Before the
Federal Communications Commission
Washington, D.C. 20554

In the Matter of Special Access for Price Cap Local Exchange Carriers	)	WC Docket No. 05-25
AT&T Corporation Petition for Rulemaking to Reform Regulation of Incumbent Local Exchange Carrier Rates for Interstate Special Access Services	)	RM-10593

REPLY COMMENTS OF THE NATIONAL ASSOCIATION OF STATE UTILITY CONSUMER ADVOCATES AND THE NEW JERSEY DIVISION OF RATE COUNSEL

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SUMMARY

The National Association of State Utility Consumer Advocates ("NASUCA") and the New Jersey Division of Rate Counsel ("Rate Counsel") (together "Joint Commenters") submit these reply comments to the Federal Communications Commission ("FCC" or "Commission") to address others' recommendations regarding the appropriate analytic framework for examining special access markets (Section IV.A of the Notice of Proposed Rulemaking) and regarding the terms and conditions by which incumbent local exchange carriers ("ILECs") offer special access services to purchasers (Section IV.C. of the Notice of Proposed Rulemaking).

The initial comments demonstrate a predictable stand-off between those who assert that special access markets are robustly competitive, with sophisticated purchasers negotiating easily with ILECs, and those who provide substantial evidence of ILECs' market power, including supracompetitive rates, and describe provisions that lock in demand through "loyalty" programs and tying of competitive and non-competitive markets. The former set of commenters advocate high special access rates to encourage investment, seek to portray DS1 and DS3 circuits as belonging to an antiquated "dial-up" past, and seek more regulatory relief. The latter commenters, on the other hand, provide compelling evidence that the increasing prevalence of OCn and Ethernet circuits can occur and is occurring at the same time that there continues to be demand for DS1 and DS3 special access services, and because ILECs possess market power for DS1 and DS3 services, absent regulatory oversight, ILECs will continue to earn supracompetitive prices on these essential services. The unreasonably high rates, in turn, depress economic activity and cause consumers to pay more than is economically efficient for goods and services that depend on ILEC-provided special access services.

Joint Commenters reiterate the views set forth in Rate Counsel's initial comments, which weigh in on the view that special access markets are not working efficiently, and these market distortions (supracompetitive rates and unreasonable terms and conditions) harm consumers. Joint Commenters urge the Commission to reject the ILECs' false dichotomy: Contrary to the ILECs' position, reasonably priced and offered legacy DS1 and DS3 services will not disrupt the nation's broader transition to IP networks. Joint Commenters' reply comments also discuss and recommend the following as the Commission embarks on its data-driven analysis of special access services markets and special access services terms and conditions:

- The Commission should issue its data request in a timely manner.
- The Commission should adopt the traditional market power analysis that it used in the Qwest Phoenix Forbearance decision, and should only consider potential entry that is "timely, likely and sufficient in its magnitude, character and scope to deter or counteract the competitive effects of concern."[1] If in doubt, the Commission should reject speculations about potential entry – the Commission's past predictions have not proven out.
- The Commission should avoid allowing the design and implementation of regression models to become an end unto itself: Diverse parties could endlessly debate the significance and correlation of key variables in any econometric model, and that debate could cause undue delay in remedying the flawed special access rules.
- The Commission should reject ILECs' investment scare tactics: Accurate pricing signals will encourage, not stifle, efficient investment.
- The Commission should not adopt the role of an economic development agency – raising rates with the goal of encouraging suppliers to enter markets would be a misguided policy. The purpose of the proceeding should be to result in efficient rates, and if some markets cannot efficiently support multiple suppliers, the solution is to ensure that the providers' rates, terms and conditions are regulated adequately rather than to allow the incumbent carriers to raise their rates to supracompetitive levels.

[1] U.S. Department of Justice and the Federal Trade Commission, Horizontal Merger Guidelines, Issued August 19, 2010 ("DOJ/FTC 2010 Merger Guidelines"), at § 9.

- The Commission should not allow ILECs' clamor about their transition to an IP network to obfuscate an economic analysis of whether markets are competitive.

- The Commission should reject ILECs' recommendations to postpone remedies for unfair and anticompetitive terms and conditions, and rather should expeditiously adopt solutions. Freeing up demand that is now locked in ILECs' contracts will spur new investment because other suppliers will be able to attract capital to serve the "liberated" special access services demand.

Joint Commenters neither supply nor purchase special access services, and therefore, do not bring first-hand experience of the workings of the relevant product and geographic markets to the FCC. On the other hand, Joint Commenters are aware of evidence that has been gathered on this subject, for instance by the California Public Utilities Commission ("CPUC") in its investigation of the AT&T/T-Mobile merger. The CPUC gathered information on the large ILECs' market power in the cellular telephony backhaul space.[2]

As a general matter, consumers benefit from well-functioning special access services market and therefore support fully regulatory remedies where market imperfections persist. Joint Commenters also welcome data-driven, analytically sound examinations of the structure of relevant geographic and product markets for special access services, not as an end unto itself, but rather to provide an administratively feasible roadmap for modifying regulatory oversight where necessary. Furthermore, Joint Commenters have been and continue to be skeptical of undue reliance on predictions about where and how competition might exist, and instead have consistently supported a more grounded, analytically sound market structure approach that affords proper weight to the market structure that exists today rather than an approach that favors unrealistic hopes for competition.

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2 .*See, e.g.,* July 8, 2011 public hearing in CPUC proceeding I.11-06-009 *Investigation of Planned Purchase by AT&T of T-Mobile,* transcript at pp. 87 (Sprint assertion that "90-plus percent of our special access [backhaul] is with the ILECs"); *see also id.* at 93-94; *cf.* www.nochokepoints.org. The CPUC also collected data from all the large wireless companies operating in the state regarding their use of special access backhaul, which data – although confidential – reportedly confirms the statements made by Sprint.

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I. INTRODUCTION

The National Association of State Utility Consumer Advocates ("NASUCA")[3] and the New Jersey Division of Rate Counsel ("Rate Counsel")[4] (together "Joint Commenters") reply to

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[3] NASUCA is a voluntary association of advocate offices in more than 40 states and the District of Columbia, incorporated in Florida as a non-profit corporation. NASUCA's members are designated by laws of their respective jurisdictions to represent the interests of utility consumers before state and federal regulators and in the courts. Members operate independently from state utility commissions as advocates primarily for residential ratepayers. Some NASUCA member offices are separately established advocate organizations while others are divisions of larger state agencies (e.g., the state Attorney General's office). NASUCA's associate and affiliate members also serve utility consumers but are not created by state law or do not have statewide authority. NASUCA did not submit initial comments in response to the FCC's notice of proposed rulemaking *In the Matter of Special Access for Price Cap Local Exchange Carriers; AT&T Corporation Petition for Rulemaking to Reform Regulation of Incumbent Local Exchange Carrier Rates for Interstate Special Access Services*, WC Docket No. 05-25; RM-10593, Report and Order and Further Notice of Proposed Rulemaking, rel. December 18, 2012. These comments refer to this Report and Order and Further Notice of Proposed Rulemaking as "NPRM."

[4] Rate Counsel is an independent New Jersey State agency that represents and protects the interests of all utility consumers, including residential, business, commercial, and industrial entities. Rate Counsel has submitted numerous comments in Docket 05-25, most recently on February 11, 2013 in response to the NPRM.

the comments submitted regarding the issues that the Federal Communications Commission ("FCC" or "Commission") raised in Sections IV.A and IV.C of the NPRM.[5]

Not surprisingly, the ILECs that submitted comments describe a "competitive dynamic" market,[6] with competitors poised to enter quickly, easily and ubiquitously. The ILECs attempt to explain their special access rate increases as a trend that occurred because, purportedly, their original historic prices had been artificially low; they contend that regulation "is unnecessary and counterproductive."[7] According to the ILECs, cable companies and wireless companies offer new sources of supply that provide sufficient competition with the ILECs' special access services; the transition to an IP network will, of course, solve all problems; and "[e]xcessive regulation of DS1 and DS3 offerings in price-cap jurisdictions would inhibit the deployment of *all* of these services, and undercut the immense benefits customers have enjoyed as next-generation networks have proliferated."[8]

In sharp contrast, consumers (e.g., Ad Hoc) and CLECs depict very different special access service markets, ones that are plagued by unjustified rate increases, with significant barriers to entry, and characterized by terms and conditions that thwart competition by locking in consumers' demand.

