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August 9, 2016

VIA ECFS

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; Investigation of Certain Price Cap Local Exchange Carrier Business Data Services Tariff Pricing Plans, WC Docket No. 15-247; Special Access Rates 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***

Dear Ms. Dortch:

On behalf of Level 3 Communications, LLC (“Level 3”), I hereby submit the redacted version of Level 3’s reply comments in response to the Order and Further Notice of Proposed Rulemaking released on May 2, 2016 in the above-referenced proceeding.¹ These redacted materials are being submitted pursuant to the terms of the *Modified Protective Order*,² *Second*

¹ *Business Data Services in an Internet Protocol Environment; Investigation of Certain Price Cap Local Exchange Carrier Business Data Services Tariff Pricing Plans; 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*, Tariff Investigation Order and Further Notice of Proposed Rulemaking, 31 FCC Rcd. 4723 (2016).

² *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*, Modified Protective Order, 25 FCC Rcd. 15168 (2010).

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*Protective Order,*³ *Data Collection Protective Order,*⁴ *Business Data Services Data Collection Protective Order,*⁵ and the *Tariff Investigation Protective Order,*⁶ as well as the *Protective Order Extension Order.*⁷

The Highly Confidential version of this submission has been filed with the Secretary's Office.

Please contact me at (202) 303-1111 if you have any questions regarding this submission.

Respectfully submitted,

/s/ Thomas Jones

Thomas Jones

Counsel for Level 3 Communications, LLC

Attachment

³ *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*, Second Protective Order, 25 FCC Rcd. 17725 (2010).

⁴ *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*, Order and Data Collection Protective Order, 29 FCC Rcd. 11657 (2014); see also *Wireline Competition Bureau Now Receiving Acknowledgments of Confidentiality Pursuant to Special Access Data Collection Protective Order*, Public Notice, 30 FCC Rcd. 6421 (2015).

⁵ *Investigation of Certain Price Cap Local Exchange Carrier Business Services Tariff Pricing Plans; 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*, Order and Protective Orders, 30 FCC Rcd. 13680, App. A (2015).

⁶ *Id.* at App. B.

⁷ *Business Data Services in an Internet Protocol Environment; Investigation of Certain Price Cap Local Exchange Carrier Business Data Services Tariff Pricing Plans; 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*, Order, WC Docket Nos. 16-143, 15-247, & 05-25, RM-10593, DA 16-722 (rel. June 24, 2016).

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

In the Matter of)	
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Business Data Services in an Internet Protocol Environment)	WC Docket No. 16-143
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Special Access for Price Cap Local Exchange Carriers)	WC Docket No. 05-25
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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 LEVEL 3

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August 9, 2016

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REPLY COMMENTS OF LEVEL 3

Level 3 Communications, LLC (“Level 3”), through its undersigned counsel, submits these reply comments in response to the May 2, 2016 *Order and FNPRM* in the above-captioned proceeding.¹

I. INTRODUCTION AND SUMMARY.

The Joint CLECs, similarly-situated commenters, and expert economists have conclusively demonstrated that there is virtually no actual competition and very little potential

¹ *Business Data Services in an Internet Protocol Environment; Investigation of Certain Price Cap Local Exchange Carrier Business Data Services Tariff Pricing Plans; 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, Tariff Investigation Order and Further Notice of Proposed Rulemaking*, 31 FCC Rcd. 4723 (2016) (“*Order and FNPRM*” or “*Tariff Investigation Order*”).

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competition in the provision of Business Data Services. The incumbent LECs protest that Business Data Services markets are robustly competitive, but the record provides no support for their claims. In fact, the record supports adoption of a market competition test that requires at least four competitors in a geographic area no larger than a census block before that area is deemed competitive, as well as the use of price caps and tariffs to constrain leading competitors' ability to exercise market power. The incumbent LECs' attempts to defend their volume and term lock-up plans and their need to hide behind non-disclosure agreements fare no better.

The Commission Should Exclude Best-Efforts and UNE-Based Services from the Relevant Market. It is critical that the Commission properly define the relevant product market for Business Data Services. *First*, Dr. Jonathan Baker's market structure analysis and market evidence supplied by Level 3 and other competitive LECs confirm the conclusion that the Commission appropriately excluded best-efforts services from the definition of Business Data Services. This is unsurprising because best-efforts services lack the service level guarantees and symmetrical capacities of Business Data Services. The cable companies confirm that their customers do not regard best-efforts services as substitutes for Business Data Services.

Second, a host of practical and legal limitations prevent competitive LECs relying on UNEs from competing with incumbent LECs at more than a limited number of customer locations and for more than a limited set of Business Data Services. Accordingly, UNEs likely offer some competitive constraint on facilities-based providers, but only in some locations, only for some customers, and only to some extent and therefore are appropriately excluded from the definition of Business Data Services. There is no basis in the record for the Commission to include such limited competitive services in the relevant market.

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No Meaningful Competition in the Provision of Low-Bandwidth Services. Record evidence strongly supports the conclusion that there is no meaningful competition in the provision of Business Data Services at bandwidths of 100 Mbps or below (“Low-Bandwidth Services”).

Incumbent LEC tariff filings. AT&T’s and Verizon’s proposed tariff revisions filed in response to the *Tariff Investigation Order* show that incumbent LECs have substantial and persisting market power in the provision of Low-Bandwidth Services. AT&T’s disregard for its customers’ strong preference for circuit portability and its introduction of penalties that harm its customers as well as Verizon’s unilateral price increase of almost three percent for DS1 services are blatant exercises of market power in the provision of those services and the packet-based dedicated services (“PBDS”) that are substitutes for those services.

Competitive LECs’ ability to deploy connections. Evidence that Level 3 cannot economically deploy new fiber connections at capacities of 100 Mbps or less to most customer locations, along with additional evidence provided by other competitors, demonstrates that reasonably efficient competitors are infrequently able to deploy connections to provide Low-Bandwidth Services. AT&T and its economists have virtually nothing to say about non-cable companies’ ability to compete in the provision of Low-Bandwidth Services, other than to assert that more than half of competitive LEC connections have bandwidths equal to 37 Mbps or less and that this somehow means that competitive LECs have the ability to construct facilities connecting to buildings with demand for Low-Bandwidth Services.² But, as Dr. Baker explains,

² As used herein, the terms “connection” and “location” have the meaning defined in the special access mandatory data request. *See 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*, Order on Reconsideration, 29 FCC Rcd.

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a competitor's deployment of a connection in the past (e.g., when customers in the location may have demanded far more bandwidth than is the case today) does not support the inference that a competitor could deploy a connection to the same location today. In any event, inaccuracies in the bandwidth data supplied in response to the mandatory data request undermine the credibility of any attempt to determine the average bandwidth of competitive carrier connections.

Prices. Analysis of prices for Low-Bandwidth Services further supports the conclusion that there is no competition for these services. Notably, Dr. Baker's regression analysis shows large reductions in incumbent LECs' prices for Low-Bandwidth Services in response to competitive entry, which is powerful evidence of incumbent LEC market power.

Ethernet-over-HFC. In addressing Low-Bandwidth Services, incumbent LECs rely almost exclusively on claims that cable companies' Ethernet provided over hybrid fiber-coaxial ("HFC") facilities has emerged as a robust source of competition. But evidence provided by the cable companies in their comments strongly supports the conclusion that Ethernet-over-HFC is not a significant source of actual or potential competition for Low-Bandwidth Services. Dr. Baker's regressions also confirm that Ethernet-over-HFC is not a meaningful source of Low-Bandwidth Services competition.

Headroom under price caps. Incumbent LECs' lack of headroom under the Commission's price caps demonstrates that incumbent LECs charge prices at the highest level permitted by regulation, which is powerful evidence of their market power. AT&T argues that

10899, App. A (2014) (defining (1) "connection" as "a wired 'line' or wireless 'channel' that provides a dedicated communication path between a *Location* and the first *Node* on a *Provider's* network" and (2) "location" as "a building, other man-made structure, a cell site on a building, a free-standing cell site, or a cell site on some other man-made structure where the *End User* [i.e., the purchaser of Business Data Service] is connected").

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the absence of headroom is only evidence of market power if prices charged under price caps are above competitive levels, but this is exactly what both Dr. Baker's regression results and Sprint's analysis of the appropriate X Factor and the appropriate reduction to the price cap index ("PCI") demonstrate.

Limited Competition in the Provision of Mid-Bandwidth Services. The record confirms that competition for Business Data Services above 100 Mbps capacity up to one Gbps ("Mid-Bandwidth Services") is mixed, and there is strong evidence that the market is not competitive in many situations.

Competitive LECs' ability to deploy connections. Level 3's experience deploying fiber to customer locations supports the conclusion that incumbent LECs have market power in the provision of many Mid-Bandwidth Services. Other competitors have provided additional evidence that competition for Mid-Bandwidth Services is limited.

Competition from cable companies. Again, incumbent LECs rely heavily on the presence of cable companies in the market for their claims that Mid-Bandwidth Services are competitive. But cable companies are not a significant source of competitive Mid-Bandwidth Services. As the cable companies explain in their comments, they face the same barriers to expanding their fiber networks that other competitors face, and, as a result, their fiber networks reach a small number of customer locations as compared to incumbent LEC fiber networks.

Prices. The available information regarding prices for Mid-Bandwidth Services further supports the conclusion that there is generally no competition for these services. Dr. Baker's regression analysis shows large reductions in incumbent LECs' prices for Mid-Bandwidth Services in response to competitive entry, and price reductions are even greater for connections at these capacities in Phase II regions.

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Multi-Location Customers Lack Competitive Choices. Competitive LECs must rely on incumbent LEC facilities – and contend with incumbent LEC price squeezes – in order to serve multi-location customers. Competitive LECs’ experiences refute incumbent LEC claims that there are even more competitive alternatives for multi-location customers than there are for other customers. Evidence provided by the cable companies demonstrates that they also do not compete vigorously with incumbent LECs for multi-location customers.

No Other Information in the Record Supports the Incumbent LECs’ Arguments. The incumbent LECs make additional claims in their attempt to show that competition exists at essentially all capacities. None of these arguments has any merit.

Entry since 2013. The incumbent LECs claim that there has been significant entry since the data collection in 2013, but this is not so. Cable companies have not become a significant source of Business Data Services competition, and competitive LECs have not deployed connections to many locations since 2013.

Increase in competitive LEC Ethernet bandwidth. AT&T and its economists asserts that the bandwidth of competitive LEC-provisioned Ethernet circuits increased more rapidly in 2013 than the bandwidth of incumbent LEC-provisioned Ethernet circuits, thereby showing the pace of competition in the market. But, as Dr. Baker explains, competitive carriers’ purported rate of growth did virtually nothing to diminish the high concentration levels in Business Data Services markets, and, in any event, AT&T and its economists have mischaracterized the data that they claim supports their argument.

Declining Ethernet prices. Incumbent LECs argue that declining Ethernet prices in recent years show that PBDS competition is increasing, but this too is incorrect. The key measure of an incumbent LEC’s market power is not price trends but its profit margins. There is

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no evidence that incumbent LECs are no longer charging prices for Ethernet that far exceed a reasonable measure of their costs.

The Regression Analyses Are Reliable. In his declaration filed today, Dr. Baker explains that his prior conclusions – that incumbent LECs are likely able to exercise market power in the provision of Business Data Services in most markets, including at bandwidths at or below 50 Mbps and bandwidths above 50 Mbps through at least one Gbps – are not called into question by the analyses of the incumbent LECs’ economists and the economists who have provided peer reviews of Dr. Rysman’s regressions.

Endogeneity. The incumbent LECs’ economists repeat their argument that the data suffers from an endogeneity problem that renders the regression results unreliable. But Dr. Baker explains that county- or census-tract-level location fixed effects included in his and Dr. Rysman’s regressions focus on variations in prices within those locations and control for almost all of the important cost variations. He concludes that the regression results are conservative in estimating the magnitude of the price effects observed in the presence of competition.

Further refinements of regressions. In order to enhance the reliability of the regressions even further, Dr. Baker re-estimated his regression results using clustered standard errors and other refinements, as suggested by peer reviewers of Dr. Rysman’s analysis. Doing so did not change his previously reported conclusions.

The Market Competition Test Should Require the Presence of Four Competitors. As the Joint CLECs have explained, the Commission’s market competition test for Mid-Bandwidth Services should require that at least four competitors have established connections used to provide Business Data Services to a customer location in the relevant geographic area before that geographic area is classified as competitive. This test assumes that a competitor that has

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deployed a connection to one location in an area can be expected to deploy a connection to a different location in the same area. Requiring the presence of four such competitors in the relevant geographic area is consistent with competition policy and Commission precedent. And, as Dr. Baker explains, a four-provider test would not distort competitive LECs' investment incentives.

AT&T has proposed a test that would require only the presence of two competitors (the incumbent LEC and one non-incumbent LEC) with fiber in the relevant area. This test would not be an effective means of identifying competitive markets. There is no reason to think that at a competitor with fiber in an area can or would deploy a connection to nearby customer. In addition, as Dr. Baker explains, classifying an area with only two competitors as competitive is inconsistent with basic principles of economics.

The Appropriate Geographic Area for the Market Competition Test Is no Larger than a Census Block. The size of the geographic area used in the Commission's market competition test should be determined by the length of the connections that competitors could reasonably be expected to deploy in the future. Level 3's construction feasibility analysis demonstrates that it would be inappropriate to use a geographic unit larger than a census block for the test. AT&T proposes a census tract-based test, but AT&T's test would incorrectly classify large geographic areas as competitive.

Price Caps and Tariffs Provide the Most Appropriate Means of Preventing Abuse of Market Power in Non-Competitive Markets. Application of price cap and tariff regulations for both circuit-based dedicated services ("CBDS") and PBDS to leading competitors (which are today the incumbent LECs) in non-competitive markets is the most appropriate method of constraining leading competitors' exercise of market power. The Mid-Size ILECs' argument

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that any price regulations the Commission adopts should apply to all providers in a non-competitive market is inconsistent with Commission precedent and ignores the affirmative harm to competition that could result from the application of *ex ante* rate regulation to non-leading competitors. As Dr. Baker explains, applying price regulation to leading competitors in non-competitive markets would not discourage investment in Business Data Services.

Price caps. Applying price caps to both CBDS and PBDS in non-competitive areas, and including CBDS and PBDS in the same price cap basket, will provide a flexible, effective means of constraining the exercise of market power. Among other things, price caps would limit the extent to which the Commission would have to identify reasonable prices for PBDS in non-competitive markets in the future, in contrast to a benchmark approach. It is important to emphasize that Level 3 would support a benchmark approach to *ex ante* rate regulation for PBDS that ensures that rates are just, reasonable, and not unjustly or unreasonably discriminatory, consistent with Sections 201(b) and 202(a) of the Communications Act. However, devising such a regime poses difficult challenges, including the strong likelihood that it would become mired in legal challenges and would be susceptible to regulatory evasion.

