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May 18, 2009

EX PARTE

Ms. Marlene Dortch
Secretary
Federal Communications Commission
4454 12th Street, SW
Washington, DC 20554

Re: 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

Dear Ms. Dortch:

The Commission initiated a rulemaking proceeding more than four years ago to examine whether the rules on the pricing of special access services needed revision. It has yet to adopt an order in that proceeding. Now USTelecom and Verizon are asking the Commission to further delay the process by initiating an extensive data collection that is both unnecessary and would, as explained below, distort the facts. COMPTEL urges the Commission to instead give immediate attention and priority to the special access docket and quickly heed the calls from carriers and non-carriers alike to issue rules resetting, and in particular reducing, the special access rates incumbents are permitted to charge. The Commission cannot continue to allow the pricing of special access services to go unaddressed, as the repercussion are far too great.

Special access is a multi-billion dollar service industry, the price and quality of which has an immense impact on our economy. Virtually all other telecommunications and information services are dependent on special access.¹ Special access is also a critical input for non-carrier enterprise customers who use it for a wide variety of products and services such as the sending and receiving of financial transaction data.² It has been estimated that fixing special access pricing can be expected to result in a savings

¹ See SBC Communications Inc. and AT&T Corp. Applications for Approval of Transfer of Control, Memorandum Opinion and Order, 20 FCC Rcd. 18290, ¶ 24 (2005).

² See Comments of the Special Access Coalition, WC Docket No. 06-74, DA-06-2035, p.2 (2006).

to business customers of \$22.7 million *per day*³ – an amount of savings that is crucial in today’s economy. Economics and Technology, Inc., in 2007, predicted that during the period of 2007 through 2009 properly regulated special access rates would have allowed the U.S. Economy to grow by 234,000 new jobs and \$66 billion in GDP.⁴ Indeed, a consumer representative testified before Congress that if the dominant carriers can continue to overcharge for special access lines, “this broken market will ensure a slowed economic recovery for all but one small sector of our economy.”⁵

Special access also provides the high-bandwidth broadband connections to commercial buildings and cell towers, including the backhaul wireless carriers need to provide residential wireless broadband services. As Congressman Waxman, Chairman of the Committee on Energy and Commerce, recently stated: “[P]ro-competitive policies in the Special Access market *are essential* to maximize choice, affordability, and technological innovation in the broadband market.”⁶ If the Commission is serious about expanding the use of broadband services it must address the exhorbiant pricing of special access services that result from the ILEC dominance of the market. Ensuring reasonable rates for special access services will enable more competitors to enter the broadband market and allow existing ones, dependent on the ILEC special access services, to provide additional bandwidth and value to end-user customers and, consequently, promote choice and affordability in broadband services. As stated by the VON Coalition, and echoed by numerous others, including a state public service commission, “[e]xcessive special access rents significantly impair wireless and wireline broadband deployment and pricing levels.”⁷

³ Comments of the Ad Hoc Telecommunications Users, WC Docket 05-25, p. 6 (Aug. 8, 2007).

⁴ Lee. L. Selwyn *et al.*, Economics and Technology, Inc., Special Access Overpricing and the US Economy: How unchecked RBOC Market Power is Costing US Jobs and Impairing US Competitiveness, at iii (Aug. 2007)(“ETI Study”).

⁵ Testimony of Chris Murray, on behalf of Consumers Union, Consumer Federation of America, Free Press and Public Knowledge, Before the U.S. House of Representatives Subcommittee on Communications, Technology and the Internet, Committee on Energy and Commerce, p. 8, May 7, 2009 (“Murray Testimony”).

⁶ Opening Statement of Rep. Henry A. Waxman, Chairman, Committee on Energy and Commerce, “An Examination of Competition in the Wireless Industry,” Before the Subcommittee on Communications, Technology, and the Internet, p. 2, May 7, 2009 (emphasis added).

