Before the
Federal Communications Commission
Washington, DC 20554

In the Matter of	)	
	)	
Petition of AT&T Inc. For Forbearance	)	
Under 47 U.S.C. § 160(c) From Enforcement	)	
Of Certain of the Commission's Cost	)	
Assignment Rules	)	WC Docket No. 07-21
	)	
Petition of BellSouth Telecommunications,	)	
Inc. For Forbearance Under 47 C.F.R. § 160(c)	)	
From Enforcement of Certain of the	)	
Commission's Cost Assignment Rules	)	

OPPOSITION OF SPRINT NEXTEL CORPORATION

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Sprint Nextel Corporation ("Sprint Nextel") hereby files its Opposition to the Petitions for Forbearance from enforcement of the Federal Communication Commission's ("Commission") cost assignment rules (together the "Petition") filed by AT&T Inc. and BellSouth Telecommunications, Inc. (together "AT&T") in the above-referenced proceeding.[1]

I. INTRODUCTION AND SUMMARY

AT&T's Petition asks the Commission to forbear from enforcing the cost assignment rules -- the very rules the Commission needs to help keep AT&T's market power in check. Given that such rules affect several ongoing, more comprehensive Commission proceedings and affect the ability of the states to carry out their regulatory obligations, the Commission should address any changes in the context of those proceedings or other rulemakings, rather than through one company's forbearance petition.

[1] The rules from which AT&T seeks forbearance collectively will be referred to herein as the "cost assignment rules."

Furthermore, upon reviewing the merits of the Petition, the Commission must determine that AT&T fails to provide sufficient evidence satisfying any of the three elements of the statutory forbearance test because:[2] (1) enforcement of the cost assignment rules is necessary to ensure charges are just and reasonable and are not unjustly or unreasonably discriminatory; (2) enforcement is necessary to protect consumers; and (3) forbearance is against the public interest.

AT&T fails to satisfy the first element because the cost assignment rules generate key information the Commission needs to confirm whether its pricing policies are effective and yield just, reasonable and nondiscriminatory prices. Cost data are essential not only to assess the efficacy of the current price cap plan and to recalibrate price cap rate levels, but also to provide evidence regulators need to detect and take enforcement action against anticompetitive conduct in deregulated environments. The states also need these data for a wide variety of regulatory purposes, such as determining rate regulation and state universal service policies. Moreover, given that market forces have failed to restrain incumbent local exchange carrier ("ILEC") market power in certain critical sectors of the market, such as special access and switched access, cost assignment data are needed to prevent, detect, and remedy anticompetitive behavior.

AT&T also does not demonstrate that enforcing the cost assignment rules is unnecessary to protect consumers, nor could it. Cost assignment rules are necessary to help ensure that AT&T's customers in markets where it faces little or no competition are not forced to cross-subsidize AT&T's offerings in increasingly competitive markets and that consumers are not subjected to AT&T anticompetitive actions. Cost assignment rules also protect consumers by ensuring that AT&T cannot use universal service fund ("USF") monies to subsidize its non-USF covered services.

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[2] *See* 47 U.S.C. § 160(a).

Moreover, AT&T fails to prove that forbearance is in the public interest. The cost assignment rules help ensure that the rates for essential inputs are cost-based, thereby sending the correct market signals to other market participants that may be considering expanding their offerings or entering new markets. The Commission's overarching public interest mandate as set forth in Title I of the Communications Act, as amended, is to enable competition. Any decision that detracts from that mandate – and granting AT&T's forbearance petition would do so – plainly would run afoul of this mandate and would therefore not be in the public interest. Accordingly, because AT&T fails to satisfy all three elements of the forbearance test, the Commission must deny AT&T's Petition.

II. A RULEMAKING, NOT A PETITION FOR FORBEARANCE, IS THE APPROPRIATE VEHICLE TO REVIEW THE COST ASSIGNMENT RULES.

AT&T's Petition is not asking the Commission merely to remove a reporting requirement it finds burdensome, but rather to eliminate fundamental tools that both the Commission and the state public utility commissions need to fulfill their statutory obligations. Given the significance of the cost assignment rules, any changes should be made only through a thorough, deliberative, industry-wide rulemaking, not through a petition for forbearance for a single company. Specifically, a comprehensive review should be done through a rulemaking informed by a federal-state joint board review or through one of the pending proceedings addressing many of the same issues the Petition has raised.

