

and feasibility of administering a regulatory regime in narrow geographic areas.” Topper Decl. ¶¶ 61.

It is also important for the geographic areas selected for the Commission’s analysis to reflect how competitors offer their services. As Verizon explained, using the current MSA-based regime for purposes of analyzing competition would be more consistent with the manner in which competitors market and deploy their high capacity services. When competitors announce their entry into new areas, the geographic scope of those areas is often quite large. For example, when Clearwire announced entry into the Atlanta and Las Vegas markets last year, it claimed to be “adding nearly five million people and 1,800 square miles to [its] coverage footprint.”<sup>60</sup>

Several commenters argue that each building represents its own separate geographic market.<sup>61</sup> One commenter even goes so far as to suggest “individual floors with a building exist as a separate geographic markets.”<sup>62</sup> Such tiny geographic areas are not appropriate from an economic perspective because they do not reflect how competitors offer their services; carriers do not market their services to a particular floor at a specific street address. Topper Reply Decl. ¶¶ 7-11. It would also be impossible for the Commission to administer a framework based on such tiny geographic areas and any attempt to do so would place a burden on both customers and carriers alike.

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<sup>60</sup> Clearwire Press Release, *Clearwire Reports Second Quarter 2009 Results*, <http://investors.clearwire.com/phoenix.zhtml?c=214419&p=irol-newsArticle&ID=1319733&highlight=> (Aug. 11, 2009) (last visited Jan. 19, 2010).

<sup>61</sup> See, e.g., No Choke Points Comments at 7 (“the most useful way to analyze special access geographic markets is to analyze competition at individual buildings and cell sites”); PAETEC, *et al.*, Comments at 33 (“a building remains the relevant geographic market”).

<sup>62</sup> Ad Hoc Comments at 5.

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As Dr. Topper explained, “[t]he choice of geographic scale should reflect the reach or ‘footprint’ of all competing provider networks deployed within a given area” which “includes ‘actual’ competitors whose network reaches a given area, and ‘potential’ competitors who could extend their network to serve a particular group of customers.” Topper Reply Decl. ¶ 7.

Defining the geographic market as a building or a floor in a building is not consistent with how competitors provide their services or the reach of their competitive networks. As explained above, the evidence shows that competitive entry and customer purchases occur over a fairly large geographic area, such as a metropolitan area, and that competitors deploy network facilities to serve many buildings and customer locations in that area. An “[a]nalysis at a building-level scale will improperly exclude actual and potential competitors from the relevant geographic market, understate the degree of competition, and thus yield an economically inaccurate conclusion.” Topper Reply Decl. ¶ 8.

Given the large number of buildings in even a single MSA (e.g., “71,000 total significant commercial buildings” in the Chicago MSA), it would not be practical for the Commission to attempt to use such a tiny definition of the relevant geographic market. In fact, even one of the proponents of this narrow geographic market definition admits that “conducting a market analysis on a building-by-building basis is, at best, cumbersome and ignores the fundamental purpose of telecommunications service – which is to provide connectivity between and among all of the locations at which the customer has business interests.”<sup>63</sup> Accordingly, the choice of geographic market definition should “be guided by a cost-benefit analysis that balances accuracy in measuring competitive conditions against the cost and feasibility of administering a regulatory

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<sup>63</sup> Ad Hoc Comments at 5.

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regime in narrow geographic areas.” Topper Decl. ¶ 61. The sheer quantity of buildings at which the Commission would need to make such assessments would overwhelm the Commission and its limited resources. And even if the Commission could undertake such building-level assessments, they would be quickly out of date as soon as new facilities were constructed or planned.

While some commenters argue that a building-specific analysis is consistent with what the Commission did in the merger context, such an analysis is not pertinent or controlling here. In those proceedings, the Commission’s analysis was focused on a snapshot in time and a limited number of buildings where both merging companies had network facilities. The Merger Guidelines were “designed primarily to articulate the analytical framework in determining whether a merger is likely substantially to lessen competition” and thereby to identify those mergers that warrant close scrutiny and potential enforcement action.<sup>64</sup> Modern antitrust analysis recognizes that analysis of market structure often reveals little about whether markets are performing efficiently. As a result, market structure analysis is used only as a preliminary screen – that is, market power is treated as an essential *prerequisite* to anticompetitive effects.<sup>65</sup>

Here, there is clear marketplace evidence that markets are delivering investment and innovation, and benefiting consumers; such direct evidence that markets are functioning well makes a market-power analysis superfluous. Just as important, using a market-structure analysis as a basis for regulatory policy is inappropriate in circumstances where rapid technological change makes a snapshot of market power analysis especially speculative and uncertain. As the

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<sup>64</sup> DOJ Merger Guidelines § 0.1.

<sup>65</sup> 4 Phillip E. Areeda & Herbert Hovenkamp, *Antitrust Law* ¶ 928, at 158 (3d ed. 2009).

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Commission has observed, “[t]he 1992 *Horizontal Merger Guidelines* focus on static markets.”<sup>66</sup>

The Merger Guidelines “do not detail any specific methodology” for market-structure analysis “in markets that have experienced significant recent, or ongoing, changes.”<sup>67</sup>

Several commenters propose that the Commission define the geographic market on a route-specific basis. For example, Ad Hoc argues that “the relevant market for special access services is the route connecting the two points that a prospective purchaser seeks to link.”<sup>68</sup> Not only would this geographic market definition be unworkable, it would not reflect the way customers purchase high capacity services.

