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

In the Matter of	)	
	)	
Applications of AT&T Inc. and Deutsche Telekom AG	)	**WT Docket No. 11-65**
	)	
For Consent to Assign or Transfer Control of Licenses and Authorizations	)	

COMMENTS OF HANCE HANEY
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Sprint Nextel Corp. and COMPTEL both object to a merger between AT&T Corp. and T-Mobile USA, among other reasons, because it could remove T-Mobile as a purchaser of special access services from providers who are unaffiliated with AT&T and Verizon.[1] Sprint and COMPTEL allege that if all of T-Mobile's special access requirements are purchased from AT&T where AT&T is the dominant provider, it could threaten the viability of the independent suppliers and possibly lead to higher rates that Sprint and other wireless carriers pay for backhaul services.[2]

According to COMPTEL, T-Mobile obtains backhaul from providers other than AT&T and Verizon for only 20 percent of its cell sites.[3] Nevertheless, the trade association foresees apocalypse for some of its members if this share decreases.

> The loss of such a major customer will increase the difficulty for competitive providers to achieve *minimum viable scale* (emphasis added) and will create a serious risk that competitive providers will either exit the special access market

[1] In the Matter of Applications of AT&T and Deutsche Telekom AG For Consent to Assign or Transfer Control of Licenses and Authorizations, *Petition to Deny of Sprint Nextel Corp.*, WT Docket No. 11-65 (May 31, 2011) at 39-43; *Petition to Deny of COMPTEL* (May 31, 2011) at 25-30.

[2] *Id.*

[3] COMPTEL, *supra* note 1, at 25.

altogether or significantly scale back their investment in special access facilities.[4]

Without more facts, it is impossible to evaluate these claims. Two things are clear, however. *First,* Sprint has been complaining for years about the rates it pays for special access. Sprint CEO Daniel R. Hesse complained again last month that AT&T and Verizon are able to obtain backhaul at cost. Furthermore, according to Hesse,

> Whereas Sprint must pay more than $2 billion a year in backhaul fees to its competitors, AT&T and Verizon earn *enormous profits* (emphasis added) from their control over backhaul. By controlling the availability and price of backhaul, AT&T and Verizon are also able, to a large degree, to control their competitors' cost and quality of service.[5]

But, as the balance of these comments will briefly highlight, so far Sprint has utterly failed to prove the rates it pays are excessive. The National Broadband Plan confirms that there is no evidence to support the carrier's claim.

> It may well be the case that the cost of providing these circuits is so high that there is no private sector business case to offer broadband in some areas, even if the rates, terms and conditions are just and reasonable.
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> It is not clear whether the high costs of middle-mile connectivity in rural areas are due solely to long distances and low population density, or also reflect excessively high special access prices as some parties have alleged. (footnotes omitted.)[6]

COMPTEL is a trade association that seeks to create and protect commercial opportunities for its members through legislation and regulation. When COMPTEL alleges "difficulty for competitive providers," it is unclear whether the organization is

[4] *Id.* at 25.
[5] Written Testimony of Daniel R. Hesse before the Subcommittee on Antitrust, Competition Policy and Consumer Rights, *United States Senate* (May 11, 2011) *available at* http://judiciary.senate.gov/pdf/11-11-5%20Hesse%20Testimony.pdf at 5-6.
[6] "Connecting America: The National Broadband Plan" (NBP) *available at* http://www.broadband.gov/plan/ at 143.

seriously suggesting that *competition* is threatened or merely that particular dues-paying members face the loss of a customer and may have to scramble to generate new business. It is the Commission's job to protect competition, not competitors. Incidentally, there are always opportunities for nimble competitors to prosper; well-run firms do not obtain inputs like special access from affiliated sources indefinitely if someone else offers a better value proposition. The deployment of fourth generation wireless services may create a new opening for competitors.[7]

Second, the merger review process provides an opportunity to extract "voluntary concessions" from merging entities as the price for avoiding denial or delay.[8] Concessions may go far beyond the requirements of the Communications Act or the FCC's own rules, yet because they are "voluntary" they cannot be appealed absent evidence of coercion. Whether the perception is fair or not, many businesspeople and Washington representatives view the Commission as a candy store, particularly when evaluating mergers.

Since there is considerable uncertainty around the issue of special access pricing, it would be inappropriate for the Commission to condition merger approval on huge discounts for Sprint and other wireless carriers who purchase special access services from AT&T. As noted in the National Broadband Plan, this matter is under review and is not ripe for resolution.

