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EX PARTE

June 27, 2012

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

Re: Special Access NPRM, WC Docket No. 05-25 and RM-10593

Dear Ms. Dortch:

In response to ex partes filed in this docket by Level 3 and others,[1] AT&T, Verizon and CenturyLink[2] (the "price-cap LECs"), have filed at least ten *(and likely more by the time this*

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[1] Letter from Michael Mooney, General Counsel Regulatory Policy, Level 3, to Marlene H. Dortch, Secretary, FCC, WC Docket No. 05-25 (filed Feb. 22, 2012) ("February Level 3 Letter"); Letter from Michael Mooney, General Counsel Regulatory Policy, Level 3, to Marlene H. Dortch, Secretary, FCC, WC Docket No. 05-25 (filed June 8, 2012) ("June Level 3 Letter"); *see also* Letter from Sarah De Young, Executive Director, CALTEL to Marlene H. Dortch, Secretary, FCC, WC Docket No. 05-25 (filed Feb. 9, 2012) ("CALTEL Letter"); and Letter from Thomas Jones, Willkie Farr and Gallagher, counsel to twtc, to Ms. Marlene H. Dortch, Secretary, FCC, WC Docket No. 05-25 (filed Feb. 27, 2012) ("twtc Letter").

letter is filed) separate letters in an effort to convince the Commission that "no additional [special access] regulation is necessary."[3] Their trade association, USTelecom, has also filed ex partes seeking to make the same point.[4] Level 3's main contention in this docket has been that the price-cap LECs' use of anticompetitive demand lock-up arrangements should be restricted. The price-cap LECs are obviously adamant about retaining the right to use such arrangements as they uniformly do today.

With the exception of a single novel substantive argument, none of the ten+ new filings by the price-cap LECs and their trade association does anything more than re-hash the arguments they have previously made.[5] The lone new substantive argument advanced is that because (they

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[2] *See* Letter from Donna Epps, Vice President, Federal Regulatory Affairs, Verizon, to Marlene H. Dortch, Secretary, FCC, WC Docket No. 05-25 (filed Mar. 27, 2012) ("March Verizon Letter"); Letter from Donna Epps, Vice President, Federal Regulatory Affairs, Verizon, to Marlene H. Dortch, Secretary, FCC, WC Docket No. 05-25 (filed Apr. 25, 2012) ("April Verizon Letter "); Letter from Donna Epps, Vice President, Federal Regulatory Affairs, Verizon, to Marlene H. Dortch, Secretary, FCC, WC Docket No. 05-25 (filed May 2, 2012) ("May Verizon Letter"); Letter from Donna Epps, Vice President, Federal Regulatory Affairs, Verizon, to Marlene H. Dortch, Secretary, FCC, WC Docket No. 05-25 (filed June 12, 2012) ("June Verizon Letter"); Letter from David Lawson, Sidley and Austin, counsel to AT&T, to Marlene H. Dortch, Secretary, FCC, WC Docket No. 05-25 (filed Mar. 28, 2012) ("March AT&T Letter 1"); Letter from David Lawson, Sidley and Austin, counsel to AT&T, to Marlene H. Dortch, Secretary, FCC, WC Docket No. 05-25 (filed Mar. 28, 2012) ("March AT&T Letter 2"); Letter from Linda Vandeloop, Directory of Federal Regulatory, AT&T, to Marlene H. Dortch, Secretary, FCC, WC Docket No. 05-25 (filed Apr. 27, 2012) ("April AT&T Letter"); Letter from Frank S. Simone, Assistant Vice President, Federal Regulatory, AT&T, to Marlene H. Dortch, Secretary, FCC, WC Docket No. 05-25 (filed June 6, 2012) ("June AT&T Letter"); Letter from Mellissa Newman, Vice President, Federal Regulatory Affairs, CenturyLink, to Marlene H. Dortch, Secretary, FCC, WC Docket No. 05-25 (filed Apr. 20, 2012) ("CenturyLink Letter"); Letter from Maggie McCready, Vice President, Federal Regulatory Affairs, Verizon, to Marlene H. Dortch, Secretary, FCC, WC Docket No. 05-25 (filed June 6, 2012) ("June Verizon Letter"); Letter from Frank Simone, Assistant Vice President, Federal Regulatory, AT&T to Marlene H. Dortch, Secretary, FCC, WC Docket No. 05-25 (filed June 6, 2012) ("June AT&T Letter").

[3] *See* Matthew S. Schwartz, "Verizon Reverses Course, Withdraws Petition to Raise Special Access Rates," Communications Daily, (May 15, 2012).

[4] *See* Letter from Glenn T. Reynolds, USTelecom, to Marlene Dortch, Secretary, FCC, WC Docket No. 05-25 (filed June 11, 2012);) Letter from Glenn T. Reynolds, USTelecom, to Marlene Dortch, Secretary, FCC, WC Docket No. 05-25 (filed June 14, 2012) ("USTelecom Letters").

[5] The price cap LECs have also raised a new procedural argument, prompted by the reported circulation of an order that would freeze any further grant of pricing flexibility, claiming that it would be procedurally improper to issue such an order because it would "prejudge the outcome of the Commission's ongoing analysis of the marketplace before the Commission has collected the competitive data it needs to complete its review." June Verizon letter at 1; *see* USTelecom Letters (complaining of "rush to judgment" by the Commission).

claim) the special access market is shrinking in light of the growth of Ethernet, the Commission should just ignore it. For instance, AT&T opines that lock-up arrangements in the special access market should be permitted because customers are "switching en-masse" to Ethernet services[6] — both Verizon and CenturyLink make parallel claims.[7] There are several glaring problems with this new price-cap LEC view:

First, it is a wild exaggeration to suggest that Ethernet services will replace TDM-based special access services anytime soon. Special access services are required by nearly every business that needs to move data between multiple locations around the nation. This is why the existing special access market is a multi-billion dollar market, and it will continue to be a multi-billion dollar market for many, many years to come. As recently as May 29, 2012, Sprint, which as a large CMRS carrier, may be better positioned than most special access buyers to switch to Ethernet, filed an ex parte stating:

> . . . despite claims to the contrary, special access circuits remain a vitally important market. Sprint alone has hundreds of thousands of special access circuits deployed in its network today and expects to purchase tens of thousands of additional circuits in 2012. Special access is an $18 billion market and has

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Yet, when the Commission established the pricing flexibility rules in 1999, it had before it far less data about competitive conditions in the marketplace than it has today. The price cap LECs did not assert when the Commission established rules for pricing flexibility in 1999, that the Commission lacked sufficient data to establish such rules. The Commission has recognized in establishing this proceeding that it has a responsibility to "re-examine periodically rules that were adopted on the basis of predictive judgments to evaluate whether those judgments are, in fact, corroborated by marketplace developments." *Order and Notice of Proposed Rulemaking*, Docket 05-25, 20 FCC Rcd 1994, 1996-97 ¶ 5 (2005). Having collected much more comprehensive data over the past seven and a half years than it had before it in 1999, the Commission is certainly in a position to suspend those rules, even if it chooses to seek still more data in an effort to arrive at what it believes is a more perfect long-term resolution. Any action by the Commission to suspend the pricing flexibility rules after a more than seven year proceeding in which there have been well over 1000 docket entries should not be described (as USTelecom does) as a "rush to judgment." On June 25, the Commission allowed the pending petitions to become effective because they met the criteria in effect at the time they were filed, however, it would be appropriate for the Commission to state going forward that it is suspending the flawed price flexibility rules, and that no new petitions can be filed under these rules.

6 March AT&T Letter 1. Tangentially, AT&T claims that for some reason, lock-up arrangements in the special access market would be inconsistent with the amount of investment competitors are making in markets that are not locked up. *See* March AT&T Letter 1 at 5. This simply makes no sense at all. If locked out of one market, why would competitors not invest in markets where their hands were not tied?

7 *See* June Verizon Letter at 5; CenturyLink Letter at 4.

> generated triple-digit rates of return for the RBOCs at a time when most American companies are struggling.[8]

This is precisely why the price-cap LECs, through at least ten ex parte filings in roughly three months, are working so hard at avoiding any reforms to it at all. Verizon has gone so far as to, on May 15, 2012, withdraw a special access price increase (in the face of numerous objections to it) "in order to focus [its] resources on the broader issues in the special access rule making proceeding" to demonstrate that "no additional regulations are necessary."[9] Simply put, if this market is shrinking and becoming irrelevant to the degree the price-cap LECs appear to claim, then why are they fighting so hard and devoting so many resources to their relentless efforts to retain the right to monopolize it?[10]

Second, assuming for a moment that it is factually true that the special access market is getting smaller, that would be irrelevant. For example, if the market was $20 billion a year ago, is $18 billion today, and will be $16 billion a year from now, would that somehow legitimize anti-competitive conduct in the market that remains or make it unnecessary or inadvisable for the Commission to take steps to prevent future anti-competitive conduct? The answer to these questions is clearly no.

Third, there is evidence in the record that at least AT&T is attempting to leverage its existing market power in the special access market to extract commitments in the Ethernet market.[11] This would not be possible if the price-cap LECs' stranglehold on the special access

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8 Letter from Charles McKee, Vice President, Government Affairs, Sprint, to Ms. Marlene H. Dortch, Secretary, FCC, WC Docket No. 05-25, WT Docket No. 02-55 (filed May 29, 2012) at 2.

9 Matthew S. Schwartz, "Verizon Reverses Course, Withdraws petition to Raise Special Access Rates, Communications Daily," (May 15, 2012).

10 In a recent blog discussing FCC regulation of special access, Bob Quinn, AT&T Senior Vice President-Federal Regulatory, suggested that the only obstacle to transition from TDM to IP was "subsidies" to the "TDM/POTS infrastructure." http://attpublicpolicy.com/broadband-policy/repealing-de-regulation-how-not-to-build-a-roadmap-towards-an-all-ip-world/. If Mr. Quinn was suggesting that AT&T's TDM special access customers are receiving subsidies, that is completely contradicted by a mountain of evidence that AT&T and the other price cap LECs are earning enormous rates of return on special access. If, on the other hand, Mr. Quinn was suggesting that AT&T is receiving subsidy in its prices for its sales of special access, Level 3 is in full agreement, and suggests that the elimination of lock-up contracts will allow competitors to compete away the subsidy received by price cap LECs on their sales of special access.

11 *See generally,* CALTEL Letter. AT&T responds to this by pointing to an Affidavit by a T-Mobile SVP, filed in an effort to gain approval of the failed T-Mobile/AT&T merger. This affidavit does not deny that AT&T attempted to use special access termination liability waivers to secure Ethernet business, and in fact, implies that AT&T did make such effort (but that T-Mobile did not base its decisions on those efforts alone). "CALTEL claims that T-Mobile's 'only rational economic choice T-Mobile could make was to deal with the devil—and lock itself into Ethernet contracts with AT&T' due to early-cancellation penalties and minimum-volume

market were broken. Further, as TW Telecom ("twtc") recently noted, "ILECs control the only facility serving the vast majority of commercial locations in the United States . . . [and] as Ethernet is more widely deployed, the ILECs will almost certainly exploit their control over transmission facilities to dominate the Ethernet market just as they have the DSn market."[12]

Fourth, AT&T has greatly overstated the level of competition in the Ethernet market, asserting that in a supposed national market, "No provider has > 24% market share."[13] There is, of course, no national market for Ethernet services. A customer needing circuits in St. Louis, MO can buy from AT&T, but not from Verizon, CenturyLink or competitive suppliers not serving the St. Louis area. The relevant question is what AT&T's market share is within its own region, not what is its market share is in a non-existent national market.

