WRITTEN TESTIMONY

OF

ROBERT S. FOOSANER

SENIOR VICE PRESIDENT – GOVERNMENT AFFAIRS,
SPRINT NEXTEL CORPORATION

ON

S. 2686,
THE COMMUNICATIONS, CONSUMERS'CHOICE, AND BROADBAND DEPLOYMENT ACT OF 2006

BEFORE THE
U.S. SENATE COMMITTEE ON
COMMERCE, SCIENCE AND TRANSPORATION

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Good Morning Chairman Stevens, Co-Chairman Inouye, and Members of the Committee. I am Bob Foosaner, Senior Vice President of Government Affairs for Sprint Nextel Corporation. Thank you for the opportunity to appear before you today to discuss S. 2686, the Communications, Consumers' Choice and Broadband Deployment Act of 2006. I appreciate this opportunity and I commend you for taking on the complex task of reforming our Nation's communications law.

In my view, the goals of the bill before you today - encourage competition, the deployment of broadband nationwide and, most importantly, bringing the benefits of telecommunications advances to all consumers - would be enhanced if your bill addressed the serious market failure for special access services – a market that is a lynchpin to the success of a vibrant, competitive broadband marketplace.

Today, Sprint Nextel, like many of our Nation's businesses (including Internet Service Providers, cable companies, long distance carriers, competitive local exchange carriers, and other wireless companies), remains heavily dependent on the Bell Operating Companies (BOCs) to provide "last mile" connections known as "special access services." In fact, Sprint Nextel has identified alternative providers of special access

services at less than one percent of its cell sites nationwide. In other words, in nearly every case the BOC is the *only* choice for service in their respective service territories. Sprint Nextel needs these dedicated circuits to link together different parts of its own network (for example, from our cell sites to our switches) and to link its network to the networks of other carriers. Sprint Nextel and other businesses' reliance on special access services, moreover, will only increase as we need more and more capacity between our cell sites and our networks to support the transmission of voice, video and other data over broadband networks.

Sprint Nextel would very much prefer to have the option of obtaining these dedicated circuits from someone other than the BOCs who, after all, are the parents of our largest competitors Cingular and Verizon Wireless. The reality, however, is that even ten years after passage of the Telecommunications Act of 1996, the competitive availability of special access services, such as DS1 and DS3 services, is woefully limited. In the Boston, Massachusetts metropolitan area, for example, Sprint Nextel provides service to its subscribers through a sophisticated wireless network with more than 1500 cellular radio towers and five mobile switching offices. To move our traffic from the cell site to our switches, and then ultimately to the Public Switched Telephone Network, we purchase dedicated DS1 and DS3 circuits that interconnect the towers and switches and link our Boston customers to Sprint Nextel's national and international telecommunications network. Ninety-eight percent of Sprint Nextel's expense for the hundreds of dedicated circuits Sprint Nextel uses in the Boston area is paid to Verizon.

Several other critical markets tell the same story. In Portland, Maine, Sprint Nextel has over 100 cell sites, one mobile switching center and approximately 150

special access pipes connecting those network components. One hundred percent of those special access circuits are purchased from Verizon. In Miami there appears to be a little more competition with 88% of Sprint Nextel's expense for 2800 special access pipes, connecting over 1,200 cell sites to four mobile switching centers, paid to BellSouth. In Richmond, Virginia our network of over 400 cell sites and one mobile switching center is connected by approximately 900 special access connections, with 85% of the cost of those connections going to Verizon. The Charleston, South Carolina network is reliant on Bellsouth for 86% of its special access, and in San Francisco, we purchase 98% of our special access from AT&T to connect our 2,000-plus cell sites to six mobile switching centers.

To provide just one more example that demonstrates the monopoly market Sprint Nextel and numerous other businesses face for special access services, look to the New York City metropolitan area – an area generally regarded as one of the *most competitive* areas in the nation. Prior to its merger with Sprint, Nextel made a concerted effort to reduce its dependence on Verizon special access service, and it failed utterly. When Nextel sought bids for special access services in the New York metropolitan area, competitors bid to serve fewer *than 3% of the required locations* in one of the most competitive geographic markets in the nation. On a nationwide basis, according to an FCC report, wholesale revenues from the sale of special access by the BOCs and other incumbent local exchange carriers to Sprint Nextel and other carriers amounted to $10.5 billion, while the wholesale revenues generated by competing providers amounted to $664 million.[1]

[1] See the Federal Communications Commission, 2004 Telecommunications Industry Revenues, released March 2006, at Table 5.

