Before The
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

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

COMMENTS OF COMPTEL

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SUMMARY

The goal of the Commission, as expressed in the *Access Reform Order* and reiterated in the *Special Access NPRM*, was to bring special access rates into line with forward-looking costs. The Commission initiated this proceeding in order to assess if its current regulatory framework has been successful in achieving this goal. This should remain the focus of the proceeding. Thus, the sole question before the Commission is whether or not the Commission's current price cap/pricing flexibility regulatory framework has been successful in driving the rates price-cap LECs charge for special access services toward the forward-looking costs of providing the services, both to assess if the Commission predictions were accurate in that the current regulatory framework precludes incumbent abuse of its market power and, separately, to fulfill its statutory obligations to ensure just and reasonable rates.

Since the goal is to drive prices toward cost, the Commission should apply an analytical framework that enables it to make reasonable comparisons between price and cost. COMPTEL recommends a conservative analysis, namely a price/cost ratio. In a perfectly competitive market, the price/cost ratio would be 1.00. The higher the price/cost ratio is above 1.00, the greater the deviation from cost.

The Commission should use as the measure of cost the TELRIC rates of the corresponding network elements, which are publicly available. TELRIC rates are an ideal cost-basis since the purpose of price cap regulations was to provide incentive for the incumbents to be more efficient and reduce costs. Moreover, as the *Special Access NPRM* states, the goal is for rates to be in line with forward-looking costs, and TELRIC estimates the incumbent's forward-looking average total costs.

The prices the Commission should use in performing the price/cost ratio analysis are the rack rates, which are publicly available. The incumbents' claims that these are not the prices purchasers actually pay are irrelevant. First, the Commission has a statutory obligation to ensure that *no* rates are unjust or unreasonable. Second, ensuring the just and reasonableness of the rack rates will lend to remedying the anti-competitive impact of the discount pricing plans discussed more fully below. Once the Commission has ensured the base rates are at a just and reasonable level, the Commission has reduced the incentive for the incumbent to use discount plans in an anti-competitive manner. Finally, since the rack rates are the basis of the rates in the discount plans, any reduction to the rack rates (to bring them to a cost-based level) should also be reflected in the discounted rates. This may ultimately save the Commission from having to continuously wade through the myriad of complicated discount plans.

As the Commission has previously stated, the Commission has the authority to adjust the rates for special access if the current regime has failed to move the rates toward the forward-looking costs of providing these services. COMPTEL believes a price/cost ratio analysis will confirm what the record is already plentiful in demonstrating - that price cap/pricing flexibility regulations have failed - and looks forward to swift action by the Commission in fixing the pricing of special access services.

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COMPTEL respectfully submits these comments, pursuant to the Commission's Public Notice ("*Notice*") released on November 5, 2009 (DA 09-2388) in the above-referenced dockets. In its *Notice* the Commission invites parties to comment on the appropriate analytical framework for examining the various issues that have been raised in the *Special Access NPRM*. As the record demonstrates, special access is a crucial service that impacts the overall health of our economy. Unfortunately, the record also reveals that the current regulatory framework governing the pricing of special access services has led to supra-competitive prices and substantial over-earning by incumbents. COMPTEL applauds the Commission's examination of the special access market and hopes the Commission will address the market failure in this critical market promptly.

The goal of the Commission's regulation of price cap carriers has been to *drive prices to costs* while providing incentives to reduce costs, thereby further reducing prices to more efficient cost-based rates. The Commission initiated this proceeding in order to assess if its current

regulatory framework has been successful in achieving this goal. In developing the analytical framework, the Commission should not lose sight of this objective amid the incumbent calls for extensive and superfluous data[1] and pleas to maintain the supra-competitive prices so that they are able to fund their other projects[2] (perhaps so that they are able to dominate the market for next generation broadband as well). The Commission's task at hand is very straightforward - - did the current regime work to drive special access rates to more efficient cost-based rates, i.e., are the rates just and reasonable. COMPTEL proposes the Commission perform a price/cost ratio analysis to judge the reasonableness of special access prices. This course of action is not only consistent with Commission precedent but also a simple and useful metric for determining if the current regime met its goal of driving prices to cost.

As the Commission has previously stated, the Commission has the authority to adjust the rates for special access if the current regime has failed to move the rates toward the forward-looking costs of providing these services. COMPTEL believes a price/cost ratio analysis will confirm what the record is already plentiful in demonstrating - that price cap/pricing flexibility regulations have failed - and looks forward to swift action by the Commission in fixing the pricing of special access services.

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[1] *See e.g.*, Letter of Donna Epps, Verizon, to Marlene Dortch, pp. 1-2 (dated Jun. 18, 2009).

[2] *See e.g.*, Letter of James W. Cicconi, AT&T Services, Inc., to Marlene H. Dortch (dated Jun. 22, 2009). AT&T claims reforming special access pricing will weaken their ability to invest in next generation broadband infrastructure. *Id*. at 2. AT&T's argument of the need to take from smaller carriers that purchase special access to pay for AT&T's future broadband projects conveniently ignores the fact that gouging these carrier-purchasers limits these carriers' resources to invest and compete in broadband infrastructure.

