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October 24, 2007

Via Electronic Filing

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

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

Dear Ms. Dortch:

On October 24, 2007, Anna Gomez of Sprint Nextel Corporation ("Sprint Nextel"); Christopher J. Wright of Harris, Wiltshire & Grannis, LLP, outside counsel to Sprint Nextel; and A. Richard Metzger, Jr., Lawler, Metzger, Milkman & Keeney, LLC, outside counsel to Sprint Nextel, met with Chris Moore, Legal Advisor to Commissioner Tate. During the meeting, Sprint Nextel described the harms caused by the lack of competition for special access services and urged the Commission to revise its price cap and pricing flexibility rules for special access in the manner described in the company's October 5, 2007 written *ex parte*. Sprint Nextel noted that, although Verizon has argued that Commission action is unnecessary because it is subject to price caps in most metropolitan statistical areas, Verizon has publicly stated that more than half of its special access revenues are not subject to regulation.[1] The discussion of special access competition and proposed remedies was consistent with the attached materials, which Sprint Nextel handed out during the meetings.

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[1] Verizon Communications Inc., Quarterly Report (Form 10-Q), at 40 (July 31, 2007) (stating that "[m]ore than half of special access revenues are now removed from price regulation.")

This letter and attachments are being submitted for inclusion in the record of the above-referenced proceeding in accordance with the Commission's rules.

Sincerely,

Gil M. Strobel

cc: Chris Moore (w/out attachments)

Attachments

October 5, 2007

Via Electronic Filing

Ms. Marlene H. Dortch
Secretary
Office of the Secretary
Federal Communications Commission
445 12th Street, S.W., Room TW-A325
Washington, DC 20554

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

Dear Ms. Dortch:

Sprint Nextel Corporation ("Sprint Nextel") urges the Federal Communications Commission ("Commission" or "FCC") to act expeditiously to stop incumbent local exchange carriers ("incumbent LECs") – in particular, AT&T Corporation ("AT&T") and Verizon Communications ("Verizon") – from exploiting their market power in the provision of special access services. The record before the Commission clearly demonstrates that the special access market has failed. This market failure continually and increasingly harms consumers and competition. The Commission has an explicit statutory obligation to act now to reform its regime for regulating the provision of special access services. Sprint Nextel submits the attached paper, which explains in detail its proposed remedies, as well as the Commission's legal authority to adopt them.

The Special Access Market Failure has Resulted in Unjust and Unreasonable Special Access Rates and Practices

The failure of competition to discipline the prices and practices of price cap LECs in the provision of special access services, as well as the failure of the Commission's current regulatory regime to reduce appropriately the price cap indices for the last three years, are well-documented in the record of this proceeding. First, the record contains substantial evidence that special access prices, both those under price cap regulation and those subject to Phase II pricing flexibility, are significantly higher than comparable unbundled network element prices and many times the prices for comparable services offered in competitive broadband markets.[1]

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[1] *See, e.g.,* Comments of Sprint Nextel Corporation at 22-24 and Exhibit 3 (Aug. 8, 2007) ("Sprint Nextel Comments"); *ex parte* presentation attached to letter from Anna M. Gomez, Sprint Nextel, to Marlene Dortch, FCC Secretary, at 11 (Aug. 22, 2007) ("Sprint

For example, as Verizon acknowledges, the transmission speeds of DSL and FiOS are "comparable to or greater than DS1 facilities."[2] Yet, despite these similarities, the monthly prices for DSL, cable modem service and Verizon FiOS are approximately $30 to $40, while incumbent LECs charge $390 per month for a DS1 special access circuit.[3] Although differences between special access services and the other broadband services may justify some price differential,[4] the differences are not sufficient to justify a *ten-fold* price differential.[5]

Second, special access purchasers, such as providers of competing wireless, Internet access and broadband services, as well as enterprise customers, remain heavily reliant on incumbent LECs, and price cap LECs in particular, for special access, frequently for more than 90 percent of their special access purchases.[6] Rather than losing customers to competing providers, the incumbent LECs' share has grown.[7] In 2001, the incumbent LECs enjoyed a 92.7 percent share of the special access market; by 2005, the incumbent LECs' share had grown to 94.1 percent – of an even larger market.[8]

Nextel Aug. 22 *Ex Parte*") (comparing prices for AT&T Elite DSL, Verizon Power Plan DSL, Time Warner Road Runner, and Verizon FiOS to the average price charged across nine states for a DS1 circuit (2 channel termination and 10 miles of transport) under a five-year term plan). (Unless otherwise indicated, all filings cited herein are found in WC Docket No. 05-25.)

