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

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

REPLY COMMENTS OF SPRINT NEXTEL CORPORATION

Laura H. Carter
Vice President, Government Affairs

Anna M. Gomez
Vice President, Government Affairs

J. Christopher Frentrup
Director, Government Affairs

Sprint Nextel Corporation
2001 Edmund Halley Drive
Reston, VA 20191
703-433-4143

A. Richard Metzger, Jr.
Gil M. Strobel
Lawler, Metzger, Milkman & Keeney, LLC
2001 K Street, NW, Suite 802
Washington, D.C. 20006
(202) 777-7700
Counsel for Sprint Nextel Corporation

August 15, 2007

Table of Contents

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

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

REPLY COMMENTS OF SPRINT NEXTEL CORPORATION

Sprint Nextel Corporation ("Sprint Nextel") submits these reply comments in response to the *Public Notice* issued by the Federal Communications Commission ("FCC" or "Commission") on July 9, 2007 asking parties to refresh the record in the above-captioned proceedings regarding special access rates.[1]

I. INTRODUCTION AND SUMMARY

The comments filed last week reinforce what was already clear from the record in 2005: the current special access regime is broken and in desperate need of repair. Verizon Communications, Inc. ("Verizon"), AT&T, Inc. ("AT&T") and their allies, however, urge the Commission to do nothing, or even further deregulate special access, asserting that all is well. The record contradicts their unfounded claims and exposes their arguments for what they are: attempts to obfuscate reality. For example:

---

[1] Public Notice, "Parties Asked to Refresh Record in the *Special Access Notice of Proposed Rulemaking*," WC Docket No. 05-25, FCC 07-123 (rel. July 9, 2007) ("*Public Notice*").

- AT&T and Verizon claim that there is widespread competition for special access services. In fact, customers cannot find competitive alternatives for the vast majority of their special access needs and Sprint Nextel, for example, must purchase over 96% of its DS1 and 84% of its DS3 special access needs from Verizon, AT&T or another incumbent local exchange carrier ("LEC").

- AT&T and Verizon claim that competition has led to innovative new pricing plans that benefit customers. In fact, the pricing plans touted by AT&T and Verizon are designed to lock-in customers and preempt competition that might drive special access prices down, thereby subsidizing AT&T's and Verizon's other services at the expense of consumers.

- AT&T and Verizon claim that the fact that demand for special access has grown shows that high special access prices have not had a harmful effect on demand for those services. In fact, the growth in special access demand reflects the dramatic explosion in wireless services (2G and 3G) in the last decade, and the launch of broadband services. These consumer offerings were not deployed because special access was competitively priced; they were deployed because consumers demanded wireless and broadband services. The services were deployed *in spite of* supra-competitive special access rates.

- AT&T and Verizon claim that high special access prices are not harming consumers or competition. In fact, funds that are used to pay AT&T, Verizon and others for over-priced special access are not available for financing competitive broadband deployment and network upgrades that would bring competitive and innovative new offerings to consumers. Thus, supra-competitive special access rates are harming consumers and competition by slowing deployment of next-generation broadband networks. Furthermore, excessive special access rates harm consumers as the ultimate end users of the services that rely on special access.

- AT&T and Verizon use a smoke and mirrors approach to claim that special access prices have been declining. In fact, these claims are based on erroneous analyses that mask the lack of competition for special access.

These arguments distort reality while, at the same time, AT&T's and Verizon's economic analyses attempt to change the story. For example, AT&T and Verizon assert that special access prices are falling by claiming that the price per unit (*i.e.*, "Voice Grade Equivalent" or "VGE") is falling. However, their per-unit analysis is misleading because, for example, it counts units (or, VGEs) that special access buyers are not using.

This method of computing "price" would be analogous to the following situation. If a customer wants an apple a day, and can buy them individually for $1 per apple or as a bundle of 10 for $6, the customer may buy the bundle for $6, but if the uneaten apples are inedible after the seventh day, the customer still only gets 7 edible apples for $6. To the customer, the price per apple is $0.86. Using the incumbent LECs' average revenue methodology, however, the customer's "price" per apple is $0.60. Like the grocer selling apples in this example, AT&T and Verizon are spreading their prices across "apples" that the customer must buy (to lower overall cost) but does not use. This allows AT&T and Verizon to report a lower per-"apple" price.

In sharp contrast to AT&T and Verizon's unsupportable claims and misleading pricing analyses, the reality of the special access market is that:

- Verizon is charging small businesses $99.99 per month for 5 Mbps / 2 Mbps FiOS while its DS1 special access offering, at significantly lower speeds, is $197.00.[2]

- Verizon and AT&T are charging rates for DS1 and DS3 special access services that are often two times the price of similar Unbundled Network Elements ("UNEs"), which are offered at cost-based rates.[3]

---

[2] Comments of ATX Communications, Inc., Bridgecom International, Inc., Broadview Networks, LLC, Cavalier Telephone, LLC, DeltaCom, Inc., Integra Telecom, Inc., Lightyear, Inc., McLeodUSA Telecommunications Services, Inc., Penn Telecom, Inc., RCN Telecom Services, Inc., Savvis, Inc., and U.S. Telepacific Corp. d/b/a Telepacific Communications (Redacted Version) at 15-16 ("ATX, *et al.* Redacted Comments"). (Unless otherwise indicated, all comments cited herein were filed in WC Docket No. 05-25 on August 8, 2007.)

[3] *See* Comments of Sprint Nextel Corporation at 22-23 and Exhibit 3 ("Sprint Nextel Comments"); *see also* T-Mobile Comments, WC Docket No. 04-313, at 21-22 and attached Declaration of Michael A. Williams at Appendix B (Oct. 4, 2004) (showing that the prices incumbent LECs charged for special access DS1 channel termination services were approximately twice the prices, on average, for comparable UNE loops); Declaration of M. Joseph Stith, ¶ 2, attached to Comments of the Ad Hoc Telecommunications Users Committee (June 13, 2005) ("Ad Hoc 2005 Comments") (showing that the BOCs' tariffed rates for a typical 10-mile special access circuit –

- AT&T's and Verizon's rates for DS1 and DS3 special access services frequently are higher in Phase II markets than they are in markets still subject to price caps.[4]

- AT&T and Verizon control approximately 81% of the $15.6 billion incumbent LEC special access business.[5]

- Every day special access surcharges are not subjected to competitive pressures or FCC action, American business overpays the incumbent LECs an estimated $22.7 million.[6]

- Special access overcharges are estimated to cost American business 234,000 jobs and $66 billion in economic output over the next three years.[7]

- In 2006, AT&T and Verizon alone overcharged buyers – and, ultimately, American consumers – more than $6.3 billion.[8]

AT&T's and Verizon's fallback position seems to be that whatever problems may exist in their provision of special access, it is not worth the effort to fix them. The reality is that the Commission cannot afford further delay in addressing the special access market failure, as American consumers continue to pay the price for the lack of Commission action. First, consumers are being forced to pay inflated prices for wireless and other telecommunications services (as a result of the inflated price of a critical input,

---

including two channel terminations, a fixed mileage transport charge and a ten-mile channel mileage circuit – were, on average "significantly above their rates for equivalent UNEs," in many cases "by well over 100%.").

4 Sprint Nextel Comments at 50 and Exhibit 1.

5 2006 FCC ARMIS Report 43-01, Table 1 – Cost and Revenue, Row 1090, Column (s).

6 Comments of the Ad Hoc Telecommunications Users Committee at 6 ("Ad Hoc Comments").

7 Economics and Technology, Inc., *Special Access Overpricing and the US Economy: How Unchecked RBOC Market Power Is Costing US Jobs and Impairing US Competitiveness*, attached as Appendix 1 to Ad Hoc Comments, at i (Aug. 2007) ("ETI 2007 Study").

8 Over-earnings were computed using Automated Reporting Management Information System ("ARMIS") data ((Reported rate of return – 11.25)*ANI*Tax Factor).

special access). Second, American consumers are being forced to subsidize one set of carriers' networks at the expense of the development of innovative, competitive networks. Thus, immediate Commission action is crucial to ensuring that American consumers will experience the benefits of full-fledged intermodal broadband competition.