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[5] These reply comments were prepared with the assistance of Susan M. Baldwin. Comments were submitted by incumbent local exchange carriers ("ILECs"), including Alaska Communications Systems ("ACS"), AT&T, Inc. ("AT&T"), CenturyLink, Inc. ("CenturyLink"), Verizon and Verizon Wireless ("Verizon"); competitive local exchange carriers ("CLECs"), including, BT Americas Inc. ("BT"), Cbeyond Communications, LLC ("Cbeyond"), EarthLink, Inc. ("EarthLink"), Integra Telecom, Inc. ("Integra"), Level 3 Communications, LLC ("Level 3"), and tw telecom inc. ("tw telecom") (collectively, the "CLEC Joint Commenters"), Level 3, XO Communications LLC ("XO"), and TelePacific Communications ("TelePacific"); wireless carriers that are not affiliated with incumbent local exchange carriers, e.g., Sprint Nextel Corporation ("Sprint"); and consumers, including, in addition to Rate Counsel, Ad Hoc Telecommunications Users Committee ("Ad Hoc"). As Rate Counsel stated in its initial comments (at 3), the FCC should not equate the relative silence of consumer advocates and state regulators in this phase of Docket 05-25 as indifference, but instead should attribute their silence to the spate of FCC proceedings that strains the limited resources of public agencies.

[6] Verizon, at 1. See also CenturyLink at 45, referring to "a story of robust competition."

[7] Verizon, at 1.

[8] CenturyLink, at 2-3, emphasis in original.

The ILECs urge the Commission to postpone addressing issues regarding the terms and conditions by which ILECs offer special access services, and, in support of this position, contend that the Commission must first determine whether markets are competitive. By contrast, CLECs and Ad Hoc emphasize that every day that the ILECs are permitted to continue to impose onerous terms and conditions on their services corresponds with delay in facilitating the very competition that the FCC seeks to achieve.

Joint Commenters neither supply nor purchase special access services, and therefore, do not bring first-hand experience of the workings of this market to the FCC. On the other hand, consumers benefit from well-functioning special access services market and therefore support fully regulatory remedies where market imperfections persist. Joint Commenters also welcome data-driven, analytically sound examinations of the structure of relevant geographic and product markets for special access services, not as an end unto itself, but rather to provide a roadmap for modifying regulatory oversight where necessary. Furthermore, Joint Commenters have been historically and continue to be skeptical of undue reliance on predictions about where and how competition might exist. Instead, Joint Commenters have consistently supported a more grounded, analytically sound market structure approach that affords proper weight to the market structure that exists today, with potential entry afforded weight only where, consistent with the Department of Justice and Federal Trade Commission guidelines, such entry is "timely, likely and sufficient in its magnitude, character and scope to deter or counteract the competitive effects of concern.'"[9]

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[9] U.S. Department of Justice and the Federal Trade Commission, Horizontal Merger Guidelines, Issued August 19, 2010 ("DOJ/FTC 2010 Merger Guidelines"), at § 9.

The ILECs also present a false dichotomy, seemingly seeking to persuade the Commission that reasonably-priced "legacy DS1 and DS3 services"[10] will necessarily "disrupt the broader transition to IP networks."[11] The purpose of this proceeding should be to identify and remedy market imperfections; the remedies for these imperfections will not prevent the economically-efficient transition to IP networks.

Joint Commenters are also skeptical of the ILECs' attempts to rely on the presence of cable companies,[12] OCn-capacity fiber-optics and gigabit Ethernet offerings, and wireless services[13] as constraints on the behavior and prices of ILECs' special access services, for several reasons. First, as these comments discuss below, best efforts broadband is clearly not in the same product market as special access services, and, therefore these services do not exert competitive pressure on special access services market. Also, contrary to the suggestions in some comments,[14] the increasing demand for Ethernet-based services does not alter the fact that there is continuing need for legacy DS1 and DS3 circuits. Although carriers may seek to depict DS1 and DS3 as services of a bygone past,[15] there continues to be demand for these ILEC-provided services throughout the country, and rumors of their demise are greatly exaggerated.[16]

The ILECs' position that the FCC should rely on fixed wireless as a way to constrain the prices of special access services is also without merit: ILECs' special access services provide levels of performance, security, and ubiquity that fixed wireless does not offer. Furthermore, the

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[10] CenturyLink, at 1.

[11] Id., at 2.

[12] See, e.g., id., at 23-27; Verizon, at 21-23.

[13] See, e.g., CenturyLink, at 28-29; Verizon, at 23-26.

[14] See, e.g., CenturyLink at 14-18, discussing the shift from DSn offerings to higher-capacity Ethernet services.

[15] See, e.g., id., at 10-11.

[16] See, e.g., id., at 17-18.

notion that AT&T and Verizon wireless affiliates, which together control 62 percent of the nation's wireless customers (and a similar percentage of wireless revenues) provide any kind of market discipline for AT&T's and Verizon's special access services lacks any traction whatsoever.[17]

Joint Commenters have repeatedly expressed their dismay to the FCC that the FCC eliminated the very reporting requirements that would inform proceedings such as this, i.e., the Automated Reporting Management Information System ("ARMIS") reports that would show the likely billions of dollars that ILECs earn from special access services, which overshadow the far smaller market share served by CLECs. Joint Commenters continue to recommend that the FCC, which prizes data-driven decisions, re-impose reporting requirements to inform future special access decisions so that one could for example, refer to the precise annual dollars in revenues that Verizon and AT&T generate from their special access services. Joint Commenters are unaware of any CLEC that comes close to the ILECs' presence in the special access market, and these skewed positions are critically important to keep in context when considering if and where CLECs create any competitive pressure.

[17] *In the Matter of Implementation of Section 6002(b) of the Omnibus Budget Reconciliation Act of 1993; Annual Report and Analysis of Competitive Market Conditions With Respect to Mobile Wireless, Including Commercial Mobile Services*, WT Docket No. 10-133 (Terminated), *Fifteenth Report*, rel. June 27, 2011, at Table 4. The FCC sought year-end 2011 data in March 2012 in anticipation of publishing its Sixteenth Annual Mobile Competition Report. It has not yet released this report. See: http://www.fcc.gov/reports/mobile-wireless-competition-report-16th-annual.

II. ANALYTIC FRAMEWORK FOR EXAMINING SPECIAL ACCESS SERVICES MARKETS (PART IV.A OF NPRM)

A. Special access services are essential inputs for large businesses and also for CLECs.

The special access services that ILECs offer are essential inputs for large businesses, government agencies, and CLECs. End users (e.g., large business users) rely on ILEC-provisioned special access services in order to produce their goods and services. In turn, their consumers pay indirectly for special access services when they purchase these goods and services.

CLECs provide "on net" special access services to customers, i.e., they use their own facilities to offer special access service, and also rely on "off net" services, i.e., they rely on the facilities of others, and also use a combination of on-net and off-net facilities. Therefore, the way that ILECs price their services and the conditions by which they offer special access services directly affect CLECs' ability to compete. As XO explains: "When XO sells TDM-based transport and channel termination services 'off net' 90%+ of those sales consists solely of or incorporate price cap LEC special access circuits, which XO obtains directly from the price cap LECs or from competitive providers that are reselling price cap LEC special access," thus "price cap LECs' special access facilities are an essential component to XO's 'off net' transport and channel termination services."[18] Because of their geographic reach, ILECs possess a unique position in special access markets. ILECs have deployed channel terminations (which are essential elements of special access circuits) "far more extensively" than CLECs, and also are the

[18] XO, Declaration of James A. Anderson, XO's Director of Standard Pricing and Analysis ("Anderson Declaration"), at para. 7.

primary supplier of special access transport.[19] Furthermore, CLECS cannot "negotiate" with ILECs, but instead are captive to the rates, terms, and conditions that ILECs set.

B. Price signals should encourage efficient investment, not investment just for the sake of investment.

Others echo Rate Counsel's concern expressed in the initial comments that special access prices should encourage **efficient** investment.[20] Ad Hoc stated: "The Commission should clarify that its primary goal under the Communications Act is to ensure just and reasonable rates, not new sources of investment revenue for incumbents and competitors."[21] The FCC is primarily charged with ensuring that telecommunications rates are just and reasonable, not with economic development, and, therefore, should not be implementing policies that unnecessarily tilt the market toward inefficient investment, particularly where such policies would jeopardize the achievement of economically efficient rates.

