

**SUMMARY OF TESTIMONY OF
GARY D. FORSEE
CHAIRMAN AND CHIEF EXECUTIVE OFFICER
SPRINT NEXTEL CORPORATION
ON THE DIGITAL FUTURE OF THE UNITED STATES:
PART VI: THE FUTURE OF TELECOMMUNICATIONS COMPETITION
BEFORE THE HOUSE SUBCOMMITTEE ON
TELECOMMUNICATIONS AND THE INTERNET
OCTOBER 2, 2007**

Thank you for the opportunity to testify about the importance of special access services to the future of telecommunications competition and broadband deployment in the United States. The dedicated circuits known as “special access” are a critical component of virtually every communications product in the Nation. The special access market is a failure, however, and this market failure is a substantial barrier to bringing broadband to the American public.

The special access market failure is apparent in the overwhelming and increasing market share of the two dominant special access providers, AT&T and Verizon. It is apparent in their vast and increasing special access revenues, in their inflated special access prices, and in their anti-competitive contract terms and conditions.

The Federal Communications Commission has the tools, the evidentiary record, and the Congressionally-mandated obligation to ensure that special access prices are just and reasonable. I urge this subcommittee to let the FCC know that it must meet its obligation by reducing special access rates to reasonable levels, and reinstating effective incentive regulation, until the BOCs face competition for special access services.

Addressing the special access market failure will produce significant, tangible benefits for consumers, including more competitive telecommunications, improved service quality and faster rollout of broadband networks in the United States.

Thank you.

WRITTEN TESTIMONY

OF

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ON

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I. Introduction

Good Morning, Chairman Markey and Members of the Subcommittee. I am Gary Forsee, Chairman and CEO of Sprint Nextel Corporation. Thank you for the opportunity to testify about the future of telecommunications competition and something that goes to the heart of today's topic: the special access market failure.

Sprint Nextel offers a comprehensive range of wireless and wireline communications services and brings the freedom of mobility to consumers, businesses and government users. Sprint Nextel is widely recognized for developing, engineering and deploying innovative technologies, including two robust wireless networks serving 54 million customers, industry-leading mobile data services, instant national and international walkie-talkie capabilities, and a global Tier 1 Internet backbone. Special access is a critical input to every one of Sprint Nextel's businesses – broadband, wireless, long distance, and enterprise.

Like Internet Service Providers, competitive local exchange carriers, and other wireless and long distance companies, Sprint Nextel uses dedicated circuits, known as special access, to connect its networks and reach its customers.¹ Each of these providers

¹ See Appendix.

must rely on special access to link different parts of its network and to link its network to the networks of others.² At Sprint Nextel, for example, we use special access to connect our cell sites to our switches.

Special access is the lifeblood of the telecommunications industry and touches virtually every communications product. It is a critical part of the services consumers use every day. When consumers make wireless calls, access the Internet, send e-mails, swipe their credit cards at stores, or use automated teller machines, they are using services that rely on special access. As Chairman Markey has recognized, special access also directly affects the pace of deploying the Nation's next generation broadband services.³

Despite this central role in telecommunications and broadband deployment, the special access market is a failure. The special access market failure is apparent in the overwhelming and increasing market share of the two dominant special access providers, AT&T and Verizon. It is apparent in their vast and increasing special access revenues, in their inflated special access prices, and in their anti-competitive contract terms and conditions. The special access market is a textbook example of a market failure, and consumers are suffering the consequences of this failure. The future of competition in telecommunications hinges on whether we address the special access market failure.

Fortunately, the Federal Communications Commission (FCC) has the tools and the evidentiary record to forge a solution to the special access market failure. Congress has

² See, e.g., *AT&T Inc. and BellSouth Corporation Application for Transfer of Control*, Memorandum Opinion and Order, 22 FCC Rcd 5662, ¶ 27 (FCC 06-189) (2007).

³ See Letter from The Honorable Edward J. Markey, Chairman, House Subcommittee on Telecommunications and the Internet, to Chairman Kevin J. Martin and Commissioners Michael J. Copps, Jonathan S. Adelstein, Deborah Taylor Tate, and Robert M. McDowell (May 23, 2007), available at: <http://markey.house.gov/index.php?option=com_content&task=view&id=2859&Itemid=46>.

