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REDACTED – FOR PUBLIC INSPECTION

February 5, 2016

<u>VIA ECFS</u>

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

Re: ***Investigation of Certain Price Cap Local Exchange Carrier Business Data Services Tariff Pricing Plans*, WC Dkt. No. 15-247;**
REDACTED – FOR PUBLIC INSPECTION

Dear Ms. Dortch:

On behalf of Birch Communications, Inc., BT Americas Inc., EarthLink, Inc., INCOMPAS, Integra Telecom, Inc., and Level 3 Communications, LLC (collectively, the "Joint CLECs"), I hereby submit the redacted version of the Joint CLECs' Opposition to the direct cases filed in response to the *Designation Order* in the above-referenced proceeding.[1] These redacted materials are being submitted pursuant to the terms of the *Business Data Services Data Collection Protective Order*[2] and the *Tariff Investigation Protective Order*[3] in effect in this

[1] *Investigation of Certain Price Cap Local Exchange Carrier Business Data Services Tariff Pricing Plans*, Order Initiating Investigation and Designating Issues for Investigation, 30 FCC Rcd. 11417 (2015).

[2] *Investigation of Certain Price Cap Local Exchange Carrier Business 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*, Order and Protective Orders, WC Docket Nos. 15-247 & 05-25, RM-10593, App. A (rel. Dec. 4, 2015).

[3] *Id.* at App. B ("*Tariff Investigation Protective Order*").

proceeding. Pursuant to the procedures outlined in the *Tariff Investigation Protective Order*, I have filed the original Highly Confidential version of this submission with the Secretary's Office and have provided two copies of the Highly Confidential version of this submission to Mr. Marvin Sacks in the Pricing Policy Division of the Wireline Competition Bureau under separate cover.

Please contact me at (202) 303-1111 if you have any questions regarding this submission.

Respectfully submitted,

/s/ Thomas Jones
Thomas Jones

Counsel for Birch, BT Americas, EarthLink, INCOMPAS, Integra, and Level 3

Attachments

REDACTED – FOR PUBLIC INSPECTION

Before the
Federal Communications Commission
Washington, D.C. 20554

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Investigation of Certain Price Cap Local Exchange Carrier Business Data Services Tariff Pricing Plans	)	WC Docket No. 15-247
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OPPOSITION OF
BIRCH, BT AMERICAS, EARTHLINK, INCOMPAS, INTEGRA,
AND LEVEL 3

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OPPOSITION OF
BIRCH, BT AMERICAS, EARTHLINK, INCOMPAS, INTEGRA,
AND LEVEL 3

Birch Communications, Inc., BT Americas Inc. ("BT Americas"), EarthLink, Inc. ("EarthLink"), INCOMPAS, Integra Telecom, Inc. ("Integra"), and Level 3 Communications, LLC ("Level 3") (collectively, the "Joint CLECs"), through their undersigned counsel, submit this Opposition to the Direct Cases of AT&T Inc. ("AT&T"),[1] CenturyLink,[2] Frontier Communications Corporation ("Frontier"),[3] and Verizon[4] (collectively, the "incumbent LECs") submitted in response to the *Designation Order*[5] in the above-referenced proceeding.

[1] Direct Case of AT&T, WC Docket No. 15-247 (filed Jan. 8, 2016) ("AT&T Direct Case").

[2] Direct Case of CenturyLink, WC Docket No. 15-247 (filed Jan. 8, 2016) ("CenturyLink Direct Case").

[3] Direct Case of Frontier Communications Corporation, WC Docket No. 15-247 (filed Jan. 8, 2016) ("Frontier Direct Case").

[4] Direct Case of Verizon, WC Docket No. 15-247 (filed Jan. 8, 2016) ("Verizon Direct Case").

[5] *Investigation of Certain Price Cap Local Exchange Carrier Business Data Services Tariff Pricing Plans*, Order Initiating Investigation and Designating Issues for Investigation, 30 FCC Rcd. 11417 (2015) ("*Designation Order*").

I. Introduction and Summary

For years now, the Commission has been concerned that incumbent LECs would use tariffed volume and term plans governing the sale of dedicated services ("lock-up plans") as a means of harming competition and consumer welfare. As the records in this investigation and the companion rulemaking demonstrate, this is exactly what has occurred. The Commission should therefore promptly rule that the incumbent LECs' lock-up plans are unlawful and adopt comprehensive remedies designed to address the far-reaching harm caused by these plans.

Section 201(b). The lock-up plans subject to this investigation are unjust and unreasonable in violation of Section 201(b) because they harm competition and undermine the transition from TDM to IP. Specifically, the lock-up plans exploit wholesale customers' need for circuit portability and discounts by offering these benefits on the condition that wholesale customers commit a high percentage of their past purchase levels for TDM-based dedicated services to the incumbent LECs. Once wholesale customers commit to these volumes, they find it very difficult to escape. High shortfall and early termination penalties prevent customers from, respectively, reducing their spend volumes during the terms of the plans and terminating their plans early. To the extent that a wholesale customer's demand for dedicated services increases during the life of the plan, upper percentage thresholds and overage penalties ensure that wholesale customers commit that increased demand to the incumbent LEC. Finally, long-term commitments under the lock-up plans ensure that demand is locked up for many years at a time, delaying even further the development of competition.

Because most wholesale demand in the relevant market is locked up in these plans, the addressable competitive wholesale market is small. This prevents providers of competitive wholesale services from building out their networks to the locations they might otherwise efficiently serve. When wholesale customers' lock-up plans expire, the dedicated services they lease from incumbent LECs are often subject to circuit-specific term commitments (and high early termination penalties) that extend long past the expiration of volume commitments in lock-up plans. Even where this is not the case, wholesale customers have little ability to switch to a non-incumbent LEC supplier because there are few commercial buildings where competitors have deployed loops. Wholesale customers also cannot wait for competitive wholesale providers to build out their networks because the costs that wholesale customers incur to lease dedicated services from incumbent LECs outside of lock-up plans are too high. They therefore have little alternative but to renew their lock-up plans with the incumbent LECs. The result is that wholesale competition never takes hold, and wholesale prices are set well above competitive levels.

The incumbent LECs also use the lock-up plans to control the technology transition. For years, the incumbent LECs forced wholesale customers to purchase TDM-based dedicated services when they would have preferred to purchase Ethernet. They did this by effectively preventing wholesale customers from counting Ethernet dedicated services toward their volume commitments under the lock-up plans. Now that they are at last ready to permit the technology transition to take hold in the market for business services, the incumbents have switched to using the lock-up plans as a means of capturing demand for wholesale Ethernet dedicated services. They do this by offering wholesale customers relief from shortfall penalties under their TDM plans in return for commitments to purchase large volumes of Ethernet services.

While these harms directly affect the wholesale market, they inevitably harm retail customers as well. The absence of wholesale competition leads to higher wholesale prices, which in turn necessarily results in higher retail prices. Similarly, the ability to control the technology transition in the wholesale market will also enable the incumbent LECs to largely dictate the technology transition as experienced by retail customers.

The data and information filed in this proceeding and the companion special access rulemaking proceeding support these conclusions. The Commission classifies the incumbent LECs as dominant in the provision of DS1 and DS3 services, and rightly so. **[BEGIN HIGHLY CONFIDENTIAL]**

[END HIGHLY CONFIDENTIAL] These facts mean that incumbent LECs have the incentive and ability to prevent wholesale competition from developing. **[BEGIN HIGHLY CONFIDENTIAL]**

[END HIGHLY CONFIDENTIAL]

[BEGIN HIGHLY CONFIDENTIAL]

[END HIGHLY CONFIDENTIAL] Finally, the commercial agreements filed in this proceeding indicate that the **[BEGIN HIGHLY CONFIDENTIAL]**

[END HIGHLY CONFIDENTIAL]

The Joint CLECs' individual experiences illustrate the harms caused by the incumbent LEC lock-up plans. As explained in the declarations of Gary Black of Level 3, Mark Jeary of EarthLink, and Douglas Denney of Integra, competitive LECs are usually unable to avoid signing up for a lock-up plan, and, once they sign up for a plan, they cannot exit the plan, reduce the volume of purchases under the plan, or even forgo signing up for a new plan after expiration of the old plan. The declarations also show that the need to meet volume commitments under lock-up plans prevents wholesale customers from purchasing lower-cost wholesale alternatives. [**BEGIN HIGHLY CONFIDENTIAL]**

[END HIGHLY CONFIDENTIAL] Finally, the declarations illustrate the manner in which the incumbent LECs have been inducing wholesale buyers to exchange some relief from unreasonable shortfall penalties under lock-up plans for commitments to purchase large volumes of Ethernet.

Section 202(a). The lock-up plans, and, in particular, the percentage commitments and upper percentage thresholds in the plans, are unjustly and unreasonably discriminatory in violation of Section 202(a) because they arbitrarily discriminate against large-volume customers. For example, under the percentage commitments, two customers that purchase the same percentage of their historic volumes from the incumbent LEC under a lock-up plan are eligible for the same percentage discount and circuit portability benefit even if the numbers of circuits they must purchase to receive these benefits are vastly different. There is no justification for this discrimination because it is based on the accident of a customer's historic purchase levels.

Incumbent LEC Attempts to Avoid Investigation. In their filings submitted in response to the *Designation Order*, the incumbent LECs focus primarily on arguing that the Commission should not examine the lock-up agreements at all. But their arguments in support of this claim have no merit.

The incumbent LECs assert that the Commission should not conduct this proceeding because it must first determine in the rulemaking proceeding whether the incumbents have market power. But the incumbent LECs are already classified as dominant in the provision of DS1 and DS3 services, and even a cursory review of the data demonstrates that the dominant classification is appropriate. The incumbent LECs' related argument that they are unable to leverage their control over connections to customers in remote locations to harm competition in urban areas is also incorrect because the incumbents are dominant throughout their territories, and the data supports this classification.

The incumbent LECs argue that wholesale customers cannot be locked up because the incumbent LECs are experiencing declines in DS1 sales. Far from showing that the lock-up plans are innocuous, the decline in DS1 sales has exposed wholesale buyers to ever-increasing shortfall penalties. The incumbent LECs are exploiting the threat of these penalties by coercing customers into signing up for Ethernet lock-up plans.

The incumbent LECs assert that the lock-up plans do not cover a sufficiently large portion of the "market" to have a harmful effect on competition. But these assertions ignore key market definition issues, such as the need to differentiate retail from wholesale sales, and the fact that each commercial building is a separate geographic market.

The incumbent LECs argue that the growth of competitive providers' Ethernet offerings indicates that competition is not harmed by the lock-up plans. But the volume of Ethernet sales is still small compared to the volume of TDM-based dedicated services sales. As the incumbent LECs exploit the unreasonable volume and shortfall penalties in their lock-up plans to coerce wholesale buyers into large volume commitments for Ethernet, they will dominate the wholesale market for those services as well. It is just a matter of time.

The incumbent LECs argue that wholesale customers' demand cannot be locked up because those customers purchase large volumes of unbundled network elements ("UNEs"). But UNE availability is limited. In the many locations and the many service contexts in which UNEs are unavailable, wholesale customers often have no choice but to purchase dedicated services as special access from incumbent LECs.

The incumbent LECs state that concerns about the lock-up plans reduce to concerns about the level of incumbent LEC month-to-month prices, which are not designated for investigation. But this is untrue. But his proceeding concerns the manner in which incumbent LECs have exploited wholesale customers' need for discounts and circuit portability. Nothing about the level of month-to-month prices compelled the incumbent LECs to adopt the terms of their lock-up plans.

The incumbent LECs argue that the lock-up plans are flexible, that wholesale customers have been free to decline to renew the plans, and that customers have headroom under the plans which allows them to purchase services from competitive LECs. But these assertions mischaracterize the effect of the plans by overstating customers' flexibility to purchase services from competitive carriers, by overlooking the harms customers experience when they do not renew their plans, by ignoring customers' need to eventually sign up for new volume plans, and by overstating customers' headroom.

The incumbent LECs protest that the terms of their lock-up plans must be reasonable because competitive LECs purportedly include the same provisions in agreements for the sale of dedicated services. But competitive LECs, unlike incumbent LECs, are not dominant in the provision of DS1 and DS3 dedicated services, so they are unable to harm competition. In any event, the record in this proceeding shows that competitive LECs do not in fact impose the same onerous terms on their customers.

The incumbent LECs repeat over and over that the D.C. Circuit's decision in *BellSouth v. FCC* to overturn a Commission decision holding that a special access volume discount plan violated the nondiscrimination provision in Section 272 somehow prevents the Commission from enforcing the requirements of Sections 201(b) and 202(a) here. But this is incorrect. The *BellSouth v. FCC* decision did not address whether discount plans are just and reasonable. Even as to discrimination, *BellSouth v. FCC* is largely irrelevant because the Section 272 prohibitions at issue there merely concerned discrimination in favor of the BOC or its affiliates, not discrimination between and among customers, as is the case under Section 202(a). And, unlike the prices under the plan at issue in *BellSouth*, it is not at all clear that that "discounted" prices available under the lock-up plans are set below the maximum level permitted by regulation.

The incumbent LECs also assert that antitrust precedent and the economic literature do not support the conclusion that the lock-up plans harm competition. But neither argument is correct. The antitrust precedent and the economic literature fully support the conclusion that a dominant firm can use volume plans like the lock-up plans to exclude competitors and harm competition.

Incumbent LEC Attempts to Justify the Terms of the Lock-Up Plans. When the incumbent LECs finally get around to suggesting justifications for the specific terms in the lock-up plans, it becomes all too clear why they do not want the Commission to investigate the plans. Frontier at least is honest. It makes no attempt to defend its plans, stating instead that it assumed the plans when it acquired local exchange assets from AT&T and Verizon. AT&T and Verizon candidly admit that they have no idea what the cost justifications are for the percentage commitments in their plans. Both incumbents stress that the plans were adopted a long time ago and much has changed since then, but this of course begs the question of how it could be that plans designed to be reasonable for a very different time could still be reasonable today.

The incumbents also offer up some slightly more dressed-up rationales, but they are completely unsubstantiated. For example, the incumbent LECs defend their percentage commitments as a means of compensating for circuit-specific early termination penalties that they do not collect when providing circuit portability and for other costs associated with implementing circuit portability. But the incumbents do not try to quantify these purported costs or to compare them to the extra profits they receive as a result of the volume commitments. Moreover, the percentage commitments contain numerous significant differences (*e.g.*, in the level and structure of the volume commitments) that incumbent LECs do not address, and that undermine their claims that all of the percentage commitment requirements are reasonable.

The incumbent LECs' defense of the shortfall penalties in their lock-up plans have no merit for similar reasons. The incumbents assert that the shortfall penalties compensate them for customers' failure to meet their volume commitments, but that is no defense given that there is no justification for the underlying volume commitments. In addition, as with the percentage volume commitments, there are key differences in the manner in which shortfall penalties are calculated between and among each incumbent LEC's plans. Again, these differences beg the question of how all of the shortfall penalties could be reasonable, a question the incumbents do not try to answer. The incumbents also fail to justify the harmful effects that shortfall penalties are having on the technology transition. This is a serious problem because, as discussed, declining demand for TDM-based dedicated services has increased wholesale customers' exposure to shortfall penalties, and has left them no choice but to commit to purchasing large volumes of Ethernet from incumbent LECs in return for relief from the penalties.

While upper percentage thresholds and overage penalties are no longer particularly significant given the decline in demand for TDM-based dedicated services, the incumbent LECs' defense of those terms is also without substance or merit. The incumbents claim that these provisions ensure that they are compensated for the costs associated with managing circuit portability for a larger volume of dedicated services and other costs. But, again, the incumbents believe that all they need to do is utter these magic words without offering anything in support. Unsupported theory must be rejected as a justification.

Nor have the incumbent LECs offered a basis for concluding that the long terms of their lock-up plans are reasonable. These terms have the effect of delaying a customer's opportunities to purchase lower-cost wholesale services by many years, thereby slowing the development of competition to a crawl. This is especially true of the Verizon CDPs, under which customers frequently sign up for DS1 commitments for *seven years*. Neither Verizon nor any of the incumbent LECs offers any basis for concluding that long terms are necessary to ensure the recovery the costs associated with administering circuit portability or any other relevant costs. In fact, the incumbents fail to explain why any term longer than a year, at most, is reasonable.

Finally, the incumbents fail to justify the early termination penalties in the lock-up plans. Given that these penalties are basically designed to enforce unreasonable and unsupported term commitments, they are obviously themselves unreasonable. Undeterred, the incumbents claim that term commitments and early termination penalties together ensure that incumbent LECs can plan for the volume of services customers will purchase. But given that the incumbents own the only connection to the vast majority of commercial buildings in the country, it is hard to see why they have trouble planning wholesale customers' need to lease dedicated services. The wholesale customers have no choice but to lease incumbent LEC dedicated services in most locations, so planning should not be a serious concern.

Remedies. In light of the foregoing discussion, the Commission should rule that the lock-up plans violate Sections 201(b) and 202(a) of the Communications Act. The Commission has a wide range of remedies to choose from to address these legal infirmities. The Commission could simply invalidate the volume commitments. Alternatively, it could rule that incumbent LECs may not require customers to commit to volumes in excess of 50 percent of their historic purchase volumes and that Ethernet purchases count toward such volume commitments. In addition, since customers have entered into contract tariffs and commercial agreements for dedicated services as a means of addressing the unreasonable and unreasonably discriminatory terms of the lock-up plans, the Commission should grant customers the right to terminate those contract tariffs and agreements, without incurring a penalty, anytime within 12 months of the effective date of the Commission's ruling in this proceeding. This "fresh look" will give customers the ability to re-establish their business relationships in light of the Commission's ruling. The Commission may need to consider additional appropriate remedies as well.

The Commission must also address the incumbents' disregard for both the requirements of Section 203 and the condition precedent for granting forbearance from dominant carrier regulation for Ethernet dedicated services. Under Section 203, incumbent LECs' tariffs must include all provisions "affecting" the incumbent LECs' charges for DS1 and DS3 dedicated services. **[BEGIN HIGHLY CONFIDENTIAL]**

[END HIGHLY CONFIDENTIAL] The Commission must therefore require that those commercial agreements be filed as tariffs, and the Commission should initiate enforcement proceedings to investigate the incumbent LECs' apparent willful and widespread violations of Section 203.

Finally, the Commission should rule that the incumbent LECs (except for Verizon) have relinquished their right to forbearance from dominant carrier regulation of non-TDM-based dedicated services such as Ethernet. The Commission conditioned the incumbent LECs' right to such forbearance on the incumbent LECs withdrawing their tariffs for the covered services. By entering into the commercial agreements, the incumbent LECs have included the rates, terms, and conditions governing their offers of non-TDM-based dedicated services encompassed by the forbearance orders in their tariffs. In so doing, they have failed to comply with the condition precedent for forbearance. The Commission should therefore rule that its prior grants of forbearance from dominant carrier regulation are no longer valid for all affected incumbent LEC services.

II. Incumbent LEC Lock-Up Plans Are Unlawful Under Sections 201(b) and 202(a) of the Communications Act

A. Incumbent LECs' Lock-Up Plans Are Unjust and Unreasonable Under Section 201(b)

The Commission has "consistently expressed concern about the potential of incumbent LEC tariffed pricing plans to harm competition."[6] For example, the Commission has long recognized that "the existence of certain long-term access arrangements . . . raises potential anticompetitive concerns since they tend to 'lock up' the access market, and prevent customers from obtaining the benefits of special access competition."[7] The Commission has further explained that: "[b]y 'locking in' customers with substantial discounts for long-term contracts and volume commitments before a new entrant that could become more efficient than the incumbent can offer comparable volume and term discounts, it is possible that even a relatively inefficient incumbent LEC may be able to forestall the day when the more efficient entrant is able to provide customers with better prices."[8]

The incumbent LECs' tariffed lock-up plans are unjust and unreasonable under Section 201(b) because they have precisely this anticompetitive effect.[9] The plans coerce wholesale

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[6] *Id.* ¶ 19.

[7] *Id.* (internal quotation marks and brackets omitted) (quoting *Expanded Interconnection With Local Telephone Company Facilities, Amendment of Part 69 Allocation of General Support Facility Costs*, Report and Order and Notice of Proposed Rulemaking, 7 FCC Rcd. 7369, ¶ 201 (1992) ("*Virtual Expanded Interconnection Order*").

[8] *Access Charge Reform, Price Cap Performance Review for Local Exchange Carriers, Transport Rate Structure and Pricing, Usage of the Public Switched Network by Information Service and Internet Access Providers*, Notice of Proposed Rulemaking, Third Report and Order, and Notice of Inquiry, 11 FCC Rcd. 21354, ¶ 190 (1996).

