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August 24, 2005

Ms. Marlene H. Dortch
Secretary
Federal Communications Commission
Room TW-A325
445 12th St. S.W.
Washington D.C. 20554

Re: Special Access Rates for Price Cap Local Exchange Carriers, WC Docket No. 05-25

Dear Ms. Dortch:

On behalf of Time Warner Telecom, Inc. ("Time Warner"), we are filing an erratum to the redacted version of the Reply Comments filed on July 29, 2005 in the above-referenced docket. The modification removes one instance of Time Warner's proprietary data, which was inadvertently left in the document when filed.

Please let us know if you have any questions.

Respectfully submitted,

/s/

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REDACTED--FOR PUBLIC INSPECTION

BEFORE THE

Federal Communications Commission

WASHINGTON, D.C.

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

REPLY COMMENTS OF TIME WARNER TELECOM

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REPLY COMMENTS OF TIME WARNER TELECOM

Time Warner Telecom ("TWTC"), by its attorneys, hereby files reply comments in response to the Notice of Proposed Rulemaking[1] in the above-captioned proceeding.

I. INTRODUCTION AND SUMMARY

The record in this proceeding confirms that the incumbent LECs have unilaterally increased special access prices in areas in which they have received pricing flexibility. The predictive judgments upon which the Commission relied in eliminating price cap regulation for special access services that meet the Phase II triggers have proven to be incorrect. It is clearly necessary therefore to reform the Commission's pricing flexibility rules for special access.

The incumbents have not even attempted to respond to the clear evidence submitted by their competitors and customers that tariffed special access month-to-month and term rates have

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[1] *See Special Access Rates for Price Cap Local Exchange Carriers; AT&T Corp. Petition for Rulemaking to Reform Regulation of Incumbent Local Exchange Carrier Rates for Interstate Special Access Services*, Order and Notice of Proposed Rulemaking, 20 FCC Rcd 1994 (2005) ("*Special Access NPRM*").

increased in virtually every area in which Phase II pricing flexibility has been granted. Such pricing behavior would not occur in a competitive marketplace.

The incumbents limit their price-related arguments to asserting that special access prices are actually declining when prices charged under volume and term discount contracts are taken into account. This is unpersuasive. Most volume and term plans today contain onerous terms and conditions that impose substantial non-price costs on purchasers and, in any event, the discounts tend to be tied to the underlying tariffed rates that are themselves increasing. Thus, purchasers of special access are left with a Hobson's choice of either paying unreasonably high tariffed prices or entering into contracts that include substantial unquantifiable costs and that often offer little protection from rate increases in the future.

The incumbents cannot offer any basis for supporting their assertion that there is widespread facilities-based competition in the provision of special access. They have filed thousands of pages describing competitors' metro transport networks and competitors' purported ability to deploy loop facilities. Undoubtedly, CLECs have deployed substantial amounts of *long-haul* transport and, in certain downtown areas, CLECs have deployed local transport facilities. CLECs can also obviously deploy loop facilities in those few cases where the revenue opportunities can justify construction to a particular building. But as the Commission concluded just six months ago in the *Triennial Review Remand Order*, the incumbents continue to control bottleneck loop facilities serving the overwhelming majority of business customer locations and they have substantial and persisting market power in the provision of local transport outside the most dense metropolitan areas. Despite all of their protestations to the contrary, the ILECs have offered no evidence to contradict the conclusion that they are uniquely and overwhelmingly dominant in the market for special access services, especially with respect to loops. Most

damning, Verizon admits that there has only been a 25 percent increase in the still miniscule number of buildings served by competitive fiber from 1996 to 2005 (from 24,000 to approximately 32,000). This is compared to the millions of commercial buildings served by ILEC fiber. The Commission's conclusions in the *Triennial Review Remand Order* thus remain valid.

It is clear that the Commission must make substantial changes to the special access pricing flexibility regime. Most crucially, the Commission must immediately eliminate Phase II pricing flexibility and re-impose price cap regulation on all special access products in which the incumbents retain the power to unilaterally raise price. This is most obviously the case with regard to DS1, DS3 and Ethernet channel termination and mileage rates. With the expiration of the CALLS plan and in light of the BOCs' continuing productivity gains, the Commission should initiate a new study to determine the scope of those increases in order to establish an appropriate X-factor. The "backstop" of rates regulated by appropriately calibrated price caps will put a check on the incumbents' ability to unilaterally raise prices. Price cap regulation will also limit the incumbents' ability to include anticompetitive requirements on contract tariffs because purchasers will have a viable alternative to such contracts.

It is important to emphasize that Phase I relief should not be eliminated in markets where it has been granted. Despite potential abuses that may arise from certain aspects of volume and term discount contracts, such agreements offer an appropriate means of allowing purchasers to benefit from the incumbents' economies of scale and the efficiencies of volume purchases. Large special access purchasers like TWTC have planned their businesses around existing special access contract tariff arrangements based on the reasonable assumption that those arrangements will remain viable. Such expectations must continue to be honored, although the

Commission should establish more effective safeguards against the inclusion of anticompetitive provisions in those agreements in the future.

The "middle road" for interim regulatory reform of special access proposed by Time Warner Telecom offers an appropriate means of restraining the incumbents' exercise of market power while at the same time offering customers the flexibility to retain crucially important commercial contracts. With this reform in place, the Commission can initiate a comprehensive review of incumbent LEC productivity as well as the relevant product and geographic markets for special access. These reviews can then form the basis for a more long-term stable regulatory framework.

II. INCUMBENT LECS REMAIN DOMINANT IN THE MARKET FOR SPECIAL ACCESS SERVICES.

In their comments, the incumbents make a futile attempt to show that they lack market power in the provision of special access. In so doing, they conveniently ignore the FCC's previous conclusions and the substantial evidence in the record regarding the limited ability of competitors to deploy alternative transmission facilities.

Just six months ago, the Commission determined that competitors generally cannot deploy fiber transmission facilities for purposes of providing DS1-level service or a DS3 because the revenue opportunities associated with such services are too small to cover the costs of deployment.[2] The incumbents' comments in this proceeding merely confirm the validity of this finding. Most importantly, the incumbents do not allege that competitors have deployed any

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[2] *See, e.g., Unbundled Access to Network Elements, et al.,* Order on Remand, 20 FCC Rcd 2533 ¶ 149 (2005) ("*TRRO*"); *see also Review of the Section 251 Unbundling Obligations of Local Exchange Carriers, et al.*, Report and Order and Order on Remand and Further Notice of Proposed Rulemaking, 18 FCC Rcd 16978, ¶ 298 (2003), *subsequent history omitted ("TRO").*

more facilities than they claimed was the case in the *Triennial Review Remand* proceeding. In the UNE Fact Report filed in October 2004, the RBOCs asserted that competitors served 31,669 buildings[3] as compared to the millions of buildings served by ILEC fiber. Now Verizon claims that CLECs have deployed loops serving "31,467+" buildings.[4] Clearly, the overall competitive landscape has not changed appreciably, if at all, in the last 10 months. Verizon indicates that back in 1996 there were only 24,000 buildings "served directly by CLEC fiber." Verizon Comments, Attachment C, Declaration of William Taylor, Table 10, at 5. In other words, in nearly 10 years, CLECs have added connections to only 8,000+ buildings. This only underscores the difficulty of loop deployment and the ILECs' continuing dominance of the special access marketplace. Because of the lack of ongoing competitive deployment, even the most competitive markets such as New York City have few alternative loop providers. As Broadwing notes, a 2001 study by the New York PSC determined that, of the "more than 220,000 buildings that are mixed use, commercial industrial, or public institutions [in New York City], CLECs have [built loop facilities to] fewer than one-half of one percent."[5] Today, according to Verizon, the New York market is no less concentrated. Verizon asserts that there are still only **[proprietary begin] [proprietary end]** buildings served by competitive fiber in

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[3] *See BOC UNE Fact Report 2004*, WC Dkt. Nos. 04-313 *et al*., at III-4 (filed Oct. 4, 2004) ("*BOC UNE Fact Report*").