2 Reply Comments of Verizon at 35 (Aug. 15, 2007) ("Verizon Reply Comments").

3 Sprint Nextel Aug. 22 *Ex Parte* at 11.

4 Verizon Reply Comments at 10 ("[A] DS1 provides a guaranteed level of service, while DSL and FiOS generally provide best efforts Internet access.").

5 *See also* Comments of BT Americas at 16-17 and Attachment A (Aug. 8, 2007) (demonstrating that special access prices in the United States are materially higher than prices for similar services in the United Kingdom).

6 Sprint Nextel Aug. 22 *Ex Parte* at 3, *citing* FCC Universal Service Monitoring Report, Table 1.5 and Telecommunications Industry Revenue Report, Table 5 (2005 percentage adjusted to include pre-merger AT&T and pre-merger MCI in-territory revenue in the ILEC percentage). Commenters have explained that they purchase more than 90 percent of their DS1 and DS3 circuits from incumbent LECs. *See* Sprint Nextel Comments at 30; Comments of Ad Hoc Telecommunications Users Committee at 8 n.10 (Aug. 8, 2007) ("Ad Hoc Comments"); Comments of T-Mobile USA, Inc. at 6 (Aug. 8, 2007) ("T-Mobile Comments").

7 Although opponents provide lists of competitors, the more relevant fact is that competitors' collective share of special access revenues has declined since 2001. *See* Sprint Nextel Aug. 22 *Ex Parte* at 3.

8 *Id.*

Sprint Nextel continually searches for alternatives to incumbent LECs, but it has found alternative providers for only a very small portion of its special access needs. Specifically, Sprint Nextel purchases nearly 98 percent of its DS1 connections from incumbent LECs in the top 50 Metropolitan Statistical Areas ("MSAs").[9] T-Mobile similarly explained that incumbent LECs are its "sole source" of special access services at virtually all of its cell sites.[10] Given a choice, neither carrier would purchase from AT&T or Verizon, their two largest wireless competitors.

Third, competition is not putting downward pressure on special access prices, either for services still subject to price cap indices or for those subject to Phase II flexibility. Because the Commission's current X-factor for special access is set to equal the rate of inflation, it does not require reductions in the price cap indices or the prices subject to those indices. Consequently, incumbent LECs are not reducing their price capped prices below the applicable indices, but instead are pricing at the cap. Where the incumbent LECs have obtained pricing flexibility, prices frequently are even higher.

Although price cap incumbent LECs claim that their per-line special access revenues are falling, these claims are based on averaging the revenue amounts across all special access product categories. This approach masks the high prices they charge for the services that face little or no competition. Significantly, these carriers declined the Commission's invitation to submit calculations of: 1) an Average Price Index for all price capped and price flex special access services; 2) a Service Basket Index ("SBI") for each special access service category and subcategory; and 3) the revenues associated with the Average Price Index and SBIs.[11] Those calculations would have revealed the overall change in the prices for the services included in the baskets.

Finally, the price cap LECs' own Automated Reporting Management Information System ("ARMIS") data show that the price cap LECs are earning returns for their special access services far beyond the returns they would earn in a competitive market. The Commission cannot ignore the data these carriers themselves file.

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[9] *Id.* at 5. For example, in Chicago, Sprint Nextel purchases 99.4 percent of special access circuits from the incumbent LEC, while in New York that number is 95.7 percent and in Boston it is 97.9 percent. *Id.*

[10] T-Mobile Comments at 6.

[11] *Special Access Rates for Price Cap Local Exchange Carriers; AT&T Corp. Petition for Rulemaking to Reform Regulation of Incumbent Local Exchange Carrier Rates for Interstate Special Access Services*, WC Docket No. 05-25, RM-10593, Order and Notice of Proposed Rulemaking, 20 FCC Rcd 1994, ¶ 76 (2005) ("*NPRM*").

High Special Access Prices Harm Consumers and Deter Broadband Deployment

A particularly pernicious effect of the current unjust and unreasonable special access rates is that they deter the deployment of innovative, competitive broadband networks. The prices of the critical special access services that competitive broadband providers need to provide service are inflated. These inflated special access prices serve as a barrier to broadband deployment. As Chairman Markey noted in his recent letter to the Commission, "unduly high prices may force carriers to expend funds on special access that would be better spent on upgrading their networks to provide broadband services."[12] Special access represents approximately 33 percent of Sprint Nextel's costs to operate a cell site, a figure that is at least twice what it would be if special access prices were related to cost. The excessive special access prices divert funds from Sprint Nextel's deployment of its fourth-generation broadband network and, in many cases, subsidize Sprint Nextel's wireless competitors.

