

September 29, 2016

**VIA ECFS**

***NOTICE OF EX PARTE***

Ms. Marlene H. Dortch  
Secretary  
Federal Communications Commission  
445 12th Street, SW, Room TW-A325  
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:

The undersigned and Joe Cavender of Level 3 Communications, LLC (“Level 3”) met with Claude Aiken, Wireline Legal Advisor to Commissioner Clyburn, on September 27, 2016 and with Travis Litman, Senior Legal Advisor to Commissioner Rosenworcel, on September 28, 2016. During the meetings, we expressed Level 3’s support for the adoption of comprehensive reform in the above-referenced proceedings to prevent incumbent LECs from abusing their market power in the provision of circuit-based dedicated services (“CBDS”) and packet-based dedicated services (“PBDS”) (together, “business data services”).

We explained that, because there is virtually no actual competition in the provision of business data services, the Commission should analyze the market by assessing the likelihood that a reasonably efficient competitor can deploy a connection to a customer location. As the record demonstrates, there is little prospect that competitors can deploy connections at or below 100 Mbps (“low-bandwidth services”). Accordingly, the Commission should treat low-bandwidth services as non-competitive in all locations. We further explained that, because competitive LECs cannot reliably deploy connections for business data services above 100 Mbps up to and including one Gbps (“mid-bandwidth services”), and because regression analyses confirm that incumbent LECs exercise market power in the provision of mid-bandwidth services, the Commission should apply a competition test to those services. The Commission should apply ex ante rate regulation to leading competitors in markets deemed non-competitive under the test.

We also explained that it is reasonable for the Commission to use census blocks as the geographic area for the competition test for mid-bandwidth services. For example, Level 3 compared its construction feasibility analysis for mid-bandwidth services at 200 Mbps, 500 Mbps, and one Gbps in the top ten metropolitan statistical areas with the sizes of census blocks and census tracts set forth in Dr. Marc Rysman's report.<sup>1</sup> Level 3 found that analyzing the construction feasibility in circumstances where a competitor's splice point is located (1) on the edge of the geographic area, (2) 1,000 feet from the edge of the geographic area, or (3) 2,500 feet from the edge of the geographic area shows that it is far more appropriate to use census blocks rather than census tracts or other larger geographic areas in the competitive market test for mid-bandwidth services.<sup>2</sup> In fact, using census tracts or other geographic areas larger than census blocks likely would result in the incorrect classification of large swaths of territory as competitive.<sup>3</sup>

We further explained that the Commission's framework should provide that only a single leading competitor should be subject to ex ante rate regulation in relevant markets classified as non-competitive. Non-leading competitors should not be subject to ex ante rate regulation in any market under any circumstances. The Commission should consider whether to identify a leading competitor other than an incumbent LEC during a periodic agency review of the regulatory framework (e.g., every three years) based on market conditions at the time of the review. The Commission need not, and should not, establish a test for classifying leading competitors at this time. When the Commission develops such a test, the inquiry likely should include consideration of whether there is a provider with a ubiquitous (or near-ubiquitous) network in a region that is more likely than the incumbent LEC to be able to exercise market power in a relevant market. Classification as the leading competitor likely would apply throughout the provider's network footprint for the relevant market(s) in which the provider (or class of providers) is deemed the leading competitor. If a provider other than the incumbent LEC is classified as the leading competitor in a relevant market, the incumbent LEC would no longer be so classified.<sup>4</sup>

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<sup>1</sup> See Reply Comments of Level 3, WC Docket Nos. 16-143, 15-247, & 05-25, RM-10593, at 43-49 (filed Aug. 9, 2016) ("Level 3 FNPRM Reply Comments").

<sup>2</sup> *Id.* at 45.

<sup>3</sup> See *id.* at 43.