[4] *See* Verizon Comments, Attachment D, Declaration of Quintin Lew, at App. B ("*Lew Declaration*").

[5] *Broadwing Comments* at 16 (citing *Opinion and Order Modifying Special Services Guidelines for Verizon New York, Inc. Conforming Tariff, and Requiring Additional Performance Reporting*, Case 00-C-2051, Case 92-C-0665, Opinion No. 01-1 at 7 (rel. June 15, 2001)).

New York,[6] or less than **[proprietary begin] [proprietary end]** percent of 220,000 total buildings.

To avoid the obvious implications of this data, the incumbents try to conjure up a world with near-ubiquitous competitive fiber deployment based upon competitors' press statements and website advertisements describing *service offerings*. This attempt to equate the offer of service with the deployment of facilities is no more convincing now than it was when the Commission rejected it in the *Triennial Review Remand Order* ¶ 46, *et seq.* No carrier is going to advertise that it uses another carrier's facilities to provide service, but advertising services does not mean that the competitor owns all or any of the facilities over which they are provided. Since the incumbents again admit that competitor loops serve at most approximately 32,000 buildings, it is not surprising that carriers must purchase the RBOCs' loop facilities in the vast majority of cases.

For example, while it may be true that Broadwing offers "high-capacity services ranging from DS-1 through OCn and including Private Line…" (*Lew Declaration* ¶ 22(d)), Broadwing has stated that purchases **[proprietary begin] [proprietary end]** of its DS1 loops from RBOCs. *See Broadwing Comments* at 9. WilTel offers "high-capacity DS-1s, DS-3s, OCns, SONET, ATM and Frame Relay facilities to other carriers" (*Lew Declaration* ¶ 22(dd)), yet WilTel has "no choice but to use ILEC special access services in order to provide end-to-end services to [its]

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[6] TWTC has taken the confidential information submitted by Mr. Lew of Verizon (*see* Lew Declaration, at Ex. 7) and created a table showing the number of buildings served by AT&T and MCI fiber and the change in the number of buildings served by competitive carriers once AT&T's network is absorbed into SBC and MCI's network is absorbed into Verizon following their respective mergers. That table is attached as appendix A to these reply comments.

customers."[7] XO has "2300+ on network buildings" (*id.* ¶ 22(ee)) and provides DS1 services (*id,.* at Appendix C), yet XO has said that it will not construct loops unless there are more than three DS3s of demand[8] and, like all other carriers, can never construct loops to provide only DS1-level service.[9] Similarly, even though Xpedius may offer its Metro ConneX loop product "from DS-1 through OC-192" (*Lew Declaration,* App. C, at 2), "Xpedius requires a bare minimum of 3 DS3s in customer demand before constructing laterals." *MiCRA Ex Parte* at 5.[10] The logical inference is the Xpedius provides most of its services via incumbent LEC loops.

BellSouth claims that 11 percent of all DS1 "tail" (*i.e*., loop) circuits and 55 percent of the DS3 tail circuits in its region are served by competitive providers' loop facilities. BellSouth Comments at 27. This is implausible. In the *Triennial Review Remand* proceeding, BellSouth stated that CLEC fiber loops serve only approximately 2,200 *buildings* in all of BellSouth's service area.[11] There are probably at least 200,000 commercial buildings in BellSouth's service

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[7] WilTel Comments, Declaration of Mark Chaney, ¶ 4.

[8] *See Ex Parte* presentation of MiCRA *et al.,* WC Dkt. Nos. 04-313 *et al.,* at 5 (filed Oct. 18, 2004) ("*MiCRA Ex Parte*").

[9] See XO Communications Emergency Petition For Expedited Determination that Competitive Local Exchange Carriers are impaired without Access to DS1 UNE Loops, WC Dkt. Nos. 04-313 *et al*., at 3 (filed Sept. 29, 2004).

[10] The RBOCs also argue that the existence of special access aggregators should provide a competitive alternative in the marketplace (*see Lew Declaration* at 29). Yet, by their very definition, aggregators and systems integrators aggregate and integrate *other carriers facilities*; they do not deploy their own and therefore provide no indication of the scope of competitive deployment.

[11] *See Ex Parte* presentation of BellSouth, at 4, attached to Letter of Glenn T. Reynolds, Vice President, Federal Regulatory, BellSouth, to Marlene H. Dortch, Secretary, FCC, CC Dkt. No. 01-338 (filed Aug. 18, 2004).

territory.[12] Thus, competitors' loops probably serve no more than one percent of the buildings in the BellSouth region. It is hard to see how CLECs could be providing fully 11 percent of DS1s and 55 percent of DS3s over facilities that reach no more than about one percent of the buildings in the region.

BellSouth also proffers estimates of the percentage of overall service capacity and revenues CLECs have purportedly captured throughout the BellSouth region. *See BellSouth Comments* at 29. This information (even if true) is not pertinent because total capacity and revenues are likely highly skewed by a small number of very large customers served via competitors' loops. There is obviously no dispute that competitors can efficiently deploy loops to serve customers that purchase huge quantities of telecommunications services. The issue is whether competitors can broadly deploy loops to serve customers that demand DS1, DS3 and Ethernet services. The record is clear that they cannot do so.[13]

Obviously recognizing that CLEC deployment of wireline facilities is extremely limited, the incumbents resort to second-guessing the CLECs' own business plans by asserting that it would be "relatively inexpensive and wholly cost effective" for CLECs to deploy fiber in many more areas. SBC spills much ink on its study asserting that it costs between **[proprietary begin]**

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[12] There are between 739,000 and 3 million commercial buildings in the country (*see TRRO* ¶ 157) (footnote omitted). It is therefore conservative to assume that there are only 200,000 commercial buildings in the BellSouth region.

[13] It should be noted that the study upon which BellSouth relies for the estimates of competitive entry provided in its comments concludes that CLECs have the same market penetration in the largest MSAs of a state as in the least populated areas of the same state. *See* BellSouth Comments at 36. This assertion is inconsistent with numerous statements by the Commission, and even other incumbents in this proceeding, that competitive facilities are concentrated in the areas of highest demand. In this regard as well, it is likely that the BellSouth study is simply incorrect, thus further undermining the credibility of the analysis.

[proprietary end] and **[proprietary begin] [proprietary end**] to deploy at 1000 foot fiber loop.[14] Based on this assertion, SBC argues that competitors can easily deploy loop facilities to thousands of more buildings than they currently serve on their networks. But SBC's cost estimates for loop deployment are substantially lower than it's own previous cost estimates for loops deployment. In the state TRO implementation proceedings, SBC relied upon a CLEC loop deployment study by Cambridge Strategic Management Group.[15] The study alleged that the "break-even" revenue point at which it is possible to construct a 1000 foot loop is between $47,399 and $51,155. *See CSMG Stud*y at 13. Even if one were to assume that the Cambridge Study were accurate (it actually understates the relevant costs),[16] SBC admits that it would only make sense for CLECs to deploy DS3s to 994[17] out of the "670,000 enterprise customer locations in SBC Texas' service territory" (*Sparks Rebuttal Testimony* at 6). Of course, since

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[14] *See* SBC Comments, Declaration of Parley C. Casto, ¶ 15 ("*Casto Declaration*").

[15] *See, e.g., CLEC Network Extension Cost Model,* Cambridge Strategic Mgmt. Group (Apr. 26, 2001), Attachment RLS-18 to Direct Testimony of Rebecca L. Sparks, SBC Texas, PUC Texas Dkt. No. 28745 (filed Jan. 27, 2004) ("*CSMG Study*").

[16] In turn, the Cambridge study substantially low-balls the revenue necessary to make loop deployment possible. Based on TWTC's' internal business case, TWTC must obtain between **[proprietary begin] [proprietary end]** in revenue to make loop construction efficient. This assumes that the building is within 2500 feet of TWTC's transport network. *See* TWTC *Ex Parte* Letter, CC Dkt. Nos. 01-338 *et al*., at 4-5 (Dec. 1, 2004) ("*TWTC Dec. 1 Letter*").