I. THE FOCUS OF THE COMMISSION ANALYSIS SHOULD BE TO DETERMINE THE EFFECTIVENESS OF THE CURRENT PRICE CAP/PRICING FLEXIBILITY REGULATIONS IN DRIVING RATES TOWARD FORWARD-LOOKING COSTS.

The Commission initiated this proceeding to examine the current regulations governing the pricing of incumbent special access services, both the price cap and pricing flexibility rules, in order to determine the appropriate regulatory framework going forward to ensure that rates for special access services remain just and reasonable after the expiration of the CALLS plan.[3] The goal of the Commission, as expressed in the *Access Reform Order* and reiterated in the *Special Access NPRM*, was to drive special access rates to forward-looking costs.[4] This should remain the focus of this proceeding.

In the *Pricing Flexibility Order*, the Commission adopted rules that provide price cap carriers pricing flexibility where the Commission predicted, due to indications of sufficient competition or other factors, these carriers would be unable to *exploit* any individual market power over a sustained period.[5] The Commission made clear that these conclusion were not a

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[3] *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, Order and Notice of Proposed Rulemaking, FCC 05-18, ¶2, 4 (2005)("Special Access NPRM")["In this NPRM we seek comment on what steps the Commission should take to ensure that rates for special access services remain just and reasonable after the expiration of the CALLS plan…To ensure that our examination of the special access charge rules is sufficiently broad to establish the appropriate regulatory regime post-CALLS, we seek comment not only on traditional price cap issues, but also on the Commission's special access pricing flexibility rules."]

[4] *Id*. at ¶ 13; *Access Charge Reform*, CC Docket Nos. 96-262, 94-1, 91-213, 95-72, First Report and Order, FCC 97-158, ¶48 (1997)("Access Charge Reform Order").

[5] *Access Charge Reform*, CC Docket Nos. 96-262, 94-1, 98-157, CCB/CPD File No. 98-63, Fifth Report and Order and Further Notice of Proposed Rulemaking, FCC 99-206, ¶ 25 (1999)("Pricing Flexibility Order").

finding of, nor tantamount to treatment of, non-dominance.[6] In seeking forbearance from dominant carrier regulations of certain of their broadband services, AT&T and Qwest did not even seek, nor did the Commission grant of its own accord, such forbearance relief for TDM-based DS1 and DS3 special access services.[7] Indeed, the Court premised (in part) its decision upholding the *AT&T Broadband Forbearance Order* on the Commission's continued price regulation of TDM-based DS1 and DS3 special access services.[8] These incumbents have not subsequently filed a petition for treatment as non-dominant in the area of special access services, nor sought forbearance from dominant carrier regulations with regard to TDM-based DS1 and DS3 special access services.

In other words, the incumbent LECs have never successfully demonstrated, and consequently the Commission has never found, that these carriers lack market power in the

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[6] *Pricing Flexibility Order* ¶ 151 ["Phase II relief is not tantamount to non-dominance treatment."]

[7] *Petition of AT&T Inc. for Forbearance Under 47 U.S.C. § 160(c) from Title II and Computer Inquiry Rules with Respect to Its Broadband Services, Petition of BellSouth Corporation for Forbearance Under 47 U.S.C. §160 (c) from Title II and Computer Inquiry Rules with Respect to Its Broadband Services*, WC Docket No. 06-125, Memorandum Opinion and Order, FCC 07-180, ¶¶ 12, 20, n. 81 (2007)("AT&T Broadband Forbearance Order")["AT&T excludes "traditional TDM-based special access services used to serve business customers, such as DS1 and DS3 special access circuits," from the scope of their broadband relief request."]; *Id*, n. 81, *citing* Legacy BellSouth Petition at 7-8 [stating that Verizon's forbearance request excluded TDM-based special access services and that BellSouth seeks the same relief granted Verizon.]; *Qwest Petition for Forbearance Under 47 U.S.C. § 160(c) from Title II and Computer Inquiry Rules with Respect to Broadband Services*, WC Docket No. 06-125, Memorandum Opinion and Order, FCC 08-168, ¶¶ 13, 23, 31 (2008)("Qwest Broadband Forbearance Order").

[8] *Ad Hoc Telecommunications Users Committee, et al., v. FCC*, United States Court of Appeals for the District of Columbia Circuit, No 07-1426, p. 14 (decided Jul. 17, 2009)("Ad Hoc v. FCC").

provision of special access services.[9] In fact, quite the opposite, the Commission in the *Qwest Broadband Forbearance Order* explains that it had found that competitors rely on these special access services to serve enterprise customers.[10] Additionally, in the *Section 272 Sunset Order*, the Commission specifically found that "the BOCs have failed to present persuasive evidence that they no longer possess exclusionary market power within their regions as a result of their control over ubiquitous telephone exchange service and exchange access networks."[11] This finding was later confirmed in the Commission's orders granting forbearance from cost assignment rules and ARMIS reporting requirements.[12]

This market power is derived from the undeniable fact that they are the only carrier that can provide access in many cases, and the only carrier that can provide ubiquitous access is all

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[9] Even with regard to existing packet-switched broadband telecommunications services and its existing optical transmission services, the Commission only found that dominant carrier regulations were unnecessary, not that the incumbents lacked market power. *AT&T Broadband Forbearance Order* at ¶ 32 ["We find that, to the extent dominant carrier regulation of the AT&T-specified broadband services addresses any exclusionary market power AT&T may have in relation to those services, the burdens imposed by that regulation exceed its benefits."]

