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November 12, 2004

Ex Parte

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

Re: Ex Parte Presentation, *Unbundled Access to Network Elements*, WC Docket No. 04-313, CC Docket No. 01-338

Dear Ms. Dortch:

Enclosed for filing in connection with the above referenced matter is a white paper entitled "Bell OPP Tariffs Both Impede Facilities-Based Competition And Increase The Risk Of Providing Local And Long Distance Services." This white paper further demonstrates that wireline competition cannot flourish if competitive carriers are relegated to Bell special access services.

Please contact me if you have any questions.

Very truly yours,

/s/ C. Frederick Beckner III
Counsel for AT&T Corp.

Encl.

BELL OPP TARIFFS BOTH IMPEDE FACILITIES-BASED COMPETITION AND INCREASE THE RISK OF PROVIDING LOCAL AND LONG DISTANCE SERVICES

In *USTA II*, the Court directed the Commission to determine whether special access poses different "opportunities and risks" relative to the use of unbundled network elements ("UNEs").[1] As AT&T has explained, Bell "OPP" special access tariffs contain provisions that decrease competitive carriers' "opportunities" to deploy their own facilities or use those of third-parties while also increasing the "risk" of providing local and long distance service.[2] Given these poison pills, the Commission simply cannot consider special access service as relevant to its impairment determinations under § 251(d) of the Communications Act. Indeed, the Bells' OPP tariffs contain "lock-up" provisions that are manifestly discriminatory and unreasonable and the Commission should declare those provisions unlawful and unenforceable.

The Bells' OPPs Impede Facilities-Based Competition By Locking Up Traffic. In their replies, the Bells first contend that their OPPs do not require a customer "to forego any competitive alternatives as a prerequisite to obtaining the discounts available under those plans."[3] To the contrary, to get the Bells' "best" rates – that is, the rates upon which the Bells rely in claiming that special access is a viable substitute for UNEs – a carrier must subscribe *both* to (i) a base term plan, under which the carrier obtains a discount only for the individual circuits or revenues it commits to the Bell; *and*, in the case of BellSouth and SBC, to (ii) an "overlay tariff" under which a carrier must agree to "lock-up" a certain level of traffic with the Bell based on its historical special access demand.[4] These conditions quite plainly deter special access subscribers from self-deploying facilities or shifting to bypass providers and thus increase the risks of using special access services instead of UNEs as inputs in providing retail enterprise service.

As the Bells concede, their base term plans require a carrier-customer to commit either a certain volume of demand or to purchase a specific circuit over a period of time in order to obtain a discount.[5] Given the substantial penalties that apply for failure to fulfill those commitments, it is not economic for a carrier-customer to shift volumes and circuits committed

[1] *United States Telecom Ass'n* v. *FCC*, 359 F.3d 554, 577 (D.C. Cir. 2004) ("*USTA II*").

[2] AT&T at 101-14; AT&T Reply at 87-93.

[3] BellSouth Reply at 54; SBC Reply, Casto Reply Dec. ¶ 14 (the OPPs "do not in any way limit a customer's ability to deploy its own facilities, or use those of third party providers.").

[4] AT&T at 88-93; AT&T, Benway-Holleron-King-Lesher-Mullan-Swift Dec. ¶¶ 53-61.

[5] Verizon Reply, Lataille-Jordan-Slattery Reply Dec. ¶¶ 24-26; *see also* AT&T Reply at 87-93. Generally speaking, only specifically committed volumes or circuits earn the discount. Verizon Reply, Lataille-Jordan-Slattery Reply Dec. ¶ 22. Although the Bells' plans typically allow a carrier to earn discounts on growth above the commitment level for a short period, as explained below, they also contain mechanisms that effectively require a carrier to "renormalize" (*i.e.*, *increase*) its commitment if it experiences any significant and sustainable growth.

under these plans either to another competitive carrier's network or to its own facilities.[6] Although term and volume commitments are typical in many industries, the conditions imposed by the Bells reflect their monopoly power. Not only do the OPPs contain substantial shortfall and termination penalties, the best rates require a very long term commitment – a much lengthier period than retail customers will agree to accept. For example, Verizon concedes that in order to get its best rates, a subscriber must make a *ten-year* commitment.[7]

