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September 22, 2016

REDACTED FOR PUBLIC INSPECTION

Via ECFS

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

Re: WC Docket Nos. 16-143, 15-247, 05-25, RM-10593; Public Version of AT&T's Ex Parte Filing

Dear Ms. Dortch:

On September 20, 2016, Frank Simone, Gary Phillips, Rich Clarke, Keith Krom and the undersigned, all of AT&T, Mark Israel of Compass Lexecon, and Chris Shenk of Sidley Austin LLP, met with Matt DelNero, Bureau Chief, Wireline Competition Bureau, Howard Symons, General Counsel, Stephanie Weiner, Legal Advisor to Chairman Wheeler, Deena Shetler and Thom Parisi of the Wireline Competition Bureau, and Bill Dever of the Office of General Counsel. We discussed the attached document, which summarizes AT&T's position in this proceeding, the Compass Lexecon analysis of the regressions performed by Prof. Rysman and Commission staff, the flawed benchmarking proposal advanced by Verizon and INCOMPAS, and the most recent unsound X-factor calculation methodology proposed by Sprint.

In addition, on September 20, 2016, Frank Simone and Gary Phillips had a subsequent telephone conference with Matt DelNero, during which Messrs. Simone and Phillips highlighted the importance of maintaining incentives to invest in fiber deployments and correctly calculating productivity when considering adjustments to the existing price cap indices for certain business data services.

Attached is the **public version** of the attached document and is submitted in accordance with the applicable Protective Order.[1] Pursuant to section 1.1206 of the

[1] *See* Order, *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*, WC Docket Nos. 16-143, 05-25, RM-10593 (rel. Jun. 24, 2016).

Commission's rules, this ex parte notification is being filed electronically for inclusion in the record of the above-referenced proceeding. If you have any questions or need additional information, please do not hesitate to contact me.

Sincerely,
/s/ Caroline Van Wie

cc: Matt DelNero
Howard Symons
Stephanie Weiner
Deena Shetler
Thom Parisi
Bill Dever

Business Data Services Discussion Guide
September 20, 2016

AT&T's Position. AT&T urges the Commission to follow the evidence and record in this proceeding, which support the following outcome –

- The Commission should continue to forbear from regulating all Ethernet services, and all other BDS with bandwidth equal to or above 50 Mbps.
- If the Commission finds evidence of sufficient market power for legacy TDM services below 50 Mbps, the Commission should adopt the Competitive Market Test (CMT) proposed by the IRW economists for such services:
    - *A census tract will be deemed competitive where there are two facilities-based competitors present within the tract or within 2,000 feet of any building within it.*
- In areas deemed competitive by the IRW CMT, the Commission should apply its Phase II pricing flexibility rules to legacy TDM-based services. For areas not subject to effective competition under the IRW CMT, the Commission should apply Phase I regulation, but only if it finds that the benefits of regulation outweigh the substantial risks and costs.
- Finally, the Commission should maintain price caps at current levels, and adopt a prospective X-factor that is no higher than 2 percent.

The Limitations of the Regressions. The Commission cannot rely on the regressions as evidence of market power.

- The regressions produce no evidence of market power for Ethernet services of any bandwidth.
- The regressions produce no evidence of market power for any service above 50 Mbps.
- The regression results for DS1 and DS3 services do not support a finding of market power for those services.
    - Most of these regression produce statistically insignificant results that do not support a finding of market power, and there is no valid economic basis for relying only on the few results that do.
    - The regressions suffer from foundational flaws that cannot be cured given the substantial limitations in the available cross-sectional data. These flaws include endogeneity problems and inaccurate and incomplete data. These and other flaws are clearly causing the regressions to produce invalid results, as shown by the many inconsistencies and anomalies in the results (*e.g.*, results indicating that competitive entry leads to higher prices, and results indicating that ILECs respond to three competitors, but not one competitor or four competitors). Due to these flaws, there is no reasonable basis for assuming that the minority of regression results that purport to indicate market power are valid.
- *The Latest Round Of Regressions.* The regressions released by Staff on August 22nd do not cure these problems. In fact, by correcting the measurement of statistical significance (just one of the multiple flaws in the regressions), those regressions actually void many of the previously statistically significant results. As a result:

- The weight of the corrected DS3 regression results does not support a finding of market power for DS3s – the majority, including the more rigorously tailored inquiries, find no statistically significant results for these services.
- The results for DS1s, as well, are mixed, and, again, the more highly specified regressions find no statistically significant evidence of market power. Those that come out the other way suggest price effects in the range of only about 3-4%.
- No evidence of price effects were found for any service in Phase I price cap areas. This means either those areas are already competitive and/or that price caps are already constraining prices at (or below) competitive levels.
- The regressions continue to produce no evidence of market power for Ethernet services for any bandwidth or any services above 50 Mbps.

Harm from Overregulation. The potential harm posed by regulating is not justified by these weak findings market power.

- Slashing Ethernet rates and DS1/DS3 rates in non-competitive areas without strong evidence of market failure could have serious detrimental effects on consumers and competition, including:
  - It will undermine incentives for ILECs, cable companies, CLECs and other providers to continue investing in BDS infrastructure in at least two ways: (1) it will make it less economically feasible to make such investments due to much lower potential returns and (2) it will produce strong incentives for providers to rely on the new below-market priced wholesale services rather than build out their own facilities.
  - These reduced incentives to build out fiber would be directly contrary to the Commission's goal of promoting 5G wireless roll-out. 5G wireless will require substantial investment in new fiber to serve the substantially increased number of small cells that will be deployed to support this technology. Significantly decreasing the return on fiber investment will discourage that investment.
  - Obviously, slashing TDM rates will not encourage 5G deployment since 5G networks will require much higher capacity backhaul.
  - Even if competitive providers are exempt from rate regulation under the FCC's final regime, competitors would likely be forced to lower prices to meet lowered ILEC rates, which, as is apparent from the statements made by competitors like Lumos, Wilshire Connection, LighTower, and cable companies, would negatively impact competitive investment.

The Competitive Market Test. The CMT that the IRW economists have proposed would be the most reasonable way to distinguish between competitive and non-competitive areas.

- Given the characteristics of this marketplace, the presence of two facilities-based providers in a geographic area will constrain prices.
  - BDS purchasers are generally sophisticated buyers that purchase these services through a bidding process; BDS providers have strong incentives to compete aggressively to win customers because they incur large sunk costs and low

incremental costs; and when BDS providers build out their networks, they gain the dynamic benefit of reducing incremental costs to future customers.
  - There is no economic evidence on the record that supports a finding that more than two providers is required for competitive market outcomes.

Verizon-INCOMPAS Benchmarking. The Verizon-INCOMPAS benchmarking proposal is not supported by the record and would lead to patently arbitrary outcomes.

- As an initial matter, as noted, there is no evidence in the record to support a Commission finding that ILECs exercise market power for Ethernet services at any speed; the Commission should continue to forbear from *ex ante* price regulation of Ethernet services.
- Beyond that, the benchmarking regime proposed by Verizon and INCOMPAS is arbitrary in the extreme, and wholly untenable. It would subject AT&T (and, we believe, virtually all other Ethernet providers) to massive, unsustainable price cuts, while giving Verizon *increased* headroom, even though its existing rates are *higher* than AT&T's.

Comparison of Ethernet Benchmark Rates Produced By The Verizon/INCOMPAS Proposal (Year 2)[1]

Speed in Mbps	AT&T	Verizon	% By Which VZ's Benchmark Exceeds AT&T's Benchmark
2 or 3	$219	$373	70%
10	$287	$496	73%
20	$344	$683	99%
50	$370	$996	169%
100	$410	$1,242	203%
1000	$791	$2,548	222%

- This disparity is driven by 2 factors:
  - Verizon's starting DS1 rate is much higher than AT&T's ($460 versus $270 – a difference that also underscores how arbitrary it would be to ratchet down DS1 price cap indices by the same percentage everywhere, regardless of what they are now).
  - Verizon's Ethernet rate relationship between its low bandwidth anchor service and its higher Ethernet speeds is substantially wider than AT&T's (333% versus 187% for 100 Mbps; 683% versus 361% for 1000 Mbps).
- As a result of this benchmarking, AT&T's Ethernet guidebook prices would be lowered by **63%** in Year 2 of this plan, and almost all of AT&T's new benchmarked rates would be significantly lower than the Tier 1 rates Verizon currently receives from AT&T.

