Vibrant Special Access Competition Are Exaggerated or Wrong

66. The BOCs make a variety of claims to support a finding that special access services are highly competitive. In this section, we evaluate a number of the key claims made by the BOCs and find them to be unconvincing, at best.

1. The CLECs Do Not Have a Substantial Share of Special Access Services

67. In the most extreme example of stretching the data, RHK consultant Stephanie Boyles, in her declaration on behalf of BellSouth, claims that across the BellSouth region 46% of all of wholesale special access tail circuit capacity and 87% of all

⁶² *Sachs Declaration*, ¶ 7.

⁶³ *Taylor Declaration in Special Access Proceeding*, ¶ 30.

⁶⁴ The BOC’s ability to price in this way will depend in part on the extent to which special access customers tend to purchase CTs and CMs for joint usage, and the efficacy of any non-discrimination provisions.

interoffice facility capacity are provided by competitive carriers.⁶⁵ Without more support for these calculations, the Commission should not rely on these claims.

68. The Boyles/RHK estimates of market shares rely on a flawed and highly indirect estimate of the size of the total wholesale special access services market that renders Boyles/RHK's market share values biased and unreliable.
69. Boyles/RHK first estimates "total enterprise demand for private line data services"⁶⁶ nationwide by combining estimates from two national marketing services of total purchases of DS0 through OCn circuits by enterprise customers across the United States.
70. To estimate how much of that demand is in the BellSouth serving area, Boyles/RHK estimates the enterprise demand for private line data services in the BellSouth serving area using a measure of data circuit demand per business that is based on industry type, number of employees, proximity to major metropolitan area, and headquarters versus branch location and applying that information to a database of businesses that are resident in BellSouth's service area. That measure—data circuit demand per business—is derived from a third marketing service's estimates of enterprise purchasing patterns and a fourth marketing service's estimate of bandwidth demand by metropolitan area.
71. The resulting calculation purports to measure both retail and wholesale enterprise demand for total private line data services in the BellSouth serving area. Boyles/RHK subtracts from this measure the actual sales of data circuits by BellSouth Retail to obtain what she terms the "total demand for Wholesale

⁶⁵ Declaration of Stephanie Boyles, *In the Matters of Special Access Rates for Price Cap Local Exchange Carriers and AT&T Petition for Rulemaking to Reform Regulation of Incumbent Local Exchange Carrier Rates for Special Access Services*, WC Docket No. 05-25; RM 10593, (Hereafter, "*Boyles Declaration in Special Access Proceeding*"), Exhibit A, p. 2.

"Tail circuits are circuits that originate at an enterprise building and terminate at the serving wire center. Interoffice circuits are circuits that originate at a serving wire center and terminate on another serving wire center or at a carrier POP (point-of-presence)." *Boyles Declaration in Special Access Proceeding*, Footnotes 1 and 2.

⁶⁶ *Boyles Declaration in Special Access Proceeding*, ¶ 3.

wireline-generated tale [*sic*] circuits.”⁶⁷ However, this adjustment fails to subtract the retail sales of data circuits by CLECs and consequently overstates the size of the wholesale market for private line data services and understates the share of BellSouth by some unknown amount.

72. Next, Boyles/RHK applies a model “using typical multiplexing arrangements and typical fill rates”⁶⁸ to the estimate of the total “wholesale” demand in order to calculate what the Declaration regards as the total wholesale wireline market for tail circuit and total wholesale wireline market for interoffice circuits.
73. Having obtained an (inflated) estimate of the total wholesale demand for private line data services, Boyles/RHK finally estimates the demand supplied by CLECs as the difference between the indirectly estimated total special access demand and the known BellSouth number of special access circuits plus UNE circuits.
74. The Boyles/RHK calculation is not a reliable estimate of BellSouth and CLEC market shares. Among other reasons, it necessarily underestimates the BOC market share (and overestimates the CLEC market share) of the wholesale market because it includes the CLEC retail circuits in the denominator of the market share calculation.
75. In addition, the estimates of total tail circuits and interoffice circuits in the BellSouth study area are constructed from a host of assumptions derived from nationwide marketing survey data. The estimates rely on one source for Bell South’s sales, two others for all sales in the United States, a fourth for purchasing patterns, and a fifth for bandwidth purchased in the United States. Nowhere does the Declaration provide the Commission any substantive basis for concluding that this ad hoc mixture of surveys, each of which likely has different, and perhaps inconsistent, underlying methodologies and time frames, produces credible market share estimates. In short, Boyles/RHK provides no measure of the

⁶⁷ *Boyles Declaration in Special Access Proceeding*, ¶ 4.

⁶⁸ *Boyles Declaration in Special Access Proceeding*, ¶ 4.

reliability of her market share estimates and thus, the Commission should attach little, if any, weight to her estimates of market shares.⁶⁹

2. *Proximity to Competitive Fiber Claims Are Misleading*

76. In his declaration on behalf of SBC, Parley Casto claims that in most MSAs, a large proportion of all special access customers are located near CLEC fiber and, furthermore, that CLECs could compete for the demand of those customers at low incremental cost.⁷⁰ He asserts that “it would be relatively inexpensive and wholly cost effective for a competitor to extend a fiber drop 1000 feet to access DS1 or DS3 demand ...”

77. At the outset, even Mr. Casto’s analysis highlights **[BEGIN CONFIDENTIAL]**

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED] **[END CONFIDENTIAL]**

78. Moreover, Mr. Casto’s very premise—that being close to fiber is sufficient to ensure effective competition—is highly questionable. In particular, proximity to fiber does not mean being close to a node that provides access to the fiber ring. The Sachs Declaration discusses how mere proximity to CLEC fiber fails to account for the frequently substantial costs of connecting data loops to the existing CLEC facilities.⁷² Thus, Nextel would still have to incur the costs of

⁶⁹ However, the reliability of Boyles/RHK’s estimates could be better assessed by starting with the same nationwide survey data and applying the same assumptions in order to estimate BellSouth’s tail and interoffice circuits and revenues and then comparing those estimates with the actual BellSouth values. Yet, Boyles/RHK did not undertake this obvious sensitivity test.

⁷⁰ *Casto Declaration in Special Access Proceeding*, ¶¶ 15-20.

⁷¹ *Casto Declaration in Special Access Proceeding*, ¶ 14 and Table 1.

⁷² *Sachs Declaration*, ¶ 9.

connecting to the CLEC node via a new DS1 facility or a leased facility, and these costs can be substantial even if Nextel's cell site is close to the fiber. By treating these costs as insignificant, Mr. Casto has overstated, perhaps substantially, the possibility that much or most "nearby" fiber is a competitive alternative to the BOCs. And as noted at the beginning of this discussion, [BEGIN

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[REDACTED]

[REDACTED]

[REDACTED] [END CONFIDENTIAL]

3. *Large Customers' Purchases Do Not Discipline Prices throughout the MSA*

79. Dr. Taylor argues that in areas where there are large and knowledgeable customers for special access services who are willing and able to switch providers, their demand can drive special access prices down to competitive levels in other areas where customers do not have multiple suppliers from which to choose.⁷³
80. Dr. Taylor's conclusion is incorrect. In MSAs in which large customers have alternative suppliers and BOCs have Phase II pricing flexibility, the BOCs are able to use customer-specific contract tariffs that are tailored to the service requirements of just those customers with competitive alternatives.⁷⁴ This pricing flexibility enables the BOCs to price discriminate against customers located in areas that lack competitive supply. As a result, lower effective rates under contract tariffs do not drive the rates for month-to-month and optional payment plan (OPP) tariffs to competitive levels. Thus, under these circumstances, competition that benefits the large customers does not spread to more BOC-captive customers.

⁷³ Taylor Declaration in Special Access Proceeding, ¶ 56.

⁷⁴ Ordovery/Willig Reply Declaration in Special Access Proceeding, ¶¶ 62-65.