⁷ Letter from Birta D. Strandberg, Counsel to the Voice on the Net Coalition, to Marlene Dortch, FCC, CC Docket No. 01-92, WC Docket Nos. 04-36 and 05-25, p. 7 (Oct. 2, 2008). *See also*, NTCA Comments, GN Docket No. 09-40, DA 09-668, p.9 (Apr. 9, 2009)[“When [] carriers must purchase special access services at above cost rates, customers eventually will see these higher costs included in the broadband rates.”];

AT&T, for one, acknowledges that high-speed broadband services can improve the lives of Americans and stimulate the economy, but contends that regulation of the ILEC rates on special access will “destroy” incumbent LECs incentive to invest in new infrastructure, is the “path to broadband failure” and is at odds with “establish[ing] the United States as the undisputed broadband leader.”⁸ Yet, the Commission’s allowance of AT&T and Verizon to continue to gouge other carriers and business end-users seems to only have led to the extraordinary profitability of AT&T and Verizon, not the US broadband leadership. Indeed AT&T, Verizon and Qwest have had pricing flexibility since 2000 – a time when the United States was ranked fifth among the world’s nations in broadband penetration – and since then the United States has dropped to 22nd place.⁹ Meanwhile, AT&T and Verizon are ranked *seventh* and *sixteenth* on Fortune 500’s 2009 list of *most profitable companies* during a crumbling economy, with 2008 profits of \$12.87 billion and \$6.43 billion, respectively.¹⁰ The simple fact is that, so long as the ILECs earn a normal rate of return, they will have incentive to invest. They do not need to charge supracompetitive rates to have motive to invest in infrastructure. Indeed,

Comments of the Michigan Public Service Commission, GN Docket No. 09-40, p. 4 (Apr. 13, 2009)[“...higher transport and backbone access costs [] could eventually result in higher and unaffordable rates for consumers.”]; Email from Ian Livingston, CEO, BT, to Kevin Martin, Chairman, FCC, CC Docket No. 96-45, WCB No. 06-122 and WC Docket No. 05-25, dated Oct. 27, 2008 [“We believe that we could engage further were there more effective regulation of wholesale or special access to the networks of the main two incumbents, along the lines of non-discriminatory prices, quality and terms enjoyed by our competitors in the UK...”]; Written Testimony of Paul Schieber, Sprint Nextel Corp., Before the House Subcommittee on Communications, Technology and the Internet, p. 14, May 7, 2009 (“Schieber Testimony”)[“High priced special access has had a direct impact on Sprint’s deployment of mobile broadband services. Sprint has been forced to defer the deployment of mobile broadband services in its acquired affiliate territories because of the high cost of special access. In addition, the high cost of special access has forced us to delay adding additional special access capacity to our mobile broadband network which limits bandwidth availability to consumers during peak usage periods.”]; Notice of *Ex Parte* Presentation, Sara F. Leibman, T-Mobile USA, Inc. to Marlene H. Dortch, FCC, WT Docket Nos. 05-265 and 00-193 and WC Docket No. 05-25, Apr. 29, 2009 [“...[T]he lack of competition in the critical market for high-capacity special access services and [] unreasonable rates, terms, and conditions imposed by large incumbent local exchange carriers hinder the deployment of broadband services.”]

⁸ Letter of Robert W. Quinn, Jr., AT&T, to Marlene H. Dortch, FCC, WC Docket No. 05-25, pp. 1-2, dated Feb. 6, 2009 (“AT&T Feb. 6 *Ex Parte* Letter.”)

⁹ S. Derek Turner, “Dismantling Digital Deregulations: Toward a National Broadband Strategy,” FreePress, pp. 7 and 16, using data extracted from International Telecommunications Union.

¹⁰ Available at:
<http://money.cnn.com/magazines/fortune/fortune500/2009/performers/companies/profits/>

according to an analysis by Free Press, the ILEC recoverable interstate investment has declined considerably since they have received pricing flexibility.¹¹ Ensuring reasonable rates for ILEC special access services will enable competition – needed to stimulate investment incentives – to flourish in downstream markets, rather than be stifled as is the case under the current regime.

