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October 28, 2014

VIA ECFS ***EX PARTE***

Ms. Marlene H. Dortch
Secretary
Federal Communications Commission
445 12th Street, SW, Room TW-A325
Washington, DC 20554

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

Dear Ms. Dortch:

Cbeyond Communications, LLC, Integra Telecom, Inc., Level 3 Communications, LLC, and tw telecom inc. hereby file the attached proposed framework for the analysis of the exclusionary effects of incumbent LEC special access volume/term lock-up agreements in the above-referenced proceedings.

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

Respectfully submitted,

/s/ Thomas Jones

Counsel for Cbeyond Communications, LLC, Integra Telecom, Inc., Level 3 Communications, LLC, and tw telecom inc.

cc: Pam Arluk

Enclosure

ISSUES TO CONSIDER IN FCC REVIEW OF ILEC SPECIAL ACCESS LOCK-UP AGREEMENTS

(October 28, 2104)

Incumbent LECs charge unreasonably high rates for DSn and Ethernet special access services. In order to obtain some relief from these charges (e.g., discounts, credits, or other benefits such as circuit portability), competitive carriers have no choice but to agree to the onerous volume and term commitments required under the incumbent LECs' lock-up "discount" plans. These commitments have the effect of excluding wholesale competitors from the market, which in turn slows the deployment of fiber to commercial buildings, slows the deployment of Ethernet, and prevents competition from driving down prices.

In order to address these exclusionary effects, the Commission should undertake a review of the incumbent LECs' DSn and Ethernet special access lock-up tariffs (in a tariff investigation) and commercial agreements (in the special access rulemaking proceeding). This document describes the issues that should be assessed and the information that should be collected and analyzed in such a review. Addressing these issues will result in significant increases in consumer welfare. Of course, addressing these issues will not remedy all the effects of incumbent LEC abuse of market power over last-mile connections. A comprehensive approach requires that the Commission adopt rate regulations in the relevant DSn and Ethernet special access markets in which incumbent LECs have substantial and persisting market power. Review of the lock-up agreements is thus an important first step in a larger process for reforming the policies governing incumbent LEC special access service offerings.[1]

1. <u>Unreasonable volume purchase commitments combined with large shortfall penalties</u>. Commercial agreements and tariffs that condition the availability of discounts, credits, or other benefits on the buyer purchasing the overwhelming majority of its past special access volumes from the incumbent LEC and that include large shortfall, early-termination, and overage penalties violate sections 201(b) and 202(a).

   Section 201(b) requires that "all charges, practices, classifications, and regulations for and in connection with" common carrier services such as DSn and Ethernet special access services be "just and reasonable."[2] Section 202(a) states that it is unlawful to "make any unjust or unreasonable discrimination in charges, practices, classifications, regulations, facilities, or services for or in connection with" common carrier services such as DSn and Ethernet special access services.[3] The historic purchase commitments in

[1] This document addresses tariffs (including contract tariffs) and non-tariffed commercial agreements under which the buyer receives a special access discount, credit, or other benefit in return for a commitment to purchase a particular volume of special access services (DSn, Ethernet, or both) for a specified term. The analysis does not address circuit-specific discount plans.

[2] 47 U.S.C. § 201(b).

[3] *Id.* § 202(a).

incumbent LEC special access commercial agreements and tariffs are unreasonable or unreasonably discriminatory (or both) in at least five respects.

a. Large volume commitments combined with large shortfall penalties. Conditioning the availability of discounts on a buyer's purchase of large volumes of special access services combined with large penalties for the failure to meet such minimum volumes reduces elasticity of demand, shrinks the addressable market for competitive wholesale special access providers (thereby preventing them from achieving minimum viable scale), and causes special access prices to remain higher than would otherwise be the case.[4]

   The incumbent LECs should be required to demonstrate that their volume commitment arrangements do not have these effects. In so doing, they should address the following.

   Incumbent LECs should be required to calculate the actual size of the shortfall and early termination penalties under various scenarios specified by the Bureau. The purpose of this analysis is to determine the extent to which a competitor must underprice the incumbent LEC or expand the geographic scope of its offering in order to induce a buyer to switch to the competitor under the chosen scenarios.