[9] Section 201(b) states, in relevant part, "[a]ll charges, practices, classifications, and regulations for and in connection with [interstate or foreign communication by wire or radio] shall be just

customers into purchasing a large proportion of their demand for DS1 and DS3 dedicated services from incumbent LECs. As a result, most potential wholesale customers that a competitive LEC might serve are locked up and unavailable as customers. Because of this, potential entrants intending to offer wholesale connections frequently cannot achieve the required minimum scale to compete at wholesale.[10] This enables incumbent LECs to maintain supracompetitive wholesale prices and likely supracompetitive retail prices as well.

Moreover, the incumbent LECs have used the lock-up plans to control the pace of the technology transition. For years, incumbent LECs stalled the transition to IP in most locations by effectively preventing wholesale customers from counting Ethernet dedicated services toward their volume commitments under the lock-up plans. Now, as the demand for TDM-based dedicated services is declining and incumbent LECs are finally ready to start rolling out Ethernet wholesale service, the incumbent LECs are using the threat of high shortfall penalties under the lock-up plans to coerce wholesale customers into overlay agreements that will lock up the wholesale Ethernet market.

1. The Lock-Up Plans Harm Competition and the Technology Transition

Anticompetitive effects. In their 2013 declaration, Drs. Stanley Besen and Bridger Mitchell explain how incumbent LECs induce competitors to sign up for tariffed lock-up plans

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and reasonable, and any such charge, practice, classification, or regulation that is unjust or unreasonable is declared to be unlawful.” 47 U.S.C. § 201(b).

[10] In this context, achieving sufficient scale often means winning enough revenues (perhaps from two or more wholesale customers) to justify the deployment of a new loop facility to a commercial building.

from which they cannot extricate themselves.[11] As Drs. Besen and Mitchell explain, dominant firms generally have an incentive to set undiscounted rates very high – even above monopoly levels – in order to cause competitors to agree to the discounted rates.[12] A dominant firm then locks customers into volume commitments by conditioning the availability of some relief from the exorbitant undiscounted rates on the customers' agreement to purchase large volumes of services.

Regulation affects the manner in which incumbent LECs act on these incentives. Incumbent LECs have the incentive to earn the maximum level of revenues permissible under price cap regulation while at the same time locking up the market to prevent the development of wholesale competition. To do this, they will set undiscounted rates at high levels (perhaps even at or above the monopoly level), and then set the "discounted" rate at a level that allows them to earn the maximum amount of revenue permitted under price caps (and given other market conditions such as price elasticity of demand). Of course, if a large number of customers were to actually pay the undiscounted rates, the incumbent LECs' revenues would likely exceed the limit allowed under price caps, and they would need to lower the undiscounted prices. But this is unlikely to occur because the undiscounted prices are so high that wholesale customers can

[11] Stanley M. Besen & Bridger M. Mitchell, Anticompetitive Provisions of ILEC Special Access Arrangements, ¶ 16 (Feb. 11, 2013) (*attached to* Comments of BT Americas, Cbeyond, EarthLink, Integra, Level 3, and tw telecom, WC Docket No. 05-25, RM-10593 (filed Feb. 11, 2013)) ("Besen & Mitchell").

[12] Reply Declaration of Joseph Farrell on Behalf of CompTel, (July 29, 2005) (*attached to* Reply Comments of CompTel, Global Crossing North America, Inc., and NuVox Communications, WC Docket No. 05-25, RM-10593, ¶ 4 (filed July 29, 2005)).

rarely pay them and compete in downstream retail markets with the incumbent LEC.[13] The incumbent LECs lock wholesale customers into volume commitments by conditioning the availability of some relief from the exorbitant undiscounted rates on the wholesale customers' agreement to purchase large volumes of dedicated services from the incumbent LECs over many years.[14]

While all of the lock-up plans conform to this basic model, they vary in their details. For example, Drs. Besen and Mitchell describe the way in which many of the plans exploit wholesale buyers' need for circuit portability by forcing them to make volume commitments.[15] Incumbent LECs offer substantially discounted monthly recurring charges and discounted or waived non-recurring charges to buyers that commit to purchasing individual circuits under term-only plans.[16] However, under these plans, customers that cease purchasing dedicated services prior to the expiration of their commitment terms incur extremely high circuit termination penalties.[17] Circuit termination penalties disproportionately harm wholesale buyers that use special access as

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[13] This may even be true in circumstances where the incumbent LEC is not subject to price cap regulation (because it has received Phase II pricing flexibility), to the extent that the threat of Commission intervention disciplines incumbent LEC prices, even where *ex ante* regulation has been eliminated.

[14] Competitive LECs have no choice but to purchase dedicated services from incumbent LECs because incumbent LECs own the only loop to most commercial buildings, and it is not possible for competitive LECs to deploy their own loops to most commercial buildings. Even where it is possible for a competitive LEC to deploy a loop to a commercial building, the customer often demands dedicated services at multiple locations, and competitive LECs usually cannot deploy loops to all or even most of the commercial buildings where the customer demands service.

[15] Besen & Mitchell ¶ 22.

[16] *See* Comments of BT Americas, Cbeyond, EarthLink, Integra, Level 3 and tw telecom, WC Docket No. 05-25, RM-10593, at 22 (filed Feb. 11, 2013) ("Joint CLEC 2013 Comments").

[17] *Id.* at 23.

inputs to downstream retail services.[18] This is because the wholesale buyers' retail customers typically purchase service for periods of time that are far shorter than the commitment terms of the incumbent LECs' term-only contracts.[19] Wholesale customers therefore frequently incur the high circuit termination penalties.[20]

The incumbent LECs provide "relief" from these penalties by offering plans that allow for circuit portability, but the Joint CLECs and other wholesale buyers cannot sign up for these plans without making significant volume commitments, often based on their historic or current purchase volumes.[21] Thus, wholesale buyers are presented with a Hobson's choice: either incur exorbitant circuit termination penalties under the incumbent LECs' term discount plans, or forfeit the flexibility to shift purchases to alternative suppliers by committing significant volumes of demand to the incumbent LECs under their tariffed lock-up plans. For most competitive carriers, the first of these is not a realistic option. This is because competitive carriers must rely on incumbent LEC dedicated services to reach most customer locations, and the early termination penalties are high enough and incurred frequently enough that the resulting costs

[18] *Id*. at 23-24.

[19] *Id*. at 24.

[20] *Id*. at 22-24.

[21] *See, e.g.*, Discount Commitment Plan of the Ameritech Operating Companies Tariff F.C.C. No. 2 § 7.4.13 ("Ameritech DCP") (customers must commit to purchasing 90 percent of their in-service DS1s for a term of either three or five years receive to circuit portability and discounted rates); Commitment Discount Plans of the Verizon Telephone Companies Tariff F.C.C. No. 1 § 25.1.3(A)(5) ("Verizon South CDP") & Verizon Tariff F.C.C. No. 11 § 25.1.3(A)(5) ("Verizon North CDP") (collectively "Verizon CDPs") (customers must agree to a percentage commitment level equal to 90 percent of the circuits in service with Verizon (measured in DS0 equivalents) for between two and seven years to receive circuit portability and discounted rates); Regional Commitment Program of the CenturyLink Operating Companies Tariff F.C.C. No. 11 § 7.1.3(B) ("CenturyLink RCP") (customers must commit 95 percent of their historic DS1 and DS3 spend for a four-year term to receive circuit portability and a 22 percent rate discount).

make it difficult to compete with the incumbent LECs in the provision of downstream retail services. Competitive LECs therefore almost invariably see no alternative but to sign up for circuit portability and the volume commitments that come with it.

As Drs. Besen and Mitchell have explained, incumbent LEC lock-up plans function like loyalty contracts in that they provide benefits to customers that purchase large proportions of current or historic purchase volumes for long periods of time and impose penalties on customers that shift demand to alternative suppliers.[22] Drs. Besen and Mitchell readily acknowledge that the incumbent LECs' lock-up plans do not explicitly require competitive LECs to make very large percentages of their purchases from incumbent LECs, but the lock-up plans' "*effect* is to condition discounts, or the avoidance of penalties, on this percentage."[23] Thus, the incumbent LECs' lock-up plans produce the same outcomes as loyalty contracts described in the economic literature.[24]

The penalties imposed under the incumbent LECs' lock-up plans increase the effective cost of purchasing dedicated services from competitive wholesale providers and function as a tax on the purchase of competitive wholesale offerings.[25] As a result, competitors' incentives to shift demand to alternative providers are significantly diminished, the addressable market available to alternative providers is reduced, prices for dedicated services remain at the high levels set by incumbent LECs, and effective competition cannot emerge.[26]

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[22] Besen & Mitchell ¶ 7.

[23] *Id*.

[24] *See id.* ¶¶ 7-10.

[25] *Id.* ¶ 14.

[26] *Id.* ¶¶ 10-11.

Provisions in the lock-up plans that establish and enforce volume commitments, in particular shortfall fees and early termination penalties, work together with other provisions like long-term commitments and overage penalties to achieve the harmful effects described above.[27] The threat of high shortfall penalties, imposed when customers fall below their committed volumes, deters competing wholesale providers from shifting demand to alternative providers[28] and **[BEGIN HIGHLY CONFIDENTIAL]**

[END HIGHLY CONFIDENTIAL] Customers cannot reduce their volume commitments while their lock-up plans are in effect or exit the plans altogether without being charged prohibitively high early termination penalties. Because the terms of the plans are quite long, usually between three and seven years in duration, there are few opportunities for competitive wholesalers to compete for the demand locked up in the plans.[29] And, under many tariffed lock-up plans, customers also are subject to very high overage penalties if their purchases exceed an upper percentage threshold; customers can avoid overage penalties only by increasing their commitment levels to account for overages, thereby locking up even greater volumes of demand.[30]

Wholesale buyers are also unable to shift demand to competitive wholesale providers after the expiration of an incumbent LEC's lock-up plan. This is due to several factors. *First*, a wholesale customer's dedicated services are sometimes subject to circuit-specific term

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[27] *Id*. ¶¶ 14-15.

[28] *Id*. ¶¶ 14-16.

[29] Joint CLEC 2013 Comments at 22-30.

[30] Besen & Mitchell ¶ 30.

commitments that extend well past the expiration date for the volume commitment the customer has made in order to receive circuit portability. Since the penalties for terminating the circuit-specific term commitments are often too high to enable the wholesale customer to justify switching to a competitive wholesaler, the lock-up effect extends past the end of the volume commitment.

Second, due in part to the incumbent LECs having locked up significant volumes of demand for dedicated services, competitive wholesale providers have deployed loop facilities only to a small percentage of commercial buildings.[31] As a result, wholesale buyers that purchase dedicated services under incumbent LEC lock-up plans are often unable to shift demand to competitive wholesale providers at many locations.

Third, even where dedicated services are available from alternative providers, a competitor must purchase dedicated services from an incumbent LEC at its exorbitant undiscounted rates until customers can be transitioned from the incumbent LEC's network to the competitive LEC's network. If a wholesale customer wishes to shift demand to a competitive LEC in a location where the competitor has not deployed facilities, it must purchase services from an incumbent LEC at undiscounted rates for an even longer time, because a competitive provider must deploy facilities and begin providing service before customers can be transitioned. This is an uneconomic proposition for most wholesale competitors. Accordingly, wholesale competitors often find that they have no choice but to renew their lock-up plans with the incumbent LECs, and when they do so, they are unable to reduce their purchase volumes.

[31] Joint CLEC 2013 Comments at 14-17.

To see the way the lock-up plans harm both wholesale and retail competition, it is helpful to consider possible realistic market scenarios. For example, if a potential entrant intending to offer wholesale connections cannot expect to achieve the minimum scale required for profitability, because most of the wholesale market is committed to incumbent LEC lock-up plan, the potential entrant will not find it profitable to invest in its own ring or loop facilities from an existing fiber ring. As a result, competitive entry is precluded, and the incumbent LEC is able to maintain its dominant position and continue to charge supracompetitive wholesale prices. As wholesale services are an input to providing retail services, supracompetitive wholesale prices can also lead to supracompetitive retail prices. In the extreme example, a monopoly incumbent LEC could raise wholesale prices high enough to preclude any competitive LEC from competitively providing retail services, thus establishing a monopoly in retail services as well (if facilities-based competitive LEC entry is also not profitable).

Even if wholesale entry by a competitive wholesale provider has already occurred, lock-up plans could harm competition. A wholesale customer may continue to purchase from the incumbent LEC rather than from a less expensive competitive wholesale provider, because of its volume commitment to the incumbent LEC. Purchasing from the competitive wholesale would raise the probability of a shortfall penalty. If shortfall penalties are onerous enough, and they usually are, the wholesale customer would find it more profitable to purchase the higher priced wholesale connection from the incumbent LEC. This discourages the wholesale customer from lowering retail prices, allowing the incumbent LEC to maintain supracompetitive retail prices.

Consider also the situation where there are two competitive LECs serving a particular building by leasing loops from the incumbent LEC under lock-up plans. Suppose that either competitive LEC would be willing to build its own new facility to serve that building at a cost lower than the cost it is currently incurring if it could sell wholesale service to the remaining competitive LEC. Yet neither competitive LEC would have the incentive to do so if each is locked into a pricing plan. Despite the fact that either competitive LEC could build a new facility and offer a lower price to the remaining competitive LEC to serve its customer, the remaining competitive LEC still may not purchase at this lower price because of the penalties it would incur from losing the connection as part of its pre-existing volume commitment to the incumbent LEC. As a result, neither competitive LEC builds. This allows the incumbent LEC to maintain higher wholesale and retail prices in the building, and allows it to maintain higher wholesale and retail prices in any other building that could have been served by an extension to the new facility, had either competitive LEC constructed one.

Technology transition. The incumbent LECs use their lock-up plans to control the industry transition from TDM to IP rather than allowing market forces to drive the transition. The incumbent LECs' lock-up plans contain provisions that are designed to suppress demand for Ethernet dedicated services, presumably because those services were thought to cannibalize revenues from the incumbent LECs' provision of TDM-based dedicated services. Some of the incumbent LECs' lock-up plans prevent customers from upgrading to Ethernet by expressly prohibiting Ethernet purchases from counting toward fulfillment of a volume commitment.[32] Other incumbent LEC lock-up plans include technology migration provisions that make it all but

[32] *See, e.g* Term Payment Plan of the Pacific Bell Telephone Company Tariff F.C.C. No. 1 § 7.4.18(B) ("PacBell TPP"); Term Payment Plan of the Southwestern Bell Telephone Company Tariff F.C.C. No. 73 § 7.2.22(E)(1) ("Southwestern Bell TPP") (collectively, "AT&T TPPs").

impossible for a buyer to count Ethernet purchases toward a volume commitment.[33] For example, the Verizon CDPs' technology migration provisions allow customers to apply only *existing* circuits upgraded to Ethernet toward their volume commitments, but Ethernet purchased at new customer locations does not contribute to the volume commitment. The CDPs' technology migration provisions also include additional conditions that limit their application and utility.[34] Similarly, under the CenturyLink RCP, a customer may count an Ethernet dedicated service toward its volume commitment only under conditions that most new Ethernet dedicated services purchases do not meet.[35]

As described further below, the incumbent LECs have begun to realize that they cannot contain demand for Ethernet dedicated services, and their incentives to do so have diminished as they have increasingly deployed their own Ethernet facilities. As a result, the incumbent LECs

[33] *See, e.g.*, Verizon South CDP §§ 2.9, 25.1.3(B)(1)(d); Verizon North CDP §§ 2.10, 25.1.3(B)(1)(d); DS1 Term Volume Plan of the Verizon Telephone Companies Tariff F.C.C. No. 14 §§ 2.10, 5.6.14(G) ("Verizon DS1 TVP").

[34] They require that (1) the commitment term for the new service is longer than the commitment term for the existing service, and (2) the upgrade satisfies one of two revenue tests. *See, e.g.*, Verizon South CDP §§ 2.9, 25.1.3(B)(1)(d); Verizon North CDP §§ 2.10, 25.1.3(B)(1)(d); Verizon DS1 TVP §§ 2.10, 5.6.14(G).

[35] *See* CenturyLink RCP §§ 7.1.3(B)(5)(c), 7.1.8(C) (permitting migration to higher speed services to count toward the commitment level without incurring termination liability, as long as all of the following conditions of the RCP Waiver Policy are met: (1) the customer agrees to a new pricing plan for the new services; (2) the customer may not discontinue service before the end of the minimum service period without incurring termination charges equal to 100 percent of the total monthly charges for the remaining months of the period; (3) the total value of the new service (not including nonrecurring charges and special construction) is equal to or greater than 115 percent of the remaining value of the existing pricing plan; (4) the order to disconnect the existing service and the order for the new service are received at the same time and both orders reference the application of the Waiver Policy; (5) the new service due date is on or before the due date of the disconnection of the old service, unless the installation is delayed by CenturyLink; (6) a new minimum service period applies to the new service; and (7) the customer agrees to pay all outstanding recurring and nonrecurring charges).

are exploiting the threat of shortfall penalties under their lock-up plans by offering some relief from those penalties in exchange for even larger volume commitments that include services such as Ethernet.

2. The Data and Information in the Record Confirm that the Lock-Up Plans Harm Competition and the Technology Transition

The data and information submitted by the incumbent LECs in response to the *Designation Order* and the data submitted in response to the mandatory data request in the special access rulemaking support the conclusion that the lock-up plans subject to investigation pose a serious threat to competition in the dedicated services market and to the technology transition. *First,* the Commission rightly classifies incumbent LECs as dominant in the provision of DS1 and DS3 services.[36] While there is no need to engage in a detailed market power analysis in this proceeding, it is worth noting that **[BEGIN HIGHLY CONFIDENTIAL]**

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[36] *Designation Order* ¶ 2.

Second, in acting on this incentive, the incumbent LECs are using the lock-up plans to capture wholesale demand for dedicated services. For example, the data filed in response to the *Designation Order* show that **[BEGIN HIGHLY CONFIDENTIAL]**

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[38] **[END HIGHLY CONFIDENTIAL]**

The data also show that **[BEGIN HIGHLY CONFIDENTIAL]**

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[37] *See* Appendix D.

[38] *See* Appendix E.

[39] *See id.*

[40] **[BEGIN HIGHLY CONFIDENTIAL]**
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Third, the data and information in the rulemaking proceeding and in this proceeding **[BEGIN HIGHLY CONFIDENTIAL]**

[41] *See* Appendix F.

[42] **[END HIGHLY CONFIDENTIAL]**

The commercial agreements filed in response to the *Designation Order* also provide an indication of the extent to which the incumbent LECs have exploited wholesale customers' exposure to shortfall penalties to lock up demand for wholesale Ethernet. **[BEGIN HIGHLY CONFIDENTIAL]**

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[42] *See* Appendix G.

As this description makes clear, the incumbent LECs are well on their way to taking control of the wholesale Ethernet market. If they are allowed to continue to do so, the incumbent LECs, rather than market forces, will dictate the pace of innovation and investment in the deployment of packet-based dedicated services for American businesses for years to come. The incumbent LECs' control over the wholesale market is causing serious harm to end-user customers, in the form of higher prices, reduced innovation, and reduced investment in business broadband services.

3. The Joint CLECs' Experiences Illustrate the Harmful Effects of the Lock-Up Plans on Competition and the Technology Transition

The Joint CLECs have experienced the harms caused by the lock-up plans. Those harms are described in detail in the declarations of Gary Black of Level 3, Mark Jeary of EarthLink, and Douglas Denney of Integra.[43]

Inability to escape lock-up plans. The competitive LECs' experiences demonstrate that wholesale customers have almost no choice but to commit to lock-up plans. Moreover, their experiences confirm that, once a competitive LEC has signed up for a lock-up plan, it is not generally possible for it to exit the plan, reduce its volume commitment during the plan, or even to forgo signing up for a new plan after the expiration of the plan.

[BEGIN HIGHLY CONFIDENTIAL]

[43] Declaration of Gary Black, Jr. on Behalf of Level 3 Communications, LLC, attached hereto as Appendix A ("Black Decl."); Declaration of Mark Jeary on Behalf of EarthLink Holdings Corp., attached hereto as Appendix B ("Jeary Decl."); Declaration of Douglas Denney on Behalf of Integra Holdings, Inc., attached hereto as Appendix C ("Denney Decl.").