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[7] *See* Maisie Ramsay, "Booming Business for Backhaul," *Wireless Week* (May 3, 2010) *available at* http://www.wirelessweek.com/articles/2010/05/booming-business-for-backhaul/ ("Copper-based backhaul has the major benefit of being in the ground already but lacks cost-effective scalability to support 4G technologies.")

[8] *See, e.g.,* "Any Volunteers? The FCC unfairly regulates 'by condition' when it extracts concessions from merging telecom companies," by Randolph J. May, *Legal Times,* (May 6, 2000) *available at* http://www.freestatefoundation.org/images/Any_Volunteers--Legal_Times.pdf.

> The FCC is currently considering the appropriate analytical framework for its review of these offerings. The FCC needs to establish an analytical approach that will resolve these debates comprehensively and ensure that rates, terms and conditions for these services are just and reasonable. (endnote omitted.)[9]

Due to the absence of any compelling evidence that special access prices are unreasonable, the National Broadband Plan recommends only that the Commission "examine middle-mile costs and pricing."[10]

When considering the likely competitive effects of the merger itself, the Commission should guard against mere speculation that the loss of a major purchaser would be likely to seriously jeopardize competition among special access providers. Sprint and COMPTEL have painted a familiar hypothetical picture without providing any relevant evidence.

II. THE EVIDENCE SO FAR SUGGESTS THAT PRICES FOR SPECIAL ACCESS SERVICES ARE REASONABLE

A coalition backed by Sprint attempted to quantify the "enormous" profits that ILECs charged for special access services in 2009.

> Huge companies like Verizon and AT&T control the broadband lines of almost every business in the United States. The virtually unchallenged, exclusive control of these lines costs businesses and consumers more than $10 billion annually and generates a profit margin of more than 100 percent for the controlling phone companies, according to their own data provided to the FCC. This hidden broadband tax results in enormous losses for consumers and the economy, and this country cannot afford it; especially now.[11]

A contemporaneous analysis prepared by Peter Bluhm and Dr. Robert Loube

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[9] NBP, *supra* note 6, at 48.

[10] *Id.* at 148.

[11] "Special Access Reform a Must For Broadband Economy," *NoChokePoints Coalition* (Jun. 22, 2009) *available at* http://nochokepoints.org/sites/default/files/resources/launch%20Release%20Final.pdf.

under contract with the National Association of Regulatory Commissioners (NARUC) notes that accounting changes have distorted ARMIS earning reports, and that they are not useful for resolving the current debate over the reasonableness of special access pricing.

> Buyers have criticized the FCC's current regulatory regime because it has apparently allowed excessive earnings. For their part, the RBOCs contend that the ARMIS figures are virtually meaningless. We agree with the RBOCs
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> Before 2000, special access investment was categorized by what is called "direct assignment." The purpose was to assign 100% of investment for interstate special access to the interstate jurisdiction and 100% of investment for intrastate special access to the state jurisdiction. In practice, direct assignment required carriers to perform studies on how their networks were used
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> In 2001, the FCC "froze" separations categories and factors for large companies. At that point, large carriers stopped performing direct assignment studies .... During [the ensuing] period, carriers greatly increased their sales of interstate special access, and all of that revenue was assigned to interstate. *As a result, interstate special access revenues increase every year, but not interstate special access costs. This imbalance has inflated ARMIS special access earnings reports and made them unreliable.* (emphasis added.)[12]

A paper paper by Harold Ware, Christian Dippon and William Taylor at NERA Economic Consulting reached a similar conclusion.

> accounting profits generated from [ARMIS] data bear no relationship with economic profits and cannot serve any useful purpose in determining whether

[12] Peter Bluhm and Robert Loube, "Competitive Issues in Special Access Markets (Revised Edition)," *NRRI* (Jan. 21, 2009) *available at* http://nrri.org/pubs/telecommunications/NRRI_spcl_access_mkts_jan09-02.pdf.

pricing flexibility has generated excessive rates of return.[13]

Bluhm and Loube estimated the current actual cost and found that the carriers are probably earning substantially less than ARMIS indicates. Instead of earning a 138% return on special access investment, AT&T was more likely earning 30%. Qwest was probably earning 38%, not 175%. And Verizon, 15% instead of 62%.[14] Ware, Dippon and Taylor rejected this analysis, noting that "allocations and adjustments can produce wildly different results depending on what factors are used."[15] However, they did predict that the potential benefits of additional special access regulation are not worth the "potentially large costs."[16]

George S. Ford and Lawrence J. Spiwak at the Phoenix Center have concluded that deregulation has not produced higher prices for special access services.[17] They note that the rates of return Bluhm and Loube estimated AT&T, Qwest and Verizon were earning at the time either were similar to or less than the rates of return these companies used to earn when the market was fully regulated.