As Sprint Nextel proposed in its initial comments, the FCC immediately should reduce rates for special access services provided by the largest Bell Operating Companies ("BOCs")[9] pursuant to Phase II pricing flexibility to the levels of comparable price-capped services and eliminate Phase II pricing flexibility for the largest BOCs. The Commission should then restate special access price cap indices for the largest BOCs to reflect productivity gains since 2004 and apply an X-Factor of 5.3% for special access services for the 2008 and subsequent annual access tariff filings by the largest BOCs, pending the adoption of an updated adjustment factor. In the longer term, the FCC should move the special access rates of the largest BOCs to reasonable levels by requiring that by no later than July 1, 2008, those rates either be based on forward-looking costs[10] or be targeted to earn a rate of return of no greater than 11.25%. Collectively, these actions would finally address the ongoing competitive and other harms caused by the largest BOCs' dominance of the special access business.[11]

---

9 As Sprint Nextel explained in its comments, its proposed remedies focus on AT&T and Verizon as those are the two largest carriers that have compelling incentives to use their dominant positions in the special access markets to harm competition in downstream markets.

10 These rates could be based on the cost-based rates established in state proceedings setting prices for UNEs.

11 As Sprint Nextel noted in its initial comments, any action taken in this proceeding to remedy the problems in the provision of special access should apply to all dedicated point-to-point services, including both packet-based and TDM services, as well as any special access services that may have been part of previous forbearance petitions. *See* Sprint Nextel Comments at 2 n.2 and 3 n.4.

The record contains substantial evidence that the special access business is a textbook example of market failure. The Commission adopted the current pricing flexibility regime eight years ago, with the hope that it would "accelerate the development of competition in all telecommunications markets."[12] That hope has proven to be unfounded. The Commission, therefore, must not delay any further and must act promptly to discipline the largest BOCs' ability to exploit their market power to the detriment of consumers and competition.

II. INITIAL COMMENTS CONFIRM THAT THE LARGEST BOCS ARE DOMINANT IN THE PROVISION OF SPECIAL ACCESS

A. The Record Contains Ample Evidence that the Special Access Market Is Broken

Contrary to the claims of the BOCs and various incumbent LECs,[13] the record contains overwhelming evidence of the need for the Commission to replace the current special access regulatory regime. As COMPTEL correctly points out, "the Commission already possesses a substantial amount of . . . relevant data by virtue of its investigations in recent Bell/IXC and Bell/Bell merger proceedings."[14] Moreover, as BT Americas observes, similar data were submitted previously, first in 2002 (in support of AT&T's special access petition), then in 2004 (in the TRO Remand proceeding),[15] and again in

---

12 *Access Charge Reform*, Fifth Report and Order and Further Notice of Proposed Rulemaking, 14 FCC Rcd 14221, ¶ 1 (1999) ("*Pricing Flexibility Order*").

13 *See, e.g.,* Comments of Embarq at i-ii, 3, 6 (claiming there is no factual evidence that the existing pricing flexibility regime is not working) ("Embarq Comments").

14 Comments of COMPTEL at 2 ("COMPTEL Comments").

15 *Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers*, Report and Order and Order on Remand and Further Notice of Proposed Rulemaking, 18 FCC Rcd 16978 (2003) (subsequent history omitted) ("TRO Remand proceeding").

2005 (in the revived special access proceeding that the FCC now seeks to "refresh").[16] In each proceeding, the clear weight of record evidence showed that the BOCs were exploiting their dominance in the provision of special access to assess unreasonably high rates.

The initial comments submitted in this phase of the proceeding again confirm, in great detail, that the BOCs' ability to maintain or increase supra-competitive prices for special access is currently constrained by neither competition nor government regulation. The record further shows that conditions have deteriorated in the past two years, as the two mega-BOCs acquired two of the largest competitive providers of special access. In light of this compelling evidence, the Commission has an obligation to act to reduce the excessive prices that the BOCs continue to assess for special access services.

The record reflects broad agreement on fundamental issues among competitive service providers, wireless carriers, consumer advocates and large businesses. For example, the initial comments submitted by these parties show the following facts:

- The BOCs have been able to raise Phase II special access prices in Metropolitan Statistical Areas ("MSAs") where they are not constrained by competition;[17]

---

16 Comments of BT Americas Inc. at 15 ("BT Americas Comments").

17 Ad Hoc Comments at 3-6, ETI 2007 Study at 4 & A-8, and Declaration of Susan M. Gately, attached as Appendix 2 to Ad Hoc Comments, ¶ 10 ("Gately 2007 Decl.") (documenting BOC price increases and unprecedented returns of 52% to 132% as of year end 2006); Comments of the New Jersey Division of Rate Counsel at 18-19 ("the rate of return for the [BOCs'] special access services increased from approximately 38% in 2001 to approximately 78% in 2006. . . . [I]n New Jersey, Verizon's rate of return has increased from 26% in 2001 to 104% in 2006."); Comments of XO Communications, LLC, Covad Communications Group, Inc. and NuVox Communications (Redacted Version) at 12-16 ("Covad, *et al.* Redacted Comments"); ATX, *et al.* Redacted Comments at 9-16 (special access prices and unconscionable rates of return have increased); Sprint Nextel Comments at 8-21 (providing data showing that the BOCs continue to reap a windfall from the provision of special access); Comments of Time

- BOC special access prices are generally much higher than prices for comparable unbundled network elements ("UNEs") or comparable services for which the BOCs face direct competition, such as DSL service or Verizon's FiOS;[18]

- viable intra- or intermodal competitive alternatives to the incumbent LECs are rarely available for consumers of special access, including in MSAs subject to Phase II pricing flexibility;[19]

- the FCC's special access pricing flexibility triggers use an overly large geographic market (the MSA) and fail to account for important distinctions among special access product markets;[20]

Warner Telecom and One Communications (Redacted Version) at 29-31 ("TWTC/One Redacted Comments") (stating that "[t]he increase in special access rates under pricing flexibility has been studied and documented in excruciating detail," and providing high level summaries of such studies).

[18] Covad, *et al.* Redacted Comments at 16-20; TWTC/One Redacted Comments at 29 ("ILEC rates are almost universally higher than UNE rates, and are often two times higher than most competitive wholesale providers' (including TWTC's) rates in both Phase II and price cap areas, especially for circuits with any interoffice mileage"); Sprint Nextel Comments at 21-24 (AT&T and Verizon's special access prices far exceed the prices for comparable UNEs and DSL offered by AT&T and Verizon); ATX, *et al.* Redacted Comments at 15-16 (pointing out that Verizon offers 5 Mbps / 2 Mbps FiOS to small businesses at a rate of $99.99 per month, while its DS1 special access offering, at significantly lower speeds, is $197.00, and observing: "If Verizon is able to charge such low rates for newly deployed, unamortized facilities, this raises questions about why it needs to charge such high rates for lower capacity [special access] facilities that are substantially depreciated."); Comments of the Office of Advocacy, U.S. Small Business Administration, at 7 ("SBA Comments") (special access prices "are significantly higher than cost based UNE rates").

[19] Ad Hoc Comments at 8 n.10 ("For locations with capacity requirements totaling four DS-1 circuits or below, [Ad Hoc] members reported that viable competitive alternatives to the ILEC were available at less than 10% of their locations"); TWTC/One Redacted Comments at 2-3, 6-8, & 14-18 (competitors simply do not serve many buildings; incumbent LECs retain overwhelming market power over the upstream loop and transport inputs needed to serve small, medium, and large business customers; and intermodal alternatives are not a viable substitute for special access); Comments of the American Petroleum Institute at 6 ("For member companies, the price cap ILECs remain the predominant providers in all of the major special access service categories."); *id.* (CLEC-provided special access is "virtually non-existent" in rural areas); BT Americas Comments at 6-9 (even national CLECs often cannot meet the multi-site demand of special access customers, and intermodal alternatives are not viable substitutes); Covad, *et al.* Redacted Comments at 22-25 (few competitive alternatives exist in Phase II MSAs to discipline special access rates).

- wireless and small carriers are particularly vulnerable under the existing pricing flexibility regime, since price cap incumbent LECs are virtually the sole source in most of their service areas for special access;[21]

- the existing special access regime is inflicting serious harm on consumers and the economy as a whole, and will continue to do so unless and until exorbitant rates for special access are reduced;[22]

- the BOCs use exclusionary pricing practices that are designed to deter the entry and growth of competitive providers by restricting the amount of demand that customers may purchase from competitors;[23] and

- the recent Bell/IXC mergers have further lessened competition for special access.[24]

---

[20] Comments of T-Mobile USA, Inc. at 9-11 ("T-Mobile Comments"); Sprint Nextel Comments at 11-18; TWTC/One Redacted Comments at 18-21.

[21] Sprint Nextel Comments at 29-33 (Sprint Nextel remains almost completely dependent on incumbent LECs – especially the BOCs – for its special access needs); T-Mobile Comments at 6-7 (T-Mobile has few if any alternatives to incumbent LEC special access, especially for initial links connecting its base stations to wire centers); SBA Comments at 7-8 (pricing flexibility has led to increased prices for small carriers – as much as 46% higher – and has created an "insurmountable burden to small carriers trying to conduct business in the telecommunications market").

