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February 24, 2010

Ms. Marlene H. Dortch
Secretary
Federal Communications Commission
Room TW-325
445 12th Street, S.W.
Washington D.C. 20554

Re: In the Matter of Special Access Rates for Price Cap Local Exchange Carriers, WC Docket No. 05-25

Dear Ms. Dortch:

On behalf of tw telecom inc., please find enclosed two copies of the redacted version of reply comments filed today in the above-referenced docket pursuant to the protective order in this proceeding.[1] An electronic copy of the redacted version of the reply comments has also been filed electronically via ECFS. Two copies of the confidential version of the reply comments have also been provided to Margaret Dailey under separate cover. One copy of the confidential version of the reply comments has also been filed with the Secretary's Office under separate cover.

Please let us know if you have any questions with respect to this submission.

Respectfully submitted,

Thomas Jones
Jonathan Lechter

WILLKIE FARR & GALLAGHER LLP
ATTORNEYS FOR TW TELECOM INC.

[1] *Special Access Rates for Price Cap Local Exchange Carriers*, Order, 20 FCC Rcd 10160 (2005).

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BEFORE THE
Federal Communications Commission
WASHINGTON, D.C.

In the Matter of	)	
	)	
Special Access Rate for Price Cap Local Exchange Carriers	)	WC Dkt. 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 TW TELECOM

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REPLY COMMENTS OF TW TELECOM

tw telecom inc. ("TWTC"), by its attorneys, hereby files these reply comments in response to the public notice released on November 5, 2009 in the above-referenced proceedings.[1] In addition to filing these reply comments, TWTC is a member of the NoChokePoints ("NCP") coalition and a signatory to the NCP reply comments in this proceeding.

I. INTRODUCTION AND SUMMARY

In comments filed in this proceeding, several incumbent LECs seek to distract the FCC from undertaking a reliable assessment of incumbent LEC market power in the provision of DS1, DS3 and Ethernet special access services. For example, those incumbent LECs argue that reducing incumbent LEC special access prices to reasonable levels would deprive the incumbent LECs of the resources needed to deploy mass market broadband services. These arguments appear to be implicit concessions that special access services are overpriced. They demonstrate the need for the FCC to do the work of

[1] *See Parties Asked to Comment on Analytical Framework Necessary to Resolve Issues in the Special Access NPRM*, Public Notice, DA 09-2388 (rel. Nov. 5, 2009).

actually studying this market closely and designing appropriate regulations for addressing market failure where it exists.

Indeed, as explained by wireline and wireless competitors, large non-carrier purchasers of special access and even Qwest, the FCC has a responsibility to undertake a reliable, data-driven market power analysis of special access. Such an examination must include (1) defining product and geographic markets based on the FTC/DOJ "small but significant and nontransitory increase in price" ("SSNIP") test or other probative data regarding demand elasticity; (2) examining market shares; and (3) examining elasticity of supply by evaluating barriers to entry and economies of scale and scope.

In conducting this analysis, the FCC should decline the incumbent LECs' invitation to rely on (1) anecdotal information regarding the scope of intermodal and intramodal competition gleaned primarily from competitors' websites and (2) assertions that incumbent LEC prices have been declining. Anecdotal evidence, particularly evidence that has been rejected in other proceedings, cannot provide a reliable basis for evaluating the competitive conditions in the market. Moreover, it is well established that the direction of incumbent LEC prices does not provide insight as to whether incumbent LECs are exercising market power. Rather, market power should be assessed based on whether incumbent LEC prices are well above competitive levels or the incumbent LECs' costs. TWTC and others have suggested numerous benchmarks, including ARMIS data, to determine whether that is the case.

It is also important that the FCC examine all special access service product markets by capacity and technology. This includes all relevant TDM and Ethernet product markets. In particular, the FCC must closely examine the Ethernet special access

market and ensure that Ethernet special access rates are just and reasonable because it is now more clear than ever that there are limits on competitors' ability to use TDM special access inputs to provide Ethernet service.

As several parties have suggested, it may be necessary for the FCC to undertake its market power analysis in representative subsets of relevant markets. In TWTC's initial comments, it proposed a detailed approach for analyzing incumbent LEC market power in the provision of special access loops on a zip code or wire center basis. TWTC supplements that proposal below by explaining how the FCC can conduct a loop market power analysis in a representative subset of zip codes/wire centers. In addition, TWTC explains how the FCC can undertake an analysis of interoffice transport markets.

Finally, TWTC agrees with many other commenters that the FCC should not wait until the completion of a detailed analysis of the special access market to address market failure. The FCC should take interim action to rein in incumbent LEC special access rates where the existing record shows them to be unreasonable by (1) reducing all special access prices in Phase II areas to the level of prices subject to price caps; (2) refusing to grant incumbent LECs pricing flexibility in any new geographic or product markets; and (3) requiring a 15 percent interim rate reduction to wholesale Ethernet services (for AT&T, this would require continuation of Condition 6 from the AT&T-BellSouth Merger conditions).

II. INCUMBENT LEC ATTEMPTS TO DISTRACT THE FCC FROM FOCUSING ON A MARKET POWER ANALYSIS SHOULD BE REJECTED.

The incumbent LECs raise a host of arguments in an attempt to persuade the FCC not to undertake a reliable assessment of market power in the provision of special access. The FCC should reject these arguments.

