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July 25, 2016

Ms. Marlene H. Dortch
Secretary
Federal Communications Commission
445 12th Street, SW
Washington, DC 20554

Re: *Business Data Services in an Internet Protocol Environment*, WC Docket No. 16-143; *Special Access Rates for Price Cap Local Exchange Carriers*, WC Docket No. 05-25; *AT&T Corp. Petition for Rulemaking to Reform Regulation of Incumbent Local Exchange Carrier Rates for Interstate Special Access Services*, RM-10593

Dear Ms. Dortch:

In accordance with the *Second Protective Order* for the above-referenced proceedings,[1] Windstream Services, LLC ("Windstream") herein submits a <u>redacted</u> version of the attached ex parte filing in the above-referenced proceedings.

Windstream has designated for highly confidential treatment the marked portions of the attached documents pursuant to the *Second Protective Order* in WC Docket No. 05-25 and RM-10593.

Pursuant to the *Second Protective Order*, Windstream is filing a redacted version of the document electronically via ECFS, one copy of the highly confidential version and two copies of the redacted version with the Secretary, and delivering two copies of the highly confidential versions to Marvin Sacks.

* * *

[1] *Special Access for Price Cap Local Exchange Carriers; AT&T Corp. Petition for Rulemaking to Reform Regulation of Incumbent Local Exchange Carrier Rates for Interstate Special Access Services*, Second Protective Order, DA 10-2419, 25 FCC Rcd. 17,725 (Wireline Comp. Bur. 2010).

Please contact me if you have any questions or require any additional information.

Sincerely,

John T. Nakahata
Counsel to Windstream Services, LLC

Attachment

cc:

Chairman Thomas Wheeler	William Kehoe
Matthew DelNero	Christopher Koves
Eric Ralph	William Layton
Deena Shetler	Belinda Nixon
Pamela Arluk	Thomas Parisi
Irina Asoskov	Joseph Price
William Dever	Marvin Sacks
Justin Faulb	David Zesiger

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Dear Ms. Dortch,

On July 20, 2016, Jennie Chandra and Malena Barzilai from Windstream Services, LLC ("Windstream"), and Henry Shi and the undersigned from Harris, Wiltshire & Grannis LLP, met with Commission staff regarding the Further Notice of Proposed Rulemaking in the above-referenced proceedings.[1] The staff attending this meeting were Eric Ralph, Chief Economist; Deena Shetler, Pam Arluk, Irina Asoskov, Justin Faulb, William Kehoe, Christopher Koves, William Layton, Belinda Nixon, Thomas Parisi, Joseph Price, Marvin Sacks, and David Zesiger, all of the Wireline Competition Bureau; and Bill Dever of the Office of General Counsel. In a separate meeting on the same day, Jennie Chandra and Eric Einhorn from Windstream and the undersigned met with Matthew DelNero, Chief of the Wireline Competition Bureau, and Mr. Dever, and I also spoke separately with Ms. Shetler on July 21, 2016. On July 25, 2016, Windstream's Chief Executive Officer, Tony Thomas, spoke with Chairman Wheeler to underscore the importance of the points discussed below.

I. Commission Action Is Necessary to Preserve Non-Incumbent Options for Business Communications Solutions and to Promote Competitive Fiber and IP Investments.

While continuing to support adoption of multiple reforms, including the reform of price caps for TDM services,[2] Windstream, in these discussions, focused on how the Commission

[1] *See Business Data Services in an Internet Protocol Environment et al.*, Tariff Investigation Order and Further Notice of Proposed Rulemaking, FCC 16-54, 31 FCC Rcd. 4723 (2016) ("*FNPRM*").

