REDACTED - FOR PUBLIC INSPECTION

EX PARTE

October 31, 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, Level 3 Follow Up On Proposed Special Access Remedy

Dear Ms. Dortch:

On June 27, 2012, Level 3 Communications, LLC ("Level 3") met with Deena Shetler, Eric Ralph, Nicholas Alexander, Andrew Mulitz, Kenneth Lynch, Jamie Susskind, Joseph Lilly and Maxwell Slackman of the Wireline Competition Bureau, to discuss Level 3's recent special access ex parte[1] submitting data (as requested by the Bureau) into the record in this proceeding.[2] In that meeting, members of the Bureau asked whether it would be an adequate remedy relating to special access demand lock up clauses if the Commission were to reduce the amount of business the price-cap LECs could lock-up to one half—or 50%—without taking any additional action.

Having considered this question and existing Commission precedent, the answer is "yes." Level 3 recognizes that others in the industry are likely to raise additional anticompetitive terms and conditions which the Commission should address, and Level 3 is likely to support those views as well. However, speedy action by the Commission to limit the price-cap LECs ability to lock-up more than one-half of the market would have an immediate effect. While certainly

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[1] *See* Letter from Michael Mooney, General Counsel, Regulatory Policy, Level 3 Communications, LLC, to Marlene H. Dortch, Secretary, Federal Communications Commission, WC Docket No. 05-25 and RM-10593 (filed June 8, 2012) ("June 8 Ex Parte").

[2] *See* Letter from Erin Boone, Senior Corporate Counsel, Federal Regulatory Affairs, Level 3, to Marlene H. Dortch, Secretary, Federal Communications Commission, WC Docket No. 05-25 and RM-10593 (filed June 28, 2012).

mindful of the comments made by the Commission in its August 22, 2012 order (suspending automatic grants of pricing flexibility) to the effect that it needs "more specific data" to fully evaluate CLEC claims "that the terms and conditions associated with the sale of ILEC services are anticompetitive and inhibit competitors' ability to attract new customers and build new facilities,"[3] Level 3 estimates that if the Commission were to reduce the amount of business the price-cap LECs could lock-up to one half, that it would save over **[BEGIN HIGHLY CONFIDENTIAL]** [redacted] **[END HIGHLY CONFIDENTIAL]** by being able to freely purchase up to half of its demand from competitive suppliers as opposed to being beholden to the incumbents under their lock-up plans. Level 3 is also troubled by the dissenting comments of Commissioners McDowell and Pai to the effect that the process of gathering and thereafter analyzing data in this proceeding could take a substantial amount of time, Commissioner Pai predicting that even in a best case scenario, final action may not occur until sometime in 2015.[4]

Every month of delay costs Level 3 approximately **[BEGIN HIGHLY CONFIDENTIAL]** [redacted] **[END HIGHLY CONFIDENTIAL]**. Avoiding these costs would result in significant savings—savings that could be passed on to Level 3's customers, and ultimately to American consumers. Level 3 has no reason to believe that other competitive providers are not in similar positions. In this letter, Level 3 articulates the legal basis on which the Commission can take action now to make these savings a reality. Level 3 remains hopeful that the Commission, consistent with its comments in the *Pricing Flexibility Suspension Order*, "will continue to analyze the information submitted in the record" . . . and use that information "to issue further decisions as warranted by the evidence."[5]

Based on the evidence before the Commission, Level 3 proposes the following, limited remedy to address the price-cap LECs unlawful demand lock-up practices:

i) Preclude any price-cap LEC from including in any new contract tariff or tariff discount plan a customer's commitment, in any future period, to purchase from the price-cap LEC, either directly or indirectly[6], more than 50% of the amount i)

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[3] *Special Access for Price Cap Local Exchange Carriers; AT&T Corporation Petition for Rulemaking to Reform Regulation of Incumbent Local Exchange Carrier Rates for Interstate Special Access Services*, WC Docket No. 05-25, RM-10593, Report and Order (rel. Aug. 22, 2012) ("*Pricing Flexibility Suspension Order*") at fn. 15.

[4] *Pricing Flexibility Suspension Order* at 97, Dissenting Statement of Commissioner Ajit Pai.

[5] *Pricing Flexibility Suspension Order* at ¶ 7.

[6] This would prohibit, for example, clauses that commit a customer to buy more than 50% of their then current number of circuits from the price-cap LEC, and would also prohibit contracting arrangements where the lock-up is not stated as a percentage. For example, a price-

spent on special access services with the price-cap LEC in a previous, similar period or ii) then being spent with the price-cap LEC for special access.

ii) With respect to existing contract tariffs and tariff discount plans containing commitments that would violate the prohibition above, the Commission should prohibit enforcement of such plans to the extent they are inconsistent.

iii) The Commission should make clear that its actions do not impact other provisions of parties' contract tariffs or tariff discount plans. The effect of the Commission's actions on the remaining provisions of the applicable contract tariff or tariff discount plan would be governed by the contract tariffs or tariff discount plans themselves, or by state law, if applicable.

