

**Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554**

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	WC Docket No. 05-25 RM-10593
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REPLY COMMENTS

XO Communications, LLC (“XO”), by its attorney, hereby files its reply comments in response to the Public Notice issued by the Federal Communications Commission (“FCC” or “Commission”) in the above-captioned proceedings on November 5, 2009.¹ In its initial comments on the appropriate analytical framework to assess whether the current rules regulating incumbent local exchange carrier (“LEC”) special access rates are working as intended, XO urged the Commission to (1) adopt a market power test and (2) determine whether incumbent LECs possess market power by conducting an empirical analysis of incumbent LEC profit margins using data supplied by incumbent and competitive LECs. XO based its approach on the *Horizontal Merger Guidelines*² and the extensive empirical analysis of the local private line market it undertook with other competitive LECs during the government’s review of the

¹ Parties Asked To Comment on Analytical Framework Necessary To Resolve Issues In The *Special Access NPRM*, WC Docket No. 05-25, RM-10593, Public Notice, DA 09-2388 (rel. Nov. 5, 2009) (“*November 5th Public Notice*”).

² U.S. Department of Justice & Federal Trade Commission, *Horizontal Merger Guidelines* 2 (rev. 1997), available at: www.usdoj.gov/atr/public/guidelines/hmg.htm. (“*HMG*”)

mergers of SBC-AT&T and Verizon-MCI.³ After examining initial comments filed by other interested parties, XO is even more convinced that its analytical framework will enable the Commission to evaluate most accurately whether and to what extent incumbent LECs are charging supra-competitive prices for special access circuits and thus whether additional regulation is required. It urges the Commission to employ it expeditiously to determine the extent of market power incumbent LECs possess in special access markets and to impose regulations where prices are supra-competitive.

The great value of XO's approach is that by examining incumbent LECs' prices and costs for rack rate special access circuits and term contracts, as well as prices from competitive LECs, it captures both current and future market activity by all providers of these services using all technologies. It thus fulfills AT&T's call for a "fact-based and data-driven" inquiry.⁴ Also, by using the lowest prices on the most competitive routes as proxies for incumbent LEC costs, XO's approach avoids issues raised by the incumbent LECs regarding use of accounting costs or the allocation of joint and common costs.⁵ There thus is no reason to examine imprecise surrogates, such as the extent of network deployment by competitive LECs. Such surrogates at best provide only a vague indication of the degree to which market power exists.⁶

³ Comments of XO Communications, LLC, WC Docket No. 05-25, RM-10593 (filed Jan. 2010) at 5-7. ("XO Comments")

⁴ Comments of AT&T Inc., WC Docket No. 05-25, RM-10593 (filed Jan. 19, 2010) at 19. ("AT&T Comments")

⁵ See, e.g., AT&T Comments at 57-74.

⁶ In the Declaration of Timothy J. Tardiff and Dennis L. Weisman attached to the Comments of Qwest Communications International Inc. in this proceeding (filed Jan. 19, 2010), the declarants at least attempt to quantify the extent of competitive facility deployment by creating a "competitive availability index" (at ¶¶ 50-56). ("Tardiff/Weisman Declaration") However, such an index only provides a rough approximation of the extent of competitive deployment and is a poor substitute for actual market price data.

In these reply comments, XO highlights the following key arguments to support its approach:

1. An Examination of Incumbent LEC Prices for Special Access Circuits is Necessary But Not Sufficient. There is a consensus among commenters that an examination of incumbent LEC prices for special access circuits should be essential part of the Commission's analysis.⁷ However, some incumbent LECs argue that the analysis does not need to go any further, contending that declining prices alone when coupled with rising output are sufficient to indicate that the current special access rules are working properly. For instance, Verizon and Verizon Wireless ("Verizon") state, "These facts [declining prices and increasing output] alone demonstrate that there has been no market failure requiring the Commission to impose more intrusive regulations on special access rates."⁸ Such a claim, however, is an overstatement. The record is replete with expert declarations, including from the legacy AT&T,⁹ that the key determinant of market power is profit margins (the relation of prices to costs). XO is confident the Commission understands the value of this approach and that an examination of price alone is insufficient.