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[END HIGHLY CONFIDENTIAL] it still would have to "sign up for term commitments on individual circuits in order to receive the discounts it needs to compete for downstream retail customers."[46] **[BEGIN HIGHLY CONFIDENTIAL]**

[END HIGHLY CONFIDENTIAL] EarthLink "would be subject to an early termination penalty each time its retail customer discontinues service prior to the expiration of the term commitment on a circuit," which would be a frequent occurrence.[47] Purchasing dedicated services on shorter terms or at **[BEGIN HIGHLY CONFIDENTIAL]**

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[44] **[BEGIN HIGHLY CONFIDENTIAL]**

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[45] **[BEGIN HIGHLY CONFIDENTIAL]** **]END HIGHLY CONFIDENTIAL]** ¶ 8.

[46] *Id.* ¶ 9.

[47] *Id.*

[END HIGHLY CONFIDENTIAL] undiscounted rates is not a viable option for EarthLink because doing so would force EarthLink to pass on to its customers the incumbent LECs' exorbitant rates, potentially causing EarthLink to lose customers to a competitor, most likely **[BEGIN HIGHLY CONFIDENTIAL]** **[END HIGHLY CONFIDENTIAL]** as Mr. Jeary observes.[48]

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[50] **[END HIGHLY CONFIDENTIAL]**

Though not operating as a competitive LEC, BT Americas has experienced many of the same harms as the competitive LECs. In order to obtain competitively tolerable rates for

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[48] *Id.*

[49] *Id.* ¶ 14.

[50] *Id.*

dedicated services from incumbent LECs, BT has had no alternative but to sign agreements with incumbent LECs' affiliates that commit BT Americas to purchasing very large volumes of dedicated services, and other services, both within the incumbent LEC territory and outside that territory. BT Americas has frequently failed to meet its volume commitments under its wholesale agreements with incumbent LECs' affiliates. It has also found that it is extremely difficult to purchase dedicated services from competitive LECs, because doing exposes BT Americas to steep shortfall penalties under the wholesale agreements.

Competitive LECs generally have little choice but to sign up for a new lock-up term plan soon after the expiration of a term. This inability to operate for extended periods of time outside of a lock-up plan is one of the main reasons why it generally is not possible for competitive LECs to reduce the volume of dedicated services they purchase from incumbent LECs. Doing so would require that the wholesale customer absorb the huge costs associated with early termination penalties during the extended period of time required for a wholesale competitor to deploy loop facilities to a significant number of new customer locations.

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[51] **[BEGIN HIGHLY CONFIDENTIAL] [END HIGHLY CONFIDENTIAL]** ¶ 8.

[52] **[END HIGHLY CONFIDENTIAL]** Mr. Denney also explains that Integra could not afford to wait for competitive LECs to build to serve its customers' locations. This is because, "in order to switch a large volume of dedicated services currently purchased from an incumbent LEC to competitive LECs after the expiration of an incumbent LEC volume commitment," a competitive LEC must "cease purchasing dedicated services under a plan with a volume commitment for the extended period of time it takes . . . to build facilities to the locations in question."[53] Integra could not sustain its business while purchasing dedicated services without the benefits of circuit portability. **[BEGIN HIGHLY CONFIDENTIAL]**

[54] **[END HIGHLY CONFIDENTIAL]**

Forgone purchases of lower-cost wholesale alternatives. The need to meet minimum volume commitments, enforced by high shortfall and early termination penalties, has caused competitive LECs to (1) forgo purchasing dedicated services from lower-cost competitive LECs and (2) forgo their legal right to purchase UNEs. The result is that wholesale prices for dedicated services are higher than would otherwise be the case. This in turn weakens competitors' ability to compete against incumbent LECs for downstream retail customers.

[BEGIN HIGHLY CONFIDENTIAL]

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[52] *Id.*

[53] *Id.* ¶ 13.

[54] *Id.* ¶ 8.

[END HIGHLY CONFIDENTIAL] He states that "EarthLink's efforts to meet its volume commitment under the **[BEGIN HIGHLY CONFIDENTIAL]** **[END HIGHLY CONFIDENTIAL]** . . . negatively impact network grooming and savings initiatives by preventing EarthLink from moving existing circuits from the incumbent LEC to an alternate wholesale provider."[55]

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[55] **[BEGIN HIGHLY CONFIDENTIAL]** **[END HIGHLY CONFIDENTIAL]** ¶ 10.

[56] *Id.*

[57] *Id.*

[58] *Id.* ¶ 15.

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[59] *Id.* ¶ 13.

[60] *Id.*

[61] *Id.* ¶ 12.

[62] *Id.*

[63] **[BEGIN HIGHLY CONFIDENTIAL]** **[END HIGHLY CONFIDENTIAL]** ¶ 11.

[64] *Id.*

[65] **[END HIGHLY CONFIDENTIAL]**

In addition, lock-up plans have caused Level 3 to forgo purchasing large volumes of dedicated services from competitive wholesale providers. For example, **[BEGIN HIGHLY CONFIDENTIAL]**

[END HIGHLY CONFIDENTIAL], Level 3 purchases dedicated services from **[BEGIN HIGHLY CONFIDENTIAL]** **[END HIGHLY CONFIDENTIAL]** in locations where it would prefer to purchase those services from competitive LECs.[66] In particular, "Level 3 pays **[BEGIN HIGHLY CONFIDENTIAL]** **[END HIGHLY CONFIDENTIAL]** approximately $103 million per year for dedicated services at the locations where competitive LECs have offered to serve Level 3, but Level 3 would only pay competitive carriers approximately $86 million per year for those same dedicated services."[67] Because the penalties that Level 3 would incur by switching providers would far exceed these potential savings, Level 3 has "forgone purchasing dedicated services from competitive LECs at the locations in question."[68]

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[65] *Id.*

[66] Black Decl. ¶ 19.

[67] *Id.* ¶ 16.

[68] *Id.*

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[70] **[END HIGHLY CONFIDENTIAL]**

Purchase of unused circuits. Lock-up plans have even caused competitive LECs to purchase dedicated services as special access that they do not use to serve customers in order to meet the volume commitments. **[BEGIN HIGHLY CONFIDENTIAL]**

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[69] *Id.* ¶ 17.

[70] *Id.*

[71] **[BEGIN HIGHLY CONFIDENTIAL]** **[END HIGHLY CONFIDENTIAL]** ¶ 7.

[72] *Id.*

[73] *Id.*

[74] **[END HIGHLY CONFIDENTIAL]**

Harm to the technology transition. The Joint CLECs have experienced the detrimental effects of the incumbent LECs' use of their lock-up plans to control the transition to the more efficient IP-based technologies that business customers increasingly demand. For years, competitive LECs have had little ability to count Ethernet purchases toward volume commitments under the incumbent LECs' lock-up plans. **[BEGIN HIGHLY CONFIDENTIAL]**

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[74] *Id.*

[75] **[BEGIN HIGHLY CONFIDENTIAL]**

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[76] **[BEGIN HIGHLY CONFIDENTIAL]** **[END HIGHLY CONFIDENTIAL]** ¶ 29.

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The CenturyLink RCP also includes a technology migration provision that inhibits **[BEGIN HIGHLY CONFIDENTIAL]** **[END HIGHLY CONFIDENTIAL]** ability to purchase Ethernet dedicated services. The RCP permits a customer to count an Ethernet dedicated service toward its volume commitment only if it meets conditions that most new Ethernet dedicated services purchased by competitive carriers do not meet.[79] As a result, competitive LECs purchase TDM-based services under the RCP in order meet their volume commitments when they would much prefer to purchase Ethernet.[80] **[BEGIN HIGHLY CONFIDENTIAL]**

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[77] **[BEGIN HIGHLY CONFIDENTIAL]**

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[78] **[BEGIN HIGHLY CONFIDENTIAL]** **[END HIGHLY CONFIDENTIAL]**.

[79] CenturyLink RCP §§ 7.1.3(B)(5)(c), 7.1.8(C); *see also supra* note 35.

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[83] **[END HIGHLY CONFIDENTIAL]**

As explained, some of the incumbent LECs have apparently determined that they are ready to allow the transition from TDM-based dedicated services to Ethernet to move forward, but only on the condition that they dominate the business. As Mr. Black explains, "the incumbent LECs have gradually shifted from stunting the migration from DSn to Ethernet dedicated services . . . to seeking to use new volume commitments in overlay agreements to lock up the market for Ethernet dedicated services."[84]

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[81] **[BEGIN HIGHLY CONFIDENTIAL]** **[END HIGHLY CONFIDENTIAL]** ¶ 7.

[82] *Id.*

[83] *Id.*

[84] Black Decl. ¶ 31.

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86 **[BEGIN HIGHLY CONFIDENTIAL]**

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87 *Id.* ¶ 8.

88 **[BEGIN HIGHLY CONFIDENTIAL]**

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[90] **[BEGIN HIGHLY CONFIDENTIAL] [END HIGHLY CONFIDENTIAL]**

[91] **[BEGIN HIGHLY CONFIDENTIAL] [END HIGHLY CONFIDENTIAL]** ¶ 9.

[92] *Id.* ¶¶ 9-10.

[93] *Id.* ¶ 10.

[94] *Id.*

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[95] *Id.* ¶ 21.

[96] *Id.*

[97] *Id.*

[98] *Id.* ¶ 10.

[99] *Id.*

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[100] **[BEGIN HIGHLY CONFIDENTIAL]**

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[101] **[BEGIN HIGHLY CONFIDENTIAL]** **[END HIGHLY CONFIDENTIAL]** ¶¶ 15-16.

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[104] **[END HIGHLY CONFIDENTIAL]**

B. Incumbent LEC Tariffed Lock-Up Plans are Unjustly and Unreasonably Discriminatory under Section 202(a)

Section 202(a) of the Communications Act prohibits the incumbent LECs from engaging in unjust or unreasonable discrimination.[105] The provisions states that it is

> unlawful for any common carrier to make any unjust or unreasonable discrimination in charges, practices, classifications, regulations, facilities, or services for or in connection with like communication service, directly or indirectly, by any means or device, or to make or give any undue or unreasonable preference or advantage to any particular person, class of persons, or locality, or to subject any particular person, class of persons, or locality to any undue or unreasonable prejudice or disadvantage.[106]

An inquiry into whether a carrier is discriminating in violation of Section 202(a) requires consideration of "(1) whether the services are 'like'; (2) if they are, whether there is a price

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[102] *Id.* ¶ 18.

[103] *Id.*

[104] *Id.*

[105] 47 U.S.C. § 202(a).

[106] *Id.*

difference between them; and (3) if there is, whether that difference is reasonable."[107] Likeness "depends upon 'functional equivalence.'"[108] In applying this test, the Commission "look[s] to the 'nature of the services offered' and ascertain[s] whether customers view them as performing the same functions. If a user perceives the service 'as the same with cost considerations being the sole determining criterion,' then the services are 'like.'"[109] It should be noted that Section 202(a) prohibits "any unreasonable discrimination in charges," which includes non-price features of charges.[110]

There can be no dispute that the dedicated services subject to percentage commitments and upper percentage thresholds in the incumbent LECs' lock-up plans are "like" services. Under these provisions, each wholesale customer essentially commits to purchasing a volume of DS1 and/or DS3 services. The DS1 and DS3 dedicated services that each wholesale customer must purchase pursuant to these provisions are identical in terms of engineering and service level commitments. Wholesale customers unquestionably perceive all DS1s offered by an incumbent LEC as offering the same function and all DS3s offered by an incumbent LEC as providing the same function. The DS1s and DS3s are also offered to the wholesale customers in exactly the same geographic areas, defined by the incumbent LEC tariffs.

Application of the minimum and upper percentage volume commitments results in differential treatment of customers depending on their historic purchase levels. As Drs. Besen

[107] *Competitive Telecomms. Ass'n v. FCC*, 998 F.2d 1058, 1061 (D.C. Cir. 1993).

[108] *Id.*

[109] *Id.* (quoting *MCI Telecomms. Corp. v. FCC*, 917 F.2d 30, 39 (D.C. Cir. 1990)).

[110] *Id.* at 1062 ("An unreasonable 'discrimination in charges'. . . can come in the form of a lower price for an equivalent service or in the form of an enhanced service for an equivalent price.").

and Mitchell have explained, two wholesale customers that purchase the same percentage of their respective historic volumes from an incumbent LEC under a lock-up plan are eligible for the same percentage discount and other benefits, even if the numbers of circuits that they must purchase to meet the commitment are vastly different.[111] Alternatively, two other wholesale customers that purchase the same number of circuits are eligible for vastly different discounts and benefits if their historic purchase levels are different.[112] This is because a customer that has historically purchased a large volume of circuits but nevertheless cannot reach the lock-up plan's percentage commitment level will have to purchase a great many more circuits to meet that level, while a customer that has historically purchased a relatively small number of circuits may only need to purchase a few extra circuits to reach the percentage commitment level.[113]

In addition, the incumbent LECs' lock-up plans require purchasers to maintain dramatically different volume commitments in different geographic areas. For example, Verizon provides circuit portability in legacy Bell Atlantic and NYNEX territories only to customers that commit to maintaining 90 percent of their historic purchase volumes under the CDPs, whereas in legacy GTE territory, Verizon provides circuit portability under the DS1 TVP to customers that commit to purchasing a fixed quantity of circuits that is not based on historic purchase volume.

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[111] Besen & Mitchell ¶ 41.

[112] *Id.*

[113] *See* Letter from Thomas Jones, Counsel for Cbeyond, et al., to Marlene Dortch, Secretary, FCC, WC Docket No. 05-25, RM-10593, at 3 (Oct. 28, 2014) ("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)." (internal citations omitted)).

Upper percentage thresholds in the incumbent LECs' lock-up plans also are discriminatory because, although the same percentage threshold applies to all customers, the volume of circuits required to meet the threshold varies widely across customers, creating a disparate application of ratcheting provisions. For example, two wholesale customers that receive the same discount and other benefits under a lock-up plan are exposed to the same ratcheting provision, even if the numbers of circuits that they purchase are vastly different. Alternatively, where two other customers purchase the same number of circuits but have different historic purchase commitment levels, it is possible that one customer could exceed the upper percentage threshold and be forced to ratchet up its commitment level, while the other customer does not exceed the upper percentage threshold and is not exposed to the ratchet.

These forms of discrimination are unjust and unreasonable because they are based on arbitrary differences in customers' historic purchase volumes and on the incumbent LEC territories in which wholesale customers operate. In addition, as discussed below, the incumbent LECs have failed to articulate a single credible efficiency justification for the percentage commitments and upper percentage thresholds in their lock-up plans. The Commission should therefore rule that the percentage commitments and upper percentage thresholds are unlawful under Section 202(a).

III. The Incumbent LECs' Attempts to Justify Their Volume and Term Plans in Their Direct Cases Are Without Merit

A. Incumbent LECs' Attempts to Avoid an Investigation of the Lock-Up Plans Should be Rejected

In their Direct Cases, the incumbent LECs make numerous arguments that reduce to the claim that the Commission should not actually consider the issues discussed in the *Designation*

Order. These arguments are essentially elaborate attempts at diversion and obfuscation, and have no merit.

Incumbent LEC market power. The incumbent LECs argue that there is no need to conduct this investigation because the special access marketplace is robustly competitive.[114] That assertion is both irrelevant and incorrect. The question of incumbent LEC market power is irrelevant because the incumbent LECs are already classified as dominant in the provision of DS1 and DS3 dedicated services. In fact, the Commission began its discussion of the lock-up plans in the *Designation Order* by recognizing this fact.[115] It then considered and rejected Verizon's argument that it must complete the review of the special access market in the companion rulemaking proceeding before conducting the instant investigation.[116] It follows that the incumbent LECs' (futile) attempts to show that they lack market power in the provision of DS1 and DS3 dedicated services must be made in the rulemaking proceeding, not in this tariff investigation.

The Commission had good reason to adopt this approach. It has on numerous occasions during the recent past considered and, with rare and extremely limited exceptions, rejected incumbent LEC arguments that the level of competition in the provision of DS1 and DS3

[114] AT&T Brief at 9; CenturyLink Direct Case, CenturyLink White Paper on Discount Plan Terms & Conditions, WC Docket No. 15-247, at 3, 32 (filed Jan. 8, 2016) ("CenturyLink White Paper"); Verizon Direct Case at 18-23.

[115] *Designation Order* ¶ 2.

[116] *Id.* n.27 ("We accordingly disagree with Verizon's recent suggestion that a review of these plans prior to a complete analysis of the special access data collection would 'jump the gun' with respect to that separate rulemaking proceeding.").

dedicated services justifies eliminating rate regulations from those services.[117] Nevertheless, just to be safe, the Commission went a step further and conducted a preliminary review of the special access data to ensure that there is no indication that the market has become competitive. It found nothing of the kind. As the Commission explained in the *Designation Order*, the "preliminary results from the Commission's data collection show that incumbent LECs remain the sole facilities-based providers of TDM-based special access services to a majority of business locations that demand or are likely to demand business data services nationwide."[118] This control over bottleneck facilities at a large number of business customer locations gives the incumbent LECs both the incentive to utilize lock-up plans to stave off competition and the ability to do so. Especially in light of this evidence, it is entirely reasonable for the Commission to conduct this proceeding now, rather than wait for the conclusion of the rulemaking proceeding.

While this is not therefore the place for a full discussion of market power, it is at least worth reiterating that the record in the special access rulemaking confirms the Commission's initial findings in the *Designation Order*. As Dr. Baker has explained in his declaration filed in

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[117] *See Petition of Qwest Corporation for Forbearance Pursuant to 47 U.S.C. § 160(c) in the Phoenix, Arizona MSA*, Memorandum Opinion & Order, 25 FCC Rcd. 8622, ¶¶ 71-72, 87 (2010); *Petitions of the Verizon Telephone Companies for Forbearance Pursuant to 47 U.S.C. § 160(c) in the Boston, New York, Philadelphia, Pittsburgh, Providence and Virginia Beach MSAs*, Memorandum Opinion and Order, 22 FCC Rcd. 21293, ¶ 38 (2007); *Petitions of Qwest Corp. for Forbearance Pursuant to 47 U.S.C. § 160(c) in the Denver, Minneapolis, St. Paul, Phoenix and Seattle MSAs*, Memorandum Opinion and Order, 23 FCC Rcd. 11729, ¶ 23 (2008). In fact, the incumbent LECs have more recently largely abandoned this line of argument, opting instead to concede their dominant status while trying to preserve the now-suspended pricing flexibility rules. *See* Comments of AT&T Inc., WC Docket No. 05-25, RM-10593, at 10-18 (filed Feb. 11, 2013).

[118] *Designation Order* ¶ 4.

the rulemaking proceeding on behalf of Level 3, XO, and Windstream, and as the Joint CLECs further demonstrated in their comments, incumbent LECs continue to have substantial and persisting market power in the provision of all dedicated services, including DS1 and DS3 services.[119]

Declining demand for TDM-based services. The incumbent LECs argue that the Commission should ignore the terms of the lock-up plans because sales of TDM-based dedicated services are declining.[120] While it is true that such sales are declining, the volume of TDM-based dedicated services sold continues to be enormous. For example, the Commission's preliminary analysis of its special access data collection demonstrates that revenues from TDM-based services comprise approximately 60 percent of the roughly $40 billion annual market for special access dedicated services.[121] Millions of American businesses continue to rely on DS1 and DS3 services for communications needs.

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[END HIGHLY CONFIDENTIAL] In addition, as

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[119] *See* Declaration of Dr. Jonathan B. Baker on Market Power in the Provision of Dedicated (Special Access) Services, ¶ 107 (Jan. 22, 2016) (attached to Letter from Dr. Jonathan B. Baker, to Marlene H. Dortch, Secretary, FCC, WC Docket No. 05-25, RM-10593 (filed Jan. 27, 2016)); Comments of Birch Communications, Inc., BT Americas Inc., EarthLink, Inc., and Level 3 Communications, LLC, WC Docket No. 05-25, RM-10593, at 48-49 (filed Jan. 27, 2016) ("Joint CLEC Comments").

[120] *See, e.g.*, AT&T Brief at 10; CenturyLink White Paper at 2; Verizon Direct Case at 23.

[121] *Designation Order* ¶ 2.

[BEGIN HIGHLY CONFIDENTIAL] **[END HIGHLY CONFIDENTIAL]** experiences illustrate, the lock-up plans make it extremely difficult for buyers to reduce the number of DS1 dedicated services they purchase as special access.

Moreover, as also explained above, the incumbent LECs have exploited the combined effects of declining purchases of TDM-based dedicated services and large shortfall penalties under the lock-up plans as a means of extending their lock-up strategy to Ethernet. As **[BEGIN HIGHLY CONFIDENTIAL]** **[END HIGHLY CONFIDENTIAL]** the harms caused by this lock-up strategy are very real.