Existing Commission precedent fully supports the remedies Level 3 requests.

For example, in its *Video Nonexclusivity Order*, the FCC prohibited the use of exclusivity clauses and the enforcement of exclusivity clauses in existing contracts.[7] In *Video Nonexclusivity*, various single multichannel video programming distributors, predominantly incumbent cable companies (each an "MVPD")[8] had entered into contracts providing them the exclusive right to provide video services into multiple dwelling units ("MDUs") like apartment complexes. In some cases, MDU owners were provided consideration for agreeing to such exclusivity clauses by way of guarantees of better service, lower prices or other concessions. In other cases, MDU owners were essentially forced into signing exclusivity clauses if they wanted video services provided in their buildings, because the incumbent cable companies were "the only game in town"[9] at the time.

AT&T, Verizon and others, who were then just entering the video services market, complained to the Commission that such exclusivity arrangements were anti-competitive, were preventing them from entering large portions of the video market, and were proscribed by the

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cap LEC would be prohibited from obligating a customer who spends $1,000,000/year on special access with a price cap LEC to commit that customer to spend more than $500,000/year (expressed in dollars) on special access with the price-cap LEC going forward. The later could be viewed as an "indirect" method of extracting a commitment of greater than 50%.

[7] *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, 22 FCC Rcd 20235 (2007), *aff'd sub nom. Nat'l Cable & Telecomm. Ass'n v. FCC,* 567 F.3d 659 (D.C. Cir. 2009) ("*Video Nonexclusivity Order*").

[8] *See id.* at ¶ 3.

[9] *Id*. at ¶ 12.

Act.[10] The objections made to the incumbent cable companies' anticompetitive exclusivity arrangements in the *Video Nonexclusivity Order* were strikingly similar to the objections Level 3 and others have been making for years to the incumbent telephone companies' demand lock-up terms and conditions in the special access market. In both cases, incumbent providers were/are using anticompetitive contracting practices to tie up a market at the expense of emerging competition. The one glaring difference, of course, is that in the *Video Nonexclusivity Order*, AT&T and Verizon were among those complaining about the use of anticompetitive terms and conditions by incumbents to keep them out of the video market, whereas in the special access market, AT&T and Verizon are among the incumbents making use of similar anticompetitive terms to limit competition from CLECs.

Along the way to finding the use of exclusivity clauses unlawful and proscribing their use (entirely) the Commission observed the following in the *Video Nonexclusivity Order*, all quite similar to various commenters' arguments against the incumbents' use of demand lock-up arrangements for special access:

> . . . the entry of incumbent LECs into the MVPD business has led incumbent cable operators to increase their use of exclusivity clauses in order to bar or deter new entrants.[11]
>
> AT&T states that 'efforts to lock up MDUs have occurred in . . . virtually every market where AT&T has begun to enter the service market'—efforts that are 'plainly intended to block competition' . . . .[12]
>
> Within the MDU, the incumbents, protected by its exclusivity clause from any competition . . . would have no incentive to hold down prices within the MDU.[13]
>
> In addition, exclusivity clauses can insulate the incumbent . . . from any need to improve its services.[14]
>
> We reject arguments that 'exclusivity clauses are not really a problem' because many MDUs are not subject to them . . . A practice that harms a significant number of households in this country warrants remedial action even if it does not harm everyone.[15]

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10 *See id*. at ¶ 10.

11 *Id*. at ¶ 3.

12 *Id*. at ¶ 10.

13 *Id*. at ¶ 17.

14 *Id*. at ¶ 22.

15 *Id*. at ¶ 29.

In an effort to prevent Commission action to prohibit exclusivity clauses in the *Video Nonexclusivity Order*, Comcast argued, as AT&T has (ironically and similarly)[16] argued in this special access docket, that an adjudicatory proceeding was required before the Commission could prohibit specified conduct (*i.e*., the use of exclusivity clauses). The Commission rejected that argument outright.[17] In doing so, the Commission noted that the statutory provisions at issue in the *Video Nonexclusivity Order* granted the Commission rulemaking authority to specify conduct that was prohibited, and that therefore, an adjudicative process was not a prerequisite to the Commission doing so.[18]

Likewise here, Level 3 and others have argued that the Commission can use its authority under Section 201(b) of the Act to restrict the incumbent's use of anticompetitive demand lock-up practices. Section 201(b) of the Act specifies that "any . . . practice . . . that is unjust or unreasonable is hereby declared unlawful," and further 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."[19] Accordingly, under the plain language of the Act, if the Commission finds special access demand lock-up arrangements unjust and unreasonable, the Act itself declares them unlawful, and Section 201(b) expressly authorizes the Commission, without any requirement of a prior adjudicative process, to issue rules prohibiting their use.