Tariffs. As demonstrated by the Commission's review of the incumbent LECs' tariff revisions in response to the *Tariff Investigation Order*, the tariff filing and review provisions in Sections 203, 204, and 205 of the Communications Act establish a robust regime under which the Commission can efficiently and quickly address provisions that appear to be unlawful. It would be far more difficult for the Commission to evaluate leading competitors' conduct under a benchmark regime that does not include tariffs and relies instead on the customer-initiated complaint process.

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Regulations Governing Volume and Term Lock-Up Plans. In their comments, the Joint CLECs proposed a comprehensive regime to prevent incumbent LECs from using volume and term lock-up plans to harm competition and consumer welfare. As explained below, this regime should be supplemented by prohibiting a leading competitor from establishing the term of a circuit-specific discount at longer than two years, the time necessary to recover customer-specific sunk costs. The incumbent LECs have provided no meaningful opposition to the adoption of this regime. For example, they lamely argue that their lock-up provisions are not harmful because the market is competitive, which is obviously incorrect. They claim that competitive carriers include some of the provisions at issue in their own sales contracts. This claim is irrelevant because only providers with market power can use contract terms to harm competition. It is also highly misleading because the record shows that most competitive LECs do not include the terms at issue in contracts and, where they do so, they generally do not enforce them. The incumbent LECs also argue that the Commission may not apply the new rules to existing tariffs and agreements, but this too is incorrect. The *Sierra-Mobile* doctrine gives the Commission the authority to modify carrier contracts where the public interest so demands. It would be hard to find a circumstance in which the public interest would benefit more from changing the harmful lock-up contracts that have for so long stifled competition and innovation in Business Data Services markets.

Prohibition Against Non-Disclosure Agreements. The Commission should adopt its tentative conclusion that Business Data Services providers may not utilize non-disclosure provisions that prevent parties to an agreement from sharing the terms of the agreement with the Commission on a confidential basis. AT&T's claim that such a rule would undermine parties'

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confidentiality concerns is without merit because the Commission’s rules and procedures prohibit disclosure of information that has been made subject to confidentiality requirements.

II. THE RECORD CONFIRMS THE ABSENCE OF COMPETITION IN MOST BUSINESS DATA SERVICES MARKETS.

The record confirms that, when the relevant Business Data Services markets are properly defined, there is virtually no actual or potential competition for services up to and including one Gbps of capacity.

A. The Definition of Business Data Services Should Exclude Best-Efforts Services and UNE-Based Services.

It is appropriate to exclude both best-efforts services and UNE-based competition from the relevant product market.

Best-efforts services. The record confirms that the Commission appropriately excluded best-efforts Internet access services from the definition of Business Data Services. Dr. Baker has explained that best-efforts services are not in the relevant market because those services do not have the “service quality features – particularly availability, reliability, customer support, and security – required by most . . . retail customers.”³ Market evidence supplied by Level 3 in its capacities as both a provider and a purchaser of Business Data Services confirms that conclusion. In Level 3’s experience, “retail business customers generally demand services that offer dedicated bandwidth, symmetrical speeds, robust service level agreements, and a high level of security,”⁴ which best-efforts services do not offer. In addition, “Level 3’s wholesale carrier

³ Declaration of Jonathan B. Baker on Market Power in the Provision of Dedicated (Special Access) Services, ¶ 31 (Jan. 22, 2016), attached to Letter from Jonathan B. Baker to Marlene H. Dortch, Secretary, FCC, WC Docket No. 05-25, RM-10593 (originally filed Jan. 27, 2016) (refiled as revised Apr. 14, 2016) (“Baker Decl.”).

⁴ Declaration of Chris McReynolds on Behalf of Level 3 Communications, LLC, ¶ 20 (Jan. 21, 2016) (“McReynolds Decl.”), attached as Appendix A to Comments of Birch, BT Americas,

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customers generally purchase dedicated services from Level 3 in order to provide their own higher-layer services (such as voice, Internet access, and networking capabilities) over this capacity,”⁵ which they cannot do with best-efforts connections. Accordingly, “Level 3 generally does not monitor or respond to the cable companies’ rates, terms, and conditions for these services.”⁶ That is the case even where cable companies offer best-efforts broadband services subject to service level agreements, because those services “have technological limitations that prevent them from meeting the needs of customers that demand services beyond basic voice and Internet access.”⁷ For these same reasons, where Level 3 is seeking to lease connectivity to customer locations to which it has not built its own loops, the company does not generally view cable best-efforts broadband service to be a substitute for Business Data Services.⁸

The Mid-Size ILECs, AT&T, and Drs. Israel, Rubinfeld, and Woroch argue that best-efforts services should be included in the Business Data Services market, but they offer no basis for this conclusion.⁹ The incumbent LECs point to the fact that cable providers have experienced

EarthLink, and Level 3, WC Docket No. 05-25, RM-10593 (filed Jan. 27, 2016) (“Joint CLEC Comments”).

⁵ *Id.*

⁶ *Id.*

⁷ *Id.* ¶ 21.

⁸ Declaration of Gary Black, Jr. on Behalf of Level 3 Communications, LLC, ¶ 16 (Jan. 21, 2016), attached as Appendix B to Joint CLEC Comments (“Black Buy-Side Decl.”).

⁹ See Comments of AT&T Inc., WC Docket Nos. 16-143 & 05-25, RM-10593, at 42-47 (filed June 28, 2016) (“AT&T FNPRM Comments”); Joint Comments of CenturyLink, Inc., Consolidated Communications, FairPoint Communications, Inc., and Frontier Communications Corp., WC Docket Nos. 16-143, 15-247, & 05-25, RM-10593, at 38-44 (filed June 28, 2016) (“Mid-Size ILECs FNPRM Comments”); Mark Israel, Daniel Rubinfeld, & Glenn Woroch, *Analysis of the Regressions and Other Data Relied Upon in the Business Data Services FNPRM and a Proposed Competitive Market Test*, at 34-37 (June 28, 2016), attached to Letter from

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an increase in sales of best-efforts services to business customers.¹⁰ But that fact simply suggests that many business customers that do not need or want Business Data Services have purchased best-efforts services. As explained, the available evidence shows that customers that demand Business Data Services do not perceive best-efforts services as a substitute for Business Data Services.

The incumbent LECs also point to the fact that best-efforts services are offered at speeds of 100 Mbps or higher.¹¹ But this does not show that best-efforts services are a substitute for Business Data Services because, critically, best-efforts services offered at *any* capacity lack the service level guarantees and symmetrical capacities that are the *sine qua non* of Business Data Services.

The cable companies provide evidence supporting these conclusions in their comments. For example, Comcast notes that the “small and mid-sized businesses purchase Comcast’s best-efforts Internet access service, but that service . . . is offered with asymmetrical download and upload speeds on a best-efforts basis . . . without SLAs providing availability or performance

Glenn Woroch to Marlene H. Dortch, Secretary, FCC, WC Docket Nos. 16-143, 15-247, & 05-25, RM-10593 (filed June 28, 2016) (“Second IRW White Paper”). In addition, the United States Telecom Association (“USTelecom”) asserts that a market research survey it commissioned demonstrates that small and medium business retail customers view best-efforts services as interchangeable with Business Data Services. *See* Comments of the USTelecom, WC Docket Nos. 16-143, 15-247, & 05-25, RM-10593, at 3-17 (filed June 28, 2016). USTelecom’s anecdotal survey is not a substitute for the exhaustive competition analyses demonstrating otherwise that have been compiled in the record of this proceeding.

¹⁰ AT&T FNPRM Comments at 44-46; Second IRW White Paper at 34-36.

¹¹ AT&T FNPRM Comments at 44; Mid-Size ILECs FNPRM Comments at 43; Second IRW White Paper at 34.

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guarantees.”¹² Accordingly, Comcast’s best-efforts services, which it states constitute the “overwhelming majority” of business services provided via its HFC plant, “are priced very differently than dedicated services with SLAs and are not considered competitive substitutes by customers.”¹³ Similarly, NCTA observes that “[m]any smaller businesses do not need the higher quality dedicated services that drive up costs[,] and they are adequately and efficiently served with best efforts services, which the Commission correctly excludes from the BDS product market definition.”¹⁴

UNE-based competition. Dr. Baker has found that “providers serving end users with UNEs likely offer some competitive constraint on facilities-based providers, but only in some locations, only for some customers, and only to some extent.”¹⁵ This is true because, as the Joint CLECs have explained, a host of practical and legal limitations prevent competitive LECs relying on UNEs from competing with incumbent LECs at more than a limited number of customer locations and for more than a limited set of Business Data Services.¹⁶

For example, there are many locations that are not served by incumbent LEC copper loops, and the number of such locations is increasing.¹⁷ In addition, incumbent LECs are not

¹² Comments of Comcast Corporation, WC Docket Nos. 16-143, 15-247, & 05-25, RM-10593, at 10-11 (filed June 28, 2016) (“Comcast FNPRM Comments”).

¹³ *Id.* at 11, 30.

¹⁴ Comments of The National Cable & Telecommunications Association, WC Docket Nos. 16-143 & 05-25, at 9 (filed June 28, 2016) (“NCTA FNPRM Comments”).

¹⁵ Baker Decl. ¶ 37.

¹⁶ *See* Joint CLEC Comments at 25.

¹⁷ Incumbent LECs are required to offer conditioned copper loops as UNEs in all locations where they exist. 47 C.F.R. § 51.319(a)(1). But the Commission’s rules also allow incumbent LECs to retire copper loops without seeking prior FCC approval for doing so. *See id.* §§ 51.319(a)(3)(iv),

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required to provide DS1 and/or DS3 loops or transport facilities as UNEs in many locations and under many circumstances, and incumbent LECs are not required to provide Ethernet dedicated service connections as UNEs at all.¹⁸ And it is most often the case that UNE-based Ethernet-over-Copper can be used to provide Business Data Services only “at relatively low capacities in the range of 1-20 Mbps,” and “competitive LECs often cannot profitably offer Ethernet-over-DSn services at capacities above . . . approximately 7.5 Mbps when relying on UNEs.”¹⁹ Finally, even in cases where UNEs are available and can be used to provide the service a customer demands as a matter of engineering, incumbent LEC lock-up plans often prevent competitive LECs from purchasing UNEs.²⁰

Notwithstanding these limitations, the Mid-Size ILECs argue that UNE-based competition should be included in the relevant market, but they offer no valid basis for this assertion.²¹ They fail to address any of the many reasons why competitive carriers’ ability to rely on UNEs is both extremely limited now and diminishing over time. Accordingly, there is no reason for the Commission to depart from its conclusion that “UNE competition has its limits,”²² and there is no reason to include such limited competitive services in the relevant market. In all

51.332. Incumbent LECs are increasingly taking advantage of this right, thereby steadily reducing the availability of conditioned copper loops. *See* McReynolds Decl. ¶ 13. This process can be expected to continue, and possibly to accelerate, in the future.

¹⁸ 47 C.F.R. § 51.319(a)(4)-(5).

¹⁹ McReynolds Decl. ¶¶ 13-14.

²⁰ *See* Joint CLEC Comments at 26.

²¹ Mid-Size ILECs FNPRM Comments at 44-48.

²² *Order and FNPRM* ¶ 228.

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events, if the Commission disagrees with this conclusion and includes UNE-based services in the relevant market, it should give such services little or no weight in its competitive analysis.

B. There Is No Meaningful Competition in the Provision of Low-Bandwidth Services.

Record evidence strongly supports the conclusion that there is no meaningful competition in the provision of Low-Bandwidth Services.

Incumbent LEC tariff filings. AT&T’s and Verizon’s recent proposed tariff revisions filed in response to the *Tariff Investigation Order* are the latest evidence that incumbent LECs have substantial and persisting market power in the provision of Low-Bandwidth Services. In its filing, AT&T discontinued highly-valued circuit portability plans for DS1 Business Data Services,²³ even though AT&T has stated that it made the plans available in response to customer demand,²⁴ and even though the Commission has acknowledged that “[g]iven the importance of circuit portability to competitive LECs . . . most, if not all of them elect that option when

²³ The Wireline Competition Bureau rightly rejected AT&T’s proposals to grandfather three circuit portability plans. *Ameritech Operating Companies Tariff F.C.C. No. 2; Pacific Bell Telephone Company Tariff F.C.C. No. 1; Southwestern Bell Telephone Company Tariff F.C.C. No. 73; Investigation of Certain Price Cap Local Exchange Carrier Business Data Services Tariff Pricing Plans*, Order, Transmittal Nos. 1847, 539, & 3428, WC Docket No. 15-247, DA No. 16-806, ¶ 5 (WCB rel. Jul. 15, 2016) (“*AT&T Tariff Rejection Order*”). The proposals fell far short of complying with “the *Tariff Investigation Order* directive to remove language requiring customers to aggregate all of their purchases under a single plan[.]” *Id.* ¶ 11. If AT&T’s re-filed transmittals attempt to grandfather the portability plans for new or existing customers, AT&T must make the showings required by the Commission’s price cap rules. *See id.* ¶ 12.

²⁴ Brief of AT&T Inc. in Support of its Direct Case, WC Docket No. 15-247, at 4 (filed Jan. 8, 2016) (“AT&T Brief”).

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purchasing [Business Data Services] from incumbent LECs.”²⁵ AT&T also introduced shortfall and early termination penalties that, although lower than the penalties they replaced, exceed expectation damages and harm customers.²⁶ For its part, Verizon increased the price for DS1 Business Data Services by 2.85 percent without any apparent concern that such a price increase would cause Verizon’s customers to switch to a competitor.²⁷ AT&T’s disregard for its customers’ strong preference for circuit portability and introduction of penalties that harm its customers as well as Verizon’s unilateral price increase are blatant exercises of market power. Only providers with market power have the incentive and ability to treat their customers this way. And, as the Joint CLECs have explained, because PBDS is a substitute for CBDS, incumbent LECs’ exercise of market power in the provision of CBDS confirms the absence of competition in the provision of CBDS *and* PBDS at lower bandwidths.²⁸

²⁵ *Investigation of Certain Price Cap Local Exchange Carrier Business Data Services Tariff Pricing Plans*, Order Initiating Investigation and Designating Issues for Investigation, 30 FCC Rcd. 11417, ¶ 34 (WCB 2015).

²⁶ The Bureau suspended the revised penalty provisions and set for investigation the question of whether they comply with the *Tariff Investigation Order. Pacific Bell Telephone Company Tariff F.C.C. No. 1; Southwestern Bell Telephone Company Tariff F.C.C. No. 73; Investigation of Certain Price Cap Local Exchange Carrier Business Data Services Tariff Pricing Plans*, Order, Transmittal Nos. 539 & 3428, WC Docket No. 15-247, DA No. 16-805, ¶ 1 (WCB rel. Jul. 15, 2016).

