WRITTEN TESTIMONY

OF

PAUL SCHIEBER
VICE PRESIDENT ACCESS AND ROAMING
SPRINT NEXTEL CORPORATION

ON

AN EXAMINATION OF COMPETITION IN THE WIRELESS INDUSTRY

BEFORE THE
HOUSE SUBCOMMITTEE ON
COMMUNICATIONS, TECHNOLOGY AND THE INTERNET

MAY 7, 2009

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I. Introduction and Executive Summary

Good Morning, Chairman Boucher and Members of the Subcommittee. I am Paul Schieber, Vice President Access and Roaming, Sprint Nextel Corporation. Thank you for the opportunity to testify today about competition in the wireless industry in the United States.

Sprint for years has been a leader in the development and deployment of data services, including a 3G mobile broadband platform throughout most of its network and the development of 4G technology. Over the past several years, Sprint has spent billions of dollars to deploy its 3G EVDO network, improve its performance capabilities, and increase the array of advanced services that are available to consumers through its mobile broadband platform. Through our investment in Clearwire, we also are committed to maintaining our leadership role in making 4G broadband services widely available. These mobile broadband services will fuel significant economic development and job growth.

Unfortunately, there continues to be a major impediment to the ability of Sprint and other wireless and wireline providers to make their broadband services ubiquitously accessible and reasonably affordable for all American consumers: "middle mile" special access telecommunications links.

Special access is the lifeblood of the telecommunications industry, both narrowband and broadband, 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. Because of its central role in the deployment of mobile and fixed broadband services, reform of the current FCC regime governing incumbent local exchange carrier (LEC) special access services must be an urgent priority if Congress's vision of universal, affordable access to broadband services is to become a reality. The importance of middle mile facilities to the wider deployment of broadband was underscored in a recent article on the Wall Street Journal's web site. According to the article, Susan Crawford, a member of President Obama's National Economic Council, stated that requests for stimulus funds to underwrite "investments in backhaul (or middle-mile) networks, particularly in rural communities, will likely be particularly helpful."[1]

Sprint offers a comprehensive array of wireless and wireline telecommunications and information services to consumers, businesses and government users. Sprint is widely recognized for developing, engineering and deploying innovative technologies, including two robust mobile networks serving 49 million customers, cutting-edge mobile data services, instant national and international walkie-talkie capabilities, and a global Internet backbone. "Middle mile" special access facilities are an essential input to every one of Sprint's businesses – broadband, wireless, long distance, and enterprise.

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[1] Amy Schatz, *Broadband Funding Hopefuls Pair Up in Search of Stimulus Dollars*, The Wall Street Journal Blogs, April 30, 2009, available at http://blogs.wsj.com/digits/2009/04/30/broadband-funding-hopefuls-pair-up/.

When Sprint and other carriers provide mobile broadband services, we need other providers to link together – into a seamless network – our facilities. In the simplest configuration, a broadband provider must interconnect three segments of an end-to-end service: a local network, middle mile facilities, and a backbone network (see attached Appendix).

In Sprint's case, its local mobile broadband facilities connect a caller or a laptop user to a nearby cell site. Sprint then needs middle mile transmission circuits to transport the customer's traffic from the Sprint cell site to a mobile telephone switching office or another point on Sprint's mobile backbone network and from there to Sprint's Internet backbone network. As has been repeatedly demonstrated by Sprint and other wireless and wireline broadband service providers, as well as by reports issued by the Government Accountability Office (GAO) and the National Regulatory Research Institute (NRRI), we are overwhelmingly dependent on special access facilities provided by incumbent LECs, particularly AT&T and Verizon in their respective home regions, for these middle mile links.

Despite the central role of special access in mobile and fixed broadband deployment, two dominant carriers, AT&T and Verizon, control overwhelming shares of the special access marketplace. Their dominance is apparent from their billions (and increasing) in special access revenues, from their inflated special access prices, and from their anti-competitive contract terms and conditions. Sprint pays AT&T, Verizon and other incumbent LECs hundreds of millions of dollars annually for middle mile special access facilities (the monthly lease payments for these facilities represent more than one-third of the costs of operating a cell site) and, in most cases, Sprint simply has no competitive

alternatives to the incumbent LECs for these facilities. The excessive prices that incumbent LECs charge for these middle mile connections harm consumers and cost jobs by diverting needed resources from Sprint's broadband network and services.

