<u>Question II.A.19 -- Response of Level 3 Communications, LLC</u>

Unlike the ILECs, Level 3 Communications, LLC ("Level 3") does not have market power over *Connections* needed to provide *Dedicated Services*. ILECs can and do utilize combinations of *Term* and *Volume Commitments* to effectively require customers to continue to purchase the overwhelming majority (e.g., 95 percent of historic spend with the ILEC) of their special access needs from the ILEC. Level 3 cannot, and does not, impose onerous "demand lock-up" arrangements of this kind on its customers. As is common among *Competitive Providers*, Level 3 does offer discounts to customers that make term and/or volume commitments. But unlike the ILECs' demand lock-up provisions, the *Term* and *Volume Commitments* offered by Level 3 are based on legitimate efficiency justifications and are reasonable and common practices in any competitive marketplace.

Level 3 provides discounts from month-to-month pricing if the customer commits to buying the circuit for a certain number of months or years. The longer the term, typically, the greater the discount. There are at least three reasons for this:

First, it is the expectation of nearly all customers, and a simple market reality, that a term commitment yields a lower price for the customer. Rational market players that have no market power must accommodate that expectation in order to win business.

Second, with a term commitment the provider is assured of revenue for a circuit for a minimum period of time and may therefore be assured that it will recoup its upfront costs and earn its expected margin over an extended period of time. Where there is no term commitment, the provider must recoup its costs up front or in the form of a higher monthly recurring charge than would be necessary for a circuit with a longer term commitment. Further, being assured of its expected margin over a longer, committed period generally justifies a lower monthly rate in exchange.

Third, because *Competitive Providers* are subject to competition in all locations in which they offer *Dedicated Services*, *Competitive Providers* generally experience a phenomenon known as "price compression" over time for each circuit the longer a particular buyer purchases it. This means that customers typically attempt to negotiate a lower price for their circuits during each renewal window for their services. Therefore, it is rational to expect that a circuit ordered for a longer term commitment will have a lower price per month.

In addition, customers expect, and Level 3 provides, lower unit prices for high-volume purchases. This is a market reality for *Competitive Providers*, and those providers must respond to this customer expectation in order to win business. Customers negotiating for the purchase of a high volume of services from *Competitive Providers* that lack market power typically have increased leverage related to the unit price for those services than lower-volume purchasers. In addition, where a single customer commits to purchasing a certain volume of services, the provider may incur somewhat lower administrative costs (for billing, sales and other internal functions) than it would if the same volume of business were being provided to several customers. This further justifies the existence of volume commitments in a competitive marketplace.

The term and volume commitments offered by *Competitive Providers* like Level 3 should not be confused with the ILEC "lock-up" arrangements. This anti-competitive ILEC practice is not based on the volume of circuits a CLEC buys but rather on the percentage (e.g., 95 percent) of the CLEC's overall, historic spend on circuits in a particular region. In return for committing a high percentage of its historic spend with the ILEC, the CLEC receives a discount off of the

ILEC's exorbitantly high month-to-month rate for *Dedicated Services* and/or *Non-Rate Benefits* like circuit portability. If the CLEC fails to meet the required purchase commitment, it faces a large penalty for any shortfall or early termination.

ILEC lock-ups bear no rational relationship with the ILEC's costs or the revenue being provided to the ILEC. Instead, their primary function is to prevent the CLEC's spend on *Dedicated Services*, no matter how large, from going to *Competitive Providers*. These requirements reduce demand elasticity, shrink the number of *Competitive Providers* that can enter or a market, and cause pricing for *Dedicated Services* to be higher than they would otherwise be. This is an inherently anti-competitive practice that bears no resemblance to the reasonable practice of Level 3 and other CLECs to offer efficiency-based term and volume commitments to customers in a competitive marketplace.