Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

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

COMMENTS OF PAETEC COMMUNICATIONS, INC.
AND US LEC CORP.

PAETEC Communications, Inc. and US LEC Corp.[1] (collectively "PAETEC") welcome the opportunity to refresh the record in this ongoing Federal Communications Commission ("Commission") proceeding focused on correcting the national market failure in the wholesale special access marketplace. In these comments, PAETEC addresses a number of the specific questions posed in the Commission's *Notice to Refresh Record In The Special Access Notice Of Proposed Rulemaking*, WC Docket No. 05-25, RM-10593 (released July 9, 2007) ("*Notice*").

PAETEC's comments will help illuminate (i) the continuing monopoly price pressure that competitive carriers and other types of service providers are

[1] Including its operating subsidiaries US LEC COMMUNICATIONS INC d/b/a PAETEC Business Services; US LEC OF ALABAMA INC d/b/a PAETEC Business Services; US LEC OF FLORIDA INC d/b/a PAETEC Business Services; US LEC OF GEORGIA INC d/b/a PAETEC Business Services; US LEC OF MARYLAND INC d/b/a PAETEC Business Services; US LEC OF NORTH CAROLINA INC d/b/a PAETEC Business Services; US LEC OF PENNSYLVANIA INC. d/b/a PAETEC Business Services; US LEC OF SOUTH CAROLINA INC d/b/a PAETEC Business Services; US LEC OF TENNESSEE INC d/b/a PAETEC Business Services; and, US LEC OF VIRGINIA L.L.C. d/b/a PAETEC Business Services.

experiencing when purchasing special access from the large incumbent local exchange carriers ("ILECs") and (ii) the anticompetitive behavior of those same ILECs in markets where they have prematurely been granted special access pricing flexibility by the Commission. PAETEC also demonstrates the harm recent ILEC mergers have caused to what otherwise might have been at least a superficially competitive special access marketplace. Finally, PAETEC will provide to the Commission what it believes is the right formula for government intervention to bring the sale and purchase of these vital telecommunications services to a semi-competitive state.

Its merger with US LEC earlier this year reinforced PAETEC's status as one of the premier national providers of competitive wireline local, long distance, data and Internet services. Because it primarily uses special access services as the wholesale input for its retail loop services, PAETEC is particularly well positioned in understanding the ongoing special access wholesale market distortions. As a result of its experience, PAETEC also has identified a viable regulatory alternative that can minimize those distortions and contribute to the development of the vibrant, competitive, multiple player marketplace that is clearly lacking today.

I. Recent BOC Mergers and Industry Consolidation Have Reinforced the ILECs' Monopolization of Special Access Services By Decreasing the Availability of Competitive Special Access Facilities and Providers

The *Notice* specifically asked for information about the effect of the 2005 and 2006 BOC/IXC and BOC/BOC mergers and other industry consolidation on the availability of competitive special access facilities and providers. *Notice* at 2.

That effect is clear and entirely predictable. Special access services are now monopolized by ILECs to an even greater extent than was the case at the beginning of the BOC merger spree in early 2005.

Any other result would have been a surprise. The 2005 BOC/IXC mergers combined the two largest providers of special access services, SBC and Verizon, with the two largest non-ILEC national special access networks, those of AT&T and MCI.[2] Moreover, AT&T and MCI were also the largest purchasers of special access services from the ILECs and the largest alternative providers of special access services to other CLECs, including PAETEC.[3] PAETEC and many others pointed out in those merger proceedings that the MCI and AT&T special access offerings, whether provided through resale of ILEC services or over their own facilities, were the most important alternatives in many special access markets.[4] This was true for both the high capacity loop[5] and interoffice transport[6] segments of the special access market.

[2] See Memorandum Opinion and Order, *In the Matter of SBC Communications Inc. and AT&T Corporation Applications for Approval of Transfer of Control*, FCC WC Docket No. 05-65 (rel. Nov. 17, 2005) ("*SBC/AT&T Merger Order")*; and Memorandum Opinion and Order, *In the Matter of Verizon Communications Inc. and MCI, Inc. Applications for Approval of Transfer of Control*, FCC WC Docket No. 05-75 (rel. Nov. 17, 2005) ("*Verizon/MCI Merger Order")*.

[3] *See, e.g., id.* at ¶ 42 and filings cited therein at footnotes 110-112.

[4] *Id*.

[5] The Commission has defined high capacity loop facilities as "the transmission facilities between a central office and the customer's premises . . . of DS1 or higher capacity." *Unbundled Access to Network Elements; Review of the Section 251 Unbundling Obligations for Incumbent Local Exchange Carriers*, 20 FCC Rcd 2533, ¶ 146 (2005) ("*TRRO*").

[6] In the *TRRO*, the Commission defined dedicated interoffice transport facilities as "incumbent LEC transmission facilities dedicated to a particular customer or carrier that provide telecommunications between wire centers owned by incumbent LECs or requesting telecommunications carriers, or between switches owned by incumbent LECs or requesting telecommunications carriers." *Id.* at ¶ 136. This definition encompasses entrance facilities, which are those interoffice transmission facilities connecting a competitive LEC's network to the incumbent LEC's network. The continued availability of entrance facilities is of particular concern to PAETEC.

No non-BOC competitor had an interoffice network nearly as large as either AT&T or MCI, and those companies also had the two largest numbers of high capacity loops (i.e., existing building connections to their network) among non-BOCs. Given the breadth of their networks, MCI and AT&T served to discipline the markets by acting as the key constraints on pricing and market power of the ILECs.[7] Finally, and crucially in this post-9/11 and post-Katrina environment, MCI and AT&T also offered CLECs the opportunity to have geographic and route diversity in their operations.[8]

All of those benefits to competition and market efficiency were lost with the mergers. AT&T's and MCI's networks are now parts of the new AT&T and Verizon networks respectively. Naturally, those BOC networks are correspondingly larger. At the same time, however, there has been no countervailing expansion of fiber special access capacity by CLECs or other competitive communications providers that begins to make up even a small percentage of the loss of the AT&T and MCI networks in either the high capacity loop or interoffice transport markets.

