BEFORE THE

Federal Communications Commission

WASHINGTON, D.C.

In the Matter of	)	
	)	
Unbundled Access to Network Elements	)	WC Docket No. 04-313
	)	
Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers	)))	CC Docket No. 01-338

COMMENTS OF PAETEC COMMUNICATIONS, INC.

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PAETEC Communications, Inc. ("PAETEC") hereby files its comments in response to the Order and Notice of Proposed Rulemaking ("Notice")[1] regarding alternative unbundling rules implementing obligations of Section 251(c) (3) of the Communications Act of 1934, as amended ("Act").[2] The Notice is intended by the Commission to implement rules in a manner consistent with the decision of the U.S. Court of Appeals for the District of Columbia ("D.C. Circuit") in *United States Telecom Ass'n v. FCC* ("USTA II").[3]

I. INTRODUCTION

PAETEC is a privately held, facilities-based, integrated communications provider headquartered in Fairport, New York. PAETEC provides competitive local exchange carrier

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1 In the Matter of Unbundled Access to Network Elements, WC Docket No. 04-313, Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers, CC Docket No. 01-338, Order and Notice of Proposed Rulemaking, FCC 04-179 (released August 20, 2004).

2 47 U.S.C. § 151 et seq.

3 359 F.3d 554(D.C. Circuit)("*USTA II*").

(“CLEC”) and interexchange carrier (“IXC”) telecommunications services as well as data and applications support services. PAETEC offers these services via wholesale channels to other providers, as well as to end-user enterprise customers. PAETEC sells primarily to customers requiring DS-1 or greater bandwidth capacity. PAETEC currently operates in twenty-seven metropolitan markets throughout the United States.

PAETEC utilizes Lucent 5ESS switching platforms to carry local, long distance and data traffic. Through intelligent network planning and design, PAETEC extends its network out from its switching centers located in several key US metropolitan areas. In a design reminiscent of incumbent LEC hub and spoke construction, PAETEC extends its network out to additional points of presence (“POPs”) in multiple, neighboring local access and transport areas (“LATAs”). Concurrently, PAETEC provides multiple LATA points of interconnection (“POIs”) to facilitate efficient interconnection with LECs, CLECs, wireless providers, IXCs and other service providers (see footnote 4 for more information). The single switch/multiple POP design allows PAETEC to concentrate network, reduce mileage sensitive loop charges and provide for an overall cost effectiveness critical to marginal performance.

Since its inception in 1998, PAETEC has relied primarily on Regional Bell Operating Company (“RBOC”) wholesale tariffed special access services in order to connect to end-users. PAETEC orders special access from end-user sites and connects the service either to its switch or the extended POP. PAETEC relies secondarily on competitive access provider (“CAP”) transport and loop facilities to augment this network design.

For six years PAETEC has seen consistent customer and revenue growth. PAETEC is also happy to report that it has been a net income positive business for eight consecutive calendar quarters.

II. EXECUTIVE SUMMARY

PAETEC believes that special access services as they are traditionally defined,[4] and as provided by the RBOCs, are subject to significant barriers to competitive provision. Without reliable substitute services or government regulation, RBOC providers of special access will act as natural monopolies and price such services accordingly. As such, RBOC-provided special access is a quintessential market failure ripe for government intervention and pricing correction. PAETEC is agnostic as to the means by which the government controls the pricing of special access services. Traditional and long standing regulatory enforced price ceilings as well as the existence of a reasonable economic substitute in the form of CLEC access to ILEC high capacity (DS-1 or greater) loops via the Act's unbundled network element ("UNE") provisions at state commission determined prices (Total Element Long Run Incremental Cost or "TELRIC") have worked in tandem to keep special access pricing in check. PAETEC is concerned that RBOC special access pricing flexibility[5] as well as *USTA II* may have, in fact, removed effective and necessary pricing controls vital in the absence of a competitive market for these services.

III. COMMENTS ADDRESSING THE NOTICE

In its Notice, the Commission asked the industry to comment on the applicability of various LEC service offerings and obligations, such as tariffed offerings, and how they fit into

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4 Special access is a means by which a dedicated transmission path is made between two or more customer designated premises ("CDPs") bypassing the exchange carrier's end office switching capability (See NECA Access Handbook, Section 7, Page 7-1, February 1997). Traditionally, one CDP is an interexchange carrier ("IXC") POP. At PAETEC's POPs, the network is configured from that point on to carry local, interexchange and data traffic. At the switches or certain POPs also acting as POIs, PAETEC offers reliable interconnection with other national carriers and service providers. Jurisdictional separation is maintained in order to properly route and rate calls in accordance with federal and state rules, industry standards, tariffs, commercially negotiated agreements and interconnection agreements under Sections 251/252 of the Act.