A. A Federal-State Joint Board Review Would Take State Issues Into Account.

Federal and state cooperation is essential given that such complex interstate and intrastate pricing mechanism issues could impact both federal and state regulators' ability to regulate, as described in greater detail below. The Public Service Commission of Wisconsin ("PSCW") agrees. In its Comments, the PSCW urges the Commission to refer this matter to the Federal-

State Joint Board on Jurisdictional Separations, "for a more thorough (and necessary) examination of how the AT&T proposal could affect state accounting and other requirements," such as assessments, affiliate transactions regulation, price cap oversight, subscriber line charges and other state functions.[3] In addition to the Federal-State Joint Board on Jurisdictional Separations, the Federal-State Joint Conference on Accounting Issues could perform the analysis or the Commission could choose to convene a specially formed Federal-State Joint Board on Cost Assignment Issues.

The Commission typically relies on federal-state joint board reviews to assess cost assignment issues. For example, the Commission established the Federal-State Joint Conference on Accounting Issues "to ensure that regulatory accounting data and related information filed by carriers are adequate, truthful and thorough."[4] In the Wireline Competition Bureau's 2006 Biennial Review Staff Report ("WCB Staff Report"), WCB staff noted that this Joint Conference is considering Part 43 affiliate transactions rule issues, and the Joint Conference may recommend modifications.[5] It may be that the Joint Conference will recommend significant modifications to the affiliate transactions rules. Yet AT&T, which has a strong interest in reducing the Commission's oversight over its affiliate transactions given its numerous affiliates, has sought immediate forbearance from enforcement of key sections of the Part 43 affiliate transactions rules. As the WCB staff has specifically advised, the Commission should await the recommendations of the Federal-State Joint Conference before taking any action on these rules.[6]

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[3] Comments of the Public Service Commission of Wisconsin, WC Docket No. 07-21 at 1 (filed March 16, 2007).
[4] *Federal-State Joint Conference on Accounting Issues*, WC Docket No. 02-269, Order, 17 FCC Rcd 17025, 17025, para. 1 (2002).
[5] *Federal Communications Commission 2006 Biennial Regulatory Review, Wireline Competition Bureau Staff Report*, WC Docket No. 06-157, at 25 (rel. Feb. 14, 2007) (*WCB Staff Report*).
[6] *Id.*

B. Pending Proceedings Address or Are Affected By The Issues AT&T's Forbearance Petition Raises.

Alternatively, the Commission already has several open proceedings that either rely on the data derived from the cost assignment rules or examine the very same issues that AT&T raises in its Petition. Considering cost assignment issues in the context of a single forbearance petition could short circuit these pending, more comprehensive proceedings.

For example, the Commission is in the process of determining whether its special access pricing flexibility rules have worked as intended, and if not, whether they should be modified or repealed.[7] This proceeding involves a thorough examination of the supra-competitive prices ILECs, including AT&T, are charging under the current interstate price cap system. Excessive earnings are a key indicator that prices are not just and reasonable, and it is the very cost assignment data AT&T seeks to avoid that exposes whether special access earnings are excessive relative to the cost of providing special access services. Granting the Petition, however, will deprive the Commission of an independent source of information, i.e., the Automated Reporting Management Information System ("ARMIS") reports. The Commission could check this independent information against whatever data the former SBC has provided in the record and whatever data AT&T elects to provide in the Commission's review of ILEC costs under the existing price cap mechanism as well as under pricing flexibility.

The Commission's comprehensive review and reform of the intercarrier compensation framework also requires cost data to ensure that any new regime promotes a competitive telecommunications market. For example, the Commission indicated that intercarrier

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[7] *Special Access Rates for Price Cap Local Exchange Carriers, 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, Order and Notice of Proposed Rulemaking, 20 FCC Rcd 1994, 1995, para. 1 (2005) (*Special Access NPRM*).

compensation reform efforts require the continued availability of information reported in the ARMIS reports.[8]

Furthermore, the Commission already is considering extensive reform of the Part 36 jurisdictional separations rules, which allocate costs between state and federal jurisdictions. Last year, the Commission extended the jurisdictional separations freeze and issued a further notice of proposed rulemaking to consider additional reform of the jurisdictional separations process.[9] In its WCB Staff Report, WCB staff recommended that any Part 36 changes be instituted in the context of the *Separations Freeze FNPRM* proceeding. Specifically, WCB staff, "notes that issues related to Part 36 are under review in the Separations Freeze FNPRM and believes that possible changes to Part 36 rules are within the scope of review contemplated by that Notice."[10] Moreover, the WCB Staff Report stated,

> WCB staff concludes that Part 36 remains necessary in the public interest, in some form, but merits further consideration for possible amendment. Staff recommends that the Commission consider, *in the context of the record in the Separations Freeze FNPRM proceeding*, whether the Part 36 rules are necessary in the public interest and, if not, to repeal or modify any rule so that it is in the public interest.[11]

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[8] *2000 Biennial Regulatory Regime – Comprehensive Review of the Accounting Requirements and ARMIS Reporting Requirements for Incumbent Local Exchange Carriers: Phase II, Amendments to the Uniform System of Accounts for Interconnection; Jurisdictional Separations Reform and Referral to the Federal-State Joint Board; Local Competition and Broadband Rulemaking*, Report and Order in CC Docket Nos. 00-199, 97-212, and 80-286; Further Notice of Proposed Rulemaking in CC Docket Nos. 00-199, 99-301, 80-286, 16 FCC Rcd 19913, 19967-68, paras. 148-149 (2001) (*Phase II Report and Order*) ("The Commission's ability to monitor and evaluate local transport access rates would be greatly hindered if it could not identify and track local transport costs separately from switched access costs.")