First, the incumbents argue that reductions in special access rates will prevent incumbent LECs from deploying mass market broadband and continuing to provide wireline voice service at reasonable rates. If true, this assertion is both an admission that incumbent LEC profits are unreasonably high and an admission that incumbent LECs are engaging in cross-subsidy in violation of Section 254(k) of the Act.[2]

In any event, if the FCC believes that there are certain geographic areas in which incumbent LECs are unable to economically justify broadband deployment based on the revenue generated from those services, the Commission can consider establishing an explicit universal service funding mechanism for the purpose of promoting affordable broadband deployment. Indeed, AT&T recently filed a paper explaining what it believes is an appropriate legal basis for doing so.[3] In all events, the FCC's goal of widespread

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[2] *See* 47 U.S.C. 254(k) ("A telecommunications carrier may not use services that are not competitive to subsidize services that are subject to competition. The Commission, with respect to interstate services, and the States, with respect to intrastate services, shall establish any necessary cost allocation rules, accounting safeguards, and guidelines to ensure that services included in the definition of universal service bear no more than a reasonable share of the joint and common costs of facilities used to provide those services."); *Southwestern Bell Tel. Co. v. FCC*, 153 F.3d 523, 559 (8th Cir. 1998) ("[T]he first sentence of § 254(k) 'addresses the concern that [incumbent LECs] may attempt to gain an unfair market advantage in competitive markets by allocating to their less competitive services, for which subscribers have no available alternative, an excessive portion of the costs incurred by their competitive operations.'"). The incumbent LECs' admission also demonstrates that they are capable of assessing their profits on a service-specific basis, something the incumbents have long claimed they cannot do.

[3] *See* Letter from Gary L. Phillips, General Attorney & Associate General Counsel, AT&T, to Marlene H. Dortch, Secretary, FCC, Attachment: *The Federal Communications Commission Has Statutory Authority to Fund Universal Service Broadband Initiatives*, GN Dkt. No. 09-51 (filed Jan. 29, 2010).

broadband deployment should not be funded on the backs of business customers and competitive carriers.[4]

Second, the incumbents assert that any further regulation of incumbent LEC special access rates will harm the incentives of incumbents and competitors to invest in additional facilities. These arguments are make-weight. Customer demand will drive last-mile construction. As AT&T explains, "the industry is virtually unanimous that . . . increases in wireless traffic cannot be handled by legacy TDM-based DS1s and DS3s."[5] If it is truly the case that these special access services are not up to the task of providing backhaul for modern wireless services, then they will not be purchased, *regardless* of the price. However, as Sprint has indicated, many cell sites can still get by with copper-based DS1 and DS3 backhaul.[6]

Nor is there a basis for incumbent LEC assertions that lower special access rates will discourage competitors' investment in facilities.[7] As the FCC has found, competitors

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[4] *See* PAETEC *et al.* ("PAETEC") Comments at 74 ("BOCs should not be permitted to justify higher DS1 and DS3 special access rates to offset their costs of deploying such mass market broadband services. While certain BOCs assert that 'slashing special access rates' would deprive them of revenues needed to deploy next generation facilities, Section 254(k) of the Act prohibits this type of cross subsidization."). Unless otherwise indicated, all comments referenced herein are to those filed in WC Dkt. No. 05-25, RM-10593, on Jan. 19, 2010.

[5] *See* AT&T Comments at 14.

[6] *See* Sprint Nextel Comments at 20.

[7] *See* AT&T Comments at 17 (stating that mandating rate reductions will "inevitably lead to a *decrease* in broadband infrastructure investment by all providers") (emphasis in original); Qwest Comments at 20 ("By artificially reducing prices for those legacy services, special access re-regulation would merely prolong the dependence of customers on those services in the short to intermediate term and suppress their demand for new, non-price-regulated services. And that in turn would delay the deployment of next-generation alternatives to those legacy services.").

will deploy facilities to locations where it is economically feasible do to do so based on the cost of construction and the revenue available.[8] Competitors will deploy their own loops where feasible and economic because reliance on incumbent LEC loop facilities, i.e., reliance on facilities owned and controlled by the dominant competitor in the market, is bad business.[9] Thus, special access regulation will not diminish the extent to which competitors deploy loops.

III. THE FCC MUST EXAMINE THE SPECIAL ACCESS MARKET USING TRADITIONAL TOOLS OF MARKET POWER ANALYSIS

As TWTC, BT Americas, Sprint, the NCP Coalition, XO, Level 3, PAETEC[10] and even Qwest all explained in their comments, the FCC should examine the special access market by using traditional tools of measuring market power.[11] The FCC should reject arguments that it forgo a market power analysis in favor of reliance on (1)

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[8] The incumbents make much of Sprint's statement that the availability of DS1 facilities has retarded the deployment of microwave backhaul facilities. *See* AT&T Comments at 17 ("[A]s Sprint's CTO observed, the ready supply of inexpensive TDM-based DS1s already has dampened development and deployment of microwave backhaul in the United States."). But if the backhaul market could be satisfied with existing facilities, it would make little economic sense for any carrier to invest in higher capacity backhaul until that capacity is needed. Once the higher capacity is needed, carriers will make the investment required to deliver it.

[9] Of course, competitors will not deploy their own loops if the revenue does not justify the cost of deployment. This is so regardless of the price charged by the incumbent.