Market definition. The incumbent LECs argue that the lock-up plans cannot have a harmful effect on competition because the plans cover only a small portion of the "market."[122] But in making this argument, the incumbent LECs incorrectly assume that the "market" includes every customer location, includes both retail and wholesale services, and includes every variety of dedicated service, whether it be DS1s or Ethernet connections of one Gbps or more. This is obviously incorrect. Any serious attempt to measure the effect of the lock-up plans would need to account for the fact that every commercial building is a separate relevant geographic market, that the wholesale market must be analyzed separately from the retail market, and that customers that demand, for example, low-capacity DS1 services do not view much higher capacity dedicated services (*e.g.*, on Gbps Ethernet) as substitutes for DS1s.

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[122] *See* AT&T Brief at 10-15; CenturyLink White Paper at 5-9; Verizon Direct Case at 18-23. AT&T makes this argument in numerous ways. *See, e.g.*, AT&T Brief at 14-15; AT&T Direct Case, Attachment 1, Declaration of Paul Reid, WC Docket No. 15-247, ¶ 21 (filed Jan. 8, 2016) ("Reid Decl.").

Ethernet deployment. AT&T, Verizon, and CenturyLink assert that their lock-up plans cannot be harming competition because there are dozens of non-incumbent LEC Ethernet providers.[123] This too is incorrect. **[BEGIN HIGHLY CONFIDENTIAL]** **[END HIGHLY CONFIDENTIAL]** But as the volume of Ethernet dedicated services sold increases and the volume of TDM-based dedicated services sold declines, the incumbent LECs will increasingly be able to utilize the unreasonably restrictive terms of their plans to lock up demand for wholesale Ethernet dedicated services. As **[BEGIN HIGHLY CONFIDENTIAL]** **[END HIGHLY CONFIDENTIAL]** the incumbent LECs have unquestionably begun to implement this strategy.

There is little doubt that the incumbent LECs will successfully implement this strategy if the Commission does not intervene to prevent this outcome. Ethernet can generally only be provided via a wireline connection, and incumbent LECs own the only wireline connection to the vast majority of commercial buildings in their territories. Upgrading electronics from TDM to Ethernet is relatively inexpensive, as compared to deploying loop facilities. It is therefore highly likely that the incumbent LECs will own the only Ethernet loop facilities to the vast majority of locations in their territories. The incumbent LECs' market share will therefore likely grow quickly over the next few years. As with TDM-based dedicated services, competitive LECs will

[123] AT&T Brief at 12; Verizon Direct Case at 18-19; CenturyLink White Paper at 11-16. As is invariably the case when incumbent LECs cite Ethernet market share numbers, the information is essentially useless for purposes of analyzing effects on competition because the incumbent LECs do not differentiate between locations that competitors serve via incumbent LEC dedicated services and locations that competitive LECs serve via their own facilities.

need to lease Ethernet services from the incumbent LECs in order to serve the many locations that they cannot reach with their own loop facilities. In order to obtain discounts off of the incumbent LECs' high standard prices for Ethernet, competitors will continue to sign up for volume lock-up plans, and the incumbent LECs will dominate the wholesale market for Ethernet and stifle competition just as they have in the wholesale TDM-based dedicated services market.[124]

Availability of UNEs. AT&T incorrectly asserts that its lock-up plans do not harm competitive LECs because competitive LECs have been able to purchase hundreds of thousands of DS1 UNE loops *in lieu* of special access.[125] While it is true that UNE loops are not included in the plans at issue here, and therefore theoretically could provide some relief to competitive LECs trapped in a lock-up plan, there are many, many locations and circumstances in which UNEs are unavailable or where competitive LECs cannot use them.[126] Where this is the case, competitive LECs must purchase special access. That is, the availability of a UNE at one location or for the provision of a service in one relevant product market does not have any bearing on AT&T's ability to leverage its market power over special access in a different location or for services in different relevant product markets in which UNEs are unavailable.

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[124] Joint CLEC Comments at 51.

[125] AT&T Brief at 13. AT&T elsewhere makes essentially the same point when it states that in the "vast majority" of cases competitive LECs purchase "services" (Ethernet, UNEs, and DS1s under other tariffed agreements) without any percentage commitment. *Id.* at 42. AT&T also claims that, as a result, competitive LECs have plenty of headroom; their true complaint is that they cannot shift demand away when their portability plans expire. *Id*. AT&T is at least correct that it is often impossible for competitive LECs to shift demand away when their portability plans expire, as explained in more detail below.

[126] *See* Joint CLEC Comments at 25 (describing the many circumstances in which competitive LECs cannot use UNEs).

This is one of the reasons why competitive LECs purchase so many dedicated services as special access rather than as UNEs. Moreover, as explained above in Section II.A.3, **[BEGIN HIGHLY CONFIDENTIAL]**

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Incumbent LECs' month-to-month rates. Verizon attempts to convince the Commission that it should not be concerned about the incumbent LECs' tariffed lock-up plans at all because competitive LECs "are really complaining that month-to-month rates are too high," and those rates will be considered in the special access rulemaking proceeding.[127] This too is incorrect. This investigation concerns the manner in which the incumbent LECs have exploited wholesale customers' need for circuit portability and discounts in order to impose unreasonable and discriminatory terms that harm competition in the wholesale marketplace, the technology transition, and consumer welfare. The incumbent LECs' conduct in this regard is independent of their month-to-month rates, and the Commission can analyze these effects without the need to address the month-to-month rates themselves. Indeed, the incumbent LECs' decision to include harmful provisions in lock-up tariffs was entirely independent of the levels they chose for month-to-month rates. For example, nothing about the month-to-month rates prevented the incumbent LECs from establishing lower (or no) percentage volume commitments, lower shortfall penalties, and lower early termination penalties in their lock-up plans.

Competitive LEC decisions not to renew lock-up plans. The incumbent LECs seize upon the rare circumstances in which competitive LECs have chosen not to renew their lock-up

[127] Verizon Direct Case at 13-14.

plan commitments as purported evidence that the plans do no harm. This is not so. As explained, the competitive LECs have generally found it to be impossible to compete without subscribing to a lock-up plan. **[BEGIN HIGHLY CONFIDENTIAL]**

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[128] **[BEGIN HIGHLY CONFIDENTIAL]**

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[129] *See* **[BEGIN HIGHLY CONFIDENTIAL]** **[END HIGHLY CONFIDENTIAL]** ¶ 11.

[130] *See id.* ¶ 12.

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[131] *Id.*

[132] *Id.*

[133] *Id.*

[134] *Id.*

[135] *Id.*

[136] *Id.*

[137] **[END HIGHLY CONFIDENTIAL]**

Headroom. AT&T argues that its lock-up plans are not harmful because they are flexible (they either provide portability or allow for the equivalent of portability)[138] and customers purportedly have headroom.[139] But AT&T's lock-up plans make it difficult, if not impossible, for customers to switch to buying dedicated services from competitive providers, and wholesale buyers have less headroom than AT&T indicates.

First, as explained above, **[BEGIN HIGHLY CONFIDENTIAL]** **[END HIGHLY CONFIDENTIAL]** lock-up plans have in fact prevented Level 3 from purchasing approximately $103 million per year for dedicated services at locations where competitive LECs have offered to serve Level 3. Level 3 needed to forgo these purchases because of the commitments it made **[BEGIN HIGHLY CONFIDENTIAL]**

[140] **[END HIGHLY CONFIDENTIAL]**

Second, AT&T misrepresents the extent to which wholesale buyers have headroom. For example, AT&T states that **[BEGIN HIGHLY CONFIDENTIAL]**

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[137] *Id.*

[138] AT&T Brief at 20-21.

[139] *Id.* at 21; Reid Decl. ¶ 22. "Headroom" refers to the difference between the customer's actual purchase volume and the purchase volume required to avoid a shortfall to avoid a shortfall penalty.

[140] **[BEGIN HIGHLY CONFIDENTIAL]** **[END HIGHLY CONFIDENTIAL]** ¶ 18.

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[141] **[BEGIN HIGHLY CONFIDENTIAL] [END HIGHLY CONFIDENTIAL]** ¶ 24 Tbl. 2.

[142] **[BEGIN HIGHLY CONFIDENTIAL] [END HIGHLY CONFIDENTIAL]**

[143] **[BEGIN HIGHLY CONFIDENTIAL] [END HIGHLY CONFIDENTIAL]**

[144] **[BEGIN HIGHLY CONFIDENTIAL] [END HIGHLY CONFIDENTIAL]** ¶ 8.

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[148] **[END HIGHLY CONFIDENTIAL]**

Ability to Switch Providers During or Between Plans. The incumbent LECs make a series of claims in a vain attempt to show that the lock-up plans enable buyers to reduce their purchase volumes during a plan or after the expiration of a plan's term.[149] However, the reality

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[145] *See id.* ¶¶ 6-7.

[146] **[BEGIN HIGHLY CONFIDENTIAL]** **[END HIGHLY CONFIDENTIAL]**

[147] **[BEGIN HIGHLY CONFIDENTIAL]** **[END HIGHLY CONFIDENTIAL]** ¶ 6.

[148] **[BEGIN HIGHLY CONFIDENTIAL]** **[END HIGHLY CONFIDENTIAL]** ¶ 19.

[149] *See* AT&T Brief at 25 (claiming that buyers have an opportunity to lower their volume commitments upon the expiration of AT&T's three-year plans); Verizon Direct Case at 37 (asserting that potential customers can control the amount of dedicated services they are required to purchase under a lock-up plan by "switching purchases to other providers or to self-

is that wholesale customers have only a very limited ability to reduce the volume of dedicated services they purchase from incumbent LECs during the life of a plan or during the period after expiration and before signing up for a new plan.

As Mr. Jeary observes, it is exceedingly difficult to shift a significant volume of dedicated services to an alternative provider during the life of a plan because "the incumbent LECs' lock-up plans impose such onerous shortfall penalties that EarthLink must rely on incumbent LEC facilities to serve new customer locations, even when it would otherwise have the ability to purchase dedicated services from competitive LECs."[150] **[BEGIN HIGHLY CONFIDENTIAL]**

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provisioned circuits before signing up [for a Verizon plan]"); *id.* at 37-38 (claiming that the minimum volume thresholds in its lock-up plans facilitate transition planning by allowing purchasers to reduce their purchase volumes below 100 percent of a commitment level, and, therefore, to shift demand to other sources during a plan term).

[150] Jeary Decl. ¶ 22.

[151] **[BEGIN HIGHLY CONFIDENTIAL] [END HIGHLY CONFIDENTIAL]**

[152] **[BEGIN HIGHLY CONFIDENTIAL] [END HIGHLY CONFIDENTIAL]**

[153] **[END HIGHLY CONFIDENTIAL]**

Nor is it generally possible to divert significant volumes of dedicated services to a competitive LEC after the expiration of a lock-up plan and before signing up for a new plan. **[BEGIN HIGHLY CONFIDENTIAL]**

[END HIGHLY CONFIDENTIAL] The Joint CLECs' experiences are consistent with these findings. Competitive LECs often find it impossible to reduce their volume commitments to incumbent LECs when they renew their lock-up plans.[154]

Ability to Engage in Tying. AT&T claims that it cannot leverage market power in areas not subject to competition into more competitive areas because (1) it charges the same prices in rural areas (not subject to competition) and urban areas (supposedly subject to competition) and (2) AT&T must set its prices at competitive levels in urban areas where demand for special access is greatest.[155] This argument assumes that AT&T lacks market power in or near urban areas, but that is simply incorrect. As explained, AT&T is deemed dominant in the provision of DS1 and DS3 dedicated services throughout its territory, and for good reason **[BEGIN HIGHLY CONFIDENTIAL]**

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[153] **[BEGIN HIGHLY CONFIDENTIAL]** **[END HIGHLY CONFIDENTIAL]**

[154] Black Decl. ¶ 22; Denney Decl. ¶ 14; Jeary Decl. ¶ 28.

[155] *See* AT&T Brief at 26-27 n.77, 36; AT&T Direct Case, Attachment 3, Declaration of Dennis Carlton et al., WC Docket No. 15-247, ¶¶ 16, 50-51, 75 (filed Jan. 8, 2016).

CONFIDENTIAL] Thus, AT&T does not need to leverage its market power over connections in remote locations—it can leverage the market power it has over end users in and near urban areas themselves.

Competitive LECs' terms and conditions. The incumbent LECs assert that the terms of their lock-up plans cannot be a concern because competitive LECs offer dedicated services pursuant to similar terms and conditions.[156] Underlying this assertion is of course the assumption that incumbent LECs and competitive LECs are similarly-situated, which is not true because the competitive LECs *lack market power* in the provision of dedicated services. Therefore, the manner in which they offer discounted rates for those services is irrelevant to this investigation.

In any event, as Messrs. Black and Jeary explain, competitive LECs offer dedicated services on far less restrictive terms and conditions than incumbent LECs.[157] Furthermore, as Mr. Black observes, "in all cases where Level 3 might be subject to a penalty under a wholesale agreement with a competitive LEC (*e.g.*, where it must terminate a circuit prior to the expiration of the applicable term commitment), the competitive LEC is usually more willing to waive or reduce the penalty as part of a negotiated solution"[158] than is an incumbent LEC.

BellSouth v. FCC. AT&T, Verizon, and CenturyLink all argue that the D.C. Circuit's opinion in *BellSouth v. FCC*[159] precludes the Commission from ruling that the lock-up plans are unlawful. But that is not true. In *BellSouth*, the court held that the Commission's decision that a

[156] AT&T Brief at 16, 47-48; Verizon Direct Case at 32-35; CenturyLink White Paper at 20.

[157] Black Decl. ¶ 16; Jeary Decl. ¶ 26.

[158] Black Decl. ¶ 27.

[159] *BellSouth Telecomms. Inc. v. FCC*, 469 F.3d 1052 (D.C. Cir. 2006).

BellSouth special access discount plan violated the antidiscrimination proscriptions in Sections 272(c)(1) and 272(e)(3) of the 1996 Act was arbitrary and capricious.[160] Because it concerned only discrimination, the D.C. Circuit's holding in *BellSouth* in no way limits the Commission's ability to conclude that the lock-up plans at issue here are unjust and unreasonable under Section 201(b) because they harm competition, undermine the transition from TDM to Ethernet, and have no valid economic or business justification.

Even as to discrimination, *BellSouth* is readily distinguishable from the instant proceeding. As explained, *BellSouth* concerned a Commission order enforcing Sections 272(c)(1) and 272(e)(3), both of which prohibit a BOC from discriminating in favor of itself or its affiliate. In contrast, Section 202(a) prohibits a carrier from engaging in unjust or unreasonable discrimination among any of its customers, including among customers that are unaffiliated with the selling carrier.[161] *BellSouth* is therefore irrelevant to the question of whether incumbent LECs' lock-up plans result in preferential treatment for some versus other unaffiliated special access customers in violation of Section 202(a). This is especially so because, as discussed further below, incumbent LECs can offer no economic or business justification for the differential treatment among different unaffiliated customers.

Furthermore, to the extent that the court in *BellSouth* concluded that BellSouth's volume discount was the voluntary offer of a benefit to its customers, that conclusion likely does not

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[160] *Id.* at 1056.

[161] 47 U.S.C. § 202(a).

hold for the lock-up plans.[162] As discussed in Section II.A.1 above, incumbent LECs have the incentive to set their "discounted" prices under the lock-up plans to produce the maximum revenue permissible under price caps. To the extent they have done so, their offer of such prices does not represent the voluntary offer of a "discount" to wholesale buyers at all, but rather the exercise of their pricing power to the maximum extent permitted by regulation.

Economic literature. The incumbent LECs assert that their lock-up plans do not produce the anticompetitive effects that the exclusionary contracts described in the economic literature produce.[163] The incumbent LECs are incorrect. As the *Designation Order* notes,[164] the economic literature recognizes that when an incumbent LEC enters into exclusive, long-term wholesale contracts with competitive LECs, those contracts can raise competitive concerns.[165] Most importantly, if incumbent LEC contracts lock up sufficient customer demand for wholesale services, the resulting "customer foreclosure" can discourage competitive LEC entry into the provision of wholesale dedicated services by making it difficult or impossible for competitive LECs to achieve an efficient scale.[166] If entry occurs, the entrant will have high costs and will be

[162] *See, e.g.*, AT&T Brief at 52 (stating that the court in *Bell South v. FCC* "admonished the Commission that complaints about such plans must be measured against the 'critical fact' that ILECs have 'no obligation to offer a discount plan at all'").

[163] *See* AT&T Brief at 6; CenturyLink White Paper at 21-22; Verizon Direct Case at 16-17.

[164] *Designation Order* ¶ 19 & n.54.

[165] Exclusive relationships can have exclusionary effects even if the formal contract term is short, even terminable at will, and even if the excluded firms have alternative (albeit less efficient) means of reaching customers. *See, e.g., United States v. Dentsply Int'l*, 399 F.3d 181, 185, 193 (D.C. Cir. 2005).

[166] *See, e.g.*, Steven C. Salop & David T. Scheffman, *Cost-Raising Strategies,* 36 J. Indus. Econ. 19 (1987). The distinction between customer foreclosure and input foreclosure is discussed in the context of vertical mergers in Michael H. Riordan & Steven C. Salop, *Evaluating Vertical Mergers: A Post-Chicago Approach*, 63 Antitrust L.J. 513, 519 (1995). For a discussion of the

unable to compete aggressively. Alternatively, entry may be deterred altogether. Either way, the incumbent LEC will be able to maintain its market power in the provision of wholesale dedicated services, and to charge supracompetitive prices.

An entering competitive LEC wholesaler may not be able to attract enough customers (*e.g.*, competitive LECs looking to purchase wholesale dedicated service in a building) to ensure profitability, even if some potential customers are not locked up by their own long-term contracts with incumbent LECs. This could be the case, for example, where a competitive wholesaler needs to win the business of at least two potential wholesale customers in order to justify building a new lateral to a commercial building. Each (or even just one) of the two potential customers may believe it is better off purchasing dedicated services from the incumbent under a volume discount plan even though both potential customers would be better off if they both chose to purchase from the competitive wholesaler (entry would result in lower prices). As emphasized by the economic literature on "naked exclusion," the benefits of competition could in this way be lost because the customers are unable to coordinate their purchasing decisions.[167]

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antitrust implications of this framework, *see generally* Jonathan B. Baker, *Exclusion as a Core Competition Concern*, 78 Antitrust L.J. 527 (2013); Thomas G. Krattenmaker & Steven C. Salop, *Anticompetitive Exclusion: Raising Rivals' Costs to Achieve Power Over Price*, 96 Yale L.J. 209 (1986).

[167] *See* Eric B. Rasmusen et al., *Naked Exclusion*, 81 Am. Econ. Rev. 1137 (1991). In a bidding war for customers between the incumbent LEC and a wholesale entrant, this literature also points out, the incumbent LEC has an advantage because it will earn monopoly profits in the event it succeeds in deterring entry, while the entrant cannot expect to receive a monopoly price if it is undeterred because it must compete with the incumbent LEC. In addition, a wholesale customer may be discouraged from purchasing from an entrant rather than the incumbent LEC if it fears that doing so will lead to greater retail competition with the incumbent LEC. *See* John Simpson & Abraham L. Wickelgren, *Naked Exclusion, Efficient Breach, and Downstream Competition*, 97 Am. Econ. Rev. 1305 (2007). A dominant incumbent may also have an advantage over the entrant in bidding for customers even if the dominant firm has lower costs or other competitive advantages (such as higher quality). If so, it may be able to negotiate exclusive contracts with

In addition, an incumbent LEC can use wholesale contacts with competitive LECs that impose penalties in the event their competitive LEC customers switch to other wholesale suppliers to make the wholesale customer less willing to switch to an entrant. Doing so would force a wholesale entrant to lower the price it offers the customer. Entry will sometimes occur, in which case the incumbent LEC appropriates some of the gains to the customer from switching to a lower-priced supplier (through operation of the penalty clause). But efficient entry will not always occur, so wholesale competition is harmed.[168] Furthermore, competition can be harmed by the way penalty provisions are structured in incumbent LEC wholesale contracts with competitive LECs. If the customer would lose a discount by switching some portion of its wholesale business from the incumbent LEC to an entrant, that penalty structure allows the incumbent to in effect impose a "tax" on the customer, discouraging it from switching in the penalized amount even if the entrant charges less.[169] Again, efficient entry could be discouraged. With reduced entry, fewer rivals will be available to bid on customer contracts that come up for renewal.

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customers that confer or protect market power by discouraging entry while offering little or no compensation to the customers for giving up their ability to switch to the entrant. Giacomo Cazolari & Vincenzo Denicolò, *Exclusive Contracts and Market Dominance*, 105 Am. Econ. Rev. 3321 (2015).