[2] There is substantial evidence in the record that ILECs, notwithstanding the existence of price caps in those areas not subject to Phase 2 pricing flexibility, have been able to exercise market power over TDM business data services. *See FNPRM* ¶¶ 240-241 and Table 6. In

should approach its oversight of wholesale Ethernet last-mile inputs to ensure choice of providers for business communications solutions in non-competitive product and geographic markets for underlying business data services. The unprecedented record compiled by the Commission makes clear that in the overwhelming majority of locations only one provider owns a last-mile connection to the business data services customer's locations, and few customers—less than 10 percent—would have more than two choices of last-mile facilities-based providers, even if cable is assumed to have ubiquitous facilities capable of providing all levels of business data services (which it does not).[3] The record also includes declarations from competitive providers, as well as a cost-based analysis of entry costs and revenue requirements, that show that competitors' last-mile overbuilding is not economically viable at locations with business data service demand at or below 100 Mbps, with only very limited exceptions.[4] This is

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the declarations filed in response to the *FNPRM*, former FCC Chief Economist Dr. David E. M. Sappington and Mr. William Zarakas of the Brattle Group find that a one-time catchup reduction of between 25 and 44 percent is warranted to capture the productivity gains that have accrued to the ILECs since the expiration of the CALLS Plan in 2005. *See* Declaration of David E. M. Sappington and William P. Zarakas ¶¶ 17-29 ("Sappington/Zarakas Declaration"), attached as Exhibit E to Comments of Sprint Corporation, WC Docket Nos. 16-143, 15-247, 05-25, RM-10593 (filed June 28, 2016) ("Sprint Comments"). Windstream agrees that a catch-up reduction to the special access price cap indices in this range would be appropriate. *See* Comments of Windstream Services, LLC, at 60-63, WC Docket Nos. 16-143, 05-25, RM-10593 (filed June 28, 2016) ("Windstream Comments").

Windstream further urges the Commission to confirm the availability of unbundled DS1 and DS3 capacity when loops are comprised of fiber and/or transmit traffic in an IP format. *See* Windstream Comments at 63-67.

It is also important for the Commission to continue to protect low-bandwidth consumers by ensuring that rates for the lowest level of Ethernet services at or above a DS1 do not exceed the rate of the predecessor TDM DS1 services. Discontinuance protections adopted in the *Emerging Wireline Order* should remain in place for five years to continue to enable competitive providers to offer long-term arrangements to retail customers seeking five-year contracts. *See* Windstream Comments at 56-57.

[3] *See* Supplemental Declaration of William P. Zarakas ¶ 9, attached as Attachment A to Letter from Jennifer Bagg, Counsel to Sprint Corporation, to Marlene H. Dortch, Secretary, FCC, WC Docket Nos. 05-25, 15-247, RM-10593 (filed Mar. 24, 2016) (refiled Apr. 11, 2016) (stating that even "if cable companies were to sell special access services in every location where the ILEC has special access facilities, there would be an ILEC-cable duopoly in 90 percent of the locations where special access services are sold"). *See also* Declaration of Jonathan B. Baker on Market Power in the Provision of Dedicated (Special Access) Services ¶ 44, WC Docket No. 05-25, RM-10593 (filed Jan. 27, 2016) (refiled Apr. 14, 2016) ("Baker Jan. 27, 2016 Declaration"); Marc Rysman, *Empirics of Business Data Services*, 31 FCC Rcd. at 4933, Table 7, attached as Appendix B to *FNPRM*.

[4] *See* Letter from Jennie B. Chandra, Vice President, Public Policy and Strategy, Windstream Corporation, to Marlene H. Dortch, Secretary, FCC, GN Docket Nos. 13-5, 12-353, RM-

consistent with analyses of Dr. Baker and Drs. Kwoka and Verlinda and Mr. Zarakas that demonstrate that ILECs exercise market power at bandwidth at least up to and including 1 Gbps.[5]

