SIDLEY AUSTIN LLP
SIDLEY

SIDLEY AUSTIN LLP
1501 K STREET, N.W.
WASHINGTON, D.C. 20005
(202) 736 8000
(202) 736 8711 FAX

cshenk@sidley.com
(202) 736-8689

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August 15, 2007

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

RE: *Special Access Rates for Price Cap Local Exchange Carriers*, WC Docket No. 05-25, RM-10593

Dear Ms. Dortch:

Enclosed for electronic filing in the above referenced proceedings is the **REDACTED** version of the Supplemental Reply Comments of AT&T Inc.

Please contact me with any questions.

Respectfully submitted,

/s/ Christopher T. Shenk

cc: Margaret Dailey (Margaret.dailey.fcc.gov)
Best Copy and Printing (fcc@bcpiweb.com)

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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

SUPPLEMENTAL REPLY COMMENTS OF AT&T INC.

David W. Carpenter
SIDLEY AUSTIN LLP
One South Dearborn Street
Chicago, Illinois 60603

David L. Lawson
James P. Young
Christopher T. Shenk
SIDLEY AUSTIN LLP
1501 K St., N.W.
Washington, DC 20005
(202) 736-8088

Christopher M. Heimann
Gary L. Phillips
Paul K. Mancini
AT&T Inc.
1120 20th Street, N.W.
Washington, D.C. 20036
(202) 457-3058

Attorneys for AT&T Inc.

August 15, 2007

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SUPPLEMENTAL REPLY COMMENTS OF AT&T INC.

Pursuant to the Commission's *Notice*,[1] AT&T Inc. ("AT&T") respectfully submits these supplemental reply comments.

INTRODUCTION AND SUMMARY

This latest round of comments repeats the pattern we have seen many times before. The price cap LECs submit extensive evidence showing that myriad special access competitors have extensive, sunk networks capable of serving the vast majority of special access demand, that special access prices have been steadily falling, and that competition is becoming ever more intense as existing competitors extend their networks and new competitors enter. Those that ask the Commission to respond to these hallmarks of deregulatory success by reimposing the most intrusive sorts of regulation and mandating multi-billion dollar rate decreases, in contrast, proffer only overheated rhetoric supported by no hard data. These recycled re-regulation requests become more and more hollow with each new refreshing of the record. As special access competition becomes increasingly widespread and robust, now reaching even the farthest corners

[1] Public Notice, *Parties Asked To Refresh Record in the Special Access Notice Of Proposed Rulemaking*, WC Docket No. 05-25, RM-10593 (released July 9, 2007) ("*Notice*").

of the marketplace – and alternative providers' silence about their own facilities and operations becomes increasingly deafening – the calls for massive re-regulation that would mire the Commission and the industry in a quagmire of epic proportions have become truly absurd.

The evidentiary record is decidedly one-sided. AT&T and the other price cap LECs have made detailed evidentiary showings that they face robust facilities-based competition from dozens of CLECs that have deployed fiber networks throughout the commercial centers where special access is heavily concentrated. Not a single commenter disputes the existence of this competitive fiber or its overlap with the bulk of price cap LECs' special access demand. And, tellingly, not a single CLEC has bothered to supplement the incomplete information available to price cap LECs with complete data about the reach and capabilities of its networks.

Price cap LECs have documented the significant and sustained *decreases* in the prices customers pay for even the lowest capacity DS1 and DS3 special access services where price caps have been removed in response to the spread of competition. No commenter refutes this evidence that the prices customers actually pay for price cap LEC services have been falling for years. Indeed, none of those clamoring for rate regulation has provided *any* evidence about the trends in the rates they actually pay.

Price cap LECs have submitted unassailable evidence that cable and wireless special access alternatives have been widely and successfully deployed, that these intermodal providers are specifically targeting the lower demand and more remote customer locations that re-regulation proponents previously contended were entirely dependent on price cap LEC services, and that wireless and other customers are already using these intermodal DSn alternatives at many remote locations. No commenter can dispute these facts or that the availability of intermodal alternatives is rapidly expanding.

Because disclosing their actual experience of paying less each year for services that continue to improve would confirm that the Commission's policies are working, the re-regulation proponents persist in relying on isolated increases in non-discounted "rack" rates. They replay nonsensical arguments that special access rates are simply "too high" in some metaphysical sense as compared to rates for other things, including long distance services, services provided in foreign countries, and even services that price cap LECs are forced to provide at below-cost TELRIC rates. And they continue to harp on ARMIS-based special access "rates of return" that have repeatedly been shown to reflect arbitrary and long-frozen allocations that render them meaningless. AT&T and others have demonstrated in detail in prior filings that none of these comparisons has the slightest relevance.

Similarly, the re-regulation proponents proffer only backward-looking anecdotal snapshots of past purchase decisions, because specific information about the full range of choices now available to them and additional choices fast becoming available would confirm not only that alternatives already exist in virtually all areas for all services, but that rapidly expanding intermodal competition is certain to fill any gaps in the very near future. Sprint, for example, asserts that it has purchased the vast majority of its mobile base station DSn backhaul circuits from price cap LECs in recent years and that few CLECs have existing connections to its base stations. But the relevant fact – which Sprint and its allies do not dispute – is that the explosive growth of wireless services and of bandwidth intensive wireless applications is fueling a corresponding explosion of competition for wireless backhaul services. As geographically remote cell sites generate more and more traffic (and more and more revenue opportunity), competitors are lining up to serve them, moving into those areas, just as they previously blanketed other areas with appreciable demand. In addition to those CLECs who could

economically *extend* fiber to remote cell sites, cable operators are targeting the increasingly lucrative wireless backhaul market. At the same time, wireless carriers are now taking advantage of wireless backhaul technologies that have, for years, been used extensively in Europe and elsewhere. Whatever may have been the case in the past, there plainly are a growing array of facilities-based alternatives to price cap LEC services even at remote cell sites today.

Those seeking government-mandated price decreases do not like to talk about these developments. Thus Sprint relegated to a footnote any acknowledgement that it had recently selected one such provider, FiberTower, to provide the backhaul circuits in seven of the first markets in which Sprint is deploying its 4G/WiMax service. And Sprint made no mention whatsoever of its multi-billion dollar investment in a national WiMax network that Sprint has acknowledged will be used, among other things, to self-supply special access connections (and can likewise be used to sell such connections to others).

But no amount of obfuscation can sweep these developments under the rug, nor, as some re-regulation proponents would have it, can they be ignored simply because wireless and cable intermodal alternatives are not today available to every customer everywhere. These commercially proven intermodal technologies – the *majority* of wireless backhaul circuits worldwide are provided over wireless technologies – are widely available on attractive terms, are experiencing extremely rapid growth, and will be available ubiquitously in the near and foreseeable future. The Commission is assessing requests that it jettison its existing pricing flexibility rules and adopt new regulations that will apply *prospectively*, and its decision therefore obviously has to be based, not only on the conditions that currently exist, but also on how the competitive landscape is currently changing and what it will look like in the near future. It requires no predictive judgment to recognize that wireless broadband and other intermodal

alternatives are here to stay and will soon be available wherever customers demand them. The Commission cannot rationally entertain re-regulation proposals when it is now clear that the only remaining complaint of the re-regulation proponents – *i.e.*, that they will remain entirely dependent upon price cap LECs for the provision of DSn-level services outside commercial centers – has lost all force.

That is particularly so, because entertaining these proposals unquestionably would embroil the Commission and the industry in a regulatory quagmire. The Commission has explained that it adopted the pricing flexibility rules in 1999 based on its determination that the costs of regulating special access prices are immense and that the costs "to carriers and the public" would exceed any benefits "even if competition had [then] not fully developed" and even if it did not thereafter develop "as fast as the Commission had projected."[2] Indeed, attempting to resurrect a cost-based or return-based regulation, and to do so on a service-specific basis – something that has *never* been done before – would be far more mammoth an undertaking than continuing the regulatory regime the Commission found too costly eight years ago when it introduced pricing flexibility. The Commission could not even begin such an undertaking without, among many other things, completely overhauling its accounting rules so that they reflect today's network and marketplace realities and without completing universal service reform and revisiting its regulation of switched access services (which, according to ARMIS data earn virtually *no* return) to ensure that any cost or return-based regulation of special access services did not result in an inappropriately low enterprise-wide return on investment. And the Commission would have to figure out how to develop a productivity factor on a service-specific

[2] *See* Letter from FCC (Anthony Dale, Managing Director) to GAO (Mark Goldstein, Director, Physical Infrastructure Issues), at 2 (Nov. 13, 2006) ("FCC GAO Response Letter") *reprinted in* Gov't Accountability Office, FCC Needs to Improve Its Ability to Monitor and Determine the Extent of Competition in Dedicated Access Services, App. III (Nov. 2006) ("GAO Report").

basis even though it struggled for years to sustain even an enterprise-wide factor. On top of all of this, the Commission would have to continually update its rules to keep pace with the dynamic changes taking place throughout the telecommunications marketplace, a task that the Commission has previously concluded is beyond its capabilities. It is self-evident that any attempt to go down this path would spawn a nightmare of protracted litigation, inherently arbitrary judgments, judicial reversals, business uncertainty, disincentives for facilities investment and harm to consumers.

Recognizing as much, the re-regulation proponents propose blatantly arbitrary "short-cuts" such as "X-factors" adopted more than ten years ago (based upon even older data), simplistic reliance on flawed ARMIS data that has been shown to be of no use in this context, and patently unlawful delegation of Commission authority to state commissions and private arbitrators who would establish rates out of a "black box." The Commission would have no hope of defending potentially confiscatory rate decreases on the basis of such facially deficient short-cuts, and no commenter has come close to making the case for the extremely burdensome proceedings that would actually be required if there were any reason to head down any re-regulatory path. And there plainly is no reason to do so. Indeed, even initiating any such proceedings would send deleterious signals to all parties, undermine market predictability, and dampen investment. The record in this proceeding overwhelmingly compels the conclusion that the Commission should maintain and extend its deregulatory policies, and the Commission should promptly and firmly end any continuing speculation that it may entertain intensely regulatory proposals to turn back the clock.

ARGUMENT

I. THE COMMENTS OVERWHELMINGLY CONFIRM THAT THE PROVISION OF SPECIAL ACCESS SERVICES IS INTENSELY COMPETITIVE.

Even in the face of competitive special access suppliers' steadfast refusal to supply information about their networks and capabilities, the record in this proceeding undeniably establishes that (i) competitive fiber blankets the downtown areas and other commercial centers where special access demand is heavily concentrated and, indeed, is already connected to or very near the buildings that account for the bulk of price cap LEC special access sales, and (ii) there are now viable intermodal alternatives to price cap LECs' services not only in these commercial centers but also at cell towers and other more remote customer locations, and these intermodal alternatives are dramatically reshaping the special access landscape. The record contains detailed evidence that customers of even DS1-level services – including the most vocal proponents of increased regulation – can and do choose other providers, and that price cap LECs have responded to reduced regulation and competitive pressure just as the Commission predicted they would: by lowering their prices, improving their services, investing in their networks and tailoring their offerings to meet customers' diverse and evolving needs.[3]

AT&T and the other price cap LECs have taken seriously the Commission's multiple requests that industry participants support their reform proposals with specific evidence of the relevant marketplace developments and have submitted highly granular evidence, to the extent available to them, of the vibrant competition that justifies additional deregulation. Price cap LECs have identified the small subset of wire centers that account for the vast majority of their

[3] *See, e.g.*, SBC Initial Comments at 21-24 & Casto Initial Decl. ¶ 56 & Casto Reply ¶ 27; AT&T Supp. at 21-24 & Casto Supp. Decl. ¶¶ 55-60; Verizon at 10-13; Qwest at 45-47; Embarq at 8-10.

special access demand[4] and have submitted maps that plot known fiber of dozens of CLECs capable of serving that demand.[5] They have submitted analyses that the Commission has credited in other proceedings that demonstrate that in some areas competitors already serve nearly half of the DS1 and DS3 circuit demand.[6] Through examples of their own competitive losses as well as industry reports and public statements by wireless and cable competitors and their customers, price cap LECs have shown that intermodal providers not only compete successfully for DS1 and higher capacity services today, but that they specifically target small and medium business and wireless backhaul customers that purchase services outside the commercial centers where the bulk of special access demand is concentrated.[7] Indeed, price cap LECs have documented that they themselves already purchase thousands of DS1 and DS3 circuits from wireless and cable providers,[8] and that those that falsely claim that they are entirely dependent upon price cap LEC special access services have likewise entered into very large contracts with these intermodal providers.[9]

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[4] *See* SBC Initial Comments at 13 & Casto Initial Decl.¶ 12; Verizon at 15 & Garzillo Decl. ¶ 3.

[5] *See, e.g.,* SBC Initial Comments at 13 & Casto Initial Decl. ¶¶ 16-20 & Attachment 1 (maps for 10 MSAs); AT&T Supp. Comments at 10-11 & Casto Supp. Decl. ¶ 6 & Attachment (maps of 5 additional MSAs); Verizon at 16-17 & Attachment H (25 maps).

[6] *See, e.g.,* Qwest at 22. Qwest further submitted MSA specific information for four MSAs showing that CLECs have deployed thousand or so miles of fiber networks and that they "are using this capacity to win retail and wholesale customers from Qwest." *Id.* at 25-27. Similarly, Embarq, reports that "[m]ost of Embarq's markets have 5 competitors" and that "[o]n a DS0 equivalent basis, 50% of special access lines have both [a] CLEC and a Cable alternative and 75% have either a CLEC or a Cable alternative." Embarq at 5.

[7] *See, e.g.,* SBC Initial Comments at 16-20 & Casto Initial Decl. ¶¶ 37-53; AT&T Supp. Comments at 10-21 & Casto Supp. Decl. ¶¶ 14-20, 23-59; Verizon at 18-19, 25-29 & Lew Supp. Decl. ¶¶ 22-33 & Brown/Tarazi Decl. ¶ 12; Qwest at 28-41; Embarq at 5-8.

[8] AT&T Supp. Comments at 16; Casto Supp. Decl. ¶¶ 22, 25, 49-50; Verizon at 28 & Wells Decl. ¶¶ 6-7.

[9] *See, e.g.,* SBC Initial Comments at 18 & Casto Initial Decl. ¶ 43; AT&T Supp. Comments at 9, 17-21 & Casto Supp. Decl. ¶¶ 37-50; Embarq at 6 & Jewell Decl. ¶¶ 2-10.

This record of widespread – and rapidly spreading – facilities-based competition unquestionably validates the Commission's progressive deregulation efforts and justifies additional steps in that direction. While commenters may quibble about the current capabilities of individual competitors or technologies to serve particular customer locations, there can no longer be any serious dispute that price cap LECs face intense and intensifying competition in all areas where there is appreciable special access demand. In this regard, complaints that some competitors and technologies have only recently begun to enjoy widespread commercial success simply miss the point of this rulemaking proceeding. The issue here is what rules should govern the *future* provision of special access services. Regardless how many facilities intermodal competitors have already deployed and how many customers they have already won – questions that are impossible to answer given the refusal of those competitors to supply that information – the undeniable reality is that intermodal special access alternatives that have already been embraced by customers are explosively expanding. No exercise in predictive judgment is necessary to recognize that this competition is here to stay, that it will continue rapidly to expand, and that it would be folly for the Commission to respond to it by *reducing* price cap LECs' flexibility.[10]

Given this intense and growing competition, and the year-over-year price declines it has fostered, it is hardly surprising that those that ask the Commission to repeal pricing flexibility

[10] *See, e.g.*, Report and Order and Notice of Proposed Rulemaking, *Appropriate Framework for Broadband Access to the Internet over Wireline Facilities*, 20 FCC Rcd. 14853, ¶ 50 (2005) ("*Wireline Broadband Order*"). (where "a wide variety of competitive and potentially competitive providers and offerings are emerging in th[e] marketplace" the need for regulation "is more appropriately analyzed in view of larger trends in the marketplace, rather than exclusively through the snapshot data that may quickly and predictably be rendered obsolete as th[e] market continues to evolve"); Memorandum Opinion and Order, *Petition for Forbearance of the Verizon Telephone Companies Pursuant to 47 U.S.C. § 160(c)*, 19 FCC Rcd 21496, ¶ 22 (2004) ("*Broadband 271 Forbearance Order*") ("actual and potential intermodal competition informs rational competitors' decisions").

and to return to the intensely regulatory regime of the past are unable to support their rhetoric with detailed factual showings of the "Economics 101 textbook example of a market failure,"[11] they claim exists.

Not a *single* provider of alternative special access service – and there are scores of them – has supplied the Commission with specific information about its existing and planned footprint, the buildings it already does and readily could serve, or the special access business it has won or competed for. Not a *single* wholesale customer has supplied the Commission with hard data detailing the locations where alternative wireline and intermodal competitors have offered to or could supply services. And not a *single* wholesale customer has refuted the showings by price cap LECs – confirmed by the GAO – that the prices it actually pays for DS1, DS3, and all other special access services have been declining substantially for years.

Instead of supplying actual evidence of the true extent of facilities-based competition, of the choices actually available to special access customers, and of the prices customers actually pay, the re-regulation proponents simply regurgitate shopworn assertions that price cap LECs face "little, if any," competition and charge "excessive" rates. To the extent they even purport to support these claims, they offer "evidence" that can only be designed to mislead, rather than illuminate. For example, although it has been shown beyond dispute that ARMIS data cannot be used to calculate a service-specific rate of return, some commenters continue irresponsibly to advance absurd claims about astronomical returns based on misuse of such data. Others claim that rates have skyrocketed in Phase II areas, even though the facts and, indeed the GAO Report, show that they have declined.

[11] Sprint at i.

Still others make dubious claims about their past purchases. Indeed, the re-regulation proponents' principal support for their claim that special access competition does not exist is that the Commission can simply assume, based upon their representations that in recent years they have bought a large percentage of their DSn-level services from price cap LECs, that they have had no choice but to do so. The relevant metric, of course, is not the choices customers have made, but the choices they *could* make given the alternatives available in the marketplace. And those seeking re-regulation offer little or no evidence on that issue, preferring instead simply to treat their blanket assertions as evidence. The obvious explanation for the re-regulation proponents' refusal to submit any hard data about the availability of alternative special access services is that the facts are flatly inconsistent with their rhetoric.

Sprint, for example, complains that in 2006 it purchased 98% of its DS1 and DS3 circuits in Chicago – a hotbed of competitive activity – from AT&T. There is, of course, no way to verify that claim, but even if true, it would be entirely irrelevant. Sprint unquestionably has alternatives to AT&T in Chicago. Sprint does not disclose that it has its own extensive metro area network in Chicago that it uses to self-supply special access. Sprint also fails to disclose that AT&T is currently bidding against other providers to supply circuits to nearly 1000 Sprint cell sites in the Chicago area in connection with Sprint's 4G/Wimax deployment. **[Begin Confidential]**

[12]

[12] Casto Supp. Reply Decl. ¶ 4.

[13]

[End Confidential] This is not a hollow threat. Sprint is already widely using wireless broadband backhaul, cable and other alternatives. **[Begin Confidential]**

[End Confidential] Of course, Sprint has already announced that it has selected FiberTower to provide the backhaul circuits in seven of the initial markets in which Sprint is deploying its 4G/WiMax service.[14] Plainly, the fact that Sprint today continues to purchase many circuits in Chicago or elsewhere from AT&T thus says nothing about the *availability* of competitive alternatives in these area – there are many.

Rather, Sprint's purchases from AT&T may simply reflect that AT&T provides good service and has been responsive to competitive pressure. In this regard, the prices that Sprint actually pays AT&T for DS1 circuits – a subject on which Sprint is notably silent – have been declining for years. The average amount that Sprint paid to AT&T for all DS1 circuits in Chicago for the first quarter of 2007 (*before* the recent significant additional rate reductions associated with AT&T's BellSouth merger commitment), for example, was more than **[Begin**

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[13] *See* Casto Supp. Reply ¶ 5.

[14] *See* Press Release, FiberTower Announces Backhaul Agreement With Sprint Nextel for WiMax Buildout (Aug. 6, 2007), available at http://www.bbwexchange.com/pubs/2007/08/06/page1423-647177.asp.

lower than Sprint paid in 2005.[15]

The wide availability of, and intense competition from, CLEC fiber connections – evident from, *inter alia*, the maps provided by AT&T and other price cap LECs – is starkly confirmed by Time Warner Telecom's ("TWTC") admission (at 11) that it self-supplies loop facilities to more than a quarter of the customer locations it serves, and that it purchases a substantial number of additional loop facilities from other competitive suppliers.[16] Further, recent reports indicate that TWTC continues to add buildings to its network at break-neck speed.[17] And CLECs continue to win customers. For example, XO just announced that it "has signed a multi-year, multi-million

[15] Casto Supp. Reply Decl. ¶ 4. Sprint's claim that a recent vendor questionnaire reported alternative fiber facilities connected to only 1% of 52,000 Sprint cell sites is also designed to mislead. The relevant statistic is, of course, not how many towers are already served by competitive fiber, but how many towers *could be* supplied by wireline and wireless competitors if Sprint chose to purchase from them.

[16] *Id.* TWTC (at 8) nonetheless speculates that the total number of competitively served buildings "may have actually decreased substantially in the last few years." That is absurd. TWTC and other competitive suppliers could have supported that statement if it were true and their failure to submit any information about the rapidly growing reach of their networks starkly confirms that it is false. Competitive suppliers continue to report in their financial statements and press releases that they are adding, not subtracting, fiber from their networks, and, as Qwest notes (at 20-24), available third party studies confirm that there has been substantial growth in the number of buildings served by traditional wireline LECs (not to mention intermodal providers).

[17] *See, e.g.*, Press Release, *Time Warner Telecom Reports Strong Second Quarter 2007 Results* ("'We continue to deliver strong organic enterprise revenue growth, drive sales momentum, and achieve solid margins while integrating a major expansion of our operations,' said Larissa Herda, Time Warner Telecom's Chairman, CEO and President"), available at http://www.twtelecom.com/Documents/Announcements/News/2007/TWTC_Q2_07PR_.pdf; *id.* at 13 (showing a 23% increase – from 6,433 to 7,884 – in the number of buildings to which it has deployed fiber connections during the last year and a more than 150% increase in the number of customers it serves).

dollar agreement to provide local access . . . to SAVVIS Inc.," a global provider of IT infrastructure service for business and government applications.[18]

Unable to square their false assertions that they are entirely dependent on price cap LEC special access services with the facts, proponents of re-regulation contend that there is no reason even to examine the marketplace facts, because "every government agency with relevant expertise" has concluded that "ILECs retain overwhelming market power over" special access services in the areas where the Commission has granted pricing flexibility.[19] That too is patently false. The GAO pointedly did *not* conclude that the Commission has granted price cap LECs too much pricing flexibility. To the contrary, the GAO expressly determined that the Commission lacks a sufficient record to make any such finding, precisely because CLECs and other proponents of re-regulation have refused to supply information about the availability of alternative facilities and services.[20]

Proponents of re-regulation trumpet the GAO's finding that the information available to it identified existing CLEC fiber connections to less than 6 percent of buildings with at least DS-1 demand. But, as the record already shows, that would be a meaningless figure even if it reflected complete information.[21] As the Commission has previously recognized, the relevant metric is the level of special access demand that is *contestable*, because the existence of alternative

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[18] Press Release, *XO Communications Selected by SAVVIS to Provide Local Access Network Services* (Aug. 13, 2007), available at http://www.xo.com/news/357.html; *see also id.* (describing XO as "a leading provider of 21st century communications services for business and communications services providers").

[19] TWTC at 6.

[20] AT&T Supp. Comments at 52-53; GAO Report at 40 (finding that the Commission has "limited data on competitors' provision of dedicated access services" and in particular has "no specific or current data on competitors' prices for dedicated access services or on the extent to which competitors have extended their networks"); *id.* at 15 (this "report does not call for the reregulation of dedicated access prices").