Even worse, the Bells' "overlay" plans contain "lock-up" provisions that require a carrier to maintain 90+% of its *historic* traffic levels with the Bell for a multi-year term. SBC's "MVP" tariff is illustrative.[8] The MVP's key terms condition the receipt of significant special access discounts upon a customer's five-year commitment to maintain *100%* of the recurring revenue it had with SBC at the time it entered into the agreement.[9] Moreover, the MVP provides that the minimum commitment level can only be *increased* (but never decreased), and the discounts

[6] A simple example shows how, contrary to the Bells' assertions, the penalty provisions of their tariffs "lock carriers into maintaining service with" the Bells. *See id.*, ¶ 29. Assume a carrier has a seven-year commitment to buy 4,000 special access DS1s under the Verizon-North Commitment Discount Plan and that each DS1 is priced at $250 per month. For each 6-month review period under the plan, the carrier's access cost would be $6M (6 * 4,000 * $250). Now assume that another competitor could supply 10% of the carrier-customer's circuits at the much lower rate of $200 per month. That would leave the customer with only 3,600 Verizon-provided circuits, 400 below its commitment level, and thus subject it to a shortfall penalty. Under Verizon's tariff, for each six-month period, that penalty equals the average number of circuits below the commitment times the monthly rate for six months. Here, that would equal: 400 * $250 * 6 = $.6M. As a result, if the customer switched to the competitive service, its payments to Verizon alone for the six month period would be $.6M (the shortfall penalty) + $5.4M (3,600 * $250 * 6 for Verizon circuits) – the very same amount it would have owed if it had purchased *all* of its circuits from Verizon. In addition, it would have to pay $480K (400 * 200 * 6) for the competitive circuits, making its total payments $6.48M. Thus, it would be economically irrational for the customer to switch its service to the competitive carrier after it has committed to Verizon.

[7] Verizon Reply, Lataille-Jordan-Slattery Reply Dec. ¶ 21. Under antitrust law, it is presumptively unreasonable for a monopolist to lock up a substantial percentage of relevant demand for such a period. *See FTC* v. *Motion Picture Advertising Serv. Co.*, 344 U.S. 392, 395-96 (1953).

[8] The other Bells' access tariffs contain similar lock-up provisions. *See, e.g.*, BellSouth Tariff FCC No. 1, § 2.4.8; Qwest Tariff FCC No. 1, § 7.1.3(C); Verizon FCC Tariff No. 14, § 5.16.14(A).

[9] *See* Ameritech FCC Tariff No. 2, § 19; Southwestern Bell Tel. Co. FCC Tariff No. 73, § 38; Pacific Bell Tel. Co. FCC Tariff No. 1, § 22. In addition, SBC's MVP *also* requires a carrier-customer to purchase 95% of the high capacity circuits it buys from SBC as special access services, rather than UNEs. Furthermore, UNE purchases do not count towards the MVP commitment. This provision is patently anticompetitive and should be declared unlawful. AT&T at 150; AT&T Reply at 90.

apply *only* to the committed revenue. Thus, access purchases greater than the commitment do not earn any discounts, but a failure to fulfill the minimum revenue commitment creates a shortfall penalty.

As a result, even when competitive alternatives exist, a carrier-customer purchasing special access under the MVP or analogous Bell tariffs generally cannot economically use them. Indeed, the competitive constraints imposed by the lock-up requirement arise exactly when the Bells' wholesale access customers have a choice between keeping their service demand on a Bell's network or diverting it to their own facilities or to those of an alternative, non-Bell supplier. Where that choice arises, the shortfall liability provisions in the lock-up plans ensure that the Bells – and not any competitor – will serve the locked-up demand.[10]

Falling back, the Bells next argue that wholesale customer-carriers are not required to commit all of their traffic to the Bells, because they remain "free to take all of their *growth* elsewhere."[11] As AT&T explained, many competitive carriers have *declining* demand as a result of the Bells' aggressive entry into long distance markets.[12] Accordingly, sending *any* significant amount of traffic over their own facilities, or those of alternative wholesalers, risks triggering the shortfall penalties imposed under the Bells' OPPs tariffs.