²⁷ Verizon’s tariff revision instituting the proposed rate increases has been deemed granted, presumably because the Bureau believes that Verizon’s increased rates will not result in an actual price index that exceeds the relevant PCI. Verizon’s conduct nevertheless confirms that it has the incentive and the ability to unilaterally increase prices to the maximum extent permitted by law without any apparent concern that doing so will cause Verizon to lose market share.

²⁸ Comments of Birch, EarthLink, and Level 3, WC Docket Nos. 16-143, 15-247, & 05-25, RM-10593, at 27 (filed June 28, 2016) (“Joint CLEC FNPRM Comments”).

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Competitive LECs' ability to deploy connections. The evidence provided in the Joint CLECs' comments regarding Level 3's ability to deploy connections to customer locations also strongly supports the conclusion that there is no meaningful competition in the provision of Low-Bandwidth Services.²⁹ As the Joint CLECs have explained, the absence of actual competition in the market means that the Commission must assess the level of competition based on whether a reasonably efficient competitor can deploy connections to customers demanding a defined bandwidth of service.³⁰ It is therefore highly significant that Level 3 cannot economically deploy new fiber connections at capacities of 100 Mbps or less to most customer locations. This fact shows that nearby providers have little or no competitive impact at those capacities. As Level 3's John Merriman has explained, "[t]his is because the distance between a customer location and a splice point on Level 3's network usually exceeds the construction feasibility limits for bandwidths of 100 Mbps and below."³¹ Moreover, Mr. Merriman's construction feasibility analysis assumes that a customer would pay the highest "list price" that Level 3 charges for a connection at the specified bandwidths. However, Level 3 must frequently charge prices significantly below its list prices because, for example, it must compete with incumbent LECs that reduce their own prices when faced with competition from Level 3. Therefore, Mr.

²⁹ *Id.* at 21-25.

³⁰ *Id.* at 19-20.

³¹ Declaration of John Merriman on Behalf of Level 3 Communications, LLC, ¶ 6 (June 27, 2016), attached to Joint CLEC FNPRM Comments ("Merriman FNPRM Decl."). Sprint notes that "the build-buy analysis of potential entrants differs dramatically by capacity[.]" and that "[c]ompetitors simply will not expend the time and money needed to expand their networks across even modest distances to bring a below-50 Mbps circuit to a new building." Comments of Sprint Corporation, WC Docket Nos. 16-143, 15-247, & 05-25, RM-10593, at 16 (filed June 28, 2016) ("Sprint FNPRM Comments"). Mr. Merriman's analysis demonstrates that the same is true when a customer demands a circuit at or below 100 Mbps.

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Merriman’s analysis substantially overstates the extent to which Level 3 can deploy such connections.³²

Other competitors have provided additional evidence that reasonably efficient competitors cannot deploy connections to provide Low-Bandwidth Services. For example, like Level 3, TDS CLEC is unable to “build economically to connect customers to its network at 100 Mbps and below.”³³ According to TDS CLEC, “a fiber lateral build to a customer located 100 to 1,000 feet and beyond from the nearest splice point is not competitive at speeds ranging from 10 to 100 Mbps because TDS CLEC could not recover its required revenue and compete with lower RBOC retail rates.”³⁴ Windstream similarly states that “a single 100 Mbps circuit almost never generates the amount of revenue required to justify deployment of a new last-mile connection by its competitive carrier operations, even when Windstream has already deployed fiber feeder in the customer’s vicinity.”³⁵ And Windstream finds that “as bleak as the prospects of entry are at 100 Mbps service to a location, they are even bleaker at 50 Mbps.”³⁶

³² Letter from Thomas Jones, Counsel for Level 3, to Marlene H. Dortch, Secretary, FCC, WC Docket Nos. 16-143, 15-247, & 05-25, RM-10593, at 2 (filed Jul. 14, 2016) (“July 14 Level 3 Ex Parte”).

³³ Comments of TDS Metrocom, LLC, WC Docket Nos. 16-143, 15-247, & 05-25, RM-10593, at 11 (filed June 28, 2016) (“TDS FNPRM Comments”).

³⁴ Third Declaration of Matthew J. Loch, ¶ 13 (Feb. 19, 2016), attached as Attachment A to Reply Comments of TDS Metrocom, LLC, WC Docket No. 05-25, RM-10593 (filed Feb. 19, 2016).

³⁵ Declaration of David Schirack and Mike Baer, ¶ 16 (June 28, 2016), attached as Attachment A to Comments of Windstream Services, LLC, WC Docket Nos. 16-143 & 05-25, RM-10593 (filed June 28, 2016) (“Windstream FNPRM Comments”).

³⁶ Windstream FNPRM Comments at 33.

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Notwithstanding this evidence, Dr. Israel et al. claim that the 2013 data show that more than half of competitive LEC connections have bandwidths equal to 37 Mbps or less, which, they assert, means competitive LECs have the ability to construct facilities connecting to buildings with demand for Low-Bandwidth Services.³⁷ Again, the existing competitors' analyses of their ability to deploy connections flatly contradict this argument. Moreover, as Dr. Baker explains, a competitive carrier's deployment of a connection in the past "is meaningless as an indicator of entry conditions as of 2013 (the date at which the observations in the FCC's data were recorded) or today."³⁸ This is because "[a] [50 Mbps or below] connection observed in the data could have been built any time within the past three decades; even if its electronics have been upgraded in the meantime, its presence would largely reflect entry conditions (or irrational exuberance) in an earlier era, not entry conditions today."³⁹

In any event, inaccuracies in the bandwidth data provided in response to the mandatory data request undermine the credibility of any attempt to determine competitive LEC bandwidths. *First*, it is likely that switched Ethernet bandwidth data is unreliable because the mandatory data request did not provide guidance on how to calculate bandwidth sold over a connection. For example, respondents could have provided port speed (maximum speed available) or the committed data rate, average data charged for, or perhaps even something else. *Second*, the fact that total bandwidth sold is reported as zero for many connections further confirms that the data

³⁷ Second IRW White Paper at 23; *see also* AT&T FNPRM Comments at 26.

³⁸ Reply Declaration of Jonathan B. Baker on Competition and Market Power in the Provision of Business Data Services, ¶ 15 (Aug. 9, 2016), attached to Letter from Jonathan B. Baker to Marlene H. Dortch, Secretary, FCC, WC Docket Nos. 16-143, 15-247, & 05-25, RM-10593 (filed Aug. 9, 2016) ("Baker FNPRM Reply Decl.").

³⁹ *Id.* (internal citations omitted).

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cannot be relied upon for the purpose AT&T and its economists wish. While it is not clear why some providers reported connections as having zero bandwidth, one possibility is that those providers did not have information for bandwidth sold to customers on those connections. If that is true, it seems likely that even where providers had *some* information for bandwidth sold over a connection and reported it, they were missing information regarding all bandwidth sold over that connection, which could have resulted in the underreporting of the total bandwidth *actually* sold over that connection.

Prices. The available information regarding prices for Low-Bandwidth Services further supports the conclusion that there is no competition for these services. Dr. Baker’s regression analysis shows large reductions in incumbent LECs’ prices for Low-Bandwidth Services in response to competitive entry, which is powerful evidence of market power. In his report filed today, he finds that “competition from four or more in-building providers and four or more nearby providers . . . reduces ILEC prices for DS1 connections by 51% according to one estimate and by 42% according to another.”⁴⁰

Similarly, **[BEGIN HIGHLY CONFIDENTIAL]**

⁴⁰ *Id.* ¶ 5.

⁴¹ [END

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Ethernet-over-HFC. The record strongly supports the conclusion that Ethernet-over-HFC is not a significant source of actual or potential competition for Low-Bandwidth Services. As the Joint CLECs have explained, cable companies do not provide Ethernet-over-HFC pursuant to service level guarantees comparable to those provided to customers of fiber-based or copper-based PBDS, and, with a maximum capacity of 10 Mbps (and sometimes below), Ethernet-over-HFC does not deliver speeds sufficient to meet most Business Data Services customers' needs.⁴²

Dr. Baker's regressions confirm that Ethernet-over-HFC is not a meaningful source of competition in the provision of Low-Bandwidth Services. Dr. Baker has found "that the competitive constraint an [Ethernet-over-HFC] provider offers at lower bandwidths is small,"⁴³ and that the inclusion of Ethernet-over-HFC data in the data set has no material effect on in-building and nearby rivalry.⁴⁴ As Dr. Baker explains in his declaration filed today, when he re-estimated his regression results using clustered standard errors, the results support his previous conclusion that "the empirical evidence shows that the availability of HFC Ethernet exerts only a

⁴¹ [BEGIN HIGHLY CONFIDENTIAL]

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⁴² Joint CLEC FNPRM Comments at 25-26.

⁴³ Declaration of Jonathan B. Baker on Competition and Market Power in the Provision of Business Data Services, ¶ 32 (June 28, 2016), attached to Letter from Jonathan B. Baker to Marlene H. Dortch, Secretary, FCC, WC Docket Nos. 16-143, 15-247, & 05-25, RM-10593 (originally filed June 28, 2016) (refiled as revised Jul. 14, 2016) ("Baker FNPRM Decl.").

⁴⁴ Baker FNPRM Decl. ¶ 32.

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small constraint on ILEC prices at low bandwidths.”⁴⁵ In fact, in re-running his analysis with clustered standard errors, Dr. Baker only found a modest effect on prices for DS1 services.⁴⁶ He found no effect on prices for DS3 services.⁴⁷ These results are consistent with the fact that Ethernet-over-HFC can only be used to offer services at or below 10 Mbps.

Notwithstanding the limited competitive significance of Ethernet-over-HFC, the incumbent LECs argue (as they always do) that Ethernet-over-HFC disciplines incumbent LEC prices for at least some incumbent LEC Business Data Services or that they will do so in the future.⁴⁸ But there is no merit to this argument.

The cable companies have demonstrated that Ethernet-over-HFC is unlikely to emerge as a significant source of competition even for Low-Bandwidth Services. For example, Comcast explains that the “vast majority of businesses seeking Ethernet services demand full carrier-grade performance and SLAs that EoHFC cannot provide,”⁴⁹ and Cox states unambiguously that “the lack of performance guarantees renders [its Ethernet-over-HFC services] outside the [Business

⁴⁵ Baker FNPRM Reply Decl. ¶ 44.

⁴⁶ *Id.*

⁴⁷ *Id.*

⁴⁸ *See* AT&T FNPRM Comments at 15-16 (asserting that cable companies compete successfully for Business Data Services customers and revenue by providing Ethernet-over-HFC in suburban and rural areas); Mid-Size ILECs FNPRM Comments at 30-31 (arguing that an assessment of incumbent LEC market power must include Ethernet-over-HFC due to its significant competitive impact); Letter from Bryan N. Tramont, et al., to Marlene H. Dortch, Secretary, FCC, WC Docket Nos. 16-143, 15-247, & 05-25, RM-10593, at 2, 3-6 (filed Jul. 19, 2016) (arguing the Rysman Report rejected “the prospect that cable providers could deploy fiber facilities attached to . . . Metro Ethernet-enabled headends, and the ways in which their ability to do so in the future applies competitive pressure even today”).

⁴⁹ Comcast FNPRM Comments at 31.

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Data Services] product definition.”⁵⁰ According to Cox, the Ethernet-over-HFC that it provides “is much more akin to the best effort Internet services that the Commission correctly excludes from the market and that is provided over the same shared HFC network.”⁵¹

If demand for Ethernet-over-HFC services were to increase, the costs of increasing shared HFC network capacity and deploying HFC connections would limit cable companies’ ability to respond to that demand.⁵² Comcast explains that “[i]n order to add significant wholesale BDS traffic to its shared HFC network, Comcast would need to undertake significant expansions of capacity to avoid adverse impacts on the broadband Internet access, video, and voice traffic supported by that network, including impacts on residential subscribers.”⁵³ In fact, Comcast finds that it would be more efficient to build new fiber connections than to expand its HFC network to provide service to business customers.⁵⁴ Cox explains that the quality of Ethernet-over-HFC is unlikely to improve significantly as DOCSIS 3.1 deployment progresses because Cox will continue to provide Ethernet-over-HFC over a shared network, and “Cox does not plan to convert performance objectives to credit-backed guarantees or commitments.”⁵⁵ Cox also explains that increasing shared HFC capacity, including through node-splitting, “is an

⁵⁰ Comments of Cox Communications Inc., WC Docket Nos. 16-143 & 05-25, at 16 (filed June 28, 2016) (“Cox FNPRM Comments”).

⁵¹ *Id.* at 16.

⁵² Comcast FNPRM Comments at 32.

⁵³ *Id.*

⁵⁴ *Id.*

⁵⁵ Cox FNPRM Comments at 18.

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expensive and time consuming process.”⁵⁶ Moreover, when Cox must decide whether to extend coaxial cable to the location of a customer that demands Ethernet-over-HFC, “[g]iven the low prices of EoHFC service, construction costs must be exceedingly low” in order to meet Cox’s internal rate-of-return requirement.⁵⁷

Finally, even if Ethernet-over-HFC were to somehow emerge as a significant source of competition in Low-Bandwidth Business Data Services markets, that would mean that at most two competitors would serve most locations. As discussed further in Section III.A below, Dr. Baker has explained that the presence of two competitors in a market does not produce competitive outcomes.

Headroom under price caps. Incumbent LECs’ lack of headroom under the Commission’s price caps provides further evidence of market power because it demonstrates that incumbent LECs charge prices at the highest level permitted by regulation. Nevertheless, AT&T argues that the absence of headroom only supports claims of market power to the extent that the prices permitted under price caps are higher than prices charged in a competitive market.⁵⁸ The available evidence does not in fact show that this is the case.

For example, Dr. Baker explains that the statement in the Commission staff report “that DS1 and DS3 prices ‘are consistently lower when facing competition in Phase II areas than when facing competition in price cap and Phase I areas’ . . . should not be interpreted as suggesting

⁵⁶ *Id.* at 17.

⁵⁷ *Id.* at 18.

⁵⁸ AT&T FNPRM Comments at 24-25; *see also* Second IRW White Paper at 21-22 (“The mere fact that an ILEC’s rates are at or near the price cap cannot by itself establish that ILECs exercise market power. That conclusion could be drawn only if it were also demonstrated that the current caps are set above competitive levels.”).

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that the ILECs only exercise market power in Phase II regions.”⁵⁹ He states that, on the contrary, “the data analyses, analyses of market structure, and other evidence consistently demonstrate that rivalry leads to a substantial reduction in ILEC prices over all bandwidths and regions.”⁶⁰

This is unsurprising given that the Commission has failed to ensure that the PCI for the special access price cap basket is reduced to account for increased incumbent LEC productivity over the past decade. As Sprint’s experts Dr. David Sappington and Mr. William Zarakas have explained, because price cap levels have been too high for over a decade, the PCI should be reduced by at least 25.2 percent, which “reflects a conservative estimate of the extent to which [price cap LECs] have experienced productivity gains in excess of input price increases in the supply of BDS since 2005.”⁶¹ In addition, Dr. Sappington and Mr. Zarakas have found that the prospective X Factor should be at least 4.4 percent in order to account for rapid future productivity growth and slower future input cost growth as compared to the economy as a whole.⁶²

C. Competition Is Limited in the Provision of Mid-Bandwidth Services.

Record evidence confirms that competition for Mid-Bandwidth Services is mixed, and there is strong evidence that the market is not competitive in many situations.