[10] *Qwest Broadband Forbearance Order* at n. 136 ["Qwest has not asked for, nor are we granting, forbearance for the traditional TDM-based DS1 and DS3 special access services that the Commission has previously found that competitors rely on to serve enterprise customers."]

[11] *Section 272(f)(1) Sunset of the BOC Separate Affiliate and Related Requirements*, WC Docket Nos. 02-112, 06-120, CC Docket No. 00-175, Report and Order and Memorandum Opinion and Order, FCC 07-159, ¶64 (2007)("Section 272 Sunset Order").

[12] *Petition of AT&T Inc. For Forbearance Under 47 U.S.C. § 160 From Enforcement of Certain of the Commission's Cost Assignment Rules,* WC Docket Nos. 07-21, 05-342, Memorandum Opinion and Order, FCC 08-120, ¶14, 27 (2008); *Petition of AT&T Inc. For Forbearance Under 47 U.S.C. § 160(c) From Enforcement of Certain of the Commission's ARMIS Reporting Requirements*, WC Docket Nos. 08-190, 07-139, 07-204, 07-273, 07-21, Memorandum Opinion and Order and Notice of Proposed Rulemaking, FCC 08-203, ¶ 8 (2008).

cases.[13] As the special access market is dominated by multi-location purchasers,[14] this ubiquity allows the incumbents to engage in anti-competitive exclusionary pricing, and thereby thwart the ability of what otherwise might be sufficient competition in certain areas from restraining incumbent prices. This occurrence is apparent in the findings by independent sources. The United States Government Accounting Office ("GAO"), in a report it submitted to Chairman of the Committee on Government Reform, House of Representatives, on the special access market, concluded that "in areas where FCC granted full pricing flexibility due to the presumed presence of competitive alternatives, list prices and average revenues tend to be higher than or the same as list prices and average revenues in areas still under some FCC price regulation."[15] This finding

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[13] Geographic footprint critically defines a carrier's competitive position in the special access market given the nature of the enterprise market and the preference of its customers for multi-location services. Declaration of Joseph Gillan, *US v. SBC Communications, Inc. et al.*, Docket Nos. CA-05-2102 and CA-05-2103, Document 155, Redacted Version, ¶ 20 (filed Sep. 5, 2006)("Gillan Declaration"); The Court in *Ad Hoc v. FCC* states that "business customers ordinarily can obtain essential broadband services *only* through a dedicated high-capacity special access line owned by an ILEC such as AT&T, Verizon, or Qwest…one ILEC usually controls the only special access line to an individual business…"*Ad Hoc v. FCC* at 5(emphasis added and deleted). "Only the incumbent carriers are able to provide service ubiquitously throughout their service territory." Declaration of Janet Fischer on behalf of Global Crossing North America, Inc., WC Docket No. 05-25, ¶4 (dated Aug. 7, 2007).

[14] *See* Gillan Declaration at ¶¶ 15, 20; *See also*, John Thorne, Verizon Communications, Transcript of July 12, 2006, Oral Argument in *United States v. Verizon Communications, Inc. et al.*, Docket Nos. CA-05-2102 and CA-05-2103, p. 83 ("Tunney Act Transcript").

[15] "FCC Needs to Improve its Ability to Monitor and Determine the Extent of Competition in Dedicated Access Service," United States Government Accountability Office, GAO- 07-80, Hightlights "What GAO Found" (November 2006)("GAO Report"); *See also id.* at 27; *See also* Declaration of Don Eben, Petition for Modification of McLeodUSA Telecommunications Services, Inc., *In the Matter of Petition of Qwest Corporation for Forbearance Pursuant to 47 U.S.C. § 160(c) in the Omaha Metropolitan Statistical Area*, WC Docket No. 04-223, ¶ 9 (dated Jul. 23, 2007)("Eben Declaration")["Qwest's special access DS1 rates have increased dramatically since it obtained Phase II special access pricing flexibility in the Omaha MSA. The rates are significantly higher than the price cap DS1 rates that would otherwise apply had it not received Phase II special access pricing relief."]

is not an anomaly limited to areas where prices may have been below cost due to regulation, as alleged by incumbents. The GAO found higher price-flex list prices prevailed "regardless of whether the price was for channel terminations, interoffice mileage, DS-1 or DS-3 service, different term arrangements, or different density zone."[16] The National Regulatory Research Institute, in a report commissioned by the National Association of Regulatory Utility Commissioners, likewise concluded that "the evidence fails to support a conclusion that sellers are being restrained in Phase II areas by competition to offer lower prices. Instead, it suggests the contrary conclusion, that sellers are using market power in Phase II areas to raise prices to their large wholesale customers."[17]

Consequently, the sole question before the Commission in this proceeding is whether or not the Commission's current price cap/pricing flexibility regulatory framework has been successful in driving the rates price-cap LECs charge for special access services to the forward-looking costs of providing the services, both to assess if the Commission predictions were accurate in that the current regulatory framework precludes incumbent abuse of its market power and, separately, to fulfill its statutory obligations to ensure just and reasonable rates.[18] Indeed, even while advocating for the Commission to initiate an extensive and time-consuming data collection process on the extent of actual and potential competition, AT&T acknowledges, as recently as last year, that the criterion for adopting regulations that would reduce incumbent

[16] GAO Report at 28.