   Incumbent LECs should also be required to document the extent to which buyers have reduced their special access purchase volume commitments (DSn and Ethernet) when renewing their volume/term plan commitments. For example, what is the total volume (measured in either dollars or circuits, depending on how the volume commitment under the plan is measured) committed by each customer who purchases special access services under the plan? Over the past five years, what adjustments have customers made to their volume commitments (measured by the number of circuits or dollars, depending on how the volume commitment is measured, and percentage changes) when they have renewed their agreements with the incumbent LEC?

   Furthermore, incumbent LECs should be required to explain in detail how they determined the levels of their shortfall penalties and early termination fees and the variables involved in making this determination. How many times have buyers incurred shortfall penalties and early termination fees over the past five years and what was the amount of those penalties or fees?

b. Volume commitments tailored to individual purchase volumes. The incumbent LEC practice of defining DSn special access volume commitments based on an extremely high percentage of the buyer's historic purchase volumes is also unreasonable and

[4] *See* Stanley M. Besen & Bridger M. Mitchell, "Anticompetitive Provisions of ILEC Special Access Arrangements," ¶¶ 33-39 (2013) (*attached as* "Appendix A" to Comment s of BT Americas, Cbeyond, EarthLink, Integra, Level 3 and tw telecom, WC Dkt. No. 05-25 (filed Feb. 11, 2013)).

unreasonably discriminatory. These commitments take different forms: (1) many tariffs require that a buyer purchase a percentage of the buyer's historic special access spend (e.g., 95 percent in the CenturyLink/Qwest Regional Commitment Plan ("RCP")[5] and 90 percent in the Verizon Commitment Discount Plans ("CDPs")[6]), and (2) many commercial agreements and contract tariffs define the volume commitment as an absolute dollar amount or as a volume of circuits, a total which in fact equals most or all of the buyer's historic purchase volumes.[7] Although the size (in absolute terms) of the volume commitments vary substantially from customer to customer (e.g., the 95 percent of historic purchases commitment under the RCP yields a far larger volume commitment for a customer that purchased $10,000,000 of special access versus one that purchased $10,000), the discount, credit, or benefit is often the same for all customers (e.g., all customers that meet the 95 percent volume commitment under the RCP receive the same 22 percent discount off of recurring charges and circuit portability[8]). Thus, the benefits of the arrangements seem to have no efficiency justification and appear to be designed solely to lock up the market.

Accordingly, incumbent LECs should be required to demonstrate why it is that volume commitments set (either explicitly or effectively) to capture a high percentage of an individual buyer's historic demand are reasonable and not unreasonably discriminatory. For example, why is it reasonable to grant the same discount, credit, or other benefit to a buyer that must purchase 95 percent of its $10,000,000 of historic special access purchases (i.e., $9,500,000) and to a buyer that need only purchase 95 percent of its $10,000 of historic special access purchases (i.e., $9,500)?

In addition, incumbent LECs should be required to explain why it is reasonable and not unreasonably discriminatory to maintain dramatically different volume commitment requirements in different geographic areas. For example, Verizon should be required to explain why it provides circuit portability in legacy Bell Atlantic and NYNEX territories only to customers who commit to maintaining 90 percent of their historic purchase volumes under the CDP,[9] whereas in legacy GTE territory, it provides circuit portability under the Term Volume Plan ("TVP") to customers in exchange for committing a fixed quantity of circuits (i.e., not based on the customer's historic purchase volume), which can be as low as two circuits.[10]

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[5] CenturyLink Operating Companies, Tariff F.C.C. No. 11 § 7.1.3(B)(3).

[6] Verizon Telephone Companies, Tariff F.C.C. No. 1 § 25.1.3(A); Verizon Telephone Companies, Tariff F.C.C. No. 11 § 25.1.3(A).

[7] *See* Southwestern Bell Telephone Company, Tariff F.C.C. No. 73 § 41.187.

[8] CenturyLink Operating Companies, Tariff F.C.C. No. 11 § 7.1.3(B)(2)(c).

[9] *See* Southwestern Bell Telephone Company, Tariff F.C.C. No. 73 § 41.187.

[10] Verizon Telephone Companies, Tariff F.C.C. No. 14 § 5.6.14(D).