⁵⁹ Baker FNPRM Reply Decl. ¶ 47 (quoting FCC Memorandum, “Distinguishing the Effects of Competition on ILEC Prices under Price Cap only Regulation, Phase I Pricing Flexibility, and Phase II Pricing Flexibility,” at 5, appended as Attachment 2 to Memorandum from Wireline Competition Bureau (June 28, 2016)).

⁶⁰ *Id.*

⁶¹ Declaration of David Sappington and William Zarakas, ¶ 5 (June 28, 2016), attached as Exhibit E to Sprint FNPRM Comments.

⁶² *Id.* ¶¶ 5, 34-38.

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Competitive LECs' ability to deploy connections. As described in the Joint CLECs' comments, Level 3's experiences deploying fiber to customer locations support the conclusion that incumbent LECs have market power in the provision of many Mid-Bandwidth Services.⁶³ Mr. Merriman has explained that Level 3 can efficiently deploy a new fiber connection to serve a customer that demands more than 100 Mbps of bandwidth up to and including one Gbps of bandwidth only as long as the customer is within the maximum distance to which Level 3 can deploy a connection for the relevant capacity.⁶⁴ He emphasizes that "there are many circumstances in which customers that demand Business Data Service in this range of capacity are within the construction feasibility limit and many circumstances in which such customers are not within the construction feasibility limit."⁶⁵ Again, because Mr. Merriman's analysis assumes that a customer would pay the highest list price that Level 3 charges for a connection above 100 Mbps, but Level 3 must frequently charge significantly lower prices, his analysis substantially overstates the extent to which Level 3 can deploy such connections.⁶⁶

Other competitors have provided additional evidence that competition for Mid-Bandwidth Services is limited. For example, the Windstream-commissioned CostQuest analysis of Ethernet deployment also demonstrates that there is limited fiber-based competition for Mid-Bandwidth Services. As Windstream explains, the CostQuest analysis shows there are "far

⁶³ Joint CLEC FNPRM Comments at 28-29.

⁶⁴ Merriman FNPRM Decl. ¶ 6.

⁶⁵ *Id.* Mr. Merriman's analysis also confirms that the provision of Business Data Services above one Gbps is competitive, as Level 3 can usually deploy a new fiber connection to serve customers demanding such service. *Id.*

⁶⁶ July 14 Level 3 Ex Parte at 2.

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higher economic obstacles faced by a competitive carrier entering on a targeted, greenfield basis as a second (or third or fourth) entrant in a market, as compared to the ILEC that has a large existing subscriber base over which to spread its deployment costs.”⁶⁷

Competition from cable companies. Cable companies are not a significant source of competitive Mid-Bandwidth Services. Cable companies’ fiber networks reach a small number of customer locations compared to incumbent LEC fiber networks.⁶⁸ That is because, as Comcast and Cox explain, they face the same barriers to expanding their fiber networks that other competitors face, such as the inability to obtain access to building locations at reasonable rates, or at all, and the need to obtain costly rights of way.⁶⁹ In addition, Cox explains that its decision to deploy fiber to a particular customer location depends on several factors, **[BEGIN HIGHLY CONFIDENTIAL]**

⁷⁰ **[END HIGHLY CONFIDENTIAL]** Cox observes that construction costs, particularly costs it incurs when it must trench to deploy fiber, can be significant. As a result, “Cox does not have anything close to a ubiquitous fiber network.”⁷¹

⁶⁷ Windstream FNPRM Comments at 18.

⁶⁸ See, e.g., Comcast FNPRM Comments at 20 (noting that Comcast’s fiber network “is far from ubiquitous” (internal quotation marks omitted)).

⁶⁹ See *id.* at 19-20; Cox FNPRM Comments at 11-12.

⁷⁰ See Declaration of Ken Shelton, ¶ 8 (June 27, 2016), attached as Exhibit 2 to Cox FNPRM Comments.

⁷¹ Cox FNPRM Comments at 13.

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Prices. The available information regarding prices for Mid-Bandwidth Services further supports the conclusion that there is no competition in the provision of these services. Dr. Baker’s regression analysis shows large reductions in incumbent LECs’ prices for Mid-Bandwidth Services in response to competitive entry. According to Dr. Baker, “the cumulative effect of competition from four in-building and four nearby providers” lowers prices for connections above 45 Mbps by 25 percent or 43 percent, “depending on which location fixed effects are employed.”⁷² And price reductions are even greater for connections at these capacities in Phase II regions, where “the cumulative effect of competition from four in-building and four nearby rivals” reduces prices by 45 percent or 53 percent, again depending on the fixed effects employed.⁷³ Moreover, **[BEGIN HIGHLY CONFIDENTIAL]**

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D. Multi-Location Customers Lack Competitive Choices.

The Commission finds in the *Order and FNPRM* that “[m]ulti-location customers are often provisioned by BDS providers that ‘have a broad regional footprint without significant gaps in coverage to serve large enterprises with multiple sites across given geographic regions

⁷² Baker FNPRM Reply Decl. ¶ 9.

⁷³ *Id.*; *see also id.* ¶ 46.

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effectively[.]” and that “[s]uch providers may be relatively rare.”⁷⁵ Incumbent LEC price squeezes compound the challenges that competitors face in serving multi-location customers. For example, as Mr. Merriman has explained, even when it may be economic to deploy fiber to serve some or most of a multi-site customer’s locations, “the cost of leasing off-net facilities from the incumbent LEC to serve some of a potential customer’s locations can be so high that Level 3 cannot effectively compete for the customer’s business.”⁷⁶

AT&T nevertheless argues that there are even more competitive alternatives for multi-location customers than there are for other customers because Business Data Services providers compete especially vigorously for multi-location customers.⁷⁷ There is no evidence for this assertion. Not only do competitive LECs face significant challenges in serving multi-location customers, cable companies’ experiences in the marketplace demonstrate that they also do not compete vigorously with incumbent LECs for multi-location customers.

For example, in its comments Comcast explains that cable operators’ “limited geographic footprint and barriers to providing services that are true competitive substitutes [for Business Data Services] present challenges for certain customer segments.”⁷⁸ Comcast states that, despite efforts to expand fiber network reach, “cable providers’ penetration of geographic markets and

⁷⁵ *Order and FNPRM* ¶ 201 (quoting Public Interest Statement of Charter Communications, Inc., Time Warner Cable Inc., and Advance/Newhouse Partnership, MB Docket No. 15-149, at 35 (filed June 25, 2015)).

⁷⁶ Declaration of John Merriman on Behalf of Level 3 Communications, LLC, ¶ 17 (Feb. 18, 2016), attached as Appendix to Reply Comments of Birch, EarthLink, and Level 3, WC Docket No. 05-25, RM-10593 (filed Feb. 19, 2016).

⁷⁷ AT&T FNPRM Comments at 48-49.

⁷⁸ Comcast FNPRM Comments at 20.

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buildings through their own facilities remains limited, both in the retail and wholesale markets.”⁷⁹ Cable companies purchase wholesale Business Data Services from other non-incumbent LECs, but the record demonstrates that non-incumbent LEC networks serve only a tiny minority of locations. The only way for a competitor to serve most multi-location customers is to lease incumbent LEC connections. But cable companies generally do not purchase wholesale Business Data Services from incumbent LECs.⁸⁰ And even when cable companies are able to obtain wholesale Business Data Services “in order to serve multi-site customers,” doing so “rais[es] the cost and coordination required to offer BDS.”⁸¹ Thus, not surprisingly, Charter states that its share of the provision of multi-locations customer services remains “quite small.”⁸² Comcast states that its recent investments to extend its fiber network reflect its “desire to *become competitive . . .* on a broader geographic basis for the types of high-performance services that enterprise customers demand,” but it remains “a relatively minor player.”⁸³

E. No Other Information in the Record Supports the Incumbent LECs’ Arguments that the Business Data Services Market Is Competitive.

In addition to the information discussed above that pertains to the level of competition in the provision of Low-Bandwidth Services, Mid-Bandwidth Services, and multi-location

⁷⁹ Comcast FNPRM Comments at 21.

⁸⁰ *See Order and FNPRM* ¶ 75 (“Carrier customers purchasing BDS at wholesale are most likely to include non-cable competitive LECs, including incumbent LECs operating outside their study areas. . . . All top ten purchasers [of Business Data Services in 2013] were carriers, and none of the carriers were cable companies.”).

⁸¹ Comments of Charter Communications Inc., WC Docket Nos. 16-143, 15-247, & 05-25, RM-10593, at 9 (filed June 28, 2016).

⁸² *Id.* at 6.

⁸³ Comcast FNPRM Comments at 21-22.

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customer services, the incumbent LECs point to several different types of information in their attempt to show that competition exists at essentially all capacities. None of these arguments has any merit.

Entry since 2013. The incumbent LECs claim that there has been significant competitive entry since the data collection in 2013.⁸⁴ This is incorrect.

The incumbent LECs rely almost exclusively on the entry of cable companies into the market for their claim that competition has grown significantly since 2013. But cable companies' entry, or expansion, has in fact been extremely limited in the Business Data Services market. As explained, best-efforts services are not in the relevant product market, and Ethernet-over-HFC is not, and is unlikely to become, a significant source of competition to incumbent LECs in the provision of Business Data Services. In addition, the cable companies' deployment of fiber-based Business Data Services has been limited because they face significant deployment costs and barriers to entry, just as competitive LECs do.

The record also shows that competitive LECs have not deployed connections to many locations since 2013. To begin with, most competitive carriers do not appear to deploy connections with any frequency. For example, in 2013, the median provider served only 35

⁸⁴ See AT&T FNPRM Comments at 14-17 (arguing that “metrics that are based on 2013 data dramatically understate the extent of competition *today*” due to “expansion by non-ILEC competitors” including competitive LECs, fixed wireless providers, and, most prevalently, cable companies); Mid-Size ILECs FNPRM Comments at 20-25 (asserting that competitive providers, and “[c]able companies in particular[,] have dramatically expanded the availability of Ethernet access” at the expense of incumbent LECs’ legacy TDM-based facilities and services); Second IRW White Paper at 24-25 (claiming no Ethernet provider has market power, and that, “[d]uring the past several years, numerous providers, including ILECs, CLECs, cable companies, and others, have invested billions of dollars to deploy Ethernet services”).

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building locations, and the 90th percentile provider served 1,148 building locations.⁸⁵ These totals are extremely low given that it has now been 20 years since the Telecommunications Act of 1996 opened the local market for telecommunications services to competition. It is therefore highly unlikely that even the 90th percentile provider has deployed connections to a large number of locations since 2013.

Moreover, Level 3’s experience demonstrates that the few competitors that do deploy connections aggressively could not have diminished incumbent LECs’ market power. Level 3 aims to deploy new loops to approximately 3,000 to 4,000 commercial buildings in the U.S. each year. At this pace, competitive LECs like Level 3 could not have come close to deploying connections to a significant percentage of the well over one million locations at which customers purchased Business Data Services as of 2013.

Increase in competitive LEC Ethernet bandwidth. AT&T and Dr. Israel et al. assert that the bandwidth of competitive LEC-provisioned Ethernet circuits increased more rapidly in 2013 than the bandwidth of incumbent LEC-provisioned Ethernet circuits.⁸⁶ They claim that this supports the conclusion that competitive LECs are gaining market share and that the market for Business Data Services is competitive.⁸⁷ But this is not the case.

As Dr. Baker explains in his declaration filed today, “regardless of the relative rates of growth of ILEC and CLEC bandwidth, business data services markets remained highly

⁸⁵ Dr. Marc Rysman, Empirics of Business Data Services, at 13, tbl. 5 (rev. June 2016), https://apps.fcc.gov/edocs_public/attachmatch/DOC-340040A6.pdf (“Rysman Report”).

⁸⁶ AT&T FNPRM Comments at 31-32; Second IRW White Paper at 25.

⁸⁷ AT&T FNPRM Comments at 31-32; Second IRW White Paper at 25.

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concentrated” during 2013.⁸⁸ In any event, Dr. Israel et al. understate incumbent LEC Ethernet growth during 2013 because they “improperly assume that ILEC connections with missing data have very high bandwidths and they appear to count connections not used to provide service to a building and count the same ILEC connection multiple times.”⁸⁹ When Dr. Baker replicated Dr. Israel et al.’s results and corrected Dr. Israel et al.’s flawed assumptions, he found that “ILEC bandwidths increased by a greater percentage than CLEC bandwidths during 2013.”⁹⁰

Declining Ethernet prices. The Mid-Size ILECs assert that declining Ethernet prices demonstrate that PBDS competition is increasing,⁹¹ but this too is incorrect. Trends in price levels prove nothing about whether incumbent LECs exercise market power.

Even monopolists that face no threat of competitive entry have the incentive to reduce prices where doing so is profit-maximizing, and increases or decreases in marginal costs can cause monopoly prices to rise and fall for reasons that have nothing to do with market power.⁹² The key measure of an incumbent LEC’s market power is not price trends but its *profit margins*, that is, the difference between its prices and its costs. As Dr. Stanley Besen has explained, “the

⁸⁸ Baker FNPRM Reply Decl. ¶ 16.

⁸⁹ *Id.*

⁹⁰ *Id.* ¶ 16 n.42.

⁹¹ Mid-Size ILECs FNPRM Comments at 24-25.

⁹² *See* Declaration of Stanley M. Besen, ¶ 3 (Apr. 22, 2009), attached as Attachment B to Letter from Thomas Jones & Jonathan Lechter, Counsel to tw telecom inc., to Marlene Dortch, Secretary, FCC, WC Docket No. 05-25 (filed Jul. 9, 2009) (“[I]t would be incorrect to infer that a monopolist is in the competitive industry from the fact that its price has fallen just as it would be incorrect to infer that the competitive industry is not competitive because its price has increased. The monopolist is still a monopolist and the competitive industry is still competitive.”).

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difference between a competitive and monopolistic industry is not the direction of, or rate at which, . . . prices *change* during a given period but the fact that a monopolist charges a *higher* price relative to its marginal cost than does a competitive firm.”⁹³ Tellingly, the Mid-Size ILECs have provided no evidence that their profit margins have been reduced as a result of declining Ethernet prices. This is unsurprising because the results of Dr. Baker’s regressions show that incumbent LECs are in fact earning high profit margins in the provision of Business Data Services.

