August 12, 2016
Ms. Marlene H. Dortch, Secretary
Federal Communications Commission
445 12th Street, S.W.
Washington, DC 20554

Re: *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; AT&T Corp. Petition for Rulemaking to Reform Regulation of Incumbent Local Exchange Carrier Rates for Interstate Special Access Services*, WC Docket No. 05-25, RM-10593

Dear Ms. Dortch:

On September 12, 2016, Dr. Mark Cooper, Director of Research at the Consumer Federation of America, met with members of the Wireline Competition Bureau Staff – William Kehoe, Richard Benson, Thomas Parisi, Pam Arluk, William Layton, Deena Shetler, Eric Ralph, Shane Taylor, Christopher Koves, and Richard, Kwiatkowski. He discussed how recent filings in the above captioned proceeding fit with earlier comments and reply comments file jointly by CFA and the New Network Institute.

He pointed out that in the joint comments we argued that justice delayed is justice denied. A decade ago it was clear that the deregulation and regulatory reform of special access services was premature, ill-considered and poorly designed, harming consumers and the economy. At this stage, based on the extensive evidence in this proceeding and numerous filings of the New Network Institute in a number of proceedings, the FCC cannot conclude that the rates terms and condition on which these Title II services are made available in the market are "just and reasonable."

The FCC's Long Overdue Action to Address Severe Problems in the Business Data Services Market

He commended the Commission for taking two and one half major steps in the right direction to address a major problem that has plagued the telecommunications market for well over a decade.

1) The commission identified special access as a part of a much broader category of services – Business Data Services (BDS) – that are growing in importance and central to the continued development of the digital communication economy. He argued that the size of the BDS market is close to $100 billion and the strategic importance in the digital communications network is even larger. Therefore, the final order should give a nod to the virtuous cycle. Arguably, abuse of market power in BDS is as large a threat to the virtuous cycle as violation of network neutrality. He noted that CFA/NNI had shown the close connection between the BDS proceeding and the IP-transition proceeding.

Now that broadband Internet access service has been restored to its proper place under the statute as a Title II service, joining BDS which has always (and correctly) been a Title II service, the Commission has the opportunity to holistically oversee the digital communications market. It

can restore the balance between public interest principles and private market action that were the hallmark of U.S. Communications policy and the pillars on which the digital communications revolution stood in the thirty years after the Carterphone and Computer Inquiries.

2) After almost of decade of self-imposed blindness, the FCC's undertook to most extensive data gathering exercise in its history. The result is a deep and rich data set that provides evidence to support the above conclusions, one that corroborates and adds to the extensive hearing record provided by commentors.

2.5) The FCC has proposed policies that move in the right direction, which is no small feat after more than a decade of irresponsible inaction. Dr. Cooper likened the special access proceeding to an aircraft carrier that can only change direction slowly and deliberately. He argued that, having changed the direction of the aircraft carrier, it is critical to continue the process and build the momentum heading in the right direction.

The Pervasive Abuse of Market Power in the BDS market

The hearing record shows that the Business Data Services market provides a textbook case of the abuse of horizontal market power and vertical leverage.

Structure
- Extremely highly concentrated market
- No good substitutes
- High economic barriers to entry
- Huge deep-pocket dominant firms

Conduct
- Artificial barriers to entry in (lock-in/lock-out) contract terms
- Cross subsidy
- Price Squeeze
- Foreclosure
- Multi-market contract
- Reciprocity

Performance
- High prices
- Profits that are not merely "supranormal," but astronomical

The incumbent local exchange carriers (ILECs) had market power throughout the network in the monopoly era. Because that market power was not directly addressed by the Telecommunications Act of 1996, which tried to build competition on top of a monopoly structure, ILECs have simply transferred the key point of market power from the terminating mile of the network to the key point of interconnection between consumers and the core of the network. Access to the core network has become the key chokepoint because of the huge quantities and always on nature of digital traffic.

While special access services were always important for some types of (primarily business services) BDS has become the vital link for a wide range of both business and residential services including:

the sale of communication services to residential and business end-users,

- Broadband Internet Access Service
- mobile broadband and phone service,

connections for businesses that do not sell communications to consumers, but need BDS to conduct their daily business,

- small, medium, and large businesses that need much more capacity than a single telephone line,
- branch networks (like ATM's or gasoline stations) that have many nodes that need to be online all the time, and
- businesses like health care providers, who need to move large quantities of data between their offices, frequently in real time

The New Evidentiary Basis for Finding the Abuse of Market Power

The survey of the BDS market shows several fundamental characteristics that have been demonstration throughout the past decade of this proceeding

- high concentration,
- competition lowers prices and
- the highest prices are paid where competition is weakest.