4. *The BOCs' High Margins Do Not Indicate a BOC Willingness to Cut Prices to Prevent Even Small Losses of Customers to Rivals*

81. The BOCs make several claims that sunk costs prevent them from charging supracompetitive prices. For example, Dr. Taylor argues that sunk costs constitute a high proportion of the costs of supplying special access services and that the possible loss of a small fraction of the BOC's customers to competitors limits the BOC's ability to impose price increases.⁷⁵ Similarly, Drs. Furchtgott-Roth and Hausman argue that because the costs of providing broadband special access services are largely fixed costs, only a small number of the BOC's customers need to defect to defeat a potential price increase and as a result, the BOC is unable to exercise market power.⁷⁶ That is, the variable margin earned on these customers is so high (Drs. Furchtgott-Roth and Hausman assume a substantial 80% margin) that the loss of even a small number of customers due to a small but significant price increase will offset the profits earned from those customers who remain.
82. The analyses of Dr. Taylor and Drs. Furchtgott-Roth and Hausman, however, indicate only that a potential increase in price from the level of the current price could be defeated; it does not establish that in areas where the a BOC has Phase II pricing flexibility, the current BOC special access price does not exceed the competitive price and that the BOC is not currently exercising market power. In particular, if the BOC has already set a profit-maximizing monopoly price for special access services in Phase II MSAs, then any increase in price will be unprofitable regardless of the size of the BOC's margin.
83. Even assuming that the FCC is concerned about future price increases, as opposed to present pricing, the analyses of these economists retained by the BOCs may be incorrect. When the price-cost margin is high, it is certainly true that the customer loss required to make a price increase unprofitable (what is called the

⁷⁵ Taylor Declaration in Special Access Proceeding, ¶ 57.

⁷⁶ Furchtgott-Roth/Hausman Declaration in Special Access Proceeding, pp. 32-33, 37.

“critical loss”) is relatively small. However, in economics, there is a well-known relationship between the price-cost margin (the variable margin) and the firm’s own-price elasticity of demand. When a firm is maximizing profits, a high margin indicates a relatively low elasticity of demand—any given percentage change in price results in a relatively small percentage change in the quantity of the service demanded.⁷⁷ A high margin (as assumed by Drs. Furchtgott-Roth and Hausman) then implies a relatively low demand elasticity—consumers are not as responsive to price changes as they would be if the demand elasticity were higher.

84. As a result of the relatively low price elasticity of demand, the price increase posited by Dr. Taylor and Drs. Furchtgott-Roth and Hausman may not, in fact, lead to the actual loss being greater than the critical loss, i.e., large enough to render the price increase unprofitable. One analogy here is with issues involved in market definition in merger matters. One recent paper (co-authored by a former chief economist of the Justice Department’s Antitrust Division and by a former chief economist of the FCC as well as the Antitrust Division) examined the validity of a typical argument for a broad product market. That paper noted that the argument “runs as follows: ‘because suppliers’ profit margins are high, any lost sales have a big adverse impact on profits, and so even a hypothetical monopolist controlling a group of products could not profitably raise price.’ This story is incomplete because high margins also tend to imply that that actual loss is small, and thus a price increase might be profitable even when the critical loss is small.”⁷⁸

85. This recent literature suggests that the “critical loss” contentions of Dr. Taylor and Drs. Furchtgott-Roth and Hausman may well be flawed. Those contentions rely on high margins to demonstrate how small the critical loss might be to render a price increase unprofitable. Relying on those same margins, these economists then conclude that the actual loss is likely to be greater than the “small” critical

⁷⁷ See, for example, Dennis Carlton and Jeffrey Perloff, *Modern Industrial Organization* (New York: HarperCollins, 1994), pp.133-137.

⁷⁸ Michael L. Katz and Carl Shapiro, “Critical Loss: Let’s Tell the Whole Story,” *Antitrust* 17 (Spring 2003), p. 49.

loss. But the margin itself suggests that the actual loss may not be as large as the critical loss because consumers are relatively insensitive to price changes (which allowed the BOCs to charge high prices and earn high margins in the first place). In addition, for a BOC to lose special access customers of any magnitude would require entry of rivals, entry that is unprofitable in many special access markets, particularly for CT service on routes with only limited demand for high-capacity circuits. Without the credible threat of competitive entry, the potential loss of customers does not limit the ability of the BOCs to raise prices above competitive levels or to maintain such supracompetitive pricing. The only alternatives for such customers are to continue purchasing from the BOC, perhaps with a reduction in the amount purchased, or to withdraw from the market entirely.⁷⁹

B. Summary

86. In brief, Nextel's own experience and that of other special access customers indicate that the emergence of competition anticipated by the Commission under the current price flexibility triggers did not occur and today, competition is not sufficiently robust to regulate the special access rates charged by the BOCs. While the BOCs in their comments expend considerable effort to demonstrate the robustness of special access competition, those arguments are undermined by flaws in the data used or the competitive analysis itself.

V. THE EXERCISE OF MARKET POWER: THE PRICING EVIDENCE

87. The previous sections have illustrated the general absence of competition faced by the BOCs in the provision of special access. Thus, the structural conditions necessary for supracompetitive pricing exist in the markets for special access services. And it is the case that in areas where the BOCs have been granted pricing flexibility, the prices of special access services appear to have remained

⁷⁹ Self-provisioning of special access circuits is theoretically possible, but is limited in practice by the same factors that limit competition in special access, particular along routes in a MSA with limited demand for high-capacity circuits.

significantly above competitive levels. As we discuss below, that pricing behavior is evident from data that have previously been provided to the Commission.

88. The BOCs' submissions would seem to suggest just the opposite—that rates for special access have been falling at least since the introduction of pricing flexibility in the MSAs that satisfy the current pricing flexibility triggers. As discussed below, when these BOC-provided data are examined carefully, such inferences cannot be justified.

A. Comparing Rates Under Pricing Flexibility and Those Under Price Caps

89. A meaningful analysis of rates requires comparisons that eliminate differences due to changes in spending on special access services that result from differences in volume purchased, duration of contract, and aggregation and bundling of services subject to different price regulations. Evaluating the effect of pricing flexibility on special access rates thus requires looking at a rate for a particular service for a particular term, with otherwise identical contractual provisions. The Commission has available to it the relevant comparisons.
90. For example, Joseph Stith calculated *pro forma* price flexibility rates (i.e., rates no longer subject to price caps), price-capped rates, and the UNE rate for each BOC in effect on July 1, 2004.⁸⁰ The *pro forma* rates provide a meaningful comparison by examining for the same commitment period exactly the same service offered for each capacity—a stand-alone circuit consisting of two CTs, a fixed mileage transport charge, a variable mileage transport charge, and an assumed 10 miles of transport.⁸¹
91. While Dr. Stith's review shows that there is considerable variation in prices across BOCs, in no instance does the *pro forma* price flexibility rate for either a

⁸⁰ Declaration of M. Joseph Stith, *Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers*, WC Docket No. 04-313; CC Docket No. 01-338, (Hereafter, "*Stith Declaration*"), Attachment 1, Comparison of costs (10-mile Standalone Circuit) Rates in Effect on July 1, 2004, p. 4.

⁸¹ *Stith Declaration*, ¶ 5. If a BOC has zoned rates, the calculation used the Zone 1 rate.

DS1 or DS3 comparison (for both month-to-month and 3-year OPPs) fall below the *pro forma* price-capped rate.⁸² For example, for BellSouth in North Carolina, Dr. Stith finds that the month-to-month price-flexibility rate for DS1s is 5% above the month-to-month price-capped rate while the 3-year OPP price-flexibility rate is 15% above the OPP price-capped rate.⁸³ For DS3s, the month-to-month price-flexibility rate is 14% above the month-to-month price-capped rate while the corresponding 3-year OPP price-flexibility rate is 29% above the OPP price-capped rate.

92. And in all of these cases, the pricing flexibility rate is far above the comparable UNE rate. The month-to-month price-flexibility rate for DS1s is nearly three times the comparable UNE rate (which is month-to-month) and, similarly, the month-to-month price flexibility rate for DS3s is over three times the UNE rate. Thus, not only are these BellSouth price-flexibility rates above the price-capped rates, they remain considerably above the UNE rate, one proxy for the competitive costs of provisioning special access services. Such large margins typically signify a supplier with considerable market power.
93. The BellSouth data are not atypical. When rates are averaged across all BOCs and all geographic areas analyzed in the Stith Declaration, the Stith review of the BOCs' prices suggests that for month-to-month DS1 service, the pricing flexibility rates are 19% above the price cap, and are nearly three times the UNE rates. For DS3s, the average month-to-month pricing flexibility rate is 15% greater than the price-capped rate and more than three times the UNE rate.⁸⁴
94. In her declaration on behalf of Global Crossing, Janet Fischer also provides a number of service-specific comparisons of rates for (among others) DS1 and DS3 CTs and CMs for all four RBOCs in June 2005. For each service, Ms. Fischer

⁸² *Stith Declaration*, Attachment 1, pp.1 – 20.

⁸³ *Stith Declaration*, Attachment 1, p. 4.