[22] Ad Hoc Comments at 6, Gately 2007 Decl. ¶ 6-7, & ETI 2007 Study at i, iii, & 15-16 (overcharges for special access are now costing business customers $22.7 million per day, and if the Commission fails to constrain BOC special access prices to competitive levels, the U.S. economy will lose some 234,000 jobs and roughly $66 billion in economic output); T-Mobile Comments at 8 ("Consumers ultimately suffer from the high cost of special access as companies like T-Mobile must expend their limited resources on exorbitant fees in lieu of investing in improved services, including wireless broadband, and expanded coverage areas."); TWTC/One Redacted Comments at 35-36 (high incumbent LEC special access prices harm consumer welfare by reducing the size of competitors' addressable markets, especially for Ethernet services).

[23] COMPTEL Comments at 3-4, 7-8, 11 (describing various examples); Covad, *et al.* Redacted Comments at 26-35 (the terms and conditions of incumbent LEC price-flexibility tariffs and contracts are onerous and exclusionary); TWTC/One Redacted Comments at 36-42 (incumbent LECs have engaged in exclusionary pricing practices to prevent wholesale competition in the provision of special access from developing); Sprint Nextel Comments at 24-29; SBA Comments at 8 (small carriers lack negotiating power and thus are subject to onerous contract provisions for special access); BT Americas at 10-11 (BOCs impose onerous "lock in" provisions in their agreements).

[24] TWTC/One Redacted Comments at 8 ("the number of loop facilities deployed by competitive carriers may have actually decreased substantially in the last few years as a

The comments of TWTC are especially noteworthy because USTelecom hails TWTC as a prime example of a competitor that supposedly has made major inroads in the special access market.[25] TWTC, however, contradicts this claim, by showing that "competitors have only been able to deploy their own local transmission facilities to a small fraction of the commercial buildings in the country."[26] Specifically, TWTC states that it provides service to only about one fourth of its buildings via its own facilities, even though TWTC by its own admission "has likely deployed its own loop facilities to more commercial buildings than any other competitor."[27] The TWTC comments also show that despite its best efforts to purchase local transmission facilities from competitors, TWTC has largely been unsuccessful in doing so; that it is no more able to rely on competitive wholesalers for Ethernet service than for DS1 or DS3 service;[28] and that the reliance of it and other competitors on incumbent LEC local transmission facilities is increasing.[29]

TWTC's comments regarding its fiber deployment and other issues belies not only the myth of "robust" competition, but also the BOCs' claim that competitors have not provided the FCC sufficient information for it to assess the availability of alternative

---

result of the Bell/IXC mergers"); T-Mobile Comments at 3-4 (pricing discipline formerly exerted by MCI and pre-merger AT&T in the special access marketplace has disappeared); Covad, *et al.* Redacted Comments at 20-22 (merger conditions do not cure the evident special access market failure); Sprint Nextel Comments at 36-39.

25 *See* Comments of the United States Telecom Association at 14-15 ("USTelecom Comments").

26 TWTC/One Redacted Comments at 11.

27 *Id.*

28 As TWTC explained in its comments, "[t]he economics of loop deployment do not magically improve when a different protocol is used to transmit the signal. The same trench must be dug, the same fiber must be laid and similarly priced electronics must be attached." TWTC/One Redacted Comments at 13-14.

29 *Id.* at 11-14.

facilities.[30] In any event, the most relevant issue is not whether competitive *sellers* of special access have been forthcoming about the extent of their facilities, but whether *purchasers* of those facilities have, in the real world, been able to avail themselves of the competitive alternatives that the BOCs portray as being so prevalent.[31] On this point the record is crystal clear: on the vast majority of routes, Sprint Nextel and others that depend on special access have no alternatives to the special access offerings of the incumbents.[32]

The record contains substantial evidence that the special access business is a textbook example of market failure. The Commission should not delay further in taking action to remedy this situation. The current pricing flexibility regime was adopted eight years ago, with the hope that it would "accelerate the development of competition in all telecommunications markets."[33] That hope has proven to be unfounded and the Commission, therefore, must act promptly to reduce special access prices.

B. Alternative Providers and Technologies Have Not Developed Sufficiently to Constrain the Special Access Prices of the Incumbent LECs

Despite the compelling evidence to the contrary, AT&T, Verizon and their allies continue to assert that there are numerous alternative special access providers competing in the marketplace. These assertions do not withstand scrutiny, however.

---

30 *See, e.g.*, Comments of Verizon (Redacted Version) at 14, 38, 49 ("Verizon Redacted Comments"); Supplemental Comments of AT&T Inc. (Redacted Version) at 50-51 ("AT&T Redacted Comments").

31 *See* COMPTEL Comments at 9 ("No item of data is more relevant to the actual presence of competition than purchaser behavior. If purchasers truly had a choice, why would they pay the excessive special access rates offered by the Bells?").

32 *See* discussion *supra* at 9 & note 21; *see also infra* section II.B.

33 *Pricing Flexibility Order* ¶ 1.

USTelecom, for example, devotes pages to listing the names and press releases of companies – such as TWTC and XO Communications – that provide competitive special access service.[34] Similarly, AT&T points to an analyst's report citing 45 competitors in the "wholesale private line market" as evidence of a competitive special access market.[35]

These lists of competitive carrier names and quotes from carriers' sales pitches demonstrate nothing, however. Sprint Nextel has identified at least 77 potential competitive providers that offer service in parts of the United States,[36] but the mere existence of these 77 companies does not automatically translate into competition at a particular cell site or other location. As Sprint Nextel explained previously, when it surveyed those 77 competitive providers, only 16 companies responded indicating that they had facilities at a cell site covered by the survey. Moreover, those facilities only reached about 1% of the cell sites.[37] The "competitors" touted by AT&T and Verizon simply do not have facilities and infrastructure where Sprint Nextel needs them. Consequently, those 77 vendors are not able to compete effectively to provide Sprint Nextel's backhaul business, leaving Sprint Nextel to purchase nearly all of its wireless backhaul from incumbent LECs.[38]

Similarly, although Verizon and AT&T suggest in their comments that cable is a significant and growing competitive threat to their special access market shares,[39] reality paints a much different picture. Even in a large city, such as Boston, Sprint Nextel relies

---

34 USTelecom Comments at 14-21.

35 AT&T Redacted Comments at 11 & n.15, citing Frost & Sullivan Report.

36 Declaration of Gary B. Lindsey, Attachment 1 to Sprint Nextel Comments, ¶ 4 ("Lindsey Decl.").

37 *Id.* ¶ 5.

38 *Id.* ¶ 9.

39 Verizon Redacted Comments at 20-23; AT&T Redacted Comments at 13-15.

on ***Verizon*** – not a fixed wireless provider, not a cable company and not a competitive LEC – for **97%** of its DS1 and DS3 special access purchases.[40] Moreover, TWTC noted that AT&T's Chief Financial Officer ("CFO") recently stated that "[i]n small and medium business . . . we are not seeing a lot of [competition] in the market at this point [from cable companies], other than probably from Cox who has been in the market for some time."[41] Sprint Nextel's experience confirms it is not "seeing a lot of competition" from cable for the wireless segment of special access users, as Sprint Nextel is able to use cable or other alternative vendors at only a small fraction of its cell sites nationwide.

Verizon's claim that "the number of competitive suppliers vying to serve the niche for wireless backhaul services is growing rapidly"[42] is meaningless without an analysis of the effectiveness of those suppliers. Verizon's assertion about the growing number of alternative providers says nothing about the reach of those providers' network infrastructures, the percentage of the market they serve as compared with Verizon or AT&T, or in what specific circumstances – and how often – they can actually serve a wireless carrier's cell site. Verizon Wireless may be aware of "[m]ore than a dozen competitive providers" that attended its "symposium,"[43] but – as Sprint Nextel has noted repeatedly – if those "competitive providers" do not have facilities at wireless carriers' cell sites, then those vendors are not, in fact, providing effective competition to the incumbent LECs at those locations.

---

40 Lindsey Decl. ¶ 10.

41 TWTC/One Redacted Comments at 15, citing AT&T's July 24, 2007 earnings call.

42 Verizon Redacted Comments at 28.

43 *Id.* at 28.