Finally, even if the Ethernet market were competitive, the price cap LECs have made no showing that it is an adequate substitute for all or even most customers of TDM special access (or even that it is available to all customers of TDM special access). In fact, many commenters have said they have no plans to "mass migrate" TDM circuits to Ethernet.[14]

In addition to the above position, while not made in an ex parte, AT&T has made recent public comments that "[t]he Commission's policies should be looking to move us forward to an all-IP, fiber-based world and getting companies like Level 3 off the sidelines and investing in building out fiber to the 100,000 buildings within 500 feet of its fiber network."[15]

Level 3 agrees with AT&T that the Commission should adopt policies that encourage fiber network construction, which is the whole point of Level 3's effort to eliminate unlawful demand lock up arrangements. Level 3 would construct fiber to many more buildings that are near its network, if AT&T's (and the other price cap LECs') lock up arrangements did not hinder it from doing so. Level 3 is forced to sit out more often than it would like not because it wants to, but because if it did incur the expense to build to these buildings, its prospective, large customers would be unable to buy more than a fraction of their demand from Level 3 as they are already locked in to buying from AT&T and the other price cap LECs instead. The Commission

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commitments in existing AT&T contracts (CALTEL Additional Comments at 10), but T-Mobile never based its decision of backhaul provider on such limited criteria." Mayo declaration at 10, underline added. That AT&T's efforts were only part of the reason why T-Mobile purchased Ethernet from AT&T does not justify them.

12 Letter from Thomas Jones, Willkie Farr & Gallagher, counsel for twtc, to Ms. Marlene H. Dortch, Secretary, Federal Communications Commission, WC Docket No. 05-25, RM 10593, (filed. June 5, 2012) at 14.

13 AT&T April Letter, Attachment, p. 6.

14 *See* Letter from Colleen Boothby, counsel for the Ad hoc Telecommunications Users Committee, to Ms. Marlene H. Dortch, Secretary, FCC, WC Docket No. 05-25, RM 10593, (filed. Jun 15, 2012), at 4-5, noting six carriers with no plans to make wholesale shifts from TDM circuits to Ethernet.

15 *See* Matthew S. Schwartz, "Level 3 Criticizes Price Cap Lec's Market Power, 'Unreasonable' Lock Up Contracts," Communications Daily, (June 4, 2012).

itself has rightly concluded that "carriers generally are unwilling to invest in deploying their own loops unless they have a long-term retail contract that will generate sufficient revenues to allow them to recover the cost of their investment."[16] Consistent with the ultimate goals of the Communications Act, Commission action should be aimed at fostering the growth of facilities-based competition so that competition, rather than regulation, ensures that special access rates, terms and conditions are reasonable. The Commission should immediately abolish price-cap LEC behavior that eliminates potential demand for competitively supplied special access in large portions of the market because that behavior impedes investment in and deployment of facilities-based competitive networks. AT&T and the other price cap LECs could certainly help Level 3 get off the sidelines by agreeing to eliminate their use of demand lock-up arrangements. Until they do so or the Commission requires them to do so, Level 3 is stuck on the bench far more often than it would like.

In the end, the facts in this docket speak for themselves: AT&T, Verizon and CenturyLink cannot run away from their long-term super-dominant shares of the special access market,[17] their supra-competitive returns on special access service investments for sustained periods of time,[18] and the fact that their shares of the market are remarkably close to the "lock-up" commitments they extract (85-100%). Sprint filed an ex parte as recently as April 24, 2012 (in opposition to the Verizon Wireless/SpectrumCo transaction) in which it said that approximately 90% of its existing TDM DS-1s are still provided by ILECs.[19] And, as Level 3 has previously noted, it continues to buy the vast majority of its DS-1's from the price-cap LECs.[20] It is hard to believe that these figures, when compared to the lock-up percentages contained in the price-cap LECs' lock-up arrangements, are a coincidence.[21]

Common to each of the price-cap LECs' recent filings are claims that lock-up plans are designed to give customers more "choice."[22] The underlying assumption implicitly advanced by these arguments is that the price-cap LECs' customers are happy with the options afforded them—but the record in this proceeding belies that completely. The fact is that the price-cap LECs' largest special access customers have submitted multiple filings in this docket expressing ***extreme dissatisfaction*** with the prices, terms and conditions offered by the price-cap LECs for special access services. These include filings by, and in many cases, multiple filings, by each of Sprint Nextel Corp., T-Mobile USA, Inc., US Cellular, the Ad Hoc Telecommunications Users

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16 *SBC Communications Inc. and AT&T Corp. Applications for Approval of Transfer of Control*, WC Docket No. 05-65, Memorandum Opinion and Order, 20 F.C.C.R. 18290 (2005) ("*SBC/AT&T Merger Order*") at ¶ 39.

17 *See* June Level 3 Letter at 26-32.

18 February Level 3 Letter at 5; June Level 3 Letter at 26-32.

19 Letter from David H. Pawlik, Skadden Arps, counsel to Sprint Nextel Corp. to Marlene H. Dortch, Secretary, FCC, WT Docket No. 12-4 (April 24, 2012).

20 *See* June Level 3 Ex Parte.

21 June Level 3 Letter at 2.

22 March Verizon Letter at 3-6; March AT&T Letter at 1-2.

Group, BT Americas, Inc., Global Crossing, PAETEC Communications, TelePacific Communications, New Edge Networks, Inc., TDS Metrocom, Integra Telecom, One Communications, twtc, Cbeyond, Inc., Deltacom, Inc., Clearwire, CALTEL, Comptel and XO Communications.[23] If, as the price-cap LECs say, lock-up plans are a means of providing customers choices that they want, they are miserable failures. The truth is that they do not provide customers choices that they want. They are a means of eliminating competition.

In response to certain of each of the price-cap LECs' specific allegations, Level 3 offers the following:

Verizon

Verizon uses an analogy to a health club in an effort to convince the Commission that its lock-up plans are perfectly normal.[24] Consider this:

> Suppose a family of 5 joined a health club to get the family discount, and the next year, one of their daughters went to college. Could the family get the discount offered by the health club that is available to 4-person families? Sure.
>
> Could the same family, now composed of 4 instead of 5 members needing club access (80% of the prior number) get the discount available to other 4-member families at "Club Verizon?" No. To get Verizon's "volume" discount, the family would have to commit to at least 85% of the volume it had with Verizon previously, so it would be out of luck--no discount. This is so even though a discount would be available from Verizon to another 4-member family (as long as it had previously been purchasing service for 4 (instead of 5). Verizon's approach is not perfectly normal.