Fortunately, the Federal Communications Commission (FCC) has the legal authority and the evidentiary record to fix the problem and spur broadband deployment. Reform of special access will promote mobile and fixed broadband growth by freeing resources that can be used to invest in new facilities, create new jobs, and contribute to the nation's economic recovery. I ask this Subcommittee to urge the FCC to complete its long pending special access rulemaking proceeding by implementing the reforms that will rein in anticompetitive special access prices and practices by incumbent LECs and thereby allow Sprint and other competitive providers to accelerate their deployment of mobile and fixed broadband. Stimulating broadband deployment in this way will generate economic growth and expand consumer access to broadband communications.

II. Middle Mile Special Access Facilities

A. Overwhelming Market Share

The incumbent LECs overwhelmingly dominate the special access market. Despite the pro-competitive initiatives adopted by Congress in the Telecommunications Act of 1996, the incumbent LECs' share of wholesale special access services has remained in excess of 90%. According to data collected by the FCC, the incumbent LECs' share of the wholesale special access market amounted to 92.7% in 2001 and declined only slightly to 92.1% of an even larger market in 2006.[2]

[2] FCC Monitoring Report Table 1.5, line 305. These data are compiled by the FCC from revenue data reported by all carriers on Form 499-A. The FCC has not yet released data for 2007 or 2008.

During this period, Sprint has become even more dependent 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. In 2001, for example, Sprint obtained 91% of the DS1 channel terminations[3] for its wireline business in the top 50 metropolitan statistical areas (MSAs) from an incumbent LEC. By 2007, that number had risen to almost 98%.[4]

AT&T and Verizon are by far the dominant providers of special access services. Indeed, SBC's acquisition of AT&T (forming the "new AT&T") and Verizon's acquisition of MCI further solidified their dominant position. Those two transactions eliminated not only two of the most prominent advocates for special access reform, but also the two largest competitive providers of special access services. AT&T and Verizon now account for 81% of incumbent local exchange carrier special access revenues nationwide.[5] In the meantime, these two new "mega-BOCs" have dramatically increased their share of the wireless marketplace through acquisitions funded in no small part by excessive special access revenues.

Moreover, revenues generated by special access services have grown exponentially, driven by demand for data services, from approximately $2.5 billion annually in 1990 to $18.1 billion in 2007.[6] Today, interstate special access service revenues account for more

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

[4] *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 and n. 2.

[5] 2007 FCC ARMIS Report 43-01, Table 1 – Cost and Revenue, Row 1090 (Total Operating Revenues), Column (s) (Special Access).

[6] Special Access revenue is reported on ARMIS 43-01, row 1190, column (s).

than half of the incumbent LECs' total revenues from interstate telecommunications services.

Although Sprint actively pursues alternatives to BOC-provided special access, such alternatives are rarely available. For example, many of our cell sites are located in areas other than those where cable companies have typically deployed alternative facilities and wireless backhaul has not yet developed into an economically viable alternative. Today, Sprint buys access from vendors other than the LEC at only 4% of its cell sites.

The absence of geographically broad alternatives to the incumbent LECs for middle mile transmission links has been well-documented in the FCC record over several years.[7] The Ad Hoc Telecommunications Users Committee, an organization of major U.S. businesses, for example, demonstrated that as recently as 2005, the incumbent LECs remained the sole source of dedicated access at roughly 98% of all business premises nationwide, even for the largest corporate users.[8] Similarly, T-Mobile showed that it has few if any alternatives to incumbent LEC special access, especially for initial links connecting its base stations to wire centers.[9]

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[7] *See, e.g.*, 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. Reply 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 Bell operating companies (BOCs) do not dispute the conclusion that competitive alternatives are available only in a small number of buildings).

[8] 2005 Gately Decl. ¶ 18.

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

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 needs to connect our cell sites to our network. Sprint remains heavily dependent on the incumbent LECs for DS1s, currently purchasing 95% of the DS-1 channel terminations needed to reach our cell sites from incumbent LECs.

