Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 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

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EXECUTIVE SUMMARY

Sprint Nextel ("Sprint") applauds the Commission's decision to take a comprehensive approach to overhauling its special access rules. The existing regime has been the focus of concern almost since the pricing flexibility rules were adopted in 1999. After years of proceedings regarding the incumbent local exchange carriers' ("LECs'") excessive rates and unjust and unreasonable practices, the Commission now seems poised to undertake a thorough analysis of the problems with the current regulatory scheme. Although Sprint appreciates the Commission's decision to begin with first principles by seeking comment on the proper analytical framework for examining special access, Sprint urges the Commission to move forward as expeditiously as possible to correct long-standing defects in its price cap and pricing flexibility rules.

Special access is vitally important to virtually every form of telecommunications-based service, providing a critical input not only to broadband, but also wireless, interexchange and other services. As Sprint has noted, special access is used every time a consumer sends an email, surfs the Web, swipes a credit card, uses an automated teller machine ("ATM") or places a wireless or long distance call. The Commission therefore should immediately begin to gather whatever additional evidence it needs to supplement the current record and implement the changes necessary to bring special access prices down to reasonable levels and to address anticompetitive practices employed by incumbent LECs.

In these comments, Sprint draws on the work of Dr. Bridger Mitchell, an established expert in competition and pricing in the telecommunications industry, to provide the Commission with an analytical framework for evaluating the effectiveness of its current special access regulations. This framework includes defining the relevant geographic and product

markets for special access services and determining whether the incumbent LECs continue to dominate the relevant markets, by examining factors such as market share and concentration, demand elasticity and supply responsiveness.

As Dr. Mitchell notes, the evidence already in the record strongly suggests that the price cap LECs have market power in special access and that they have been able to use this market power to charge supra-competitive rates in areas where they have been granted Phase II pricing flexibility. Even in areas where the incumbent LECs are subject to price caps, the Commission's current regulations do not appear to have effectively constrained the incumbent LECs' ability to charge unreasonably high rates. And in all areas of the country, the price cap LECs have been able to use anticompetitive terms and conditions to maintain and enhance their dominant positions.

For example, evidence already in the record shows that:

- The incumbent LECs have an overwhelming share of the special access business. Over 98 percent of all DS1 circuits are purchased from incumbent LECs, as are the vast majority of DS3 connections.
- Special access rates are substantially higher than the rates for comparable unbundled network elements – in some cases up to 171 percent higher.
- Special access rates are several times higher than the rates for retail services such as DSL, cable modem and FiOS that provide equal or greater capacity as well as additional functionalities, such as email and web surfing, that are not a part of special access.

Given this evidence that the current regulatory scheme has not successfully curbed the incumbent LECs' ability to impose supra-competitive prices and deter competition, the Commission should act swiftly to revise its special access price cap and pricing flexibility rules. If the Commission needs time to formulate final revisions to its special access regulations, it should consider implementing interim relief as quickly as possible. The FCC should:

- Eliminate Phase II pricing flexibility, at least in some areas, pending the adoption of comprehensive reforms to its pricing flexibility rules; and

- Bring services currently subject to Phase II pricing flexibility back under price cap regulation, and reset all special access price caps using an interim X-factor of 5.3 percent.

The Commission should issue an order adopting these interim measures in time for them to take effect before the incumbent LECs' next annual tariff filings to be effective on July 1, 2010. Such an order would be a welcome and necessary first step toward the long-awaited reform of special access regulation and would begin the process of providing much-needed relief to American businesses and consumers.

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COMMENTS OF SPRINT NEXTEL CORPORATION

Sprint Nextel Corporation ("Sprint") submits these comments in response to the *Public Notice* issued by the Federal Communications Commission ("FCC" or "Commission") on November 5, 2009, in the above-captioned proceedings, seeking comment on the analytical framework necessary to resolve outstanding issues related to special access.[1]

I. INTRODUCTION AND SUMMARY

The FCC adopted its *Pricing Flexibility* order in 1999, providing price cap incumbent local exchange carriers ("LECs") a means to avoid price cap regulation in metropolitan statistical areas ("MSAs") where they could demonstrate that certain triggers were met, as measured by competitors' establishment of collocation

[1] Public Notice, *Parties Asked to Comment on Analytical Framework Necessary to Resolve Issues in the Special Access NPRM*, WC Docket No. 05-25; RM-10593, DA 09-2388 (rel. Nov. 5, 2009) ("Public Notice").

arrangements.[2] By 2002, the adverse effects of that ill-considered order led AT&T to file a petition for rulemaking seeking reform of the special access rules to protect consumers from the unjust and unreasonable rates, terms and conditions imposed by the price cap LECs.[3] The anticompetitive harms identified by AT&T in its 2002 petition persist today, and indeed have been exacerbated by structural changes in the industry, including the massive horizontal and vertical re-integrations caused by the reunion of multiple Bell Operating Companies ("BOCs") and the acquisitions of AT&T Long Distance and MCI by SBC and Verizon, respectively.

If anything, the need for reform is more urgent now than ever before, as the country struggles to recover from the most severe economic recession since the 1930's. Special access reform is critical to spurring job growth, broadband deployment and innovation. The Commission therefore should act as expeditiously as possible to undertake both interim and permanent reforms necessary to ensure that special access services are provided at competitive rates and on terms and conditions that are just and reasonable.[4]

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

3 *AT&T Corp. Petition for Rulemaking to Reform Regulation of Incumbent Local Exchange Carrier Rates for Interstate Special Access Services*, RM-10593, Petition for Rulemaking (Oct. 15, 2002).

4 The Commission has defined special access as a dedicated transmission link between two locations. *See, e.g., AT&T Inc. and BellSouth Corporation, Application for Transfer of Control*, Memorandum Opinion and Order, 22 FCC Rcd 5662, ¶ 27 n.88 (2007). Consistent with this definition, "special access" includes any dedicated transmission link, regardless of the type of technology deployed over that link (including TDM-based services as well as Ethernet and other packet-based services). *See id.* (using

Footnote continued on next page

As part of its long-running review of special access pricing, the FCC has asked parties to provide a framework that will enable the Commission to evaluate the effectiveness of the current pricing flexibility triggers and other price cap rules.[5] As explained in the comments below and the accompanying Declaration of Dr. Bridger M. Mitchell, the process of developing an appropriate analytical framework for examining the special access marketplace must begin with a determination of the relevant geographic and product markets. The FCC should then analyze whether the price cap incumbent LECs are dominant in the provision of special access services in those markets by properly applying the criteria that the Commission historically has employed in making that determination: share of the relevant markets; elasticity of supply; elasticity of demand; and other factors, such as barriers to entry, that may shield price cap incumbent LECs from effective competition.

Dr. Mitchell explains that the relevant geographic market for special access services is a point-to-point connection, but that for administrative ease, the Commission may choose to aggregate individual point-to-point markets into broader categories.[6] If customers face comparable competitive alternatives in multiple wire centers, the Commission can group those wire centers together into a single geographic area for

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the term "special access" to include *all* services that involve dedicated transmission links). Throughout these comments, the discussion of special access is limited to interstate special access.

5 *See* Public Notice.

6 Declaration of Bridger M. Mitchell, appended hereto as Attachment A, ¶ 32 (Jan. 19, 2010) ("Mitchell Decl.").

purposes of determining whether to provide pricing flexibility.[7] The appropriate product markets must distinguish between the type of connection (*i.e.*, channel termination vs. channel mileage) and the capacity of the connection.[8] Once it has defined the relevant markets, the Commission should analyze the factors that establish market dominance: market shares and concentration; demand elasticity; supply responsiveness; and cost structure.[9]

The hallmarks of market dominance are the ability to: (1) raise and maintain prices; (2) foreclose competition; and (3) raise rivals' costs. Sprint and other parties firmly believe that the price cap incumbent LECs are dominant in the provision of special access services in the relevant geographic and product markets. Once the Commission adopts an analytical framework and collects appropriate data, it should expeditiously act to reform the existing pricing flexibility and other price cap rules to ensure that the rates, terms, and conditions of those services are just and reasonable in all of the relevant markets. The Commission should continue to collect data and examine special access

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[7] *Id.* ¶ 45. One possible starting point for grouping together wire centers is the three tiers the Commission established for purposes of analyzing impairment under section 251. *See id.* ¶¶ 41, 45; *Unbundled Access to Network Elements; Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers*, Order on Remand, 20 FCC Rcd 2533, ¶ 111 (2005) ("*TRRO*"). The Commission could choose to utilize this grouping on an interim basis to determine whether pricing flexibility should be withdrawn until additional data is collected and analyzed and permanent standards are established. There is sufficient evidence in the record to allow for this interim relief.

[8] Mitchell Decl. ¶¶ 50-51. The technology used to provide the connection (*e.g.*, TDM or Ethernet) is not relevant to the analysis. Rather, the product market definitions should focus solely on the economic cost of installing the connection and the revenue opportunities associated with a particular bandwidth (*e.g.*, DS1 or DS3).

[9] Mitchell Decl. ¶ 59.

prices under both price caps and pricing flexibility – and to analyze the existence of competitive alternatives in both types of markets – to determine the effectiveness of the current regulatory scheme.[10]

Based on the available evidence, Dr. Mitchell concludes that the Commission's price cap regulations and pricing flexibility rules have not resulted in special access prices that would be expected in a competitive market.[11] As Dr. Mitchell notes, special access prices are well above forward-looking costs; prices have not declined as volumes have increased; nominal prices for special access services subject to price caps have not declined since 2003; and the predominant pattern for special access services sold in areas subject to Phase II pricing flexibility has been that prices are higher than the prices for the same services in price cap areas.[12]

Although Sprint fully supports the Commission's plans to undertake a thorough and careful analysis of special access based on additional data, the evidence cited by Dr. Mitchell strongly suggests that any newly collected information will only confirm what the extensive data already in the record show: that the special access market is dominated by incumbent LECs such as AT&T and Verizon, and that the current price cap and pricing flexibility regulations have failed to prevent these carriers from abusing their market power. Without prompt action to establish new regulatory safeguards that

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10 *See, e.g.*, Proposed Data Request attached to letter from CCIA, *et al.*, to Marlene H. Dortch, FCC Secretary, WC Docket No. 05-25 (June 3, 2009) ("No Choke Points Coalition Proposed Data Request").

11 Mitchell Decl. ¶ 15.

12 *Id.* ¶ 14.

promote and expand competition for special access, broadband, interexchange, and wireless services, the telecommunications industry will be unable to contribute fully to job growth, broadband deployment, and innovation. Accordingly, the FCC must act expeditiously to revise its special access price cap and pricing flexibility rules.

On an interim basis, the FCC can and should suspend current Phase II pricing flexibility rules and bring services currently subject to Phase II pricing flexibility back under price cap regulation.[13] In addition, the Commission can and should act to reinstate the 5.3 percent productivity (X) factor, net of inflation, and have price cap carriers adjust their price cap indices using the X-factor in the forthcoming annual tariff filing to be effective on July 1, 2010.[14] Action by the Commission in the form of an interim order would be a welcome and necessary first step toward the long-awaited reform of special access regulation that will provide immense benefits to American businesses and consumers and help revitalize the nation's economy.

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[13] If the Commission is reluctant to eliminate Phase II pricing flexibility in all areas, even on an interim basis, it should consider an alternative of retaining Phase II pricing flexibility only in wire centers that meet the "non-impairment" standard for comparable unbundled network elements. *See* Comments of Nextel Communications, Inc., WC Docket No. 05-25, at 22-24 (June 13, 2005) ("Nextel 2005 Special Access Comments").

[14] *See* "Special Access Pricing," attached to letter from Counsel for Sprint Nextel Corporation to Marlene H. Dortch, FCC Secretary, WC Docket No. 05-25, at 42 (Oct. 5, 2007) ("Oct. 5, 2007 *Ex Parte*"); *see also Special Access Rates for Price Cap Local Exchange Carriers; AT&T Corp. Petition for Rulemaking to Reform Regulation of Incumbent Local Exchange Carrier Rates for Interstate Special Access Services*, Order and Notice of Proposed Rulemaking, 20 FCC Rcd 1994, ¶ 131 (2005) ("*Special Access NPRM*"). Sprint continues to believe that the FCC should set interim price caps to reflect the levels that would have been in effect if the X-factor adjustment had been made annually each year since 2004. *See* Oct. 5, 2007 *Ex Parte* at 42. The Commission may, however, choose to take a more conservative approach and apply the interim X-factor only for 2010, while it contemplates the appropriate long-term changes to special access regulation.

II. THE COMMISSION'S ANALYTICAL FRAMEWORK SHOULD ENABLE IT TO DETERMINE WHETHER PRICE CAP INCUMBENT LECS REMAIN DOMINANT IN THE PROVISION OF SPECIAL ACCESS SERVICES

The Public Notice asks whether the current special access rules are working as intended to ensure that special access rates, terms, and conditions are just and reasonable nationwide, as required by the Act.[15] To answer this question, the Commission must first determine whether, if left unregulated, price cap incumbent LECs would have sufficient market power to set prices or prescribe material terms and conditions of service unilaterally. If so, the FCC should then determine whether its current price cap and pricing flexibility rules have successfully constrained the incumbent LECs' ability to exploit their market power by charging supra-competitive rates or by imposing unjust or unreasonable terms and conditions.

The first step in this analysis is determining whether the price cap incumbent LECs are dominant in the provision of special access services. As the Commission has found, the criteria for dominance are high market share, limited supply elasticity, limited substitution elasticity for consumers, and cost structure and resources that confer an advantage over competitors.[16] When a price cap incumbent LEC meets these criteria, it has the ability to raise and maintain the price of special access services; to foreclose competition in the supply of special access; and to raise rivals' costs even if it cannot

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15 Public Notice at 1-2; 47 U.S.C. § 201(b).

16 Mitchell Decl. ¶ 3; *Motion of AT&T Corp. to be Declared Non-Dominant for International Service*, Order, 11 FCC Rcd 17963, ¶ 36 (1996); *Motion of AT&T Corp. to be Reclassified as a Non-Dominant Carrier*, Order, 11 FCC Rcd 3271, ¶ 38 (1995).

foreclose entry completely.[17] In other words, a price cap incumbent LEC that is dominant in the provision of special access can establish and maintain special access rates, terms, and conditions that are unjust and unreasonable, without facing significant countervailing pressure from existing or potential competitors. A rigorous dominance analysis therefore is the appropriate first step for determining the extent to which the current pricing flexibility and price cap rules must be modified in order to ensure that special access rates, terms, and conditions are just and reasonable in all relevant markets.

This section describes the methodology the Commission should follow in conducting its dominance analysis. Under FCC precedent, to determine whether price cap incumbent LECs are dominant in the provision of special access services, the FCC must conduct a market power analysis.[18] The first step in conducting that analysis is to define the relevant geographic and product markets and the second step is to assess whether the incumbent LECs possess market power in the relevant markets. Both steps are described in detail below.

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[17] Mitchell Decl. ¶ 4.

[18] *See, e.g.*, *Policy and Rules Concerning Rates for Competitive Common Carrier Services and Facilities Authorizations Therefor*, First Report and Order, 85 F.C.C.2d 1, ¶ 26 (1980) ("We will consider a carrier to be dominant if it has market power (*i.e.*, power to control price)."); *Petition of Mid-Rivers Telephone Cooperative, Inc. for Order Declaring It to Be an Incumbent Local Exchange Carrier in Terry, Montana Pursuant to Section 251(h)(2)*, Report and Order, 21 FCC Rcd 11506, ¶¶ 29-34 (2006) (conducting market power analysis to conclude that Qwest should be treated as a non-dominant carrier for its interstate telecommunications services in a particular exchange); 47 C.F.R. § 61.3(q) (defining "dominant carrier" as "[a] carrier found by the Commission to have market power (*i.e.*, power to control prices).").

A. Geographic Market

In applying the 1992 Merger Guidelines, the Commission has found that the relevant geographic market for a telecommunications service is a point-to-point connection.[19] For special access services, this approach dictates that the relevant geographic market for channel termination service is the building in which the customer is located, and that the relevant geographic market for interoffice transport is pairs of wire centers.[20]

The granularity of these definitions allows for a precise assessment of market power. As the Commission recognized in the *LEC Classification Order*, however, "assessing market power in each individual point-to-point market would be administratively impractical and inefficient."[21] Therefore, "for all practical purposes ... the relevant geographic area for assessing market power will usually consist of multiple point-to-point connections that exhibit the same competitive conditions."[22] Accordingly, the Commission may conclude that administrative feasibility requires it to aggregate the

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19 *See, e.g.*, *Regulatory Treatment of LEC Provision of Interexchange Services Originating in the LEC's Local Exchange Area and Policy and Rules Concerning the Interstate, Interexchange Marketplace*, Second Report and Order and Third Report and Order, 12 FCC Rcd 15756, ¶ 65 (1997) ("*LEC Classification Order*").

20 Mitchell Decl. ¶¶ 35-36.

21 *LEC Classification Order* ¶ 66.

22 *Id.* ¶ 68; *see also Petition of Qwest Corporation for Forbearance Pursuant to 47 U.S.C. § 160(c) in the Omaha Metropolitan Statistical Area*, Memorandum Opinion and Order, 20 FCC Rcd 19415, ¶ 18 (2005) (the relevant geographic market is "an area in which all customers in that area will likely face the same competitive alternatives for a product"); Mitchell Decl. ¶ 32.

individual geographic markets into broader categories for purposes of assessing the need for pricing flexibility.[23]

Although a certain amount of aggregation may be necessary, the Commission should strive to keep its analysis as granular as possible, since a greater degree of aggregation necessarily entails a greater risk of misclassification of individual point-to-point connections.[24] For example, the Commission likely should not treat all the connections in an MSA as part of a single geographic market. As the Commission has recognized, economic conditions vary significantly within an MSA, and therefore "an MSA-wide approach . . . would require . . . lumping together areas in which the prospects for competitive entry are widely disparate."[25] Further, the risk of anticompetitive consequences is compounded when the geographic area identified for providing special access pricing relief covers a large area (*e.g.*, an MSA) and the triggers used to identify the presence of effective competitive alternatives cover a smaller portion of that area (*e.g.*, a wire center or group of wire centers). As described below, that is one of the key flaws in the Commission's current pricing flexibility rules.

Rather than use an overly broad market definition such as an MSA, Dr. Mitchell recommends that the Commission consider alternatives, such as adapting the geographic

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23 Mitchell Decl. ¶ 32.

24 *Id.* ¶ 38.