[21] AT&T Supp. Comments at 52-53.

facilities near many of the buildings where special access is concentrated is sufficient to ensure market-based prices even if many buildings are not currently connected to alternative facilities. Moreover, the fraction of lit buildings identified by GAO is well off the mark, because it was calculated with reference to an understated numerator and an overstated denominator. The numerator is understated not only because it excludes the universe of "unlit" buildings that are nevertheless contestable by virtue of nearby fiber or intermodal alternatives, but because, in the absence of lit building data from alternative special access providers, GAO was forced to rely on public data sources that exclude large numbers of buildings.[22] The denominator is overstated because the GAO defined the universe of buildings with special access demand to be all those with 18 lines, notwithstanding that many such buildings may have no demand for special access services.[23] The GAO also assumed that incumbents have deployed fiber to all such buildings, when in fact the vast majority of buildings with demand for a single DS1 (or a handful of DS1s) are served over copper facilities.[24]

Nor did the DOJ conclude that the Commission's progressive deregulation has gone too far. Rather, the DOJ merely concluded that allowing AT&T and Verizon to acquire legacy AT&T Corp. and MCI fiber connections to buildings that it deemed unlikely to be served by other CLECs would unduly increase concentration. And the DOJ and the Commission provided

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[22] *See, e.g.*, Verizon at 17 ("Verizon was able to determine that more than 40 percent of the former MCI's competitive fiber did not appear" in the database used by GAO); Casto Supp. Decl. ¶ 20.

[23] AT&T Supp. at 52-57. For example, such buildings may house 18 different businesses, each with its own voice line, or several businesses with a few lines each. In either case, there would be no demand for DS1 or higher capacity services.

[24] *Id.*

a complete remedy for that perceived merger-specific harm by requiring divestiture of 100% of those building connections.[25]

The re-regulation proponents' attempts to rely upon the Commission's own *Triennial Review Order* decision expose yet another fatal flaw in their advocacy. Claims that special access customers have no alternative to DSn-level price cap LEC special access services outside commercial centers ignore the near ubiquitous availability of below cost UNEs in these areas that many of those complaining the loudest purchase in lieu of special access.[26] XO concedes that it "relies on the availability of cost-based DS-1 and DS-3 UNEs to serve most of our customer base";[27] other CLECs likewise admit that they focus on UNEs, not special access.[28] And, far from becoming less available as the re-regulation proponents claim, DS1 UNE loops continue to be available in more than 95% of the wire centers in most MSAs, and the use of AT&T DS1 and DS3 UNEs has actually *increased* substantially since 2004.[29]

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[25] A number of commenters simply attempt to reargue the same claims they previously made about the effectiveness of the divestiture remedy that were soundly rejected by the Commission, the DOJ and the Tunney Act Court. *See SBC Commc'ns and AT&T Corp. Applications for Approval of Transfer of Control*, 20 FCC Rcd. 18290, ¶ 24 (2005) ("*SBC-AT&T Merger Order*") ("We conclude, however, that the consent decree" by which "the Applicants agreed to certain divestures . . . should remedy any likely anticompetitive effects"); *Verizon Comm'ns and MCI Inc., Applications for Transfer of Control*, 20 FCC Rcd. 18433, ¶ 24 (2005) ("*Verizon-MCI Merger Order*"); *see also AT&T Inc. and BellSouth Corp. Application for Transfer of Control*, 22 FCC Rcd. 5662, ¶ 27 (2007) ("*AT&T-BellSouth Merger Order*") (concluding that AT&T's voluntary commitment to divest IRUs to specified buildings "adequately remedies the potential harms"); *United States* v. *SBC Communications, Inc.*, 489 F. Supp. 2d 1, 70 (D.D.C. 2007) (upholding the merger and finding the divestiture and other merger commitments to be "in the public interest").

[26] *See, e.g.*, AT&T Supp. Comments at 13; Casto Supp. Decl. ¶ 13; Qwest at 42.

[27] XO, Govil Decl. at 6, Heading III.

[28] *See, e.g.*, Covad Clancy Decl. ¶ 7.

[29] *See* Casto Supp. Reply ¶ 19.

Nowhere are the re-regulation proponents claims more divorced from reality, however, than with respect to the already robust and rapidly expanding competition from intermodal special access alternatives. The record contains concrete evidence that myriad broadband wireless providers are actively and successfully competing against price cap LECs in the provision of DSn-level special access services, and that they are doing so at the more remote customer locations upon which re-regulation proponents have focused their advocacy.[30] Indeed, the record establishes that all of the major wireless carriers, including those that continue falsely to claim that they have no alternatives to price cap LEC services, now rely heavily on wireless backhaul. According to a third party study cited by Qwest, "[r]oughly 20% of mobile base stations in the United States are backhauled via wireless technologies today," and that percentage is expected to double by 2011.[31] Moreover, wireless technologies have already captured the majority of the wireless backhaul market in Europe, and globally nearly two thirds of mobile base stations are linked via wireless backhaul.[32] Wireless special access alternatives indisputably are here now, are expanding rapidly, and are being adopted in a big way by those that claim they are entirely dependent on price cap LECs.

Against these facts, claims by re-regulation proponents that wireless alternatives are unproven or somehow inadequate border on outright falsehoods.[33] Out of one side of its mouth

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[30] *See, e.g.*, *See, e.g.*, AT&T Supp. Comments at 12-21 & Casto Supp. Decl. ¶¶ 22-54; Verizon 2007 Comments at 21-29; Qwest 2007 Comments at 28-41; Embarq 2007 Comments at 5-8.

[31] Qwest at 29, i (*citing* Visant Strategies, *US Mobile Backhaul: Evolving Market 2007*, available at http://www.visantstrategies.com/Prback2007.html).

[32] *Id.*

[33] *See, e.g.*, Paetech at 12 (wireless is "unproven"); TWTC at 16 ("Successful deployment of fixed wireless services continues to elude major license holders of spectrum"); BT at 8 (wireless does not "currently provide the level of reliability and security demanded by current purchasers of special access services"); XO at 25 (fixed wireless services are only "starting to be deployed successfully").

XO, for example, tells the Commission that fixed wireless services are only "starting" to be deployed and face many obstacles, while out of the other side it boasts through its broadband wireless subsidiary, Nextlink, that it "operates the nation's largest broadband wireless network in the U.S.," that it can offer customers "access to more than five million business locations with a wide range of scalable bandwidth options,"[34] and that for more than a year it has been able to serve any building that is within 5 miles line-of-sight of its wireless hubs that are broadly deployed across its service areas.[35] Just last month XO and Nextlink announced that they had expanded their "broadband wireless service to 24 new . . . markets [and can now] provide alternative last mile connections to service providers" in those markets.[36]

For its part, even though Sprint grudgingly admits in a footnote that it just inked a deal with FiberTower to provide backhaul for Sprint's 4G/Wimax service in seven of the markets where that service is first being deployed, it complains that FiberTower "will only be able to satisfy a portion of Sprint Nextel's special access needs for its 4G services."[37] But Sprint pointedly declines to identify just how large that portion is, and Sprint has told AT&T that it may choose FiberTower over AT&T in other markets as well.[38] Indeed, earlier this month Sprint stated that "FiberTower's superior service quality, flexibility and scalability are a perfect fit for

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[34] Press Release, *Nextlink, XO Communications Expands Broadband Wireless Coverage to 36 Markets* (July 11, 2007), available at http://www.nextlink.com/news_71.htm.

[35] *See* Press Release, *XO communications Deploys Fixed Broadband Wireless in Nine Cities to Expand Metro Coverage and Reduce Network Access Costs* (Aug. 28, 2007, available at www.xo.com/news/316.html.

[36] Carol Wilson, *XO Expands Broadband Wireless To 36 Markets, TelephonyOnline* (July 11, 2007), available at http://telephonyonline.com/home/news/xo_broadband_wireless_071107/index.html.

[37] *See* Sprint at 4, n.7; Press Release, *FiberTower Announces Backhaul Agreement With Sprint Nextel for WiMax Buildout* (Aug. 6, 2007), available at http://www.bbwexchange.com/pubs/2007/08/06/page1423-647177.asp.

[38] Casto Supp. Reply Decl. ¶ 4-5 (Chicago); Casto Supp. Decl. ¶ 46 (Dallas).

our next-generation network plans and we look forward to *dramatically expanding* this relationship going forward."[39] Moreover, the FCC appears to be on the verge of adopting rules that will enable FiberTower and others to greatly improve and expand the services provided to XO and other customers by allowing broadband wireless providers to use "smaller antennas for 11-GHz transmissions."[40] These smaller antennas "will help carriers expand their networks as they offer 3G and 4G services" because they "cost less to install and maintain, are less vulnerable to wind and enable delivery of low-cost broadband service to unserved areas," and they will allow broadband wireless providers to "get longer distances in areas where normally we're not allowed to put a larger dish because of zoning requirements or wind loading or weight loading requirements on towers or buildings."[41]

Sprint's claim that FiberTower will not replace any existing special access circuits is equally disingenuous, for Sprint's 4G facilities are generally located on the *same* towers as Sprint's existing services,[42] and there is therefore nothing stopping Sprint (or any other carrier with facilities at that location) from replacing existing circuits with FiberTower's services.[43] Indeed, a Sprint executive recently admitted that "Sprint will leverage multiple architectures and technologies (wired and wireless) to provide backhaul for the company's new and legacy

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[39] *FiberTower Announces Backhaul Agreement With Sprint Nextel for WiMax Buildout*, CNNMoney.com (Aug. 1, 2007) (emphasis added), available at http://money.cnn.com/news/newsfeeds/articles/prnewswire/LAW03301082007-1.htm.

[40] Howard Buskirk, *Martin Circulates Order to Allow Smaller Antenna for Backhaul*, Communications Daily (Aug. 13, 2007).

[41] *Id.*

[42] Casto Supp. Reply Decl. ¶ 4.

[43] *Accord* Qwest at 34-35 ("once wireless providers deploy . . . they could use those fat bandwidth pipes to serve small and large business . . . [and] telcos").

networks."[44] Sprint also fails even to acknowledge its own widely publicized plans to self-provision backhaul services using its dominant position in 2.5 GHz WiMax and its ventures with Clearwire and Google, which will allow Sprint not only to provide its own broadband wireless backhaul, but to provide wholesale special access services to others, particularly those carriers with facilities located at the same cell cites as Sprint. Sprint is spending billions of dollars on its WiMax venture, an investment that the carrier plainly would not bet on an "unproven" technology. Sprint's bald assertion (at 4) that it "remains almost completely dependent on . . . the BOCs" is thus patently false and refuted by its own marketplace behavior.

But wireless services are not the only sources of intermodal competition to which regulation proponents pay mere lip service. All of the major cable companies also are today competing aggressively in the provision of DSn-level special access services or are poised to do so, particularly in more remote areas outside commercial centers where they have the advantage of much deeper fiber/coax deployment nearer more customer premises. The record contains documented evidence that numerous cable operators are offering a wide range of T-1 and other special access substitutes to small and medium businesses nationwide today, and that they are rapidly expanding their offerings.[45] For example, Cablevision states that it "has invested more

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[44] Sue Marek, *Rethinking Backhaul*, *Fierce Wireless* (April 12, 2007), available at http://www.fiercewireless.com/story/rethinking-backhaul/2007-04-13.

[45] AT&T Supp. Comments at 18-24; Casto Supp. Decl. ¶¶ 30-51; Verizon at 20-23; Qwest at 35-39; Embarq at 5-8. There is no merit to TWTC's assertion that cable companies are limited in providing service to commercial customers due to the "limited reach of their fiber networks," because cable companies have developed and are developing technologies that provide commercial-grade high capacity services using their coaxial cable. Indeed, just days ago it was announced that Comcast, Charter and Cox are adopting and working with "Vyyo's spectrum overlay technology," which provides "additional bandwidth" over coaxial cable, to provide better service to "small and midsized businesses." *Comcast, Charter Move Forward With Vyyo Tests*, Communications Daily (Aug. 14, 2007).

than $1 billion"[46] to expand its business offerings, Comcast is deploying "fiber deep into where customers are present, either in the residential side or along where commercial business are,"[47] and Time Warner has increased the number of fiber-connected buildings in its network by nearly 25%.[48] As AT&T and other price cap LECs have explained, incumbents are already losing special access business to these cable providers, including the business of Sprint, T-Mobile and other wireless carriers, and expect this competition to increase substantially in the near future.[49] Although re-regulation proponents try to sweep this competition under the rug, even TWTC concedes that it competes today with cable operators that offer Ethernet alternatives to special access services.[50]

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[46] Optimum Lightpath, *Our Network*, http://www.optimumlightpath.com/Interior.123.html.

[47] *Comcast Investor Day P.M. Session – Final*, FD (Fair Disclosure) Wire, Transcript 050107aw.753 (May 1, 2007) (statement by Comcast Corp. EVP John Schanz).

[48] Press Release, *Time Warner Telecom Reports Strong Second Quarter 2007 Results*, at 13, available at http://www.twtelecom.com/Documents/Announcements/News/2007/TWTC_Q2_07PR_.pdf (showing a 23% increase – from 6,433 to 7,884 – in the number of buildings to which it has deployed fiber connections during the last year and increased the number of customers by more than 150% during the past year). In addition, as Verizon, points out (at 21-23), Cablevision has "more fiber in the [NY/NJ/CT] tri-state area" "than any phone company" and has "identified over 600,000 businesses inside our footprint that we passed with cable that were serviceable today [using plant originally deployed for residential service]"; business services represent the "next great business opportunity" for Comcast, and it will make a "$250 million investment in commercial services in 2007"; Cox "ended the [first quarter of 2007] with more than 187,000 commercial customers, reflecting 32.2% year-over-year growth"; and RCN's network "accesses over 800 customer 'on-net' buildings and passes 20,000 additional 'off net' buildings that are within 500 feet of the network." Further, cable companies were the purchasers of the fiber IRUs in four of the eight MSAs in which Verizon was required to divest fiber laterals in connection with the MCI merger. *See* Verizon at 21, n.23.

[49] *See, e.g.*, SBC Initial Comments at 18 & Casto Initial Decl. ¶ 43; AT&T Supp. Comments at 9, 17-21 & Casto Supp. Decl. ¶¶ 37-50; Embarq at 6 & Jewell Decl. ¶¶ 4-5.

[50] TWTC at 15. With liberal use of ellipses, inserted words, and omissions, TWTC goes well beyond the bounds of responsible advocacy when it claims that AT&T's CFO said that AT&T faces little competition from cable companies for small business services. That is not what Mr. Linder said at all. Rather, in response to a question as to whether there has been a "decline in competition" for small business customers, Mr. Linder stated that "the situation hadn't changed

In short, the record in this proceeding conclusively demonstrates that the provision of special access services is intensely competitive today and only becoming more so as CLECs continue to expand their networks and wireless and cable intermodal providers continue to expand their already widespread and commercially successful services. Proponents of special access re-regulation have now had multiple opportunities over the course of several years to back up their contrary rhetoric, and each time they have failed to do so, even as they continue to ask the Commission to take the extraordinary and unprecedented step of rescinding deregulatory measures taken eight years ago by the Kennard administration. It would be a remarkable act of regressive policymaking and the height of folly for the Commission to re-regulate a service characterized by growing competition and falling prices simply because purchasers of that service would like even lower prices. The Commission should therefore reject requests for re-regulation and conclude, consistent with the record evidence, that its pricing flexibility regime

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dramatically," that AT&T is already sustaining losses to its cable competitors (about 15% of its losses to competitors), and that he expects those losses to accelerate over this next year. The full text of the relevant section of the transcript reads as follow: "Where we do have competitive losses and maybe a good way to say this would be if you look at our access line disconnects in the regional business space, most of them are related to technology migration. Only about 30% of access line disconnects are competitive disconnects. In terms of cable competition up to this point of that 30%, the disconnects that are cable related are very small, four to five percentage points of that 30. So we are not seeing a lot in the market at this point, other than probably from Cox who has been in the market for some time. But I do expect over this next year we'll see more activity as Comcast and Time Warner both begin to roll out their plans." AT&T Q2 2007 Earnings Call Transcript (July 24, 2007), available at http://seekingalpha.com/article/42142. TWTC further claims that Mr. Linder stated that cable companies "are only targeting small businesses with ten lines and under, maybe even four lines and under." TWTC Comments at 15. What Mr. Linder actually said was "I think where we will see them [cable] will tend to be *more* [not "only"] in the lower end of the small/medium business space, kind of 10 lines and under, maybe even four lines and under." *Id.* Of course, TWTC's suggestion that cable competition is somehow less relevant to the extent it is focused on smaller DS1 and DS3 customers outside commercial centers is mystifying. After all, those customers are the very customers who proponents of re-regulation most often cite as lacking sufficient competitive alternatives.

and other progressive deregulatory reforms have worked exactly as intended and should be extended as outlined in AT&T's opening comments.

II. THERE IS NO MERIT TO CLAIMS THAT PRICE CAP LECs HAVE SOMEHOW RESPONDED TO ROBUST FACILITIES-BASED COMPETITION BY RAISING PRICES, CHARGING PRICES THAT ARE "TOO HIGH," OR EARNING "EXORBITANT" RETURNS.

A. Special Access Prices Have Significantly Declined Since Pricing Flexibility Was Granted, And There Is No Basis To Claims That Rates Remain "Too High."

The claim that "price cap LECs have used pricing flexibility to raise prices" has long been the mantra of proponents of special access re-regulation. The claim was repeatedly made in 2005, and has been repeated here, again and again, in the supplemental comments. But the re-regulation proponents have never offered any meaningful evidence in support of these claims. The reason that they have not done so is that this charge is simply false. The special access prices that customers actually pay have steadily declined since pricing flexibility was granted. The price cap LECs documented these price reductions in *sworn testimony* that they filed in 2005, and they have filed supplemental declarations that establish that prices continued to decline during the past two years.[51] Contrary to the claims of the re-regulation proponents, this uncontradicted evidence establishes that the average revenues that price cap LECs receive for special access circuits, including average revenues for DS1 circuits and average revenues for DS3 circuits, have steadily and dramatically declined.

[51] *See* AT&T Supp. at 21-24 & Casto Supp. Decl. ¶¶ 56-57; Qwest at 45-47 & Cogan Decl. ¶¶ 16-17; Verizon at 10-13 & Taylor Supp. Decl. ¶¶ 7, 11; *see also* Embarq at 9-10; Iowa Telecom at 10-11.

Preliminarily, the uncontradicted evidence establishes that average revenues have dramatically declined for special access services as a whole.[52] A few commenters criticize the incumbents' use of average revenue per unit, claiming that it simply reflects customers' shifts from DS1 to DS3 and to higher capacity, lower cost circuits.[53] Even if these criticisms had merit – as they do not – they are quite irrelevant, for the sworn testimony and other uncontradicted evidence in the record also establishes that prices paid by customers have declined at each capacity level.

For example, Verizon demonstrates that "[b]etween 2002 and 2006, prices paid for DS1 services fell an average of 5.28 percent per year, while prices paid for DS3 services during that time fell an average of 4.97 percent per year, both in real terms."[54] AT&T and Qwest report comparable reductions in prices paid for their DSn level services.[55] Further, the incumbents' price-revenue data has been confirmed by the GAO. As Qwest points out, the data in the GAO Report shows that the average DS1 price in the 56 MSAs studied by GAO went down 20.3 percent, from $161.62 before pricing flexibility to $128.88 in 2005 and that the average price for DS3 level circuits in the same time frame fell by 19.0 percent, from $1,475.83 to $1,194.97.[56] As GAO correctly concludes, these price reductions are powerful evidence that the

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[52] *See, e.g.*, Verizon at 11 & Taylor Supp. Decl. ¶ 11 ("average revenue per voice-grade equivalent special access line has decreased an average of 27.7 percent per year in real terms"); Qwest at 46 & Cogan Decl. ¶ 16 ("revenue per DSO equivalent capacity in 2006" was only a fraction of its 2001 level).

[53] *See, e.g.*, TWT at 34-35; XO at 13-14.

[54] Verizon at 12 & Taylor Supp. Decl. ¶ 18.

[55] *See* AT&T Supp. at 22 & Casto Supp. Decl. ¶¶ 56-57 (reporting declining prices for DS1 and DS3 circuits); Qwest at 46 & Cogan Decl. ¶ 17 (reporting declines for DS1 level circuits in the largest MSAs).

[56] Qwest at 45-46 (citing GAO Report at 59, 65, App. 2, Table 9).

Commission's pricing flexibility rules are benefiting consumers in precisely the ways that the Commission predicted that they would.[57]

Given that the prices customers pay for DSn level circuits actually have declined, it should come as no surprise that the ostensible support offered by proponents of re-regulation for the contrary proposition is feeble and irrelevant at best. Indeed, they rest their claims entirely on a few instances in which "rack" rates have risen.[58] But as the Commission has recognized, these "rack" rates bear no relationship to what average customers actually pay for service.[59] Customers rarely purchase services at the base tariff month-to-month rates; rather, they typically receive large discounts via a variety of discount plans. Indeed, the re-regulation proponents elsewhere acknowledge the point, stating that it is "true" that prices customers pay are heavily discounted off base tariff rates.[60]

Such discount plans are standard practice, not only for special access services, but in other competitive markets. For example, when long distance services were tariffed, the base tariff rates were often increased to very high levels, but customers on average paid far less, because they subscribed to volume, term, or other plans that provided substantial discounts off base rates.[61] As re-regulation proponents admit, they obtain their special access services under

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[57] GAO Report at 13.

[58] *See, e.g.*, TWTC at 23 & n.39 (claiming that Qwest's prices for special access "increased by approximately 19 percent" but citing Qwest's "Revisions by Qwest Corporation to Tariff FCC No. 1, Transmittal No. 206" for that proposition).

[59] *SBC-AT&T Merger Order*, 20 FCC Rcd. 18290, ¶ 53 n.142; *AT&T-BellSouth Merger Order*, 22 FCC Rcd. 5662, ¶ 43 n.117.

[60] *See* TWTC at 28.

[61] *Motion of AT&T Corp. to be Reclassified as a Non-Dominant Carrier*, 11 FCC Rcd. 3271 (1995) (finding an "intense rivalry" in long distance, even though "basic schedule [tariffed] rates for domestic residential service ha[d] risen approximately sixteen percent;" customers were paying less because they were "selecting discount plans rather than paying . . . basic rates"). Likewise, many wireless carriers offer higher base rates for cellular phones and for per minute

such plans, dramatically underscoring that the relevant rates are the discounted rates that customers actually pay, not the "rack" rates.

Unable to demonstrate that special access have risen, as they claim, proponents of re-regulation are reduced to making a series of arguments – based on various "inferences" (TWTC at 30) – that the competitively-set prices that price cap LECs are charging are nonetheless "too high" and are unreasonable. In particular, they assert that price cap LEC special access prices are higher than price cap rates, UNE rates established by state regulators under TELRIC, long-haul private line rates, and even rates in other countries. They further point to the "high" returns calculated using ARMIS data and allocations. These same claims were made in 2005, and AT&T and others previously explained in detail why each of these comparisons are entirely invalid.[62] In their supplemental comments, the re-regulation proponents do not even acknowledge these criticisms and simply persist in relying on these same irrelevant "benchmarks." But nothing has occurred in the intervening two years that makes any of these invalid comparisons any better.

Price Cap/Price Flex Rate Comparisons. Re-regulation proponents first allege that DSn level channel termination prices in pricing flexibility areas are higher than price cap rates

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cellular calls, but customers actually pay much less by subscribing to plans or by bargaining for reduced rates. *See Orloff* v. *FCC*, 352 F.3d 415, 417-18 (D.C. Cir. 2003) ("Like its competitors, Verizon [Wireless] had several standard rate plans and regularly engaged in special advertising promotions, offering airtime minutes or additional services at no extra charge").

