ILEC Exclusionary Contracts

COMPTEL has already shown that the DOJ has not adequately described all the barriers to entry in the Local Private Line market. As we have noted, most private lines include a transport component as well as a loop component.[1] Moreover, most private lines are purchased by carriers, which combine these private lines with intelligence and other network facilities and features to create finished services that are then sold to retail customers. Thus, what little facilities competition that exists in the special access/Local Private Line market is provided by other carriers for other carriers. The barriers that these entrants—who compete directly against the Bells—face are enormous. The DOJ only lists some of the "natural" economic barriers to entry. There are other, artificial barriers that have been erected by the Bell companies, including defendants SBC and Verizon.

The most notable features about the special access market are that: 1) the Bells still maintain a monopoly over the market; even the carriers with the largest networks must buy over 90% of their total special access circuits (Local Private Lines) from the Bells; 2) in the most populous markets, the Bells are no longer price regulated by the FCC; and 3) almost all of the

[1] Indeed, AT&T has explained that 40,000 of its local business customers require the lowest capacity private line service—DS1 service. The vast majority of these customers—about 65%--are served via combinations of loops and transport. See AT&T Presentation, CC Docket No. 01-338, October 7, 2002, at p. 10.

special access circuits sold by SBC and Verizon are sold under "optional pricing plans."[2]

These contracts are relevant to this proceeding for three reasons that we have already discussed to some degree: 1) they are important to understand in order to understand proper geographic market definition; 2) they are an ongoing barrier to facilities-based competitive entry into the Local Private Line/special access market because they severely foreclose access to customers and distort entry decisions; 3) the continued existence of these contracts will make it even less likely that the proposed remedy will allow a new firm to take the place of AT&T—even if all of AT&T's in-region assets were divested.

The key feature of these optional pricing plans is that in order to get "discounts" on circuits for which they have no competitive alternative (the vast majority of their circuits) customers (like the pre-merger AT&T and MCI, and COMPTEL's members) must commit to purchasing the majority of their total circuit volumes from the Bell companies—including circuits for which a cheaper competitive alternative may be available. In other words, because only the incumbent can supply all of any customer's Local Private

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[2] These "optional pricing plans" are an essential feature of the special access market that the court must understand in order to understand why entry of the proposed consent decrees is not in the public interest. To this end, COMPTEL has included with its comments a detailed analysis of SBC's optional pricing plan, prepared by former DOJ and FCC chief economist Joseph Farrell. Dr. Farrell's pricing plan analysis is included as Attachment 3 to these comments. COMPTEL also provides analyses of SBC and Verizon's exclusionary pricing plans prepared by MCI and AT&T as Attachments 4 and 5.

Line demand, the incumbent can condition the availability of discounts on certain circuits (the majority, for which no competitive alternative is available) on the customer's commitment to transfer the "competitively sensitive" portion of its demand to the incumbent.

In this respect, the optional pricing plans—which are pervasive—act to foreclose circuit demand from potential competitors of the incumbents for Local Private Line services.[3] This feature—contracts that foreclose sales opportunities to rivals—is yet another factor that the Department, in its Merger Guidelines, has identified as making post-merger entry less likely.[4] However, the Department has chosen not to eliminate this entry barrier for the prospective IRU purchaser.

Another feature of these contracts is that customers that cannot meet their volume commitments must pay high "termination" penalties. While customers do not like these contracts, they have little choice but to sign them.[5] Because, as noted previously, for the densest metro areas the FCC no

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3 See, e.g., "Quantity-Discount Contracts as a Barrier to Entry," T. Randolph Beard, PhD, George S. Ford, PhD, Lawrence J. Spiwak, Esq., Phoenix Center Policy Paper No. 20 (November 2004). Available at http://www.phoenix-center.org/ppapers.html

4 "Factors that reduce sales opportunities to entrants include . . . (b) the exclusion of an entrant from a portion of the market over the long term because of vertical integration or forward contracting by incumbents. . . ." Merger Guidelines, Section 3.3.