[17] *See* Rebuttal Testimony of Rebecca L. Sparks, SBC Texas, PUC Texas Dkt. No. 28745, at 27 (filed Mar. 12, 2004) ("*Sparks Rebuttal Testimony*").

DS1s generate between only $500 and $700 of revenue per month, it would never be economically rational to deploy DS1 loops.[18]

More fundamentally, if it were economically rational for TWTC or other CLECs to deploy loops in a more extensive manner, they no doubt already would have done so. Most carriers attempt to deploy their own facilities wherever possible because, among things, self-deployment allows carriers to control repair, monitoring and maintenance and yields lower average costs where volume is high enough. If, as SBC notes, **[proprietary begin] [proprietary end]** of the buildings in many major cities are within 1,000 feet of the competitors' transport networks and yet CLECs have not deployed loops to most of those buildings, the most logical inference is that such deployment is inefficient. This is precisely the conclusion reached by the Commission in the *Triennial Review Remand Order*.[19] SBC has offered no basis for doubting that the Commission was correct.

The incumbents' assertion that "cable companies" are offering services that compete with wireline facilities is no more persuasive. The Commission has determined that cable companies' HFC offerings are not suitable replacements for high capacity wireline loops. *See TRRO* ¶ 193. The incumbents take a different tack here, and try to rely on evidence of fiber loop deployment by the cable companies' competitive telecommunications divisions to prove the existence of "intermodal" competition. But, as the Commission has recognized, the operations of cable

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[18] Even assuming the CSMG study's approximately $50,000 break even point is correct, it would take 7 years to recoup an investment in a single DS1. For this reason, the Commission has held that DS1s are not suitable for competitive supply.

[19] The Commission has already determined that "reasonably efficient competitor[s]" cannot deploy and are therefore impaired without access to DS3 and DS1 loops in the vast majority of cases (*TRRO* ¶¶ 27-28).

companies' LEC affiliates are not "intermodal" at all.[20] In order to deliver video service from the head-end to the customer premises, cable companies historically constructed fiber transport networks in areas where they had been granted franchises much in the same manner that CLECs construct their metro fiber networks. These cable fiber networks stopped short of the customer premises. The cable companies connected end user customers to the fiber network via coaxial cable drops that do not generally serve businesses and that generally do not support business class service. Cable companies generally need to build new loop facilities to serve business customers. In so doing, cable companies face exactly the same barriers to entry and obstacles to loop construction as any other CLEC with a fiber transport network.[21]

The incumbents' assertions regarding intermodal competition from satellite and fixed wireless should similarly be dismissed. The incumbents' arguments in this regard are based primarily on the providers' marketing materials, and most of the providers cited by the RBOCs

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[20] For example, the Commission rejected Qwest's assertion that it had lost customers to "intermodal competition" from cable companies because "those losses are to the circuit-switched telephony service offered by Cox's competitive LEC affiliate, rather than to its cable operation." *Id.*¶ 193 & n.514.

[21] Indeed, the core of TWTC's metro fiber networks in many markets were originally constructed by Time Warner Cable in the early 1990s. *See Time Warner Telecom, Inc., Form 10-K Annual Report for the Fiscal Year Ended Dec. 31, 2004*, at 33 (filed Mar. 16, 2005) ("We benefit from our relationship with Time Warner Cable both through access to local rights-of-way and construction cost sharing. We have similar arrangements with a partnership owned by affiliates of our Class B Stockholders that is currently managed by Bright House Networks LLC ("Bright House"), an affiliate of Advance/Newhouse. We have constructed 23 of our 44 metropolitan networks substantially through the use of fiber capacity licensed from Time Warner Cable or Bright House. As of December 31, 2004, our property, plant, and equipment included $188.1 million in licenses of fiber capacity pursuant to the capacity license agreements."). Yet, as TWTC has stated in this and other proceedings, it must rely heavily on ILEC special access facilities for last-mile access.

have only recently started providing service or emerged from bankruptcy. *See Verizon Comments* at 32; *Lew Declaration* ¶¶ 25-32; *SBC* at 18-21; *Casto Declaration* ¶¶ 44-53. The "puffery" in carrier promotional materials does not provide an adequate basis upon which to claim that competition from fixed-wireless services can constrain incumbent special access prices. Indeed, the FCC held in its *Triennial Review Remand Order* that "[t]he record does not indicate that other intermodal options, such as fixed wireless and satellite, offer significant competition in the enterprise loop market." *TRRO* n.508. The record in this proceeding supports the same conclusion.

The incumbents themselves have stated that there are only 300,000 satellite broadband subscribers nationwide. *BOC UNE Fact Report 2004* at I-12. Satellite and fixed wireless broadband represent less than 2% of the total high-speed lines in service.[22] Furthermore, the fact that fixed wireless products are often orders of magnitude less expensive than the RBOCs' special access offerings, yet have been unable to capture more than a tiny foothold in the marketplace, demonstrates that fixed wireless and special access services are not in the same product market. For example, First Avenue Networks has been unable to sell more than 25 leases for its ExpressLink product, despite the fact that its wireless footprint covers the entire nation and its OC-3 level product is priced at less than seven percent of the tariffed rate of an ILEC DS-1 circuit ($500 per year).[23]

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[22] *See Industry Analysis and Technology Division, Wireline Competition Bureau, High-Speed Services for Internet Access: Status as of December 31, 2003, Table 1, Chart 2* (June 2004).

[23] *See* Comments of First Avenue Networks, Inc. (FAN), Declaration of Simon Wilkie, ET Dkt. Nos. 95-183 *et al*., ¶ 8 (filed Dec. 2, 2004) ("*Wilkie FAN Declaration*").

A cursory view of the history of fixed wireless indicates just how poorly fixed-wireless service has fared in the marketplace. The major license holders in the 39-Ghz and 24-Ghz bands (LMDS), Advanced Radio Telecom, Inc., Winstar Communications, Teligent, Inc., and XO Communications, have all attempted to offer fixed wireless services. Each one of those companies has been forced into bankruptcy.[24] The reorganized entities have generally redrawn their business plans around leasing spectrum to carriers and large end users under the FCC's secondary markets policies.[25] It is far too early to tell whether even this "modest business model will be successful given current excess capacity." *Wilkie FAN Declaration* ¶ 7.

Companies with licenses in lower spectrum bands, *e.g.*, AT&T, Sprint, MCI, and Nextel, have also failed to bring a viable fixed-wireless product to market. *Id.* ¶ 6. Sprint and Nextel are the largest license holders and lessees of lower-band spectrum licenses suitable for multichannel multipoint distribution service (MMDS/Broadband Radio service), but they have yet to deploy fixed-wireless service successfully. The Sprint/Nextel public interest statement in support of their proposed merger catalogues each company's significant efforts and lack of success in implementing fixed-wireless services on a widespread commercial basis.[26]

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[24] *See Wilkie FAN Declaration* ¶ 6.

[25] FAN Comments at 2-3.

[26] *Sprint/Nextel Application for Transfer of Control*, Attach. E, Declaration of Todd Rowley & Robert Finch, ¶¶ 14-21, WT Dkt. No. 05-63 (Feb. 8, 2005) ("*Rowley/Finch Declaration*"). Sprint has tested line-of-sight and non-line-of-sight technologies and determined that the rates of failure and technology costs were too high for widespread deployment. Similarly, Nextel has attempted to implement the Flash-OFDM standard and determined that the low propagation distance of radio signals militated against full-scale deployment of a wireless broadband network.

It is also clear that deployment of fixed-wireless services faces significant challenges that have yet to be overcome. For example, Sprint-Nextel must overcome the limited range and propagation characteristics of radio signals in higher spectrum bands. Also, ownership restrictions require would-be fixed-wireless service providers to continually negotiate and re-negotiate leases under Commission rules. Finally, the 2.5 GHz band will remain in transition at least until January 2008, an unstable status that will hinder large-scale deployment of any wireless service in this particular band.[27] Other viable spectrum bands in which high-capacity wireless services can be deployed (*e.g.*, the 700 MHz band, 1.7-2.1 GHz bands) are subject to similar leasing and transition difficulties.

