Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 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 QWEST COMMUNICATIONS INTERNATIONAL INC.

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INTRODUCTION AND SUMMARY

As discussed in our opening comments, the special access debate has taken a critical step forward. Since last June, a consensus has emerged across the industry that the Commission can and should resolve the empirical disagreements at the heart of this debate by conducting a rigorous empirical analysis of the special access market. In their opening comments, most of the major stakeholders acknowledge the Commission's need to conduct that empirical inquiry, at least in principle, and offer to lend their help. These commenters thus join the Government Accountability Office in concluding that the Commission cannot "describe the state of competition accurately" without a genuine empirical analysis and that "additional data collection is necessary for the FCC to better fulfill its regulatory responsibilities."[1]

There is, indeed, no responsible alternative. The proponents of re-regulation bear the burden of proving that the present regime, in place since 1999, is so fundamentally misconceived that the Commission should simply discard it and, in the process, enrich special access purchasers to the tune of billions of dollars per year. But the advocates of re-regulation cannot

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[1] U.S. GAO Report to Comm. on Gov't Reform, H.R., *FCC Needs to Improve Its Ability to Monitor and Determine the Extent of Competition in Dedicated Access Services*, GAO-07-80 (Nov. 2006) ("*GAO Report*") (*see* "GAO Highlights" page). Unless otherwise indicated, all references below to the "Comments" of a party refer to the comments that party filed in WC Docket No. 05-25 in January 2010.

carry that burden of proof—and the Commission cannot lawfully effect that massive wealth transfer—unless the Commission first conducts a data-driven analysis of actual competitive conditions in the special access market and concludes (despite many indications to the contrary) that the resulting data prove the case for re-regulation.

A few commenters, while grudgingly acknowledging the merits of a genuine market-power analysis, nonetheless tempt the Commission to take the lazy way out by replacing a rigorous empirical inquiry with dubious analytical short-cuts. For example, before turning to its own proposals for an empirical analysis, tw telecom suggests that "an assessment of the incumbent LECs' own cost and revenue data is the most direct and comprehensive means of assessing the extent to which the incumbents have market power in the provision of special access as a whole." tw telecom Comments at 2. This is illogical. The "most direct and comprehensive means of assessing the extent to which the incumbents have market power" is, by definition, to conduct *a direct and comprehensive market-power analysis*—namely, a data-driven inquiry into how much existing and potential competition ILECs face for particular types of services within particular types of markets.

In contrast, accounting rate-of-return figures are a sloppy and irremediably flawed proxy for actual competitive data. As explained in the opening and reply declarations of Dr. Tardiff and Professor Weisman, they are economically meaningless as a measure of market power, particularly (1) where applied to specific services and (2) where, as here, the underlying facilities are already substantially depreciated. And quite apart from those defects, ARMIS-derived data are distorted in *yet further* respects because of the separations freeze. At bottom, the use of accounting figures would be an intellectually indefensible shortcut for an actual inquiry into competitive conditions in the special access market. And it would accomplish nothing in the long term but judicial invalidation, a remand for responsible decisionmaking, and years of regulatory uncertainty. Moreover, as discussed in the opening Tardiff-Weisman declaration (at ¶ 28), any economically sound analysis of Qwest's company-wide rate of return in particular would confirm that it is far lower than one might assume on the basis of reported accounting figures, and forcing it lower still could take it into confiscatory territory.

More generally, some proponents of re-regulation appear to have missed the central purpose of this round of comments. This is not simply another opportunity for them to repeat time-worn clichés about the supposed excesses of ILEC special access prices or rates-of-return. The Commission is quite familiar with the parties' views on those subjects. Instead, the November 5 *Public Notice* seeks fresh, concrete proposals on how to "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."[2]

Qwest has answered that call by proposing an empirical analysis that will resolve the key disputes dividing the parties precisely because, unlike some other proposals, it does *not* begin by assuming the validity of disputed empirical propositions about the special access market. Avoiding such assumptions will allow *factfinding* to shape the Commission's *policy conclusions*. In contrast, some proponents of re-regulation would have the Commission assume key disputed conclusions from the outset, curtail the empirical inquiries needed to determine whether those conclusions are valid, and thereby allow disputed *policy conclusions* to truncate the Commission's *factfinding*. That approach would turn the concept of reasoned decisionmaking

2 Public Notice, *Parties Asked to Comment on Analytical Framework Necessary to Resolve Issues in the Special Access NPRM*, WC Docket No. 05-25, DA 09-2388, at 2 (Nov. 5, 2009) ("*Public Notice*").

on its head. If the Commission is to re-examine its special access regime, it should use a data-driven process that allows it to answer all the empirical questions in dispute. It may not simply assume the validity of disputed factual assertions for the purpose of lowering special access rates, particularly in the face of evidence that special access rates have been declining—even as demand is increasing—as the result of increasing competition.

The need for such analytical rigor is particularly acute given the harmful consequences of imposing unjustified new price constraints on the traditional special access services at issue here. Erring on the side of artificially low prices for those services would needlessly prolong the industry's reliance on legacy DSn-level facilities and thus perversely undercut incentives to deploy the high-capacity next-generation facilities that are needed to fulfill the Commission's broadband goals.

In sum, if the Commission is to reconsider the foundations of its special access regime, it will need to collect and analyze actual competitive data from all stakeholders in a statistically valid sample of Phase I and Phase II markets. As discussed in our opening comments, that analysis will enable the Commission to resolve every major disputed issue in this proceeding, including:

- whether the Phase II triggers are overinclusive (if the data show that certain Phase II markets are not competitive) or underinclusive (if the data show that certain Phase I markets *are* competitive);
- whether and to what extent cable companies, fixed wireless providers, and other intermodal providers, in addition to facilities-based CLECs, offer (or could offer) services that compete with ILEC special access services or otherwise constrain their prices;
- the ability of providers to self-provision service, including through the construction of laterals to connect new locations to existing competitive fiber networks;
- what prices ILECs charge in Phase II markets that the Commission finds competitive, which are *by definition* "just and reasonable" prices; and

- whether the prices ILECs charge for the same services in *non*-Phase II markets—where per-unit costs may well be higher (particularly in price cap areas)—are comparable to or lower than the prices charged in Phase II markets that the Commission finds competitive, in which case those non-Phase II prices are also, by definition, no higher than "just and reasonable" levels.

In sum, the recent consensus in favor of an empirical inquiry shines light at the end of the tunnel for this lengthy proceeding. Collecting and analyzing the necessary data from sample Phase I and Phase II markets will of course require substantial work. But the Commission can make this task as administrable as it is illuminating by identifying a stratified sample of markets, confining its data-collection effort to those markets, and then drawing statistically sound inferences from those markets to the industry at large.

DISCUSSION

I. The Key Disputes Between the Parties All Involve Empirical Issues That the Commission Should Settle by Collecting and Analyzing the Relevant Data from All Market Participants.