And that is not all. In some cases, the Bells have crafted provisions designed to foreclose subscribers from shifting even their *growth* in demand to alternative providers. In the Ameritech region, SBC's OPP contains a "ratchet" provision that ensures carriers will *never* develop significant "head room" under the tariff that could be diverted to competitive facilities.[13] If a carrier's revenues increase substantially during the committed term, it *must* "renormalize" its commitment so that its *higher* level of usage establishes the new commitment floor.[14] Similarly,

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[10] Another example illustrates why the Bells' OPPs preclude a subscriber from purchasing special access alternatives from a third party, even when that third party offers highly attractive rates. Assume that an MVP customer currently has a monthly revenue commitment of $10M and is currently purchasing that level of special access service from SBC. Further assume, for simplicity, that the subscriber's purchases are DS1 circuits with the same per unit price of $250. Thus, the subscriber is purchasing 40,000 circuits at $250 per circuit for a total of $10M. Now assume that a competitive carrier offered to provide 10% of the customer's demand (4,000 units) at the much lower price of $200 per circuit. However, if the customer were to accept that offer, it would only be purchasing $9M in special access from SBC (36,000 * $ 250) – creating a shortfall of $1M ($10M - $9M) per month. Under the MVP, the customer would be required to pay SBC $9M per month for the circuits it continued to buy from SBC, as well as the $1M per month shortfall – the very same amount it would have paid if it purchased *all* of its circuits from SBC. And the customer would also incur $.8M in expenses for the access purchased from the competitive carrier (4,000 * $200). Such a decision would obviously be economically irrational.

[11] SBC Reply, Casto Reply Dec. ¶ 13 (emphasis added).

[12] AT&T, Benway-Holleron-King-Lesher-Mullan-Swift Dec. ¶ 40.

[13] Ameritech FCC Tariff No. 2, § 7.4.13(D).

[14] *Id.*

as noted above, the MVP gives a carrier *no* discount for any growth above its commitment level, thus creating strong economic pressure to raise its commitment to cover any such growth – and thus eliminate its ability to shift that traffic to competitive carriers. And SWBT's OPP governing DS0 and DS1 circuits even imposes a *penalty* on carriers that exceed their commitment level by more than 25%, effectively forcing customers who have experienced growth to increase their commitment level.[15]

SBC likewise suggests that carriers can shift traffic from its OPPs to "pric[ing] flex[ibility] contracts,"[16] but this suggestion is misleading at best. Most notably, SBC makes no claim that its pricing flexibility contracts offer discount levels better than those under its OPPs. And in all events, any reduction in access expenses under such a contract would reduce the expenditures that count towards the customer's MVP commitment. Thus, the MVP impedes customers from shifting to SBC's pricing flexibility contracts in the same way it impedes customers from shifting to alternative providers.

Unable to show that OPP tariffs do not require customers to lock up their traffic, the Bells next contend that the anticompetitive impacts of these plans should be ignored because carriers' participation in them is "voluntary."[17] This is nonsense. Even the Bells do not claim that competition is viable under their sky-high month-to-month rates (which are, as explained below, the proper analog to UNEs for purposes of determining comparable risks). The Bells simply cannot in one breath claim that competition is viable so long as carriers agree to lock themselves up with the Bells for lengthy terms and simultaneously claim that these carriers could simply purchase month-to-month rates and avoid the OPP lock-up and term conditions. Moreover, this argument simply ignores the market-driven reason why competitive carriers routinely knuckle under to these terms – if they fail to buy special access inputs to their services at the lowest possible rates, they are at an enormous cost disadvantage *vis-à-vis* the Bells, which makes it impossible to compete in the marketplace at all.[18]

For these reasons, Bells' special access services are simply not "available" in the way *USTA II* requires in order to be considered a UNE substitute. As the D.C. Circuit recognized, the Commission's impairment analysis must be conducted on the basis of relevant markets with *similar* characteristics.[19] But to get the Bells' best prices – *i.e.*, the ones that the Bells claims enable competition – a subscriber must be willing to lock up virtually *all* of its traffic and forgo *both* self-deployment *and* third party supply in *all* Bell serving areas. Thus, even in those limited instances where one could imagine a competitive carrier might be able to use special access in lieu of the limited facilities that may be available as UNEs, that carrier can only obtain special

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[15] SWBT FCC Tariff No. 73, § 7.2.19 (C)(1)(a).