The merger earlier this year of the new AT&T and BellSouth simply made a bad situation worse.[9] The limited competition that existed in special access

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[7] *See, e.g., Verizon/MCI Merger Order* at ¶ 48 and submissions cited in fns 126 & 127.

[8] *See, e.g.,* Letter from Mark C. Del Bianco, Counsel for PAETEC, to Marlene H. Dortch, Secretary, FCC, *In the Matter of Verizon Communications Inc. and MCI, Inc. Applications for Approval of Transfer of Control*, WC Docket No. 05-75 at 1-2 (filed Oct. 6, 2005).

[9] *See* Memorandum Opinion and Order, *In the Matter of AT&T Inc. and BellSouth Corporation Application for Transfer of Control,* WC Docket No. 06-74 (March 26, 2007) ("*AT&T/BellSouth Merger Order")*.

markets in the former BellSouth region in the southeastern United States has been even further eroded.

The Ad Hoc Telecommunications Users Committee ("Ad Hoc") reported in 2004 "that incumbent local exchange carriers remain the sole source of special access connectivity at roughly 98 percent of all business premises nationwide."[10] This is fully consistent with PAETEC's experience with regard to the availability of special access services in major metropolitan areas before the government-sanctioned reconstitution of a single national wireline carrier began in 2005. Indeed, in 2005, PAETEC informed the Commission that rather than being able to obtain alternative means of special access to reach its customers, it was dependent on ILECs for 95 percent of its special access service lines in markets where Phase II pricing flexibility had been implemented.[11]

The bottom line is that there were very few alternatives to ILEC special access services to which CLECs could turn in 2005. There are fewer now. In the two years since its 2005 filing, PAETEC's dependence on ILEC special access services has risen further, and it now exceeds 98 percent in Phase II areas. This development is a direct result of the lack of competitive alternatives now that the BOCs have swallowed the country's largest competitive access providers, and AT&T and BellSouth have merged. This increased reliance on

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[10] *See In the Matter of AT&T Corp and SBC Communications Inc.*, Reply Declaration of the Ad Hoc Telecommunications Users Committee, WC Docket No. 05-65 (filed May 10, 2005) ("Ad Hoc Committee Update") at 4-5.

[11] *See* Comments of PAETEC Communications, Inc., WC Docket No. 05-25 (filed June 13, 2005) ("*PAETEC Comments*").

ILEC facilities has occurred in spite of vigorous and concentrated efforts by PAETEC to find alternative special access providers.

PAETEC seeks for both business and network security reasons to procure alternatives to ILEC special access, where it can do so without jeopardizing its ability to build and maintain a viable business. It is axiomatic that competitive special access providers would focus their efforts on providing alternatives to ILEC special access lines in high-density markets (such as those examined by the GAO and discussed in Part II(A) below) due to the availability of a large business customer base.[12] Yet even in these areas, PAETEC is generally unable to find reasonable competitive alternatives.

PAETEC and numerous other commenters identified these inevitable effects of BOC consolidation in pleadings filed in the Commission's BOC merger proceedings in 2005 and 2006.[13] Both the Commission and the Department of Justice had the opportunity to offset the competitive harms, but did not do so. The special access conditions imposed in the BOC/IXC and AT&T/BellSouth mergers were limited in scope to a few buildings and some agreements to maintain pricing stability, and have certainly not provided any relief to PAETEC. As we discuss in more detail in Part II (B) below, the BOC mergers not only left the merged firms free to continue their anticompetitive practices in the special

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[12] "When competitive LECs seek to enter a new special access market, they generally concentrate their efforts in high density areas where the revenue opportunities are the greatest – such as locations where enterprise customers are located." *AT&T/BellSouth Merger Order* at ¶ 55. S*ee also TRRO* at ¶ 154 (stating that when competitive LECs are deciding whether and where to build their own facilities, they "target areas that offer the greatest demand for high-capacity offerings (*i.e.*, that maximize potential revenues) and that are close to their current fiber rings (*i.e.*, that minimize the costs of deployment).").

[13] *See, e.g., AT&T/BellSouth Merger Order* at ¶ 52 and filings cited in fns. 137-140.

access market, but actually created greater incentives and ability to do so because with each merger the surviving BOC controlled a larger share of the special access market in its region.

At the same time, the importance of special access services, and of the need for the Commission to ensure that true competition emerges in the market, have grown exponentially. As various parties have noted, the nature of special access services has changed substantially since the mid-1990's.[14] From its inception in the wake of the original breakup of AT&T*,* special access was a collection of end-to-end services (e.g., private lines, telegraph lines, Muzak, "hi-cap," and WATS access lines). In the 1980s and 1990s, because of the line of business restrictions imposed by the 1981 AT&T consent decree, BOCs did not compete with most purchasers of their special access services and had little reason to discriminate against or among their access customers.

The uses and strategic importance of special access services changed dramatically in the aftermath of the introduction of competition in all telecommunications markets by the Telecommunications Act of 1996. In a shift whose outlines were only dimly apparent at the time of the 1999 *Pricing Flexibility Order*,[15] special access has become a crucial input for most other communications products and services. As the Commission has repeatedly recognized, BOC competitors for whom special access is a key input include "competitive LECs in providing services to their retail enterprise customers,

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14 *See, e.g.,* Ex Parte Letter of COMPTEL, the Ad Hoc Telecommunications Users Committee, et al, WC Docket No. 05-25 (filed August 2, 2007).