Verizon also claims that there is a "niche for wireless backhaul services" which is expected to grow in the next few years as capacity needs at cell sites increase.[44] Similarly, AT&T asserts that the capacity demands of 3G wireless networks have "intensified" competition in recent years.[45] Whether alternative wireless providers will become effective alternatives to the incumbent LECs in providing backhaul to a large percentage of wireless broadband cell sites remains very much in doubt, however. Certainly, Sprint Nextel is evaluating this possibility and is hopeful that additional opportunities to use alternative providers will present themselves – opportunities such as its recent agreement with FiberTower which involves alternative backhaul technologies in a small number of Sprint Nextel markets.[46] But these alternatives today are limited, as it is not economical for alternative providers to deploy the lower-capacity circuits (less than a DS3) that the vast majority of Sprint Nextel cell sites will continue to require for the foreseeable future.[47]

Claims that Sprint Nextel's 4G network will soon become a competitive alternative to incumbent LEC special access are overstated.[48] Sprint Nextel is focused on using its finite spectrum resource to provide robust, innovative, broadband wireless

---

44 *Id.* at 25.

45 AT&T Redacted Comments at 14.

46 *See* FiberTower News Release, "FiberTower Announces Backhaul Agreement with Sprint Nextel for WiMax Buildout" (Aug. 1, 2007), *available at*: <http://www.firstavenet.com/corp/news-press-releases-080107.shtml>; *see also* AT&T Redacted Comments at 17.

47 *See, e.g.*, *Unbundled Access to Network Elements*, Order on Remand, 20 FCC Rcd 2533, ¶¶ 166, 170-171 (2005) ("*UNE TRRO*") (competitive carriers "cannot deploy stand-alone DS1-capacity loops on an economic basis"); *see also* Embarq Comments at 21-23 (carriers are unlikely to build lower-capacity DS1 circuits).

48 *See* USTelecom Comments at 20-21; Verizon Redacted Comments at 24, citing Sprint Nextel's news release announcing Sprint Nextel's 4G partnership with Clearwire to develop and deploy the first nationwide broadband network using WiMAX.

services to retail customers. It should be noted that even if alternative vendors were to increase their ability to serve wireless cell sites, they would have to serve practically all of the DS1 or DS3 services that Sprint Nextel and other wireless broadband carriers will require to meet their 4G needs to make even a dent in the overwhelming share of special access services that AT&T and Verizon control. Moreover, the mere *possibility* that alternatives could arise at more cell sites at some future time does not provide a basis for allowing excessive charges now. It was the *possibility* of competition that led us to where we are today: a marketplace where Sprint Nextel purchases over **96%** of its DS1s and over **84%** of its DS3s from incumbent LECs[49] with no competitive pressure on, and little or no governmental regulation of, the grossly excessive prices they charge for those services. The Commission must address the reality of today instead of relying on the potential for tomorrow.

III. ECONOMIC DATA SUBMITTED BY AT&T AND VERIZON DO NOT SHOW THAT PROVISION OF SPECIAL ACCESS IS COMPETITIVE

A. Claims that Special Access Rates Have Declined are Misleading

AT&T's and Verizon's erroneous claims that existing prices for special access are declining[50] are based essentially on two arguments, neither of which presents a realistic picture. First, they claim the average revenue per voice grade equivalent or per circuit is declining.[51] Second, they claim that average prices for DS1 and DS3 services are declining in real terms.[52] These methods of measuring the change in special access prices

---

49 Lindsey Decl. ¶ 8, citing percentage of DS1 and DS3 purchases in the Top 50 MSAs.

50 *See, e.g.*, AT&T Redacted Comments at 2, 8, 21-23; Verizon Redacted Comments at 2-3, 10-13.

51 AT&T Redacted Comments at 22; Verizon Redacted Comments at 11.

52 AT&T Redacted Comments at 22, 39; Verizon Redacted Comments at 2, 11-12.

over time are misleading – and perhaps more importantly, completely at odds with the realities of today's special access marketplace.

1. Evaluating rates using *average* revenue is misleading

Assessing price trends on the basis of changes in the average revenue per VGE circuit is misleading because the revenue per VGE circuit is not constant across DS1, DS3 and higher-capacity circuits.[53] For example, a customer that uses 5 DS1s would have 120 VGEs (5 DS1s times 24 VGEs per DS1). If that customer's demand grew to 6 DS1s, it could either purchase another DS1, which would leave its average revenue per VGE unchanged and give it 144 VGEs, or it could purchase a DS3, which has 672 VGEs.[54] Purchasing these circuits as a DS3 would thus more than quadruple the number of VGEs (the vast majority of which the buyer does not need) and, assuming that the price for 6 DS1s was equal to the price for one DS3, reduce by over 75% the computed average revenue per VGE. By averaging the revenue across more than 500 VGEs the customer is not using, the BOCs can claim a price reduction – even though there has been no change in the price of either DS1 or DS3 services. Rather, there simply has been a change in the mix of services.

---

[53] This is not the first time that special access customers have had to debunk the BOCs' attempts to use an average revenue per VGE analysis. As far back as 2003, pre-merger AT&T noted that "calculating revenue per line on a DS0 equivalent [*i.e.*, VGE] basis is fundamentally misleading, because it ignores the fact that the Bells' effective price per DS0 equivalent circuit varies between different kinds of services. In other words, the decline in revenue per DS0 . . . is likely due principally to a changing mix of services." AT&T Reply Comments, RM-10593, at 27-29 (Jan. 23, 2003) (noting that it would be more appropriate to compare rates for the same service over time).

[54] The point at which the price of a DS3 is equal to the price of multiple DS1s is typically between 6 to 8 DS1s for most incumbent LECs.

This per-unit averaging device is no different than a grocer claiming the price of apples is only $0.60 per apple because a customer would be charged $6 for a bundle of ten apples. If a customer only wants an apple a day, and can buy them individually for $1 per apple or as a bundle of 10 for $6, the customer may buy the bundle for $6, but if the uneaten apples are inedible after the seventh day, the customer still only gets 7 edible apples for $6. To the customer, the price per apple is $0.86, while using the incumbent LECs' average revenue methodology, the customer's "price" per apple is $0.60. The Commission should not be fooled by the BOCs' misleading "per-unit" pricing analysis. Like the grocer, AT&T and Verizon are spreading their prices across "apples" that the customer must buy (to lower overall cost) but does not use, which allows AT&T and Verizon to report a lower per-"apple" price and claim they are charging competitive prices.

Use of average revenue per VGE can also yield illusory results by combining the effect of price changes in differing capacity circuits. For example, a change in the price of an OC-48 circuit will have a much larger effect on the computed average revenue per VGE than will a change in the price of a DS1 circuit, simply because the OC-48 circuit represents 32,256 VGEs (compared to only 24 VGEs per DS1).[55] In the case of the grocer example, a change in the price of apples purchased in 500-unit lots will appear to affect more severely the overall average price per apple than would a change in the price of apples bought individually. Assume, for example, that the grocer dropped the price of a box of 500 apples because customers purchasing in those quantities had several different grocers competing to serve them. The grocer could nonetheless raise the price

---

[55] An OC-48 is the equivalent of 48 DS3 circuits, or 32,256 VGEs (48 DS3s times 672 VGEs per DS3 = 32,256 VGEs).

of apples sold individually and still claim that the average revenue per apple had fallen. Consider a simple example: During one week the grocer sold one box of 500 apples for $40 instead of its prior price of $50 and sold seven apples individually at a price of $2 instead of its prior price of $1. In that case, the price for an individual apple would have doubled, but the average revenue per apple would still decline from 11.2 cents to 10.7 cents.

Because higher capacity circuits may be more susceptible to competitive pressures, the BOCs' use of average revenue per VGE may allow them to mix the effects of price changes in large-capacity competitive (*e.g.*, OC-48) and low-capacity non-competitive (*e.g.*, DS1 and DS3) circuits, and make it appear that the price for the smaller, non-competitive circuits is declining even if it is not. In other words, the use of average revenue per VGE can have the effect of indicating that, for example, DS1 prices are decreasing when they are actually increasing.

Limiting the computation of average revenue per circuit to an individual DS1 or DS3 could still show a misleading reduction. If a customer over time changes its network configuration such that it no longer uses as much incumbent LEC "long haul" special access facilities, this will reduce the average revenue received by the incumbent LEC for the entire special access circuit. AT&T and Verizon, however, would take credit for that reduction and claim that their special access prices have declined due to competition when, in fact, the reduction may be due to nothing more than buyers' reconfiguring their networks.