[168] *See generally* Phillipe Aghion & Patrick Bolton, *Contracts as a Barrier to Entry*, 77 Am. Econ. Rev. 388 (1987). In the model, the supplier and customer have imperfect information about entrant costs. Were it otherwise, they would always allow efficient entry and set the penalty to extract all the rents the entrant creates.

[169] *See* Joseph Farrell et al., *Economics at the FTC: Mergers, Dominant-Firm Conduct, and Consumer Behavior*, 37 Rev. Indus. Org. 263, 267 (2010) ("While 'discounts' sound good, discounts based on *market share* to non-final buyers can enable a dominant firm to tax sales by a nascent or small rival.").

Antitrust precedent. The Commission is not bound by antitrust precedent. In fact, Sections 201(b) and 202(a) require that the Commission consider factors that have nothing to do with competition policy *per se*, such as promoting the technology transition, consistent with the goals established in Section 706. In any event, contrary to the incumbent LECs' arguments,[170] antitrust precedent supports the conclusion that lock-up plans harm competition. Agencies and courts that have assessed contract provisions that are similar to the loyalty and tying terms and conditions in incumbent LEC lock-up plans have found that such provisions violate the antitrust laws where the firm in question has market power.

First, the Federal Trade Commission ("FTC") has brought enforcement actions against companies that offer discounts or other benefits conditioned on the proportion of a customer's requirements for a product or service that it purchases from the company. For example, in 2009, the FTC filed a complaint against Intel alleging that Intel had violated Section 5 of the Federal Trade Commission Act[171] by, among other things, conditioning discounts and other benefits on a buyer's commitment to purchase a large share of its microprocessor requirements from Intel.[172]

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[170] *See, e.g.*, AT&T Brief at 28; CenturyLink White Paper at 40. CenturyLink argues that shortfall fees do not violate antitrust law. CenturyLink White Paper at 40. CenturyLink cites *Barry Wright Corp. v. ITT Grinnell Corp.*, 724 F.2d 227, 239 (1st Cir. 1983), to support this proposition. *Id.* But the *Barry Wright* Court explicitly states, that "a practice . . . is 'improper' [from an antitrust perspective] if it is 'exclusionary.'" *Id.* (quoting 724 F.2d 227, 239 (1st Cir. 1983)) Here, CenturyLink has market power and maintains that market power through its lock-up plans. Thus, CenturyLink has a monopoly over certain wholesale markets, just as AT&T and Verizon have. CenturyLink's exorbitant shortfall fees are exclusionary, and because CenturyLink has market power, violate antitrust law.

[171] 15 U.S.C. § 45.

[172] Administrative Complaint, *In the Matter of Intel Corporation*, FTC Docket No. 9341 (Dec. 16, 2009) ("FTC Complaint"), https://www.ftc.gov/sites/default/files/documents/cases/091216intelcmpt.pdf. The FTC's allegations were similar to those made in a private antitrust suit filed by AMD in 2005. *See*

In its Complaint, the FTC alleged that Intel possessed monopoly power because its market share exceeded 75 percent, and Intel's competitors faced significant barriers to entry.[173] It further alleged that "Intel offered market share or volume discounts selectively to [original equipment manufacturers ("OEMs")] to foreclose competition."[174] The FTC explained that "[i]n most cases, it did not make economic sense for any OEM to reject Intel's exclusionary pricing offers."[175] Thus, OEMs almost always accepted, and "Intel's offers had the practical effect of foreclosing rivals from all or substantially all of the purchases by an OEM."[176] To resolve these allegations, Intel entered into a consent decree with the FTC that prohibited it from, among other things, entering into any purchase arrangement that conditioned a discount or benefit on the share of a customer's requirements for microprocessors that the customer purchased from Intel rather than its competitors.[177]

Complaint, *Advanced Micro Devices, Inc. v. Intel Corp.*, Docket Nos. MDL No. 1717, Civ. Action No. 1:05-cv-00441-JJF (D. Del. June 27, 2005). In order to settle the dispute with AMD, Intel agreed to pay AMD $1.25 billion and adhere to a set of conditions, including a commitment not to induce customers to exclusively purchase microprocessors from Intel. *See* Stephen Shankland, *Intel to Pay AMD $1.25 Billion in Antitrust Settlement*, CNET (Nov. 12, 2009), http://news.cnet.com/8301-1001_3-10396188-92.html.

[173] FTC Complaint ¶¶ 41-46.

[174] *Id.* ¶¶ 7, 53 ("Intel offered market share or volume discounts selectively to OEMs to foreclose competition in the relevant CPU markets. . . . Intel taxed OEM purchases of non-Intel CPUs through the use of market share discounts.").

[175] *Id.* ¶ 7.

[176] *Id.*

[177] Decision and Order, *In the Matter of Intel Corporation*, FTC Docket No. 9341, § IV.A.5 (Oct. 29, 2010), https://www.ftc.gov/sites/default/files/documents/cases/101102inteldo.pdf. In a similar case, Transitions Optical entered into a consent decree with the FTC in which it agreed, among other things, to refrain from "offering market share discounts that are based on what percentage of a customer's photochromic lens sales are Transitions' lenses." *See* FTC Bars Transitions Optical, Inc. from Using Anticompetitive Tactics to Maintain its Monopoly in

Second, courts have analyzed contracts that effectively require a customer to purchase a large proportion of its requirements from a given seller as *de facto* forcing the customer to purchase only from the seller. For example, in *ZF Meritor v. Eaton*, the Third Circuit Court of Appeals found that a manufacturer of truck transmissions entered into *de facto* exclusive dealings contracts when it conditioned discounts on a customer meeting purchase volume thresholds that ranged from 70 to 97.5 percent of the customer's requirements.[178] The Court explained that such agreements can have adverse economic consequences similar to those of explicit exclusive dealings contracts (*e.g.*, "allowing one supplier of goods or services unreasonably to deprive other suppliers of a market for their goods").[179] The Court found that, "although the market-share targets covered less than 100% of the OEMs' needs, a jury could nevertheless find that the [agreements] unlawfully foreclosed competition in a substantial share of the . . . market."[180] Thus, it affirmed the jury's verdict that the agreements were anticompetitive and caused the manufacturer's competitor to suffer antitrust injury.[181]

Darkening Treatments for Eyeglass Lenses (Mar. 3, 2010), http://www.ftc.gov/opa/2010/03/optical.shtm.

[178] *ZF Meritor, LLC v. Eaton Corp.*, 696 F.3d 254, 265 (3d Cir. 2012).

[179] *Id*. at 270 (citing *Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 466 U.S. 2, 45 (1984) (O'Connor, J., concurring)); *Barry Wright Corp. v. ITT Grinnell Corp.*, 724 F.2d 227, 236 (1st Cir. 1983) ("[U]nder certain circumstances[,] foreclosure might discourage sellers from entering, or seeking to sell in, a market at all, thereby reducing the amount of competition that would otherwise be available.").

[180] *ZF Meritor*, 696 F.3d at 283.

[181] *See id*. at 303 ("[W]e conclude that Plaintiffs presented sufficient evidence to support the jury's finding that Eaton engaged in anticompetitive conduct and that Plaintiffs suffered antitrust injury as a result.").

Third, courts have analyzed bundled discounts that require a customer to purchase both a monopoly good and a competitive good in order to receive a discount on the monopoly good as tying arrangements.[182] For example, in *Lepage's v. 3M*, the Third Circuit held that 3M illegally leveraged its dominance in the market for transparent tape (afforded by its Scotch tape brand) to induce stores to purchase other 3M product lines that were subject to competitive supply.[183] 3M accomplished this leveraging by providing a discount on Scotch tape only if a store bought certain volumes of its other product lines that were subject to competition.[184] Similarly, in *SmithKline v. Eli Lilly*, the Third Circuit found that Lilly violated Section 2 of the Sherman Act by conditioning a discount for two antibiotics, over which it had a monopoly, on a hospital purchasing quantities of a third antibiotic that was subject to competition from SmithKline.[185] In order to match the discount provided on all three Lilly antibiotics, SmithKline would have to sell

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[182] For an explanation of such discounts, *see* Phillip Areeda & Herbert Hovenkamp, Antitrust Law ¶ 749, at 83 (Supp. 2002) ("The anticompetitive feature of package discounting is the strong incentive it gives buyers to take increasing amounts or even all of a product in order to take advantage of a discount aggregated across multiple products. In the anticompetitive case, which we presume is in the minority, the defendant rewards the customer for buying its product B rather than the plaintiff's B, not because defendant's B is better or even cheaper. Rather, the customer buys the defendant's B in order to receive a greater discount on A, which the plaintiff does not produce. In that case the rival can compete in B only by giving the customer a price that compensates it for the foregone A discount.").

[183] *See Lepage's Inc. v. 3M*, 324 F.3d 141 (3d Cir. 2003).

[184] *Id*. at 155 ("The principal anticompetitive effect of bundled rebates as offered by 3M is that when offered by a monopolist they may foreclose portions of the market to a potential competitor who does not manufacture an equally diverse group of products and who therefore cannot make a comparable offer.").

[185] *See SmithKline Corp. v. Eli Lilly & Co.*, 575 F.2d 1056, 1060-61 & n.3 (3d Cir. 1978).

the competitive antibiotic at uneconomically low prices, and thus was effectively excluded from the market.[186]

The tying and loyalty provisions at issue in these cases bear a close resemblance to the tying and loyalty provisions in incumbent LECs' exclusionary special access purchase arrangements. Just as the courts and regulatory agencies have found that these kinds of provisions violate antitrust laws, the Commission should conclude that they are unreasonable in violation of Section 201(b) of the Communications Act.

B. The Incumbent LECs Have Provided No Justification for the Specific Terms of Their Lock-Up Plans

Even when it comes to their proffered justifications for the specific terms of their lock-up plans, the incumbent LECs again rely largely on evasion and obfuscation. For example, Verizon argues that it should not be required to provide a cost justification for the manner in which it charges its customers because special access is subject to price caps, and price caps purportedly completely sever the connection between prices and costs.[187] This is, of course, wrong. As competitive carriers have explained in the past in response to similar incumbent LEC claims,[188] the Commission has repeatedly acknowledged that it must retain the ability to evaluate carriers' costs in order to assess whether prices are reasonable under price caps. It follows that incumbent

[186] *See id*. at 1065 ("The effect of the [discount plan] was to force SmithKline to pay rebates on one product, Ancef, equal to rebates paid by Lilly based on volume sales of three products. . . . [T]he court found SmithKline's prospects for continuing in the cephalosporin market under these conditions to be poor.").

[187] *See* Verizon Direct Case at 47-48, 109-10.

[188] *See* Joint Reply Comments of Time Warner Telecom, Cbeyond Communications, and XO Communications, WC Docket No. 04-405, at 9-10 (filed Jan. 28, 2005).

LECs cannot avoid the obligation to cost-justify the provisions of its tariffed lock-up plans by simply invoking the magical power of price caps.

The incumbent LECs also assert that they simply do not know why they have included many of the terms in their plans. For example, Verizon claims that it is unaware of any documentation that would demonstrate the methodology used to determine thresholds and penalties in its plans.[189] AT&T states that the plans were adopted a long time ago, so it no longer has the records needed to justify many of the terms in its plans.[190] The long life of these plans raises an important problem. Customer demand patterns and market dynamics have changed greatly since these plans were adopted. Most importantly, there is a greater potential for competition now than was the case when the lock-up plans were initiated. The fact that the plans might have been reasonable under the circumstances when first adopted in no way shows that they are reasonable under current conditions.

In contrast to Verizon and AT&T, Frontier tries a slightly different approach, saying effectively that it has nothing to offer in defense of its tariffs since it inherited them from AT&T and Verizon when it acquired their local exchange properties.[191] Frontier's response is obviously insufficient, but it is actually not meaningfully different from the slightly more dressed up responses discussed below. In fact, the incumbent LECs offer nothing more than vague,

[189] *See* Verizon Direct Case at 89, 112, 118.

[190] *See, e.g.*, AT&T Direct Case, Attach. 4.C, Narrative Responses to Tables I-IX, WC Docket No. 15-247, at 6 (filed Jan. 8, 2016) ("AT&T Narrative Responses") (stating "[b]ecause [the DCP] was put in place more than 20 years ago, any records that may have existed that address the 'cost justification' for the percentage commitment are no longer available. Similarly, the DS1 Term Payment Plans were filed in 2003, and any records that may have existed that address the 'cost justification' for the percentage commitments in those plans are also no longer available.").

[191] *See* Frontier Direct Case at 1-2.

unsupported generalizations in defense of their tariffs, confirming what has been obvious all along. There is no justification for the lock-up plans other than the incumbent LECs' fervent desire to retain their tight grip on the wholesale market and the technology transition.

1. Percentage Commitments

All of the incumbents seek to justify the volume commitments in their plans based on the purported need to be compensated for the costs associated with providing circuit portability. But none of the incumbent LECs even attempts to measure those costs, or to demonstrate why it is that their percentage and volume commitments reasonably compensate them for such costs. Moreover, the significant differences in the level and structure of the volume and percentage commitments as well as other key differences in the plans undermine incumbent LEC claims that each plan provides necessary compensation.

AT&T. AT&T argues that concerns about volume discounts are not relevant to its lock-up plans because AT&T's plans merely provide circuit portability, not a discount, in exchange for a volume commitment.[192] But as AT&T's own declarant Paul Reid explains, when it provides circuit portability, "AT&T has effectively given the customer a substantial discount for the DS1 service" since it allows the buyer to avoid paying early termination penalties.[193]

AT&T next claims that the volume commitments in its plans are justifiable compensation for (1) permitting "the customer to pay a lower term-discounted rate even though the customer may cancel the service at any time," (2) permitting "the customer to avoid the early termination liability," (3) assuming "the physical costs of the disconnection and re-establishment of service for a new customer if one can be found," and (4) "forgoing the predictability provided by the

[192] *See* AT&T Brief at 16.

[193] Reid Decl. ¶ 10.

underlying term-discount plans that may be terminated prematurely."[194] But AT&T makes no attempt to quantify these costs. It also makes no attempt to compare such costs to the profits it earns as a result of requiring customers to meet a minimum volume commitment.

For example, AT&T's plans require that customers maintain a high percentage of their original volume (80 percent under the TPPs, 90 percent under the DCP, or 100 percent under the ACP) in order to receive the benefit of circuit portability. But customers do not of course utilize circuit portability for such a high percentage of the circuits they purchase. In order to set a volume commitment that compensates for the purported costs of circuit portability, the incumbent LECs would presumably need to calculate the percentage of circuits that customers terminate early on average, multiply that total by the associated costs, add other relevant costs and then compare those costs to the profits earned and savings realized at different volume commitment percentages. Of course, AT&T did not do that.

The available evidence indicates that the volume commitments in AT&T's lock-up plans bear no rational relationship to the cost that AT&T incurs in providing portability. Consider, for example, early termination penalties on individual circuits that AT&T does not collect from buyers that opt for circuit portability. The formulae for calculating per-circuit early termination penalties vary significantly among AT&T's plans. For example, under the TPPs, the per-circuit early termination penalty is equal to 40 percent of the monthly recurring charge for the service, multiplied by the number of months remaining in the commitment term.[195] But under the DCP, the per-circuit termination penalty is equal to the difference between the DCP rate for the plan

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[194] AT&T Narrative Responses at 7.

[195] *See* Southwestern Bell TPP § 7.2.22(G); PacBell TPP § 7.4.18(G).

term that could have been completed during the time the service was actually in service (or the monthly rate for services in place less than 36 months) and the customer's current DCP rate for each month the service was provided.[196] In light of these differences, forgone early termination penalties likely represent very different forgone revenues in the two plans, all other things being equal. AT&T presumably could have set volume commitments in the plans at levels that account for these differences. But there is no evidence that AT&T did so.

There are also differences in the ways AT&T sets the volume commitments in its plans for which it offers no, or no meaningful, justification. For example, as Mr. Reid explains, the volume commitments in the TPPs are set at 80 percent of the number of DS1 channel terminations purchased by the customer prior to signing up for the plan; in the DCP they are set at 90 percent of the DS1 channel terminations the customer purchased prior to signing up for the plan; and in the ACP they are set based on the level chosen by the customer.[197] But Mr. Reid does not even try to explain why it is appropriate to require that a customer commit to a volume equal to a percentage of the customer's prior spend levels under the TPPs and DCP when customers have the flexibility to choose the level of their volume commitment under the ACP.

Finally, AT&T also claims that percentage commitments are not unreasonably discriminatory under Section 202(a) because "the more circuits a customer has purchased from AT&T or chooses to place in the portability plan, the greater the benefit the customer obtains under the portability provisions."[198] The problem with this assertion is that there is no reason to think that a linear relationship exists between the benefits AT&T experiences from volume

[196] Ameritech DCP § 7.4.13(E).

[197] *See* Reid Decl. ¶¶ 13-15.

[198] AT&T Brief at 33.

commitments and the level of the volume. In fact, both Verizon and CenturyLink assert that volume commitments allow incumbent LECs to experience lower administrative costs, which in turn likely result in economies of scale.[199] This would mean that incumbent LECs incur lower per unit costs in implementing circuit portability for a large volume of circuits than for a small volume of circuits. Thus, treating large and small volume customers equally, as the plans do, in fact discriminates against large volume customers. AT&T fails to account for this fact.

In addition, AT&T's rationale ignores the fact that a buyer with large historic spend levels gets no benefit from circuit portability at all, *i.e.*, it does not qualify for the benefit, unless it purchases the large number of circuits needed to meet the percentage requirement. In contrast, a buyer with small historic spend is required to purchase a much smaller volume of dedicated services to meet the percentage requirement to obtain circuit portability. Thus, two buyers can purchase the same volume of dedicated services, but one will receive circuit portability and the other will not. This is obviously blatant discrimination based on the accident of historic spending levels, and AT&T offers no justification for it.

Verizon. Verizon claims that in order to offset the "significant" cost of circuit portability, it must require a commitment level to "equilibrate the bargain so that it is economically viable for both parties."[200] But, as with AT&T, Verizon makes no attempt to quantify the costs of circuit portability, or to quantify the extra profits Verizon earns as a result of requiring buyers to meet volume commitments. Without this information, it is not possible to assess whether the percentage commitments in the CDPs reasonably compensate Verizon for the

[199] Verizon Direct Case at 26-27; CenturyLink White Paper at 33.

[200] Verizon Direct Case at 27.

costs associated with circuit portability. Moreover, it appears that Verizon could have conducted this analysis. For example, Verizon indicates that it monitors the extent to which its customers use circuit portability.[201] It could have used that data to determine the cost of forgone circuit termination penalties, which it could have compared to the purported benefits of increased volume commitments.

It is also notable that, again as with AT&T, not all Verizon plans require that purchasers commit to a percentage of historic spend as part of the plan. Under the TVP, customers choose the volume of their commitment, and the discount offered increases with higher volume commitments. Verizon makes no attempt to explain why it could not have utilized this approach in the CDPs.

Verizon claims that the requirement under the CDPs and the NDP that a customer include in a lock-up plan all of its purchases from Verizon of a given type of dedicated service "reduces uncertainty regarding circuit demand, which facilitates network planning."[202] It also claims that commitment levels reduce "Verizon's significant administrative costs in overseeing standard, circuit-specific term discount plans."[203] Verizon makes no attempt to show how its percentage commitments generate these purported efficiencies, which it claims "make possible the discounts and portability available under the CDP and NDP."[204] Nor does Verizon show how any such efficiencies bear any relation to the discounts and portability made available under the those plans. Verizon's assertion is especially implausible because other incumbent LECs, such as

[201] *Id.* at 7-8.

[202] *Id.* at 27.

[203] *Id.*

[204] *Id.* at 50.

AT&T, offer circuit portability without requiring that a customer purchase all circuits under the same plan.

Moreover, as explained above in connection with the AT&T plans, the economies that Verizon believes are produced by volume commitments would seem to indicate that its per unit costs of implementing circuit portability decline with increased volume. This means that the equal treatment of all customers regardless of volumes purchased under the CDPs is discriminatory. Verizon makes no attempt to show why this discrimination is reasonable.

Finally, Verizon asserts that its lock-up plans include technology migration provisions that "ensure" that meeting demand for IP-based services is not impeded.[205] Verizon's technology migration provisions do no such thing. While Verizon's lock-up plans permit subscribers to upgrade an existing circuit to Ethernet and "count" the upgrade toward fulfillment of a percentage commitment, the CDP, for example, does not allow for Ethernet upgrades at new customer locations. Accordingly, competitive LECs are rarely able to take advantage of the CDPs' technology migration provisions because they generally need to purchase new Ethernet circuits at locations where they are not currently purchasing TDM-based dedicated services. In fact, it is fairly unusual for a customer that purchases a TDM-based circuit to convert that circuit to Ethernet.