F. Regression Analyses Demonstrate that Incumbent LECs Have Market Power in the Provision of Business Data Services.

In his declaration filed today, Dr. Baker once again addresses issues that have been raised by both the incumbent LECs’ economists and the economists who have provided peer reviews of Dr. Rysman’s regression analyses. Dr. Baker explains that his prior conclusions that “ILECs are likely able to exercise market power in the provision of business data services in most markets – including at bandwidths at or below 50 Mbps (such as DS1 and DS3 connections) and bandwidths above 50 Mbps through at least 1 Gbps – and would be expected to charge prices above competitive levels unless prevented by regulation”⁹⁴ – are not called into question by the analyses of other commenters or by peer reviews of Dr. Rysman’s white paper.

Endogeneity. Dr. Israel et al. argue, as they have in the past, that the results of the regression analyses are unreliable because they do not properly control for endogeneity among variables accounting for rivalry in a particular geographic area.⁹⁵ This is because, they assert, it

⁹³ *Id.* ¶ 5.

⁹⁴ *See* Baker FNPRM Reply Decl. ¶ 2.

⁹⁵ *See* Second IRW White Paper at 9-17.

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is possible that lower costs in certain areas could result in greater numbers of competitors entering those areas, resulting in lower prices (relative to the average) in those areas that would not be accounted for in the regressions.⁹⁶ But, as Dr. Baker explains, he and Dr. Rysman included county- or census-tract-level location fixed effects in their regressions to focus the regressions on variations in prices within those locations.⁹⁷ He further explains that the location fixed effects that he and Dr. Rysman utilized would likely control for all of the important cost variations, except for variation in building access fees and costs of obtaining rights-of-way across counties or census tracts, and that these costs are unlikely sources of endogeneity bias.⁹⁸ Dr. Baker concludes that “there are many reasons to expect the analysis to be biased in the opposite direction, toward understating an inverse relationship” and thus his results and Dr. Rysman’s are in fact conservative in estimating the magnitude of the price effects observed in the presence of competition.⁹⁹

⁹⁶ *Id.*

⁹⁷ Baker FNPRM Reply Decl. ¶ 31. Moreover, both Dr. Baker and Dr. Rysman include controls for the density of business locations within Census blocks, which also accounts for possible locations with both low prices and many rivals. *Id.* ¶ 32 n.73. Dr. Israel et al.’s asserted preference for the use of instrumental variables or event studies is merely academic as Dr. Israel et al. have proffered neither a specific viable instrument nor event, and studies that have employed instrumental variables indicate that analyses relating price and rivalry are not necessarily prone to serious endogeneity bias. *Id.* ¶ 31 n.71.

⁹⁸ *Id.* ¶¶ 32-33. Dr. Baker explains that these two costs are unlikely to produce endogeneity bias because variation in these costs within the geographic units measured would not likely affect the number of competitors serving a building or nearby providers unless such costs are so high that no competitor could feasibly enter. In addition, variation in these costs would not likely affect incumbent LEC prices because incumbent LECs would not need to alter their prices in response to competitive prices. As Dr. Baker explains, when competitive LECs can feasibly construct new facilities to enter, their prices rarely vary significantly due to differences in these costs. *Id.* ¶¶ 33-35.

⁹⁹ *Id.* ¶ 36.

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Further refinements of regressions. Consistent with the recommendations of peer reviewers of Dr. Rysman’s analysis,¹⁰⁰ Dr. Baker re-estimated his results using standard errors clustered within census blocks. He finds that, for connections at bandwidths above 45 Mbps, “[u]sing clustered standard errors did not change the statistical significance of any coefficients on variables accounting for the *presence* of rivalry from in-building or nearby providers” when using either census tract or county fixed effects.¹⁰¹ He states that in regressions designed to account for the *number* of in-building or nearby rivals, some coefficients lost their statistical significance, but all coefficients accounting for the number and cumulative effect of nearby rivals remained significant statistically.¹⁰² Dr. Baker explains that these statistical significance tests “should not be interpreted as suggesting that in-building rivals do not affect prices for [connections above 45 Mbps]”¹⁰³ and that “the regressions with Census tract fixed effects should not be interpreted as inconsistent with identifying an inverse relationship between price and rivalry.”¹⁰⁴ He states that “[e]stimation of these equations with clustered standard errors does not change the interpretation of the results set forth in [his] prior declaration[s],” namely that “the

¹⁰⁰ See Andrew Sweeting, Review of Dr. Rysman’s ‘Empirics of Business Data Services’ White Paper, ¶ 23 (April 26, 2016) (posted June 28, 2016) (“Sweeting Review”); Letter from Tommaso Valetti, Professor of Economics, Imperial College London, to Matthew S. DelNero, Chief, Wireline Competition Bureau, FCC, at 7 (April 28, 2016) (posted June 28, 2016); Letter from Andrew Sweeting, Associate Professor, University of Maryland, to Matthew DelNero, Chief, Wireline Competition Bureau, FCC, at 1 (July 13, 2016) (posted July 25, 2016); see also FCC Memorandum, “Use of Clustered Standard Errors in Business Data Service Regressions,” appended as Attachment 1 to Memorandum from Wireline Competition Bureau (June 28, 2016).

¹⁰¹ Baker FNPRM Reply Decl. ¶ 39.

¹⁰² *Id.* ¶¶ 39-40.

¹⁰³ *Id.* ¶ 41.

¹⁰⁴ *Id.* ¶ 42.

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presence of additional rivals leads to lower prices, and the full effect of rivalry does not dissipate with only one or two nearby rivals.”¹⁰⁵

Similarly, Dr. Baker re-estimated his specifications consistent with Professor Sweeting’s peer analysis of Dr. Ryman’s analysis¹⁰⁶ by adding indicator variables to account for term commitments, volume commitments, and multi-location customers.¹⁰⁷ But doing so had such a small effect as to indicate that the regression results are robust as to accounting for these variables.¹⁰⁸

Dr. Baker also re-estimated his regressions to account for wholesale customers and connections in Phase II-regulated regions. When he did so, he found that each revised regression “shows substantial (and statistically significant) cumulative effects of rivalry: the presence of four or more in-building rivals and four or more nearby rivals reduces . . . prices [for connections above 45 Mbps] by 45% in the estimates with Census tract fixed effects and by 53% in the estimates with county fixed effects,”¹⁰⁹ thus confirming the results discussed in his prior declarations. Dr. Baker summarizes his findings as follows:

Nothing in the comments filed in response to the FNPRM leads me to question my conclusion that ILECs are likely able to exercise market power in the provision of business data services in most markets, from low bandwidths through

¹⁰⁵ *Id.* ¶ 43.

¹⁰⁶ *See* Sweeting Review ¶¶ 24-25; *see also* Memorandum from Wireline Competition Bureau, at 2-3 (June 28, 2016).

¹⁰⁷ Baker FNPRM Reply Decl. ¶ 45.

¹⁰⁸ *Id.*

¹⁰⁹ *Id.* ¶ 46.

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at least 1 Gbps, and would be expected to charge prices above competitive levels unless prevented by regulation.¹¹⁰

III. THE COMMISSION MUST ADOPT A RELIABLE FRAMEWORK FOR IDENTIFYING CIRCUMSTANCES IN WHICH MID-BANDWIDTH SERVICES ARE SUBJECT TO COMPETITION.

As the Joint CLECs explained in their comments, the Commission should classify all Low-Bandwidth Services as non-competitive, all High-Bandwidth Services (i.e., above one Gbps) as competitive, and it should apply a market competition test to determine whether Mid-Bandwidth Services are subject to competition in a relevant geographic area.¹¹¹ As the Joint CLECs also explained in their comments, the market competition test for Mid-Bandwidth Services should require that at least four competitors have established connections used to provide Business Data Services to a customer location in a census block before the census block is classified as competitive.¹¹²

A. The Commission Should Classify Mid-Bandwidth Services as Competitive Only in Geographic Areas in which at Least Four Competitors Have Connections.

Under the test for Mid-Bandwidth Services proposed by the Joint CLECs, a competitor's deployment of a connection within a defined geographic area serves as a proxy for the competitor's presence as an actual competitor to each location in the geographic area.¹¹³ The test

¹¹⁰ *Id.* ¶ 49.

¹¹¹ *See* Joint CLEC FNPRM Comments at 46-48.

¹¹² *See id.* at 43-45.

¹¹³ The best test for Mid-Bandwidth Services would measure the extent to which each building is near enough to a splice point on each competitor's fiber transport network such that the competitor could efficiently deploy a connection to the location. *See id.* at 48. Unfortunately, as the Joint CLECs have explained, the Commission does not have reliable information regarding the location of splice points on competitive providers' networks. *Id.* The presence of

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assumes that a competitor that has deployed a connection to one location in an area can be expected to deploy a connection to a different location in the same area. But this proxy is highly conservative in the sense that it overstates the extent of competition for Mid-Bandwidth Services. This is because a competitor with a connection in a geographic area may not be able to deploy another connection to a customer in a different location in the same geographic area. There are many reasons why this might be the case. *First*, a pre-existing connection could have been deployed for the purpose of providing a very high capacity service (e.g., 10 Gbps) from a splice point at a distance that exceeds the maximum construction distance over which the competitive provider can feasibly build a Mid-Bandwidth connection to a different location in the area. *Second*, the provider may have no choice but to offer the new customer a discount for a Mid-Bandwidth connection due to competition from the incumbent LEC. This could, and often does, cause the revenue associated with serving the location to be lower than the amount needed to justify deployment of a new connection. *Third*, the pre-existing connection in the area could have been the product of inefficient deployment from the time when competitive providers were building their networks at a rate and under build investment criteria that proved to be unsustainable, and that caused a significant number of facilities-based providers to file for bankruptcy.¹¹⁴ *Fourth*, the provider might not be able to overcome other obstacles to deployment, such as obtaining access to the building on reasonable terms and conditions.

competitors with connections in the area is the best alternative to the presence of splice points, although it is a far less precise alternative, as discussed herein.

¹¹⁴ See Joint CLEC Comments at 36-37, Appendix D.

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Notwithstanding the appropriate and conservative nature of the four-competitor test, Dr. Israel et al., AT&T, and the Mid-Size ILECs argue that a competition test should classify an area as competitive where there are only two competitors (the incumbent LEC and one non-incumbent LEC) with fiber in the relevant geographic area.¹¹⁵ This proposed test is an unreliable means of identifying competitive markets. As the Joint CLECs have explained, the use of pre-existing fiber, as opposed to a connection, in an area as a proxy for competitive presence is inappropriate because it offers no indication that the provider could or would deploy a connection to a new location near the fiber.¹¹⁶

In addition, as Dr. Baker has explained, classifying an area with two competitors as competitive is inconsistent with basic principles of economics.¹¹⁷ In his declaration filed today,

¹¹⁵ AT&T FNPRM Comments at 37-39; Mid-Size ILECs FNPRM Comments at 57-61; Second IRW White Paper at 27.

¹¹⁶ Joint CLEC FNPRM Comments at 50-51. This test also is inappropriate for the independent reason that it would include the cable companies' DOCSIS 3.0 service over HFC in the relevant geographic area. For the reasons discussed in Sections II.A and II.B above, including such services in a competitive test for Mid-Bandwidth Services is not appropriate.

¹¹⁷ Baker FNPRM Reply Decl. ¶¶ 11-13. Dr. Baker notes that the practical effect of relying on the incorrect assertion that only one nearby provider is required to yield competitive outcomes is that the vast majority Business Data Services markets would be considered subject to competition, notwithstanding the fact that "77.2% of buildings have a single in-building provider (almost always an ILEC) and almost all the rest (21.8%) have only two in-building providers." *Id.* ¶ 11 (citing Rysman Report at 15, tbl. 7). A two-provider competitive test also is inconsistent with Commission precedent. In the *Phoenix Order*, the Commission determined that its prior predictive judgments about the potential for effective competition in a two-provider market were not "borne out by subsequent developments, were inconsistent with prior Commission findings, and [were] not otherwise supported by economic theory." *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, ¶ 34 (2010), *aff'd*, *Qwest Corp. v. FCC*, 689 F.3d 1214 (10th Cir. 2012). The Commission therefore undertook a rigorous traditional market power analysis and found that a duopoly was not sufficient to ensure actual or potential competition in the Phoenix MSA. *See id.* ¶¶ 37, 91.

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Dr. Baker explains that oligopoly economic models predict, and within-industry empirical studies find, that greater concentration leads to higher prices.¹¹⁸ Moreover, his empirical analyses of the Business Data Services data demonstrate that “in general . . . rivalry from four or more in-building providers and four or more nearby providers has a cumulative effect in reducing ILEC prices that is more than ten times the effect of rivalry from one nearby provider alone,” thus Dr. Baker “cannot say that the presence of even as many as four in-building rivals and four nearby rivals would be enough to lead ILECs to set fully competitive prices.”¹¹⁹ Dr. Baker further explains that competition from a single nearby provider is insufficient to generate competitive prices because nearby competitive providers cannot serve some buildings due to “insufficient demand, costs to span the distance from the nearest fiber ring splice point, and difficulties or costs of obtaining building access and rights of way,” and because substantial sunk costs are typically required to serve a building.¹²⁰

Finally, there is no basis for asserting that a test under which a relevant market is classified as competitive only where there are at least four competitors present would distort investment incentives. As Dr. Baker explains, a four-competitor test would not affect competitive LECs’ incentives to build to locations where entry is currently unprofitable “because

¹¹⁸ Baker FNPRM Reply Decl. ¶ 12.

¹¹⁹ *Id.* ¶ 13. Moreover, as Verizon has explained, competitors often purchase redundant Business Data Services from more than one provider at a single location to ensure “facilities diversity.” See Comments of Verizon, WC Docket Nos. 16-143, 15-247, & 05-25, RM-10593, at 17 (filed June 28, 2016) (“Verizon may use alternative Ethernet suppliers within its footprint for several reasons, including because some customers seek to have facilities diversity at their locations but also wish to obtain all of their Business Data Service through one-stop shopping with a single provider.”). Where this occurs, the presence of a second provider would have even less of a competitive effect than would otherwise be the case.

¹²⁰ Baker FNPRM Reply Decl. ¶ 14.

of various costs and risks or insufficient demand” or to build fiber to customers demanding Mid-Bandwidth Services where the incumbent LEC is regulated and has a copper-based network.¹²¹ In fact, the only incentives that might be affected would be those of the third competitive LEC entrant because its entry would cause the geographic area to meet the competition test (the incumbent LEC plus three competitors would equal four providers in the area).¹²² But, as Dr. Baker explains, if the incumbent LEC’s regulated prices are set at competitive levels, the third competitive LEC will likely have no less investment incentive than it would have in a competitive market.¹²³

B. The Commission Should Use Census Blocks as the Geographic Area in the Market Competition Test for Mid-Bandwidth Services.