15 *Access Charge Reform*, Fifth Report and Order, 14 FCC Rcd 14221 (1999), aff'd sub nom., *WorldCom v. FCC*, 238 F.3d 449 (D.C. Cir. 2001) ("*Pricing Flexibility Order*").

wireless and competitive LECs in connecting their networks to other carriers, long distance carriers seeking to connect customers to their long-distance networks, and entities seeking to connect with Internet backbones."[16]

After they began to enter the long distance market and provide nationwide services to enterprise customers after 2000, BOCs competed with even more of their special access customers. This group included dramatically different private networks (*e.g.,* national corporate networks, secure data networks, and the Internet) and the plethora of services offered on new private or semi-private networks that have arisen.[17] Each of these developments cut into the ILECs' revenue stream and provided them with incentives to increase the prices of their own special access services and impede the growth of alternative special access providers.

Today, BOCs and other ILECs compete not only with PAETEC and other CLECs, but also with the great majority of non-business-customer purchasers of their special access services, and the BOCs and ILECs have strong incentives to discriminate both against and among their access customers. Special access has become a powerful competitive weapon for ILECs. Thus, the importance of the Commission getting the predictive triggers right for competitive reasons is magnified.

The importance of the Commission's actions to encourage facilities-based competition in the special access market is greatly magnified for another reason

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[16] *See SBC/AT&T Merger Order* at ¶ 24; Verizon/MCI *Merger Order* at ¶ 24; and *AT&T/BellSouth Merger Order* at ¶ 27.

[17] *See AT&T/BellSouth Merger Order* at ¶¶ 27-61.

that was barely on anyone's radar screen in 1999. The dual tragedies of the terrorist attacks of 9/11 and Hurricane Katrina have demonstrated the importance of having multiple, independent, facilities-based communications networks to provide redundancy in the event of disaster, whether manmade or natural. The Commission, like every other government agency, must now consider the national security implications of its decisions. The ongoing special access market failure has left all communications networks (even those CLEC, cable, wireless, and broadband over powerline networks that appear to be separate from and competing with the ILECs) relying on the same physical network – the local ILEC – for most of their backhaul and large parts of their commercial access. This is no longer just a matter of theoretical concern to economists, venture capitalists, and non-ideological investment bankers. A failure to implement policies that stimulate construction of competitive special access facilities may again result in the failure of a regional or national communications network precisely when American citizens will need it the most. If the Commission is to err, it should be on the side of national security, not on the side of protecting ILEC revenues and profits.

II. Comments on the Analysis and Findings in the *GAO Report*

PAETEC lacks the data necessary to address many of the findings made in the *GAO Report.*[18] Nonetheless, PAETEC generally agrees with the key conclusions set out on pages 12-16 of the *Report.* In addition, PAETEC does

[18] Government Accountability Office, *FCC Needs to Improve its Ability to Monitor and Determine the Extent of Competition in Dedicated Access Services*, Report 07-80 (Nov. 2006) ("*GAO Report*").

address several specific findings because its experience provides useful additional data points for the Commission to consider.

A. Facilities-based competitive alternatives for dedicated access are not widely available

The *GAO Report* focused only on one part of the special access market – the part comprising high capacity loops or end user connections. The *Report* did not address conditions in the interoffice transport market. Nonetheless, PAETEC's considerable operational experience as both a long distance and local exchange carrier in the lower forty-eight states and fifty-two metropolitan statistical areas ("MSAs") confirms that the conclusions reached by the GAO with regard to the end user market are equally valid in other geographic areas and in the interoffice transport market.

The *GAO Report* analyzed the pricing and availability of high capacity loop special access services in a select group of major metropolitan areas. One of its key conclusions was that

> According to data from July 2006, facilities-based competitors have extended their networks to a relatively small subset of buildings in the MSAs that we examined. Of the buildings with a level of demand greater than the DS-1 level in our model, we found that only about 6 percent of buildings, on average, have a fiber-based competitor. Competition is more widespread where buildings have a higher level of demand. For the subset of buildings identified in our model as likely having companies with a DS-3 worth of demand, competitors have a fiber-based presence in 15 percent of buildings, on average. For buildings identified in our model with at least 2 DS-3s of demand, competitors have a fiber-based presence in 25 percent of buildings, on average . . . [19]

[19] *Id.* at 19 (footnote omitted).

PAETEC's experience confirms the accuracy of the GAO's finding. PAETEC operates in nine of the sixteen markets examined by the GAO - Atlanta, Georgia; Chicago, Illinois; Miami, Florida; New York, New York; Norfolk, Virginia; Pittsburgh, Pennsylvania; New Orleans, Louisiana; Los Angeles, California and Washington, D.C. In all of those markets, the number of buildings served by competitive special access providers is miniscule. The same is true of interoffice transport routes, which are overwhelmingly dominated by the ILECs.

Moreover, these MSAs constitute some of the most competitive areas of the country. While PAETEC does not have specific data for other MSAs, it is aware from its own experience that in the non-Tier 1 MSAs where it offers service (such as Rochester, Buffalo and Syracuse, New York), the availability of alternative special access facilities is substantially more limited than in the 16 Tier 1 MSAs examined by the GAO.

Unfortunately, given the economic and financial realities of the competitive LEC world, neither the cost of deploying new fiber or copper special access facilities nor the competitive situation in the special access market will improve anytime soon. Due to the nature of these facilities, there are inherent barriers to building and deploying them quickly or cheaply (e.g., the costs of trenching, and the need to obtain conduit space, rights-of-way, and access to buildings).[20]

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[20] *See, e.g., SBC/AT&T Merger Order* at ¶ 24: "The record also indicates that, for many buildings, there is little potential for competitive entry, at least in the short term. As the Commission has previously recognized, carriers face substantial fixed and sunk costs, as well as operational barriers, when deploying loops, particularly where the capacity demanded is relatively limited. Given these barriers, it appears unlikely that a carrier would be willing to make the significant sunk investment without some assurance that it would be able to generate revenues sufficient to recover that investment. Consistent with this analysis, there is evidence in the record that carriers generally are unwilling to invest in deploying their own loops unless they have a long term retail contract that will generate sufficient revenues to allow them to recover the cost of their

While there are potential new technologies (such as wireless) that may involve lower costs and faster rollout, those alternatives are at best unproven and are certainly far from realization as a robust competitive alternative at this point. *See* Part II(D) below. Special access services using these technologies are not going to be widespread enough to affect the competitive balance for years, if ever.