⁸⁴ In order to calculate the differences in prices, a simple average of the percentage differences was taken in which each observation was the percentage difference between a state's rates as reported by Dr. Stith. In cases where UNE rates were not reported in Dr. Stith's tables, the observation was treated as a missing value and ignored in the UNE rate calculation.

takes care to compare only term rates for those MSAs in which Phase II price flexibility triggers applied with the rates for exactly that service and the same term commitment in MSAs under price caps.⁸⁵ She does so for a broad cross section of various BOC tariffs.⁸⁶

95. While there is considerable variation in the percentage difference between the price flexibility rates and the price-capped rates, the magnitudes of the differences between the rates can be substantial. In the Qwest service areas, for example, the price flexibility rates for DS1 CTs exceed the price-capped rates in the same service areas by percentages that vary between 22% and 47% as term commitment varied. For DS1 CMs, the price flexibility rates exceed the price-capped rates in the same service areas by percentages that range between 27% and 48%.⁸⁷ Across all BOCs, for a broad cross-section of DS1 CT rates, the price flexibility rate in Phase II MSAs is lower than the price-capped rate only for some variants of the offering in Bell South's territory. For all other BOC areas, the DS1 pricing flexibility rate is no lower than, and often above, the price-capped rate for the same service areas.
96. The Fischer Declaration also charts service-specific comparisons between the BOCs' price flexibility and price-capped rates over the 1997-2005 period across various states and BOCs. The comparison for BellSouth reveals that as soon as pricing flexibility became available in 2001, the BOC immediately raised DS1 rates (for both CTs and for CMs). And in three of Fisher's four comparisons for BellSouth, the price flexibility rate has remained above the price-capped rate.⁸⁸ For the other BOCs examined by Ms. Fischer, the pricing flexibility rate remained

⁸⁵ Declaration of Janet S. Fischer on behalf of Global Crossing North America, Inc. Declaration, *In the Matters of Special Access Rates for Price Cap Local Exchange Carriers and AT&T Petition for Rulemaking to Reform Regulation of Incumbent Local Exchange Carrier Rates for Special Access Services*, WC Docket No. 05-25; RM 10593, (Hereafter, "Fischer Declaration in Special Access Proceeding"), ¶ 5.

⁸⁶ *Fischer Declaration in Special Access Proceeding*, ¶ 5.

⁸⁷ *Fischer Declaration in Special Access Proceeding*, Table 1.

⁸⁸ *Fischer Declaration in Special Access Proceeding*, Table 4. In the one exception, the price-capped rate for DS1 month-to-month CTs converges to the price-flexibility rate because of an increase in the price-capped rate (which had been below the price cap index), not because of a fall in the price-flexibility rate.

constant or increased while the gap between the pricing flexibility rates and the price-capped rates increased.

97. In summary, these data indicate that pricing flexibility has allowed the BOCs to increase prices above the levels that price caps otherwise would have allowed and far above the comparable UNE rates. Moreover, it appears that the onset of pricing flexibility was much more likely to cause prices to increase rather than fall. This is hardly what one would have expected if the supply of special access services were effectively competitive.

B. The BOC Comparisons

98. Instead of focusing on specific special access services with exactly the same purchase terms, the economists retained by the BOCs and other BOC experts focus on “average rates” that include revenues from rates with volume discounts and rates without such discounts, rates subject to price caps and rates subject to pricing flexibility, and other ingredients that can change from offering to offering. For example, in his declaration, Mr. Casto creates two charts that show the trend of average revenue per DS1 and per DS3 circuit between 2001 and 2003 in Phase II price flexibility MSAs.⁸⁹ According to Mr. Casto, those price reductions in average revenue per circuit were “driven entirely by SBC’s response to customers’ purchasing decisions.”⁹⁰ Like Mr. Casto, Dr. Taylor in his declaration focuses on the average revenue per DS1 and DS3 circuit. In his comparison that is most nearly service-specific, Dr. Taylor finds very modest declines in almost all DS1 and DS3 average revenues per circuit (adjusted for inflation) over the 1999-2004 period in those areas where Verizon has pricing flexibility. In general, the declines in average revenues per DS1 circuit are only a fraction of those per DS3 circuit (an outcome one might expect if the provisioning of DS3s were more

⁸⁹ *Casto Declaration in Special Access Proceeding*, Figures 9 and 10, (Confidential).

⁹⁰ *Casto Declaration in Special Access Proceeding*, ¶ 56.

competitive than those of DS1s), and he finds increases in the average revenue per DS1 CM circuit.⁹¹

99. In contrast to the direct *pro forma* comparisons of special access prices discussed in the previous subsection, the BOCs (with one exception) rely on comparisons of revenues averaged over different mixtures of month-to-month, volumes, contract durations (and other terms) and rate elements subject to pricing flexibility. These comparisons, at best, conflate a host of differences in supply circumstances. For example, Mr. Casto's calculations include MSAs in which the BOC had received Phase II pricing flexibility for POP-side transport but not for end-user CTs.⁹² As noted by Dr. Taylor, this procedure will yield a biased estimate of the effect of price flexibility.⁹³
100. The averages used by Mr. Casto and Dr. Taylor obscure other non-price changes that significantly limit the probative value of their comparisons. As one important example, Dr. Taylor notes that "ordinary month-to-month prices for individual services might remain unchanged, while a shift of consumers to discounted term and volume contracts would reduce measured average revenue per unit of service but without any reduction in tariffed prices."⁹⁴ Dr. Taylor subsequently asserts that "the effect of lower-priced services entailing term and volume contracts is voluntary ... Customers do not have to purchase these offers, and, to the extent that they do, they are better off."⁹⁵
101. Thus, Dr. Taylor agrees that an observed decline in average revenue per high-capacity circuit could simply mean that with the growth in high-capacity demand, customers have shifted from the month-to-month price to contracts offering volume discounts or discounts for longer terms. To be sure, individual consumers choosing those contracts are seemingly better off than they would be had they

⁹¹ *Taylor Declaration in Special Access Proceeding*, Table 8.

⁹² *Casto Declaration in Special Access Proceeding*, Footnote 47.

⁹³ *Taylor Declaration in Special Access Proceeding*, ¶ 35.

⁹⁴ *Taylor Declaration in Special Access Proceeding*, ¶ 38.

⁹⁵ *Taylor Declaration in Special Access Proceeding*, ¶ 41.

chosen to purchase the service at a month-to-month rate.⁹⁶ But, for any given BOC offering, that does not mean that because the discounted price is lower than the undiscounted price, the discounted price is an effectively competitive price.

102. Suppose, for example, that the same 10% discount off of the month-to-month rate were offered in both more competitive and less competitive markets, but that in more competitive markets, the month-to-month rate was \$100 while that in less competitive markets the month-to-month rate was \$125. Then the discounted price in the more competitive markets (i.e., \$90) is still substantially (i.e., 25%) below the discounted rate in less competitive markets (i.e., \$112.50). Thus, *pro forma* rate comparisons such as those provided by Dr. Stith and Ms. Fischer are a far better basis for inferring the pricing effects of allowing the BOCs pricing flexibility than are the “average” comparisons put forward by the BOCs that conflate price changes with numerous other factors.
103. Of all the BOCs, BellSouth appears to be the only one that provided service-specific rate data. The rate patterns in these data are generally consistent with those found by Dr. Stith and Ms. Fischer, reviewed previously. Specifically, during the period reported by BellSouth, none of BellSouth’s special access rates (with one exception) fell, and many were increased.⁹⁷ A natural expectation would have been that these rates would fall as a result of the competition in MSAs with pricing flexibility, but that did not happen. While BellSouth notes that prices have fallen in real terms (i.e., after adjusting for inflation),⁹⁸ one would have expected prices to fall even faster given the scale economies in the provision of special access, the likely higher-than-average rate of productivity increase for

⁹⁶ Even though individual consumers may perceive themselves as better off by taking the lower-priced contract, consumers may be collectively worse off if the effect of those contracts is to exclude competitors by tying up customers. Absent the exclusion, prices would have been even lower. See Eric B. Rasmussen, J. Mark Ramseyer, and John S. Wiley, Jr., “Naked Exclusion,” *American Economic Review*, December 1991, pp. 1137-45.

⁹⁷ See BellSouth Comments in WC Docket No. 05-25, filed on June 13, 2005, Attachment 1. We understand that BellSouth was first granted pricing flexibility in December 2000, but the data reported by BellSouth begin in late January 2001. It is possible that in the earlier time period, rates were lower than they were in late January 2001.