[17] Peter Bluhm and Dr. Robert Loube, "Competitive Issues in the Special Access Markets," National Regulatory Research Institute, Revised Edition, 09-02, p. 66 (First Issued Jan. 21, 2009)("NRRI Report").

[18] 47 U.S.C. §201.

special access rates is a determination as to the just and reasonableness of the current rates[19] and, furthermore, AT&T also previously conceded that this analysis should be performed using the incumbents' tariffed rates.[20]

Additionally, in granting the incumbents forbearance from dominate carrier regulations in the provision of packet-switched broadband telecommunications services and existing optical transmission services, the Commission found that application of dominant-carrier regulations to the provision of those services were unnecessary to ensure that the incumbents' special access charges for those services were just and reasonable, and not unjustly or unreasonably discriminatory.[21] Nevertheless, as the DC Circuit states, this decision "is not chiseled in marble" and can be reassessed by the Commission.[22] Consequently, the Commission should also evaluate the rates incumbents charge for these broadband special access services to determine if its assessment that dominant carrier regulations are unnecessary to ensure just and reasonable rates for these services was accurate.

II. THE COMMISSION SHOULD PERFORM A PRICE/COST RATIO ANALYSIS TO DETERMINE WHETHER THE CURRENT SPECIAL ACCESS RATES ARE JUST AND REASONABLE.

The Commission, in its *Access Charge Reform Order* adopted a primarily market-based approach to drive interstate access charges toward the forward-looking cost of providing these

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[19] Letter of Robert W. Quinn Jr., AT&T Services, Inc., to Marlene H. Dortch, p. 8 (dated Feb. 6, 2009)("AT&T Feb. 6 Ex Parte").

[20] Letter of Gary L. Phillips, AT&T Services, Inc., to Marlene Dortch, p. 4 (dated Feb. 12, 2008)('AT&T Feb. 12 Ex Parte").

[21] *AT&T Broadband Forbearance Order* at ¶ 30; *Ad Hoc v. FCC* at 12-13.

[22] *Ad Hoc v. FCC* at 16.

services.[23] While the Commission established a market-based approach to the governance of special access services, the Commission has made clear that to "the extent that competition did not fully achieve *the goal of moving access rates toward costs, the Commission reserved the right to adjust rates in the future to bring them into line with forward looking costs*."[24] Since the goal is to drive prices to cost, the Commission should apply an analytical framework that enables it to make reasonable comparisons between price and cost, namely a price/cost ratio.

Comparing prices to costs is not only the most obvious analysis when the goal is prices that reflect the costs of providing services, it is also consistent with Commission precedent on determining the just and reasonableness of a rate. In the Commission's own words: "Costs are traditionally and naturally a *benchmark for evaluating the reasonableness of rates*, because cost-based rates both deliver price signals which contribute to the efficient use of the networks and generally distribute network costs to the customer who causes those costs."[25] The incumbents' claims that the Commission, in regulating special access services, moved to a regime that severed the link between cost and prices are inaccurate.[26] In adopting price cap regulations,

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[23] *Access Charge Reform Order* at ¶¶ 44, 48 [The Commission opted for "a market-based approach that relies on competition itself to drive access charges down to forward-looking costs…reserv[ing] the right to adjust rates in the future to bring them into line with forward-looking costs"] .

[24] *Special Access NPRM* at ¶13.

[25] *Investigation of Special Access Tariffs of Local Exchange Carriers*, CC Docket No. 85-166, Memorandum Opinion and Order, 4 FCC Rcd 4797, 4800, ¶ 32 (1988).

[26] *See e.g.*, Letter of Frank S. Simone, AT&T Services, to Marlene H. Dortch, at slide 2 (dated Nov. 4, 2009).

while trying to create incentives to reduce costs,[27] the intent remained to "ensure a continuing nexus between tariffed rates the underlying cost of providing service…[and] ensure rates that are based on the cost of providing service…."[28] Indeed, the United States Supreme Court in discussing how, in the aftermath of *Hope Natural Gas*, state and federal commissions generally set rates on the basis of cost describes the price-cap regime as starting with a rate generated by the conventional cost-of-service formula.[29] Thus, the just and reasonable rate criterion has remained a cost-based measure, even as it has evolved through price caps and other policies. The incumbents seem to acknowledge that this is the appropriate standard, even as they incredulously contend that there is no means to determine costs.[30]

The price-cost analysis COMPTEL is recommending is a conservative analysis, employing the simple ratio of price-to-cost. In a perfectly competitive market, the price/cost ratio would be 1.00 (recognizing that in standard economic analysis "cost" includes a normal return on investment, with the conventional measure of cost being marginal cost).[31] As we explain below, however, COMPTEL is recommending that the Commission use as its measure of cost TELRIC, which estimates the incumbent's forward-looking average total cost (despite

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[27] *Policy and Rules Concerning Rates for Dominant Carriers*, CC Docket No. 87-313, Report and Order and Second Further Notice of Proposed Rulemaking, 4 FCC Rcd 2873, FCC 89-91, ¶ 865 (1989).