Any attempt to analyze competition on a route-specific basis would overwhelm the Commission with a multitude of extremely small geographic markets. The number of possible routes between pairs of buildings is many times greater than the total number of buildings. As Dr. Selwyn explains, “the number of potential point-to-point connections that can be created on a network increases exponentially with the number of individual ‘nodes’ on the network.”<sup>69</sup> If there were a total of 10,000 buildings, there could potentially be almost 50 million point-to-point

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<sup>66</sup> *Application of WorldCom, Inc. and MCI Communications Corporation for Transfer of Control of MCI Communications Corporation to WorldCom, Inc.*, Memorandum Opinion and Order, 13 FCC Rcd 18025, ¶ 18 (1998); see also *Price Cap Performance Review for Local Exchange Carriers*, Second Further Notice of Proposed Rulemaking in CC Docket No. 94-1, Further Notice of Proposed Rulemaking in CC Docket No. 93-124, and Second Further Notice of Proposed Rulemaking in CC Docket No. 93-197, 11 FCC Rcd 858, ¶ 143 (1995) (any analysis of “the level of competition for LEC services based solely on a LEC’s market share at a given point in time would be too static and one-dimensional”).

<sup>67</sup> *Id.*; see also DOJ Merger Guidelines § 1.521 (“recent or ongoing changes in the market may indicate that the current market share of a particular firm either understates or overstates the firm’s future competitive significance”).

<sup>68</sup> Ad Hoc Comments at 5.

<sup>69</sup> Ad Hoc Comments, Declaration of Lee J. Selwyn ¶ 4.

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connections between those buildings. With hundreds of thousands of buildings in the country, the potential number of point-to-point connections is quite staggering.

More importantly, many customers do not purchase high capacity services just to connect two points or buildings. Special access customers are typically large, sophisticated businesses with many locations that they wish to interconnect with high capacity services. In addition, as explained above, the typical special access circuit connects one point to as many as 24 other points through a multiplexer. In other words, customers typically purchase high capacity services to connect multiple points and don't consider pairs of buildings to be separate geographic markets. Topper Reply Decl. ¶ 9.

Finally, a regulatory regime that grants relief based on proving competition at individual buildings or routes would not be practical for service providers or customers. Many customers have multiple locations within a geographic area and would expect to purchase services on a consolidated basis for those locations. Today, Verizon and other carriers offer multiple discount plans or individualized contract tariffs that cover broad areas and would be disrupted by a switch to a very localized pricing flexibility regime. Building-by-building or route-by-route relief would be too granular to provide the sort of services many customers expect. It would also hamper the ability of incumbent carriers to compete against competitors that are not subject to such restrictions.

**D. The Commission's Analytical Framework Should Include Areas That Competitors Currently Serve, Can Serve and Plan to Serve.**

As Verizon explained in its comments, the Commission's analysis should include not only the customer locations that competitors are serving today, but also the locations that they are capable of serving and planning to serve. In a forward looking analysis, the Commission

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should include not only the individual buildings actually served by competitors but also the areas that competitors are able to serve. Topper Decl. ¶ 56. Dr. Carlton and Dr. Sider agree that “any additional data collection should include route and location information for the alternative networks, and not merely the buildings to which they are currently connected.”<sup>70</sup>

Once competitors have deployed fiber or wireless *networks* in an area, they are able cost-effectively to use or extend those networks to serve customers in individual *buildings* where there is sufficient demand. Topper Decl. ¶¶ 58, 59. Accordingly, even if a competitor is not yet serving particular buildings, the Commission’s forward looking analysis should account for the fact that they readily could do so in many cases. As Dr. Carlton and Dr. Sider explained, “CLECs typically bid for customers’ special access business both at locations already connected to their fiber networks and at locations that can be reached by extensions from those networks; when they win contracts for this business, they then build ‘lateral’ connections from their network to the customer locations they do not already serve.”<sup>71</sup>

The prospect of such competition provides an additional check on special access rates. Topper Decl. ¶ 60. The investments that competitors are making today to upgrade and expand their networks must be part of the Commission’s forward looking analysis of competition for high capacity services. Topper Reply Decl. ¶¶ 12-14.

Several parties suggest that the Commission limit its analysis to those commercial buildings that are lit using the competitor’s own facilities.<sup>72</sup> They propose that the Commission

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<sup>70</sup> AT&T Comments, Carlton/Sider Decl. at 4-5.

<sup>71</sup> AT&T Comments, Carlton/Sider Decl. ¶ 9.

<sup>72</sup> See, e.g., Level 3 Comments at 15-16

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exclude the buildings that competitors serve using wholesale services provided by incumbent carriers. The Commission should not limit its analysis in this fashion.

There is no economic justification for the Commission to limit its analysis to those competitors providing service entirely over their own facilities. Topper Reply Decl. ¶¶ 13-14. Competitors can and are competing effectively by using wholesale services or leasing network elements from third parties. Topper Reply Decl. ¶¶ 14. If the customer can purchase service from a competitor that uses third party facilities or services, that customer has competitive alternatives. From an economic perspective, it doesn't matter how the competitor serves the customer. Topper Reply Decl. ¶¶ 13-14.

Moreover, these commenters also assume that the only way to provide high capacity services is through lit fiber optic cables. This assumption is unwarranted. An efficient competitor will serve a customer using the most efficient and cost effective means possible. If a fixed wireless technology is more cost effective than lit fiber, an efficient competitor would deploy that technology. There is therefore no reason to limit the Commission's analysis to buildings served by lit fiber.