B. Excessive Prices

The dramatic growth in incumbent LEC special access earnings in recent years coincided with FCC decisions granting incumbent LECs, especially the BOCs, greater freedom to set special access prices and keep them high regardless of declining costs. According to a 2006 report of the United States Government Accountability Office (GAO), the FCC gave the BOCs some form of special access pricing flexibility in 97 of the 100 largest markets.[10]

The Commission's pricing flexibility decisions assumed that competition to the incumbent LEC middle mile special access services would develop and, consequently, marketplace forces would be adequate to constrain the prices and practices of the incumbents. Regrettably, that assumption proved to be utterly unfounded. As the former AT&T noted several years ago, "[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

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[10] *See* GAO Report to the Chairman, Committee on Government Reform, U.S. House of Representatives, *FCC Needs to Improve its Ability to Monitor and Determine the Extent of Competition in Dedicated Access Service*, GAO Report No. GAO-07-80, at 6 (Nov. 2006) (GAO Report).

special access customers. Years of data now confirm that the Commission's predictive judgment was wrong."[11]

Further, reports issued by the GAO and the NRRI in recent years affirm that competitive wireless and wireline carriers have few, if any, alternatives to incumbent LEC middle mile special access services. The November 2006 GAO Report to Congress concluded that in the 16 metropolitan areas that it had analyzed, "facilities-based competitive alternatives for dedicated access are not widely available."[12] More recently, Peter Bluhm and Robert Loube issued a report commissioned by the National Association of Regulatory Utility Commissioners (NARUC) under the auspices of NRRI that found that incumbent LECs possess "strong market power in most geographic areas, particularly for channel terminations and DS-1 services."[13] Both reports also concluded that prices for DS-1 channel terminations were consistently higher in geographic areas where a BOC had obtained more extensive pricing flexibility (Phase II).[14]

The premium that Sprint and other wireless and wireline broadband competitors of the incumbent LECs must pay in the form of excessive prices for middle mile special access facilities is substantial. In many instances, the BOCs' special access prices are nearly *twice the price* of the comparable unbundled network elements (UNEs) which continue to be subject to tighter pricing regulation.

Special access prices are also multiples of the prices set by competitive marketplaces for similar capacity connections. For example, compare the price for

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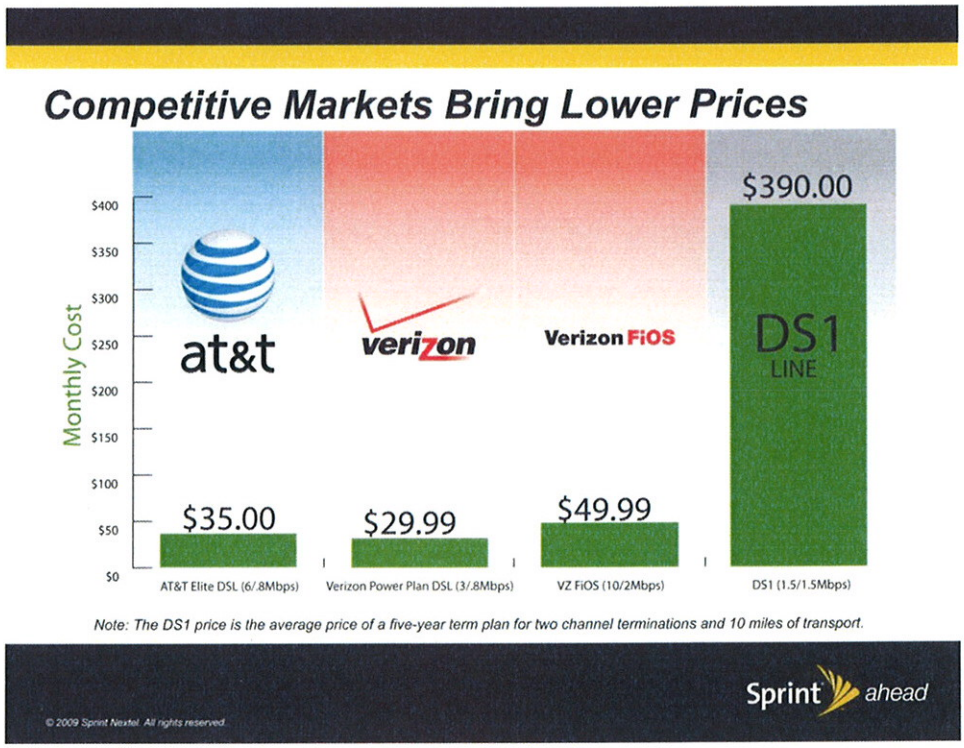
[11] AT&T Petition for Rulemaking, RM-10593, at 38 (Oct. 15, 2002).
[12] GAO Report, Highlights at 1.
[13] *See NRRI, Competitive Issues in Special Access Market,* at iii (Jan. 2009) (NRRI Report).
[14] *See* GAO Report at 27; NRRI Report at 69.