Sprint Nextel is also heavily reliant on the BOCs' special access services to serve *wireline* large business customers with sophisticated telecommunications requirements, especially high-capacity data networks. Although many of these customers are located in and around the center of urban areas, Sprint Nextel nonetheless has had very limited success in securing service from competing providers of dedicated circuits, especially in the wake of the BOC acquisitions of AT&T and MCI last year, the two companies that had been the leading competitive providers of special access service. In Boston, for example, Sprint Nextel currently obtains 90% of the special access it needs to reach large business customers through Verizon. In Portland, Maine and Miami, Florida Sprint Nextel's special access for wireline service is obtained from the BOC 98% and 91% of the time, respectively. In Richmond, Charleston and San Francisco, those numbers for Sprint Nextel's special access services are 81%, 86% and 87%, respectively. All of these markets are overwhelmingly dominated by the BOC.

Sprint Nextel is not the only company captive to the BOCs' special access market dominance.[2] Other companies – including, notably, AT&T and MCI prior to their absorption into the Nation's two largest BOCs – have demonstrated repeatedly that there is a special access market failure. In 2004, MCI (now Verizon) informed the FCC that

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[2] Other carriers appear to have been similarly unsuccessful in obtaining competitively provided dedicated circuits. (*See* AT&T Reply Comments, RM-10593 at 12-16 (Jan. 23, 2003); Ad Hoc Telecommunications Users Committee Reply Comments, WC Docket No. 05-65, Attachment A, ETI Report at pp.16-22 (May 10, 2005).) In addition, Ad Hoc's analysis shows that intermodal technologies do not offer competitive alternatives to high speed special access services. Declaration of Susan M. Gately, attached to Ad Hoc Telecommunications Users Committee Reply Comments, at ¶¶ 19-25. In fact, it appears to be undisputed that competitive alternatives are available only at a "tiny percentage" of commercial buildings. AT&T Reply at p. 13 (stating that the BOCs do not dispute the conclusion that competitive alternatives are available only in a small number of buildings).

"[t]he ILECs' market power over the market for DS1 and DS3 facilities, coupled with the Commission's decision largely to deregulate the pricing of those facilities, has resulted in prices that are far in excess of cost. The result is that special access has become the ILECs' most profitable line of business."[3] Pre-BOC merger AT&T similarly argued for correction of the special access market failure by promoting the very action that many of us have asked be included in your bill. That is, AT&T recognized the need for "re-imposing an annual productivity offset (X-Factor) . . . [to] ensure that ratepayers share in the benefits of special access productivity gains, as the Commission originally intended."[4] Finally, the Ad Hoc Telecommunications Users Committee, an organization of major US businesses, also has filed data with the FCC showing that the BOCs in 2005 remained the sole source of dedicated access at roughly 98% of all business premises nationwide, even for the largest corporate users.[5]

Will competition develop and correct this market failure? Unfortunately, that is not likely. As the FCC itself has noted, the competitive deployment of stand-alone DS1 circuits connecting two points – for just one carrier's traffic -- is rarely if ever an economic possibility.[6] Competitive carriers simply cannot establish a business case to

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[3] MCI Comments, WC Docket 04-313, at p. 156 (Oct. 4, 2004).

[4] ATT Comments, WC Docket 05-25, at p. 5 (June 13, 2005).

[5] Ad Hoc Telecommunications Users Committee Reply Comments, Attachment B, Declaration of Susan M. Gately, ¶ 18 (May 10, 2005).