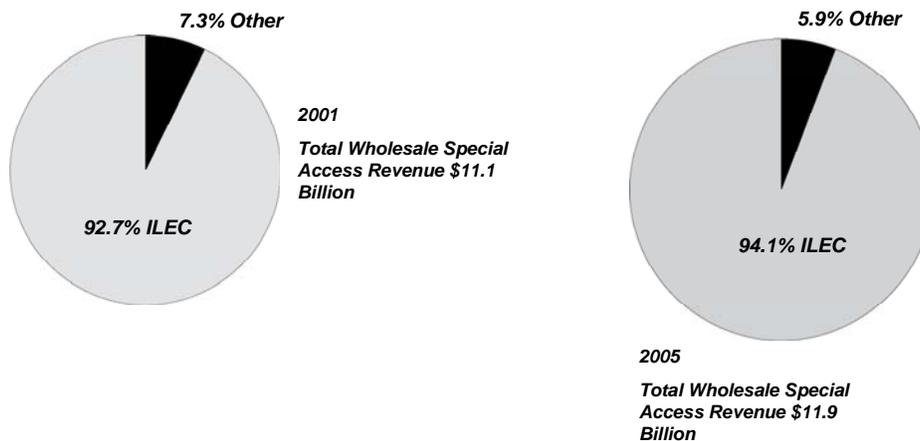
given the Commission the statutory authority and, indeed, the *statutory obligation* to ensure that special access prices are just and reasonable. I urge this Subcommittee to let the FCC know that it must fulfill this statutory obligation.

II. Special Access Market Failure

A. Overwhelming Market Share

The incumbent local exchange carriers (ILECs) overwhelmingly dominate the special access market. This dominance has grown in recent years even as the Commission was relaxing its regulation of many special access services. The incumbent ILECs' share of the wholesale special access market has grown from 92.7% in 2001 to 94.1% of an even larger market in 2005.

Taking a Bigger Slice of a Bigger Pie



In 2001, for example, Sprint obtained 88% of the DS1 circuits⁴ and 74% of the DS3 circuits⁵ for its wireline business in the top 50 metropolitan statistical areas (MSAs) from an incumbent LEC. By 2006, those numbers had risen to over 96% and over 84%, respectively.⁶

The Bell Operating Companies (BOCs) in particular dominate the special access market. When SBC merged with AT&T (to form the “new AT&T”) and Verizon merged with MCI, the BOCs not only eliminated two of the leading proponents of special access reform, they also acquired the two largest competitive providers of special access services. After these mergers, AT&T and Verizon now account for 81% of incumbent local exchange carrier special access revenues nationwide.⁷ In 1990, when the FCC first adopted incentive regulation for incumbent local exchange carriers, special access only accounted for \$2.5 billion of the BOCs’ interstate access revenues. Today, the BOCs annually generate \$15.6 billion from interstate special access services, which is over half their total revenues from interstate telecommunications services.

Although Sprint Nextel actively pursues alternatives to BOC-provided special access, such alternatives are rarely available. For example, many of our cell sites are located outside the residential areas where cable companies typically deploy alternative facilities. A recent Sprint Nextel survey confirmed the BOCs’ dominance, finding that

⁴ A DS1 circuit is equivalent to 24 voice-grade (DS0) circuits and has a capacity of 1.5 Mbps.

⁵ A DS1 circuit is equivalent to 672 voice-grade circuits and has a capacity of 45 Mbps.

⁶ See Comments of Sprint Nextel Corporation, WC Docket No. 05-25, at 29-30 (Aug. 8, 2007) (“Sprint Nextel Comments”) and attached Declaration of Gary B. Lindsey, ¶ 8.

⁷ 2006 FCC ARMIS Report 43-01, Table 1 – Cost and Revenue, Row 1090 (Total Operating Revenues), Column (s) (Special Access).

there were *alternative special access facilities available at less than two percent of our cell sites*.