Verizon's initial responsive ex parte actually admits what Level 3 has said all along—that its lock-up plans are targeted at locking-up large customers in the special access market. To this end, Verizon admits that its "term only" plans, which contain no lock-up requirement, are targeted at Verizon's smaller special access buyers.[25] This makes sense, as few large special access buyers would commit to buying large quantities of circuits for 10 year terms[26] (to get the best discount) without any flexibility to move circuits as its or its customer's needs change. Rather, Verizon's large special access buyers generally sign up for "volume and term" plans, which, in Verizon's words "are designed for customers who purchase multiple special access circuits from Verizon."[27] When large buyers sign up to such volume and term plans with Verizon, they agree to a lock-up of either 85% (under Verizon's National Discount Plan

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23 *See* June Level 3 Letter at 26.

24 March Verizon Letter at 2.

25 *Id*. at 3.

26 *Id*. at 4.

27 *Id*. at 6.

"Standard")[28] or 90% (under Verizon's National Discount Plan "Premier" or its Commitment Discount Plan)[29] of their existing special access spend with Verizon. Verizon's lock-up plans target its large buyers of special access services, who, in order to get the necessary flexibility to move 10 or 15% of their circuits without paying early termination penalties, commit not to move more than that 10 or 15% of their circuits away from Verizon. When the vast majority of large buyers of special access are committed in this way, and therefore cannot buy more than an insubstantial amount of service from competitive providers, effective competition will not emerge, as there is inadequate demand for competitors to enter on any sort of viable scale or scale that will constrain the incumbents' ability to exercise monopoly power.

Verizon claims its volume and term plans "reflect increased discounts for buying larger volumes of services"[30] from Verizon, but this is only half accurate. While Verizon's discounts do indeed increase the more a customer buys[31] (allowing Verizon to argue that these are simply "volume discounts") customers can't get the discounts for merely achieving the stated volume levels. Rather, customers must achieve the stated volume **AND** they must lock in the stated percentage of their special access volume—either 85 or 90%—with Verizon. Accordingly, all customers under these plans must ***first*** agree to lock-up 85 or 90% of whatever they spend with Verizon on special access, ***then*** those whose locked-up demand is the largest get the largest discounts because they happen to spend more. As Level 3 stated in its February Letter:

> For example, Verizon's Commitment Discount Plan (CDP) requires the customer to commit 90% of all the channel terminations that are in-service at the time of subscription to CDP. Verizon has stated to the FCC that "[u]nder Verizon's CDP, a customer who purchases just 14 DS1 channel terminations from Verizon can receive the same level of discounts as larger volume customers who subscribe to the CDP for the same term of years." What Verizon fails to tell the FCC is that while the customer previously purchasing 14 DS1s can get a discount for purchasing 14 DS1s, the customer previously purchasing 16 DS1s (or 100 or 1000 DS1s) cannot get a discount for purchasing 14 DS1s. The discount, therefore, is not a volume discount, but, rather, a "loyalty" discount in which the customer is rewarded for buying little or nothing from competitors.[32]

Verizon also offers another excuse for the lock-up features of its CDP, claiming that it developed the CDP "to make circuit management easier" and that to "allow customers to enroll only some of their volumes would detract from that benefit."[33] This argument is a red herring. If Verizon did not lock-up all of a customer's demand with this requirement, nothing would stop a customer from buying only from Verizon if the customer found that made "circuit management easier." The lock-up is clearly for Verizon's benefit, not the customer's. If in fact Verizon's

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[28] Verizon FCC Tariff No. 1, Section 25.3.4(C)(ii)(2).

[29] Verizon FCC Tariff No. 1, Section 25.3.4(C)(ii)(1) and 25.1.3(A)(5).

[30] March Verizon Letter at 7.

[31] Verizon FCC Tariff No. 1, Section 25.3.5.

[32] February Level 3 Letter at 10.

[33] June Verizon Letter at 3.

large customers were appreciative of the ease in management of circuits that this type of lock-up provides, one would not expect to have seen the flood of complaints in this docket from the price-cap LEC's large customers. The Commission may want to poll Verizon's customers to see if they truly appreciate Verizon's supposed consideration of their circuit management or if, as Level 3 and others have asserted, the lock-ups create an administrative nightmare in ensuring that take-or -pay minimums are met and that circuits do not go off contract, causing costs to skyrocket.[34]

Verizon claims that Customers can "freely switch" between plans when they expire,[35] but this claim is illogical given what Verizon says elsewhere in its filings. As plans expire, small buyers will still be small buyers and large buyers will still be large buyers. Large buyers will still need the "flexibility" Verizon uses to target its lock-up plans at them (see page 2 above). Thus, while large buyers requiring flexibility may have the theoretical flexibility to "switch" to an inflexible "term-only" plan, they won't as a practical matter. Verizon may also claim that a large buyer is free to choose between its different lock-up plans, but the lock-up commitment is 85% in one plan, and 90% in the other two—not a highly motivating differential.

Verizon's claim that its volume and term plans do not cover widely dispersed geographic areas fares no better. Verizon claims that it allows customers to choose one sort of plan, say a

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34 The Commission may also wish to follow up on Verizon's assertion that its 81contract tariffs are each available to all "similarly situated" customers. June Verizon Letter at 4. To test this assertion, the Commission could ask, for each of the 81 contracts, what other customers were eligible to purchase under the contract during the brief time window when it was open. It also could ask Verizon to explain the legitimate business reason underlying each of the eligibility conditions. For example, Verizon Contract Option 10, Verizon FCC Tariff No. 1, § 21.11, provides a discount to any purchaser that signed up between May 27, 2004 and July 26, 2004, and that purchases between $49,000,000 and $56,000,000 of special access during the one-year term, buys Switched Access DS1 and DS3 Direct Trunked transport in an amount between $350,000 and $2,000,000, and does not concurrently subscribe to another Verizon discount plan at the time it enters into the contract tariff or during the term of the contract tariff. The Commission could ask Verizon to explain what business reason motivated Verizon to exclude from eligibility, for example, customers that currently buy DS1 and DS3 Direct Trunked transport in an amount of $2,000,005 (as well as the rational for the other eligibility criteria). This example also highlights a concern that Level 3 has with the phrasing of the Commission's second round of data requests. Note that this particular tariff limits eligibility to those that previously purchased between $49,000,000 and $56,000,000 of special access during the one-year term preceding entry into the contract tariff. On its face, it does not tailor the limit to a percentage of a particular customer's prior purchases, but in reality, the contract tariff was meant for a single customer, for which this amount was undoubtedly in the 80-100% range. Level 3 is concerned that price cap LECs may have interpreted the second data request to exclude this type of purchase from its prior purchase based discount inquiries, and suggests that the question be appropriately reworded.