Level 3 suggests that the data on the buildings competitors have lit with their own fiber will show that competitors have deployed facilities to only a small fraction of all buildings in a geographic area.<sup>73</sup> But even if competitors have targeted their deployment of facilities to a limited set of buildings, that is not necessarily indicative of their competitive impact. As Verizon explained in its comments, the record in this case already demonstrates that demand for special access services is highly concentrated in areas like metropolitan areas, office parks,

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<sup>73</sup> Level 3 Comments at 7-9.

cellular towers and the like.<sup>74</sup> In Verizon's service areas, nearly 80 percent of special access revenues in 2007 were generated in 25 MSAs, and within these MSAs special access demand is concentrated in the downtown core of cities or in certain suburban areas in which there are large numbers of customers in communications-intensive industries.<sup>75</sup> AT&T has shown that "about 80 percent of its special access revenues in Phase II pricing flexibility areas are derived from about 23 percent of wire centers located in such areas."<sup>76</sup> Competitors can easily reach the vast bulk of the demand for high capacity services by simply targeting the few buildings where such demand is most highly concentrated.

Focusing solely on the percentage of lit buildings would not be a valid competitive analysis because it would ignore the competitive impact at buildings that are not yet lit. As Dr. Carlton and Dr. Sider explained, "the 'lit buildings market share' metric identified in the Public Notice would not accurately gauge competitive constraints because . . . CLEC and other special

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<sup>74</sup> According to the USTelecom, "[a]pproximately half of ILEC special access revenue is concentrated in the top 25 largest MSAs" and within these top MSAs, "demand is concentrated further still, in the wire center serving areas with the highest concentration of business customers." *High-Capacity Services: Abundant, Affordable, and Evolving*, attached to United States Telecom Association Ex Parte, *Special Access Rates for Price Cap Local Exchange Carriers*, WC Docket. 05-25; *National Broadband Plan for Our Future*, GN Docket. 09-51, at 4 (July 16, 2009) ("USTelecom High-Cap Report").

<sup>75</sup> See Verizon 2007 Comments, at Attachment E: Declaration of Patrick A. Garzillo ¶ 3 & Exh. 1 ("Garzillo Decl."); see also *id.* (nearly 80 percent of the demand for high-capacity special access services (as measured by revenues) is concentrated in approximately 15 percent of the wire centers where Verizon bills high-capacity special access (or 740 wire centers)); see also *Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers*, Report and Order and Order on Remand and Further Notice of Proposed Rulemaking, 18 FCC Rcd 16978 (2003) ("*Triennial Review Order*"), *vacated in part and remanded, United States Telecom Ass'n v. FCC*, 359 F.3d 554 ¶¶ 205, 375 (D.C. Cir. 2004) (recognizing that customers of high-capacity services tend to be highly concentrated geographically).

<sup>76</sup> AT&T Comments, Carlton/Sider Decl. ¶ 8.

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access providers can influence industry price and output even if their current share of lit buildings is small by bidding to provide service in buildings nearby their existing facilities and then extending laterals to those buildings if they win.”<sup>77</sup>

**E. The Commission’s Analysis Should Not Rely on Backwards Looking Market Shares.**

As Verizon explained in its comments, in a dynamic industry like the one for high capacity services, it would be inappropriate for the Commission to rely on backwards looking market shares as some commenters recommend.<sup>78</sup> These static measures tend to understate the real impact of competitive alternatives and therefore have limited utility in dynamic industries.

First, static measures, by their very nature, become out of date very quickly. By the time the Commission actually completed market share measures, they could easily be two years out of date and obsolete. In a rapidly changing marketplace, “historical market share information based on sales volumes will likely understate the competitive significance of alternative providers” and therefore would not be useful or meaningful in assessing competition. Topper Decl. ¶ 53. The DOJ has likewise noted that “market share and market concentration data may understate . . . the likely future competitive significance of a firm . . . in the market.”<sup>79</sup> Dr. Carlton and Dr. Sider also noted that market share measures are inappropriate because “a carrier with a small share of current sales but the ability to offer services to many customers can exert a powerful competitive constraint.”<sup>80</sup>

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<sup>77</sup> *Id.* ¶ 63.

<sup>78</sup> *See, e.g.,* PAETEC, *et al.*, Comments at 48.

<sup>79</sup> Horizontal Merger Guidelines, § 1.52.

<sup>80</sup> AT&T Comments, Carlton/Sider Dec. ¶ 63.

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Second, the market share measures advocated by some commenters would understate competition because they would not account for self supply.<sup>81</sup> Even one of the proponents of more stringent regulation recognized the importance of including self supply in the Commission's analysis. According to tw telecom, "the incumbent LEC may also face some competition on the route where competitors can self deploy transport facilities and substitute those facilities for incumbent LEC mileage services."<sup>82</sup> However, the proposed market share measures only capture commercial transactions and exclude self supply. Topper Decl. ¶¶ 33-34.