Accordingly, Joint Commenters are concerned by the FCC's statements: "In undertaking that [regression] analysis we will consider evidence as to what leads firms, including competitive providers, to undertake infrastructure investments. In so doing, we will consider whether our current regulatory regime may be hindering, for example, by keeping prices low, competitive investments that would reduce or obviate the need for regulation."[22] It would be imprudent policy (the cost of which consumers ultimately would bear) to let carriers with market power raise their prices simply to attract new (and inefficient) investment in markets that cannot sustain efficient investment by multiple suppliers.

[19] XO, Declaration of John T. Dobbins, XO's VP of Network and Access Optimization ("Dobbins Declaration"), at para. 4.

[20] Rate Counsel, at 10-11.

[21] Ad Hoc, at i.

[22] NPRM, at para. 67.

As discussed more extensively below, Joint Commenters, therefore urge the Commission to exercise caution as it designs its econometric models.[23] Joint Commenters welcome a competitive market if competition leads to just and reasonable rates, but competition should not be pursued where the artificially created competition leads to inflated rates. Joint Commenters are hopeful that the Commission will use its regressions to ensure that the appropriate regulatory oversight is in place to yield prices that provide accurate signals, with the overall consequences that society's resources are used efficiently and consumers pay reasonable prices for the goods and services that depend on companies' use of special access services.

C. The FCC should reject the ILECs' attempt to obfuscate the analysis of markets with discussion of new technologies.

In addition to Rate Counsel,[24] others address the relationship between the transition to an IP network and special access services. Joint Commenters concur with Ad Hoc that "[t]he Commission must ... structure its analysis in this docket to ensure that the particular transmission protocol that carriers may choose to use on non-competitive loop plant does not cloud its economic and policy analysis."[25] The ILECs continually argue in multiple proceedings trying to persuade the FCC that somehow the use of a new technology means that economic analyses are irrelevant. Joint Commenters urge the FCC to reject this line of "reasoning" outright. As XO aptly explains, "the clear market advantages that incumbent LECs have today over their competitors due to their unparalleled facilities-based reach to end user locations,

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[23] Id.

[24] Rate Counsel, at 11.

[25] Ad Hoc, at 10.

particularly in business and enterprise settings, will not automatically dissipate as the public switched network evolves toward an Internet protocol public communications network."[26]

The ILECs are unabashedly seeking to scare the FCC into a belief that new special access service rules could "imperil the migration to high-capacity IP networks."[27] Particularly galling, in the context of the ILECs' vocal lobbying for hastening the nation's transition to an IP network, is the fact that the ILECs' special access terms and conditions actually **thwart** rather than spur the nation toward the IP network. XO states, regarding the ILECs' onerous volume discount constraints:

> XO has only a limited ability, for example, under its special access commitment plans with Verizon and AT&T to move TDM circuits to Verizon Ethernet platforms to meet the increasing demand and have the Ethernet purchases count against its volume commitments. The Commission should be troubled by this inability to evolve to IP platforms, particularly as AT&T and other price cap LECs seek to assume the role of heralding a transition to such networks.[28]

The ILECs' behavior is consistent with companies that seek to dictate the way in which the nation migrates to an IP network, and to control the way that ILECs provide access to their competitors and customers to their networks. Joint Commenters certainly welcome a migration to an IP network, but the migration should not become an excuse for ILECs to shed regulatory oversight. Similarly, if the FCC exercises regulatory oversight of those special access service markets that lack effective competition, then the FCC will facilitate the transition to an IP network by encouraging efficient investment. Contrary to the ILEC arguments that artificially low prices are impeding technological progress, Joint CLEC Commenters suggest that the

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[26] XO, footnote 27. See also, TelePacific, at 7, stating: "Further, the ongoing evolution to IP-based networks does not alter the fact that ILECs have the only last mile connections to most businesses." (Internal citations omitted.)

[27] CenturyLink, at 32. See, generally, id., at 32-36.

[28] XO, at 13, internal citations omitted.

purchasing agreements the ILECs require (i.e. large amounts of DS1 and DS3) "delay the adoption of Ethernet and other packet-mode services."[29]

Ultimately, AT&T is opposed to the FCC's regressions based on 2010 and 2012 static time "because that period of time has seen rapid technological change and a marketplace shift from the TDM services at issue to newer, unregulated broadband technologies such as Ethernet."[30] AT&T's position suggests that industry stonewalling has been effective and that it is too late to do anything now: "The Commission should be devoting its scarce resources to facilitating the transition to IP-based networks, not to a large-scale, quixotic investigation into whether it should re-impose long outdated rate regulation on legacy TDM-based services that have entered a permanent and irreversible decline."[31] This position fails to acknowledge that the purportedly antiquated TDM-based special access services are still in substantial demand throughout the country and generate significant revenues for ILECs.

D. The goal of this proceeding should be to correct the current flawed regime.

AT&T's self-serving recommendation that the FCC place more emphasis on ensuring that prices are not artificially low rather than artificially high[32] should be dismissed. AT&T's analysis that prices above competitive levels will ultimately attract entry fails to account for the myriad market failures that exist that make that outcome highly doubtful. If this analysis were accurate, rate regulation would never have been required in the first place!

Ad Hoc raises a concern similar to that voiced by Rate Counsel[33] regarding the FCC's seemingly misguided approach to this phase of Docket 05-25. Ad Hoc observes:

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[29] Joint CLEC Commenters, at 41.

[30] AT&T, at 8.

[31] Id., at 2.

[32] AT&T, at 32.

[33] Rate Counsel, at 7.

> Even more troubling to enterprise customers is the statement that "[t]he goal of the proposed market analysis is to gain a fulsome picture of competition in the special access market so we can develop rules to more precisely provide regulatory relief as necessary." Developing a replacement for the failed pricing flexibility regime is an appropriate secondary goal for the Commission's market analysis. The Commission's primary goal should be an immediate identification of the areas in which its failed policies have resulted in premature deregulation and excessive rates, so that customers in those locations can obtain essential services (including DS-1, DS-3, Ethernet, and other packet-mode services) at just and reasonable rates from carriers who face neither actual nor potential competition that is sufficient to discipline their pricing behavior.[34]

Joint Commenters urge the Commission to consider not only areas where relief from regulation may be needed, but also to determine where **more effective** regulation is essential.

E. A traditional market power analysis should form the foundation of the Commission's analytic framework.

Joint Commenters concur with recommendations that the Commission begin its examination of special access markets with a traditional market power analysis. Toward that end, the Commission should define relevant product and geographic markets, distinguish between facilities-based and non-facilities-based providers, and examine wholesale and retail product markets separately.[35] As Sprint observes, the framework that the FCC used in its recently upheld Qwest Phoenix Forbearance Order should be followed in this proceeding.[36]

1. Product markets

Joint Commenters concur with Sprint that "to determine whether two services belong in the same product market, the Commission should employ the 'SSNIP' test, which examines

[34] Ad Hoc, at 13. See also, Ad Hoc, Appendix A, which aptly illustrates how the current system leads to higher rates – not the lower rates one would anticipate in a competitive market. Id, at 6, footnote 12. 12.

[35] Sprint, at 3.

[36] Id., at 5-6, citing *Petition of Qwest Corporation for Forbearance Pursuant to 47 U.S.C. § 160(c) in the Phoenix, Arizona Metropolitan Statistical Area*, Memorandum Opinion and Order, 25 FCC Rcd 8622, ¶ 37 (2010), *aff'd, Qwest Corp. v. FCC*, 689 F.3d 1214 (10th Cir. 2012) ("*Qwest Phoenix Forbearance Order*"). See also, TelePacific, at 3.

whether a 'hypothetical monopolist' would be able to impose a small but significant and nontransitory increase in price ('SSNIP') without reducing its profitability."[37] If the increase in the price would cause enough customers to migrate to a second service so as to make the price increase unprofitable, then the services belong in the same product market.[38]

XO provides a reasonable overview of product market delineations for special access services:

> The Commission should define the relevant product market according to (1) the points connected by the transmission link and (2) the capacity of the link. In regard to the points connected, special access circuits are offered as stand-alone channel termination transmission facilities connecting a building to a carrier facility, as stand-alone transport facilities connecting carrier facilities, or as a combination of channel termination and transport facilities. As for the capacity of the link, special access circuits vary by performance (e.g. TDM Circuits – DS1 (1.54 Mbps), DS3 (44.74 Mbps) and Ethernet IP Circuits – 10 Mbps, 100 Mbps, and larger), and each should be examined independently.