[10] *See* PAETEC Comments at 26-28; TWTC Comments at 2; BT Americas Comments at 4-5; Sprint Nextel Comments at 7; NoChokePoints ("NCP") Coalition Comments at 1-2; XO Comments at 3; Level 3 Comments at ii; Qwest Comments at 21.

[11] The FCC has held that a dominant carrier is "'[a] carrier "found by the Commission to have market power (*i.e.*, power to control prices)."' PAETEC Comments at 18 (internal citations omitted). Market power, in turn, is the "'ability to raise prices by restricting output'" or "'to raise and maintain prices above the competitive level without driving away so many customers as to make the increase unprofitable.'" *Id.*

anecdotal evidence regarding intermodal and intramodal competition and (2) misleading evidence of allegedly declining incumbent LEC prices.

A. The FCC Must Reject Arguments That A Market Power Analysis Would Be Too Difficult Or That It Would Be Inappropriate.

The incumbent LECs argue that analyzing market power is only appropriate for proceedings in which the FCC assesses whether to apply dominant carrier regulation and that a market power analysis, and in particular market definition, is too difficult. Neither argument has merit. As Qwest argues, the FCC has examined indicia of incumbent LEC market power in a host of proceedings other than dominance classification proceedings, including proceedings concerning mergers[12] and unbundling.[13] Indeed, Qwest correctly argues that the central goal of the FCC's analysis in this proceeding should be to determine the extent to which incumbent LECs possess market power.[14]

In addition, it is well within the FCC's capabilities to undertake a reliable market definition analysis. In doing so, it is particularly important for the FCC to rigorously examine the extent to which intermodal competitors (HFC-based cable services and fixed

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[12] *See AT&T Inc. and BellSouth Application for Transfer of Control*, Memorandum Opinion and Order, 22 FCC Rcd 5662 ¶ 24 (2007) ("*AT&T-BellSouth Merger Order*") ("We begin by defining the relevant product markets and relevant geographic markets. We next identify market participants and examine market concentration and how concentration will change as a result of the merger. We also consider whether entry conditions are such that new competitors could likely enter and defeat any attempted post-merger price increase.").

[13] *See* Qwest Comments at 5 ("As a first step, the Commission should select a statistically valid sample of Phase I and Phase II markets from which to collect the information necessary to conduct a market-power analysis-similar to the information and analysis the Commission has used in a range of other proceedings, including merger and forbearance proceedings.").

[14] *See id.* at 21 ("The debate about special access rates has dragged on for years, and it can be responsibly resolved in only one way: by conducting a market-power analysis[.]").

wireless providers) offer services that are substitutes for incumbent LEC special access services.[15] In conducting that analysis, the FCC could, as it has previously, rely on (1) comparisons of prices charged for different services,[16] (2) comparisons of technical characteristics[17] (e.g., latency, jitter, availability of service level guarantees vs. "best effort" offerings),[18] (3) data regarding customer churn,[19] and (4) service providers' marketing materials.[20]

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[15] As they have in the past, the incumbents attempt to conflate (1) fiber-based services provided by cable companies, which are substitutes for incumbent LEC special access services, and (2) HFC-based services, which do not appear to be substitutes for incumbent LEC special access services. *See* Verizon & Verizon Wireless ("Verizon") Comments at 21-22 (discussing Cablevision's fiber-based services and Cox's overall commercial revenues as proof that all cable companies' products marketed to businesses are substitutes for special access services). The FCC rejected this approach in the *TRRO* because of the very different capabilities of fiber and HFC-based services. *See Unbundled Access to Network Elements; Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers,* Order on Remand, 20 FCC Rcd 2522, n.514 (2004) ("*TRRO*") ("Qwest, for example, indicates that it lost lines to Cox in Omaha, but those losses are to the circuit-switched telephony service offered by Cox's competitive LEC affiliate, rather than to its cable operation.").

[16] *See TRRO* ¶ 193 ("Commenters also note that businesses that do require DS1 loops are willing to pay significantly more for them than the cost of a cable modem connection, which also indicates that the two are not interchangeable.").

[17] *See* Sprint Nextel Comments at 19-20 ("For instance, fixed wireless service is not a viable substitute for wireline special access services in many cases due to a variety of factors, including: propagation issues that limit the distance a fixed wireless connection can cover; line of sight requirements which render fixed wireless services ineffective in certain locations; sensitivity to weather…; costs that are too high to justify to use for relatively low-capacity connections; limited access to rooftops and other building access issues; and fixed wireless providers' focus on the retail market.").

[18] *See TRRO* ¶ 193 ("Competitive LEC commenters explain that bandwidth, security, and other technical limitations on cable modem service render it an imperfect substitute for service provided over DS1 loops."); *UK Broadband Speeds 2008*, Ofcom (Jan. 8, 2009), *available at* http://www.ofcom.org.uk/research/telecoms/reports/bbspeed_jan09/.

[19] In the *TRRO*, the FCC concluded that cable modem and DSn based services were not part of the same product market based on customer churn data provided by competitors. *See TRRO* ¶ 193 ("Finally, at least two competitors maintain that, based on their internal

B. The FCC Must Examine The Special Access Markets By Capacity

Verizon argues that the FCC need not delineate special access product markets by capacity.[21] But as TWTC and PAETEC have explained, the FCC must account for capacity and associated price differences in defining product markets.[22] For example, customers demanding a DS-1 cannot economically turn to a much higher-priced DS-3 in response to a SSNIP for a DS-1. The FCC can also establish product markets for those capacities of service below which competitors would rarely, if ever, deploy their own facilities based on build/buy data. Ethernet services, which are sold in granular bandwidth increments, can be divided into product markets based on the costs of providing the service.

