



August 13, 2010

**EX PARTE**

Ms. Marlene Dortch  
Secretary  
Federal Communications Commission  
445 12<sup>th</sup> Street, S.W.  
Washington, DC 20554

Re: WC Docket No. 05-25 – *Special Access Rates for Price Cap Local Exchange Carriers*

Dear Ms. Dortch:

USTelecom submits this letter in response to the *ex parte* filing of Public Knowledge in WC Docket No. 05-25 dated July 28, 2010, regarding the appropriate analytical framework for evaluating the effectiveness of the Commission's Pricing Flexibility rules for special access.<sup>1</sup>

USTelecom and others have already filed extensive comments addressing this issue, and urging the Commission to adopt a framework that is analytically sound, administratively practical and accounts for the significant and asymmetric risks of regulatory error (including the risk that artificially slashing special access rates will undermine competition and incentives to invest in broadband if the Commission gets it wrong). As we have explained, that framework should be forward looking and focus on evaluating the scope of *all* competition – both actual and potential – in this dynamic marketplace, without qualitative judgments or rules of thumb, such as simple in or out rules when defining markets, or assumptions about potential competition – or the purported lack thereof.<sup>2</sup> In short, the Commission must collect the data and see where it leads, rather than relying on preconceived notions to exclude relevant data or to reach pre-ordained conclusions. That would be the surest way to reversal on review.

In its July 28, 2010 *ex parte*, Public Knowledge proposes the opposite approach.<sup>3</sup> In particular, Public Knowledge encourages the Commission to adopt the product market and market power analyses outlined in the recent Qwest Forbearance Order,<sup>4</sup> which divided the

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<sup>1</sup> *In the Matter of Special Access Rates for Price Cap Local Exchange Carriers*, WC Docket No. 05-25, RM-10593, DA 09-2388 (November 5, 2009).

<sup>2</sup> *In the Matter of Special Access Rates for Price Cap Local Exchange Carriers*, WC Docket No. 05-25, RM-10593, DA 10-1238 (June 30, 2010) and DA 10-1309 (July 13, 2010).

<sup>3</sup> See *ex parte* letter from Harold Feld, Legal Director, Public Knowledge, to Marlene Dortch, Secretary, FCC (July 28, 2010) (“Public Knowledge *ex parte*”).

<sup>4</sup> *Petition of Qwest Corporation for Forbearance Pursuant to 47 U.S.C. §160(c) in the Phoenix, Arizona Metropolitan Statistical Area*, WC Docket No. 09-135, Memorandum Opinion & Order (Released June 22, 2010).

marketplace based on technology and excluded from consideration a variety of wireline and wireless alternatives to ILEC special access services, and undertook a backward looking evaluation of “market power” based on standards that were designed for merger analysis in a static market. As USTelecom and others have demonstrated, such an approach ignores the dynamic changes that are occurring in this market. Most importantly, it ignores the rapidly exploding demand for ever greater bandwidth, which has fueled investment in alternative fiber and microwave facilities that compete with and replace ILECs’ lower capacity, copper and TDM-based facilities and services. The approach Public Knowledge proposes thus would rely on unrealistically narrow definitions of the market to exclude from consideration a host of actual and potential, inter- and intramodal alternatives.

Public Knowledge’s further suggestion that the Commission analyze ILEC costs to determine whether ILECs are earning a “supracompetitive” rate-of-return (which it defines, without any support, as anything over 15%) fares no better. As USTelecom and others previously have explained, the approach Public Knowledge proposes is inherently arbitrary and meaningless. Indeed, there are few propositions that are more widely accepted in the field of economics than the meaninglessness of accounting profits.<sup>5</sup> As the Commission’s chief economist previously has observed, “high profits or margins might reflect efficiencies, such as low costs or superior product design, rather than market power” and therefore antitrust authorities today do not rely on “profitability measures in making inferences about market power.”<sup>6</sup>

Moreover, as Drs. Carlton and Taylor explained at the Commission’s recent special access workshop, any attempt to calculate accounting profits for special access services would be hopelessly arbitrary because of the impossibility of accurately allocating costs of joint use facilities.<sup>7</sup> For this reason, the Commission has recognized that ARMIS data were never designed to compute service-specific returns, and has held in this very proceeding that “[h]igh or increasing rates of return calculated using regulatory cost assignments for special access services do not themselves indicate the exercise of monopoly power.”<sup>8</sup>

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<sup>5</sup> See, e.g., Franklin M. Fisher, *Economic Analysis And “Bright-Line” Tests*, J. of Competition L. & Econ., at 139 (2008) (“[t]he most important . . . misconception[] is to believe the following argument: Economic analysis shows that economic profits . . . are zero under competition. Hence . . . profitable firms must have market power. This is a fundamental misunderstanding of basic economic principles”).