In non-competitive markets, non-incumbents like Windstream have been able to offer business, government, and non-profit customers choice for Ethernet services—in some but not all areas and at some but not all service levels—by purchasing last-mile connectivity through unbundled loops, Ethernet-over-Copper, or under long-term commitments for DS1 and DS3 special access services.[6] However, there are significant technological, geographic, and bandwidth limitations to using legacy inputs, including at or below 100 Mbps, and incumbents have announced plans to discontinue and retire many of these inputs.[7] Business data services customers also are showing an increasing appetite for a wider variety of service tiers (e.g., 10 Mbps, 20 Mbps, and 100 Mbps). This all means that wholesale Ethernet prices are increasingly important to determining whether business communications solution providers that must lease some last-mile facilities can continue to offer their products—which can be differentiated from those of the ILEC or cable (where they have deployed sufficiently to provide the desired level of service) with regard to service quality, customer support, and other service dimensions. As other legacy alternatives fall away, for these products and to these locations for which overbuilding a last-mile connection is not feasible, wholesale Ethernet prices will increasingly dictate a "buy versus market exit," not "build versus buy," decision for competitive providers.

And without viable wholesale access to non-competitive locations, competitive providers will be challenged to build a customer base to sustain additional middle-mile and last-mile fiber

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10593, WC Docket Nos. 05-25, 15-1 (filed June 8, 2015); *id.* at Attachment A, 9; Declaration of David Schirack and Mike Baer ¶¶ 16-18, attached as Attachment A to Windstream Comments; Declaration of John Merriman on Behalf of Level 3 Communications, LLC ¶ 6, attached as Appendix to Comments of Birch, EarthLink, and Level 3, WC Docket Nos. 16-143, 15-247, 05-25, RM-10593 (filed June 28, 2016).

5 *See* Declaration of Jonathan B. Baker on Competition and Market Power in the Provision of Business Data Services ¶¶ 3-5, WC Docket No. 16-143, 15-247 and 05-25, RM-10593 (filed June 28, 2016) ("Baker June 28, 2016 Declaration"); Declaration of John Kwoka ¶¶ 23-26, 32-33, attached as Exhibit A to Sprint Comments; Declaration of William P. Zarakas and Jeremy A. Verlinda ¶¶ 14-19, attached as Exhibit D to Sprint Comments (Zarakas/Verlinda Declaration").

6 *See* Declaration of Dan Deem, Douglas Derstine, Mike Kozlowski, Arthur Nichols, Joe Scattareggia, and Drew Smith ¶¶ 55-72 ("Windstream Declaration"), appended as Attachment A to Comments of Windstream Services, LLC, WC Docket No. 05-25, RM-10593, GN Docket No. 13-5 (filed Jan. 27, 2016) (refiled Apr. 20, 2016) ("Windstream Jan. 27, 2016 Comments").

7 *See id.* ¶¶ 56-67. The already limited set of CLEC-owned last-mile fiber facilities would be further reduced if the Commission approves Verizon's proposed acquisition of XO. *See* Comments of Windstream Services, LLC at 3-4, WC Docket No. 16-70 (filed May 12, 2016).

investments that offer diversity to incumbent facilities. Windstream and other competitive carriers have invested billions to deploy some of the largest fiber networks nationwide; Windstream's own fiber network is the nation's sixth largest, spanning approximately 125,000 miles across its ILEC and CLEC areas. But, for example, the lack of a viable wholesale market may foreclose their future investment to self-provision middle-mile connectivity and offer both on-net and off-net IP services at different offices of a federal government entity with nationwide operations.

Windstream also pointed out that, with a growing need to purchase Ethernet inputs, wholesale Ethernet prices are increasingly becoming a very effective means to execute a price squeeze. Windstream and other carriers have provided multiple examples of instances in which ILECs charged them more for wholesale Ethernet service than the ILEC charged its retail customers.[8] Moreover, these price squeezes are occurring even when all enterprise customer revenues are considered. ***** BEGIN HIGHLY CONFIDENTIAL***** [redacted] *****END HIGHLY CONFIDENTIAL***** ILEC wholesale Ethernet prices are a big lever with which to exclude downstream competition in delivering integrated enterprise communications solutions and limit the ability of CLECs to formulate a business case for more fiber investments.