[28] *Id.* at ¶¶ 8, 38.

[29] *Verizon Communs., Inc. v. FCC*, 535 U.S. 467, 487 (2002)("Verizon v. FCC").

[30] *AT&T Feb. 6 Ex Parte* at 8.

[31] "For a perfectly competitive firm, the competitive price level is that firm's marginal cost." "The Role and Assessment of Classical Market Power in Joint Venture Analysis," Policy Planning, Federal Trade Commission (Staff Discussion Draft), Section III A. (1997) available at: http://www.ftc.gov/opp/jointvent/classic3.shtm.

incorporating the term "incremental" in its label.)[32] Because TELRIC produces cost estimates higher than an incumbent's incremental cost, even a price/cost ratio value of 1.00 would indicate price levels higher than what would be expected from a perfectly competitive market. The higher the price/cost ratio is above 1.00, the greater the deviation from cost. Although a price/cost ratio value greater than 1.00 may still be just and reasonable in accordance with Section 201, there comes a point at which the value indicates rates that are unreasonably above cost. The purpose of these comments is to recommend a framework for the Commission's analysis and subsequent data will assist the Commission in determining the appropriate limits on a price/cost ratio result.[33]

A. <u>The Costs Used in the Analysis Should be TELRIC rates.</u>

Remarkably, the incumbents claim that there is no means of determining the cost of special access services. Yet special access services have corresponding unbundled network elements. This is demonstrated by the fact that when competitive carriers are no longer able to obtain network elements such as DS1 and DS3 loops and transport, the incumbents point them to

[32] Commission rules compute TELRIC as the total forward looking cost of an element divided by total output. See C.F. R. § 51.505(b) and (c). In standard economics, such a calculation produces a measure of average total cost. Because the Commission's rules require that the cost of each network element be determined as though the rest of the network already exists, the cost of each network element is "incremental" to the rest of the network. Hence the Commission adopted the term Total Long Run Incremental Cost ("TELRIC"). The use of the term "incremental" in this context, however, does not refer to an incremental addition of output (as the term is used in conventional economics), which has sometimes created confusion. As a measure of average total cost, TELRIC produces a measure of cost higher than marginal cost for any element exhibiting economies of scale, which is the case for most telecommunications facilities.

[33] The last regulated rate of return was 11.25 percent, which may be excessive in today's economy.

their special access tariffs.[34] Therefore, the TELRIC rates – hashed out in numerous cost proceedings throughout the states – likewise provide a cost basis for special access services that are publicly available.

The incumbents' objections to the use of TELRIC rates to evaluate the just and reasonableness of special access rates are unfounded. In particular, the incumbents' claims that the re-pricing special access services at TELRIC has been litigated extensively over the last decade and rejected by the D.C. Circuit, citing *COMPTEL v. FCC* and *USTA v. FCC*,[35] are irrelevant and false. Using TELRIC as a gauge in evaluating the just and reasonableness of current special access prices does not necessarily lead to the re-pricing of special access services at TELRIC pricing, as COMPTEL has acknowledged that a strict price/cost ratio of 1.00 may not be needed for the price to be considered reasonable.[36] So any ruling concerning the re-pricing of

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[34] *See e.g.*, Petition for Modification of McLeodUSA Telecommunications Services, Inc., *In the Matter of Petition of Qwest Corporation for Forbearance Pursuant to 47 U.S.C. § 160(c) in the Omaha Metropolitan Statistical Area*, WC Docket No. 04-223, p. 4-5 (filed Jul. 23, 2007)("McLeod Petition")["Qwest has offered only to replace high-capacity UNEs with special access services… With regard to DS1 and DS3 loops, Qwest has merely offered the tariffed "Regional Commitment Program" ("RCP") from its special access tariffs."]

[35] *AT&T Feb. 12 Ex Parte* at 5, *citing CompTel* v. *FCC*, 309 F.3d 8 (2002)("COMPTEL") and *USTA* v. *FCC*, 359 F.3d 554, 590-92 (2004)("*USTA II*");

[36] Even if one were to suggest that special access rates should not equal the corresponding TELRIC rates, it disingenuous for one to argue that the special access rates are just and reasonable given the substantial disparity in the current rates. For instance, the *Eben Declaration* contained a comparison of special access rates to the rates of analogous UNEs and found special access rates to be drastically higher. For example, the declaration shows a DS1 special access circuit priced at 152% more than the UNE rate. *Eben Declaration* at ¶8; *See also, id.* Exhibit 1. Even if the carrier availed itself to the discounts provided through Qwest's exclusionary contract offering (which requires that the customer purchase 90% of its entire demand throughout the Qwest 14-state region from Qwest), the declaration found discounted prices 91% to 111% higher than the UNE rates. *Id* at ¶¶ 10-13. Sprint Nextel also performed a comparison of *discounted* special access rates to comparable UNE rates and found a difference of up to 123%. Comments of Sprint Nextel Corporation, *In the Matter of a National Broadband Plan for Our Future*, GN Docket No. 09-51, p. 20 (filed Jun. 8, 2009).