Moreover, a capacity-based approach is consistent with FCC precedent. As PAETEC argues, the FCC concluded in the BellSouth/AT&T Merger Order that

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data, they rarely lose enterprise customers to cable providers."); *id.* at n.514 ("Nuvox, for example, states that only a tiny fraction of its customer losses between January and October 2004 were to cable companies, and even those may have been to wireline competitive LEC affiliates....Cbeyond similarly asserts that very few telephone numbers have been ported from Cbeyond to a cable company and vice versa....None of the BOCs provide comparable numbers indicating how many enterprise customers they have lost to cable providers.").

[20] *See Applications of Nextel Communications, Inc. and Sprint Corporation et al.,* Memorandum Opinion and Order, 20 FCC Rcd 13967, ¶ 142 (2005).

[21] *See* Verizon Comments at 17-18.

[22] *See* TWTC Comments at 8; PAETEC Comments at 23-24.

"different capacity circuits are likely to constitute separate relevant product markets[.]"[23] The FCC similarly examined separate capacity markets in the *TRO* and *TRRO*.[24]

C. The FCC Must Examine Both The TDM And Ethernet Special Access Markets

As TWTC and PAETEC argue, the FCC must examine the market for incumbent LECs' TDM *and* Ethernet services. As an initial matter, incumbent LECs are mistaken that customers will abandon TDM-based services any time soon. Retail customers continue to demand TDM-based services in substantial volumes and TDM-based special access services remain the key input for these services. For example, one of TWTC's most popular products, Versipak (offering bundled voice, data, and Internet services), is generally provisioned *via* incumbent LEC DS-1 special access services. Businesses are used to and familiar with the capabilities of TDM-based services. That fact alone will ensure that there is substantial demand for such services for some time.[25]

But while the FCC must examine TDM services, it must recognize the differences between TDM and Ethernet services. Indeed, wholesale TDM service is not a substitute for wholesale Ethernet service. TWTC's experience proves the point. TWTC can only partially rely on TDM-based special access to provide Ethernet at retail. More

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[23] *See AT&T-BellSouth Merger Order* at n.94.

[24] *See, e.g., Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers,* Report & Order and Order on Remand and FNPRM, 18 FCC Rcd 16978, ¶¶ 376-377 (2003), *subsequent history omitted* ("*TRO*") ("Because a carrier using higher capacity levels of transport has a greater incentive and broader revenue base to support the self-provisioning of transport facilities, we adopt an approach to analyzing transport that considers different capacity levels."); *TRRO* ¶ 86 (finding "there are significant differences between the potential revenues available from circuits of different capacities.").

[25] *See* Sprint Nextel Comments at 20.

widespread reliance on TDM-based special access is not possible due to the expense and inefficiency of translating TDM signals to Ethernet.[26] In addition, TWTC is unable to obtain reasonably priced Ethernet special access services from incumbents. **[confidential begin]**[27] **[confidential end]**

D. The FCC Must Analyze Incumbent LEC Market Share As Part Of Its Market Power Analysis

The incumbent LECs argue that there is no need to focus on market share because market share is inherently "backward looking" and therefore inappropriate for the allegedly fast-moving and rapidly changing market for high capacity services demanded by businesses. There is no basis for this assertion.

First, where a firm is able to sustain a high market share over time in a market characterized by high entry barriers, it is reasonable to conclude that the firm possesses market power.[28] The information already in the record shows that incumbent LEC market share by location and by service has remained remarkably consistent (at over 80 percent) over a long period of time.[29] As the FCC has recognized, the entry barriers to

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[26] See Letter of Thomas Jones, Counsel, tw telecom inc., to Marlene H. Dortch, Secretary, FCC, GN Dkt. Nos. 09-51 *et al.* (filed Dec. 22, 2009) ("*TWTC Dec. 22, 2009 Letter*"). Qwest argues that TWTC has been "notorious for telling the Commission that it could not provide Ethernet services over traditional special access services while telling investors and customers the opposite[.]" Qwest Comments at n.21. But the fact remains that actual TWTC deployment patterns demonstrates that it cannot rely on TDM special access services in most instances and **[confidential begin] [confidential end]**

[27] *See TWTC Dec. 22, 2009 Letter.*

[28] *See* Phillip E. Areeda & Herbert Hovenkamp, *Antitrust Law: An Analysis of Antitrust Principles and Their Application* ¶ 501 (3rd ed. 2007) ("*Areeda*") ("[M]arket power is the abilities (1) to price substantially above the competitive level *and* (2) to persist in doing so for a significant period without erosion by new entry or expansion.")

[29] *See, e.g.*, PAETEC Comments at 45 ("For example, Paetec recently explained that ILEC-provided access loops represent the only means of reaching premises for over 95%

facilities-construction are particularly high. As a result, and because of real-world capital constraints, competitors can build fiber laterals to a small number of additional buildings each year.[30] As AT&T notes, TWTC is the most prolific competitive builder of on-net locations.[31] Yet, TWTC can only build laterals to approximately 1,000 locations each year.[32] This is a small number given that there are approximately three million commercial buildings in the U.S.[33]

Second, while the technology used to provide special access service is quickly evolving, this is not a reason to ignore consistently high incumbent LEC market shares. This is because the underlying basis for the incumbent LECs' market power, ownership of underlying bottleneck copper and fiber loop facilities, remains largely unchanged.