Given that a competitor’s connection in a geographic area serves as a proxy for that competitor’s ability to deploy connections in the future to customers demanding Mid-Bandwidth Services, the size of the geographic area used in the test should be determined by the length of the connections that competitors could reasonably be expected to deploy in the future. Mr. Merriman’s construction feasibility analysis demonstrates that it would be inappropriate to use a geographic unit larger than a census block for the test. Under no circumstances should the Commission utilize census tracts, as proposed by AT&T and its economists. The use of census tracts would cause the test to be extremely unreliable, incorrectly classifying large swaths of territory as competitive.

¹²¹ *Id.* ¶ 21.

¹²² *See id.*

¹²³ *Id.* (“If the regulated price is set at a competitive level, and the third CLEC’s entry would be profitable at a regulated (competitive) price, it is unlikely that the third CLEC would be dissuaded from entry by the expectation of charging a deregulated price.”).

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As discussed above, Mr. Merriman analyzed the distances over which Level 3 can economically justify deploying connections of bandwidths ranging from 1.5 Mbps to 10 Gbps to end user locations in the top 10 metropolitan statistical areas (“MSA”).¹²⁴ For each MSA, Mr. Merriman estimated the maximum distance in linear feet that Level 3 finds it economically justified to construct fiber connections between a splice point on Level 3’s transport network and the location of a Business Data Service customer separately for areas within the central business district (“CBD”) of the MSA and for areas outside the CBD (“non-CBD”) for each analyzed product.¹²⁵

Comparing Mr. Merriman’s construction feasibility analysis for Mid-Bandwidth Services he analyzed (i.e., 200 Mbps, 500 Mbps, and one Gbps) with the size of census blocks and census tracts demonstrates the appropriateness of these geographic units for the market competition test. The size of census blocks and census tracts can be taken from Dr. Rysman’s analysis. Dr. Rysman found that the median census block in which there was at least one Business Data Services connection in 2013, if assumed to be a square, has an area of 0.026 square miles and sides 0.16 miles long, and a 25th percentile census block in the shape of a square has an area of 0.1 square miles and sides 0.3 miles long.¹²⁶ Dr. Rysman found that a median census tract, if assumed to be a square, has an area of 1.71 square miles and sides 1.31 miles long, and a 25th percentile census tract in the shape of a square has sides 2.3 miles long, implying an area of 5.29

¹²⁴ Merriman FNPRM Decl. ¶¶ 2-3.

¹²⁵ *Id.*

¹²⁶ Rysman Report at 11.

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square miles.¹²⁷ The following three hypotheticals assess the suitability of census blocks and tracts where the competitor's splice point is located (1) on the edge of the geographic area unit, (2) 1,000 feet from the edge of the geographic area unit, or (3) 2,500 feet from the edge of the geographic area unit. Again, this analysis demonstrates that census blocks, while not perfect, are far more appropriate than larger geographic areas, such as census tracts, for assessing competition in the provision of Mid-Bandwidth Services.

Splice Point Located on the Edge of the Block or Tract. When the splice point is located on the edge of a census block or census tract, on average in the top ten MSAs, Level 3 can feasibly build connections to locations representing approximately the following percentages of the area of the relevant block or tract: **[BEGIN HIGHLY CONFIDENTIAL]**

¹²⁷ *See id.* This is roughly consistent with the Commission's findings. *See Order and FNPRM* ¶ 214.

¹²⁸ These estimates were determined by calculating the length of half of the perimeter of a median-sized census block and determining the percentage of that distance, on average for all ten MSAs measured, that Level 3 could build to in a CBD. Half the perimeter is used because realistically Level 3 would not build more than half of the way around the perimeter of a census block or a census tract unless extenuating circumstances (e.g., a right of way issue) required it to build only in one direction around the block or tract. For example, if a building is located three-quarters of the way around the edge of the census block from the splice point going clockwise, to reach the building, the company would simply go counter-clockwise around the edge of the splice point, thus having to build only one-quarter of the way around the perimeter, instead of three-quarters of the way around the perimeter. This analysis assumes that census blocks in CBDs are the size of median census blocks in which there was a Business Data Services connection in 2013, as determined by Dr. Rysman.

¹²⁹ These percentages were calculated using the same methodology as discussed in note 128 above, but using the 25th percentile census block area identified by Dr. Rysman. *See* Rysman Report at 11. We understand Dr. Rysman's 25th percentile census block to be the census block that is larger than 75 percent of all other census blocks with at least one BDS-connected building represented in the Commission's 2013 data collection. *See id.* The 25th percentile figure is used to represent the fact that census blocks outside of CBDs tend to be larger than those within CBDs. Thus, this analysis assumes that census blocks in non-CBDs are the size of the 25th percentile census blocks in which there was a Business Data Services connection in 2013, as determined by Dr. Rysman.

¹³⁰ These calculations were performed using the same methodology described in note 128 above, but with census tracts rather than census blocks.

¹³¹ These calculations were performed using the same methodology described in note 129 above, but with census tracts rather than census blocks.

[END HIGHLY CONFIDENTIAL]

Splice Point Located 1,000 Feet from the Census Block's or Tract's Edge. When the splice point is located 1,000 feet from the edge of a census block or tract, the percentage area to which Level 3 could build decreases substantially. **[BEGIN HIGHLY CONFIDENTIAL]**

¹³² The percentages in this charge were calculated using the same methodology explained *supra* in notes 128-131, but the mean maximum build distance was calculated by subtracting 1,000 feet from the estimates for each MSA and recalculating the mean separately for CBD and non-CBD estimates.

[END HIGHLY CONFIDENTIAL]

Splice Point Located 2,500 Feet from the Census Block's or Tract's Edge. When the splice point is located 2,500 feet from the edge of a census block or census tract, [BEGIN

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Thus, comparing Mr. Merriman's construction feasibility analysis with these metrics affirms that the Commission must not use a geographic unit larger than a census block for the Mid-

¹³³ These percentages were calculated using the same methodology explained *supra* in notes 128-131, but the mean maximum build distance was calculated by subtracting 2,500 feet from the estimates for each MSA and recalculating the mean separately for CBD and non-CBD estimates.

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Bandwidth Services test. Even a test that utilizes census blocks would cause many locations to be classified as competitive that are in fact not competitive. But a geographic unit larger than a census block, such as a census tract, would cause the test to be extremely unreliable and would cause a large number of customer locations to be classified as competitive without any basis for such a classification. Doing so would enable leading competitors to charge unreasonable prices in violation of Section 201(b) of the Communications Act.¹³⁴

IV. APPLICATION OF PRICE CAPS AND TARIFF-FILING REQUIREMENTS TO LEADING COMPETITORS IS THE MOST APPROPRIATE MEANS OF PREVENTING ABUSE OF MARKET POWER IN NON-COMPETITIVE MARKETS.

While Level 3 would support a benchmark approach to price regulation for Business Data Services if an effective, efficient, and administratively feasible one could be devised, the record supports the conclusion that application of price cap and tariff regulations for both CBDS and PBDS to leading competitors in non-competitive markets provides the most appropriate method of constraining leading competitors' exercise of market power.

Ex ante rate regulation should apply only to leading competitors. The Joint CLECs have explained that, in order to ensure that the regulatory regime for Business Data Services is technology-neutral and service provider-neutral, the Commission should adopt a regulatory framework under which *ex ante* rate regulation applies only to the leading competitor in a non-competitive market.¹³⁵ Under this framework, leading competitors, which today are incumbent LECs in all relevant Business Data Services markets, but which may include other providers in

¹³⁴ 47 U.S.C. § 201(b).

¹³⁵ See Joint CLEC FNPRM Comments at 57-60.

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the future, would be subject to *ex ante* rate regulation in Business Data Services markets classified as non-competitive under the Commission’s competitive test.¹³⁶

As the Joint CLECs explained in their comments, the Commission has found that it is unnecessary and even potentially harmful to apply *ex ante* rate regulation to competitors without market power.¹³⁷ Doing so would subject non-leading competitors to compliance costs and would make designing *ex ante* rate regulations more complex. It could also undermine non-leading competitors’ incentives to invest. The latter problem would be particularly acute if non-leading competitors were required to charge prices based on any measure of the leading competitors’ costs, which are frequently lower than those of non-leading competitors as a result of leading competitors’ ubiquitous network footprints, scale economies, and first-mover advantages. If a non-leading competitor is forced to charge prices that are below its own costs, it could be forced to withdraw from the market, to the detriment of competition and consumer welfare.

The Mid-Size ILECs assert that any price regulations the Commission adopts should apply to all providers in a non-competitive market.¹³⁸ This argument is inconsistent with

¹³⁶ The Joint CLECs also have explained that the leading competitor should be defined to include any of its affiliates that sells Business Data Services in the leading competitor’s service territory. *See id.* at 59.

¹³⁷ *See id.* (citing *Policy and Rules Concerning Rates for Competitive Common Carrier Services and Facilities Authorizations Therefor*, First Report and Order, 85 FCC 2d 1, ¶¶ 2, 35 (1980) (“*Competitive Carrier Order*”)) (describing basis for eliminating *ex ante* rate regulation for common carriers without market power); *see also Competitive Carrier Order* ¶ 55 ([A] firm without market power does not have the ability or incentive to price its services unreasonably, to discriminate among customers unjustly, to terminate or reduce service unreasonably or to overbuild its facilities.”).

¹³⁸ Mid-Size ILECs FNPRM Comments at 66-69.

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Commission precedent and ignores the affirmative harm to competition that could result if the Commission were to apply *ex ante* regulation to providers that lack market power. As NCTA rightly observes, “regulating carriers without market power imposes[s] unnecessary costs on companies [and] wastes the valuable and scarce resources of the regulator”¹³⁹ and would “discourage entry into the BDS market.”¹⁴⁰

Price cap regulation for CBDS and PBDS is the most effective and efficient option for ex ante rate regulation. As the Joint CLECs explained in detail in their comments, applying price caps to both CBDS and PBDS in non-competitive areas, and including CBDS and PBDS in the same price cap basket, will provide a flexible, effective means of constraining the exercise of market power by leading competitors.¹⁴¹

For example, reliance on the existing price cap regime would obviate the need for the Commission to devote substantial resources to devising an entirely new regulatory regime for PBDS and would allow providers greater flexibility to set rates than they would have under a benchmark approach. Inclusion of PBDS and CBDS in the same price cap basket would promote the transition to more efficient packet-based Business Data Services because it would ensure that leading competitors could establish the relationship between CBDS and PBDS prices in response to changes in customer demands. As the Commission has explained, including PBDS and CBDS in the same Business Data Services price cap basket “would allow carriers

¹³⁹ NCTA FNPRM Comments at 33.

¹⁴⁰ *Id.* at 34.

¹⁴¹ Joint CLEC FNPRM Comments at 62-66.

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flexibility to set prices for both packet-based services and TDM services based on the relative cost of and demand for these services, as would be the case in a competitive market.”¹⁴²

In addition, price cap regulation would limit the extent to which the Commission would have to identify reasonable prices for PBDS in non-competitive markets in the future, in contrast to a benchmark approach, which necessarily would entail a reassessment of the reasonableness of individual prices as market conditions evolve over time. Price cap regulation also would allow the Commission to utilize pricing bands and pricing zones, which give providers additional flexibility in setting rates, thereby resulting in less administrative burden than would exist under a benchmark regime. Finally, because price caps have been in place for decades and are well understood, there is little risk that reliance on price caps would lead to unintended consequences or would be overturned on appeal.

Extending price cap regulation to PBDS would render moot several of the concerns that incumbent LECs have raised in their comments about the effects of a new regulatory regime for Business Data Services. *First*, under the technology neutral price cap regulation that the Joint CLECs have proposed there is no basis for AT&T’s assertion that price regulation targeted at CBDS will somehow reduce the incentive and ability of incumbent LECs to invest in new PBDS.¹⁴³ Again, under the Joint CLECs’ proposal, price cap regulation would apply to both CBDS and PBDS, so regulation would not skew investment incentives between CBDS and PBDS. *Second*, because price cap regulation allows providers significant flexibility to set their own rates and does not constitute rate prescription, it avoids AT&T’s concern that the

¹⁴² *Order and FNPRM* ¶ 512.

¹⁴³ AT&T FNPRM Comments at 71.

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Commission would need to provide a specific basis for concluding that each rate subject to rate prescription is unreasonable and to provide a specific basis for each prescribed rate.¹⁴⁴ *Third*, because the Commission’s price cap regulations permit carriers to establish pricing zones to account for overall differences in regional costs, applying price caps to PBDS addresses the Mid-Size ILECs’ argument that regulated rates must account for higher costs in rural areas.¹⁴⁵

In addition, Dr. Farrell suggests that price caps give firms the incentive to reduce service quality,¹⁴⁶ but that concern does not appear to be relevant here. While it may be true in theory that firms subject to price caps might have the incentive to reduce costs by reducing service quality, there is no basis for concluding that price caps have in fact had this effect on CBDS provided by incumbent LECs or that they would have that effect in the future. In any event, to the extent that price cap LECs have the incentive to forgo service quality improvements, that incentive is borne of market power itself, not of regulations designed to curtail market power.

Applying benchmark regulation to PBDS poses considerable challenges. Level 3 has explained that it would support a benchmark approach to *ex ante* rate regulation for PBDS that ensures that rates are just, reasonable, and not unjustly or unreasonably discriminatory, consistent with Sections 201(b) and 202(a) of the Communications Act,¹⁴⁷ but it is not clear that such a benchmark approach can be devised.¹⁴⁸ Setting prices for PBDS in non-competitive areas

¹⁴⁴ *Id.* at 65-66.

¹⁴⁵ Mid-Size ILECs FNPRM Comments at 76-79.

¹⁴⁶ Declaration of Joseph Farrell, ¶¶ 82-83 (June 28, 2016), attached as Exhibit A to Comcast FNPRM Comments (“Farrell Decl.”).

¹⁴⁷ 47 U.S.C. §§ 201(b), 202(a).

¹⁴⁸ *See* Joint CLEC FNPRM Comments at 66-69.

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would require, among other things, setting a separate price for each different service, for each different service quality level, for each bandwidth, for each relevant technical configuration, in each relevant geographic area, and for each term length. Because it is likely impossible to do this, the Commission would instead need to develop benchmarks for a subset of services that, together, are deemed sufficient to constrain the prices of other non-competitive Business Data Services. But the Commission lacks the customer demand information needed to determine accurately which services are substitutes for others. And even if the Commission were able to establish initial benchmark prices for anchor services, the difficult task of price setting would pose a recurring problem because the list of benchmark services would need to be revised as market conditions change. Because initial and new rate levels would likely require rate prescriptions for each leading competitor, there is a significant risk that the entire regime would become bogged down in endless legal challenges.¹⁴⁹

A benchmark regime also would be susceptible to forms of regulatory evasion that are difficult, perhaps impossible, to police. For example, leading firms would have the incentive to improve the features and quality of the unregulated services at the expense of the regulated services, just as incumbent LECs have done with UNEs. Addressing this form of evasion would likely require an onerous and intrusive framework that relies on service quality regulation, in stark contrast to the flexible incentive regulation of a price cap regime.