<sup>4</sup> NCTA criticizes Level 3's suggestion that the Commission might consider whether a competitor owns a ubiquitous (or near-ubiquitous) network across a region in assessing whether the firm should be classified as a leading competitor. Letter from Steven Morris, NCTA, to Marlene H. Dortch, Secretary, FCC, WC Docket Nos. 16-143, 05-25, at 6 (filed Sept. 27, 2016) ("NCTA September 27 Letter"). But this is an entirely appropriate consideration because ownership of a ubiquitous network indicates that the provider experiences lower incremental costs than providers with less extensive networks, is likely able to dictate the market price in relevant markets in which there is only one provider (likely the provider with the ubiquitous network) or a small number of providers, and likely has the incentive and ability to engage in

We noted that Level 3 supports the reforms jointly proposed by Verizon and INCOMPAS in their June 27, 2016 letter. We also discussed the differences in benchmark prices for Ethernet services produced by the methodology proposed by Verizon and INCOMPAS in their August 9, 2016 letter, and we described the alternative approach previously proposed by Level 3 and others. We observed that, as TDS has shown, the Verizon-INCOMPAS proposal would establish benchmark levels that differ substantially from incumbent LEC to incumbent LEC.<sup>5</sup> Under Level 3's earlier proposal, the Commission would determine each price cap incumbent LEC's current prices in non-competitive markets and then reduce those prices by the differential shown in the regression analyses for services subject to (at least some) competition.<sup>6</sup> Under this alternative approach, the Commission could allow incumbent LECs to calculate their current

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exclusionary conduct by, for example, conditioning the provision of service at non-competitive locations on a customer's agreement to purchase service at competitive locations. NCTA also expresses rather overwrought outrage at the suggestion that prices for business data services could be set above competitive levels in markets where there are three providers. *Id.* at 6 & n.36. But it is entirely consistent with competition theory to expect prices to be set above competitive levels in a market with only three competitors in the presence of high entry barriers, and Professor Baker's regressions show that this is likely the case with business data services. *See* Phillip E. Areeda & Herbert Hovenkamp, *Antitrust Law* §§ 1429a-1429b (3d ed. 2010); *see also Applications of AT&T Inc. and Deutsche Telekom AG for Consent to Assign or Transfer Control of Licenses and Authorizations*, Staff Analysis and Findings, 26 FCC Rcd. 16188, ¶¶ 47, 71 (2011) (explaining that a merger of two of the four largest retail mobile wireless providers would be "presumed to create or enhance market power or facilitate its exercise, creating significant potential for competitive harm in most retail mobile wireless services markets, to the detriment of consumers" and would "threaten[] to harm competition by making coordination among the sellers of retail mobile wireless services [to achieve profits above competitive levels, among other things] more likely and/or more effective"); Reply Declaration of Jonathan B. Baker on Competition and Market Power in the Provision of Business Data Services, attached to Letter from Jonathan B. Baker to Marlene H. Dortch, Secretary, FCC, WC Docket Nos. 16-143, 15-247, & 05-25, RM-10593, tbls. 1-3 (filed Aug. 9, 2016) ("Baker FNPRM Reply Decl.") (showing that the prices in markets with eight or more providers are lower than in markets with four or more providers). NCTA implies that Level 3 must have designed its leading competitor framework to somehow avoid the effects of ex ante rate regulation. *See* NCTA September 27 Letter at 6. But NCTA has itself argued strenuously that all competitors (presumably including Level 3) must charge rates at or below the regulated rate in a relevant market. *See* Reply Declaration of Michael L. Katz and Bryan G.M. Keating, ¶¶ 12, 14 (Aug. 9, 2016), attached to Reply Comments of NCTA, WC Docket Nos. 16-143, 05-25 (filed Aug. 9, 2016).

<sup>5</sup> *See* Attachment to Letter from Tamar Finn, Counsel for TDS Metrocom, to Marlene H. Dortch, Secretary, FCC, WC Docket Nos. 16-143, 15-247, & 05-25, RM-10593 (filed Aug. 25, 2016).