[62] *Compare* SBC Reply Comments at 31-43 (explaining defects in using, *inter alia*, price caps rates, TELRIC-based rates, long haul rates, and ARMIS returns as benchmarks) and Verizon Reply Comments at 7-19 (same) *with, e.g.*, Ad Hoc Initial Comments at 21 (proposing price cap rates as a benchmark); Sprint Initial Comments at 2 (same); BT Initial Comments at 5 (TELRIC rates); ATX (same); T-Mobile Initial Comments, Wilkie Decl. (long-haul rates); XO Initial Comments at 5-6 (ARMIS-based rates of return).

and that this is proof that pricing flexibility has been a failure.[63] The threshold problem with this claim is that the allegation is categorically false as to AT&T. All of AT&T's rates in Phase II MSAs are at or below its price cap rates for the same rate elements and will remain so through at least 2010.[64] As even the most ardent of rate re-regulation proponents concede, "there is no price caps/pricing flexibility differential throughout AT&T's twenty-two state region."[65]

Beyond that, comparisons between price cap rates and price flex rates prove nothing because it cannot be presumed that the price cap rates are the "correct" rates.[66] Indeed, the Commission has already recognized as much and decided to transition to a market-based system precisely because "competition will provide a more accurate means of . . . moving access prices to economically sustainable levels."[67] The reality, therefore, is that in those instances where Phase II pricing flexibility rates exceed price cap rates, it is far more likely that the Phase II rates are the "correct" rates and that the price cap rates are inappropriate.

Indeed, it would take a religious faith in the virtues of economic regulation and an evangelical antipathy toward the workings of free markets to conclude otherwise. Even in the best of circumstances, price caps are an inherently mechanical and imprecise way to set prices.

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[63] *See, e.g.*, TWTC at 29-31; CompTel at 7-8; ATX at 5; Ad Hoc at 11. Most of these comments rely on the GAO Report, which makes the same comparison. GAO Report at 14.

[64] *See AT&T-BellSouth Merger Order*, 20 FCC Rcd. 5662, App. F, Special Access Commitment 6. The GAO Report and most of the commenters alleging that rates in Phase II MSAs exceed price cap rates rely on data the predates AT&T's merger commitment and these analyses are thus outdated.

[65] Ad Hoc at 11; *see also* T-Mobile at 3-4 (discussing the recent "savings that T-Mobile and others have gained" in purchases from AT&T).

[66] *See, e.g.*, AT&T Supp. at 55-56; Verizon Reply Comments at 13-14 & Taylor Reply Decl. ¶ 25; SBC Reply Comments at 32.

[67] First Report and Order, *Access Charge Reform; Price Cap Performance Review for Local Exchange Carriers; Transport Rate Structure and Pricing End User Common Line Charges*, 12 FCC Rcd 15982, ¶ 44 (1997).

They cannot possibly account for all of the numerous supply and demand factors that affect prices in competitive markets. But the special access price cap rates to which comparisons are made were not set under the "best of circumstances." Initially, the caps were set based on rates that resulted from years of rate-of-return regulation, which suffered from obvious flaws and distorted rates in myriad ways, as the Commission has previously found.[68] Thus, price cap rates were flawed at the outset, and could not thereafter represent the kind of rates that would exist in a competitive market even if subsequent adjustments precisely reflected productivity gains and other market forces. But subsequent adjustments did not reflect such factors. Rather, for a decade, price cap rates mechanically were reduced each year by arbitrary "X-factors" that the Commission was unable to defend in the courts of appeals.[69] The resulting price cap rates could not possibly have accurately replicated rates set by competitive market forces. Beyond that, following the *CALLS Order*, price cap rates were arbitrarily reduced further by a negotiated factor that did not even purport to estimate accurately the efficiency gains that might occur in competitive conditions.[70] That factor, not insignificantly, was agreed to with full knowledge that it would not apply in Phase II MSAs. Given this history, any notion that price cap rates are the proper measure of the rates that should exist in a competitive market is simply a fantasy.

Indeed, even prior to the *CALLS Order*, the Commission acknowledged that the price cap rates did not reflect the operation of marketplace forces, for it "explicitly recognized that Phase II

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[68] *See, e.g.*, Second Report and Order, *Policy and Rules Concerning Rates for Dominant Carriers*, 5 FCC Rcd. 6786, ¶¶ 23, 26-29, 34 (1990) ("*Price Cap Order*").

[69] AT&T Supp. at 40-41; *USTA* v. *FCC*, 188 F.3d 521, 525-26 (D.C. Cir. 1999).

[70] Sixth Report and Order, *Access Charge Reform; Price Cap Performance Review for Local Exchange Carriers; Low-Volume Long-Distance Users; Federal-State Joint Board on Universal Service*, 15 FCC Rcd 12962, ¶ 40 (2000) ("*CALLS Order*") (the negotiated X-factor is not a true "productivity estimate" but merely a "method to reduce rates to certain levels").

pricing relief could lead to price increases for customers in some areas."[71] The Commission acknowledged that there likely were areas where the price cap rules "required incumbent LECs to price access services below cost,"[72] and it concluded that rates set under the pricing flexibility rules are "superior to continued price regulation."[73] For all these reasons, the GAO's and commenters' comparisons of DSn level channel termination prices in Phase II pricing flexibility areas with those in price cap areas are irrelevant and do not remotely undermine the evidence that the Commission's pricing flexibility rules have been successful.

TELRIC Prices. Re-regulation proponents next assert that special access rates are "too high" because they sometimes substantially exceed the UNE rates for high capacity loops that certain state commissions have set under TELRIC. These claims are specious.[74]

Initially, as discussed below in Part III, TELRIC is the standard that was established to set cost-based UNE and interconnection rates for purposes of Sections 251 and 252 of the Telecommunications Act of 1996. As Congress made explicit, and as two courts of appeals have held, the standard has no applicability to special access and other access services which are governed by the more general and flexible "just and reasonable" pricing standard in Section 201.

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[71] *See* Letter from FCC (Anthony Dale, Managing Director) to GAO (Mark Goldstein, Director, Physical Infrastructure Issues), at 2 (Nov. 13, 2006) *reprinted in* GAO Report, App. III ("FCC GAO Response Letter") (citing *Pricing Flexibility Order,* 14 FCC Rcd 14221, ¶ 155).

[72] *Id.* (citing Fifth Report And Order And Further Notice Of Proposed Rulemaking, *Access Charge Reform; Price Cap Performance Review for Local Exchange Carriers,* 14 FCC Rcd. 14221, ¶ 155 (1999) ("*Pricing Flexibility Order*")).

[73] *Id.* In all events, even if the Commission were wrong and the price increases resulted in an "unreasonably high rate for access in an area that lacks a competitive alternative," the Commission has concluded the pricing flexibility rules are still preferable to price cap regulation because the high "rate will induce competitive entry, and that entry will in turn drive rates down." *Id.* (citing *Pricing Flexibility Order,* 14 FCC Rcd 14221, ¶ 144).

[74] *See, e.g.*, Sprint at 22-23; ATX at 4; XO at 16-20.

Even if it were permissible under the Act, the use of UNE prices as a benchmark for special access rates would be all the more inappropriate given the grave infirmities of the TELRIC standard that (for now) is used to calculate UNE prices. Re-regulation proponents contend that because competition drives prices to costs and because TELRIC-based UNE rates are alleged to be "cost-based," TELRIC establishes the rates that should prevail in a competitive market. But TELRIC prices are not "cost-based" in any real world sense of the term. Rather, they are based on "purely hypothetical" models of networks constructed using patently "unrealistic" and internally inconsistent assumptions about the market.[75] The Commission recognized as much in 2003 when it opened its still pending rulemaking proceeding to revisit virtually every aspect of TELRIC.[76] The Commission stated that TELRIC rules are "extremely complicated," "excessively hypothetical," and "very general," leading to highly "variable results" in UNE prices that do not in fact "reflect genuine cost differences."[77] In particular, a number of the unrealistic assumptions within the TELRIC standard means that UNE rates are systematically understated. To describe but one example, although "in the real world," "even in extremely competitive markets," the "efficient carrier's network will reflect a mix of new and older technology at any given time," TELRIC improperly sets prices lower because it

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[75] Notice of Proposed Rulemaking, *Review of the Commission's Rules Regarding the Pricing of Unbundled Network Elements and the Resale of Service by Incumbent Local Exchange Carriers*, 18 FCC Rcd 20265, ¶¶ 4-5 (2003) ("*TELRIC NPRM*"). Moreover, as explained below and in AT&T's comments, TELRIC attempts to model the cost of facilities, not individual services like special access. Such models presume a network that will be used to provide a similar service to every location, assumptions that do not apply to designed services like special access and that make the rate comparisons between special access and UNEs even more tenuous. *See* AT&T Supp. at 57 n.129.

[76] *TELRIC NPRM* ¶ 6 (acknowledging that TELRIC has "been the subject of extensive criticism").

[77] *Id.* ¶¶ 6-7.

counterfactually assumes that a firm could "instantaneously replace all of their facilities with every improvement in technology."[78]

The problems with the TELRIC methodology itself were exacerbated by the process through which TELRIC was applied. Current TELRIC rates were generally set in connection with section 271 proceedings. In that context, this process operated as a one-way ratchet. The Commission sought only to assure that rates were not too high by adopting benchmarks to which BOCs had to lower their UNE rates and, states assured section 271 relief by lowering UNE rates. However, as the Commission has explained, there was "no comparable process" to "correct[] rates when an error in applying the TELRIC rules results in rates that are inappropriately low."[79] As a result of these analytical and practical flaws, the rates that have emerged from the TELRIC "black box" are entirely too low. As one analyst has succinctly put it, "for all RBOCs, UNEs are priced below total operating cost."[80]

Extending such excessively low prices to special access would hurt not just price cap LECs, but consumers everywhere because those prices would dampen investment and facilities-based competition and thereby undercut a principal goal of the 1996 Act and this Commission. The Commission has already recognized as much in the context of UNEs, noting that TELRIC

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[78] *Id.* ¶ 50; *see also, e.g., id.* ¶ 51 ("[s]imultaneously assuming a market inhabited by multiple competitors and one with a ubiquitous carrier with a very large market share may work to reduce estimates of forward-looking costs below the costs that would actually be found even in an extremely competitive market").

[79] *Id.* ¶¶ 27-28.

[80] *See, e.g.*, A. Kovacs, et al., Commerce Capital Markets, Inc., "The Status of 271 and UNE-Platform In The Regional Bells Territories, at 15 (May 2002) ("The discounts from total cost are 50%-60% below total cost even when total cost does not include the cost of equity"). The Commission Staff also has concluded that in many instances "traditional TELRIC pricing will not permit incumbents to recover the costs of their investment." David M. Mandy and William W. Sharkey, Office of Strategic Planning and Policy Analysis, "Dynamic Pricing and Investment from Static Proxy Models," at 1 (September 2003).

"distorts [the Commission's] intended pricing signals by understating forward-looking costs" and as a consequence, "thwarts one of the central purposes of the Act: the promotion of facilities-based competition."[81] Indeed, TELRIC reduces investment incentives for incumbents and competitors alike: the former will not deploy new facilities because they cannot make a reasonable return on their investments, and the latter have no need to invest in facilities because they can obtain the incumbents' facilities at below-cost rates.[82] If TELRIC-based UNE rates became a benchmark for special access rates, the Commission would transfer the reduced investment incentives to the special access marketplace as well – thereby undercutting the substantial investments that incumbents, CLECs, cable operators, and wireless broadband providers have made in new technologies to deliver more and better advanced services.

For all of these reasons, the Commission could not rationally use existing UNE rates as a benchmark for the reasonableness of market-based special access rates.

Competitors' Rates. Re-regulation proponents next argue that incumbents' special access rates are too high because they purportedly exceed competitors' rates by substantial margins.[83] As a preliminary matter, there is no factual basis in the record to support these assertions, for CLECs do not file tariffs and have not chosen to submit complete data regarding the pricing of their services.[84] Rather, they selectively provide the Commission only with a handful of rates, and, as explained in Mr. Casto's supplemental reply declaration, there are a

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[81] *TELRIC NPRM*, 18 FCC Rcd. 20265, ¶ 3.

[82] *Id.* ¶ 51 & n.100 (citing economic literature and tentatively concluding that TELRIC "may undermine the incentive for either competitive LECs or incumbent LECs to build new facilities").

[83] *See, e.g.*, Global Crossing, Fischer Decl. ¶ 6; TWTC at 32.

[84] *See, e.g.*, *Pricing Flexibility Order*, 14 FCC Rcd 14221, ¶ 96; GAO Report at 40 (both noting that the Commission is hampered because it has "no specific or current data on competitors' prices;" despite requests to "competitive firms to supply prices," "they did not").

number reasons why the selected rates may not in fact be representative of pricing by alternative providers.[85]

In all events, even assuming (despite the absence of complete data) that competitors' rates are on average lower than incumbents, this would hardly be surprising or show that pricing flexibility is not working. Competitors offer different services and different service quality under different business models with different facilities and without the burdens and costs that come with pervasive regulation. They may also enjoy certain technology and other cost advantages over incumbents. For instance, as AT&T's comments explained, cable companies and wireless broadband providers may be better situated than incumbents to provide backhaul services because of the technology they have deployed in their networks.[86] Beyond that, the Commission has long recognized that CLECs may be able offer lower prices than incumbents because CLECs have complete control over where they provide service, and they may choose to do so in the high-density, cheapest market segments, whereas incumbents offer service to all customers in all parts of their territory.[87]

Long-Haul Rates And Rates from other Countries. Other re-regulation proponents go even further afield and argue that special access rates are too high because they allegedly exceed

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[85] Casto Supp. Reply Decl. ¶¶ 7-8.

[86] AT&T Supp. at 21 & Casto Supp. Decl. ¶ 44 (explaining that while incumbents often have copper facilities where backhaul services are demanded, alternative providers have fiber or wireless broadband facilities).

[87] *Application of Ameritech Corp., Transferor, and SBC Communications, Inc., Transferee, SBC-Ameritech Merger Order*, 14 FCC Rcd 14712, ¶ 92 (1999) (competition is typically introduced when "entrants attempt[] to win consumers' business with lower prices and improved services, and [when] incumbents [a]re forced in turn to respond to the entrants or lose customers"); *see also Reform of Access Charges Imposed By Competitive Local Exchange Carriers*, 16 FCC Rcd. 9923, ¶ 37 (2001) ("it is highly unusual for a competitor to enter a market at a price dramatically above the price charged by the incumbent, absent a differentiated service offering").

rates for long-haul services and rates for dedicated access provided in other countries.[88] Both contentions are meritless.[89]

First, with respect to the comparisons of long-haul services to special access, it is quite plainly fallacious to say that the per unit price of a 1 mile circuit running through city streets in downtown Chicago should resemble the per unit price of a 300 mile circuit between POPs in Chicago and St. Louis.[90] The costs and characteristics of the two facilities are wildly different. Along with the manifest cost differences in deploying fiber in these areas, the fixed costs of providing service are spread out over a much greater number of miles on a long-haul circuit. The comparison is thus one of apples to oranges.

No more availing is BT's suggestion that special access prices in the U.S. are higher than those in the UK. Independent analysts have found that U.S. access costs are among the lowest in the world, and are not higher than those in the UK.[91] As AT&T has previously demonstrated, the only way BT can now claim otherwise is by systematically misstating the data in both the U.S.

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[88] *See, e.g.*, TWTC at 34 (long haul); BT at 16-17 (international benchmarks).

[89] Global Crossing, after conceding that the special access rates it pays to AT&T have fallen, contends that AT&T has unfairly raised prices for *switched* access services. Global Crossing at 11 & Fischer Decl. ¶ 7. Such claims are not relevant to the issues in this proceeding, but in all events, as Mr. Casto explains, because the revenue base for the switched access services at issue is very small relative to special access and the modifications to those rates were modest, the total rate impact of the changes to the switched access rate elements is less than **[Begin Confidential]** **[End Confidential]** of the total rate impact of AT&T's merger commitment reductions to its Phase II special access rates (not the 60% that Global Crossing claims). Casto Supp. Reply Decl. ¶ 9.

[90] *See, e.g.*, Verizon Reply comments at 17-19 & Taylor Reply Decl. ¶¶ 34-42; SBC Reply Comments at 34-35.

[91] *See, e.g.*, Teligen, *Local Access Circuit Pricing for Key Asia-Pacific Countries vs. Each Other, the European Union & OECD Countries*, at Figures 8 & 9 (Nov. 2003).

and the UK.[92] In all events, any rate comparison is meaningless in the absence of any analysis showing that the costs and other characteristics of the services are substantially the same.

Service-Specific ARMIS Returns. Finally, re-regulation proponents persist in claiming that the unreasonableness of existing rates is established by high special access returns that were calculated using ARMIS data and allocations.[93] AT&T and others have addressed these claims in detail in prior filings and will not repeat those arguments in full here.[94] Suffice it to say that these claims are so hopelessly flawed as to be disingenuous. Indeed, the Commission itself has recognized that ARMIS data were never meant to be used to calculate service-specific rates of return. The Commission made that clear in 1990 when it adopted price caps and agreed with commenters claiming that "the collection of rate of return data on an access category or rate element level is improper and unnecessary for price cap LECs."[95] Simply put, the cost allocations required by Commission rules for joint use facilities are simply too arbitrary to serve as an appropriate basis for service-specific ratemaking. That has always been true, and as far back as seven years ago, the Commission recognized that its accounting requirements and the associated allocations were hopelessly archaic. It noted that its ARMIS rules are "outdated regulatory mechanisms" that cannot properly track in any accurate manner the actual costs for a

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[92] Letter from Gary L. Phillips & Lawrence Lafaro, AT&T, to Marlene Dortch, FCC, WC Docket No. 05-65 (June 2, 2005) (noting that BT understated its own charges by nearly half and apparently failed to consider discounts and included inappropriately large mileage charges in analyzing AT&T's rates).

[93] *See, e.g.*, ATX at 4-5; Ad Hoc at i; Sprint at 8.

[94] *See, e.g.*, AT&T Supp. at 34-36; Verizon at 41-45 & Taylor Supp. Decl. ¶¶ 38-44; Qwest at 50-53; USTA at 21-23; Embarq at 10-11; SBC Reply Comments at 36-43; Verizon Reply Comments at 8-12; Qwest Reply Comments at 6-9.

[95] *Price Cap Order*, 5 FCC Rcd. 6786, ¶ 380; *see id.* (there is "no need for disaggregated rate of return data.").

specific service like special access.[96] But what was true then is even more true today. Instead of trying to reform and update these requirements on an ongoing basis, the Commission essentially threw in the towel and froze the separations factors.[97] Since special access demand has been increasing since that time, while switched access demand has been declining, ARMIS-based special access rates of return are becoming more inaccurate each year.

Of course, if the Commission were to reverse course and examine service-specific ARMIS-based rates of return, it would also have to consider ARMIS-based rates of return for other services, notably switched access. According to ARMIS, returns for BOC switched access services have been in the low single digits (and for some BOCs have dipped below zero). The Commission could not establish special access rates based on ARMIS data without also considering the effects of such a change on the affected LECs' overall rates of return.

Although these arguments have been repeated throughout this proceeding, most re-regulation proponents have made no effort to respond to them. Instead, apparently indifferent to the legitimacy of their arguments, they continue to tout "updated" service-specific rates of return for special access as though they were entirely accurate. For all of the reasons set forth herein and in AT&T's earlier submissions in this proceeding, the Commission could not lawfully rely on these ARMIS-based service-specific returns.

Certain other commenters, tacitly recognizing that it would be inappropriate to rely upon ARMIS data for an absolute measure of returns, attempt to rehabilitate their reliance on ARMIS by arguing that year-over-year increases in ARMIS-based returns demonstrate that special access

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[96] *Jurisdictional Separations and Referral to the Federal-State Joint Board*, 16 FCC Rcd. 11382, ¶ 1 (2001) ("*Separations Freeze Order*").

[97] *Id.*

rates are too high.[98] This argument is simply wrong. To the extent ARMIS "returns" for special access are increasing, that is because the misallocations that result from the regulatory freeze are increasing year-over-year. As re-regulation proponents admit, special access services and revenues are growing rapidly.[99] Where revenues from a service grow and the costs and investment allocated to the service are frozen, the "rate of return" will necessarily increase. Thus, the ARMIS service-specific return simply have no probative value either in absolute terms or as a gauge of trends.[100]

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[98] *See, e.g.*, Ad Hoc, Selwyn Decl. App. 1, at A-1.

[99] *E.g.*, TWTC at 30 ("special access lines grew as a percentage of all access lines from 8.9 percent to 41 percent").

[100] ATX's declarant Dr. Selwyn also attempts a complex analysis of the ARMIS cost allocation data, ultimately concluding that the special access cost data improperly includes costs for unregulated services. Ad Hoc, Selwyn Decl., at A-5 to A-10. But rehabilitating the ARMIS service-specific cost data in this piecemeal manner is hopeless. The reality is that changes in the telecommunications industry over the years have resulted in countless allocations that have become arbitrary and exacerbated by the separations freeze, and trying to unpack the effects of these myriad changes would take far more analyses than Dr. Selwyn has attempted, and in any event, such allocative choices are inherently arbitrary in the context of today's multi-service networks. Dr. Selwyn's analysis also appears to be riddled with errors. As just one example, Dr. Selwyn asserts (at A-5) that AT&T's investment in Project Lightspeed should not be reflected in the regulatory accounts, and he tries to remove those investments. As an initial matter, Dr. Selwyn assumes that AT&T's cumulative Project Lightspeed investment has been $4.5 billion dollars. But the 2006 AT&T 10-K Report relied on by Dr. Selwyn states that AT&T projects that level of investment in the future (through 2008). That $4.5 billion figure therefore cannot legitimately be used, as Dr. Selwyn does, to revise AT&T's *historical* returns. Further, Dr. Selwyn fails to account for the fact that a significant portion of AT&T's Project Lightspeed investment are associated with AT&T's non-BOC operations and are booked to non-regulated service accounts. Third, Dr. Selwyn improperly assumes that none of the Project Lightspeed investments that are reflected in the ARMIS regulatory accounts are used for regulated services, when in fact increased fiber investments benefit a wide range of services, including regulated services, such as special access.

B. The Robust Competitiveness Of Wireless, Enterprise And Other Downstream Services That Use Special Access Inputs Further Confirms That Special Access Pricing Is Not Anticompetitive.

The Commission's deregulatory special access policies have paid enormous dividends in wireless, enterprise and other downstream markets that use special access inputs. Wireless and enterprise services, in particular, are fiercely competitive and have only become more so in the wake of special access pricing flexibility that has spurred competition, investment and arrangements tailored to customers' individual needs.

As the Commission recognized in the *Eleventh CMRS Report*, U.S. wireless markets are among the most competitive communications markets in the world, and U.S. wireless consumers continue to enjoy dramatically falling prices, rapid innovation and ever better service.[101] That explains why neither Sprint nor T-Mobile have accepted the Commission's invitation to demonstrate that (declining) special access prices have negatively impacted wireless services or deployment in any way. Both of these very large wireless carriers are competing quite successfully. Sprint just announced that its subscriber base is once again increasing as it finally begins to work the kinks out of its Nextlink integration difficulties.[102] And T-Mobile reported almost a million new customers and significantly increased average revenues in the first quarter of 2007.[103] Special access prices plainly have posed no obstacle to broadband deployment –

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[101] Eleventh Report, *Implementation of Section 6002(b) of the Omnibus Budget Reconciliation Act of 1993; Annual Report and Analysis of Competitive Market Conditions With Respect to Commercial Mobile Services*, 21 FCC Rcd. 10947 (2006) ("*Eleventh CMRS Report*"); *see* AT&T Supp. at 46-49.

[102] *See* Press Release, Sprint Nextel Reports Second Quarter 2007 Results (Aug. 8, 2007) ("subscriber base increases by nearly 400,000", "Higher post-paid ARPU and cost reductions drive strong sequential improvement in profitability", "Continued strength in wireless data and Internet Protocol (IP) services").

[103] Press Release, T-Mobile First Quarter 2007 Earnings Release (May 10, 2007), available at www.t-mobile.com.

since 2005 wireless carriers have invested tens of billions of dollars, much of that in 3G networks to provide improved broadband services.[104] The Commission and the D.C. Circuit were thus clearly correct in recognizing that wireless carriers, perhaps more so than any other market segment, are doing just fine with the many special access alternatives available to them and do not remotely need a regulatory leg up in the form of mandatorily reduced prices.[105]

Instead of responding with any actual evidence of market harm, Sprint and T-Mobile each just assume that special access rates are too high and that things would be even better if the Commission forced rates down by regulatory fiat. That argument is silly. It is hardly a credible or permissible basis for ratemaking simply to note that, if the Commission mandates rate reductions for particular services, those who purchase those services will have more money to spend on other things. The probative question is whether the rates are just and reasonable, not whether a rate reduction would put more money in the pockets of purchasers. Of course, as mandated rate reductions enrich the purchasers of a service, they diminish incentives for facilities-based competition and take money out of the pockets of service providers – money that might be used to invest in broadband and other services.[106] Thus, there is no conceivable legal or

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[104] *See Eleventh CMRS Report*, 21 FCC Rcd. 10947, ¶ 125 ($25 billion for 2005); Wireless Quick Facts (Dec. 2006) (another $24 billion for 2006), available at www.ctia.org/media/industry_info/index.com/AID/10323.