Incumbent LECs should also be required to explain in detail how they determined the particular percentage-based commitments required under their tariffs and agreements (e.g., 95 percent) and the variables involved in making this determination. For example, CenturyLink should be required to explain why, in 2010, it increased the volume commitment required under the RCP from 90 percent to 95 percent.[11]

Incumbent LECs should be required to provide data demonstrating the costs avoided when offering a volume discount and to explain why the structure discussed here is consistent with the manner in which they avoid costs under the plans. Is there any efficiency justification for these plans? If incumbent LECs claim that they would incur additional costs as a result of volume commitments being reduced (e.g., to 50 percent), they should be required to submit data supporting these projections.

c. Ratcheting volume commitments. The incumbent LEC practice of requiring buyers to meet increased volume commitments if their purchase volumes increase during the term of a plan is unreasonable and unreasonably discriminatory. This "ratcheting" up is often (but not always) used in combination with overage penalties, so that customers incur such penalties unless they meet the ratcheted volume (in some cases, the minimum volume commitment increases automatically to account for higher purchase levels, so there is no need for an overage penalty[12]). Whether used alone or in combination with overage penalties, however, ratcheting serves both to lock up increased demand and to create greater exposure to shortfall penalties over time. Moreover, buyers must meet the increased volume commitment merely to retain the discount or benefit originally made available in the agreement. Where this is the case, the increased volume commitment serves no purpose other than to lock-up the market.

Incumbent LECs should be required to demonstrate why ratcheted volume commitment structures are efficient. What is the specific efficiency rationale for requiring a buyer to meet ratcheted volume commitments merely to retain the discount, credit, or other benefit offered under a plan?

In addition, incumbent LECs should be required to demonstrate why it is not unreasonably discriminatory to require buyers that receive the same benefits under a plan to meet dramatically different ratcheted volume increases. For example, consider a situation where buyer A has a volume commitment of 100 units and buyer B has a volume commitment of 1000 units, and both buyers receive a 40 percent discount under a plan. Why is it reasonably discriminatory to require each buyer to ratchet up

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[11] *See* CenturyLink Operating Companies, Tariff F.C.C. No. 11 § 7.99.13(A) (setting forth terms and conditions for the previous version of the RCP, which was grandfathered and replaced by the current version on May 31, 2010).

[12] *See, e.g.*, CenturyLink Operating Companies, Tariff F.C.C. No. 11 § 7.1.3(B)(3) (automatically adjusting a customer's commitment level upward if the customer's purchase volume increases).

their volumes if they exceed the applicable commitment by 25 percent (i.e., 25 units for A and 250 units for B) where both buyers receive the same 40 percent discount under the plan?

d. Overage penalties. The imposition of overage penalties appears to be designed exclusively to lock up future demand and to prevent competitive wholesalers from competing for such demand. They complement customer-specific volume commitments by essentially compelling buyers to increase their commitments soon after demand increases, thereby diminishing the opportunities for competitors to capture the increased demand.[13]

Incumbent LECs should be required to demonstrate why such penalties are reasonable. For example, what costs does the incumbent incur, and might therefore justifiably recover in a penalty, when a buyer purchases more DSn circuits than had been anticipated under a planned commitment? Wouldn't the increase in volume in fact reduce the incumbent LEC's costs by yielding increased economies of scale?

If incumbent LECs claim that their overage penalties are reasonable, they should be required to explain in detail how they determined the level of such penalties and the variables involved in making this determination. How many times have buyers incurred overage penalties during the past five years and, in each case, what was the amount of those penalties?

e. Volumes limited to DSn purchases. Many incumbent LEC tariffs (and possibly commercial agreements as well) establish volume commitments based on DSn special access purchases only.[14] At the same time, contract tariffs and commercial agreements sometimes define the volume commitment as an aggregate volume, say $10 million, a subset of which, say $5 million, the customer can only meet by purchasing DSn special access services (the rest can generally be met by purchasing Ethernet special access and possibly other services). By defining volume commitments (or subcommitments) in terms of DSn purchases alone, incumbent LECs lock in buyers to purchasing older technologies when they might well prefer to purchase more efficient Ethernet services at equal or greater capacities. This is unreasonable because it slows down the technology transition and deprives business customers of the benefits of Ethernet provided by competitive carriers.