<sup>6</sup> *See* Comments of Birch Communications, Inc., EarthLink, Inc., and Level 3 Communications, LLC, WC Docket Nos. 16-143, 15-247, & 05-25, RM-10593, at 70-71 (filed June 28, 2016) ("Joint CLEC FNPRM Comments").

PBDS prices in non-competitive areas by determining the weighted average of the current PBDS prices they charge their five largest wholesale and five largest retail customers.<sup>7</sup> Incumbent LECs could instead calculate current PBDS prices by determining the weighted average of all of the current PBDS prices they charge in non-competitive areas. Regardless of which approach is used, the Commission should grant incumbent LECs the discretion to establish different price levels in different geographic regions as long as the incumbent LECs can demonstrate that doing so is consistent with their actual pricing practices and does not result in unreasonable price discrimination.

Current incumbent LEC PBDS prices would then be reduced by at least 19.7 percent, the amount by which regression analyses have shown incumbent LECs reduce their prices in response to the presence of competitors.<sup>8</sup> Alternatively, an incumbent LEC would be free to reduce current prices by a different percentage if the incumbent LEC can demonstrate that the 19.7 percent reduction would produce prices below a reasonable measure of the incumbent LEC's costs. Where the incumbent LEC is able to meet this standard, the Commission should review the resulting prices to determine whether the prices produced by the incumbent LEC's preferred approach are reasonable.

During our discussions, we addressed criticisms of this proposed methodology for setting regulated PBDS prices. We explained that there is no reason to believe that use of the top five retail and top five wholesale customer prices is likely to result in unreasonably low prices. For example, there is evidence in the record that incumbent LEC wholesale prices are higher than retail prices,<sup>9</sup> and analysis of the Commission's data shows that the majority of incumbent LEC-provided standalone PBDS – 68 percent – is purchased by wholesale customers. Thus, the

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<sup>7</sup> NCTA asserts that this approach must have been designed to produce low prices. NCTA September 27 Letter at 7. In fact, it was designed to be easy for incumbent LECs to administer. In any event, as stated, incumbent LECs should be allowed to use all of their PBDS prices if they prefer to do so.

<sup>8</sup> See Declaration of Jonathan B. Baker on Market Power in the Provision of Dedicated (Special Access) Services, attached to Letter from Jonathan B. Baker to Marlene H. Dortch, Secretary, FCC, WC Docket No. 05-25, RM-10593, ¶ 63 (filed Jan. 27, 2016) (refiled Apr. 14, 2016) (“Baker Decl.”).

<sup>9</sup> See, e.g., Reply Comments of Windstream Services, LLC, WC Docket Nos. 16-143, 05-25, RM-10593, at 25 (filed Aug. 9, 2016) (“[A]s Windstream and others have stated in the record, ILEC wholesale Ethernet rates for both lower and higher bandwidth, i.e., more than 50 Mbps, services exceed retail Ethernet rates, even when commercially negotiated wholesale discounts are included.”); Fifth Declaration of Matthew J. Loch, ¶¶ 4-5 (Aug. 9, 2016), attached to Reply Comments of TDS Metrocom, LLC, WC Docket Nos. 16-143, 15-247, & 05-25, RM-10593 (filed Aug. 9, 2016) (describing an instance in which an incumbent LEC quoted retail prices that were lower than wholesale prices).

weighted average of the top five retail and top five wholesale customer prices is likely to produce a reasonable estimate of incumbent LEC prices in non-competitive areas.