[105] In overturning the Commission's initial decision that wireless carriers should be able to purchase UNE transport facilities, the Court of Appeals observed that "[w]here competitors have access to necessary inputs at [special access] rates that allow competition not only to survive but to flourish, it is hard to see any need for the Commission to impose the costs of mandatory unbundling." *USTA* v. *FCC*, 359 F.3d 554, 576 (D.C. Cir. 2004). On remand, the Commission agreed with the Court of Appeals that non-ILEC providers of wireless services had competed successfully against ILEC wireless providers while purchasing special access services and that the market was fully "competitive." Order On Remand, *Unbundled Access to Network Elements; Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers*, 20 FCC Rcd 2533, ¶ 36 & n.106 (2005) ("*Triennial Review Remand Order*").

[106] *See, e.g., Appropriate Framework for Broadband Access to the Internet Over Wireline Facilities*, 20 FCC Rcd 14853, ¶ 19 (unnecessary regulation would "constrain technological

policy basis upon which the Commission could conclude that rate reductions are somehow appropriate simply because they could reduce the costs of providing wireless services.

The same, of course, is true for enterprise services. Retail competition for enterprise customers is fierce, as Verizon and other commenters have previously detailed.[107] The Commission recently concluded that enterprise customers are "sophisticated" buyers that "frequently purchase high-capacity transmission services," and are therefore able to "negotiate for significant discounts."[108] In doing so, they can bargain with "a significant number of carriers competing in the market" – including "interexchange carriers, competitive LECs, cable companies, []incumbent LECs, systems integrators, and equipment vendors."[109] Because of these characteristics, the enterprise market has more than "sufficient competition" that "should remain strong" over time.[110] In particular, because of robust special access competition, enterprise service suppliers are well-positioned to use "emerging technologies [that] are likely to make this market more competitive.[111]

Some commenters predictably drag out price squeeze arguments, claiming that incumbents' wholesale special access pricing could in theory foreclose retail competition. Such claims have been made in proceeding after proceeding for the better part of decade, and yet these commenters still cannot cite a single instance of a successful price squeeze. To the contrary, the

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advances and deter broadband infrastructure investment by creating disincentives to the deployment of facilities capable of providing innovative broadband Internet access services."); *Broadband 271 Forbearance Order*, 19 FCC Rcd. 21496, ¶ 21 (2004) (finding that unnecessary regulations created "disincentive effects . . . on BOC investment").

[107] Verizon at 30-32, 35-37; Qwest at 39; SBC Reply Comments at 10-11.

[108] *SBC-AT&T Merger Order*, 20 FCC Rcd. 18290, ¶ 74 & n.226.

[109] *Id.* ¶¶ 56, 64.

[110] *Id.* ¶¶ 56, 73.

[111] *Id.* ¶ 74.

real world evidence shows that providers that are not vertically integrated (*e.g.*, T-Mobile and Sprint) have been competing successfully for years with those that are. In light of this real world evidence, the Commission itself has repeatedly found that vertical foreclosure predation claims are rarely credible in dynamic telecommunications markets.[112] In particular, the Commission has rejected claims that ILECs could use market power in local services to effect vertical price squeezes in downstream markets, where, as here, the existence of numerous established carriers with sunk investments in national networks renders improbable any claim that an ILEC could recoup forgone profits.[113] The Commission should also reject these claims here.[114]

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[112] *See AT&T/TCI*, 14 FCC Rcd. at 3215, ¶ 118 n.327 (1998) ("We find that firms in dynamic industries such as telecommunications generally do not have the incentives to engage in predatory practices, because the success of such practices rests on a series of speculative assumptions"); *In re Rules and Policies on Foreign Participation in the U.S. Telecommunications Market*, 12 FCC Rcd. 23891, ¶ 199 n.405 (1997); *see also Matsushita Elec. Indus. Co., Ltd.* v. *Zenith Radio Corp.*, 475 U.S. 574, 588-91 (1986) (predatory conduct that requires profit sacrifice is "rarely tried, and even more rarely successful").

[113] *See, e.g., Application by SBC Communications Inc., et al. for Authorization to Provide In-Region, InterLATA Services in California*, 17 FCC Rcd. 25650, 25741-41, ¶¶ 157-59 (2002); *see also WorldCom, Inc.* v. *FCC*, 238 F.3d 449, 458-59 (D.C. Cir. 2001) ("the presence of facilities-based competition with significant sunk investment makes exclusionary pricing behavior costly and highly unlikely to succeed," because "that equipment remains available and capable of providing service in competition with the incumbent, even if the incumbent succeeds in driving that competitor from the market"); *Triennial Review Remand Order*, 20 FCC Rcd. 2533, ¶ 36 & nn.107, 64.

[114] Nor is it remotely the case that alternative special access providers cannot compete effectively unless they own fiber connections to every building occupied by a multi-location customer. TWTC at 12-13. *No* provider, including AT&T, has fiber connections to all commercial buildings nationwide, and it thus absurd to suggest that customers will consider only suppliers that can serve all of their locations over the suppliers' own facilities (indeed many customers insist on the diversity of multiple suppliers). AT&T explained in its previous comments in this proceeding (at n.63) that it had deployed fiber to only about 17,000 buildings in the legacy 13-state territory. And AT&T provides service to business customers nationwide (and worldwide) over a combination of its own facilities and special access facilities purchased from both competitive and incumbent suppliers outside its region. TWTC and every other enterprise service provider does the same, and, as the Commission has recognized, the enterprise services marketplace is robustly competitive with numerous successful providers competing in all areas.

III. THE SPECIFIC RE-REGULATION PROPOSALS ARE UNLAWFUL, PATENTLY ARBITRARY AND WOULD EMBROIL THE COMMISSION AND THE INDUSTRY IN A REGULATORY QUAGMIRE OF EPIC PROPORTIONS.

The record unambiguously confirms that the Commission's longstanding policy of progressive, incremental deregulation of special access services should be maintained. Indeed, the record confirms that the time is now ripe for further incremental deregulatory steps, such as universal Phase I relief for all special access services (which the vast majority of commenters support), as well as complete deregulation of all OCn and packet-based services and further Phase II relief where the existing triggers are not detecting the full range of facilities-based entry.

Nonetheless, a number of commenters continue to ask the Commission to mandate massive rate decreases through such devices as "reinitialization," X-Factors, and mandatory "baseball-style" arbitration. None of these commenters has made any serious attempt to demonstrate that the price cap LECs' current rates are unjust and unreasonable. Nor have any of them submitted the sort of evidence, studies, and analyses that would be necessary even to consider the imposition of some alternative rate. Rather, they advocate a series of short-cut measures, such as a 5.3% X-Factor based solely on the fact that it was the last X-Factor that was judicially upheld (more than twelve years ago and only on an interim basis), or reinitialization of all special access to an 11.25% rate of return based on ARMIS data (even though the separations factors have been frozen for six years and the Commission has not re-examined the 11.25% rate of return for seventeen years). Any attempt to mandate potentially confiscatory multi-billion dollar rate decreases on the basis of such transparently arbitrary short-cut measures would have no hope of surviving judicial review. If the Commission had any interest in returning to intrusive regulation of these competitive services, it would have no choice but to conduct full-blown rate cases. Such proceedings would be costly, burdensome, and inherently arbitrary, producing a regulatory quagmire of epic proportions. No party to this proceeding has come

remotely close to making the case for initiating such proceedings, and the Commission should promptly and firmly end any further speculation that it might do so.

A. There Is No Justification For Eliminating Phase II Pricing Flexibility.

A number of commenters want to turn back the clock to 1999 and relitigate the underlying theory of the pricing flexibility regime itself. These commenters are astonishingly out of touch with reality: for example, Time Warner Telecom literally proposes the complete repeal of the pricing flexibility regime, with price cap LECs "required to include all TDM, OCn and packetized special access service offerings in all geographic areas in the special access price cap basket," and the suspension of even Phase I relief pending a new proceeding to "revisit[] under what circumstances ILECs should be permitted to enter into volume and term contracts for special access."[115] The extreme nature of these proposals confirms that they have nothing to do with the realities of the marketplace or with protecting consumers, but rather are naked appeals to insulate established competitors like Time Warner Telecom from competition from the market-based arrangements that pricing flexibility allows.

Some commenters still argue the pricing flexibility triggers themselves are theoretically "incoherent."[116] By and large, however, these are the same arguments that CLECs have been making since the late 1990s against the *Pricing Flexibility Order*. Both the Commission and the D.C. Circuit have carefully considered these arguments and rejected them again and again, and they have not become more persuasive with age.

For example, Sprint and Time Warner Telecom repeat the time-worn argument that the triggers improperly provide relief throughout an MSA based on a showing of collocations in only

[115] TWTC at 44.

[116] TWTC at 18-24.

part of an MSA.[117] The Commission has explained, however, that its goal was to "define these geographic areas [for relief] narrowly enough so that the competitive conditions within each area are reasonably similar, yet broadly enough to be administratively workable."[118] The Commission rejected proposed areas larger than MSAs (such as LATAs[119]), but it also considered and rejected smaller geographic areas such as wire centers. As the Commission explained, "defining geographic areas smaller than MSAs would force incumbents to file additional pricing flexibility petitions, and although these petitions might produce a more finely-tuned picture of competitive conditions, the record does not suggest that this level of detail justifies the increased expenses and administrative burdens associated with these proposals."[120] The D.C. Circuit specifically affirmed the Commission on this point, noting that the Commission had determined that MSAs "best reflect the scope of competitive entry" and that more granular alternatives would be "less beneficial to consumers."[121]

Beyond that, arguments about the appropriateness of MSA-wide relief ring particularly hollow because AT&T and other price cap LECs generally establish Phase II rates that apply region-wide to all areas in all Phase II MSAs. Thus, rates for customers in any areas where there are fewer competitors are determined with reference to competition in areas where special access demand is highly concentrated.[122]

Although the Commission thus acted entirely reasonably when it decided to apply pricing flexibility on an MSA basis, that policy still is all the more reasonable today. The collocation

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[117] TWTC at 18; Sprint at 10.

[118] *Pricing Flexibility Order,* 14 FCC Rcd 14221, ¶ 71.

[119] *See id.* ¶ 73

[120] *Id.* ¶ 74.

[121] *WorldCom,* 238 F.3d at 460-61 (quoting *Pricing Flexibility Order,* 14 FCC Rcd 14221, ¶ 72).

[122] *See also, e.g.,* Verizon at 7.

triggers indisputably understate the true extent of CLEC fiber deployment in an MSA, because they do not capture the substantial and growing fiber deployment that bypasses price cap LEC wire centers, nor do they account for the many collocation hotels that further extend the reach of a competitors' networks outside the scope of the triggers.[123] Moreover, as AT&T and others have demonstrated, cable and fixed wireless companies today are expanding aggressively into the furthest corners of MSAs, but the Commission's triggers generally do not detect such intermodal expansion. Indeed, given the realities of today's marketplace, the Commission's priority should be allowing price cap LECs to gain Phase II relief in the largest, most competitive MSAs where the triggers do not capture the full extent of competitive deployment – not starting from scratch with new, more granular triggers that would tie relief to showings on a wire-center or building-by-building basis.

Time Warner Telecom also argues (at 19-20) that the triggers improperly rely on the presence of collocations to deregulate DS1 loops, because collocations allegedly are "for the purpose" of using ILEC facilities, not for constructing CLEC loop facilities. The argument is meritless. The Phase II triggers for loops have extremely high collocation thresholds – indeed, Phase II relief for DS1 loops is not granted until competitors have facilities-based collocations serving most of the MSA either by geography (65%) or by addressable revenue (85%). And because the collocation triggers understate the true extent of CLEC fiber, it is necessarily the case that any MSA that qualifies for Phase II channel termination relief has extensive competitive fiber relative to where the special access customers are. The FCC adopted higher triggers for loops because it recognized that, as CLEC transport networks became more

[123] *See* Casto Supp. Decl. ¶¶ 10-12. *See also Pricing Flexibility Order*, 14 FCC Rcd 14221, ¶ 95 (collocation trigger understates true level of deployment because it does not capture CLEC fiber that bypasses ILEC facilities); *WorldCom*, 238 F.3d at 462 (same).

extensive, CLECs would be much more likely to extend those facilities to individual buildings.[124] Like the Commission's other predictive judgments, that finding was unquestionably sound: while the CLECs refuse to submit evidence concerning the reach of their networks, even the limited evidence available to price cap LECs confirms that CLECs in fact routinely extend loops from their mature and extensive transport networks to serve individual buildings. And even if that were not the case, in *today's* marketplace cable and fixed wireless providers are increasingly offering DS1 loops to customers outside the central business districts where CLECs have historically concentrated their deployments. For all of these reasons, the real issue before the Commission is how to extend Phase II relief to those MSAs where the triggers are missing substantial facilities-based competition, not whether to carve services out of pricing flexibility for reimposition of price caps.[125]

B. There Is No Basis For "Reinitialization" of Price Caps.

Re-regulation proponents argue that the Commission should intervene in the market and mandate massive rate reductions by "reinitializing" price caps on all special access services.

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[124] *Pricing Flexibility Order*, 14 FCC Rcd 14221, ¶ 104; *see id.* ("it also seems likely, therefore, that the extent to which competitors have collocation arrangements in an MSA is probative of the degree of sunk investment by competitors" in channel terminations).

[125] Time Warner Telecom's suggestion (at 21-23) that some of the Commission's assumptions in the *Pricing Flexibility Order*, 14 FCC Rcd 14221, have been "disproven" is meritless. First, it makes the curious argument that the Commission incorrectly assumed that only IXCs would buy special access and not CLECs (citing *Pricing Flexibility Order*, 14 FCC Rcd 14221, ¶¶ 142, 155), but CLECs offering local service are independently protected, because they can purchase UNEs wherever they cannot feasibly deploy their own facilities. It argues (at 22) that the Commission assumed that ILECs would offer special access only where their downstream retail services were offered through affiliates, but to the extent the FCC affirms ILECs' nondominant status in the interexchange market (without having to provide long-distance service through a Section 272 affiliate), it will do so only after finding that the separate affiliate requirement is not necessary to prevent discrimination or cross-subsidization. Finally, Time Warner Telecom argues that the Commission incorrectly assumed that competitors would respond to high prices with facilities-based entry, but as AT&T has shown (and no commenter has refuted), it is clear that special access competitors do frequently construct their own facilities to serve customers they win from ILECs.

Some propose that the caps be set at levels designed to produce an 11.25 percent return based on ARMIS data.[126] Others suggest that caps should be set at state-determined TELRIC rates for unbundled high capacity loops and transport.[127] As AT&T previously explained, these proposals are unabashed calls for the resurrection of long-discredited rate-of-return regulation and would put the Commission back in the business of micromanaging price cap LECs' rates based on agency estimates of costs and appropriate returns. Such heavy-handed re-regulation of special access would be a singularly inappropriate response to intense and growing competition.

Equally important, however, these commenters are engaged in futile attempts to obtain massive regulatory intervention in these markets "on the cheap." None of these commenters has submitted any evidence, studies, or expert testimony that confront the issue of how the Commission, as of 2007, might estimate special access costs and an appropriate rate of return in a manner that would survive judicial review. Rather, these commenters have proposed various short-cut methods, such as relying on ARMIS data or state-determined TELRIC rates, each of which has obvious fatal flaws, particularly as applied to today's competitive special access marketplace. As AT&T previously showed, if the Commission were serious about reinitialization, it could not lawfully rely on such short-cuts but would have no choice but to conduct the equivalent of a full-blown rate case.

ARMIS. Ad Hoc and others repeat their proposals to mandate rate reductions by reinitializing price caps to levels designed to produce an 11.25 percent return, based on ARMIS cost data. This would be a patently arbitrary misuse of ARMIS. ARMIS data were never intended to be used to determine service-specific returns, and they are particularly unsuited for such purposes today, because the separations freeze has made those data increasingly inaccurate

[126] *See* Ad Hoc at 24; XO et al. at 45.

[127] *See* ATX at 36-39; BT at 21 (LRIC); T-Mobile at 14-15.

every year.[128] No party has refuted this showing. Any attempt to take today's out-of-date and indisputably inaccurate ARMIS data, and apply it against the Commission's seventeen-year-old 11.25% rate of return, would have no hope of surviving judicial review.

The Commission could not lawfully even take ARMIS data into account without undertaking a complicated rulemaking proceeding to undo the separations freeze, to make substantial adjustments to the ARMIS data to bring them up to date, and to establish a new rate of return appropriate to special access. Even by the late 1990's the Commission was already acknowledging that ARMIS data were failing to keep pace with dynamic technological developments in the telecommunications industry.[129] Making the appropriate periodic adjustments under the cost allocation rules was becoming more difficult, but it was also becoming irrelevant given that the price caps did not depend on the accuracy of such data. Rather than expending the effort to keep such data current, the Commission abandoned the effort altogether and instituted the separations freeze. Undoing the freeze now, and instituting a proceeding to make almost ten years worth of cost allocation adjustments, would be an extraordinarily complex undertaking and an extraordinary waste of energy. Moreover, the Commission could not uncritically rely upon the existing 11.25 percent rate-of-return prescription, which was adopted in 1990; the Commission would have to undertake the extensive rulemaking proceeding necessary to select a new, much higher rate of return for a service as

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[128] *See, e.g.*, *USTA* v. *FCC*, 188 F.3d 521, 528 (D.C. Cir. 1999) ("direct productivity measurement requires measurement of inputs, and there is no obviously meaningful way to segregate LEC interstate and intrastate inputs, because, as is undisputed, interstate and intrastate services are usually provided over common facilities").

[129] *Separations Freeze Order*, 16 FCC Rcd. 11382, ¶ 1 ("rapid changes in telecommunications infrastructure" cause "cost shifts in separations results because these and other new technologies . . . as well as a competitive local exchange marketplace" have not been appropriately incorporated into the "current Part 36 rules"); Notice of Proposed Rulemaking, *Jurisdictional Separations Reform and Referral to the Federal-State Joint Board*, 12 FCC Rcd 22120, n.86 (1997) ("*Separations NPRM*").

competitive as special access. As AT&T has previously explained, all of these proceedings would turn on a whole host of inherently arbitrary judgments that would guarantee protracted litigation and uncertainty and hold little promise of ultimately producing results that are different or "better" than today's market results, because any re-examination of ARMIS data would unquestionably result in a very substantial reallocation of costs to special access, and the target rate of return for these competitive markets would be well above 11.25%.

TELRIC. The contention of some commenters that price caps should be re-imposed and reinitialized based on state-determined TELRIC rates is even more misguided, if that is possible. First, the Commission has no authority to delegate special access ratemaking functions to state commissions. As the D.C. Circuit has explained, there is no presumption that an agency may delegate its authority to outside parties (as opposed to subordinate federal authorities), and "[i]ndeed, if anything, the case law strongly suggests that subdelegations to outside parties are presumed to be improper absent an affirmative showing of congressional authorization."[130] The Communications Act does not remotely contain an "affirmative showing" that Congress contemplated that the Commission could abdicate its obligation to ensure just and reasonable rates for interstate services to fifty state commissions. To the contrary, Sections 201, 203-205 and 208 all squarely and unambiguously place that responsibility on the Commission, with no hint that such obligations may be foisted on outside parties such as the states.[131]

Equally important, as explained in Section II above, the Commission has acknowledged that the TELRIC methodology has "been the subject of extensive criticism," and it has opened a new rulemaking proceeding to reconsider virtually every aspect of the TELRIC methodology.[132]

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[130] *USTA* v. *FCC*, 359 F.3d at 565.

[131] 47 U.S.C. §§ 201, 203-05, 208.

[132] *TELRIC NPRM*, 18 FCC Rcd. 20265, ¶ 6 (2003).

Given that the Commission is actively reconsidering the entire TELRIC methodology, it would be manifestly arbitrary to extend the existing methodology unchanged to the special access context, and to mandate potentially confiscatory billion-dollar rate reductions, without even considering or resolving the fundamental issues the Commission has raised in the pending rulemaking. That is especially true given the Commission's repeatedly stated concern that its TELRIC rules "should not create incentives for carriers to avoid investment in facilities."[133]

But even if the Commission resolved the many outstanding issues concerning TELRIC, TELRIC is not readily transferable to this context because it is intended to price out facilities, not individual services like interstate special access services that are, in large part, provided over joint and common facilities.[134] In other words, the Commission could not simply "borrow" state-determined loop and transport element rates; it would have a fashion a new long run incremental cost (LRIC) methodology tailored to the context of determining prices for special access services. But as AT&T explained previously, this would require an exhaustive rulemaking proceeding that would turn on inherently arbitrary judgments about how to allocate costs to these services.[135] In addition, the Commission could not lawfully adopt a LRIC methodology for special access without determining a higher cost of capital appropriate to these specific, competitive services, and that would also require extensive rulemaking proceedings that would ultimately turn on arbitrary Commission judgments. Even initiating such a proceeding would send disastrous signals to the market, promising protracted litigation, creating severe business uncertainty, and dampening incentives for competitive facilities investment – which is why the

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[133] *Id.* ¶ 3.

[134] *See, e.g.*, ATX et al. at 40 n.137 (acknowledging the difference); BT at 21.

[135] AT&T Supp. Comments at 58-59.

Commission rejected such an approach even ten years ago, when competition was not nearly as well developed as it is today.[136]

In reality, these commenters are seeking to re-litigate (yet again) the Triennial Review, because in essence they are asking the Commission to mandate the conversion of *all* special access circuits to "enhanced extended loops" (EELs) – *i.e.*, combinations of unbundled loop and transport network elements. Indeed, the Eighth Circuit had already held that "it is clear from the Act that Congress did not intend all access charges to move to cost-based pricing,"[137] and the D.C. Circuit later held that impairment could not be found (and thus the TELRIC standard could not be applied) "[w]here competitors have access to necessary inputs at [special access] rates [established under § 201(b)] that allow competition not only to survive but to flourish."[138] Nonetheless, for several years, CLECs repeatedly urged the Commission to reprice all special access at TELRIC through the guise of finding "impairment" for high capacity loop and transport combinations, and to repeal rules designed to ensure that such UNE combinations were used to provide local services. These extreme CLEC requests were repeatedly rebuffed in multiple Commission orders and multiple D.C. Circuit decisions.[139] After years of litigation, the Commission has finally established a sustainable set of regulations that balance the UNE

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[136] *Access Reform Order*, 12 FCC Rcd. 15982, ¶¶ 289-90 (1997) (adopting market-oriented approach to access regulation and rejecting calls for reinitialization of price caps at LRIC). *See also USTA* v. *FCC*, 188 F.3d 521, 530 (D.C. Cir. 1999) ("Universal, complete reinitialization would impair the supposed incentive advantages of price caps – which derive from firms' supposing that their efficiencies will *not* come back to haunt them") (emphasis in original).

[137] *Comptel* v. *FCC*, 117 F.3d 1068, 1072 (8th Cir. 1997). The court of appeals also held that, even though access services and interconnection may be "technologically identical," there was nothing discriminatory or unlawful if these "distinct" services were not priced identically. *Id.* at 1073.

[138] *USTA* v. *FCC*, 359 F.3d 544, 576 (D.C. Cir. 2004).