25 *TRRO* ¶ 155; *see also id.* ¶ 82; Mitchell Decl. ¶ 33 (noting that competitive alternatives available to customers will rarely be uniform across a geographic area as large as an MSA).

market definitions that it used in assessing impairment under section 251,[26] to classify areas within an MSA that should be grouped together for purposes of analyzing market power in the marketplace for special access services. In establishing its impairment standards under section 251, the Commission divided wire centers into three tiers, based on the number of business lines served by the wire center (representing revenue potential for competing providers), or the number of fiber-based collocations at the wire center (representing competitive presence):

- Tier 1 wire centers – those with four or more fiber-based collocations or with 38,000 or more business lines.
- Tier 2 wire centers – those with three or more fiber-based collocations or with 24,000 or more business lines.
- Tier 3 wire centers – all those that are not Tier 1 or Tier 2 wire centers.[27]

The Commission relied on these tiers in adopting the impairment criteria used to determine whether competitive carriers should have access to UNEs.[28]

If customers face comparable competitive alternatives in multiple wire centers within an MSA, those wire centers can be grouped together in a single geographic market for purposes of conducting a market power analysis. Dr. Mitchell concludes that grouping wire centers based on the criteria the Commission employed in its impairment analysis "would provide an administratively practical way to distinguish geographic areas in which competitive alternatives [to special access] are likely to limit incumbent LEC

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26 47 U.S.C. § 251. The impairment analysis is used to determine whether competitive carriers are entitled to purchase unbundled network elements ("UNEs") in a particular market.

27 *TRRO* ¶¶ 112, 118, 123.

28 *Id.* ¶ 66.

market power from other areas in which there is little or no prospect of effective competition."[29] For example, under this approach all DS3 transport routes connecting two tier one wire centers could be considered to be in the same (or similar) geographic market(s). This approach would delineate relatively precise geographic markets, comprised of wire centers facing similar competitive conditions. These markets could then be treated similarly for purposes of determining whether the incumbent LEC is able to exercise sufficient market power to warrant a finding of impairment and, by extension, a denial of pricing flexibility.[30]

Use of the UNE impairment criteria to define the relevant special access geographic markets would require the Commission to collect data for individual wire centers.[31] Dr. Mitchell, however, recommends that, at a minimum, the Commission expand the *TRRO* criteria to include the total number of DS1 and DS3 channel terminations and channel mileage circuits provided by competitive suppliers in each wire center (or by census tract or ZIP code for competitors that do not use incumbent LEC wire centers to organize their supply data).[32] This adjustment would enable the

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[29] Mitchell Decl. ¶ 45. As Dr. Mitchell points out, however, while the number of incumbent LEC business lines provides a reasonable proxy for demand in a geographic area, a more comprehensive measure would include lines supplied by competitors and self-supplied by customers. *Id.* ¶ 39.

[30] Conversely, if an incumbent LEC faces sufficient competition to justify a finding of non-impairment, the Commission may use that evidence to support a grant of pricing flexibility.

[31] Mitchell Decl. ¶ 47.

[32] *Id.* ¶ 82. Collecting data by census tract or ZIP code will allow the Commission to account for competitors that do not collocate in wire centers. However, as Dr. Mitchell also notes, the findings of the NRRI Study indicate that there is a limited supply of

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Commission "to assess whether it is appropriate to apply the tier-based triggers for UNE impairment or to revise those criteria to best reflect the relationship of competitive supply of channel terminations [and channel mileage circuits] to the number of business lines and number of collocators in a wire center."[33] As Dr. Mitchell explains, the Commission could limit the scope of the effort required to use this analytical framework by obtaining data regarding the supply conditions in a sample of MSAs.[34] The approach proposed by Dr. Mitchell would enable the Commission to determine whether the extent of competition for specific relevant special access products within a relevant geographic area is sufficient to permit Phase II regulatory relief.

In contrast, the Commission's current Phase II pricing flexibility rules, which are intended to deregulate special access prices only where customers have access to

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special access circuits from competitors, so that relying on incumbent LEC data only would yield a reasonable approximation of demand. *Id.* ¶ 39; *see also* Peter Bluhm and Dr. Robert Loube, National Regulatory Research Institute, "Competitive Issues in Special Access Markets," Revised Edition, at 42 (Jan. 21, 2009), *available at*: <http://nrri.org/pubs/ telecommunications/NRRI_spcl_access_mkts_jan09-02.pdf> ("NRRI Study").

33 Mitchell Decl. ¶ 47.

34 *Id.* ¶ 37. For example, in its 2006 study, the GAO selected 16 MSAs for intensive analysis of the level of demand (differentiating between DS1, one DS3, and two or more DS3s) in each lit building and whether the building was supplied by a competitor. Such building-level data could be augmented by the identification of each building's serving wire center. The extent of competitive supply could then be analyzed in terms of the areas defined by tier of wire center (number of business lines, number of collocators). *See* Mitchell Decl. ¶ 37 (discussing United States Government Accountability Office ("GAO"), Report to the Chairman, Committee on Government Reform, House of Representatives, *Telecommunications: FCC Needs to Improve Its Ability to Monitor and Determine the Extent of Competition in Dedicated Access Services* (rel. Nov. 30, 2006), Report No. GAO-07-80, *available at*: <http://www.gao.gov/ new.items/d0780.pdf> ("GAO Report").)

effective competitive alternatives, in fact do not distinguish between competitive and non-competitive geographic areas.[35] Relief is granted on an MSA-wide basis, even though, as noted above, the FCC itself has recognized that competitive conditions are likely to vary among different wire centers in an MSA. Furthermore, pricing flexibility currently is granted based solely on the presence of a certain number of collocation facilities, even though this criterion alone does not reliably indicate the availability of competitive alternatives to the incumbent LEC.[36] In short, the pricing flexibility triggers currently used for granting Phase II flexibility do not provide "an accurate proxy for the kind of sunk investment by competitors that is sufficient to constrain incumbent LEC prices, including for both channel terminations and inter-office facilities."[37]

B. Product Market

In conducting its analysis of special access, the FCC should treat those services that are reasonable substitutes for one another as part of a single product market, and assign to separate markets those services that are not reasonable substitutes for each other.[38] Thus, for example, the Commission's market definitions should recognize that channel terminations (loops) and channel mileage (interoffice transport) belong in separate product markets. As Dr. Mitchell observes, "[f]or a special access customer, channel termination and channel mileage are not substitutes" for one another: "a small

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35 Mitchell Decl. ¶ 46.

36 *See, e.g.*, *id.* ¶¶ 17-18 (explaining that operators of collocation facilities may not be offering alternatives for special access channel terminations, for example).

37 Public Notice at 2.

38 *See* United States Department of Justice and the Federal Trade Commission, "Horizontal Merger Guidelines," § 1.11 (1992; rev. 1997), *available at*: <http://www.justice.gov/atr/public/guidelines/hmg.htm> ("Horizontal Merger Guidelines").

increase in the price of channel termination will not lead the customer to reduce the quantity of termination purchased and purchase greater channel mileage service."[39]

Channel termination and channel mileage products are not only distinct from each other, but also are distinguished internally by differences in capacity: DS1 circuits are not substitutes for DS3 circuits, and *vice versa*. As Dr. Mitchell points out, however, in evaluating the prospects for competitive entry in a particular geographic area, the Commission should focus on the economic viability of constructing a DS3 facility.[40] As Dr. Mitchell explains, "[c]ompetitive supply of *stand-alone* DS1 channel terminations is uneconomic."[41] Because a competitive provider of DS3 channel terminations can channelize them to offer a DS1 product, "the availability of competitive DS1 channel terminations will depend on the availability of competitive DS3 (and higher-capacity) services in the wire center area."[42]

As a practical matter, the opportunities for competitive supply of DS3 channel terminations, for example, are likely to be greatest in areas that have a high density of business lines (primarily central business districts).[43] Consequently, as Dr. Mitchell notes, "[o]ther things being equal, the more business lines served by a wire center and the greater the number of collocated competitive LECs, the more likely it is that competitive

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39 Mitchell Decl. ¶ 50.

40 *Id.* ¶ 51.

41 *Id.*; *see also TRRO* ¶¶ 82, 166, 170-171.

42 Mitchell Decl. ¶ 51.

43 *Id.* ¶ 52.

DS3 capacity [that can be channelized to offer DS1 service] will be available to particular business locations that have demand for only DS1 loops."[44]

Consistent with the approach Dr. Mitchell recommends for identifying relevant geographic markets within an MSA, the Commission's analysis of sample MSAs should include data that separately identify the number of competitively provided DS1 channel terminations, DS3 channel terminations, DS1 channel mileage circuits, and DS3 circuits in each wire center.[45]

The Commission need not adopt a separate product market analysis for channel termination to mobile service providers' cell towers.[46] A large number of CMRS providers' cell sites are located in, and throughout, the lower-density areas of an MSA.[47] In these sections of the MSA, there is little potential for competitive entry in the supply of channel termination to CMRS providers,[48] especially given that most of these cell sites require only DS1 channel termination service. Provided that the Commission adopts revised price flexibility triggers that effectively distinguish between competitive conditions in low-density areas and those in other areas within an MSA, it should not be necessary to define service to CMRS cell sites as a stand-alone product market.[49]

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44 *Id.*

45 *See id.* ¶¶ 41-49.

46 *See* Public Notice at 3 (asking whether there should be "a customer dimension to market definition – *e.g.*, considering wireless service providers that purchase special access channel terminations for towers as a separate relevant market from purchasers of channel terminations to buildings and interoffice transport?").

47 Mitchell Decl. ¶ 57.

48 *Id.*

49 *Id.*

C. Market Dominance

Once the Commission has defined the appropriate geographic and product markets, it should proceed to analyze those markets by applying the four criteria the Commission traditionally has employed to assess dominance: market shares and concentration, demand elasticity, supply elasticity, and cost structure and barriers to entry.

1. Market Shares

Although there is little evidence in the record providing market shares based on the relevant geographic markets,[50] there is a great deal of evidence indicating that price cap LECs have an overwhelming share of the special access business throughout the country. The NRRI Study, for example, found that of the 50 MSAs surveyed, the median for all DS1 and DS3 channel termination and channel mileage services fell well within the zone characterized as "highly concentrated" by the Merger Guidelines,[51] and none of the MSAs surveyed had even two effective competitors to the incumbent LEC.[52]

The record also contains reports by several major buyers of special access services showing that they remain highly reliant on incumbent LECs for special access. Sprint, for example, has explained that it remains heavily dependent on incumbent LEC

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50 The GAO Report, although limited to 16 MSAs, did use the appropriate geographic market, measuring competitive presence at the individual building level. This study showed that the presence of competitors was quite limited in 2006, particularly for buildings in which there was only limited demand. *See* GAO Report at 12.

51 In 2007, the median percentage of total DS1 channel termination circuits purchased from incumbent LECs was 99 percent, and for DS1 transport 98 percent. For DS3 channel terminations the median was 91 percent, and for DS3 transport 67%. NRRI Study at 42.

52 NRRI Study at 41.

special access services, despite its efforts to find alternative providers.[53] Other special access customers have provided evidence of similar dependence on incumbent LECs.[54]

As noted above, Dr. Mitchell recommends that the FCC obtain more granular measures of incumbent LEC shares of the relevant special access markets by collecting data measuring the presence of competitive facilities in a representative sampling of locations.[55] These results can then be extrapolated to other similarly situated locations.[56]

2. Demand Elasticity

As part of its dominance analysis, the Commission should examine whether special access services are subject to significant demand elasticities – *i.e.*, whether there are close substitutes for special access services in a particular market and whether consumers are impeded in switching to those substitutes.[57] As explained below, the record evidence suggests that such elasticities are low. If necessary, the Commission

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53 *See* Written Testimony of Paul Schieber, Vice President Access and Roaming, Sprint Nextel Corp., on An Examination of Competition in the Wireless Industry, Before the House Subcommittee on Communications, Technology and the Internet, at 5 (May 7, 2009), *available at*: <http://energycommerce.house.gov/Press_111/20090507/testimony_schieber.pdf> ("Schieber Testimony") (for channel termination, Sprint Nextel in 2007 purchased 98% of its DS1 service from incumbent LECs); *see also* Comments of Sprint Nextel Corp., WC Docket No. 05-25, at 31-32 (Aug. 8, 2007) ("Sprint 2007 Special Access Comments"); Declaration of Gary B. Lindsey, Attachment 1 to Sprint 2007 Special Access Comments, ¶ 5 (explaining that competitors were only able to reach a little over 1 percent of over 52,000 cell sites for which Sprint sought competitive alternatives).

54 *See, e.g.*, Declaration of Susan M. Gately, Appendix 2 to Comments of the Ad Hoc Telecommunications Users Committee, WC Docket No. 05-25, ¶ 20 (Aug. 8, 2007) (98% of all business premises are supplied by incumbent LECs).

55 *See* Mitchell Decl. ¶¶ 37, 47, 77.

56 *See id.* ¶ 49.

57 *Id.* ¶ 65.

could supplement this evidence by conducting the intensive sampling recommended by Dr. Mitchell.[58]

As Dr. Mitchell notes, "[t]he opportunity to switch to a different supplier depends on the presence of an alternate supplier in the market, and the quality of the potentially substitutable product."[59] For example, customers in a building or location where alternatives to special access are available may have high demand elasticities. For such customers, the cost of switching to an alternate supplier may be lower than for purchasers in locations without alternative suppliers, unless the customers in competitive locations are constrained by the terms and conditions of their service agreements with the incumbent LEC or by the transaction costs of migrating circuits to a substitute provider.[60] In the latter circumstances, the demand elasticities of customers at locations with alternative suppliers would remain low.

Evidence in the record indicates that customers have extremely limited alternatives to incumbent LEC special access offerings. As Dr. Mitchell explains, intermodal options generally do not offer effective substitutes to special access services.[61] For instance, fixed wireless service is not a viable substitute for wireline special access services in many cases due to a variety of factors, including: propagation issues that limit the distance a fixed wireless connection can cover; line of sight requirements which render fixed wireless services ineffective in certain locations; sensitivity to weather,

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58 *See id.* ¶¶ 76-90.

59 *Id.* ¶ 66.

60 *Id.*

61 *Id.* ¶ 68.

which can affect reliability; costs that are too high to justify use for relatively low-capacity connections; limited access to rooftops and other building access issues; and fixed wireless providers' focus on the retail market.[62] Thus, while microwave backhaul shows promise and may be effective in certain situations, it is highly unlikely to replace wireline special access in the vast majority of locations.[63] Indeed, Sprint expects to continue to rely extremely heavily on DS1 and DS3 facilities provided by incumbent LECs for many years to come.

To date, cable services similarly have offered only limited alternatives to special access. Although cable company fiber optics may provide a suitable alternative to incumbent LEC special access in a few areas, cable companies are focused mostly on retail offerings and not the wholesale services Sprint and other carriers need.[64] In addition, cable modem service is generally supplied on a "best efforts" basis – without the quality of service guarantees that customers can obtain from special access providers – and lacks the dedicated capacity required by wireless operators and others.[65]

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62 *See, e.g.,* Comments of Sprint Nextel Corp. – NBP Public Notice #11, GN Docket No. 09-51, at 8-10 (Nov. 4, 2009) ("Sprint NBP PN#11 Comments").

63 As a Verizon Wireless executive explained, "if you have to use wireless microwave to get there [*i.e.,* as backhaul], do it, but do it in the most expeditious manner because that's the most unstable part of your entire system. That's what causes the problems and that's what limits your bandwidth as well." Tom Swanobori, VP of Network and Technology Strategy, Verizon Wireless, at FCC Workshop on Wireless Broadband Deployment – General (Aug. 12, 2009), Transcript at 48, *available at*: <http://www.broadband.gov/docs/ws_03_deploy_wireless_transcript.pdf>.

64 *See* Mitchell Decl. ¶ 68.

65 *Id.*

Furthermore, cable companies generally have not built out to cell sites and don't have facilities in many areas where Sprint needs access facilities.[66]

3. Supply Elasticity, Cost Structure and Barriers to Entry

The Commission's dominance analysis also should include an evaluation of the supply elasticity for special access services: *i.e.*, the capacity of competitors to handle additional demand and to increase capacity in response to greater demand spurred by higher prices by the incumbent LEC.[67] As explained below, it is likely that an examination of the relevant markets will reveal only limited elasticities, further reinforcing the conclusion that incumbent LECs generally remain dominant in the provision of special access.

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[66] Although Ethernet services are very attractive from an engineering standpoint to Sprint and other special access customers, the economics of providing an Ethernet connection are very similar to the economics of providing a TDM-based special access connection, so that competitive carriers are no more economically able to build their own facilities to provide Ethernet services than they are to provide TDM-based special access. Thus, except in locations where competitive LECs may be using access to incumbent facilities to offer Ethernet products, incumbent LECs are the principal providers of such services and, consequently, such services are not effective competitive alternatives to other incumbent LEC special access offerings. Rather, Ethernet today remains primarily an incumbent wireline special access offering that employs different electronics to make more efficient use of the copper facilities. It is highly unlikely that an alternative provider will offer stand-alone Ethernet services over its own facilities to a cell site that is served by an incumbent LEC's DS1 service. Moreover, even the incumbent LECs may not offer Ethernet to carrier-customers in every location where Ethernet is available. In addition, to the extent that the incumbent LECs require customers to commit to certain volumes of non-Ethernet services in order to be eligible for incumbent LEC Ethernet services or otherwise price Ethernet services in a manner that does not permit purchasers to economically transition or migrate from non-Ethernet services, Ethernet cannot become a viable alternative technology for any providers other than the incumbent LECs and their affiliates.

[67] Mitchell Decl. ¶ 69. Dr. Mitchell explains at length how the Commission could conduct a rigorous analysis of competitive supply. *See id.* ¶¶ 76-90.

As Dr. Mitchell points out, competing providers "can potentially increase supply in two ways: by increasing service to the locations of their existing customers, and by extending the reach of their networks to serve new customers' locations."[68] To increase the supply of channel terminations provided to a location it already serves, a competitive provider likely would have to increase the capacity of the circuits serving that location, which would require the installation of new cables and/or additional electronic equipment.[69] To expand its network to reach new locations, a competitive provider of channel terminations likely would have to incur significant sunk costs, such as the costs of installing new cable (or microwave facilities), which would include not only the direct costs of construction, but also the administrative costs and delays of obtaining access to rights of way (or building roofs) and entry into buildings.[70]

A competitive provider seeking to expand its supply of interoffice transport by serving new routes would also likely face significant up-front incremental costs.[71] Such costs would include the installation of collocation facilities in wire centers as well as the costs of installing new cables along the desired routes.[72]

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68 *Id.* ¶ 69.

69 *Id.* ¶ 70.

70 *Id.* ¶ 71.

71 A competitive carrier would be able to increase its capacity along a route it already serves without incurring substantial incremental costs, only if the carrier did not need to install additional cables to supply the increased capacity.

72 Mitchell Decl. ¶ 72. UNEs may be available for use in offering transport services by some competing providers, but CMRS carriers such as Sprint are not eligible to lease UNEs. 47 C.F.R. § 51.309(b); Mitchell Decl. ¶ 73.