[9] *Jurisdictional Separations and Referral to the Federal-State Joint Board*, Order and Further Notice of Proposed Rulemaking, CC Docket No. 80-286, 21 FCC Rcd 5516 (2006) (*Separations Freeze FNPRM*).

[10] *WCB Staff Report* at 18.

[11] *Id.* (emphasis added).

Apparently, the Commission's own expert staff has concluded that, in general, the separations rules from which AT&T seeks total forbearance are "necessary in the public interest." Accordingly, any modifications to those separations rules should be determined in the pending *Separations Freeze FNPRM* proceeding, not a petition for forbearance. This will provide the appropriate forum for all parties to address potential changes to Part 36.

Cost assignment rules are also key factors in the Commission's review of Regional Bell Operating Company ("RBOC") regulation after the sunset of Section 272 affiliate requirements. In the *Section 272 Sunset FNPRM*, the Commission is reviewing the regulatory requirements that may be necessary to address the threat that ILECs will have increased opportunities to engage in "cost-misallocation" and in a "predatory price squeeze" once Section 272 structural safeguards sunset.[12] In particular, the Commission has sought comment on whether "cost allocation rules, which are intended to prevent cross-subsidization and cost misallocation for regulated and non-regulated activities and competitive and non-competitive services, serve as an effective alternative to a separate affiliate requirement."[13] If the Commission decides to eliminate the separate subsidiary requirement and also grants AT&T's forbearance petition at issue here, it will have little if any ability "to prevent cross-subsidization and cost misallocation for regulated and non-regulated activities and competitive and non-competitive services." It will have effectively deregulated AT&T despite the fact that AT&T, like all ILECs, still retains bottleneck control over essential upstream inputs needed by entities seeking to compete with AT&T.

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[12] *Section 272(f)(1) Sunset of BOC Separate Affiliate and Related Requirements: 2000 Biennial Regulatory Review – Separate Affiliate Requirements of Section 64.1903 of the Commission's Rules*, Further Notice of Proposed Rulemaking, 18 FCC Rcd 10914, 10929-30, 10932, 10934, paras. 29, 35, 40 (2003) (*Section 272 Sunset FNPRM*).
[13] *Id.* at 10938, para. 48.

The federal-state joint board reviews and the open proceedings discussed above demonstrate that cost assignment is not a discrete issue, but is inextricably entwined with other major complex issues the Commission is in the process of carefully weighing and assessing. The Petition also raises industry-wide issues, such as intercarrier compensation and universal service funding levels, which may affect all ILECs, competitive carriers, and customers, not just AT&T. Any changes to the cost assignment rules, therefore, demand a comprehensive, holistic analysis rather than a piecemeal review through a single-party forbearance proceeding.

III. AT&T FAILS TO SATISFY THE THREE-PRONG FORBEARANCE TEST.

Section 10 of the Communications Act, as amended, requires the Commission to forbear from applying a regulation only if it determines that (1) enforcement of the regulation is not necessary to ensure that charges are just and reasonable and are not unjustly or unreasonably discriminatory; (2) enforcement of the regulation is not necessary for the protection of consumers; and (3) forbearance from applying the regulation is consistent with the public interest.[14] As discussed in greater detail below, AT&T has failed to satisfy any of the three elements of this stringent statutory test.

A. Enforcement of the Cost Assignment Rules is Necessary to Ensure Charges are Just and Reasonable and Are Not Unjustly or Unreasonably Discriminatory.

To satisfy the first prong of the forbearance test, AT&T bears the burden of demonstrating that enforcement of the cost assignment rules is not necessary to ensure rates and charges are just and reasonable and not unjustly or unreasonably discriminatory.[15]

1. The Commission Needs Cost Assignment Data to Determine Whether its Pricing Policies are Effective.

[14] 47 U.S.C. § 160(a).
[15] *Id.* at § 160(a)(1).

AT&T claims that price cap regulation obviates the need for the cost assignment rules. By arguing that the Commission can rely on price caps, AT&T concedes that the market is not competitive.[16] And, an effectively competitive market is the only alternative to regulation for ensuring rates are just and reasonable and not unjustly discriminatory.

