

August 24, 2016

VIA ELECTRONIC FILING

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 for Price Cap Local Exchange Carriers, WC Docket No. 05-25, RM-10593

Dear Ms. Dortch:

Business Data Services (“BDS”) are critical to wireless and wireline services for employers, governments, schools, and competitive telecommunications companies across the Nation. Now, the most comprehensive record ever developed in a Commission proceeding demonstrates that competition for BDS is insufficient to restrain incumbent Local Exchange Carriers (“ILECs”) from engaging in anti-competitive behavior. Based on this record, the Commission must act now to ensure BDS rates, terms, and conditions are just, reasonable, and not discriminatory. To this end, INCOMPAS and Verizon have jointly proposed a new governing framework for BDS.¹ The proposal includes pricing reform both for TDM-based and packet-based BDS, for products and geographic areas deemed non-competitive.

As part of the proposed framework, INCOMPAS and Verizon agreed that the Commission should continue to set price caps on TDM-based BDS in areas served by price cap ILECS. Both parties further agreed that there should be a one-time adjustment to BDS rates under price caps because the FCC has not accounted for productivity gains since the expiration

¹ See Letter from Kathleen Grillo, Verizon, and Chip Pickering, INCOMPAS, to Marlene H. Dortch, Secretary, FCC, WC Docket Nos. 16-143, 05-25 (filed June 27, 2016) (“INCOMPAS-Verizon June 27 Letter”); Letter from Kathleen Grillo, Verizon, and Chip Pickering, INCOMPAS, to Marlene H. Dortch, Secretary, FCC, WC Docket Nos. 16-143, 05-25, RM 10593 (filed Aug. 9, 2016) (“INCOMPAS-Verizon Aug. 9 Letter”).

of the CALLS plan, and a going-forward annual productivity adjustment to avoid making this mistake twice.²

CenturyLink filed a letter in response to this proposal in which it claimed that the rate reductions are only justified “if ILECs’ average cost of providing service had declined steeply since 2005.”³ It asserts that CenturyLink’s “operating expenses have fallen at a much slower rate than the demand for its services . . . causing CenturyLink’s average cost of providing service to steadily climb.”⁴ CenturyLink’s purported support for this claim, however, is unreliable. It depends on opaque, results-driven accounting, and is inconsistent with prior statements by CenturyLink leadership. Furthermore, the company’s financial filings fail to support the claims made in the letter. In fact, CenturyLink’s earnings statements show that the company is exploiting its market power to reap large and growing profits in the marketplace. The Commission therefore should reject CenturyLink’s assertion. Instead, it should find that the proposed rate reduction is necessary to correct the failure to make productivity adjustments to the rates of TDM-based services for more than ten years and to restore effective price cap regulation for TDM-based BDS offerings.

A closer look at CenturyLink’s letter reveals its failings. First, the company bases its claim that BDS costs are rising on what it calls “operating expense per BDS circuit.” But CenturyLink’s use of this metric is unreliable and misleading. First, CenturyLink relies on an operating expense numerator that prevents the Commission from determining how CenturyLink has determined these costs. Despite its claims that the operating expense (and revenue) numbers in this letter come from its annual 10-K filings, it is not possible to reconcile the two sets of numbers. For example, in its 2015 10-K, CenturyLink reported its 2014 and 2015 operating expenses and revenues separately for “strategic services,” “legacy services,” “data integration,” and “other” services.⁵ While none of these categories report pure special access, the revenues reported in CenturyLink’s letter do not equal the revenues reported for any of these categories nor the sum of any of these categories. Therefore, CenturyLink’s calculations must be based on

² See INCOMPAS-Verizon June 27 Letter at 2 (“price caps should apply to TDM-based Business Data Services in areas served by price cap ILECs. We agree that there should be a one-time adjustment to these rates (implemented over no more than a two-year period) to account for the freeze in rates under the *CALLS Order*, and that going forward there should be an annual adjustment); INCOMPAS-Verizon Aug. 9 Letter at 1 (“we agreed that price caps should apply to TDM-based Business Data Services in areas served by price-cap LECs. This would include areas currently subject to Phase II pricing flexibility, and prices in Phase II areas would be returned to price cap levels before any further adjustment described in this letter. We also agreed there should be a one-time adjustment to rates for these services (implemented over no more than a two-year period) to account for the freeze in rates under the *CALLS Order*.”)

³ See Letter from Melissa Newman, CenturyLink, to Marlene H. Dortch, Secretary, FCC, at 2, WC Docket Nos. 05-25, 15-247, RM-10593 (filed Aug. 15, 2016).