B. ILEC contracts contain various conditions or termination penalties that constitute huge barriers to entry and inhibit customer choice in the special access market

The GAO is absolutely correct in noting that long-term arrangements required by ILECs (in most cases, BOCs) foreclose much of the special access market and thus serve as formidable barriers to competition.[21]

Numerous commenters in this proceeding have documented the wide variety of contract provisions that are being used by ILECs to lock up the special access market and make it economically inefficient – and thus irrational - for competitors to enter.[22] Special access circuits purchased by PAETEC (and other CLECs and large purchasers of BOC special access services) are generally sold under tariffed "optional pricing plans" or commercial agreements. A key feature of these optional pricing plans and commercial arrangements is that in order for the customer to obtain discounts on circuits for which there is no competitive

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investment. Moreover, even where there is adequate retail demand, the costs of constructing the loop may be sufficiently high, or there may be other operational barriers, that may deter entry." (Footnotes omitted.) *See also Verizon/MCI Merger Order* at ¶ 39.

[21] *GAO Report* at 30-31.

[22] *See, e.g., Reply Comments of COMPTEL, Global Crossing North America, Inc. and NuVox Communications,* WC Docket No. 05-25 (filed June 25, 2005) ("*COMPTEL 2005 Reply Comments*") at 1, 24-33, and filings cited in fns. 90-110.

alternative (which constitute the vast majority of ILEC/RBOC circuits),[23] customers must commit to purchasing the great majority of their total circuit volumes from the ILEC — including those circuits for which a cheaper competitive alternative may be available. In other words, because only the ILEC can supply all (or at least the vast majority) of any customer's special access demand, the ILEC can condition its discounts on the majority of circuits (for which no competitive alternative is available) on the customer's commitment to keep the "competitively sensitive" portion of its demand with the ILEC, even when far cheaper alternatives are available on smaller groups of services. The most insidious feature of this contractual device is that the larger the geographic footprint of the ILEC (i.e., the larger the area in which it offers discounts on circuits for which competitors have no competitive alternative), the more leverage it has to force customers to give it the competitively sensitive portion. For students of history, this contract situation is eerily reminiscent of the stranglehold the large regional railroads had over smaller railroads and the business entrepreneurs wishing to move their goods via intra or interstate rail in the late 19th and early 20th centuries.

These types of contractual provisions are an ongoing barrier to facilities-based competitive entry because they foreclose competitors' access to customers over the long term and distort entry decisions. As several parties

[23] The GAO, for example, found that in the markets it surveyed only 6% of the buildings with demand at a DS1 level or greater had non-ILEC special access alternatives, and only 15-25% of buildings with DS3 or greater demand had such alternatives. *GAO Report* at 19-20. This is consistent with PAETEC's experience with regard to both high capacity loop and interoffice transport availability in those same markets. The percentages are far lower in Tier 2 and 3 markets.

have demonstrated, new competitors offering special access services in limited areas or on limited routes would have to offer tremendous, economically unsustainable discounts in order to offset the increased costs to customers of switching from ILEC circuits.[24]

The problem of customer lock-in has been exacerbated by the BOC/IXC and BOC/BOC mergers. The conditions imposed in those merger proceedings failed to address the problems raised by the types of anticompetitive contractual provisions discussed above. The BOC/IXC mergers not only left the merged firms free to continue their practices, but actually created greater incentives and ability to do so because with each merger the BOC controlled a larger share of the special access market in its region. The AT&T/BellSouth merger, by expanding the geographic footprint of AT&T, substantially increased AT&T's leverage to force customers to give it the competitively sensitive portion of the special access services in the AT&T and BellSouth regions.

The merged BOCs now have a virtually unfettered ability to impose on their special access customers anticompetitive provisions that bear no reasonable relationship to any efficiencies yielded by volume and term commitments. The BOCs are free to, and routinely do, require that purchasers submit to onerous contractual provisions that would never be agreed to in a competitive market, such as tying arrangements, agreements to move special access purchases from competitors' networks, and requirements to increase spend annually with the incumbent (either in absolute terms or as a percentage

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24 *See, e.g., COMPTEL 2005 Reply Comments* at 27-29.

of total spend).[25] The end result is that the BOCs have been able to use their monopoly power in the special access market to exclude competitors from effectively competing, thereby forcing customers to use BOC-provisioned special access services for the vast majority of their needs.

C. Without more complete and reliable data, the Commission is unable to determine whether its deregulatory policies are achieving their goals.

PAETEC disagrees with this conclusion.[26] The Commission does not need additional data to determine that its deregulatory policy has failed in the special access market. Given the paucity of alternative special access service providers, it is clear beyond doubt that the predictive triggers ILECs are required to meet to obtain Phase I and Phase II pricing flexibility have proven to be incorrect in predicting whether special access services are or will become competitive. The triggers have not worked; they simply do not predict when or where competition will develop. As a result of premature deregulation based on these incorrect triggers, competition has failed to develop.

The question the Commission must decide, therefore, is what regulatory regime to adopt, whether on an interim or permanent basis, in order to accomplish its stated goal of encouraging the development of competition in the special access market while at the same time deterring anticompetitive behavior by ILECs. PAETEC offers its views on this question in Part III below.

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25 *See GAO Report* at 30-31.

26 *Id.* at 36-41.