The need for an immediate remedy in response to these market ails is acute. Unless the Commission acts to bring wholesale Ethernet prices in non-competitive markets significantly closer to competitive levels, business data services customers will have fewer choices of providers as competitive providers are squeezed out of the market and prevented from making further investments. Indeed, *****BEGIN HIGHLY CONFIDENTIAL***** [redacted] *****END HIGHLY CONFIDENTIAL*****.[9]

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8 *See* Comments of TDS Metrocom, LLC at 23-29, WC Docket No. 05-25, RM-10593 (filed Jan. 27, 2016) ("TDS Jan. 27, 2016 Comments"); Second Declaration of Matthew J. Loch ¶¶ 19-20, attached to TDS Jan. 27, 2016 Comments; Windstream Jan. 27, 2016 Comments at 49-56; Windstream Declaration ¶¶ 86-96; Reply Comments of Windstream Services, LLC at 28-30, WC Docket No. 05-25, RM-10593, GN Docket No. 13-5 (filed Feb. 19, 2016) (refiled Apr. 20, 2016); Comments of XO Communications, LLC on the Further Notice of Proposed Rulemaking at 43, WC Docket No. 05-25, RM-10593 (Jan. 27, 2016) ("XO Comments"); Declaration of James A. Anderson ¶ 20, attached to XO Comments. *See also* Comments of Birch, BT Americas, EarthLink, and Level 3 at 5, WC Docket No. 05-25, RM- 10593 (filed Jan. 27, 2016) ("[I]ncumbent LECs have powerful incentives to set wholesale prices high so as to place competitors in a price squeeze.").

9 *See* Windstream Declaration ¶ 90.

II. The Commission Can and Should Take Immediate Action to Reduce Excessive Charges for Packet-Based Wholesale Access.

Windstream continues to urge the Commission to address the chronic lack of competition through a cost-based approach, which it continues to believe is the best path to the true comprehensive reform that the Commission is aiming to achieve. Given the pressing need for action, however, the Commission also should implement stop-gap measures at least to preserve customers' existing choices. Windstream described two different proposals that could make meaningful progress in accomplishing this near-term goal.

A. Initial Readjustment of Ethernet Rates

As one interim option, for any non-competitive services, the Commission could require the market leader to reduce the actual, post-discount wholesale Ethernet rates paid by each wholesale purchaser by a fixed percentage, with future annual adjustments based on the same X-factor that the Commission may adopt for calculating the price cap index for TDM services.[10] The evidence in the record—including the calculations of productivity gains for business data services, and the regression analyses by Dr. Jonathan Baker and by the Brattle Group—provide support for such a reduction in current prices to be closer to competitive prices.[11] With TDM special access service prices at unjustifiably high levels, these rates cannot have constrained Ethernet rates to competitive levels, as the Commission had hypothesized would occur when it granted the large ILECs limited forbearance from dominant carrier regulation for specified Ethernet services.[12]

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[10] The initial fixed percentage reduction or implementation timeframe also could vary between market leaders.

[11] *See* Sprint Comments at 50-53; Sappington/Zarakas Declaration ¶ 22; Baker June 28, 2016 Declaration ¶¶ 16-18; Zarakas/Verlinda Declaration ¶¶ 17-19.

[12] *See, e.g., 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; Petition of BellSouth Corporation for Forbearance Under Section 47 U.S.C. § 160(c) from Title II and Computer Inquiry Rules with Respect to Its Broadband Services*, Memorandum Opinion and Order, FCC 07-180, 22 FCC Rcd. 18,705, 18,716-17 ¶ 20 & n.86 (2007) ("[W]e observe that the relief we grant excludes TDM-based, DS1 and DS3 special access services. Thus, those services, in addition to section 251 UNEs, remain available for use as wholesale inputs for these enterprise broadband services."). In addition, it is also apparent that the availability of DS1 and DS3 capacity UNE loops is also not sufficiently constraining ILECs from --exercising market power. *See* Baker Jan. 27, 2016 Declaration ¶¶ 57-58 (finding that the presence of a provider offering business data services over UNEs lowered ILEC priced by only 3.69 percent, compared to a 14.63 percent reduction in ILEC prices based on four in-building and four nearby providers).