5 Access Charge Reform, Fifth Report and Order, 14 FCC Rcd 14221 (1999) ("Pricing Flexibility Order").

the Commission's unbundling framework.[6] PAETEC takes this opportunity to advance the notion that, from our perspective, ILEC – particularly RBOC – provisioned special access is a viable means by which PAETEC may purchase wholesale access to its end-users. This observation comes with a caveat. PAETEC makes this claim only because PAETEC believes that the existence of high capacity UNEs and price caps on special access services have created an imperfect but tolerable pseudo-competitive environment. In the apparent absence of a competitive market for access services, a reasonable substitute must exist in order to control what would otherwise be unfettered ILEC natural monopoly behavior.

IV. WHY SPECIAL ACCESS WORKS FOR PAETEC

PAETEC makes no representations here regarding the viability of use of special access for any other telecommunications company or service provider. Any attempt to draw conclusions based on PAETEC's experience and applying those conclusions to the industry would be anecdotal at best. PAETEC's niche market strategy with a focus on customers located in Tier-1 cities and requiring at least a DS-1 sized circuit, combined with our intelligent network build, makes our experience unique. However, PAETEC believes our story is one the Commission can use to draw up effective public policy rules in order to stimulate the facilities-based competition envisioned by Congress in the 1996 Act.

PAETEC relies significantly on RBOC special access for all last mile connectivity. Aside from the overall advantages PAETEC's network build provides to us, special access as a service of choice works for PAETEC because we serve markets with a high-density population and an aggregation of our targeted base –medium and large business customers.[7] That translates

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6 FCC 04-179, para 9.

7 PAETEC's vertical markets program has established long-term relationships with several high profile Fortune 1000 companies along with scores of hospitals, universities, colleges and state level governments.

to a marketing strategy designed to serve approximately 15% of the total available US business telecom marketplace. PAETEC does not believe that special access, as currently priced, would represent a viable alternative for serving small business customers or customers in rural locations.

Additionally, PAETEC has worked diligently to bring aboard a significantly sized customer base that provides sufficient volume and allows PAETEC to take aggressive advantage of term and volume discounts offered by our wholesale vendors. Those term and volume discounts, particularly those offered by RBOCs, can be advantageous if and only if the purchaser is willing to assume certain risks inherent in a long term commitment. Considering the vagaries in the telecommunications marketplace today, that formula may not work for all firms. PAETEC prides itself in limiting customer churn by an exceptional devotion to customer service. Brand loyalty based on our service quality, network reliability and investment in maintenance and repair services allow us to mitigate special access long-term commitment risk because we believe in our service quality creed and so do our customers.

V. MONOPOLIES ACT RATIONALLY

PAETEC's expertise is in service and technology, not economics. However, the fact that it is natural for firms with market power to behave monopolistically if given the opportunity has been proven throughout history. This is rational behavior for any firm and any similarly situated entity would do the same. Monopolies simply cannot help themselves. Decision makers reviewing Section 251 rules cannot ignore fundamental economic facts regarding monopolistic behavior.

PAETEC's experience in ordering loop services via RBOC special access tariffs to our targeted customer base and in our markets is illustrative of what we believe is, in most cases, a marketplace with one supplier. Our experience has been that we have few other vendor choices from which to select. The odd CAP fiber route, particularly when it comes to loop plant, does not provide sufficient alternatives for us to apply the commercial pressure we would otherwise prefer as behavioral control on RBOC special access pricing. To use the economic vernacular, PAETEC believes that high capacity services are inelastic services. Without a vibrant CAP market, price ceilings or alternative pricing via UNEs priced at TELRIC, PAETEC has few options for substitute services.

VI. REASONABLE SUBSTITUTE – CAP PROVIDED ALTERNATIVE

PAETEC makes every attempt when ordering access to a customer premise to seek out competitive alternatives provided via other facilities-based access providers. Because of either price or availability, more than 90% of the time, access to the end-user can only be obtained from the RBOC or the large incumbent LEC serving the territory in which PAETEC desires to compete. Some carriers claim that facilities-based competition, to include choices among wholesale providers, has been whittled away by both federal and state regulations favoring those that do not invest in their own networks. PAETEC does not have enough evidence to support or refute this conclusion. PAETEC has observed the contraction of the competitive access market through mergers and acquisitions. We have a good idea of which competitive wholesale alternatives remain in the marketplace because we look for them as a fundamental step in network planning. Our lack of success in using competitive providers for loop access services is a warning sign to PAETEC that the access market is not as robust as a purchaser would hope and as others may claim.