Verizon's FiOS service, $49.99 a month for speeds of up to 10 Mbps, to the $390 average monthly charge for the much lower-capacity (1.5 Mbps) DS1 circuits that are the backbone of Sprint's middle mile links.[15] Granted, there are some differences between the services, but certainly those differences do not justify a price that is many times higher than the competitive price.



The anticompetitive effects of excessively priced special access services are exacerbated by the fact that the billions of dollars of special access charges are paid to two of Sprint's most formidable competitors, AT&T and Verizon, the largest providers of long distance and cell phone services (Commercial Mobile Radio Services or CMRS). Sprint

[15] *See* also *ex parte* presentation of Sprint, WC Docket No. 05-25, at Slide 11 (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).

and the other long distance and wireless carriers have no choice but to purchase over-priced special access from our two biggest competitors.

AT&T and Verizon plainly have a strong incentive to maintain the high special access costs of their wireless, long distance and broadband rivals. Given their dominant position in providing middle mile transmission links, these carriers also are able to act on that incentive. Moreover, the mergers of the BOCs have only provided greater geographic opportunity to impose high special access costs on their wireless rivals.

C. Anti-Competitive Terms and Conditions

The incumbent LECs, particularly AT&T and Verizon, have bolstered their dominance in special access services by engaging in practices that are designed to discourage nascent competition.[16] For example, special access agreements frequently include exclusionary "lock up" and pricing arrangements that require customers to commit to purchasing virtually all of their access service needs from the incumbents.[17] Approximately 93% of Sprint's wireline DS-1s are "locked up" in volume or term agreements.

In addition, incumbent LECs may condition an offer of more attractive prices for special access service in one area on a customer's acceptance of proposed rates, terms and conditions for other services in the same area or other areas. AT&T and Verizon offer special access pricing plans that link lower prices to a customer's commitment to continue

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[16] *See* GAO Report at 14, 18, 27, 30 and Table 4.

[17] *See, e.g., id.* 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.

to purchase service in quantities at or above its historic demand levels over a multi-year period.[18] For example, in 2005, Sprint entered into a five-year agreement with the legacy SBC LECs (Ameritech, Pacific Bell, Nevada Bell, SNET and Southwestern Bell) for dedicated customer DS3, OC3 or OC12 point-to-point circuits in order to avoid the exorbitant non-discounted month-to-month rates. If minimum demand quantities are not met, harsh shortfall penalties apply.

Given the paucity of competitive alternatives and the sole option of even higher priced month-to-month rates, customers of the BOCs have little opportunity to pursue economically viable alternatives. These exclusionary "lock up" terms and conditions reinforce the BOCs' dominance of the middle mile transmission marketplace and deter new entry.

D. Exorbitant Special Access Earnings

Unconstrained by effective competition, the two largest BOCs – AT&T and Verizon – annually generate billions of dollars in excess earnings from special access offerings – and they 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 138% in 2007.[19] Verizon's reported rate of return for interstate special access more than quadrupled over the same period, growing from 15% to 63%.[20] It bears emphasis that rate of return reports and other metrics that enable the FCC and interested parties to assess the financial and operational performance of the BOCs will no longer be kept current. The FCC last year granted the BOCs forbearance from their obligation to file