The continuation of price cap regulation requires the continuation of the cost assignment rules. This is so because the costs AT&T and other ILECs incur to provide regulated services formed the basis for setting the initial rates under price caps. Any subsequent adjustments to index levels have simply been the mechanism the Commission has used to attempt to maintain rates at cost-based levels. As the Commission recognized,

> Although price cap regulation diminished the direct link between changes in allocated accounting costs and change in prices, *it did not sever the connection between accounting costs and prices* entirely. Rather, because the rates to which the price cap formulae were originally applied resulted from rate-of-return regulation, overall price cap LEC interstate revenue levels continued generally to reflect the accounting and cost allocation rules used to develop access charges.[17]

If anything, "the connection between accounting costs and prices" must be strengthened because changes to the regulatory and technological landscape over the past several years require price caps to be reinitialized. Such reinitialization will require the Commission to determine what price cap indices will yield reasonable earning levels in the current market. The cost data generated from the cost assignment rules will help the Commission calculate those reasonable earnings. This is especially the case in determining reinitialized price caps for the ILECs'

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[16] *See Special Access NPRM*, 20 FCC Rcd at 1998-99, para. 11 ("price caps act as a transitional regulatory scheme until the advent of actual competition makes price cap regulation unnecessary.").
[17] *Id.* at 1999, para. 12 (emphasis added).

special access services.[18] Indeed, the Commission has proposed using cost data to help determine how it should reform the interstate special access regime.[19] It is worth noting that, were AT&T under-earning under its special access (or any other) price caps, it would use the very data that it seeks to eliminate to show its under-earnings merit a low-end adjustment to its price cap indices.[20]

Cost assignment data may also be important in determining the productivity factor, also known as the "X-Factor." The productivity factor is a critical component of the price cap regime since it represents the extent to which the overall LEC productivity growth rate is expected to exceed the productivity growth rate of the economy as a whole. Including the productivity factor helps ensure that price changes over time reflect overall LEC productivity gains. And setting the proper X-Factor depends upon cost assignment rules.[21] Granting forbearance, however, will forever preclude the use of those alternatives.

Moreover, the retention of price cap regulation will require the Commission to have the necessary cost data to evaluate any price cap increases AT&T and other ILECs may seek based

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[18] The Commission has frozen the ILECs' special access price caps at 2003 levels until the Commission implements a post-CALLs (Coalition for Affordable Local and Long Distance Service) price cap regime. *Id.* at 2000-2001, para. 15.

[19] *See, e.g.*, *Special Access NPRM*, 20 FCC Rcd at 2005-06, 2016, paras. 27-29, 64. The Commission also noted that rate of return data, which rely on cost assignment data, are useful in its analysis of special access pricing. *Id.* at paras. 59-64.

[20] *See generally Policy and Rules Concerning Rates for Dominant Carriers*, CC Docket No. 87-313, Second Report and Order, 5 FCC Rcd 6786, paras. 120-165 (1990), *aff'd Nat'l Rural Telecom Ass'n v. FCC*, 988 F.2d 174 (D.C. Cir. 1993) (*1990 Price Caps Order*).

[21] As part of the CALLS plan, the Commission determined not to apply a productivity factor, but rather to set a "transitional X factor" at inflation. That action has permitted the price cap ILECs to maintain their prices far above cost despite their productivity gains in past years. The Commission, therefore, must act to remove implicit subsidies in price capped rates by re-imposing a productivity factor and reinitializing price capped rates to reflect cost-based rates. While the Total Factor Productivity method for setting the X-Factor may not require the cost data at issue here, there are other methods for setting the X-Factor that do require the cost assignment rules.

on exogenous costs. Exogenous costs are generally costs an ILEC incurs due to administrative, legislative, or judicial action beyond an ILEC's control, and ILECs are permitted to adjust their price caps to reflect any such costs they incur.[22] While exogenous cost adjustments to price caps result in changes to a carrier's price cap indices, the amount of the adjustment is based on a carrier's actual costs. In most cases, the Commission must use the cost information generated from the rules from which AT&T seeks forbearance to evaluate exogenous adjustment claims based on actual cost changes.[23]

If AT&T's Petition is granted, however, there are two specific exogenous changes listed in the current price cap rules that will no longer be possible -- changes to either Part 36 (the jurisdictional separations rules) or Part 64 (the regulated/nonregulated cost assignment rules). Instead, the Commission would have to accept AT&T's calculations as to the amount of exogenous costs it had incurred as a result of the change. Sprint Nextel believes that it is always better to have another way to evaluate the exogenous cost increases to price caps ILECs seek.