Both AT&T and Verizon claim that their average price for DS1 circuits has declined since 2001.[56] Although AT&T and Verizon may want to attribute those price decreases to competitive market forces, it would be erroneous to assume these DS1 price changes necessarily were due primarily to competition. As an initial matter, in 2001, 2002 and 2003, price-capped DS1 services remained subject to an X-Factor of 6.5%, net of inflation. In addition, since 2001 the incumbent LECs' captive special access customers have been shifting their DS1 and other demand to the incumbent LECs' term and volume discount plans, because they are the only available vehicles for realizing some pricing relief. The effect of this shift has been to lower the average revenue per circuit from preexisting levels, but, again, the Commission should not conclude that these reductions necessarily were driven by competitive pressures. Rather, some of these reductions were caused by X-Factor adjustments while others were driven by the *lack* of competitive alternatives, which forced customers to agree to accept greater term and volume commitments to achieve any price reductions.

For all these reasons, the use of *average* revenue, whether per VGE or per circuit, presents a misleading index of price trends. Actions taken by the customer can make it appear that the price of a circuit has fallen, even if no price has changed, or, indeed, even if all prices have increased. It is precisely in order to avoid this false indication of price changes that most price indices, such as the Commission's Actual Price Index under price caps, or the Consumer Price Index computed by the Bureau of Labor Statistics, use fixed weights to average together price changes. These fixed weights ensure that any change in the index is the result of actual changes in price, not just in the mix of goods that

[56] AT&T Redacted Comments at 22; Verizon Redacted Comments at 12.

purchasers buy. Otherwise, the price index will show a price change even when no individual price has been changed. In sum, the BOCs have chosen pricing analyses that distort reality by creating the appearance of favorable pricing changes.

2. Declines in "real" prices have not kept pace with productivity gains

Claims that special access prices have declined in real terms do not mean, of course, that the rates are just and reasonable. Prices will decline in real terms if they are constant or if they rise by less than the rate of overall inflation. If, for example, overall inflation were running at 2% per year, prices that remained constant would "decline" in real terms by 10.4% over a five-year period. Incumbent LECs historically have achieved productivity gains that have greatly exceeded the average productivity gains realized in the economy as a whole. It is axiomatic that in a competitive market, efficiency gains would be shared with customers.[57] Thus, if special access prices were subject to competitive pressure, one would reasonably expect that those gains would be shared with customers and, consequently, that prices would fall by more than 10.4% in the example above.

Verizon contends that prices for DS1 and DS3 circuits fell in real terms an average of 5.28% and 4.97% per year respectively between 2002 and 2006.[58] For the reasons described above, it would be wrong to assume that these asserted reductions were caused by competitive pressure. In fact, as Sprint Nextel demonstrated in its comments, Phase II pricing flexibility rates that are not subject to X-Factor reductions are higher

---

57 *See, e.g.*, GAO Report at 6.

58 Verizon Redacted Comments at 12, citing Supplemental Declaration of William E. Taylor, Attachment A to Verizon Redacted Comments, ¶ 7 ("Taylor Supp. Decl.").

than capped rates, so these calculated reductions are all the result of regulatory restrictions or of purchaser decisions.

B. The Fact that Demand for Special Access Has Grown Despite Unreasonable Prices and Practices Does Not Mean that Competition Exists nor that Prices Are Reasonable

Verizon also contends that continued growth in both special access and in the services that use special access shows that high special access prices have not had a harmful effect on demand for special access circuits.[59] Such claims entirely miss the point.

First, demand for special access in recent years has been strong, and with the growth in the Internet, wireless telecommunications, and the vast number of other services that use special access, it is hardly surprising that special access demand has continued to grow. But this growth does not prove that special access is priced at economically efficient levels. The relevant question is – how much faster would demand for special access and the services that use it have grown if prices for special access were just and reasonable.

In fact, special access prices are diverting scarce resources from innovators seeking to deploy mobile broadband. Although companies are investing in broadband deployment, the question is how much more money would be invested – and how much faster would these new services be deployed – if funds were not needed to pay unreasonably high special access rates.

Second, carriers need dedicated access services to deploy additional retail services. Thus, the growth in demand for special access reflects only the significant

---

[59] Verizon Redacted Comments at 2-3, 11-12; *see also* AT&T Redacted Comments at 2, 14.

expansion of existing services (*e.g.*, build-out of wireless networks) and growth in new and innovative services. This growth also increases the already alarming extent to which Verizon and AT&T can harm consumers of these services by exploiting their dominance over special access.

C. Robust Competition Among Providers of Downstream Retail Services Does Not Mean that the Upstream Wholesale Market Is Competitive

The intensity of competition among retail service providers, such as wireless carriers, that use special access sheds no light on whether the wholesale special access market is competitive. AT&T and Verizon, as both providers of wholesale special access (to themselves and others) and sellers of the retail services (*e.g.*, wireless, long distance, Internet access) that use special access, have the incentive and ability to use their dominance in the provision of special access to disadvantage their competitors.

First, by charging special access rates that exceed economic cost, AT&T and Verizon can raise their rivals' costs of providing a competing service, such as wireless. To remain competitive with AT&T's and Verizon's wireless affiliates – who face only the economic cost of special access – their rivals must: (a) be able to recover those above-cost rates in their prices to end users; (b) pay less for the other inputs they use; or (c) be more efficient than AT&T and Verizon at combining the inputs they use to provide service. The level of competition in the wireless business will limit the competitors' ability to pass through increases in input prices. Similarly, because other inputs – *e.g.*, labor, plant and equipment – used by wireless companies will be purchased in competitive markets, these companies will not be able to pay less for those inputs.

Thus, only if the competitors are more efficient than AT&T's and Verizon's wireless affiliates will they be able to provide service without having to raise their prices

to reflect inflated special access charges.[60] However, if they are more efficient than AT&T's and Verizon's wireless affiliates, it would be better for consumers if the competitors, rather than AT&T and Verizon, provided service. Thus, above-cost special access rates result either in price increases for end-user customers, or in a less efficient provider (AT&T's and Verizon's wireless affiliates) capturing a larger portion of the market, or both. In either case, consumers are worse off.

1. Competition must be examined on the basis of special access circuit capacities

Sprint Nextel showed previously that the FCC's existing Phase II pricing flexibility triggers are based on improper geographic and product market definitions. In particular, as Dr. Mitchell of CRA International explained in his declaration filed with Sprint Nextel's initial comments, it is critical for the product market to distinguish among special access circuits with different characteristics.[61] Verizon claims that "there is no sense in referring to separate product markets for different speeds of high-capacity service."[62] In his supplemental declaration attached to Verizon's comments, Dr. Taylor states that if an incumbent LEC supplying DS3 special access services increased the price of those services, competitive suppliers of DS1 services could, by reconfiguring their facilities, offer competing DS3 service and thereby prevent the incumbent LEC from

---

60 This problem would not arise if the BOC wireless operations were not affiliated with BOC wireline operations, or if special access rates were set at economically efficient levels. In that case, all wireless competitors would be on an equal footing.

61 Declaration of Bridger M. Mitchell, Attachment 2 to Sprint Nextel Comments, ¶¶ 13-25.

62 Verizon Redacted Comments at 40, citing Taylor Supp. Decl. ¶ 17.

retaining DS3 demand at the higher price.[63] Verizon and Dr. Taylor fail to distinguish the differing supply conditions for DS1 and DS3 services.

Dr. Taylor's flawed analysis fails to recognize that, with the possible exception of areas with considerable demand for high-capacity transmission service, the deployment of competitive DS1 facilities is unlikely. As the Commission, Sprint Nextel, and even Embarq have observed,[64] the demand for channel termination ("CT") DS1 services required by Commercial Mobile Radio Services ("CMRS") providers is too thin outside the central business district to be likely to attract stand-alone entry by competing suppliers. And, as the FCC also noted, where demand for high-capacity loops exists only at the DS1 level of service, there is insufficient traffic for competitive suppliers to enter with DS3 facilities and supply DS1 loops,[65] and the analogous conclusion can be reached for channelized DS1 CTs. Consequently, in such markets the BOC may be the only (or the dominant) provider of DS3 services in those areas and there are very unlikely to be competitive providers of channelized DS1 services that could reconfigure their facilities to provide DS3 CT services and thereby constrain a BOC price increase.

For channel mileage ("CM") services, a correct analysis must similarly distinguish the conditions of supply in terms of transport capacity. On many routes outside the central business district, demand for transport more likely requires DS1 rather

---

63 Taylor Supp. Decl.¶ 47 ("[I]f a hypothetical monopolist of DS-3 services were to attempt to increase the DS-3 price above the competitive level, current suppliers of DS-1 services could use their present network infrastructure to provide DS-3 services and drive DS-3 profits back to a normal level.").

64 *TRRO* ¶¶ 166, 170-171; Sprint Nextel Comments at 14-16; Embarq Comments at 21-23.