<sup>6</sup> Jonathan B. Baker & Timothy F. Bresnahan, *Empirical Methods of Identifying and Measuring Market Power*, 61 Antitrust L.J. 3, 5 (1992).

<sup>7</sup> See FCC Special Access Workshop (July 19, 2010) available at [http://reboot.fcc.gov/video-archives/?utm\\_source=fcc.gov&utm\\_medium=rotator&utm\\_campaign=live-archive](http://reboot.fcc.gov/video-archives/?utm_source=fcc.gov&utm_medium=rotator&utm_campaign=live-archive). See also e.g., *In the Matter of Special Access Rates for Price Cap Local Exchange Carriers*, WC Docket No. 05-25, RM-10593, Declaration of Dennis W. Carlton and Hal S. Sider in Support of AT&T, Inc. (January 19, 2010) (*Carlton/Sider Declaration*) at pp. 31-32 and pp. 38-42; Declaration of Michael D. Topper on Behalf of Verizon and Verizon Wireless (January 19, 2010) (*Topper Declaration*) at pp. 40-43; and Declaration of Timothy J. Tardiff and Dennis L. Weisman in Support of the Comments of Qwest Communications International, Inc. (January 19, 2010) (*Tardiff/Weisman Declaration*) at pp. 16-34.

<sup>8</sup> *Special Access Rates for Price Cap Local Exchange Carriers*, Order and Notice of Proposed Rulemaking, FCC 05-18, WC Docket No. 05-25, ¶ 129 (rel. Jan. 31, 2005).

Equally important, economists have emphasized that profit measures are especially misleading in industries like special access that have high fixed and sunk costs with scale economies, in which firms must set prices well above marginal cost to recover their large fixed and sunk investments if they are to avoid bankruptcy.<sup>9</sup> The Commission has thus recognized that “price-cost margins” are particularly useless when “the industry is characterized by large fixed costs and economies of scale.”<sup>10</sup> And even prominent proponents of new regulation now concede that accounting profits are “virtually meaningless.”<sup>11</sup>

Finally, Public Knowledge suggests that the Commission should require ILECs to file enterprise service agreements to determine whether ILECs are engaging in a price squeeze. This proposed requirement is unnecessary. In fact, pricing flexibility contracts are already publically available and subject to the reasonable and nondiscriminatory pricing requirements of sections 201 and 202. Despite the scrutiny these prices have been exposed to, there has only been a single complaint while the pricing flexibility rules have been in effect, and in that case the D.C. Circuit found that there was no violation of the Act.<sup>12</sup>

Please include this letter in the record of the proceeding identified above.

Sincerely,



Glenn T. Reynolds  
Vice President – Policy

c: Sharon Gillett  
Albert Lewis  
Donald Stockdale  
Pamela Arluk  
Nicholas Alexander  
Jenny Prime  
Jonathan Baker  
Paul de Sa

<sup>9</sup> See also Alan J. Daskin & Lawrence Wu, *Observations On The Multiple Dimensions Of Market Power*, 19 Antitrust ABA 53, 55 (2005) (“although the firm *could* set the price equal to marginal cost, it would lose money by doing so”).

<sup>10</sup> Second Report, *Second Annual Report and Analysis of Competitive Market Conditions with Respect to Domestic and International Satellite Communications Services*, 23 FCC Rcd. 15170, ¶ 80 (2008). See also *id.* ¶ 81 (“It is reasonable to expect, therefore, that substantial markups over the marginal cost of production will be observed in the industry.”); see also Baumol & Swanson, *The New Economy and Ubiquitous Competitive Price Discrimination: Identifying Defensible Criteria of Market Power*, 70 Antitrust L.J. 661, 682 (2003) (imposing a “price-equals-marginal-cost standard” on industries with the large scale economies as “tantamount to a requirement that every firm with scale economies, no matter how competitive the market, commit hara-kiri in order for its prices to be deemed ‘competitive’”); Daskin & Wu, *Observations On The Multiple Dimensions of Market Power*, 19 Antitrust ABA 53, 55 (2005).

<sup>11</sup> See National Regulatory Research Institute, *Competitive Issues in Special Access Markets*, at 74 (January 21, 2009) (“NRRI Report”) (“the RBOCs contend that the ARMIS figures are virtually meaningless. We agree with the RBOCs”).

<sup>12</sup> *BellSouth Telecommunications, Inc. v. F.C.C.*, 469 F.3d 1052 (D.C. Cir. 2006).