As Dr. Mitchell explains, because the costs that a competing provider likely would have to incur to expand its network to serve new locations (and, in some cases, to increase its capacity to serve existing locations) can involve significant sunk investments, they can create significant barriers that may prevent competitive entry (or expansion) in response to high prices charged by the incumbent LEC.[73] The installation of cables along a particular route, the construction of a collocation facility in a particular wire center, and similar sunk investments cannot be redeployed to serve alternative locations if the competitive carrier fails to win sufficient business away from the incumbent, or if the incumbent subsequently wins back the business initially captured by the new entrant.

Furthermore, construction of both channel termination and transport facilities is subject to economies of scale. Unless the competitor can anticipate sufficient demand to recover the necessary investment, it will be unlikely to enter the market for DS1 and DS3 services.[74] Compounding these barriers are the terms and conditions in existing service agreements with incumbent LECs that restrict customers' ability to switch to alternative providers.[75]

These barriers are reinforced by the cost structure of special access. As Dr. Mitchell explains, incumbent LECs enjoy economies of scope in the supply of special

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73 Mitchell Decl. ¶ 74. In addition, deploying new facilities can involve extraordinarily long lead times that make hit-and-run entry improbable.

74 *Id.* The incumbent LEC's large embedded network and economies of scale and scope make it more likely that the incumbent will be able to recover its (relatively lower) investment.

75 *See* section VI, *infra*.

access transport services.[76] Special access transport for customers' dedicated circuits can be supplied along with switched access traffic and Internet connections over interoffice facilities that interconnect LEC wire centers.[77] Moreover, the two largest incumbent LECs, Verizon and AT&T, also have the largest wireless and interexchange networks, and obtain additional competitive advantage from transporting traffic for those services on their special access facilities.[78] By transporting traffic of multiple services on the same facilities, the incumbent LEC is able to support the cost of those transport facilities with revenues from multiple services – an advantage that new entrants lacking the vertical integration advantages of AT&T and Verizon are unlikely to possess.[79] Moreover, even if AT&T's and Verizon's wireless and interexchange affiliates have to pay the same special access rates as independent carriers, such as Sprint, the affiliated providers are likely to be indifferent to the excessive special access rates charged by the BOCs, because those special access costs are simply intra-company transfers between the affiliates and the BOC.

Collectively, these barriers and cost structure issues substantially limit the potential for entry by new providers or new construction by existing providers. These deterrents to entry also diminish substantially the effect of the threat of competition on an incumbent LEC's incentive and ability to exercise its dominance in the provision of special access services.

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76 Mitchell Decl. ¶ 93.

77 *Id.*

78 *Id.*

79 *Id.*

III. THE COMMISSION'S ANALYSIS SHOULD INCLUDE AN ASSESSMENT OF THE EVIDENCE THAT THE PRICES FOR SPECIAL ACCESS SERVICES IN THE RELEVANT MARKETS ARE UNJUST AND UNREASONABLE

Assuming that the Commission finds that the incumbent LECs remain dominant in the provision of special access, the FCC should assess whether the pricing flexibility rules have effectively constrained the incumbent LECs' ability to exercise their dominance in the provision of special access services in areas in which they have been granted Phase II pricing flexibility. A seller has market power if it can profitably maintain prices above competitive levels for a significant period of time without losing customers or attracting new entry.[80] The Commission can measure the incumbent LECs' exercise of market power in the provision of special access services by examining whether the incumbent LECs' special access rates in areas where they have been granted pricing flexibility are higher than the prices they could reasonably expect to charge in a competitive market, or the rates they could charge under price caps.[81]

There are a number of benchmarks that the Commission can use to determine the rates that a competitive market likely would produce. For example, the Commission could compare existing special access prices to the rates that would prevail if the services were priced based on forward-looking costs.[82] Other benchmarks include: the rates charged for similar high-bandwidth services that are subject to competition; the prices

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80 *Id.* ¶ 95, citing Horizontal Merger Guidelines, § 0.1.

81 The effectiveness of price cap regulation at ensuring just and reasonable special access rates is discussed in section V, *infra.*

82 As Dr. Mitchell notes, forward-looking costs measure the costs incurred by an efficient provider of a service using best-practices technology and indicate the level of costs that would prevail in a competitive market. Mitchell Decl. ¶ 96.

charged for similar services in other countries; and the prices charged under price caps (which may also be excessive).[83] The evidence already in the record indicates that the incumbent LECs' special access prices are higher than each of these relevant benchmarks, strongly suggesting that the current pricing flexibility triggers are insufficient to ensure that the price cap LECs charge just and reasonable rates in those markets in which they have been granted Phase II pricing flexibility.

A. UNE Rates

High capacity UNEs (*i.e.* DS1s and DS3s) are the functional equivalents of special access services.[84] The rates for UNEs have been established by state public utility commissions in contested proceedings and are based on forward-looking cost studies. UNE rates, therefore, are an effective proxy for the prices incumbent LECs should be expected to charge for special access services in a competitive marketplace.

UNEs typically are sold at month-to-month rates, and therefore are directly comparable to special access month-to-month rack rates.[85] As Dr. Mitchell explains, if state commissions were to establish rates for purchasing UNEs subject to term commitments, those rates would be lower than the current month-to-month rates for UNEs.[86] Thus, comparing UNE rates – which do not include any discount for term commitments – to multi-year term rates for special access services provides a conservative view of whether special access rates exceed the prices that would be

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83 *See* Mitchell Decl. ¶¶ 108, 111; *see also infra* note 92.

84 *See Special Access NPRM* ¶ 66; Mitchell Decl. ¶ 98.

85 Mitchell Decl. ¶¶ 101-102.

86 *Id.* ¶ 101.

expected to prevail in a competitive market.[87] Even using this conservative comparison, however, the record before the Commission indicates that incumbent LEC special access prices in Phase II pricing flexibility areas are substantially higher than the forward-looking cost-based UNE rates for comparable services.[88]

B. Rates for High-Bandwidth Services

Verizon has acknowledged that broadband services such as digital subscriber line ("DSL") and fiber-optic-based Internet services ("FiOS") provide speeds that are "comparable to or greater than DS1 facilities."[89] These retail high-bandwidth services, along with cable modem services offered by cable operators, are generally subject to competition in most MSAs. As Dr. Mitchell explains, the prices for these competitively-provided services, therefore, provide another benchmark that can be used to determine whether incumbent LECs are exploiting their market power by charging supra-

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87 *Id.* ¶ 102.

88 *See* Declaration of M. Joseph Stith (Redacted Version) at Attachment 1, attached to letter from David L. Lawson, Counsel for AT&T, to Marlene H. Dortch, FCC Secretary, RM-10593 (Dec. 7, 2004) (as attached to Comments of AT&T (Redacted Version), WC Docket No. 04-313 (Oct. 4, 2004)) ("Stith Decl.") (showing that three-year term rates for special access services are up to 171% higher than the month-to-month rates for comparable UNEs); *see also* Sprint 2007 Special Access Comments at 22-23 (demonstrating that five-year term rates for special access were significantly higher than the month-to-month rates for comparable UNEs). The data provided by Dr. Stith may be somewhat dated, but according to Dr. Mitchell, Dr. Stith's analysis remains the most comprehensive study comparing UNE rates to special access prices. Mitchell Decl. ¶ 105; *see also id.* ¶ 106 (recommending that the Commission update the Stith study by obtaining from the incumbent LECs each special access rate it has charged for each DS1 and DS3 service in each MSA for the period 1999 – 2009).

89 Reply Comments of Verizon (Redacted Version), WC Docket No. 05-25, at 35 (Aug. 15, 2007).

competitive rates for special access services.[90] The record evidence demonstrates that the average monthly price Sprint pays for DS1 special access links is seven-to-ten times higher than the monthly retail prices of DSL, FiOS and cable modem services of similar or higher capacity.[91] This vast disparity in price indicates that the incumbent LECs are able to exploit their dominant position by charging unreasonably high rates for their special access services.

C. Rates in Foreign Markets

Another potential benchmark the Commission can use to determine the reasonableness of special access rates is the price for similar services in other industrialized nations. The record shows that special access rates in the United States are significantly higher than the prices of similar services in other countries. For example, BT Americas has submitted evidence demonstrating that special access prices in the United States are materially higher than the fully incremental cost-based rates that BT

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90 Mitchell Decl. ¶ 111.

91 *See* Schieber Testimony at 9. Verizon's FiOS service is available at a stand-alone price of $54.99 per month for speeds up to 15 Mbps and AT&T offers U-verse service and DSL for $35 per month for speeds up to 6 Mbps, whereas the average price Sprint pays for DS1 links (1.5 Mbps bandwidth) is $390 per month. *See* "Verizon FiOS Internet," *available at*: <http://www22.verizon.com/Residential/FiOSInternet/Plans/Plans.htm> (last visited Jan. 13, 2010); "AT&T U-verse High Speed Internet," *available at*: <http://www.att.com/u-verse/explore/internet-landing.jsp> (last visited on Jan. 13, 2010) for U-verse prices; "Compare DSL Plans – AT&T High Speed Internet," *available at*: <http://www.att.com/gen/general?pid=10891> (last visited Jan. 13, 2010) for DSL prices. Although there are differences between special access services and the other broadband services that may justify some price differential (for example, DSL, cable modem and FiOS offer only a "best efforts" level of service), the differences are not sufficient to justify such a large price differential. In addition, the retail service prices of cable modem, DSL and FiOS include significant costs (*e.g.*, content, applications, advertising) that carriers do not incur in the provision of wholesale special access services.

charges for comparable services in the United Kingdom, and that this differential has persisted for years.[92] This is yet further evidence that the incumbent LECs have been able to charge supra-competitive rates for special access in the United States, even in areas where they have been granted pricing flexibility.

D. Incumbent LEC Price Cap Rates

Because Phase II pricing flexibility is granted in areas where competition is supposed to constrain incumbent LECs' exercise of market power, one would expect prices in Phase II pricing flexibility areas to be lower than those areas in which the incumbent LECs are not subject to effective competition (*i.e.*, geographic areas where special access services are regulated by the Commission's price cap regime). If incumbent LECs increase their special access prices in areas where they have been granted pricing flexibility, this would provide evidence that competition is not adequately constraining the exercise of incumbent LEC market power. Dr. Mitchell discusses the substantial record evidence that incumbent LECs' special access rates in Phase II pricing flexibility areas are, on average, actually *higher* than incumbent LECs' price cap rates for the same services.[93] For example, the GAO concluded in 2006 that special access rates were, on average, higher in pricing flexibility areas than in price cap areas.[94] Joseph Stith's study similarly concluded that the BOCs' pricing flexibility rates for special

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92 Comments of BT Americas Inc., WC Docket No. 05-25, at 16-17 and Attachment A (Aug. 8, 2007); *see also* Comments of BT Americas Inc., WC Docket No. 05-25, at 5-6 (June 13, 2005).

93 Mitchell Decl. ¶¶ 107-110.

94 GAO Report at 28.

access services were equal to or higher than their price cap rates in almost every instance.[95]

NRRI, upon examining the relevant data, found that "pricing evidence shows that market forces are not reducing rates in Phase II [pricing flexibility] areas."[96] Dr. Mitchell explains that, if incumbent LECs' special access rates before receiving pricing flexibility were sufficient to cover economic costs (and no incumbent LEC has argued to the contrary), then incumbent LECs' price increases after receiving pricing flexibility can constitute evidence of their continued ability to exercise market power.[97] Thus, evidence that prices have risen in areas where the incumbent LECs have been granted pricing flexibility demonstrates that there is not sufficient competition in Phase II areas to effectively constrain the incumbent LECs' ability to exploit their market power.[98]

The Commission's analytical framework should include an examination of pricing benchmarks, such as those described above. Comparing special access rates to the prices of similar high-capacity services offered at competitive rates will permit the Commission to assess the extent to which incumbent LECs are exercising their dominance in the provision of special access services.[99]

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95 Stith Decl. ¶ 19.

96 NRRI Study at 68.

97 Mitchell Decl. ¶ 107.

98 *See, e.g.*, GAO Report at 67; *see also* NRRI Study at 68.

99 As explained below, in addition to charging high prices for their services, incumbent LECs may also exploit (and preserve) their dominant position by engaging in price discrimination and imposing terms and conditions designed to deter competitive entry. The Commission's analytic framework, therefore, should also include an

Footnote continued on next page

IV. THE FRAMEWORK RECOMMENDED BY DR. MITCHELL FOR ANALYZING THE CURRENT REGULATORY REGIME FOR SPECIAL ACCESS DEMONSTRATES THAT THE CURRENT PHASE II PRICING FLEXIBILITY RULES ARE FUNDAMENTALLY FLAWED

The FCC currently grants price cap incumbent LECs Phase II pricing flexibility on an MSA-wide basis if the incumbent can show that competitors have collocated facilities in wire centers that account for either a specified percentage of business lines within the MSA or a specified percentage of special access revenues within the MSA.[100] To date, the FCC has granted Phase II pricing flexibility for both channel terminations and interoffice transport in more than 100 MSAs and for interoffice transport in more than 200 MSAs.[101] As Dr. Mitchell's analysis shows, the current Phase II pricing flexibility triggers grant relief in overly broad geographic areas and are not based on reliable indicators of the presence of competitive alternatives. These conclusions are supported by the evidence already in the record.

A. The FCC's Reliance on an MSA as the Effective Geographic Market for Granting Phase II Flexibility Is Misplaced

As explained above, MSAs are not the appropriate geographic market for analyzing special access competition, particularly in light of the criteria the Commission adopted to identify the presence of effective alternatives to the incumbent.[102] One of the problems with the current pricing flexibility triggers is that collocation in one wire center

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evaluation of incumbent LECs' special access terms and conditions. *See infra* at section VI.

100 *Pricing Flexibility Order* ¶ 25.

101 GAO Report at 6; NRRI Study at 13.

102 *See* section II, *supra*.

does not constrain prices for lines served out of other wire centers, even if the wire centers are located within the same MSA. In areas where they have been granted Phase II pricing flexibility, incumbent LECs can price discriminate between locations where they face competition and those where there are no competitive alternatives (*i.e.*, the incumbent can charge a monopoly price in areas where it does not face competition while charging lower prices in areas where it is subject to competitive pressures). Because special access facilities in one location cannot effectively substitute for special access facilities in another location, the presence of competitive alternatives in some wire centers does not constrain practices in other wire centers.[103]

Even if the incumbent LEC charges a uniform price throughout an MSA or a region, it can still set that uniform price at a level that allows it to exploit the lack of competition in some parts of the MSA or region. In such situations, the incumbent LEC can maximize its profits by setting a uniform region-wide price that is supra-competitive, but that accounts for the presence of competition in some areas within the region.[104] This type of pricing deprives consumers in competitive areas from realizing the full benefit of the lower prices that would prevail if the incumbent did not "average" prices across the

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[103] Mitchell Decl. ¶ 19.

[104] Declaration of Bridger M. Mitchell and John R. Woodbury (Redacted Version), ¶ 46, Attachment 1 to Reply Comments of Nextel Communications, Inc., WC Docket No. 05-25 (July 29, 2005) ("Mitchell/Woodbury Decl.").

MSA or region.[105] Moreover, a uniform price does not protect consumers in less competitive parts of the relevant area from supra-competitive prices.[106]

B. The FCC's Reliance on the Presence of Collocation Facilities as a Surrogate for the Presence of Providers of Alternatives to Special Access Is Flawed

The current pricing flexibility triggers rely too heavily on the presence of collocated providers to constrain incumbent LEC pricing and practices. Collocation alone is a poor proxy for the presence of competition. As Dr. Mitchell explains, the fact that a competitor has collocated facilities in a wire center, assuming they are in use, indicates only that the competitive carrier has some capacity to compete in the provision of interoffice transport services for customers served out of that wire center.[107] It does not necessarily indicate that the collocating provider is offering competitive channel termination – or "last mile" – services out of that wire center or competitive transport along routes desired by existing special access customers.[108]

Moreover, the fact that a carrier has collocated facilities in a wire center does not mean that the carrier is offering competitive services to unaffiliated customers. The carrier may have collocated simply to meet its own interoffice transport needs. In

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105 *See* Mitchell Decl. ¶ 20; *see also* Mitchell/Woodbury Decl. ¶¶ 42-48. The incumbent LEC's ability to price-discriminate effectively is enhanced by its ability to use contract tariffs to offer more competitive prices to customers that have ready access to competitive alternatives. Mitchell/Woodbury Decl. ¶ 48.

106 *See* Mitchell/Woodbury Decl. ¶ 46.

107 Mitchell Decl. ¶ 17.

108 As explained above, channel termination and transport are in separate product markets, so the availability of competitive transport does not by itself enable a customer to reduce its dependence on the incumbent LEC for channel termination service. Mitchell Decl. ¶ 18.

addition, because the triggers are never revisited after the initial grant of pricing flexibility, there is no guarantee that collocated facilities will remain operational after the incumbent LEC obtains Phase II relief.

C. Record Evidence of Prices and Price Trends in Phase II Areas Buttresses the Conclusion that the Commission's Rules Do Not Ensure Just and Reasonable Rates

Available evidence regarding special access prices and pricing trends reinforces the conclusion that the Commission's Phase II pricing flexibility regime is fundamentally flawed. As Dr. Mitchell points out, if the pricing flexibility triggers have been set correctly, there should be sufficient actual or potential competitive alternatives in Phase II areas to constrain the incumbent LECs' prices.[109] The evidence in the record indicates that the triggers have not been set correctly, however, given that competition has not constrained the incumbent LECs' special access prices in Phase II areas. As noted above, special access prices in Phase II areas are well above forward-looking costs.[110] In addition, even though special access volumes continue to increase, prices in Phase II areas have not declined on average, as one would expect. Instead, prices have generally increased in Phase II areas, demonstrating that "market forces are not reducing rates in Phase II areas."[111] The record also shows that prices are as high, or higher, in Phase II

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109 *Id.* ¶ 95.

110 *See* section III.A, *supra; see also, e.g.,* Stith Decl. ¶ 17 (showing that special access rates are significantly higher than the forward-looking-cost-based UNE rates for comparable circuits); Sprint 2007 Special Access Comments at 21-23 and Exhibit 3 (showing that special access rates are up to 150% higher, on average, than the prices for comparable UNE circuits).

111 NRRI Study at 68.

areas than in areas subject to price caps.[112] All of this evidence strongly suggests that there is insufficient competitive pressure in Phase II areas to constrain incumbent LEC pricing practices.

V. THE COMMISSION'S ANALYTICAL FRAMEWORK SHOULD ENABLE IT TO ASSESS WHETHER ITS CURRENT RULES ENSURE THAT RATES FOR SPECIAL ACCESS SERVICES THAT REMAIN UNDER PRICE CAPS ARE JUST AND REASONABLE

The Commission did not intend the current price cap rules to remain in effect beyond 2005 without being subject to additional review. When the Commission adopted the CALLS plan in 2000 setting forth the special access charge regime for special access services for price cap carriers, it planned to reexamine its price cap system when the CALLS plan expired in 2005.[113] Indeed, the Commission issued an NPRM in January 2005, as part of an effort to conduct a "broad examination of the regulatory framework to apply to price cap local exchange carriers' interstate special access services after June 30, 2005."[114] The public interest would be served if the analytical framework being considered in the instant proceeding caps the Commission's five-year reexamination and results in expeditious and long overdue reform.