AT&T further contends rate reductions in special access will eliminate CLEC incentive to invest in broadband infrastructure.¹² As an initial matter, if these carriers continue to be forced to pay the exorbitant rates to the ILECs on special access they will not have the resources to invest. Moreover, permitting the ILECs to “lock up” the market demand for special access via their exclusionary volume and term commitments, offered as part of their “discount” plans, already diminishes CLEC incentives. Such conditions require customers to purchase the vast majority of their total circuit demand from the ILEC.¹³ As the GAO explains, the consequence of these type of contracts is that “[u]less a competitor can meet the customer’s entire demand, the customer has an incentive to stay with the incumbent and to purchase additional circuits from the incumbent, rather than switch to a competitor or purchase a portion of their demand from a competitor – even if the competitor is less expensive.”¹⁴ Since these type of contracts prevent a customer from migrating its service to a competitor that enters a market, they prevent competition from developing, regardless of whether or not competitors otherwise have facilities or desire to compete. This is why the CLEC data on network facilities, which the ILECs repeatedly ask for, is irrelevant.¹⁵ Even if the CLECs had the facilities to compete in discrete geographic areas, they do not have the scale and scope to compete with the three predominant ILECs for the major purchasers of special access.

USTelecom claims that there is “abundant evidence” in the record of this proceeding demonstrating that the decision to grant ILECs pricing flexibility for special access has led to declining prices.¹⁶ This claim, however, has been contradicted by

¹¹ *Id.* at 58-59.

¹² AT&T Feb. 6 *Ex Parte* Letter at 2.

¹³ *See* Schieber Testimony at 10.

¹⁴ “FCC Needs to Improve Its Ability to Monitor and Determine the Extent of Competition in Dedicated Access Services,” GAO-07-80 Deregulation of Special Access Services, p. 30, Nov. 200006 (“GAO Report”).

¹⁵ *See* Letter of Brad E. Mutschelknaus of Kelly Drye and Warren, to Marlene H. Dortch, FCC, WC Docket Nos. 06-172, 07-97, 06-125, 06-147, and 04-440, p. 8, Oct. 1, 2007 [“The evidence presented here by the Joint CLECs demonstrates that competitors have spent enormous sums of money to build networks, but these networks only serve – or are capable of serving in a commercially reasonable period of time – an extremely small portion of buildings in each local market at issue.”]

studies performed by objective third parties, including a government entity. One example of the flaws in the ILECs “evidence” is presented in an ex parte last year by AT&T regarding the findings of the United States General Accountability Office (“GAO”) in its study of the special access market. AT&T asserts that the GAO confirmed “that there have been substantial and sustained decreases in the prices special access purchasers pay ever since the Commission began granting pricing flexibility applications in late 2000.”¹⁷ AT&T however failed to acknowledge that the GAO did not attribute any price decline to pricing flexibility or market forces, but instead to the *Calls Order* (“price-cap list prices available in phase I and price cap areas were pushed downward over the same period—largely by the *CALLS order*.”¹⁸) In the phase II pricing flexibility areas, where the Commission has granted maximum deregulatory relief, GAO found that “list prices for dedicated access that apply under phase II, on average, *have increased*.”¹⁹

Another indication of the existence, and abuse, of market power by the three predominant ILECs is that, although AT&T, Qwest and Verizon’s rates of return on special access services were already extraordinarily high, they continue to increase significantly. Rate of the return in 2004 were as follows: BellSouth 81.9%, SBC 76.2%, Qwest 76.8% and Verizon 31.5%.²⁰ AT&T, Qwest, and Verizon rates of return for 2007 were 138%, 175%, and 62%, respectively.²¹ While the ILECs have claimed that the use of ARMIS data to calculate these rates of returns is invalid, rather than correcting the alleged flaws in the data they instead persuaded the Commission simply to eliminate the requirement that they generate and submit the data.²² Indeed, one of the main arguments they made for the invalidity of the data was the jurisdictional separations freeze²³ which

¹⁶ Letter of Glenn Reynolds, USTelecom, to Marlene Dortch, FCC, WC Docket No. 05-25, p. 1, Apr. 27, 2009. (“USTelecom Letter”). Interestingly, the letter provides no citations to this “abundant evidence.”