Nor is the case for WiMAX significantly more convincing. For example, SBC claims that WiMAX already poses a significant threat to RBOC special access revenues. *See SBC Comments* at 18. SBC fails to note that WiMAX equipment has only just begun to be manufactured, and the testing to ensure compliance with the WiMAX standard has only just begun this July,[28] a full six months behind schedule.[29] Trade press reports speculate that the

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[27] *Rowley/Finch Declaration* ¶ 22 (cataloguing the risks and challenges of deploying a broadband wireless network).

[28] Press Release, WiMAX Forum, WiMAX Forum™ Launches Certification Program, Expects First Equipment in Market by Year-end (Apr. 18, 2005) *available at* http://www.wimaxforum.org/news/press_releases/WiMAX_CertificationLaunch_FINAL_04_18_05.pdf; *Wave of Unofficial WiMAX Interoperability Testing Begins*, Mobile Pipeline, *reprinted in* INFORMATIONWEEK (June 27, 2005) *available at* http://www.informationweek.com/shared/printableArticleSrc.jhtml?articleID=164902905.

[29] *WiMAX Timeline Delayed by Six Months*, BROADBAND WIRELESS ONLINE (Jan. 20, 2005) *available at* http://www.shorecliffcommunications.com/magazine/print_news.asp?news=4133.

competitive impact of WiMAX may not be felt until 2007.[30] While the pre-WiMAX trials may be offered to some early adopters, it is impossible to deploy WiMAX usefully without a network of providers using the standardized, interoperable equipment which has yet to be released with the WiMAX stamp of approval. It is therefore clear that any competition to be offered by WiMAX or any other unlicensed wireless service remains entirely speculative.

Finally, if the proposed acquisitions of AT&T by SBC and of MCI by Verizon are consummated, the special access market will only become more concentrated. Overall, Verizon estimates that, in its top 40 MSAs, the number of buildings served by competitive carriers will drop by **[proprietary begin] [proprietary end]** percent from **[proprietary begin] [proprietary end]** to **[proprietary begin] [proprietary end]** buildings if MCI and AT&T are removed from the marketplace. *See* Attachment A. In New York alone, if AT&T and MCI are removed from the loop count, only **[proprietary begin] [proprietary end]** buildings or **[proprietary begin] [proprietary end]** percent of the buildings in New York would be served by competitive fiber. *See id.*

The impact of the mergers would be equally large in Chicago. As Broadwing demonstrates, there are only 429 total buildings served by providers other than SBC.[31] Given

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[30] Dave Molta, *Impact of WiMAX Adoption May Take Awhile*, Network Computing, *reprinted in* INFORMATIONWEEK (June 17, 2005) *available at* http://www.informationweek.com/shared/printableArticleSrc.jhtml?articleID=164900603.

[31] *See* Declaration of Mark Pietro ¶ 10, attached to Opposition of Broadwing *et al.,* WC Dkt. No. 05-65 (filed Apr. 25, 2005). (*Pietro Declaration*")

that there are approximately 241,000 commercial buildings in Chicago,[32] it appears that competitors serve far less than one percent of the buildings in Chicago. Moreover, of the only 429 buildings served by competitor fiber in Chicago, AT&T and MCI combined serve more than half. The next largest competitor, XO, serves 72 with LGN at only 24 buildings. *See Pietro Declaration* ¶ 10.

III. THE ILECS HAVE EXERCISED THEIR MARKET POWER OVER SPECIAL ACCESS SERVICES BY UNILATERALLY RAISING PRICES, A PROBLEM THAT CAN ONLY BE ADDRESSED BY ELIMINATING PHASE II PRICING FLEXIBILITY

Because of the ILECs' enduring market power over special access, it is no surprise that their special access rates continue to increase. Multiple parties have submitted data showing that, regardless of the alleged rate-of-return of the ILECs, they continue to raise month-to-month and term special access rates well above what would be expected in a competitive marketplace.[33] Indeed, former FCC economists Zimmerman and Uri have determined that rates for special

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[32] *See* Prof. Simon J. Wilkie, *Proposed Mergers of SBC/AT&T and VZ/MCI: Preliminary Analysis of Competitive Effects*, attached to *Ex Parte* Presentation of Cbeyond Communications *et al*., Dkt. Nos. 05-65, 05-75, at 15 (June 15, 2005).

[33] *See, e.g.,* ATX Comments at 10 (noting Verizon DS1 transport increases are on average 30 percent higher than price caps); *See also* Comptel/ALTS Comments, Declaration of Janet S. Fischer on behalf of Global Crossing North America ("*Fischer Declaration*") (comparing price cap and price flex rates of RBOCs and their operating subsidiaries); *Id.* ¶ 5 ("Thus, for example, DS1 channel terminations are 22% to 47% higher in Qwest Phase II pricing flexibility MSAs than in Qwest's price caps territory, and DS1 mileage rates are 13% to 71% higher in BellSouth Phase II MSAs than in BellSouth's price caps territory.

access services subject to pricing flexibility increased substantially for almost every BOC, in almost every pricing flexibility market for both month-to-month and discounted term offerings.[34]

Increases in these rates are not "irrelevant"[35] simply because volume and commitment plan discounts are available. As TWTC noted in its comments, incumbents can erode or eliminate discounts off the tariffed price by increasing the tariffed prices themselves. For example, even though TWTC purchases most of its special access circuits in the Qwest region under a volume commitment plan, Qwest's increase in its tariffed rates led to an increase of 25 percent for DS1 channel termination rates in "the most competitive" zone 1 as well as for rates applicable to 0-8 mile mileage DS1 transport. *See TWTC Comments* 18-19. Similarly, many of the volume and term discount plans include onerous and costly terms and conditions.

While the incumbents' overwhelming dominance over special access loops has led to supra-competitive rates, the ILECs' dominance over special access transport is just as harmful. Although there is no doubt *some* correlation between the costs of transmission deployment and distance, the ILECs charge well above what would be possible for mileage in a competitive marketplace.[36] For example, as Professor Wilkie notes, the market price for a long-haul DS3 circuit on the competitive route between New York and Los Angeles is $3,500. This works out

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[34] Noel D. Uri & Paul R. Zimmerman, S*pecial Access Service and its Regulation in the United States*, 6 J. OF POLICY, REGULATION, AND STRATEGY FOR TELECOMMUNICATIONS, 122, 156-7 (2004) ("*Uri & Zimmerman*").

[35] *See Ex Parte* Letter of Donna Epps, Vice President, Federal Regulatory, Verizon, to Marlene H. Dortch, Secretary, FCC, WC Dkt. No. 05-25, at 4 (filed June 7, 2005).

[36] This is especially true for RBOC provisioned *transport* since these circuits between wire centers have long been sunk into the ground and paid for. The incremental cost of providing transport service, just like any other telecommunications service, does not vary with distance.

to $1.40 per mile.[37] The same $3,500 will only buy a 30 mile DS3 local interoffice transport circuit from SBC.[38] As Professor Wilkie notes, a similar dynamic is present in New York.[39] In addition, mileage charges increase astronomically with the number of DS3s purchased. For example, on a one year contract, a single DS3 circuit costs $90 per mile, a three DS3 circuit costs $195 per mile, a six DS3 circuit costs $390 per mile and a twelve DS3 circuit costs $1,080 per mile.[40] Yet, the capacity of a circuit has little to do with the costs of extending a circuit for a longer distance.[41] In a competitive marketplace, the incumbents would never get away with these sorts of capacity-based mileage charges. The fact that incumbent prices are "50 to 100" times higher than competitive long-haul routes demonstrates that intractable barriers make entry into the local transport market often uneconomic. *See Wilkie T-Mobile Declaration* ¶ 14.[42]

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[37] *See* Comments of T-Mobile, Declaration of Simon J. Wilkie, ¶ 12 ("*Wilkie T-Mobile Declaration*").