The Commission will need the cost assignment data not only to reinitialize price caps, but also to detect anticompetitive pricing. AT&T claims that price cap regulation renders the cost assignment rules obsolete because they are no longer used to set its rates. The reporting required under the cost assignment rules, however, tracks how well price cap regulation is keeping AT&T's rates at reasonable levels – in particular, whether AT&T is enjoying unreasonable profit levels with which it can subsidize its competitive services or, as noted previously, whether AT&T is under-earning under its price cap levels.

Moreover, deregulation actually increases the need for the Commission to maintain cost data in its enforcement arsenal. As regulation is reduced in the wake of competition and

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[22] *1990 Price Caps Order,* 5 FCC Rcd at 6806, para. 166.
[23] *See Phase II Report and Order,* 16 FCC Rcd at 19929-30, para. 46.

enforcement becomes the primary mechanism for safeguarding against anti-competitive conduct, the need for cost assignment data increases exponentially. Without publicly available cost data, AT&T would have the freedom, for example, to cross-subsidize its non-regulated services by charging supra-competitive rates for its regulated services without fear of detection. Indeed, WCB staff has emphasized the growing importance of the cost assignment rules in a market with increasing, but not yet effective competition by pointing out that, "[a]s competition and deregulatory actions are realized, . . . the magnitude of nonregulated costs is likely to grow, and the separation of costs associated with non-regulated activities from regulated costs is likely to become more significant."[24] For this reason alone, AT&T does not meet the first prong of the three-part forbearance test.

2. The States Need Cost Assignment Data for Their Own Regulatory Purposes.

Abandonment of the cost assignment rules would jeopardize the states' ability to satisfy their own statutory obligations to ensure just and reasonable rates for intrastate regulated services. If the Commission grants the Petition, AT&T would no longer have to report any regulated state cost data in the ARMIS reports. For many states, the ARMIS reports are the only publicly available source of state-level cost data. States use cost assignment data in the ARMIS reports for several purposes, including, but not limited to, assessing rates (such as *via* price caps) determining intrastate universal service support, and evaluating unbundled network element ("UNE") rates.[25]

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[24] *WCB Staff Report* at 60.

[25] *See, e.g.*, *Ex Parte* Comments of the Florida Public Service Commission, WC Docket No. 05-342 (Feb. 9, 2007). Many states rely on Commission data or have instituted price cap rules mirroring those of the Commission. States using rate of return regulation or cost-based reviews of price cap plans would no longer have access to the cost data they need to track and assess how well those plans are working in their state. Like the Commission, states also need access to valuable cost assignment data to reassess and reinitialize intrastate regulated rates.

AT&T appears to recognize the problem that would be created for the states if its Petition were granted. Thus, AT&T offers to provide the states with the information they need upon request. However, if AT&T is no longer required to submit the data to the Commission, or allocate its costs between regulated and non-regulated services, or separate its costs on a jurisdictional basis, it will have to develop the information a given state may request from scratch. AT&T may be unwilling to expend resources to develop a thorough compilation of the data, and in any event, the state data AT&T may provide would be based on its own interpretation of what the state portion of costs should be. To make matters worse, there would be no way to verify that, for instance, the methodology AT&T uses does not claim the same costs in both state and federal jurisdiction.

States also place significant reliance on the jurisdictional separations rules, which contain procedures and standards for dividing telephone company investment, expenses, taxes, reserves, operating revenues and other income between federal and state jurisdictions. The purpose of the separations rules is "to prevent incumbent LECs from recovering the same costs in both in the interstate and intrastate jurisdictions."[26] The division of costs between federal and state jurisdictions that the separations rules generate is also necessary to calculate state and federal earned rates of return. Like the Commission, states need periodic reports on intrastate costs and earnings to check the potential effectiveness of policy changes (such as deregulation) and determine appropriate state universal service funding levels.

Moreover, many states rely on state-specific cost assignment data as a basis for setting total element long-run incremental cost ("TELRIC") rates for UNEs.[27] Without access to these data, UNE charges could be overstated and thus negatively impact competitors and ratepayers.

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[26] *Separations Freeze FNPRM,* 21 FCC Rcd at 5517, para. 2.
[27] *See Phase II Report and Order*, 16 FCC Rcd at 19932-33, paras. 49-50.

ILECs certainly do not shy away from using ARMIS data in UNE proceedings when it best suits their needs. When the data shows evidence of excessive earnings, they try to suppress it. However, when the data shows evidence of under-earnings, they have favored its use.[28] Without separated costs, it would be impossible to determine AT&T's earnings for any individual state. Eliminating the separations rules essentially would allow AT&T to assign costs to either jurisdiction (or both) as it suited AT&T's purposes.