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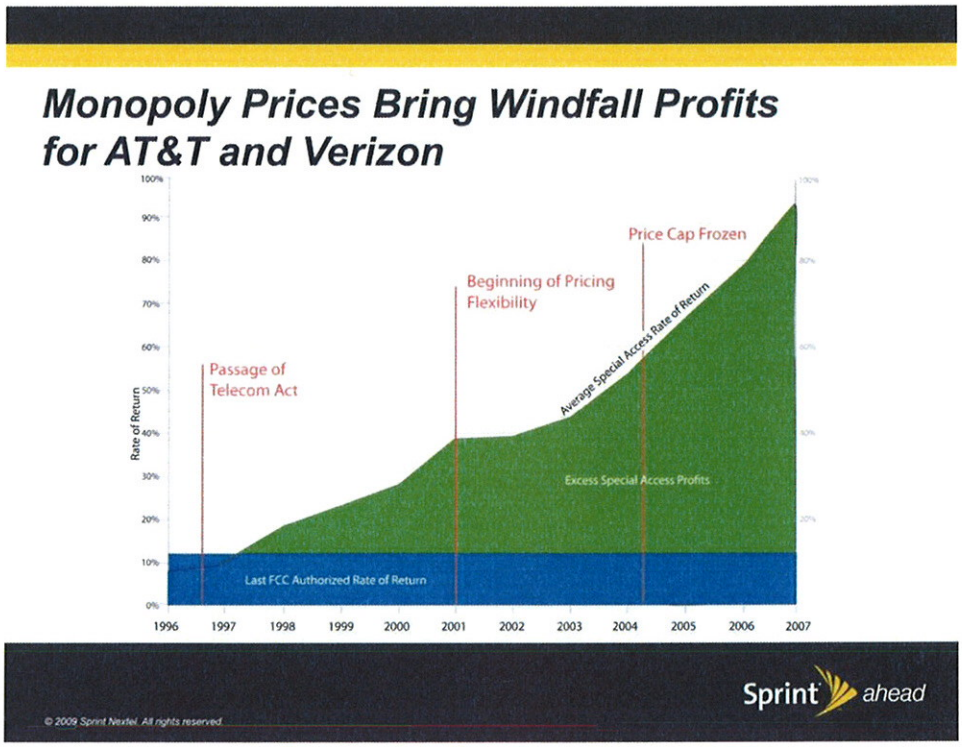
[18] *See* Sprint Nextel Comments at 24-29.

[19] 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).

[20] *Id.*

annual reports with the Commission's Automated Reporting Management Information System (ARMIS).[21]



The scale of the excessive special access profits is breathtaking. In 2004, what the BOCs actually earned above what they would have earned at a healthy 11.25% rate of return[22] was more than $7.8 billion. By 2007, the annual over-earnings grew to $11.0 billion, with Verizon and AT&T accounting for over $9.0 billion of that total.[23]

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[21] *See* AT&T Cost Assignment Rules Forbearance Order, 23 FCC Rcd 7302 (2008); ARMIS Forbearance Order, 23 FCC Rcd 13647 (2008); and ARMIS Legacy Reporting Forbearance Order, 23 FCC Rcd 18483 (2008).

[22] 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).

[23] Over-earnings were computed using Automated Reporting Management Information System ("ARMIS") data ((Reported rate of return – 11.25)*ANI*Tax Factor). As noted,

III. Excessive Special Access Prices Will Discourage and Delay Wireless Broadband Build-Out to the Detriment of Consumers

Mobile broadband services offer unique benefits to consumers that set these services apart from fixed broadband offerings. Most importantly, mobile services can offer all consumers – urban and rural – continuous, ubiquitous access to broadband. The mobility advantage is particularly important in rural areas where, for example, health care professionals can use mobile broadband services to diagnose, monitor, and treat patients remotely and to obtain access to relevant patient medical information. Public safety and first responders in urban areas similarly can benefit greatly from mobile broadband services that allow them access to advanced information at the scene of an emergency.

Mobile broadband services also enjoy a distinct cost advantage over fixed services in areas with a widely dispersed population or challenging terrain. Because mobile broadband services rely on a single tower in a geographic area to deliver high-speed transmission services, mobile providers are not required to incur the substantial costs of constructing individual, "last mile" connections to each end user location. As a result, deploying a mobile broadband offering to a geographic area instantly provides a universally available high-speed service.[24] Coverage in these areas with lower density

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earnings data for these companies are unavailable for 2008 because they are no longer required to update their ARMIS reports.