A. The Commission Should Conduct a Market-Power Analysis Based on a Statistically Valid Cross-Section of Markets.

As discussed in our opening comments, the Commission should begin its empirical inquiry by selecting a statistically valid cross-section of Phase I and Phase II markets and examining prices and competitive conditions within those sample markets. Of necessity, because the Commission has already defined these markets on an MSA-wide basis, the Commission should now gather data on an MSA-wide basis. Of course, collecting data from sample MSAs will not preclude the Commission from considering the adoption of some other geographic unit as the basis for future empirical analyses. In fact, the data it collects on an MSA-wide basis will enable it to assess claims by some parties that the appropriate geographic unit should be significantly more granular, down to each individual route to a building (since the data collected would include specific geographic locations for customers and telecommunications facilities).[3] But only after examining price variations and the geographic reach of competitive facilities within an MSA will the Commission be able to determine whether its current MSA-based approach remains, as the D.C. Circuit has put it, "'narrow[] enough so that the competitive conditions within each area are reasonably similar, yet broad[] enough to be administratively workable.'"[4] The Commission should not prejudge that issue, as some parties propose, *before* collecting the relevant data.[5]

Collecting a full set of data within each sample MSA will likewise enable the Commission to resolve any questions about products that compete with the ILECs' TDM-based DSn-level special access services. For example, the Commission will need to analyze a range of competitive data before it can reasonably resolve the parties' core disputes concerning whether, in providing TDM-based DSn-level special access services, ILECs face price-constraining competition not only from conventional CLECs, but also from cable companies, fixed-wireless providers, providers of packet-switched Ethernet services, and fiber wholesalers. In contrast, the

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3 As discussed in our opening comments (at 26-30), there are strong reasons to retain the MSA as the appropriate geographic unit whether or not the level of current competition is generally homogeneous throughout an MSA. These reasons include the relative homogeneity of rates and potential competition throughout any given MSA, as well as the far greater administrative feasibility of implementing a regulatory regime on the basis of MSAs rather than more geographically granular units. Indeed, even many of the advocates of re-regulation effectively concede that any route-specific analysis would be inadminstrable. *See, e.g.*, tw telecom Comments at 14 & n.19; NoChokePoints Comments at 8; PAETEC Comments at 35. Moreover, as Dr. Tardiff and Professor Weisman further explain, any route-specific analysis would be deeply flawed for analytical reasons as well. *See* Reply Declaration of Timothy J. Tardiff & Dennis L. Weisman in Support of the Reply Comments of Qwest Communications International Inc. ¶¶ 63, 68 n.90 ("Tardiff-Weisman Reply Decl. ") (attached as Exh. 1).

4 *WorldCom Inc. v. FCC*, 238 F.3d 449, 461 (D.C. Cir. 2001) (quoting Fifth Report & Order and Further Notice of Proposed Rulemaking, *Access Charge Reform*; *Price Cap Performance Review for Local Exchange Carriers*, 14 FCC Rcd 14221, 14259 ¶ 71 (1999)).

5 *See, e.g.*, PAETEC Comments at 32-36; NoChokePoints Comments at 6-9; Sprint Nextel Comments at 9; XO Communications Comments at 8.

advocates of re-regulation invite the Commission to resolve those disputes *before* gathering the relevant data—and then limit its data-gathering efforts accordingly. As discussed in Section I.B below, that approach is precisely backwards.

Having determined the appropriate geographic markets, the Commission should then conduct a market-power analysis of the sampled markets to determine the extent to which special access prices in those markets are constrained by actual and potential competition. As explained in our opening comments, certain basic guidelines should govern that analysis: (1) The analysis should not focus on current market share and must account for potential competition; (2) the number of competitive alternatives need not be large to indicate an effectively functioning marketplace, especially given the high ratio of any special access provider's fixed network costs to its marginal costs of serving additional customers; and (3) the extent of competition should be assessed on a demand-weighted index that gives greater weight to locations with greater potential revenues.[6]

Once the Commission has conducted market power analyses in the sampled markets, it will be in a position to assess the accuracy of its collocation triggers, and will no longer need to rely on uninformed *assumptions* about their accuracy, as many CLECs ask the Commission to do. *See* Section I.B, *infra.* For example, if virtually all of the statistically sampled Phase II markets are competitive, that would indicate that the Commission's existing collocation triggers are not (as some CLECs claim) overinclusive. Conversely, if at least some Phase I markets are fully competitive even though they do *not* meet the existing Phase II triggers, the Commission

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6 *See* Qwest Comments at 36-38; Declaration of Timothy J. Tardiff & Dennis L. Weisman in Support of the Comments of Qwest Communications International Inc. ¶¶ 7, 43-56 ("Tardiff-Weisman Opening Decl.") (filed with Qwest Comments); Tardiff-Weisman Reply Decl. ¶¶ 64-67, 69.

should conclude that the triggers are underinclusive and should be revised to capture the full range of facilities-based special access competition.

As Qwest explained in its opening comments, moreover, this empirical analysis will enable the Commission to assess the *reasonableness of rates* in non-sampled markets as well. ILEC rates in a Phase II market that the Commission finds competitive are *"just and reasonable" by definition*. *See* Qwest Comments at 21 & n.55. The Commission can therefore use such rates as benchmarks for judging the reasonableness of rates in other markets that the Commission's current collocation-trigger framework does not deem competitive. If, for example, the rates in Phase I and price cap markets are comparable to (or even lower than) the rates in Phase II markets found to be competitive, then the rates in Phase I and price cap markets are necessarily reasonable as well from the perspective of any customer, because in general the per-unit network costs in such markets are comparable to or—particularly in the case of price cap markets—quite possibly higher than the corresponding costs in competitive Phase II markets.[7]

These observations undermine claims by tw telecom (at 31) and others that an ILEC's rates in a competitive area should be deemed unjust if they are similar to rates in other areas that allegedly lack competition. That argument has it backwards. Rates in a competitive market where there is full pricing flexibility are "just and reasonable" by definition. The fact that rates in another area are equivalent or lower is decisive evidence that rates in the latter area do not exceed just and reasonable levels (so long as there is no reason to suppose the per-unit costs in

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[7] *See* Qwest Comments at 21-22. The inverse, of course, does not necessarily hold. If rates in *non*-Phase II areas are higher than their counterparts in Phase II areas that the Commission has found competitive, it would not necessarily follow that those rates are supracompetitive, and further inquiry would be needed to determine whether the discrepancy is due to factors such as the higher per-unit costs in non-Phase II areas.

the latter area are substantially lower). It is not evidence that competitive rates are somehow unjust or unreasonable.

Advocates of re-regulation stumble into this logical error because they start with the improper assumption that price cap rates must be either about right or too high. But as Dr. Tardiff and Professor Weisman explain in their attached reply declaration (at ¶¶ 27-29, 32-38), price cap levels may well be *too low*. Per-unit costs in the special access market are highly sensitive to competitive entry, given the high ratio of fixed costs to marginal costs within the telecommunications industry. For that reason and others (such as variable labor rates), per-unit special access costs may well rise over time as entrants win market share from incumbents and increase their costs of capital, and it is hardly surprising that competitive special access *rates* would follow suit. *See id.* ¶¶ 27-29, 34. And even if per-unit costs remained flat, rates could also rise if, before the advent of pricing flexibility, price caps for various services were set at below-cost levels. *See id.*

In sum, the only logical means of determining whether these ILEC price cap rates are too high or too low is to compare them to the one set of rates that are just and reasonable by definition: rates that an ILEC charges for the same services in markets that are free from price regulation (*i.e.*, Phase II markets) and are found, after careful study, to be competitive.[8]

[8] A number of re-regulation advocates propose various means of reducing price cap levels, whether through "reinitialization" or the imposition of a new X factor. In addition to their other defects (*see, e.g.*, Qwest Comments at 3-4), all of these proposals are radically premature, since the Commission has not yet conducted the market-based inquiry needed to determine whether price cap levels are "too high" in the first place. And quite apart from those considerations, these proposals are flawed even on their own terms, as discussed in the Tardiff-Weisman Reply Declaration (¶¶ 39-55).