3. Market Forces Have Failed to Discipline AT&T's Charges for Special Access and Switched Access Services.

a) Competitive Forces Do Not Restrain AT&T from Price Gouging Special Access and Switched Access Services.

AT&T claims that "[c]ompetition is fierce in all aspects of the telecommunications market."[29] In the ensuing discussion, however, AT&T addresses competitive forces in only the retail voice market. AT&T fails to demonstrate competition is "fierce" in other market segments, particularly in the special access and switched access sectors, nor could it.

For example, competitive forces are too weak to restrain AT&T from pricing special access services at supra-competitive levels. There are few, if any, ILEC competitors offering special access to carriers and enterprise customers in the vast majority of the U.S. market. ILECs in general and the two largest remaining RBOCs – AT&T and Verizon – in particular dominate the special access market.[30] In many places, only one provider exists. In fact, the Government Accounting Office ("GAO") recently confirmed that competitive alternatives for

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[28] *See, e.g.*, Opposition of Ad Hoc Telecommunications Users Committee, WC Docket No. 05-342, footnote 12 (filed Jan. 23, 2006).

[29] Petition of AT&T Inc. for Forbearance Under 47 U.S.C. § 160(c) From Enforcement of Certain of the Commission's Cost Assignment Rules, WC Docket No. 07-21, at 29 (filed Jan. 25, 2007) (AT&T Petition).

[30] AT&T and Verizon have over an 82 percent share of the nationwide ILEC special access market as measured by revenues.

special access are practically non-existent. The GAO determined that "[o]f the buildings with a level of demand greater than the DS-1 level in [its] model, . . . only about 6 percent of buildings, on average have a fiber-based competitor."[31] To the extent any competition exists at all, it is limited to the offering of high capacity special access circuits in densely populated markets. Sprint Nextel's own experience, in addition, is that AT&T is the sole provider of special access to its cell sites in the vast majority of the new AT&T's territory.[32]

Given that there is little, if any, competition in the special access market to exert downward pressure on special access rates, and given that the Commission has granted the RBOCs significant special access pricing flexibility, it should come as no surprise that the RBOCs and other ILECs have been able to price their special access services at supra-competitive levels and have earned substantial monopoly rents in the provision of such services. The returns that the RBOCs have realized are not only exorbitant, but also continue to trend upward. In 2004, the then-existing three largest RBOCs – AT&T (nee SBC), BellSouth, and Verizon – achieved rates of return of 73.02%, 81.90%, and 31.64%, respectively. In 2005, the returns were even higher: AT&T's return was 91.73%; BellSouth's return was 98.37%; and Verizon's return was 41.97%. Returns at this level are totally inconsistent with the notion that the special access market is competitive and that regulation is no longer needed to ensure that the RBOCs' special access rates are just, reasonable and not unjustly discriminatory.

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[31] Government Accountability Office ("GAO") Report to the Chairman, Committee on Government Reform, House of Representatives, "*FCC Needs to Improve Its Ability to Monitor and Determine the Extent of Competition in Dedicated Access Services*," November 2006 at 19 ("GAO Report").

[32] *See* Comments of Sprint Nextel Corporation on Application of BellSouth Corporation, Transferor, and AT&T Inc., Transferee, for Consent to Transfer Control of Licenses and Authorizations, WC Docket No. 06-74 (filed June 5, 2006).

More importantly in the context of this proceeding, these returns were calculated using the very ARMIS data AT&T would no longer have to file with the Commission if its Petition were granted.[33] As the Commission noted, RBOC special access earnings far exceed the 11.25% that even rate-of-return LECs receive.[34] If the Petition is granted, the Commission and other interested parties will lose their ability to calculate RBOC special access rates of return, and AT&T will have *carte blanche* ability to raise rates and exercise market power unchecked.

Furthermore, in some cases, the prices ILECs charge in geographic areas under Phase II pricing flexibility are substantially higher than in those geographic areas still regulated under Phase I pricing flexibility. In fact, the GAO determined that, "[s]ince FCC first began granting pricing flexibility in 2001, our comparison of prices and revenues across phase I flexibility and phase II flexibility suggests that list prices and revenue are higher on average for circuit components in areas under phase II flexibility (areas where competitive forces are presumed to be greatest) than in areas under phase I flexibility or under price caps."[35] The GAO remarked that, "[t]he data developed in this report indicates that there are fewer competitive alternatives and that prices for dedicated access in the theoretically more competitive phase II markets are higher on average than prices in phase I markets. . . ."[36]

Plainly, the absence of competition in the special access market requires the submission of cost assignment data. Such data are absolutely essential if the Commission is to detect RBOC anticompetitive pricing behavior in this market. Without cost assignment data, the Commission

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[33] These returns are based on data set forth in FCC Report 43-01, Table I Cost and Revenue, Column(s) Special Access, Row 1915 Net Revenue divided by Row 1010 Average Net Investment.