35 March Verizon Letter at 9.

lock-up plan, in the "Verizon East" territory and a no-lock-up "term plan" in "Verizon West."[36] Assuming for the sake of argument that a customer would do that, the lock-up plan in Verizon East would cover the following, which Verizon apparently considers something other than a "widely dispersed geography:" New York, Connecticut, Massachusetts, Rhode Island, the District of Columbia, Maryland, New Jersey, Pennsylvania, Virginia and West Virginia.[37] Clearly, this lock- up arrangement in Verizon East would cover a wide and dispersed geography.

Verizon claims that term commitments provide "predictability and certainty"[38] and "the commitments associated with term based plans increase the likelihood [that provisioning and material costs] will be covered."[39] Verizon cannot credibly claim that it is having trouble recovering its costs when the record in this proceeding so overwhelmingly establishes that it, along with the other price-cap LECs, earn supra-competitive returns on special access investments (see page 2 above). Verizon's allowance of portability is also inconsistent with its alleged desire for predictability, and finally, almost every successful, competitive business in America manages to achieve certainty and predictability without using anticompetitive lock-up arrangements that are based on a customer's prior purchase volume. In the end, the only thing "predictable" here is that Verizon's large special access customers will not be allowed to buy much of their special access needs from a Verizon competitor.

Verizon claims (several times) that its plans only lock-up its customers' purchases with Verizon, and that the plans do not commit a customer's "total" special access purchases to Verizon.[40] Level 3 agrees, and did not intend to say otherwise. The problem is, AT&T does the same thing, as does CenturyLink, and collectively, they cover the waterfront given their individual and collective ubiquity. Further, if this analysis is limited to Verizon's territories standing alone, it would seem to suggest that Verizon's large customers already buy special access service from other suppliers in Verizon's region when they agree to a Verizon lock-up plan. If a customer does not already buy significant amounts of special access from other suppliers when it signs up for a Verizon "volume and term plan," the accompanying lock-up arrangement will prevent it from beginning to do so thereafter.

Finally, Verizon claims that the relief that Level 3 and others seek will only result in fewer options being made available to special access customers and that Level 3's sought-after restrictions will wreak havoc on the special access marketplace.[41] These claims couldn't be further from the truth. If the measures Level 3 proposes were adopted and instituted, competitors would be able to compete fully with the incumbents and as a result, customers would benefit from more choices and lower prices (both from incumbents and from competitors) without draconian lock-up provisions. As things stand now, the price cap LECs have little incentive to

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36 *Id*. at 11.

37 *See* http://www22.verizon.com/wholesale/glossary/?l=v.

38 March Verizon Letter at 1.

39 *Id*. at 7.

40 *Id*. at 2.

41 March Verizon Letter at 12.

offer any pricing plan that is attractive to large customers other than ones that come with lock-ups. Competition will force price cap LECs to offer innovative pricing plans that meet their large customers' actual needs.

AT&T

AT&T claims that "[t]he record in this proceeding overwhelmingly establishes that the special access volume and term discounts offered by ILECs are pro-competitive responses to competition that benefit both providers and consumers."[42] For this proposition, AT&T cites to four comments filed by AT&T itself, and two filed by Verizon.[43] This is hardly compelling. In fact, the record actually overwhelmingly demonstrates monopolistic market shares by the price-cap LECs, supra-competitive returns on special access investment earned by the price-cap LECs for sustained periods of time, and complaints about their contracting practices from a broad swath of the price-cap LECs' larger special access customers. These facts and opinions come from Level 3's own advocacy, but also from over a dozen unhappy customers of the price-cap LECs (see above at p 2), coalitions representing hundreds of customers of the price-cap LECs,[44] the Commission,[45] Commission economists,[46] the United States Department of Justice,[47] the United Stated General Accountability Office,[48] the National Regulatory Research Institute,[49] and others.

AT&T also states that the Commission itself has recognized that both volume and term commitments are generally legitimate means of pricing special access facilities.[50] Level 3 agrees. The trouble for AT&T is that its lock-up arrangements are not volume and term

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42 March AT&T Letter 2 at 1-2.

43 *Id*. at fn. 3.

44 COMPTEL is a trade association which alone represents nearly 100 companies.

45 *Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers*, CC Docket No. 01-338, Report and Order and Order on Remand and Further Notice of Proposed Rulemaking, 18 Commission Rcd. 16978, 17155, n.856 (2003).

46 Uri and Zimmerman, Market Power and the Deregulation of Special Access Service by the Federal Communications Commission, 13 Information & Telecommunications Technology Law No. 2 at 129 (2004).

47 PRICE-CAP LEC Merger Complaints, ¶ 15, 20.

48 *See e.g.*, United States Government Accountability Office, Report to the Chairman, Committee on Government Reform, House of Representatives, Telecommunications: FCC Needs to Improve its Ability to Monitor and Determine the Extent of Competition in Dedicated Access Services, GAO-07-80 (2006), *available at* http://www.gao.gov/new.items/d0780.pdf.

49 *See* Peter Bluhm with Dr. Robert Loube, National Regulatory Research Institute, *Competitive Issues in Special Access Markets – Revised Edition*, No. 09-02 (First Issued Jan. 21, 2009), *available at* http://nrri.org/pubs/telecommunications/NRRI_spcl_access_mkts_jan09-02.pdf.

