

**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
)	

REPLY COMMENTS OF THE NEW JERSEY DIVISION OF RATE COUNSEL

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SUMMARY

Based on its review of initial comments, the New Jersey Division of Rate Counsel fully supports a comprehensive assessment by the Federal Communications Commission of special access markets including the design and subsequent application of a sound analytic framework for determining the level of competition that exists in relevant geographic and product markets. Initial comments amply demonstrate, sufficient information and data have been provided in this docket to justify immediate interim modifications to the rates, terms, and conditions of incumbent local exchange carriers' ("ILECs") special access services. ILECs possess market power as is evidenced by the supracompetitive profits that they have been enjoying. Continued delay benefits incumbent local exchange carriers and harms consumers.

Traditional, well-accepted economic analysis should provide the foundation of any analytic framework. The determination of relevant geographic and product markets is an essential first step. The Commission should use those criteria that it has historically applied in order to assess market power: share of relevant market; elasticity of supply; elasticity of demand; and other factors, such as barriers to entry. Consumers' actual purchasing decisions and the prices that carriers can sustain in a declining cost industry provide the most reliable information about ILECs' market power. The Commission should reject proposals that would afford undue weight to speculative technologies, future plans, and potential entry. In today's economy, costly access to capital presents a significant barrier to entry.

Consistent with Rate Counsel's previous filings in earlier phases of this proceeding, Rate Counsel is persuaded by those initial comments that recommend that the Commission discontinue use of the MSA as the geographic market because it is overly broad, and because it includes areas with widely disparate levels of competition. Also, the use of collocation as a

proxy for competition is misleading and is not an appropriate economic indicator of competitors' presence in relevant markets and ability to serve customers. Furthermore, DS1 and DS3 channel terminations and DS1 and DS3 transport should be viewed as four distinct product markets. Statistically valid subsets of buildings can be used to conduct analyses of ILECs' market power.

Supracompetitive rates for special access products provide economically inefficient pricing signals and distort investment decisions. When competitors and customers confront above-cost prices, they may invest to replicate special access facilities, which could lead to society supporting the inefficient duplication of resources. Accurate pricing signals will lead to efficient deployment of resources. Among other areas to investigate, the Commission should examine the special access rates that prevail in any markets that more than one ILEC serves, if such markets exist. Also, the Commission should consider the merits of structural separation so that ILECs' special access services are offered by a separate affiliate, which would minimize the incentives and opportunities for anticompetitive rates, terms, and conditions.

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I. INTRODUCTION

The Federal Communications Commission (“FCC” or “Commission”) sought public input in response to its Public Notice on “the appropriate analytical framework” with which to examine evidence in its special access proceeding,¹ and parties filed comments on January 19, 2010.² During the past several years, the New Jersey Division of Rate Counsel (“Rate Counsel”)

¹/ Federal Communications Commission Public Notice, “Parties Asked to Comment on Analytical Framework Necessary to Resolve Issues in the *Special Access NPRM*,” rel. November 5, 2009 (“Public Notice”). *Federal Register* Vol. 74, No. 232, December 4, 2009, 63702.

²/ Comments were filed by Ad Hoc Telecommunications Users Committee (“Ad Hoc”); AT&T Inc. (“AT&T”); BT Americas Inc.; Competitive Enterprise Institute; COMPTTEL; Global Crossing North America, Inc. (“Global Crossing”); Hance Haney; Massachusetts Department of Telecommunications and Cable (“Massachusetts DTC”); NoChokePoints Coalition; Paetec Holding Inc., TDS Metrocom, LLC, U.S. Telepacific Corp. and MPower Communications Corp., both d/b/a Telepacific Communications, Masergy Communications, Inc., and New Edge Network, Inc. (“Paetec et al.”); Qwest Communications International, Inc. (“Qwest”); Sprint Nextel Corporation (“Sprint Nextel”); tw telecom, inc. (“TWTC”); Verizon and Verizon Wireless (“Verizon”); XO Communications (“XO”). The NoChokePoints Coalition includes: New America Foundation, Public Knowledge, Media Access Project, Association for Information Communications Technology Professionals in Higher Education (“ACUTA”), Ad Hoc, Computer & Communications Industry Association (“CCIA”), Deltacom, Inc., Cbeyond, BT Americas Inc., One Communications, Sprint Nextel, T-Mobile, U.S. Cellular, Cellular South, Clearwire, Integra Telecom, and TWTC.

has participated in the Commission's review of the special access market³ and welcomes the Commission's examination of a framework with which to determine whether the pricing flexibility rules have been successful. Rate Counsel commends the Commission for its well-reasoned approach to examining the special access market, and, with this filing, responds to the initial comments that have been submitted.

Rate Counsel is an independent New Jersey State agency that represents and protects the interests of all utility consumers, including residential, business, commercial, and industrial entities. Rate Counsel participates actively in relevant Federal and state administrative and judicial proceedings. The above-captioned proceeding is germane to Rate Counsel's continued participation and interest in implementation of the Telecommunications Act of 1996.⁴ The New Jersey Legislature has declared that it is the policy of the State to provide diversity in the supply of telecommunications services, and it has found that competition will "promote efficiency, reduce regulatory delay, and foster productivity and innovation" and "produce a wider selection of services at competitive market-based prices."⁵ Consumers ultimately pay for inflated prices either directly to incumbent local exchange carriers ("ILEC") (in the instance of large consumers) or indirectly in the prices they pay for non-ILEC telecommunications services as well as goods and services across the economy. The inefficient rates lead to loss of consumer

³ / See, e.g., In the Matter of 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, FCC WC Docket No. 05-25; RM-10593, Comments of the New Jersey Division of the Ratepayer Advocate, June 13, 2005 ("Rate Counsel comments, June 13 2005"); Reply Comments of the New Jersey Division of the Ratepayer Advocate, July 29, 2005 ("Rate Counsel reply, July 29 2005"); Comments of the New Jersey Division of Rate Counsel, August 8, 2007 ("Rate Counsel refresh comments, August 8 2007"); Reply Comments of the New Jersey Division of Rate Counsel, August 15, 2007 ("Rate Counsel refresh reply, August 15 2007").

⁴ / Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 ("1996 Act"). The 1996 Act amended the Communications Act of 1934. Hereinafter, the Communications Act of 1934, as amended by the 1996 Act, will be referred to as "the 1996 Act," or "the Act," and all citations to the 1996 Act will be to the 1996 Act as it is codified in the United States Code.

⁵ / N.J.S.A. 48:2-21.16(a)(4) and 48:2-21.16(b)(1) and (3).

welfare, and thwart competition. The resolution of the complex economic and policy issues that this proceeding embraces directly affects the structure of telecommunications markets, and the prices that consumers pay for telecommunications services.

II. SCOPE OF PROCEEDING

On multiple occasions, parties in this proceeding have provided comments regarding the current status of competition in the special access market and on measures to ensure that special access rates remain just and reasonable.⁶ The Commission, in its Public Notice, states:

The Commission would benefit from a clear explanation by the parties of how it should use data to determine systematically whether the current price cap and pricing flexibility rules are working properly to ensure just and reasonable rates, terms, and conditions and to provide flexibility in the presence of competition.⁷

The FCC is seeking input as to the framework for determining the answers to several questions, including:

- Do the Commission's pricing flexibility rules ensure just and reasonable rates?
 - Are the pricing flexibility triggers, which are based on collocation by competitive carriers, 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?
 - If so, are the triggers set at an appropriate level?
- Do the Commission's price cap rules ensure just and reasonable special access rates?
- Do the Commission's price cap and pricing flexibility rules ensure that terms and conditions in special access tariffs and contracts are just and reasonable?

⁶ / Comments and reply comments were filed in response to: In the Matter of 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, FCC WC Docket No. 05-25; RM-10593, Order and Notice of Proposed Rulemaking, released January 31, 2005 ("Special Access NPRM") and Federal Communications Commission, Public Notice, "Parties Asked to Refresh Record in the Special Access Notice of Proposed Rulemaking," WC Docket No. 05-25, RM-10593, FCC 07-123, released July 9, 2007 ("Refresh the Record Public Notice") as well as ex parte presentations and filings over the past several years.

⁷ / Public Notice, at 2.