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112 *See* section III.D, *supra; see also, e.g.*, GAO Report at 13; Sprint 2007 Special Access Comments at Exhibit 1 (showing that the BOCs' prices in areas where they have been granted Phase II pricing flexibility generally remain as high, and in most cases higher, than their rates in areas where they are still subject to price caps).

113 *Access Charge Reform*, Sixth Report and Order in CC Docket Nos. 96-262 and 94-1, Report and Order in CC Docket No. 99-249, Eleventh Report and Order in CC Docket No. 96-45, 15 FCC Rcd 12962, ¶ 36 (2000) ("envision[ing] that the Commission will conduct a proceeding" to reevaluate the price cap regime as the term of the CALLS plan neared its end).

114 *Special Access NPRM* ¶ 1.

As part of its ongoing review of the current price cap regime, the Commission should examine the level and trend of special access prices under price caps. In the absence of effective competition, price cap regulation is the only check on incumbent LEC prices.[115] Thus, the analytical framework adopted by the Commission should include a mechanism for evaluating the efficacy of the current regulatory regime by examining the prices and trends of services subject to price caps and comparing them to the prices and trends that one would reasonably expect to see in a competitive market.

The evidence already in the record shows that the incumbent LECs are using their market power to charge supra-competitive rates in areas subject to price caps. For example, the evidence shows that even in areas subject to price caps, prices for special access services are higher than prices for comparable UNE prices (which are set based on forward-looking costs intended to emulate the prices that would prevail in a competitive market); higher than prices for comparable DSL and cable modem services, which are subject to competition; and higher than prices for comparable services in other countries.[116]

In addition, the evidence suggests that incumbent LECs are earning excessive profits from their special access services. For example, ARMIS data currently in the

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115 Where effective competition exists, the Commission should grant pricing flexibility. In the remaining markets, the Commission's price cap regime should regulate incumbent LEC prices and practices in an effort to approximate the prices and practices that would prevail in a competitive market.

116 *See, e.g.,* section III, *supra.*

record shows that AT&T's rate of return for special access exceeded 137% in 2007 and Verizon's rate of return was over 62% at that time.[117]

Another indication that the current price caps have not resulted in competitive rates is the fact that efficiency gains made by the incumbent LECs since 2003 have not resulted in lower prices. Instead, nominal rates have remained unchanged since the price cap level was frozen in 2003, despite growth in the number of special access lines.[118] All the evidence discussed above strongly suggests that the current price cap regime has not proven effective at regulating incumbent LEC prices for special access or in replicating the pricing and behavior that would exist in a competitive market.[119]

VI. THE COMMISSION'S ANALYSIS OF INCUMBENT LEC SPECIAL ACCESS SERVICES SHOULD INCLUDE AN ASSESSMENT OF THE REASONABLENESS OF THE TERMS AND CONDITIONS OF OFFERINGS UNDER PHASE II FLEXIBILITY AS WELL AS PRICE CAPS

A. Price Cap LECs Are Able to Use Unreasonable Terms and Conditions to Deter Competitive Entry

As described below, some of the non-price terms and conditions that apply to the provision of special access services can deter competitive entry. Accordingly, the Commission's analytical framework for evaluating incumbent LEC special access services should include an assessment of the reasonableness of the terms and conditions, such as volume and term discounts, of incumbent LEC special access offerings under Phase II pricing flexibility as well as price caps. Reasonableness, for purposes of

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117 Special access rate of return is computed from data in column (s) of Form 43-01, specifically by dividing Row 1915 – Net Return by Row 1910 – Average Net Investment.

118 Mitchell Decl. ¶ 14.

119 *See, e.g.*, *id.* ¶ 15.

determining whether the Commission's current special access rules are effective, should be evaluated in the context of the effect that the incumbent LECs' terms and conditions have on the development of meaningful competition.

Customers of incumbent LEC special access services – including those services offered under traditional tariffed terms, as well as those offered under Phase II pricing flexibility – generally are able to obtain price discounts in exchange for committing to specific volume amounts or minimum service terms.[120] Volume and term discounts are not *per se* unreasonable. As Dr. Mitchell notes, when a consumer is offered a lower price for purchasing a greater quantity of a service, the consumer's surplus generally is increased if it opts for the discount.[121] The seller in that circumstance expects to benefit despite the discounted per-unit price because it expects that the additional revenues it will realize from the sale of additional units will exceed the revenues that the sales of lower unit volumes at a higher per-unit price would have produced.[122]

Dr. Mitchell makes clear, however, that volume and term discounts can be problematic in an industry dominated by a single provider because they may have the effect of deterring new entry.[123] Price discrimination, in the form of volume and term discounts, increases the quantity that a new entrant must be prepared to supply in order to

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120 *See, e.g.*, Sprint NBP PN#11 Comments at 35-42.

121 Mitchell Decl. ¶ 115.

122 *Id.*

123 *Id.* ¶ 116.

match or improve upon the terms of purchase offered by the incumbent LEC.[124] As Dr. Mitchell explains, the result is that the competitor must enter the market at a higher minimum scale, and often over a wider geographic area, than would be needed if the new entrant were able to compete on a circuit-by-circuit basis.[125] Incumbent LECs are likely to engage in this form of price discrimination because, unlike classic predatory pricing, this conduct does not require them to set any price below cost and, therefore, is sustainable and virtually costless. Dr. Mitchell identifies several types of requirements related to volume and term discounts that warrant careful Commission review.

In particular, discounts tied to the percentage of a customer's total demand that it obtains from the incumbent LEC, rather than to a specified number of circuits or specified amount of revenue, deter competitive entry, especially when combined with the severe penalties described below.[126] This type of discount is based not on the savings the incumbent LEC achieves in providing a high volume of services to a single customer; it is simply a tool used by the incumbent to "lock in" customers.[127] Legitimate volume discounts should not be based on limiting purchases from competing providers.

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124 *See* T. Krattenmaker & S. Salop, *Anticompetitive Exclusion: Raising Rivals' Costs to Achieve Power over Price*, 96 Yale L.J. 209 (1986); *LePage's Inc. v. 3M,* 324 F.3d 141, 158 (2003) (citations omitted) ("[d]iscounts conditioned on exclusivity are 'problematic' 'when the [supplier] is a dominant firm in a position to force manufacturers to make an all-or-nothing choice.'").

125 Mitchell Decl. ¶¶ 119-120.

126 The Commission has acknowledged that by "locking up" large customers through volume and term discounts, an incumbent LEC can foreclose competition for both large and small customers alike. *See Pricing Flexibility Order* ¶ 79.

127 *See* Mitchell Decl. ¶ 126.

Unreasonably high shortfall penalties also deter customers from shifting demand to other vendors for fear of failing to meet their volume commitments to the incumbent LEC.[128] Although the application of shortfall penalties can, in theory, be economically justifiable, many of the actual penalties imposed by incumbent LECs are so onerous as to be unreasonable. In some cases, the shortfall penalty for failing to meet a volume commitment far exceeds the price of purchasing the additional circuits needed to meet the commitment.[129] As Dr. Mitchell explains, severe shortfall penalties discourage customers from self-provisioning, where possible, or subscribing to available competitive options.[130]

Price cap incumbent LECs also impose substantial "overage penalties" when customers' volume exceeds minimum expected levels.[131] Customers have the incentive to increase their minimum volume level commitments at the outset to lessen the risk of incurring overage penalties. By agreeing to inflated minimum volume levels, however, customers increase their risk of incurring shortfall penalties and are deterred from migrating some of their circuits to competitive suppliers of special access services.

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128 *See* Mitchell Decl. ¶ 129.

129 *See* Sprint NBP PN#11 Comments at 40-41 n.81 (providing examples of incumbent LECs' tariffed shortfall penalties of up to $900 per DS1 channel termination).

130 *See* Mitchell Decl. ¶ 129.

131 For example, if a customer's DS 1 channel terminations exceed 150 percent of the commitment level (under the 5-year term plan), Ameritech charges the non-discounted month-to-month rate on *all* channel terminations above the commitment level (not, for example, on demand above the 150 percent maximum allowable level). *See* Ameritech FCC Tariff No.2, Section 7.4.13.

Excessive early termination penalties also inhibit customers from moving traffic off of incumbent LECs' networks. Instead of basing the penalty on a reasonable measure, such as the discounted rate times a factor related to the number of months the customer received the discount, some incumbent LECs calculate early termination liability by multiplying the number of committed circuits by the non-discounted month-to-month rate times the number of months remaining in the plan. These early termination penalties go beyond making the incumbent LEC whole for the costs it has incurred, or even for the foregone revenue resulting from the customer's termination. Instead, these penalties appear to be designed specifically to punish customers for leaving the incumbent LEC. The threat of large termination penalties often makes it punitively uneconomic for a customer to move traffic off of the incumbent's network before the term of its commitment expires.

Incumbent LECs also impose very high charges to perform circuit migrations – up to $1,125 per circuit plus, in some cases, hourly overtime labor charges.[132] These charges bear little, if any, relation to the costs incurred by incumbent LECs to execute the migration. The incumbent LECs' high migration charges, however, increase the costs for customers to move circuits to lower-priced competitors and, at a minimum, extend the period of time before a switch to a competitor can be cost-justified.[133] Incumbent LECs also impede circuit migration to competitive special access providers by imposing restrictions on the number of circuits a customer may migrate within a specified time

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132 *See* Sprint NBP PN#11 Comments at 43 & n.87 (citing BellSouth FCC Tariff No. 1, Sections 7.4.5(A) and (B) and Section 7.5.9).

133 *See* Mitchell Decl. ¶¶ 130-131.

period and delaying migration through slow communication, refusal to work on one part of a project until every part of the project is ready to proceed, and other similar practices.[134]

Minimum volume commitments based on purchases aggregated across multiple geographic areas are also potentially problematic. Multiple-market terms and conditions tie the availability of discounts in areas without competition to the purchase of incumbent LEC services in areas where competition is present or feasible, thereby hampering the ability of alternative providers in the latter areas to compete effectively.[135] Moreover, as Dr. Mitchell explains, if the incumbent LEC is able to attain volume commitments aggregated across multiple geographic markets, such multi-market agreements may substantially increase the scope and scale of entry that a potential competitor would have to achieve to a point well beyond the level that would make potential entry attractive or even feasible.[136]

All of the terms and conditions described above, particularly when employed in combination with each other, have the effect of discouraging competitive entry.

B. The Current Rules Do Not Prevent Incumbent LECs from Imposing Unjust or Unreasonable Terms and Conditions

The Commission, in the past, has adopted the position that competitors' sunk investments in collocation facilities preclude the incumbent LECs from imposing

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134 *See* Sprint NBP PN#11 Comments at 43-45.

135 Mitchell Decl. ¶ 120.

136 *Id.* ¶ 121 (citing evidence that some minimum value commitments are structured so as to make it unprofitable for a competitor to win a small portion of a customer's business, even if the incumbent LEC's price exceeds the competitor's long-run cost).

anticompetitive volume and term discounts. It explained that even if a particular competitor is driven from the market, the competitor's facilities would remain available for use by another entrant to compete with the incumbent (competition that would be successful, according to the theory, if the new entrant could charge a price that covered average variable cost).[137] According to this theory, where variable costs are a small component of total costs, the presence of facilities-based competition would render exclusionary pricing strategies, such as anticompetitive volume and term discounts, "costly and highly unlikely to succeed."[138]

Dr. Mitchell, upon whose work the Commission partially relied in fashioning its conclusion, repudiates the manner in which the Commission applied this theory. As Dr. Mitchell explains, the mere presence of collocation facilities in a fraction of the MSA wire centers may be insufficient to constrain incumbent LEC pricing throughout the MSA.[139] Further, Dr. Mitchell correctly notes that the Commission's rules do not prohibit an incumbent LEC from offering volume and term discounts that deter a potential entrant from deploying collocation facilities in a wire center in the first place.[140]

The GAO's analysis is consistent with Dr. Mitchell's assessment. After extensive study, GAO found that many special access contracts that provide discounts off the rack

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137 *Pricing Flexibility Order* ¶ 80 (citing B. Mitchell and I. Vogelsgang, *Telecommunications Pricing Theory and Practice* 9 (1991)).

138 *Pricing Flexibility Order* ¶ 80.

139 Mitchell Decl. ¶ 19.

140 *Id.* ¶ 118.

rates require customers to agree to minimum revenue guarantees and include severe termination penalties.[141] According to GAO:

> Unless a competitor can meet the customer's entire demand, the customer has an incentive to stay with the incumbent and 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.[142]

Dr. Mitchell concludes that because the Commission's current Phase II pricing flexibility and price cap rules do not prevent incumbent LECs from conditioning discounts on customers agreeing to exclusionary terms and conditions, the current rules fail to ensure that the terms and conditions under which special access services are offered are just and reasonable.[143] The incumbent LECs' exclusionary terms and conditions – terms and conditions that are currently permitted by the Commission – foreclose the competitive entry and investment in facilities necessary to discipline the incumbents' market power. The record contains substantial empirical data and descriptive evidence of incumbent LEC anticompetitive special access terms and conditions. The Commission should incorporate this information into its analysis. Specifically, the Commission's analytical framework should assess the reasonableness of incumbent LEC terms and conditions by their effect on the development of meaningful competition in the provision of special access services.

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141 GAO Report at 30-31.

142 *Id.* at 30.

143 Mitchell Decl. ¶¶ 134, 138.

VII. NEXT STEPS

The analytical framework outlined above will enable the FCC to confirm problems with its current regulatory scheme for special access services. The Commission should act expeditiously to supplement the existing record by collecting additional data consistent with this analytical framework and to make any necessary adjustments to its pricing flexibility triggers and its price cap indices.[144]

The simple fact is that the current special access regime costs Sprint and other customers billions of dollars in excessive charges every year that these rules remain in place. The Commission, therefore, should position itself to act swiftly to remedy any problems it identifies. In light of the evidence already in the record regarding the apparently unjust and unreasonable special access rates charged by the incumbent LECs, in both price cap and pricing flexibility areas, the Commission should be prepared to provide interim relief to special access customers while it works to fashion a longer-term remedy to address the ongoing harms created by the existing regulatory scheme which appears to have allowed price cap LECs to charge unjust and unreasonable rates for special access services and to impose unjust and unreasonable terms and conditions on special access customers. Further, the Commission's goal should be to adopt significant short-term reform measures in time to put them in place as part of the 2010 annual access tariff filings.

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[144] *See id.* ¶ 139-140; No Choke Points Coalition Proposed Data Request. Sprint supports the No Choke Points Coalition's call for the Commission to act now to gather the data it need to determine whether and how to modify existing special access regulations.

Such interim relief should include the elimination of Phase II pricing flexibility pending the comprehensive reform of the pricing flexibility rules to ensure that incumbent LECs receive relief from price caps only where there is sufficient competition to constrain the incumbents' ability to exercise market power.[145] In addition to bringing services currently subject to Phase II pricing flexibility back under price cap regulation, the Commission should also adopt an interim X-factor of 5.3 percent in time for that X-factor to be applied to the incumbent LEC's next annual access tariff filing scheduled for implementation in July 2010.[146] Finally, the Commission should consider prohibiting the use of anticompetitive terms and conditions that preserve the incumbent LECs' dominant position and create barriers to new entry.[147] These steps will provide special access customers a modicum of relief while the Commission works to overhaul its price cap regulations and ensure that special access customers are not subject to unjust or unreasonable rates, terms or conditions.

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145 *See* Sprint 2007 Special Access Comments at 40-41. As an alternative, the Commission could adopt the UNE impairment criteria as an interim benchmark for determining whether Phase II pricing flexibility is warranted. Under this approach, the Commission would allow the incumbent LECs to retain Phase II pricing flexibility for channel terminations and channel mileage services in those wire centers which qualify as "non-impaired" for unbundled access to loops and transport, respectively, for services of comparable capacity pursuant to the impairment standards established in the *TRRO* proceeding. *See* Nextel 2005 Special Access Comments at 2-3, 22-23; *see also* Mitchell Decl. ¶ 41.

146 *See* Oct. 5, 2007 *Ex Parte* at 42. This step is long overdue. In January 2005, the Commission "anticipate[d] adopting an order prior to July 1, 2005 that [would] establish an interim plan to ensure special access price cap rates remain just and reasonable while the Commission considers the record in this proceeding." *Special Access NPRM* ¶ 131 (noting that "one interim option would be to impose the last productivity factor, 5.3 percent, that was adopted by the Commission and judicially upheld.").

147 Mitchell Decl. ¶ 133.

VIII. CONCLUSION

The comments above, along with the accompanying declaration of Dr. Bridger Mitchell, provide a practical framework for effectively analyzing the issues raised in the FCC's *2005 Special Access NPRM*. Using this framework, the Commission will be able to determine whether its current price cap and pricing flexibility rules have succeeded in ensuring that customers are able to purchase special access services from price cap LECs at reasonable rates and on reasonable terms and conditions. If the Commission finds, as the evidence in the record suggests, that its current rules have proven ineffective, it should act immediately to begin remedying the situation.

Respectfully submitted,

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January 19, 2010

Certificate of Service

I hereby certify that on this 19th day of January, 2010, I caused true and correct copies of the foregoing Comments of Sprint Nextel Corporation and attached Declaration of Bridger M. Mitchell to be mailed by electronic mail to:

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Attachment A

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 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

DECLARATION OF BRIDGER M. MITCHELL

January 19, 2010

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DECLARATION OF BRIDGER M. MITCHELL

I. QUALIFICATIONS

1. My name is Bridger M. Mitchell and I am a Senior Consultant to Charles River Associates, an economics, finance, and business consulting firm with 21 offices across North America, Europe, Asia Pacific, and the Middle East. I am an expert in competition and pricing in the telecommunications industry and have provided expert testimony, litigation support, and economic consulting services to numerous business and government clients. My research on major regulatory issues encompasses the theory and practice of telecommunications pricing, competition, and equal access in local telephone markets, interconnection in telecommunications networks, international telephone rates, and broadcasting and cable television. I have developed pioneering models of the cost structure of a cable television firm and the incremental costs of local telephone networks. I previously taught economics at Stanford University and UCLA and was a senior economist at The RAND Corporation. From 1994 to 2008 I was a Vice President of Charles River Associates. I have a Ph.D. in Economics from the Massachusetts Institute of Technology. My CV is included as Attachment A to this declaration.

2. I have been asked by Sprint Nextel to provide this declaration in response to the Commission's *2009 Public Notice*[1] requesting comments on the analytical framework necessary to resolve the *2005 Special Access NPRM*.[2] I have previously filed declarations in this proceeding, on behalf of Nextel in 2005 jointly with John Woodbury,[3] and on behalf of Sprint Nextel in 2007.[4]

II. THE NEED FOR AN ANALYTIC FRAMEWORK

3. The Commission has found that price-cap local exchange carriers (LECs) remain dominant in the supply of special access services.[5] The criteria for dominance

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[1] FCC, Public Notice, WC Docket No. 05-25, RM-10593, DA 09-2388 (November 5, 2009) (*2009 Public Notice*).