Third, the proposed market share measures are also flawed because they do not account for the concentration of demand. As Qwest explained, "the market-share figures invoked by advocates of re-regulation . . . often reflect only a crude percentage of all buildings served."<sup>83</sup> As a result, "they count each dry-cleaner or gas station as the equivalent of a multi-tenant office building, even though such small businesses normally do not purchase special access and, in any event, should not be treated as equivalent to multi-tenant office buildings for market-share purposes even when they do."<sup>84</sup>

Finally, the proposed market share measures do not recognize the competitive pressure exerted by competitors that *could* serve customers. As Qwest explained, "such figures altogether ignore the pricing pressures imposed by *potential* competition – *e.g.*, by providers that could

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<sup>81</sup> See, *e.g.*, PAETEC, *et al.*, Comments at 48-49.

<sup>82</sup> tw telecom Comments at 20.

<sup>83</sup> Qwest Comments at 11.

<sup>84</sup> *Id.*

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cost-effectively extend their nearby facilities to provide service if and when an ILEC's prices rise."<sup>85</sup>

**F. Because Competitors Have Already Entered and Are Continuing to Enter the Market, the Commission Does Not Need To Address Barriers to Entry.**

Several commenters suggest that the Commission should consider separately whether there are barriers to entry for high capacity services.<sup>86</sup> As Dr. Topper explains, such an analysis would only be appropriate where competitors have not entered the market. *See* Topper Reply Decl. ¶¶ 13-14. Where competitors have already entered the market and are continuing to enter the market, as they have here, either there are no barriers to entry or competitors have been able to overcome any such barriers. Topper Reply Dec. ¶¶ 13-14.

As Verizon explained in its comments, there is ample evidence of recent competitive entry as well as planned future entry and such entry demonstrates that to the extent there are any barriers to entry, competitors have been able to overcome those barriers. Verizon has already submitted evidence showing that as of 2007, in Verizon's top 25 MSAs in terms of special access demand, there is an average of nine known competitive fiber providers.<sup>87</sup> As of 2007, there were two or more known competitive fiber providers in all of these MSAs, five or more known providers in 18 MSAs, and at least 11 known providers in nine MSAs.<sup>88</sup>

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<sup>85</sup> Qwest Comments at 11-12.

<sup>86</sup> *See, e.g.,* PAETEC, *et al.*, Comments at 44-47.

<sup>87</sup> *See* Verizon 2007 Comments, Attachment F: Declaration of Kenneth J. Martinian, Exh. 1.

<sup>88</sup> *See id.*

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With the ample evidence of recent and planned competitive entry, there is no reason for the Commission to conduct a separate analysis of barriers to entry. Entry has already occurred and is continuing to occur at a rapid pace demonstrating the absence of any barriers to entry.

**III. THE COMMISSION SHOULD REJECT PROPOSALS TO COMPARE SPECIAL ACCESS PRICES TO ARBITRARY BENCHMARKS.**

The goal of any regulatory regime is to ensure prices reflect what would occur in a competitive market. By examining the existing record evidence or by conducting a further competitive analysis, the Commission can determine the extent to which special access services are subject to competition. Special access rates that have resulted from the forces of competition are, by definition, just and reasonable.

The Commission has also found that in competitive markets, the “just and reasonable” standard of Sections 201 and 202 is not “cost-based.” In *AT&T Corp. v. Business Telecom*, the Commission granted in part a complaint by AT&T and Sprint finding that access rates charged by Business Telecom, Inc. (“BTI”) were unjust and unreasonable. In so doing, the Commission assessed “the reasonableness of BTI’s access rates by evaluating the market for access services, rather than by ascertaining BTI’s costs of providing access service.”<sup>89</sup> The Commission concluded that it was neither “necessary” nor “appropriate” to examine BTI’s costs in determining whether its rates were just and reasonable.<sup>90</sup>

Nonetheless, several parties recommend that the Commission compare special access prices to certain benchmarks. In fact, one commenter urges the Commission to rely entirely on a profitability benchmark and not undertake any analysis of competition for special access

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<sup>89</sup> *AT&T Corp. v. Business Telecom*, 16 FCC Rcd 12312 at 12321 (2001).

<sup>90</sup> *Id.* at 12333.

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services.<sup>91</sup> But comparing special access prices to benchmarks as a substitute for market prices is unnecessary where special access rates have been set by the forces of competition. Moreover, none of the benchmarks proposed by these parties provide a reasonable measure for special access rates.

**A. The Commission Should Not Compare Special Access Rates to Unbundled Network Element (UNE) Rates.**

Several commenters recommend that the Commission compare special access rates to the UNE rates set by state commissions for unbundled DS1s and DS3s.<sup>92</sup> There are several reasons why the UNE rates are not appropriate benchmarks and do not reflect competitive prices for special access services.

The Commission has already found that the TELRIC pricing standard only applies to unbundled network elements and specifically rejected the use of TELRIC pricing in other contexts, such as for Section 271 elements. As the Commission explained, Section 271 elements are those elements for which CLECs are “not impaired in [their] ability to offer services without access to that element” as a UNE.<sup>93</sup> The Commission held that it “would be counterproductive to mandate” that Bell Operating Companies offer 271 elements “at forward-looking prices,” such

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<sup>91</sup> See *tw telecom Comments* at 5 (“the FCC could of course avoid this entire complex analysis by examining incumbent LEC profit margins”).

<sup>92</sup> See, e.g., *No Choke Points Comments* at 35 (“the Commission might consider requiring special access rates to be based on UNE prices”); *Sprint Comments* at 26; *PAETEC, et al., Comments* at 70.