2. An Examination of Incumbent LEC Economic Costs of Providing Special Access Circuits is Necessary and Achievable. The heart of the debate between incumbent and competitive LECs in the initial round of comments concerns the ability to determine the

⁷ See, e.g., Comments of TW Telecom, WC Docket No. 05-25, RM-10593 (filed Jan. 19, 2010) at 2-3; Comments of Verizon and Verizon Wireless, WC Docket No. 05-25, RM-10593 (filed Jan. 19, 2010) at 1. ("Verizon Comments"); Tardiff-Weisman Declaration at ¶¶ 15-21; Comments of Sprint Nextel Corporation, WC Docket No. 05-25, RM-10593 (filed Jan. 19, 2010) at 25-26 ("Sprint Comments").

⁸ Verizon Comments at 1.

⁹ Petition of AT&T Corp., *Petition for Rulemaking to Reform Regulation of Incumbent Local Exchange Carrier Rates for Interstate Special Access Services*, RM-10593 (filed Oct. 15, 2002) at 8-9.

incumbent LEC's costs of providing special access circuits. AT&T, Verizon, and Qwest's economic experts wax at length about problems with the use of accounting cost data and the allocation of joint and common costs.¹⁰ AT&T, in fact, goes so far that it asks the Commission to eschew use of a market power analysis either because the large fixed cost nature of the telecommunications makes use of short-run margin costs "improper" or because use of average costs would be "complex and burdensome."¹¹ Verizon and Qwest take a somewhat different approach. Verizon states that if the Commission finds it necessary to examine incumbent LEC costs, it could compare "the changes in the costs of network components used to provide special access services and the changes for the prices customers pay."¹² It suggests that the Commission could use the AUS Telephone Plant Index to determine of the costs of network components. Qwest proposes a different scheme, whereby incumbent LEC prices in the most competitive areas are used to benchmark to compare other prices.¹³

In contrast to the approach of AT&T, Verizon, and Qwest regarding cost data, competitive providers propose use of cost data based on total element long run incremental cost ("TELRIC") or ARMIS data. Sprint, for instance, submits a lengthy Declaration by Bridger Mitchell wherein he proposes the use of forward-looking costs based on unbundled network element (TELRIC) rates adopted by state regulatory commissions.¹⁴ The NoChokePoints

¹⁰ See n. 5, and Attachment A, Declaration of Michael D. Topper, to Verizon Comments at ¶¶ 77-83 ("Topper Declaration"), and Tardiff/Weisman Declaration at ¶¶ 38-42.

¹¹ Exhibit A of AT&T Comments, Declaration of Dennis W. Carlton and Hal S. Sider in Support of AT&T Inc., at ¶¶ 57-58. ("Carlton/Sider Declaration")

¹² Verizon Comments at 4.

¹³ Comments of Qwest Communications International Inc., WC Docket 05-25, RM-10593, (filed Jan. 19, 2010) at 41-43.

¹⁴ Declaration of Bridger M. Mitchell, attached to Sprint Comments, at ¶ 98.

Coalition also supports use of TELRIC rates and additionally urges the Commission to rely on ARMIS data.¹⁵