Sprint Nextel is not the only carrier whose competitive broadband deployment is delayed by high special access prices.[13] T-Mobile, another unaffiliated wireless broadband provider, has raised similar concerns, stating that "[c]onsumers 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."[14] Rural incumbent wireline carriers also have called on the Commission to reduce the price of the special access services they

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[12] Letter from The Honorable Edward J. Markey, Chairman, House Subcommittee on Telecommunications and the Internet, to Kevin J. Martin, Chairman, Michael J. Copps, Commissioner, Jonathan S. Adelstein, Commissioner, Deborah Taylor Tate, Commissioner, and Robert M. McDowell, Commissioner, Federal Communications Commission, at 2 (May 23, 2007), *available at*: <http://markey.house.gov/index.php?option=com_content&task=view&id=2859&Itemid=46>.

[13] *See, e.g.,* Reply Comments of Clearwire Corporation at 6 (Aug. 15, 2007) ("If the Commission declines to address the current and increasingly serious market failure in the provision of special access, the future success and availability of alternative wireless broadband networks and other wireless services could be substantially hindered."); Comments of Mobile Satellite Ventures Subsidiary LLC at 1-3 (Aug. 15, 2007); Comments of Time Warner Telecom, Inc., GN Docket No. 07-45, at 11-12 (May 16, 2007) (explaining that there is "evidence that ILECs are exploiting their control over bottleneck end user connections to control the pace at which competitors roll out next-generation facilities, thereby frustrating the goals of Section 706," which mandates the deployment of advanced services to all Americans); Reply Comments of BT Americas, GN Docket No. 07-45, at 15 (May 31, 2007) ("The result of . . . premature deregulation [of broadband infrastructure bottlenecks] has been the dramatic decline in competition and with that a decline in broadband investment and innovation").

[14] T-Mobile Comments at 8.

need to access the Internet backbone. These rural LECs note, specifically, that "smaller rural carriers who rely on three or fewer Internet backbone transport providers could find themselves forced to delay service expansion or increase retail broadband prices due to increased Internet backbone transport costs."[15]

Finally, consumer representatives also have sounded the alarm about the adverse effect of high special access pricing on consumers and on broadband deployment.[16] As Consumers Union wrote to House Energy and Commerce Committee Chairman John Dingell, "[t]o be clear, consumers pay for these excessive ILEC special access overcharges, through higher rates, lost competition, and lost innovation."[17] And, as the New Jersey Rate Counsel reiterated in its most recent comments in Docket No. 05-25, "[a]ccurate pricing signals for ILECs' non-competitive special access circuits is essential to permit the economically efficient development of a multi-modal ubiquitous advanced telecommunications network. Artificially high special access rates are jeopardizing the Commission's ability to achieve its broadband deployment goals."[18]

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[15] Reply Comments of National Telecommunications Cooperative Association, WC Docket No. 06-125, at 4 (Aug. 31, 2006) (describing the consequences if the Commission grants forbearance for special access services, specifically, for access to the Internet backbone); *see also* Comments of the Organization for the Promotion and Advancement of Small Telephone Companies, WC Docket No. 06-125, at 6 (Aug. 17, 2006) ("It is essential that rural ILECs have access to the Internet backbone at just, reasonable, and nondiscriminatory rates and terms in order to provide their customers with high-quality, affordable advanced services.").

[16] Reply Comments of the New Jersey Division of Rate Counsel at 5 (Aug. 15, 2007) ("To deny the mismatch that now exists between lax regulation and exorbitant rates would harm consumers and thwart efficient investment in the nation's telecommunications infrastructure."); Reply Comments of the National Association of State Utility Consumer Advocates, GN Docket No. 07-45, at 15 (May 31, 2007) ("NASUCA recommends that the Commission heed Sprint's concern about the dampening effect of high special access rates on broadband deployment goals."); Reply Comments of National Association of State Utility Consumer Advocates (Aug. 15, 2007) ("None of this is good for competition or good for consumers."); *see also, e.g.*, Ad Hoc Comments at 7-8; Comments of the American Petroleum Institute at 6-9 (Aug. 8, 2007).

[17] Letter from Chris Murray, Senior Counsel, Consumers Union, to the Honorable John Dingell, Chairman, Committee on Energy and Commerce, United States House of Representatives (Oct. 1, 2007), appended to the attached paper as Exhibit A.