<sup>93</sup> *Implementation of the Local Competition Provisions of the Telecommunications Act of 1996*, Third Report and Order and Fourth Further Notice of Proposed Rulemaking, 15 FCC Rcd 3696, ¶ 473 (1999), *vacated and remanded, United States Telecom Ass'n v. FCC*, 290 F.3d 415 (D.C. Cir. 2002), *cert. denied*, 538 U.S. 940 (2003).

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as the TELRIC rates that the Commission's rules establish for UNEs.<sup>94</sup> Instead, "the market price should prevail, as opposed to a regulated rate."<sup>95</sup>

The Commission reaffirmed those findings in the *Triennial Review Order*, in which it again refused to apply TELRIC pricing to 271 elements. The Commission specifically held that "TELRIC pricing" for 271 elements is "no[t] necessary to protect the public interest" because TELRIC implements the "pricing standard under section 252," which applies only "*where impairment is found to exist*."<sup>96</sup>

Reviewing those conclusions, the D.C. Circuit affirmed the Commission's "determin[ation] that TELRIC pricing [is] not appropriate in the absence of impairment" – that is, for "elements for which unbundling [is] required only under § 271."<sup>97</sup> Indeed, the court found that "the CLECs have no serious argument that the text of the statute" requires TELRIC rates for 271 elements, and that there was "nothing unreasonable in the Commission's decision to confine TELRIC pricing to instances where it has found impairment."<sup>98</sup> More recently, the Seventh Circuit has rejected claims that TELRIC pricing is appropriate for 271 elements, explaining that, "if the rate for unbundled access under section 271 were identical to the rate under section 251, it

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<sup>94</sup> *Id.*

<sup>95</sup> *Id.*

<sup>96</sup> *Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers*, Report and Order and Order on Remand and Further Notice of Proposed Rulemaking, 18 FCC Rcd 16978, ¶ 656 (2003) ("*Triennial Review Order*") (subsequent history omitted); *accord id.* ¶ 657 (finding that § 252(d)(1) "is quite specific that it applies only for the purposes of implementation of section 251(c)(3) – meaning only where there has been a finding of impairment with regard to a given network element").

<sup>97</sup> *USTA II*, 359 F.3d at 589.

<sup>98</sup> *Id.*

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wouldn't make sense for Congress to have required a showing of 'necessity' and 'impairment' by competing carriers wanting those cost-based section 251 rates."<sup>99</sup>

The Commission's decisions limiting TELRIC pricing to those elements where it has found that the statutory impairment standard is satisfied are also consistent with the Supreme Court's decision upholding the Commission's TELRIC rules for UNEs. In reaching that decision, the Supreme Court stressed that § 252(d)(1) – which provides for UNE rates to “be set without reference to a rate-of-return or other rate-based proceeding” – is “radically unlike all previous [just and reasonable rate] statutes” and “appears to be an explicit disavowal of the familiar . . . model of rate regulation” under statutes such as § 201(b), “in favor of a novel rate setting methodology.”<sup>100</sup> Moreover, the Supreme Court repeatedly made clear that its affirmance of the Commission's TELRIC rules was limited to the application of those rules to “bottleneck elements” – that is, those elements for which the Commission had made “impairment findings.”<sup>101</sup>

Moreover, the Commission has found that requiring TELRIC rates in the absence of impairment is affirmatively harmful to competition. TELRIC pricing “create[s] disincentives for incumbent LECs and competitive LECs to deploy innovative services and facilities.”<sup>102</sup> Indeed, in the specific context of the high-capacity facilities, the Commission recognized that eliminating

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<sup>99</sup> *Illinois Bell Tel. Co. v. Box*, 548 F.3d 607, 613 (7th Cir. 2008).

<sup>100</sup> *Verizon Communications Inc. v. FCC*, 535 U.S. 467, 489 (2002) (internal quotation marks omitted).

<sup>101</sup> *Id.* at 510, 515-16.

<sup>102</sup> *Unbundled Access to Network Elements; Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers*, Order on Remand, 20 FCC Rcd 2533 ¶ 36 (2005), *petitions for review denied*, *Covad Communications Co. v. FCC*, 450 F.3d 528 (D.C. Cir. 2006).

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TELRIC pricing in the absence of impairment “will benefit competing carriers that invest or have invested in their own transport facilities” – which would otherwise have “to compete against carriers able to obtain” TELRIC-priced facilities – and therefore “will produce desirable incentives” for further competition.<sup>103</sup> Courts have likewise found that TELRIC pricing “discourage[s] . . . investment in innovation.”<sup>104</sup> Forcing ILECs to charge very low, regulated rates for access to their networks “reduce[s] or eliminate[s] the incentive for an ILEC to invest in innovation” because “it will have to share the rewards with CLECs.”<sup>105</sup> Likewise, unbundling creates a disincentive “for a CLEC to innovate” because “it can get the element cheaper” at TELRIC rates.<sup>106</sup>

The Commission’s reasoning for not applying the TELRIC pricing standard to Section 271 elements is even more compelling for special access services. TELRIC rates are, in theory, simply the costs of leasing an unbundled network element. They are not designed to capture the costs of providing services over those network elements. For example, Verizon provide more extensive customer support for special access services than for unbundled network elements.<sup>107</sup> By excluding these additional service-related costs, TELRIC costs do not fully reflect the costs of providing special access services and are not an appropriate benchmark.

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<sup>103</sup> *Triennial Review Order* ¶ 404.

<sup>104</sup> *USTA II*, 359 F.3d at 572.

<sup>105</sup> *USTA I*, 290 F.3d at 424.