65 *TRRO* ¶¶ 166, 170-171.

than DS3 service. In less densely populated areas there will not likely be any competitive DS3 transport providers to constrain the BOC's DS3 CM prices.

Thus, in markets where the demand for high-capacity services is limited and the competitive deployment of DS3 facilities is unlikely, there will be no competitive DS1 constraint on DS3 prices. In such markets, the BOC may be the only, or dominant, provider of DS3 services.

2. Uniform special access rates across a wide region are designed to maximize incumbent LEC profits and discourage competitive entry

AT&T and Verizon claim that, where their special access discount plans offer a uniform pricing structure across a broad geographic area, those plans benefit customers that do not have competitive alternatives, because the prices will be driven by competition in other areas of the region.[66] In other words, AT&T and Verizon claim they are reducing prices in non-competitive markets (*i.e.*, DS1 circuits to cell sites) by, essentially, tying the purchase of these non-competitive services to more competitive services (*i.e.*, OCns in the urban core). There are two flaws in this argument. First, it highlights, once again, that the BOCs lock-in customers of their non-competitive DS1 services by requiring them to buy the more competitive OCns from the incumbent LEC

---

[66] Supplemental Declaration of Parley C. Casto on Behalf of AT&T Inc., attached to AT&T Redacted Comments, ¶ 21 ("Casto Supp. Decl.") ("Customers located in buildings where there may be fewer or no competitive alternatives to AT&T's special access pricing get the full benefits of the intense competition that exists in most other areas. This is because AT&T provides special access under tariffs and contracts that are available to any similarly-situated customer within each particular MSA, state or region."); Verizon Redacted Comments at 7 ("Verizon has accordingly introduced plans that allow customers to aggregate their demand across broad regions or, more recently, the entire country. . . . These plans offer the same special access pricing structures regardless of location within a tariff region, which means that customers get the benefits of competition wherever they purchase service.") (citing Supplemental Declaration of Quintin Lew, Attachment B to Verizon Redacted Comments, ¶ 7 ("Lew Supp. Decl.")).

(rather than, perhaps, another competitor) if the buyer wants to get a more advantageous price for the DS1. Second, to ensure they profit from the "uniform rate," AT&T and Verizon likely will set the price at a level (a) lower than they otherwise might have charged in the non-competitive market (*i.e.*, "lowering" their rates on DS1s) but (b) higher than they otherwise might have charged in a stand-alone competitive market for OCns.

Furthermore, to the extent that AT&T or Verizon has the ability to identify those special access customers that do have readily-available competitive alternatives, they may be able to use contract tariffs selectively to offer them more competitive prices. In this case the uniform price available to all other customers that lack competitive alternatives will be set at an even higher supra-competitive level because the customers with more competitive alternatives have been "removed" by the targeted contracts.

The BOCs also exaggerate the benefits that their "discount" plans offer. First, the "discounts" are based on the so-called "rack" or month-to-month rates, which are excessive. Second, the discounts in some plans do not increase materially, despite the long-term commitments they require from subscribing customers in order to be eligible for the discounts. Verizon's "National Discount Plan," for example, provides for a very modest increase in the discount based on unreasonable month-to-month channel termination rates over a five-year term from 36% to 36.55%.[67] If a customer renewed its agreement for another five-year term, the discount would remain the same at 36.55%. Third, still other discounts are designed to discourage customers from "grooming," *i.e.*, changing the configuration of, their circuits in order to reduce their demand for channel

---

[67] *See, e.g.,* Verizon Tariff FCC No. 1, Section 25.3.5(B)(1) Discount Tier E (found in base tariff filed Aug. 6, 2007).

mileage from the BOCs.[68] All these "discount" plans therefore are designed to "capture" customers, not to pass through savings generated from large volumes sold or from longer term contracts.

3. Supra-competitive BOC prices are not prevented by the threat of competitive entry

AT&T asserts that in MSAs where it has gained pricing flexibility the majority of customer demand is contestable and the ability of potential competitors to enter and supply special access service "would be sufficient to constrain the risk of anticompetitive pricing" even where the vast majority of buildings with demand for a single, or a handful of DS1s, are served over copper facilities.[69] But for markets to be contestable, competitors must be able to enter rapidly and exit without requiring the entrant to absorb unrecoverable costs if it decides to abandon that market.[70] As the comments of TWTC made clear, the sunk-cost requirements of entry into special access are substantial.[71] In these markets, there is no possibility of "hit-and-run" entry to discipline the market power of a BOC to set supra-competitive prices.

Dr. Taylor makes a related claim that the sunk costs of an incumbent LEC supplying special access severely limit any price increase the incumbent LEC might attempt because, were it to raise prices, it would sustain a large loss of volume.[72] First,

---

68 *See, e.g.,* Verizon Tariff FCC No. 1, Section 21.42(J) ("Network Grooms Restriction") (found in base tariff filed Aug. 6, 2007).

69 AT&T Redacted Comments at 52-53 & n.120; *id.* at 53 ("[T]he existence of alternative facilities near a building is more than sufficient to ensure market-based prices even if the building is not currently served by alternative facilities.").

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

71 TWTC/One Redacted Comments at 12-14.

72 Taylor Supp. Decl. ¶ 48.

Dr. Taylor's analysis mistakenly assumes that buyers have an alternative source for their special access services and that they can simply terminate their contract with the incumbent LEC to seek out those competitive services. Second, Dr. Taylor's analysis fails to establish that in areas where the BOC has Phase II pricing flexibility, the BOC's current special access price does not exceed the competitive price and that the BOC is not currently exercising market power. Rather, his analysis indicates only that a potential increase in price from the level of the *current* price *could* be defeated.

Moreover, Dr. Taylor's analysis posits that the variable margin earned on these customers is so high that with a small price increase the loss of even a small number of customers will offset the profits earned from those customers who remain. However, when a firm is maximizing profits, a high margin indicates a relatively low elasticity of demand. Thus, when customers have nowhere else to go for their services, any given percentage change in price results in a relatively small percentage change in the quantity of the service demanded. A high margin (as assumed by Dr. Taylor) then implies a relatively low demand elasticity – consumers are not as responsive to price changes as they would be if the demand elasticity were higher.

As a result, the posited price increase may not, in fact, lead to an actual loss large enough to render the price increase unprofitable. Economists who have examined this situation find that "high margins also tend to imply that the actual loss is small, and thus a price increase might be profitable even when the critical loss [the customer loss required to make a price increase unprofitable] is small."[73]

---

[73] Michael L. Katz and Carl Shapiro, "Critical Loss: Let's Tell the Whole Story," 17 Antitrust ABA 49, 50 (Spring 2003).

4. Effect of near-net facilities

AT&T claims that extending fiber from a fiber ring is quick and easy[74] and Verizon claims that extending fiber to add a building to a fiber network is economical.[75] Mr. Casto, in his 2005 declaration on behalf of SBC Communications (now the new AT&T), claimed that in most MSAs, a large proportion of all special access customers are located near competitive LEC fiber and, furthermore, that competitive LECs could compete for the demand of those customers at low incremental cost.[76] He asserted that "it would be relatively inexpensive and wholly cost effective for a competitor to extend a fiber drop 1000 feet to access DS1 or DS3 demand."[77]

Proximity to competitive LEC fiber, however, does not mean that the location is close to a node that provides access to the competitive LEC's fiber ring. The Sachs Declaration filed with Nextel's 2005 reply comments discussed how mere proximity to competitive LEC fiber fails to account for the frequently substantial costs of connecting data loops to a competitive LEC's existing facilities.[78] Thus, Sprint Nextel would still have to incur the costs of connecting to the competitive LEC node via a new DS1 facility or a leased facility, and these costs can be substantial even if the fiber ring passes close to

---

74 AT&T Redacted Comments at 53; Casto Supp. Decl. at 6 n.3 ("[I]t generally would be relatively inexpensive and wholly cost effective for a competitor to extend a fiber drop 1000 feet to access DS1 or DS3 demand and then rely on existing competitive fiber for the rest of the route.").

75 Verizon Redacted Comments at 20 ("The experience of Verizon Business provides further confirmation that it is economical to extend fiber in many circumstances. . . . [A] lateral of up to one-quarter mile in length in a major urban area can in most cases be constructed for less than $100,000.").

76 Declaration of Parley C. Casto on Behalf of SBC Communications Inc. ¶¶ 15-20 (June 13, 2005) ("Casto 2005 Decl."); Casto Suppl. Decl. ¶ 10.