[139] *Supplemental Order Clarification*, 15 FCC Rcd. 9587 (2000), *aff'd*, *CompTel* v. *FCC*, 309 F.3d 8 (D.C. Cir. 2002); *Review of the Section 251 Unbundling Obligation of Incumbent Local Exchange Carriers*, 18 FCC Rcd. 16978, ¶¶ 591-600 (2003); *USTA* v. *FCC*, 359 F.3d at 590-92.

impairment standard and the needs of the access marketplace, and that balance has been affirmed by the D.C. Circuit.[140] There is absolutely no reason for the Commission to reopen that debate now, a mere one year after its UNE rules were upheld, and there is certainly no reason to order what would amount to the sort of "blanket unbundling" of all high capacity transport and loops, without even any use restrictions, that would go well beyond even the unbundling that the D.C. Circuit previously found unlawful in *USTA I*.[141]

C. The Comments Provide No Justification For Modifying the X-Factor.

A number of commenters also repeat their claims that the Commission should adopt a higher X-Factor, but once again, these commenters do not even begin to answer AT&T's previous showings that such an X-Factor would be unnecessary and could not in any event be sustained. Here, too, these commenters are seeking an unlawful "short-cut" to massive rate reductions: some assert that the Commission should adopt a 5.3% X-Factor;[142] others assert that the Commission should adopt a 6.5%, on the ground that it was "agreed to" in the CALLS plan;[143] and Ad Hoc argues again for an "imputed" X-Factor of 10-11 percent, which is designed to reverse engineer the X-Factor that would have resulted in an average of an 11.25 percent special access return in prior years based on ARMIS data.[144]

None of these commenters, however, comes to grips with the fact that there is absolutely no basis in this record to adopt any of these "short-cut" X-Factors. For example, the 5.3 percent X-Factor advocated by some commenters is based on an estimate that the Commission made in

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[140] *Covad Communications Co.* v. *FCC*, 450 F.3d 528, 543-46 (2006)

[141] *USTA* v. *FCC*, 290 F.3d 415, 422-26 (D.C. Cir. 2002).

[142] *E.g.*, Sprint/Nextel at 41; XO et al. at 45; T-Mobile at 15.

[143] *E.g.*, TWTC at 45.

[144] Ad Hoc at 25.

1995 of historical productivity gains made by the LECs on an enterprise basis *in the late 1980's*.[145] The Commission adopted that X-Factor purely as an interim measure, and acknowledged that it was based on a methodology that would be inappropriate going forward.[146] No commenter has offered any reason why these estimates of LEC productivity in the late 1980's, made according to a methodology that the Commission itself has found unsuitable, would have any probative value in predicting the productivity gains price cap LECs may experience in the coming years. Similarly, the 6.5% X-Factor, adopted in 1997 based on data from the early 1990's, was vacated by the D.C. Circuit as arbitrary.[147] Although it was re-adopted in 2000 in the *CALLS Order*, it was not adopted (or "agreed to") as an estimate of productivity gains, but as a now-irrelevant transitional mechanism to reach negotiated rate levels[148] – and even then the Fifth Circuit held that it was arbitrary.[149] Again, no commenter has offered any grounds to believe that estimates of LEC productivity in the early 1990's, made according to a methodology that the D.C. Circuit found to be "irrational," could be uncritically

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[145] First Report and Order, *Price Cap Performace Review for Local Exchange Carriers*, 10 FCC Rcd. 8961, ¶¶ 201-22 (1995) ("*LEC Price Cap Performance Review*") (adopting three X-Factor options, 4.0, 4.7, and 5.3 percent, based on corrections made in 1995 to estimates of productivity gains achieved in the late 1980's prior to price caps).

[146] *Id.* ¶ 144; *see also Bell Atlantic Tel. Cos.* v. *FCC*, 79 F.3d 1195, 1204 (D.C. Cir. 1996) (upholding the 5.3% X-Factor as an interim measure and noting the Commission's conclusion that there was insufficient record to choose a permanent methodology). The 5.3% X-Factor also includes a 0.5% "consumer productivity dividend" that the D.C. Circuit has since held is arbitrary. *USTA* v. *FCC*, 188 F.3d 521, 527 (D.C. Cir. 1999).

[147] *USTA* v. *FCC*, 188 F.3d at 525-26.

[148] *CALLS Order*, 15 FCC Rcd 12962, ¶ 40 (CALLS Plan "treats the X-Factor not as a productivity estimate but as a method to reduce rates to certain levels"). Indeed, Time Warner Telecom's suggestion (at 45-46) that the Commission impose the 6.5% X-Factor retroactively back to 2004 would affirmatively countermand what was "agreed to" in the CALLS plan. *See also* ATX at 44 (same).

[149] *Texas Office of Public Utility Counsel* v. *FCC*, 265 F.3d 313, 328-29 (5th Cir. 2001) ("the FCC has failed to show a rational basis as to how it derived the 6.5 percent figure").

re-adopted today as a valid means of estimating future productivity gains. And as AT&T previously demonstrated, Ad Hoc's "imputed" method is meritless both because it relies on ARMIS data that are unreliable and were never intended for that purpose, and because it relies on an 11.25% rate of return that is woefully outdated.[150]

The current X-Factor, which is set equal to inflation and thus ensures ongoing rate decreases in real terms, is entirely reasonable in light of the intensely competitive nature of the market, in which rates are typically set through market negotiations. Indeed, as Embarq shows in an expert declaration, productivity in the wired telecommunications sector has, according to Bureau of Labor statistics, trailed economy wide productivity in recent years.[151] If the Commission were going to alter the status quo by selecting a new X-Factor, it could not write a sustainable order relying on these commenters' short-cut proposals. Instead, it would have no choice but to start a completely new rulemaking proceeding that grappled with the numerous methodological issues as to how to measure productivity that were left over from the D.C. Circuit's 1999 remand.[152] Moreover, as the record here abundantly confirms, such proceedings would be even more difficult here because the Commission has never attempted to determine an X-Factor for a single service, nor has any proponent of re-regulation proposed a coherent method for doing so.[153] The result of such proceedings would be the return of the severe market uncertainty that existed in the 1990's when the Commission previously tried to estimate productivity gains, as well as intractable litigation with a high likelihood of judicial reversals –

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[150] AT&T Supp. Comments at 43-44.

[151] *See* Embarq, Staihr Decl. ¶¶ 9-11.

[152] *See* Further Notice of Proposed Rulemaking, *Price Cap Performance Review for Local Exchange Carriers; Access Charge Reform*, 14 FCC Rcd. 19717, ¶¶ 20-39 (1999).

[153] *See* AT&T Supp. Comments at 42-43.

all for extremely dubious gains in the accuracy of the X-Factor. No commenter has offered any sound basis for starting down that path.

D. The Commenters' "Baseball" Arbitration Proposals Are Unlawful, Unjustified, and Unworkable.

Global Crossing and others revive proposals for "baseball-style" arbitration of special access rates.[154] These proposals are typically billed as "market-oriented" and "deregulatory," with the explicit promise of shunting the work of establishing special access rates from the Commission onto private arbitrators.[155] In fact, however, the very purpose of these proposals is to *eliminate* market solutions and replace them with heavy-handed, contract-by-contract rate regulation administered by commercial arbitrators and overseen on a case-by-case basis by the Commission. These proposals would in reality exponentially increase Commission intrusion into these markets, effectively recreating the unworkable cost-of-service regulation that the Commission abandoned years ago in favor of price caps and pricing flexibility.[156]

First, as Global Crossing has conceded, it would be unlawful for the Commission to delegate its statutory mandate to oversee special access regulation to private arbitrators.[157] As explained above, "subdelegations to outside parties are assumed to be improper absent an affirmative showing of congressional authorization."[158] And there is no indication in the statute

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[154] Global Crossing at 11-16; BT at 23; Paetec at 18-21.

[155] *See* Global Crossing at 13 ("For the Commission, this approach avoids the difficult ratemaking and regulatory oversight that would otherwise be required to ensure that carriers achieve reasonable special access rates, terms, and conditions").

[156] In the context of merger proceedings, where these proposals first arose, the Commission rejected imposing such arbitrations as a merger condition and concluded that "it is not clear that Global Crossing's proposed alternative to the section 208 complaint process would necessarily be superior." *SBC/AT&T Merger Order* ¶ 177 n. 499.

[157] *See* Global Crossing 11/28/06 *Ex Parte* in AT&T/BellSouth Merger at 3.

[158] *See, e.g.*, *USTA* v. *FCC*, 359 F.3d at 565 (D.C. Cir. 2004).

that the Commission has the authority simply to hand special access regulation over to private arbitrators and walk away. Accordingly, the Commission would be quickly inundated with numerous individualized contract tariff disputes on "appeal" from private arbitrations, each of which would have to be considered *de novo*.

De novo Commission consideration in this context would necessarily take the form of a prescription under 47 U.S.C. § 205. However labeled, the arbitration proposals contemplate Commission-imposed rates implemented through tariff (as Section 203 would require for any new rate to become effective) and would operate to force AT&T to file new rates that are different from those it has filed in its existing tariffs or that it offered to file in a new contract tariff.[159] Accordingly, the Commission would be required to follow the procedures set forth by Congress in Section 205 that govern any rate prescription. Under the terms of Section 205, the Commission cannot prescribe a rate unless it first finds that the rate that the carrier has proposed and filed is itself unjust, unreasonable, or unjustly discriminatory in violation of Sections 201 and 202 of the Act.[160] As the D.C. Circuit has cautioned, "the[se] mandates of the Act are not open to change by the Commission."[161]

Accordingly, the Commission could not lawfully implement an arbitration regime that upheld a lower rate chosen by an arbitrator merely on the ground that this rate is "just and

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[159] *See, e.g.*, *MCI Telecomms. Corp.* v. *FCC*, 627 F.2d 322, 337 (D.C. Cir. 1980) (it "is the actual impact of the FCC's actions, rather than the language it uses, which determines whether or not the FCC has 'prescribed' tariffs or other conditions under the statute").

[160] 47 U.S.C. § 205; *see AT&T* v. *FCC*, 487 F.2d 864, 872-80 (2d Cir. 1973) (a "full opportunity for hearing" and express Commission findings that the carrier-initiated rate is unjust and unreasonable and the prescribed rate is just and reasonable "are essential to any exercise by the Commission of its authority" to prescribe rates).

[161] *Southwestern Bell Corp.* v. *FCC*, 43 F.3d 1515, 1519 (D.C. Cir. 1995) ("Commission is not free to circumvent or ignore th[e] balance [created by Congress]. Nor may it rewrite this statutory scheme on the basis of its own conception of the equities of a particular situation").

reasonable." Rather, the Commission could not prescribe the lower rate on *de novo* review unless it first determined that the rates that a price cap LEC had filed and proposed were themselves unjust and unreasonable and outside the zone of just and reasonable rates. And because there is a broad range of rates that are just and reasonable, the mere fact that an arbitrator (or the Commission) believes that a CLEC-proposed rate is more "commercially reasonable" could not remotely establish that AT&T's existing rate or proposed new contract tariff rate is unjust and unreasonable.[162] Thus, adoption of the arbitration proposals would mean that the Commission would have to conduct a rate case and make findings regarding at least two sets of rates – the rates that AT&T filed or proposed and any lower rate that an arbitrator selected.

Equally important, and even apart from the "precise procedures and limitations" embodied in Section 205,[163] the Commission could not, consistent with its statutory responsibilities, resolve these new special access proceedings under the "final offer" approach that Global Crossing and others advocate. The Commission has elsewhere recognized that such strict baseball-style arbitration is far too inflexible to be used where the agency must ensure compliance with the Communications Act and the Commission's policies.[164] The Commission's actual experience confirms this point: for example, when the Commission conducted arbitration proceedings between Verizon and various CLECs for interconnection agreements in Virginia

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[162] *FPC* v. *Conway Corp.*, 426 U.S. 271, 278 (1976) ("there is no single cost-recovering rate, but a zone of reasonableness: statutory reasonableness is an abstract quality represented by an area, not a pinpoint").

[163] *AT&T* v. *FCC*, 487 F.2d 865, 874 (2nd Cir. 1973).

[164] *See* Order, *Procedures for Arbitrations Conducted Pursuant to Section 252(e)(5) of the Communications Act of 1934, as amended*, 16 FCC Rcd 6231 ¶ 5 (2001) ("Experience gained by states in arbitrating scores of interconnection disputes over the past five years suggests that 'final offer' arbitration may not always afford the arbitrator sufficient flexibility to resolve complex interconnection issues.").

pursuant to 47 U.S.C. § 252(e)(5), it recognized the need to depart from baseball-style arbitration to resolve outstanding issues in numerous instances.[165]

Thus, far from reducing the Commission's involvement in special access oversight, the proposed third party "arbitration" conditions would create the need for a radical increase in Commission oversight, and generate far more special access litigation than under the Commission's current pricing flexibility regime. There would undoubtedly be numerous rate proceedings in which the Commission would be required to mandate the specific rates and terms that AT&T could offer in particular contracts to particular customers for particular special access services. And because the Commission would under any version of these proposals be conducting its own extensive review and could not be bound by the arbitrator's decision, the arbitration itself would serve no purpose except to *add* a layer of regulatory review to the existing system.

But this is only the beginning of the difficulties with these arbitration proposals, because the CLECs have designed a "black box" in which the arbitrator sets the price cap LEC rate based on nebulous comparisons with data points largely within the control of the CLECs, such as CLEC rates and estimations of the "value" of the services. In an attempt to rig the proceedings to generate lower rates, Global Crossing would have the arbitration focus not on which final offer is just and reasonable or nondiscriminatory – after all, AT&T's existing rates and terms are already presumptively just and reasonable and in most cases are "deemed lawful" under Section 204(a)(3) – but on the more amorphous standard of which is more "commercially reasonable." Thus, from the outset there would be a fundamental disconnect between the arbitrator's focus

[165] Forfeiture Order, *Petition of WorldCom, Inc. Pursuant to Section 252(e)(5) of the Communications Act for Preemption of the Jurisdiction of the Virginia State Corporation Commission*, 18 FCC Rcd. 17722 ¶¶ 24, 103, 140, 387, 432, 457 (2003).

and what the statute requires the Commission to assess. But there are no workable standards for determining "commercial reasonableness," even if that were an appropriate test, and Global Crossing's proposed rules of decision would require rates to be determined from a witches' brew of ingredients all of unverifiable veracity.[166] Price cap LECs generally do not have access to the rates that non-ILEC competitors charge, since such rates are not subject to tariff, and comparing the two final offers based on the litany of factors and comparisons the CLECs have proposed would always be open to substantial dispute. As a result, the Commission would inevitably be required to conduct what amounts to a full-blown ratemaking case on *de novo* review, because the appealing party will always argue that the arbitrator did not give appropriate consideration to the rate comparison evidence (even assuming it were available) or to the evidence of cost and other differences between networks that render such comparisons meaningless.[167]

More fundamentally, however, any Commission decision affirming rate reductions on the basis of comparisons with CLEC rates would be arbitrary and unlawful. The Commission has held that it is unlawful to find a rate unreasonable merely because it is higher than a competing carrier's rate.[168] And these principles are especially pertinent in this context, because CLECs typically first target their entry to the least costly locations to serve, which means that they often have a substantially different cost structure than an ILEC. Accordingly, the mere fact that an ILEC's special access rates may be higher than a CLEC's should not even be a relevant consideration. At a minimum, on *de novo* review, the Commission would be forced to consider

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[166] *See, e.g.*, Global Crossing at 14-46 (listing the numerous factors the arbitrator may consider).

[167] The Commission could also anticipate participation by third parties claiming that the contracts resulting from baseball arbitration are unreasonably discriminatory – claims that only the Commission (not a private arbitrator) has the perspective to judge.

[168] *See, e.g.*, *Sprint Communications Co.* v. *MGC Communications, Inc.*, 15 FCC Rcd. 14027 ¶ 6 (2000) ("Relying, as it does, solely on the competing ILEC rate as a benchmark for what is just and reasonable, Sprint has failed to meet its burden").

cost and other relevant differences between the various competing carriers. The difficulty of this type of reconciliation of costs and prices, however, is precisely why the Commission replaced rate-of-return regulation with price caps.[169]

In short, the arbitration proposals are not in any sense "market-based." No firm in a competitive market is ever forced to accept any "final offer" that the other party (or anyone else) deems "more" commercially reasonable. Rather, these CLECs are hoping that arbitrators will act as a surrogate Commission and will dictate specific – and CLEC-selected – prices that ILECs may charge for hundreds of services in dozens of pricing flexibility areas. There is no justification whatsoever for transforming the Commission's incentive regulation regime into such an intrusively regulatory scheme with case-by-case, contract-by-contract prescription of rates. The Commission properly declined to insist on such a regime in the context of the merger proceedings, and it certainly should not enshrine such a burdensome scheme in its rules.

E. The Comments Provide No Justification for Limiting Volume and Term Discounts.

There is likewise no possible justification for limiting price cap LECs' discounting flexibility. Far from indicating a lack of competition, the plethora of discount options available to customers demonstrates just the opposite: that incumbents are in a fight with competitors for the business of special access customers and must provide a variety of discount options tailored to customers' individual needs to retain their business. The fact that some of these plans entail

[169] Even worse, there is a serious risk that CLECs could game the process under these rules of decision. To the extent that certain CLECs are net purchasers of special access, they would have an incentive to offer very low prices to a few customers in an attempt to influence arbitrators' judgment of what is "commercially reasonable." But even in the best of circumstances, the "evidence" relating to CLEC alternatives is likely to be spotty, highly selective, and difficult to verify, which would create additional burdens for the Commission in *de novo* rate proceedings. Discovery would inevitably be necessary to get a clearer and more comprehensive picture of the evidence on which the arbitrator relied and to ensure that there has been no CLEC gamesmanship.

term, volume, or spend commitments is hardly anticompetitive. These kinds of discount plans are routine throughout some of the most competitive sectors of the economy. Like incumbents, businesses in those other sectors respond to stiff competition by providing customers with incentives to maintain or, better yet, increase their purchases over time, and to make long-term commitments. For example, wireless carriers, including Sprint and T-Mobile, offer pricing plans where the rates drop when customers agree to purchase more minutes per month or to purchase for a longer term.[170] Likewise, airlines offer significant price and non-benefits to members of their "elite" award programs, which are "incentive[s] for would-be elites to increase their loyalty to a single airline and are a compelling reason for existing elites to maintain their past loyalty."[171] Insurance companies offer larger discounts to customers that agree to insure multiple vehicles.[172] Investment advisors charge less the more customers commit to investing with the investment firm; magazine publishers commonly give substantial discounts to subscribers that commit to multi-year subscriptions.

As in these other competitive industries, incumbent LECs offer a variety of discount plans with a variety of features, including term plans with no volume commitments and volume plans with no term commitments – which means there is absolutely no truth to re-regulation proponents' claims that the only way customers can avoid base tariff rates is to agree to unfair terms that preclude them from using alternative providers' services. AT&T, for example, offers

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[170] *See* Nextel- Plan http://nextelonline.nextel.com/NASApp/onlinestore/en/Action/DisplayPlans?audience=INDIVIDUAL&id12=UHP_PlansTab_Link_AllPlans; http://www.t-mobile.com/shop/plans.

[171] *See* Smarter Travel – Elite Status, the Ultimate Frequent Flyer Perk, http://www.smartertravel.com/frequent-flyer/Elite-status-ultimate-frequent.html?id= 14123.

[172] *See* GEICO – Discounts, http://www.geico.com/auto/sales/discounts.htm ("Insure more than one car with us and you could get a discount of up to 25 percent on most coverages").

a number of non-MARC based contracts.[173] Indeed, AT&T voluntarily committed during the merger proceedings with BellSouth that it would offer reasonable volume and term discounts without MARCs or growth discounts.[174] AT&T also agreed that in negotiations for a pricing flexibility contract where AT&T offered a proposal with MARC, it would propose an alternative that would allow the customer to obtain a volume or term discount without the MARC.[175] And, AT&T agreed that, for existing pricing flexibility contracts, it would allow customers to freeze existing MARCs provided the customer froze the existing contract discount rate.[176]

Other incumbents offer a similarly broad range of discounts, including plans that aggregate customers' demand over a broad region so that prices and discounts are the same over the whole area (to the extent allowed by the current price cap rules).[177] Incumbents also offer, both in tariffs and in individualized contracts made available to similarly-situated customers, circuit specific discounts that provide the same level of discounts without a volume commitment. Some customers may prefer discounts tied to absolute volume or term commitments while others may prefer MARC-based arrangements that tie discounts to historical purchase volumes. But no customer is "forced" to accept a particular type of limitation – rather, a customer agrees to those

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[173] Casto Supp. Reply Decl. ¶¶ 11-14.

[174] *AT&T-BellSouth Merger Order*, 22 FCC Rcd. 5662, App. F, Special Access Commitment 9, p. 152.

[175] *Id.*, Special Access Commitment 10.

[176] *Id.*, Special Access Commitment 11. Moreover, the examples commenters offer of "anticompetitive" terms are entirely irrelevant in the current marketplace. For example, some commenters complain that plans contain terms that limit their ability to use UNEs. But AT&T has committed to refrain from including in pricing flexibility contracts "access service ratio terms which limit the extent to which customers may obtain transmission services as UNEs" *Id.*, Special Access Commitment 8. Likewise, AT&T has withdrawn the MVP plan. *Cf.* Sprint at 27-28; XO at 31 (discussing AT&T MVP plan).

[177] *See e.g.*, Verizon at 7.

terms as part of a bargain for a particular type or level of discount, just like in other competitive markets.[178]

In all events, there is nothing unlawful with the particular discount plans that some commenters claim are anticompetitive. In considering the claims that such discount plans harm special access purchasers, it is important to consider the D.C. Circuit's recent review of an incumbent LEC's special access discount plan that contained minimum purchase commitments; there, the court found nothing unlawful with a discount plan that required customers to purchase "no less than 90% of what they purchased on an annualized basis in the six months preceding their subscription to the plan."[179] The court reminded the Commission that complaints about incumbents' discounts must be measured against the "critical fact" that they have "no obligation to offer a discount plan at all" and thus on their face, these discount plans necessarily offer far more benefits to consumers than non-discounted rates.[180] Further, as to this plan's 90 percent purchase requirement, despite the Commission's detailed review of the evidence, the court determined that it "imposed no burden on [purchasers] at all," because "nearly five years of data" showed that particular purchasers of the plan at issue either had significant "headroom" or could have enjoyed more headroom but for their "free choice" to "voluntarily increase[] their commitments."[181]

The commenters complaining about these types of discount plans do not even attempt to match the level of analysis performed by the Commission in the *BellSouth* case that the D.C. Circuit found to be inadequate. Although these commenters make generic allegations that

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[178] *BellSouth* v. *FCC*, 469 F.3d 1052, 1060 (D.C. Cir. 2006) (access discount plans are "most naturally viewed as a bargain containing terms that both benefit and burden its subscribers").

[179] *Id.*, at 1055.

[180] *Id.* at 1057.

[181] *Id.* at 1059-60.

certain discounts impede their ability to switch to alternative providers' special access, none of them offer detailed evidence showing that these plans actually injured them, notwithstanding their "free choice" to subscribe or increase their purchasing commitments. The bottom line is that customers are undeniably better off in an environment in which they have the unrestricted ability to negotiate whatever discount arrangements best meet their individual needs.

F. The Comments Provide No Justification For Fresh Look Requirements, the Reimposition of Sharing, or Adding Multiple Special Access "Sub-Baskets."

Finally, several commenters propose yet additional re-regulatory measures that would be imposed on top of reinitialization, including "fresh look" abrogation of contracts, re-imposition of the price cap "sharing" mechanism, and various proposals to add sub-baskets to the special access basket. These proposals are all severely misguided in the context of today's competitive special access marketplace, and would put the Commission in the position of micromanaging the LECs' special access returns and individual rate elements to a degree that is unprecedented under the price cap regime.

Fresh Look. The commenters' "fresh look" proposals – which are designed to let them capitalize immediately on the radical pricing re-regulation they have proposed by seizing the benefits of the price reductions (including negotiated discounts) while walking away from the aspects of their contracts they do not like (the term or revenue commitments that were given in exchange for those discounts) – would be patently unlawful.[182] Indeed, the Commission has never approved fresh look measures of any sort except in rare cases as an "extraordinary remedy."[183] The Commission has explained that a fresh look "is a very rare occurrence" because

[182] ATX at 51-52; Paetec at 21-23.