CenturyLink. CenturyLink argues that the percentage commitment provisions in the RCP and the TDP plans do not violate Sections 201 or 202 because they permit customers to purchase additional services from other providers.[206] This is a particularly implausible argument

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[205] *Id.* at 38, 96.

[206] CenturyLink White Paper at 32; Special Access Term Discount Plan of the CenturyLink Operating Companies Tariff F.C.C. No. 9 § 7.4.11 ("CenturyLink TDP").

because the RCP requires that purchasers commit to an astonishing 95 percent of prior spend, measured in dollars, and the volume commitment automatically ratchets up with increases in spending levels. As explained in Section II.A.3, the Joint CLECs' experiences show that the RCP in fact prevents customers from purchasing services from competitive LECs.

CenturyLink also contends that percentage commitments result in several kinds of efficiencies.[207] But CenturyLink makes no attempt to quantify these efficiencies or the profits it earns from requiring customers to make the extremely high volume commitments under its plans. CenturyLink also makes no attempt to quantify any costs associated with providing circuit portability. CenturyLink claims that it changed the method for measuring volumes under the RCP from circuits to revenues in 2010 because it was worried that it might not make enough money to cover its costs.[208] But CenturyLink makes no effort to quantify its cost recovery before and after the change in 2010 or to demonstrate in any other way why the change was reasonable. It has therefore offered no way of justifying the structure or level of the percentage commitments in its plans.

Again, a comparison of CenturyLink's plans with other incumbent LECs' plans further undermines any claim of reasonableness. The RCP requires a higher percentage of historic purchases (95 percent) than even the unreasonably high spend requirements in other incumbent LEC plans (*e.g.*, 80 percent under the AT&T TPPs). And, CenturyLink measures the spend in

[207] *Id.* at 33 (benefits include guaranteed supply, thereby facilitating business planning; revenue predictability for an agreed period of time, which is important to CenturyLink because it needs to know that it can direct the necessary resources to the work involved in disconnecting and moving circuits); CenturyLink Direct Case, Narrative Responses, WC Docket No. 15-247, at 14 (filed Jan. 8, 2016) ("CenturyLink Narrative Responses") (portability in the plans allows for more flexibility than traditional term plans).

[208] CenturyLink Narrative Responses at 15.

dollars under the RCP whereas the other incumbent LEC plans do not. By measuring the spend in dollars, CenturyLink effectively requires that customers continue to purchase channel terminations, mileage, multiplexing, and other facilities in order to meet their total dollar spend obligations. It is not at all clear why this is reasonable given that some other incumbent LEC plans merely measure spend in channel terminations (as is the case with the AT&T TPPs). Indeed, by effectively including both channel terminations and mileage services in the volume commitment, the RCP makes it harder for competitors to combine channel terminations leased from the incumbent LEC with transport services provided by a competitive wholesale provider. Nor is it clear why it is reasonable for the RCP to set volume commitments based on a percentage of a customer's prior spend as opposed to allowing customers to set their own volume levels (as is the case with AT&T's ACP and Verizon's TVP).

Finally, as explained with regard to the AT&T and Verizon plans, CenturyLink's equal treatment of small and large volume customers is discriminatory because, among other things, the efficiencies that CenturyLink cites almost certainly result in lower per unit costs of portability administration for larger as opposed to smaller volume customers. There is no apparent basis for concluding that this discrimination is reasonable.

2. Shortfall Penalties

Because, as explained, there is no reasonable basis for the level or structure of the volume commitments in the plans subject to investigation, there can also be no justification for shortfall penalties designed to enforce those volume commitments. But even on their own terms, the shortfall penalties in the lock-up plans are unreasonable.

AT&T. AT&T argues that shortfall penalties are "the consideration AT&T obtains in exchange for forgoing [early termination penalties] and incurring additional expense when the customer prematurely moves or disconnects circuits."[209] In other words, AT&T views shortfall penalties as compensating AT&T for a customer's failure to meet its volume agreement. Given that AT&T offered no basis for concluding that the volume commitments in its plans are just and reasonable, there is also no basis for concluding that the shortfall penalties meet this standard either.

Moreover, there are substantial differences in the way shortfall penalties are measured in AT&T's plans: shortfall penalties are set (1) in the ACP based on the difference between the customer's volume commitment and its actual purchases, multiplied by 50 percent of the ACP [monthly recurring rate]; (2) in the DCP based on the number of shortfall circuits multiplied by the [monthly recurring rate] applicable under the DCP; and (3) in the TPPs based on the number of shortfall penalty circuits multiplied by the non-recurring charge for DS1 channel terminations. AT&T offers no explanation or justification for why it is reasonable to require that customers pay a shortfall equal to the full price of the shortfall circuits under the DCP while customers pay 50 percent of that price under the ACP. It is hard to imagine how it could be that AT&T experiences losses associated with shortfalls in its different operating territories that justify these differences.

In fact, AT&T has itself asserted that it incurs more costs when customers order more circuits.[210] It follows that AT&T would incur fewer costs when a customer orders fewer circuits.

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[209] AT&T Brief at 32. AT&T makes this arguments in many ways. *See, e.g.*, *id.* at 44-45 ("shortfall penalties represent the necessary quid pro quo for the separate agreement to provide the customer with the ability to avoid [early termination penalties]" because the "portability plan in effect rebalances the relative risks and costs to be borne by the parties for premature cancellation of circuits subject to term plans, and it does so by placing greater risk and costs on AT&T.").

[210] AT&T Brief at 33.

This calls into question the reasonableness of any shortfall penalty that requires a customer to pay the full amount it would have paid had it met its volume commitment.

Verizon. Verizon's attempts to justify the shortfall penalties it imposes under its lock-up plans fare no better. Verizon claims that its shortfall penalties are not punitive and instead enforce commitment levels to ensure that Verizon receives the benefit of the bargain struck with its customer.[211] Again, Verizon appears to be asserting that shortfall penalties compensate it for its customer's failure to meet its volume commitment. Because, as discussed, Verizon makes no effort to justify its volume commitments, it cannot justify its shortfall penalties either.

The shortfall penalty under the CDPs is set equal to a customer's average CDP rate per DS0 equivalent, multiplied by the difference between the average minimum commitment and the average number of in-service DS0 equivalents, multiplied by six months.[212] In other words, the shortfall penalty ensures that Verizon is paid the full amount that the customer would have paid if it had met its volume commitment. As explained, this overcompensates Verizon for a customer's failure to meet its volume commitment because Verizon incurs fewer costs when customers order fewer circuits. It is therefore more profitable for Verizon when a customer signs up for a large volume commitment and then *does not* satisfy the volume commitment than when the customer actually obtains the services under the lock-up plan. And of course, when, as is no doubt frequently the case, Verizon is able to sell the same DS1 to another customer (*e.g.*, when

[211] Verizon Direct Case at 30, 108. Verizon claims that *dicta* in a recent federal court decision supports its assertion. *Id.* at 108. However, the decision did not address whether the CDPs' shortfall provision is just and reasonable. *See Verizon Va., LLC v. XO Commc'ns, LLC*, Civ. Action No. 3:15-cv-1712015 WL 6759473, at *11 (E.D. Va. Nov. 5, 2015), *appeals docketed*, Nos. 15-2496 & 15-2549 (4th Cir. Dec. 15, 2015).

[212] Verizon South CDP § 25.1.7(B); Verizon North CDP § 25.1.7(B).

one competitive LEC disconnects a circuit because it has lost a retail customer to another competitive LEC and the second competitive LEC purchases the same circuit), Verizon gets paid twice. The onerous and unreasonable nature of the shortfall penalty under the CDPs is all the more evident given that some incumbent LEC lock-up plans (*e.g.*, AT&T's ACP) do not require such high shortfall penalties.

CenturyLink. CenturyLink argues that there are no "shortfall fees" under its RCP, because customers are simply held to the full amount of their agreed-upon percentage revenue commitments for the terms of their plans.[213] CenturyLink claims that without this requirement customers would always opt in to commitments, knowing there would be no consequences for failure to honor them.[214] But all of this of course begs the question of why it is reasonable to require that customers commit to a volume commitment of 95 percent of past purchases measured in dollars. Because there is no justification for such volume commitments, there can be no justification for a penalty that enforces the commitment. Moreover, the early termination penalty that CenturyLink imposes on companies that fail to meet the minimum volumes is extremely high – 50 percent of the monthly charges multiplied by the number of months remaining in the plan. CenturyLink makes no attempt to explain why this penalty is reasonable.

Technology transition. As explained above, the incumbent LECs have been increasingly exploiting the decline in demand for TDM-based dedicated services, combined with high shortfalls in the lock-up plans, to coerce competitive LECs into signing overlay agreements that lock up wholesale demand for Ethernet services. The Commission must therefore scrutinize

[213] CenturyLink White Paper at 38.

[214] *Id.*; *see also* CenturyLink Narrative Responses at 25.

the incumbent LECs' shortfall penalties extremely closely in light of this effect. Indeed, the harm to the technology transition caused by the lock-up plans in general, and by shortfall penalties in particular (along with volume commitments and early termination penalties), is an independent basis for concluding that the plans are unlawful under Section 201(b) of the Act (as well as Section 706 of the Act).

3. Upper Percentage Thresholds and Overage Penalties

Given the decline in demand for TDM-based dedicated services, the upper percentage thresholds and overage penalties in the lock-up plans are no longer as relevant as they once were. As briefly discussed herein, however, they are unjust and unreasonable, as well as unjustly and unreasonably discriminatory.

AT&T. As explained, upper percentage thresholds and overage penalties are discriminatory. AT&T does not even attempt to show that this discriminatory effect is reasonable. Instead it argues that upper percentage thresholds relate to portability plans only, not rate discounts,.[215] But that is untrue, as also previously explained.

In addition, the 124 percent upper percentage threshold in the TPP plans is unjust and unreasonable. That number is entirely arbitrary, and AT&T makes no attempt to show that there is a rational relationship between this threshold and the company's costs or needs. Without citing to any studies that show that a 124 percent upper percentage threshold is rational (for example, perhaps because AT&T begins to lose money at an increasing rate at that threshold unless there is an additional volume commitment by customers), AT&T simply asserts that it is

[215] AT&T Brief at 49.

reasonable to set an upper limit on AT&T's potential costs from premature disconnections.[216] This *ipse dixit* approach to justifying tariff terms must be rejected. Because AT&T takes the same approach to justifying its overage penalties, those too must be deemed unjust and unreasonable for the same reasons.

Verizon. Like AT&T, Verizon makes no effort to show that the discrimination inherent in upper percentage thresholds and overage penalties is just and reasonable. Again, this is understandable because there is simply no justification for this discrimination.

Verizon does gamely argue that upper percentage thresholds, and the overage penalties that enforce them, discourage customers from committing to small volumes of dedicated services while receiving multi-year discounts on much greater volumes of dedicated services.[217] Verizon makes no effort, however, to show that this is a realistic concern, especially given declining demand for TDM-based dedicated services. Verizon asserts that increased volumes of customer purchases impose correspondingly higher costs associated with administering circuit portability. But Verizon does not quantify or otherwise measure those costs or assess whether the increased charges for the new circuits would cover those costs.

Verizon also makes vague, unsupported assertions that upper percentage thresholds and overage penalties facilitate network planning, but these assertions are impossible to assess because Verizon does not quantify or in any way measure the savings purportedly associated

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[216] *Id.* at 49.

[217] Verizon Direct Case at 31.

with such planning.[218] The Commission should give no weight to Verizon's unsubstantiated claims.

In addition, differences in Verizon's plans further undermine its claims of reasonableness. Verizon makes no attempt to explain why it is reasonable to set the upper threshold at 30 percent above the minimum commitment level under the CDPs, but 60 percent above the minimum commitment level under the NDP. Verizon also does not explain why it is reasonable that customers purchasing dedicated services under the CDPs are subject to an overage penalty when they exceed the upper threshold, unless they commit to increase their volume commitment levels, while customers purchasing dedicated services under the NDP that exceed the threshold are subject to a ratchet that automatically increases their volume commitment levels.

CenturyLink. CenturyLink argues that its upper percentage thresholds are not discriminatory because they apply similarly to large and small volumes of use and tend to enhance predictability for buyer and sellers alike.[219] As discussed, however, applying the same requirement to increased purchases above a uniform percentage threshold, 130 percent in the case of the TDP, results in discrimination between large and volume and small volume customers. CenturyLink does not attempt to justify such discrimination. Moreover, just as the specific percentage of the upper thresholds in AT&T's and Verizon's plans are arbitrary, so too are those in CenturyLink's.

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[218] *Id.*

[219] CenturyLink White Paper at 42.

CenturyLink argues that upper percentage threshold in the TDP encourages customers to predict their future needs more accurately, that they help CenturyLink plan for network usage, and (combined with the 90-day grace period) that they create a workable management solution for customers as they connect and disconnect circuits in response to their changing needs.[220] But wholesale customers have powerful incentives to plan their network usage separately and apart from any penalty CenturyLink may impose. These same objectives could be achieved through cooperative planning between seller and buyer and without the need for arbitrary upper limits and penalties.

4. Long-Term Commitments

The long-term commitments in incumbent LEC plans lock up the demand for special access for many years, making it more difficult for competitive LECs to shift demand away from the incumbent LEC lock-up plans, as well as slowing the transition from TDM-based special access services to Ethernet. The incumbent LECs offer no reason why they could not offer the discounts and circuit portability benefits in plans with durations not longer than a year. Indeed, in some of the areas encompassed by the plans, the incumbent LECs are already required to offer UNE DS1 and even UNE DS3 loops at rates well below special access rates on a month-to-month basis.

Long plan durations are particularly relevant to Verizon, since wholesale customers frequently feel the need to sign up for the seven-year CDP for DS1s, an extraordinarily long-term. This poses a special problem for wholesale competition because demand in Verizon incumbent LEC territories is locked up for extremely long periods of time, and a potential

[220] *Id.* at 42-43; CenturyLink Narrative Responses at 28.

customer of a competitive wholesale provider would have to wait many years before the committed volume becomes subject to any competition at all.

Verizon claims that long-term commitments provide longer periods over which to spread non-recurring costs and are necessary to justify the discount levels provided under plans that include circuit portability. Otherwise, Verizon argues, a customer could receive a multi-year discount on its purchases without actually making a multi-year commitment. Verizon does not attempt to quantify the non-recurring costs that it claims justify long terms, or the uncertainty that Verizon claims makes it costly to provide discounts. Nor does Verizon explain why a particular term length is necessary to reduce the claimed risk, or to recover non-recurring costs. Given that it already sells UNE loops on single-month terms in large portions of its territory, it is unlikely that shorter terms, or no terms at all, would be harmful to Verizon.

5. Early Termination Penalties

Along with shortfall penalties, early termination penalties for lock-up plans with volume commitments enforce the lock-up effects of the incumbent LEC plans. They are therefore a key component of the plans and warrant close scrutiny.

The incumbent LECs' arguments in support of early termination penalties are predictable. AT&T claims that early termination penalties are important because, without them, a customer could sign up for the longest term rate available and then cancel at any time without penalty.[221] CenturyLink claims that when a customer breaks its long-term commitment, the savings that it had shared with the customer in the form of discounted rates are lost, and that it is at risk of

[221] AT&T Brief at 53.

being unable to recoup its investment and maintenance costs.[222] Verizon similarly claims that the early termination penalties in its lock-up plans "are not punitive but instead discourage a customer from reneging on the deal it struck after obtaining the benefits of its bargain."[223]

But none of these assertions, or indeed any of the assertions in the incumbent LEC Direct Cases,[224] addresses the key issue, which is whether the early termination penalties under the incumbents' lock-up plans are necessary to compensate incumbent LECs for the costs they incur to provide circuit portability. It is very unlikely that this is the case, given that a customer that terminates early will almost certainly need to sign up for a new incumbent LEC lock-up plan with a volume commitment. That is because the incumbent LECs own the only connection to most commercial buildings in their respective regions. Wholesale customers have no choice but

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[222] CenturyLink White Paper at 47. CenturyLink argues – without quantification – that early termination penalties help ensure that a portion of the expected revenue stream will continue over the life of the commitment and provide some compensation to CenturyLink if it does not. *Id.* at 39-41. CenturyLink also argues that fixed costs are greater than incremental costs in this industry, thus a requirement that a consumer pay 50 percent of the remaining contract is reasonable and has no anticompetitive effect. *Id.* at 47. But CenturyLink does not seek to quantify the fixed and incremental costs or the extent to which both have already been recovered over many years of charging customers for DS1 and DS3 services. Nor does it explain why, given that CenturyLink has the only connection to most commercial buildings in its territory, it is at any risk of not recovering its costs.

[223] Verizon Direct Case at 35.

[224] CenturyLink incorrectly argues that the Commission's decision in *Ryder Communications Inc., v. AT&T Corp.* is somehow relevant to this investigation. *See* CenturyLink Direct Case at 39-40 (quoting *Ryder Communications Inc., Complainant, v. AT&T Corp., Defendant*, 18 FCC Rcd. 13603 (2003) ("*Ryder v. AT&T Corp.*"). *Ryder* concerned whether an early termination penalty in a contract tariff for 900 transport service is just and reasonable under Section 201(b) if the carrier's own violation of a separate, but related, agreement and its misconduct cause the customer to terminate its contract early and incur the penalty. *Ryder v. AT&T Corp.* ¶ 17. The case did not concern the questions at issue here, which are whether early termination penalties, in combination with the other provisions of a lock-up plan, harm competition and the technology transition.

to sign up for new plans with the incumbent LECs. There is therefore no justification for imposing early termination penalties under the plans.

IV. The Commission Should Rule that the Volume Commitments in the Incumbent LECs' Lock-Up Plans Are Unlawful and that the Commercial Agreements Violate Section 203 and the Condition Precedent for Ethernet Forbearance

Based on the foregoing discussion, the Commission should rule that the lock-up plans violate Sections 201(b) and 202(a). In addition, as discussed further below, the Commission should rule that the non-tariffed commercial agreements filed in this proceeding include "classifications, practices, and regulations affecting" incumbent LECs' charges for DS1 and DS3 services. The Commission should therefore require the incumbent LECs to file those agreements as contract tariffs, to the extent the incumbent LECs have not already done so. To the extent those agreements encompass services, such as Ethernet, subject to forbearance from dominant carrier regulation (most, possibly all, do), the Commission should rule that the incumbent LECs have relinquished their right to such forbearance because they have failed to comply with the terms of the orders in which forbearance was granted. The Commission may well need to consider additional appropriate remedies.

First, Section 205 grants the Commission the authority, "after full opportunity for hearing . . . under an order for investigation and hearing made by the Commission on its own initiative," to investigate the lawfulness of a charge or practice included in a tariff, and, upon a finding that a charge or practice violates any provision of the Act, to prescribe a just and reasonable charge or practice.[225] The Commission has the broad discretion to prescribe remedies when it finds a practice to be unreasonable or discriminatory. As the Second Circuit has explained,

[225] 47 U.S.C. § 205(a).

> [I]t is within the Commission's sole discretion either to prescribe a remedy pursuant to § 205(a) of the Act or to order, pursuant to the broad authority conferred on it by other provisions of the Act, that carriers themselves end the discrimination. . . . The language of § 205 does not mandate prescription; it merely authorizes and empowers the FCC to prescribe fair and reasonable charges or practices when existing charges or practices are found to be unlawful. The choice of prescription *vel non* is entirely one for the agency, not the courts. [226]

The Commission has often relied on Section 205(a) to prescribe reasonable practices in the past. For example, in the *Virtual Expanded Interconnection Order*, the Commission stated that "continuation of the current special access rate structure by the Tier 1 LECs would be unjust and unreasonable in violation of Section 201(b) of the Act,"[227] and that the Commission had the authority under Section 205(a) "to order the LECs to provide expanded interconnection and to implement a new rate structure and pricing rules for expanded interconnection."[228] Similarly, in the *Investigation of Access and Divestiture Related Tariffs*, the Commission determined that a tariffed rate (the rate in the Docket No. 20099 Settlement Agreement) was too low, and prescribed a 20 percent mark-up of that rate, even though it was first set in a filed contract.[229] In fact, the Commission noted that it has "express authority under the *Sierra-Mobile* doctrine 'to prescribe a change in contract rates whenever it determines such rates to be unlawful.'"[230] In support of this proposition, the Commission cited the D.C. Circuit's decision in *MCI Telecommunications Corp. v. FCC*, in which the court "duly recognized the Commission's

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[226] *Nat'l Ass'n of Motor Bus Owners v. FCC*, 460 F.2d 561, 565 (2d Cir. 1972) (internal citations omitted).