[34] The Commission noted that, "[i]n recent years, the BOCs have earned special access accounting rates of return substantially in excess of the prescribed 11.25 rate of return that applied to rate of return LECs." *Special Access NPRM*, 20 FCC Rcd at 2008, para. 35.

[35] GAO Report at 27.

[36] *Id.* at 44-45.

will be unable to determine whether special access rates are unreasonably excessive relative to the cost of providing special access service and take appropriate measures. Moreover, if the Commission decides it needs to more closely regulate special access rates (as it should based on the record evidence in that proceeding),[37] it will need cost data to monitor and update whatever price regulation it decides to impose.

As in the special access market, market forces are non-existent in the switched access market. Carriers paying for terminating access have no control in selecting the terminating ILEC used, and therefore have no competitive alternatives. The Commission has recognized this market failure and has never suggested deregulating switched access services. Granting AT&T's petition, however, would remove an important check on switched access rates and have the adverse – and presumably unintended -- effect of essentially deregulating the terminating switched access market. As long as ILECs hold market power in the provision of terminating switched access services or until the Commission moves to a bill and keep system for switched access, the Commission is statutorily bound to track ILEC costs to ensure that switched access charges remain just, reasonable and nondiscriminatory pursuant to Sections 201(b) and 202(a) of the Communications Act, as amended.[38]

b) Weakened Market Forces as a Result of Industry Consolidation Justify the Retention and Strengthening of the Affiliate Transaction Rules.

Weakened market forces as a result of recent mergers further justify the retention, and even the strengthening, of the affiliate transaction rules. AT&T claims that the affiliate transactions rules are no longer necessary because under price cap regulation, affiliate transaction costs do not pass through to any rates, and thus "no longer serve the intended

[37] *See* note 7 above.
[38] 47 U.S.C. §§ 201(b), 202(a).

ratepayer protection role."[39] AT&T goes on to argue that, "the results of these rules are solely to populate ARMIS reports."[40]

Those ARMIS reports are not "chokepoints" as AT&T describes them, but crucial checkpoints for the Commission to ensure AT&T does not engage in anticompetitive behavior. Recent market consolidation provides even more reason to ensure that the affiliate transactions rules remain intact. SBC's acquisition of AT&T, Verizon's acquisition of MCI, and AT&T's acquisition of BellSouth, to name just a few of the industy's mergers, have substantially diminished competition, especially in the special access market. In all instances, these mergers eliminated significant ILEC competitors, which provided at least some check to ILEC market power. The divestitures the Department of Justice required and the conditions the Commission imposed are insufficient to regenerate the competition that disappeared as a result of the mergers, so the only check the Commission has for identifying a market failure is the cost assignment information AT&T is seeking to no longer provide.

Also, as a result of the mergers, AT&T and Verizon are able to expand their bundled service offerings, which combine intrastate, interstate, regulated and unregulated services. For example, AT&T recently launched its Unity Plan, which provides free calls (*i.e.*, unlimited wireless minutes) to and from AT&T wireless and wireline phones.[41] Customers who combine their wireless bill with their AT&T local services bill and subscribe to unlimited local and long distance service are eligible.[42] Moreover, AT&T and Verizon are deploying largely deregulated

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[39] AT&T Petition at 13.
[40] Petition of BellSouth Telecommunications, Inc. For Forbearance Under 47 U.S.C. § 160(c) From Enforcement of Certain of the Commission's Cost Assignment Rules, WC Docket No. 05-342, at 40 (filed Dec. 6, 2005) (BellSouth Petition). AT&T refiled the BellSouth Petition into WC Docket No. 07-21.
[41] *See* www.att.com/unity.
[42] *Id.*

networks and bundling services over those networks with regulated services. Bundled offerings, which increase the incentive and ability of ILECs to leverage their market power in a way that harms competition, are all the more reason why the Commission must vigilantly scrutinize affiliate transactions data to detect potential misconduct.

B. Enforcement of the Cost Assignment Rules is Necessary to Protect Consumers.

AT&T has failed to provide sufficient, relevant evidence that the cost assignment rules are not necessary to protect consumers under the forbearance standard.[43] AT&T's sole argument in this regard is that "there is ample federal regulatory governance over AT&T's financial reporting and use of accounting in those reports" such as Securities and Exchange Commission ("SEC") regulations, Generally Accepted Accounting Principles ("GAAP") and the Sarbanes-Oxley Act.[44] In addition, the original BellSouth Petition claims that the cost assignment rules are unnecessary to guard against price squeezes and to fulfill the Commission's universal service obligations.[45] However, AT&T's assertion that SEC and related regulation is enough to protect consumers is misguided. The Commission has never used financial transparency accounting requirements to ensure regulated carrier costs are appropriately identified and allocated, so they are irrelevant to the Commission's review.