special access at TELRIC is not dispositive as to the use of TELRIC as the cost-basis in a price/cost ratio analysis. Nonetheless, contrary to the incumbent assertions, the cited cases concern the Commission's impairment analysis under Section 251 of the Act for purposes of what constitutes an unbundled element and the application of unbundling rules to Section 271 network elements, they do not hold that special access cannot be priced at TELRIC.[37]

More pertinent to the matter at hand is the US Supreme Court's discussion and decision in *Verizon v. FCC*. The Court upheld the Commission's use of TELRIC as a valid pricing methodology for *setting* "nondiscriminatory" and "just and reasonable rates" in the context of network elements. As such, the incumbents' claims that the use of TELRIC to *evaluate* the just and reasonableness of their special access rates would not survive judicial scrutiny is ludicrous.

Indeed, TELRIC rates are an ideal cost-basis since the purpose of price cap regulations was to provide incentive for the incumbents to be more efficient and reduce costs. What better means of the determining the success of the current regulatory framework in achieving that goal than to compare the current rates to rates that "should be measured based on the use of the most efficient telecommunications technology currently available and lowest cost network configuration, given the existing location of the incumbent's wire centers."[38] As the Court

[37] Specifically, the Court in *COMPTEL* merely upheld the Commission's determination that Section 251 of the Act does not bar service-by-service distinctions in its impairment findings and therefore the Commission is not required (but presumable would be permitted) pursuant to Section 251 to mandate that a network element be unbundled for all services when it only finds it to be impaired for one service. *COMPTEL at* 8. The Court noted, however, that all parties agreed that the Act does not *require* such service-by-service distinctions. *Id*. at 14. In doing so, the Court upheld the Commission's decision against the "*immediate* provision of special access as a UNE." *Id*. at 19. One of the factors the Courts discusses in upholding the Commission's decision, however, was that it was an interim rule while the Commission further studied the issue. *Id*. at 21. While the Court in *USTA II* did not bar the Commission from limiting TELRIC rates to UNEs the Court did not impose such a limitation.

[38] 47 C.F.R. § 51.505(b)(1).

explains, in *Verizon v. FCC*, the difference between most-efficient cost and embedded cost is inefficiency,[39] exactly what price-cap regulations were intended to eliminate.

Moreover, as the *Special Access NPRM* states, the goal is for rates to be in line with *forward-looking costs*, which the TELRIC rates reflect. Additionally, TELRIC studies estimate forward-looking costs using the most efficient technologies available nearly a decade ago (when most studies were conducted). The incumbents have had ample opportunity to deploy such technologies in their networks. Indeed, given the advances in technology over the past decade, it is almost certain that TELRIC cost-estimates are inflated because they fail to consider new technologies and, at least for AT&T and Verizon, the substantial synergies achieved by such carriers through their merger with other incumbents and (the pre-merger) AT&T and MCI. There is simply no valid argument that TELRIC rates cannot be used as a *conservative* proxy for forward-looking costs, other than the argument that the studies are premised on technology assumptions that cause the cost estimates to be *unreasonably high* in today's environment.

The Commission has found that an historical cost approach, on the other hand, "is highly dependent on the accuracy of an incumbent LEC's accounting records, which potentially creates a significant information asymmetry that benefits the incumbent LECs."[40] In the case of special access services, the information asymmetry presented by cost analysis using historical or embedded costs has led to the incumbents' dubious claims that they cannot identify their

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[39] *Verizon v. FCC* at 511.

[40] *Review of the Commission's Rules Regarding the Pricing of Unbundled Network Elements and the Resale of Service by Incumbent Local Exchange Carriers*, WC Docket No. 03-173, Notice of Proposed Rulemaking, FCC 03-224, ¶ 32 (2003).

historical costs.[41] The incumbents incredulously continue to argue that the Commission must accept their special access prices as just and reasonable because there is no means of determining the costs of providing the service to perform a proper analysis. If the incumbents object to the use what is already an accepted means of determining the just and reasonableness of rates by both the Commission and highest court in country, in the very least, they must offer another reasonable solution. It is unacceptable to merely say it can't be done, particularly when it already has been done.

B. <u>The Prices Used in the Analysis Should be the "Rack" Rates.</u>

Price cap carriers file federal tariffs that list the recurring and nonruccuring rates available to all special access customers. These price-cap and price-flex list prices are often called "rack rates." Most carriers offer the same rack rates throughout their entire footprint, although some carriers define several "zones" with different rates.[42] The simplest form of the generally available rate is the so-called month-to-month rate, which is often used synonymously with the term "rack rate." [43] While large carriers also typically offer several volume and term

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[41] A number of commenters in this proceeding have used ARMIS data to show that that the incumbents are earning exorbitant rate of returns on special access. Specifically, AT&T, Qwest, and Verizon rates of return for 2007 were 138%, 175%, and 62%, respectively. *See* COMPTEL Letter to Marlene Dortch, p. 5 (dated May 18, 2009). Incumbents have claimed such use of ARMIS is invalid, one of their main arguments being the jurisdictional separations freeze which they themselves supported. NRRI, however, adjusted the investment base to address this issue, yet still found earning rates on special access to be high and determined that this finding "supports a conclusion that all three large RBOCs have raised prices above average cost, defined in the traditional accounting sense." NRRI Report at 71.