⁹⁸ See BellSouth Comments in WC Docket No. 05-25, filed on June 13, 2005, pp. 14-19.

special access services, and the substantial gap between UNE rates and the BOC pricing flexibility rates, among other reasons. Indeed, as Nextel indicated in its initial comments, all of the evidence suggests that BOC margins on special access are increasing, not decreasing, certainly a surprising outcome if special access competition had been growing.

C. Summary

104. The rigorous *pro forma* comparisons of special access prices that have been provided to the Commission (as well as those of BellSouth) are consistent with a conclusion that the effect of pricing flexibility has been to allow the BOCs to exercise market power. Those comparisons reveal that the DS1 and DS3 price-flexibility rates charged by the BOCs exceed the equivalent price-capped rates and are far higher than one reasonable measure of costs of service, the comparable UNE rates. By contrast, the BOCs (other than BellSouth) compare special access prices only in terms of average revenues, thus concealing customer movements to discounted plans and presenting a picture of pricing behavior following the introduction of price flexibility that is far too favorable to the BOCs.

VI. REMEDIES

A. Introduction and Summary

105. In this section, we evaluate a possible alternative to the current special access pricing flexibility triggers, one that is clearly focused on reflecting the development of competition in appropriately defined service and geographic markets. We then sketch the general approach that should be taken to impose price caps on those services in geographic markets that do not satisfy the new pricing flexibility criteria. Finally, we consider the arguments of the economists retained by the BOCs that the social and administrative costs of price regulation are so substantial that, the Commission should not make the current pricing-flexibility regime any more constraining, but should consider loosening the current rules even further.

B. The Impairment Standards as an Illustration of More Appropriate Criteria for Pricing Flexibility

106. As discussed above, the current MSA-wide pricing flexibility triggers have not been a reasonable proxy for the development of MSA-wide competition. Consumers would be better served by pricing flexibility criteria that are more precise predictors of special access competition. The revised triggers should account for (1) geographic markets that more accurately reflect areas where the BOC can exercise substantial market power; (2) differences in the type of special access service provided (CTs or CMs); and (3) differences in capacities (DS1 or DS3). The revised triggers should also be easy to administer.
107. The impairment standards adopted by the Commission in the *TRRO* are one example of the kind of “triggers” that would satisfy these criteria. In that Order, the Commission adopted different impairment standards for DS1 loops and DS3 loops, and for DS1 transport and DS3 transport. Those standards are more easily satisfied for transport than for loops, because competition is more likely to develop in the former. For similar reasons, the standards are more easily met for DS3s than for DS1s. Thus, the standards take into account differences in competitiveness of services as well as differences in capacities.
108. The impairment standards also are applied at a geographic level that more likely delimits the locus of competition: the wire center, rather than the MSA. As a result, there may be complete pricing flexibility in the geographic areas where demand for high-capacity circuits is sufficient to generate effective competition, but only downward pricing flexibility (i.e., price-capped rates) in other areas where competition is slow, or unable, to develop.
109. Moreover, the incremental costs of administering the impairment tests are zero since these same tests are already used to determine whether a BOC must offer UNEs to CLECs. Thus, this proposed approach addresses one of the concerns raised by the economists retained by the BOCs. Drs. Furchtgott-Roth and Hausman assert that “well intended tweaks to the structure of price regulation

may likely do little more than add to complexity.”⁹⁹ However, because the regulatory structure for the impairment tests is already in place, the replacement of the pricing flexibility triggers with the impairment standards creates no additional complexity. Indeed, the replacement of the current pricing flexibility triggers (which require some additional regulatory administrative determinations) with the impairment standards or something similar can reduce administrative costs.

110. The impairment standards would also mitigate BOC concerns that the current pricing flexibility triggers understate the extent of competition because, by focusing only on collocation, they do not account for competitive services that completely bypass the wire center. In particular, a carrier’s ability to obtain transport is classified as impaired if there are either too few business lines or too few collocated CLECs at the central offices on either end of the route. As the Commission observes, the correlation between the potential for competition and the number of business lines is likely to be high.¹⁰⁰ Thus, a competitive provider could be found to be unimpaired on a transport route even if there were no competitive facilities collocated in the central offices on either end of the route.¹⁰¹

C. Price Caps for Services and Geographic Areas that Lack Sufficient Competition

111. Of course, the proposed refinement of special access triggers requires instituting some sort of price control for those services and routes that fail the impairment tests. Specifically, those circuits should be subject to an effective system of price cap regulation. The Commission already has extensive experience with setting a GDP-PI – X price cap.

⁹⁹ *Furchtgott-Roth/Hausman Declaration in Special Access Proceeding*, p. 20.

¹⁰⁰ *TRRO*, ¶ 104.

¹⁰¹ Given the sunk and fixed costs of deploying high-capacity loops, the FCC standard for wire center impairment includes both a business line test and a collocation test.

112. To be sure, reform of the existing price cap regime will require the Commission to undertake some difficult tasks, including setting a new X factor and re-initializing the special access rates for purposes of setting the price cap index. Nextel has provided the Commission with a number of options for moving forward in this matter, which include allowing the BOCs to file rates based on forward-looking cost studies or to set the initial rates such that their annual rate of return will be 11.25%. Other non-BOC commenters have suggested similar alternatives.¹⁰² Given the evidence of the extent to which the BOCs have been able to set supracompetitive prices and the Commission's extensive experience with price caps, the costs of revising the existing price cap regime are likely worth the benefits.

D. The Economists Retained by the BOCs Exaggerate Regulatory Costs

113. The economists retained by the BOCs provide a litany of regulatory costs that leads them to the conclusion that any FCC move towards more refined special access regulation will fail a cost-benefit test. If the provision of special access were as widely competitive as these economists suggest, then a return to regulation would not likely generate any significant—and possibly no—benefits. However, the extent to which MSAs have been effectively (and inappropriately) deregulated with respect to special access prices suggests that the BOCs have had

¹⁰² Comments of AT&T Corp., *In the Matters of Special Access Rates for Price Cap Local Exchange Carriers and AT&T Petition for Rulemaking to Reform Regulation of Incumbent Local Exchange Carrier Rates for Special Access Services*, WC Docket No. 05-25; RM 10593. pp. 2-6.

Comments of ATX Communications Services, Inc. et al., *In the Matters of Special Access Rates for Price Cap Local Exchange Carriers and AT&T Petition for Rulemaking to Reform Regulation of Incumbent Local Exchange Carrier Rates for Special Access Services*, WC Docket No. 05-25; RM 10593. pp. 17-22.

Comments of Paetec Communications, Inc., *In the Matters of Special Access Rates for Price Cap Local Exchange Carriers and AT&T Petition for Rulemaking to Reform Regulation of Incumbent Local Exchange Carrier Rates for Special Access Services*, WC Docket No. 05-25; RM 10593. p. 11.

Comments of The Ad Hoc Telecommunications Users Group, *In the Matters of Special Access Rates for Price Cap Local Exchange Carriers and AT&T Petition for Rulemaking to Reform Regulation of Incumbent Local Exchange Carrier Rates for Special Access Services*, WC Docket No. 05-25; RM 10593. pp. 37-43.

Comments of XO Communications, Inc., *In the Matters of Special Access Rates for Price Cap Local Exchange Carriers and AT&T Petition for Rulemaking to Reform Regulation of Incumbent Local Exchange Carrier Rates for Special Access Services*, WC Docket No. 05-25; RM 10593. p. 12.

considerable potential to exercise market power in the pricing of special access. The evidence discussed above indicates that they have exercised that market power. Thus, the consumer benefits from the replacement of the pricing flexibility triggers with more competitively meaningful standards are likely to be substantial.

1. The Economists Retained by the BOCs Ignore the Benefits from the Proposed Regulation

114. The economists for the BOCs argue that competition is, in fact, widespread and there is no need for any regulation of special access services. For example, Dr. Kalt, relying on the Casto Declaration, concludes that entry has been robust in most if not all MSAs.¹⁰³ Yet, as discussed above and in the comments of numerous other parties, the MSA is far too extensive a geographic area to be a relevant antitrust market. Indeed, the Commission made the same points in the *TRRO*. As a result, even if there is limited competition in (e.g.) the densest parts of a MSA, the experience of Nextel and others indicates that that competition does not extend throughout the MSA.
115. The economists (and other experts) for the BOCs note that the fact that prices in some MSAs for some special access services may have risen is not a sufficient reason to impose a more competitively sensitive regulatory regime because such price increases do not indicate a non-competitive market.¹⁰⁴ As suggested by the Fischer Declaration discussed above, the price increases have not been isolated but appear to have occurred in most, if not all, MSAs in which Phase II pricing flexibility has been granted. In any event, special access prices remain far above the rates for the comparable cost-based UNE services, one obvious benchmark for what competitive prices might be.