50 March AT&T Letter 2 at 2.

commitments. A volume commitment would be available to any customer that commits to the specified volume of circuits. AT&T's discounts are available only to customers that previously purchased that number of circuits, or a small percentage above the current commitment. In other words, an AT&T discount for buying 1000 circuits is not available to a customer that previously purchased 1500 circuits. These are not "volume" plans. AT&T also often ties its lock-up terms to portability rights which, as discussed at page 3 above, AT&T knows its large customers will find essential. Take, for example, AT&T's SBC tariff No. 73, which AT&T discusses in the March AT&T Letter 2 at page 5. To get a discount, a customer must make a "term" commitment, with the greatest discount being tied to the longest term. While AT&T says these services can be "moved" without making a commitment, this is false. Without making a lock-up commitment, a customer can: 1) move ***one end*** of the circuit; 2) to another location within the same LATA only; and 3) it must have satisfied the "minimum term commitment" on the circuit before doing so.[51] In reality, the only way a customer ***really*** gets the ability to move circuits with AT&T—meaning cancelling the circuit and replacing it with a new one—is to agree to lock-up 100% of its existing circuits with AT&T, which then gives the customer the flexibility to terminate 20% of them without termination liability.[52] The result of this is a lock-up of 80%. Under this plan, if more than 20% of circuits are terminated, a penalty applies,[53] and, strangely, if circuits totaling more than 124% of the commitment are purchased, a penalty also applies (unless the customer increases its commitment to make the "overage" less than 24%).[54] The latter is an example of how AT&T extracts greater commitments from its customers by waiving "overage" penalties (which are bizarre in the first place) but only if customers agree to "ratchet-up" their commitments to AT&T to higher levels, thereby impeding their future flexibility to move circuits to an AT&T competitor. In any event, the point here is that AT&T's lock-up plans <u>are not</u> volume and term commitments, and its reliance on the Commission's endorsement of such plans is entirely misplaced.

AT&T cites to a recent deal done with a major wireline and wireless carrier containing a lock-up of only 50%.[55] This argument (while buried in a footnote) is remarkable, as it is precisely what Level 3 is seeking in its advocacy—a rule saying that the price-cap LECs cannot link discounts or other terms and conditions to a lock-up of more than 50%.[56] If AT&T could agree to such terms with this one carrier and hold such terms out as being reasonable, why is it so resistant to rules forbidding more onerous agreements with the industry as a whole? Reducing the lock-up percentages to 50% across the board (as AT&T apparently did with this customer) would provide the entire industry the flexibility it needs to sell to, and buy from one another for half of their volume, and that would unleash the competitive forces that the industry (and, based

[51] SCB Tariff No. 73, Section 7.2.22(C).

[52] SCB Tariff No. 73, Section 7.2.22 (E). We note also that neither "handset discounts" nor discounts for buying "buckets of minutes" (see March AT&T Letter 2, fn 5) are dependent on the customer's prior purchase levels.

[53] *Id*. at 7.2.22(E)(4)(b).

[54] *Id*. at 7.2.22(E)(c) and (d).

[55] March AT&T Letter 2 at fn 10.

[56] February Level 3 Letter at 28-29.

on the FCC's use of the term "predictive judgment," the FCC itself) have been waiting on for over a decade.

AT&T also quibbles with Level 3's characterization of the 2007 dispute between itself and Broadwing, claiming that Broadwing was trying to "force AT&T to renew a contract that expired."[57] What Broadwing was actually doing was trying to enforce a merger condition to which AT&T had voluntarily agreed. AT&T was violating the merger condition by trying to increase rates associated with the agreement, which was prohibited by the merger conditions. In any event, why the outcome happened is less important than what happened. By availing itself of the contract tariff AT&T filed after the applicable complaint was dismissed, Level 3 obtained more flexibility to move circuits off of AT&T's network than it has with Verizon or Qwest (though Level 3 is still in a commitment to AT&T large enough that it restricts Level 3's ability to freely purchase from AT&T's competitors everywhere it wants to do so). Unfortunately, while Level 3 has bettered its position in its role as a *customer* of AT&T, it fares no better as a *competitor* of AT&T. This is because prospective purchasers from Level 3 continue to be saddled with restrictive lock-ups that preclude them from buying much of their needs in AT&T territory from any entity other than AT&T. For the same reasons, the competitive process in the AT&T territory continues to suffer significant harm by reason of AT&T's lock-up contracts.

AT&T asserts that Level 3's proposed "remedies" would be "unlawful," and that "on the current record, the Commission would thus have no basis for the intrusive remedies Level 3 proposes. . . ."[58] Both allegations are wrong.

First, the data available in this proceeding provide a complete and adequate record on which the Commission can and should easily conclude that the price-cap LECs' retention of their dominant positions in the special access market through the use of unjust, unreasonable and anticompetitive lock-up arrangements make such practices unlawful under Section 201(b) of the Act.[59] The price-cap LECs' market power in the special access market lends further credence to those conclusions.

Second, contrary to AT&T's contentions, the Commission has the clear ability to impose the remedies suggested by Level 3. In evaluating exclusivity clauses in the cable industry in 2007, for example, the Commission "***prohibit[ed] the enforcement of existing exclusivity clauses and the execution of new ones*** [emphasis added]" by cable operators who were subject to Commission rules making it "unlawful for cable operators to engage in certain unfair acts and methods of competition."[60] In that proceeding, Comcast argued that other rules requiring an adjudicatory proceeding limited the Commission's ability to prohibit specified conduct, but the

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57 March AT&T Letter 2 at 5.

58 *Id*. at 7-8.

59 June Level 3 Letter at 16-33.

60 *Exclusive Service Contracts for provision of Video Services in Multiple Dwelling Units and Other Real Estate Developments*, Report and Order and Further Notice of Proposed Rulemaking, MB Docket 07-51, (Oct. 31, 2007), at ¶¶ 37, 4 ("*Exclusive Service Contracts Order*").

Commission rejected that argument.[61] In doing so, the Commission noted that the statutory provisions at issue granted the Commission rulemaking authority to specify conduct that was prohibited, and therefore, an adjudicative process was not a prerequisite to doing so.[62]

Likewise here, Section 201(b) of the Act specifies that "any . . . practice . . . that is unjust or unreasonable is hereby declared unlawful," and Section 201(b) further specifically provides that "the Commission may prescribe such rules and regulations as may be necessary in the public interest to carry out the provisions of this Act."[63] Section 403 of the Act also provides that "[t[he Commission shall have full authority and power to at any time institute an inquiry, on its own motion . . . relating to the enforcement of any provisions of this Act."[64]

Under the plain language of the Act, the Commission has full authority to institute an inquiry into the "justness" and/or "reasonableness" of the price-cap LECs' lock-up practices, and if the Commission finds them unreasonable, the Act itself declares them unlawful. Section 201(b) further expressly authorizes the Commission, without any requirement of a prior adjudicative process, to issue rules prohibiting such practices. Exactly as it did in the *Exclusive Service Contracts Order*,[65] the Commission has the authority to prohibit the enforcement of lock-up contracts by the price-cap LECs as they currently exist.