[2] *Special Access Rates for Price Cap Local Exchange Carriers; AT&T Corp. Petition for Rulemaking to Reform Regulation of Incumbent Local Exchange Carrier Rates for Interstate Special Access Services*, WC Docket No. 05-25, RM-10593, Order and Notice of Proposed Rulemaking, 20 FCC Rcd 1994 (2005) (*2005 Special Access NPRM*).

[3] Declaration of Bridger M. Mitchell and John R. Woodbury, filed as Attachment 1 to Reply Comments of Nextel Communications, Inc., WC Docket No. 05-25 (July 29, 2005) (2005 Mitchell-Woodbury Decl. and 2005 Nextel Reply).

[4] Declaration of Bridger M. Mitchell, filed as Attachment 2 to Comments of Sprint Nextel Corporation, WC Docket No. 05-25, (August 8, 2007) (Mitchell 2007 Decl.)

[5] *Motion of AT&T Corp. to be Reclassified as a Non-Dominant Carrier*, Order, 11 FCC Rcd 3271, ¶ 163 (1995); *Petition of Qwest Corporation for Forbearance Pursuant to 47 U.S.C. § 160(c) in the Omaha Metropolitan Statistical Area*, Memorandum Opinion and Order, 20 FCC Rcd 19415, ¶ 18 (2005) (*Qwest Forbearance Order*).

are: high market share, limited supply elasticity, limited substitution elasticity for consumers, and cost structure and resources that confer advantage over competitors.

4. When these dominance factors obtain they convey market power to the incumbent LEC and crucially affect the performance of special access markets. Where special access is supplied by an incumbent LEC that also supplies interexchange and wireless services the incumbent LEC's market power in special access can be leveraged into those additional markets and harm their performance as well. A dominant carrier has the ability to raise and maintain the price of special access services; to foreclose competition in the supply of special access; and to raise rivals' costs even if it cannot foreclose entry completely.

5. Price and conduct regulation, if well-designed and informed by market evidence, can mitigate anticompetitive effects of a dominant firm that result from that firm's market power. Price-cap regulation has largely supplanted earlier rate-of-return regulation of dominant carriers. Well-designed price caps are a regulatory tool that can give a dominant firm incentives to produce services with greater efficiency and at lower prices while providing opportunities for efficient competitive entry. However, a poorly-designed price cap regime will fail to control the exercise of the dominant firm's market power and harm competition and consumers.

A. Price cap regulation

6. Under price cap regulation, the regulatory authority establishes an initial level for the maximum price of an index of a basket of telecommunications services. The cap is then adjusted annually, or more frequently, to account for expected improvements in productivity and exogenous changes in costs, including general inflation. By setting the initial level at a measure of the forward-looking cost of producing special access services the resulting regulated prices mimic the results that would be expected if the market were competitive.

7. The productivity adjustment accounts for the improved cost efficiency that can be achieved over time as a result of advancing technology, realization of economies of scale and growth, and improvements in management practices. In competitive markets, suppliers' productivity gains lower their forward-looking costs and are passed on to consumers as lower prices or increases in product quality. In the price cap index, the productivity factor ensures that the expected gains are translated into updated prices.

1. Special access price caps

8. The special access price caps currently in place were not designed to the standards described above. The initial levels were not established at forward-looking cost, but based on accounting costs prevailing in 1990. The Commission revised the

price cap regime in 2001,[6] targeting productivity factor reductions to switched access rates over a period of three years. Both switched and special access rates were then effectively frozen at 2004 levels, when the productivity factor was set equal to the inflation rate.[7] The Commission took no steps to move special access rates toward forward-looking cost.

2. Price flexibility

9. The Commission provided relief from the special access price caps in market segments where it presumed that competitive forces would be effective in limiting incumbent LECs' market power.[8] Although the Commission has continued to consider incumbent LECs to be, in general, dominant in the supply of special access services it has established proxy triggers in an attempt to determine the presence and level of competition for special access services on an MSA-by-MSA basis. Based on quantitative standards of investments made by competitive carriers in the incumbent LEC wire centers, the price cap restrictions were relaxed in two phases.

10. In Phase I areas, an incumbent LEC could offer special access customers individually negotiated contracts with lower prices, but also had to continue to make the price cap rates available as filed tariffs. In Phase II areas, an incumbent LEC was no longer required to offer service at the price cap rates and could lower or raise rates and offer special terms and conditions to individual customers. In all areas, incumbent LECs could offer volume and term discounts from the price cap rates.

11. To serve as indicators of irreversible sunk investment by competitors and competitive checks on incumbent LEC market power, the Commission has defined four separate triggers that allow Phase II flexibility in pricing channel terminations and interoffice transport. Each trigger measures the presence of competitors' fiber optic facilities collocated in a sufficient number of wire centers in an MSA, measured as either wire centers that account for a specified percentage of all MSA business lines or wire centers that account for a specified percentage of all special access revenues in the MSA.

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[6] *See Access Charge Reform*, Sixth Report and Order in CC Docket Nos. 96-262 and 94-1, Report and Order in CC Docket No. 99-249, Eleventh Report and Order in CC Docket No. 96-45, 15 FCC Rcd 12962 (2000) (CALLS Order), *aff'd in part, rev'd in part, and remanded in part, Texas Office of Public Util. Counsel v. FCC*, 265 F.3d 313 (5th Cir. 2001), *cert. denied, Nat'l Ass'n of State Util. Consumer Advocates v. FCC*, 535 U.S. 986 (2002), *on remand, Access Charge Reform*, CC Docket Nos. 96-262, 94-1, 99-249, 96-45, Order on Remand, 18 FCC Rcd 14976 (2003).

[7] *2005 Special Access NPRM* ¶15.

[8] *See* 47 C.F.R. §§ 69.701, *et seq.*; *Access Charge Reform*, Fifth Report and Order and Further Notice of Proposed Rulemaking, 14 FCC Rcd 14221, 14224-25, 14232-33, 14234-35, 14257-310, ¶¶ 1-4, 19, 24-26, 67-175 (1999) (*Pricing Flexibility Order*), *aff'd WorldCom v. FCC*, 238 F.3d 449 (D.C. Cir. 2001).

12. To date, the Commission has granted Phase II price flexibility in at least 112 MSAs (for both channel termination and interoffice transport)[9] and in more than 200 MSAs (for interoffice transport).[10]

B. Effectiveness of price cap regulation

13. How effective have the Commission's special access price regulations been at limiting the exercise of market power and preventing incumbents from using their dominance to foreclose entry? The question can be answered from three directions: the level and trend in special access prices; the extent to which competitive entry, as measured by the Commission's triggers, exerts competitive pressures on incumbent LECs; and incumbent LECs' ability to use pricing flexibility to foreclose entry of competitors.

1. Special access prices

14. Special access prices provide direct evidence of the incumbent LECs' use of market power. Evidence in the record of this proceeding as well as recently completed studies by the GAO[11] and the NRRI for NARUC,[12] establish the following conclusions:

- In both price cap areas and price flexibility areas special access prices are consistently well above the available measures of forward-looking costs.[13]
- For special access services subject to price caps, nominal prices have been unchanged since the price cap level was frozen in 2003, despite growth in number of special access lines. This result is consistent with the exercise of market power; if the special access market were competitive, the declining cost nature of providing special access would result in reduced prices. What creates downward pressure on prices in price cap service areas are reductions in the price cap indices, and the indices have been unchanged for five years.
- For special access services sold in Phase II price flexibility areas, where the price cap limit does not apply, the predominant pattern has been prices that are higher than the prices in price cap areas.[14]

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[9] Government Accountability Office, "FCC Needs to Improve Its Ability to Monitor and Determine the Extent of Competition in Dedicated Access Services", GAO 07-80, at 6 (November 2006) (GAO).

[10] Peter Bluhm with Robert Loube, National Regulatory Research Institute, "Competitive Issues in Special Access Markets" at 13 (January 21, 2009) (NRRI), citing Wallsten.

[11] *See* GAO.

[12] *See* NRRI.

[13] NRRI at 67.

- Despite the capped special access rates, total special access revenue has increased due to increased volumes. The scale of special access services for the price cap incumbent LECs who report in ARMIS has grown from revenue of $12.9 billion in 2001 to $18.1 billion in 2007.[15] As the Commission has noted, with economies of scale and scope, in a competitive market special access prices should decline with increased volumes.[16]

15. In short, the Commission's price cap regulations and price flexibility relief provisions have not resulted in special access prices that resemble prices that would be expected in a competitive market, given the cost characteristics of special access.

2. Supply responsiveness and competitive entry

16. If competitive supply is available, the ability of a customer to substitute a competitive alternative for the incumbent's offering could constrain incumbent LEC prices.

17. Competitors' collocation of facilities at an incumbent LEC wire center indicates some capacity to compete in transport services for customers served from that wire center; however, it does not necessarily indicate that competitors have entered to provide "last mile" services in competition with the special access channel termination offerings of incumbents.

18. Collocation for transport at some wire centers does not constrain channel termination special access prices throughout an MSA. Channel termination and transport are in separate product markets, so the availability of competitive supply in transport does not by itself enable the customer to reduce its dependence on the incumbent LEC for channel termination service.

19. Furthermore, the presence of competitive alternatives in some wire centers does not constrain the incumbent LEC's practices in other wire centers in the same MSA. In Phase II areas, the incumbent LEC can price discriminate between areas where it faces competition and those where it is the monopoly supplier, charging the monopoly price to customers who lack competitive alternatives and lower prices in competitive areas. Because arbitrage by special access customers or other suppliers (*i.e.*, buying the service at the low price and reselling it at the higher price) cannot take place across the two geographic areas, the presence of

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[14] GAO at 27; Declaration of M. Joseph Stith, WC Docket No. 04-313; filed as Attachment H to Comments of AT&T Corp. (Oct. 4, 2004), Attachment 1 at 4, "Comparison of costs (10-mile Standalone Circuit) Rates in Effect on July 1, 2004," at 3 (Stith Decl.).

[15] ARMIS (Form 43-01). No later data are available, because the FCC gave the incumbent LECs relief from reporting ARMIS.

[16] 2005 Special Access NPRM ¶26.

competitive alternatives in some wire centers does not constrain practices in other wire centers in the same MSA.[17]

20. Even in cases in which the incumbent LEC charges a uniform price across all geographic areas in an MSA, if customers perceive quality differences between the incumbent LEC and competitive supply the incumbent LEC will set the uniform price so as to account for the lack of competition in some areas. Consequently, consumers purchasing special access services in competitive areas do not realize the benefit of lower, competitive prices that they would obtain if the incumbent LECs did not "average" prices across the MSA. And consumers in the non-competitive areas of the MSA continue to pay supra-competitive prices.[18]

3. *Foreclosure of competitors*

21. The pricing flexibility granted by the Commission has freed incumbent LECs to craft terms and conditions for special access customers that penalize customers that purchase service from competitors and that raise barriers to entry. Requirements that a customer commit to purchasing nearly all of its special access service from the incumbent LEC, reduce purchases from incumbent LEC competitors, and pay very substantial penalties for deviating from committed quantities tend to lock customers into the incumbent LEC supplier. To compete against such terms a potential competitor would need to enter the market at a large scale and in many geographic areas.

C. Designing more effective regulations

22. Improving the performance of the special access markets requires systematic review and revision of the Commission's price cap and price flexibility regime.

23. The evidentiary record of this proceeding includes substantial data that enable key conclusions to be drawn about incumbent LEC market power and the effectiveness of the Commission's regime. In order to craft well-founded revisions to price caps and price flexibility regulations, the Commission should gather additional evidence on conditions in special access markets to enable it to:

- distinguish competitive from non-competitive markets;
- measure the exercise of market power in incumbent LEC pricing;
- reduce barriers to entry in the supply of special access by imposing restrictions on terms and conditions that foreclose competitors; and
- make price regulation more effective.

24. Using these data, along with evidence already in the record, the Commission should conduct a systematic analysis of special access market performance. The

[17] 2007 Mitchell-Woodbury Decl. ¶42.

[18] 2007 Mitchell-Woodbury Decl. ¶44-46.

remainder of this paper sets out the analytic framework that can be applied to carry out this analysis.

III. CONDUCTING THE ANALYSIS

25. Conducting the analysis of the effectiveness of special access price regulation requires that the Commission define the relevant markets, assess market dominance factors, and assess behavior that forecloses competitors.

A. The relevant geographic and product markets

26. Market definition is necessarily a prerequisite to determining the market share held by the incumbent. Appropriate definition of markets is equally necessary in order to establish effective regulations to limit the use of market power while also providing the incumbent with pricing flexibility in those markets where competition provides an effective check on market power.

27. It is necessary to define the relevant geographic and product markets in order to determine a supplier's share of each market and that, in turn, requires one to determine what products are in, and not in, the relevant markets (demand substitution). Determining whether a firm has market power in the relevant product and geographic markets requires an assessment of supply substitution (the extent to which buyers can switch to an alternative provider if the firm at issue raises price or restricts output).

28. Defining markets appropriately is essential to (1) constraining use of market power while (2) avoiding incurring costs of regulation where competitive forces can be effective. In practice, the Commission must necessarily strike a balance between the analytical rigor of defining markets precisely and the cost and practicality of administering market regulations.

1. The markets established by the Commission

29. The Commission, in its *Pricing Flexibility Order*, identified the MSA as the relevant geographic area for the purpose of granting pricing flexibility for special access services, stating that "MSAs best reflect the scope of competitive entry, and therefore are a logical basis for measuring the extent of competition."[19] The Commission reaffirmed this in its *2005 Special Access NPRM,* recalling that the 1999 *Pricing Flexibility Order* had "identified the MSA as the relevant geographic market."[20]

30. The variation in competitive entry conditions within an MSA was then determined for each special access product (channel terminations and channel

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[19] *Pricing Flexibility Order* ¶¶72-74.

[20] *2005 Special Access NPRM* ¶120.

mileage, and capacity of circuit, indicated by DS1 or DS3) by the fraction of wire centers in an MSA in which one or more competitors had established collocation facilities – the "collocation triggers." Incumbent LECs were given pricing flexibility for all sales of a product throughout an MSA if the number of wire centers with collocation facilities met or exceeded the trigger percentage established for that product.

2. How should special access markets be defined?

31. The criteria established in the Department of Justice and Federal Trade Commission's 1992 Merger Guidelines for market definition are that "market definition focuses solely on demand substitution factors – i.e., possible consumer responses" and querying whether a hypothetical monopolist of special access services can profitably raise price, holding other things equal, including the number and extent of service supplied by all firms in a market.[21] Competitive supply enters the analysis in the role of "supply substitution factors - i.e., possible production responses – [that] are considered by identification of firms that participate in the relevant market and the analysis of entry."[22] The Merger Guidelines summarize the tests most often used by economists to measure market power, and should guide the Commission in defining special access markets.

32. The Commission has indicated that the relevant product market for telecommunications services consists of point-to-point connections, aggregated over consumers facing the same competitive conditions. And that "for all practical purposes, we fully expect that the relevant geographic area for assessing market power will usually consist of multiple point-to-point connections that exhibit the same competitive conditions."[23] Similarly, the DOJ observes that "it is typically quite useful to aggregate customers facing very similar competitive conditions for the purpose of measuring market shares."[24] The Commission said again, in issuing its *Qwest Forbearance Order* that it "treat[ed] as a geographic market, an area in which all customers in that area will likely face the same competitive alternatives for a product."[25]

33. For special access services, the competitive alternatives available to customers in an MSA will rarely be uniform across the MSA. As the Commission noted in the

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[21] U.S. Department of Justice and Federal Trade Commission, *1992 Horizontal Merger Guidelines* (as revised in 1997), Section 1.0 (Horizontal Merger Guidelines).

[22] Horizontal Merger Guidelines, Section 1.

[23] *Regulatory Treatment of LEC Provision of Interexchange Services Originating in the LEC's Local Exchange Area and Policy and Rules Concerning the Interstate, Interexchange Marketplace*, Second Report and Order and Third Report and Order, 12 FCC Rcd 15756, ¶68 (1997).

[24] DOJ, *Ex Parte* submission, GN Docket No. 09-51 (January 4, 2010).

[25] *Qwest Forbearance Order* ¶18.

TRRO, economic conditions vary within an MSA.[26] Using the Washington, D.C. region as an example, it observed that even if competitive transport facilities are widely deployed throughout part of the MSA (such as in its urban areas), competitive carriers may be impaired in distant areas in the MSA, such as parts of West Virginia, if they are not able to obtain unbundled transport. "[A]n MSA-wide approach ... would require ... lumping together areas in which the prospects for competitive entry are widely disparate."[27]

B. Geographic markets

34. To establish meaningful geographic areas and product markets the Commission needs to identify customers who are similarly situated with respect to their competitive alternatives. For channel termination service the relevant geographic market is determined by asking whether the consumer would shift its demand to an alternative as a substitute for the supplier's channel termination service if all service in the provisional geographic market were hypothetically supplied by a monopolist. If there is such an alternative, the provisional geographic area should be expanded until the customer has no effective substitute. For channel mileage service, the relevant geographic market is determined by examining whether the consumer would shift its demand for transport service to an alternative as a substitute for a hypothetical monopolist's channel mileage service between two wire centers.

1. Building-level and paired wire centers market definition

35. The Merger Guidelines' test suggests that the relevant special access geographic market for channel termination service is the building in which the customer is located. An even smaller area – *e.g.*, a floor of the building – would not likely constitute a market, provided a customer could readily substitute service from an adjacent floor at a lower cost than would be required to enter the building. A larger area – multiple buildings or the area served by a wire center – would be excessively large, because the customer's cost of switching to service available at a different building would not prevent the hypothetical monopoly supplier of the building from sustaining a price increase in that building.

36. For purposes of assessing the effectiveness of special access price cap regulation and price flexibility of channel termination service, the Commission should collect and analyze data at the level of the geographic market – individual buildings or customer locations. Similarly, to assess regulation of channel mileage service the Commission should collect and analyze data at the level of the transport geographic market – pairs of wire centers.

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[26] *Unbundled Access to Network Elements; Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers*, Order on Remand, 20 FCC Rcd 2533, ¶¶ 82, 164 (2005) ("*TRRO*").

[27] *TRRO* ¶82.

37. To limit the analysis that needs to be undertaken, the Commission can rely on data for supply conditions obtained in a sample of MSAs. For example, in its 2006 study, the GAO selected 16 MSAs for intensive analysis of the level of demand (differentiating DS1, one DS3, and two or more DS3s) in each lit building and whether the building was supplied by a lit competitor. Such building-level data would then be augmented by the identification of the building's serving wire center. The extent of competitive supply can then be analyzed in terms of the areas defined by several tiers of wire center (number of business lines, number of collocators).