Windstream emphasized additional points critical to the implementation of this remedy:

- The price reduction must be made to the actual prices, inclusive of all discounts, that wholesale customers are currently paying, on a wholesale purchaser-specific basis.[13]

- The Commission should make clear that market leaders subject to the reduction cannot effect back-door price increases—such as through inappropriate special construction charges, moving buildings off lists designated for lower pricing, increasing rates of other network components, imposing unwarranted penalties (like those applied when last-mile inputs transition from TDM to IP), or any other unjustified charges, as Windstream has previously explained.[14]

To the extent there is a desire to transition implementation of reform, for a wholesale customer that is currently purchasing under a multi-year term commitment for an individual circuit, Windstream added that the Commission could consider applying the reduction at the end of the term for that circuit. This approach toward a transition makes more sense than one where appropriate rate reductions are phased in more slowly, but to all circuits at one time, as the former will unlock vigorous competition in new customer sales immediately.

B. Application of a TDM-Based Pricing Benchmark to Ethernet Services

Alternatively, the Commission could adopt Windstream's modification of the Commission's proposal to anchor Ethernet rates in non-competitive markets to TDM price caps.[15] As further explained in Windstream's opening comments,[16] the Commission should set the Ethernet wholesale benchmark through a three-step process:

- First, the Commission should identify the TDM special access anchor rate for any given provider by using that provider's price cap regulated DS3 rate, net of all volume and term discounts, and apply both (1) the one-time catch-up adjustment for TDM rates, and (2) an adjustment to account for cost-efficiencies that Ethernet has over TDM. For the latter, Windstream has proposed that the Commission apply a factor based on the difference between the average DS3 rate in the United States and the average 50 Mbps Ethernet rate from outside of the United States, taken from TeleGeography's H2 2015 Local Access Pricing survey of Ethernet and TDM special

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13 Consistent with the Commission's proposed benchmark approach under Sections 201 and 202 of the Communications Act of 1934, 47 U.S.C. §§ 201-202, under Windstream's proposal the Commission could adjust the benchmark based on the specific facts presented by a particular seller or buyer of business data services to ensure that the rates charged by that seller are just and reasonable.

14 *See, e.g.,* Windstream Comments at 72-78.

15 *See FNPRM* ¶ 422.

16 *See* Windstream Comments at 53-55.

access pricing in Global Enterprise Network cities outside of the United States.[17] The survey shows that shows that weighted average 50 Mbps Ethernet rates are 39 percent lower than corresponding DS3 rates.

- Second, the Commission should use the market leader's existing Ethernet rate structures to array benchmarks for each service level. This calculation can be done simply using the percentage relationship to the 50 Mbps price under pre-existing prices. For example, the TeleGeography data set shows that the weighted average price of a 10 Mbps Ethernet circuit is approximately 51 percent of the price of a 50 Mbps Ethernet circuit, with a 20 Mbps circuit priced on average at approximately 60 percent of a 50 Mbps circuit. The benchmark rates can be set by applying the same percentage relationship to the 50 Mbps benchmark rate, such that the benchmark 10 Mbps rate would be approximately 51 percent of the benchmark 50 Mbps rate.

- Third, the Commission should apply a wholesale discount to the benchmark rates to reflect the lower cost of wholesale sales versus retail. This discount should at least be equal to, if not greater than, the percentage commission awarded by business data services providers to channel partners for new enterprise sales. Otherwise, leading providers could continue to raise their retail rivals' costs through charging higher wholesale rates than retail rates for the same capacity.

Adjusting for Ethernet's added efficiency and wholesale cost savings is essential for this option to have any meaningful impact on Ethernet competition. A TDM benchmark solution, without the additional adjustments proposed by Windstream, would allow the trend of more frequent and substantial price squeezes to continue.[18]

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[17] TeleGeography's independent market survey data cover a list of major global metros, as defined by TeleGeography's Global Enterprise Networks study. Metros in this list are either economic hubs or technological hubs for the telecom space within their region. *See* TeleGeography, *Local Access Pricing Service, H2 2015 Local Access Market Summary* (2015).