Nor is Sprint Nextel the only company captive to the BOCs' special access market dominance.⁸ The Ad Hoc Telecommunications Users Committee, an organization of major U.S. businesses, has also shown that the LECs remain the sole source of dedicated access at roughly 98% of all business premises nationwide, even for the largest corporate users.⁹ Similarly, T-Mobile has shown that it has few if any alternatives to incumbent LEC special access, especially for initial links connecting its base stations to wire centers.¹⁰

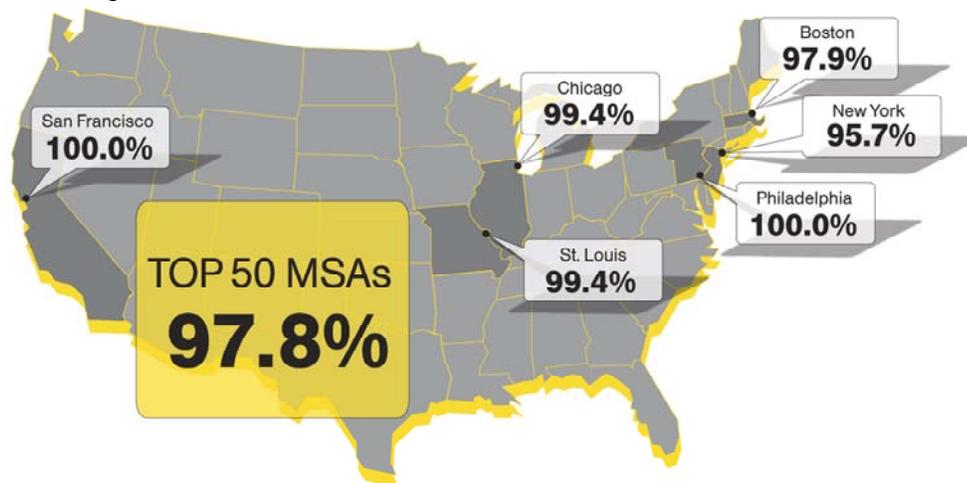
Even in large urban areas, the incumbent LECs continue to dominate the provision of special access service, particularly for the DS1 and DS3 circuits that Sprint Nextel needs to connect our cell sites to our network. As the chart below shows, Sprint Nextel remains heavily dependent on the incumbent LECs for DS1s in the top 50 markets.

⁸ See AT&T Reply Comments, RM-10593, at 12-16 (Jan. 23, 2003) ("AT&T 2003 Reply Comments"); Economics and Technology, Inc., "Competition in Access Markets: Reality or Illusion, A Proposal for Regulating Uncertain Markets," at 16-22 (Aug. 2004) ("ETI Report"), appended as Attachment A to Ad Hoc Telecommunications Users Committee Reply Comments, WC Docket No. 05-65 (May 10, 2005) ("Ad Hoc 2005 Reply Comments"). 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, appended as Attachment B to Ad Hoc 2005 Reply Comments, ¶¶ 19-25 ("2005 Gately Decl."). It appears undisputed that competitive alternatives are available only at a "tiny percentage" of commercial buildings. AT&T 2003 Reply Comments at 13 (stating that the BOCs do not dispute the conclusion that competitive alternatives are available only in a small number of buildings).

⁹ 2005 Gately Decl. ¶ 18.

¹⁰ Comments of T-Mobile USA, Inc. WC Docket No. 05-25, at 6-7 (Aug. 8, 2007) ("T-Mobile Comments").

Dependent on Local Phone Monopolies Nearly 98 Percent of the Time



According to 2006 figures, nearly 98 percent of Sprint Nextel's DS1 connections to cell sites in the country's Top 50 Metropolitan Statistical Areas are provided by incumbent local exchange carriers, primarily AT&T and Verizon.

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Sprint ahead

In the Boston metropolitan area, for example, Sprint Nextel provides wireless service to its subscribers through our network of over 1,500 cellular radio towers and five mobile switching offices. To move our traffic from cell sites to our switches, and then ultimately to the Public Switched Telephone Network, we purchase dedicated DS1 and DS3 circuits to interconnect the towers and switches and link our Boston customers to our national and international telecommunications network. In 2006, Sprint Nextel purchased 98% of the special access circuits for its Boston cell sites from Verizon. That percentage is only slightly lower for Sprint Nextel's purchases for access to buildings – 91.5% of the DS1 and DS3 circuits we purchased in Boston were from one company: Verizon. And the story is the same in Chicago, San Francisco and northern New Jersey.