> NRRI bases this analysis on ARMIS rates of return, a perplexing approach once one calculates ARMIS rates of return from the period in which all special access services were price regulated. In 1999, for example, the average rate of return for special access computed using ARMIS data was 32% for Qwest, 37% for AT&T, and only 4.5% for Verizon. For Qwest and AT&T, the returns under complete price regulation are not much different than the "adjusted" returns computed

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[13] Harold Ware, Christian Dippon and William Taylor, "Is More Special Access Regulation Needed? Reactions to the NRRI Report on Special Access Competition," *NERA* (Mar. 4, 2009) *available at* http://www.nera.com/extImage/PUB_Special_Access_Regulation_03.2009_final.pdf.

[14] Blum and Loube, *supra* note 11.

[15] Ware, et al., *supra* note 12.

[16] *Id.*

[17] George S. Ford and Lawrence J. Spiwak, "The Need for Better Analysis of High Capacity Services," *Phoenix Center* (Jun. 2009) *available at* http://www.phoenix-center.org/pcpp/PCPP35Final.pdf.

> in the NRRI Study. The conclusion, then, is the pricing flexibility has had no effect. For Verizon, its rate of return prior to the Pricing Flexibility Order was substantially lower than the other Bell companies and even below any reasonable estimate of the firm's cost of capital. One interpretation, then, is that a more deregulatory approach has provided for more reasonable returns on investment for the firm. (footnote omitted.)

III. THE MARKET WILL DISCIPLINE PRICES FOR SPECIAL ACCESS SERVICES

Assuming, for the sake of argument, that special access services are highly profitable, why hasn't Sprint invested in its own special access facilities? If special access is over-priced, it would be profitable in theory for Sprint to save operating expenses by investing in it's own backhaul facilities. Clearwire, for example, has established it's own wireless backhaul network that connects 90 percent of Clearwire's cell sites.[18] Sprint may not invest in facilities of it's own if merger conditions make it cheaper buy access to someone else's facilities.

There are many players on the special access market. If AT&T or Verizon provide poor service or charge excessive prices, firms like Bright House, CenturyLink, Comcast, Cox, FiberTower, Level 3, TTM and Time Warner Cable will steal their business. Incidentally, regulation of special access prices could affect these firms' access to capital needed for expansion. If regulation pushed special access prices lower, that would reduce the revenue investors could expect to earn from new competitive facilities. If investment is not expected to be profitable, it won't be made. There is a tension between price controls and incentives for private investment in networks. As the National Broadband Plan acknowledges, "prices that are too low may deter efficient

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[18] Kevin Fitchard, "Clearwire leans heavily on wireless to backhaul WiMax network," *Connected Planet* (Sept. 14, 2009) *available at* http://connectedplanetonline.com/3g4g/news/clearwire-wireless-backhaul-wimax-0914/.

investment by both incumbents and new entrants."[19]

If the FCC requires AT&T to share its facilities at prices low enough to allow Sprint to become profitable regardless of AT&T's actual cost, AT&T would have no alternative but to mark up other products and services to generate a cross-subsidy for special access. Providers can temporarily overcharge some customers in order to subsidize other customers. But that is an unsustainable strategy. Competitors will target the the exploited customers, which in turn will jeopardize the services provided to subsidized customers.

IV. CONCLUSION

So far, the evidence suggests not only that ILECs are not earning excessive margins, but rather margins which are comparable to what ILECs earned under rate-of-return regulation. If prices did produce excessive profits, it will be profitable for competitors to invest in new facilities which will create jobs. The bottom line here is there is no evidence of a market failure, just a concerted effort by purchasers to use lobbyists to persuade policymakers to intervene in the market to reallocate profits. A merger review is the perfect forum for such an effort, and the Commission should act cautiously to ensure that it does not become a shakedown. Hold-ups undermine confidence in the Commission and in regulation generally.

[19] NBP, *supra* note 6, at 65 (fn. 78).

For these reasons, I urge the Commission neither to expect the applicatants to offer deep discounts in the prices that Sprint and other customers pay for special access, nor to approve a merger based on such conditions.

Respectfully submitted,

/s/

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