[16] SBC Reply, Casto Reply ¶ 35.

[17] *Id.* ¶ 33; *see also id.* ¶ 34.

[18] Indeed, SBC's own evidence shows that the majority of customers have been forced to knuckle under to the OPP conditions. SBC, Casto Dec. ¶ 8. Competitors with viable alternatives clearly would not bind themselves to such long-term and competitively onerous commitments.

[19] *USTA II*, 359 F.3d at 575.

access at a lower (but still exorbitant) price by agreeing to *give up purchasing UNEs*, and *also* the opportunity to self-deploy facilities or use any wholesale alternative everywhere else.[20]

The Bells' OPPs Substantially Increase The Risk Of Providing Local And Long Distance Services Relative To UNEs. Purchasing Bell special access service is, in *USTA II*'s words, "riskier" than purchasing UNEs. As explained above, a competitive carrier must make purchase commitments as long as ten years to get the Bells' best special access rates. Moreover, many Bell plans (especially for DS3 access), require the carrier to commit to purchasing *specific circuits* for the entire term, even though enterprise customers virtually never agree to buy retail services for such lengthy contract periods. And failure to meet these commitments subjects the purchaser to shortfall and termination penalties.

That puts competitive carriers on the horns of a dilemma. Given that the Bells are able to self-provide access at economic cost, competitive carriers need to obtain special access at the lowest possible rate. But if they commit to the extremely long contract periods the Bells demand for their best rates (which are still above economic cost), they take on substantial risk if their business declines over that period. Indeed, for circuit-specific plans, a competitive carrier must assume the risk of carrying circuits in its inventory far beyond their usefulness to itself or any retail customer. Competitive carriers taking service under the Bells' OPPs also lose the ability to take advantage of any competitive opportunities (including self-deployment) that may arise after they have signed up with the Bells. In stark contrast, the Bells' affiliates obtain access at economic cost and do not incur any of these risks, because even if a "shortfall" or "termination" penalty were to arise, it is a mere left pocket/right pocket transaction.

The Commission Should Declare The Bells' Lock-Up Tariffs Unlawful And Unenforceable. The record not only establishes that special access should be deemed irrelevant to impairment determinations under § 251(d), but also that the lock-up provisions contained in BellSouth's and SBC's "overlay" OPPs are unlawful and unenforceable. There is no doubt that these lock-up commitments devastate competitive special access purchasers' ability to shift traffic to alternative suppliers, even where it is otherwise possible to do so. A carrier that subscribes to a lock-up OPP must agree to provide the vast majority of its traffic to the Bell. That means that even when competitive alternatives exist (possibly even on a carrier's own facilities), it generally cannot use them without triggering the severe penalties caused by their failure to order the minimum traffic levels the OPPs require. Moreover, many carriers (but not the Bells' long distance affiliates) are experiencing substantial declines in their retail services, due largely to fierce retail competition coming from the Bells themselves. Thus, the lock-up provisions prevent these competitors from carrying any significant amount of incremental traffic over their own facilities, or sending such traffic to alternative wholesalers. A tariff provision that undermines the Commission's policy of promoting facilities-based competition is unreasonable and thus unlawful under § 201(b).[21]

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[20] AT&T, Benway-Holleron-King-Lesher-Mullan-Swift Dec. ¶ 59.