CenturyLink

After many pages opining on why the CLECs' allegations in this docket are wrong, CenturyLink announces that it is working on an "Innovative New Plan" for special access services which appears to: 1) have no "lock-up" requirement; 2) have no maximum or minimum spend requirements; 3) have no shortfall penalties; and 4) offer discounts tied to revenues, presumably meaning that the same discounts would be available across the board to all customers achieving the applicable revenue thresholds.[66] Assuming Level 3 correctly understands what CenturyLink is working on, it urges CenturyLink to execute this plan expeditiously and eliminate its existing lock-up plans, which should be declared unlawful under Section 201(b) of the Act. Level 3 also notes that given that this new plan, CenturyLink should have no continuing objection to the special access lock-up plan remedies that Level 3 has proposed.

Among the problems with CenturyLink's existing lock-up plans are the following:

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61 *Id.* at fn. 156.

62 *See id*.

63 47 U.S.C § 201(b).

64 47 U.S.C § 403.

65 *See generally Exclusive Service Contracts Order*.

66 CenturyLink Letter at 13.

CenturyLink claims that its "[c]ustomers set their own spend/volume threshold when they enter into a Regional Commitment Plan ["RCP"],"[67] but Level 3 fails to see how that is. Under the CenturyLink RCP, customers are locked into spending, for 4 years, 95% of the monthly recurring revenue for special access services being spent in CenturyLink's 14 state Qwest region when they sign up for the plan. Here are the words of the RCP:

> For DS1 Service, a customer must commit to a minimum of 95% of the monthly recurring revenue of their total Company-provided in-service DS1 Service circuits provided under Sections 7 and 17 of this Tariff within the Company's 14-state region. For DS3 Service, a customer must also commit to a minimum of 95% of the monthly recurring revenue of their total Company-provided in-service DS3 Service circuits provided under Sections 7 and 17 of this Tariff within the Company's 14-state region.[68]

CenturyLink also claims its RCP is not geographically focused,[69] but again, that is difficult to reconcile with the fact that the lock-up commitment extracted from its customers applies across CenturyLink's entire 14 state Qwest region (see above).

CenturyLink claims that it imposes no "logistical constraints" on a customer's ability to transition services to competitors. Whether it imposes constraints that are "logistical" is irrelevant, because it does impose constraints that are both legal and practical:

First, as a purely legal matter, the failure of a customer to achieve CenturyLink's 95% lock-up commitment under its RCP on a monthly basis results in a shortfall penalty equal to 100% of the amount falling below the commitment level. It is hard to argue that such shortfall penalties are not a legal constraint on a customer's ability to buy services from competitors, as opposed to buying them from CenturyLink:

> For each month the eligible monthly recurring revenue falls below the commitment level, the customer will be charged a shortfall on their next month's billing. The shortfall amount will be the difference between the commitment amount and the actual monthly recurring revenue.[70]

Second, as a practical matter, once it signs an RCP with CenturyLink, it is very difficult for a customer to extricate itself from the grip of the plan. The 95% lock-up requirement applies until the plan expires, and all plan discounts are lost instantaneously on expiration of the plan, unless the plan is immediately renewed:

> An extension of the existing RCP with existing RCP rates is not available. *If the customer does not subscribe to a new RCP, the RCP credit will no longer be*

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67 CenturyLink Letter at 3, 6.

68 Qwest F.C.C. Tariff #1, Sec. 7.1.3.B.1, paragraph 3.

69 CenturyLink Letter at 6.

70 Qwest F.C.C. Tariff #1, Sec. 7.1.3.B.3.c.

applied to the customer's bill(s).[71]

The practical application of the above is that CenturyLink customers have no realistic ability, at the expiration of an RCP plan, to migrate circuits away from CenturyLink to an alternative provider (which they may want to do in an effort to decrease what is committed to CenturyLink for 4 more years when the RCP is renewed). They cannot move more than 5% of their circuits away before the plan expires without paying a shortfall penalty. And once the plan does expire, during the time it takes to migrate circuits away from CenturyLink, CenturyLink's already above market prices would jump dramatically (resultant from the loss of the 22% discount associated with the RCP during migration activities). For example, using real numbers, a large special access purchaser, which pays $100 a month for a single DS1, would see a price spike of $28 (for that circuit alone) for each month in which it is not committed to CenturyLink in an RCP—and the process of circuit migration (assuming, contrary to fact, that competitive carriers offer equivalent service in all locations where a typical large customer requires service) can take months. These penal charges during any "gap" in RCP plans virtually guarantee minimal customer defections away from CenturyLink lock-up plans once they are in place. Accordingly, CenturyLink's allegation that it imposes no "logistical constraints" on customer defections is quite hollow.

CenturyLink does, as it says, provide portability as part of its lock-up plan[72]—as long as the customer agrees to pay CenturyLink a 15% premium (on top of its already above market special access rates).[73] This is because, among many other portability requirements and restrictions, the new services ordered by the customer from CenturyLink must have a value of at least 115% of the remaining value of the service terminated.[74]

CenturyLink alleges that "all customers receive the same [22%] discount regardless of their mix of other services purchased."[75] This is accurate, provided that all such customers commit, for a term of 4 years, 95% of what they are spending with CenturyLink to CenturyLink at the time they enter the lock-up plan. And this is a major problem with the price-cap LEC lock up plans. As Level 3 has noted previously, a customer who purchases only a handful of circuits from CenturyLink (say $1,000/month) gets a 22% discount for agreeing to retain $950/month with CenturyLink, but a customer which buys $2,000 (or $1,000,000) worth of circuits from CenturyLink per month cannot get the 22% discount for agreeing to buy $950/month. Rather, the latter customers must commit to $1,900/month and $950,000/month, respectively, to get the identical discount percentage. Accordingly, these discounts plans are not volume discounts, but, rather, are "loyalty" discounts in which customers are rewarded not for their volume, but for agreeing to buy little or nothing from competitors of CenturyLink.

