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RBOCs' Market Power Comes Under Attack

Monopoly Control Of Special Access Becomes Focal Point

The independent Washington, D.C.-based telecom policy “think tank” **Phoenix Center** this week is poised to release a scathing “white paper” – at least 31 pages long – that will take to task the four **Regional Bell Operating Companies** (RBOCs) for abusing their market power in the “special access” arena. *TPR* has learned.

The Phoenix Center’s white paper is expected to report that the RBOCs retain pervasive market power in the provision of special access services; that they are abusing their market power by imposing unreasonable rates; and that, in effect, the result of the RBOCs’ market power abuse is a multibillion dollar annual overcharge on businesses and consumers.

	BellSouth	Qwest	SBC	Verizon
1996	\$508,929	\$429,790	\$1,217,546	\$1,281,907
1997	\$599,609	\$566,877	\$1,494,486	\$1,639,837
1998	\$762,893	\$715,333	\$1,954,938	\$2,093,947
1999	\$919,988	\$921,313	\$2,480,544	\$2,810,671
2000	\$1,233,258	\$1,226,016	\$3,405,544	\$3,724,881
2001	\$1,831,143	\$1,528,226	\$4,294,276	\$4,353,031

Source: FCC

Special access refers to lines, such as T1s, that connect customers directly to long distance carriers. Businesses tend to be the biggest users of special access. In fact, it was the business community’s usage of special access that prompted the **Federal Communications Commission** some years ago to deregulate the service. At the time, the FCC said there was ample competition in the marketplace to justify the decision.

For the past two years, however, a movement has been growing within the business community and elsewhere based on a belief that the FCC’s deregulatory measure may have been hurried and not well thought out. In fact, a number of notable entities have begun applying tremendous pressure on the commission to reconsider its earlier decision, among them the **Special Access Reform Coalition** (SPARC), a group of large business customers and telecom service providers. SPARC’s membership includes **AT&T**, **MCI**, **Cable & Wireless**, the **American Petroleum Institute**, the **Competitive Telecommunications Association** (CompTel), and the **eCommerce & Telecommunications Users Group** (eTUG).

AT&T late last year filed a petition with the FCC seeking a rulemaking that would, if implemented, reverse the FCC’s deregulation of special access. The petition to date has been largely ignored, primarily because FCC Chairman Michael Powell has been unwilling to give AT&T’s complaint an airing. Sources inside the commission say Powell is sensitive to a perception held by some – including pro-RBOC

elements – that the FCC is overly regulatory, and that any move he might make to re-regulate a deregulated service would exacerbate that perception. Nevertheless, the Phoenix Center study, combined with other research from independent sources, could nudge Powell to move the special access issue onto the FCC’s radar screen.

The Phoenix study makes essentially the same argument AT&T made nearly a year ago when it petitioned the FCC to reopen the special access docket. And it also mirrors the views of SPARC, as articulated in a letter to the commission last month. Thus far, however, Powell continues to keep the special access issue on the FCC’s back burner.

Even so, with the Phoenix Center weighing in on the matter, some observers believe that Powell and the other commissioners could soon find themselves getting pressured by key members of Congress to address the issue. The Center’s staff comprises a number of well-respected telecom policymaking professionals, including Lawrence Spiwak, president, who was a senior attorney with the Competition Division in the FCC’s Office of General Counsel from 1994-1998. While there, he provided the commission and its individual bureaus with legal and economic advice on domestic and international interexchange (i.e., long distance), local exchange, delivered video programming, broadcast, wireless and satellite policies. Among his more noteworthy contributions at the FCC, Spiwak provided the primary legal and economic analysis for the agency’s landmark decision to de-regulate AT&T. He also drafted the commission’s rules on public utility entry into telecommunications and information services markets.

Last week, Spiwak and the Phoenix Center surfaced a “policy bulletin” – the fifth in an ongoing series – that concluded there is no reliable “econometric evidence” to show unbundling discourages investment by either the RBOCs or competitive local exchange carriers (CLECs), or has any negative impact on economic performance in the telecommunications industry. This conclusion flies in the face of RBOC assertions and stunningly contradicts the findings of Bell-backed studies suggesting otherwise.

The RBOCs are investing more heavily in their network in states where competition is most intense – even as an economic slowdown has caused total telecom investment to decline, the Phoenix Center said in its latest policy bulletin. On average, net investment by **BellSouth, SBC and Verizon** has increased \$759 per year per UNE-P access line, or about \$5.2 billion in 2002. (UNE-P is an acronym referring to platforms of unbundled network elements.) On average, UNE-P adds about 6.4 percent a year to RBOC investment.

Even in 2002, when the Bell companies’ total net investment fell by about 7 percent, investment dollars were more heavily allocated to states with greater UNE-P competition, according to the Phoenix bulletin, titled “Competition and Bell Company Investment in Telecommunications Plant: The Effects of UNE-P.” But the aggregate decline was cut in half by the additional investment related to UNE-P competition.

“The evidence is unmistakable,” Spiwak told *TPR*. “When the Bell companies face competition in the local phone market, they have to invest more heavily in order to upgrade their offerings and hold on to their customers.”

The Phoenix policy bulletin is posted on the Center’s web site at www.phoenix-center.org.

The Bell companies have for months complained that the FCC’s rules on wholesale pricing for UNE-P discourages investment in new technologies. The RBOCs argue that the UNE-P wholesale pricing formula, which was devised by the FCC, creates a situation in which the Bells are forced to sell network access to their competitors at below-cost prices.

BellSouth's Bill McCloskey was particularly critical of the Phoenix Center's last report. "This study, like others from the Phoenix Center on this topic, conveniently ends with 2001 data," he told *TPR*. "The 2002 data on capital expenditures has been available from the Securities and Exchange Commission for some months. CapEx [capital expenditures] did not 'taper off in recent quarters,' as the [Phoenix Center] study puts it – it plummeted. On the other hand, use of UNE-P picked up in 2002. CapEx and UNE-P numbers are going in the opposite direction. For example, in BellSouth's territory UNE-P lines in service increased by a multiple of seven, while our CapEx dropped 38 percent."

This week, the Phoenix Center's white paper promises to be far more detailed and in-depth than any of its previous "policy bulletins." In fact, its findings are expected to mirror those of a recent SPARC-backed economic study showing that returning special access charges to an 11.25 percent rate of return (ROR) historically allowed by the FCC would add \$14.5 billion to U.S. economic output (in terms of real gross domestic product, or GDP) in the first two years.

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Lawrence Spiwak
President, Phoenix Center

"We didn't use the same model to do our study that [the SPARC study] used," Spiwak told *TPR*. "We created our own model, based on publicly available data." Even so, the Phoenix study's findings "are surprisingly similar" to those of the SPARC study, he said.

The SPARC study noted that rates of return to the incumbent Bell telcos for special access services have risen nearly fourfold to 39.7 percent in 2002 as an increasing amount of the market has been removed from FCC price regulation.

The SPARC study, titled "Macroeconomic Benefits from a Reduction in Special Access Prices," pegged the excess profits to the RBOCs at \$5.6 billion. It said that returning that money to purchasers of special access service would free up billions of dollars for investment, creating a net of 64,000 jobs in the first year and a total of 132,000 jobs in the first two years after prices declined.

The study also concluded that lower prices would increase the total sales of special access services so that the Bells would match their current special access revenues even though margins would decline.