The FCC asks that the proposed frameworks be both “analytically rigorous (*i.e.*, fact-based and systematic” as well as “administratively practical.”⁸ Although a tension exists between these two goals, initial comments have identified components of an analytic framework that balances these goals. The FCC has limited the scope of the comments to the analytical framework to be used to come to a fact-based conclusion. Finally, the FCC asks for parties to address whether their proposed framework for addressing the above questions can utilize evidence in the existing record, or in the alternative, whether new data will be required. If new data is required, parties have been directed by the FCC to indicate specifically what additional data is required, from whom, and how the FCC should collect the data.⁹

III. COMMENT

A. OVERVIEW OF SPECIAL ACCESS MARKETS AND THEIR IMPORTANCE TO CONSUMERS

Structural changes in telecommunications markets heighten concerns about anticompetitive behavior and prices.

Structural changes in telecommunications markets, including horizontal and vertical integrations resulting from mergers among ILECs and from ILEC acquisitions of legacy AT&T and MCI, have exacerbated anticompetitive harms that legacy AT&T identified in its original 2002 petition, seeking review of interstate special access rates.¹⁰ Rate Counsel has consistently voiced its concerns about the impact of the multiple mergers and acquisitions that have occurred since the enactment of the Telecommunications Act of 1996 on competition in various telecommunications markets, and concurs with Sprint Nextel’s concern about the impact of

⁸ / *Id.*

⁹ / *Id.*, at 3.

¹⁰ / Sprint Nextel, at 2.

increasing market concentration on the potential for and possible existence of anticompetitive practices in special access services markets.

Special access reform influences job growth, broadband deployment, and innovation.

Special access reform will benefit job growth, broadband deployment, and innovation. Much is at stake in this proceeding. Through the application of a sound analytic framework to representative data, the Commission can ensure that special access rates, terms, and conditions provide accurate pricing signals to consumers and providers, and thus promote the development of efficient competition. These results have widespread consequences for the health of the economy and the deployment of state-of-the-art telecommunications infrastructure in the United States. Rate Counsel is aware of only one state public utility commission that submitted comments in this proceeding – the Massachusetts Department of Telecommunications and Cable (“Massachusetts DTC”). As the Massachusetts DTC recognizes, although the vast majority of special access circuits are classified as interstate (in Massachusetts, more than 99 percent¹¹), state regulators have a stake in how interstate special access is regulated “given their impact on competition and the economy within the state.”¹²

The Commission should not be deterred from a sound analysis by threats from the industry. Despite arguing that the special access market no longer matters, AT&T speculates that broadband deployment would be irreparably harmed by regulation of special access rates: “the direct result of mandated reduction in rates for DSn-level services would inevitably be to reduce investment and innovations by ILECs and all other providers in the higher-capacity broadband infrastructure that the nation so desperately needs.”¹³ Overarching the RBOCs’

¹¹ / Massachusetts DTC, at 2.

¹² / *Id.*

¹³ / AT&T, at 3.

filings is the not so subtle blackmail regarding broadband deployment.¹⁴ Qwest asserts that purportedly low special access rates cause companies to purchase special access instead of investing in new technologies that will make speeds faster and the Internet more efficient.¹⁵ AT&T asserts that many proposals for addressing special access market concentration would put the Commission's broadband goals in jeopardy, and that the most important principle for the FCC's framework "is the need to preserve the healthiest possible incentives for providers of all types to invest in the broadband infrastructure of the future."¹⁶

Rate Counsel concurs with NoChokePoints Coalition's contrasting observation that broadband deployment continues to be harmed because of high special access rates.¹⁷ As NoChokePoints Coalition explains, "[s]pecial access services are critical inputs for broadband services provided by rural telecommunications carriers and wireless carriers, and therefore are essential for broadband deployment and competition. Special access is also the foundation of dedicated high-speed broadband for businesses, universities, hospitals, public safety organizations, and government agencies throughout the country."¹⁸ Establishing an analytic framework that enables the Commission to set rates for interstate special access that provide accurate pricing signals can only be beneficial to the efficient deployment of broadband infrastructure throughout the United States.

A 2006 report from the United States Government Accountability Office ("GAO") concluded that the FCC failed to monitor market deregulation and that in order "to better meet its

¹⁴ / *Id.*, at 6; Qwest, at 20.

¹⁵ / Qwest, at 20.

¹⁶ / AT&T, at 6 and 13.

¹⁷ / NoChokePoints Coalition, at 3. See Qwest, at 20 (positing that prices are artificially low in the special access market, thus creating an incentive for competitors to continue to use special access when they should be deploying "next-generation alternatives" and thus the broadband facilities that Americans demand).

¹⁸ / NoChokePoints Coalition, at 4-5.

regulatory responsibilities” it should “collect more meaningful data” and also “needs a more accurate measure of competition.”¹⁹ Rate Counsel is pleased that the Commission has now concluded, as Rate Counsel and others have recommended, that it must focus first on a comprehensive examination of whether, and to what extent, competition exists in the special access market.

According to AT&T, Commission analysis of the special access market is “straightforward” and the principle that ILECs should have rate flexibility where “competitors have relatively extensive deployments of sunk competitive facilities” is not being debated.²⁰ However, clearly the appropriate indicator of “relatively extensive deployments” is very much up for debate. AT&T further suggests that the challenges to the current pricing flexibility rules are empirical but that the framework is clear: “the Commission should collect detailed competitive data to determine whether the current, collocation-based pricing flexibility triggers are in fact a reasonably accurate proxy for the presence of sunk competitive networks that are sources of actual and potential competition.”²¹ As Rate Counsel discusses further in these comments, collocation-based triggers are an *inaccurate* proxy for measuring competition.

AT&T urges the Commission to require intermodal and intramodal competitors to submit data on the location and “potential reach” of their networks as well as the purported “rapidly decreasing prices they actually pay for special access services.”²² With data in hand, the Commission can then “assess claims that there is a poor fit between existing ‘triggers’ and the

¹⁹ / United States Government Accountability Office, Report to the Chairman, Committee on Government Reform, House of Representatives, *FCC Needs to Improve Its Ability to Monitor and Determine the Extent of Competition in Dedicated Access Services*, GAO-07-80, November 2006 (“GAO Report”), at 15.

²⁰ / AT&T, at 4.

²¹ / *Id.* AT&T’s position is that the triggers need not be perfect, but be “reasonable proxies.” *Id.*, at 7.

²² / *Id.*, at 4. See, also, *id.*, at 8 recommending that the Commission issue data requests to competitive local exchange carrier (“CLEC”), cable and wireless special access competitors.

presence of sunk competitive facilities.”²³ According to AT&T, a “full-blown market power analysis designed to ensure that the last vestiges of theoretical market power have been excised from every nook and cranny” is unnecessary.²⁴ AT&T overstates the presence of competition and underestimates the inaccuracy of the existing triggers as a measure of competition.

Rate Counsel strongly disagrees with AT&T’s recommended approach to examining special access markets. It is not surprising that AT&T and others oppose a comprehensive analysis of market power nor that they oppose an assessment of ILECs’ profits. It is only if the FCC retains a superficial assessment of special access markets that ILECs could retain the pricing flexibility they now enjoy. A fact-based analysis of ILEC market power using traditional antitrust economic analysis, and an analysis of ILEC prices and profits would not lead to the pricing flexibility that now, inappropriately, exists.

B. ANALYTIC FRAMEWORK

The Commission should undertake a market-power analysis.

The foundation of any analytic framework should be the determination of the relevant geographic and product markets.²⁵ Then, the Commission should use those criteria that it has historically applied in order to assess market power: share of relevant market; elasticity of supply; elasticity of demand; and other factors, such as barriers to entry.²⁶

It is critical to define markets when examining the extent of competition in a market and prior to performing a market power analysis. Economists generally agree that defining the market properly is an essential first step to assessing market structure. As stated by some:

²³ / *Id.*, at 5.

²⁴ / *Id.*, at 7.

²⁵ / Sprint Nextel, at 3.

²⁶ / *Id.*, at 3, 8, 17; PAETEC et al., at 26-28.