Channel termination and channel mileage services are distinct products; and services with different capacities are distinct products.[39] Joint CLEC Commenters propose that the FCC:

> (1) exclude "best efforts" services, such as cable modem services, from any relevant product market for dedicated special access services; (2) consider utilizing the capacity of services as a simplified means of defining markets; (3) treat channel termination and transport services as separate product markets where, as with DS1 and DS3 services, those two services are offered separately at different prices but not treat these components as separate product markets where, as with Ethernet, channel termination and transport are offered on an integrated basis and at a single price; and (4) treat services sold to wholesale and retail purchasers as belonging to different product markets.[40]

Joint Commenters agree.

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[37] Sprint, at 6.

[38] Id., at 7, citing *Qwest Phoenix Forbearance Order* ¶ 56; DOJ/FTC 2010 Merger Guidelines, § 4 ("Market definition focuses solely on demand substitution factors, i.e., on customers' ability and willingness to substitute away from one product to another in response to a price increase or a corresponding non-price change such as a reduction in product quality or service."). See also, CenturyLink at 13.

[39] Sprint, at 7.

[40] Joint CLEC Commenters, at 7. See also, TelePacific, at 8-9.

2. *Comments demonstrate that "best efforts broadband Internet access services" are not interchangeable with special access services.*

The FCC should reject comments seeking to incorporate "best efforts" broadband services in special access market analysis.[41] As XO explains:

> Special access and Ethernet services are usually sold with quality of service guarantees. 'Best efforts' Internet broadband access or transport services do not offer those same guarantees and typically do not appeal to XO's customers, other carriers, mid-sized and large businesses, and enterprises.[42]

Ad Hoc further explains why best efforts broadband services have no place in the Commission's market analysis:

> A passing familiarity with the nature and history of special access services is sufficient to de-bunk this idea. All special access services have two definitional characteristics which distinguish them from best efforts business broadband Internet access services – special access connections are, by definition, dedicated to the exclusive use of the customer and they originate and terminate at locations designated by the customer, not the carrier.
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> First, as dedicated services (or "private line" services, as they were known historically), special access offers customers a higher reliability option and higher capacities than traditional switched services provided over shared loop plant and shared end office facilities. Carriers sell special access at specified capacities or speeds (DS1, DS3, Ethernet, etc.) and customers buy them in order to obtain fixed capacity transmission links that are dedicated to their exclusive use, guaranteeing that the minimum bandwidth they purchase will always be available when they want to use it. There are no busy signals when special access is used for voice service. ILECs commit to provide a specified capacity level that does not fluctuate when they sell special access to their customers. By comparison, best efforts business broadband Internet access services are, well, best efforts – the antithesis of special access and the modern day equivalent of traditional switched voice service which may or may not be available (or too slow) when the network is busy.
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> Second, special access services are services for which the customer, rather than the carrier, specifies the end points. Theoretically, a customer could choose an

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[41] See, e.g., Verizon, at 23.

[42] XO, Anderson Declaration, at para. 10. See, also, Joint CLEC Commenters, at 7; Sprint, Attachment A, Declaration of Paul W. Schieber, Jr., Sprint Vice President of Roaming and Access Planning. See id., at para. 4 stating: "While best efforts services can be used for some communications needs (such as consumer WiFi hotspots, or femtocells or other microcells that can offload data in small areas), these services cannot substitute for dedicated special access services that Sprint uses for its core wireless and wireline service offerings."

> Internet access point as the terminating end of a special access connection. But the choice is the customer's. By definition, best efforts business broadband Internet access services take customers to the Internet and only to the Internet, via the carrier's choice of Internet access point; they cannot provide a dedicated connection between two premises designated by the customer, such as a bank ATM machine, a merchant's point-of-sale terminal, a secure data storage facility, or a cellular service tower.[43]

In summary, the Commission should exclude "best efforts" broadband Internet access services from its analysis of special access markets. Therefore, Joint Commenters agree with Sprint and Joint CLEC Commenters that there is no need to assess the impact of "best efforts" services in the Commission's regression analyses of the special access market.[44]

3. Geographic markets

Joint Commenters concur with comments that demonstrate that the relevant geographic market for channel terminations is a particular building or customer location.[45] In its determination of relevant geographic markets, the Commission, of course, needs to incorporate administrative feasibility, and so may need to define individual geographic markets according to broader categories based on areas where customers face similar competitive alternatives.[46] In defining the relevant geographic market for interoffice transport, the Commission may need to develop categories that place similar routes in the same geographic markets.[47] XO's recommended approach to determining relevant geographic markets has merit:

> The relevant geographic market for special access services are the point-to-point connections of these circuits, most of which originate and terminate in a single metropolitan area. While it may be impractical to analyze every point-to-point

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[43] Ad Hoc, at 11-12.

[44] Sprint, at 20; CLEC Joint Commenters, at 50-57.

[45] See, e.g., Sprint, at 7; Joint CLEC Commenters, at 7.

[46] Sprint, at 8.

[47] Id.. Joint CLEC Commenters recommend defining the geographic market by commercial building and on a route-specific basis. Joint CLEC Commenters, at 7.

connection, the Commission can either choose to study connections in a limited geographic area (e.g. exchange or wire center) or select a random sample of circuits over the entire metropolitan area.[48]

AT&T contends that a building-by-building analysis is not appropriate. Having a fiber ring or other transport facilities in the general area is seemingly enough for AT&T and, according to AT&T, does not constitute simply "potential" competition: "[E]xisting facilities-based competitors are actually competing in the marketplace for the right to build (what remain 'potential') direct connections to a location."[49] Yet, competitors such as TelePacific[50] and Joint CLEC Commenters provide compelling evidence that entry barriers remain high and that competitors are forced to use the ILECs' services, and remind the Commission of prior findings by the Department of Justice, the General Accounting Office, and the FCC in its own forbearance proceedings.[51]

4. *Role of potential supply*

Verizon recommends that the Commission consider not only today's alternatives, but also "new sources of supply that competitors have planned or that are likely to become available

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[48] XO, at 6.

[49] AT&T, at 16.

[50] TelePacific states that it "does not believe that the existence of potential competition based on the deployment of laterals to buildings will have an effect on the Commission's proposed market analysis" and that the "entry into a market by a competitive carrier is far more difficult than for an incumbent." TelePacifiic, at 4. Even adding buildings that are close to a network ring is difficult and costly. Id.

[51] Joint CLEC Commenters, at 14-19, citing Opinion, *United States v. SBC Communications, Inc. & AT&T Corp.; United States v. Verizon Communications, Inc. & MCI, Inc.*, Civil Action No. 05-2102, at 7 (D.D.C. Mar. 29, 2007) (citing Complaint, *United States v. SBC Communications, Inc. & AT&T Corp.*, Civil Action No. 05-2012, ¶ 15 (D.D.C. filed Oct. 27, 2005) ("DOJ SBC-AT&T Complaint"); Complaint, *United States v. Verizon Communications, Inc. & MCI, Inc.*, Civil Action No. 05-2012, ¶ 15 (D.D.C. filed Oct. 27, 2005) ("DOJ Verizon-MCI Complaint")); GAO, "FCC Needs to Improve Its Ability to Monitor and Determine the Extent of Competition in Dedicated Access Services," GAO 07-80 (rel. Nov. 2006) ("GAO Report"); See *In the Matter of Petitions of the Verizon Telephone Companies for Forbearance Pursuant to 47 U.S.C. § 160(c) in the Boston, New York, Philadelphia, Pittsburgh, Providence and Virginia Beach MSAs*, Memorandum Opinion and Order, 22 FCC Rcd. 21293 (2007) ("6-MSA Order"); *In the Matter of Petitions of Qwest Corp. for Forbearance Pursuant to 47 U.S.C. §160(c) in the Denver, Minneapolis, St. Paul, Phoenix and Seattle MSAs*, Memorandum Opinion and Order, 23 FCC Rcd. 11729 (2008) ("4-MSA Order"); Qwest Phoenix Forbearance Order, ¶ 71.

going forward."[52] Joint Commenters do not disagree that the industry is evolving, but are unaware of evidence to suggest that these "new sources" to which Verizon alludes are as ubiquitous or imminent in relevant markets as ILECs would have the Commission assume. Furthermore, Joint Commenters urge the Commission to dismiss the veiled threats regarding the purported consequences of "stifled investment and innovation" resulting from "static assumptions" that ILECs raise.[53] Simply wishing for "dynamic" and pervasive entry by competitors will not make such entry occur. Instead, as these reply comments discuss further, ILECs' tactics to discourage migration from their networks by exacting stiff penalties for early termination or failure to satisfy volume discounts discourage investment and innovation.