B. The Commission's Empirical Analysis Should Consider All Relevant Data and Should Not Assume Away Key Issues in Dispute.

As discussed, Qwest has designed its proposed market-power analysis to enable the Commission to "use data to determine systematically" whether its special access regime is functioning properly. In particular, it would allow the Commission to use market data to drive its conclusions about whether and when ILECs exercise market power and whether price caps are set at appropriate levels. Nonetheless, many commenters advocating re-regulation of special access rates—while paying lip service to the need for a genuine market-power analysis—invite the Commission to rig that analysis from the outset by assuming the validity of sharply disputed empirical propositions that any sound analysis would be designed to test. These include, for example, disputes about—

- whether the competitive triggers, which the re-regulation advocates claim are overinclusive, are in fact *underinclusive* because cable companies, fixed wireless providers, and other non-collocating, facilities-based competitors offer competitive substitutes for ILEC special access services;
- whether the traditional special access services at issue here—ILEC-provided DS1 and DS3 services—are subject to competition not just from carriers offering identical services (whether on a standalone basis or as channelized circuits on larger pipes), but also from providers of technologically distinct services such as Ethernet, and from providers of raw fiber capacity such as Zayo Bandwidth and American Fiber Systems; and
- whether *potential* competition, in the form of competitive fiber close to office buildings, can and does discipline prices as effectively as *actual* competition.

These are all critical questions, and the Commission cannot responsibly abandon its longstanding special access regime by picking answers out of a hat; it must collect and analyze actual market data. This point should be uncontroversial, but unfortunately most of the advocates of re-regulation would undermine the legitimacy of the Commission's market analysis by inviting it to posit answers to these questions beforehand and avoid collecting much of the market data that could answer those questions in an empirically responsible manner. The Commission should decline that invitation.

Intermodal competition. Consider, for example, one of the core empirical questions that the Commission asks in the *Public Notice*, which the proponents of re-regulation urge it to assume away without collecting any market data: the substitutability of the services offered by cable, fixed wireless, and other intermodal competitors. The *Public Notice* seeks input on how to determine whether the collocation triggers are "an accurate proxy for the kind of sunk investment by competitors that is sufficient to constrain incumbent LEC prices."[9] Answering this question necessarily requires the Commission to draw conclusions about the effectiveness of the intermodal facilities-based competition that do not register under the collocation triggers because the competitors do not collocate. If the evidence shows that, in some locations, those non-collocating providers offer (or could readily offer) an effective alternative to ILEC services, it would establish that the collocation triggers are underinclusive in this respect.

Qwest and other ILECs have long cited abundant evidence of this phenomenon and have asked the Commission to investigate it further. In our opening comments, we showed that many of these intermodal competitors proclaim that their services are attractive substitutes for traditional ILEC special access services, and they trumpet their success in (and prospects for) persuading potential customers of this fact. For example, Towerstream, Sprint, and FiberTower all tout fixed wireless services as a special access alternative,[10] while many cable companies boast success in serving customer needs for high-capacity (enterprise) services and *not* just cable modem service.[11] Qwest and others have also cited abundant evidence that special access

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9 *Public Notice* at 2.

10 Qwest Comments at 15; Verizon Comments at 25-26.

11 Qwest Comments at 13-14; Verizon Comments at 21-23.

customers, including U.S. Cellular Corp., T-Mobile, Stelera, and Sprint, have all recognized the value of these competitive alternatives and broadly use them.[12]

The Commission need not conclude that this evidence of intermodal competition is *dispositive* in order to find, as it must, that it is *highly probative* and thus demands further investigation. The Commission could not simply dismiss this evidence if it were inclined to transform special access regulation. Instead, as Qwest has proposed, it should investigate the parties' dispute on this issue by collecting data from *all providers*, including intermodal service providers and suppliers of competitive fiber, *and by polling customers* about what they perceive as their special access options. And it should start by posing those questions to the carrier-customers who have openly acknowledged—in some cases, to the Commission itself in recent broadband workshops—that they rely heavily and increasingly on intermodal special access options, including fixed wireless and cable.[13] These are, after all, empirical questions, and the Commission should answer them as it does in merger proceedings and other settings in which it must assess the competitiveness of a particular marketplace: it should collect all the relevant data, and only then draw conclusions.

12 *See* Qwest Comments at 15-17; *see also* Verizon Comments at 24-25 (discussing the "ample evidence that many customers consider fixed wireless to be a competitive alternative to fiber in many situations and a superior alternative in some situations").

13 *See* Qwest Comments at 13-17; *see also* AT&T Comments at 4 ("Any challenges to the pricing flexibility rules . . . are largely *empirical* issues, and the framework for analyzing those issues 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."); *id.* at 19, 28, 39; Verizon Comments at 34 ("In order for the Commission to perform a meaningful competitive analysis, it must base that analysis on competitive information that is comprehensive, complete and valid."); *id.* at 20, 29.

In contrast, many proponents of re-regulation urge the Commission to skew the analysis from the outset by arbitrarily excluding any inquiry into intermodal competition.[14] PAETEC and its fellow commenters, for example, assert that "[t]he Commission need not consider fringe competition from so-called nascent services, such as Wi-Max, fixed wireless or satellite, nor should it consider wireline carriers with negligible market shares that are unlikely to expand outside of an isolated market niche."[15] But none of these commenters explains why the Commission cannot (and should not) make these determinations for itself, *after* collecting the relevant data.

Similarly, tw telecom suggests that the Commission should "[a]ssum[e] that HFC [*i.e.*, cable] and fixed wireless are excluded from the relevant product markets" on the theory that these services "are not substitutes for special access services"—all without gathering the data needed to determine whether that is so or not.[16] tw telecom also cites the three-year-old *Verizon 6-MSA Order* for the proposition "that cable companies other than Cox were not particularly aggressive in marketing to business customers" in several eastern markets in 2007, and from this suggests that it would be "appropriate to exclude from the special access analysis the transport networks of the cable companies discussed in the *6-MSA Order* other than Cox."[17] This is

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14 *See, e.g.*, MDTC Comments at 5 (failing to propose any "analytical framework" the Commission could use to make independent decisions, but insisting nevertheless that the Commission should take as fact that "cable operators predominantly offer services to residential customers and, thus far, have made limited investments towards providing robust special access services that are sought out by business customers. Similarly, fixed wireless is not currently a viable substitute for wireless special access service due to operational and security concerns and, hence, is available only to a few business customer lines."); Sprint Nextel Comments at 19-20; Declaration of Bridger M. Mitchell ¶¶ 63, 68 (filed as Attach. A to Sprint Nextel Comments) ("Mitchell Decl.").

15 PAETEC Comments at 31.

16 tw telecom Comments at 2-3, 15.

17 *Id.* at 18. Cox is a particularly active intermodal competitor in Qwest's territory, as the Commission itself observed in the *Qwest Omaha Forbearance Order*. Memorandum Opinion

untenable. Three years is a virtual eternity in the world of modern telecommunications. And cable companies have made substantial inroads into the special access market just within "the last year or so," as one of the largest national purchasers of special access services has candidly explained.[18] And the Commission cannot reasonably disregard intermodal competition from cable providers (let alone fixed wireless providers and wholesale fiber suppliers) in drawing industry-wide conclusions about the special access market on the basis of stale data from a tiny handful of markets studied in one carrier-specific proceeding.