It adds important nuances and identifies several new aspects of ILEC market behavior that suggest the depth of anticompetitive practices across multiple markets and services. It reinforces the importance our evidence on cross subsidy and price squeeze in the BDS market.

- The dominant incumbents exhibit reciprocity when they purchase BDS services outside of their home territory, by buying those services exclusively from the dominant in-region incumbents.
- This reciprocity has the effect of significantly shrinking (foreclosing) the potential market for competitors.
- Dominant incumbents charge extremely high prices set on mobile services, which weakens competition in the most competitive line of business of the dominant incumbent local exchange carriers.
- Charging themselves less for these services creates a brutal price squeeze on potential and actual competitors who cannot escape the abuse rates terms and conditions because of the stranglehold the ILECs have on the BDS market.

The reciprocity, foreclosure and price squeeze placed on competitors are independent evidence of the abuse of market power. These findings are added to the Commission's earlier analysis that found contract rates, terms and conditions to be anticompetitive. .

Market Structure and Competition Analysis

The survey of the BDS market gives important insight into the nature of competition that not only illuminates the nature of this market, but provides lessons for the analysis of competition more broadly.

Prior to 2010, the competitive standard used by the antitrust authorities was roughly "4 is few and 10 is many." The most recent *Merger Guidelines* suggest that "four is few and six is many." The latter is based primarily on theoretical/laboratory analysis of non-cooperative game theory. We believe that the empirical evidence in the broader literature supports a combination of these two – "four is few, six may be enough and 10 is many."

Professor Baker's analysis of the FCC data is consistent with our formulation, showing significant competitive effects up to the 8th market participant. He did not report empirical specifications with larger number of competitors, but his analysis is adequate to make the point that six may not be many.

Dr. Cooper acknowledged that communications markets have a great deal of difficulty achieving and sustaining even four equal-sized competitors, but he argued that the lesson to be drawn from that fact is not to abandon the aspiration for competition, but to recognize that these markets are inherently vulnerable to the abuse of market power. He pointed out that infrastructure sectors (like communications) have always been overseen by both antitrust and sector specific regulation because the underlying market conditions do not support a sufficient number of competitors to yield the results usually associated with vigorous competition. In these circumstances, while it is important to ensure as much competition as possible (particularly for the services that rely on or are complementary to the infrastructure network) competition and antitrust are not sufficient to prevent the abuse of endemic and pervasive market power. Regulation is necessary.

Deregulation should not take place until the growth of competition has demonstrated an ability to prevent the abuse of market power. In fact, the 1996 specifically required that the elimination of regulation should not take place until the development of competition had rendered it no longer necessary in the public interest. The premature deregulation of the special access market violated this economic and legal principle.

The Need for Careful Analysis of Cost Causation, Cost Allocation and Subsidies.

Cooper pointed out that the joint comments noted that the Commission challenged the companies to provide cost data to rebut the clear analysis that found many of the contracting practices to be an abuse of market power, rather than a recovery of legitimate costs. No company chose to do so in the comment and reply process. At the eleventh hour, CenturyLink has filed some cost data. In our replies we analyzed this type of data for Verizon NY, where we have detailed cost data and we have shown that it is totally misleading. The CenturyLink effort to mislead the Commission underscores the need for a thorough and rigorous analysis of costs, as we have recommended throughout the proceeding.

CenturyLink engages in the line count shell game and misallocation of costs and revenues that we showed for Verizon, New York. They divide the operating expense by the number of voice access lines. Since the number has declined by 53%, the expense appears to go through the roof (up over 50%). This is totally misleading for three reasons,

- First, net operating income has not declined as fast as the line count, so operating income per line has increased by 75%.

- Second, and more importantly, this line count shell game misrepresents what is going on. We showed in New York that, although voice access lines declined by 52%, total lines increased and by 18% and services that rely on special access lines (excluding cable which is likely self- supplying) increased by 40%. The explanation is clear in New York, Verizon misallocates costs to the access line (Title II) category and under compensates the Title II company for the use of its services.