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of the businesses customers it served); *see id.* at n.144 (discussing competitors' filings over the past two years and a GAO report regarding competitors' reliance on the incumbent connections to over 90 percent of locations); *see also TRO* at n.856 (finding that, based on 2003 data, competitors reached approximately 3-5 percent of commercial locations); *see also* TWTC *et al.*, Comments, WC Dkt. No. 05-25, RM 10593, at 9-10 (filed Aug. 8, 2007) ("Two years ago, Verizon asserted that competitors had deployed loops serving '31,467+' buildings. Verizon indicated that, back in 1996, there were only 24,000 buildings 'served directly by CLEC fiber.' In other words, in nearly 10 years, competitors added connections to less than 8,000 buildings.").

[30] *See* PAETEC Comments at 43 ("The Commission should not consider generalized claims that facilities-based wireline competitors have the ability to add significant capacity rapidly. For many of the same reasons why new entry is unlikely, existing competitors are also unlikely to be able to add new capacity quickly to serve locations where they have not already deployed facilities, even in response to anti-competitive practices or pricing from the incumbent provider.").

[31] *See* AT&T Comments at n.81.

[32] *See* tw telecom inc., Q4 2009 Earnings Call Transcript (Feb. 9, 2010), *available at* http://seekingalpha.com/article/187653-tw-telecom-inc-q4-2009-earnings-call-transcript.

[33] *See TRRO* ¶ 157.

Third, there is nothing anomalous about the FCC examining market share in "rapidly changing markets." Indeed, there are likely few markets under the FCC's jurisdiction that would not fall under that category, yet the FCC often examines market share data. For example, the FCC examined market shares and market power in rapidly evolving markets such as the long distance market.[34]

E. The FCC Must Reject Incumbent LEC Assertions of Competition Based on Anecdotal Evidence Which Has Already Been Rejected

The incumbents argue that vague generalizations regarding competition based on company press releases or nationwide data already rejected in previous proceedings can take the place of a disciplined market power analysis. This approach should be rejected again.

For example, Verizon argues that the FCC should eliminate all rate regulation of loop and transport facilities in Zone 1 wire centers within the top 50 MSAs without gathering any additional information, because "[t]here seems to be little dispute that competitive alternatives are widely available in metropolitan areas and office parks or other locations of concentrated demand."[35] Verizon seems to base this assertion on maps submitted to the FCC in the unbundling and special access proceedings "showing the extensive deployment of competitive network facilities" and the fact that there are multiple competitive fiber transport networks in major markets across the country.[36] But in the *TRRO*, the FCC found that such maps of transport networks do not provide reliable

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[34] *See, e.g., Policy and Rules Concerning the Interstate, Interexchange Marketplace Implementation of Section 254(g) of the Communications Act of 1934, as Amended*, Report and Order, 11 FCC Rcd 9564, ¶¶ 40-44 (1996).

[35] *See* Verizon Comments at 40.

[36] *See id.*

evidence as to whether competitors have deployed loop facilities.[37] The FCC's reasons for reaching this conclusion are equally applicable in this context. Most importantly, Verizon assumes that the availability of nearby competitive transport makes loop deployment of every capacity possible in every instance. The FCC has repeatedly rejected this idea.[38]

Moreover, incumbent LECs have relied, in a misleading way, on TWTC statements to investors that there are one million "target" businesses demanding more than 2 DS-1s of service within one mile of TWTC's network.[39] TWTC's statements assumed reliance on wholesale incumbent LEC loop facilities in the many circumstances in which TWTC cannot deploy its own loop facilities. Such reliance is only possible if

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[37] *See TRRO* ¶¶ 187-189 ("The maps provided by the incumbent LECs do not specify the capacity of service demanded in particular locations along the competitive routes identified; if those locations require capacity only at multiple DS3 or higher capacities, and are providing revenues commensurate with those capacities, then the presence of competitive routes is not relevant to the question whether it is economic to deploy to serve customers at the DS1, or even the single DS3, capacity level. Similarly, as described above, the costs of deployment will depend in part on the length of the lateral that must be constructed between the building being served and the splice point on the fiber ring. The incumbent LECs' maps do not indicate the placement of splice points, rendering evaluation of such costs impossible....Third, even if we were able to surmount the weaknesses described above, and could rely on the incumbent LEC maps as evidence that unbundling of high-capacity loops for the provision of local exchange service was inappropriate in some cases, the incumbent LECs have provided no evidence in our record linking those maps to administrable tests allowing for a sufficient degree of geographic nuance.").

[38] *See id.* ¶ 86 ("[T]he economic characteristics of different capacities of transport vary, and thus require varied treatment.").