Similarly, Joint CLEC Commenters suggest that "there is simply no reliable basis for predicting that there will be significant entry"[54] in a market where the ILEC has market power. Joint CLEC Commenters further state: "[T]he Commission has a long history of predicting future competition in the special access market, but every one of those predictions has been proven to be wrong."[55]

As Ad Hoc aptly observes, the fact that CLECs may be able to supply a small portion of an area (while lacking the capacity to serve an entire MSA) does not constrain the ILEC's prices – instead the ILEC can simply raise the rates charged to *all other customers* to recoup the forgone revenues.[56] Initial comments provide other evidence of the lack of alternative suppliers to constrain ILECs' market power. XO states:

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[52] Verizon, at 3.

[53] See, e.g., id., at 5.

[54] Joint CLEC Commenters, at 9.

[55] Id., at 10.

[56] Ad Hoc, at 6-7.

> As a practical matter, XO cannot transition its circuits at the expiration of a price cap LEC agreement to other providers. Of paramount importance, no competitor could support the circuits as a whole, given that only the price cap LEC has the facilities in place with the reach to meet XO's needs in many locations. As discussed earlier, this is the source of the price cap LECs' market power, especially in the business and enterprise markets. Even if another provider could handle all or a significant portion of XO's demand in a geographic area or region, presumably it would be by reselling price cap LEC circuits, rather than providing services entirely over its own facilities. The transition would take a number of months to a couple of years. During that migration period after expiration of its price cap LEC agreement, XO would have no good choice to satisfy its demand: either XO would have to pay the price cap LEC's undiscounted month-to-month rates or enter into another long-term agreement with the price cap LEC to get the lower rates during the transition and then face the consequences of a potential shortfall below minimum numbers under the discount plan. This creates clear disincentives for the alternative supplier that would have to be overcome by other aspects of the deal.[57]

As Joint Commenters discuss more fully below, the ILECs' onerous terms and conditions lock up demand, which, in turn, discourages alternative suppliers from investing.[58] By essentially freezing demand through the imposition of hefty penalties for failure to meet volume or term discounts, ILECs prevent the very competition they contend is imminent or "potential." Furthermore, Joint Commenters caution the FCC that in incorporating the possibility of new entry,[59] the FCC truly "recognize that potential entry must be 'timely, likely and sufficient in its magnitude, character and scope to deter or counteract the competitive effects of concern.'"[60]

5. The FCC should analyze the relationship between special access prices and costs.

Joint Commenters concur with XO that it is unfortunate that the FCC's special access

[57] XO, at 15-16.

[58] See, e.g., XO, Dobbins Declaration, at para. 16.

[59] See, e.g., Verizon, at 9.

[60] NPRM, at footnote 152, citing 2010 DOJ/FTC Horizontal Merger Guidelines at § 9.

data request does not seek cost data.[61] As Ad Hoc observed,[62] the FCC's unfortunate elimination of the ARMIS reports, an action which Joint Commenters actively opposed, has lessened the FCC's access to cost information. Joint Commenters urge the FCC to revisit its premature decision and to re-impose cost accounting reporting requirements on ILECs. The record in this proceeding amply demonstrates that special access markets are not competitive. Accordingly, the FCC should have access to cost and revenue data for the incumbent carriers.

In the absence of such cost information, the FCC can look to the available total element long-run incremental cost ("TELRIC") study results and can also, as XO suggests, examine the routes with the most suppliers in order to estimate the price cap LECs' profit margins.[63] Joint Commenters agree with XO's analysis of the importance of analyzing trends in the difference between special access prices and costs. XO aptly states;

> In other words, even assuming that the absolute difference between price and marginal cost does not necessarily reflect a given degree of market power, dynamic movements in price-cost margins reflect changes over time in a firm's ability to exercise market power. Thus, if the Commission determines that the price-cost margins for a price cap LEC have increased significantly during a period, it should view that as powerful economic evidence that the LEC has exercised more market power over that time.[64]

6. *Contrary to ILECs' assertions, the FCC should exercise care in relying on predictive judgments in its analyses of the structure of special access services markets.*

In support of its preference for a "dynamic" analysis, Verizon relies in part on what it calls the Commission's prior "refusal to insist upon static market share information in the context

[61] XO, at 7. See, also, NPRM, at para. 47 and footnote 87.

[62] Ad Hoc, at footnote 2.

[63] XO, at 7.

[64] Id., at 5.

of enterprise broadband services."[65] In 2007, however, when the FCC issued the order to which Verizon cites, two of the five commissioners dissented, and the reasoning set forth in the dissent is not only applicable to this proceeding but is consistent with the FCC's more recently issued Qwest Phoenix Forbearance order. Among other things, the dissenting statement in the FCC's 2007 order concluded:

> With regard to the appropriate geographic market, petitioners argue that a national analysis of the services being considered is applicable here. We have repeatedly argued that deregulating broadband is no national strategy for deploying these services, and we believe that today's Order is a missed opportunity for the Commission to critically review whether a national framework for the market specific services before us is appropriate. Particularly distressing is the fact that more than 13 months into this 15 month forbearance process the Bureau requested market data from petitioners to enable a local market analysis. Not only does this suggest that petitioners did not make their case in this regard, but it is apparent that little if any additional data was provided because the majority concluded it was unnecessary. The Order regrettably concludes that the Commission does not "find it essential to have such detailed information." Also troublesome is the fact that the Order finds that "potential" competition is sufficient to protect consumers. In places where substantial competition does not demonstrably exist, it seems that forbearance actually can make the problem worse as "potential" competitors will have even less ability to successfully compete to provide a check on any anti-competitive behavior.
>
> We have repeatedly proffered that these kinds of decisions are too important to be made without the in-depth market analysis that might support them. Recent Congressional hearings have demonstrated a growing impatience with policymaking via analysis-poor forbearance decisions. Here the Commission clearly has chosen not to chart a different course. The lack of data concerning the specific product and geographic markets at issue and this Order's lack of analysis cause us great concern about both the substance and the process by which the Commission grants forbearance from our rules.[66]

The FCC's conclusions in the Qwest Phoenix Forbearance Order, which the Tenth Circuit Court of Appeals upheld, and which reflect more recent Commission analysis than does the AT&T

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[65] Verizon at 6, citing *Petition of AT&T Inc. for Forbearance Under 47 U.S.C. § 160(c) from Title II and Computer Inquiry Rules with Respect to Its Broadband Services*, Memorandum Opinion and Order, 22 FCC Rcd 18705 (2007) ("AT&T Broadband Forbearance Order").

[66] *Petition of AT&T Inc. for Forbearance Under 47 U.S.C. § 160(c) from Title II and Computer Inquiry Rules with Respect to Its Broadband Services*, Memorandum Opinion and Order, 22 FCC Rcd 18705 (2007), Joint Statement of Commissioner Michael J. Copps and Commissioner Jonathan S. Adelstein, dissenting.

Broadband Forbearance decision that Verizon cites, clearly underscore the FCC's recognition that speculation about potential entry may not be reliable.

7. *The FCC has previously acknowledged flaws in its analysis of competition, and its recent findings should similarly inform its deliberations in this proceeding.*

In addition to Rate Counsel,[67] others point to the relevance of the Commission's analytic framework relied upon in the Qwest Phoenix Forbearance Order to this proceeding. XO states:

> The Commission's admission follows on a similar conclusion about its predictive bases for policies in the *Qwest Phoenix Forbearance Order*: "[The Commission] first predicted that Qwest would continue to make wholesale facilities...available to competitors at 'competitive rates and terms.' Second, and relatedly, it predicted that non-cable competitors could 'rely on the wholesale access rights and other rights they have under sections 251(c) and section 271 [to] minimize [] the risk of duopoly and coordinated behavior or other anticompetitive conduct in the market.' Third, it predicted that the areas where Cox currently had facilities would see further investment by Cox and by other competitors even without access to unbundled loops or transport. Upon further consideration, we find that these predictions have not been borne out by subsequent developments, were inconsistent with prior Commission findings, and are not otherwise supported by economic theory."[68]

XO also states, regarding the FCC's earlier special access analysis: "In the FNPRM, the Commission notes that its special access pricing flexibility rules 'were not an effective proxy for special access competition predicted in the *Pricing Flexibility Order*.'"[69]

The significance of these two FCC conclusions is that the FCC has revisited its framework for analyzing competition and determined that its frameworks provided flawed foundations for analyzing the level of competition in relevant markets. In the instance of special

[67] Rate Counsel, at 9, 12.