[18] *See* Letter from John T. Nakahata, Counsel to Windstream, to Marlene H. Dortch, Secretary, FCC at Attachment 3, WC Docket No. 05-25, RM-10593 (filed June 3, 2016). After applying an assumed initial reduction of 21.88 percent, the benchmark rate for a 50 Mbps Ethernet would be $1,069.81. *See id.* By comparison, for example, AT&T's retail rate for a 50 Mbps Ethernet circuit (including port cost) under a contract with the City of Madera, California, is $513.27. *See* Master Agreement between City of Madera and AT&T Corp., AT&T Switched Ethernet Service (with Network on Demand) Pricing Schedule Provided Pursuant to Customer Terms, http://www.cityofmadera.ca.gov/web/guest/documents?p_p_id=20&p_p_lifecycle=1&p_p_state=exclusive&p_p_mode=view&_20_struts_action=%2Fdocument_library%2Fget_file&_20_folderId=6021559&_20_name=DLFE-44205.pdf (showing a recurring rate of $323.52 for a 50 Mbps committed information rate at the "Interactive" class of service and a recurring rate of $189.75 for a 100 Mbps port).

III. The Commission Simultaneously Should Advance Efforts to Establish More Comprehensive Reforms.

Finally, Windstream urged the Commission to continue work toward true comprehensive reform based on a cost-based approach to setting benchmark prices in non-competitive markets. In particular, Windstream recommended that the Commission use a modified version of the Connect America Cost Model ("CACM"). This model can provide an important reference point to help the Commission evaluate the extent to which average business data service prices within a "competitive" census block still reflect market power by individual providers—especially if, as the record and current marketplace behavior indicate, ILECs respond to competition on a building-by-building basis and not uniformly across a census block. This is consistent with the peer review report of Dr. Andrew Sweeting, who stated, "It may make sense to consider the size of the coefficients alongside engineering-based estimates of the costs and margins involved in providing [business data services]."[19] The model also can be the basis for more comprehensive, ongoing establishment of benchmarks for products and areas where rates are deemed to be too high, as its cost inputs and computations can be readily updated on a regular basis. It is critical that wholesale rates be set at a level whereby a market leader does not possess such a wide profit margin that it is easy for the market leader to engage in price squeezes whereby it drops its retail rates to drive business communications solutions competitors reliant on the market leader's underlying business data services inputs out of the market while still remaining quite profitable.

In addition to applying the modified CACM, the Commission should periodically collect data on business data services prices, which would help the Commission further refine the competitive market test and assess the effectiveness of its remedies. The interim rates established by the methods discussed above, while offering much needed short-term relief, represent the beginning, not the end, of reforms needed to fix the business data services market.

* * *

[19] Andrew Sweeting, *Review of Dr. Rysman's "Empirics of Business Data Services" White Paper* ¶ 22 (Apr. 26, 2016), http://transition.fcc.gov/Daily_Releases/Daily_Business/2016/db0628/DOC-340040A4.pdf. In response to Prof. Sweeting's observation, the FCC staff economists, "agree[d] with Professor Sweeting's assessment that such an approach would bolster finding on the estimated effects of competition." Staff continued, "However, the Commission has no engineering-based estimates of the cost and margins involved in providing business data services, and, do not consider obtaining such estimates to be feasible." Memorandum from the Wireline Comp. Bur., at 3 (June 28, 2016), http://transition.fcc.gov/Daily_Releases/Daily_Business/2016/db0708/DOC-340040A8.pdf. While it is not feasible to obtain such estimates in the very near term, it is feasible to update the CACM model for this purpose as part of a longer-term continuing effort to evaluate the state of competition for broadband data services and the need for price regulation.

Please contact me if you have any questions or require any additional information.

Sincerely,

John T. Nakahata
Counsel to Windstream Services, LLC

cc:

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