Along the same lines, tw telecom suggests that the Commission should conduct separate, compartmentalized market analyses of traditional special access services (DS1s and DS3s) and packet-switched alternatives such as Ethernet, reasoning that the two service categories "are not substitutes."[19] Here, too, the extent to which Ethernet services are competitive alternatives for traditional ILEC special access services is an empirical question, which the Commission should investigate without biasing the inquiry with preconceptions about which way the data will point. In any event, tw telecom's own desired conclusion is irreconcilable with Commission findings on the subject and D.C. Circuit precedent upholding those findings. As the D.C. Circuit has explained, "price-regulated TDM-based services . . . compete with . . . non-TDM-based special

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and Order, *Petition of Qwest Corporation for Forbearance Pursuant to 47 U.S.C. § 160(c) in the Omaha Metropolitan Statistical Area*, 20 FCC Rcd 19415, 19432-33 ¶ 36 (2005) ("*Qwest Omaha Forbearance Order*"). Even on its own terms, therefore, tw telecom's argument has limited applicability to Qwest.

[18] Om Malik, *The GigaOM Interview: Cole Brodman, CTO, T-Mobile USA*, GigaOM, May 12, 2009, http://gigaom.com/2009/05/12/the-gigaom-interview-cole-brodman-cto-t-mobile-usa/ (explaining that "high-capacity microwave" presents an "organic opportunity" for wireless providers seeking backhaul solutions, along with two other categories of "nontraditional backhaul partners": "alternate access companies that are building businesses and networks around shared tenant or multi-carrier backhaul"; and "*the cable industry*," with whom wireless carriers have been "mak[ing] *significant progress in partnering*" over "*the last year or so*") (emphasis added).

[19] tw telecom Comments at 2-3.

access services. All parties concede that it is technically feasible to use TDM-based services in this way[.]"[20]

As the court added, tw telecom's related argument—that competitors cannot use traditional ILEC special access services as inputs for their own Ethernet services—"lies in some tension with the evident success of big-time competitive broadband business service providers that use ILECs' TDM-based inputs, as reflected in the record evidence. For example, [tw telecom] has proclaimed that, by using ILECs' TDM-based special access inputs in areas where it has not deployed its own facilities, it has been able to 'affordably' and 'cost-effectively deliver our industry-leading Ethernet portfolio to customers anywhere.'"[21] For that and other reasons, there is likewise no merit to tw telecom's proposal to reapply dominant-carrier regulation to Ethernet services themselves in addition to DSn-level services. As we have explained, the Commission was right in 2007 and 2008 to forbear from dominant-carrier regulation of Ethernet and all other enterprise broadband services, and the D.C. Circuit was right to uphold that decision in *Ad Hoc*. *See* Qwest Comments at 8 n.9. The *Public Notice* does not propose to reopen that issue, and tw telecom's call for re-regulating Ethernet services is properly rejected as a collateral attack on the Commission's enterprise forbearance orders. It is also highly ironic that tw telecom, which surpasses Qwest in the provision of Ethernet services, *see id.* at 13, would impose *dominant-carrier* regulation on those services when *Qwest* provides them but not when *it* provides them. Any such outcome would be untenable as a matter of both policy and law.

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[20] *Ad Hoc Telecommc'ns Users Comm. v. FCC*, 572 F.3d 903, 910 (D.C. Cir. 2009).

[21] *Id.* (citations omitted; citing, *inter alia*, Memorandum Opinion and Order, *Petition of AT&T Inc. for Forbearance Under 47 U.S.C. § 160(c) from Title II and Computer Inquiry Rules with Respect to Its Broadband Services*, 22 FCC Rcd 18705, 18721 ¶ 26 & n.109 ("*AT&T Enterprise Forbearance Order*")); *see also* Qwest Comments at 12-13 n.21.

Potential competition. Many of the parties seeking multi-billion-dollar regulatory benefits also urge the Commission simply to assume, in advance, that *potential* competition plays no role in constraining ILEC special access rates, and they seek to cut off all further inquiry into that issue, even though the Commission has sought guidance on how it should account for the effects of potential competition.[22] But just as the Commission cannot reasonably exclude evidence of intermodal competition from its analysis, neither can it reasonably ignore the price-constraining effects of potential competition.

In various respects, the advocates of re-regulation ask the Commission to forgo collecting data relevant to the price-constraining effects of potential competition, such as the proximity of existing competitive fiber to buildings, the cost-efficiency of building laterals to connect those buildings to these competitive networks, and the details of individual providers' "build-buy" decisions. For example, PAETEC argues (at 21) that the Commission should restrict its analysis to buildings already "lit" with competitive fiber on the premise that potential competition has a limited impact because of "the non-contestability of the special access market." NoChokePoints (at 12-14) supports this same approach on the theory that competitive access providers are "essentially foreclose[d]" from building out facilities, and therefore from providing effective competitive pressure. And tw telecom similarly insists that the Commission should not consider potential competition on the grounds that competitors face various barriers to loop deployment; that cable company transport networks "may only pass near a small portion of the commercial locations in a market" or may "vary from market to market;" and that "deployment of transport

[22] *Public Notice* at 4-5; *see, e.g.*, PAETEC Comments at 22 ("any analytical approach the Commission applies in determining if the pricing flexibility rules are producing just and reasonable rates should be based on 'actual competition' and not 'potential competition'"); tw telecom Comments at 21-22 (the "FCC should . . . focus on actual competition in its assessment of the extent to which incumbent LECs face competition in the provision of special access mileage services").

between two wire centers does not necessarily indicate that the competitor can deploy transport on a similar route in a different geographic area."[23]

All of these proposals are meritless. As a threshold matter, there is an unsightly disconnect between what these parties say to the Commission (in hopes of winning huge compulsory price breaks) and what they say to investors and potential customers. *See* Qwest Comments at 12-17. For example, tw telecom explained just two months ago—in a formal, prepared presentation to investors—that it will aggressively implement a "[f]ocused strategy to leverage [its] fiber network [and] connect primary customer locations."[24] That "focused strategy" is far bolder than tw telecom's regulatory advocacy here would suggest is possible. In particular, tw telecom has boasted to investors that, in "connect[ing] primary customer locations," it will exploit the "large opportunity near our network" presented by (1) the approximately "2.0 million . . . 'target' businesses at sites with ***2+ DS1s*** of bandwidth utilization" and (2) the "nearly 1,000,000 'target' businesses . . . within ***1 mile*** of TWTC's fiber":[25]

