

**Before the
Federal Communications Commission
Washington, D.C. 20554**

In the Matter of

Special Access Rates for Price Cap Local
Exchange Carriers

AT&T Corp. Petition for Rulemaking to Reform
Regulation of Incumbent Local Exchange Carrier
Rates for Interstate Special Access Services

WC Docket No. 05-25

RM-10593

**REPLY COMMENTS OF
PUBLIC KNOWLEDGE**

Public Knowledge (PK), a non-profit public advocacy organization dedicated to providing a public voice for an open digital future, files these reply comments in the above captioned proceeding. As a member of the NoChokePoints Coalition (NCP), PK fully supports the comments and reply comments filed by NCP in this proceeding. PK files separately to emphasize two distinct points. First, despite its arcane nature and application to the enterprise market, special access rates have profound direct and indirect access on consumers. Second, the arguments raised about the presence or absence of competitive alternatives appear to miss the point of why, as a matter of public policy, we care about competition. Competition is not an end in itself. It is a means of achieving the statutory goals of just and reasonable rates and practices, while prohibiting unreasonable discrimination in the provision of services.¹

ARGUMENT

I. WHY THIS PROCEEDING MATTERS TO ALL AMERICANS

Every person and every business in this country relies on communications. Every cell phone user, from the most intense and sophisticated smart phone adopter to the parent carrying

¹ 47 U.S.C. §§201, 202.

his or her phone for emergencies depends on a cellular tower system linked by lines obtained via special access. Every small business that does its ordering online and maintains a website to stay in touch with its customers relies on having a choice of providers, who must have access to lines obtained by special access. Every hospital that will comply with the new requirements for electronic medical records, every college or university making use of distance learning, every local government using broadband to streamline services and improve emergency response, somewhere in the chain, relies on lines obtained through special access regulation.

When the special access regime does not function properly, people pay more for these services. The cell phone user pays a higher bill to cover the cell company's higher special access cost – or the competing cell company eats the extra cost and may be forced out of business. The small businesses pay higher costs for telecom services, or have fewer competing carriers who can offer service because fewer competitors can afford the unreasonably high rates of deregulated special access. And cash strapped local governments and educational institutions, find their ever-increasing need for connectivity subject to prices undisciplined either by competition or regulation.

It may be helpful to think of special access in the same way as the price of a barrel of crude oil. Consumers do not buy special access services directly anymore than they buy barrels of oil directly from the tanker. But when the price of crude oil goes up, consumers pay more for gas in their cars, more for groceries brought by truck to supermarkets, more to heat their homes, and so forth. Similarly, when the special access market does not function properly, consumers pay higher prices for their own telecommunication services, pay higher prices for goods and services to cover the higher telecom costs to businesses, and then suffer a third time when

manipulation of special access rates diminishes competition by making it harder for new entrants or non-vertically integrated competitors.

In short, when the market for special access does not operate properly and allows providers to charge unjust and unreasonable rates, it hits even those who have never heard of special access, not merely the competitors and businesses that buy special access. A non-functioning special access market effectively imposes a “monopoly special access tax” on every phone call and every download. But instead of paying for something that benefits consumers, this monopoly special access tax goes straight to the bottom line of those providers able to charge prices unconstrained either by competition or regulation.

The Commission must therefore resist the temptation to take the path of expedience, or to brush aside the complaints of CLECs as competitive rivals seeking to leverage the regulatory process for competitive advantage. This technical and obscure proceeding, that not one in a million Americans has ever even heard of, ultimately has more impact on everyone’s pocketbook and bottom line than billion dollar stimulus and job creation measures debated in the Congress today. The Commission therefore has a duty to all Americans to review this record thoroughly and expeditiously, and create rules that repeal any “monopoly tax” for good.

II. HOW THE COMMISSION SHOULD EVALUATE COMPETITION FOR PURPOSES OF THIS PROCEEDING.

While measuring competition, both present and potential, plays a role in determining whether prices or practices are “just and reasonable,” the Commission cannot fulfill its obligation simply by counting the number of competitors.² Accordingly, parties providing a list of possible alternative services that might serve as substitutes for special access – even if these substitutes provide genuine competitive alternatives – have not shown that the rates charged are therefore

² See *Telocator Network of America v. FCC*, 691 F.2d 525, 550 (D.C. 1982) (“the Commission . . . may not forget that furtherance of the public interest has been entrusted to its hands, not left to the forces of the market.”)

per se in compliance with Sections 201 and 202. A market with many competitors might still produce unreasonable prices and practices.³ Conversely, a market with relatively few competitors might, in theory, provide just and reasonable rates. In making its determination, the Commission must look to the unique aspects of the special access market to determine whether, in fact, the presence of competition (or possible competition) ensures that the market rate is “just and reasonable” as defined by Sections 201 and 202. This consideration must include an appropriate mechanism to ensure that a market once found to properly self-regulating market has not changed to one that produces unjust, unreasonable, or unjustly discriminatory rates.