[183] *Intelsat System Order*, 14 FCC Rcd. 15703, ¶¶ 118, 124 (1999).

it may be "unfair [and] disruptive to the marketplace, and ultimately inconsistent with the public interest."[184]

Of the three occasions in which the Commission has ordered at least limited fresh look for interexchange and/or access services, two occurred in conjunction with the adoption of new rules that, for the first time, opened a particular market to meaningful competition. In both cases, the Commission noted that customers that had entered into contracts prior to these market opening measures lacked competitive options and that fresh look was necessary for these customers to take advantage of the new options now available to them. Indeed, underscoring the limited availability of fresh look, the Commission hinged its fresh look requirement in both cases on a finding that the termination liability clauses to which its fresh look requirements were directed were, under the circumstances, unlawful.[185]

The other instance in which the Commission imposed fresh look involved adoption by the Commission of what it characterized as "a change in universal service policy that was not anticipated at the time existing contracts were signed"[186] and that would have denied carriers the ability to recover their universal service contribution costs under those contracts. In that

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[184] *Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers*, 18 FCC Rcd 16978, ¶ 694, *vacated and remanded in part on other grounds, USTA* v. *FCC*, 359 F.3d 554 (D.C. Cir. 2004). *See also* Third Report and Order and Fourth Further Notice of Proposed Rulemaking, *Implementation of the Local Competition Provisions of the Telecommunications Act of 1996*, 15 FCC Rcd 3969, ¶ 486 (1999), *reversed and remanded in part on other grounds, USTA* v. *FCC*, 290 F.3d 415 (D.C. Cir. 2002) (rejecting fresh look notwithstanding the adoption of rules allowing CLECs under certain circumstances to convert special access circuits to unbundled network elements).

[185] Order on Reconsideration, *Expanded Interconnection with Local Telephone Company Facilities*, 8 FCC Rcd 7341, ¶ 17 (1993); Order on Reconsideration, *Competition in the Interstate Interexchange Marketplace*, 7 FCC Rcd 2677, 2682, ¶ 25 (1992).

[186] *Federal-State Joint Board on Universal Service*, 17 FCC Rcd 24952, 24981 (2002).

instance, a very limited fresh look was necessary so that carriers would not be unfairly or unlawfully denied the opportunity to recover their costs of implementing a federal mandate.

None of these circumstances is remotely present here. As demonstrated above, special access customers have for years had myriad alternatives in all areas where there is appreciable demand. Nor have the re-regulation proponents made any serious attempt to demonstrate that their current rates or contractual terms, which they voluntarily negotiated and accepted, are unlawful – as would be required as a prerequisite to abrogation of these tariffed arrangements[187] – and therefore it would be manifestly contrary to the public interest to intervene in these contracts by mandating that ILECs give up the *quid* while letting the CLECs keep their *quo*.

Sharing. Any reimposition of a "sharing" requirement for special access services would be absurd.[188] The Commission eliminated this "major vestige of rate-of-return regulation" in 1997, concluding that it "severely blunts the efficiency incentives of price cap regulation" and "reduce[s] the benefits of price caps to consumers."[189] Notably, the Commission found that while sharing had been intended only as a transitional "backstop," it had become especially inappropriate in light of the passage of the 1996 Act and the expected increase in competition, because "reducing our regulatory reliance on earnings calculations based on accounting data is

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[187] *AT&T* v. *FCC*, 487 F.2d 864, 872-80 (2d Cir. 1973) (a "full opportunity for hearing" and express Commission findings that the carrier-initiated rate is unjust and unreasonable and the prescribed rate is just and reasonable "are essential to any exercise by the Commission of its authority" to prescribe rates).

[188] *See* ATX at 45-46; BT at 21.

[189] *Price Cap Performance Review for Local Exchange Carriers*, 12 FCC Rcd. 16642, ¶ 147 (1997) ("*1997 X-Factor Order*"); *LEC Price Cap Performance Review*, 10 FCC Rcd. 8961, ¶¶ 187-89, 197 (1995) (concluding as early as 1995 that sharing blunted efficiency incentives and should eventually be eliminated).

essential to the transition to a competitive marketplace."[190] And, the Commission expressly emphasized that sharing (unlike price caps) did *not* mimic the pressures of a competitive market even in theory, because competitive markets do not hold each individual firm to a consistent, pre-determined annual return.[191] The D.C. Circuit affirmed these conclusions, noting simply that "[w]hen all profits are taken away, a firm has no incentive to make them."[192]

No commenter has remotely justified re-imposing a sharing requirement on special access at this late date, which would not only undermine the incentive effects of price caps but force the Commission once again to actively manage the LECs' annual returns on the basis of accounting data. These commenters have obviously given no thought to the mechanics of a renewed sharing requirement, which would necessarily depend on the availability of accurate and continuously updated ARMIS data. Like other CLEC proposals that rely on ARMIS, the Commission could not lawfully impose a sharing requirement without undoing the separations freeze, performing the necessary cost allocation adjustments to correct for the years of built-up inaccuracies in the ARMIS data, establishing a new, higher rate of return appropriate to current competitive conditions, and reviving the practice of periodically adjusting the cost allocations. Even then, ARMIS data were never intended to be used to calculate service-specific returns, and the Commission would find it impossible to explain or defend such an inherently arbitrary regime.[193] Coupling reinitialization of price caps with a sharing mechanism would for all intents

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[190] *1997 X-Factor Order*, 12 FCC Rcd. 16642, ¶ 150; *see also id.* ¶ 152 ("elimination of sharing reduces our reliance on, and thus the importance of, jurisdictionally separated embedded costs," and "reducing reliance on accounting costs thus facilitates our transition to the competitive paradigm of the 1996 Act").

[191] *Id.* ¶ 153.

[192] *USTA* v. *FCC*, 188 F.3d 521, 528 (D.C. Cir. 1999).

[193] *See also Nat'l Rural Telecom Association* v. *FCC*, 988 F.2d 174, 183-84 (D.C. Cir. 1993) (rejecting claim that Commission arbitrarily refused to impose sharing for each individual

and purposes mark the complete reimposition of rate-of-return regulation – which would be an utterly indefensible step backwards for these competitive services.

Special Access Sub-Baskets. Some commenters also seek to make re-regulation even more closely approximate rate-of-return regulation by separating different special access services into myriad separate baskets.[194] These proposals would put the Commission in the position of micromanaging almost every special rate element, and they should be rejected. Even at the beginning of the price cap regime, when special access services were far less competitive than they are today, the Commission saw no need to subdivide individual special access rate elements into separate baskets. To the contrary, the Commission concluded that "a carrier's ability to adjust prices constitutes one of the major benefits of incentive regulation."[195] The Commission "chose a middle course, dividing LEC services into four product 'baskets,'" a scheme that was upheld by the D.C. Circuit.[196] The current special access basket was established in the *CALLS Order*, and no party appealed that decision (even though the Commission had already adopted the *Pricing Flexibility Order*).[197] In today's highly competitive environment, there is plainly no need to take the unprecedented step of establishing rate-element-specific baskets within the special access basket.

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basket, and explaining that "basket-level sharing would require continued application of the existing fully distributed cost methodologies," the use of which was harming consumers).

[194] ATX et al. at 46-48.

[195] Report And Order And Second Further Notice Of Proposed Rulemaking, *Policy and Rules Concerning Rates for Dominant Carriers*, 4 FCC Rcd. 2873, 2924 (1989).

[196] *See Nat'l Rural Telecom Association* v. *FCC*, 988 F.2d 174, 181-83 (D.C. Cir. 1993).

[197] *CALLS Order*, 15 FCC Rcd 12962, ¶ 149.

IV. THE COMMISSION SHOULD REJECT COMPETITORS' ATTEMPTS TO INTERJECT UNRELATED DISPUTES.

A few commenters seek to use this proceeding to raise specific narrow disputes and to convert them into serious allegations regarding the special access market. None of these individual disputes has a significant bearing on the questions in the *Notice*.

TWTC's Ethernet Claims. Time Warner Telecom alone continues to raise allegations about AT&T's Ethernet services. It has filed in this proceeding two declarations, initially submitted in the AT&T-BellSouth merger proceeding, outlining TWTCs' unhappiness over ongoing commercial business negotiations involving AT&T's finished Ethernet service, called OPT-E-MAN.[198] AT&T in the merger proceeding repeatedly explained that TWTC's advocacy was merely a ploy to gain negotiating leverage[199] – a claim the Commission found entirely "plausible" even though it did not fully consider TWTC's allegations, which the Commission termed as "vague speculation."[200] The Commission instead "direct[ed] TWT[C] to the Commission's rules on petitioning for a rulemaking.[201]

TWTC did not follow the Commission's advice and instead raises its Ethernet claims in this proceeding. But nothing has changed significantly in the months since TWTC first pressed its claims to the Commission. TWTC and AT&T are still negotiating over commercially reasonable terms for AT&T's OPT-E-MAN services – AT&T made its most recent proposal just

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[198] TWTC at 11-12 & n.19, 26-28, 36, 46 & App. A (attaching a Declaration and Reply Declaration of Graham Taylor ("Taylor Reply Decl."), filed in WC Docket No. 06-74).

[199] *See* Reply Declaration of Parley C. Casto, attached to Joint Opposition of AT&T Inc. and BellSouth Corporation to Petitions to Deny and Reply to Comments, WC Docket No. 06-74 (filed June 20, 2006); Letter of Gary L. Phillips, AT&T, et al., to Marlene Dortch, at 5-11, WC Docket No. 06-74 (filed August 21, 2006), attaching Supplemental Declaration of Parley C. Casto; Letter of Gary L. Phillips, AT&T, et al., to Marlene Dortch, at 5-11, WC Docket No. 06-74 (filed December 5, 2006).

[200] *AT&T-BellSouth Merger Order*, 22 FCC Rcd. 5662, ¶ 186 & n.510.

[201] *Id.*

weeks ago.[202] It thus still unnecessary for the Commission to review the "terms and conditions included in those negotiations."[203] Notably, Ethernet services are still robustly competitive, and the Commission can rely on that, far more than the sparse record TWTC provides here, to ensure that any agreement will result in fair terms.[204] Service providers deploy Ethernet services at retail using their own on-net facilities, TDM loops purchased from incumbents, or circuits supplied by competitive providers (either "finished" Ethernet services or TDM loops to which they attach Ethernet electronics). TWTC concedes that it already provides services quite successfully via all these methods.[205] Given that competition is establishing fair and market-based terms for Ethernet services of all types, there is simply no need for the Commission to revisit its decision "declining [TWTC's] invitation to create Ethernet standards" through regulatory fiat.

Indeed, the only significant changes provide palpable benefits to TWTC: the Commission granted AT&T a waiver of its rules allowing AT&T to exercise Phase I pricing flexibility for OPT-E-MAN services in areas where it otherwise qualifies for pricing flexibility.[206] As a consequence, AT&T can now offer individualized contracts for those services that are specifically tailored to customers' needs.[207] Further, consistent with its commitments in the merger proceedings, AT&T in fact lowered its prices for OPT-E-MAN services, thereby

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[202] *See* Casto Supp. Reply Decl. ¶ 18.

[203] *AT&T-BellSouth Merger Order*, 22 FCC Rcd. 5662, ¶ 186 & n.510.

[204] Casto Supp. Reply Decl. ¶¶ 15-16.

[205] *See* Taylor Reply Decl. ¶ 9.

[206] *SBC Comm. Inc. Petition For Waiver of Section 61.42*, 22 FCC Rcd. 7224, ¶ 8 (2007) (finding that "[p]roviding AT&T the flexibility to offer contract tariffs tailored to the needs of individual customers will enable it to respond more effectively to competition. Thus, the waiver will promote competition in the market for advanced services and result in more choices and better prices for customers").

[207] Casto Supp. Reply Decl. ¶ 17.

providing still additional benefits to customers actually interested in purchasing the service rather than attempting to persuade the Commission to conduct proceedings to dictate the terms, prices and standards for this new, advanced, and highly competitive service.[208] And, most importantly, all parties, including TWTC, agree that the market for Ethernet services remains robustly competitive – indeed, TWTC just days ago affirmed that it has "long been a leader in the delivery of Ethernet services" and that "Ethernet services have been key in fueling the growth of the enterprise business for the company."[209]

ATX's Dry Fiber Claim. ATX has decided to raise in this proceeding claims about a Section 214 petition that was recently filed by AT&T to withdraw the tariff that BellSouth had filed for "dry fiber" service (more commonly known as "dark fiber"). Even though ATX and any other interested party will have a full opportunity to air its claims once the FCC places AT&T's petition out for comment, ATX asserts that the Commission should jump the gun and act on AT&T's petition now, based purely on ATX's paranoid speculation that AT&T "is planning to increase prices" for this service.[210] But there is a far more innocent and a fully reasonable explanation for AT&T's discontinuance petition: BellSouth has for some years been the only BOC to offer this service via tariff; other BOCs have long provided this service via private carriage offerings – arrangements that the D.C. Circuit had found valid in 1994.[211] Further, AT&T is not going to discontinue the tariff and then immediately raise prices. The Petition provides on its face that existing customers will continue to receive service "pursuant to terms and conditions contained in [the] tariff" – which includes prices – until they execute a

[208] *Id.* ¶ 17.

[209] Press Release, Time Warner Telecom, "Time Warner Telecom Surpasses 10,000 Ethernet Ports in Service for Enterprise Customers, at 1-2 (Aug. 1, 2007).

[210] ATX at 11.

[211] *Southwestern Bell Tel. Co.* v. *FCC*, 19 F.3d 1475, 1480-84 (D.C. Cir. 1984).

private carriage agreement, migrate to an alternative arrangement, or, at worst, "for 36 months after AT&T Southeast receives approval to discontinue [the] service."[212] To the extent a merger commitment applies to this offering, AT&T will honor that commitment in the context of its private carriage agreements.

XO's Collocation Demands. XO contends that AT&T has undermined intermodal competition by refusing to allow XO to place microwave facilities on the roofs of AT&T's buildings and to use them to connect with other XO facilities. But as AT&T has explained, AT&T is happy to enter into an arrangement with XO on mutually agreeable terms.[213] In fact, however, XO wants a special benefit: it seeks, in effect, to obtain collocation at regulated prices even though Congress expressly limited collocation to providers seeking access or interconnection with UNEs. AT&T's determination to follow the Act's terms patently will not preclude XO from offering broadband wireless service. Other broadband wireless providers have clearly been able to provide services without mandated "collocation" arrangements that go far beyond anything the statute requires, and clearly AT&T holds no monopoly on rooftops suitable for housing microwave facilities.

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[212] *See* Section 63.71 Application of AT&T Southeast, at 2-3 (July 17, 2007).

[213] *See* Letter from Gary L. Phillips, AT&T, to Marlene Dortch, FCC, WC Docket No. 06-74, at 2, 4-5 (Sept. 25, 2006).

CONCLUSION

For the foregoing reasons and for the reasons stated in AT&T's prior comments in this proceeding, the Commission should reject proposals to further regulate special access services and should adopt the additional deregulatory proposals set forth herein and in AT&T's prior comments.

/s/ Christopher M. Heimann

Christopher M. Heimann
Gary L. Phillips
Paul K. Mancini
AT&T Inc.
1120 20th Street, N.W.
Washington, D.C. 20036
(202) 457-3058

David W. Carpenter
SIDLEY AUSTIN LLP
One South Dearborn Street
Chicago, Illinois 60603

David L. Lawson
James P. Young
Christopher T. Shenk
SIDLEY AUSTIN LLP
1501 K St., N.W.
Washington, DC 20005
(202) 736-8088

Attorneys for AT&T Inc.

August 15, 2007

***** REDACTED FOR PUBLIC INSPECTION *****

ATTACHMENT TO SUPPLEMENTAL REPLY COMMENTS OF AT&T INC.

(SUPPLEMENTAL REPLY DECLARATION OF PARLEY C. CASTO)

***** REDACTED FOR PUBLIC INSPECTION *****

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 Access Services	)	RM-10593

SUPPLEMENTAL DECLARATION OF PARLEY C. CASTO
ON BEHALF OF AT&T INC.

1. My name is Parley C. Casto. I previously filed a declaration in this proceeding in support of the Supplemental Comments of AT&T Inc. on August 8, 2007, and my background and qualifications are set forth therein. The purpose of this declaration is to correct inaccurate statements in the comments of certain other commenters in this proceeding.

2. A handful of commenters assert that they have purchased the majority of their special access services from AT&T, and that the Commission should assume therefore that they have no alternatives to AT&T's special access services. But the mere fact that these carriers have chosen to purchase service from AT&T says nothing about the availability of alternatives or the level of competition. As I and others have demonstrated with detailed information, including fiber maps plotting CLEC fiber facilities, specific examples of competitive losses, competitors' public statements, third party market analyses and other data, special access customers do in fact have many intramodal and intermodal alternatives to AT&T's special access services both within the commercial centers where special access demand is heavily concentrated and outside those areas.

3. Sprint/Nextel's complaint about Chicago illustrates the flaws in these arguments. According to Sprint/Nextel, it purchased 98% of the DS1 circuits serving its mobile base stations in Chicago from AT&T in 2006. Sprint/Nextel suggests that this somehow establishes that Sprint is entirely dependent upon AT&T's services. Even if it were true that Sprint/Nextel purchased almost all of its DS1 circuits in Chicago from AT&T – and Sprint/Nextel offers no data to back this up – that is not because Sprint/Nextel lacks alternative providers.

4. Chicago has long been a hotbed of competitive special access activity as I detailed in my 2005 submissions in this proceeding. In fact, Sprint/Nextel has deployed its own extensive metro area network ("MAN") in Chicago, which it uses to self-supply special access there. Moreover, Sprint/Nextel has made it clear to AT&T during business negotiations that, in addition to its own network, Sprint/Nextel has other alternatives to AT&T in Chicago, including intermodal special access providers. Thus, AT&T has long had to compete to keep and win Sprint/Nextel's special access business in Chicago. Tellingly, Sprint/Nextel does not disclose the accommodations AT&T has made to Sprint/Nextel in this regard. For example, AT&T has, at Sprint's request, entered into a number of individualized circuit specific arrangements with Sprint at substantial discounts. Indeed, the average amount that Sprint paid to AT&T for all DS1 circuits in Chicago for the first quarter of 2007 (*before* the recent significant additional rate reductions associated with AT&T's BellSouth merger commitment) was more than **[Begin Confidential]** **[End Confidential]** lower than Sprint paid in 2005.[1] Further, earlier this year, Sprint/Nextel sought bids from AT&T and others to supply additional DS1 and DS3 circuits to nearly 1000 cell sites in the Chicago area – mostly towers and other cell sites where Sprint/Nextel already has facilities – in

[1] The amount Sprint/Nextel pays to AT&T for DS1 services throughout AT&T's legacy 13-state territory also has fallen significantly since 2005.

connection with Sprint/Nextel's 4G and WiMax upgrades. To try and win that business AT&T has offered Sprint/Nextel significant additional discounts off the current prices Sprint/Nextel pays to AT&T in Chicago.

5. So far, Sprint/Nextel has declined to accept that offer, which to me, strongly confirms that Sprint/Nextel is considering purchasing all or a portion of these facilities from another carrier, or that it is considering self-supplying them. There is no question in my mind that, in Chicago and elsewhere, Sprint/Nextel has other facilities-based alternatives (including self-supply) to AT&T's special access services and that Sprint/Nextel intends to use them. AT&T's sales representatives tell me that they have been informed by their Sprint/Nextel counterparts that Sprint/Nextel **[Begin Confidential]**

[End Confidential]

6. In fact, Sprint/Nextel has done just that in other markets. For example, as I explained in my opening supplemental declaration, Sprint/Nextel and FiberTower recently announced that "FiberTower had entered into an agreement with Sprint Nextel . . . to provide backhaul services [to Sprint/Nextel] in seven of the wireless carrier's [Sprint/Nextel's] initial

WiMax launch markets."[2] **[Begin Confidential]**

[End Confidential] which is consistent with Sprint/Nextel's public announcement of its intention to "bypass[]" traditional special access services for its backhaul demand by deploying its own nationwide WiMAX network that will be capable of providing such backhaul services.[3] In this context, I do not find Sprint/Nextel's assertion that it has no alternatives to AT&T's special access services in Chicago to be at all credible.

7. Global Crossing is another commenter that relies on incorrect assertions in support of its request for special access re-regulation. Global Crossing's Director of Access Management Regulatory, Ms. Fisher, correctly states that competitors "do offer on-net services along discrete routes in many markets," and that competitors are able to provide service to "locations that have substantial telecommunications demand."[4] Nonetheless, Ms. Fischer contends that pricing flexibility has allowed price cap LECs' special access rates to charge excessive rates. But as I have shown in my prior declarations in this proceeding, the average

[2] Press Release, FiberTower Announces Backhaul Agreement With Sprint Nextel for WiMax Buildout (Aug. 6, 2007), available at http://www.bbwexchange.com/pubs/2007/08/06/page1423-647177.asp.

[3] *See, e.g.*, Olga Kharif, Sprint's Secret to Cost Cutting: Wimax, BusinessWeek (Dec. 27, 2005).

[4] Global Crossing 2007 Comments, attached Declaration of Janet Fischer on Behalf of Global Crossing North America, Inc., ¶ 4 ("Fischer Decl.").

price that special access customers actually pay to AT&T has fallen dramatically since AT&T obtained pricing flexibility. Global Crossing's submissions ignore these analyses and improperly rely on only a handful of tariffed month-to-month and term rates that omit the substantial additional discounts available in various pricing flexibility contract tariffs and overlay discount offerings.

8. Global Crossing also purports to compare AT&T's prices to the prices offered by four of AT&T's competitors, and claims that the comparison shows that AT&T's prices are much higher. While these comparisons show that AT&T does in fact face stiff competition from multiple facilities-based competitors, there is no way to assess whether the price comparisons in these tables are correct, because Global Crossing has not revealed the particular competitors and the particular routes on which the comparisons are based.

9. I can, however, offer a few observations that explain why I believe these price comparisons are not accurate. Foremost, these comparisons appear to compare AT&T's non-fully discounted month-to-month and term rates to the CLECs' fully discounted rates. Moreover, Global Crossing appears to have selected atypical "example" circuits – 10 mile and 30 mile circuits – that bias its comparisons. The average length of special access circuits that AT&T sells to Global Crossing is **[Begin Confidential]** **[End Confidential]**. And it is far from clear that the unnamed competitive providers that Global Crossing uses in its comparisons – some of which it counter intuitively claims would charge the same price for a 30-mile circuit as for a 0-mile circuit – would even sell to Global Crossing any circuits of that length. In my experience, providers asked to provide 30-mile circuits typically charge more for those circuits than they do for much shorter circuits, and it is likely that if those competitors ever were actually asked to provide circuits of that length, they would charge much

higher rates for those longer-mileage circuits, rather than the flat mileage rates listed by Global Crossing, which are typically used in areas where circuit lengths are much shorter.

10. Global Crossing also complains that AT&T recently raised rates on a few switched access service rate elements. It is unclear what conclusions about the competitiveness of special access markets that Global Crossing asks the Commission to draw from these isolated switched access rate modifications, but I can state that Global Crossing's claim that increases in these switched access rates somehow "offset" 60 percent of the very large benefits to special access customers from AT&T's recent merger commitment reductions is false. The modest switched access rate increase to which Global Crossing apparently is referring were changes made by AT&T to certain price cap tariffs in its July, 2007 annual access tariff filing and to certain pricing flexibility tariffs in May, 2007. The July, 2007 price cap increases obviously have no impact on the prices paid by Global Crossing (or others) in Phase II pricing flexibility areas. And the May, 2007 pricing flexibility increases were quite modest. The overall impact of these rate changes to AT&T's switched access revenues is less than **[Begin Confidential]**

[End Confidential] of the impact of the merger commitment special access rate reductions, which is far below the 60 percent figure reported by Global Crossing.