2. Aggregation of geographic areas

38. Having assessed the effects of its regulations at the level of individual geographic markets, the Commission may conclude that it needs to aggregate the individual geographic markets into categories in order to craft administratively feasible regulations for purposes of assessing the need for pricing flexibility. Aggregation necessarily involves some tradeoff between misclassification of individual buildings and locations, which results if buildings with only incumbent LEC service are grouped together with other buildings having multiple suppliers, and costs of data collection and analysis.

39. The demand for service in the special access markets includes both the special access lines supplied by the incumbent LEC and also the comparable products supplied by competitive suppliers and by customers who self-supply high-speed transport service. A proxy for demand in a geographic area is the number of incumbent LEC special access lines, but a comprehensive measure would also include lines supplied by competitors and self-supplied by customers. The findings of the NRRI – that there is only a limited supply of special access circuits from competitors and self-supplying firms[28] – imply that relying on the number of incumbent LEC special access lines as the indicator of demand will be a reasonable approximation of total demand.

40. Areas with a high density of business communications demand, where revenue from the traffic of multiple high-volume users can be efficiently aggregated to offset sunk costs of transport and termination facilities, are generally the first locations of an MSA targeted for service by entrants. Demand conditions in intermediate-density and low-density areas may be insufficient to support entry that would lead competitors to construct facilities that would then become sunk investments and serve to constrain incumbent market power.

41. The approach adopted by the Commission in the *TRRO* to determine that competitive carriers were impaired without access to unbundled interoffice transport provides an example of how to classify geographic areas within an MSA where competitive conditions for special access services are similar. In the *TRRO,* the Commission designated three tiers of wire centers, based on the

[28] NRRI at 42.

number of business lines served by the wire center (representing revenue potential), or the number of fiber-based collocations at the wire center (representing competitive presence):

- **Tier 1 wire centers** are those with four or more fiber-based collocations **or** with 38,000 or more business lines.
- **Tier 2 wire centers** are those with three or more fiber-based collocations **or** with 24,000 or more business lines.
- **Tier 3 wire centers** are all those that are not Tier 1 or Tier 2 wire centers.

42. The *TRRO* notes that dense business districts account for "an enormous proportion of the telecommunications revenues available."[29] The Tier 1 and Tier 2 wire centers accounted for just 8.6% of all 10,796 BOC wire centers but almost half (46.8%) of all business lines.[30]

Table 1. Impairment Classifications for UNEs

	# fiber-based collocated CLECs		# bus lines	% wire all centers	% all bus lines		% of wire centers in tier
Transport							
Tier 1	4+	*or*	38,000+	5.4%	34.2%		90% have 4+ collocators, 98% with at least one
Tier 2	3+	*or*	24,000+	3.2%	12.6%		67% have 3+ collocators
Tier 3	(not Tier 1 or Tier 2)			91.4%	53.2%		
Loops							
DS3 loop	4+	*and*	38,000+		14%		
DS1 loop	4+	*and*	60,000+		8%		

Source: TRRO, ¶¶115-119, ¶¶176-178.

43. For access to DS1-capacity transport, the Commission found that competitive LECs are impaired unless the transport route connects two Tier-1 wire centers – routes where the volume of traffic would likely enable competitors to construct facilities and compete. For access to DS3-capacity transport, the Commission found that competitive LECs are not impaired unless the transport route connects to a Tier-3 wire center at one or both ends of the route.

44. For access to unbundled high-speed loops, the Commission employed a two-pronged standard – number of lines *and* number of collocators. The Commission found that a carrier was impaired without access to unbundled DS1 loops at any

[29] *TRRO* ¶70.

[30] *TRRO* ¶115.

wire center that did not have both at least 60,000 business lines and 4 or more collocators. For DS3 loops, the (non)impairment standard was a wire center that had both at least 38,000 business lines and 4 or more collocators.

45. If customers face comparable competitive alternatives in multiple wire centers then those wire centers can be grouped together for purposes of determining whether to provide pricing flexibility. A grouping of wire centers based on the Commission's 3-tiered criteria for unbundled network elements (UNEs) would provide an administratively practical way to distinguish geographic areas in which competitive alternatives are likely to limit incumbent LEC market power from other areas in which there is little or no prospect of effective competition.

46. Based on evidence in the record to date, the Commission's price flexibility triggers do not discriminate between competitive and non-competitive geographic areas, but lump all areas in an MSA together. The disparity is greatest for channel terminations. If the Commission were to employ the criteria it established in requiring access to unbundled loops then incumbent LECs should be granted price flexibility for DS3 channel terminations only in wire centers that satisfy *both* the number of lines and number of collocators criteria for Tier 1. For DS1 channel terminations, the criteria would be wire centers with at least 60,000 business lines and four or more collocated competitors.

47. By collecting data, for each wire center, on the number of competitively supplied DS1 and DS3 channel terminations the Commission will be able to assess whether it is appropriate to apply the tier-based triggers for UNE impairment or to revise those criteria to better reflect the relationship of competitive supply of channel terminations to the number of business lines and number of collocators in a wire center. Below, I suggest how the Commission could analyze a sample of data to measure the competitive supply from competitive LECs, CMRS carriers who may self-supply, and cable and fixed wireless providers, combined with incumbent LEC data at the wire center level. A suitably designed sampling study would control for the level of potential demand in the area and degree of price regulation for each special access product.

48. The analysis I describe would permit the Commission to judge whether the extent of competition in areas defined by the tiers is sufficient to meet its expectation of competitive constraints on incumbent LEC pricing and justify relief from the price cap requirements in the wire centers satisfying the criteria in the sampled MSAs. The distribution of demand and competitive supply can also be analyzed for various other levels of business lines and collocations in order to distinguish wire centers where competitive supply is observed and presumed sufficient to constrain incumbent LEC prices as well as to examine how the pricing flexibility triggers might be revised to better reflect competitive constraints in different areas within entire MSAs.

49. Having determined meaningful triggers that define areas of similar competitive conditions for the sampled MSA, the Commission could then reasonably apply

those triggers to establish revised pricing flexibility standards for special access services in all MSAs.

C. Product markets

50. The major special access products are high-capacity channel termination from the customer's premises to the incumbent LEC serving wire center, and channel mileage (dedicated transport) from the wire center to another wire center, a point of interconnection with a competitive supplier, or with the customer's distant facilities. For a special access customer, channel termination and channel mileage are not substitutes; a small increase in the price of channel termination will not lead the customer to reduce the quantity of termination purchased and purchase greater channel mileage service. Channel termination and channel mileage are therefore distinct product markets. For many customers, channel termination and channel mileage are likely to be complements.

1. Distinguishing products by capacity

51. Channel termination and channel mileage products are also distinguished by differences in capacity (DS1 or DS3). The capacity of one DS3 is equivalent to 28 DS1s.[31] Because of this functional equivalence, the application of the hypothetical monopoly test to either channel termination or channel mileage could lead one to conclude that for any particular geographic market DS1 prices would ultimately constrain the prices of DS3s and *vice-versa*.[32] The availability of special access service from competitive suppliers will likely differ by geographic area. Competitive supply of *stand-alone* DS1 channel terminations is uneconomic, whereas when a competitive carrier has DS3 facilities it can channelize them at small incremental cost.[33] So the availability of competitive DS1 channel terminations will depend on the availability of competitive DS3 (and higher-capacity) services in the wire center area.

52. In areas (principally central business districts) with a high density of business lines the opportunities for competitive supply of DS3 channel termination services are greatest. In areas outside the central business district, the demand in an MSA for special access services at many locations is likely to be for DS1, but not DS3, levels of capacity. Therefore, an increase in price by a hypothetical monopolist of DS1 channel terminations is unlikely to be defeated because it is unlikely that competitive DS3s will be available at those locations. Instead, the incumbent LEC is likely to be the dominant provider in markets with limited demand for high-capacity circuits because it can provide stand-alone DS1 channel terminations over its legacy copper facilities. Other things being equal, the more business lines served by a wire center and the greater the number of collocated

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[31] *TRRO* ¶ 170.

[32] Horizontal Merger Guidelines, Section 1.0.

[33] *TRRO* ¶¶ 166, 170-171.

competitive LECs, the more likely it is that competitive DS3 capacity will be available to particular business locations that have a demand for only DS1 loops.

53. Could a price increase by a hypothetical monopolist of *DS3* channel terminations be made unprofitable by competitive providers of DS1 services who reconfigured their DS1 facilities to provide DS3 services? That would require sufficient DS3 demand in the area to attract entry. So as a practical matter, it is the availability of sufficient demand to warrant the construction of DS3 facilities in the first place that would constrain DS3 service prices. Many markets outside the central business district may not provide the revenue opportunities to justify sinking the costs of a DS3 facility by a competitive LEC or other provider, resulting in the incumbent LEC being the dominant provider of DS3 loops over its existing facilities.

54. In markets where the demand for capacity is limited and the competitive deployment of DS3 facilities is unlikely, there will be no opportunity to redeploy competitive DS1 channelized services to provide DS3 services and thus no DS1 constraint on DS3 prices. Similarly, in markets where the demand for capacity is limited and competitive carriers are unlikely to deploy DS3 facilities there will be no competitive DS3 constraint on DS1 prices. Thus, although a DS3 channel mileage or channel termination circuit is not a substitute for a channel mileage or channel termination DS1 circuit and *vice versa*, in evaluating the prospects for competitive entry in a particular geographic area, the Commission needs to focus on the economic viability of constructing a DS3 facility. This is so because a new entrant will build a facility to serve DS1 customers only if the revenue from DS1 demand is at least equivalent to the revenue from a DS3 circuit. There is no evidence indicating that a competitor would construct a stand-alone DS1 facility to serve a single DS1 customer.

2. Should product markets be distinguished by customer type?

55. The *2009 Public Notice* asks whether price flexibility triggers need to be calibrated to business line density and customer type within an MSA.[34]

56. Some special access customers have multiple locations within an MSA and require connections to all of their locations in order to conduct their businesses effectively. For such customers, for example CMRS providers, the demand for special access service at one location is complementary to their demand at other locations. They may benefit from transaction economies by purchasing most or all of their circuits from a single supplier.

57. Should there be a separate analysis for channel termination to CMRS providers' cell towers? A large proportion of a CMRS provider's cell sites are located in, and throughout, the lower-density areas of an MSA. In these portions of the MSA there is low potential for competitive entry in the supply of channel termination to

[34] *2009 Public Notice* at 2, Question 1(A).

CMRS providers and to other customers in low-density areas. Provided that the Commission adopts revised price flexibility triggers that effectively distinguish competitive conditions between low-density areas and other areas within an MSA it should not be necessary to add a separate customer dimension to the definition of the special access channel termination market to identify competitive supply conditions experienced by mobile service providers at their cell sites.

58. In order to provide metropolitan area coverage, CMRS providers need to buy special access service to their cell sites throughout the MSA. The fact that CMRS providers and interexchange carriers (IXCs) serve business customers, whose locations are widely distributed throughout the MSA, makes them attractive targets for any incumbent LEC contractual conditions that leverage incumbent LEC market power in low-density areas into metropolitan areas. In revising its price flexibility regulations, the Commission needs to prohibit conditions that tie customer purchases in non-competitive areas to locations where competitive alternatives are available.

D. Market dominance

59. Having defined the relevant geographic and product markets, the Commission's analysis should proceed to investigate the factors determining market dominance – market shares and concentration, demand elasticity, supply responsiveness, and cost structure.

1. Market shares

60. Only one study in the record has systematically measured competitive presence in geographic markets at the individual building level. In the 16 MSAs studied by the GAO, the presence of competitors in geographic markets defined by individual buildings was quite limited in 2006, particularly for buildings in which there was only limited demand.[35]

- In buildings where customer demand was limited to a single DS1 line, less than 6 percent had competitive alternatives.
- In buildings likely to generate at least a single DS3 level of demand, about 15 percent had fiber-based competitors.
- In buildings likely to require 2 DS3s, about 24 percent had fiber-based competitors.

61. Evidence in the record contains measures of market shares for broader geographic areas. That evidence similarly indicates that the special access market is highly concentrated. For instance, the NRRI's study finds that the median results for all four special access products (DS1 channel terminations, DS1 transport, DS3 channel terminations, DS3 transport) in the 50 MSAs surveyed are far into the zone characterized as "highly concentrated" by the Merger Guidelines, and none

[35] GAO at 12.

of the MSAs has as many as two effective firms.[36] Shares for individual services indicate that in 2007 the median percentage of total DS1 channel termination circuits purchased from incumbent LECs was 99%, and for DS1 transport 98%. For DS3 channel terminations the median was 91%, but for DS3 transport 67%.[37]

62. The record contains reports by several major buyers of special access services that indicate they are highly reliant on special access purchased from incumbent LECs. For channel terminations, Sprint Nextel reported in 2007 that it purchased 98% of its DS1 and 84% of its DS3 service from incumbent LECs.[38] Ad Hoc stated that 98% of all business premises are supplied by incumbent LECs.[39]

63. The record indicates that special access customers who have sought to reduce their dependence on incumbent LECs' special access services by inviting bids by competitive suppliers found that at the time bids were submitted only limited, geographically spotty offerings were available.[40]

64. In order to obtain more accurate measures of market shares in special access markets, the Commission should collect data on individual buildings that measure the number of services (DS1 channel terminations, DS3 channel terminations, DS1 channel mileage, and DS3 channel mileage) at each wire center supplied by incumbent LECs and by competitive suppliers.

2. Demand elasticity

65. Economists traditionally measure demand responsiveness by identifying other options open to buyers, relevant to that particular market, that are close substitutes for the product in question (*e.g.*, special access), and determining whether consumers are impeded from switching to these substitutes.[41] Demand responsiveness (measured by firm elasticity, not industry elasticity) results from demand reduction at a higher price, and the switching of demand to another supplier.

66. The opportunity to switch to a different supplier depends on the presence of an alternate supplier in the market, and the quality of the potentially substitutable product. In a building or location where a competitor has facilities, customers have potentially high elasticities. For such a customer, the costs of switching to an alternate supplier may be low, unless it is constrained by the terms and

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[36] NRRI at 41.

[37] NRRI at 42.

[38] See *ex parte* presentation attached to letter from Anna M. Gomez, Sprint Nextel, to Marlene Dortch, FCC Secretary, at 5-7 (Aug. 22, 2007) (Sprint Nextel Aug 22 Ex Parte).

[39] See Gately Declaration, attached as Appendix 2 to Comments by Ad Hoc Telecommunications Users Committee, WC Docket 05-25, ¶20 (August 13, 2007).

[40] *See, e.g.*, Sprint Nextel Aug 22 Ex Parte at 9.

[41] *2005 Special Access NPRM* ¶94.

conditions of existing contracts, or by the transaction costs of migrating circuits to a service if the alternative is available at only a few end offices.

67. In a building or other location where there are no competitive facilities, the customer typically has little opportunity to switch to an alternate supplier, and so the demand elasticity faced by the incumbent LEC is lower than in buildings where a competitor supplies service.

68. Evidence in the record indicates that intermodal substitutes are currently judged inferior to channel termination service from an incumbent LEC. Fixed wireless service is reported to be of lower reliability.[42] Cable modem service, supplied on a "best-efforts" basis, lacks the dedicated capacity required by wireless operators and others.[43] Furthermore, it appears that cable companies do not typically offer high capacity transport services.[44]

3. Supply elasticity and competitive presence

69. If competitive supply is available, the ability of a customer to substitute a competitive alternative for the incumbent's offering can constrain incumbent LEC prices. The capacity of competitors' facilities and the ability to increase supply if price were to increase provide a potential constraint on the exercise of market power by a dominant supplier. Competitors can potentially increase supply in two ways: by increasing service to the locations of their existing customers, and by extending the reach of their networks to serve new customers' locations.

70. At buildings and locations where it currently provides service, a competitor generally will have incurred the sunk costs of extending infrastructure and access from its metropolitan network facilities. To increase the supply of channel terminations to existing customers or to supply new customers may require it to increase circuit capacity by installing additional electronic equipment or pulling new cables.

71. In contrast, in order to supply channel terminations to new locations, a competitor must incur many of the sunk costs of trenching and laying cable, or in the case of wireless backhaul service of installing microwave radio facilities. It will also likely face the administrative costs and delays of obtaining access to rights-of-way and customer buildings.

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[42] *See, e.g.,* Declaration of Ajay Govil, attached to Comments of XO Communications, *et al.,* WC Docket 05-25, ¶21 (August 8, 2007) (Govil Declaration); "Special Access Pricing," attached to letter from Counsel for Sprint Nextel Corporation to Marlene H. Dortch, FCC Secretary, WC Docket No. 05-25, at 42 (Oct. 5, 2007).

[43] *See, e.g.,* Govil Declaration ¶¶22-24.

[44] *See, e.g.,* Comments of Time Warner Telecom and One Communications, WC Docket 05-25, at 15 (August 18, 2007).

72. The capacity to increase the competitive supply of channel mileage (transport) service to customers whose channel termination is supplied by the incumbent LEC depends on collocation of competitor facilities in the terminating wire center and the capacity of the competitor's transport facilities from the wire center to its backbone network. If the competitor is not collocated in the wire center, significant sunk investment is generally necessary to install interconnection equipment in the wire center and to construct the infrastructure and cable connecting to the competitor's network.

73. In some instances, competitors can increase supply indirectly if they are able to obtain UNEs from the incumbent LEC. The capacity to increase supply indirectly depends on the availability of UNEs to the competitor and the time necessary to contract for and to provision the network elements. While UNEs may be available to some competing providers, they are not an alternative source of supply for CMRS carriers, who are not eligible to lease UNEs.

74. Increases in a competitor's supply of services to new locations are impeded by several barriers to entry. Service to a new location requires sinking investment into facilities that are location-specific and thus cannot readily be redeployed to supply customers at other locations. Construction of both channel termination and transport facilities are subject to economies of scale and scope, which the incumbent has already realized in the construction of its legacy network, and ability to supply a range of services over it. Unless the competitor can anticipate sufficient demand to recover the necessary investment, it will be unlikely to enter the market for DS1 and DS3 services.

75. The evidence in the record is that there are substantial impediments to competitive supply of channel termination. As the Commission has observed, "loop investments require large sunk costs and therefore pose substantial barriers to competition for high-capacity loops."[45]

a) Analyzing competitive supply

76. A suitable proxy for the demand for high-speed dedicated termination and transport services is the total number of business lines at a customer location, including those supplied by competitors as well as the incumbent LEC. In urban areas, the presence of multiple customers in a single office building typically increases the density of demand that can potentially be supplied by one lateral connection from a competitor's fiber transport facilities.

77. A complete analysis of competitive supply would examine the availability of each special access product building-by-building. To limit the effort required, the Commission can conduct the analysis for a sample of buildings that are representative of the variety of conditions present in different parts of an MSA and across different MSAs. Having analyzed competitive conditions in the

[45] *TRRO* ¶¶150, 152-153.

sampled buildings, the Commission can then aggregate similarly situated customers by type of building and location; alternatively, for purposes of assessing dominance, demand can be measured for small geographic areas in which customer density is comparable per unit area.