¹⁰³ Kalt Declaration in Special Access Proceeding, ¶¶ 7-39.

¹⁰⁴ Kalt Declaration in Special Access Proceeding, ¶ 69. Furchtgott-Roth/Hausman Declaration in Special Access Proceeding, p. 31.

2. *The Economists for the BOCs Overstate the Incentive Effects of the Proposed Regulations*

116. In addition to understating the benefits, the economists retained by the BOCs have likely overstated the costs of any return to price regulation, costs which they cite as reasons why adopting a more precise standard for pricing flexibility would be a policy mistake. For example, Drs. Furchtgott-Roth and Hausman note that rate-of-return regulation has been shown “to retard investment in new technologies by the regulated companies, to lead to productive inefficiency (failure of cost minimization) and thus higher prices to consumers, and to severely distort competition between the regulated service provider and its unregulated competitors.”¹⁰⁵ This critique is made against the backdrop of the observation that “[e]conomists generally agree that rate-of-return regulation should almost never be used in a situation where competition exists...”¹⁰⁶ And Dr. Kalt makes similar points.¹⁰⁷
117. First, we agree with these economists that rate of return regulation (or, for that matter, any kind of price regulation) should not be imposed on competitive markets in the absence of any market failure. In such markets, the regulation could cause harms without any offsetting benefits. But as just discussed, that is not an accurate characterization of special access markets. “Letting the market work” is not the best prescription for advancing consumer welfare in these non-competitive markets.
118. Second, it should be noted that neither Nextel nor, to our knowledge, any other party has proposed a return to rate-of-return regulation. Thus, the discussion of

¹⁰⁵ *Furchtgott-Roth/Hausman Declaration in Special Access Proceeding*, p. 22.

¹⁰⁶ *Furchtgott-Roth/Hausman Declaration in Special Access Proceeding*, p. 23.

¹⁰⁷ *Kalt Declaration in Special Access Proceeding*, ¶ 17.

the economists for the BOCs on the costs associated with this traditional type of regulation is beside the point.¹⁰⁸ Those costs will not be incurred.

119. Third, the potential social costs of regulation highlighted by Drs. Furchtgott-Roth and Hausman, cited above, could equally well apply to an unregulated BOC monopolist of special access services. The lack of special access competition results in higher input prices to special access customers, thereby distorting competition (e.g., among CMRS carriers and between CMRS carriers and wireline providers); diminishes innovation by those customers because of the higher input costs; allows the unregulated monopolist to act inefficiently in the absence of any ability of investors to benchmark the monopolist's performance; and via the control of bottleneck facilities, allows the monopolist to prevent any downstream competition with the BOC from arising in the first place. Moreover, by restricting the availability of special access services below the competitive level, the monopolist under-invests in network capacity, resulting in a certainly less extensive and possibly less innovative telecommunications infrastructure.
120. Given the existence and exercise of substantial market power by the BOCs, the necessary conditions for more nuanced special access rate regulation are fulfilled. And the kinds of regulations that Nextel and other parties have proposed will tend to protect consumers from excessive prices while minimizing the costs of regulation.
121. Moreover, parties urging the Commission to regulate special access have proposed a return to price caps, not to rate-of-return regulation. As compared to rate-of-return regulation, price caps for a BOC's special access services have numerous well-known virtues, because the BOC can retain any earnings above

¹⁰⁸ *Furchtgott-Roth/Hausman Declaration in Special Access Proceeding*, p. 22-23; *Kalt Declaration in Special Access Proceeding*, ¶¶ 77-78.

Note, however, that Kalt claims that "AT&T's suggestion that the Commission should reinitialize special access Phase II rates at a level sufficient to generate an 11.25% rate-of-return price-cap on LECs' special access services amounts to little more than a return to rate-of-return regulation." (note omitted). *Kalt Declaration in Special Access Proceeding*, ¶ 76. This is simply incorrect. Once the cap has been set, the key costs of rate-of-return regulation (described above) are eliminated. And in any event, Nextel has proposed an alternative to this method of rate re-initialization.

normal productivity increases generated under the price cap.¹⁰⁹ Thus, the BOC has an incentive to adopt more efficient productive techniques and to otherwise reduce costs. A price cap regime provides continuing incentives for network modernization and for innovations. Further, the price cap permits the BOC to respond to any lower prices that might be offered by a rival. With respect to special access in particular, the kind of regulatory proposals made by Nextel and others reduces regulatory costs by allowing the BOCs to have pricing flexibility when competitive conditions warrant.

122. The economists for the BOCs agree that even a price cap regime that limits downward pricing flexibility “removes many of the worst investment distortions of rate-of-return regulation.”¹¹⁰ They nonetheless argue that adopting such a price cap regime “still presumes the absence of competition” and therefore imposes costs on consumers.¹¹¹ Adoption of the Commission’s impairment standards to identify wire centers where competition has developed should limit these consumer costs.
123. Moreover, these economists find fault even with the pricing flexibility afforded by Phase II flexibility. They suggest that instead of any price regulation, the FCC can rely on (e.g.) “limitations on the pricing of access services through merger conditions, Section 271 non-discrimination provisions, and Section 272 non-discrimination provisions” (notes omitted).¹¹² Yet, the evidence they cite is not on point or misses the point. For example, the merger conditions cited have nothing to do with special access, nor does the cited Section 271 non-discrimination matter.¹¹³ The Section 272 citation does not refer to discrimination in favor of

¹⁰⁹ To be sure, many of the benefits of price caps can be reduced by the way in which price caps are implemented, which (of course) highlights the importance of careful implementation.

¹¹⁰ *Furchtgott-Roth/Hausman Declaration in Special Access Proceeding*, p. 23.

¹¹¹ *Furchtgott-Roth/Hausman Declaration in Special Access Proceeding*, pp. 23-24.

¹¹² *Furchtgott-Roth/Hausman Declaration in Special Access Proceeding*, pp.36-37.

¹¹³ With respect to the merger conditions, Drs. Furchtgott-Roth and Hausman cite SBC Communications, Inc.; Apparent Liability for Forfeiture, Forfeiture Order, 17 FCC Rcd 19923 (2002). Yet, this order addresses shared transport, not special access. With respect to Section 271, they cite BellSouth Corp.,

special access customers with competitive alternatives but refers to discrimination “in favor” of a BOC affiliate.¹¹⁴

124. The economists for the BOCs also assert that any change in regulatory regimes will add to the already-existing regulatory uncertainty, further reducing the incentives to invest and innovate.¹¹⁵ While regulators should surely avoid sudden and arbitrary changes in regulations, the changes Nextel has proposed to the current special access regulations will be neither. As the Commission considers the policy alternatives, the process will not be sudden—if anything, the process may be too lengthy, allowing continuing harm to consumers from the BOCs’ provision of special access services at supracompetitive prices. And, in light of the evidence on the lack of special access competition, measuring the potential for competition by changing from the current triggers to the impairment standards would be anything but arbitrary.
125. Thus, while regulatory uncertainty does complicate investment decisions by the BOCs, that cost must be weighed against the consumer consequences of supracompetitive pricing by the BOCs in wire centers that fall far short of competition. In the areas served by those wire centers and in the absence of more finely-tuned regulation, special access customers will surely limit their investments as a result of supracompetitive special access prices, with the effect of raising prices to consumers above what they would otherwise be.

Order, 18 FCC Rcd 15135 (2003), which addresses (among other things) improperly rejecting local service requests of CLECs, not access service requests for interstate special access services. These citations are in Footnotes 66 and 67, respectively, in the *Furchtgott-Roth/Hausman Declaration in Special Access Proceeding*.

¹¹⁴ AT&T Corp. v. BellSouth Telecommunications, Inc., Memorandum Opinion and Order, 19 FCC Rcd 23898 (2004), which is cited in Footnote 68 of the *Furchtgott-Roth/Hausman Declaration in Special Access Proceeding*.

¹¹⁵ *Furchtgott-Roth/Hausman Declaration in Special Access Proceeding*, pp. 25-26; *Kalt Declaration in Special Access Proceeding*, ¶ 70.