XO believes it is both essential and possible to obtain, either directly or indirectly through the use of actual market data, the incumbent LECs' economic costs for providing special access circuits, and it is possible to do so without running afoul of the incumbent LECs' claims. More specifically, XO takes issue with AT&T's argument (as propounded in the Carlton/Sider Declaration) that a market power study of special access rates cannot be usefully performed by examining the relation between prices and marginal costs.¹⁶ Carlton/Sider argue that, in an industry with large fixed costs and low marginal costs, the absolute difference between prices and marginal costs does not provide a useful measure of market power. As a threshold matter, XO's proposal, as discussed above, eliminates the need to estimate marginal costs. However, assuming, *arguendo*, that Carlton/Sider's claim were correct, they ignore the fact that dynamic movements in price-cost margins provide a robust measure of whether a firm's market power has increased or decreased over time. In other words, even assuming that Carlton/Sider were correct that the absolute difference between price and marginal cost does not necessarily reflect a given degree of market power, dynamic movements in price-cost margins certainly reflect changes over time in a firm's ability to exercise market power. If the Commission determined that, for example, dynamic changes in an incumbent LEC's price-cost margins for special access services have increased, that would constitute powerful economic evidence that the incumbent LEC had exercised more market power over time.¹⁷

¹⁵ Comments of the NoChokePoints Coalition, WC Docket 05-25, RM-10593 (filed Jan. 19, 2010) at 15-27.

¹⁶ Carlton/Sider Declaration at ¶ 57.

¹⁷ Carlton/Sider also claim that a comparison of an incumbent LEC's prices and average costs cannot shed light on the degree of its market power (¶ 58). Their argument is that

In contrast to AT&T's position that the Commission should not embark on a market power analysis, XO notes that Qwest at least sought to provide a benchmark of actual market activity, albeit based just on incumbent LECs' prices.¹⁸ If Qwest had taken the next logical step and asked the Commission to obtain prices from competitive LECs providing special access circuits, it would have arrived at XO's solution.¹⁹ By gathering complete data on prices offered both by incumbent and competitive LECs on the most competitive routes, the Commission would arrive at a sufficiently close approximation of costs for the provision of service by incumbent LECs. It would employ those cost proxies to establish overall cost benchmarks (which could be compared to TELRIC rates, which could then be used to determine whether incumbent LECs were pricing special access circuits at supra-competitive levels.

LECs are multiproduct firms and so have substantial common costs. They state that "there is no theoretical basis for allocating common costs across services that is widely accepted among economists" (¶ 58). XO respectfully disagrees. In fact, there is a large accounting and economics literature that analyzes the efficiency properties of alternative cost allocation methodologies. (See, e.g., Ray (2007), "Efficient Cost Allocation" and the papers cited therein, available at: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=965925.) As with their comments on price-marginal cost margins, Carlton/Sider claim that the absolute difference between a LEC's prices and average costs cannot be used to determine the extent of that firm's market power (¶ 59). As before, however, Carlton/Sider ignore the fact that dynamic movements in price-average cost margins provide a robust measure of whether a firm's market power has increased or decreased over time.

¹⁸ AT&T also focuses on the need for competitive LECs to provide price data from their purchase of incumbent LEC special access services. (AT&T Comments at 4.)

¹⁹ Qwest contends that it would be "irrational to conclude that ILEC rates are 'supracompetitive' simply because they are sometimes higher than some competitors rates for superficially similar services." (Qwest Comments at 24.) Qwest bases this conclusion on a claim that CLECs enjoy scale economies and price differences may reflect differences in service quality. XO notes that Qwest has provided no evidence to support these claims. Further, XO can demonstrate that incumbent LECs, in fact, have far greater economies of scale than competitive LECs and that quality differences, while important, either have a *de minimis* effect on price or can be factored in to any analysis. Finally and most importantly, under XO's approach, the Commission would not be examining rates on select routes for a small group of competitors. Rather, the Commission would need to ensure that it collected a statistically significant sample from a large group of competitors.

3. The Relevant Geographic Market to Analyze Market Power are Point-to-Point

Connections of Special Access Circuits. In his Declaration accompanying the Verizon Comments, Dr. Topper argues that the relevant geographic market for analyzing the ability of an incumbent LEC to exercise market power must be larger than the point-to-point connections of special access circuits.²⁰ In support of his argument, he makes the following claim, “Individual buildings and city blocks within the footprint of existing networks are contestable.”²¹ This contention is clearly contrary to developments in the field of Industrial Organization in the past 20 years. The theory of contestable markets was refuted in numerous empirical studies throughout the 1980’s and 1990’s and is no longer regarded as a credible theory of firm behavior.²² As discussed in XO’s initial comments, using the methodology of the *HMG*, the relevant geographic markets for analyzing the ability of a LEC to exercise market power are the point-to-point connections of special access circuits.