⁴ See *id.*

⁵ See, e.g., CenturyLink, *Form 10-K* at 44 (2015), <http://ir.centurylink.com/Cache/33091366.pdf?IID=4057179&FID=33091366&O=3&OSID=9>.

some unspecified revenue and expense allocation method.⁶ Additionally, despite the \$1.025 billion in synergies that CenturyLink experienced from its acquisition of Embarq, and Qwest, the letter conveniently excludes all pre-2011 years from its “BDS circuit” operating expense calculations, resulting in an overstatement of costs.⁷

Further, the use of “BDS circuits” as the denominator makes the calculation even more untrustworthy. The TDM-IP transition has enabled purchasers of BDS to replace, for example, five to eight DS1 circuits with one 50 to 150 Mbps packet-based circuit. Thus, even though BDS demand is actually increasing, the use of a per-circuit measurement will artificially raise the per circuit cost as a result of a decrease in the overall BDS circuits purchased.⁸ Finally, in a further effort to obscure the matter, CenturyLink uses the same revenues and expenses to compute a second per unit measure—operating expenses per voice line—which makes it impossible to discern the actual meaning of these calculations.

The Commission should also question CenturyLink’s letter because the claim that BDS costs are rising is inconsistent with the company’s public statements. Earlier this year, in the company’s second quarterly earnings, CenturyLink’s Chief Financial Officer, Stewart Ewing, revealed a very different set of facts: “Second quarter strategic revenues for the [Business] segment was \$1.23 billion, an increase of 5% compared to second quarter 2015 and was driven primarily by the continued growth in high-bandwidth data services, partially offset by the decline in hosting revenues.”⁹ More specifically, in response to an analyst question on its first quarter earnings call about the potential impact of BDS reform, Ewing responded that “it’s the wholesale revenue basically, and its [sic] high margin So there aren’t a lot of continuing incremental expenses associated with providing that service. It’s mostly in the investment that was required to build a service out. There’s some maintenance costs, but it’s probably pretty minimal.”¹⁰

⁶ They are not, apparently, based on the Commission’s accounting rules, which are in any case forborne in CenturyLink’s case. *See, e.g.*, accounting rules in 47 C.F.R. §§ Parts 32, 36, 64, 69.

⁷ *See* CenturyLink, “CenturyTel and EMBARQ Agree to Merge” (Oct. 27, 2008), <http://news.centurylink.com/news/centurytel-and-embarq-agree-to-merge> (“The transaction is expected to generate synergies of approximately \$400 million annually”); CenturyLink, “CenturyLink and Qwest Agree to Merge” (Apr. 21, 2010), <http://news.centurylink.com/news/centurylink-and-qwest-agree-to-merge> (“Leveraging CenturyLink’s proven integration experience, the transaction is expected to generate annual operating and capital synergies of approximately \$625 million”).

⁸ The same is true for the “per access line” calculation. Subscribers may cancel an access line, but it is still good for business because they will use other CenturyLink services to replace the cancelled access line.

⁹ CenturyLink, *FQ2 2016 Earnings Call Transcripts* at 7 (Aug. 3, 2016), <http://ir.centurylink.com/Cache/1001212835.PDF?Y=&O=PDF&D=&fid=1001212835&T=&iid=4057179>.

¹⁰ CenturyLink, *FQ1 2016 Earnings Call Transcripts* at 11 (May 4, 2016), <http://ir.centurylink.com/Cache/1500085040.PDF?Y=&O=PDF&D=&fid=1500085040&T=&iid=4057179>.

Additionally, CenturyLink's earnings results do not support CenturyLink's claims. And, importantly, while these filings discuss increases in overall company operating expense resulting from matters unrelated to BDS, they do not mention any rising BDS costs, as they should do if costs were in fact rising.¹¹ Looking deeper, CenturyLink's SEC financial reports for 2005 (the year price caps were frozen under CALLS) through 2015 shows no evidence that CenturyLink is experiencing BDS cost increases. Instead, these reports demonstrate that, on a per subscriber basis, CenturyLink's revenues are 18 percent higher, and its margins are 32 percent higher. So while the company's recent letter attempts to convince the Commission that its BDS business is struggling, it is telling investors that business is booming.¹² Astoundingly, CenturyLink's 2015 shareholder payout was 416 percent higher than it was in 2005 for CenturyTel, Embarq, and Qwest.¹³

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The data collection and the record evidence in this proceeding confirm that ILECs do not face meaningful, effective competition in the provision of BDS. As a result, the Commission must act to bring down artificially inflated BDS prices. The record provides a more than sufficient basis upon which to act, and CenturyLink's assertion that its costs are rising is based on unreliable evidence that contradicts public statements. Accordingly, the Commission should disregard CenturyLink's claim and move forward swiftly to implement a new framework for BDS.

Respectfully submitted,

/s/ Karen Reidy

Karen Reidy

Vice President, Regulatory

¹¹ *Id.* at 7 (“Operating expenses increased \$18 million or 2.8% compared to the same period a year ago due to higher Prism TV costs, commissions and marketing expenses, partially offset by reductions in employee costs from lower headcount.”)

¹² *See* U.S. Securities and Exchange Commission Form 10-K data for CenturyLink (2012-2015), along with 10-K data from Qwest (2005-2011), CenturyTel (2005-2011), and Embarq (2005-2009.I), available at <https://www.last10k.com/sec-filings/>.

¹³ *Id.* This shareholder payout includes dividends plus share buyback.