[42] NRRI Report at 21. *See also, id* at n. 80 [AT&T identifies different rates by state in the former Ameritech region, but the rates in each state are identical."]

[43] *Id.*

commitment plans that provide substantial discounts, the discounts provided are generally off of the applicable rack rate.[44]

The prices the Commission should use in performing the price/cost ratio analysis are the rack rates, which are publicly available. The incumbents' claims that these are not the prices purchasers actually pay are irrelevant. First, the Commission has a statutory obligation to ensure that *no* rates are unjust or unreasonable. Second, ensuring the just and reasonableness of the rack rates will lend to remedying the anti-competitive impact of the discount pricing plans discussed more fully below. Once the Commission has ensured the base rates are at a just and reasonable level the Commission has reduced the incentive for the incumbent to use discount plans in an anti-competitive manner. Finally, since the rack rates are the basis of the rates in the discount plans, any reduction to the rack rates (to bring them to a cost-based level) should also be reflected in the discounted rates.[45] This may ultimately save the Commission from having to continuously wade through the myriad of complicated discount plans.

As COMPTEL has repeatedly stated, under the current regulatory regime the three predominant incumbents (the RBOCs) are able to "lock up" the market demand for special access via their exclusionary volume and term commitments, offered as part of their "discount" plans. Three factors play into their ability to engage in such anticompetitive pricing: 1) most

[44] *See* GAO Report at 7; *See also*, Letter of Donna Epps, Verizon, to Marlene Dortch, WC Docket No. 05-25, p. 3 (filed Oct. 27, 2009)("Verizon Oct. 27, 2009 Ex Parte")["Customers that have participated in Verizon's discount plans and/or pricing flexibility promotions and contracts have received substantial discounts on Verizon's standard month-to-month rates for special access services."]

[45] While the reduction in price may automatically be reflected in discount plans going forward, to the extent existing discounts plans have a set price that was calculated based on the unjust and unreasonable rack rates at the time the contract was formed, Commission action may be needed to bring those discounted rates to just and reasonable levels.

large business customers desiring special access have multiple locations; 2) the uniqueness of the ubiquity of the RBOC network; and, 3) the RBOC rack rates for special access are exorbitant. The Commission has the authority to remedy the third factor.

The record is resplendent with economists' description of the exclusionary, and therefore anticompetitive, nature of the RBOC discount plans. As explained in the Declaration of Michael Pelcovits, filed with WorldCom's Reply Comments in this proceeding, "exclusionary pricing refers to circumstances where entry is deterred or exit induced by the dominant firm's price structure."[46] Pelcovits identifies the following examples:

- Quantity discounts, individually negotiated with each customer, where the discount is paid back to the "first dollar" when the designated quantity is met.
- Market Share discount which reward a customer that purchases a required percentage of its requirements from the dominant firm, but no discount if this requirement is not met. At the extreme, these discounts can provide incentives for a customer to deal exclusively with the dominant firm.
- Purchase growth discounts.
- Liquidated damages far above the dominant firm's actual costs of discountinuing service, which are paid if the customer switches to a competitor or fails to meet minimum quantity commitments.[47]

The RBOCs are able to successfully engage in these anti-competitive pricing structures because most of the large business customers that are access by special access services have multiple locations[48] and the RBOC, being the only carrier that can provide ubiquitous access in its region, prices its service on a wider basis than an individual building. As Verizon itself

[46] Declaration of Michael D. Pelcovits On Behalf of WorldCom, Inc., RM-10593, p. 5 (dated Jan. 23, 2003)("Pelcovits Declaration").

[47] *Id.*

[48] Gillan Declaration at ¶ 15, 20 [More than 85% of the customer-declarations the Department of Justice provided the Court, as being representative of the special access market, describe a customer with multiple locations].

explained to a U.S. District Court during the *Tunney Act* proceedings, retail enterprise customers "buy in all their locations. And these kinds of customer typically have many locations that have to be knit together. So it's not just one building with a fiber connection, it's a lot of buildings and a lot of stuff in the middle."[49]

By pricing its service on a wider basis than an individual building, the RBOC contracts bind the purchaser to the RBOC services across its region; preventing the purchaser from buying from a competitor even in the discrete areas where competitors may have a presence. The RBOCs are able to accomplish this affect because the basic tariff or "rack" rate is significantly higher than the discount rate the purchaser obtains when buying across the region. Since customers are often unable to deal entirely with a competitor for all their requirements the RBOC can condition the pricing on the monopoly portion of the customer's demand on the choices the customer makes for the competitively sensitive portion of demand. In other words, the customer will pay the higher price (rack rate) on the monopoly demand if he deals with a competitor on the competitively sensitive demand.[50] The competing provider will have to compensate the customer for this significant penalty. For example, if the customer is going to lose a 40% discount on 90% of its service in order to use the entrant for the remaining 10%, the price the entrant offers on the 10% service would have to make up for the substantial loss on the other 90%. As Pelcovits explains, "the required compensation is a real cost to the entrant of making a sale. For the dominant firm, the cost of the rebate or discount plan can be essentially zero."[51]

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[49] Tunney Act Transcript at p. 83.