77 Casto 2005 Decl. ¶ 15; Casto Supp. Decl. at 6 n.3.

78 Declaration of Steven Sachs, Attachment 2 to Reply Comments of Nextel Communications, Inc., ¶ 9 (July 29, 2005).

a Sprint Nextel cell site. By treating these costs as insignificant, Mr. Casto has overstated, perhaps substantially, the possibility that much or most "nearby" fiber is a competitive alternative to the BOCs. Similarly, the GAO's analysis "suggests that wireline facilities-based competition itself may not be a realistic goal for some segments of the market for [special] access,"[79] and certainly the reality of today's special access marketplace indicates that Mr. Casto's assumptions are incorrect.

IV. THE REMEDIES PROPOSED BY SPRINT NEXTEL ARE REASONABLY DESIGNED TO CORRECT THE SPECIAL ACCESS MARKET FAILURE

A. Existing Rates are Not Just and Reasonable

The evidence in this proceeding – including the extensive evidence presented by AT&T in its petition,[80] the evidence presented in 2005 and more recent evidence from the comments refreshing the record – clearly demonstrates that the special access rates charged by AT&T, Verizon and others are not just and reasonable. Pricing comparisons submitted by Sprint Nextel and others demonstrate that Verizon and AT&T Phase II special access rates generally exceed their own price capped rates for the same services and that their price capped rates are well above their economic costs, as shown by the prices that have been established for comparable services based on their forward-looking costs.[81]

---

79 GAO Report at 42.

80 *See, e.g.*, AT&T Petition for Rulemaking, RM-10593, at 7 (Oct. 15, 2002) ("[i]t can no longer be disputed that the Bells' special access rates are unjust and unreasonable").

81 *See, e.g.*, Ad Hoc Comments at 12-14 (pricing flexibility rate is higher than the price cap rate for both DS1 month-to-month and DS3 5-year term in various states); Sprint Nextel Comments at Exhibit 1 (comparing pricing flexibility rates to price cap rates); Sprint Nextel Comments at Exhibit 3 (comparing special access rates to UNE

AT&T seeks to dismiss the importance of the evidence of unreasonable special access rates by claiming that ARMIS earnings and the level of "rack rates" are irrelevant[82] and that special access services are available from "many facilities-based providers, including other fiber-based LECs, cable providers, and broadband wireless providers."[83] AT&T and Verizon further claim that ARMIS data present a distorted view of special access earnings, because the separations freeze in 2001 results in an under-assignment of costs to the Special Access category.[84]

A freeze in the cost allocation factors would cause reported special access earnings to be overstated only if the unfrozen allocation would have been higher. It is not clear that Verizon's or AT&T's cost allocations would have been higher but for the freeze. For example, a portion of the increased investment in fiber and electronics used to provide certain services, such as Verizon's FiOS, appears to have been assigned by the frozen allocators to the special access category even though this investment is not used to provide special access service. In other words, the cost allocations may, in fact, include costs that are not incurred to provide special access, thereby *over*-stating the ARMIS costs.

The incumbent LECs' criticisms of ARMIS also ignore the fact that the Commission in this docket invited those carriers to provide the "correct" allocations of costs, if they believed that the ARMIS allocations were incorrect. The fact that none of the incumbent LECs has done so undermines their objections to ARMIS. Further, as the

---

rates); *see also* GAO Report at 13 (prices are higher, on average, in Phase II MSAs than they are in Phase I MSAs, or in areas still subject to price caps); *see id.* at 27-28.

82 AT&T Redacted Comments at 34-37.

83 *Id.* at 38.

84 *See id.* at 43-44; Verizon Redacted Comments at 44.

FCC observed in the *2005 Special Access NPRM* in this proceeding, ARMIS data, even if imperfect, remain useful for "examining the relationship between demand growth and growth in expenses and investment" in special access.[85]

AT&T dismisses price comparisons submitted in this record, arguing that they are based on "rack rates" and do not account for discounts AT&T offers for longer-term commitments.[86] Contrary to AT&T's assertion, however, Sprint Nextel did not base its comparisons of AT&T special access prices on AT&T's "rack" rates. Rather, those comparisons examine prices offered in five-year discount plans. Thus, Sprint Nextel has demonstrated that even so-called discounted special access rates are well above UNE rates, which are based on forward-looking costs.[87] The price of a special access circuit often is twice the price of a functionally-equivalent circuit at UNE rates.[88]

Finally, as Sprint Nextel explained above, and as others described in their comments in this proceeding, assertions that competitors have installed thousands of miles of fiber optic cable throughout the country do not change the fact that wireless carriers rarely find effective alternatives to AT&T and Verizon when they need links

---

85 *Special Access Rates for Price Cap Local Exchange Carriers; AT&T Corp. Petition for Rulemaking to Reform Regulation of Incumbent Local Exchange Carrier Rates for Interstate Special Access Services*, Order and Notice of Proposed Rulemaking, 20 FCC Rcd 1994, ¶ 29 (2005) ("*2005 Special Access NPRM*"). Sprint Nextel is not advocating that the FCC use ARMIS data for setting rates. *Cf.* Verizon Redacted Comments at 43. The point is that, in the absence of other public data, ARMIS – along with other evidence submitted in the record – all point to the need to reform special access regulation. *See also* Opposition of Sprint Nextel, WC Docket No. 07-21 (March 19, 2007) (opposing AT&T's petition for forbearance from the obligation to submit the very ARMIS data which the Commission has found to be a useful indicator of marketplace performance).

86 *See* AT&T Redacted Comments at 34.

87 Sprint Nextel Comments at 23; *id.* at Exhibit 3.

88 *Id.*

between their cell sites and a serving wire center or between wire centers and their own networks.[89] Thus, none of AT&T's challenges to the evidence of unreasonable special access prices has merit.

AT&T further suggests that the Commission should not even consider initiating a proceeding to bring special access prices to reasonable levels on the ground that it would produce lengthy litigation, uncertainty, and disincentives for AT&T and other incumbents to invest in special access.[90] Clearly, the Commission's statutory obligation to ensure that rates for interstate telecommunications services are just and reasonable precludes it from declining to reform regulation of special access because its decisions may be challenged on review by interested parties. Furthermore, as commenters to this proceeding have shown, the lack of discipline on AT&T's market power has resulted in disincentives for competitors to invest, which in turn harms consumers of both AT&T's and competitors' services.[91]

AT&T and Verizon would prefer that the Commission simply continue to apply the terms of the expired CALLS plan and continue to enforce the Phase II pricing flexibility rules. The expired CALLS plan, however, was expressly designed to remain in effect only for a period of five years, beginning in 2000. At the end of that period, the Commission committed to undertake a review of the intervening marketplace

---

89 *See* Sprint Nextel Comments at 29-33; T-Mobile Comments at 6-7.

90 This is not the first time a BOC has sought to pressure the Commission through the prospect of litigation. *See, e.g.,* Letter from William P. Barr, Executive Vice President, Verizon, to Michael Powell, FCC Chairman, WT Docket No. 02-55 (June 28, 2004). The Commission should not give consideration to these irrelevant threats.

91 *See* Ad Hoc Comments at 6, Gately 2007 Decl. ¶¶ 6-7, and ETI 2007 Study at i, iii & 15-16; COMPTEL Comments at 3-4, 7-8, 11; Covad, *et al.* Redacted Comments at 26-35; Sprint Nextel Comments at 24-29; T-Mobile Comments at 8; TWTC/One Redacted Comments at 35-42; SBA Comments at 8; BT Americas Comments at 10-11.

developments.[92] As the record developed in this proceeding demonstrates, the provision of special access has not become effectively competitive and the predictive judgments on which the pricing flexibility rules are based have proven to be erroneous. AT&T and Verizon are asking that the Commission turn a blind eye to their exploitation of their dominance over special access services and its concomitant harm to consumers.

B. Sprint Nextel's Proposals for Short-Term and Longer-Term Relief Are Reasonable

Sprint Nextel proposed in its comments that the Commission adopt a two-phased approach to reforming the special access charges of the largest BOCs. First, the Commission should take several immediate steps toward moving special access charges to more reasonable levels by: 1) reducing the prices for special access services subject to Phase II flexibility to the levels of equivalent services that remain subject to price cap indices, placing all of those services under applicable price cap indices, and restating the indices at the levels that would have been in effect if a 5.3% X-Factor had been applied in the 2004-07 annual access filings; and 2) repealing the Phase II pricing flexibility rules, pending the adoption of more reliable "triggers" for granting such relief.[93] Second, Sprint Nextel recommended that the Commission: 1) require those BOCs to propose special access rates in the 2008 annual access tariff filing that reflect the forward-looking costs of those services or, alternatively, to set those rates so that they are designed to earn an 11.25% rate of return during the rate year; and 2) apply an X-Factor of 5.3% for the

---

92 *Access Charge Reform*, 15 FCC Rcd. 12962, ¶¶ 36, 166, 178 (2000) ("*CALLS Order*").