Even the New York City metropolitan area serves as a striking example of the special access market failure. Nextel, before its merger with Sprint, tried to reduce its

dependence on Verizon's special access service, but found that there was almost no alternative. When it sought bids for special access services for its cell sites in the New York metropolitan area – widely considered to be one of the nation's most competitive markets for wireline services – competitors bid to serve fewer than 3% of the required locations.

B. Exorbitant Prices

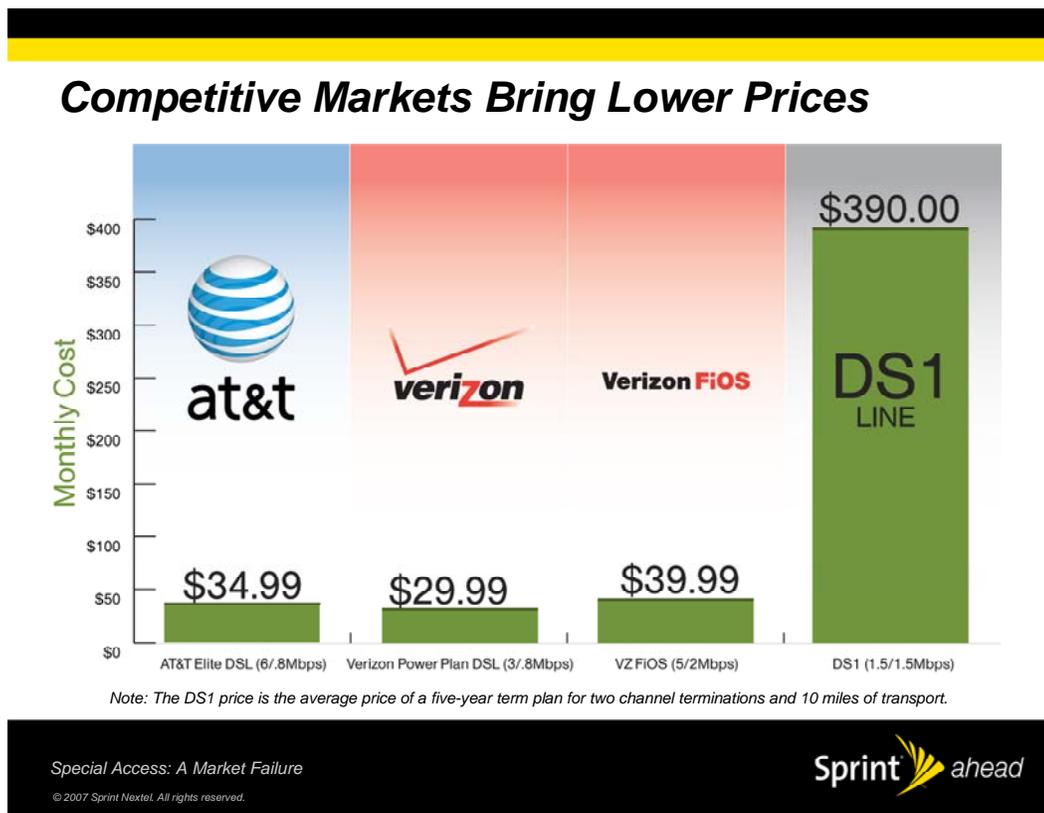
The BOCs' astounding special access earnings have coincided with the FCC's decisions to grant the BOCs greater freedom to set special access prices and keep them high regardless of declining costs. According to the United States Government Accountability Office (GAO), the FCC has given the BOCs some form of special access pricing flexibility in 97 of the 100 largest markets.

The Commission *expected* competition for special access to develop. In fact, it used this *predicted competition* as the basis for its special access pricing flexibility rules. Unfortunately, the Commission's predictions, hopes and aspirations were not met. As the former AT&T noted, "[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."¹¹

Competition for special access did not materialize and the already-excessive special access prices *increased*. In many instances, the BOCs' special access prices are nearly twice as high as the cost of the comparable unbundled network elements (UNEs).