[227] *Virtual Expanded Interconnection Order* ¶ 223.

[228] *Id.*

[229] *Investigation of Access and Divestiture Tariffs*, Memorandum Opinion and Order, 49 Fed. Reg. 50457-01, ¶ 99 (1984).

[230] *Id.* (quoting *FPC v. Sierra Pac. Power Co.*, 350 U.S. 348, 353 (1956)).

authority to prescribe rate changes in abrogation of the [Docket No. 20099 Settlement] Agreement."[231]

In this case, the Commission should declare the volume commitments in the incumbent LEC lock-up plans to be unlawful. As part of that ruling, the Commission could also specify that the incumbent LECs' prior purchase-based commitments cannot exceed fifty percent of a customer's historic spend with the incumbent LEC, and that packet-based services must count toward such commitments. The Commission should consider other remedies as well, such as requiring that incumbent LECs allow customers to choose the level of volume commitments rather than setting the commitment level based on the volume of a customer's past purchases. The Commission should require that shortfall, overage, and early termination penalties, if permitted, be just and reasonable.

Moreover, because wholesale buyers have entered into contract tariffs and commercial agreements for the provision of dedicated services as a means of mitigating the unreasonable terms and conditions contained in the lock-up plans, the Commission should allow customers to terminate such contract tariffs and commercial agreements without incurring early termination penalties within 12 months of the effective date of the Commission's order in this proceeding. The Commission has granted customers this right in analogous circumstances in the past. In the *Virtual Expanded Interconnection* proceeding, for example, the Commission granted competitive LECs the opportunity to take a "fresh look" at their long-term access arrangements "to determine if they wish to avail themselves of a competitive alternative."[232] The Commission held:

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[231] *Id.* (citing *MCI Telecomms. Corp. v. FCC*, 665 F.2d 1300 (D.C. Cir. 1981)).

[232] *Virtual Expanded Interconnection Order* ¶ 201.

> Notwithstanding any termination charges provided in the applicable LEC tariffs, the [incumbent] LEC may not charge more than the difference between (1) the amount the customer has already paid and (2) any additional charges that the customer would have paid for service if the customer had taken a shorter term offering corresponding to the term actually used, plus interest at the prime rate. This termination procedure will allow special access customers with long-term arrangements to select among competitive providers of access service, while ensuring that the LEC obtains the compensation appropriate for the term actually taken by the customer.[233]

That was an eminently reasonable solution, and it would work here as well.[234]

Second, the Commission should require that the incumbent LECs file their commercial agreements pursuant to Section 203 of the Act, which states that, "[e]very common carrier . . . shall . . . file with the Commission . . . schedules showing all charges for itself and its connecting carriers . . . whether such charges are joint or separate, and showing the classifications, practices, and regulations *affecting* such charges."[235] The term "affecting" is extremely broad. There is no question that some of the commercial agreements filed in this proceeding, perhaps all of them "affect" the incumbent LECs' charges for DS1 and DS3 dedicated services.

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[233] *Id.* ¶ 202.

[234] The remedies adopted for incumbent LEC tariffs and overlay agreements should also apply to commercial agreements entered into by an incumbent LEC's affiliate where the services encompassed by the agreement include dedicated services provided by the incumbent LEC and for which the incumbent LEC is classified as dominant.

[235] 47 U.S.C. § 203(a) (emphasis added).

[236]

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The incumbent LECs appear to have ignored the requirements of Section 203 in not tariffing commercial agreements like this one. Where this is the case, the incumbent LECs have denied customers the right to opt into commercial agreements that should have been filed as tariffs. Denying customers this right enables the incumbent LECs to discriminate unreasonably between and among customers without detection. Accordingly, the Commission should initiate a separate enforcement proceeding to address the incumbent LECs' apparently rampant and widespread violations of Section 203.

Third, the Commission should rule that the incumbent LECs (other than Verizon) have now relinquished their right to take advantage of Commission orders granting forbearance from dominant carrier regulation for non-TDM-based dedicated services. In granting such forbearance to AT&T, the Commission explained that, "we condition the forbearance relief granted to AT&T on its not filing or maintaining any interstate tariffs for its specified broadband services [i.e., non-TDM-based dedicated services such as Ethernet]."[237] The Commission

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[236] **[BEGIN HIGHLY CONFIDENTIAL] [END HIGHLY CONFIDENTIAL]**

[237] *Petition of AT&T Inc. for Forbearance Under 47 U.S.C. § 160(c) from Title II and Computer Inquiry Rules with Respect to Its Broadband Service, Petition of Bell South Corporation for Forbearance Under Section 47 U.S.C. § 160(c) from Title II and Computer Inquiry Rules with*

established the same condition in the subsequent Ethernet Forbearance Orders.[238] Many of the commercial agreements that have been filed as contract tariffs or that must be filed as tariffs pursuant to Section 203 govern the rates, terms, and condition on which incumbent LECs offer Ethernet and other dedicated services encompassed by the *Ethernet Forbearance Orders*. Accordingly, the incumbent LECs have failed to comply with the condition precedent for receiving the benefit of forbearance from dominant carrier regulation. The Commission must therefore rule that the incumbent LECs are now deemed dominant in the provision of affected non-TDM-based dedicated services.

Respect to Its Broadband Services, Memorandum Opinion and Order, 22 FCC Rcd. 18705, ¶ 42 (2007).

[238] *See Petition of the Embarq Local Operating Companies for Forbearance Under 47 U.S.C. § 160(c) from Application of Computer Inquiry and Certain Title II Common-Carriage Requirements, Petition of the Frontier and Citizens ILECs for Forbearance Under Section 47 U.S.C. § 160(c) from Title II and Computer Inquiry Rules with Respect to Their Broadband Services*, Memorandum Opinion and Order, 22 FCC Rcd. 19478, ¶ 41 (2007); *Qwest Petition for Forbearance Under 47 U.S.C. § 160(c) from Title II and Computer Inquiry Rules with Respect to Broadband Services*, Memorandum Opinion and Order, 23 FCC Rcd. 12260, ¶ 45 (2008).

V. Conclusion

The Commission should promptly adopt the legal conclusions and remedies described herein.

Respectfully submitted,

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February 5, 2016

APPENDIX A

Before the
Federal Communications Commission
Washington, D.C. 20554

In the Matter of	)	
	)	
Investigation of Certain Price Cap Local	)	WC Docket No. 15-247
Exchange Carrier Business Data Services Tariff	)	
Pricing Plans	)	

DECLARATION OF GARY BLACK, JR.
ON BEHALF OF LEVEL 3 COMMUNICATIONS, LLC

1. I, Gary Black, Jr., am Vice President, Carrier Relations for the North American Off-Net Access Planning organization of Level 3 Communications, LLC ("Level 3"). I am responsible for managing Level 3's relationships with service providers from which Level 3 purchases wholesale last-mile access services in North America. My responsibilities include contract management, cost management, and ensuring vendor compliance with negotiated agreements and regulated conditions.

2. The purpose of this declaration is to describe the manner in which the volume and term plans, including tariffs, contract tariffs, and non-tariffed agreements (together, "volume and term" or "lock-up" plans) under which incumbent local exchange carriers ("LECs") sell dedicated services harm Level 3[1] both in its capacity as a purchaser of dedicated services and in its capacity as a wholesaler of dedicated services.[2]

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[1] Except where otherwise noted, "Level 3" refers to Level 3 Communications, LLC and its affiliates, including legacy tw telecom.

[2] For purposes of this declaration, I use the term "dedicated services" as the FCC defined it in the special access data request. *See 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,* Order on Reconsideration, 29 FCC Rcd.

3. Level 3 purchases a large volume of dedicated services from other carriers in order to serve locations that Level 3 cannot serve using its own network facilities. Level 3 would prefer to purchase dedicated services from providers other than incumbent LECs (*i.e.*, competitive LECs) as frequently as possible. However, because competitive LECs do not serve many locations, and because Level 3 is bound by the terms and conditions in incumbent LEC lock-up plans, Level 3 has no choice but to purchase a significant majority of its dedicated services requirements from incumbent LECs.

4. In addition to purchasing dedicated services, Level 3 sells dedicated services to wholesale and retail customers. It is my experience that most of Level 3's prospective wholesale customers currently purchase a large percentage of their dedicated services requirements from incumbent LECs pursuant to lock-up plans that are the same as, or that closely resemble, those under which Level 3 purchases dedicated services from incumbent LECs.

5. The lock-up plans under which Level 3 and its prospective wholesale customers purchase dedicated services from incumbent LECs require that purchasers make term commitments and/or volume commitments, often in the form of prior purchase-based commitments, in order to obtain benefits such as discounts, credits, and circuit portability. If the purchaser fails to meet a volume or term commitment, it incurs a large penalty (or receives a significantly reduced discount or credit, which is effectively the same as a penalty) for the

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10899, App. A at 2 (2014) (defining "dedicated service" as a service that "transports data between two or more designated points, *e.g.*, between an End User's premises and a point-of-presence, between the central office of a local exchange carrier (LEC) and a point-of-presence, or between two End User premises, at a rate of at least 1.5 Mbps in both directions (upstream/downstream) with prescribed performance requirements that include bandwidth-, latency-, or error-rate guarantees or other parameters that define delivery under a Tariff or in a service-level agreement.").

shortfall. Purchasers are also subject to large penalties if they terminate a lock-up plan before it expires. Although these plans offer some relief from the incumbent LECs' unreasonable and cost-prohibitive undiscounted rates and early termination fees, I have observed the ways in which they restrict competitive LECs' ability to purchase dedicated services from competitive LECs, to the detriment of Level 3 as both a buyer and seller of dedicated services.

<u>Level 3's Experience as a Buyer of Dedicated Services</u>

6. **Lock-Up Plans under which Level 3 Purchases Dedicated Services from Incumbent LECs.** Level 3 purchases dedicated services from AT&T, CenturyLink, and Verizon under lock-up plans. As explained in the Level 3 and tw telecom responses to Question II.F.8 of the Mandatory Data Request in WC Docket No. 05-25, **[BEGIN HIGHLY CONFIDENTIAL]**

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13. **Volume Commitments and Shortfall Penalties under Incumbent LEC Plans.** In overseeing Level 3's wholesale purchases of dedicated services, I have observed numerous

instances in which the incumbent LECs' lock-up plans restrict Level 3's ability to purchase dedicated services provided by competitive LECs.

14. Where Level 3 purchases dedicated services from an incumbent LEC pursuant to a plan that requires Level to make a volume commitment, Level 3 has little ability to switch its base of existing dedicated services from the incumbent LEC to competitive LECs. Because this "embedded" base of circuits represents the vast majority of Level 3's dedicated services spend in a particular region, Level 3 must usually purchase a large percentage of its overall dedicated services requirements from the incumbent LEC in order to meet its volume commitment to the incumbent LEC.

15. Moreover, as discussed above, Level 3 incurs significant costs in the form of shortfall penalties and forgone credits or discounts (together "shortfall penalties") if Level 3 fails to meet its volume commitments under the incumbent LEC lock-up plans. These high shortfall penalties, combined with the large volume of dedicated services that Level 3 must purchase from incumbent LECs in order to meet the volume commitments, have the effect of locking up Level 3's demand for dedicated services and restricting the extent to which competitive LEC wholesalers can sell dedicated services to Level 3.

16. For example, in order to meet its volume commitments to **[BEGIN HIGHLY CONFIDENTIAL]** **[END HIGHLY CONFIDENTIAL]** and to avoid costs associated with failing to meet those commitments, Level 3 purchases dedicated services from **[BEGIN HIGHLY CONFIDENTIAL]** **[END HIGHLY CONFIDENTIAL]** in locations where it could purchase such services from competitive LECs. The competitive LECs offer dedicated services using a combination resold facilities and their own facilities. Level 3 would prefer to purchase dedicated services from a competitive LEC where the competitive LEC relies on its

own loop facilities because the competitive LEC can ensure higher quality service and has greater flexibility to lower its prices where it offers services in this manner. Nevertheless, Level 3 would likely purchase services from competitive LECs in some locations where they resell another carrier's loop facilities (in this example, usually **[BEGIN HIGHLY CONFIDENTIAL]** **[END HIGHLY CONFIDENTIAL]**) because the competitive LECs' prices and other terms and conditions are often more favorable than the incumbent LEC's. Level 3 pays **[BEGIN HIGHLY CONFIDENTIAL]** **[END HIGHLY CONFIDENTIAL]** approximately $103 million per year for dedicated services at the locations where competitive LECs have offered to serve Level 3, but Level 3 would only pay competitive carriers approximately $86 million per year for those same dedicated services. While Level 3 would save $17 million per year as a result of purchasing the dedicated services from competitive LECs, it would incur higher prices (due to lost discounts) and penalties, resulting in losses that far exceed that amount if it were to switch these purchases from **[BEGIN HIGHLY CONFIDENTIAL]** **[END HIGHLY CONFIDENTIAL]** to competitive LECs. In particular, Level 3 would incur approximately $100 million in higher prices over three years and incur penalties of, at a minimum, $700,000 per month. As a result, Level 3 has forgone purchasing dedicated services from competitive LECs at the locations in question.

17. **[BEGIN HIGHLY CONFIDENTIAL]**

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18. It is my understanding that incumbent LECs have argued that the volume commitments and shortfall penalties in the incumbent LEC lock-up plans do not in fact prevent buyers from purchasing dedicated services from competitive LEC wholesalers because (1) buyers have significant "headroom" under the plans (*i.e.*, they purchase a large volume of dedicated services above minimum volume commitment under the plan), (2) buyers with growing demand for dedicated services can purchase their future incremental growth in dedicated services (*i.e.*, dedicated services at new locations in the future) from competitive LECs, (3) buyers are free to reduce their volume commitments under incumbent LEC plans, and correspondingly increase the volume they purchase from competitive LEC wholesalers, when they renew their lock-up plans with the incumbent LECs, and (4) incumbent LECs offer many different plans, some of which do not require purchasers to make a volume commitment. I address these assertions below as they apply to Level 3 as a buyer of dedicated services.

19. **[BEGIN HIGHLY CONFIDENTIAL]**

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[END HIGHLY CONFIDENTIAL] Level 3 is therefore wary of committing to purchase from competitive providers dedicated services in excess of its volume commitments under the lock-up plans because doing so could well expose Level 3 to shortfall penalties. Moreover, no competitive LEC has deployed, or could deploy, network facilities to most of the locations where Level 3 needs to purchase dedicated services from a wholesale provider.

21. *Second*, Level 3's volume commitments to incumbent LECs limit its ability to purchase dedicated services from competitive LECs in order to serve new customer locations. **[BEGIN HIGHLY CONFIDENTIAL]**

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22. *Third*, it is my experience that Level 3 often is unable to reduce its volume commitment to an incumbent LEC when it renews a lock-up plan. As explained above, it is often not feasible for Level 3 to divert large volumes of its existing purchases of dedicated services to competitive LECs during the life of a lock-up plan. Level 3 also has little ability to switch large volumes of dedicated services to a competitive LEC's facilities after an incumbent LEC volume commitment expires because (1) as mentioned above, Level 3 would prefer to purchase dedicated services from competitive LECs where the competitive LECs provide the services over their own loop facilities but, as mentioned, competitive LECs' networks usually do not, and cannot, reach most of the locations where Level 3 needs to purchase dedicated services from a wholesale provider, and (2) the process required to cut over dedicated services from the incumbent LEC's network to a competitive LEC's network is often extremely slow. Accordingly, in order to switch a large volume of dedicated services currently purchased from an incumbent LEC to competitive LECs after the expiration of an incumbent LEC volume commitment, Level 3 must cease purchasing dedicated services under a plan with a volume commitment for the extended period of time it takes for either competitive LECs or Level 3 itself to build facilities to the locations in question and perform the necessary cutover of service. But this is not a viable business model in many cases.

23. Level 3 cannot operate outside of a lock-up plan during this transition period because the terms and conditions under which Level 3 would be required to purchase dedicated services from incumbent LECs outside of plans that include volume commitments are often too costly to permit Level 3 to operate under those conditions for an extended period of time. This is

in part because Level 3's primary competitor in most markets for business customers is the incumbent LEC itself. It is often not possible for Level 3 to compete with incumbent LECs for an extended period of time during which Level 3 must incur much higher costs for local transmission facilities (*e.g.*, due to early termination penalties that Level 3 is likely to incur when purchasing on term-only plans) than those incurred by incumbent LECs themselves.

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25. *Fourth*, while it is true that the incumbent LECs offer a number of different lock-up plans for the purchase of dedicated services, this fact often does not diminish the pressure on Level 3 to enter into a plan that has the effect of locking up its demand for dedicated services.

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26. **Rates, Terms, and Conditions Offered by Competitive LECs.** It is my understanding that the incumbent LECs have sought to justify the volume commitments and shortfall penalties in their lock-up plans by arguing that competitive LEC wholesalers impose similar terms on their customers. This has not been my experience.

27. Competitive LECs generally offer dedicated services on one-year terms at affordable rates, without imposing shortfall penalties, overage penalties, or ratcheting provisions (*i.e.*, provisions that automatically increase a customer's volume commitment to capture increases in the customer's dedicated services purchases). After the expiration of the initial term of a dedicated services contract with a competitive LEC wholesaler, Level 3 typically has the option to purchase dedicated services from a competitive LEC on a month-to-month basis at the rate that applied under the term commitment. Level 3's purchase arrangements with competitive LECs usually do not include volume commitments. Where volume commitments apply, the volumes are small, and competitive LECs do not base the volumes on customers' prior purchases. Moreover, competitive LECs offer circuit portability on far more favorable terms than incumbent LECs do, and, unlike incumbent LECs, competitive LECs do not charge Level 3

to aggregate DS1s to DS3 facilities. Finally, in all cases where Level 3 might be subject to a penalty under a wholesale agreement with a competitive LEC (*e.g.*, where it must terminate a circuit prior to the expiration of the applicable term commitment), the competitive LEC is usually more willing to waive or reduce the penalty as part of a negotiated solution than is the case with incumbent LECs (this is true even where incumbent LECs sell dedicated services not subject to tariffs).

28. **Migration from DSn-Based Dedicated Services to Ethernet Dedicated Services.** Business end users increasingly demand Ethernet dedicated services. The volume commitments in incumbent LEC tariffs, however, generally prevent purchasers from counting their Ethernet dedicated services purchases toward those volume commitments. Many of the tariffed plans do not allow customers to count circuits upgraded from DS1s and DS3s to Ethernet toward their volume commitments under any circumstances. Some plans contain limited "technology migration" provisions, which allow purchasers to either reduce their volume commitment levels when they upgrade circuits from DS1 or DS3 to Ethernet or to count circuits upgraded from DS1 or DS3 to Ethernet toward their volume commitments. However, because these provisions apply only to upgrades to current end users' services, they fail to account for the broader demand shift in the market for dedicated services. Moreover, even the provisions allowing upgrades to existing end users' services are subject to a number of limiting conditions. As a result, Level 3 is left with a Hobson's choice. It can either suffer the ever-growing risk of incurring high shortfall penalties under incumbent LEC lock-up plans as its dedicated services purchases from incumbent LECs transition from DSn dedicated services to Ethernet dedicated services, or it can enter into an overlay agreement with the incumbent LEC **[BEGIN HIGHLY CONFIDENTIAL]** **[END HIGHLY**

CONFIDENTIAL] in which it obtains some relief from shortfall penalties, among other things, in return for committing to purchase large volumes of Ethernet dedicated services from the incumbent LEC.

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31. Over the past several years, the incumbent LECs have gradually shifted from stunting the migration from DSn to Ethernet dedicated services (*i.e.*, by not permitting customers to count their Ethernet dedicated services purchases toward volume commitments), to seeking to use new volume commitments in overlay agreements to lock up the market for Ethernet dedicated services. They have done so by granting competitors some relief from shortfall penalties under volume commitments for DS1 and DS3 dedicated services in exchange for large volume commitments that include Ethernet and other non-TDM-based dedicated services. As

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explained above, in order to meet these volume commitments, Level 3 will need to purchase larger and larger volumes of Ethernet dedicated services from incumbent LECs. In this manner, incumbent LECs are exploiting their dominance in the provision of DSn dedicated services as a means of locking up Level 3's demand for Ethernet dedicated services.