D. Other changes in the market have not yet affected the availability of comparable alternatives

The *GAO Report* correctly made clear that any competition from non-wireline technologies in the special access market is a hope, not a fact:

> New technologies, such as WiMax, also have the potential to bring more competition. However, it is unclear the extent to which this technology can provide a widespread alternative to wireline dedicated access, how long that transition will take to become an effective alternative, or who will be in the best position to provide that alternative. . . .[27]

The ILECs in their comments filed today will no doubt gloss over the distinction between hype and reality and will, without factual support, argue that there are a plethora of alternatives available. They will cite the "usual suspect" fiber competitors such as Level 3, Global Crossing, XO, Time Warner Telecom, and perhaps even PAETEC. They will also identify new technologies such as WiMax and new competitors such as Clearwire, FiberTower, and Google that are "poised to enter the market" or "rolling out special access (or backhaul) networks." What the ILECs will not provide, because they cannot, is hard numbers that show that the availability of competitive alternatives to special access has increased since 2005.[28]

III. The Commission Must Adopt a New Regulatory Paradigm to Assure Reasonable Rates and Conditions for Special Access Services

The Commission has acknowledged that its predictive triggers are not a useful gauge of competition. In the *TRO*, for example, it stated that "this test

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[27] *Id.* at 41.

[28] In undertaking a competitive analysis of these markets, a route-specific and building-specific inquiry is a necessary part of the analysis. *SBC/AT&T Merger Order* at ¶ 28-29; Verizon/MCI *Merger Order* at ¶ 27-29; and *AT&T/BellSouth Merger Order* at ¶ 31-32.

provides little, if any, indication that [a] competitor has been able to widely, if at all, self-deploy alternative loop facilities" outside of a few, highly-concentrated wire centers.[29] The Commission has also acknowledged that intervention would be required if it determined that competition was not developing sufficiently for the collocation-based approach to work.[30] The Commission must now recognize what PAETEC and other competitive communications providers have long known: the collocation-based approach has never worked because it does not demonstrate the existence of a competitive market. A new regulatory paradigm is needed.

A. Proposed Interim Relief

PAETEC believes that the information already in the record, when combined with the data on pricing and facilities availability being placed in the record today by Ad Hoc, COMPTEL, and others in response to the *Notice*, not only demonstrates but compels a finding of market failure in the special access markets. The Commission should therefore be considering what form of relief to implement in order to rectify the ongoing market failure and encourage the development of true competition in special access services. Experience and time have modified PAETEC's view of the best regulatory approach to take in correcting this market failure. We now suggest an approach that is based upon

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[29] *Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers; Implementation of the Local Competition Provisions of the Telecommunications Act of 1996; Deployment of Wireline Services Offering Advanced Telecommunications Capability, Report and Order and Order on Remand and Further Notice of Proposed Rulemaking*, 18 FCC Rcd 16978, 17145, ¶ 341 (2003) ("*Triennial Review Order*"), corrected by Errata, 18 FCC Rcd 19020 (2003), *vacated and remanded in part, affirmed in part, United States Telecom Ass'n v. FCC*, 359 F.3d 554 (D.C. Cir. 2004), *cert. denied*, 125 S.Ct. 313, 316, 345 (2004).

[30] *In the Matter of Access Charge Reform, First Report and Order*, 12 FCC Rcd 15982, 16003 (1997).

our most recent experience in the special access marketplace (as both a buyer and a seller) and upon our experience in and subsequent to the BOC/BOC and BOC/IXC merger proceedings.

If the implementation of permanent relief will not occur in 2007, then it is imperative that the Commission implement interim relief. Specifically, PAETEC requests that in that case the Commission issue an order within 30 days implementing the following interim steps:

(1) a baseball-style, best and final offer arbitration procedure that may be invoked by entities seeking to purchase special access from any ILEC in a Phase I or II market, and

(2) a fast track arbitration procedure for alleged breaches of resulting agreements, and

(3) a limited fresh look option for affected special access customers to allow them to benefit from steps 1 and 2.

The proposed interim relief is described in more detail in the attached Exhibit A. Failure to implement interim relief, coupled with the already lengthy nature of this proceeding, could foreclose any hope of achieving even marginally competitive special access markets in this decade.

i. Best and Final Offer Arbitration

The commercial arbitration condition is designed to better replicate the outcome of commercial negotiations among parties of relatively equal bargaining power, as would be found in a competitive market with numerous buyers and sellers. It reduces the likelihood that an ILEC can use its market power to implement its incentives to deny, delay and degrade special access services sold to competitors. At the same time, the condition minimizes the day-to-day involvement of the Commission in regulating the market, thus allowing it to concentrate its resources on designing creative solutions to the special access problem. Special consideration must be given to ensure that the mechanism allows for region-wide negotiations and agreements, and prevents the incumbents from shielding parts of their in-region territory from the results of final offer arbitration.

The commercial arbitration condition is modeled closely on remedies that the Commission has used in the past, particularly in similar situations involving horizontal or vertical foreclosure or pricing problems created by an imbalance in bargaining power. For example, the Commission's rules prescribe the use of final offer arbitration to settle certain interconnection disputes.[31] The Commission has also applied this remedy as a condition to its approval of mergers. For example, in its 2004 order consenting to News Corp.'s acquisition of an interest in Hughes Electronics Corp.,[32] the Commission found that the combination of News Corp.'s regional sports network programming with DirecTV's national distribution platform could result in price increases because

[31] 47 C.F.R. § 51.807(d)-(f). As the Commission explained in its order implementing the Telecommunications Act of 1996, "[a]dopting a 'final offer' method of arbitration and encouraging negotiations to continue allows us to maintain the benefits of final offer arbitration, giving parties an incentive to submit realistic 'final offers,' while providing additional flexibility for the parties to agree to a resolution that best serves their interests." *Implementation of the Local Competition Provisions of the Telecommunications Act of 1996*, First Report and Order, 11 FCC Rcd 15499, at ¶ 1294 (1996).

[32] *General Motors Corp. and Hughes Electronics Corp., Transferors, and The News Corp. Ltd., Transferee, for Authority to Transfer Control*, Memorandum Opinion and Order, 19 FCC Rcd 473 (2004) ("*Hughes/News*").