[38] This assumes a $650 one year contract on a DS3 in zone 1 with a $90 per mile per DS3 charge. *See* SWBT Tariff FCC No. 73, Section 20.5.3(A), 20.5.4(A) (effective Nov. 21, 2003).

[39] *See Wilkie T-Mobile Declaration* ¶ 13 ("[I]n New York, Verizon's monthly special access price for DS3 interoffice transport is $118.60 per mile, plus a $631.12 fixed fee. Thus the cost of a 10 mile Verizon special access circuit in New York is $1,817.12, or over 100 times the $14.00 per mile price of a circuit of the same length along the New York-Los Angeles Route.").

[40] This is the rate for Zone 1 in Arkansas. *See* SWBT Tariff FCC No. 73 Section 20.5.4(A). Other states and zones in SBC's region have comparable rates.

[41] As the RBOCs note, when carriers build fiber routes, they typically add additional strands that can be lit to easily increase capacity. *See TRO* ¶ 312. The marginal cost of adding an additional fiber strand when the route is first constructed is minimal. *Id.*

[42] Even normalizing for distance, a 10-mile DS3 circuit should cost approximately $240 in a competitive marketplace. This is only one sixth of the price Verizon charges for a similar 10-mile offering in New York. *See Wilkie T-Mobile Declaration* ¶ 18. Data submitted by ALTS also indicates that the RBOCs charge several times more than competitive carriers for circuits of similar length (in those instances where competitive facilities are available). *See Fischer*

The incumbents allege that switched access services have always restrained special access prices and they will continue to do so "particularly if the Commission implements intercarrier compensation reform, which is likely to reduced switched access rates." USTA Comments at 9. This is grossly overstated. Switched access only provides a substitute for special access at very low traffic volumes. Many customers demand integrated circuits that contain both voice and data channels, which cannot be provisioned via switched access.[43] Moreover, the Commission should not prejudge the outcome of the intercarrier compensation proceeding. In any event, many intercarrier compensation proposals contemplate replacing some or all of the intercarrier per-minute payment charges with higher end user rates, subscriber line charges and universal service fees.[44] Any reductions in per minute rates for switched access as a result of intercarrier compensation reform will therefore have little or no impact on the overall rates paid by customers.

Declaration, at Table 8 (noting that, for example, a 30 mile DS1 point to point circuit costs approximately $220 while the equivalent Verizon circuit costs $1,000).

[43] Indeed, companies such as Nuvox and Cbeyond have based their business largely upon selling DS-1 integrated voice and data solutions to small business customers sold over RBOC provisioned loops. The RBOCs now offer similar services. As the RBOCs themselves, note, these solutions can save business customers substantial sums over separately provisioned voice and data products. *See, e.g.*, *BellSouth Integrated Solutions* ("Due to the elimination of costs associated with managing multiple networks, customers save valuable time and money by implementing an integrated solution."), *available at* http://smallbusiness.bellsouth.com/internet/integrated.asp. Integrated access solutions are inherently more flexible since channels that are used for voice at one moment can easily be repurposed for data the next. As BellSouth notes, customers can use between 6 and 22 channelized voice circuits provided over BellSouth's integrated DS-1 product. *See FAQs, Voice, available at* http://smallbusiness.bellsouth.com/internet/integrated_q1.asp.

[44] *See, e.g.*, Intercarrier Compensation Forum's *Intercarrier Compensation and Universal Service Reform Plan*, filed in CC Dkt. No. 01-92 (Oct. 5, 2004).

As TWTC explained in its comments, the Commission must prevent any further increases in special access rates by eliminating Phase II pricing flexibility immediately for services over which the incumbents retain unilateral pricing power (DS1, DS3 loops, and Ethernet and mileage rates).[45] In order to determine the rates of newly re-regulated services, the Commission could take one of two general approaches. *First*, the Commission could look to price cap rates in an analogous market in the same study area. For example, if Phase II pricing flexibility has been granted for channel terminations in an MSA in North Carolina, the Commission could look to the current price cap channel termination rates in an MSA of similar size in or near North Carolina where Phase II pricing flexibility for channel terminations had not been granted in order to establish price cap rates in the first market. *Second*, if an analogous market cannot be identified, the Commission could simply apply price reductions to those categories (channel terminations or mileage) in an MSA as if those prices had been under price caps all along.

IV. THE CURRENT TRIGGERS ARE AN INAPPROPRIATE MEASURE OF COMPETITIVE DEPLOYMENT.

The comments in this proceeding confirm the widely held view that the pricing flexibility triggers are fatally flawed. *First*, both CLEC and RBOCs commenters agree that the current collocation-based triggers are an unreliable measure of competitive deployment and should be scrapped. The problem is especially severe with regard to channel terminations. As TWTC observed in its comments (*see TWTC Comments* at 8-12), many carriers deploy collocations in

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[45] As demonstrated below, the FCC should initiate a study of incumbent LEC productivity to determine an appropriate x-factor that should be going forward. However, because of the supra-competitive prices of the incumbents in areas where Phase II pricing flexibility has been granted, it is important that Phase II be eliminated immediately and rates be brought under price caps even before the new x-factor is established.

ILEC central offices yet do not deploy any of their own loops. Similarly, as the RBOCs argue, competitors sometimes deploy loop facilities between "carrier hotels" and end user locations (that is, without the need for collocations in ILEC central offices). *See e.g.*, *Casto Declaration* at 16-23.

Second, as TWTC also noted in its comments (*see TWTC Comments* at 11), the proposed Verizon/MCI and AT&T/SBC mergers, if approved, will only exacerbate the inaccuracies of a collocation-based test. The RBOCs would retire newly obtained in-region collocations and associated competitive transport facilities, thus increasing their market power in-region. Yet, the current pricing flexibility rules have no provision for "undoing" pricing flexibility determinations when collocations are eliminated. Moreover, as discussed above, the newly merged entities are unlikely to compete in the wholesale special access market outside of their regions. The newly-acquired out of region collocations will therefore have no impact on the competitive marketplace.

Third, the record is also clear that an MSA is an inappropriately broad area to gauge competitive entry. As SBC notes, competitive deployment and demand for special access services is "highly concentrated in a relatively small number of dense urban *wire-centers* and ex-urban *wire centers* containing office parks and other campus environments." *Casto Declaration* ¶ 12 (emphasis added). Verizon also notes that "More than 80 percent of [special access] demand is generated by roughly 8 percent of Verizon's wire centers." *Verizon Comments* at 3. Thus, by the incumbents' own admission, the competitive conditions in a wire center in one part of the MSA have nothing to do with the competitive conditions in a wire center in another part of the MSA. Furthermore, as Professor Wilkie notes, fiber networks in the dense urban areas of an MSA cannot provide competition in outlying areas of an MSA. *See Wilkie T-Mobile*

Declaration ¶ 22.[46] Accordingly, even if the Commission retains some sort of trigger for pricing flexibility, the Commission must abandon the MSA as the relevant geographic market.

Finally, any trigger should not take into account competitors' use of UNEs as BellSouth urges. *See BellSouth Comments* at 3. By definition, UNEs are ILECs' facilities, not the competitive carrier's own. Therefore, they provide no evidence of the type of sustainable, facilities-based competitive entry that must be a precondition to pricing flexibility.

V. THE COMMISSION SHOULD INITIATE A NEW LEC PRODUCTIVITY STUDY TO ESTABLISH A NEW X-FACTOR GOING FORWARD

The limited evidence already in the record suggests that LEC productivity continues to outpace the productivity of the economy a whole. Therefore, in order to take this productivity into account and maintain price cap rates at reasonable levels, the Commission should initiate a study of ILEC productivity to determine an appropriate X-factor.