[50] Pelcovits Declaration at 7.

[51] *Id.*

Consequently, the competitor is effectively foreclosed from serving that customer.[52] Additionally, carrier customers may be deterred from building their own facilities to meet their own needs because doing so may cause them to fall short of the volume commitments needed for the discount under their existing (potentially long-term) special access agreements.

The RBOC discount plans are pervasive. Verizon acknowledges that over ninety percent of the special access revenue it receives from carrier customers comes from its discount plans.[53] The record is plentiful with examples of extent of the discounts (e.g., 67% of f the original price)[54] and the impact to competitors. Indeed the extent and impact is confirmed by independent sources. The NRRI Report states that Verizon reported discounts that range up to 65% off standard month-to-month rates and a customer receives 53% discount under a typical AT&T Term Pricing Plan.[55] As the GAO explains, the consequence of these type of contracts is that "[u]less a competitor can meet the customer's entire demand, the customer has an incentive to stay with the incumbent and to purchase additional circuits from the incumbent, rather than switch to a competitor or purchase a portion of their demand from a competitor – even if the competitor is less expensive."[56] Since these type of contracts prevent a customer from migrating its service to a competitor that enters a market, they prevent competition from developing, regardless of whether or not competitors otherwise have facilities or desire to compete. This is why the CLEC data on network facilities, which the ILECs repeatedly ask for, is irrelevant.

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[52] *See* Reply Declaration of Joseph Farrell On Behalf of CompTel, WC Docket No. 05-25 and RM-10593, ¶ 15 (dated Jul. 29, 2005)("Farrell Declaration").

[53] *Verizon Oct. 27, 2009 Ex Parte* at 3.

[54] Pelcovits Declaration at 12.

[55] NRRI Report at p. 22, n. 83; *See also Verizon Oct. 27, 2009 Ex Parte* at 3.

[56] GAO Report at 30.

Even if the CLECs had the facilities to compete in discrete geographic areas, they do not have the scale and scope to compete with the RBOCs for the major purchasers of special access.[57]

The RBOCs claim that the discounts are in the consumers' interest and the Commission should look at any regulation banning lower prices with a jaundice eye. Discounts are generally a good thing for consumers. But if what is really happening is a substantial overpricing of the base price the benefit of the discount is a facade and, in this case, much worse – it creates an actual and substantial harm. This pricing practice is akin to a store pricing a dress at twice what it actually plans to sell it for and then putting it on sale at 50% off. While in the case of the store it amounts to no more than a marketing scam, with the customer still paying the appropriate price, in the case of the incumbent's special access pricing it creates an anti-competitive effect by tying the "discount" to the purchaser buying from the RBOC in areas where the purchaser may wish to use someone else. Moreover, a comparison of both the rack rates and discounts rates to UNE rates demonstrate that *both* categories of RBOC rates are *substantially above cost*.[58] As discussed in the Farrell Declaration, under the current regime, when the incumbent offers "discounts off its undiscounted prices in order to induce customers to agree to exclusionary provisions, it has an incentive to set the undiscounted price above even the monopoly level (because, rather than simply deterring demand, an increase above the monopoly level steers

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[57] *See* Letter of Brad E. Mutschelknaus of Kelly Drye and Warren, to Marlene H. Dortch, FCC, WC Docket Nos. 06-172, 07-97, 06-125, 06-147, and 04-440, p. 8, Oct. 1, 2007 ["The evidence presented here by the Joint CLECs demonstrates that competitors have spent enormous sums of money to build networks, but these networks only serve – or are capable of serving in a commercially reasonable period of time – an extremely small portion of buildings in each local market at issue."]

[58] *See supra* n. 35.

customers into the discount plans and also *brings the discount prices closer to the monopoly level*.)"[59]

The Commission asks what remedial action it could take. If the Commission were to adopt regulations that ensure the rack rates (price cap and price flex list prices) for special access services were cost-based it would diminish, for the most part at least, the incumbents' incentive to engage in exclusionary pricing without the Commission's constant oversight and review of the terms and conditions.[60] In other words, COMPTEL is not suggesting the incumbents be barred from offering discounts plans. Rather, the Commission must ensure that the rack rates these discount plans are based on are just and reasonable, i.e., cost-based.

In conclusion, if the Commission does not feel the record is currently sufficient to act, the Commission should perform a price/cost ratio analysis (using the TELRIC rates of comparable UNEs as cost and the "rack" rates as price) to evaluate the current prices incumbents charge for their special access services in order to assess if the current regulatory regime was successful in driving prices toward the forward-looking costs of providing these services.

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[59] Farrell Declaration at ¶ 4.

[60] This may not remedy all anti-competitive terms and conditions, e.g., terms that ban the use of UNEs. Moreover, as stated previously, While the reduction in price may automatically be reflected in discount plans going forward, to the extent existing discounts plans have a set price that was calculated based on the unjust and unreasonable rack rates at the time the contract was formed, Commission action may be needed to bring those discounted rates to just and reasonable levels.

Respectfully submitted,

/s/

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