3. *The Economists Retained by the BOCs Overstate the Implementation Costs of the Proposed Regulations*

126. The economists for the BOCs also argue that implementing a new regulatory regime will be so costly that the Commission should forego any change, except one that provides the BOCs with even more pricing flexibility. For example, Drs. Furchtgott-Roth and Hausman claim that the information requirements for a refined pricing flexibility regime are so substantial that the Commission will be unable to justify such a regime.¹¹⁶ In particular, these economists claim that without comprehensive econometric demand studies, accurate cost measures, and a low-cost way of monitoring competitive developments, the Commission should not only forego any new regulations but should abandon all existing special access regulations. Similarly, Dr. Kalt notes that the “relevant information from the marketplace—products, customers, technology, and costs—is infinitely detailed and variegated” and unless regulation is “done perfectly” will lead to distortions.¹¹⁷
127. These claims are exaggerated at best. For example, Drs. Furchtgott-Roth and Hausman insist that comprehensive demand studies are required to determine the extent of price substitutability across special access services and geographic areas: “Such studies would be necessary for the FCC to have a rational basis for price regulation of special access services.”¹¹⁸
128. In regulatory and antitrust analysis generally and in the competitive analysis of communications markets in particular, such comprehensive demand studies are rarely available, yet that lack of availability does not render antitrust enforcers, policymakers, or the courts impotent. There are numerous other ways of establishing patterns of service substitution and geographic substitution and the extent of competition, including an examination of the functionality and costs of

¹¹⁶ *Kalt Declaration in Special Access Proceeding*, ¶¶ 79-82.

¹¹⁷ *Kalt Declaration in Special Access Proceeding*, ¶ 17.

¹¹⁸ *Furchtgott-Roth/Hausman Declaration in Special Access Proceeding*, p. 30.

providing alternative services and the way in which customers actually purchase those services. As previously discussed, the analyses of Nextel, other parties, and also the Commission suggest what the appropriate service and geographic boundaries for special access services should be.

129. Drs. Furchtgott-Roth and Hausman also assert that the Commission lacks the necessary cost basis for the development of the more focused regulation of special access services.¹¹⁹ In fact, the Commission has available to it the estimated costs of very close functional substitutes for the current special access services—UNE high-capacity loops and transport. These estimates (and the periodic revisions in those estimates) can serve to ensure that the new price caps are not set below those cost measures.

130. Finally, Drs. Furchtgott-Roth and Hausman assert that “the FCC would rationally have to monitor competitive conditions in each of these markets. Administratively, all of this monitoring would be costly to the FCC.”¹²⁰ As noted previously, the incremental administrative cost of monitoring changes in competitive conditions in the proposed price cap regime can be virtually nil if the Commission adopts refined triggers similar to those already in place in its UNE impairment standards.

E. Summary

131. Previous sections have described some key “stubborn facts” that should lead the Commission to implement a more refined special access regulatory regime. The entry barriers to the provision of CT and CM services are substantial and only likely to be overcome in some parts of a MSA, not all of the MSA. The existence of those barriers has prevented special access competition from emerging throughout the MSA. And the effect of allowing the BOCs pricing flexibility in areas where competition is non-existent or nearly so has elevated special access

¹¹⁹ *Furchtgott-Roth/Hausman Declaration in Special Access Proceeding*, pp. 26-27.

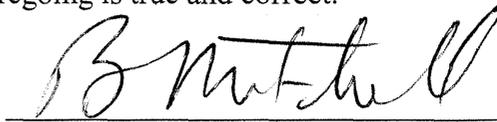
¹²⁰ *Furchtgott-Roth/Hausman Declaration in Special Access Proceeding*, p. 30.

rates further above competitive levels. As a result, consumers have been harmed through these higher prices.

132. The remedy that Nextel has proposed is to replace the current pricing flexibility triggers with the Commission's UNE impairment standards or similar standards as the criteria for permitting BOC pricing flexibility. It has the advantages of being appropriately focused on areas smaller than the MSA and can be implemented with virtually no additional administrative costs. While the Commission would have to apply price caps to the BOCs' special access services in impaired markets, even these costs will be limited, given the Commission's price cap experience.
133. The claims by the economists for the BOCs that the costs of more refined special access price regulation far outweigh the benefits of that regulation are based in the first instance on the view that the provisioning of special access is already subject to substantial competition and therefore any benefits from added regulation are small. This view is incorrect, as we have discussed above.
134. In addition to understating the benefits of more refined regulation, the economists for the BOCs overstate the costs of the proposed regulation. Many of the worst fears of these economists—that regulation would create perverse incentives—are mitigated if not eliminated through the use of price caps, as these economists themselves admit. And the costs of implementing the new regulatory framework are not likely to be so substantial as to offset the significant benefits to consumers from special access rates that are closer to competitive levels.

I declare under penalty of perjury that the foregoing is true and correct.

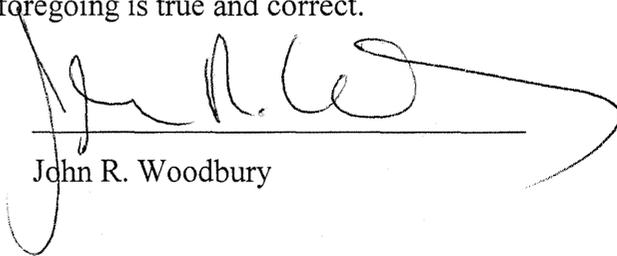
Executed on July 26, 2005

A handwritten signature in cursive script, appearing to read "B Mitchell", written over a horizontal line.

Bridger M. Mitchell

I declare under penalty of perjury that the foregoing is true and correct.

Executed on July 27, 2005

A handwritten signature in cursive script, appearing to read "John R. Woodbury", written over a horizontal line.

John R. Woodbury

ATTACHMENT 2

DECLARATION OF STEVEN SACHS

**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-10593
)	
)	

DECLARATION OF STEVEN SACHS

1. My name is Steven Sachs. My current title is Senior Director, Telco Management at Nextel Communications, Inc. ("Nextel"). My experience in the telecommunications industry includes more than nine years with Nextel in positions of increasing responsibilities, two years at MCI, Inc., and one year at Cable & Wireless. I received an MBA from Case Western Reserve University in 1989, and an A.B. from Brandeis University in 1986.
2. In my current position, I am responsible for a wide range of issues, including but not limited to: managing Nextel's telecommunications expenditures from contract through accrual; creating budgets and forecasts for such expenditures; negotiating all telecommunications carrier contracts and interconnection agreements; processing and auditing all telecommunications invoices; resolving billing disputes; reviewing all SONET procurements to ensure optimal design and compliance to network standards; evaluating new vendors; coordinating and communicating with existing vendors; and

managing cost savings projects associated with Nextel's internal network provisioning and network optimization.

3. The purpose of this declaration is to describe: a) Nextel's extensive reliance on special access services provided by Bell Operating Companies ("BOCs") under tariff; b) Nextel's largely unsuccessful efforts to use services provided by competing service providers; and c) the significant cost and service quality drawbacks associated with the use of fixed wireless and cable services to meet Nextel's needs.
4. Nextel is a Commercial Mobile Radio Service ("CMRS") provider based in Reston, Virginia, and is the fourth largest nationwide wireless carrier in the United States with over 17.8 million customers. Nextel's network includes cell sites in the great majority of MSAs in the country. In many cases, Nextel's cell sites are spread widely throughout an MSA, with many cell sites located outside of central business districts.
5. Nextel's network architecture relies heavily on wireline facilities from other providers for the links between its cell sites and its mobile switching centers ("MSCs"). Three interconnected segments provide this connectivity: links between Nextel's cell sites and the BOCs' serving wire centers; transport facilities between the BOCs' central offices; and connections between the central offices and Nextel's MSCs.
6. Nextel principally uses a DS1 level of service to connect its cell sites with BOC central offices. Because of the iDEN technology Nextel uses in its network, DS1 circuits are sufficient to handle the volumes of traffic that originate and terminate at a single cell site. In the BOCs' service territories, Nextel obtains approximately 97% of its DS1 channel termination circuits between Nextel's cell sites and the BOC serving wire center from BOCs. These DS1 connections are cell site circuits and are

purchased out of the BOCs' tariffs as special access channel terminations. Depending on traffic volumes, Nextel then either utilizes DS1 circuits to carry traffic between BOC central offices or aggregates traffic from several Nextel cell sites at a BOC central office and moves the traffic onto one or more DS3 circuits for transmission to another central office. Nextel obtains the vast majority of this interoffice transport from the BOCs as special access channel mileage services purchased out of the BOCs' tariffs. From the serving wire center closest to Nextel's MSC, Nextel obtains DS3 or OCn services to carry that traffic to the MSC via a SONET configuration (either ring or point-to-point). Over 40% of these "entrance facilities" are purchased from competitive providers. The remainder is obtained as special access services purchased out of the BOCs' tariffs. Nextel has been unable to obtain any of these connections as unbundled network elements. As a result, all of Nextel's special access purchases are made under price cap and pricing flexibility optional pricing plans. Nextel obtains term and/or volume discounts for these purchases. Nextel typically purchases channel terminations and channel mileage as separate services and is charged a separate rate for each service.