A. The Act Speaks In Terms of Just and Reasonable Outcome, Not About Competition.

The majority of commenters focus on describing various ways to determine if the market is competitive, as if this alone could resolve the question before the Commission. However, as the Bureau explained in the most recent *Public Notice*, the question the Commission must first resolve is not the number of competitors or potential competitors, but rather whether, given the nature of the industry, the presence or absence of competition produces just and reasonable rates.

Those citing evidence of “competition” (or potential competition) as if this determination alone resolved the question have thus utterly failed to address the key question presented: even *assuming* competition, do the existing rules produce “just and reasonable” rates and practices? For the most part, incumbents have generally reduced this to a tautology: if there is “competition” or “potential competition,” the Commission should simply assume that the rates and practices are reasonable. Why? Because “competitive” market will automatically produce a “just and reasonable” rate. Q.E.D.

³ See Krafft, Jackie & Evens, Sallie, “Why and How Should Innovative Industries With High Consumer Switching Cost Be Re-Regulated,” (2007) available at http://ideas.repec.org/p/hal/wpaper/hal-00239289_v1.html. See generally Akerlof, George A. (1970). "The Market for 'Lemons': Quality Uncertainty and the Market Mechanism". *Quarterly Journal of Economics* **84** (3): 488–500.

This faulty reasoning presents so many difficulties for the Commission’s analytical framework that it is difficult to know where to begin. As an initial matter, “competition” is not a binary system, either present or not present. Even the most basic analysis conducted by federal agencies under the Herfindahl-Hirschman Index (HHI) relies on a sliding scale from a “completely competitive market” to a “highly concentrated market” based not merely on the number of firms, but also on the market share of the firms. Indeed, since the 19th Century economists have described how a market with only two firms can range from perfectly competitive to reaching the monopoly price to a range in between.⁴

Commenters providing a list of possible sources of competition have provided no test for determining whether the presence of these competitors has any actual impact on pricing and practices, and if so whether the level of competition is sufficient to produce just and reasonable rates without additional regulation. In other contexts, the Commission has relied on a range of tests to determine whether a market is competitive.⁵ But the incumbent commentors do not suggest whether these tests or some other test is appropriate.

Similar problems arise from the suggestion of “potential competition.” As the Commission and the D.C. Circuit have observed, it is *theoretically* possible that the fear of entry by a new competitor will in some way restrain the behavior of an incumbent with market power.⁶ But recitation of this comforting theoretical possibility – with a list of possible or would-be competitors – does not provide the Commission with any sort of framework for actually

⁴ Compare the analysis of duopoly by Cournot, Bertrand, and Stackelberg for example, each providing a theoretical justification for entirely different outcomes in a duopoly market.

⁵ See, .e.g, *Review of Regulatory Requirements for Incumbent LEC Broadband Telecommunications Services*, 16 FCC Rcd 22745 (2001); *Motion of AT&T Corp. to Be Reclassified As Non-Dominant Carrier*, 11 FCC Rcd 3271 (1995); *Competition in the Interstate Interexchange Marketplace*, 6 FCC Rcd 5880 (1991).

⁶ See *Verizon Telephone Companies v. FCC*, 570 F.3d 294 (D.C. Cir. 2009).

analyzing whether the prospect of potential competition actually *does* produce the just and reasonable rates the law requires Commission regulation to secure.

In short, it is not enough to simply say “behold competition” with a flourish, as if this actually addressed the public notice. PK therefore provides some possible factors for the Bureau to consider in formulation of the theoretical framework.

B. Factors The Commission Must Consider To Determine If Competition or Potential Competition Actually Produces Just and Reasonable Rates and Practices Without Unreasonable Discrimination.

The most obvious way to determine whether the existing rules are, in fact, providing just and reasonable rates would be to do a random sample of audits of special access providers under the different special access regulatory regimes. Using the fully rate regulated markets as a control, the Commission can determine whether the prices charged in the Phase I and Phase II deregulated markets bear the same relationship to cost as the entities explicitly regulated under Section 201. If the Commission discovered that providers in Phase I and Phase II markets enjoyed far greater profit margins, or that prices offered to firms were wildly at variance from other similarly situated firms, or that certain classes of carriers directly competing with vertically integrated subsidiaries of special access providers faced unusually higher prices or onerous access conditions than similarly situated parties offering non-competing services, this would strongly indicate that the existing Phase I and Phase II regulations failed to protect the public from unjust and unreasonable rates or unreasonably discriminatory practices regardless of the purported level of competition.⁷

PK recognizes that the Commission may prefer to determine the effectiveness of competition (or potential competition) to yield “just and reasonable rates” by indirect means.

⁷ The Commission has more than adequate authority to demand the necessary information from special access providers regardless of any NDA. *See* 47 U.S.C. §§ 211, 213, 215, 218, 220.

These indirect means are, of course, less reliable. Further, the Commission must still have some metric for determining whether a rate is “just and reasonable” rather than whether some arbitrary number of competitors theoretically exists. PK suggests that the traditional return on investment permitted common carriers provides an appropriate metric. If special access carriers consistently charge rates in excess of those traditionally considered reasonable, it would indicate that whatever competition exists is ineffective from the perspective of ensuring unjust and unreasonable rates.