[39] *See* AT&T Comments at n.34; Qwest Comments at 12.

the FCC ensures that incumbent LEC special access service prices are just and reasonable.[40]

F. Market Power Is Measured By Whether Incumbents' Prices Are Set Well Above Their Own Costs or Competitive Levels, Not Whether Those Prices Are Allegedly Declining

Incumbent LECs assert that evidence purportedly showing that special access prices are declining is *prima facie* evidence that the special access market is fully competitive.[41] The evidence in the record indicates that incumbent LEC rates are not in fact declining.[42] In any event, as Professor Stanley M. Besen and others have explained, the *direction* of incumbent LEC prices has no relevance as to whether incumbents are exercising market power.[43] A monopoly price may rise or fall for any number of reasons that have nothing to do with the effects of competition.[44]

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[40] *See generally Ex Parte* Presentation of tw telecom inc., WC Dkt. No. 05-25 (filed July 9, 2009) ("*TWTC July 9, 2009 Ex Parte*").

[41] *See* AT&T Comments at 6 ("[T]he consistent and substantial price declines are not mirages; they are facts. Accordingly, the burden is clearly on those advocating radical rule changes to show that there is a *real,* not merely conjectural, problem here") (emphasis in original); Verizon Comments at 5 ("With abundant evidence of declining special access prices and increasing output, the Commission can determine that competition is constraining prices for special access services and that those prices are just and reasonable."); and Qwest Comments at 10 ("[F]alling prices are surely *prima facie* evidence of competition[.]").

[42] *See* Sprint Nextel Comments at 37 ("[N]ominal rates have remained unchanged since the price cap level was frozen in 2003, despite growth in the number of special access lines."); PAETEC Comments at 64-65 ("[T]he BOCs have 'raised prices above average cost' and. . . their higher earnings are evidence that they have market power and have made substantial and sustained price increases associated with their special access services based on the use of that market power.").

[43] *See TWTC July 9, 2009 Ex Parte*, Attach. B: Declaration of Stanley M. Besen ¶ 5 ("*Besen Declaration*").

[44] For the same reason, Verizon is incorrect in stating that if "[incumbent] carriers possessed the market power that these other parties allege, they would not have the

It is for this reason that the level of a firm's market power should be measured by whether its prices are set above levels yielded by competition or above a reasonable measure of cost.[45] Therefore, to determine whether the incumbent LECs are exercising market power and whether price cap rates are set at appropriate levels, the FCC must compare incumbent LEC price cap, Phase II and Ethernet special access rates to appropriate competitive price and cost benchmarks. As several commenters have indicated, such benchmarks include UNE prices,[46] ARMIS rates of return,[47] competitor prices,[48] and prices of incumbent LECs that remain under rate of return regulation (e.g., NECA carriers).[49]

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incentive to reduce prices in the first instance, but instead would maintain or increase prices to maximize revenues." Verizon comments at 4. Verizon also omits the fact that its prices may already be at the monopoly profit maximizing level, in which case it would not make sense to increase price. *See Areeda* ¶ 502 ("[A] profit-maximizing monopolist will increase its output only up to the point that its rising (or constant) marginal cost meets its falling marginal revenues, which are derived from the demand function.").

[45] As Prof. Besen indicates, the key measure of a firm's market power is the firm's profit margin (the difference between prices and costs): "[T]he difference between a competitive and monopolistic industry is not the direction of, or rate at which, their respective prices *change* during a given period but the fact that a monopolist charges a *higher* price relative to its marginal cost than does a competitive firm." *See Besen Declaration* ¶ 5. (emphasis in original). AT&T argues that high profits are to be expected in an industry with high fixed costs because those fixed costs must be recouped. *See* AT&T Comments at 10. But this reasoning does not apply to DS1 and DS3 services which are provided primarily over copper facilities, the costs of which have long ago been paid for.

[46] *See* Sprint Nextel Comments at 26 ("UNEs typically are sold at month-to-month rates and therefore are directly comparable to special access month-to-month rack rates.").

[47] *See* PAETEC Comments at 67 ("ARMIS data remains a reliable indicator that BOC special access prices are unreasonable and reflect the lack of competitive alternatives to the BOCs' special access services.").

[48] *See* BT Americas Comments at 30. It is reasonable to compare competitor prices to incumbent LEC prices if incumbent LEC costs are at or below competitors' costs. Given the incumbents' superior economies of scale and scope and the fact that their DS-1, DS-3

IV. THE FCC CAN ANALYZE COMPETITION IN LOOP AND TRANSPORT SERVICES IN REPRESENTATIVE SAMPLE MARKETS

In its comments, TWTC described a comprehensive approach to evaluating incumbent LEC special access market power over loops based in part on OfCom's approach to analyzing the special access market in the U.K and the framework proposed by BT in its comments. As TWTC explained, in analyzing the loop market, the FCC should (1) identify those special access product markets that would never be subject to competitive supply; (2) establish a "competitive screen" to identify those geographic markets that it should examine more closely for evidence of competition; and (3) apply tools of market power analysis in those areas that meet the screen to determine if there is a sufficient level of competition to roll-back regulation of particular special access services. Below, TWTC explains how the FCC could analyze both the loop and transport markets by applying a market power analysis to only a representative sample of geographic markets.

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and low bandwidth Ethernet services are provided over fully depreciated copper facilities, this is almost certainly the case.

[49] *See* PAETEC Comments at 71-72 (detailing how incumbent LECs' price cap rates are far higher than NECA rates); Sprint Comments at 25 ("There are a number of benchmarks that the Commission can use to determine the rates that a competitive market likely would produce. For example, the Commission could compare existing special access prices to the rates that would prevail if the services were based on forward-looking costs. Other benchmarks include: the rates charged for similar high bandwidth services that are subject to competition; the prices charged for similar services in other countries; and the prices charged under price caps (which may also be excessive)").