¹⁷ Letter of Gary L. Phillips, AT&T, to Marlene Dortch, FCC, WC Docket No. 05-25, p. 2 (Feb. 21, 2008).

¹⁸ GAO Report at 13 (emphasis added).

¹⁹ *Id.* (emphasis added.)

²⁰ See Comments of COMPTTEL *et al.*, WC Docket No. 05-25 and RM-10593, p. 4 (filed Jun. 13, 2005).

²¹ ARMIS Report 43-04, column (o), row 8041 divided by row 804. Column (o) reports Special Access results, row 8041 is Net Return, and row 8040 is Average Net Investment.

²² See Memorandum Opinion and Order, FCC 08-203, WC Docket Nos. 08-190, 07-139, 07-204, 07-273, and 07-21 (2008); Memorandum Opinion and Order, FCC 08-120, WC Docket Nos. 07-21 and 05-342 (2008).

²³ See *e.g.*, Comments of SBC Communications Inc., WC Docket No. 05-25, RM-10593, pp. 29-31 (Jun. 13, 2005).

*they themselves supported.*²⁴ Moreover, in AT&T's [then SBC] own words, "...ARMIS is no better or worse than any cost accounting system for a large, multiproduct firm....Virtually all cost accounting systems will be subject to criticism....However, the fact nevertheless remains that *accounting systems are the basis for decision making in our economy...*"²⁵

If the Commission, nonetheless, is unwilling to rely on the previously filed ARMIS data, it should seek data from the ILECs regarding their special access costs and profit margins,²⁶ as well as price. The Commission cannot ignore these indicia of market power. While Verizon now seems to be claiming that this type of cost data does not exist,²⁷ the provision by AT&T, Qwest and Verizon of accounting data on request by the Commission for regulatory purposes was a condition of the forbearance relief from cost allocation rules.²⁸ AT&T confirmed that it could "...allocate the data in any affected Part 32 accounts based upon whatever parameters were deemed appropriate and would comply with any lawful requirement to that end within a reasonable time frame."²⁹

Finally, USTelecom's claims of "rapidly expanding" competitive options, which it supports with citations to the incumbents' own filings and press releases, is contradicted by the actual purchasers of special access. Buyers of special access – including government entities such as the Department of Defense - have repeatedly stated that they have no alternative to the ILEC for the vast majority of their demand.³⁰ Indeed,

²⁴ See Comments of SBC Communications Inc., CC Docket No. 80-286, p.1 (Sept. 25, 2000)[“SBC agrees with the Joint Board that a freeze of the Part 36 category relationships and jurisdictional allocation factors for price cap carriers is appropriate.”]; See also, Comments of Verizon, CC Docket No. 80-286, p. 1 (Sept. 25, 2000)[“The Commission should ...implement such a freeze”].

²⁵ Surrebuttal Testimony of Dr. Debra J. Aron On behalf of SBC Illinois, Before the Illinois Commerce Commission, Docket No. 02-0864, SBC Illinois Exhibit 2.2., p. 9 (2004)(emphasis added.)

²⁶ See Letter of Paul Margie, Harris, Wiltshire & Grannis, to Marlene Dortch, FCC, WC Docket No. 05-25, May 5, 2009. See also, Letter of Thomas Jones, Willkie Farr & Gallagher, WC Docket 05-25, p. 1, May 1, 2009.

²⁷ Letter from Donna Epps, Verizon, to Marlene Dortch, FCC, WC Docket No. 05-25, p. 2, May 7, 2009.