The first step in any analysis of competition in a market is to properly define the product and geographic dimensions of the relevant market. If a market is defined either too broadly or too narrowly, spurious conclusions may arise.²⁷

In considering substitution possibilities, further economic discussion of the complexities of defining relevant products is as follows:

The ideal definition of a market must take into account substitution possibilities in both consumption and production. On the demand side, firms are competitors or rivals if the products they offer are good substitutes for one another in the eyes of buyers. But how, exactly, does one draw the line between ‘good’ and ‘not good enough’ substitutes.²⁸

In its *Notice of Proposed Rulemaking* (“NPRM”) of August 2004 in the Triennial Review proceeding, the FCC appropriately sought comment on “how best to define relevant markets (e.g., product markets, geographic markets, customer classes) to develop rules that account for market variability and to conduct the service-specific inquiries to which *USTA II* refers.”²⁹ The *Triennial Review NPRM*, incorporated by the FCC into the August 2004 NPRM, also sought comment on how best to define markets.³⁰ Defining markets accurately is equally important in the Commission’s review of competition in the special access market. In its August 2004 *TRRO NPRM*, the FCC states that the *USTA II* decision requires that it “must account for specific characteristics of the market in which a particular requesting carrier operates” when undertaking

^{27/} David L. Kaserman and John W. Mayo, “Competition in the Long-Distance Market,” *Handbook of Telecommunications Economics*, Vol.1, Martin E. Cave, Sumit K. Majumdar, and Ingo Vogelsang, eds., (Elsevier: Amsterdam, 2002), at 512.

^{28/} *Industrial Market Structure and Economic Performance*, F. M. Scherer (Chicago: Rand McNally & Company, 1970), at 53.

^{29/} *In the Matter of Unbundled Access to Network Elements, Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers*, WC Docket No. 04-313, CC Docket No. 01-338, *Order and Notice of Proposed Rulemaking*, released August 20, 2004 (“TRRO NPRM”), at para. 9.

^{30/} *Id.*, at para. 11, footnote 39; *Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers, Implementation of the Local Competition Provisions of the Telecommunications Act of 1996, Deployment of Wireline Services Offering Advanced Telecommunications Capability*, CC Docket Nos. 01-338, 96-98, 98-147, Notice of Proposed Rulemaking, 16 FCC Rcd 22781 (2001) (“Triennial Review NPRM”), at paras. 39, 43, 57-58.

its impairment analysis.³¹ The D.C. Circuit Court of Appeals found in *USTA II* that “the FCC is obligated to establish unbundling criteria that are at least aimed at tracking relevant market characteristics and capturing significant variation.”³² This follows the Court’s objection expressed in *USTA I*, to the FCC’s issuance of “broad” unbundling rules that apply across all geographic markets and customer classes “without regard to the state of competitive impairment in any particular market.”³³

Economic theory relies, in part, on the presence of price discrimination to define markets.³⁴ In their *Horizontal Merger Guidelines*, the U.S. Department of Justice (“DOJ”) and the Federal Trade Commission (“FTC”) define a market “as a product or group of products and a geographic area in which it is produced or sold such that a hypothetical profit-maximizing firm, not subject to price regulation, that was the only present and future producer or seller of those products in that area likely would impose at least a ‘small but significant and nontransitory’ increase in price, assuming the terms of sale of all other products are held constant.” The DOJ and FTC explain further that a “relevant market is a group of products and a geographic area that is no bigger than necessary to satisfy this test.”³⁵ An excessively broad market masks important structural differences within the area.

The FCC has previously stated:

Consistent with Commission precedent and the record before us, we conclude that the relevant geographic market for wholesale special access services is a particular customer’s location, since it would be prohibitively expensive for an enterprise customer to move its office location in order to avoid a “small but

^{31/} *TRRO NPRM*, at para. 9, footnote 35.

^{32/} *USTA II*, 359 F.3d 554 (D.C. Cir. 2004), at 9.

^{33/} *Id.*, citing *USTA I*, 290 F. 3d, at 422.

^{34/} Horizontal Merger Guidelines, Department of Justice and the Federal Trade Commission, issued April 2, 1992, revised April 7, 1997 (“Horizontal Merger Guidelines”), § 1.12.

^{35/} *Id.*, §1.0.

significant and nontransitory” increase in the price of special access service. In order to simplify its analysis, however, the Commission has traditionally aggregated or grouped customers facing similar competitive choices, and we will do so in our discussion below to the extent appropriate.³⁶

In addition, however, we will consider the potential effect of the merger on BellSouth’s special access prices, which generally are set on a wider geographic basis. Because BellSouth has gained Phase II pricing flexibility for its special access services in some metropolitan statistical areas (MSAs), but not others, BellSouth’s rates for special access may vary from MSA to MSA. Accordingly, we will also examine on an MSA basis how the merger is likely to affect BellSouth’s special access prices.³⁷

Geographic market: building by building recommendation

The broader the market definition, the greater the likelihood that a finding of competition can be reached, and similarly, the smaller the market, the less likely the Commission will determine that the market is competitive. Improperly defined geographic markets may harm consumers if pricing flexibility is prematurely granted.

The goal in this proceeding should be to designate markets that conform to the actual development of competition; the structure of the relevant market; the pricing and regulatory history of the market; and administrative feasibility. The overriding criterion should be whether customers are actually being served by alternative providers in specific geographic and product markets, that is, the presence of *actual* rather than *potential* competition. The boundaries of the markets should correspond with the economics of the supply and the demand for the relevant products.

Initial comments that support the use of the MSA as the proper geographic market are not

³⁶ / In the Matter of AT&T Inc. and BellSouth Corporation Application for Transfer of Control , FCC WC Docket No. 06-74, *Memorandum Opinion and Order*, rel. March 26, 2007 (“AT&T/BellSouth Merger Order”), at para. 31 (cites omitted).

³⁷ / *Id.*, at para. 32 (cites omitted).

persuasive.³⁸ The MSA improperly encompasses wire centers with differing structural attributes, ignores the fact that customers are not actually being served throughout these proposed broad geographic markets, and ignores the fact that facilities that may have been deployed in one part of an MSA cannot be re-deployed to serve a different area within the MSA. Economic and competitive conditions vary enormously within an MSA, and, therefore, the Commission should consider using geographic market definitions that it used to assess Section 251 impairment.³⁹ The Commission should discontinue the use of the MSA as the relevant geographic market and use the wire center or a more granular demarcation as the relevant geographic market.⁴⁰

Rate Counsel concurs with NoChokePoints Coalition’s recommended use of “the route connecting the two points that a prospective purchaser seeks to link⁴¹ As a practical matter, this means that the most useful way to analyze special access geographic markets is to analyze competition at individual buildings and cell sites.”⁴² As noted by NoChokePoints Coalition, the GAO report that Rate Counsel cites above undertook a building by building analysis.⁴³ The GAO found:

In the 16 major metropolitan areas we examined, facilities-based competition for dedicated access services exists in a relatively small subset of buildings. Our analysis of data on the presence of competitors in commercial buildings suggests that competitors are serving, on average, less than 6 percent of the buildings with at least a DS-1 level of demand. Competition is more widespread where buildings have a higher level of demand. For the subset of buildings identified as likely having companies with a DS-3 level of demand, competitors have a fiber-based

³⁸ / See, e.g., AT&T, at 9; Verizon at 11. Rate Counsel is not persuaded by Verizon that demand in metropolitan areas disciplines prices outside those areas. Verizon, at 11. See also *id.*, at 31-34.

³⁹ / Sprint Nextel, at 10, 11, 14.

⁴⁰ / Massachusetts DTC, at 2, 10-11; PAETEC et al., at 16-17; 32-25 (recommending the use of the building as the relevant geographic market for loops but in the alternative recommending the use of the wire center).

⁴¹ / NoChokePoints Coalition, at 6.

⁴² / *Id.*, at 7; PAETEC et al., at 32-35.