7. Where possible, Nextel attempts to use a single carrier to provide both the channel termination and the channel mileage services needed to connect a particular cell site to Nextel's MSC. The desire to use a single carrier (rather than having two carriers providing different portions of the circuit) is driven by maintenance and repair concerns. Using a single provider facilitates the ability to resolve troubles on the circuit. Nextel uses a competitive provider for one part of a circuit and a BOC for another part of the circuit when the competitive provider's services are cheaper than

the BOC's but the competitive provider cannot provide the entire, end-to-end service. In such a situation, however, Nextel must weigh the lower price it can obtain by using a competitive carrier for part of the circuit against the increased difficulties associated with resolving troubles on multiple-vendor circuits. If Nextel experienced a service outage or other problems on a circuit provided by more than one carrier, its reliance on multiple service providers for the circuit would complicate the troubleshooting and repair process. Because no single carrier would have responsibility for the entire connection, pinpointing and correcting a problem would take longer as the providers would need to coordinate testing and maintenance activities between themselves, as well as with Nextel.

8. Nextel actively seeks alternatives to special access services provided by BOCs and selects competitive providers when it is economically and operationally feasible to do so. In the overwhelming majority of cases, however, the BOC is the only service provider capable of providing the "last-mile" DS1 channel termination between the serving wire center and Nextel's cell sites.
9. Even in MSAs where competitors have fiber rings, those facilities may not be located in the areas where some of Nextel's cell sites are located. Moreover, even at locations where a Nextel cell site is situated near a competitive fiber ring, that fact alone does not mean that it is feasible to connect Nextel's cell site directly to the competitive provider's ring. A key threshold question is whether Nextel's cell site is near a node that provides access to the ring. Even then, Nextel would still have to determine whether it is cost-effective to connect its cell site to the node, either by having the competitive provider build a new DS1 link between the tower location and

the node or, alternatively, by leasing DS1 service between the tower and the node from the BOC. Because the costs associated with the new construction needed to connect a cell site to a competitive carrier's ring are substantial, it is more cost-effective to use BOC special access to connect the cell site to the ring. In that event, Nextel would need to consider the disadvantages (described above) of using a multiple-vendor service arrangement for the connection between its cell site and its MSC (*i.e.*, using BOC special access to connect the cell site to a node on the competitive carrier's ring and relying on the competitive provider to carry traffic between the node and Nextel's MSC).

10. The lack of meaningful competitive alternatives was highlighted by the lack of responses to Nextel's recent attempt to replace its BOC-supplied special access connections in the New York metropolitan area with services from competitive providers. Specifically, in the spring of 2004, Nextel issued a request for information ("RFI") soliciting bids from competitive providers for links it had been obtaining from the BOC to connect all of Nextel's over 1,500 New York-area cell sites to its hub locations (ring nodes where Nextel aggregates traffic for backhaul) in the New York metropolitan area. The RFI specified that service must be provided over the vendor's own on-net facilities and meet certain service level commitments that Nextel requires to satisfy the needs of its end-user customers.
11. The RFI was sent to 13 providers. Despite the fact that each vendor submitted a formal letter confirming its intent to participate and provide a proposal, only four vendors provided responses indicating they could serve at least some of the locations

listed in the RFI. Those four vendors offered to provide service to a total of only 43 cell sites – fewer than 3% of the over 1,500 listed in the initial request.

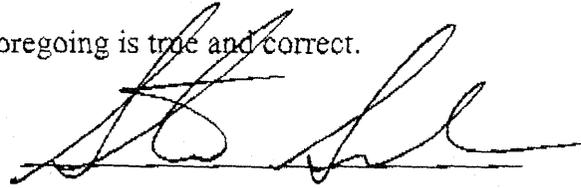
12. Nextel experienced similar results when it issued a RFI seeking connections between its cells sites and hub locations in the Nextel West Region (including the Seattle, Northern California Bay, Los Angeles/San Diego/Las Vegas, Denver and Phoenix metropolitan service areas). Of the seven non-BOC vendors to which the RFI was sent, only three submitted viable offers. These providers indicated an ability to serve a total of only 76 sites – fewer than 2% of the nearly 4,700 sites identified in the RFI. The other respondents did not make viable bids. For example, one provider offered to resell BOC circuits at 165 sites. Likewise, two cable vendors responded with cost-prohibitive solutions, one requiring Nextel to incur \$30,000 per site in fixed costs.
13. Although Nextel is very interested in alternatives to the BOCs' special access circuits, it rarely relies on fixed wireless or cable providers to provide service because of concerns regarding the costs and reliability of these alternative technologies. For example, fixed wireless technology often requires direct line-of-sight between the cell site and the fixed wireless transmitter, which may be difficult to achieve in some of the locations (such as downtown areas in major cities) where Nextel's cell sites are located. In addition, fixed wireless service is susceptible to poor performance in inclement weather, such as snow or rain, and therefore may not provide Nextel with the reliable service it requires to satisfy its customers. Fixed wireless alternatives are also not cost-effective in many instances due to the relatively high cost of the equipment and the relatively low bandwidth requirements (typically DS1) of a single cell site. As a result, only approximately 2% of DS1 circuits between Nextel's cell

sites and BOC serving wire centers are provided over fixed wireless. (Nextel does not use fixed wireless for any of its DS3 connections.) Nextel is continually exploring wireless alternatives to BOC special access but to date has not found a technology that is commercially acceptable.

14. Cable alternatives suffer from many of the same problems as fixed wireless. Nextel usually cannot justify the costs of a cable-provided circuit for the limited amount of capacity it requires. In addition, cable systems offer service only in limited areas and do not reach the areas where many of Nextel's cell sites are located. Cable providers also do not operate carrier-grade networks and often cannot meet Nextel's service level requirements, including maintenance and repair intervals. Due to the shortcomings described above, fewer than 1% of Nextel's local DS3s are provided over cable. (Nextel does not purchase any DS1 connections from cable providers.)
15. This concludes my declaration.

I declare under penalty of perjury that the foregoing is true and correct.

Executed on July 29, 2005

A handwritten signature in black ink, appearing to read 'S. Sachs', written over a horizontal line.

Steven Sachs

EXHIBIT 1

NEXTEL REGRESSION ANALYSIS

ESTIMATED BOC SPECIAL ACCESS RATE OF RETURN

	Y1996	Y1997	Y1998	Y1999	Y2000	Y2001	Y2002	Y2003	Y2004
Average Net Investment	\$5,682,447	\$6,373,074	\$7,149,582	\$8,440,569	\$10,438,349	\$11,757,671	\$11,486,181	\$10,235,230	\$9,146,832
Net Return	\$445,552	\$617,253	\$1,279,675	\$1,906,740	\$2,895,075	\$4,502,439	\$4,566,328	\$4,456,785	\$4,912,622
Actual Rate Of Return	7.84%	9.69%	17.90%	22.59%	27.73%	38.29%	39.75%	43.54%	53.71%
Estimated Rate of Return	6.61%	11.88%	17.15%	22.42%	27.69%	32.96%	38.23%	43.50%	48.77%

Average Net Investment (ANI) and Net Return data are in 000s and are from ARMIS 43-01 roll-up for large companies.

Actual Rate of Return data are calculated by dividing Net Return by Average Net Investment.

Estimated Rate of Return data are calculated based on linear regression using actual rate of return data (1996-2000).

1996-2000 time period is used because it is pre-separations freeze and post-sharing.

BOC REVENUE REDUCTION CALCULATION

Assumed Rate of Return Value	27.73%	48.77%	53.71%
Net Return Adjustment	\$1,507,398	\$3,431,891	\$3,883,745
Income Tax Adjustment	\$964,735	\$2,196,410	\$2,485,597
Revenue Adjustment	\$2,472,133	\$5,628,302	\$6,369,342

Net Return Adjustment is calculated by subtracting Assumed Rate of Return Value from 11.25 % net return times 2004 ANI and is in 000s.