²⁸ Memorandum Opinion and Order, FCC 08-203, WC Docket Nos. 08-190, 07-139, 07-204, 07-273, and 07-21, ¶28 (2008); Memorandum Opinion and Order, FCC 08-120, WC Docket Nos. 07-21 and 05-342, ¶45 (2008).

²⁹ Letter from Robert W. Quinn, AT&T, to Marlene Dortch, FCC, WC Docket No. 07-21, p. 4, Apr. 22, 2008.

the ILEC share of the wholesale special access market has been reported to be in excess of 90%.³¹ Only monopolists could believe that alternative providers obtaining less than 10% of a market renders that market competitive.

Yet rather than confront the questions as to how it is that incumbents' prices have increased in theoretically competitive markets, why purchasers who purportedly have options for fulfilling their special access needs would continue to pay excessive prices for over 90% of their demand, and how it is that incumbents are making unheard of rates of return, USTelecom and Verizon, understandably, wish to shift the focus to supposed widespread competitive providers' facilities.

The data requested in proposals of USTelecom and Verizon are, to a large extent, irrelevant and would present a distorted picture. For example, both proposals seek data in a manner intended to exaggerate the extent of competition by failing to distinguish data on facilities leased from the ILEC from data on the competitor's own facilities, e.g., USTelecom's request for information on facilities "you own, utilize or control," its inclusion of dark fiber, and Verizon's request for data on services "provided either on an on-net or off-net basis." Responses to RFIs and RFPs are also irrelevant, as the bids may also have been based on leased facilities or a partnership with another provider, such as one of the incumbent LECs. Only facilities that are owned by competitors are competitive

³⁰ See e.g., Tariff Filing of Verizon New York to Implement Pricing Flexibility for Non-Basic Services, N.Y. Pub. Sev. Comm'n, Case No. 06-C-0897, Initial Comments of the United States Department of Defense and All Other Federal Executive Agencies, pp. 3 and 13 (filed Oct. 22, 2007) ["Enterprise users such as federal agencies need more competition for retail services...competition has not been sufficient to limit Verizon's pricing power...If there were strong competition, as Verizon contends, the company would not be increasing its prices...[DOD/FEA concurs with the statement that] "for the vast majority of business subscribers in the state of New York, Intermodal telecommunications services do not represent a viable *substitute* for the traditional landline offerings of the incumbent local exchange carriers and, as such, do nothing to diminish or to constrain the market power of the incumbent provider..."]; Schieber Testimony at 5 ["Sprint has become even more dependant on incumbent LEC special access services, despite the fact that it would be commercially advantageous to Sprint if it could reduce its reliance on incumbent LECs."]; Comments of PAETEC Communications Inc., WC Docket No. 05-25, pp. 5-6, Aug. 8, 2007 ["PAETEC's dependence on ILEC special access services has risen further, and now exceeds 98 percent in Phase II areas...in spite of vigorous and concentrated efforts by PAETEC to find alternative special access providers."]; ETI Study at 2 ["When business users require dedicated voice and data connections from the places of work to the world more than nine times out of ten the only providers available to offer that connection is an ILEC."](emphasis deleted); Comments of The American Petroleum Institute, WC Docket No. 05-25, p. 6, Aug. 8, 2007 ["For member companies, the price cap ILECs remain the predominant providers in all of the major special access service categories."]

³¹ Schieber Testimony at 4.

facilities. Facilities leased by a competitor from the ILEC provide no basis for determining the extent of competition in the wholesale special access market.

The simple truth is that the GAO's finding that ILEC special access prices have increased in areas where they allegedly face more vigorous competition, that the ILECs backed away from rather than confront their astonishing rate of returns, and that purchasers rely on the ILECs for over 90% of special access demand dispel the myth that there is widespread competition to the ILECs' special access service. The record is sufficient and the Commission should act on it.

Respectfully Submitted,

/s/

Karen Reidy