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71 *Id*. Sec. 7.1.3.B.2.e.

72 Qwest F.C.C. Tariff #1. Sec. 7.1.3.B.5.c. .

73 *Id*.

74 Qwest F.C.C. Tariff #1, Sec. 7.1.8.C.

75 CenturyLink Letter at 7.

CenturyLink says that it does not charge "overage penalties" if a customer exceeds its commitment. What CenturyLink actually does, on either a monthly or annual basis during the 4 year RCP plan term, is *automatically* increase the customer's commitment if its special access spend with CenturyLink increases (but the commitment never decreases). Here are the words from the CenturyLink RCP (where the monthly option is selected):

> At the customer's written request, the Company will validate the customer's commitment level either monthly or annually to ensure that the customer maintains the 95% minimum commitment**. If customer selects the monthly option, the Company will automatically increase the monthly recurring revenue commitment level each month that the monthly recurring revenue for in-service circuits increases** except as specified for DS3 in 2.h., preceding. **If the monthly recurring revenue for DS1/DS3 circuits has decreased from the previous month's commitment level, the commitment level will not decrease.**[76] [Emphasis added]

CenturyLink claims (without offering any evidence of it) that many CLECs offer multi-year agreements that cover 100% of the customer's existing base of services with the CLEC at the time the contract is entered. Level 3 is aware of no such thing, either as a buyer of special access circuits or a seller of them. Level 3 does provide discounts for term purchases and does provide discounts for revenue commitments. Level 3 does not, however, provide lock-up plans where it tries to commit customers to obligate an astronomically high percentage of a customer's overall purchases to Level 3. Level 3 is also unaware of complaints from special access purchasers about being beholden to CLECs for high percentages of their special access purchases, quite simply, because they are not.

Finally, CenturyLink's most recent (as of June 22, 2012, at least) ex parte filing makes admissions Level 3 finds unsurprising. CenturyLink asks itself, and then answers the following question in the following way:

> How many customers subscribe to each contract-based tariff?
>
> Response: CenturyLink's contract-based tariffs are individually negotiated and tailored to meet individual customers' needs. Consequently, it is rare for a customer to opt into an existing contract-based tariff negotiated by a different customer.[77]

First, "it is rare" does not answer the question "how many." CenturyLink has "more than 300" contract tariffs.[78] Level 3 wonders how many of those 300+ have more than one customer. If CenturyLink was going to ask itself a question, the least it could do was answer it. But regardless of the answer, as Level 3 has said for years, customers can't opt in to contract tariffs

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76 Qwest F.C.C. Tariff #1, 7.1.3.B.4.a.

77 Letter from Melissa E. Newman, Vice President, Regulatory Affairs, CenturyLink, to Marlene H. Dortch, Secretary, FCC, WC Docket No. 05-25 (filed June 19, 2012), at 1, question 6.

78 *Id*. at 1, question 5.

negotiated by other customers of the price-cap LECs because the terms and conditions are gerrymandered so that no other customers qualify so as to be *able to* opt in. This fact, combined with allowing other customers only 30 days to make a decision to opt in to a CenturyLink contract tariff,[79] makes it predictable that it happens "rarely."

Conclusion

As aptly stated by Telecom Rambling's Rob Powell:

> Say I'm the only grocery store in a small town, very profitable but with a high cost of entry. One day an upstart local businessman opens a discount cheese shop across the street. I then tell all my customers that if they don't buy 90% of their cheese from me, I'll charge them double for everything they buy in my store. If he wants to compete, he'll have to be as big as me and he'll have to do it all at once – it doesn't matter if his cheese is better or cheaper. Predatory? Err, you think? I really can't figure out why this isn't an obvious abuse already prevented by current laws. At least with predatory pricing a monopoly takes a margin hit. This way, they can keep prices artificially high by raising them even higher for those who stray – and call it a discount plan.[80]

Lock-up terms and conditions tying up significant portions of special access demand have no place in a competitive marketplace, particularly when employed by price-cap LECs with dominant shares of the market. Level 3 believes these practices are pervasive, in which case they should be restricted as set forth in its February 22, 2012 ex parte. If the price-cap LECs, as they apparently do, claim the practices are not pervasive (or that the market is shrinking such that it can simply be ignored), they should have no objection to Level 3's proposed rules restricting them.[81]

As Level 3 has noted, by some estimates, special access price reductions of 60% could create over 176,000 American jobs and increase US economic output by over $37 billion.[82] Level 3 believes a robustly competitive special access market could produce price reductions exceeding 60% (based on the pricing seen today in the limited competitive markets that do exist). Vigorous competition will increase construction of competitive facilities, reduce prices and increase competitive supply of much needed special access services, and fulfill ever-increasing

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79 *Id*. at 1, question 4.

80 Rob Powell, "Telecom Ramblings On Spectrum and Wireless Backhaul Bottlenecks," March 27, 2012, *available at*http://www.telecomramblings.com/2012/03/spectrum-and-wireless-backhaul-bottlenecks/.

81 In addition to Level 3's request that the Commission abolish "lock-up" provisions, in its June 4 *Ex Parte*, twtc asks the Commission to limit ILEC volume commitments to no more than 50%. *See* Letter from Thomas Jones, Willkie Farr & Gallagher, counsel for twtc, to Ms. Marlene H. Dortch, Secretary, FCC, WC Docket No. 05-25, RM 10593, (filed June 4, 2012) at 5.

82 *See* Letter from Daniel Hesse, CEO, Sprint Nextel to the Honorable Julius Genachowski, Chairman, FCC, WC Docket No. 05-25 (filed March 15, 2011).

demand for those services so that (as only one example) wireless providers of all kinds can more efficiently use scarce spectrum to meet the needs of American consumers.

It is time for the Commission to act and make these possibilities real.

Sincerely,

/s/ Michael Mooney

Michael J. Mooney

Cc: Deena Shetler
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