78. Collocation in a wire center enables a competitor to aggregate traffic –collected from incumbent LEC channel terminations, its own channel termination facilities, or UNE high-speed loops and transport that traffic in competition with incumbent LEC interoffice transport service. Because collocation entails sunk investment by a competitor, it enables the competitor to compete with the incumbent LEC for demand for transport for those customers that the competitor does not serve with its own channel termination facilities. However, collocation is not necessary in order to serve customers who are connected by a competitor's channel termination facilities that connect directly to the competitor's network. Thus, to capture all competitive supply it will also be necessary to measure competitive services that are not supplied in conjunction with collocation facilities in incumbent LEC wire centers.

79. The Commission's analysis should therefore be designed to determine the quantity of competitive services provided in each wire center area, both those in which a competitor does not have collocation, as well as areas where collocation investment has occurred. When that quantity is measured, it will provide evidence regarding how satisfactory the current proxy measure – the presence of collocation facilities – is for the availability of competitive supply of both transport and channel terminations.

80. The analysis can be conducted by systematic sampling of competitive supply conditions in geographic areas where the density of demand is reasonably similar within each sampled area.

(1) Measuring competitive supply

81. The wire center is a reasonable unit of observation for defining the geographic area in which to collect the required data. In the central business districts dominated by multi-story buildings, the geographic area served by a single wire center is quite limited. In the outlying low-density areas of the MSA, a single wire center may serve an area comprising several square miles. By obtaining the size of the area (sq. miles) served by each wire center, the data can be restated in terms of business line density per unit area.

82. The goal of the analysis is to estimate the extent of competitive supply of each special access product in geographic areas of different density. The Commission can do this by estimating a statistical function for each product, using as the measure of competitive supply the percentage of a product supplied by competitors and relating that to the business line density per unit area and the applicable pricing category in that area (price cap, Phase I price flexibility, Phase II price flexibility):

Competitive supply = an increasing function *f* (business line density per unit area, pricing category: pcap, Phase I, Phase II)

- For each incumbent LEC wire center obtain data on the number of business lines provided by all suppliers, the size of the service area, and the number of collocators in the wire center.
- Draw a random sample of wire centers, stratified to ensure adequate representation of buildings in each quintile of wire centers ranked by line density per unit area.
- Then, for each wire center in the sample, obtain supply data from competitors: number of products of each type it supplies in the wire center area, and whether it is collocated in the wire center. For competitors that do not use incumbent LEC wire centers to organize their supply data, supply data should be obtained by census tract or zip code and then mapped onto the incumbent LEC wire centers.
- Estimate the statistical function, using as the dependent variable the percentage of special access products (*CS*%) provided by the incumbent LEC, measured as the number of competitive services (summed over all competitors) divided by the number of incumbent LEC and competitive LEC services. The *CS*% variable is calculated for each product: DS1 channel terminations, DS3 channel terminations, DS1 channel mileage, and DS3 channel mileage).

83. Although data should be collected for each wire center in every MSA, the magnitude of the statistical analysis needed can be confined to a much more limited number of locations that are representative of all wire center areas.

(2) Sample size

84. The GAO study obtained data on some 177,000 buildings (including wireless service cell sites and "carrier hotels") in 16 MSAs. In 5.8% of these buildings there was a "lit" competitor providing service at DS1 capacity or greater.[46] The frequency of competitive supply in this sample provides an evidentiary basis for determining how large a sample of wire centers would need to be analyzed in order to make reliable inferences about competitive supply across all MSAs.

85. Given an estimate of the value of *CS*% in the population of all wire centers, the appropriate size sample of wire centers that is needed to obtain a precision of plus or minus x% for an estimate of the true value of *CS*% can readily be derived from standard sampling theory.

86. The sample size *n* can be computed by the formula:[47]

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[46] GAO at 20, Table 2.

[47] *See*, e.g., George W. Snedecor and William G. Cochran, 1980, *Statistical Methods*, 7th edition, Iowa State University Press, at 442.

$$n = 4pq/L^2$$

where p is the proportion of lines served by competitive LECs, $q = 1 - p$, and L^2 is the square of the desired accuracy of our estimate (and the factor 4 assumes we want a 95% probability of the "right" answer). Thus, if p is (expected to be) 6 percent and we want to get within 2% of the true value, sample size would be 564. If p is 15 percent, the sample size needed is 1275. The statistic n is largest when $p = q = .5$, which yields a sample of 2500.

87. Because the problem is to estimate the value of *CS*% in a finite population, the required sample size is slightly smaller and is given by the formula

$$n' = n / (1 + n / N)$$

where n is defined as above and N is the total number of all wire centers.

(3) Analysis

88. Using the estimated competitive supply equation, the Commission can project the expected number of competitive products in the non-sampled wire centers. The projected level of competition can be summarized for each MSA. For each product, the extent of competitive supply in MSAs with Phase II price flexibility can be compared to the competitive supply in Phase I and price cap MSAs.

89. The reliability of the sampling methodology can be ascertained by drawing a second sample of wire centers from the collected data and then comparing the projected number of competitive products in those buildings and wire centers to the actual number of competitive services in the second sample.

90. A similar analysis can be undertaken to compare differences in competitive supply across wire centers of different densities. The effectiveness of the Commission's price triggers for price flexibility, which depend on the percentage of wire centers in which collocation occurs, can then be assessed by comparing the extent of competitive supply in wire centers in which there is collocation with other wire centers in the same MSA.

4. Cost structure and barriers to entry

91. Incumbent LECs possess legacy distribution networks composed of multi-strand copper cables and fiber nodes that serve virtually every business location. DS1 channel termination can be provided over existing facilities or by adding short construction runs from existing cables. In dense areas of an MSA, DS3 channel termination can be supplied by fiber connection to fiber nodes.

92. In order to supply a substitute for special access channel terminations, a competitive entrant must overcome substantial barriers to entry. Construction of a new distribution network involves very substantial fixed costs for trenching and

laying cable and costs of acquiring rights-of way. Particularly for small-capacity special access service to low-density locations, these sunk costs are large in relation to the potential revenue from customers demanding only DS1 or DS3 service and pose substantial barriers to competition.[48]

93. Incumbent LECs enjoy economies of scope in the supply of special access transport services. Special access transport for customers' dedicated circuits can be supplied along with switched access traffic and Internet connections over interoffice facilities that interconnect LEC wire centers. Moreover, the two largest incumbent LECs, Verizon and AT&T, also have the largest wireless and interexchange networks, and obtain additional competitive advantage from transporting traffic from those networks on their special access facilities. By transporting traffic of multiple services on the same facilities, the LEC is able to support the cost of those transport facilities with revenues from multiple services.

94. A firm seeking to enter a geographic area to supply service in competition with the incumbent LEC must obtain access to rights-of-way in order to construct its facilities and to buildings in which its potential customers are located in order to install channel termination equipment. Incumbent LECs enjoy a first-mover advantage in obtaining the necessary access and the Commission has noted that competitors face delays and lengthy negotiations with local authorities for the use of public rights-of-way.[49]

E. Assessing market power

95. A seller has market power if it has the ability to profitably maintain prices above competitive levels for a significant period, without significant customer loss and without attracting entry by competitors.[50] Direct evidence of market power is obtained if, by comparing special access prices with supplier costs, prices are found to exceed forward-looking costs for a significant period. Trends in prices provide additional information as to whether market power is being eroded by competition over time. An examination of terms and conditions of special access contracts in Phase II areas where incumbent LECs are not constrained by price caps allows inquiry about pricing practices that may foreclose competitive entry. If the pricing flexibility triggers have been set correctly, there should be sufficient actual or potential competitive alternatives in Phase II areas to constrain the incumbent LECs' prices.

1. Price vs. cost comparisons

96. A direct measure of market power is obtained by comparing existing prices for special access services with the competitive price levels that would obtain if the

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[48] *TRRO* ¶¶150, 152-153.

[49] *TRRO* ¶151.

[50] Horizontal Merger Guidelines, Section 0.1

services were supplied at prices based on forward-looking costs. Forward-looking costs measure the costs incurred by an efficient provider of a service using best-practices technology and provide the level of costs that would prevail in a competitive market. The comparison of prices to forward-looking costs should be made for a period of one to three years, in order to allow for the effect of competitive entry on price levels.

97. In geographic areas where they have Phase II price flexibility, incumbent LECs are free to set prices above, or below, the level previously established by the price cap mechanism. In these areas, the market conditions are presumed to be competitive. If incumbents maintain prices above forward-looking costs in the face of the presumed competition, this is evidence that they are exercising market power and that competition is not, in fact, acting as an effective constraint.

98. Measures of forward-looking costs in many of the MSAs can be obtained by using the rates established by state commissions for UNEs. High capacity UNEs (DS1s and DS3s) are the functional equivalents of special access. For example, the Commission has said that "a special access channel termination service extending between an IXC POP and a LEC serving wire center is comparable to a switched access entrance facility."[51] Except where incumbent LECs and competitive LECs have negotiated rates for competitive LECs' use of UNEs, state commissions have established the UNE rates based on forward-looking cost studies.[52] Negotiated rates presumably also recover the incumbent LEC's cost of providing the UNE, or the incumbent LEC would not have agreed to provide service at the negotiated rate.

99. Special access is sold under a wide variety of terms, ranging from month-to-month supply at list ("rack") rates, to term commitments of up to five or more years that provide discounts that are typically stated as percentages off of the rack rate. In pricing flexibility areas, incumbent LECs offer additional discount contracts when buyers make minimum quantity or revenue commitments for the term of the contract.

100. For the special access customer, month-to-month rack rates provide flexibility to obtain service for an indefinite period and to modify or terminate service when its needs change. For the incumbent LEC supplying service on month-to-month terms, there is the financial risk that circuits that the buyer does not continually purchase will be idle until they can be sold to another customer. Over a five year period, the supplier can anticipate that some circuits that it sells on month-to-month terms will turn over and be occupied less than full time. Obtaining term commitments of several years insulates the supplier from the vacancy risk resulting from termination. Consequently, rates for service obtained under term contracts can be lower and still yield total revenue over their full term that is as

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[51] *2005 Special Access NPRM* ¶66.

[52] *TRRO* ¶198.

much as the incumbent LEC would expect to receive over the same period of time from selling service to month-to-month customers and incurring occasional vacancies.

101. UNEs are generally sold at month-to-month rates. The cost studies on which rates for UNEs are based include a competitive return to invested capital over the economic life of the facility, based on a stream of revenue that provides for circuit turnover and vacancy. If rates for purchasing UNEs subject to term commitments were established from the same forward-looking cost studies, the term commitment UNE rates would presumably be lower than the available month-to-month UNE rates.

102. Special access month-to-month rack rates and UNE rates are directly comparable as in each instance the supplier bears the risk of customer turnover and circuit vacancy. When special access multi-year term rates are compared to UNE rates, because of the lower expected circuit turnover one would expect the special access rates to be lower than the UNE rates if competitive forces are constraining the special access supplier. Consequently, a comparison of special access multi-year term rates to UNE rates provides a conservative indication of whether special access rates exceed forward-looking costs.

103. A number of price comparisons in the record have been based on calculations of "average rates" that include revenues from rates with volume discounts and rates without such discounts, rates subject to price caps and rates subject to pricing flexibility, and other ingredients that can change from offering to offering.[53] While a convenient simplification, average revenue data do not provide a reliable basis on which to compare prices to costs, nor of the trend in prices over time. Average revenue calculations rely on comparisons of revenues averaged over different mixtures of volumes, contract durations (and other terms) and rate elements subject to pricing flexibility. These comparisons, at best, conflate a host of differences in supply circumstances. Differences in these factors between areas, or over time, cause the average revenue measure to change even when the individual rate elements are fixed. For example, an observed decline in average revenue per high-capacity circuit could simply mean that with the growth in their high-capacity demand, customers have shifted from the month-to-month price to contracts offering volume discounts or discounts for longer terms.

104. In order to obtain valid price measures, comparisons between areas or over time must be based on a fixed quantity of services and the same terms and conditions.[54]

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[53] See, for example, Declaration of Parley C. Casto on Behalf of SBC Communications Inc., *In the Matters of Special Access Rates for Price Cap Local Exchange Carriers and AT&T Corp. Petition for Rulemaking to Reform Regulation of Incumbent Local Exchange Carrier Rates for Interstate Access Services*, WC Docket No. 05-25; RM-10593, Figures 9 and 10; Declaration of William E. Taylor on Behalf of Verizon, *In the Matters of Special Access Rates for Price Cap Local Exchange Carriers and AT&T Corp. Petition for Rulemaking to Reform Regulation of Incumbent Local Exchange Carrier Rates for Interstate Special Access Services*, WC Docket No. 05-25; RM No. 10593, Table 8.

[54] For example, the consumer price index is calculated using a fixed market basket of goods.

A consumption index number calculation is required, in order to remove bias resulting from combining heterogeneous capacities and terms. For example, comparisons in the record have used as a fixed unit of consumption two DS1 channel terminations, a fixed mileage charge for transport, and 10 miles of per-mile charge for transport, for a 3-year term.

105. Evidence in the record indicates that existing prices in Phase II pricing flexibility areas are substantially above the cost-based UNE rates for comparable services. The most comprehensive study is by Joseph Stith in July, 2004 who undertook a systematic comparison of rates in Phase II price flexibility areas with UNE rates for the same basket of services.[55] When rates included in his review are averaged across all Bell Operating Companies (BOCs) and all geographic areas, for month-to-month DS1 service the pricing flexibility rates are nearly three times the UNE rates. For DS3s, the average month-to-month pricing flexibility rate is also more than three times the UNE rate.[56] Dr. Stith's comparisons of Phase II pricing flexibility rates, for a three-year term, with month-to-month UNE rates find the "staggering" result that the three-year term rates range from 129% higher for Verizon to 171% higher for Ameritech.[57]

106. A meaningful analysis of rates requires comparisons that eliminate differences due to changes in spending on special access services that result from differences in volume purchased, duration of contract, and aggregation and bundling of services subject to different price regulations. Evaluating the effect of pricing flexibility on special access rates thus requires looking at a rate for a particular service for a particular term, with otherwise identical contractual provisions. As an essential component of its analysis the Commission should update the Stith study by obtaining from the incumbent LECs each special access rate it has charged for each DS1 and DS3 service in each MSA for the period 1999 – 2009.

2. Price comparisons and price trends

107. A number of other filings in the record have examined special access prices by comparing trends in Phase II rates and by comparing Phase II rates to Phase I (price-cap) rates. Price-to-price comparisons can potentially provide evidence of market power if prior to receiving price flexibility special access rates were sufficient to cover incumbent LECs' economic costs and the incumbent LECs have subsequently raised prices in areas where they have been granted pricing flexibility.

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[55] Stith Decl. Attachment 1.

[56] Mitchell 2007 Decl. ¶50

[57] Stith Decl. at 3.

a) Price flexibility rates vs. price cap rates

108. Methodical studies of special access rates already in the record have found that in price flexibility areas special access rates are, for the most part, higher than rates in price cap areas. The GAO found that "as of June, 2006 the price-flex list price was on average higher than the price-cap price, regardless of whether the price was for channel terminations, interoffice mileage, DS-1 or DS-3 service, different term arrangements, or different density zones."[58] In his systematic study of 2004 rates, Dr. Stith concluded that "the Bells' tariffed pricing flexibility rates are equal to or higher than their tariffed price cap rates in virtually every instance."[59]

109. Many contracts provide for fixed percentage discounts off the list price: the GAO concluded that effective prices for dedicated access under these contracts in Phase II areas were generally higher than in Phase I areas because Phase II list prices were higher, on average, than the Phase I list prices.[60]

b) Price trends

110. Multiple studies in the record show that in price flexibility areas, which are presumed to be competitive, special access rates have not decreased or have increased over time. Uri and Zimmerman examined changes in rack rates from 2000 to 2003. They found that in areas under price caps prices had declined, whereas in areas with pricing flexibility many rates had risen.[61] The GAO found that in areas with Phase II flexibility, average list prices had increased since the prices prevailing in 2001, just prior to the introduction of price flexibility.[62] Since Phase II pricing flexibility was first granted, list prices for dedicated access that apply under Phase II, on average, have increased. Conversely, price-cap list prices available in Phase I and price-cap areas were pushed downward over the same period, largely by the CALLS order. As a result, average list prices in areas with Phase II flexibility are higher than average list prices in Phase I and price-cap areas.[63] The NRRI study concluded that overall "the data do not support any clear conclusions about price trends. Some data suggest rising prices, while other data suggest declining prices. Data quality could well be the reason for these ambiguities." However, it did find that "pricing evidence shows that market forces are not reducing rates in Phase II areas."[64]

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[58] GAO at 28.

[59] Stith Decl. at 3.

[60] GAO at 30.

[61] Uri and Zimmerman, "Market Power and the Deregulation of Special Access Service by the Federal Communications Commission", 13 Information & Telecommunications Technology Law No. 2 at 129 (2004).

[62] GAO at 67.

[63] GAO at 13.

[64] NRRI at 67-68.

c) Prices of competitively-supplied high-bandwidth services

111. The availability of other high-bandwidth services provides another benchmark against which to compare special access prices. Incumbent LECs offer digital subscriber line (DSL) service and fiber-optic-based internet (FiOS, U-verse) services at speeds that are comparable to the speeds provided by DS1 and DS3 special access service.[65] These services have been introduced by the incumbent LECs in order to respond to the competition for consumer broadband (and video) services provided by cable modem service.

112. These retail services generally face competition in most MSAs. Yet prices are notably lower than DS1 special access rates, for which Sprint pays on average $390 per month (1.5 Mbps).[66] For example, Verizon's FiOS service is available at a stand-alone price of $54.99 a month for speeds up to 15 Mbps,[67] while AT&T offers U-verse service and DSL service at speeds up to 6 Mbps for $35 per month.[68]

d) Summary

113. While price comparisons in the record not unexpectedly show variations by market density, product, and rate schedule, three major systematic analyses of special access prices in the record reach the same fundamental conclusion – price flexibility has not lowered special access prices.[69] The Commission should suspend action on any applications for Phase I or Phase II price flexibility while proceeding expeditiously to collect the data needed to carry out the analysis of its price cap regulation and pricing flexibility set out in the analytic framework it adopts.

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[65] The speeds provided by these incumbent LEC services are "best efforts" rather than the guaranteed speeds provided in special access. On the other hand, these consumer broadband services incur additional costs, such as for e-mail, web browsing, web hosting, etc., that are not incurred for special access. It is unclear whether the additional costs that would be needed to guarantee transmission speeds for these consumer broadband services exceed the costs of the additional functions provided in consumer broadband but not in special access.