[18] Comments of the New Jersey Division of Rate Counsel at 16-17 (Aug. 8, 2007), *quoting* Reply Comments of the New Jersey Division of Rate Counsel, GN Docket No. 07-45, at 14 (May 31, 2007).

The Commission Has a Statutory Obligation to Ensure that Special Access Rates, Terms, and Conditions are Just, Reasonable, and Not Unduly Discriminatory

The Commission has a continuing, unequivocal statutory obligation to ensure that the rates, terms, and conditions of interstate telecommunications services are just, reasonable, and not unduly discriminatory.[19] The public interest demands that the Commission fulfill that obligation.

Section 706 of the Communications Act also directs that the Commission "encourage the deployment on a reasonable and timely basis of advanced telecommunications capability to all Americans . . . by utilizing, in a manner consistent with the public interest, convenience, and necessity, [*inter alia*] price cap regulation."[20] As Congress explicitly recognized, price cap regulation is an appropriate tool to encourage the deployment of advanced telecommunications services. In light of the Commission's obligations to ensure just and reasonable rates and to encourage the deployment of advanced – broadband – services, the Commission must adopt the remedies outlined below.

The Commission Must Reform Its Incentive-Based Regime for Special Access Services Provided by Price Cap LECs

The Commission commenced its current examination of its special access rules in 2005 to address two general issues: 1) what, if any, regulations should apply to the provision of interstate special access by price cap incumbent LECs after the Coalition for Affordable Local and Long Distance Services ("CALLS") Plan[21] expired in July 2005; and 2) whether the standards that the Commission adopted in 1999 to relax its regulation of special access services in certain areas had proven to be reliable predictors of nascent competition sufficient to constrain the practices of price cap LECs.

As to the first issue, as summarized above, the record clearly establishes that the Commission should update its existing incentive-based scheme for regulating special access services offered by price cap LECs. Price cap LECs continue to enjoy substantial economies of scale in the provision of special access, even though the Commission anticipated in 1999 that they were likely to experience significant competitive losses to new entrants. Instead, as noted, wireless carriers, large businesses and other special access customers have become more dependent on price cap LEC special access services.

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19 47 U.S.C. §§ 201(b), 202(a).

20 Title VII, § 706(a) of the Telecommunications Act of 1996, Pub. L. 104-104, 110 Stat. 153 (1996), reproduced in the notes under 47 U.S.C. § 157.

21 *See Access Charge Reform*, Sixth Report and Order in CC Docket Nos. 96-262 and 94-1, Report and Order in CC Docket No. 99-249, Eleventh Report and Order in CC Docket No. 96-45, 15 FCC Rcd 12962 (2000).

The Commission must base its decisions on the current state of competition, rather than on predictions. Forecasts that the marketplace *is about* to undergo dynamic changes because of the deployment of broadband 4G networks by wireless carriers and other developments that *may* increase demand for special access are not the same as competition. Even if competition were to begin to take hold on a widespread basis, given the incumbent LECs' current market share, it would take significant time before the special access market became effectively competitive.

To fulfill its statutory obligation to ensure that rates and practices are just and reasonable, the Commission must update its incentive-based pricing mechanism for special access services. The current mechanism does not ensure reasonable rates because it allows price cap LECs to set prices that reflect neither competitive pressures nor productivity gains. Rates for special access services, like DVDs or digital televisions and other high-tech goods and services, should be declining, rather than staying the same or increasing.

The Commission, therefore, should adopt a new X-factor that reflects the superior productivity gains of the price cap LECs as compared to the economy as a whole. Until the Commission determines the appropriate X-factor, it must move current special access rates to just and reasonable levels by adopting the previously-approved X-factor of 5.3 percent. This interim X-factor represents a conservative yet reasonable estimate of the price cap LECs' ongoing annual productivity gains. Use of that factor, on an interim basis, pending adoption of a more permanent factor, would enable the Commission to ensure that the some of the productivity gains realized by the price cap LECs are shared with special access customers while providing an incentive for continued efficiency gains.

The Commission should also require price cap LECs to restate immediately their special access Price Cap Indices ("PCIs") to the levels they would have been if the LECs had applied a 5.3 percent X-factor in their July 2004 and subsequent annual access tariff filings. Sprint Nextel does not propose that the price cap LECs refund the billions of dollars in special access overcharges received by the price cap LECs. Rather, Sprint Nextel urges the Commission to ensure that, going forward, the price cap indices reflect at least some of the reductions in cost that these LECs have enjoyed over the past few years. This conservative approach permits the incumbents to retain their overearnings, but at least imposes a check on their market power prospectively.