11. A number of commenters complain about particular provisions in certain of AT&T's discount plans, claiming that these provisions are anticompetitive because, in their view, these provisions limit customers' ability to purchase special access services from alternative providers. However, these commenters ignore the fact that AT&T offers a wide variety of discount plans, including plans without the features these commenters dislike. As a consequence, it is simply not true that customers must purchase at AT&T's base tariff rates unless they agree to volume commitments tied to their historical purchases from AT&T or to

limitations on the number of UNEs they can purchase. AT&T offers terms discounts without volume commitments and volume discounts based upon the particular circuits customers commit to purchase without regard to their historical levels of purchases from AT&T. AT&T's plethora of discount options reflects that special access customers have very different needs and that AT&T is competing vigorously by designing plans that meet those needs.

12. There is absolutely no truth to the claims that the only way customers can take advantage of the numerous discounts offered by AT&T is to agree to terms that preclude them from using alternative providers' services. In this regard, a few commenters argue that AT&T's "MARC" (or minimum annual revenue commitment) based plans force customers to commit to maintaining the same level of special access purchases from AT&T in order to obtain the associated volume discounts and to avoid penalties. AT&T has been able to offer very large discounts under these MARC based plans because those plans allow AT&T to better predict volumes and efficiently design its network.

13. But AT&T also offers a number of non-MARC based tariff offerings (both contract tariffs and generally available) that provide substantial volume discounts. For example, AT&T offers numerous circuit-specific term and volume discount plans. Under those plans, a customer agrees to purchase particular circuits for a term and is provided additional discounts depending on the volume of those purchases. In addition, AT&T recently filed a tariff that provides for volume discounts for purchasing a particular number of circuits that are not tied to specific circuits.[5] Under these plans, customers receive discounts as long as the number of

[5] This plan has been filed in each of AT&T's operating territories. *See, e.g.,* Transmittal No. 1056, FCC Tariff No. 1 (filed Feb. 27, 2007) (BellSouth); Transmittal No. 1600, FCC No. 2 (filed Feb. 27, 2007) (Ameritech); Transmittal No. 3184, FCC Tariff No. 73 (SWBT); Transmittal No. 337, FCC Tariff No. 1 (Pacific Bell); Transmittal No. 150, FCC Tariff No. 1 (Nevada); Transmittal No. 934, FCC Tariff No. 39 (SNET).

circuits they purchase in the area covered by the plan reach the levels that trigger volume discounts. These plans therefore allow a customer to receive the volume discount even if the customer discontinues service for any particular circuit, as long as the customer replaces that circuit with a purchase of a different circuit located somewhere within the area covered by the tariff.[6]

14. In addition, AT&T committed during the merger proceedings with BellSouth that it would offer reasonable volume and term discounts without MARCs or growth discounts.[7] AT&T also agreed that in negotiations for a pricing flexibility contract where AT&T offered a proposal with MARC, it would propose an alternative that would allow the customer to obtain a volume or term discount without the MARC.[8] And, AT&T has agreed that, for existing pricing flexibility contracts, it would allow customers to freeze existing MARCs provided the customer froze the existing contract discount rate.[9]

15. Time Warner Telecom ("TWTC") appears to be using this proceeding to gain leverage in ongoing business negotiations with AT&T. TWTC asserts (at 46) that the Commission should "prevent ILECs from stunting the development of Ethernet competition by addressing ILECs' exorbitant prices for these services." To support these claims, TWTC

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[6] XO points out that AT&T has an offer designed to encourage customers to switch to AT&T's special access services from a competitor's service by offering additional discounts when a customer transitions circuits previously purchased from a competitor to AT&T's network. This is a common practice in competitive markets. For example, cable television companies frequently offer special discounts to satellite customers that choose to switch to cable. In any event, customers who would prefer to obtain significant discounts from AT&T and to continue purchasing service from AT&T's competitors can do so under any on of the numerous other term and volume plans offered by AT&T.

[7] *AT&T Inc. and BellSouth Corp. Application for Transfer of Control*, 22 FCC Rcd. 5662, , App. F, Commitment 9, p. 152 (2007).

[8] *Id.*, Commitment 10.

[9] *Id.*, Commitment 11.

provides two declarations that it previously submitted in the proceeding over AT&T's merger with BellSouth. I submitted two declarations in response (attached hereto), explaining in each that there was no merit whatsoever to TWTC's claims and in particular that (1) as TWTC has admitted, a robustly competitive marketplace for Ethernet services has developed without reliance upon wholesale AT&T Ethernet services and (2) the AT&T Ethernet service that TWTC says is overpriced (known as OPT-E-MAN) is not a necessary input for providing retail Ethernet services. Consequently, AT&T has not "stunted" the development of Ethernet competition generally or TWTC's Ethernet services in particular. In fact, just a few weeks ago, TWTC affirmed that it has "long been a leader in the delivery of Ethernet services" and that "Ethernet services have been key in fueling the growth of the enterprise business for the company."[10]

16. So far as I can tell, TWTC provides no new evidence to support its claims that it needs lower prices for AT&T's OPT-E-MAN services in order to compete. TWTC thus continues to concede that it has been able to "deploy Ethernet services at retail . . . using 1) its on net facilities; 2) TDM loops purchased from AT&T;" and 3) "competitive facilities" from other providers offering TDM loops or finished Ethernet loops.[11] Given these admissions, and TWTC's claims about its market success, it is impossible to conclude that AT&T's OPT-E-MAN service is a necessary input for any of the numerous retail Ethernet providers.

17. There are no new developments that could change these conclusions. In fact, the most significant developments have only provided further benefits to consumers: in April 2007, the Commission granted AT&T's pricing flexibility petition for OPT-E-MAN services, and as a

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[10] Press Release, Time Warner Telecom, "Time Warner Telecom Surpasses 10,000 Ethernet Ports in Service for Enterprise Customers, at 1-2 (Aug. 1, 2007). TWTC previously has made similar proclamations. Press Release, *Time Warner Telecom Reports Strong Second Quarter 2006 Results*, at 1-2, July 31, 2006 (touting itself as an "industry-lead[er]" in Ethernet services and claiming that its revenues are growing "due to success with Ethernet").

[11] *Taylor Reply Decl.* ¶ 9.

consequence, AT&T can now offer individualized contracts for those services that are specifically tailored to customers' needs. Further, consistent with its commitments in the merger proceedings, AT&T in fact lowered its prices for OPT-E-MAN services, thereby providing still additional benefits to customers actually interested in purchasing the service.

18. TWTC, by contrast, seems less interested in purchasing AT&T's OPT-E-MAN services and more interested in trying to use the Commission to force AT&T to lower its prices even further to levels that TWTC desires. The negotiations between AT&T and TWTC for a pricing flexibility contract for OPT-E-MAN services are ongoing – in fact, **[Begin Confidential]** **[End Confidential]** and TWTC has not yet responded. In any event, the fact that AT&T has not immediately capitulated in negotiations to TWTC's pricing demands does not signify any market failure for Ethernet services. It means only that two parties are seeking to reach mutually agreeable terms and that neither party has the power to dictate terms to the other.

19. Finally, many proponents of reregulation also ignore that low cost UNEs often can be substituted for special access. Indeed, DS1 UNE loops and transport are available in more than 95% of the wire centers in most MSAs, and the use of AT&T DS1 and DS3 UNE loops and transport actually has *increased* by more than **[Begin Confidential]** **[End Confidential]** since 2004 in AT&T's 13-state and 9-state regions, respectively.

I declare under penalty of perjury that the foregoing is true and correct to the best of my knowledge.

Executed on August 15, 2007.

Parley Casto

ATTACHMENT
(AT&T-BellSouth Merger – Ethernet Declarations)

REDACTED – FOR PUBLIC INSPECTION

BEFORE THE
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of Applications for Consent to the Transfer of Control of Licenses and Section 214 Authorizations from	)	WC Docket No. 06-74
BELLSOUTH CORPORATION **Transferor**	)	
to	)	
AT&T INC. **Transferee**	)	

REPLY DECLARATION OF PARLEY C. CASTO

Sales Vice President – AT&T Wholesale

I, Parley C. Casto, hereby declare the following:

1. My name is Parley C. Casto. My title is Vice President – Sales – AT&T Wholesale, for AT&T. I am responsible for the management of a nationwide sales force that represents AT&T Wholesale products and services to interexchange carriers, CLECs and ISPs.

2. My declaration responds to claims made by Time Warner Telecom ("TWTC") and its declarant Graham Taylor that AT&T has impeded TWTC's ability to compete in the retail market for "Ethernet" services. TWTC Comments at 46-47. According to TWTC, AT&T has "been especially resistant to TWTC requests for Ethernet loops" that TWTC claims are an essential input into TWTC's retail Ethernet services. *Id.*

3. As I explain below, these claims, which have nothing to do with the pending merger between AT&T and BellSouth and appear to be an attempt to gain negotiating leverage

in the parties' ongoing negotiations, do not withstand scrutiny. TWTC is a valued customer of AT&T, and AT&T and TWTC are in the middle of negotiations to structure the terms and conditions of a complex contract tariff under which AT&T would supply TWTC with, among other services, AT&T's new OPT-E-MAN Ethernet service. In AT&T's view, these ongoing negotiations have been productive, and AT&T hopes the parties can agree on terms that meet both parties' business needs. As I explain below, however, TWTC is wrong in suggesting that AT&T has taken unreasonable positions and in claiming that AT&T's OPT-E-MAN service is an essential input to TWTC's retail Ethernet services.

4. AT&T's OPT-E-MAN proposals to TWTC have done nothing to limit TWTC's ability to compete in the market for retail Ethernet services. The market for retail Ethernet services is, without a doubt, highly competitive. Yet, AT&T currently sells very little of its OPT-E-MAN to unaffiliated carrier customers, and the competition for Ethernet has developed almost completely without OPT-E-MAN. Consequently, AT&T's OPT-E-MAN can in no way be considered some kind of necessary input to retail Ethernet services. To the contrary, AT&T is trying to get this new product into the market. To attract carrier customers to AT&T's OPT-E-MAN product, AT&T is compelled by market forces to offer reasonable terms.

5. Further, with respect to the TWTC negotiations for OPT-E-MAN, in contrast to its claim here that AT&T is insisting on unreasonable prices, for example, **[BEGIN TWTC PROPRIETARY]**

[1] **[END TWTC PROPRIETARY]**. And in contrast to its claims here that it cannot compete in the retail Ethernet business without a better OPT-E-MAN deal from AT&T,

[1] TWTC Counter Proposal to AT&T, May 8, 2006, p. 2.

TWTC issued a press release – the day after it filed its comments in this proceeding – in which it touted its new arrangement with Overture Networks as enabling TWTC "to *cost-effectively* deliver [its] industry-leading Ethernet portfolio to businesses *anywhere*."[2] TWTC's filings with the Commission raise no valid concerns about Ethernet services, and the specific price terms for TWTC's custom tariff arrangements, as well as the terms for the other "minor" technical concerns raised by TWTC, can and should be resolved at the bargaining table.

6. In this declaration, I also respond to the charge of EarthLink, Inc. ("EarthLink") that "AT&T has stalled negotiations and/or refused to negotiate any broadband transmission arrangements."[3] This allegation, too, is an attempt by EarthLink improperly to take advantage of this merger proceeding to gain leverage in its commercial relationship with AT&T.

I. RETAIL ETHERNET PROVIDERS CAN OFFER SERVICES EITHER THROUGH SELF-PROVISIONING OR BY PURCHASING "FINISHED" ETHERNET ACCESS SERVICES OFFERED BY NUMEROUS WHOLESALE PROVIDERS.

7. Before addressing the substance of TWTC's claims, TWTC's terminology is somewhat misleading, to the extent it implies that a special type of loop exists that is needed to provide Ethernet services to end users. That is simply not true. To put TWTC's arguments in a proper context, I explain briefly what Ethernet services are and what equipment and facilities are needed to provide Ethernet services to end users.

8. Retail Ethernet services are a type of advanced service that allows business customers to connect local area networks, or LANs, across multiple locations in a metropolitan area. Ethernet services can provide customers with multiple uplink speeds and a variety of network configurations, depending on the customers' needs. Ethernet is simply a protocol.

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[2] Time Warner Telecom, Press Release, at 1, June 6, 2006.

[3] EarthLink Pet. at 30.

Ethernet services can be provided over several types of network architecture, which are available from several competing providers.

9. To offer Ethernet Services, a provider deploys Ethernet switches and Ethernet equipment at the customers' premises that connects to the customers' LANs. Ethernet providers then use dedicated transmission facilities to connect customers' LANs to Ethernet routers and switches. However, they do not need special facilities, such as "Ethernet loops." In fact, there is no such thing as an "Ethernet loop." Rather, Ethernet providers can use ordinary dedicated transmission facilities that are also used for other types of services. Typically, fiber facilities are used, but copper loops can also support Ethernet services at some speeds.

10. Accordingly, a retail Ethernet provider like TWTC can readily self-provision Ethernet services. All that it necessary is for the retail Ethernet provider to deploy its own loop facilities (or obtain them from another provider as special access or private line services or through IRU or other arrangements), attach the necessary Ethernet electronics, and then sell the retail Ethernet services to end users. For customer locations with large demand, the retail provider will typically use OCn-level fiber facilities. For smaller locations that do not require the highest Ethernet speeds, the retail provider can use basic DS1 or DS3 special access circuits. Numerous retail Ethernet providers, including TWTC, AT&T and others, offer retail Ethernet services through this method today.[4]

11. Retail Ethernet providers increasingly have an additional option for providing services. In response to market demand, a number of companies offer "finished" wholesale Ethernet access services, in which the wholesale provider combines fiber loops with Ethernet

[4] *See* Taylor Decl. ¶ 43 (in addition to using its own loop facilities, "TWTC has relied [] on . . . DS1 and DS3 AT&T ILEC loops with TWTC-provided Ethernet equipment to compete in the provision of Ethernet in the AT&T ILEC territory.").

electronics and management. Some providers also have developed (or are developing) Ethernet access services that use copper loops. These services essentially provide a retail Ethernet provider with optical connectivity to its customers using a single point hand-off.

12. If a carrier purchases one of these finished services, it does not need to deploy its own personnel to the customer's premises to install or to maintain Ethernet equipment. Rather, it outsources these functions to the wholesale Ethernet provider. The end user's traffic is routed over the facilities and electronics provided by the wholesale Ethernet provider, which then routes all of the traffic to the retail Ethernet provider at a collocation facility or a POP.

13. Wholesale "finished" Ethernet services are relatively new. AT&T, for example, first offered its wholesale switched Ethernet service – which it calls OPT-E-MAN – beginning in about March 2005.[5]

II. THERE ARE MANY PROVIDERS OF WHOLESALE ETHERNET SERVICES.

14. Like other high-capacity services provided to enterprise and carrier customers, the provision of Ethernet Services is highly competitive, with a variety of providers offering services, both wholesale and retail. All of the major cable companies are taking advantage of their ubiquitous fiber networks to offer Ethernet access services.[6] There are also numerous

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[5] AT&T also offers a high-capacity, dedicated Ethernet service called Gigaman. This declaration relates to the switched OPT-E-MAN service.

[6] *See, e.g.,* Press Release, Cablevision Systems Corporation, Optimum Lightpath - First Cable MSO to Earn Metro-E Forum's Carrier Ethernet Certification (April 26, 2006) http://www.optimumlightpath.com/Interior187-3.html (describing Cablevision's E-line and E-LAN services offerings for enterprise customers through its Optimum Lightpath business telecommunications services division); Cox Optical Internet, http://www.coxbusiness.com/pdfs/cox_optical.pdf (last visited June 7, 2006), at 2 (offering Gigabit Ethernet service to business customers); Press Release, Artica, New Atrica A-2160 Outdoor Carrier Ethernet Edge Switch Extends Network Operator Points of Presence Virtually to Anywhere (April 5, 2006), http://www.atrica.com/landing.php?page=31s77 ("'Cox Business Services continues to experience significant growth in our Carrier Ethernet service offerings,' said Andrew Redman, a Senior Network Engineer at Cox."); Time Warner Cable, "Metro

companies that actively provide *wholesale* Ethernet access to retail Ethernet providers like TWTC. These include CLECs like Level 3, XO, Global Capacity Group, and USCarrier Telecom.[7] TWTC itself provides wholesale Ethernet access services.

15. Thus, a retail Ethernet provider typically has a variety of options in deciding how to provide its services. As described above, it can self-provision a retail Ethernet service by deploying or leasing its own loops and combining them with its own Ethernet electronics. Alternatively, it can purchase a wholesale service from an alternative provider like one of the companies discussed above. Or, it can purchase similar services from an incumbent LEC.

16. AT&T's Ethernet service, available to both retail and wholesale customers, is called "OPT-E-MAN." A copy of the FCC tariff for this service is available online.[8] As the

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Ethernet Services," http://www.twc-sa.com/business/bs_eos_m.asp (stating that its "substantial Metro Ethernet network is solely owned and operated locally by Time Warner Cable"); Cisco Systems, "With Cisco, Comcast Scales Its Commercial Metro Services and Company Reach," http://www.cisco.com/en/US/products/hw/switches/ps5023/products_customer_success_story0900aecd8013dfeb.html (describing Comcast's Ethernet offerings); Cisco Systems, "Charter Business Delivers Flexible Metro Ethernet-Based Services," http://www.cisco.com/en/US/netsol/ns465/networking_solutions_customer_profile0900aecd80361014.html (same).

[7] *See, e.g.,* Level 3 Metro Ethernet Private Line Service, http://www.level3.com/3257.html (last visited June 7, 2006) (describing Ethernet service offered to carriers); Level 3 Ethernet VPN Service, http://www.level3.com/1505.html (last visited June 7, 2006) (same); XO Carrier Ethernet Services, http://www.xo.com/products/carrier/transport/Ethernet/index.html (last visited June 6, 2006); *see also* Press Release, Global Capacity Group, Inc., Global Capacity Group Offers Carriers Cost-Effective Customer Access Strategy with Flat-Rate Ethernet Service (Feb. 27, 2006), http://host.issupport.com/GCG/News/feb27release.htm (announcing offering of a "flat-rate Ethernet product to provide carriers a cost-effective network access strategy for customers in remote, off-net locations[]" that is available in 41 states and "delivers a completely transparent, totally secure Layer 2 extension of the carrier's MPLS backbone directly to the customer premise"); USCarrier Telecom Carrier Solutions, http://www.uscarrier.com/carriersolutions.htm (last visited June 7, 2006) ("Other services provided include wholesale Internet access ports with speeds to gigabit levels"); Press Release, USCarrier Telecom LLC, Southeast wholesaler offers long-haul Ethernet (June 29, 2004), http://www.uscarrier.com/pressroom10.htm; Press Release, USCarrier Telecom LLC, US Carrier Telecom Selects Fujitsu Platforms for E-Max 1000 Long-Haul Wholesale Ethernet Service (February 9, 2004), http://www.uscarrier.com/pressroom12.htm.

tariff states, "OPT-E-MAN provides an integrated service consisting of fiber transport connected to an Ethernet device capable of switching [and] provides dedicated bandwidth ranging from 5 Mbps to 1 Gbps. Customers may connect to the service using a router, bridge, or a switch."[9] AT&T is deploying the technology that supports OPT-E-MAN on a central office-by-central office basis. AT&T's interstate OPT-E-MAN is available in **[BEGIN AT&T PROPRIETARY]**

[END AT&T PROPRIETARY]

AT&T offers the OPT-E-MAN service on a month-to-month basis and under discounted term plans.

17. In addition, for carriers that seek individualized terms and conditions that meet their specific business needs, AT&T stands ready to negotiate terms and conditions for a contract tariff for these Ethernet access services (in pricing flexibility areas once pricing flexibility is granted). AT&T has begun contract tariff negotiations with a number of providers. If AT&T obtains pricing flexibility relief, it will be able to offer the types of customized arrangements that these providers seek. As described in more detail below, AT&T is currently negotiating with TWTC for a contract tariff that includes OPT-E-MAN services.

18. To date, AT&T has sold very little OPT-E-MAN services to unaffiliated carrier-customers. This fact is significant for two reasons. First, it shows that the retail market for Ethernet Services has developed and is highly competitive even *without* the availability of OPT-

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[8] http://www.sbc.com/Large-Files/RIMS/Federal/SWBT/Tariff_No._73/fd730043.pdf.

[9] Southwestern Bell Tel. Co., Tariff F.C.C. No. 73, § 43.1, 2d Rev. Page 43-1 (eff. May 4, 2005).

E-MAN as an input. Second, AT&T has filed a Petition at the Commission to obtain pricing flexibility for OPT-E-MAN services.[10] The Petition is still pending.

III. AT&T'S OPT-E-MAN SERVICE IS NOT AN ESSENTIAL INPUT TO TWTC'S SUCCESSFUL RETAIL ETHERNET SERVICES.

19. In a press release reporting its results for the first quarter of 2006, TWTC announced that its revenues for data and Internet services grew by 31% compared to first quarter 2005 – an increase that TWTC said was "*due to success with Ethernet* and IP-based product sales."[11] Further, on June 6, 2006, the day after it filed its comments in this proceeding, TWTC issued a press release announcing its new arrangement with Ethernet provider Overture Networks that gives TWTC a "'branch office' solution [that] enables us to cost-effectively deliver our industry-leading Ethernet portfolio to customers anywhere."[12] According to TWTC, this "branch office" access is designed to allow TWTC to provide Ethernet services in areas where TWTC does not already have facilities in place to serve a particular customer location and where "it may be uneconomical to directly connect" to TWTC's network.[13] In other words, TWTC does not require AT&T's OPT-E-MAN service (or any other provider's wholesale Ethernet access service), because this Overture arrangement allows it "to cost-effectively deliver" its Ethernet services "anywhere" using standard special access (loop) facilities. In light of these statements, TWTC's assertions that it "must obtain access to Ethernet transmission facilities from the ILEC" and cannot "rely on DS1 or DS3 local transmission facilities" ring

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[10] SBC *Ex Parte Letter* from Davida Grant to Marlene Dortch, WC Docket No. 03-250 (filed Nov. 15, 2005).

[11] Time Warner Telecom, Press Release, at 2, June 6, 2006.

[12] *Id.* at 1.

[13] *Id.*

hollow. TWTC's public statements confirm that, as described above, TWTC is fully capable of continuing to self-provision retail Ethernet services by using its own loops or leasing special access facilities from incumbent LECs or other competitive providers to connect its customers' networks to TWTC's Ethernet equipment.

20. Further, based on my dealings with TWTC, I can confirm that TWTC has a long history of buying special access services, and then connecting Ethernet equipment to these circuits to provide retail Ethernet services. TWTC's ability to self-provision Ethernet services has been significantly enhanced by a pricing flexibility agreement that it entered into with AT&T only a year ago. **[BEGIN AT&T PROPRIETARY]**

[END AT&T PROPRIETARY]

At the time the contract was signed, TWTC stated that the contract "strengthens Time Warner Telecom's ability to compete effectively for the nationwide business market."[14]

21. TWTC complains that if it uses DS1 or DS3 special access circuits, it will "incur extra costs of equipment and encounter service degradation."[15] TWTC's declarant provides no

[14] *See* "Time Warner Telecom, AT&T, SBC Extend Long-Term Service Agreement," joint news release issued June 1, 2005, by TWT, AT&T, and SBC, at 2.

[15] Taylor Decl. ¶ 26; *see id.* ¶ 43.

description or quantification of these "extra costs." He certainly makes no effort to quantify these supposed costs or to explain how they have impeded TWTC's provision of Ethernet services. It is true that, compared to a carrier that purchases "finished" Ethernet access services like AT&T's OPT-E-MAN, a carrier that self-provisions Ethernet services over its own loops or special access circuits will need to purchase Ethernet electronics to be placed at the customer's premises and at its collocation facilities or POP. But these facilities must also be deployed if the retail provider purchases a finished Ethernet access service. In that case, it is the wholesale Ethernet provider that purchases and deploys the Ethernet electronics, the costs of which are then included in the overall rate for the finished Ethernet access service. Thus, the so-called "extra costs" discussed by TWTC are not really "extra" at all. They are simply the costs that any provider incurs in order to offer end users the features and functionality associated with Ethernet services.

22. I also do not agree with TWTC's claim that the commonplace use of DS1 and DS3 special access circuits to provide retail Ethernet services leads to "service degradation."[16] This argument is certainly undercut by the fact that a number of carriers, including TWTC, AT&T and others, currently – and quite successfully – use special access circuits to provide Ethernet services to end users.[17] In addition, it is important to note that when Ethernet providers lease special access circuits, they obtain use of the entire circuit. As such, the Ethernet providers control the traffic that flows over the circuits, and would be able to install Ethernet equipment that could establish class of service and prioritization commitments for IP and other traffic.