[68] XO, at footnote 9, citing Qwest Phoenix Forbearance Order.

[69] XO, at footnote 9, citing FNPRM, ¶ 26.

access, the harm done to the economy and to consumers is substantial and long-lasting.[70] It is imperative that the FCC act expeditiously to assess the actual levels of competition in special access markets and ensure that those areas in which ILECs have already been granted pricing flexibility are truly competitive.

8. Panel regressions should play a subsidiary role and should not become an end unto themselves, providing an excuse for endless debate and delay.

Initial comments discuss some concerns with the Commission's plans to design and run econometric models of special access services markets. Rate Counsel expressed concern that the panel regressions could delay the Commission's decision-making in this proceeding.[71] XO recommends that the FCC "use panel regressions, at most, as a supplement to examine whether market power currently exists,"[72] and Sprint "believes it would be prudent for the Commission to perform a more traditional market power analysis in conjunction with, or in addition to, its proposed panel regressions and other analyses."[73]

The Commission's econometric studies should consider the level of regulation, the presence of actual competitors, terms and conditions (which, in turn, affect the elasticity of demand —consumers' ability to respond to price changes —and the elasticity of supply —the willingness of competitors to enter new markets), and prices. Panel regressions may provide evidence of pricing variations that correspond with varying levels of competition in different markets. Although Joint Commenters concur with Verizon that any model that the Commission uses should be "transparent so that interested parties can verify the model's structure, inputs, and

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[70] See Susan M. Gately, Helen E. Golding, Lee L. Selwyn, and Colin B. Weir, *Regulation, Investment and Jobs: How Regulation of Wholesale Markets Can Stimulate Private Sector Broadband, Investment and Create Jobs*, February 2010.

[71] Rate Counsel, at 11-12.

[72] XO, at 3.

[73] Sprint, at footnote 36.

results,"[74] Joint Commenters caution the FCC that if and when ILECs seek to explain away "price variations,"[75] the FCC then require ILECs to provide underlying cost data to justify such variations rather than be permitted to rely on assertions that "services had been subject to artificial regulatory price constraints"[76] as justification for price increases. Joint Commenters welcome the opportunity to participate in the review of any model that the Commission intends to use in its assessment of special access markets, but expect that the process of designing econometric models will not cause undue delay in the Commission's implementation of remedies to the flawed regulation of special access markets that now exists.

As an example, ILECs' "loyalty" plans, which affect the marginal price that purchasers face, directly affect the likelihood of competitors' entry in relevant markets. The econometric model would need to reflect the interrelated variables that affect relevant outcomes. Identifying the relevant independent variables, and recognizing the probable high degree of multicollinearity among factors (making it difficult to isolate the effect of any individual variable) will prove no mean feat.[77] On the other hand, omitting some independent variables in order to minimize the challenge of multicollinearity could lead to biased outcomes for the model. The factors that the Commission intends to consider are correlated, and, therefore the model must be carefully constructed.

Various characteristics of special access markets provide context for any examination of prices, including, for example:

- Prices affect regulation: Supracompetitive prices (i.e., prices in excess of marginal cost) should lead to regulatory oversight;

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[74] Verizon, at 7.

[75] Id., at 8.

[76] See, e.g., id., at 27.

[77] Jeffrey M. Wooldridge, *Introductory Econometrics: A Modern Approach*, South-Western College Publishing, 2000, at 95-97; G.S. Maddala, *Introduction to Econometrics,* 2nd ed. New York: Macmillan, 1992, at 269-270.

- Theoretically, regulation should affect prices: The regulation of dominant carriers' prices should cause prices to approximate marginal cost (as they would in a competitive market), and, in contrast, in the absence of effective regulation, dominant carriers' prices will rise to supracompetitive levels;

- Terms and conditions affect supply: ILECs' lock-in provisions inhibit competitive entry;[78]

- The presence of alternative suppliers should affect price: All else being equal, the greater the number of able and willing suppliers, the lower the price;

- The price level affects the presence of suppliers: All else being equal, higher prices encourage entry.

- Marginal costs relate to prices.

Regardless, Joint Commenters urge the Commission to avoid getting lost in the "weeds" of the econometric model.[79] The model is one of several pieces of information that can inform decision-making, but it should not become an end unto itself, nor should the Commission seek to impose unrelated goals on the model.

Furthermore, any examination by the FCC of special access markets should be informed by marginal cost data (e.g., TELRIC costs could be used as proxies). The greater the gap between the ILEC's marginal cost and the ILEC's price, the less competitive the market is. Joint Commenters urge the Commission to reconsider its decision to exclude cost information from this proceeding.[80] Other independent and interdependent variables (presence/absence of competitors, sufficient/insufficient regulatory oversight, consumers' ability to migrate their

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[78] See, e.g., Sprint, at 17-18. For example, as Sprint explains: "Separate equations likely would be needed to explain, for example: (a) contract durations, (b) minimum volume commitments, and (c) early termination penalties." Sprint, at footnote 54.

[79] Comments have already provided a laundry list of methodological issues. See, e.g., AT&T, at 21-32 and the Declaration of Igal Hendel and Mark A. Israel, Econometric Principles That Should Guide the Commission's Analysis of Competition for Special Access Service, February 11, 2013 ("Hendel/Israel Declaration"); Joint CLEC Commenters, at 10, 73.

[80] NPRM, at para. 47 and footnote 87.

demand) affect the prevailing price, which is the variable that *depends* on these other variables. In a competitive market, the price should approximate the marginal cost.

Moreover, Joint Commenters reiterate their hope that the regression models not be designed with the purpose of artificially encouraging investment by raising prices. For example, Joint Commenters certainly welcome new investment *but only where such investment is economically efficient.* The ultimate goal should be to lead to just and reasonable rates for special access services, which, in turn, leads to social welfare (i.e. consumer surplus).[81] As stated earlier in these reply comments, low prices *even if they discourage competitive entry* are not *per se* a "bad thing" and, indeed, the more relevant question is the relationship between prevailing prices and underlying costs. The Commission's statements could be construed to suggest that the Commission would prefer to allow prices to rise to encourage new entry so that it could then determine that markets are competitive (e.g., "we will consider whether our current regulatory regime may be hindering, for example, by keeping prices low, competitive investments that would reduce or obviate the need for regulation"[82]).

It is in society's interest and in consumers' interests for rates to be reasonable. Joint Commenters, therefore urge the Commission to exercise caution as it designs its econometric models. Joint Commenters welcome a "robust competitive market,"[83] but where robust competition is lacking, regulatory oversight is essential. Joint Commenters are hopeful that the regressions would be used to ensure that prices are set to provide economically efficient pricing signals.

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[81] See, e.g., Joseph E. Stiglitz and Carl E. Walsh, *Principles of Economics*. 3rd ed. New York: W.W. Norton, 2002, at 121-122.

[82] Id., at para. 67.

[83] Id.

Theoretically, the design of any model should precede the gathering of data – otherwise the temptation to design the model "around the data" will be great. AT&T, similar to Verizon, urges transparency, noting that the FCC has "yet to disclose any specifications" and cautions against waiting to look at data and then fitting regressions and hypotheses to the data.[84] While Joint Commenters agree that the regressions should not be "fitted" to the data,[85] there are some real concerns related to spending time and resources to build an econometric model that is then unusable when the data doesn't materialize. AT&T acknowledges as much in expressing concerns about the inevitable various formats in which the data will be provided and whether the data will be comparable. AT&T also correctly point outs many methodological hurdles (which Joint Commenters will not repeat in entirety here). Chief among them is simply that the data may not be comparable: According to AT&T, ILECs and CLECs have different rate structures.[86]

AT&T contends that the real goal of this proceeding is to develop proxies for the triggers, therefore, according to AT&T, the Commission need only gather data from competitors about where they have sunk investment and the capability to provide special access to consumers.[87] Of course, this position ignores the reality that sunk investment and "capability" to serve (i.e. potential competition) may not be the best indicators of a competitive market (and, in turn, a market with just and reasonable rates).

Finally, Joint Commenters reiterate Rate Counsel's position (at 11-12) that the FCC avoid allowing the design of econometric models to distract from the pressing need to re-

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[84] AT&T, at 8.