As a longer term check on rates, the Commission should also direct the price cap LECs to revise their special access rates, effective July 1, 2008, using one of the following methods: 1) retarget special access rates to generate a rate of return of 11.25 percent on a total (switched and special) interstate basis, based on historic ARMIS[22]

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[22] Although some parties oppose the use of ARMIS data to establish special access rates, it would not be unlawful for the Commission to do so. In the absence of other

costs; 2) reset special access rates so that they recover the forward-looking costs of the services involved; or 3) reset special access rates so that they recover the costs of special access based on historic costs, as modified by the price cap LECs to rectify perceived flaws in ARMIS.

The Commission Must Replace the Current Regulatory Flexibility Triggers

In 1999, the Commission based its "anticipatorily deregulatory rules"[23] on its "predictive judgment" that its competitive triggers would measure the presence of "sufficient competitive market entry in specific geographic markets to constrain monopoly behavior."[24] The pricing flexibility triggers, however, have proven to be unreliable predictors. They are based on "an admittedly imperfect measure of competition"[25] and fail to determine whether effective competition constrains the LECs' market power.

As the former AT&T argued, "[t]he Commission adopted its aggressive deregulation of the Bells' special access services based on a predictive judgment that competition would provide sufficient safeguards to protect against the Bells' exercise of monopoly power over special access customers. Years of data now confirm that the Commission's predictive judgment was wrong."[26] The record in this proceeding has proven that, five years after the former AT&T made this argument, very few customers in a very few areas have a choice of alternative providers, even where price cap LECs have obtained Phase II pricing flexibility.

The Commission has the statutory authority and obligation to rectify its erroneous predictions. To ensure that special access rates are reasonable, the Commission must repeal its Phase II pricing flexibility rules and place services now subject to Phase II pricing flexibility under price cap regulation. The Commission should seek comment on new, more accurate triggers in a Further Notice of Proposed Rulemaking. The public policy goal of the new triggers should be to encourage efficient competitive entry and

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public data, ARMIS is the best available cost information. Furthermore, despite the explicit invitation of the Commission to do so, the price cap LECs have failed to provide their views as to the "correct" allocations of cost.

23 *NPRM* ¶ 69 (citing *Access Charge Reform*, Fifth Report and Order and Notice of Proposed Rulemaking, 14 FCC Rcd 14221, ¶ 154 (1999) ("*1999 Pricing Flexibility Order*").

24 *NPRM* ¶ 69.

25 *WorldCom, Inc. v. FCC*, 238 F.3d 449, 459 (D.C. Cir. 2001).

26 *AT&T Corp. Petition for Rulemaking to Reform Regulation of Incumbent Local Exchange Carrier Rates for Interstate Special Access Services*, RM-10593, Petition for Rulemaking at 38 (Oct. 15, 2002).

eventually eliminate unnecessary price cap controls where effective competition provides alternatives to special access customers.

The Commission Should Adopt a Sunset to the Price Cap Rules

In keeping with one of its core obligations under the Communications Act of 1934 to ensure rates are just and reasonable, as well as the pro-competitive goals of the Telecommunications Act of 1996, the Commission must immediately address the special access market failure. Once competition develops and can ensure just and reasonable rates, terms and conditions, price cap regulation will no longer be necessary. Therefore, the Commission should sunset its price cap regulation of special access services ten years from the date that the interim reforms take place. Ten years should provide sufficient time for competition to develop. Because prior predictions of such competitive entry have proven inaccurate, however, the Commission should initiate a proceeding twenty-four months prior to the scheduled expiration of its rules, to determine if, in fact, effective competition has developed.

Conclusion

The Commission must act immediately to curb the harmful effects of the price cap LECs' exploitation of their market power over special access. Special access is a critical input to most consumer communications services. The attached paper describes the steps the Commission must take to address the failure of competition to develop to discipline the pricing and other practices of price cap LECs, as well as the Commission's legal authority to do so. Collectively, these actions should move special access prices to reasonable levels, encourage efficient competitive entry, and relax regulatory controls as competition supplants the need for such safeguards. The sunset that Sprint Nextel proposes also ensures that the Commission will deregulate when competitive forces can "regulate" the market. The Commission must act today, for the good of consumers, and to ensure the rapid introduction of new services and deployment of broadband.

Respectfully submitted,

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Attachment