Several incumbents state that, since there is no evidence that they are more productive than the economy as a whole, any X-factor should continue to be equal to GDP-PI for the special access basket. The available evidence does not seem to support this conclusion. The Commission observed in the NPRM that special access demand has increased faster than expenses and investment from 1992 to 2003. *See Special Access NPRM* ¶¶ 27-29. For this reason, the Commission determined that, "the BOCs have realized scale economies." *Id*. ¶ 29. Even the BOCs admit that special access demand has increased. Economies of scale yield lower average incremental costs where the quantity of the demand increases (all other things being

[46] Indeed, as Professor Wilkie notes "the relevant factors that determine pricing are the number of competitors, or evidence of self-provisioning on a specific point-to-point route, not the number of providers with some limited presence within a broader area such as an MSA." *Wilkie T-Mobile Declaration* ¶ 22.

equal). The BOCs' most recent productivity gains are in line with the Commission's historical conclusions regarding BOC productivity outpacing the economy as a whole.[47] The evidence of rate increases despite increases in demand indicate that prices should be realigned to account for increased economies of scale.[48]

SBC argues that there is no reason to think that special access productivity has increased, especially for copper based services, since copper facilities have not been upgraded in years. *See SBC Comments* at 41-2. However, SBC ignores the fact that the move towards IP networks[49] and the declining cost of electronics[50] have a large and continuing impact on LEC productivity regardless of the transmission medium (copper or fiber) employed.[51] Additionally, the latest

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[47] *See Policy and Rules Concerning Rates for Dominant Carriers*, Second Report and Order, 5 FCC Rcd 6786, ¶ 75 ("*1990 Price Cap Order*") ("there is a substantial body of evidence indicating that the telecommunications industry has historically been more productive than the American economy as a whole.") (footnote omitted).

[48] *See Uri & Zimmerman* at 157 ("[I]n a competitive market with the demand for special access service is growing, as characterized by the growth in special access revenue, this should result in the rates actually falling. The fact that no rates have declined and that many have increased is further evidence that the price cap LECs are exercising market power and that the market for special access service is not competitive.").

[49] As SBC itself argued in the merger proceedings, the move to IP based networks can lead to substantial cost savings. *Kahan Declaration* ¶ 37, attached to AT&T/SBC Public Interest Statement in WC Dkt. No. 05-65 (filed Feb. 21, 2005).

[50] *See* Noel D. Uri, *Assessing the Effect of Incentive Regulation on Productive Efficiency in Telecommunications in the United States*, 12 EUR. J. OF LAW & ECON., 113-127, at 116 (2002) ("*Uri*") ("Most of the change in productivity experienced in the telecommunications industry is related to reductions in switching costs and to savings in transmissions [sic] costs which occur as a result of using electronics to expand the carrying capacity of transmission facilities.").

[51] For example, BellSouth is rolling out its IP based television service using advanced DSL electronics to deliver vast quantities of data over copper telephone lines. *See* Marguerite Reardon, *BellSouth's IPTV Strategy May Pay Off*, Cnet.com, June 10, 2005, *available at* http://news.com.com/BellSouths+IPTV+strategy+may+pay+off/2100-1034_3-5739844.html

government data indicates that telecommunications labor productivity continues to increase at a rate higher than the overall economy. For example, the labor productivity (output per hour) of the entire non-farm business sector increased an average of 2.5 percent from 1995 to 2002.[52] Productivity of the wired telecommunications sector rose 6.3 percent annually from 1995 to 2002 (the last year for which data is available).[53]

The recent development and deployment of Metro Ethernet technologies demonstrates why LEC productivity likely continues to outpace the overall economy. Carriers and customers are increasingly turning to IP-based Ethernet products instead of traditional TDM based products (like DS3s). Ethernet is more efficient because, among other things, customers need not purchase electronics normally associated with TDM and a direct connection can be established between the carrier's loop facility and the customer's internal LAN.[54] Service and provisioning

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("For that elusive final connection into the home, BellSouth has committed to using Asynchronous Digital Subscriber Line and similar ADSL2+ technologies, which will allow the carrier to offer about 12mbps of capacity on a single copper strand. Using a technique called bonding, which uses two copper strands instead of one, BellSouth says it can boost capacity to up to 24mbps. It is also considering working with very-high-bit-rate DSL (VDSL), which can deliver data as fast as 100mbps.").

[52] *See* U.S. Dept. of Labor, Bureau of Labor Statistics ("BLS"), *Major Productivity and Costs Index, available at* http://data.bls.gov/PDQ/servlet/SurveyOutputServlet?data_tool=latest_numbers&series_id=PRS85006092 (data extracted July 28, 2005).

[53] *See* BLS, *Industry Productivity and Costs Data* (Sept. 24, 2004), *available at* ftp://ftp.bls.gov/pub/special.requests/opt/dipts/oaehin.txt

[54] CISCO SYSTEMS, *Metro Ethernet Services Business Overview for Service Providers*, at 4, *available at* http://www.cisco.com/en/US/netsol/ns341/ns396/ns223/networking_solutions_white_paper09186a0080215adc.shtml ("*Cisco Presentation*").

costs are also lower for Ethernet,[55] in part because customers can purchase the exact amount of bandwidth they need. *See Cisco Presentation* at 5. For all of these reasons, Metro Ethernet services are estimated to save carriers an estimated 49 percent in operating expenses and 39 percent in capital expenses as compared to SONET/SDH solutions.[56] Furthermore, Ethernet deployments are not restricted to fiber: fully 60 percent of surveyed carriers plan to deploy Ethernet over copper.[57] Clearly then, productivity increases in special access have not abated, even for copper facilities.

In light of the increasing importance of Ethernet services it is important that the Commission clarify its treatment of Ethernet, and packet-switched services in general, under price caps. As TWTC argued in its original comments, Ethernet services often do not provide sufficient revenue opportunities to justify self-deployment (TWTC Comments at 22-23). It is therefore important that Phase II pricing flexibility be eliminated for Ethernet services. Any newly calibrated X-Factor should apply equally to Ethernet and TDM-based services.

It is not entirely clear whether packet switched and/or Ethernet services are subject to price caps and therefore eligible for pricing flexibility under the Commission's existing rules. As the Commission noted in the NPRM, packet-switched services were originally excluded from

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[55] For example, Cisco notes that "Ethernet per-port costs and provisioning costs are lower than other service alternatives such as ATM, Frame Relay and SONET. Rather than provisioning additional circuits, the service provider simply opens a new port on an existing switch, reducing operational expense." *Cisco Presentation* at 4.

[56] *See Metro Ethernet Forum; The Metro Ethernet Network, Comparison to Legacy Sonet/SDH MANs for Metro Data Service Providers, available at* http://www.metroethernetforum.org/WP_SPBusinessCase_Final071403.pdf.

[57] *See* Ed Gubbins, *Metro Ethernet Means Business*, Telephony Online, May 9, 2005, *available at* http://telephonyonline.com/mag/telecom_intelligence_broadband_economy_74.

price cap regulation because they were not included in the study of BOC productivity. *See Special Access NPRM* ¶ 52. Yet, as SBC pointed out in its petition for wavier to include its packet-switched services under price caps, other BOCs such as BellSouth have successfully included their packet switched services under price-caps.[58] In BellSouth's case, the Commission concluded that, because packet-switched services were included in BellSouth's 1996 tariff filing and therefore subject to Commission scrutiny, those services were properly placed under price caps.[59] It is also unclear whether Ethernet is considered a packet-switched service. For example, SBC has included its Gig-E-Man Ethernet service under price caps and this service has been subject to pricing flexibility,[60] while SBC sought its waiver for its OPT-E-Man Ethernet because it no doubt believed that service was packet-switched (and thus not subject to price caps).

Going forward, it is important that the Commission clarify this muddled situation by bringing all packet switched and Ethernet services under price caps. It makes little sense to continue to subject this growing product segment to rate-of-return regulation. Moreover, as noted, the efficiencies made possible by Ethernet constitute dramatic improvements over TDM

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[58] *See* SBC Communications Inc. Petition for Waiver of Section 61.42 of the Commission's Rules, CC Dkt. No. 03-250, at 2-3 (filed Dec. 9, 2003). SBC's petition has not been ruled upon.