¹¹ AT&T Petition for Rulemaking, RM-10593, at 38 (Oct. 15, 2002).

Tellingly, prices set in competitive markets for similar capacity connections are a fraction of special access prices. For example, compare the price for Verizon’s FiOS service, \$39.99 a month for speeds of up to 5 Mbps, to the \$390 average monthly charge for the much lower-capacity (1.5 Mbps) DS1 circuits we need.¹² Granted, there are some differences between the services, but certainly not sufficient to justify a price almost ten times the competitive price.



Compounding the problem is that, as we are being overcharged, we are subsidizing the very companies with whom we compete. AT&T and Verizon, the largest providers of

¹² See *ex parte* presentation attached to letter from Anna M. Gomez, Sprint Nextel, to Marlene Dortch, FCC Secretary, at 3 (Aug. 22, 2007) (AT&T’s Elite DSL service provides speeds of 6/.8 Mbps, Verizon’s Power Plan DSL service provides speeds of 3/.8 Mbps, Time Warner’s Road Runner Service provides 5 Mbps, and Verizon’s FiOS provides speeds of 5/2 Mbps; a DS1 provides speeds of 1.5/1.5 Mbps.).

special access, are also the largest providers of long distance and cell phone services (Commercial Mobile Radio Services or CMRS). Sprint Nextel and the other long distance and wireless carriers have no choice but to purchase over-priced special access from our two biggest competitors.

The BOCs have a strong incentive to raise the special access costs of their wireless, long distance and broadband competitors. Given the stranglehold they have on the special access market, the BOCs also have the ability to act on this incentive. Moreover, the mergers and increased integration of the BOCs have only heightened their incentive and ability to raise their rivals' special access costs

C. Anti-Competitive Terms and Conditions

The incumbent LECs, particularly AT&T and Verizon, have reinforced their dominance in the special access market by engaging in a number of practices that thwart competition.¹³ For example, they use exclusionary “lock up” and pricing arrangements that require customers to commit to purchasing virtually all of their access needs from the incumbents.¹⁴ They tie their special access prices in one area to acceptance of terms in other services and other areas; furthermore, they impose restrictions on the use of their services. AT&T and Verizon link pricing to historical purchase levels and require long-

¹³ See GAO Report to the Chairman, Committee on Government Reform, House of Representatives, “Telecommunications: FCC Needs to Improve Its Ability to Monitor and Determine the Extent of Competition in Dedicated Access Services,” at 14, 18, 27, 30 and Table 4 (Nov. 2006), available at: <<http://www.gao.gov/new.items/d0780.pdf>> (“GAO Report”).

¹⁴ See, e.g., GAO Report at 30-31. Other strategies involve poor performance in the ordering, provisioning, maintenance and repair of special access services (see *Performance Measurements and Standards for Interstate Special Access Services*, Notice of Proposed Rulemaking, 16 FCC Rcd 20896 (2001)), and practices designed to discourage or slow customers from migrating circuits from the BOC network or “grooming” circuits to reduce circuits or transport mileage costs.

term commitments to continue spending with them at or above those historical levels.¹⁵ In a market that lacks competition, these exclusionary “lock up” terms and conditions reinforce the BOCs’ dominance and deter new entry.