Level 3's Experience as a Seller of Dedicated Services

32. It is my experience that the incumbent LECs' lock-up plans restrict Level 3's prospective wholesale customers' ability to purchase dedicated services from Level 3 for the same reasons, described above, that those tariffs and overlay agreements restrict Level 3 from buying dedicated services from other competitive LECs. While the prospective buyers themselves are better placed to describe these effects, Level 3 does sometimes become aware of specific circumstances in which prospective buyers forgo purchasing dedicated services from Level 3 because of the lock-up effects of the volume commitments they have made to incumbent LECs.

33. For example, one Level 3 wholesale customer, which consistently purchased several million dollars in services (including dedicated services) from Level 3 each year, recently dramatically reduced its purchases from Level 3, including dedicated service purchases. Although the customer was satisfied with Level 3's pricing and service quality, the Level 3 sales team learned that the customer had no choice but to move its purchases to an incumbent LEC because of penalties the customer would otherwise face pursuant to its agreement for the purchase of dedicated services from the incumbent LEC.

34. Another Level 3 customer informed Level 3 that it had analyzed a sample of locations where it currently purchases services from incumbent LECs to determine the extent to which it would save money by purchasing the services from a competitive LEC. In a large

number of locations within the sample areas, the customer wanted to purchase services from Level 3 and would have saved approximately $65,000 per year if it could have done so. However, the customer determined that it could not purchase the services from Level 3 because doing so would compromise its ability to meet the volume commitments it had made to incumbent LECs for the purchase of dedicated services.

I declare under penalty of perjury that the foregoing is true and correct to the best of my information and belief.

____________________________ Dated: 2/4/16

Gary Black, Jr.

Exhibits 1-5 to Appendix A are Highly Confidential and have been redacted in their entirety.

APPENDIX B

Before the
Federal Communications Commission
Washington, D.C. 20554

In the Matter of	)	
	)	
Investigation of Certain Price Cap Local Exchange Carrier Business Data Services Tariff Pricing Plans	)	WC Docket No. 15-247
	)	
	)	

DECLARATION OF MARK JEARY ON BEHALF OF EARTHLINK HOLDINGS CORP.

1. I am Senior Vice President of Network Access & Vendor Management at EarthLink Holdings Corp. ("EarthLink"), a position I have held since October 2013. I have over 16 years of experience in the telecommunications industry, and have held various positions in Access Management at Global Crossing, Level 3, XO Communications, and EarthLink. In my current position, I am responsible for managing the relationships between EarthLink and our access and network vendors (including incumbent LECs), regulatory policy, and developing and implementing strategy decisions related to legal, regulatory, technology, and other business factors, as well as design, cost, and operational matters.

2. This declaration describes the harms that EarthLink has suffered as a purchaser of dedicated services as a result of the tariffs, contract tariffs, and non-tariffed agreements (together, "lock-up plans") under which EarthLink purchases dedicated services from incumbent LECs.[1]

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[1] For purposes of this declaration, I use the term "dedicated services" as the FCC defined it in the special access data request. *See 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*, Order on Reconsideration, 29 FCC Rcd. 10899, App. A at 2 (2014) (defining "dedicated service" as a service that "transports data

As explained below, these harms are particularly acute with regard to **[BEGIN HIGHLY CONFIDENTIAL]** [2] [3] **[END HIGHLY CONFIDENTIAL]**.

3. **Volume Commitments and Shortfall Penalties Under the Incumbent LECs' Plans.** EarthLink provides voice and data services to business customers. It is inefficient for EarthLink to deploy its own loop facilities to customer locations for the purpose of selling lower-capacity dedicated services, such DS1s and DS3s. Therefore, EarthLink must lease loop facilities from other carriers in order to reach its customers' locations when providing these services. Incumbent LECs own the only loop connection to the vast majority of commercial buildings in EarthLink's service areas. EarthLink has no choice, therefore, but to purchase dedicated services from incumbent LECs in a large number of locations.

4. EarthLink cannot offer competitive rates to its end-user business customers unless it can purchase dedicated services from the incumbent LECs at discounted rates and pursuant to circuit portability options that allow EarthLink to move circuits without incurring exorbitant

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between two or more designated points, *e.g.*, between an *End User's* premises and a point-of-presence, between the central office of a local exchange carrier (LEC) and a point-of-presence, or between two *End User* premises, at a rate of at least 1.5 Mbps in both directions (upstream/downstream) with prescribed performance requirements that include bandwidth-, latency-, or error-rate guarantees or other parameters that define delivery under a *Tariff* or in a service-level agreement").

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circuit termination penalties. In order to obtain discounts and circuit portability under most of the incumbent LECs' lock-up plans, EarthLink must commit to buying a large percentage of its historic purchase volumes from the incumbent LECs. If it fails to meet these volume commitments, EarthLink incurs large shortfall penalties.

5. The combined effect of large volume commitments and large shortfall penalties is extremely harmful to EarthLink. However, EarthLink is unable to extricate itself from its commitments under the incumbent LECs' lock-up plans because of the substantial termination penalties imposed by those plans. I describe below some recent examples of harm that EarthLink has suffered as a result of **[BEGIN HIGHLY CONFIDENTIAL]** **[END HIGHLY CONFIDENTIAL]**.

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[4] *See* **[BEGIN HIGHLY CONFIDENTIAL] [END HIGHLY CONFIDENTIAL]**

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9. Exiting the **[BEGIN HIGHLY CONFIDENTIAL] [END HIGHLY CONFIDENTIAL]** also would force EarthLink into a Hobson's choice. On the one hand, EarthLink could sign up for term commitments on individual circuits in order to receive the discounts it needs to compete for downstream retail customers. However, since EarthLink would lose the **[BEGIN HIGHLY CONFIDENTIAL] [END HIGHLY CONFIDENTIAL]** benefits, it would be subject to an early termination penalty each time its retail customer discontinues service prior to the expiration of the term commitment on a circuit. This would likely be a fairly frequent occurrence, meaning that EarthLink would likely pay a large volume of early termination penalties. On the other hand, EarthLink could choose to

[5] *See* **[BEGIN HIGHLY CONFIDENTIAL] [END HIGHLY CONFIDENTIAL]**

purchase dedicated circuits from **[BEGIN HIGHLY CONFIDENTIAL] [END HIGHLY CONFIDENTIAL]** on shorter terms or on a month-to-month basis, in which case EarthLink would pay rates that are too high to enable it to compete effectively. For example, EarthLink would be unable to renew contracts with existing customers at the rates EarthLink currently charges, and EarthLink would therefore likely lose many of those customers to a competitor **[BEGIN HIGHLY CONFIDENTIAL] [END HIGHLY CONFIDENTIAL]** It is also important to note that purchasing dedicated services as UNEs would not be a viable alternative to purchasing those services as special access dedicated service. This is because **[BEGIN HIGHLY CONFIDENTIAL] [END HIGHLY CONFIDENTIAL]**.

10. EarthLink's efforts to meet its volume commitment under the **[BEGIN HIGHLY CONFIDENTIAL] [END HIGHLY CONFIDENTIAL]** also negatively impact network grooming and savings initiatives by preventing EarthLink from moving existing circuits from the incumbent LEC to an alternate wholesale provider. For example, **[BEGIN HIGHLY CONFIDENTIAL]**

[END HIGHLY CONFIDENTIAL]

11. **[BEGIN HIGHLY CONFIDENTIAL]**

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[END HIGHLY CONFIDENTIAL]

19. **Incumbent LEC Assertions.** I understand that the incumbent LECs have argued that the volume commitments and shortfall penalties in their lock-up plans do not in fact prevent buyers from purchasing dedicated services from competitive LEC wholesalers because (1) the fact that buyers purchase a large volume of dedicated services above the minimum volume commitment under their plans indicates that they have substantial "headroom" to shift their purchases away from the incumbents, (2) buyers with growing demand for dedicated services can purchase from competitive LECs the future incremental dedicated services that they require (*i.e.*, dedicated services at new locations in the future), (3) buyers are free to reduce their volume commitments under incumbent LEC plans, and to increase the volumes they purchase from competitive LEC wholesalers, when they renew their lock-up plans with the incumbent LECs, and (4) incumbent LECs offer many different plans, some of which do not require purchasers to make a volume commitment. These claims are addressed below as they apply to EarthLink as a buyer of dedicated services.

20. **[BEGIN HIGHLY CONFIDENTIAL]**

21.

[END HIGHLY CONFIDENTIAL]

22. *Second*, EarthLink's volume commitments to incumbent LECs limit its ability to purchase dedicated services from competitive LECs in order to serve new customer locations. In my experience, and as explained above, the incumbent LECs' lock-up plans impose such

onerous shortfall penalties that EarthLink must rely on incumbent LEC facilities to serve new customer locations, even when it would otherwise have the ability to purchase dedicated services from competitive LECs.

23. *Third*, in my experience, it is possible to reduce the volume commitment for an incumbent LEC lock-up plan only at the end of the plan's term because, as described above, the incumbent LECs' "buy-down" options are as costly or more costly than the shortfall penalties they impose. However, even exiting an incumbent LEC lock-up plan at the end of a term is difficult. When EarthLink renews an incumbent LEC lock-up plan, it cannot opt for a term that is shorter than the previous term because the applicable discounts are lower for such plans, thereby causing EarthLink to incur increased costs *for its entire base of existing circuits* and for new circuits. Therefore, once a purchaser has committed to an incumbent LEC lock-up plan there is virtually no way to "get out," and the plan must be renewed after expiration. To be sure, volume commitment levels are set based on the volume purchased at the time of renewal. Because the minimum volume commitment is set slightly below that level, **[BEGIN HIGHLY CONFIDENTIAL]**

[END HIGHLY CONFIDENTIAL] it is possible for the wholesale buyer to experience a decline in demand without at first incurring shortfall penalties. However, given that the demand for DS1 and DS3 circuits is declining year over year, it is inevitable that a wholesale buyer will eventually incur shortfall penalties under any plan that requires the purchase of large volumes of DS1 and DS3 services.

24. *Fourth*, even though the incumbent LECs offer a number of different lock-up plans for the purchase of dedicated services, some of which do not include a volume commitment, EarthLink has no meaningful choice but to enter into plans that lock up its demand

for dedicated services. The lock-up plans under which EarthLink purchases dedicated services from incumbent LECs include significantly more favorable rates, terms, and conditions than other plans offered by the incumbent LECs. If EarthLink were to choose one of those other plans, it would be forced to compete at a significant disadvantage as compared to the competitive LECs that purchase dedicated services from incumbent LECs under the more favorable plans, and as compared to the incumbent LECs themselves.

25. **Rates, Terms, and Conditions Offered by Competitive LECs.** The incumbent LECs have sought to justify the volume commitments and shortfall penalties in their tariffs, contract tariffs, and non-tariffed agreements by arguing that competitive LEC wholesalers impose similar terms on their customers. That is not the case in my experience.

26. Competitive LECs generally offer dedicated services on one-year terms at affordable rates, without imposing shortfall penalties, overage penalties, or ratcheting provisions (*i.e.*, provisions that automatically increase a customer’s volume commitment to capture increases in the customer’s dedicated services purchases). After the expiration of the initial term of a dedicated services contract with a competitive LEC wholesaler, EarthLink typically can purchase competitive LEC dedicated services on a month-to-month basis at the rate that applied under the term commitment. Competitive LECs that offer volume commitments do not base discounts on customers’ prior purchases. Moreover, in order to allow customers to avoid early termination liability, many competitive LECs offer circuit portability on a circuit-by-circuit basis, or will allow a new DS3 to “replace” multiple DS1s, generally as long as the new monthly recurring charge is equal to or greater than the monthly recurring charge for the circuits being replaced, and the new circuit term is equal to or greater than the term for the circuits being replaced.

I declare under penalty of perjury that the foregoing is true and correct to the best of my information and belief.

Mark Jeary

Dated: 1-29-2016

Exhibits 1-2 to Appendix B are Highly Confidential and have been redacted in their entirety.

APPENDIX C

REDACTED – FOR PUBLIC INSPECTION

Before the
Federal Communications Commission
Washington, D.C. 20554

In the Matter of	)	
	)	
Investigation of Certain Price Cap Local Exchange Carrier Business Data Services Tariff Pricing Plans	)	WC Docket No. 15-247

DECLARATION OF DOUGLAS DENNEY
ON BEHALF OF INTEGRA TELECOM HOLDINGS, INC.

1. I am employed by Integra Telecom Holdings, Inc. ("Integra) as Vice President of Costs and Policy. I hold a B.S. degree in Business Management from Phillips University and have completed the requirements for a Ph.D. in Economics, except my dissertation. I have taught a variety of economics courses at the University of Arizona and Oregon State University. Between 1996 and 2004, I was employed by AT&T, where I was responsible for analyzing cost models. In December 2004, I was hired by Eschelon Telecom, Inc. ("Eschelon"). Eschelon was purchased by Integra in August 2007. As Integra's Vice President of Costs and Policy, my responsibilities include negotiating interconnection agreements, and monitoring, reviewing, and analyzing the wholesale prices Integra and its subsidiaries pay to incumbent LECs such as CenturyLink, AT&T, and Frontier, which includes advising Integra with respect to incumbent LEC volume and term plans.

2. This declaration describes the harms that Integra has suffered as a purchaser of dedicated services as a result of the tariffed volume and term plans under which Integra

purchases dedicated services from incumbent LECs.[1] As explained below, these harms are particularly acute **[BEGIN HIGHLY CONFIDENTIAL]**

[END HIGHLY CONFIDENTIAL].[2]

3. Integra provides voice and data services to business customers. Most of the customer locations that Integra serves do not provide sufficient revenue to enable Integra to recover the costs of deploying its own facilities. Where this is the case, Integra must lease the last-mile facilities of another carrier. Integra prefers to purchase dedicated services from alternative providers whenever possible, but because incumbent LECs own the only last-mile facilities to the vast majority of commercial buildings in Integra's service areas, Integra has no choice but to purchase dedicated services from incumbent LECs in a large number of locations.

4. **Volume Commitments and Shortfall Penalties Under the Incumbent LECs' Plans.** The incumbent LECs' month-to-month rates for dedicated services and their circuit termination penalties are so high that Integra often cannot offer competitive rates to its end-user business customers unless it can purchase dedicated services from the incumbent LECs at discounted rates and pursuant to circuit portability options that allow Integra to move circuits

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[1] For purposes of this declaration, I use the term "dedicated services" as the FCC defined it in the special access data request. *See 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*, Order on Reconsideration, 29 FCC Rcd 10899, App. A at 2 (2014) (defining "dedicated service" as a service that "transports data between two or more designated points, *e.g.*, between an *End User's* premises and a point-of-presence, between the central office of a local exchange carrier (LEC) and a point-of-presence, or between two *End User* premises, at a rate of at least 1.5 Mbps in both directions (upstream/downstream) with prescribed performance requirements that include bandwidth-, latency-, or error-rate guarantees or other parameters that define delivery under a *Tariff* or in a service-level agreement").

[2] **[BEGIN HIGHLY CONFIDENTIAL]**

[END HIGHLY CONFIDENTIAL]

without incurring exorbitant circuit termination penalties. In order to obtain discounts and circuit portability under most of the incumbent LECs' volume and term plans, Integra must commit to buying a large percentage of its historic purchase volumes from the incumbent LEC. If it fails to meet these volume commitments, Integra incurs large shortfall penalties.

5. The combined effect of large volume commitments and large shortfall penalties is extremely harmful to Integra. However, Integra is unable to extricate itself from its commitments under the incumbent LECs' volume and term plans because of the substantial termination penalties imposed by those plans. I describe below Integra's recent experiences under the **[BEGIN HIGHLY CONFIDENTIAL]** **[END HIGHLY CONFIDENTIAL]**, which illustrate the harmful effects that Integra suffers as a result of onerous volume commitments and large shortfall penalties.

6. **[BEGIN HIGHLY CONFIDENTIAL]**

[3]

[3] **[BEGIN HIGHLY CONFIDENTIAL]** **[END HIGHLY CONFIDENTIAL]**

[4]

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[4] **[BEGIN HIGHLY CONFIDENTIAL] [END HIGHLY CONFIDENTIAL]**

[5] **[BEGIN HIGHLY CONFIDENTIAL] [END HIGHLY CONFIDENTIAL]**

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[6]

[END HIGHLY CONFIDENTIAL]

10. I understand that the incumbent LECs have argued that the volume commitments and shortfall penalties in the incumbent LEC volume and term plans do not in fact prevent buyers from purchasing dedicated services from competitive LEC wholesalers because (1) the fact that buyers purchase a large volume of dedicated services above the minimum volume commitments under their plans indicates that they have substantial “headroom” to shift their purchases away from the incumbents; (2) buyers are free to reduce their volume commitments under incumbent LEC plans, and to increase the volume they purchase from competitive LEC

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[6] **[BEGIN HIGHLY CONFIDENTIAL]**

[END HIGHLY CONFIDENTIAL]

wholesalers, when they renew their volume and term plans with the incumbent LECs; and (3) incumbent LECs offer many different plans, some of which do not require purchasers to make a volume commitment. These claims are addressed below as they apply to Integra as a buyer of dedicated services.

11. *First*, **[BEGIN HIGHLY CONFIDENTIAL]**

12.

[END HIGHLY CONFIDENTIAL]

13. *Second*, as illustrated by Integra's recent experience **[BEGIN HIGHLY CONFIDENTIAL]** **[END HIGHLY CONFIDENTIAL]**, when Integra renews an incumbent LEC volume and term plan, it often is unable to reduce its volume

commitment and is correspondingly unable to increase the volume of dedicated services it purchases from competitive LEC wholesalers. As described above, in most cases during the life of a volume and term plan, Integra cannot economically shift significant demand to competitive LECs. In addition, while there are some locations where Integra could switch its purchases from the incumbent LEC to a competitive LEC upon the expiration of its volume commitment to the incumbent LEC, competitive LECs do not currently serve most of Integra's customer locations. Therefore, in order to switch a large volume of dedicated services currently purchased from an incumbent LEC to competitive LECs after the expiration of an incumbent LEC volume commitment, Integra must cease purchasing dedicated services under a plan with a volume commitment for the extended period of time it takes for either competitive LECs or Integra itself to build facilities to the locations in question.

14. But this is not a viable strategy for Integra because the rates, terms, and conditions under which Integra would be required to purchase dedicated services from incumbent LECs outside of plans that include volume commitments are often too costly to permit Integra to operate under those conditions for an extended period of time. Integra's primary competitor for business customers is the incumbent LEC itself in most markets, and Integra would not be able to sustain the costs of lopsided competition during the period in which Integra or another competitor is building facilities. Integra would be forced to incur much higher costs for local transmission facilities (*e.g.*, due to exorbitant circuit termination penalties that Integra would be forced to pay in the absence of circuit portability) than those incurred by incumbent LECs that are vying for the same customers.

15. *Third*, even though the incumbent LECs offer a number of different term plans for the purchase of dedicated services, some of which do not include a volume commitment, Integra

has no meaningful choice but to enter into volume and term plans that lock up its demand for dedicated services. The volume and term plans under which Integra purchases dedicated services from incumbent LECs include significantly discounted rates and benefits that are not available under other incumbent LEC plans. **[BEGIN HIGHLY CONFIDENTIAL]**

[END HIGHLY CONFIDENTIAL] If Integra were to choose one of those other plans, it would be forced to compete at a significant disadvantage as compared to the competitive LECs that purchase dedicated services from incumbent LECs under the more favorable plans, and as compared to the incumbent LECs themselves.

16. **Rates, Terms, and Conditions Offered by Competitive LECs.** The incumbent LECs have sought to justify the volume commitments and shortfall penalties in their tariffs, contract tariffs, and non-tariffed agreements by arguing that competitive LEC wholesalers impose similar terms on their customers. That is not the case in my experience. For example, **[BEGIN HIGHLY CONFIDENTIAL]**

[END HIGHLY CONFIDENTIAL]

17. In fact, competitive LECs generally offer dedicated services on one-year terms at affordable rates, without imposing shortfall penalties, overage penalties, or ratcheting provisions (*i.e.*, provisions that automatically increase a customer's volume commitment to capture increases in the customer's dedicated services purchases). After the expiration of the initial term of a dedicated services contract with a competitive LEC wholesaler, Integra typically can purchase competitive LEC dedicated services on a month-to-month basis at the rate that applied

under the term commitment. Competitive providers that offer volume commitments do not base those discounts on customers' prior purchases. Moreover, many competitive providers offer circuit portability after the first six months of a one-year term and allow Integra to groom multiple DS1 circuits onto DS3 circuits without charge.

18. I declare under penalty of perjury that the foregoing is true and correct to the best of my information and belief.

______________________________________ Dated: 2/2/2016

Douglas Denney

Appendices D to G are Highly Confidential and have been redacted in their entirety.