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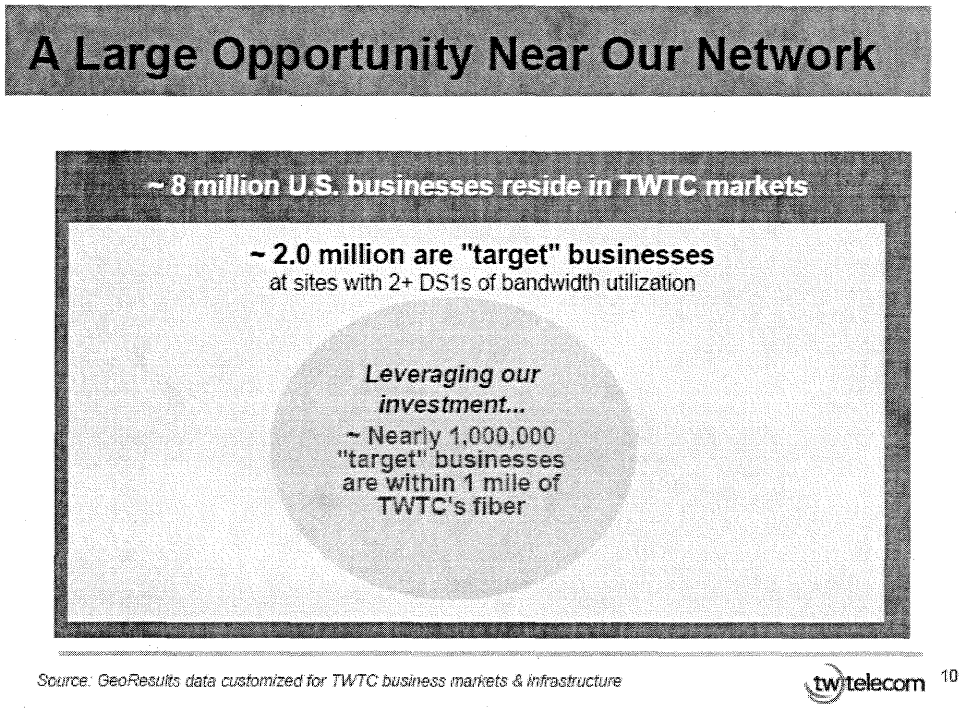
[23] tw telecom Comments at 15-17, 21; *see also* MDTC Comments at 8; Mitchell Decl. ¶ 137.

[24] TWTC, *Investor Presentation* at 9 (Dec. 2009) ("*TWTC Investor Presentation*") (attached as Exh. 2).

[25] *Id.* at 9-10 (Dec. 2009) (capitalization altered; emphasis added and some emphasis omitted).



Together with its lobbying outfit ("NoChokePoints"), however, tw telecom has separately told the Commission that "[i]t is *unprofitable* for competitors to deploy loop facilities to most commercial buildings, *even to most commercial buildings in downtown areas*,"[26] and that "it is fundamentally uneconomic to provide competition for . . . even a single *DS-3* channel termination, even if competitors have facilities as close as *1/10th of a mile* away."[27] The contradition here is stark.

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[26] *Ex Parte* Letter from Thomas Jones, *et al.*, tw telecom, to Marlene Dortch, FCC, WC Docket No. 05-25, at 10 (July 9, 2009) (emphasis added).

[27] NoChokePoints Comments at 16 (emphasis added); tw telecom Comments at 1 ("TWTC is a member of the NoChokePoints ('NCP') coalition and a signatory to the NCP comments in this proceeding."). A DS3 is the equivalent of 28 DS1s, or *fourteen times* the capacity that tw telecom told investors ("2+ DS1s") is needed to justify facilities construction. Similarly, whereas tw telecom indicated to investors that distances up to "1 mile" place customers within the company's "[f]ocused strategy to leverage [its] fiber network [and] connect primary customer locations," *TWTC Investor Presentation* at 9, that is *ten times* the distance ("1/10th of a mile") that NoChokePoints claims is "fundamentally uneconomic" to bridge *even for a DS3's worth of demand.*

In any event, and just as important, all of these assertions about when providers can or cannot efficiently deploy new facilities are *testable factual assertions*. And they are precisely the types of determinations that the Commission can make only on its own, *after* collecting all relevant data, in order to determine whether potential competition does or does not constrain ILEC pricing and practices. Indeed, any decision to ignore potential competition at the outset of this inquiry would run headlong into D.C. Circuit holdings, including *USTA II* and *Comcast*, directing the Commission to take potential competition into account when conducting competitive market analyses.[28]

PAETEC seeks to distinguish *USTA II* on the ground that the Commission's inquiry there related to "the statutory mandate of unbundled access unique to the Section 251 impairment criteria."[29] But that is a distinction without a difference. As explained in our opening comments, *every* judicial decision on this general topic has recognized that any responsible market analysis *must* account for the effects of potential competition. Indeed, as the Seventh Circuit has observed, it has been "many years since anyone knowledgeable about" competitive analysis "thought that concentration by itself imported a diminution in competition."[30] And in settings far removed from Section 251, the D.C. Circuit has reminded the Commission that whether a provider "can exercise 'bottleneck monopoly power' depends . . . 'not only on its share of the

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[28] Qwest Comments at 36-37 (citing, *inter alia*, *United States Telecom Ass'n v. FCC*, 359 F.3d 554, 575 (D.C. Cir. 2004) ("*USTA II*"), and *Comcast Corp. v. FCC*, 579 F.3d 1, 6 (D.C. Cir. 2009)).

[29] *See* PAETEC Comments at 54; *see also* COMPTEL Comments at 13.

[30] *Capital Cities/ABC, Inc. v. FCC*, 29 F.3d 309, 315 (7th Cir. 1994) (Posner, J.); *see also United States v. General Dynamics Corp.*, 415 U.S. 486, 498 (1974) (market share is imperfect measure because market must be examined in light of access to alternative supplies); *United States v. Syufy Enters.*, 903 F.2d 659, 665-66 (9th Cir. 1990) ("In evaluating monopoly power, it is not market share that counts, but the ability to *maintain* market share.") (emphasis in original); *United States v. Baker Hughes Inc.*, 908 F.2d 981, 986 (D.C. Cir. 1990) (market share statistics "misleading" in a "volatile and shifting" market).

market, but also on the elasticities of supply and demand, which in turn are determined by the *availability* of competition.'"[31]

Indeed, the Commission itself has highlighted the importance of potential competition in a broad variety of contexts. For example, in the *Omaha Forbearance Order*, it found that "the ability of suppliers in a given market to increase the quantity of service supplied in response to an increase in price"—*i.e.*, the ease of converting potential competition into actual competition—constrains an incumbent's ability "to raise and maintain price above the competitive level without driving away so many customers as to make the increase unprofitable."[32] In other words, no market power analysis can omit "the ability of alternative suppliers in a relevant market to absorb a carrier's customers if such carrier raised the price of its service by a small but significant amount and its customers wished to change carriers in response."[33] In other contexts as well, the Commission has concluded that it is "consistent with traditional market power analysis . . . not [to] give significant weight to static market share information," particularly in "evolving" markets.[34]

Of course, advocates of re-regulation resist any analysis of potential competition because they know it will undermine their case. As noted above and in our opening comments, tw

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[31] *See, e.g.*, *Comcast*, 579 F.3d at 6 (emphasis in original) (quoting *Turner Broad. Sys. v. FCC*, 512 U.S. 622, 661 (1994); *Time Warner Entm't Co. v. FCC*, 240 F.3d 1126, 1134 (D.C. Cir. 2001)). *See also* Tardiff-Weisman Reply Decl. ¶ 69 & n.96 (citing Dennis W. Carlton, "Market Definition: Use and Abuse," Economic Analysis Group Discussion Paper 07-06, United States Department of Justice, Washington D.C., April 2007).

[32] *Qwest Omaha Forbearance Order*, 20 FCC Rcd at 19425, 19432 ¶¶ 18 n.54, 35 (quoting Fourth Report and Order, *Policy and Rules Concerning Rates for Competitive Common Carrier Services and Facilities Authorizations Therefor*, 95 F.C.C.2d 554, 558 ¶ 8 (1983)).

[33] *Qwest Omaha Forbearance Order*, 20 FCC Rcd at 19432 ¶ 35 (quoting Order and Notice of Proposed Rulemaking, *In the Matter of Comsat Corp.*, 13 FCC Rcd 14083, 14123 ¶ 78 (1998) ("*Comsat Order*")).