[24] In addition to the adverse effects of the incumbent LECs' special access prices on wireless broadband availability, other parties have emphasized that those prices have also discouraged wireline broadband growth. *See, e.g.*, Comments of the Organization for the Promotion and Advancement of Small Telecommunications Companies (OPASTCO), GN Docket No. 07-45, at 10-11 (May 16, 2007) (special access prices affect the availability of broadband in rural areas); Comments of OPASTCO to NTIA and RUS on the American Recovery and Reinvestment Act of 2009, Broadband Initiatives, Docket No. 090309298-9299-01 (April 13, 2009) ("Internet backbone providers increasingly compete with rural broadband providers in the retail market as a result of consolidation...giv[ing] backbone providers both the ability and incentive to discriminate against rural providers that are dependent upon them for backbone access."); Comments of the New Jersey Division of

populations would more often be economically viable if special access services were not priced at prohibitive levels.

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.

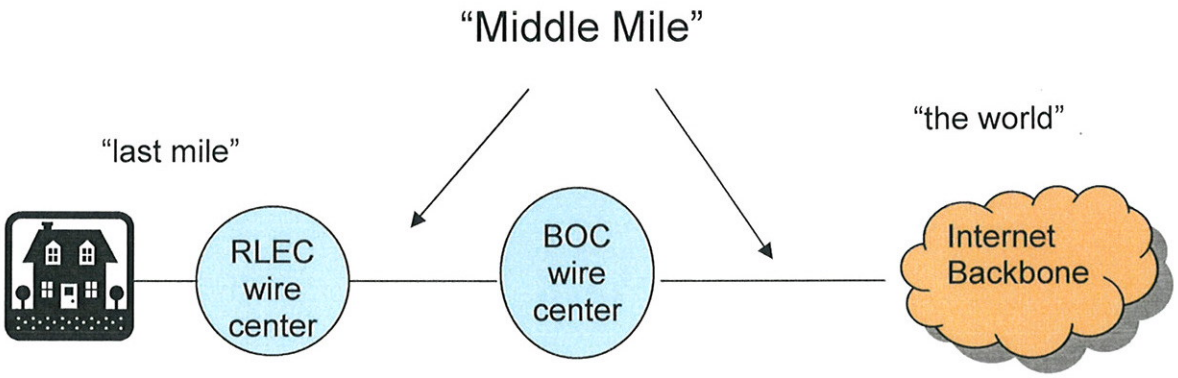
IV. The FCC Can and Must Reform its Regulation of Middle Mile Special Access Services

Congress has made clear that universally available and affordable broadband service is a critical element of its plan for restarting the nation's economic engine. Sprint and other wireless carriers' abilities to deploy these services, however, have been undermined by the excessive, ongoing special access costs associated with every cell site. The FCC has the evidentiary record and the legal obligation to do its part to accelerate broadband deployment by reforming the rules that govern middle mile special access facilities and services and making those services and facilities available at just and reasonable prices, terms, and conditions.