We described empirical evidence that supports the conclusion that a 19.7 percent reduction in the weighted average of incumbent LECs' prices in non-competitive areas is reasonable and conservative as applied to PBDS. As Dr. Jonathan Baker has explained, factors that cannot be controlled for likely cause regression analyses of the Commission's data to understate the magnitude of incumbent LEC price reductions in response to competition.<sup>10</sup> In addition, regressions that refine Dr. Rysman's methodology for analyzing competition in the provision of retail and wholesale business data services above 50 Mbps (where approximately 87 percent of incumbent LEC connections are PBDS) show incumbent LEC price reductions that are higher than 19.7 percent (43 percent according to one estimate and 25 percent according to another).<sup>11</sup> Moreover, regressions for business data services above 50 Mbps include services (e.g., services above one Gbps) that are likely to be subject to competition even in geographic areas where mid-bandwidth and low-bandwidth services are not competitive. As a result of such competition, those services likely experience few or no price reductions in response to rivalry, thereby lowering the overall results in the above 50 Mbps regressions below the level that would be expected for low-bandwidth or mid-bandwidth services.

We explained that price caps and tariffs are less intrusive and more flexible, efficient, and administratively feasible than a benchmark pricing regime and therefore are the most appropriate means of enforcing ex ante rate regulation for both CBDS and PBDS.<sup>12</sup> Notably, no party has offered a credible reason why the Commission should replace price caps and tariffs with benchmarks, and the Commission did not offer such a basis in the *FNPRM*. Indeed, as the Commission acknowledged in the *FNPRM*, it is "not aware of any other presently available alternative to price cap regulation that more effectively balances the interests of ratepayers and carriers."<sup>13</sup>

We further explained that, while the tariff filing system plays an important role in the price cap regime, the Commission could nevertheless adopt price cap regulation for PBDS that utilizes methods of disclosure and enforcement other than tariffs. For example, in a price cap

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<sup>10</sup> See Baker Decl. ¶¶ 68-94.

<sup>11</sup> Baker FNPRM Reply Decl. ¶ 9.

<sup>12</sup> See Joint CLEC FNPRM Comments at 62-66, 75-84; Level 3 FNPRM Reply Comments at 49-58.

<sup>13</sup> *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, ¶ 354 (2016) ("*FNPRM*").

regime that does not rely on tariffs, incumbent LECs would still be required to establish rates for CBDS and PBDS (assuming both are in the same price cap basket, as should be the case) such that the weighted average of those rates does not exceed the price cap index for the business data services basket. Once this is accomplished, PBDS rates would be posted publicly in the manner other than via published tariffs that the Commission deems appropriate. In addition, where an incumbent LEC's actual price index is below the price cap index, its prices would be treated the same way that below-benchmark prices are treated in a benchmark pricing regime.<sup>14</sup>

We also emphasized that the Commission should ensure that business data services reforms, including ex ante rate regulation and protections against harmful lock-up provisions, take effect as soon as possible so that business customers and consumers experience the benefits of increased competition and reduced barriers to the technology transition. The Commission should do so by applying the following requirements to incumbent LECs selling business data services in non-competitive markets. *First*, incumbent LECs should be required to modify their standard tariffs (i.e., those other than contract tariffs) immediately to comply with the new requirements. *Second*, future incumbent LEC contract tariffs and commercial agreements should comply with the new requirements. *Third*, customers should be given 180 days after the effective date of the Commission's new rules in which to decide whether to exercise fresh-look rights. Customers that purchase CBDS pursuant to volume and term plans in standard tariffs and pursuant to contract tariffs should be given the right either to reduce their volume commitments without incurring shortfall penalties or to terminate their plans or contract tariffs without incurring early termination penalties during the 180-day period. Customers that purchase PBDS pursuant to commercial agreements should be given the right to terminate their agreements without incurring early termination penalties during the 180-day period.

Please do not hesitate to contact me if you have any questions or concerns regarding this submission.

Respectfully submitted,

/s/ Thomas Jones

Thomas Jones

*Counsel for Level 3 Communications, LLC*

cc: Claude Aiken  
Travis Litman

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<sup>14</sup> See, e.g., Letter from Kathleen Grillo, Verizon & Chip Pickering, INCOMPAS, to Marlene H. Dortch, Secretary, FCC, WC Docket Nos. 16-143, 05-25, at 2 (filed Aug. 9, 2016).