In addition, Section 254(k) of the Communications Act, as amended, prohibits a carrier from using services that are not competitive to subsidize services that are competitive.[46] Enforcement of the cost assignment rules is necessary to protect consumers against unlawful cross-subsidization, and the emergence of new technologies and services makes proper cost assignment more important than ever. By having the necessary data to ensure that costs are

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[43] 47 U.S.C. § 160(a)(2).
[44] AT&T Petition at 32-38.
[45] BellSouth Petition at 55-58.
[46] 47 U.S.C. § 254(k).

properly allocated between regulated and unregulated services and between intrastate and interstate, the Commission is able to guard against ILEC efforts to have their consumers of regulated services foot the bill for ILEC forays into new unregulated lines of business.

Section 254(k) also requires the Commission, through the establishment of any necessary cost allocation rules, accounting standards, and guidelines, to ensure that services included in the definition of universal service bear no more than a reasonable share of the joint and common costs of facilities used to provide these services.[47] As long as AT&T continues to receive universal service subsidies, both the Commission and the states need the cost assignment rules to satisfy their statutory obligation and to make sure AT&T does not unfairly misallocate costs to universal service as a way to subsidize non-regulated services.

Similarly, these cost data are used to set high cost loop support levels for rural carriers. The Commission's current high cost loop mechanism for supporting service in rural areas relies on unseparated cost data filed by all carriers, including AT&T.[48] If AT&T's Petition were granted, it would no longer be able to provide this cost data, or at least would no longer be required to use the same definition of "unseparated costs" that all other carriers do. Thus, the Part 64 rules, which are used to derive the unseparated costs from the cost data reported for the total company remain necessary. The Commission should therefore reject AT&T's requested waiver of Part 64 on these grounds alone.

C. Forbearance is Inconsistent with the Public Interest Because It Would Stifle Competition and Innovation.

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[47] *Id.*

[48] Section 36.612(a) of the Commission's rules obliges non-rural carriers to submit unseparated loop cost data to NECA, and Section 36.621 details how those unseparated loop costs are to be computed. *See* 47 C.F.R. §§ 36.612(a) and 36.621. Data from non-rural ILECs such as AT&T are used to compute a nation-wide average cost per loop.

AT&T also fails to satisfy the third and final prong of the statutory forbearance analysis, which requires it to prove that forbearance from applying the cost assignment rules is consistent with the public interest.[49] The Commission may find that forbearance is in the public interest if it determines that "such forbearance will promote competition among providers of telecommunications services."[50]

AT&T argues that forbearance from the Commission's cost assignment rules is consistent with the public interest because the rules impose "substantial costs and burdens" on AT&T.[51] AT&T maintains it should be able to shift those resources "toward positive activities that generate consumer benefit."[52] AT&T has failed to satisfy this prong of the forbearance test. While forbearance is clearly in its own interest, AT&T has failed to demonstrate exactly how forbearing from rules established to safeguard the public interest would actually be in the public interest.

The cost assignment rules serve the public interest, not only for the reasons discussed above, but also because they promote investment and innovation. New technologies and services demand all forms of connectivity -- connectivity between the end user and the provider, between the provider and the Internet, between the provider and the LEC, etc. For instance, as carriers' bandwidth requirements grow to accommodate the increasing broadband speeds demanded by consumers, more special access circuits will be required to transmit traffic from, for example, Sprint Nextel's 4G broadband cell sites back to the Sprint Nextel network. Services such as special access are an essential link in the connectivity chain. However, because ILECs like

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[49] 47 U.S.C. § 160(a)(3).
[50] 47 U.S.C. § 160(b).
[51] AT&T Petition at 38.
[52] *Id.* at 39.

AT&T wield virtual monopoly control over special and switched access, they can extract excessive prices, which suppress investment and innovation.

The Commission and the states need the cost assignment rules to ensure rates for bottleneck inputs are not artificially inflated, but are based on AT&T's actual costs of providing the service. Ensuring just, reasonable and non-discriminatory rates levels the playing field for competitors and gives them the incentive and ability to bring new innovative services and technologies to the marketplace, which advances the public interest.

IV. CONCLUSION

For the reasons discussed above, Sprint Nextel Corporation urges the Commission to deny AT&T's Petition for Forbearance.

Respectfully submitted,

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March 19, 2007

CERTIFICATE OF SERVICE

I hereby certify that copies of the foregoing Opposition of Sprint Nextel Corporation were delivered by electronic mail on this 19th day of March, 2007, to the parties listed below.

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