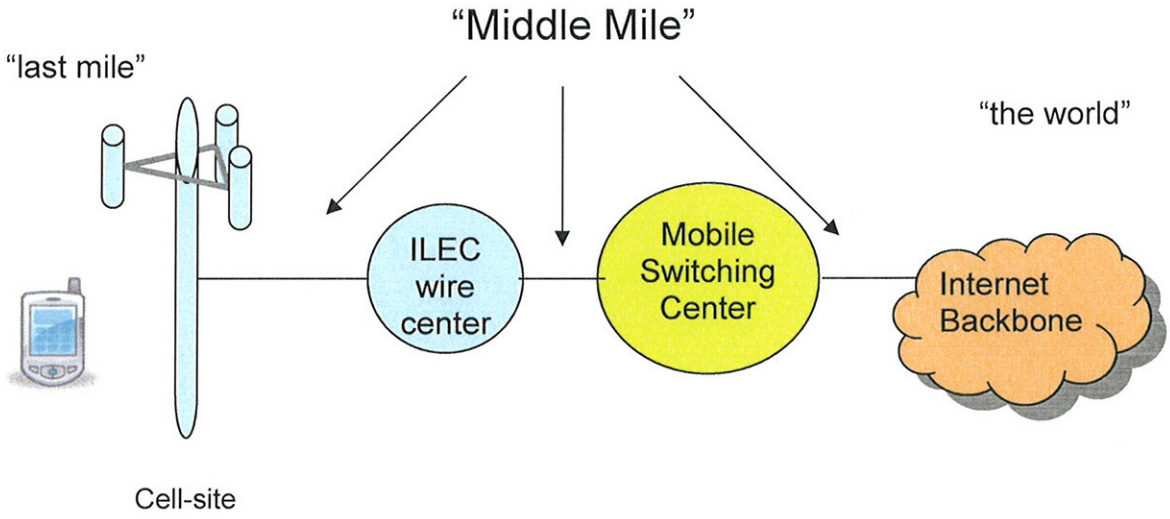
Rate Counsel, WC Docket No. 05-25, at 16-17 (Aug. 8, 2007), quoting Reply Comments of the New Jersey Division of Rate Counsel, GN Docket No. 07-45, at 14 (May 31, 2007) ("Artificially high special access rates are jeopardizing the Commission's ability to achieve its broadband deployment goals.").

APPENDIX

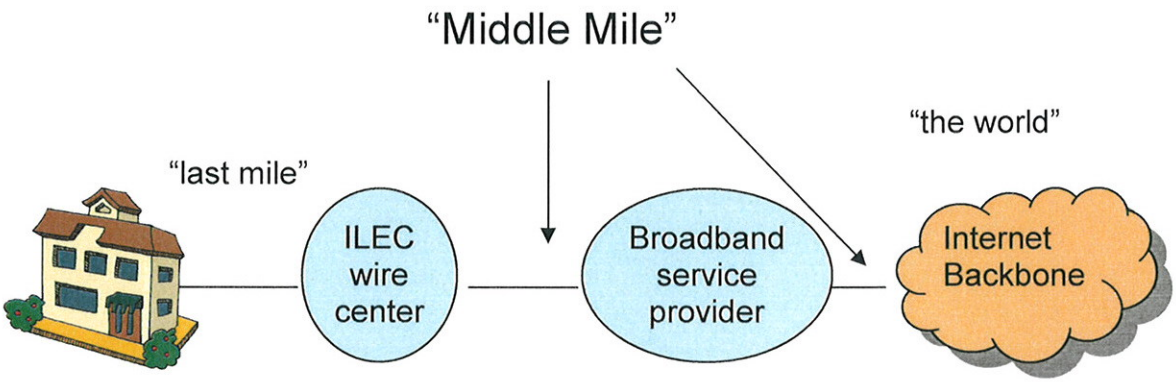
Scenario 1
Fixed Rural Broadband



Scenario 2
Mobile Broadband



Scenario 3
Fixed Office Broadband



Paul W. Schieber, Jr.
Vice President-Access and Roaming
Sprint Nextel Corporation

In his role, Mr. Schieber has responsibility for managing Sprint's access costs. This includes responsibility for both wireless and wireline access. He manages both switched and special access. In addition, he has responsibility for managing Sprint's wireless roaming relationships both domestically and internationally.

Prior to this role, Mr. Schieber was in Sprint's Finance organization. Most recently, he provided financial decision support as well as budgeting, forecasting and reporting support for capital expenditures, operating expense and access costs for Sprint's Technology Services organization.

Mr. Schieber previously supported the Sprint's long distance division as Vice President-Network and IT Finance, Vice President-National Consumer Organization Finance and Vice President-Financial Reporting and Operations Analysis. Prior to that he led the Corporate Audit function, was a Director in the Mergers & Acquisitions group and was a Director leading the Corporate Tax Consulting group. He has been with Sprint Nextel for 17 years.

Before joining Sprint Nextel, Mr. Schieber was a senior manager with public accounting firm Ernst & Young where he worked as an auditor and a tax consultant. In addition, he served as corporate controller for a small publicly held company. He has a BS degree in accounting from Northwest Missouri State University in Maryville, MO.