[34] *AT&T Enterprise Forbearance Order*, 22 FCC Rcd at 18719 ¶ 23; *see id.* at 18719 ¶ 23 n.96 (citing further authority).

telecom and Level 3 have boasted to investors about their proximity to hundreds of thousands or (in tw telecom's case) millions of "target" businesses and the ease of extending service to them.[35] Other providers, including PAETEC, XO, Clearwire, and Fibertower, likewise present themselves as key alternatives to ILECs in the provision of high-capacity services to enterprise customers.[36] Against this backdrop, the Commission obviously may not predicate a scheme of burdensome re-regulation on the untested assumption that all of these claims by self-interested ILEC competitors—which would obviously prefer to purchase ILEC inputs at compelled below-cost rates—are false.

XO nonetheless claims that "examination of competitive facility deployment and potential deployment . . . 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."[37] That is an untenable dodge. Again, the burden is on the proponents of re-regulation to explain why the Commission should hand them the multi-billion-dollar price break they seek, and they cannot meet that burden *unless* they prove their case at the conclusion of an empirically rigorous investigation. Nor need the Commission fall into any "quagmire" in the process. As discussed, the Commission could ensure the efficiency of this empirical analysis by extrapolating from an empirically valid market sample. Again, rather than conducting a market-power analysis for *every* market in the United States, or even every Phase II market, the Commission should select a statistically valid, stratified cross-section of Phase I and Phase II markets and collect the relevant data from various stakeholders in the markets in that

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35 Qwest Comments at 12-13; *see also* Verizon Comments at 23-24 (discussing statements by Clearwire, XO/Netlink, and FiberTower).

36 Qwest Comments at 13, 14-15.

37 XO Communications Comments at 4; *see also* COMPTEL Comments at 2 (arguing the Commission should not collect "extensive and superfluous data"); Global Crossing Comments at 8.

sample. The ensuing empirical analysis would not be more challenging or time-consuming than any of the other data-driven market analyses this Commission must conduct whenever it contemplates major regulatory initiatives.

C. In Conducting Its Market-Power Analysis, the Commission Should Require Parties Possessing Key Data to Submit the Data to Critical Scrutiny.

In analyzing its sample markets, the Commission should obtain information from all providers (ILECs, inter- and intramodal competitors, and wholesale fiber suppliers) and major special access customers, including not only large enterprise customers, but also the major wireless carriers that purchase special access services as inputs for their own services. The information-gathering effort should be comprehensive and credible. For example, the Commission would undermine the integrity of its inquiry into the price-disciplining effects of potential competition if it allowed the advocates of re-regulation simply to re-file the usual self-serving claims that competition is impossible except in exceedingly rare circumstances. As discussed, a widening chasm separates what some competitive providers are telling the Commission about the feasibility of special access competition with what they and others are telling their investors and potential customers. *See, e.g.*, Qwest Comments at 12-17.

The only way to resolve that inconsistency is to require the relevant parties to disclose relevant information that was *not* prepared for use in regulatory advocacy. In particular, the Commission should obtain information in the categories that USTelecom and AT&T have identified as a basis for evaluating real and potential competition.[38] These include, among other categories:

- fiber, fiber-coax, or wireless route information for competitors' local network facilities in MapInfo format at a proper level of detail;

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[38] *See generally* AT&T Comments at 41-42; *Ex Parte* Letter from USTelecom to Marlene Dortch, FCC, WC Docket No. 05-25 (filed Apr. 27, 2009) ("*USTelecom Letter*").

- all collocation arrangements established in ILEC wire centers, in collocation hotels, or with other providers;
- lists of "near-net" buildings that a competitor has already pre-qualified for network extensions;
- basic information on each provider's last 20 building lateral construction projects;
- copies of providers' responses to RFPs and RFIs as well as any unsolicited proposals it provided to prospective customers, and recent deployment feasibility studies;
- current plans to upgrade or expand existing networks, or to build new networks, to reach additional buildings and geographic areas and to deploy new services; and
- any other data that shed light on what criteria communications providers and enterprise customers actually follow in making build-buy decisions.

The Commission should similarly reject proposals to shield such information from public scrutiny on the misconceived theory that it is somehow too sensitive to be revealed to anyone outside the Commission, even subject to protective orders. Under one such proposal, providers would submit data *only* to the Commission *in camera*, where the data would then be digested, aggregated, and made public only in a generalized and anonymized form that would not even permit identification of the providers in a given market.[39]

That proposal is indefensible as a matter of both policy and law. Qwest agrees that the needed data (from ILECs as well as other parties) is proprietary and, as such, should be protected from diversion for improper competitive purposes. But the Commission has well-established procedures for protecting such information while still allowing other parties to vet it for accuracy and completeness. And no one has identified any reason why the information at issue here is any more sensitive than the information that—in merger, forbearance, and a range of other proceedings—parties routinely make available to the public subject to protective orders. Indeed,

[39] *See* NoChokePoints Comments at 36-37. XO Communications similarly "urge[s] the Commission" to consider methods to "ensure that [purchaser price] data is completely anonymized." XO Communications Comments at 14 n.21.

in the special access context in particular, the Commission has long relied on private parties to exchange confidential information (subject to appropriate safeguards) to ensure the accuracy of the reported collocation data on which pricing flexibility decisions depend.[40] Here, too, it can and must rely on private parties to vet the accuracy of any confidential information the Commission receives from other, inevitably self-interested private parties as the basis for critical regulatory determinations.

Indeed, allowing such scrutiny of the underlying data, subject to protective order mechanisms, is also the only way to ensure the fairness of this proceeding and permit meaningful judicial review of the outcome. It is also the only lawful option. As the D.C. Circuit has explained, "[t]o allow an agency to play hunt the peanut with technical information, hiding or disguising the information that it employs, is to condone a practice in which the agency treats what should be a genuine interchange as mere bureaucratic sport."[41] Put differently: "[i]ntegral to the [Administrative Procedure Act's] notice requirement is the agency's duty 'to identify and make available . . . data that it has employed in reaching the decisions to propose particular rules. . . . An agency commits serious procedural error when it fails to reveal portions of the technical basis for a proposed rule in time to allow for meaningful commentary.'"[42] In short, the Commission could not lawfully rely on data to establish new rules unless it provides access to all interested parties—subject, again, to appropriate protective-order safeguards.

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40 *See* 47 C.F.R. § 1.774(e)(1)(ii).

41 *Connecticut Light & Power Co. v. NRC*, 673 F.2d 525, 530 (D.C. Cir. 1982) (holding that agency could not rely on data to support a rule without affording comment on the data).

42 *Solite Corp. v. EPA*, 952 F.2d 473, 484 (D.C. Cir. 1991) (quoting *Connecticut Light & Power Co.*, 673 F.2d at 530-31); *see also American Radio Relay League v. FCC*, 524 F.3d 227 (D.C. Cir. 2008); *Chamber of Commerce v. SEC*, 443 F.3d 890, 901-03, 908 (D.C. Cir. 2006). *See generally* Qwest Comments at 33-34 & n.83.

II. The Commission Should Reject Proposals To Indirectly Assess the Reasonableness of Special Access Rates Through Rate of Return Analysis or Price/Cost Ratios.

Several parties reiterate proposals to look to ILECs' "rates of return" as a means of assessing the reasonableness of special access rates. As discussed above, tw telecom suggests that a review of ARMIS data (collected before ARMIS reporting requirements were eliminated) could somehow replace analysis of marketplace data. And Ad Hoc claims (at 7-8) that "the BOCs' excessive returns on investment provide stark, probative evidence that competition has failed to emerge and discipline their pricing" and that the Commission "should review the cost accounting data available in its ARMIS reports" to "assess the magnitude of the BOCs' rate of return." Qwest and others have discussed at length the numerous flaws in such an approach, and no proponent of such an approach comes close to justifying its use here.