[85] See, e.g., AT&T's concern regarding the NPRM at para. 68: "Statements such as this come dangerously close to suggesting that the commission is going to see what data it has and then decide what questions to ask." AT&T, at 25.

[86] AT&T, at 22. See, generally, AT&T, at 21-32 and the Declaration of Hendel and Israel for methodological issue discussion.

[87] Id., at 11. See, also, id., at 11-18.

initialize excessive special access rates and from remedying anticompetitive terms and conditions. CLEC Joint Commenters state: "Given the extent to which these analytical frameworks overlap, the Joint Commenters suggest that the Commission choose either the market power framework or panel regressions rather than apply both frameworks. It would be simpler for the Commission to apply the market power framework...."[88] Joint Commenters agree.

III. TERMS AND CONDITIONS (PART IV.C OF NPRM)

A. Comments provide ample evidence that the terms and conditions set forth in ILECs' special access tariffs are anticompetitive, and are consistent with the behavior of a monopolist.

CLECs supply special access in competition with ILECs, and also purchase special access from ILECs. CLECs rely not only on their own networks to serve their customers, but also rely on the special access services of ILECs.[89] The terms and conditions that ILECs impose on CLECs' purchase of ILECs' special access can be used in anticompetitive ways, and, as comments demonstrate, the record includes ample evidence of such behavior.[90] ILECs lack any economic incentive to offer reasonable terms and condition to their competitors, and it is unreasonable to assume that CLECs can "negotiate" with ILECs.[91] In light of this stark market imperfection, the FCC's adoption of remedies is essential to improving the workings of special

[88] Joint CLEC Commenters, at 6. See, also, id., at 48.

[89] See e.g., XO, at 9-10.

[90] Comments have been filed on this issue various times, including in 2005, 2007 and 2010, for example. See, also, Government Accountability Office, *FCC Needs to Improve its Ability to Monitor and Determine the Extent of Competition in Dedicated Access Services*, Report 07-80 (November 2006), at 30. In this round of comments, see XO, at 8-17; Sprint, at 23-42; Telepacific, at 12-18; Joint CLEC Commenters, at 20-34 and Appendix A: Stanley M. Besen and Bridger M. Mitchell, "Anticompetitive Provisions of ILEC Special Access Arrangements" (dated Feb. 11, 2013) ("Besen and Mitchell Paper").

[91] The relevant issue is not whether purchasers are "sophisticated" (see CenturyLink, at 36), but rather whether the suppliers (the ILECs) have market power. See also id., at 38-40.

access markets.[92] Because unreasonable terms and conditions are thwarting the very competition that the FCC seeks to enhance in special access services markets, Joint Commenters disagree with Verizon that is premature to analyze terms and conditions for special access service.[93]

AT&T contends that it has demonstrated in prior comments that "recent claims by CLECs that specific terms in AT&T's special access tariffs and contracts are anti-competitive are entirely without foundation and almost invariably rest on blatant misrepresentation of the specific terms at issue as well as of the broader give and take of negotiated agreements among sophisticated parties."[94] Yet AT&T's view that these terms and conditions are reasonable is belied by the comments of numerous CLECs.

Comments emphasize the importance of remedying unreasonable terms and conditions "right away."[95] Joint CLEC Commenters make the recommendation that the FCC should first prohibit the exclusionary terms and conditions and then after time has passed (presumably enough to measure market results), the FCC can again analyze the level of competition in the market.[96] In any case, Joint Commenters certainly agree with Joint CLEC Commenters that the FCC does not need to wait to the conclusion of this proceeding (i.e. after the market analysis) to prohibit exclusionary practices.[97] Joint Commenters concur that this issue should not be examined endlessly, but instead be remedied promptly. Unreasonable terms and conditions lock in consumers and prevent migration among diverse suppliers.

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[92] See, e.g., Sprint, at 23, stating: "The incumbent LECs' imposition of anticompetitive terms and conditions has had a tremendous impact on Sprint's ability to decrease its purchases from incumbent LECs and purchase services from the few alternative providers that can serve Sprint's special access needs."

[93] Verizon, at 28-31.

[94] AT&T, at 10. AT&T argues that volume and term discounts are hallmarks of a competitive market and that CLECs themselves offer such discounts. Id., at 38.

[95] "Because these terms and conditions are so harmful to marketplace competition, XO urges the Commission to address this problem right away and provide relief." XO, at 2.

[96] Joint CLEC Commenters, at 11.

[97] Id.

Unreasonable terms and conditions also provide evidence of market power – in competitive markets, customers would not be required to agree to onerous terms and conditions.[98] Joint Commenters do not note all of the plethora of examples that commenters have provided in this round of comments, but instead urge the Commission to examine the comments of CLECs that have first-hand experience with these terms and conditions. A sample of the many anticompetitive terms and conditions (and the resulting impacts) that initial comments reveal are briefly noted here, however:

XO states:

> To gain a greater understanding of the anticompetitive nature of the terms and conditions imposed by the price cap LECs, one only need examine what competitive providers offer. Where XO has agreements with competitors of the price cap LECs for DS1 and DS3 transport and channel terminations, the terms and conditions are materially different. Typically, XO does not have to commit to terms longer than one year for circuits, and the price per circuit typically is already lower than what XO obtains from the price cap LECs on a discount plan, often as much as 40-60% less. If XO does not renew the one year agreement with a competitive provider, under evergreen provisions, the month-to-month price is normally at the same level as the one-year deal. Unlike the price cap LEC commitment plans, in XO's agreements with competitors, there is no imposed volume or term commitment with lock-in provisions. Instead, although in some cases XO's agreements with competitive providers may provide for deeper discounts if volume increases (in real numbers rather than as a percentage of XO's spend), there are no shortfall penalties. In short, XO's dealings with competitive providers are more reflective of what would be expected in a competitive market.
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> The terms under which XO purchases DS1s and DS3s from other providers – when it can – are similar to those which XO can impose in the marketplace. As noted in the Declaration of James Anderson, XO's customers not only expect a price reflecting competitive conditions but also will not tolerate the sorts of restrictions that price cap LECs impose as a matter of course. Specifically, XO's customers for its special access services will not accept shortfall penalties, restrictions on movement of circuits, and no downturn provisions. Moreover, XO

[98] XO, at 8. See Anderson Declaration, which states, among other things: "Those terms and conditions regularly include volume and term commitments for periods of three to five years which lock-up large portions of XO's demand. XO is subject, under those commitments, to shortfall, overage, and early termination liability provisions which can lead to substantial economic penalties, in addition to an increase in price for the volume of circuits that make up the shortfall or overage." Id., at para. 5.

> cannot impose volume or term commitments on its customers for DS1s and DS3s similar to those imposed by price cap LECs.[99]

Joint CLEC Commenters describe the conditions imposed by ILECs as follows:

> Incumbent LEC purchase arrangements that condition circuit portability on large volume commitments thus present competitors with a Hobson's choice—either incur frequent and substantial early termination penalties or agree to purchase a large proportion of special access demand from the incumbent LEC. If they wish to serve a large number of retail customers, competitors must often select the latter option."[100]

Joint CLEC Commenters continue, pointing out that "[u]nsurprisingly, incumbent LECs derive a very large portion of their special access revenues from these plans."[101]

Loyalty Commitments:

Sprint explains loyalty commitments[102] as follows:

> If a customer wishes to reduce its commitment, it has two uneconomic options. First, it could pay an exorbitant "buy-down" fee – if such an option is even offered under the relevant plan. Second, it could lower its purchases below its commitment level in order to have a lower baseline for setting the commitment in future contracts. However, lowering purchases substantially below the commitment level triggers a massive "shortfall penalty." These fees and charges are uneconomic for buyers, and as a result, buyers typically maintain their commitments at the same high levels, even at contract renewal.[103]

Sprint explains the difference between loyalty plans and volume discount plans:

> The loyalty plans at issue here are entirely different. They do not depend on a purchaser buying a high volume; rather, they are based on a customer's agreement to be loyal, i.e. not to substantially reduce its current or recent purchases from the incumbent LEC. And unlike the volume discounts discussed above, these loyalty discounts do not reflect a reduction in the incumbent LECs' cost of providing

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[99] XO, at 14-15, citations omitted.

[100] Joint CLEC Commenters, at 25.

[101] Id., at 26, citing *Verizon June 6 Letter*, at 2-3.