News Corp. would be able to extract higher prices or other concessions from unaffiliated multichannel video programming distributors. The Commission again adopted a baseball-style arbitration mechanism to address this concern.[33] Most recently, in its decision last year approving the transfer of control of the assets of Adelphia to Comcast and Time Warner, the Commission imposed a similar arbitration remedy for disputes relating to commercial leased access in order to mitigate public interest harms deriving from increased horizontal concentration resulting from the transactions.[34]

The implementation of an interim commercial arbitration remedy is fully consistent with the Commission's goal of imposing regulation only where necessary. The proposed arbitration condition combines little downside risk with an opportunity to obtain solid data about the state of special access markets that could be invaluable to the Commission in reaching a decision in this proceeding. Specifically, the procedure set out in Exhibit A would require parties involved in arbitrations to make available to Commission staff, pursuant to a suitable protective order, information about the pricing and availability of both ILEC and competitive providers' special access services and facilities.

If the ILECs are right and the affected markets are competitive, special access customers will not need to use the arbitration remedy because there will be no benefit to doing so. The first few arbitrations will demonstrate that the

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[33] *Id.* at ¶ 173.

[34] *Adelphia Communications Corp, Transferor, and Time Warner Cable, Inc and Comcast Corp., Transferees, for Authority to Transfer Control*, Memorandum Opinion and Order, 21 FCC Rcd 8203 ¶¶ 109 and 156-157, and Appendix B (2006).

outcome of the process is similar, if not identical, to the rates, terms and conditions already offered by the ILEC. If, on the other hand, the affected markets are not competitive, then the arbitration remedy will be a crucial mechanism for bringing the discipline of competition to special access markets while at the same time developing an evidentiary record of widespread market failure. Indeed, the persistent use of arbitration by competitors would be a powerful indicator that competition has not yet emerged in the special access market.

ii. Fast Track Arbitration of Breaches

The Commission should also implement a second, fast track arbitration procedure for alleged breaches by ILECs of agreements resulting from the arbitration process, since an agreement can be thoroughly undermined by strategic breaches, and the delay inherent in regular litigation can effectively drive ILECs' competitors out of business. *See* Exhibit A. Both arbitration conditions should remain in effect until the issuance of a final order in this docket.

iii. Fresh Look

Finally, the fresh look provision would apply to any special access customer obligated under an existing contract or tariff for a period of more than three months at the time the Commission's order goes into effect. This fresh look provision is necessary to allow the other two parts of the interim relief to be implemented within a reasonable period of time.

The public interest will be well served by permitting customers to renegotiate contractual arrangements with ILECs. The Commission has identified the crucial goal of promoting a competitive market for the provision of special access services, and a competitive market is better for the public – both for direct customers of special access and for downstream customers of the businesses using special access (because these businesses will be able to reduce their costs and hence their prices). However, as discussed in Part II (B) above, existing long-term arrangements with ILECs are the product of hugely disproportionate bargaining power and if left unchecked will prevent for years the development of sustainable competitive alternatives. In addition, the Commission's obligation to ensure that rates are "just and reasonable" [35] requires that it permit CLECs to have a "fresh look" at special access contracts because these arrangements were entered into in an environment of market failure, where no real alternatives to ILEC special access exist, and where CLECs possess very little bargaining power to achieve competitive contract rate levels or prevent the imposition of market-foreclosing contract provisions.

Courts have held that the Commission may "modify … provisions of private contracts when necessary to serve the public interest." [36] The Commission has exercised this authority and permitted the fresh look remedy in certain circumstances in order to "promote consumer choice and eliminate barriers to competition in markets where long-term business arrangements have essentially 'locked up' service with a former monopoly telecommunications

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[35] 47 U.S.C. § 201(b).

[36] Western Union Tel. Co. v. FCC, 815 F.2d 1495, 1501 (D.C. Cir. 1987).

carrier."[37] Specifically, the Commission has previously applied the fresh look remedy in the special access context, permitting special access customers to terminate long-term agreements with ILECs in order to obtain the benefits of more competitive alternatives arising from a new regulatory framework.[38] In applying the fresh look doctrine, the Commission has considered (1) whether or not the carrier has sufficient market power to create barriers to competition and (2) whether the contract can be nullified without harm to the public interest.[39]

Both criteria are met here. As the *GAO Report* concluded, long-term arrangements entered into by CLECs and ILECs foreclose much of the market and thus serve as formidable barriers to competition. As discussed in Part II(B) above, ILEC volume and term discount structures force CLECs to "lock in" to long-term circuit commitments or contract tariffs in order to achieve cheaper rates, and significant penalties are imposed for early termination of these contracts. PAETEC, for example, takes approximately 98 percent of its special access circuits under some form of long-term arrangements with ILECs, not because it wants to, but because it has no choice as a business matter. Without a fresh look policy, any potential new competitive access providers will be precluded from entering the more favorable special access market because ILECs will still retain long-term control of the vast majority of the market.

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37 Direct Access to the INTELSAT System Order, Report and Order, 14 FCC Rcd 15703, ¶ 118 (1999) ("INTELSAT").

38 In the Matter of Expanded Interconnection with Local Telephone Company Facilities, 9 FCC Rcd 5154, ¶ 197-208 (1994).

39 INTELSAT at ¶ 119.

B. Framework for Proposed Permanent Relief

PAETEC would support Commission adoption of any of the variations on a price cap regime that have been proposed by it and other commenters in the past or are being proposed today in response to the *Notice.*[40] Any such regulatory regime should remain in place until an ILEC can prove, on the basis of demonstrated competition in a specific geographic area, that the otherwise ubiquitous market failure in the special access market has been remedied.

However, PAETEC believes that the Commission should at the same time provide an alternative to such a regulatory regime. ILECs should be afforded the opportunity to opt out of the price cap framework by agreeing to best and final offer arbitration. The choice would be made on a global basis by each ILEC across all its ILEC territories: either all of its special access services would be subject to the price cap framework, or none would be. If the ILEC selects arbitration and then chooses to revert to price cap regulation, it would still have to honor existing arbitrated contracts.