D. Windfall Special Access Earnings

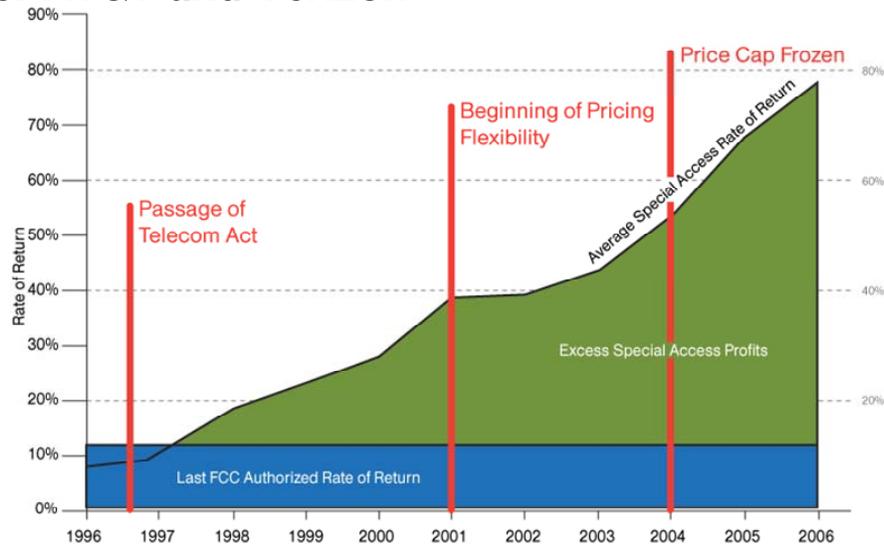
With their overwhelming special access market share, exorbitant prices, and anti-competitive practices, the BOCs are reaping windfall earnings from special access. Unconstrained by effective competition, the two largest BOCs – AT&T and Verizon – take in billions of dollars in excess earnings from special access. These windfall earnings are increasing year after year. The after-tax rate of return that AT&T reported to the FCC for interstate special access services grew from an already-excessive 40% in 2000 to 100% in 2006.¹⁶ Verizon’s reported rate of return for interstate special access more than tripled over the same period, growing from 15% to 52%.¹⁷

¹⁵ See Sprint Nextel Comments at 24-29.

¹⁶ FCC ARMIS Report 43-01, Table 1 – Cost and Revenue, Column (s) (Special Access), Row 1915 (Net Return) divided by Row 1910 (Average Net Investment).

¹⁷ *Id.*

Monopoly Prices Bring Windfall Profits for AT&T and Verizon



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SOURCE: ECONOMICS AND TECHNOLOGY, INC., "SPECIAL ACCESS OVERPRICING AND THE US ECONOMY," APPENDIX 1 TO COMMENTS OF AD HOC TELECOMMUNICATIONS USERS COMMITTEE, WC DOCKET NO. 05-25, AT A-2 (AUG. 8, 2007).

In dollar terms, the magnitude of the over-earnings is astounding. In 2004, the difference between what the BOCs actually earned and what they would have earned at a healthy 11.25% rate of return¹⁸ was more than \$6.3 billion. By 2006, the annual over-earnings grew to \$7.4 billion, with Verizon and AT&T accounting for over \$6.3 billion of that total.¹⁹

¹⁸ The most recent rate of return that the Commission prescribed for cost-of-service incumbent local exchange carriers is 11.25%. *Policy and Rules Concerning Rates for Dominant Carriers*, Second Report and Order, 5 FCC Rcd 6786, ¶ 7 (1990), *aff'd sub nom. Nat'l Rural Telecom Ass'n v. FCC*, 988 F.2d 174 (D.C. Cir. 1993); *Represcribing the Authorized Rate of Return for Interstate Services of Local Exchange Carriers*, Order, 5 FCC Rcd 7507, ¶ 1 (1990).

¹⁹ Over-earnings were computed using Automated Reporting Management Information System ("ARMIS") data ((Reported rate of return – 11.25)*ANI*Tax Factor).

As MCI (now Verizon) informed the FCC in 2004, “[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.”²⁰

III. The Special Access Market Failure Harms Consumers and Deters Broadband Deployment

While competition is thriving on the retail consumer level for wireless and long distance services, AT&T and Verizon’s grip on the wholesale special access market ultimately harms consumers. The incumbents have parlayed the special access market failure into an overcharge-bonanza of \$7.4 billion dollars a year. These overcharges for critical network connections have a material effect on the prices, quality and availability of consumer goods and services.

Let me give you an example. Special access is a major component of Sprint Nextel’s costs of providing CMRS and wireless broadband services. In fact, special access represents about one-third of our monthly network cost of operating a cell site. This figure is at least twice what it would be if special access prices were even remotely related to the cost of providing special access. Reasonable special access prices would free up funds for the construction of additional cell sites and other network improvements, to the benefit of consumers.