A. Loop Analysis in Sample Geographic Areas

As TWTC explained in its comments, the FCC should establish a "screen" to determine which zip codes or wire centers[50] would be suitable for a further examination of competitive conditions for loops. TWTC recognizes that it may not be administratively feasible to undertake a detailed market power analysis in every relevant geographic area that meets the screen. If this is so, the FCC will need to conduct its market power analysis in a representative subset of geographic areas.[51] Specifically, zip codes/wire centers that meet the competitive screen could be organized into categories based on the number of fiber transport networks in close proximity to the buildings in that zip code/wire center. For example, one category of zip codes/wire centers might be those in which commercial buildings are within a reasonable build distance of, on average, between two and three competitive transport networks. Other categories of zip codes/wire centers could be established for those in which commercial buildings are, on average, near to (1) between three and four competitive transport networks, and (2) more than four competitive transport networks.

FCC will need to conduct a granular market power analysis (using at least some of the market power factors described below) in a range of zip codes/wire centers subject to different levels of competitive entry before it can establish firm definitions of zip

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[50] Wire centers may be more appropriate to analyze both loops and transport because, under the transport test described below, wire centers must be used.

[51] In a declaration filed with the Sprint Comments, Dr. Bridger Mitchell proposed a means of conducting a market power analysis in a representative subset of broad categories of similarly-situated wire centers. *See* Sprint Nextel Comments, Attach. A: Declaration of Bridger M. Mitchell, ¶¶ 38-49 ("*Mitchell Declaration*"). Dr. Mitchell suggested using the wire center categories the FCC adopted for loop and transport unbundling requirements for this purpose.

code/wire center categories. Such analyses may indicate that the categories should be defined more narrowly (e.g., it may be necessary to establish a category of zip codes/wire centers with average proximity to between 2.0 and 2.5 competitive networks), more broadly (e.g., by combining categories (1) and (2) above) or with entirely different cutoff points (e.g., it may be necessary to establish a category of zip codes/wire centers with average proximity to between 2.5-3.5 competitive transport networks).

Once the FCC has established the categories of similarly-situated zip codes/wire centers, the FCC could undertake a market power analysis of a representative subset of each category. The results of that analysis would then apply to all zip codes/wire centers in the category.

B. Transport Analysis

TWTC also proposes a specific test for assessing incumbent LEC market power in the provision of TDM mileage service as follows.[52] As with loops, the FCC should define categories of similarly-situated transport routes, conduct a granular market power analysis for a representative sample of routes in each category, and then apply the conclusions of the sample analysis to all routes in the relevant category. The FCC can define categories of transport routes in one of two ways.

First, if the FCC decides that wire centers (rather than zip codes) are the appropriate geographic areas for assessing loops, it could utilize the categories of wire centers established for the loop analysis. Specifically, using the definitions suggested above, the FCC could, for example, classify wire centers into four tiers (e.g., those with

[52] As TWTC explained in its comments, incumbents generally do not charge for Ethernet mileage, so the mileage analysis can be restricted to TDM-based services. *See* TWTC Comments at 23.

an average of (1) fewer than two proximate competitive transport networks;[53] (2) between 2-3 proximate competitive transport networks; (3) between 3-4 proximate competitive transport networks; and (4) four or more proximate competitive transport networks). Incumbent LEC transport routes between offices in different tiers of wire centers would then be grouped into different categories with similar competitive conditions.

There are many ways in which the FCC could establish categories of similarly-situated transport routes. For example, the "least competitive" category could rationally include a transport route with *one* end in a wire center with less than two proximate transport networks *or* with *both ends* in central offices in wire centers with less than two proximate transport networks. As with its loop test, the FCC could utilize a market power analysis to further refine its categories. A sample analysis could then be undertaken for a representative number of routes in each category.

Alternatively, the FCC could, as Sprint's expert Dr. Bridger Mitchell has suggested, utilize the categories of wire centers the FCC developed for determining unbundling requirements for interoffice transport.[54] Those categories group wire centers based on the number of business access lines or collocators in the wire center. Again, interoffice transport routes between different categories of wire centers could be grouped into categories and a sample analysis could be undertaken for a representative number of routes for each category.

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[53] Because a relevant transport category would be those wire centers with an average of fewer than two proximate transport networks, all wire centers, not just those passing the two-transport network screen for loops, would have to be examined.

[54] *See Mitchell Declaration* ¶¶ 35-36.

It should be noted that the first approach suggested here is likely to be more reliable than the approach advocated by Sprint. This is because the wire centers in the first approach are classified based on the number of competitive transport networks actually deployed in a wire center whereas the second approach relies on the presence of transport networks *or the number of business access lines in a wire center*. To be sure, the transport networks that are counted for purposes of the first approach include only those owned by firms that actually deploy fiber laterals to buildings. Thus, not all transport networks are counted.[55] Nevertheless, the methodology used to classify wire centers in the first approach hews more closely to the presence of actual competition than the categories the FCC adopted for unbundling. Indeed, the categories established in the unbundling context were designed to determine those situations in which it is *possible* for a reasonably efficient competitor to deploy transport facilities -- they do not assess the extent to which such competitive entry has actually occurred.[56] This makes it more likely that the wire centers in the categories developed under the first approach are subject to similar levels of competition than is the case with the wire centers in the categories used in Sprint's suggested approach.