The arbitration process offered as part of the permanent relief should be very similar to that proposed as interim relief in Part II (B) above and explained more fully in Exhibit A. Any differences between the interim procedure and any permanent commercial arbitration remedy would probably relate mainly to the

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[40] PAETEC in 2005 called for the Commission to (1) retarget special access rates in all markets; (2) permit downward pricing flexibility, or, in the alternative, permit upward pricing flexibility only where unaffiliated competitors are providing special access over their own facilities to at least 25 percent of the enterprise customers in a given market; (3) implement annual price cap adjustments to account for changes in market dynamics; (4) apply the criteria selected for the new regulatory framework to reevaluate pricing flexibility already granted to ILECs; and (5) permit carriers that have entered into long-term contracts for special access services under the existing pricing flexibility rules a "fresh look" at those agreements. See *PAETEC Comments* at 19-23.

timing of various stages in the process: the timing need not be as compressed in a permanent relief context as in the interim relief context. Other changes could be considered once the Commission put proposed rules out for comment.

CONCLUSION

For the foregoing reasons, PAETEC respectfully urges the Commission to adopt the interim remedy outlined above and in Exhibit A pending a final order in this proceeding.

Respectfully submitted,

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Date: August 8, 2007

CERTIFICATE OF SERVICE

The undersigned hereby certifies that on this 8th day of August, 2007, a true and correct copy of the foregoing Comments of PAETEC Communications, Inc., was served via electronic mail on the following:

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EXHIBIT A

Proposed Interim Relief in the Special Access Market

Except where otherwise indicated, the following conditions apply to all special access services. For purposes of these conditions, the term special access service is defined as a "dedicated transmission link between two places" within a LATA without regard to the technology used to provide the link.[41]

I. <u>Commercial Arbitration Remedy for Entry Into a Special Access Agreement</u>

- The commercial arbitration remedy is available to:
  - Any carrier or enterprise customer seeking special access services ("Requesting Customer") from an ILEC in its ILEC territory and fitting the criteria identified in the "Fresh Look For Existing Special Access Customers" condition below. (References to an ILEC include any subsidiary or majority owned or controlled enterprises as well as any successors in interest.)
  - Any Requesting Customer following the expiration of its existing special access agreement or tariff arrangement with an ILEC.
  - Any Requesting Customer that makes a request for a special access agreement with an ILEC and that does not currently have such an agreement.
- At any time after requesting the negotiation of a special access services agreement with an ILEC (except in the case of "fresh look" below), a Requesting Customer may notify an ILEC that it intends to request arbitration over the rates, terms and/or conditions of access. Such terms or conditions may be price or non-price based.

[41] *SBC Communications Inc. and AT&T Corp. Applications for Approval of Transfer of Control*, 20 FCC Rcd 18290, ¶ 24 (2005).

- Upon receiving timely notice of the Requesting Customer's intent to arbitrate, an ILEC must continue to allow access under the terms and conditions of the existing, expired or expiring agreement or contract tariff, as long as the Requesting Customer continues to meet the other obligations of the arrangement. The ILEC shall provide to Requesting Customers making first-time requests access pursuant to tariff (or a standard special access offer, if mandatory de-tariffing has been applied), although if different rates are subsequently determined as a result of the arbitration, such rates will apply retroactively to the access services provided during the period prior to final agreement.

- Following the Requesting Customer's notice of intent to submit the dispute to arbitration, but prior to filing for formal arbitration with the American Arbitration Association ("AAA"), or a mutually agreed upon neutral third-party arbitrator (such arbitrator and the AAA being hereinafter referred to as the "Arbitrator"), the Requesting Customer and the ILEC will enter a 15 day "cooling off" period during which negotiations will continue.

- The Requesting Customer's formal demand for arbitration, which shall include the Requesting Customer's final offer and any supporting arguments and evidence, may be filed with the Arbitrator no earlier than the fifteenth business day after the Requesting Customer serves its intent to arbitrate on the ILEC. An ILEC must participate in the arbitration proceeding.

- The Arbitrator will notify the ILEC and the Requesting Customer upon receiving the Requesting Customer's formal filing.

- The ILEC must file a "final offer" and any supporting arguments and evidence with the Arbitrator within two business days of being notified by the Arbitrator that the Requesting Customer has filed a formal demand for arbitration.

- The Requesting Customer's final offer may not be disclosed to the ILEC until the Arbitrator has received the final offer from the ILEC. Upon receipt of both offers, the Arbitrator shall simultaneously provide a copy of the Requesting Customer's final offer to the ILEC, and a copy of the ILEC's final offer to the Requesting Customer.

- The final offers shall be in the form of a contract for access services for a period of 1, 2 or 3 years.

<u>Rules of Arbitration</u>

- The arbitration will be decided by a single arbitrator mutually agreed to by the parties or selected by the AAA from members of its Telecommunications Panel and shall be conducted under the expedited procedures of the AAA Commercial Arbitration Rules, excluding the rules relating to large, complex cases. The location of the arbitration shall be selected by the Requesting Customer from among Atlanta, Denver, Chicago, Dallas, Miami, New York, Los Angeles, and Washington D.C.

- The Arbitrator shall choose the final offer of the party which most closely approximates commercially reasonable rates, terms and conditions in the industry with respect to the access services at issue.

- The Arbitrator shall consider, in determining commercial reasonableness, not only price and volume, but also other material terms. An offer that provides for discounts that are not based on cost savings and not tied to purchases of specific quantities of access services - such as discounts based on (i) a percentage of a customer's total special access spend, (ii) a customer's purchase of other products or services, or (iii) a customer's agreement not to purchase certain products or services or use certain technologies - shall be considered commercially unreasonable. In determining whether other terms are commercially reasonable, the Arbitrator shall give particular weight to whether similar or identical terms are included in similar contracts between unaffiliated parties that are not ILECs.