Incumbent LECs should be required to demonstrate why it is reasonable not to allow buyers to substitute Ethernet special access services for DSn special access services

[13] *See, e.g.*, Southwestern Bell Telephone Company, Tariff F.C.C. No. 73 § 7.2.22(E)(4)(c) (imposing overage charges if a customer's purchase volume exceeds 124% of its commitment level and the customer does not "voluntarily" increase its commitment level).

[14] *See, e.g.*, CenturyLink Operating Companies, Tariff F.C.C. No. 11 § 7.1.3(B)(3) (establishing a volume commitment based on a customer's DS1 and/or DS3 purchase volume).

under their volume commitment plans. Is there a cost justification or an engineering justification for this incumbent LEC practice?

Some incumbent LEC tariffs include provisions that allow buyers to count Ethernet toward their volume commitments under defined circumstances. Incumbent LECs should be required to describe the specifics of any such migration provisions that it may have in place and to explain why these defined circumstances offer buyers sufficient flexibility to purchase Ethernet in lieu of DSn special access services.

2. Unreasonable term commitments. In addition to conditioning discounts on purchases of large volumes, many incumbent LEC commercial agreements and tariffs condition the availability of a discount, credit, or other benefit on the buyer's commitment to abide by the contract for an extremely long term. Other agreements and tariffs increase the size of the discount, credit, or benefit where the buyer commits to a longer term. For example, the discounts available under Verizon's CDPs depend on the term to which the buyer commits: for DS1 special access services in legacy NYNEX territory, such discounts range from 15 percent for customers that agree to a two-year commitment to 40 percent for customers that agree to a seven-year commitment.[15] This structure again appears to be designed to force buyers to continue to commit a huge volume of their demand (90 percent of historic purchase levels under the CDPs) over as long a time period as possible, thereby excluding competitors for as long as possible.

   Accordingly, incumbent LECs should be required to explain why the long term commitments are reasonable when applied to a large volume of circuit purchases. Why is it reasonable to require that a buyer of a large volume of circuits commit to a four-, five-, or even seven-year term? Are there sunk costs that the incumbent LEC must recover over that period of time? Also, is the correlation between longer terms and higher discounts in some discount arrangements based on any cost savings? The incumbent LEC should demonstrate the actual costs it saves, if any, where a customer commits to longer rather than shorter terms.

3. Section 203 tariff-filing requirements. Numerous commercial (i.e., untariffed) agreements in which incumbent LECs offer discounts, credits, or other benefits in connection with DSn special access prices violate the tariffing requirements of Section 203.

   Section 203(a) requires that tariffs "show[] all charges" as well as "the classifications, practices, and regulations affecting such charges" for services subject to tariff requirements.[16] Section 203(c) states that a carrier may not (1) "charge, demand, collect, or receive a greater or less or different compensation" than is set forth in a tariff; (2) "refund or remit by any means or device any portion of the charges" set forth in a tariff;

[15] Verizon Telephone Companies, Tariff F.C.C. No. 11 § 25.1.4(A)(4).

[16] 47 U.S.C. § 203(a).

or (3) "employ or enforce any classifications, regulations, or practices affecting such charges" except "as specified" in the tariff.[17]

Where an incumbent LEC offers (1) a discount, credit, or other benefit affecting a category of services that includes DSn special access services or (2) any discount, credit, or other benefit in exchange for meeting a volume commitment that includes DSn-based special access services in a commercial agreement, the incumbent's failure to file the agreement as a tariff appears to violate (1) the requirement that its tariffs include "the classifications, practices, and regulations affecting" charges for special access services; (2) the prohibition against refunding or remitting "*by any means or device* any portion of the charges" (emphasis added) set forth in the special access tariffs; and (3) the requirement that the special access tariffs include all "classifications, regulations, or practices *affecting*" (emphasis added) the charges for special access.

Accordingly, incumbent LECs should be required to file with the Commission all commercial agreements that contain (1) a discount, credit, or other benefit affecting a category of services that includes DSn special access services or (2) any discount, credit, or other benefit offered in exchange for meeting a volume commitment that includes DSn-based special access services. Incumbent LECs must explain why the failure to file such agreements does not violate their obligations under Section 203.