<sup>106</sup> *Id.*

<sup>107</sup> Attachment B: Declaration of Quintin Lew and Anthony Recine (“Lew/Recine Decl.”) ¶ 43.

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Furthermore, the TELRIC methodology does not replicate rates in a competitive market. It is based on a hypothetical network that bears no relationship to actual costs. As the D.C. Circuit found, the Commission's TELRIC methodology for UNE rates is "an artificial construct that may not closely track true economic cost."<sup>108</sup> Because of the large fixed costs associated with wireline networks, there is no reason to expect competitive prices for special access services to equal TELRIC-based UNE rates. As Dr. Topper explained, "*marginal cost is often below average cost, most notably for products with high fixed costs and few or no capacity constraints*" and "[i]n such cases, price must exceed marginal cost for firms to remain viable in the long run." Topper Decl. ¶ 14 n.20. Dr. Timothy J. Tardiff and Professor Dennis L. Weisman made the same observation: "high price-cost margins [generally result] not because firms are earning abnormally high economic profits, but because they must recover their fixed costs and account for demand and supply relations among their several products in the process of earning normal profits."<sup>109</sup>

Even if the Commission's TELRIC methodology were able to determine competitive prices, which it is not, the Commission has already recognized that there are numerous problems with the UNE rates set by the state commissions under the TELRIC methodology. For example, the Commission "note[d] that, for any given carrier, there may be significant differences in rates

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<sup>108</sup> *USTA v. FCC*, 359 F.3d 554, 573 (D.C. Cir. 2004).

<sup>109</sup> Reply Comments of Dr. Timothy J. Tardiff and Professor Dennis L. Weisman, *Implementation of Section 6002(b) of the Omnibus Budget Reconciliation Act of 1993; 14th Annual Report and Analysis of Competitive Market Conditions with Respect to Commercial Mobile Services*, WT Docket No. 09-66 at 2 (July 13, 2009).

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from state to state, and even from proceeding to proceeding within a state.”<sup>110</sup> The Commission expressed concern “that such variable results may not 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.”<sup>111</sup> The Commission concluded that “[t]he resulting rates might not, therefore, achieve fully the Commission’s goal of sending appropriate economic signals.”<sup>112</sup>

**B. The Commission Should Not Compare Special Access Rates to Broadband Access Rates.**

Several commenters recommend that the Commission compare special access rates to the rates for broadband access services, such as DSL and cable modem service.<sup>113</sup> In particular, Sprint suggests comparing special access rates to Verizon’s FiOS service rate of \$54.99 per month and AT&T’s DSL rate of \$35 per month.<sup>114</sup> There are several reasons why competitive prices for broadband access services have nothing to do with competitive prices for special access services.

Even though they may have similar bandwidth capacities, broadband access services differ in numerous key respects from special access services provided to large business customers. DSL special access service is provided entirely over a dedicated channel between the

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<sup>110</sup> *Review of the Commission’s Rules Regarding the Pricing of Unbundled Network Elements and the Resale of Service by Incumbent Local Exchange Carriers*, Notice of Proposed Rulemaking, 18 FCC Rcd 18945, ¶ 6 (2003).

<sup>111</sup> *Id.*

<sup>112</sup> *Id.*

<sup>113</sup> *See, e.g.*, Sprint Comments at 26; No Choke Points Comments at 23.

<sup>114</sup> *See* Sprint Comments at 28, n. 91.

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points selected by the customer, while broadband access service involves a channel that a portion of which is shared by multiple customers. As a result, special access services enable customers to transport data between any two physical locations chosen by the customer. By contrast, broadband access services currently provide no such choice to the customer; they can only be used to access the Internet. In addition, Verizon provides a guaranteed level of service with DS1 special access services, while DSL and FiOS generally provide best efforts Internet access. Attempting to compare prices for these two different services solely on the basis of their bandwidth capacity is like saying the price of a bus should be the same as the price of a jet because they both have the same capacity to carry 100 passengers.

Indeed, competitors themselves have tariffed rates for DS1 capacity services that far exceed the broadband access rates cited by Sprint. For example, PAETEC provides an interstate switched access service called a DS1 Entrance Facility. It is essentially a DS1 channel termination used to carry switched access traffic. PAETEC has a tariffed rate of \$300 per month for its DS1 Entrance facility,<sup>115</sup> which is five-to-eight times the broadband access prices cited by Sprint. Such a comparison does not say anything about the exercise of market power by PAETEC or any other carrier.

**C. The Commission Should Not Compare Special Access Rates to NECA Rates.**

PAETEC, *et al.*, recommend that the Commission compare special access rates in Price Cap and Price Flex areas to the Band 1 special access rates in the NECA tariff.<sup>116</sup> There are

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<sup>115</sup> PAETEC Communication, Inc., FCC Tariff No. 3 – Interstate Access, Rate Attachment – Switched Access Services Rates and Charges, Section 4.

<sup>116</sup> PAETEC, *et al.*, Comments at 8, 71.

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several reasons why NECA tariff rates do not reflect competitive prices for special access services.