⁴³ / GAO Report, at 10 and 50-54.

presence in about 15 percent of buildings on average. For buildings identified in our model with 2 DS-3s of demand, competitors have a fiber-based presence in 24 percent of buildings on average. The data also show that the theoretically more competitive phase II areas generally have a lower percentage of lit buildings than phase I areas, indicating that FCC's competitive triggers may not accurately predict competition at the building level. The data also show that there has been a decline in some MSAs in the level of competitive collocation in the wire centers used by the price-cap incumbents to obtain pricing flexibility. Limited competitive build out in these MSAs could be caused by a variety of entry barriers, including zoning restrictions, or difficulties in obtaining access to buildings from building owners that discourage competitors from extending their networks.⁴⁴

Verizon's assertion that competitors can extend networks to individual buildings "cost-effectively," and "readily" is not persuasive.⁴⁵ Circuits deployed to one building cannot be re-deployed to another building. Initial comments include several administratively practical and economically sound options for conducting a competitive analysis that address AT&T's concern that a building-by-building analysis "would be enormously burdensome and unworkable."⁴⁶ NoChokePoints Coalition suggests that a building-by-building proposal does not require that the Commission analyze every building in the country but instead can compare similar buildings.⁴⁷ NoChokePoints Coalition advocates a building-by-building analysis if practicable, and if not the Commission could "aggregate similarly situated point-to-point connections or use a sampling method."⁴⁸ However, NoChokePoints Coalition does propose that high density areas be analyzed separately for low density areas if any aggregation is undertaken.⁴⁹ Rate Counsel urges

⁴⁴ / GAO Report, at 12-13.

⁴⁵ / Verizon, at 17.

⁴⁶ / AT&T, at 46. See also, Verizon, at 33.

⁴⁷ / NoChokePoints Coalition, at 7. See also PAETEC et al. at 54-57. Rate Counsel concurs with PAETEC et al. that the Commission's analysis should be limited to those buildings where the fiber is lit ("because the analysis to determine whether the cost/time/investment for constructing laterals to existing fiber networks is not easily administrable"). PAETEC et al., at 55.

⁴⁸ / NoChokePoints Coalition, at 8.

⁴⁹ / *Id.*

the Commission to seriously consider the proposal of tw telecom, inc. (“TWTC”) to use a “competitive screen” to reduce the number of buildings the Commission would need to examine.⁵⁰ In this way, the Commission could eliminate a large number of geographic markets from consideration as competitive, and undertake a more accurate analysis on the remaining contested areas.

Product market

The Commission assessed special access product markets as part of its analysis of the AT&T/BellSouth merger. In its AT&T/BellSouth Merger Order, the Commission stated:

The Commission previously has found that there are at least two separate relevant product markets for special access services: “Type I” special access services, which are offered wholly over a carrier’s own facilities, and “Type II” special access services, which are offered using a combination of the carrier’s own facilities for two of the segments and the special access services of another carrier for the third segment. The Commission has also previously found that many purchasers of wholesale special access services view Type I services as substantially superior to Type II services, due to differences in performance, reliability, security, and price, and that these differences are sufficiently large that Type I special access services fall into a separate relevant product market from Type II.

We also recognize that the services provided over different segments of special access (e.g., channel terminations and local transport) constitute separate relevant product markets, which may be subject to varying levels of competition. In the competitive analysis section below, we will discuss the competitiveness of the different special access services.⁵¹

A single product market should include services that are reasonable substitutes for one another. Those that are not reasonable substitutes should be in separate product markets.⁵² As initial comments comprehensively demonstrate, channel terminations (loops) and channel mileage

⁵⁰ / TWTC, at 26-29.

⁵¹ / AT&T/BellSouth Merger Order, at paras. 29-30 (cites omitted).

⁵² / Sprint Nextel, at 14.

(interoffice transport) are in separate product markets.⁵³ Also, initial comments provide ample rationale for placing DS1 and DS3 circuits in separate markets because they are not substitutes for each other.⁵⁴ Furthermore, for transport, the product market should be route-specific: the availability of transport between two particular central offices cannot substitute for transport for a different route.⁵⁵

NoChokePoints Coalition, like Rate Counsel, proposes that the Commission use the merger guidelines in its analytical framework suggesting that “a product market encompasses products among which purchasers would switch in response to a small but significant non-transitory increase in price of one product.”⁵⁶ As such, NoChokePoints recommends that channel terminations and transport services should be defined as separate products and recommends that services with different capacities be considered as different product markets.⁵⁷

Rate Counsel agrees with NoChokePoints that the necessity to make large sunk investments precludes potential competition from restraining ILEC behavior.⁵⁸ Rate Counsel and others have provided ample evidence that pricing flexibility triggers are too broad, are based on potential (as opposed to actual) competition, and do not provide an accurate picture of competition in the access market.⁵⁹

⁵³ / See, e.g., *id.*

⁵⁴ / *Id.*, at 15; see Massachusetts DTC, at 2, recommending that DS1 channel terminations, DS3 channel terminations, DS1 transport, and DS3 transport should be in a minimum of four separate product markets.

⁵⁵ / Massachusetts DTC, at 11; PAETEC et al., at 36.

⁵⁶ / NoChokePoints Coalition, at 9.

⁵⁷ / *Id.*

⁵⁸ / NoChokePoints Coalition, at 13, citing NRRI Report, at 48. See, also, discussion of the barriers to entry faced by competitors in TWTC’s comments, at 15-16 and 21-22.

⁵⁹ / Rate Counsel reply, July 29, 2005, at 22-27.

Market shares provide significant evidence of market power, and should be included in the Commission’s analytic framework.

Contrary to Verizon, which opposes the “inherently backward looking” use of market shares,⁶⁰ Rate Counsel urges the Commission, consistent with widely accepted economic principles, to include market shares in its analytic framework.⁶¹ Citing to the NRRI study⁶² and to the GAO Report, Sprint Nextel asserts there is substantial evidence that price cap LECs “have an overwhelming share of the special access business throughout the country.”⁶³ Rate Counsel concurs with Sprint Nextel that the FCC should obtain more granular data regarding ILECs’ shares of relevant markets “by collecting data measuring the presence of competitive facilities in a representative sampling of locations” and then extrapolating the results to other similarly situated locations.⁶⁴

Demand elasticity and intermodal alternatives

Initial comments demonstrate the importance of including an analysis of demand elasticity as part of an analytic framework for assessing ILECs’ market dominance.⁶⁵ As initial comments explain, however, such elasticities are low – purchasers’ ability to switch to alternative suppliers depends on the presence of such suppliers and the quality of the substitute,

⁶⁰ / Verizon, at 10.

⁶¹ / Rate Counsel concurs with PAETEC et al., that because BOCs own and control UNEs and because they are not available to all special access markets, competitors that rely on UNEs to compete in a particular market should not be included in any market share analysis. PAETEC et al., at 48-49.

⁶² / National Regulatory Research Institute, *Competitive Issues in Special Access Markets* (revised edition), prepared by Peter Bluhm with Dr. Robert Loube, First Issued: January 21, 2009 (09-02) (“NRRI Report”).

⁶³ / Sprint Nextel, at 17.

⁶⁴ / *Id.*, at 18, Mitchell Decl., at para. 49.

⁶⁵ / See e.g., Sprint Nextel, at 18-21; PAETEC et al., at 47-48.

as well as the cost of switching to alternative supplier.⁶⁶ Contracts that lock customers into certain volumes or time periods raise the cost of changing providers.⁶⁷

Intermodal offerings do not provide effective substitutes for special access service.⁶⁸ Fixed wireless is not a reasonable substitute for various reasons such as light of sight requirements, high costs, limited access to rooftops, etc.,⁶⁹ and, therefore the Commission should weight the role of fixed wireless service in constraining ILECs' market power accordingly.

Sprint Nextel indicates that it “expects to continue to rely extremely heavily on DS1 and DS3 facilities provided by incumbent LECs for many years to come.”⁷⁰ Cable modem does not have the same quality as special access,⁷¹ and therefore, the FCC, contrary to Verizon's assertion, should afford limited weight to cable alternatives as providing market discipline for ILECs' special access rates, terms, and conditions.⁷²

Contrary to Verizon's assertion that “[s]o long as the technology is considered by at least some customers to be a competitive alternative, the Commission should include that technology in its analysis,”⁷³ instead the Commission should only include a technology where customers' preferences have clearly shown that they consider the technology to be an economic substitute. Similarly, the Commission should reject Verizon's recommendation to include emerging

⁶⁶ / See e.g., Sprint Nextel, at 19.

⁶⁷ / PAETEC et al., at 80-84.

⁶⁸ / Massachusetts DTC, at 5 (fixed wireless does not represent a viable substitute because of operational and security concerns; cable companies “have made limited investments towards providing robust special access services”).

⁶⁹ / Sprint Nextel, at 19-20.

⁷⁰ / *Id.*, at 20.

⁷¹ / *Id.*

⁷² / Verizon, at 20-23.