Income Tax Adjustment is calculated by multiplying Net Return Adjustment by 64% and is in 000s.

64% is calculated by summing ARMIS 43-01 federal and state income taxes for large companies and dividing by net return

Revenue Adjustment is the sum of the Net Return Adjustment and Income Tax Adjustment and is in 000s.

27.73% and 53.71% Assumed Rates of Return Values are 2000 and 2004 actual ARMIS rates of return respectively.

48.77% Assumed Rate of Return is estimated 2004 rate of return using linear regression of actual rate of return data (1996-2000).

EXHIBIT 2

NEXTEL DS1 AND DS3 SPECIAL ACCESS ANALYSIS

Nextel DS1 and DS3 Special Access Analysis

Nextel performed an analysis of the local special access DS1 and DS3 circuits that it purchased from all providers in early 2005. The purposes of the analysis were: (1) to identify which local DS1 and DS3 special access circuits were provided by BOCs versus CLECs and other competitive providers in the BOC areas; (2) to identify which BOC local DS1 and DS3 special access circuits were located in price cap versus pricing flexibility wire centers; and (3) to identify which BOC local DS1 and DS3 special access circuits were located in wire centers or routes for which the FCC would find that a carrier would be impaired without access to such circuits as an unbundled network element (“UNE”).¹

Nextel purchases over 30,000 DS1 circuits connecting to its cell sites and approximately 3,400 local DS3 circuits. Local DS1 and DS3 special access circuits are used primarily to carry calls between Nextel’s cell sites and its mobile switching centers within an MSA. DS1 special access channel termination (“CT”) circuits are used to connect Nextel’s cell sites to wire centers that serve the cell site locations. From those serving wire center locations, Nextel may purchase either local DS1 or DS3 special access interoffice transport or channel mileage (“CM”) circuits to connect the serving wire center locations either to nodes on local special access fiber rings or to some other destination points such as mobile switching centers.

To perform the analysis, Nextel used its local special access billing and circuit provisioning records. These records identify the types of circuits (DS1 or DS3), the vendors that provide the circuits, the costs of the circuits, the serving wire centers for the DS1 circuits that go to cell sites, and the originating and terminating or A and Z locations for CM. Nextel then created lists of the BOCs’ wire centers that had been granted Phase 2 pricing flexibility relief and were no longer under price cap regulation. Separate Phase 2 pricing flexibility lists were created, one for wire centers with Full Service Relief (both CT and CM) and the other for wire centers with Limited Service Relief (CM only). Nextel also created lists of the BOC wire centers that had been identified by the BOCs as satisfying the business line or collocation thresholds the FCC uses to determine impairment for DS1 UNE loops and DS1 and DS3 UNE transport.

¹ In the *Triennial Review Remand Order*, 20 FCC Rcd 2533 (2005) (“*TRRO*”), the FCC found that requesting carriers are not impaired without access to DS1-capacity loops to provide service to any location served by an incumbent LEC wire center containing at least 60,000 business lines and at least four fiber-based collocators. For DS1 transport, the Commission found that requesting carriers are not impaired on routes connecting a pair of wire centers if the wire centers on both ends of the route have at least 38,000 business lines or at least four fiber-based collocated CLECs. Similarly, the FCC found that with respect to DS3 loops, requesting carriers are not impaired in their ability to provide service to any location served by an incumbent LEC wire center containing at least 38,000 business lines and at least four fiber-based collocated CLECs. With respect to DS3 transport, the FCC found that requesting carriers are not impaired on routes connecting a pair of wire centers if the wire centers on both ends of the route have at least 24,000 business lines or at least three fiber-based collocated CLECs.

Using these data and lists, Nextel identified which local special access DS1 and DS3 circuits were provided by BOCs and which local DS1 and DS3 special access circuits were provided by CLECs and other competitive providers. Nextel then identified which BOC local DS1 special access circuits to its cell sites were located in Phase 2 Full Service Relief wire centers and which BOC local DS1 and DS3 special access CM circuits were located in or connected to Phase 2 Full Service Relief or Phase 2 Limited Service Relief wire centers based on the wire center lists and wire center data. In the case of channel mileage, if both the A and Z locations had relief, 100% of the quantities and costs were counted as having price cap relief and, if only one end of circuit had relief, then 50% of the quantities and costs were counted as having price cap relief. Once the BOC special access circuits located in Phase 2 pricing flexibility wire centers (both Full Service Relief and Limited Service Relief wire centers) were identified, these circuits were subtracted from the total BOC local DS1 and DS3 special access circuits to derive the local special access BOC circuits that were located in wire centers subject to price cap regulation.

A similar process was used to identify which BOC local DS1 and DS3 special access circuits were provided from wire centers the BOCs have identified as supporting findings of non-impairment. Using its data and the wire center lists, Nextel identified which BOC local DS1 special access CT circuits to its cell sites were served out of wire centers that met the impairment triggers established by the *TRRO*, and which BOC local DS1 and DS3 special access interoffice transport (CM) circuits served routes that met the relevant *TRRO* triggers. Once these BOC special access circuits were identified, they were subtracted from the total BOC local DS1 and DS3 special access circuits to derive the local special access BOC circuits that were located in (or connected to) impaired wire centers. A final analysis was performed that took the circuits located in just those areas with Phase 2 pricing flexibility and identified which of those circuits also were served by wire centers or routes that had met the conditions for non-impairment based on the type of UNE.

The results of Nextel's analysis are provided in the following tables:

Table 1 provides information about BOC-provided DS1 and DS3 special access used by Nextel. Table 1 shows the percentage of circuits or monthly costs in the BOC service areas that are provided by BOCs. The percentages were calculated by dividing the BOC quantities by the total quantities for each type of circuit. The total quantities include BOC and CLECs and other competitive providers in the BOC areas.

TABLE 1
PERCENT BOC-PROVIDED DS1/DS3 SPECIAL ACCESS

<u>Type</u>	<u>% BOC Provided</u>
DS1 to Cell Site Circuits	97%
DS1 to Cell Site Monthly Costs	96%
DS1 Transport Circuits	92%
DS1 Transport Monthly Costs	91%
DS3 Transport Circuits	83%
DS3 Transport Monthly Costs	82%

Table 2 provides information about BOC-provided DS1 and DS3 special access circuits used by Nextel. The data show the percentage of circuits or monthly costs that are: (1) served by wire centers or routes in impaired locations and (2) are in areas currently subject to price cap regulation. The percentages in impaired wire centers were calculated by first subtracting the non-impaired wire center quantities developed from Nextel's analysis from the total quantities for each type of circuit and then dividing the resulting impaired wire center quantities by the total quantities for each type. The price cap wire center percentages were calculated by first subtracting the pricing flexibility quantities developed from Nextel's analysis from the total quantities by circuit type and then dividing the resulting price cap quantities by the total quantities for each type. The data were DS1s to cell sites and DS1 interoffice transport and DS3 interoffice transport.

TABLE 2
BOC-PROVIDED DS1/DS3 SPECIAL ACCESS²

<u>Type</u>	<u>% In Impaired Wire Centers</u>	<u>% In Price Cap Wire Centers</u>
DS1 to Cell Site Circuits	93%	78%
DS1 to Cell Site Monthly Costs	94%	78%
DS1 Transport Circuits	84%	39%
DS1 Transport Monthly Costs	88%	43%
DS3 Transport Circuits	57%	29%
DS3 Transport Monthly Costs	58%	31%

² In some cases the DS1 to cell site data included DS1 interoffice transport from cell site serving wire centers to wire centers where the DS1 interoffice transport was aggregated with other DS1s onto a DS3.

Table 3 was developed in a similar manner as the data in Table 2 except the data are limited to wire centers where BOCs have Phase 2 pricing flexibility and shows the percentages of circuits or monthly costs within the pricing flexibility areas that also are served by wire centers or routes in impaired locations.

TABLE 3
BOC-PROVIDED DS1/DS3 SPECIAL ACCESS
IN PRICING FLEXIBILITY AREAS

<u>Type</u>	<u>% In Impaired Wire Centers</u>
DS1 to Cell Site Circuits	87%
DS1 to Cell Site Monthly Costs	87%
DS1 Transport Circuits	63%
DS1 Transport Monthly Costs	70%
DS3 Transport Circuits	33%
DS3 Transport Monthly Costs	31%