[102] See, e.g., Sprint at 25, explaining that ILECs "penalize purchasers unless they maintain a large percentage of their special access purchases with the incumbent – often equal to 90 to 100 percent of current or recent lines purchased from the incumbent – rather than shifting traffic to a competitor."

[103] Id., at 25, citation omitted.

service. It costs no more to provide 10 DS1s to a small but loyal customer than to provide 10 DS1s to a large but "disloyal" customer that shifts the remainder of its lines to a competitor, but under these loyalty plans, the latter customer would pay much more because of its disloyalty.[104]

Tying competitive and noncompetitive markets:

Sprint also explains how ILECs link purchases between noncompetitive and competitive markets, resulting in the anticompetitive locking up of competitive markets:

> For example, incumbent LECs often tie discounts for lines in rural geographic markets – where competition is least likely to develop – to a customer's commitment to remain loyal to the incumbent LEC (i.e., keep its services with the incumbent LEC) in a different geographic area where some competition may be possible.[105]

Similarly, Joint CLEC Commenters explain:

> As Drs. Besen and Mitchell explain, the incumbent LECs' exclusionary purchase arrangements perpetuate and exploit the incumbent LECs' position in the markets for DS1 and DS3 special access services by (1) forcing competitors to purchase a large proportion of their special access demand from incumbent LECs and (2) tying the sale of special access services (and sometimes other services) that are or might be subject to competitive supply to the sale of special access services that are not subject to competitive supply. These arrangements harm competition and result in higher prices for special access services by: (1) causing demand for incumbent LEC DS1 and DS3 special access services to become less elastic, thereby giving the incumbent LECs the incentive and ability to increase rates for these services without the threat of losing sales to alternative providers of special access services; (2) depriving competitors of the ability to expand their operations to achieve economies of scale, thereby requiring those competitors to increase their prices; and (3) diminishing competitors' investment in research and development.[106]

The FCC should be concerned about allegations that these ILEC practices allow the ILECs to leverage their dominance in the provision of one service or one geographic area to maintain dominance in relatively more competitive areas.[107] With the sophistication of contemporary

[104] Id., at 26.

[105] Id., at 28.

[106] Joint CLEC Commenters, at 4-5.

[107] Id., at 31-33.

computers and database programs, there is no excuse for ILECs to place consumers' purchasing options within a straitjacket.[108]

The fact that CLECs cannot impose comparable terms and conditions on their customers is consistent with their lack of market power and the ILECs' corresponding possession of market power. If markets were truly competitive, ILECs would not be able to sustain these unreasonable terms and conditions.[109]

B. The FCC should direct ILECs immediately to modify their terms and conditions so that no more than fifty percent of volume is required to be "locked in."

CLECs not only describe the ways in which ILECs' terms and conditions prevent competition from evolving,[110] but also identify practical, administratively feasible solutions, which the FCC should promptly adopt.[111] Joint Commenters support the following remedy, described by XO as follows:

> Specifically, Level 3 explained its position that it would be an adequate (albeit not perfect) remedy to the ills created by the price cap LECs' volume and term commitments if the Commission would cap the amount of special access business a price cap LEC is able to lock-up in its territories to 50 percent of a carrier customer's spend on special access within that price cap LEC's territory. By freeing up carrier customers' demand in this way, the Commission would create an environment in which true competition for DS1s and DS3s or their equivalent might emerge. Competitive suppliers should find that they will more often have ready buyers. More importantly, this sort of remedy creates the prospect that the price cap LECs will begin to experience competitive pressures to lower their rates and soften their other terms and conditions, making the price cap LECs (eventually) a more attractive choice rather than simply an effective prison, as they are today.

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108 See Sprint, at 29, rebutting Verizon's claims that Verizon simply seeks to minimize administrative burden.

109 XO, at 17.

110 See, e.g., XO's statement: "Competitive purchasers of price cap LEC special access services continue to be chained to them, and competition has been stymied because the majority of the demand in the industry is thereby effectively held hostage. Consequently, these terms and conditions are unjust and unreasonable in violation of Section 201(b) of the Act." XO, at 9.

111 See, e.g., Sprint, at 38-41 discussing "50%" provision; id., at 42-43, discussing measures that would prohibit ILECs from imposing early termination fees that exceed the unrecovered costs associated with the ILECs' provision of circuits to customers.

> To maximize this opportunity and the benefits that could flow from it, the 50 percent level for a given carrier customer should be based on the lower of the initial monthly spend with the price cap LEC or the previous twelve month's spend on average. Making the measure the lower of these two alternatives would either negate the ratcheting effect under the price cap LECs' current commitment plans that may have trapped the carrier customer at an untenable level of commitment or reflect marketplace changes if a carrier customer has been unable to maintain its initial spend levels due to market changes. Using the lower of these two alternatives will serve the public interest by creating an environment more conducive for the competitive supply of special access and equivalents to take hold.[112]

The FCC should also consider Joint CLEC Commenters' similar recommendation that the FCC limit the size of volume commitments.[113] Joint CLEC Commenters also recommend that

> the Commission should permit an incumbent LEC to set a commitment term for the purchase of a special access service only if (1) the duration of the term is no longer than needed to recover any unrecovered customer-specific sunk costs of providing the service; (2) the penalty for early termination is no higher than any unrecovered customer-specific sunk costs of providing the service; and (3) the rate for recovering any unrecovered customer-specific sunk costs of the circuit is charged independently, so as to create transparency for cost recovery. Thus, incumbent LECs would not be permitted to impose NRCs and early termination

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[112] XO, at 18-19, citations omitted, but see XO, at footnote 54, which explains the FCC's legal authority to address ILECs' conditions that lock up consumer demand:

> As Level 3 explains in its October 31 *Ex Parte*, the Commission has ample authority to prohibit the enforcement of lock-up provisions in both new and existing agreement. *Id.* at 3-9 *citing, inter alia, Exclusive Service Contracts for Provision of Video Services in Multiple Dwelling Units and Other Real Estate Developments,* 22 FCC Rcd 20235 (2007), *aff'd sub nom. Nat'l Cable & Telecomm. Ass'n v. FCC,* 567 F.3d 659 (D.C. Cir. 2009) (prohibiting the use of exclusivity clauses and the enforcement of exclusivity clauses in existing contracts providing single multichannel video programming distributors the exclusive right to provide video services into multiple dwelling units); *Promotion of Competitive Networks in Local Telecommunications Markets,* Report and Order, WT Docket 99-217, Report and Order, 23 FCC Rcd 5385 (March 21, 2008) (prohibiting the enforcement of contracts that restrict the access of other carriers to provide telephone service in residential multi-tenant buildings); *Promotion of Competitive Networks in Local Telecommunications Markets,* 15 FCC Rcd 22983 (2000) (prohibiting the enforcement of contracts that restrict the access of other carriers to provide telephone service in commercial multi-tenant buildings); and *Expanded Interconnection with Local Telephone Company Facilities,* 9 FCC Rcd 5154 (1994), *remanded on other grounds, Pacific Bell v. FCC,* 81 F.3d 1147 (D.C. Cir. 1996) (limiting termination liabilities in then-current contracts on the grounds that "certain long-term special access arrangements may prevent customers from obtaining the benefits of the new, more competitive access environment").

[113] Joint CLEC Commenters, at 43.

> penalties that, in the aggregate, exceed the customer-specific sunk costs associated with providing a circuit.[114]

Joint Commenters support this proposal.

As is the case with so many regulatory remedies, perfection is the enemy of the good. The longer the delay in addressing the anticompetitive terms and conditions for special access that now exist, the higher the excessive profits that ILECs earn, the more harm to the FCC's goal of competition, and the greater the drag on the nation's economy resulting from economically inefficient pricing signals. The FCC should promptly adopt the CLECs' proposed remedy on terms and conditions. If and when a better solution emerges, the FCC can modify the remedy accordingly.[115]

IV. CONCLUSION

Joint Commenters reiterate Rate Counsel's initial position that all consumers ultimately pay the price of exorbitant special access rates and unreasonable terms and conditions. The ILECs' inefficient rates, terms and conditions impede broadband deployment, thwart competition, and burden the economy.

Joint Commenters urge the FCC to promptly rectify the anticompetitive terms and conditions now pervasive in ILECs' special access tariffs, in order to facilitate competition. Joint Commenters welcome the FCC's timely and transparent analysis of the forthcoming responses to the detailed data request, based on the framework that Joint Commenter recommends in these reply comments, and welcome corrective actions to the rules for ILECs' special access services.

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[114] Id., at 45.

[115] XO, at 20.

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