⁷³ / *Id.*

technologies in its analysis of markets.⁷⁴ Only at such time that customers are actually purchasing a technology should the technology be considered an economic substitute. Consumers' purchasing decisions provide the most reliable evidence of whether one product is an economic substitute for another product. By contrast, speculations about consumers' potential demand should be afforded negligible weight in the analytic framework.

Supply elasticity, cost structure, and barriers to entry

Rate Counsel concurs with those recommending that the Commission's framework include an assessment of the supply elasticity for special access services, including a careful examination of competitors' ability to overcome entry barriers.⁷⁵ Expanding networks to reach new locations and to provide channel terminations requires a competitor to incur significant sunk costs (installing new cable or microwave facilities); rights of way, construction costs, administrative costs; expanding supply of interoffice transport also requires costs (installation of collocation facilities; installing new cable).⁷⁶ Supply is not nearly as elastic as ILECs would have the FCC believe. Where competitors' supply is inelastic, it cannot constrain ILECs' market power.

Economics of entry depend on economies of scale – potential demand for recovering investment cost and furthermore ILECs' restrictive terms and conditions make it less likely that customers will switch providers.⁷⁷ Barriers to entry and cost structure challenges lessen the threat of competition.⁷⁸ The elasticity of competitors' supply should be considered, but should

⁷⁴ / *Id.*

⁷⁵ / Sprint Nextel, at 21; PAETEC et al., at 43-47.

⁷⁶ / Sprint Nextel, at 22, PAETEC et al., at 21-23, explaining, at 22, among other things, that it cost one competitor "approximately \$50,000 and required nearly 12 months of effort – largely because of permitting requirements – to deploy a single lateral into a commercial building in San Francisco."

⁷⁷ / Sprint Nextel, at 23.

⁷⁸ / *Id.*, at 24.

be viewed critically as to whether it can constrain ILECs' market power in relevant geographic and product markets.

Accordingly, the Commission should reject Verizon's proposed reliance on companies' future plans to offer service as a measure of the competitiveness of special access markets.⁷⁹ capital constraints (particularly in today's economy), and unpredictable events could prevent companies from implementing their blueprints. Undue reliance on speculative capacity would provide misleading information about competitors' ability to constrain ILECs' market power.

NoChokePoints Coalition suggests that if the Commission would like to analyze supply elasticity it can seek "build/buy" analyses from competitors.⁸⁰ Rate Counsel agrees that information from competitors would be useful.⁸¹

C. CURRENT PHASE II PRICING FLEXIBILITY RULES

If the Commission uses the market power analysis above, it will determine that current rules do not ensure just and reasonable rates.

The existing pricing flexibility rules fail to result in just and reasonable rates.⁸² Rate Counsel concurs with Sprint Nextel that 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."⁸³ Collocation in one wire center does not discipline an ILEC's prices

⁷⁹ / Verizon, at 36.

⁸⁰ / NoChokePoints Coalition, at 14.

⁸¹ / See PAETEC et al., at 21, recommending that the Commission may wish to collect requisite data from the competitive community.

⁸² / *Id.*, at 2-5 (see Table 1 and Table 2 showing that Verizon's and Qwest's rates are for DS1 loop rates are higher where they have obtained pricing flexibility, and observing that a similar analysis of AT&T's rates cannot be conducted because of a merger condition, scheduled to sunset on June 30, 2010). See also, *id.*, at 8-9, demonstrating that BOCs' DS1 Phase II pricing flexibility rates exceed the rates in the NECA tariff by between 25% and 154%. See also *id.*, at 59-75 (demonstrating that rates do not reflect cost decreases; discussing excessive ARMIS rates of return, comparing special access rates that exceed UNE rates as well as rate-of-return NECA rates, and the basket structure that permits price increases in non-competitive areas and price decreases in competitive areas).

⁸³ / Sprint Nextel, at 31.

in other wire centers in an MSA, and is not a reliable indicator of competitive alternatives.⁸⁴ Collocation does not necessarily mean that the collocating provider offers channel termination from the wire center or transport between the wire centers for which customers seek special access.⁸⁵ The Commission should discontinue use of collocation as proxy for competition for transport,⁸⁶ and instead consider adopting triggers and thresholds that the Commission adopted in its Triennial Review Remand Order (released February 4, 2005).⁸⁷ Rate Counsel agrees with NoChokePoints that existing evidence in the record already demonstrates that the triggers do not measure competition.⁸⁸

Rate Counsel urges the Commission to afford minimal weight in its analytic framework to potential competition. AT&T, for example, suggests that “[i]t is well established” that sunk facilities investment by competitors will limit ILEC market power and ILECs cannot drive competitors out of the market.⁸⁹ Yet, AT&T only cites the predictive judgments about potential competition that the Commission made in 1999 and the D.C. Circuit upheld.⁹⁰ Data submitted in this proceeding clearly shows that potential competition does not adequately constrain ILEC behavior in the special access market. As noted by NoChokePoints Coalition: “competitive providers of special access face significant barriers to entry that essentially foreclose the

⁸⁴ / *Id.*, at 31-33.

⁸⁵ / *Id.*, at 33. See Massachusetts DTC, at 3 (stating that the Commission should discontinue the use of wire center collocations as a proxy for competition in channel terminations, and instead should measure the concentration of facilities-based loops provided by competitive carriers in each wire center). See also, PAETEC et al., at 10-15, including quote at 14 to NRRI Report, at 81 (“proxy consistently overestimates the competitiveness of the DS-1 and DS-3 channel termination markets”).

⁸⁶ / As the Massachusetts DTC states, “no correlation exists between the extent of collocation and competitive loop deployment.” Massachusetts DTC, at 9. See also PAETEC et al. at 15-16, citing to NRRI Report.

⁸⁷ / Massachusetts DTC, at 5. NoChokePoints Coalition claims that collocation is simply not a good proxy for special access competition particularly in the case of channel termination. NoChokePoints Coalition, at 15.

⁸⁸ / NoChokePoints Coalition, at 16.

⁸⁹ / AT&T, at 21-22.

⁹⁰ / *Id.*, at 22.

possibility that potential competition, as opposed to actual competition, could play a substantial role in restraining price cap LEC conduct.”⁹¹ Rate Counsel agrees with NoChokePoints Coalition that the Commission should seek data regarding actual deployment of channel terminations and transport facilities from competitors to enable the Commission to conduct a straightforward assessment of the validity of the triggers.⁹² Rate Counsel urges the Commission to rely on actual and not potential competition.⁹³

Rates of return and profits are reliable indicators of market power.

The evidence in this proceeding suggests that the special access market is far from competitive and that the price cap local exchange carriers are able to exercise market power. As stated in Rate Counsel’s reply comments in July 2005: The Commission should “consider, instead, undertaking a comprehensive review of the present state of competition in the industry and the legality of the contracts under which services are provided before determining the type of regulation under which ILECs offering special access services should operate.”⁹⁴ Rate Counsel continues to support “a “roll-back” of Phase II pricing flexibility at least until a more nuanced set of guidelines and triggers can be adopted that accurately reflects the real, as opposed to potential, competition in the special access market and on a realistic geographic market basis.”⁹⁵

As acknowledged by the Commission, the BOCs have been earning special access accounting rates of return substantially in excess of the prescribed 11.25% rate of return that

⁹¹ / NoChokePoints Coalition, at 12.

⁹² / *Id.*, at 17, stating: “If the data show that the number of collocated facilities is not correlated the number of competitive channel terminations (for each service type), the Commission will have confirmation that the pricing flexibility triggers are not an accurate proxy for the kind of investment that can constrain ILEC prices for those services.”

⁹³ / See also PAETEC et al., at 22.

⁹⁴ / Rate Counsel reply July 29, 2005, at 1-2.

⁹⁵ / *Id.*, at 2.

applies to rate of return LECs.⁹⁶ In 2005, various commenters provided evidence that the RBOCs achieve supracompetitive rates of return thus casting doubt on the purported competitiveness of the market.⁹⁷ Five years later, RBOCs continue to earn excessive profits, which underscores their market dominance.