[59] BellSouth Pricing Flexibility Order, FCC 01-287, 16 FCC Rcd 18174, ¶ 15 (2001)("The packet switched services for which BellSouth sought pricing flexibility have been included in BellSouth's trunking price cap basket since July, 1996, pursuant to section 61.42(g) of the Commission's rules. These services were subject to the scrutiny of the Commission at the time of BellSouth's 1996 tariff filings. Therefore, these services properly have been regulated under price caps and are eligible for pricing flexibility under the Commission's rules.")

[60] *See, e.g., Ameritech Operating Companies Petition for Pricing Flexibility for Dedicated Transport and Special Access Services; Southern New England Telephone Company Petition for Pricing Flexibility for Dedicated Transport and Special Access Services; Southwestern Bell Telephone Company Petition for Pricing Flexibility for Dedicated Transport and Special Access Services*, Order, 20 FCC Rcd 9883 (2005).

based services. By placing packet-switched and Ethernet services under price caps and making these services part of any new RBOC productivity study, the Commission will gain a complete picture of the no doubt high rates of RBOC productivity.

All of this is not to say that one can tell with exact precision what the current measure of RBOC productivity and X-factor should be. Rather, it is clear that the Commission must initiate a study of RBOC productivity to determine the appropriate X-factor going forward. This is so because the central premise of the CALLS plan was that intra- and intermodal competition would replace the need for an X-factor set above the level of inflation.[61] Of course this has not been the case. Following the 5 year term of the CALLS plan the Commission was to " re-examine the issue to determine whether competition has emerged to constrain rates effectively." *CALLS Order* ¶ 166. Since, as we have shown, competition is not constraining rates, it only makes sense that the Commission initiate a study to reinstitute a positive X-factor going forward.

While a review of incumbent LEC productivity is important, it would be a grave mistake to reinitialize special access rates across the board based on some form of rate of return methodology as some competitors suggest. For example, as Sprint notes, it would be unwise and probably impossible to reinitialize the RBOC rates at 11.25%. As the Commission and RBOCs note, ARMIS data, following the separations freeze, has become an unreliable measure of the

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[61] *See Access Charge Reform; Price Cap Performance Review for Local Exchange Carriers*, Sixth Report and Order, 15 FCC Rcd 12962, ¶ 166 (2000), *subsequent history omitted ("CALLS Order")*. The Commission phased out the X-factor in the later years of the CALLS proposal because the Commission believed that "increased competition will serve to constrain access rates in the later years of the CALLS proposal as X-factor reductions are phased out." *Id*.

rates of return. Therefore, it would be extremely difficult to determine what an actual 11.25% rate of return might be.

More fundamentally, this sort of rate of return methodology increases substantially the incumbents' incentive to engage in inefficient cost misallocation. That is, re-initialization based on a set rate of return would essentially deny incumbents the ability to retain the surplus yielded by increased productivity. Instead, the regulators would send the clear message that incumbents' prices will be tied closely to regulatory accounting costs (more closely than is the case under price caps). Incumbents would acquire powerful incentives to misallocate costs of unregulated services to the regulatory accounting categories used as the basis for setting their rates. Such misallocation (1) blunts incumbents' incentive to increase efficiency, (2) yields unreasonably high regulated rates and (3) distorts competition in the provision of the unregulated services. Not surprisingly, therefore, the Commission has generally rejected requests that the incumbents' interstate access price cap levels be reinitialized based on a set rate of return.[62] It should do so here again.

The suggestion that ILEC rates should be set at the "on-net" rates of competitive carriers is similarly misguided. There is no one "competitive rate" and since different carriers' cost structures are likely to be widely divergent, their rates are likely to be different as well.

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[62] *See, e.g.*, *Access Charge Reform*, First Report and Order, 12 FCC Rcd 15982, n.391 (1997) (rejecting "Ad Hoc's suggestion that we require a PCI reinitialization based on the currently-authorized 11.25 percent rate of return" for interstate access because such an approach, "while administratively simpler than some other ways of changing rate levels -- would undermine productivity incentives by imposing the greatest penalties (rate reductions) on those carriers that had improved their efficiency the most. Reinitialization to another rate of return level, as API suggests, could, in addition, require resolution of complex and time-consuming issues").

Moreover, competitive carriers do not have a viable presence in certain product and geographic markets, (for example, DS1 loops outside of the densest urban areas) and therefore there is no "competitive price" to use as a proxy. The absence of competitive rates would leave the Commission in the position of trying to rely on something akin to a forward-looking methodology for setting special access rates, an approach that it has appropriately rejected in the past.[63]

While a broad re-initialization of rates is not warranted, the Commission should review closely the special access mileage-based charges. The evidence discussed above indicates that these rates are far above cost in many cases. Indeed, it seems possible that some distortion in mileage rate levels under rate-of-return found its way into price caps when price cap levels were initially set, and that distortion seems never to have been corrected. The Commission should determine whether mileage charges are disproportionately high (as compared for example to channel termination rates). If so, the Commission should target the application of the applicable X-factor to mileage charges until they are brought in line with prices for other special access services.

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[63] *See id*. ¶ 45 ("We also recognize that several commenters have urged us to move immediately to forward-looking rates by prescriptive measures utilizing forward-looking cost models. We decline to follow that suggestion for several reasons. First, as a practical matter, accurate forward-looking cost models are not available at the present time to determine the economic cost of providing access service. Because of the existence of significant joint and common costs, the development of reliable cost models may take a year or more to complete. This situation might be contrasted with that addressed in our Local Competition Order, where we endorsed the use of cost models to estimate the cost of providing unbundled network elements. There, we observed that unbundled elements have few joint and common costs, so that devising accurate cost models for unbundled network elements is more straightforward.") (footnote omitted).

Finally, as several parties noted (see e.g., ATX Comments at 28-29), it is important that services subject to different levels of demand elasticity and differing levels of competitive entry be subject to separate service categories (or subcategories) and pricing bands.[64] Indeed, separate service categories were created originally because of the "their technology, customer base and demand trends," of services within the same basket. *See 1990 Price Cap Order* ¶ 219. The Commission applied separate pricing bands to these service categories to prevent discriminatory behavior in individual service categories.[65] For example, originally, DS1 and DS3 services were placed in separate sub-categories to prevent "strategic pricing" of these services.[66]

The Commission should now establish separate subcategories and bands for DS1 and DS3 loops as well as DS1 and DS3 transport. With respect to loops, as the record in the *TRRO* has indicated, carriers such as Nuvox and Cbeyond exclusively demand ILEC DS1s to provide

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[64] *See 1990 LEC Price Cap Order* ¶ 14 ("[b]y grouping similar services together, we believe we have effectively prevented opportunities for the LECs to engage in pricing discrimination or anticompetitive practices.").

[65] *See id.* ¶ 281 ("Our decision to separate LEC services into four baskets and to subdivide those baskets into service categories constrains precipitous changes to prices, and reduces LEC ability to shift the cost of one type of services to another class of ratepayers.").