- To determine commercial reasonableness, the Arbitrator may consider any relevant evidence (and may require the parties to submit such evidence to the extent it is in their possession). Such relevant evidence shall include, but is not limited to:

    a. Current contracts between the Requesting Customer and either (i) the ILEC or (ii) other access services providers, covering all or part of the ILEC's ILEC territory;

    b. Current contracts between other access customers (other than wireless and wireline affiliates of BOCs) and (i) the

ILEC or (ii) other access services providers, whether or not covering all or part of the ILEC's ILEC territory;

c. Evidence of the relative value of the requested ILEC services compared to the services of other access services providers or the services provided by the ILEC in other territories(*i.e.*, price, scope of service, quality of service, etc.);

d. Changes in the value of access agreements not involving that ILEC;

e. Changes in the value or costs of the provision of access services;

f. Evidence of rates, terms and/or conditions for comparable services in the ILEC's ILEC territories and in other states;

g. Evidence of rates, terms and/or conditions for retail services; and

h. The effect of specific terms and conditions on the competitive supply and demand for special access services.

- If a party refuses to provide any relevant evidence in its possession, the Arbitrator shall draw an adverse inference regarding the commercial reasonableness of its offer. Relevant evidence in categories (a)-(g) above which is subject to confidentiality, non-disclosure or other restrictive clauses shall be provided only to outside counsel for both parties (but not in-house counsel or employees) under protective order procedures ("Arbitration Protective Order Procedures") similar to those set forth in the Commission's regulations governing transfer of control proceedings.

- Any contracts with non-ILEC wholesalers or other relevant evidence submitted by the Requesting Customer may be designated by it as available for Future Protective Order Disclosure. Future Protective Order Disclosure shall mean that the evidence will be provided (either through storage in a secure central clearinghouse or by the Requesting Customer) under Arbitration Protective Order Procedures to outside counsel for ILECs and other Requesting Customers in future arbitrations.

- A public version of each Arbitrator's decision shall be filed with the Commission along with a public version of the executed contract between the parties.

- The parties may agree to modify any of the time limits and any of the procedural rules of the arbitration. Absent such agreement, the rules specified herein apply. The parties may not, however, modify either the requirement that they engage in final offer arbitration or the rules governing availability of relevant evidence or the contract resulting from the Arbitration.

- An ILEC is required to waive its right to invoke confidentiality, non-disclosure, or other restrictive clauses in any of its relevant contracts for access services, and in good faith to seek any necessary waivers of such clauses from counterparties to any such contracts, in order to make the contracts available to outside counsel for the Requesting Party under Arbitration Protective Order Procedures.

- If the Arbitrator finds that one party's conduct during the course of the arbitration has been unreasonable, the Arbitrator may assess all or a portion of the other party's costs and expenses (including attorney fees) against the offending party and may consider such behavior in assessing the reasonableness of the offers.

- Following the decision of the Arbitrator, the terms of the new access agreement, including payment terms, will become retroactive to the expiration date of the previous agreement. The Requesting Customer will make an additional payment to the ILEC in an amount representing the difference, if any, between the amount it must pay under the Arbitrator's award and the amount it actually paid under the terms of the expired contract during the period of arbitration. Similarly, an ILEC shall issue a refund or credit in an amount representing the difference, if any, between the amount to be paid under the Arbitrator's award and the amount actually paid under the terms of the expired contract during the period of arbitration.

- The result of the arbitration shall be binding on the parties, and judgment on the Arbitrator's award may be entered in any court having jurisdiction.

- Except where an Arbitrator has ordered otherwise (see above), each party shall pay its own fees and costs, and the parties shall split the Arbitrator's fees and costs equally.

- The Arbitrator's decision shall be reviewable by the Commission

<u>Commercial Arbitration Remedy for Breach of a Special Access Agreement</u>

- If a Requesting Customer that is a party to a special access agreement arrived at through the commercial arbitration remedy above believes there has been a material breach of the agreement by an ILEC, then it shall have the right to have the dispute resolved by third party arbitration ("Breach Arbitration") that includes a right to a damage remedy.

- The Breach Arbitration process from the date of invocation to the date of a binding decision shall not exceed 180 days.

- The arbitration will be decided by a single arbitrator mutually agreed to by the parties or selected by the AAA from members of its Telecommunications Panel and shall be conducted under the expedited procedures of the AAA Commercial Arbitration Rules, excluding the rules relating to large, complex cases. The location of the arbitration shall be selected by the Requesting Customer from among Atlanta, Chicago, Dallas, Denver, Miami, New York, Washington D.C., and Los Angeles.

- If a party refuses to provide any relevant evidence in its possession, the Arbitrator shall draw an adverse inference as to the issue(s) to which it is relevant. Relevant evidence which is subject to confidentiality, non-disclosure or other restrictive clauses shall be provided only to outside counsel for both parties (but not in-house counsel or employees) under Arbitration Protective Order Procedures.

- A public version of each Arbitrator's decision shall be made immediately available on an ILEC's website and shall remain available there so long as the underlying contract is in effect.

- The parties may agree to modify any of the time limits and any of the procedural rules of the arbitration. Absent such agreement, the rules specified herein apply. The parties may not, however, modify the requirement that they engage in arbitration.

- The result of the arbitration shall be binding on the parties, and judgment on the Arbitrator's award may be entered in any court having jurisdiction.

- If the Arbitrator finds that one party's conduct during the course of the arbitration has been unreasonable, the Arbitrator may assess all or a portion of the other party's costs and expenses (including attorney fees) against the offending party. Except as provided above, each party shall pay its own fees and costs, and the parties shall split the Arbitrator's fees and costs equally.

III. Fresh Look for Existing Special Access Customers

- All existing purchasers of special access in a covered ILEC's ILEC territories would be entitled to a "fresh look" and to void their existing arrangement if they so chose.

- The commercial arbitration remedy would be available to any Requesting Customer that (1) has more than 90 calendar days remaining on its existing special access agreement or tariff arrangement with a covered ILEC on the Effective Date of the interim relief order, (2) requests the negotiation of a new special access agreement within 120 days of the merger closing date, and (3) makes a subsequent request for arbitration within 180 days of the Effective Date.