4. <u>Unreasonable tying arrangements</u>. Numerous tariffs and commercial agreements that contain tying arrangements appear to violate the prohibition against unreasonable rates, terms, and conditions in Section 201(b).

It is unreasonable for a dominant firm to condition the availability of a discount off of prices for DSn services in areas where the firm has market power on a buyer's purchase of those same services in areas that might be subject to competition. For example, imposing volume commitments that encompass DSn purchases in both areas where the incumbent LEC has market power and areas where the incumbent LEC might be subject to competition has the effect to diminishing competitive wholesalers' addressable market, thereby denying them the ability to achieve minimum viable scale and causing DSn prices to remain higher than would otherwise be the case.

Accordingly, incumbent LECs should be required to explain why geographic tying arrangements are reasonable. For example, incumbent LECs should explain whether and to what extent it is less expensive to provide special access across the many different geographic territories encompassed by their plans (e.g., the entire legacy BellSouth territory or even the entire 22 state AT&T incumbent LEC territory) as opposed to a smaller geographic area (e.g., a single state or even a single incumbent LEC operating company territory). In other words, how do the costs of providing special access to a customer in a region change if the customer also purchases special access in a different region?

[17] *Id.* § 203(c).

5. Submission of information encompassed by mandatory data request. The incumbent LECs should be required to file in the tariff investigation docket and any other docket implicated by this review and investigation, their responses to questions II.B.8-13 in the mandatory data request.

6. Safe harbor procedure. Incumbent LECs should be given the opportunity to avoid responding to the Designation Order and the notice in the special access rulemaking proceeding if they modify their existing practices so as to address the concerns expressed in the designation order and rulemaking notice. To qualify for this "safe harbor," an incumbent LEC should be required to do the following:

    a. Cap special access percentage volume commitments at no higher than 50 percent of total historic spend. The incumbent LEC must change all existing tariffs and commercial agreements that include volume commitments tailored to the customer's purchase volumes so as to require no more than 50 percent of the customer's total historic special access spend. That is, an incumbent LEC must amend any agreement or tariff that includes a special access (either DSn or Ethernet) volume purchase commitment so that the actual volume of DSn and/or Ethernet special access circuits that the customer must purchase cannot exceed, in the aggregate, more than 50 percent of the buyer's historic special access spend.

       For example, if Buyer A purchased 1,000 DS1 special access circuits and 200 10 Mpbs Ethernet special access circuits during the relevant historic time period, the volume commitment may not be higher than 50 percent of the 1,200 circuits, however expressed (e.g., it could be 50 percent of the dollar value of the 1,200 circuits or some other comparable methodology).

    b. Eliminate overage penalties. The incumbent LEC must eliminate overage penalties in existing tariffs and commercial agreements.

    c. Eliminate ratcheting volume commitments. The incumbent LEC must eliminate provisions that require buyers to meet increased volume commitments if their purchase volumes increase during the term of a plan solely in order to retain the discount, credit, or benefits offered under the plan.

    d. Count Ethernet toward DSn volume requirements. The incumbent LEC must allow buyers to count the purchase of Ethernet special access services toward DSn volume commitments or subcommitments in the same way that DSn special access purchases count toward the commitment (e.g., minimum revenue commitments may be fulfilled with revenues from Ethernet and/or DSn products).

    e. Limit term commitments to no longer than three years. The incumbent LEC must allow buyers the option of reducing the term commitment applicable to any plan under which the buyer must meet a volume commitment to no longer than three years.

    f. File commercial agreements as contract tariffs as required by Section 203. The incumbent LEC must file as a contract tariff any agreement under which the incumbent either offers the buyer a discount on, a credit toward, or some other benefit (1) that affects the customer's costs associated with the purchase of a category of services that includes DSn-based special access services or (2) in exchange for meeting a volume commitment that includes DSn-based special access services.

g. Grandfathering and fresh look. If the incumbent LEC seeks to discontinue or alter a special access plan in any way other than as described herein, it must allow all buyers under such plan to continue to purchase services under the plan until the expiration of the relevant term, and, until the expiration, it must allow the buyer to discontinue such plan without incurring a penalty.