[66] *See* Written Testimony of Paul Schieber, Vice President Access and Roaming, Sprint Nextel Corporation, on an Examination of Competition in the Wireless Industry, Before the House Subcommittee on Communications, Technology and the Internet, May 7, 2009, at 7 (Schieber Testimony), available at: <http://energycommerce.house.gov/Press_111/20090507/testimony_schieber.pdf>.

[67] *See* http://www22.verizon.com/Residential/FiOSInternet/Plans/Plans.htm (last visited on January 13, 2010).

[68] *See* http://www.att.com/u-verse/explore/internet-landing.jsp (last visited on January 13, 2010) for U-verse prices, and http://www.att.com/gen/general?pid=10891 (last visited on January 13, 2010) for DSL prices.

[69] *See 2009 Public Notice* at 1-2.

3. *Terms and conditions*

114. In addition to the month-to-month rack rates for special access services, incumbent LECs offer customers lower rates for committing to term contracts for 1 to 5 or more years. Discounts in term contracts are generally stated as percentages of the rack rates. Evidence in the record is that discounts below rack rates can be as much as 68% for both DS3 dedicated transport mileage and DS3 channel terminations, 57% for DS1 dedicated transport and 33% for DS1 channel termination.[70]

115. It is well established in economics that third-degree price discrimination – charging a customer an individual price based on his particular circumstances – can either increase or decrease welfare.[71] In general, when the consumer is offered a lower price for purchasing a greater quantity of service – in quantity consumed per unit time, or length of time consumed – and chooses the larger quantity or term, his consumer surplus in increased. When a profit-maximizing producer offers the customer this option of greater volume at a lower price it is because the surplus he realizes on sale of the additional quantity exceeds the reduced margin on the sales that would occur at the higher price. In these circumstances, price discrimination can increase welfare. However, when price discrimination also results in a higher price to other consumers, total welfare may decrease.

116. The effect of price discrimination, in the form of term and volume discounts, on competitive entry is to increase the quantity that an entrant must be prepared to supply in order to match or improve on the terms of purchase offered by the incumbent. To achieve higher volumes requires that the competitor enter the market at a higher minimum scale, and often over a wider geographic area than would be needed to compete circuit-by-circuit. Term and volume discounts thus have the potential to discourage entry.

117. The Commission has observed that because "investments were location specific, the entrant incurred sunk costs, making it less likely that the incumbent could successfully use exclusionary strategies to drive the entrant from the market."[72] As a result, the Commission's view has been "that sunk investment in the facilities sufficient to discourage exclusionary pricing behavior would also preclude anticompetitive volume and term discounts"[73]

118. However, the current price flexibility triggers, which are based on the presence of collocation facilities (*i.e.*, "sunk investment"), are unreliable. As I have noted above, the presence of collocation facilities in a fraction of the MSA wire centers

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[70] NRRI at 62.

[71] Varian, *Handbook of Industrial Organization*, "Price Discrimination", at 619-622.

[72] *2005 Special Access NPRM* ¶109.

[73] *2009 Public Notice* at 6; *Pricing Flexibility Order* ¶¶79-80.

does not necessarily mean that there are competitive alternatives to special access in many areas of the MSA or in all special access products. Furthermore, the Commission's price cap rules do not prohibit incumbents from engaging in practices that prevent or deter the deployment of collocation facilities in the first place or prevent or deter entry with facilities that bypass wire center collocation. The Commission should examine terms and conditions from the perspective of erecting barriers to competitive entry.

a) Restrictive conditions

119. Of particular concern are the incumbent LEC contracts that include restrictive conditions in order for a buyer to qualify for term and volume discounts. Such conditions can foreclose the very entry that would result in the sunk investments that the Commission is relying on to prevent anticompetitive behavior by the incumbent LEC. Minimum volume commitments can require the buyer to purchase all, or nearly all, of his special access services from the incumbent LEC and to incur substantial penalties for failing to maintain minimum volumes over the term of the contract. The effect of such conditions is to erect barriers to entry by competitive suppliers. In order to compete for a buyer's business the entrant must be prepared either to offer to supply the entire quantity required by the buyer or to offer a smaller quantity at a sufficiently lower price such that the savings to the buyer from switching a portion of its purchases to the competitor offsets the penalty under the incumbent LEC contract.

120. **Minimum volume commitments** are especially important in restricting entry when the volume is for service aggregated over multiple markets and more than one MSA.[74] To be able to counter such "quantity forcing" conditions, the entrant must have entered and achieved the scale necessary to offer service over a sufficient number of markets. When a contract ties the availability of discounts in one market where no competitive alternatives are available to the purchase of other products in markets where competition is feasible the contractual conditions create a barrier to entry.

121. Evidence in the record has established that the conditions in some minimum value commitment contracts are structured so as to make it unprofitable for a competitor to win a small portion of a customer's business, even if the incumbent LEC's price exceeds the competitor's long-run cost. A customer who considers switching a portion of his special access demand to a competitor is unable to obtain the discounts for the volume of services it continues to purchase from the incumbent LEC, because the volume commitment is based on the customer's total prior payments to the incumbent LEC. The effect of the minimum volume commitment is to require a competitive carrier to beat a marginal price that is much less than average price paid to the incumbent LEC, and likely less than the

[74] See, for example, Marius Schwartz and Daniel Vincent, "Quantity Forcing and Exclusion: Bundled Discounts and Nonlinear Pricing", Issues in Competition Law and Policy 939 (ABA Section of Antitrust Law 2008), at 958 (Schwartz and Vincent).

average cost of an efficient competitor.[75] As a result, a competitor is unable to profitably compete to serve the special access market on a limited scale.

122. **Portability conditions** narrow the opportunity for a buyer to switch to another supplier; by increasing the switching cost for the buyer the incumbent LEC effectively decreases the buyer's demand elasticity and is able to charge a higher price without losing the demand to a competitor.

123. Accepting restrictive terms and conditions reduces the purchasing options available to the buyer during the life of the contract to obtain service from another supplier. The value of the options that are foregone are a measure of the cost the buyer incurs by accepting the terms and conditions, as compared with purchasing the same quantity of services without the restrictive conditions. In the case of a minimum volume commitment condition, for example, where the buyer's relevant alternatives might include shifting one or more quantities to an alternate supplier, the likelihood of exercising the option would be determined by the probabilities and timing of competitive entry in each of its markets. By shifting its demand to the alternate supplier the buyer would reduce its costs, and the expected value of the savings for those quantities would measure the value of the option that the buyer foregoes in accepting the incumbent LEC contract with conditions.

124. The GAO has found that many contracts that provide for discounts off the list price include revenue guarantees, requirements for shifting business away from competitors, and severe termination penalties. "Unless 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."[76]

125. Sprint has filed evidence of five categories of terms and conditions contained in BOC contracts that have the effect of locking in customers and forestalling competitive entry:[77]

- Revenue commitment levels set at up to 100 percent of current demand levels;
- Shortfall penalties if actual demand falls below specified levels;
- Overage penalties if actual demand exceeds specified levels;
- Termination liabilities for exiting the plan prior to the scheduled expiration date; and
- Onerous circuit migration charges and restrictions.

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[75] Reply Declaration of Joseph Farrell, attached to Reply Comments of CompTel, *et al.*, WC Docket No. 05-25, ¶¶ 11-16 (July 29, 2005).

[76] GAO at 30.

[77] See Sprint Comments, GN Docket No. 09-51, at 37 and Attachment 4 (November 4, 2009).

126. **Revenue commitments.** In order to obtain the "discounts" available in the BOCs' contracts the customer must make a revenue commitment that is measured as a percentage of the customer's total spending on special access services. For a contract that requires a 95% revenue commitment, in order to be eligible for the "volume" discount a customer with $10 million in total annual special access purchases would have to purchase $9.5 million worth of those requirements (95 percent), while another customer, with $100 million in annual purchases, would have to purchase $95 million worth of services to obtain the same percentage discount. The volume "discount" is based on the subscriber's commitment, rather than the size of its total demand and does not appear to be based in any way on the BOC's own cost structure (*i.e.*, the savings the BOC realizes by providing services in bulk).

127. Verizon's portability commitment levels range between 85-100 percent, depending upon the plan and the service, and in addition, it conditions certain discounts upon the in-service count for each rate element.[78] The individual rate element condition is especially problematic: while a carrier might find it economic to build some of its own interoffice transport facilities, it is sharply discouraged from doing so because the discount on low-volume channel terminations (which are rarely economic to self-provision) is tied to purchase of interoffice transport from the BOC. These conditions leverage the carrier's dominance in the provision of channel terminations into greater control of the interoffice transport business, where competition is marginally more feasible.

128. AT&T had even tariffed a volume discount plan - the MVP Plan - which required the customer to shift purchases from a competitor to the incumbent LEC.[79] In addition to requiring an annual revenue commitment based on the customer's total recurring billing for all MVP-qualified access services (prior to any MVP discounts) for the previous three months, multiplied by 4, the plan required that the customer also demonstrate that four percent of all services purchased under the plan were previously provided by a carrier other than AT&T or its affiliates.

129. **Shortfall penalties**: Subscribers are assessed penalties if their actual special access purchases fall below the level specified in their volume discount plan. While in theory, the application of shortfall penalties can be economically justifiable, many of the actual penalties imposed by the incumbent LECs are onerous and unreasonable. For example, under several AT&T FCC tariffs, the shortfall penalty for failing to meet a volume commitment far exceeds the rack rate of purchasing an additional channel termination in order to meet the

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[78] Verizon Wholesale, "Verizon launches a new, first-of-its kind discount plan for Special Access DS1s and DS3s." (See http://www22.verizon.com/wholesale/productguide/nationalplan/, accessed January 2, 2010)

[79] *See* Ameritech Operating Companies, Tariff FCC No. 2, § 22.20, at 22-122 (filed Nov. 17, 2003 under Transmittal No. 1369) (now expired).

commitment.[80] Consequently, in order to avoid falling below their volume commitment customers that have an incentive to purchase "channel terminations to nowhere" simply to avoid paying the penalty. The magnitude of shortfall penalties discourages competitive entry by deterring customers from self-provisioning or from subscribing to a competitive provider.

130. **Circuit migration charges and restrictions:** The incumbent LECs assess very high rates to perform a circuit migration in addition to levying, in some cases, hourly overtime labor charges. These migration charges are assessed even if the move involves nothing more than a few keystrokes and rerouting the circuit from one port in a central office to another port a few feet away in the same office. In Sprint's experience, the migration task is simply switching the circuit from the incumbent LEC to a competitive LEC collocated in the incumbent LEC's central office, with no change to the customer termination point.[81]

131. In evaluating an offer from an alternative access provider, Sprint and similarly situated buyers of special access must factor in the non-recurring move charges it will incur from the incumbent LEC to migrate the circuit from the incumbent LEC to the competitive LEC's port. In some instances, the several hundred or thousand-plus dollar incumbent LEC migration fee can make the competitive LEC offer uneconomic. At a minimum, these fees extend the break-even period.

132. **Exclusivity-like provisions**. Some incumbent LEC contracts condition the availability of discounts to reducing the buyer's purchases of services from competitors. In other cases, incumbent LECs limit the buyer's use of UNEs. For example, AT&T's tariffs do not permit a competitor to connect a UNE to a special access circuit.[82] As an economic matter, the unavailability of UNEs limits the effective amount of competition. Moreover, because the incumbent LEC provides network elements to itself at economic cost, when an incumbent LEC limits a competitor's access to those elements it may violate Section 251(c)(3) of the Telecommunications Act, which requires non-discriminatory access.

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[80] For example, AT&T's penalty for failing to meet commitment levels in its Term Payment Plan in Ameritech, SBC, Pacific Bell, Nevada Bell, and SNET territory is a $900 non-recurring charge assessed for each channel termination below the committed level. See AT&T Midwest (Ameritech) FCC Tariff No. 2, Section 7.4.13, AT&T Southwest (Southwestern Bell) FCC Tariff No. 73, Section 7.2.22, AT&T West (Pacific Bell) FCC Tariff No. 1, Section 7.4.18, AT&T West (Nevada Bell) FCC Tariff No. 1, Section 7.11.5.2, AT&T East (Southern New England Telephone) FCC Tariff No. 39, Section 2.11.1.1

[81] Sprint Comments, GN Docket No. 09-51, at 43-45 (November 4, 2009).

[82] AT&T Wholesale Tariff Services, "Unbundled Dedicated Transport – Currently Combined UNE Combinations, CLEC Information Package, Version 16," March 16, 2009, pp. 5-6. (Available at http://wholesale.att.com/reference_library/guides/unedocs/Currently%20Combined%20v16.doc, accessed January 2, 2010.)

b) Summary

133. A dominant supplier is able to use non-linear pricing without relying on tying and other contractual conditions to extract consumer surplus.[83] Contracts that induce a customer to purchase a very high share of its total requirements from the incumbent have greater exclusionary potential than two-part tariffs and other non-linear prices.[84] Moreover, most terms and conditions do not appear to yield lower costs for the incumbent LECs. Volume commitments across markets, exclusivity restrictions, onerous shortfall penalties, and limits on purchasing from competitors are therefore practices that the Commission should scrutinize carefully and devise regulations to prevent foreclosure of competitors in areas where it allows price flexibility.

134. Based on evidence in the record, the Commission's price cap and price flexibility rules do not restrict the incumbent LECs from offering special access contracts with exclusionary terms and conditions and do not ensure that terms and conditions are just and reasonable.[85] When incumbents offer exclusionary terms and conditions, they foreclose the competitive entry and investment in collocation and other facilities that are necessary for competition to act as a check on an incumbent's market power and supra-competitive pricing. The Commission should obtain data from the incumbent LECs detailing their volume commitment agreements, including volume levels required, geographic areas, other commitment requirements, and penalties for failing to meet commitment levels and for early termination. As well, the Commission should obtain data on the number of volume commitment agreements, circuits of each capacity subject to agreements, and distribution of circuits by length of term commitment.

F. Assessing potential competition

135. Potential supply of special access services, particularly channel terminations, is driven by potential demand at a location relative to the cost of extending a competitor's network to serve that location. The principal cost factors include the investment needed to connect from a competitor's existing fiber-optic ring or central network facility to the customer's building and to extend the lateral connection to the customer's floor. As the Commission noted in the *TRRO,* "[t]he most significant portion of the costs incurred in building a fiber loop results from deploying the physical fiber infrastructure into underground conduit to a particular location, rather than from lighting the fiber-optic cable."[86]

136. The likelihood of potential competition for an incumbent LEC's special access channel terminations depends on the economic feasibility of a competitor

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[83] Schwartz and Vincent at 959.

[84] Schwartz and Vincent at 970.

[85] *2009 Public Notice* at 2, Question 3.

[86] *TRRO* ¶150.

constructing facilities to extend its network to connect to a building or cell site. To be feasible, the present value of the likely additional revenue from new customers must at least cover the incremental investment cost and a competitive return on extending the competitor's facilities. Although construction costs of fiber loops vary with many local conditions, the Department of Justice (DOJ) established a screening test for the purpose of evaluating the effect of merging two carriers that provide competitive service in the same building. The DOJ screen eliminates non-problematic buildings when a building has, for example, a minimum demand of 2 DS3 (indicating revenue opportunity) at distance of not more than 0.1 mile from the closest competitive carrier's fiber.[87] The presence of nearby competitive fiber, combined with sufficient demand, was taken to indicate the availability of potential competitive supply that would constrain market power at that location of the merged carriers.

137. As I have noted above, the evidence in the record establishes that at locations where demand is for DS1 channel terminations, customers such as CMRS providers remain overwhelmingly dependent on incumbent LECs, who are able to provision the channel terminations circuits primarily over legacy copper facilities. It is almost never economically feasible for a competitive carrier to recover the competitive investment necessary to extend its fiber facilities to locations with such limited demand or to provision new copper loops. Consequently, the potential for stand-alone competitive supply of special access channel terminations at locations with minimum demand of less than one DS3 is very low.

IV. COLLECTING ADDITIONAL DATA

138. Using the analytic framework outlined above will allow the Commission to identify problems with its current regulatory scheme. Based on evidence in the record to date, the FCC would be likely to provisionally conclude that important components of its price cap and pricing flexibility regulatory regime are not producing the competitive effects that it anticipated:

- In both Phase I and Phase II areas prices for special access month-to-month and term contracts very substantially exceed the forward-cost-based UNE rates for the functionally equivalent network elements and the rates for equivalent-speed service provided over DSL and FiOS.
- There is substantial evidence that incumbent LECs retain and exercise market power over special access channel terminations and that prices have not been reduced to cost-based levels. Incumbent LECs supply over 99% of the DS1 channel terminations and 91% of the DS3 channel terminations.[88]

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[87] Redacted Declaration of W. Robert Majure at 11 n. 17, attached to United States' Notice of Public Filing of Redacted Submission, *United States v. SBC Commc'ns, Inc.*, Case No 1:05-cv-02102, D.E. #133 (D.D.C. Aug. 9, 2006) (*Majure Declaration*), at 11 n.17.

[88] NRRI at 42.

- Outside of the central business districts, where business line density is highest, very little competitive entry to supply channel termination has occurred. The FCC's triggers for the presumption of effective competition are based on the percentage of wire centers in an MSA at which competitors have collocated facilities. But collocation, used by competitive suppliers for interconnection to their own transport facilities, has not been a reliable indicator of competitive supply of channel terminations.
- The incumbent LECs have used the price flexibility available to them in MSAs that satisfy the collocation triggers to craft terms and conditions to special access contracts that lock in customers and increase barriers to entry.

139. The Commission should supplement the record to collect additional data that will enable it to test these preliminary conclusions, identify problems with the current regulatory scheme, and have the information needed to reset the price cap parameters and to modify the price flexibility triggers to remedy problems that it finds.

140. In describing the analytic framework above, I have identified the major types of data that the Commission should seek in order to carry out the analysis called for in its *2009 Public Notice* to determine how effective the Commission's special access price regulations have been to limit the exercise of market power and to prevent incumbents from using their dominance to foreclose entry.

- From incumbent LECs, obtain data on:
  - UNE rates for high-capacity loops and interoffice transport, to provide evidence on forward-looking costs of loops and transport for comparison with special access rates in order to assess the exercise of incumbent LEC market power in special access markets.
  - Rates for the principal special access products, to be compared with measures of forward-looking cost and to establish trends in special access rates holding constant volume, term, and other contract provisions in areas granted Phase I and Phase II pricing flexibility.
  - Terms and conditions of contracts in Phase I and Phase II MSAs, to identify conditions that potentially erect barriers to competitive entry.

- From competitive special access suppliers, obtain for each building where they supply service, the number of special access products supplied at that building and the incumbent LEC wire center serving that location, in order to assess the exercise of incumbent LEC market power by geographic area and product.

- From CMRS providers, obtain for each tower the tower location, incumbent LEC wire center, special access services purchased and competitive services purchased, in order to access the incumbent LECs' market shares in urban and non-urban areas.

I declare under penalty of perjury under the laws of the United States of America that the foregoing is true and correct to the best of my knowledge and belief.

Executed on January 19, 2010

B Mitchell

Bridger M. Mitchell