First, NECA tariff rates are the result of rate of return regulation, which is focused solely on the overall earnings of the regulated company. There is no reason to expect rate of return regulation to produce the same rates as would exist in a competitive market. As PAETEC, *et al.*, acknowledge, the “companies that participate in the NECA tariff are rate-of-return companies.”<sup>117</sup> Rate of return regulation simply governs the overall rate of return to be earned by the regulated company. It enables regulators to determine the overall revenues that a regulated company should collect to earn that prescribed rate of return, but it doesn’t specify how to set individual rates for multiproduct companies. As such, it would be pure chance if any rates set under a rate of return regulatory regime reflected the rates that would be produced by competition. That is why the Commission found that “reducing [its] regulatory reliance on earnings calculations based on accounting data is essential to the transition to a competitive marketplace.”<sup>118</sup>

Second, if NECA tariff rates truly reflect competitive rates, then Verizon’s current switched access rates are far below competitive rates. The NECA tariff lists rates for both special access services as well as switched access services. A simple comparison of Verizon’s switched access rates with comparable NECA rates shows a significant disparity. For example,

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<sup>117</sup> PAETEC, *et al.*, Comments at 9.

<sup>118</sup> See *Price Cap Performance Review for Local Exchange Carriers*, Fourth Report and Order in CC Docket No. 94-1 and Second Report and Order in CC Docket No. 96-262, 12 FCC Rcd 16642 ¶ 150 (1997) (“*Price Cap Performance Review Order*”).

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the Band 1 NECA tariff rate for Local Switching is \$0.009913 per minute,<sup>119</sup> while Verizon's corresponding Local Switching rate is \$0.002273 per minute.<sup>120</sup> Verizon would need to increase its Local Switching rate by over **330 percent** to match the NECA rate.

Similarly, the Band 1 NECA tariff rate for Tandem Switched Transport is \$0.00017 per minute, per mile,<sup>121</sup> while Verizon's corresponding Tandem Transport rate is \$0.000002 per minute, per mile.<sup>122</sup> Verizon would need to increase its Tandem Transport rate by **8,400 percent** to match the NECA rate. These wide disparities shows that the NECA tariff rates are not benchmarks for any competitive rates. They are simply the product of rate of return regulation that is not designed to set prices at competitive levels.

Finally, PAETEC itself is charging rates for high capacity services that far exceed the NECA tariff rates for corresponding services. As explained above (Section III.C., *supra*), PAETEC provides an interstate switched access service called a DS1 Entrance Facility, which is essentially a DS1 channel termination used to carry switched access traffic. PAETEC charges an FCC tariffed rate of \$300 per month for a DS1 Entrance facility,<sup>123</sup> almost three times higher than the Band 1 NECA Tariff rate for a comparable DS1 entrance facility (\$107).<sup>124</sup>

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<sup>119</sup> NECA FCC Tariff No. 5, Section 17.2.3(A).

<sup>120</sup> Verizon FCC Tariff No. 1, Section 6.9.2(A).

<sup>121</sup> NECA FCC Tariff No. 5, Section 17.2.2.

<sup>122</sup> Verizon FCC Tariff No. 1, Section 6.9.1(B).

<sup>123</sup> PAETEC Communication, Inc., FCC Tariff No. 3 – Interstate Access, Rate Attachment – Switched Access Services Rates and Charges, Section 4.

<sup>124</sup> NECA Tariff No. 4, Section 17.2.2.

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**D. The Commission Should Not Evaluate Special Access Rates on the Basis of ARMIS Rate of Return Calculations.**

Several commenters recommend that the Commission evaluate special access rates on the basis of ARMIS rate of return calculations.<sup>125</sup> But the Commission abandoned rate of return regulation more than 15 years ago in order to sever the relationship between rates and costs and replicate the efficiency incentives of a competitive market.<sup>126</sup> The Commission has since acknowledged that progressive regulation should avoid consideration of accounting rates of return: “reducing our regulatory reliance on earnings calculations based on accounting data is essential to the transition to a competitive marketplace.”<sup>127</sup> Attempting to derive service-specific profitability for special access would effectively turn back the clock to the age of rate-of-return regulation, which is widely regarded as an inferior form of regulation.

As Verizon explained in its comments, it would be an error for the Commission to use ARMIS data to look at special access costs or rates of return. The Commission has long recognized that the data reported in ARMIS “do[] not serve a ratemaking purpose.”<sup>128</sup> It has also concluded that “high or increasing rates of return calculated using regulatory cost

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<sup>125</sup> See, e.g., tw telecom Comments at 5; No Choke Points Comments at 24-26; Ad Hoc Comments at 8-9, 14-15; PAETEC, *et al.*, Comments at 64-65.

<sup>126</sup> See *Policy and Rules Concerning Rates for Dominant Carriers*, Second Report and Order, 5 FCC Rcd 6786 (1990); see also *Price Cap Performance Review for Local Exchange Carriers*, First Report and Order, 10 FCC Rcd 8961, ¶ 64 (1995) (recognizing that a price cap system “was not only superior to rate-of-return regulation, but could also act as a transitional system as LEC regulated services became subject to greater competition”).

<sup>127</sup> See *Price Cap Performance Review Order* ¶ 150.

<sup>128</sup> *Policy and Rules Concerning Rates for Dominant Carriers*, Order on Reconsideration, 6 FCC Rcd 2637, ¶ 194 (1991).