In filings to the FCC regarding its review of the proposed merger of AT&T and BellSouth, AT&T and BellSouth blamed the frozen level of separations for the seemingly exorbitant returns the RBOCs report from special access. A reply declaration submitted by AT&T and BellSouth in their merger proceeding observes that the “FCC’s cost allocation rules relating to these services are based on cost studies from the late 1990s and have been frozen since 2001. Since that time, however, there has been a substantial divergence in demand for special access and switched access revenues.”⁹⁸ The declaration also quotes comments filed by legacy SBC in a different proceeding stating, among other things:

ARMIS results . . . understate the costs an ILEC incurs to provide any service that has experienced significant growth in volumes. The costs for interstate special access services are particularly susceptible to this understatement because demand has increased dramatically over the past several years with the explosive growth in data services. The result is a mismatch between costs which do not properly reflect current utilization and volumes and revenues which do. This mismatch, of course, will overstate the calculated rate of return.⁹⁹

The ILECs are positing inconsistent views. In one proceeding, industry members acknowledge the cost-revenue mismatch arising from the explosive growth in data services as a

⁹⁶ / Special Access NPRM, at para. 35.

⁹⁷ / Comments of ATC Communications Services, Inc., Bridgecom International, Inc., Broadview Networks, Inc., Broadview Networks, Inc., Pac-West Telecomm, Inc., US LEC Corp., and U.S. Telepacific Corp. d/b/a Telepacific Communications, June 13, 2005, at 7; Comments of Ad Hoc Telecommunications Users Committee, June 13, 2005, Attachment B: Declaration of Susan M. Gately on behalf of the Ad Hoc Telecommunications Users Committee, June 13, 2005, at para. 9.

⁹⁸ / *In the Matter of AT&T Inc. and BellSouth Corporation Applications for Approval of Transfer of Control*, WC Docket No. 06-74, Reply Declaration of Dennis W. Carlton and Hal S. Sider, June 19, 2006, at para. 30.

⁹⁹ / *Id.*, at para. 32, quoting comments of David Toti, then the Executive Director – Regulatory Accounting for SBC.

way to “excuse” high interstate rates of return,¹⁰⁰ and in other proceedings, seek to preclude states from correcting this mismatch. The consequence of these two simultaneous industry arguments, if unaddressed by regulators, would be exorbitant *interstate* special access rates and excessive *intrastate* regulated rates. The purpose of separations is to prevent incumbent LECs from recovering the same costs in both the interstate and intrastate jurisdictions. The industry is gaming the process to avoid lowering either interstate or intrastate rates. As Rate Counsel (as part of joint comments with NASUCA the Maine Office of the Public Advocate) stated in reply comments in the FCC’s separations proceeding:

Initial comments echo the State Consumer Advocates’ concern about carriers’ failure to assign the increasing quantities of interstate private lines to the interstate jurisdiction. The Wisconsin PSC states that, since the 2001 freeze, costs related to special access and private lines have been improperly intermingled with common line expenses. The Wisconsin PSC cites as evidence the supra-normal profits earned by numerous ILECs for their special access service: Out of 80 companies reporting, 55 had returns on investment in excess of 60%. Describing this as “supra-normal” certainly strains the meaning of “normal.” “Mind-boggling” would seem to fit more accurately, and it should take nothing more than this one fact to convince a disinterested observer that there is something seriously amiss in the separations regime, which needs fixed [sic] for the protection of consumers and competition.¹⁰¹

AT&T opposes any Commission efforts to evaluate the special access market on the basis of profits arguing that service-specific accounting is arbitrary.¹⁰² Yet, AT&T’s position also seems to be that special access profits subsidize COLR and broadband: “As the Commission well knows, the ILECs’ overall wireline businesses are in significant decline and substantial year-

¹⁰⁰ / *In the Matter of Special Access Rates for Price Cap Local Exchange Carriers*, WC Docket No. 05-25; *AT&T Corp. Petition for Rulemaking to Reform Regulation of Incumbent Local Exchange Carrier Rates for Interstate Special Access Services*, RM-10593, Comments of Qwest Communications International, Inc., June 13, 2005, at 4, 11; Comments of the United States Telecom Association, June 13, 2005, at 11-13; Comments of Verizon, June 13, 2005, at 21.

¹⁰¹ / *In the Matter of Jurisdictional Separations and Referral to the Federal-State Joint Board*, FCC CC Docket No. 80-286, Reply Comments of The National Association of State Utility Consumer Advocates, The New Jersey Division of Rate Counsel, and the Maine Office of Public Advocate, November 20, 2006, at page 34-35.

¹⁰² / AT&T, at 3. See, also, *id.*, at 10.

over-year line losses are projected to continue with no end in sight. This decline has not only strained ILECs' ability to meet carrier of last resort and other service obligations . . . but also has jeopardized the ability to invest in the facilities and infrastructure necessary to provide broadband in rural and high cost areas."¹⁰³ Furthermore, AT&T argues that even the ILECs' overall wireline returns are not above what would be considered reasonable "given the risks inherent in today's marketplace."¹⁰⁴

In response to the Commission's question about special access profitability, AT&T states "[r]egulation of profits is the defining feature of rate of return regulation; it has no place in price cap regulation."¹⁰⁵ Whether or not the Commission intends to regulate the rate of return of the ILECs, the ability of the carriers to retain large profit margins is a valid indicator of a market characterized by market power. Therefore, contrary to AT&T's assertion, profit margins are a relevant component of an analytic framework. The merger guidelines, for example, define market power as the ability to raise prices (and sustain those prices) profitably. Excessive profits may indicate an abuse of market power. Ad Hoc thoroughly demonstrates the relevance of ARMIS-based analysis to an assessment of ILECs' market power in special access markets, and explains why ILECs would prefer that the FCC not rely on the data contained in these reports.¹⁰⁶

According to Verizon, special access "prices are declining and output is increasing."¹⁰⁷ In comparing rates, it is critically important, however, to consider whether prices are specific to particular term and volume discounts. Furthermore, Verizon's use of voice grade equivalency to

¹⁰³ / *Id.*, at 3.

¹⁰⁴ / *Id.*, at 4.

¹⁰⁵ / *Id.*, at 10, citing NPRM, at para. 5. See also, Verizon at 43-48.

¹⁰⁶ / Ad Hoc, at Attachment B: Economics and Technology, Inc., *Longstanding Regulatory Tools Confirm BOC Market Power: A Defense of ARMIS*, prepared for the Ad Hoc Telecommunications Users Committee, by Susan M. Gately, Helen E. Golding, Lee L. Selwyn, and Colin B. Weir, January 2010.

¹⁰⁷ / Verizon, at 5. See also Verizon, at 6-9, citing NRRI Report, at 9.

measure an increase in output is misleading;¹⁰⁸ instead output should be measured separately by distinct products, with DS1 circuits examined separately, for example, from DS3 circuits. Like Rate Counsel, and in opposition to ILEC claims, NoChokePoints Coalition correctly states that rates of return, are an important focus of the Commission’s analysis because high prices, rates of return, or unreasonable terms and conditions are indicators of market power.¹⁰⁹ The NRRI Report calculates special access rates of return for AT&T (30%), Qwest (38%) and Verizon (15%).¹¹⁰ Rate Counsel supports NoChokePoints Coalition’s recommended list of data to collect from ILECs to enable the Commission to analyze ILECs’ rates of return.¹¹¹

Comprehensive analysis of the special access market is entirely appropriate and long overdue.

Rate Counsel disagrees with the view of some that “full-blown” (*i.e.*, comprehensive) analyses of the market is a waste of time or requires too many resources.¹¹² The Commission and the parties to this proceeding have spent the last seven years (since AT&T’s filing in 2002) submitting filing after filing on these issues. The establishment of an analytic framework based on sound economic principles would be an appropriate next step.

In terms of the data that the Commission may require, NoChokePoints Coalition submits that “price cap LECs, which are far and away the largest providers of special access services, are the entities in the best position to provide most of the data that would prove useful to the

¹⁰⁸ / Verizon, at 9.

¹⁰⁹ / NoChokePoints Coalition, at 2, 24.

¹¹⁰ / *Id.*, at 26 citing NRRI Report at Table 13.

¹¹¹ / No ChokePoints Coalition, at 24-25.

¹¹² / See, e.g., AT&T, at 7-8 suggesting that a market power analysis would “embroil the industry and the Commission in endless debate over market definitions, demand and supply elasticities and countless other minutiae . . .”

Commission.”¹¹³ Rate Counsel agrees with the recommendations that NoChokePoints Coalition makes regarding data that the Commission should seek from the industry.