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[16] *Id.* ¶ 26.

[17] *See* Taylor Decl. ¶ 43 ("TWTC has relied [] on . . . DS1 and DS3 AT&T ILEC loops with TWTC-provided Ethernet equipment to compete in the provision of Ethernet in the AT&T ILEC territory.").

IV. TWTC'S COMPLAINTS REGARDING AT&T PRICES AND TERMS FOR FINISHED ETHERNET ACCESS ARE A TRANSPARENT NEGOTIATING PLOY, NOT A VALID CLAIM OF DISCRIMINATION.

23. Despite its ability to self-provision Ethernet services, TWTC argues that it requires access to AT&T's OPT-E-MAN services, and that i) TWTC "has been negotiating for over a year to obtain reasonable rates for Ethernet services, without success;" ii) TWTC "cannot possibly compete by relying [on] Ethernet [access] under the prices, terms, and conditions offered by AT&T; and iii) AT&T has engaged in "discrimination" against TWTC.[18] These claims are untrue.

A. AT&T Has Not Stonewalled Negotiations With TWTC.

24. **[BEGIN TWTC PROPRIETARY]**

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[18] TWTC Comments at 46-47, 49.

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B. AT&T's Pricing Offers For Ethernet Access Services Are Reasonable.

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[19] TWTC Counter Proposal to AT&T, May 8, 2006, p. 2 (emphasis added).

[20] Taylor Decl. ¶ 32.

[21] Taylor Decl.¶ 35.

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[22] *Id.*

[23] Taylor Decl. ¶¶ 36-37.

C. AT&T Has Not Stonewalled TWTC On The Few Technical Issues That The Parties Have Not Yet Resolved In Their Ongoing Negotiations.

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[24] *Id.* ¶ 39.

[25] Taylor Decl. ¶ 40.

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[26] *Id.* ¶ 42.

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[END TWTC PROPRIETARY].

V. THERE IS NO MERIT TO TWTC'S CLAIMS REGARDING SPECIAL ACCESS PERFORMANCE METRICS.

41. TWTC contends that "BellSouth provides substantially better performance metrics and pricing terms in its contract tariffs than AT&T."[28] TWTC's criticisms of the AT&T contract tariff, however, have no merit. In the first place, the various provisions of the AT&T tariff that TWTC criticizes reflect the five-year contract tariff which was negotiated *and agreed to* by TWTC with AT&T just one year ago.[29]

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[27] Taylor Decl. ¶ 38.

[28] TWTC Comments at 70.

[29] *See* TWTC Comments at 70 n.125 ("These contract tariffs are the publicly available versions [of] agreements by TWT with AT&T and BellSouth").

42. AT&T entered into this contract for the specific benefit of TWTC, which preferred such a contract to using the provisions of AT&T's access service tariff which are available to all customers, including the Managed Value Plan and performance guarantees regarding missed installations and service interruptions.[30] When the parties jointly announced their agreement in June 2005, TWTC – far from characterizing it as "extremely onerous" – stated that the contract "strengthens Time Warner Telecom's ability to compete effectively for the nationwide business market."[31]

43. In fact, as I recall, TWTC's declarant was personally involved in negotiating the terms of the contract tariff related to performance measurements. TWTC specifically agreed in the contract that when AT&T did not meet the applicable performance targets, any credits (funds) due to TWTC would be used to improve service delivery and performance, rather than be paid directly to TWTC.[32] TWTC's current view that such an arrangement is unreasonable is specious. Given a choice between using the funds to improve performance, on the one hand, and receiving the funds directly (with performance continuing at its present level), on the other, a customer could reasonably prefer the former – which was exactly what TWTC agreed to just one year ago.

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[30] These performance guarantees, including the credits that are paid and the additional credits available to customers when service outages exceed the applicable Service Assurance Warranty threshold, are described in detail in the Dysart/Watkins/Kissel Declaration. TWTC, in fact, can still receive these credits in addition to the credits available under its contract with AT&T.

[31] *See* "Time Warner Telecom, AT&T, SBC Extend Long-Term Service Agreement," joint news release issued June 1, 2005, by TWT, AT&T, and SBC, at 2.

[32] *See* TWTC Comments at 70; Pacific Bell Telephone Company Tariff FCC No. 1, § 33.56.5(F)(1) ("AT&T Tariff").

44. Moreover, TWTC neglects to mention benefits that it derives from the AT&T tariff that it does not receive from Bellsouth's.[33] For example, the performance standards for each of the metrics (the Service Level Assurances, or "SLAs") in the AT&T tariff become more stringent over the term of the five-year contract, whereas the performance standards in BellSouth's tariff remain the same during the three-year tariff period.[34] AT&T's tariff also waives all non-recurring charges associated with the purchase of the services subject to the contract, whereas the BellSouth contract tariff cited by TWTC does not.[35] In view of these and other benefits that it receives under the AT&T tariff, it is hardly surprising that TWTC agreed to the specific tariff provisions of which it now complains.

45. Once again, TWTC ignores the big picture. It selects isolated terms from an entire tariff or agreement, and then compares AT&T's position on that single term with the offers made by other carriers. This approach ignores the fact that, for other terms, AT&T's offer is more favorable, and that a reasonable retail provider could decide that, on balance, the advantages that it can obtain from the AT&T-favorable terms outweigh the disadvantages associated with the terms that other providers offer more favorably.

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[33] Contrary to TWTC's assertion that "AT&T only agreed to three" metrics (*id.*), AT&T agreed to four metrics: network availability, Mean Time to Repair (DS-1 only), Mean Time to Repair (DS-3 and OCN), and On-Time Delivery – Due Date (DS-1 – OCN). *See* AT&T Tariff, § 33.56.5(E) (Table E).

[34] AT&T Tariff, § 33.56.5 (Table E); BellSouth Tariff F.C.C. No. 1, §§ 25.29.1(A)(1), 25.29.2(B). For example, under AT&T's tariff, the SLA with respect to network availability is 99.93% during the first year of the contract, 99.96% during the second and third years of the contract, and 99.99% in the fourth and fifth years of the contract. For On-Time Delivery – Due Date, the SLAs are 96% during the first year, 96.5% during the second and third years, and 97% during the fourth and fifth years. *Id.*

[35] AT&T Tariff, § 33.56.5(C).

VI. EARTHLINK'S CLAIMS REGARDING BROADBAND TRANSMISSION ARRANGEMENTS ARE AN IMPROPER ATTEMPT TO TAKE ADVANTAGE OF THIS MERGER PROCEEDING TO GAIN LEVERAGE IN ITS COMMERCIAL RELATIONSHIP WITH AT&T.

46. EarthLink and its CLEC subsidiary, New Edge Network, Inc. ("New Edge") have contracts for broadband transmission services from AT&T. However, in light of the FCC's recent deregulation of these broadband transmission services,[36] EarthLink and New Edge have sought to enter into new long-term commercial agreements with AT&T.

47. The *Wireline Broadband Order* created a revolutionary change in the regulatory framework governing the provision of broadband transmission services. In particular, it eliminated the obligation of carriers like AT&T "to offer the transmission component of wireline broadband Internet access service on a stand-alone common carrier basis."[37] The FCC took these steps "to let wireline broadband Internet access service providers . . . produce new or improved services in response to consumer demands."[38]

48. To give providers and customers "sufficient time to adjust to [the Commission's] new [regulatory] framework" – to determine which services they want to provide or obtain and to put the necessary agreements into place – the Commission adopted a one-year transition period, until November 16 of this year, during which the status quo has been frozen.[39]

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[36] *See In re Appropriate Framework for Broadband Access to the Internet over Wireline Facilities*, Report and Order and Notice of Proposed Rulemaking, 20 FCC Rcd. 14853 (2005) ("*Wireline Broadband Order*"), *appeal docketed sub nom. Time Warner Telecom* v. *FCC*, No. 05-4769 (3d Cir.).

[37] *Id.* at 14899, ¶ 86.

[38] *Id.* at 14890, ¶ 71; *see id.* at 14891-92, ¶¶ 71-73.

[39] *Id.* at 14905 ¶ 98.

49. As encouraged by the Commission, AT&T has been using this transition period to reexamine its wireline broadband product portfolio. Because of this ongoing review, AT&T has not been able to make commitments to its wholesale customers like EarthLink about which products will be available going forward.

50. Nevertheless, AT&T is eager to continue its relationship with EarthLink , and AT&T began discussions with EarthLink a few months ago on a new long-term commercial agreement.. AT&T fully expects to continue negotiations with EarthLink.

51. With respect to New Edge, AT&T has not yet been ready to discuss the specifics of their future relationship – both because of AT&T's transitional planning process but also because **[BEGIN AT&T PROPRIETARY]**

[END AT&T PROPRIETARY]

I hereby declare under penalty of perjury that the foregoing is true and accurate to the best of my knowledge and belief.

Executed on June 19, 2006

Parley C. Casto

REDACTED – FOR PUBLIC INSPECTION IN WC DOCKET NO. 06-74

BEFORE THE
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of Applications for Consent to the Transfer of Control of Licenses and Section 214 Authorizations from	)	WC Docket No. 06-74
BELLSOUTH CORPORATION **Transferor**	)	
to	)	
AT&T INC. **Transferee**	)	

SUPPLEMENTAL DECLARATION OF PARLEY C. CASTO

Sales Vice President – AT&T Wholesale

I, Parley C. Casto, hereby declare the following:

1. My name is Parley C. Casto. My title is Vice President – Sales – AT&T Wholesale, for AT&T. I am responsible for the management of a nationwide sales force that represents AT&T Wholesale products and services to interexchange carriers, CLECs and ISPs.

2. In this declaration, I again respond to claims made by Time Warner Telecom Inc. ("TWTC") and its declarant Graham Taylor that AT&T has impeded TWTC's ability to compete in the retail market for "Ethernet" services.

I. THE INDISPUTABLY COMPETITIVE NATURE OF THE ETHERNET MARKET AND TWTC'S SELF-PROCLAIMED SUCCESS IN THAT MARKET DISPROVE THE CLAIM THAT AT&T'S FINISHED ETHERNET SERVICES ARE NECESSARY INPUTS FOR RETAIL ETHERNET.

3. TWTC's response is perhaps most notable for what it fails to dispute. In particular, TWTC and Mr. Taylor agree with me that the retail market for Ethernet services is very competitive.[1] In fact, TWTC states that competition in this market will likely "intensify over time." *TWTC Response* at 18. This is significant, because, as I discussed in my declaration and as TWTC does not dispute, AT&T has sold very little of its finished Ethernet service, which is called OPT-E-MAN, at wholesale to other carriers.[2]

4. Given these facts, it cannot be disputed that (1) a robustly competitive marketplace for Ethernet services has developed without reliance upon wholesale AT&T Ethernet services and (2) AT&T's OPT-E-MAN service is therefore not a necessary input for providing retail Ethernet services. This is true not only as a general matter for all providers in the retail Ethernet space, but also specifically for TWTC. TWTC has touted itself as an "industry-lead[er]" in Ethernet services, and has claimed that its revenues are growing "due to success with Ethernet."[3] Yet, TWTC has achieved this self-proclaimed Ethernet success without purchasing any OPT-E-MAN services from AT&T.

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[1] *See* Response of Time Warner Telecom, Inc. to AT&T Inc. and BellSouth Corporation Joint Opposition to Petitions to Deny and Reply to Comments ("*TWTC Response*"), at 17-18, enclosed within August 8, 2006 *ex parte* Letter from Thomas Jones, counsel for Time Warner, to Marlene H. Dortch; *cf.* Reply Declaration of Parley Casto ("*Casto Reply Decl.*"), ¶ 14 & nn.6-7, attached to Joint Opposition of AT&T Inc. and BellSouth Corp. to Petitions to Deny and Reply to Comments (filed June 20, 2006).

[2] *See Casto Reply Decl.* ¶¶ 4, 13, 18; *cf. TWTC Response*, Reply Declaration of Graham Taylor ("*Taylor Reply Decl.*"), ¶ 9.

[3] Press Release, *Time Warner Telecom Reports Strong Second Quarter 2006 Results*, at 1-2, July 31, 2006 ("*2Q Press Release*").

5. Although I presented these same arguments in my earlier reply declaration, TWTC's response never addresses them. TWTC never explains, for example, how AT&T's offering of a wholesale Ethernet service that TWTC and other Ethernet providers have chosen not to purchase in building and growing their competitive retail businesses establishes AT&T's "market power" in the provision of last-mile connectivity for such retail Ethernet services (*see TWTC Response* at 15). Likewise, if TWTC must have access to AT&T's finished Ethernet services, TWTC also never explains how it is an industry leader with rapidly growing Ethernet revenues and expects competition in that space to intensify even though it has not purchased AT&T's service.

II. TWTC HAS MULTIPLE PROVEN OPTIONS FOR PROVIDING RETAIL ETHERNET SERVICES BESIDES AT&T'S OPT-E-MAN SERVICES.

6. The reason TWTC cannot explain the inconsistencies between its advocacy in this proceeding and the realities of the marketplace is simple. In my last declaration, I explained that TWTC and other retail Ethernet providers have multiple last-mile connectivity options for providing service. In its response, TWTC admits that it has been able to "deploy Ethernet services at retail . . . using 1) its on net facilities; 2) TDM loops purchased from AT&T;" and 3) "competitive facilities" from other providers offering TDM loops or finished Ethernet loops. *Taylor Reply Decl.* ¶ 9. TWTC nevertheless claims that it is becoming "increasingly unviable" to use these options in some circumstances. *Id.* I see no merit in these claims.

7. TWTC does not dispute that there are numerous providers of wholesale Ethernet services, as I described in my most recent declaration. *Casto Reply Decl.* ¶ 14 & nn.6-7 (describing multiple providers including Level 3, XO, Global Capacity Group, and US Carrier Telecom). It is obvious that finished Ethernet services from competitive wholesale providers are available.

8. TWTC admits that in some cases, it has made a business decision *not* to purchase finished Ethernet services from competitive wholesale providers where they are available. *Taylor Reply Decl.* ¶ 7. **[begin TWTC proprietary]**

9.

[4]

[4] As I previously explained (*see Casto Reply Decl.* ¶ 35), a MARC is a common provision in many telecommunications contracts and reflects volume discounts that often arise in competitive markets: as the buyer commits to purchasing more services subject to the MARC, the price discounts and other benefits offered by the supplier generally increase. No buyer is compelled to commit to a particular MARC. Rather, the MARC is individually negotiated with each customer and generally represents the *quid pro quo* for lower prices or other benefits for the buyer. In this case, TWTC agreed to a particular MARC in its 2005 contract, and by doing so it obtained a number of benefits, including a particular set of pricing discounts and other favorable terms. When the agreement was signed in 2005, TWTC did not complain about the MARC but instead issued a joint press release with AT&T stating that the agreement "strengthens Time Warner Telecom's ability to compete effectively for the nationwide business market." Joint News Release, *Time Warner Telecom, AT&T, SBC Extend Long-Term Service Agreement*, June 1, 2005, at 2.

10.

[end TWTC proprietary]

11. With respect to Ethernet provided over TDM facilities, TWTC claims that this option for providing retail Ethernet is becoming "increasingly unviable" because there are "additional costs and inefficiencies" involved in providing Ethernet over TDM. *Taylor Reply Decl.* ¶¶ 9, 17. These claims are likewise entirely without merit.

12. First, TWTC's claims to the Commission in this proceeding regarding Ethernet over TDM are not consistent with its own statements and actions. TWTC currently provides, quite successfully, a large percentage of its Ethernet services using TDM. By its own count, TWTC purchases facilities from other carriers 73 percent of the time. *Taylor Reply Decl.* ¶ 4. Some of these facilities are finished Ethernet services, but TWTC has not purchased such services from AT&T, and it claims that it has not purchased a significant amount of finished services from competitive providers. Accordingly, a strong majority of TWTC's Ethernet customers are currently served over TDM facilities – yet, TWTC has proclaimed that its

revenues in the second quarter of 2006 grew by 29% "due to success with Ethernet."[5] It is apparent, therefore, that TWTC has been able to successfully sell Ethernet services using TDM facilities.

13. Further, TWTC never reconciles its claim that Ethernet over TDM is becoming "increasingly unviable" with its June 2006 announcement regarding a new arrangement with Ethernet provider Overture Networks. According to TWTC, this arrangement gives TWTC a "'branch office' solution [that] enables us to cost-effectively deliver our industry-leading Ethernet portfolio to customers anywhere."[6] TWTC further asserts that this "branch office" access is designed to allow TWTC to provide Ethernet services in areas where TWTC does not already have facilities in place to serve a particular customer location and where "it may be uneconomical to directly connect" to TWTC's network[7] – meaning that this arrangement is plainly being used in conjunction with TDM facilities. TWTC's response fails to explain the inconsistency: in its public reports, the Overture arrangement is a "solution" that is cost-effective[]" and that can be offered "anywhere;" in its statements to the Commission, Ethernet over TDM is "not a viable option," comes with "additional costs," and is difficult to offer "in areas that are not close to the AT&T/TWTC point of interconnection." *Compare Overture Release with Taylor Reply Decl.* ¶¶ 17, 19.

14. Second, although TWTC's reply does provide more detail about why it believes Ethernet over TDM causes "additional costs and inefficiencies," *Taylor Reply Decl.* ¶ 17, none of these arguments is convincing, and they are insufficient to overcome the substantial real-world

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[5] *2Q Press Release* at 2.

[6] Time Warner Telecom, June 6, 2006 Press Release, at 1 ("*Overture Release*") (emphasis added).

[7] *Overture Release* at 1.

evidence that retail Ethernet providers can – and routinely do – successfully offer Ethernet over TDM facilities.

15. TWTC claims that, when providing Ethernet services over TDM, it pays charges for TDM electronics as well as charges for Ethernet electronics (*Taylor Reply Decl.* ¶ 18) – although it never claims that the costs are prohibitive. In fact, I seriously doubt that the costs of the electronics are a significant component of TWTC's overall costs. TWTC has not permitted me to review its claims regarding its alleged costs for its "cost-effective" "solution" with Overture, *see Taylor Reply Decl.* ¶ 18, but **[begin TWTC proprietary]**

[end TWTC proprietary]

16. TWTC also claims that Ethernet over TDM requires TWTC to pay "substantial mileage charges" where it offers service in areas far from an AT&T/TWTC point of interconnection. *Taylor Reply Decl.* ¶ 19. However, mileage charges for special access service are routine and reasonably reflect the increased costs of providing longer connections. TWTC is no different than any service provider in this regard: it can either expend more capital and have more facilities closer to its customers or it can expend less capital but incur more mileage-based charges. These trade-offs are inherent whenever a provider seeks to expand the geographic reach of its services. Thus, if TWTC is dissatisfied with the levels of mileage charges, it is fully within TWTC's control to minimize those charges by deploying more points of interconnection ("POIs") with AT&T. And where TWTC chooses to save money by deploying fewer and more dispersed POIs, it can and should expect to pay more in mileage charges. **[begin TWTC/AT&T proprietary]**

[end TWTC/AT&T proprietary].

17. TWTC also claims that providing Ethernet over TDM "increases TWTC's costs because TWTC must purchase much more TDM capacity than it needs." *Taylor Reply Decl.* ¶ 20. As an example of this alleged problem, TWTC points to a customer that demands a 50 Mbps circuit, and claims that the customer's demand can be met only if TWTC uses two DS3 circuits, because a single DS3 can provide about 43 Mbps of service. Of course, for a customer who wants a 40 Mbps circuit, there is virtually no excess capacity if a DS3 is used. Like other facilities, TDM facilities have capacity limits that may not precisely match a particular customer's demand for capacity. In that case, a customer must either spend the money necessary to buy the additional capacity or accept the available lower level of capacity. In fact, the same capacity issues arise for Ethernet services that are not provided over TDM facilities. Ethernet ports come in standard 10/100 Mbps and 1 Gbps sizes, so an Ethernet supplier providing service to a customer that demands 1.2 Gbps of service must purchase more than one port. Significantly, in the actual marketplace, this is not at all a problem for customers. **[begin TWTC proprietary]**

[end TWTC proprietary]

18. There is also no merit to TWTC's assertions that TDM over Ethernet "introduces additional points of potential failure into the circuit." *Taylor Reply Decl.* ¶ 24. Ethernet over TDM is a standard arrangement used by numerous service providers, including AT&T and TWTC. I am aware of no evidence that this standard arrangement causes unusual service problems. To the contrary, TDM special access services are very mature and automated

products, and when problems do occur, they can generally be isolated and troubleshooting can occur without the need for "truck-rolls."

19. In short, TWTC provides no serious reason to question the facts from the marketplace, which show that many customers successfully receive Ethernet service over TDM facilities.

III. THE NEGOTIATIONS FOR AN OPT-E-MAN CONTRACT TO MEET TWTC'S SPECIALIZED NEEDS ARE ONGOING, AND AT&T'S OFFERS TO DATE HAVE BEEN MORE THAN REASONABLE.

20. Even though AT&T has a tariffed OPT-E-MAN offer with standard terms and conditions, AT&T is more than willing to negotiate a specialized contract arrangement that meets TWTC's particular business needs. Because TWTC has multiple other options for providing services, AT&T recognizes that its proposals must be reasonable, or it will lose TWTC's business. As I described in my last declaration, AT&T has already spent significant time with TWTC, in an effort to learn TWTC's specific business needs.[8] Although it is costly for AT&T to undertake this process and modify its standard OPT-E-MAN offerings for the needs of a single customer, AT&T is hopeful that an agreement that is beneficial to both sides will be reached.

21. **[begin TWTC proprietary]**

[8] Notably, TWTC does not dispute that it has very particularized demands. Nor has TWTC disputed that AT&T made a significant effort to understand and respond to TWTC's needs – such as responding to 183 questions that TWTC presented to AT&T in three separate questionnaires.

[end TWTC proprietary]

22. Nevertheless, TWTC apparently raises a host of complaints about AT&T's current proposals for a customized OPT-E-MAN agreement. In some cases, TWTC has refused to allow me or any other AT&T employee knowledgeable about the negotiations to learn the substance of TWTC's complaints or any supporting facts. In other cases, I have not been allowed to review the actual text of TWTC's submission, but have been allowed to discuss the substance of TWTC's allegations with AT&T's counsel.

23. In particular, although TWTC asserts that AT&T's proposed prices for OPT-E-MAN services are too high for TWTC economically to use those services, TWTC has not permitted me or any other business person to review the specifics of TWTC's claims in this regard. Accordingly, there is no way for me to evaluate TWTC's claims, including, for example, whether they are making an appropriate comparison of prices.

24. Nevertheless, two of the principal points regarding AT&T's OPT-E-MAN pricing offers that I discussed in my prior declaration remain valid. First, in negotiations, TWTC has made presentations **[begin TWTC/AT&T proprietary]**

[9]

[9] TWTC Counter Proposal to AT&T, May 8, 2006, p. 2 (emphasis added).

25.

26.

[end TWTC/AT&T proprietary]

IV. THE TECHNICAL ISSUES RAISED BY TWTC SHOULD BE ADDRESSED IN NEGOTIATIONS.

27. TWTC continues to complain about AT&T's negotiating positions on what TWTC previously described as **[begin TWTC proprietary]** [10] **[end TWTC proprietary]** My previous declaration responded to these claims, and TWTC's most recent response raises few, if any, new issues that AT&T has not already addressed. In each case, TWTC's technical issues concern specialized requests that deviate from AT&T's standard offerings. AT&T has not refused to negotiate with TWTC regarding any technical issue. In fact,

[10] *Taylor Decl.* ¶ 39.

in many cases, AT&T has made significant efforts to accommodate each of these requests and to modify its standard OPT-E-MAN offerings in an effort to meet TWTC's specialized needs.

28. **[begin TWTC proprietary]**

29.

30.

31.

[end TWTC proprietary]

I hereby declare under penalty of perjury that the foregoing is true and accurate to the best of my knowledge and belief.

Executed on August 21, 2006

/x/

Parley C. Casto