4. An Examination of Network Deployments of Competitive LECs is Neither Necessary Nor Sufficient for the Commission to Undertake the Proper Economic Analysis.

In their initial comments, incumbent LECs continue to insist that the Commission require that competitive LECs submit “detailed, specific, and complete information regarding the location and potential reach of their networks so that the Commission can assess claims that there is a poor fit between the existing ‘triggers’ and the presence of sunk facilities.”²³ But, as XO indicated in its initial comments, “an examination of competitive facility deployment and potential deployment, cannot result in the provision of precise indicia of the extent to which

²⁰ Topper Declaration at ¶¶ 54-61.

²¹ *Id.* at ¶ 58.

²² Church, Jeffrey and Roger Ware (2000), *Industrial Organization: A Strategic Approach*, Chapter 14.

²³ AT&T Comments at 4. *See, also, e.g.*, Qwest Comments at 5.

special access markets are competitive, and, in fact, will result in a quagmire, sapping Commission focus and energies, as parties submit endless fiber maps and argue with no end about whether service can be provided or extended over such facilities.”²⁴ Such a structural analysis may have a role when no data is available and empirical analysis cannot be performed, but it is far less reliable than analysis of actual market data about prices and costs, which is the framework proposed by XO. The Commission thus should not expend its resources or that of the competitive firms on data gathering exercises that at the end of the day will not produce the quality of data required to conduct the necessary economic analysis.²⁵

5. The Commission Should Be Vigilant about ILEC Price Increases. As noted earlier in these comments, the incumbent LECs contend that a decline in special access prices, assuming *arguendo* exists, demonstrates that they do not have market power. XO has already rebutted the validity of this contention, but XO agrees that price is a relevant factor in any market power analysis. To that end, XO notes that one of the special access merger conditions -- #6 -- agreed to by AT&T as part of its acquisition of BellSouth lapses in the near future. This condition caps special access prices in areas where the incumbent LEC has received Phase II Pricing Flexibility.

More specifically, the condition in part states:

In areas within the AT&T/BellSouth in-region territory where an AT&T/BellSouth ILEC has obtained Phase II pricing flexibility for price cap services (“Phase II areas”), such ILEC will offer DS1 and DS3 channel termination services, DS1 and DS3 mileage services, and Ethernet services, that currently are offered pursuant to the Phase II Pricing Flexibility Provisions of its special access tariffs, at rates that are no higher than, and on the same terms and conditions as, its tariffed rates, terms, and conditions as of the Merger Closing Date for such services in areas within its in-region territory where it has not obtained Phase II pricing flexibility. In Phase II areas, AT&T/BellSouth also will

²⁴ XO Comments at 4.

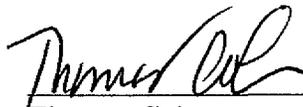
²⁵ XO notes that it has and will produce data if required to do by the Commission.

reduce by 15% the rates in its interstate tariffs as of the Merger Closing Date for Ethernet services that are not at that time subject to price cap regulation.²⁶

XO believes the Commission should at least monitor AT&T's special access prices after this condition lapses to determine whether in fact special access prices are declining as the incumbent LECs contend. XO also believes the Commission should consider preempting any potential price increase during the pendency of this proceeding.

Respectfully submitted,

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²⁶ *In the Matter of AT&T Inc. and BellSouth Corporation Application for Transfer of Control*, Memorandum Opinion and Order, WC Docket No. 06-74 (Mar. 26, 2007), Appendix F at 151.