93 Sprint Nextel agrees with Ad Hoc that the BOCs should not be limited in their ability to reduce special access rates. Ad Hoc Comments at 23, 26-27.

2008 and subsequent annual access tariff filings, pending the adoption of an updated factor.

AT&T's claim that the Commission has no basis for modifying the current X-Factor ignores the substantial evidence in the record indicating that its productivity gains in recent years have exceeded the rate of inflation. For example, both Ad Hoc and Sprint Nextel submitted updated studies that indicated BOC productivity in recent years has reached double digits.

Dr. Brian Staihr, in a declaration for Embarq, argues that a productivity factor for the incumbent LECs is unnecessary because the incumbent LECs' productivity is not higher than that of companies in the economy as a whole. Dr. Staihr attempts to demonstrate this by comparing a productivity index computed by the Bureau of Labor Statistics ("BLS") for wired telecommunications to similar BLS productivity indices for the broader economy. Since the indices are roughly the same, Dr. Staihr concludes that no X-Factor is needed in the price cap plan.[94]

Dr. Staihr's analysis is flawed. First, the indices he compares are all measures of output per unit of labor, *i.e.*, labor productivity measures. The Commission has never endorsed the use of labor productivity measures in computing the X-Factor. Since the telecommunications industry is highly capital intensive, use of such an index would ignore the constant improvements in electronics and other equipment that are used in the provision of special access services. It was precisely to capture the productivity improvements that were provided by all inputs – labor, capital, and materials – that the Commission adopted Total Factor Productivity ("TFP") to measure incumbent LEC

---

[94] *See* Declaration of Dr. Brian K. Staihr, Attachment 1 to Embarq Comments, at 8-11.

productivity. That methodology shows that incumbent LEC productivity exceeds the productivity of other firms in the economy. As the revised TFP study submitted by Sprint Nextel showed, the incumbent LECs continue to have much higher productivity than other firms in the economy.[95] Thus, use of an X-Factor of at least 5.3% is entirely justified and is likely to be vastly understated.

Sprint Nextel's recommendation that the Commission adopt 5.3% as an interim X-Factor pending the adoption of a more recent measure of the BOCs' productivity performance is a reasonable and incremental approach to moving special access rates to reasonable levels. The D.C. Circuit previously has approved the Commission's use of that factor, which was derived from the performance of the incumbent LEC industry as a whole during a period when incumbent LECs experienced far lower rates of growth in special access revenues than they have enjoyed over the past several years.[96] As Sprint Nextel explained in its initial comments, to the extent that AT&T and Verizon have been able to increase their revenues from special access by large amounts while their special access expenses grew much more slowly and their net special access investment declined, it would appear that these companies have achieved significant productivity gains.[97] Moreover, the Commission explicitly stated in the *2005 Special Access NPRM* that one of its options for interim relief in this proceeding would be "to impose the last productivity factor, 5.3%, that was adopted by the Commission and judicially upheld."[98] In addition,

---

95 Sprint Nextel Comments at 19-20; *id.* at Exhibit 2.

96 *See Price Cap Performance Review for Local Exchange Carriers*, First Report and Order, 10 FCC Rcd 8961, 9054-58 (1995), *aff'd sub nom. Bell Atlantic Tel. Cos. v. FCC*, 79 F.3d 1195, 1201, 1208 (D.C. Cir. 1996).

97 Sprint Nextel Comments at 9-10.

98 *2005 Special Access NPRM* ¶ 131.

courts have repeatedly affirmed the Commission's discretion to fashion an interim remedy pending its completion of a proceeding to adopt more permanent measures.[99]

Sprint Nextel's proposal for longer-term relief is similarly a sensible method for ensuring that special access rates do not exceed reasonable levels. AT&T complains that resetting special access rates to earn an 11.25% rate of return would represent a return to rate-of-return regulation.[100] Sprint Nextel's proposal, however, does not include applying an 11.25% rate of return on a going-forward basis; rather, Sprint Nextel's solution would simply "reset" the rates to that reasonable level and then apply an incentive-based regime to those rates going forward. Moreover, AT&T could avoid resetting its special access charges to earn an 11.25% rate of return by proposing rates that are designed to recover the forward-looking costs of those services, a pricing standard that the Commission has previously endorsed.[101] Since AT&T currently provides unbundled loops and transport to

---

[99] *See, e.g., CompTel v. FCC*, 309 F.3d 8, 14-15 (D.C. Cir. 2002) (upholding interim restrictions on the unbundling of EELs); *MCI v. FCC*, 750 F.2d 135, 141 (D.C. Cir. 1984) (upholding FCC's interim freeze of the subscriber plant factor); *ACS of Anchorage, Inc. v. FCC*, 290 F.3d 403, 408, 410 (D.C. Cir. 2002) (upholding FCC's interim jurisdictional classification of ISP-related costs for purposes of advancing a "substantial policy objective").

[100] AT&T Redacted Comments at 30-33; 59-60. As Ad Hoc notes, if the Commission were to represcribe a rate of return for interstate services, it is likely that the rate would be significantly less than the 11.25% that was set at a time when debt and equity costs were higher than currently prevailing levels. Ad Hoc Comments at 24.

[101] *Review of the Commission's Rules Regarding the Pricing of Unbundled Network Elements and the Resale of Service by Incumbent Local Exchange Carriers*, Notice of Proposed Rulemaking, 18 FCC Rcd 18945, ¶ 2 (2003); *see also Implementation of the Local Competition Provisions in the Telecommunications Act of 1996; Interconnection Between Local Exchange Carriers and Commercial Mobile Radio Service Providers*, First Report and Order, 11 FCC Rcd 15499, ¶ 672 (1996). The Supreme Court upheld the Commission's forward-looking TELRIC methodology as reasonable under the Communications Act. *Verizon Communications Inc. v. FCC*, 535 U.S. 467, 523 (2002).

requesting carriers at rates that reflect the forward-looking costs of those elements, compliance with that option would not impose an onerous burden.[102]

Finally, AT&T contends that the Commission should not attempt to determine the current productivity performance of incumbent LECs because it would require a complex, vigorously contested proceeding. The fact that such an undertaking would require the agency to assess competing estimates of the incumbents' performance and to use its expert judgment in reaching a reasoned determination, of course, is not a basis for declining to initiate such a review. This is especially true, given that special access has grown to account for more than half of the BOCs' interstate telecommunications revenue,[103] and given the importance of special access as a key input to the deployment of wireless broadband and other innovative services. Moreover, in addition to prescribing an updated X-Factor, the Commission must also use that proceeding to adopt more accurate and reliable triggers for granting Phase II pricing flexibility and to scrutinize the exclusionary pricing practices that the BOCs use in connection with Phase I plans to deter competitive entry.

---

102 UNE rates have been set in contested proceedings before state commissions in which the BOCs actively participated.

103 2006 FCC ARMIS Report 43-01, Table 1 – Cost and Revenue, Row 1090, comparing special access revenue in Column (s) to interstate revenue in Column (h).

V. CONCLUSION

For the reasons discussed above, the Commission must act immediately to constrain the BOCs', and in particular AT&T's and Verizon's, market power, by adopting the remedies proposed by Sprint Nextel.

Respectfully submitted,

/s/ Laura H. Carter

Laura H. Carter
Vice President, Government Affairs

Anna M. Gomez
Vice President, Government Affairs

J. Christopher Frentrup
Director, Government Affairs

Sprint Nextel Corporation
2001 Edmund Halley Drive
Reston, VA 20191
703-433-4143

A. Richard Metzger, Jr.
Gil M. Strobel
Lawler, Metzger, Milkman & Keeney, LLC
2001 K Street, NW, Suite 802
Washington, D.C. 20006
(202) 777-7700
Counsel for Sprint Nextel Corporation

August 15, 2007

Certificate of Service

I, Ruth E. Holder, hereby certify that on this 15th day of August, 2007, I caused true and correct copies of the foregoing Reply Comments of Sprint Nextel Corporation to be mailed by electronic mail to:

Margaret Dailey
Pricing Policy Division
Wireline Competition Bureau
Federal Communications Commission
445 12th Street SW, Room 5-A232
Washington, DC 20554
Margaret.Dailey@fcc.gov

Best Copy and Printing, Inc. (BCPI)
Portals II, 445 12th Street SW, Room CY-B402
Washington, DC 20554
fcc@bcpiweb.com

/s/ Ruth E. Holder
Ruth E. Holder