Dr. Farrell's analysis provides further support for many of these conclusions. He explains that variations in the demand patterns of Business Data Services customers would make

¹⁴⁹ Letter from Thomas Jones, Counsel for Level 3, to Marlene H. Dortch, Secretary, FCC, WC Docket Nos. 16-143, 15-247, & 05-25, RM-10593, at 5 (filed Jul. 25, 2016) (“July 25 Level 3 Ex Parte”).

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regulation of prices for selected anchor benchmark services exceedingly difficult, and, ultimately, ineffective. He explains that factors that the Commission might consider in developing benchmark rates – “technology, service tier, geographic location, [and] quality of service,”¹⁵⁰ among other things – “illustrate the challenges in implementing price regulation suitably customized for a diverse set of business needs.”¹⁵¹ In addition, with respect to service quality, he observes that “[a]ny regulatory attempt to maintain quality metrics would seem unlikely to be able to track all the performance dimensions that are important to some customers.”¹⁵² Indeed, with respect to one popular type of PBDS, switched Ethernet, providers offer different service quality levels, with varying performance levels for jitter, latency, and packet delivery, which are not the same across providers. For example, AT&T alone offers *five* classes of service for its standard switched Ethernet service.¹⁵³ Other providers have different numbers of classes of service, each with different performance characteristics.

Tariffs. As the Joint CLECs explained in their comments, tariffs play a critically important function in enforcing rate regulation and detecting discrimination that cannot be performed as effectively in the absence of tariffs.¹⁵⁴ This is because the tariff filing and review

¹⁵⁰ Farrell Decl. ¶ 78 (internal citations and quotation marks omitted).

¹⁵¹ *Id.*

¹⁵² *Id.* ¶ 85.

¹⁵³ See AT&T Switched Ethernet Service Guide (TCAL), at 15, <http://serviceguidenew.att.com/servlet/servlet.FileDownload?file=00P1A00000pQGqjUAG> (setting forth SLA service parameters for AT&T’s five classes of service).

¹⁵⁴ Joint CLEC FNPRM Comments at 81-83.

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provisions in Sections 203, 204, and 205 of the Communications Act¹⁵⁵ establish a robust regime under which leading competitors must publicize the rates, terms, and conditions on which they offer services and under which the Commission can efficiently and quickly review and address rates, terms, and conditions that appear to be unlawful. In the absence of tariffs, the Commission would be required to rely on some form of complaint proceeding, which would likely be slower, more expensive, and far less effective than the tariff regime.

The Commission's review of the incumbent LECs' tariff filings in response to the *Tariff Investigation Order* illustrates the benefits of tariffs. For example, as mentioned above, AT&T's tariff amendments filed in response to the *Tariff Investigation Order* included the discontinuance of circuit-portability, a critical wholesale input to retail Business Data Services. The elimination of circuit portability would have caused customers to incur circuit-specific early termination penalties more frequently and/or to purchase a larger volume of Business Data Services under higher-priced, shorter-term circuit-specific plans than has been the case in the past. Either way, the tariffs as revised would have resulted in an effective rate increase imposed on customers in non-competitive Business Data Service markets. Section 204 of the Act gives the Commission the authority to review these proposed changes before they become effective to ensure compliance with the applicable rate regulation regime and to assess whether AT&T's conduct is unreasonable in violation of Section 201(b) of the Act. The Commission did so and rejected the proposed changes because they would have resulted in a clear evasion of the price cap rules.¹⁵⁶

¹⁵⁵ 47 U.S.C. §§ 203-205.

¹⁵⁶ See *AT&T Tariff Rejection Order* ¶ 1.

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It is far less likely that the Commission would have been able to use benchmark regulation without tariffs to prevent AT&T's elimination of circuit portability from harming customers and consumer welfare.¹⁵⁷ In that context, the Commission would likely need to rely on a customer to bring a complaint alleging that AT&T has violated the benchmark regulations. But the Commission would not have the same ability to order AT&T to withdraw its proposed revisions in a complaint proceeding that it has as part of a tariff proceeding.¹⁵⁸ Moreover, it is not clear that AT&T's conduct, harmful though it is, would constitute a violation of a price benchmark because AT&T merely changed the structure of its service offerings in a way that forces customers to opt for higher-priced options. It did not increase prices *per se*.

Effect on competitors' incentives. There is also no reason to think that applying *ex ante* rate regulation to leading competitors in non-competitive markets would distort investment incentives. As Dr. Baker explains, imposing regulation in non-competitive markets to prevent the exercise of market power by incumbent LECs would not discourage competitive LEC and incumbent LEC investment in Business Data Services.¹⁵⁹ Dr. Baker explains that such concerns

¹⁵⁷ See July 25 Level 3 Ex Parte at 6-7.

¹⁵⁸ For example, in order to justify a stay, the Commission must assess the extent to which customers would suffer irreparable harm if AT&T's proposed changes were to take effect, among other factors. See *Qwest Commc'ns Corp. v. Farmers & Merchants Mut. Tel. Co.*, Third Order on Reconsideration, 25 FCC Rcd. 3422, ¶ 15 (EB 2010) (citing *Shaw Communications*, Memorandum Opinion and Order, 24 FCC Rcd. 5852, ¶ 12 (2009)) ("The Commission considers requests for stay under a well-established four-part test. Specifically, the petitioner must demonstrate that (1) it is likely to prevail on the merits; (2) it will suffer irreparable harm if a stay is not granted; (3) other interested parties will not be harmed if the stay is granted; and (4) the public interest favors granting a stay."). The Commission need not consider these factors in assessing whether to reject a tariff filing – it need only determine that the tariff filing violates its rules or the Communications Act. Cf. *AT&T Tariff Rejection Order*.

¹⁵⁹ Baker FNPRM Reply Decl. ¶ 17.

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assume that incumbent LEC prices are currently at competitive levels, but that assumption is inconsistent with evidence demonstrating that incumbent LECs currently price Business Data Services above competitive levels.¹⁶⁰ Dr. Baker explains further that any reasonable regulation adopted would not reduce prices below levels that would be expected in a fully competitive market, and if even if regulated prices were mistakenly set below competitive levels, the mistake would not harm Mid-Bandwidth Services investment incentives.¹⁶¹ He observes that the investment incentives of the third competitive LEC “would not be harmed because its entry would trigger deregulation, allowing it and the other providers to set competitive prices,” in turn preserving the investment incentives of the incumbent LEC and the two competitive LECs that entered previously.¹⁶² Moreover, competitive prices give both incumbent and competitive providers sufficient incentive to invest.¹⁶³ In fact, reasonable regulations encourage investment by providers that have been unable to compete as a result of incumbent LEC lock-up plans and/or over-priced wholesale services, and those investments could in turn drive incumbent LEC investment.¹⁶⁴

V. THE COMMISSION SHOULD ADOPT COMPREHENSIVE PROTECTIONS AGAINST INCUMBENT LEC EXCLUSIONARY CONDUCT.

In their comments, the Joint CLECs proposed a comprehensive regime for preventing incumbent LECs from using volume and term lock-up plans to harm competition and consumer

¹⁶⁰ *Id.*

¹⁶¹ *Id.* ¶ 19 & n.47.

¹⁶² *Id.* ¶ 19 n.47.

¹⁶³ *Id.* ¶ 19.

¹⁶⁴ *Id.*

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welfare. In subsequent *ex parte* filings in this proceeding, Level 3 and EarthLink have argued that the Commission should prevent incumbent LECs from using circuit-specific terms to harm competition.¹⁶⁵ It should do so by prohibiting incumbent LECs from requiring a customer to commit to a term longer than two years under a circuit-specific discount plan in a non-competitive area. The incumbent LECs have offered no meaningful opposition to the adoption of these protections.

A. The Commission Should Adopt Regulations Governing Volume and Term Lock-Up Plans.

The incumbent LECs make only a half-hearted effort to defend their lock-up plans. For example, the incumbent LECs' primary argument is that their lock-up plans do not harm competition because the incumbent LECs do not have market power.¹⁶⁶ But of course this is not true. As explained in Section II above, the record is replete with evidence that incumbent LECs possess substantial and persisting market power in the provision of Business Data Services.¹⁶⁷ Customers that need to purchase Business Data Services in non-competitive markets have no choice but to comply with terms and conditions that produce lock-up effects and other harmful

¹⁶⁵ See Letter from Thomas Jones, Counsel for Level 3, to Marlene Dortch, Secretary, FCC, WC Docket Nos. 16-143, 15-247, & 05-25, RM-10593, at 1-2 (filed Jul. 27, 2016) (“July 27 Level 3 Ex Parte”); Letter from Thomas Jones, Counsel for EarthLink, to Marlene Dortch, Secretary, FCC, WC Docket Nos. 16-143, 15-247, & 05-25, RM-10593, at 1-2 (filed Jul. 21, 2016) (“July 21 EarthLink Ex Parte”).

¹⁶⁶ See, e.g., Mid-Size ILECs FNPRM Comments at 83 (arguing the Commission’s protections “begin[] from the misguided premise that these [lock-up] provisions somehow reflect ILEC market power, which ILECs leverage to impose unreasonable and anticompetitive terms on CLECs,” and “that in-going presumption is simply untrue”); AT&T FNPRM Comments at 75-76 (arguing tying arrangements are not anticompetitive because ILECs lack market power).

¹⁶⁷ See *supra* Section II; see also Joint CLEC FNPRM Comments at 18-35.

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consequences. As discussed below, the incumbent LECs' attempts to defend the specific provisions in their lock-up plans fare no better.

Tying arrangements. As the Joint CLECs have explained, the Commission should prohibit any provider of Business Data Services from conditioning the sale of Business Data Services in one location on the customer's agreement to purchase Business Data Services in another location.¹⁶⁸ In addition, the Commission should prohibit incumbent LECs from tying the availability of *discounts* in harmful ways, such as conditioning the availability of discounted prices for Business Data Services in a non-competitive market on a customer's agreement to purchase Business Data Services in another market and conditioning the availability of discounted prices for Business Data Services in a non-competitive market on a customer's agreement to purchase non-Business Data Services.¹⁶⁹ These protections are especially important because, as the Joint CLECs have explained, incumbent LECs likely have a particularly powerful incentive to engage in tying where it enables them to prevent competitive entry or to evade the effects of rate regulation.¹⁷⁰

¹⁶⁸ *Id.* at 99; *see also* July 27 Level 3 Ex Parte at 4.

¹⁶⁹ Joint CLEC FNPRM Comments at 99-100. As explained in the Joint CLEC FNPRM Comments, these prohibitions should be subject to the qualification that when an area encompassed by a leading competitor's Business Data Services volume plan (either in the form of a tariff or a commercial agreement) is reclassified from non-competitive to competitive, the customer should be given the right to (1) require the volume commitment under the plan to be reduced by the volume of Business Data Services purchased by the customer in the reclassified area, or (2) continue to count the Business Data Services purchased by the customer during the life of the plan in the reclassified area toward the volume commitment in the plan. *Id.* at 100.

¹⁷⁰ *Id.* at 99.

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AT&T and the Mid-Size ILECs argue that the tying provisions in lock-up plans should be permitted because their conduct does not meet the criteria for tying under antitrust precedent.¹⁷¹ But this is both irrelevant and incorrect. The Commission is not required to adhere to antitrust precedent in determining the extent to which tying provisions are lawful under Sections 201(b) and 202(a) of the Communications Act. As the D.C. Circuit has observed, the Commission is not “strictly bound by the dictates of the antitrust laws; rather [it is] entrusted with the responsibility to determine when and to what extent the public interest would be served by competition[.]”¹⁷² Section 201(b) requires that, in fulfilling its public interest mandate, the Commission consider factors well beyond competition policy *per se*, and thus provides the Commission with ample authority to find that terms and conditions in arrangements for the sale of Business Data Services that produce tying effects are unjust and unreasonable. This logic applies equally to Section 202(a).¹⁷³ In any event, as the Joint CLECs have explained, antitrust

¹⁷¹ See AT&T FNPRM Comments at 72-77; Mid-Size ILECs FNPRM Comments at 84-88.

¹⁷² *United States v. FCC*, 652 F.2d 72, 88 (1980) (internal citations and quotation marks omitted).

¹⁷³ Sections 201(b) and 202(a) of the Communications Act empower the Commission to find unlawful *all* of the provisions discussed herein. For this reason, AT&T’s unsupported assertion that the Commission somehow is required to show that the provisions at issue “are almost always, and under almost all circumstances, unlawful” is nothing more than a creative writing exercise. See AT&T FNPRM Comments at 78. The record demonstrates that the incumbent LECs abuse their market power through the use of lock-up plans. The Commission therefore can easily conclude through reasoned decision-making that, when enforced by leading providers with market power, the provisions at issue are unjust and unreasonable, and, in some instances, unjustly and unreasonably discriminatory, and can adopt rules that restrict leading competitors’ use of the provisions.

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precedent *supports* the conclusion that tying provisions that lock up demand for Business Data Services harm competition when enforced by firms with market power.¹⁷⁴

Automatic renewal and reversion to month-to-month pricing. As the Joint CLECs have explained, automatic renewal and month-to-month reversion provisions in lock-up plans harm competition and consumer welfare and serve no economic purpose.¹⁷⁵ The Commission should therefore establish a presumption that an incumbent LEC must permit customers to purchase Business Data Services on a month-to-month basis after the expiration of a term commitment in a lock-up plan on the same rates, terms, and conditions as applied during the term of the lock-up plan. This presumption should apply to all tariffs and commercial agreements for all Business Data Services (both CBDS and PBDS) sold by incumbent LECs in non-competitive markets. In order to rebut this presumption, incumbent LECs should be required to demonstrate that the costs associated with providing the relevant Business Data Services on a month-to-month basis exceed the revenues from providing the services in this manner.

The Mid-Size ILECs attempt to justify automatic renewal and month-to-month reversion provisions based on the assertion that they are “default provisions” that apply if a customer does not notify the incumbent LEC of its intention to renew or terminate its subscription to the plan.¹⁷⁶ This is both true and beside the point. As the Commission has explained, automatic renewal provisions are “an unreasonable constraint on purchasers’ ability to modify their commitments or

¹⁷⁴ Opposition of Birch, BT Americas, EarthLink, INCOMPAS, Integra, and Level 3, WC Docket No. 15-247, at 67-71 (filed Feb. 5, 2016) (“Joint CLEC Opposition”).

¹⁷⁵ Joint CLEC FNPRM Comments at 103-04.

¹⁷⁶ See Mid-Size ILECs FNPRM Comments at 89-91.