Several commentors have suggested that the Commission seek significant data from parties not subject to its jurisdiction to establish the level of competition. Again, such information does not in any way answer the actual question the Commission must address – whether rates charged are “just and reasonable.” The Commission has it in its power to determine this basic question with scientific accuracy building upon more than 7 decades of experience in determining just and reasonable rates. It should take this most expedient and cost effective route.

PK anticipates that it will be necessary for the Commission to explain why competition, to the extent it exists or might exist, has failed to adequately discipline prices and why the tautology of “since the market produces just and reasonable rates, whatever rates the market produces are just and reasonable” fails in the instant case. Accordingly, PK suggests the following analytic framework.

1. Competition Only Disciplines Behavior If Providers Believe in the Competitive Threat.

The idea that competition disciplines behavior depends on the provider genuinely believing that customers have a choice, and on customers in fact being able to exercise an intelligent choice among competing providers. Where customers are unaware of critical

information, or have no way to judge between providers (for example, because non-disclosure agreements prevent customers from comparing terms), they will not switch providers. Similarly, where high switching costs achieve customer lock in, customers will not switch.

In examining the effectiveness of competition at disciplining prices, the Commission should not require entities to scour their markets for any hint of a potential competitor. Bluntly, any competitor that takes that much effort to discover will not discipline prices. Further, because it is the belief of the *provider* that customers may switch that leads providers to offer the competitive, rather than the monopoly, price, the critical question is whether the special access provider is aware of a competitor, and its strategies to meet this competitive threat. Accordingly, to the extent the Commission undertakes an exercise to determine the number of providers in the market, the critical question is not how many providers an observer might imagine in the best case scenario, or even the number actually available to any and all possible customers. Rather, the critical question is how many competitors does the special access provider believe exist, and how much credibility does the provider give to this competitive threat.

Similarly, the Commission should determine how much information with regard to prices and conditions are available to customers, so that customers can make informed judgments. A market requires information to function, and acute information asymmetry impedes the function of a working market. For competition to effectively discipline prices, customers must have access to information on prices offered to comparable parties so that they can effectively negotiate, and what prices could be offered by a competitor so they can accurately gauge the true price of the service. Accordingly, the Commission should determine what information is generally known in the market (for example, through industry trade magazines or other readily

available sources) and whether this information accurately represents the state of the market (for example, by comparing discoverable prices with discount packages actually sold by providers).

Finally, because of the potential for customer lock in, the Commission must examine the barriers to switching. Where a provider knows that a customer confronts significant cost in switching providers, the provider can raise the price charged from the competitive price to the competitive price *plus* the switching cost. Thus, even if competition produced a just and reasonable charge as an initial matter, the presence of high switching costs could allow each provider to charge unjust and unreasonable rates to the “captured” customers locked in by high switching costs.

2. Theoretical Competition Has Additional Difficulties In Disciplining The Market

The ability of a possible future competitor to discipline the market faces all the same threshold questions as actual competitors. Is the competitive threat credible? Can customers discover the potential competitor? Do customers lack necessary information, or face lock-in problems that discourage switching and thus enable providers to charge prices in excess of what should be considered reasonable?

As empirical evidence has borne out, the competition the Commission predicted has not actually emerged. Moreover, the existing market structure make it likely that a new competitor could emerge unexpectedly, forcing existing providers to behave *as if* the market were competitive despite the presence of a genuine competitor. A potential competitor must raise considerable capital and invest in construction of new facilities before it can even begin to challenge the existing providers. Incumbent providers will therefore have considerable warning before the emergence of a potential competitive threat, making it profoundly unlikely that the possibility of future competition could impact prices or practices in the market.

Again, the Commission has authority to require the incumbents to submit their own market analysis. Rather than speculate on whether providers might alter their behavior in the face of a possible threat, the Commission can and should require the incumbents to provide their own market analysis to determine whether they in fact do respond to the threat of potential competition, and whether this response is sufficient to require them to offer just and reasonable rates absent any regulatory changes.

CONCLUSION

Every day the Commission delays forward progress on this proceeding costs every American and every American business billions of dollars in unjust and unreasonable rates. The persistence of the unjust and unreasonable rates and practices stifles the deployment of broadband and serves as a drag on the economy as a whole. Incumbents have sought to divert the Commission from the objective of this proceeding and its responsibility under the statute to determine just and reasonable rates and convert this into an exercise glorifying the form of competition for its own sake. The Commission should see through these attempts at obfuscation and use its power to compel commercial data to resolve the actual inquiry before it: does the current deregulatory system allow providers to charge rates far in excess of cost, or to discriminate against providers of competing services?

If the Commission finds that competition has indeed failed to produce the just and reasonable rates and non-discriminatory outcomes it predicted would occur when it adopted the current regulatory regime, it must take steps to remedy the problem before it rather than continue to hope that – all experience and evidence to the contrary – some new competitor will emerge to discipline the market.

Respectfully submitted,

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