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assignments for special access services do not in themselves indicate the exercise of monopoly power.”<sup>129</sup>

Moreover, contrary to the suggestions of several commenters, there is no way to “fix” ARMIS data to produce meaningful rate of return calculations. There is no economically correct way to allocate the joint and common costs of the wireline networks among individual services. Any change to the way ARMIS allocates those joint and common costs would still be arbitrary. As several economists recently explained, “ARMIS costs and investments are derived from part 32 of the Uniform System of Accounts using an indirect, multi-tiered accounting process that allocates costs and investments between regulated and non-regulated services, between regulated interstate and intrastate services, and among regulated interstate services and access rate elements.”<sup>130</sup> According to these economists, “accounting profits generated from these data bear no relationship with economic profits and cannot serve any useful purpose in determining whether pricing flexibility has generated excessive rates of return.”<sup>131</sup>

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<sup>129</sup> *Special Access Rates for Price Cap Local Exchange Carriers and AT&T Petition for Rulemaking to Reform Regulation of Incumbent Local Exchange Carrier Rates for Interstate Special Access Services*, Order and Notice of Proposed Rulemaking, 20 FCC Rcd 1994, ¶ 129 (2005), citing Franklin M. Fisher & John J. McGowan, “On the Misuse of Accounting Rates of Return to Infer Monopoly Profits,” 73(1) *American Economic Review* 83, <http://econ-www.mit.edu/files/1384> (1983).

<sup>130</sup> Harold Ware, Christian Dippon and William Taylor, *NERA Economic Consulting*, “Is More Special Access Regulation Needed? Reactions to the NRRI Report on Special Access Competition,” [http://www.nera.co.uk/image/PUB\\_Special\\_Access\\_Regulation\\_03.2009\\_final.pdf](http://www.nera.co.uk/image/PUB_Special_Access_Regulation_03.2009_final.pdf), at 5 (March 4, 2009) (“*Is More Special Access Regulation Needed?*”).

<sup>131</sup> *Id.*

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No Choke Points mentions that NRRI made certain adjustments to ARMIS data to recalculate incumbent carriers' rates of return for special access services.<sup>132</sup> NRRI adjusted special access plant in service using revenue data so that the proportion of investment assigned to special access is equivalent to the proportion of total revenues obtained from that service. But as NERA's economists explained, "Mr. Bluhm and Dr. Loube make an adjustment that is as arbitrary as the ARMIS data they adjust" because "[r]evenue data are only loosely related to investment."<sup>133</sup> The fact of the matter is that "such allocations and adjustments can produce wildly different results depending on what factors are used" and that "is why economists and regulators have long rejected use of cost allocations such as those in the ARMIS data."<sup>134</sup>

**E. The Commission Should Not Use Foreign Rates or Studies as Benchmarks.**

BT's comments are devoted primarily to arguing that the Commission should follow the approach that Ofcom, the telecom regulator in the U.K., recently adopted following "a market review of what it called the 'business connectivity market' (BCMR) which includes the market for wholesale and retail leased lines."<sup>135</sup> The Commission should accord the Ofcom study no weight.

As an initial matter, it is problematic to rely on the regulatory experience of any foreign country as a blueprint for the U.S. given the many different variables that may affect such policies, including everything from competitive market conditions, past and current regulation, the political landscape, geographic differences, and differences in demand. That is particularly

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<sup>132</sup> No Choke Points Comments at 26.

<sup>133</sup> *Is More Special Access Regulation Needed?* at 6.

<sup>134</sup> *Id.*

<sup>135</sup> BT Comments at 2.

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true here where the regulatory policies at issue do not even have a track record of success, but have instead only recently been adopted. And given the U.K. experience in other telecom sectors – such as broadband – there is particular reason to be skeptical that Ofcom’s heavy-handed regulation will have the intended effect. With respect to broadband, for example, Ofcom has adopted aggressive unbundling regulation. And while the number of fully and partially unbundled fixed lines in the U.K. has grown dramatically,<sup>136</sup> the result has not translated into an increase in infrastructure available for service delivery. Broadband penetration growth in the U.K. has in fact lagged what has been a declining broadband growth rate for all of Europe.<sup>137</sup> While the U.K. has a fairly extensive cable infrastructure, which has most recently driven increase to what limited high-speed broadband access is available to consumers in the U.K.,<sup>138</sup> BT’s provision of broadband services has been sorely lagging,<sup>139</sup> and the U.K. “does not have fiber . . . to speak of.”<sup>140</sup>

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<sup>136</sup> From 2006 to 2008, the number of fully and partially unbundled fixed lines in the U.K. has grown 662%. See OfCom, International Comms Market 2008 – 5 Telecoms, at figure 5.31.

<sup>137</sup> Europe’s overall broadband penetration growth from July 2007 to July 2008 slowed from 31% to 19.7% (with the U.K. growing by only 12.5% overall for the same period). See ECTA Broadband Scorecard 3Q 2008, at: [www.ectaportal.com/en/upload/File/Broadband\\_Scorecards/Q3\\_2008/BBScQ308\\_final.xls](http://www.ectaportal.com/en/upload/File/Broadband_Scorecards/Q3_2008/BBScQ308_final.xls).

<sup>138</sup> Virgin Media, using DOCSIS 3.0 technology, is the first in the U.K. to commercially offer a next-generation access service, and within five years, it hopes to have a 50 Mbps downstream service available to 95% of its 12.5 million person market footprint. See IDATE, FTTx Watch Service, Insight No. 9 (for year-end 2008), at 3.

<sup>139</sup> With 24 Mbps presently the highest commercial DSL offer (with 3 Mbps upstream) in the U.K., Ofcom recently released a report detailing that actual broadband speeds received by consumers in the U.K. were “significantly below” the headline speeds advertised to them. On average, the speed that the consumer received was 57% of (43% less than) what they purchased. See OfCom, Broadband Speed Report,

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