NoChokePoints Coalition recommends that the Commission seek the following data from all providers of special access: (1) address of each building or cell site that the provider sells over its owned or controlled facilities and (2) the product and the number of products at each location disaggregated by channel termination and transport as well as different capacities.¹¹⁴ NoChokePoints Coalition also makes suggestions about the types of data the FCC could seek from other carriers. In addition to “build/buy” analyses from competitors, the NoChokePoints Coalition recommends that the Commission ask competitors for (1) the number of buildings and cell sites served by non-ILEC facilities-based providers of special access; (2) the type of service purchased by ILECS disaggregated by special access service and UNEs and the number of each; (3) total number of buildings and cell sites served from transmission facilities purchased from non-ILECs; and (4) the type and number of each service purchased from non-ILECs.¹¹⁵

In addition, Rate Counsel agrees with NoChokePoints Coalition that the Commission should seek data regarding actual deployment of channel terminations and transport facilities from competitors.¹¹⁶

Rate Counsel agrees with NoChokePoints Coalition that the Commission should not limit the data it seeks to the data needed to analyze the market, but instead should obtain the data it would need for any solution as well.¹¹⁷ As stated by NoChokePoints Coalition:

¹¹³ / NoChokePoints Coalition, at 2.

¹¹⁴ / *Id.*, at 11-12.

¹¹⁵ / *Id.*, at 14-15.

¹¹⁶ / *Id.*, at 17.

¹¹⁷ / *Id.*, at 3. NoChokePoints Coalition requests appropriate handling of confidential information and aggregation of a publicly available report. *Id.*, at 3 and 36-37.

That is, the Commission should not first decide that it needs additional information to determine whether the market is broken and only later, after confirming the obvious fact that it is, gather data on what reforms are necessary. Rather, the Commission should act now to gather data necessary to identify how it should modify its regulations to fulfill its statutory mandate.¹¹⁸

A statistical analysis of the prices where flexibility has been granted vs. where it has not.

The Commission should update, as necessary, statistical analyses of the prices in markets where it has granted pricing flexibility and in markets where it has not granted flexibility.¹¹⁹

Commenters in 2005 provided overwhelming evidence demonstrating that where pricing flexibility has been granted, special access prices have increased, thus calling into question the Commission's determination that competition existed.¹²⁰ Rate Counsel stated in 2005:

The record regarding price increases where pricing flexibility has been granted is compelling and has been submitted time and again in several proceedings over the past several years. The Commission's request for more recent data to demonstrate that such price increases are "substantial and sustained" has been answered. The Ratepayer Advocate urges the Commission to seriously examine the evidence and to consider the ramifications to competition, and ultimately, to consumers if grants of pricing flexibility continue in markets that are not fully competitive.¹²¹

A 2007 ex parte presentation filed with the Commission indicates that prices remain high in "competitive" areas.¹²² It is imperative that the Commission undertake a comprehensive review of competitive conditions in the special access market before it adopts a new framework to govern the regulation of the special access market. As the Rate Counsel stated previously:

¹¹⁸ / NoChokePoints Coalition, at 35.

¹¹⁹ / See, e.g., Comments of Sprint Nextel, August 8, 2007, Declaration of Bridger M. Mitchell, at para. 10; Comments of the Ad Hoc Telecommunications Committee, August 8, 2007, at 11-14; See, also, Ad Hoc, Appendix 2, Gately Declaration, August 8, 2007.

¹²⁰ / Sprint Nextel comments June 13, 2005, at 2-5; Wiltel comments June 13, 2005, at 21-22; Ad Hoc comments June 13, 2005, at 16-24; Comptel/ALTS comments June 13, 2005, at 6; Time Warner comments June 13, 2005, at 17-18.

¹²¹ / Rate Counsel reply July 29, 2005, at 14, footnotes omitted.

¹²² / See, also, Ex Parte Notice Letter from Karen Reidy, CompTel, to Marlene H. Dortch, Secretary, Federal Communications Commission, Re: WC Docket No. 05-25; RM-10593; and WC Docket No. 06-125, August 1, 2007, Attached presentation "Meeting with John Hunter, 8/1/2007."

“consumers need immediate relief from the price cap LECs’ anticompetitive pricing and contract practices. As such, the Commission should repeal Phase II flexibility until such a comprehensive investigation has been completed.”¹²³

Furthermore, the FCC should rely on actual special access prices, instead of special access revenue per line calculations.¹²⁴ The Commission should undertake a thorough comparison of prices in phase II MSAs where pricing flexibility has been granted (and therefore, where there is theoretically more competition) and Phase I MSAs where prices are still constrained by a price cap.

It is well-accepted economic theory that if a seller can profitably maintain prices above competitive levels the seller has market power.¹²⁵ Rate Counsel concurs with those recommending that the Commission examine ILECs’ special access service prices as part of its analytic framework.¹²⁶ Rate Counsel also agrees with NoChokePoints Coalition that prices should not be rising in a declining cost industry.¹²⁷ Certainly, prices should not be rising in areas where the price cap LECs have received flexibility. Competition theoretically leads to lower prices.¹²⁸

¹²³ / Rate Counsel reply July 29, 2005, at footnote 8.

¹²⁴ / See Rate Counsel refresh reply August 15 2007, at 8.

¹²⁵ / Horizontal Merger Guidelines, § 0.1.

¹²⁶ / See, e.g., Sprint Nextel, at 25-30, recommending that the Commission compare special access rates with various benchmarks such as UNE rates; with rates for high bandwidth services (DSL and fiber optic based services); with rates in foreign markets; and with ILEC price cap rates.

¹²⁷ / NoChokePoints Coalition, at 19.

¹²⁸ / See, e.g., NRRI Report, at 65-66; GAO Report, at 27-28 (wherein the GAO concludes that “list prices and revenue are higher on average for circuit component in areas under phase II flexibility (areas where competitive forces are presumed to be greatest) than in areas under phase I flexibility or under price caps” at 27 and that “price-flex list prices are higher on average than price-cap list prices” at 28).

The price cap LECs have not provided a compelling reason why these price increases should be ignored.¹²⁹ The FCC's Order that approved the AT&T/BellSouth merger tacitly acknowledges the flaws with the existing triggers. The conditions incorporated in the FCC's approval of the AT&T/BellSouth merger include specific measures that are intended to address special access, and the critical role that special access has in facilitating competitive entry.¹³⁰ As a threshold matter, as Commissioner Copps explained in his statement concerning the AT&T/BellSouth merger:

Finally, before accumulating enormous additional market power in the special access market, the company should address the well documented concern that businesses are being charged inflated prices for high-volume voice and data services—behavior that retards small business growth, inhibits America's international competitive posture, and eventually trickles down to consumers in higher costs.¹³¹

Then Commissioner Adelstein summarized some of the conditions that applied to the AT&T/BellSouth merger. An excerpt from his statement regarding special access services follows:

Special Access Services. It is clear that many business customers and wholesale carriers rely heavily on the applicants' special access services for their voice and high-speed connections. Independent wireless companies, satellite providers, and long distance providers also depend on access to the applicants' nearly ubiquitous network and services to connect their networks to other carriers. In addition, many small rural providers depend on these services to connect to the Internet backbone. So, if the applicants were to raise prices as a result of diminished competition, such action would directly impact the cost and availability of services for large and small businesses, schools, hospitals, government offices, and independent wireless providers. Particularly in light of DOJ's inaction, I believe it is imperative to adopt measures to protect against the loss of

¹²⁹ / AT&T, Declaration of Dennis W. Carlton and Hal S. Sider, January 19, 2010, at paras. 53-54 purporting to show price decreases where pricing flexibility but utilizes average revenue per unit.

¹³⁰ / See PAETEC, et al., at 3, observing that once the merger conditions expire on June 30, 2010, the rates that AT&T reduced pursuant to the merger conditions "are expected to shoot upwards again."

¹³¹ / Statement of Commissioner Michael J. Copps, Concurring, *In the Matter of AT&T and BellSouth Corporation Application for Transfer of Control*, WC Docket No. 06-74, December 29, 2006 ("Copps Statement on AT&T/BellSouth merger"), at 2.

competition. The Order includes modest provisions to reduce the applicants' prices for special access services in areas where the Government Accountability Office (GAO), in its recent report on special access services, raised the most significant concern, and the Order includes a price freeze for the remainder of the applicant's special access services across the entire 22 state territory of the new company.