First, as Dr. Tardiff and Professor Weisman (and many others) have explained at length, accounting rates of return today are "economically meaningless" for purposes of determining whether a company faces price-constraining competition or instead exercises market power.[43] Such rates of return for companies like Qwest are likely to be radically higher than their

[43] Tardiff-Weisman Opening Decl. ¶ 23; Tardiff-Weisman Reply Decl. ¶ 12; AT&T Comments at 58-59 (quoting sources); *see also* Tardiff-Weisman Opening Decl. ¶ 24 (explaining distinction between "accounting returns" and "economic returns"). Of course, accounting figures can serve an important rate-setting function for companies that have been traditionally regulated on a rate-of-return basis. In that context, rates set on the basis of a consistent and well-designed rate-of-return methodology over a period of many years can produce just and reasonable rates of return for the company's overall operations during that period, so long as they are periodically updated to account for changes in demand and other relevant criteria. Here, however, the proponents of rate-of-return analysis would use accounting rate-of-return figures for an entirely different purpose, for which it was never designed: as a shortcut for determining whether a particular market is or is not *competitive.* Using rate-of-return figures for that purpose would make no sense, particularly given that none of the providers in the market under study have even been subject to rate-of-return regulation for more than a decade.

economic returns.[44] Given today's inhospitable environment for new investment, an unusually large portion of their existing investment was made many years ago, and most of that investment has now been depreciated beyond the mid-point of its economic life.[45] Once most investment passes this mid-point, accounting rates of return rise dramatically and artificially, even if revenues remain stable.[46] The allegedly high rates of return for Qwest and similar carriers are an artifact of this bookkeeping phenomenon rather than an indication that they face no competition and are charging supracompetitive rates.[47] No advocate of re-regulation faces up to this problem when discussing the supposed relevance of accounting rate-of-return figures.

Quite apart from this phenomenon, accounting figures become even more meaningless when they are used, as the proponents of re-regulation use them, as a basis to calculate *service-specific* rates of return. Such calculations begin, necessarily, with the allocation of shared costs among various service categories. Economists have long explained that this allocation process is arbitrary, and calculations emanating from it are "ritualistic [and] incantational" rather than informative.[48] The Commission itself has acknowledged that "economic theory does not provide

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44 An "economic rate of return" is "defined as the discount rate that equates the present value of net revenues (revenues minus operating costs) with the economic value of the investments that allow [a] firm to generate these revenues," whereas "[a]ccounting returns . . . are calculated each year and depend on judgmental factors such as depreciation lives, along with arbitrary allocation factors and the pattern of net revenues over the lifetime of the assets." Tardiff-Weisman Opening Decl. ¶ 24 (footnote omitted).

45 *E.g.*, Tardiff-Weisman Reply Decl. ¶¶ 13-15.

46 *E.g.*, *id.* ¶¶ 16-17.

47 *See, e.g.*, Tardiff-Weisman Opening Decl. ¶ 28; Tardiff-Weisman Reply Decl. ¶¶ 13, 17-18.

48 Tardiff-Weisman Opening Decl. ¶ 23 (citing Alfred E. Kahn, "The Uneasy Marriage of Regulation and Competition," 1 *Telematics* 12 (Sept. 1984); *see also* Tardiff-Weisman Reply Decl. ¶ 12 ("[T]he accounting costs that form the basis for ARMIS returns for individual services are the result of inherently arbitrary cost allocations. Consequently, as economists have long recognized, rates of return for individual services are themselves arbitrary and economically meaningless.").

a clear answer to the question of how joint and common and fixed costs should be allocated for costing purposes," which is "particularly problematic in the telecommunications industry due to the very high proportion of joint and common costs and fixed costs."[49] And as AT&T explains, this allocation process has grown even more complex in today's "multi-service broadband network[]."[50]

Proponents of special access re-regulation simply disregard these fatal analytical problems in proposing to use ARMIS returns as a basis for re-regulating special access rates. For example, the Economics and Technology Inc. paper ("ETI Paper"),[51] submitted by Ad Hoc, is a case study in each of the analytical errors discussed here. For example, the ETI analysis begins with the false assumption that *accounting* rates of return, especially for companies like Qwest with substantially depreciated assets, could ever shed light on competitive conditions in a market; they cannot.[52] Moreover, although the authors of the ETI Paper acknowledge that the process of separating costs "associated with plant or personnel jointly used to provide multiple services" is "not necessarily *precise*," they assert, in the next breath, and without analysis or explanation, that the resulting allocations "are nevertheless accurate and useful for purposes of regulatory analysis." ETI Paper at 5. No responsible economist would agree, however—especially where the goal of the "regulatory analysis" is to draw conclusions about earnings related to a particular service.[53]

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[49] Report and Order and Order on Remand and Further Notice of Proposed Rulemaking, *Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers*, 18 FCC Rcd 16978, 17079 ¶ 157 n.515 (2003).

[50] AT&T Comments at 62.

[51] Susan M. Gately, *et al.*, *Longstanding Regulatory Tools Confirm BOC Market Power: A Defense of ARMIS* (Jan. 2010) (filed as Attach. B to Ad Hoc Comments).

[52] *See* Tardiff-Weisman Reply Decl. ¶¶ 11-14.

[53] *See id.* ¶ 12.

These shortcomings alone foreclose the use of *any* analysis based on mere *accounting* returns as a basis for drawing conclusions about competitive market conditions or otherwise re-regulating the special access market. ETI and others grapple with none of these conceptual problems, an oversight that by itself undermines their analysis. They focus instead on trying to explain away the impact of additional regulatory anomalies such as the separations freeze, which *further* undermine the usefulness of those data. And ETI and others fail even in their efforts to address those specific anomalies.

As discussed in our opening comments, ARMIS data reflect separation allocations that have remained frozen during what has been the most dynamic decade in the telecommunications industry since the invention of the telephone. As a result, reported *costs* associated with special access artificially lag far behind reported volumes and *revenues*. ETI claims that ARMIS special access costs remain relevant on the theory that they have continued to increase over time with special access demand. As Qwest and others have shown, however, those costs have not grown *proportionately* with that demand. To the contrary, investment and demand have fallen so out of sync as to make ETI's analysis, reflected in Figure 1.2 in its paper, "highly misleading," as Dr. Tardiff and Professor Weisman explain.[54] Moreover, they add, "the costs assigned to special access services do not reflect the fact that the bulk of incumbents' traditional narrow-band services have been rapidly losing volumes while special access volumes have greatly increased."[55] Indeed, "ARMIS data erroneously suggest that Qwest's special access investment levels have been changing at about the same rate as (or in some cases, even less than) the investment levels for the *declining* narrow-band services."[56]

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54 *Id.* ¶¶ 16-17.

55 *Id.* ¶ 14.

56 *Id.* (emphasis added).