[21] *See* AT&T at 153-154 (citing *Volume Discount Order*, 97 F.C.C. 2d 923, ¶¶ 12, 14 (1984); *Tariff 15 Order*, 6 FCC Rcd. 5648, ¶ 23 (1991); *Pricing Flexibility Order*, 14 FCC Rcd. 14221, ¶ 163 (1999)).

In addition, the overlay lock-up OPPs are unjust, unreasonable and discriminatory in violation of § 201(b) and § 202(a), because carriers with identical traffic volumes are charged different rates. "[I]ncumbent LECs must make [volume discounts] available to any customer with sufficient volumes,"[22] and may not have customers "who order the same quantity of a service with volume discounts charged different rates."[23] The overlay lock-up provisions flout these requirements. A customer with a specific level of demand that is willing to deal (almost) exclusively with the Bell receives a special discount, while a customer that is willing to commit the *exact same level of demand* is barred from receiving the discount unless it is willing to commit all (or virtually all) of its historical demand. At the same time, there is clearly no difference in the cost in serving these two customers, as both have committed the same level of demand. Such difference in treatment is the *sine qua non* of unreasonable discrimination. On the other hand, absent this discrimination, the Bells would be forced to offer steeper discounts to carriers with the highest traffic volumes that have the greatest potential to self-deploy their own facilities or provide "seed" traffic to alternative providers.

Lastly, these overlay lock-up provisions are structured on a region-wide and service-wide basis. Thus, they directly thwart and contradict the Commission's policies designed to foster special access competition on the one hand while providing appropriately tailored regulatory relief to the Bells on the other. The region-wide character of the overlay lock-up OPPs enables the Bells to leverage their market power in areas and for services for which competition indisputably does not exist in order to *prevent* competition in areas and for services for which competitive alternatives could potentially develop. Where a competitive carrier must obtain access throughout a Bell's territory, the lock-up OPPs ensure that it cannot choose to deal with a competitor (or self-provision) for the locations and services where alternatives exist and with the Bell in the instances where they do not. Indeed, the only way a competitor can obtain access in monopoly markets where there are indisputably *no* alternatives is to *also* agree to lock up its traffic in areas where bypass may potentially be available. For example, carriers typically have no choice but the Bells for DS1 access. But a competitor cannot satisfy the requirements of the lock-up provisions by agreeing to purchase only DS1 services under the OPP, leaving it free to buy higher level access services (for which alternatives may exist) from competitors. Instead, the overlay tariff structure only permits a competitor to obtain the overlay discount on DS1 services if it *also* foregoes competitive alternatives (including self-deployment) for other services. Likewise, a carrier cannot purchase access from competitive carriers in dense urban areas (where there may be some competition) and obtain a discount on the special access services it needs to compete in more suburban and rural areas where there is no competition. In each case, the region- and service-wide requirements imposed by the OPPs require the subscriber to use the Bell for the vast majority (if not all) of its access needs.

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Special access services simply cannot be considered a meaningful substitute for UNEs under *USTA II*. Not only are UNE rates set on the basis of a state regulatory commission's

[22] *Pricing Flexibility Order* ¶ 124.

[23] *Volume Discount Order* ¶ 38.

determination of an ILEC's long run incremental costs, they are available on month-to-month terms. This means that competitive carriers can effectively use UNEs to serve as a "bridge" mechanism that enables them, in the D.C. Circuit's words, "to enter the market gradually, building a customer base up to the level where its own investment would be profitable."[24] Similarly, when a carrier leases UNEs from the ILEC, it has the ability to shift traffic to third parties where alternatives develop without incurring shortfall or termination penalties.

To get the Bells' best special access rates, however, carriers must lock-up their traffic with the Bells for many years. This not only inhibits facilities-based competition, it also greatly increases the risk of providing service because the Bells' OPPs impose substantial shortfall and termination penalties. Competition simply cannot be expected to thrive if competitive carriers are forced to incur these risks while the Bells are not.

[24] *United States Telecom Ass'n* v. *FCC*, 290 F.3d 415, 424 (D.C. Cir. 2002); *id.* ("the more widespread the availability of elements that can be more efficiently provided by the incumbent . . . the quicker competitors will set about providing the other elements").