The Order also addresses some of the terms and conditions that have been called into question by GAO. For example, it eliminates on a going forward basis at least one condition that restricts the ability of wholesale providers to buy from other channels. While I would have supported, and many commenters have strongly urged the Commission to adopt, more stringent safeguards in this area, we have attempted to provide a modest level of stability for 48 months for these many consumers of special access services. I do note that the Commission has a long-pending proceeding on special access services and, with fresh motivation from GAO's report, it will be even more critical that the Commission tackle these issues as comprehensively and expeditiously as possible. I will continue to push for action on this long-overdue proceeding.¹³²

Evidence persists that many special access contracts are anticompetitive.

Rate Counsel continues to recommend that the Commission review the terms and conditions under which special access services are sold.¹³³ The GAO Report describes the anti-competitive effects of special access contracts in the following manner:

In revenue guarantee contracts, the customer guarantees that it will spend a certain amount with the incumbent (e.g., \$301 million per year), and, in some contracts, that amount will increase over the course of the contract. These types of contracts may inhibit choosing competitive alternatives because the customer does not receive the applicable discount, credit, or incentive if the revenue targets are not met and additional penalties may also apply. 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.¹³⁴

¹³² / Statement of Commissioner Jonathan S. Adelstein, Concurring, *In the Matter of AT&T and BellSouth Corporation Application for Transfer of Control*, WC Docket No. 06-74, December 29, 2006 ("Adelstein Statement on AT&T/BellSouth merger"), at 5-6.

¹³³ / See, e.g., Rate Counsel refresh reply, August 15 2007, at 9-10 and Rate Counsel reply, July 29 2005, at 20-22.

¹³⁴ / GAO Report, at 30.

In 2005, Rate Counsel stated:

BellSouth argues that once a price cap LEC is granted pricing flexibility in an area then there should be no restrictions on the discount packages that LEC offers. However, BellSouth's comments miss the important point raised by many other commenters in this proceeding and that is that the LECs use pricing flexibility to offer packages that apply to their services over both competitive and non-competitive service areas. Contrary to the RBOCs' claims that their terms are reasonable, commenters have identified serious concerns about the RBOCs' unreasonable terms and conditions which hinder effective competition. The contracts typically, as a matter of policy, discourage use of competitor services, contain region-wide commitments and restrictions, and force customers to buy from the incumbent in geographic areas where competition does exist in order to receive discount in noncompetitive areas.¹³⁵

Ample evidence was provided regarding the nature of many contracts.¹³⁶ The Commission observed in its 2005 Special Access NPRM that: "market power can also be exercised through exclusionary conduct. Such conduct may be evidenced from the terms and conditions contained in a carrier's tariff offering."¹³⁷ Volume and term discounts, though not *per se* unreasonable, can deter entry.¹³⁸ Furthermore, as PAETEC et al. observe "the BOCs breeze past the level of sophistication necessary on the part of the customer to obtain such discounts – the hoops that one must jump through . . . to obtain a relatively lower effective rate for special access are staggering."¹³⁹ Small and medium sized business customers may not have specialists who can navigate the complex provisions, and, therefore, are particularly susceptible to high special access prices set by dominant ILECs.¹⁴⁰

¹³⁵ / Rate Counsel reply July 29, 2005, at 20 (cites omitted).

¹³⁶ / See, e.g., *id.*, at attachment.

¹³⁷ / 2005 Special Access NPRM, at para. 114 (cite omitted).

¹³⁸ / Sprint Nextel, at 38.

¹³⁹ / PAETEC et al., at 5.

¹⁴⁰ / *Id.*, at 6-7.

Volume discounts and high shortfall penalties (failure to meet a certain volume commitment) can effectively “lock in” customers; unreasonable early termination penalties can deter customers from moving to alternative suppliers; and excessive charges to perform circuit migrations can discourage customers from migrating to other carriers.¹⁴¹ Rate Counsel concurs with Sprint Nextel that “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.”¹⁴²

On the issue of whether current contract practices lock customers in to deals, AT&T asserts that no party has suggested that below-cost pricing is occurring and in fact the complaint is that prices are too high. “Moreover, their claim is that the incumbents’ discounts preclude customers from using competitors’ services in area where alternative facilities already exist. The reality is that the ILEC discount programs are beneficial responses to competition, not a means to preclude it.”¹⁴³ Rate Counsel acknowledges that discounts can benefit purchasers, but where such discounts prevent new entrants from competing, they can thwart competition and therefore, harm purchasers. Rate Counsel concurs with NoChokePoints Coalition that the Commission should review carriers’ special access terms and conditions.¹⁴⁴

The Commission should act expeditiously.

Rate Counsel concurs with Sprint Nextel that the Commission, once it adopts an analytical framework and collects the relevant data, “should expeditiously act to reform the existing pricing flexibility and other price cap rules to ensure that the rates, terms, and conditions

¹⁴¹ / Sprint Nextel, at 39-41; PAETEC et al., at 24.

¹⁴² / Sprint Nextel, at 44.

¹⁴³ / AT&T, at 13.

¹⁴⁴ / NoChokePoints Coalition, at 27. See, generally, *id.*, at 27-32 regarding tying arrangements, excessive early termination fees and lock-in.

of those services are just and reasonable in all of the relevant markets.”¹⁴⁵ Indeed, if rates are now above those that would prevail in a competitive market (which Rate Counsel considers to be likely), regulatory delay benefits the incumbent carriers and harms competitors and consumers.¹⁴⁶ Furthermore, the Commission should consider interim relief if it requires significant time to design a long term regulatory framework.¹⁴⁷ Specifically, short-term measures should be adopted as part of the 2010 annual access tariff filings. The interim relief could include: re-initialization of rates, elimination of Phase II pricing flexibility; adoption of an X factor, and the re-institution of revenue sharing.¹⁴⁸ Rate Counsel concurs with PAETEC et al. that the Commission “should adopt and issue new measures on a rolling basis rather than sweeping all such final determinations into a single longer-term package of reforms.”¹⁴⁹ Rate Counsel continues to support “a “roll-back” of Phase II pricing flexibility at least until a more nuanced set of guidelines and triggers can be adopted that accurately reflect the real, as opposes to potential, competition in the special access market and on a realistic geographic market basis.”¹⁵⁰

IV. CONCLUSION

In summary:

¹⁴⁵ / Sprint Nextel, at 4.

¹⁴⁶ / See PAETEC et al., at 10, observing that Phase II pricing flexibility “has been a huge windfall for price cap ILECs”).

¹⁴⁷ / Sprint Nextel, at 45.

¹⁴⁸ / *Id.*, at 46; PAETEC et al., at 75-80.

¹⁴⁹ / PAETEC et al., at 84.

¹⁵⁰ / Rate Counsel reply July 29 2005, at 2.

- Supracompetitive rates and unreasonable terms and conditions for special access harm consumers, competition, the economy, and the efficient use of societal resources for national broadband deployment.
- The Commission should implement short-term relief with the upcoming 2010 access filing, pending more comprehensive reform.
- The Commission should rely on the widely accepted factors for examining market power in relevant geographic and product markets: market shares, demand elasticity, supply elasticity, and entry barriers.
- The Commission should reject the use of the MSA as the relevant geographic market because of the substantial variation of competitive conditions within an MSA. Instead, “lit” buildings should be the geographic market for channel terminations (with the use of statistically significant samples, as needed to make the application of the product market administratively practical) and routes should be the product market for transport.
- DS1 channel terminations, DS1 transport, DS3 channel terminations, and DS3 transport should each be in separate product markets.
- Immediately, the Commission should:
 - Discontinue the use of wire center collocation as a proxy for determining competition for channel terminations;
 - Eliminate all pricing flexibility unless carriers seek downward pricing flexibility only;
 - Re-instate ARMIS reporting requirements;

- Examine terms and conditions to eliminate any that are anticompetitive and improperly “lock in” customers, thereby thwarting migration from the incumbent carrier;
- Re-initialize special access rates to correspond with state PUC-approved UNE rates for comparable elements;
- Re-institute an X factor and revenue sharing; and
- Modify the basket structure to prevent anticompetitive pricing.

Rate Counsel particularly urges the Commission to consider the impact of a new regulatory framework for the regulation of special access services on residential and small business consumers, rates for basic services, rural consumers, and low-volume users.

Respectfully submitted,

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