[1] These benchmarked rates were derived from AT&T's and Verizon's publicly-available tariffed DS1 rates, AT&T's publicly-available Ethernet Guidebook rates, and the Ethernet price curve provided by Verizon in its August 5, 2016 Ex Parte filing, in accordance with the methodology proposed by Verizon and INCOMPAS.

[BEGIN HIGHLY CONFIDENTIAL][2]

AT&T's Year 2 Benchmarks Would Be Far Below Current Price Levels

Speed in Mbps	AT&T Benchmark	AT&T Guidebook	% Reduction From Guidebook	AT&T Lowest Rate for Verizon	% Reduction From Lowest Rate Paid By Verizon
2	$219	$594	-63%	[redacted]	[redacted]
10	$287	$780	-63%	[redacted]	[redacted]
20	$344	$930	-63%	[redacted]	[redacted]
50	$370	$1,005	-63%	[redacted]	[redacted]
100	$410	$1,110	-63%	[redacted]	[redacted]
1000	$791	$2,145	-63%	[redacted]	[redacted]

[END HIGHLY CONFIDENTIAL]

- Meanwhile, almost all of the most competitive rates Verizon currently offers to AT&T are actually already lower than the benchmarked rates Verizon would derive from this new scheme. But, this is not because AT&T's best rates are currently higher than Verizon's – quite the opposite. The best rates AT&T gets from Verizon are, across the board, higher than the best rates Verizon gets from AT&T.

[BEGIN HIGHLY CONFIDENTIAL]

Verizon's Benchmarks Would Be Well Above Its Current Rates

Speed in Mbps	Verizon's Second Yr. Benchmark	Verizon's Current Titan Rates	% Headroom Over Titan Rate
2	$373	[redacted]	[redacted]
10	$496	[redacted]	[redacted]
20	$683	[redacted]	[redacted]
50	$996	[redacted]	[redacted]
100	$1,242	[redacted]	[redacted]
1000	$2,548	[redacted]	[redacted]

[END HIGHLY CONFIDENTIAL]

[2] Highly confidential information indicated by asterisks ("*").

The X-Factor. Correctly calculating productivity in the legacy BDS market results in no backwards-looking price cap adjustment and a forward-looking X-factor of not more than 2%.

- The best measure of productivity for legacy BDS services uses the BLS KLEMS data for both TFP and input price growth. These data show, when measured from 2005, that productivity has been approximately equal to inflation, which aligns with the X-factor in place over this time. This also means that looking forward, the X-factor should be no more than 2%.
- Sprint's original proposal for calculating productivity (using EU KLEMS data) has been thoroughly debunked. Sprint now argues instead that the X-factor should be measured based on BLS KLEMS TFP productivity, but its input price growth component should be measured using a mish-mash of values associated with a response to a peer review of the Connect America Cost Model. This methodology is also deeply flawed and mathematically inadmissible:
    - The proposal to use CACM-related data to derive a measure of input price growth fails to understand that input price growth used to compute an X-factor must be the same input price information used to compute TFP. Sprint's proposal to use its CACM-related input price data in the X-factor equation but not in the TFP-development equation (which relies on BLS KLEMS input prices) violates fundamental economic principles and gerrymanders a higher X-factor result.
    - And, the CACM price growth inputs do not even better represent BDS input costs than the BLS KLEMS index – because they fail to account for significant architectural differences between mass-market broadband fiber networks and the custom-built, highly urban, copper-heavy BDS networks. Further, Sprint's input price growth calculations employ data that were explicitly developed to understate cost growth and fail to correctly measure economic costs for the purposes of calculating productivity.
- Moreover, Sprint would strangely use the 2005-2014 period to determine the backwards looking cap adjustment, while arguing that the 1997-2014 period should be used to calculate the forward-looking X-factor. Again, this gerrymanders the productivity results to benefit the CLECs.