C. Factors For Market Power Analysis To Be Applied in Relevant Loop and Transport Markets

Based on TWTC's and others parties' comments, the FCC should examine the following factors in those geographic markets selected for a closer examination of market power. In the loop analysis, the FCC should assess the extent of incumbent LEC market

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[55] If the FCC so chooses, in analyzing the transport market, it could include all transport networks, not just those that are used for building laterals.

[56] *See TRRO* ¶ 88.

share by building and by service.[57] In the transport analysis, the FCC should assess the extent of incumbent LEC market share by service and the extent to which the same competitive provider is collocated on both ends of a transport route between incumbent LEC central offices.[58] For both the loop and transport analysis, the FCC should assess (1) whether the incumbent LECs retain a persistently high margin over time by comparing incumbent rates to the benchmark rates and costs discussed above; (2) whether the incumbent LEC sets its wholesale price above competitor retail prices;[59] (3) whether the incumbent LECs' prices are uniform across a geographic area;[60] (4) the extent to which the incumbent LEC has substantial advantages in scale and scope (e.g., if

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[57] *See* Sprint Nextel Comments at 16 ("[T]he Commission's analysis of sample MSAs should include data that separately identify the number of competitively provided DS1 channel terminations, DS3 channel terminations, DS1 mileage circuits and DS3 circuits in each wire center."); *id.* at 9 ("[T]he relevant geographic market for channel termination service is the building in which the customer is located[.]").

[58] *See* TWTC Comments at 20-21 ("Where a customer can purchase the desired transport service from a non-incumbent LEC between the same two incumbent LEC central offices (i.e., from a competitor that has collocated fiber facilities in the central offices located on each end of the transmission service), it is clear that the incumbent LEC faces actual competition on the route in question....[T]he presence of a competitive provider of transport may not place much competitive pressure on the incumbent LECs' mileage prices unless the competitor has collocated its transport facilities in incumbent LEC central offices on both ends of the transport route desired by the customer.").

[59] *See* BT Americas Comments at 5.

[60] In their comments, the incumbents argue that the fact that their prices are largely uniform across wide areas shows that their prices are constrained by competition in a small portion of their region. *See* AT&T Comments at 44-45. The NCP Coalition reply comments address this point in detail. However, it is worth noting that the special access pricing flexibility order permits carriers to establish up to seven special access rate zones so that rates could be targeted to meet those downtown areas where competition is the highest. *See Access Charge Reform et al.,* Fifth Report and Order and Further Notice of Proposed Rulemaking, 14 FCC Rcd 14221, ¶ 62 (1999). The fact that most RBOCs do not charge lower prices in higher density areas (*see* Qwest Comments at 28) indicates that competition is having no effect on their rates.

the service in question is offered over copper facilities);[61] and (5) if the incumbent LEC conditions the availability of discounts on requirements that do not lower the incumbent's cost of providing service.[62]

V. INTERIM RELIEF IS APPROPRIATE

The FCC need not wait until it completes the analysis described herein before taking action to remedy the clear market failures in the special access market. In light of the substantial evidence already in the record that incumbent LEC special access prices are set well above competitive levels and that the current pricing flexibility triggers do not accurately assess where competitive deployment is sufficient to restrain incumbent market power, the FCC should adopt interim measures for reining in unreasonable prices. Such remedies should extend until the conclusion of this proceeding and should include

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[61] *See Mitchell Declaration* ¶ 74; PAETEC Comments at 43 ("The cost structure of the facilities-based local telecommunications market is, however, marked by the pervasive fixed and sunk costs and economies of density and scale necessary to compete and serve customers in local markets."); Comptel Comments at 20 ("Even if the CLECs had the facilities to compete in discrete geographic areas, they do not have the scale and scope to compete with the RBOCs for the major purchasers of special access.").

[62] *See* NCP Coalition Comments at 30-31 ("[M]any of the most anticompetitive terms do not appear to be designed to lower costs for the ILECs. For example, a true volume commitment discount would allow a purchaser to agree to a lower price in exchange for a commitment to buy enough circuits that the seller could provide the service at a lower cost. But these terms are typically tied to the customer's pre-existing volume rather than a particular volume level. Thus, they are not really volume commitments at all—and there is no evidence that they have any relation to the ILEC's cost. The truth is that ILECs insist on these terms to foreclose competition."); Sprint Comments at 39 ("This type of discount is based not on the savings the incumbent LEC achieves in providing a high volume of services to a single customer; it is simply a tool used by the incumbent to 'lock in' customers."); Comptel Comments at 20-21 ("[W]hen the incumbent offers 'discounts off its undiscounted prices in order to induce customers to agree to exclusionary provisions, it has an incentive to set the undiscounted price above even the monopoly level (because, rather than simply deterring demand, an increase above the monopoly level steers customers into the discount plans and also *brings the discount prices closer to the monopoly level.*)'" (emphasis in original)).

the following: (1) reducing all special access prices in Phase II areas to the level of prices subject to price caps; (2) refusing to grant any further pricing flexibility; and (3) requiring a 15 percent interim rate reduction for wholesale Ethernet services (for AT&T this would require a continuation of Condition 6 from the AT&T-BellSouth Merger conditions).[63]

VI. CONCLUSION

The Commission should adopt the foregoing analytical framework to regulate incumbent LEC special access services.

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[63] *See AT&T-BellSouth Merger Order* at 151-152.