- Third, just as we show in New York, the capital investment numbers support this interpretation. Century link shows that capital expenditures were flat over the period, so that the incremental CapEx per line more than doubled (up 120%). That makes no sense. Why invest so much in a shrinking service? A more credible explanation is that they are expending capital to support other services, while booking them as wireline costs, which we show in New York.

These cross subsidies violate the 1996 Act. Further, we showed for New York, where we have detailed cost and revenue data in the state jurisdiction, that, because of the shift in connectivity from copper wireline to broadband and mobile, the cross subsidization of BDS, EBITDA for special access was in the range of 66-80%, which contradicts CenturyLink's cost claims. These profits are not simply "supranormal," they are astronomical and have been sustained at very high levels over a decade, as the analysis of ARMIS data showed, before the FCC stopped collecting and publishing it.

Base Rates and Productivity Adjustments

In our initial comments we estimated that the historical record suggests overcharges on the order of 50% in the BDS market. The more recent filings support that finding.

Sprint's testimony on the extent of productivity improvements, although based on the FCC forward looking cost model, can inform the Commission and should be compared to the results of a rigorous audit of costs. In their analyses, the Sprint experts provide ranges and choose midpoints. While that is cautious from the point of view of a modelling exercise, our analysis shows that the audit will conclude that the high productivity growth estimates are more appropriate. Combining the heretofore underestimated productivity increases with the decline in the cost of capital from the very high level which was embedded in rates a decade and a half ago, and you arrive at the estimates of overcharges and excess profits we have been talking about – in the range of 50%.

This reinforces our conclusion that the Commission should move to give immediate relief to the BDS customers and conduct an intensive analysis of costs so that the proper basis BDS charges can be identified. We recognize that on a going forward basis the Commission will rely on a

price cap formula. All we are suggesting is that two steps are critical to ensuring that the formula used yields rates that are just and reasonable – set base rates and the productivity factor on the basis of a rigorous accounting of costs in a cost proceeding that analyzes cost causation and cost recovery.

Recommendations

The measures proposed by the FCC to deal with the abuse of market power are well-justified and quite cautious. They certainly should not be weakened. Ultimately, more vigorous reforms must be implemented to ensure that rates are and will continue to be just and reasonable.

Above all, the FCC must launch an audited cost inquiry to demonstrate prices for BDS that would yield rates that are just and reasonable. Not only would this proceeding establish a reasonable base rate, but it would afford the FCC an opportunity to test different approaches to setting the productivity factor against historical experience.

Second, it is critical to allow BDS customers, who had been forced to accept onerous, anticompetitive conditions that the Commission has now banned on a going forward basis, to negotiate better deals immediately. Only by doing so can the Commission give competition a real chance to develop. Thus, the Commission would not abrogate any contracts, it would simply allow those who had signed contracts under duress (lack of alternatives and incumbents bent on preserving their market power) to get immediate relief, a great deal of which might come from competitors. This "look back" provision is necessary to open the BDS market to immediate competition and give the FCC an opportunity to assess the competitive status of the BDS market.

For over a decade and a half, the regulation of rates (directly by the Commission or indirectly by competition) has been based on guesswork, a theory that has missed the mark by a wide margin, to the detriment of consumers and competition. An ongoing cost/productivity proceeding and a real opportunity for market transactions to show the extent of competition (freed from onerous anticompetitive terms and conditions) are the only way for the FCC to establish a firm basis for just and reasonable rates in the BDS market. Instituting a cost proceeding and a "look back" provision will enable the FCC to determine the level of prices that would be just and reasonable and under what conditions competition is sufficient to ensure that outcome.

By setting initial rates down and increasing the productivity factor by an amount that is extremely conservative, the Commission will show that its policy is headed in the direction of just and reasonable rates. A measure of justice is being delivered. By opening a cost proceeding to investigate both the base rates and the productivity factor, it will show that it intends to ultimately lay a strong foundation for delivering full justice to consumer in the BDS market, an evidence-based, nor theory-based, finding that rates are just and reasonable. Of course, tthe dominant ILECs might provide cost evidence to support their claims (although their failure to do so heretofore suggests that they do not possess such evidence). Answering the important questions with facts is the purpose of the cost proceeding.