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seek alternative providers to supply their needs.”¹⁷⁷ In addition, provisions that force customers to pay exorbitantly high month-to-month prices coerce customers into renewing their lock-up plans in order to avoid high month-to-month rates, thereby perpetuating the lock-up effects of the plans. As the Commission has concluded, “incumbent providers have the incentive and ability to use the expiration of a contract as an opportunity to increase charges for ongoing service and use that as leverage to induce customers to recommit to their pricing plans.”¹⁷⁸

Tellingly, the Mid-Size ILECs do not attempt to provide an economic basis for their automatic renewal and month-to-month price reversion provisions. This is unsurprising because there does not appear to be one. Indeed, competitive providers of Business Data Services generally do not include onerous default provisions in their contracts. Instead, when a term commitment expires, competitive providers often permit their customers to purchase Business Data Services on a month-to-month basis at the discounted rates that applied during the term of the plan.¹⁷⁹ This is presumably because those providers recover any customer-specific sunk costs during the original term to which the customer has committed. Incumbent LECs also recover customer-specific sunk costs during the original term, so there does not appear to be a legitimate reason why incumbent LECs could not extend the discounted rate following the expiration of a term commitment.

Long-term commitments. As the Joint CLECs have explained, the Commission should prohibit incumbent LECs from setting the term associated with a circuit portability volume

¹⁷⁷ *Order and FNPRM* ¶ 484.

¹⁷⁸ *Id.* ¶ 486.

¹⁷⁹ Declaration of Gary Black, Jr. on Behalf of Level 3 Communications, LLC, ¶ 27 (Feb. 4, 2016), attached as Appendix A to Joint CLEC Opposition (“Black Tariff Investigation Decl.”).

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commitment for Business Data Services circuits (either CBDS or PBDS) that are subject to circuit-specific term pricing (e.g., as is the case in the Pacific Bell and Southwestern Bell Term Payment Plans¹⁸⁰) longer than one year in non-competitive Business Data Services markets.¹⁸¹ The Commission also should adopt a presumption that the term associated with other Business Data Services volume commitments (for both CBDS and PBDS) should be no longer than one year in non-competitive Business Data Services markets. Incumbent LECs should be permitted to rebut this presumption only by demonstrating that the costs associated with providing the services on a one-year term basis exceed the revenues earned from providing the services.

The Mid-Size ILECs argue that long-term commitment provisions are justified as part of lock-up plans because non-incumbent LECs use them.¹⁸² This claim is irrelevant because, unlike incumbent LECs, non-incumbent LECs do not have market power and thus lack the incentive

¹⁸⁰ See Term Payment Plan of the Pacific Bell Telephone Company Tariff F.C.C. No. 1 § 7.4.18; Term Payment Plan of the Southwestern Bell Telephone Company Tariff F.C.C. No. 73 § 7.2.22.

¹⁸¹ Joint CLEC FNPRM Comments at 100-03; *see also* July 27 Level 3 Ex Parte at 1-2; July 21 EarthLink Ex Parte at 3.

¹⁸² Mid-Size ILECs FNPRM Comments at 93-94. When the incumbent LECs have attempted to argue that long-term commitments serve a legitimate economic purpose, the Joint CLECs have refuted those claims. For example, incumbent LECs have asserted that long-term commitments create efficiencies or allow the incumbent LECs to spread out cost recovery over a long time period, thereby enabling them to offer discounts. *See, e.g.*, AT&T Brief at 51-53; CenturyLink White Paper on Discount Plan Terms and Conditions, WC Docket No. 15-247, at 46 (filed Jan. 8, 2016). Any efficiencies are unlikely to be material in areas where incumbent LECs have market power and where customers have little choice but to buy from the incumbent LEC. In addition, the “costs” the incumbent LECs incur to provide CBDS were long ago depreciated, and the “discounts” that incumbent LECs claim to provide are illusory because their revenues are set at or very near the maximum level permitted under price caps. Moreover, incumbent LECs are required to provide CBDS as UNEs on a month-to-month basis at prices well below those at which they offer CBDS sold as Business Data Services. Joint CLEC FNPRM Comments at 102. The suggestion that long-term commitments enable incumbent LECs to recover cost incurred in performing circuit portability also makes no sense because a customer’s volume commitment is the logical means through which an incumbent LEC can recover such costs. *Id.* at 101-02.

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and the ability to *cause* customers to commit to long terms. In any event, as the Joint CLECs have explained, most competitive providers do not require customers to commit to long terms and in fact offer Business Data Services for one-year terms.¹⁸³ And, as mentioned, competitors often allow customers to purchase Business Data Services at discounted rates on a month-to-month basis after the expiration of a term, which further confirms that competitors do not condition the availability of discounts on customers' commitments to purchase services for unreasonably long terms.

Shortfall and early termination penalties. As the Joint CLECs have explained, the Commission should establish a presumption that an incumbent LEC may not include shortfall or early termination penalties in tariffs or contracts for the sale of Business Data Services in non-competitive markets that exceed 50 percent of expectation damages.¹⁸⁴ This limit is consistent with the current practice of some incumbent LECs (i.e., CenturyLink in the Tariff Special Access Term Discount Plan and Verizon in the DS1 Term Volume Plan¹⁸⁵).¹⁸⁶ In order to rebut the

¹⁸³ Joint CLEC FNPRM Comments at 103.

¹⁸⁴ *Id.* at 90-95.

¹⁸⁵ See Special Access Term Discount Plan of the CenturyLink Operating Companies Tariff F.C.C. No. 9 § 7.4.11(G); DS1 Term Volume Plan of the Verizon Telephone Companies Tariff F.C.C. No. 14 § 5.6.14(I).

¹⁸⁶ Although the Commission held that the tariffs under investigation may not include shortfall or early termination penalties that exceed “expectation damages,” it sought comment on whether this standard goes far enough to protect business data services customers. See *Order and FNPRM* ¶¶ 334, 341. As the Joint CLECs have explained, expectation damages overcompensate incumbent LECs when operating in non-competitive markets. This is because, in the event of an early termination, incumbent LECs avoid costs incurred in providing Business Data Services when a customer terminates circuits. And, to the extent incumbent LECs claim that they incur costs when terminating circuits, it is likely that the avoided costs of providing service are much larger than the costs they incur in effectuating a termination. When this is the case, an incumbent LEC makes more profit when it imposes an early termination penalty under which it is paid the full amount due under a volume commitment than when the customer satisfies its

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presumption that early termination penalties in excess of the limit are unlawful, the incumbent LEC should be required to file a detailed cost study demonstrating why the net costs it incurs when customers fail to meet their volume commitments or terminate their plans early exceed 50 percent of expectation damages. The net cost calculation in the study should account for any cost savings that result from not providing service to a customer and any profits the incumbent LEC earns, on average, from other customers that purchase the circuits that the customer paying the penalty has not purchased.

As with other harmful provisions in their lock-up plans, the Mid-Size ILECs argue that early termination penalties are justified because non-incumbent LECs include them in their sales contracts.¹⁸⁷ Again, this argument is irrelevant because non-incumbent LECs do not have market power and therefore cannot impose excessive early termination penalties. In any event, even when they do include early termination penalties in their agreements, competitive providers are frequently willing to waive them.¹⁸⁸

Fresh look and tariff revisions. As the Joint CLECs have explained, the Commission should ensure that reforms to the manner in which leading competitors offer Business Data Services take effect as soon as possible.¹⁸⁹ *First*, incumbent LECs should be required to modify their standard tariffs (i.e., tariffs other than contract tariffs) to comply with the new requirements

volume commitment. Moreover, in non-competitive markets, an incumbent LEC will likely sell terminated Business Data Services circuits to a different customer, thereby earning even higher profits. Joint CLEC FNPRM Comments at 91.

¹⁸⁷ Mid-Size ILECs FNPRM Comments at 95.

¹⁸⁸ Black Tariff Investigation Decl. ¶ 27.

¹⁸⁹ Joint CLEC FNPRM Comments at 104-06; *see also* July 27 Level 3 Ex Parte at 4-5.

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in non-competitive markets. Those amendments, except for the prohibition against all-or-nothing provisions, should take effect for all existing and future customers upon approval of the tariff amendments. In addition, all future incumbent LEC contract tariffs and commercial agreements must comply with all of the new requirements to the extent that they govern incumbent LECs' sale of Business Data Services in non-competitive Business Data Services markets.

Second, the Commission should grant “fresh look” rights to customers currently purchasing CBDS pursuant to volume and term plans under standard tariffs and pursuant to contract tariffs so that those customers can either reduce their volume commitments without incurring shortfall penalties or terminate their plans or contract tariffs without incurring early termination penalties. A fresh look opportunity will allow such customers to take advantage of the prohibition on all-or-nothing provisions while maintaining their existing purchase arrangements or to terminate their existing arrangements and enter into entirely new purchase arrangements with incumbent LECs. The Commission should also allow customers currently purchasing PBDS from incumbent LECs pursuant to commercial agreements the right to terminate those agreements at any time without incurring early termination penalties. This same right should also apply to any commercial agreement that affects, directly or indirectly, the price paid for any Business Data Service. Customers should be permitted to take advantage of these opportunities at any time during a 180-day period following the effective date of the new rules.

The Mid-Size ILECs claim that the circumstances are not “extreme” enough to permit the Commission to institute fresh look rights,¹⁹⁰ but this is incorrect. The incumbent LECs' lock-up

¹⁹⁰ Mid-Size ILECs FNPRM Comments at 96-97.

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plans harm competition and consumer welfare in violation of Sections 201(b) and 202(a) of the Communications Act, and the record requires that the Commission adopt additional reforms to curtail enforcement of harmful provisions in those plans. As the *Order and FNPRM* acknowledges, “it is well-established that “[u]nder the *Sierra-Mobile* doctrine, the Commission has the power to prescribe a change in contract rates when it finds them to be unlawful, and to modify other provisions of private contracts when necessary to serve the public interest.”¹⁹¹ A finding of unlawfulness under Section 201(b) and/or Section 202(a) is sufficient to meet that standard.

B. The Commission Should Prohibit Incumbent LECs from Establishing Circuit-Specific Terms Longer than Two Years.

The incumbent LECs use long-term commitments required as part of circuit-specific discounts as a means of coercing customers into lock-up plans.¹⁹² As a supplement to the Joint CLECs’ proposed regime for addressing lock-up plans, Level 3 and EarthLink have explained in recent *ex parte* filings in this proceeding that the Commission should prevent incumbent LECs from using circuit-specific terms to harm competition. It should do so by prohibiting incumbent LECs from setting the terms of circuit-specific plans in non-competitive areas at longer than two

¹⁹¹ *Order and FNPRM* ¶ 438 (quoting *W. Union Tel. Co. v. FCC*, 815 F.2d 1495, 1501 (D.C. Cir. 1987)) (alterations in original).

¹⁹² See Stanley M. Besen & Bridger M. Mitchell, Anticompetitive Provisions of ILEC Special Access Arrangements, ¶¶ 24, 32 (Feb. 11, 2013), attached as Appendix A to Comments of BT Americas, Cbeyond, EarthLink, Integra, Level 3, and tw telecom, WC Docket No. 05-25, RM-10593 (filed Feb. 11, 2013) (explaining that “term commitments for individual circuits with penalties for early termination” are among the provisions that make “customers . . . unable to shift more than a modest portion of their requirements for [Business Data Services] to alternative suppliers”).

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years.¹⁹³ In addition, after the expiration of any initial term on a Business Data Services circuit provided by an incumbent LEC in a non-competitive area, the customer should be permitted to continue to pay the same price that applied under the term plan but on a month-to-month basis.¹⁹⁴

There is ample basis for these requirements. **[BEGIN HIGHLY CONFIDENTIAL]**

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In addition, once the incumbent LEC has recovered the customer-specific sunk costs associated with a Business Data Services circuit, there is no reasonable basis for requiring that customers sign up for a new circuit-specific term. Nor is there any basis for increasing the price of circuits that transition to month-to-month after the expiration of a term. If anything, the customer should pay a lower price after the expiration of a term to the extent that the term price was set at a level to fully recover customer-specific costs during the initial term. Finally, in all events, the incumbent LECs run little risk of failing to recover their costs in non-competitive areas because they can be confident that they can lease Business Data Services circuits to customers for the foreseeable future in such areas.

¹⁹³ July 27 Level 3 Ex Parte at 1-2; *see also* July 21 EarthLink Ex Parte at 2 (arguing that the Commission should limit the terms of circuit-specific plans).

¹⁹⁴ July 27 Level 3 Ex Parte at 1-2.

¹⁹⁵ **[BEGIN HIGHLY CONFIDENTIAL]**
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VI. THE COMMISSION SHOULD ADOPT A PROHIBITION AGAINST ANY BUSINESS DATA SERVICES NON-DISCLOSURE AGREEMENT THAT PREVENTS A CUSTOMER FROM DISCLOSING INFORMATION TO THE COMMISSION.

In their comments, the Joint CLECs argued that the Commission should adopt its tentative conclusion that Business Data Services providers may not include non-disclosure provisions in service agreements that prevent parties to an agreement from sharing the terms of the agreement with the Commission on a confidential basis.¹⁹⁶ This restriction, which other competitive LECs also support,¹⁹⁷ would allow Business Data Services customers to provide the Commission with information about unreasonable prices, terms, and conditions contained in any non-tariffed agreement for the sale of Business Data Services.

AT&T contends that such a requirement is unnecessary and undermines the legitimate confidentiality needs of Business Data Services market participants,¹⁹⁸ but these claims are without merit. The Commission frequently collects and analyzes companies' most sensitive information subject to confidentiality restrictions embodied in its rules and protective orders. AT&T has not offered any basis for concluding that these protections are insufficient to prevent inappropriate disclosure of sensitive information. Moreover, any modest risk of such disclosure is far outweighed by the benefits associated with ensuring that the Commission can be made aware of anticompetitive and inefficient behavior that would otherwise be kept secret. This kind of behavior is especially likely to occur where leading competitors are not required to file

¹⁹⁶ Joint CLEC FNPRM Comments at 61-62 (citing *Order and FNPRM* ¶¶ 313-320).

¹⁹⁷ See Windstream FNPRM Comments at 78-79; Sprint FNPRM Comments at 85; TDS FNPRM Comments at 25-26.

¹⁹⁸ AT&T FNPRM Comments at 81-83.

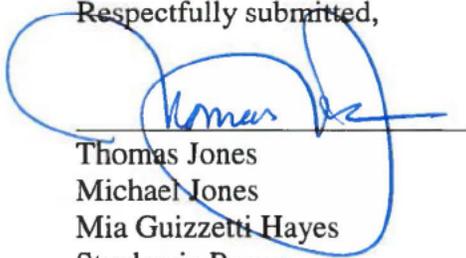
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commercial agreements as contract tariffs in non-competitive markets. The Commission therefore has every reason to prohibit the use provisions that preclude Commission review of the terms of Business Data Services agreements.

VII. CONCLUSION.

For the foregoing reasons, the Commission should promptly reform the regulatory regime governing Business Data Services in order to prevent incumbent LECs from exercising their market power and to provide American businesses with greater access to competitive broadband infrastructure and services.

Respectfully submitted,



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