[66] For example, in its order regarding DS1 pricing, the Commission was concerned that RBOCs might have the incentive to price DS1 special access circuits and voice grade lines in such a way as to offer more costly services at lower prices and less costly services at higher prices. Therefore, the Commission held that "The hierarchy of any special access rate structure incorporating strategically priced rates must be consistent with the hierarchy of underlying costs for special access services; the rates for less costly services cannot be higher than those for more costly services." *Investigation of Special Access Tariffs of Local Exchange Carriers*, Memorandum Opinion and Order, 4 FCC Rcd 4797, ¶ 58 (1988), *subsequent history omitted*. In its order regarding DS3 pricing, the Commission determined that individual case basis rates for DS3s were not just and reasonable and therefore ordered them to eliminate ICB tariffs and file publicly available tariffs. *See Local Exchange Carriers' Individual Case Basis DS3 Service Offerings et al.*, Memorandum Opinion and Order, 4 FCC Rcd 8634 (1989), *subsequent history omitted.*

their integrated access services to small and medium business customers.[67] That is, DS1s loops have unique demand patterns and customer bases. The needs of customers served by Nuvox and Cbeyond cannot be economically satisfied with DS3 circuits. DS1s are also often provisioned via copper while DS3s are almost exclusively offered over fiber. Moreover, as the Commission determined in the *Triennial Review Order*, DS3 and DS1 loop services are subject to differing levels of competitive supply. Therefore, there is a substantial threat that non-competitive DS1 service rates could subsidize more competitive DS3 level service. Similarly, with respect to transport, many carriers[68] rely heavily on DS1 EELs in areas where DS1 transport often cannot be competitively supplied.[69] Therefore, DS1 and DS3 transport should be placed in separate subcategories and remain subject to different pricing bands. Without such a remedy the RBOCs could subsidize their DS3 transport services with supra-competitive earnings from their DS1 transport service.

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[67] *See Ex Parte* presentation of Cbeyond, *Access to Unbundled Network Elements*, Sept. 7, 2004, at 4, attached to Letter of Patrick J. Donovan, Counsel, Cbeyond, CC Dkt. Nos. 01-338 *et al*. (filed Sept. 8, 2004); *Ex Parte* presentation of Nuvox, *Impact of FCC Interim Rules on Small Business*, Aug. 2004, at 6, attached to Letter of Michael H. Pryor, Counsel, Nuvox, to Marlene H. Dortch, Secretary, FCC, WC Dkt. Nos. 01-338 *et al*. (filed Aug. 19, 2004).

[68] *See, e.g.*, Cbeyond Reply Comments, WC Dkt. Nos. 04-313 *et al*., at 2-3 (filed Oct. 19, 2004) (noting that Cbeyond must rely on EELs to expand its service footprint outside of dense metropolitan cores).

[69] *See TRRO* ¶ 126 (" In the *Triennial Review Order*, the Commission found that 'competing carriers generally cannot self-provide DS1 transport' and that '[a] carrier requiring only DS1-capacity transport between two points typically does not have a large enough presence along a route (generally loop traffic at a central office) to justify incurring the high fixed and sunk costs of self-providing just that DS1 circuit.'") (footnote omitted).

VI. ILECS SHOULD BE PERMITTED TO RETAIN PHASE I PRICING FLEXIBILITY SUBJECT TO RESTRICTIONS PREVENTING THE INCLUSION OF ANTICOMPETITIVE TERMS AND CONDITIONS

As TWTC has explained, volume and term discount arrangements are a reasonable means of allowing customers to benefit from the efficiencies incumbents experience when serving a large volume purchaser. Smaller purchasers of special access or services for which special access is an input also benefit from these arrangements. This is because carriers like TWTC pass through the discounted prices to purchasers of the products for which discounted special access circuits are inputs. In all events, large volume purchasers of special access have based their businesses on the continued availability of existing volume and term discount arrangements. Those reasonable commercial expectations must be honored. For all of these reasons, therefore, it would be inappropriate for the Commission to eliminate Phase I pricing flexibility in areas in which it has thus far been granted.

The Commission must also be sure to allow customers to include multiple MSAs in a single volume/term agreement. Combining geographic areas in a single contract reduces transaction costs. In addition, purchasers are able to predict more reliably the total volume of special access they will purchase when multiple markets are considered together and isolated fluctuations in demand in a particular market have less impact on the aggregate volume purchased. That is, a purchaser can have greater confidence that it will be able to meet projected volumes and qualify for discounts when purchasing under a contract that covers multiple MSAs.

To be sure, volume and term discount arrangements offered by the incumbents have sometimes offered only illusory discounts. As TWTC has explained, this is in part due to the incumbents' freedom to unilaterally raise the underlying price to which discounts often apply, thus eroding or eliminating the size of the discount as originally set forth in the agreement. The

incumbents have also included "non-price" terms and conditions in volume and term offers that effectively impose significant costs on purchasers (e.g., by requiring that purchasers forego the use of alternative technologies or commit to steep increases in volume commitments over the life of an agreement). Eliminating Phase II pricing flexibility should (subject to the qualification discussed below) limit the incumbents' ability to engage in this conduct. As mentioned above, regulation of tariffed rates limits the incumbents' ability to unilaterally raise tariffed rates to which discounts apply. Moreover, the availability of reasonably prices services more generally limits the extent to which incumbents can increase the prices or costs of purchasers because purchasers can always opt for the regulated rates.

The Commission must be aware, however, that incumbents have included some terms and conditions in special access arrangements for which there are substantial "spillover" costs in the form of harm to competition that are not absorbed by the customer. This is the case, for example, with offers that (1) condition the availability of the maximum discount on a carrier customer agreeing to eliminate its purchases from a competitive carrier wholesaler;[70] (2) impose special fees where a purchaser seeks to move circuits from the incumbent to a CLEC

[70] *See AT&T Comments* at 8 ("[T]he Commission should clarify that bundling a tariff discount with the condition that the customer terminates service with a competitor on the same route would be improper."); CompTel/ALTS *et al*. Comments at 18 (noting that SBC Tariff No. 15 "requires that a 'minimum of 4% of [the annual commitment] must come from services previously provided by a carrier other than Southwestern Bell Telephone Company and its affiliates.' Failure to document this 4% minimum transfer of service will require customers to suffer the full termination penalty under the tariff--repayment of all discounts given plus 25 % of the committed revenue for each remaining year.").

wholesaler;[71] and (3) permit the transfer of an apparently artificially limited number of circuits to competitors per day.[72] None of these provisions is designed to ensure that customers actually meet the volume and term special access purchase commitments required to produce lower costs for incumbents. Moreover, a purchaser would likely not absorb the full "costs" associated with these provisions. For example, if a purchaser were able to purchase only a small portion of its special access needs, agreeing to conditions that essentially prevent it from purchasing any services from competitors will have a relatively limited impact on the purchaser. This is so even if the purchaser would purchase from more efficient competitors in the absence of such a restriction. Competitive providers of special access service, however, would incur substantial spillover costs not captured by the purchaser. A competitive wholesaler would be unable to stay in business or earn enough to invest in expanded entry if all special access purchasers agreed to ILEC conditions not to purchase from the competitor in the limited area in which it offers service. As a result, competition is harmed substantially in aggregate even though each individual purchaser of ILEC special access would probably not change its purchasing decisions.

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[71] For example, as WilTel notes, "In PacBell territory, for example, the one time charge for moving a circuit from PacBell to another carrier can be almost $5000 per circuit." *WilTel Comments* at 15; *See also Sprint Comments* at n.10 ("Verizon, for example, has a $380.00 'Coordinated Retermination' nonrecurring charge per channel termination (see Tariff No. 1, Section 7.5.9(a)(1)). In contrast, its installation NRC for many services that Sprint purchases is only $1.00 per channel termination (*see, e.g.*, Tariff 1, Section 7.4.1(c)(1))."

[72] "For an IXC to move 100 circuits off SBC's and onto a competing network, for example, SBC would allow a special access purchaser to groom only 8 circuits per day, resulting in at least a 13 day grooming process." *WilTel Comments* at 15; *Broadwing Comments* at 25 ("…many of the ILECs have placed arbitrary limitations on the number of circuit migrations they will perform."); *Sprint Comments* at 6 ("some RBOCs limit the quantities of circuits that can be migrated per night or by type of service.").

Accordingly, the Commission should prohibit the incumbents from including any conditions in volume and/or term discount offers that are targeted specifically at precluding or increasing the costs of purchasing special access service from a non-ILEC wholesaler. In so doing, the Commission should list the examples discussed herein as particular provisions that violate this prohibition.

VII. CONCLUSION

The Commission should modify the existing regulations governing special access pricing flexibility in the manner described herein.

Respectfully submitted,

/s/

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ATTACHMENT A

REDACTED--FOR PUBLIC INSPECTION