A particularly pernicious effect of the special access market failure is that it slows the Nation’s broadband deployment. The high cost of special access, without which competitive broadband providers cannot provide service, acts as a significant barrier to

²⁰ MCI Comments, WC Docket No. 04-313, at 154 (Oct. 4, 2004).

broadband deployment. Sprint Nextel is committed to broadband. We are investing \$2.5 billion through the end of 2008 to deploy our fourth generation network, as well as millions more to upgrade our EVDO network. But forcing us – as well as Internet Service Providers, competitive local exchange carriers, and other long distance carriers and wireless companies – to subsidize the BOCs through overpriced special access slows the rollout of broadband.

The Commission’s offices are filled with reams of filings demonstrating the detrimental effects of the special access market failure on broadband deployment.²¹ The Organization for the Promotion and Advancement of Small Telecommunications Companies (OPASTCO), has pointed out that special access prices affect the availability of broadband services in rural areas in the United States.²² Time Warner Telecom has explained 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

²¹ See, e.g., Reply Comments of Clearwire Corporation, WC Docket No. 05-25, 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.”); Reply Comments of Mobile Satellite Ventures Subsidiary LLC, WC Docket No. 05-25, at 1-3 (Aug. 15, 2007); Reply Comments of BT Americas, Inc., 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”). 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.”); Reply Comments of National Telecommunications Cooperative Association, WC Docket No. 06-125, at 3-4 (Aug. 31, 2006) (describing the consequences if the Commission grants forbearance for special access services, specifically for access to the Internet backbone).

²² Comments of the Organization for the Promotion and Advancement of Small Telecommunications Companies, GN Docket No. 07-45, at 10-11 (May 16, 2007).

“advanced” services to all Americans.²³ Consumer groups have also sounded the alarm about the adverse effect of high special access prices on broadband deployment.²⁴ As the New Jersey Rate Counsel stated: “Artificially high special access rates are jeopardizing the Commission’s ability to achieve its broadband deployment goals.”²⁵

If it remains unaddressed, the special access market failure will continue to act as a barrier to the Nation’s broadband deployment.

IV. The FCC Can and Must Address the Special Access Market Failure

There unquestionably is a market failure for special access services. Unlike many problems that policymakers face, however, this one has a readily available solution. The Federal Communications Commission has the unambiguous statutory authority *and obligation* to ensure that special access prices are just and reasonable.²⁶

To fulfill its obligation of ensuring that special access prices are just and reasonable, until the BOCs face competition for special access services, the Commission must reduce special access rates to reasonable levels by (1) applying its incentive regulation to all special access services, revised to reflect the BOCs’ cost savings, and

²³ Comments of Time Warner Telecom, Inc., GN Docket No. 07-45, at 11-12 (May 16, 2007).

²⁴ Reply Comments of the New Jersey Division of Rate Counsel, WC Docket No. 05-25, 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 (“NASUCA”), 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 NASUCA, WC Docket No. 05-25, at 10 (Aug. 15, 2007) (“None of this is good for competition or good for consumers.”); *see also, e.g.*, Comments of Ad Hoc Telecommunications Users Committee, WC Docket No. 05-25, at 7-8 (Aug. 8, 2007); Comments of the American Petroleum Institute, WC Docket No. 05-25, at 6-9 (Aug. 8, 2007).

²⁵ Comments of the New Jersey Division of Rate Counsel, WC Docket No. 05-25, 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).

²⁶ 47 U.S.C. § 201(b).

(2) by requiring special access rates to be based on costs²⁷ or targeted to earn no more than an overall 11.25% interstate rate of return. Moreover, the Commission must reject transparent attempts by the BOCs to use the “forbearance” authority granted to the Commission to obtain even greater deregulation of special access services.²⁸

The FCC has an obligation to remedy the special access market failure. There can be no doubt that the BOCs have long exercised – and continue to exercise – market power in the provision of the special access services that are a critical component of virtually every communications service. Addressing the special access market failure will produce significant, tangible benefits for consumers, including improved service quality and faster rollout of broadband networks.

²⁷ As Verizon Wireless itself has stated, the charges for telecommunications services should be based on “the cost of providing service, not serve as an uncapped, unending revenue source for certain carriers by requiring their competitors to subsidize them.” *See* Comments of Verizon Wireless, CC Docket No. 01-92, at 11 (Oct. 25, 2006).

²⁸ *See* 47 U.S.C. § 160.

Appendix

Special Access Arrangements