5 "Discount pricing plans offered by ILECs further reduce the ability of CLECs to compete and result in higher prices. Even where a CLEC may offer a competing special access service (at a substantial discount to the ILEC offering), WilTel may not use that CLEC in many cases because it can incur a lower incremental expense by committing additional services to an existing ILEC plan even though the overall unit cost from the ILEC may be higher." Declaration of Mark Chaney in support of

longer regulates the Bells' special access rates, the Bells have used this pricing flexibility to raise their "month-to-month" or non-OPP prices for special access. The resulting effect is that customers—almost all of whom are retail competitors with the Bells (Local Private Lines/special access circuits are critical inputs to all wireline and wireless telecommunications services)—cannot afford to pay higher prices when their competitors (including the Bell affiliates) are purchasing at a "discount." The word "discount" is in quotations because the discounts are discounts off the month-to-month tariff price, so the Bell can still charge a monopoly profit maximizing price (through its OPP) by establishing a "supra-monopoly" price as the non-OPP alternative.

The most important thing to consider when trying to conceptualize how the optional pricing plans work, is that the incumbent—by exchanging "discounts" on products for which demand is inelastic (customers have no alternative) for commitments to not buy from competitors on products for which the customer could choose a competitor—gets to set the minimum scale of entry for his competitors. Thus the incumbent can pick demand over a large geographic region as the inelastic product (on which discounts are offered), or the incumbent could decide to "discount" lower capacity circuits (for which the incumbent's "first mover" status and scale/scope economies give it a tremendous advantage over new entrants) as the basis on which it

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the Comments of WilTel, In the Matter of Special Access Rates for Price Cap Local Exchange Carriers, WC Docket No. 05-25, at ¶ 6.

will foreclose demand from rivals. Regardless, though, the end result is that the incumbent is able to raise the costs of its competitors by expanding the scale on which they would have to enter, or raising the size of the discount they would have to offer to make their customer indifferent between buying from the incumbent, and/or by limiting its competitors ability to expand quickly (by foreclosing demand).

Given that courts, as well, have recognized the potential for anticompetitive foreclosure effects in these so-called "bundled rebate" or "bundled discount" plans, this Court must ask the DOJ to determine what percentage of the wholesale (carrier) and retail markets for special access are foreclosed by the contracts at issue. COMPTEL believes this number will be significant.[6] The D.C. Circuit has held that exclusionary conduct by a monopolist is more likely to be anticompetitive than "ordinary" exclusionary conduct achieved through non-monopoly means (i.e., agreements among competitors).[7] Moreover, the Third Circuit has held that contracts almost identical to the Bell OPP's, when used by a monopoly, were anticompetitive

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[6] SBC notes that the "overwhelming majority" of its special access circuits are sold under term and volume contracts. See n. 11, supra. Verizon has stated that 85% of its access sales were under some form of discount contract. Verizon Comments, WC Docket No. 05-25, June 13, 2005 at p. 22.

[7] *United States v. Microsoft Corp.,* 253 F.3d 34, 70 (D.C. Cir. 2001) (Microsoft's exclusionary contracts violated Section 2 (of the Sherman Act) "even though the contracts foreclose less than the 40-50% share usually required in order to establish a § 1 violation.")

and exclusionary in violation of the antitrust laws.[8] The Supreme Court has held that a market share over 65% is sufficient to establish a prima facie case of monopoly power.[9] It is almost certainly the case that SBC and Verizon would be fairly considered monopolies, pre-merger, in the special access market—regardless of how broadly that market is defined geographically.[10] Thus, the Court need only make an inquiry into what proportion of special access services are sold under the contracts described above in order to have enough information to determine that as long as the defendants are allowed to use these contracts, the DOJ's proffered remedy has no legitimate hope of restoring competition lost through the mergers.

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[8] *LePage's Inc. v. 3 M*, 324 F.3d 141 (3d Cir. 2003)("The principal anticompetitive effect of bundled rebates as offered by [the defendant] is that when offered by a monopolist they may foreclose portions of the market to a potential competitor who does not manufacture an equally diverse group of products and who therefore cannot make a comparable offer").

[9] *American Tobacco Co. v. United States*, 328 U.S. 781, 797 (1946).

[10] Only 3 years ago, AT&T—the best-situated special access customer (with the largest competitive local network in any Bell region)—was dependent on the incumbents for 93% of its DS1-level transport and 65% of its DS3-level access. See Reply Declaration of Janusz A. Ordover and Robert D. Willig on Behalf of AT&T Corp., In the Matter of AT&T Petition for Rulemaking to Reform Regulation of Incumbent Local Exchange Carrier Rates for Interstate Special Access Services, FCC Rm-10593, at ¶ 30.