There is similarly no basis for proposals by NoChokePoints (at 22-23) and others to compare special access rates to the widely varying UNE rates that different state public utility commissions derived for analogous transmission facilities under the TELRIC methodology.[57] TELRIC was designed as a "purely hypothetical" means of modeling network costs based on a variety of best-case assumptions that, as the Commission recognized in 2003, are "unrealistic."[58] As the Commission has explained, "key internal tensions" in the TELRIC methodology, together with the "black box" nature of TELRIC-based cost studies in the states, may well lead TELRIC-based UNE rates to "understat[e] forward-looking costs."[59]

The Commission has thus expressed serious doubt about whether this "pricing methodology is . . . conducive to efficient facilities investment. To the extent that the application of [the] TELRIC pricing rules distorts our intended pricing signals by understating forward-looking costs, it can thwart one of the central purposes of the Act: the promotion of facilities-based competition."[60] Those same concerns resonate with even greater force with respect to the

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57 As Dr. Tardiff and Professor Weisman explain, it also makes no sense to insist that price caps should be reinitialized at "forward-looking" rates (such as those set under TELRIC), as Sprint's expert Dr. Mitchell proposes. Price caps have never been designed as a means of trying to perfectly capture a firm's forward-looking costs, because they are based on the premise that the regulator cannot ever know those costs with any precision; instead, price caps are designed to give the regulated firm an incentive to discover means of *reducing* its costs and performing as efficiently as possible. Tardiff-Weisman Reply Decl. ¶¶ 22-23. In any event, as discussed below, TELRIC's methodological shortcomings preclude using it, in particular, as a basis for reinitializing price caps.

58 Notice of Proposed Rulemaking, *Review of the Commission's Rules Regarding the Pricing of Unbundled Network Elements and the Resale of Service by Incumbent Local Exchange Carriers*, 18 FCC Rcd 20265 ¶¶ 4-5 (2003) ("*TELRIC NPRM*"). *See also id.* ¶¶ 6-7 (noting that TELRIC rules are "extremely complicated," "excessively hypothetical," and "very general," leading to highly "variable results" in UNE prices that do not in fact "reflect genuine cost differences").

59 *Id.* ¶¶ 3, 4, 7; *see also id.* ¶ 6 (expressing concern that TELRIC rates "might not . . . achieve fully the Commission's goal of sending appropriate economic signals").

60 *Id.* ¶ 3.

pricing rules for special access services. As discussed in our opening comments, this Administration's core tech policies require the Commission to preserve appropriate incentives for the deployment of new fiber-based facilities. Forcing down rates for DSn-level services to unrealistically low levels would create perverse disincentives for new facilities investment by prolonging the reliance of competitive providers on ILECs' legacy facilities.[61]

Similarly, the Commission cannot responsibly rely on TELRIC as a measure of "costs," or as a benchmark for evaluating the reasonableness of current special access rates, before it has resolved the serious doubts it expressed about that methodology in the still-pending rulemaking proceeding it launched in 2003. In that proceeding, the Commission suggested that the widely varying TELRIC figures derived in state arbitration proceedings "may not fully reflect genuine cost differences but instead may be the product of the complexity of the issues, the very general nature of our rules, and uncertainty about how to apply those rules."[62] And the Commission further expressed concern that UNE rates derived from TELRIC cost studies are *systematically understated* because of (among other factors) "one of the key internal tensions that marks its current application: the assumption that for some purposes rates should reflect a market with widespread facilities-based competition but, for other purposes, rates should reflect a market with a single dominant carrier."[63] That "internal tension," the Commission explained, "may

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61 *See* Qwest Comments at 17-20. The same is true, of course, with respect to artificially depressed rates designed to produce a 11.25% return based on ARMIS data.

62 *TELRIC NPRM*, 18 FCC Rcd ¶ 6. The *TELRIC NPRM* post-dated the Supreme Court's decision in *Verizon Communications Inc. v. FCC*, 535 U.S. 467 (2002), which deferred to the Commission's choice of TELRIC as its cost methodology for purposes of the 1996 Act's UNE requirements. Now that it has expressed serious doubts about the merits of TELRIC as it has been applied in the states, the Commission obviously cannot, consistent with the APA, ignore those doubts, and then use the same dubious state-commission TELRIC decisions as a basis for judging special access rates.

63 *TELRIC NPRM*, 18 FCC Rcd ¶ 4.

work to reduce estimates of forward-looking costs below the costs that would actually be found even in an extremely competitive market[.]"[64]

Qwest and other parties filed hundreds of pages of comments proposing revisions to the TELRIC rules and pointing out troubling flaws in the methodology and its application by state commissions. As Qwest noted, the CLEC-originated models used in TELRIC state commission proceedings grossly understate real-world operating costs "for the sole purpose of allowing [CLECs] to resell the ILEC's network, and avoid investment in facilities of their own."[65] Dr. Tardiff and Professor Weisman similarly explain that, among its other deficiencies, TELRIC "includes unrealistic efficiencies both in how a network can be configured and in how rapidly a carrier deploying assets with long lives can incorporate the latest technology throughout the network," and it "may include depreciation and cost of capital estimates that fail to reflect the risk that levels of demand necessary to make investments economic could fail to materialize over asset lifetimes, because of technological advances and/or competitive inroads."[66]

In short, unless and until the Commission fully resolves the serious doubts it has raised about TELRIC in its pending rulemaking proceeding, and until it addresses the substantial record demonstrating a need for full-scale revision of that methodology, it cannot responsibly even consider using TELRIC rates as a benchmark for evaluating the "reasonableness" of real-world special access rates.

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64 *Id.* ¶ 51.

65 Comments of Qwest Communications International Inc., WC Docket No. 03-173, at ii-iii (filed Dec. 16, 2003).

66 Tardiff-Weisman Reply Decl. ¶ 43 (footnote omitted). TELRIC is also designed to set rates for individual *facilities* ("network elements"), not for finished *services* such as the special access services at issue here, and this presents yet an additional reason for declining to employ it in this context.

Finally, as Dr. Tardiff and Professor Weisman point out, advocates of re-regulation cannot logically argue both (1) that ILEC special access rates are far above some measure of "cost" and (2) that competition is nearly impossible in the special access market. As they explain, "even very high barriers to entry could be overcome if the price-cost margins are even remotely close to the levels that" these advocates claim.[67] In fact, Qwest is confident that, once the Commission conducts the empirical analysis needed to draw sound conclusions, it will find that ILEC special access rates are at reasonable levels or (in some non-Phase II areas) below such levels, and that competition is developing from efficient competitors with lower or equivalent costs.[68]

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67 *Id.* ¶ 31.

68 Some advocates of re-regulation contend that the discount plans offered by certain ILECs anticompetitively exclude rivals from the special access market. Those claims are analytically dubious for the reasons discussed in the comments of AT&T (at 74-82). In any event, allegations about anticompetitive discount plans are properly conducted in case-by-case enforcement proceedings under Section 208, not through broad-brush invalidation of whole categories of volume or term discount plans, given the indisputably efficient and pro-consumer nature of discounts in general. *See generally Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209 (1993).

CONCLUSION

The Commission should base any adjustments to its existing special access regime on a genuine market-power analysis, based on competitive data, rather than on alleged ILEC rates of return, TELRIC, or other methodological shortcuts that avoid careful analysis of real-world competitive data.

Respectfully submitted,

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February 24, 2010

CERTIFICATE OF SERVICE

I, Richard Grozier, do hereby certify that I have caused the foregoing **REPLY COMMENTS OF QWEST COMMUNICATIONS INTERNATIONAL INC.** to be: 1) filed with the FCC via its Electronic Comment Filing System in WC Docket No. 05-25 and RM-10593; 2) to be served on Ms. Margaret Dailey, Pricing Policy Division, Wireline Competition Bureau, Federal Communications Commission at Margaret.dailey@fcc.gov; and 3) served via email on the FCC's duplicating contractor, Best Copy and Printing, Inc. at fcc@bcpiweb.com.

/s/ Richard Grozier

February 24, 2010