VII. REASONABLE SUBSTITUTE – GOVERNMENT ENFORCED PRICE CAPS

Prior to 1990, special access was under the pricing protection of rate of return regulation set at 11.25%.[8] In 1990, the FCC replaced rate of return regulation with an incentive-based price cap plan to act as a transitional regulatory control until competition developed. The original price cap scheme included factors that when applied to LEC financials resulted in a ceiling on interstate access charges charged by LECs.[9] In 1999, the Commission adopted pricing flexibility for price cap LECs and established a two-phase structure for granting further

8 Prescribing the Authorized Rate of Return for Interstate Services of Local Exchange Carriers, Order, 5 FCC Rcd 7507 (1990).

9 Policy and Rules Concerning Rates for Dominant Carriers, Second Report and Order, 5 FCC Rcd 6786 (1990).

flexibility contingent upon competitive showing in their geographic area. [10] The second phase allowed price cap LECs to offer some services free of rate structure and price cap rules. Incumbent LECs requested, and were granted, Phase I and Phase II pricing flexibility. In 2002, AT&T filed a petition with the Commission requesting reconsideration of the flexibility granted to ILECs, correctly citing excessive and unlawful rates as an example of severe and growing anticompetitive behavior in the market.[11] Since that time, several other papers have been published outlining the negative effects of pricing flexibility on incumbent LEC special access rates and, thus, on consumer DS-1 rates and overall high capacity market competition.[12] PAETEC draws the Commission's attention to these more detailed studies.

VIII. REASONABLE SUBSTITUTE – HIGH CAP UNES PRICED AT TELRIC

As we have demonstrated here, PAETEC has chosen to utilize one source of access to end-users. However, other CLECs, in order to remain competitive and minimize the substantial investment of building facilities, rely on the availability of ILEC networks and the unbundling provisions of the Act for providing service. These CLECs take advantage of UNEs offered at TELRIC prices to offset and possibly avoid the huge investment required of telecommunications providers. The UNE CLECs are free then to pass on those benefits to the nation's high capacity telecommunications consumers. UNEs, while affordable in and of themselves, still require the upfront investment of collocation and other capital expense investment. Recent actions by the D.C. Circuit and the Commission have led to uncertainty in the long-term future of high capacity UNE loop availability. PAETEC believes that availability of ILEC high capacity UNEs priced

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10 Access Charge Reform, Fifth Report and Order, 14 FCC Rcd 14221 (1999).

11 AT&T Corp. Petition for Rulemaking To Reform Regulation of Incumbent Local Exchange Carrier Rates For Interstate Special Access Services, RM Docket No. 10593, October 15, 2002 .

12 "Deregulation of Special Access Services: Timing Is Everything," Daniel Kelley, July 2, 1999; " Set It and Forget It? Market Power and the Consequences of Premature Deregulation in Telecommunications Markets," George S. Ford, Lawrence J. Spiwak, July 2003; "Competition in Access Markets: Reality or Illusion," Economics and Technology, Inc., August 2004.

at TELRIC contributes to special access pricing stability simply because purchasers of special access retain the flexibility to migrate to UNE services if wholesale special access prices are increased.

IX. CONCLUSION - SITUATION COMPELS GOVERNMENT ACTION

PAETEC submits these comments from the perspective of our experience only. These comments are intended to convince the Commission to retain high capacity loops as UNEs as an effective check on pricing of special access. Additionally, PAETEC would encourage a review of certain conditions of pricing flexibility for special access as well, but realizes this is not the forum for that issue. The marketplace for high capacity loops is already showing signs of the pressure.

Without necessary regulation, even the D.C. Circuit agrees that incumbent LECs have the incentive to price tariffed services as high as possible.[13] As a coalition representing large business consumers of high capacity services has observed, the incumbent LEC rate of return, set at 11.25% in 1990, has steadily risen to an average of 43.7% in 2003, and the return on special access in alleged "competitive" geographic markets with pricing flexibility is higher than in regulated "monopolistic" areas.[14]

Regulatory safeguards, while not the preferred answer, are important in that without them, competition is reduced.[15] PAETEC believes these warning signs are clear. If the Commission fails to act to preserve these monopoly safeguards, PAETEC believes its customers, along with consumers of high capacity telecommunications services nationwide, will suffer. Additionally, PAETEC believes that the cost instability inherent in constantly shifting federal

13 *USTA II, 359 F.3d* at 576.

14 Economics and Technology, p. v.

15 Kelley, p. 2.

regulatory policy both with regard to availability and pricing of ILEC network elements and special access price caps conspires to preclude competitive carrier access to capital markets. The investment community is not appreciative of uncertainty in any market.

PAETEC applauds the stated desire of this Commission to expand the availability of broadband services throughout the United States. PAETEC is convinced that government action as detailed in these comments would be big step in ensuring that that public policy goal is obtained.

Respectfully Submitted,

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