[6] Such circuits require high fixed, sunk costs to serve an individual customer location. No firm can match the scale economies that the BOCs enjoy in furnishing DS1 special access service since they alone had the opportunity to construct a ubiquitous local network over a period of decades while protected against competition. *In the Matter of Unbundled Access to Network Elements Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers*, WC Docket No. 04-313, CC Docket No. 01-338, Order on Remand, at para.166 (rel. Feb. 4, 2005).

lay a DS1 circuit out to a Sprint Nextel cell site, given the high fixed, sunk costs incurred to construct that circuit. Prior to its merger with SBC, AT&T echoed this predicament, stating that it and other special access purchasers "generally have *no* alternative suppliers for the bread and butter DS-level services."[7] Thus, for carriers like Sprint Nextel that rely heavily on those circuits, the prospects for obtaining service from competing providers are practically non-existent. In the case of wireless carriers in particular, the possibility of a competitive market for these circuits is even more doubtful, because, for zoning and other reasons, cell sites frequently are located in out-of-the way locations, such as along roadsides or atop surrounding hills. In the Boston metropolitan area, for example, 75% of Sprint Nextel's cellular radio towers are located outside of the core urban area, in the areas least likely to attract competitive offerings. Furthermore, alternative technologies, such as fixed wireless or a cable-provided circuit, rarely meet Sprint Nextel's service requirements.[8]

Despite the lack of competition for special access, even in places like metropolitan New York, the FCC deregulated the rates for these last mile special access circuits in many metropolitan areas around the country.

The result of deregulation in the face of a market failure has been predictable (and, frankly, perfectly rational from the BOC's point of view): astounding rates of return and, as a result, harm to the promise of wireless, mobile broadband. Pre-merger MCI noted to the FCC that between 1996 and 2003 the BOCs, "as a group enjoyed an almost

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[7] AT&T Reply Comments, RM-10593 at 11 (Jan. 23, 2003) (emphasis in original).

[8] *See, e.g.*, Competition in Access Markets: Reality or Illusion, A Proposal for Regulating Uncertain Markets at pp. 22-24 (ETI Aug. 2004) ("ETI Report"), attached to *Ex Parte* Letter from Colleen Boothby, counsel for Ad Hoc Telecommunications Users Committee, to Marlene H. Dortch, FCC, RM No. 10593 (Aug. 26, 2004).

six-fold increase in the rate of return for interstate special access (from 7.6 % to 43.7 %), with three BOCs reaping returns in excess of 60% in 2003."[9] The most recent data that the BOCs themselves have filed with the FCC show that they have continued to earn exorbitant profits from special access. For example, just last year ATT/SBC earned a rate of return of 92% on its special access services; BellSouth earned nearly 98%.[10] Even Verizon, which historically has lagged behind the other BOCs, reported a return of 42%.[11]

These returns are not a one-year aberration – special access rates of return (or, their after-tax profits) have grown steadily over the past five years. Indeed, SBC's rate of return rose by more than 120% from 2001 to 2005, and the rates of return for the rest of the BOCs increased by more than 167% for BellSouth and 175% for Verizon.[12] Moreover, one study has suggested that even these astronomical returns may *understate* the BOCs' earnings; the costs of other services may have been misallocated to the special access category, thereby overstating the BOCs' special access costs and understating their rates of return.[13] These high BOC returns are evidence of a market failure: the lack of competition for special access has allowed the BOCs to charge exorbitant prices without restraint.

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[9] MCI Comments, WC Docket 04-313, at p. 157-58 (Oct. 4, 2004).

[10] These returns are computed from data the BOCs filed with the FCC in their annual ARMIS 43-01 reports.

[11] *Id.*

[12] *Id.*

[13] *See* ETI Report at 33-34 (noting that the net investment allocated to the special access category is "completely disproportionate" to the number of special access loops as a percentage of loops in service, raising "suspicions that costs are being *overallocated* to the special access category.") (emphasis in the original); Gately Declaration ¶ 12.

Without effective rules or meaningful competition, the BOCs' special access earnings are likely to grow at an even faster pace in the future – a future in which special access will become even more critical to the telecom marketplace as more and more capacity will be required to support the burgeoning broadband marketplace that this Committee is committed to encouraging.

It is noteworthy that the largest providers of special access services are also the parents of our wireless competitors. These integrated firms, therefore, have the incentive and ability to raise the special access costs of, and thereby disadvantage, Sprint Nextel and other competing providers of retail wireline and wireless services.

What is the solution to the special access market failure and rate gouging? Congress needs to mandate that the FCC rollback its premature deregulation of special access services and implement the pricing discipline that the marketplace has failed to provide. Let me be clear: failure to do so will thwart broadband deployment and competition.