In addition, the fact that the exclusivity contracts in the *Video Nonexclusivity Order* were initially allowed by the Commission to go into effect did not disturb the Commission. Rather, the Commission found that "prohibition of the enforcement of existing exclusivity does not disturb legitimate expectations of investors in MDUs and the video service providers affected by this Order" because "the lawfulness of exclusivity clauses has been under our active scrutiny for a decade, making the parties to them aware that such clauses may be prohibited."[20] In yet another conspicuous parallel to the special access proceeding, the issue of the lawfulness of special access demand lock-up arrangements has been before the Commission for a decade, having first been raised by AT&T in its 2002 petition,[21] and have been raised countless times in

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[16] *See* Letter from David L. Lawson, Sidley Austin LLP, counsel to AT&T, Inc., to Ms. Marlene H. Dortch, Secretary, FCC, WC Docket No. 05-25 at 14-15 (filed Aug. 8, 2012) ("AT&T August 8 Ex Parte").

[17] *See Video Nonexclusivity Order* at fn. 156.

[18] *See id*.

[19] 47 U.S.C § 201(b).

[20] *Video Nonexclusivity Order* at ¶ 36.

[21] AT&T Corp. Petition for Rulemaking to Reform Regulation of Incumbent Local Exchange Carrier Rates for Interstate Special Access Services, RM-10593 (October 15, 2002) at 21-23.

this docket by Level 3 and other parties in the more than seven years that it has been open.[22] A Commission order consistent with the remedies requested by Level 3 would surprise no one, and could not be said to affect the expectations of the price-cap LECs.

The *Video Nonexclusivity Order* also addressed the issue of the incumbents' market power, a topic the Commission has expressed an interest in within the special access docket as well. In the *Video Nonexclusivity Order*, the Commission expressly declined to limit its order to incumbent cable companies with market power,[23] implicitly finding that a showing of market power was unnecessary. While the Commission would have no difficulty finding that the price-cap LECs have market power for special access services, the *Video Nonexclusivity Order* further evidences that such a finding is not required.

Following its analysis, in the *Video Nonexclusivity Order*, the Commission proscribed (completely) the use of exclusivity clauses.[24] The FCC held that "no cable operator or multichannel video programming distributor subject to Section 628 of the Act shall enforce or execute any provision in a contract that grants it the exclusive right to provide any video programming service (alone or in combination with other services) to a MDU" and that "[a]ny such exclusivity clause shall be null and void."[25]

It would be entirely consistent with the *Video Nonexclusivity Order* for the Commission to determine that demand lock-up practices employed by the price cap LECs in the special access market are unjust and unreasonable and therefore unlawful under Section 201 of the Act. The Commission should do so, should limit their use going forward, and should prohibit their enforcement as they exist in current contracts, tariffs or tariff discount plans.

Finally, in the *Video Nonexclusivity Order*, the FCC held specifically that while "this Order prohibits the enforcement of existing exclusivity clauses, it does not on its own terms, purport to affect other provisions in contracts containing exclusivity clauses."[26] In the *Video Nonexclusivity Order*, some building owners had obtained various forms of consideration in

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22 It is also noteworthy that the FCC prohibited enforcement of exclusivity provisions in MDU contracts even where the MVPD lacked "market power" because "we wish to avoid the burden that would be imposed by numerous individual adjudications about whether market power . . . exists in an individual MDU or community." *Video Nonexclusivity Order* at ¶ 38. Likewise, here, the Commission can and should prohibit lock-up contracts without attempting to determine whether in any given case, a price cap LEC possesses market power.

23 *Video Nonexclusivity Order* at ¶ 38.

24 *See id*. at ¶ 1.

25 *Video Nonexclusivity Order* at ¶ 31.

26 *Id*. at ¶ 37.

exchange for the exclusivity clause, but the FCC's order did not affect those terms. Rather, the FCC observed that "the treatment of such provisions will be determined by the terms of particular contracts, which may, for example, contain change of law clauses, as well as by state law."[27] Thus, unless the contract or state law required modification based on the Commission's voiding of the exclusivity clause, any consideration that the incumbent cable companies had received for the exclusivity clause was forfeited.

Applying the same principles to special access lock-up contracts, the Commission would have the clear power to limit or eliminate the extent of the lock-up without altering the remaining terms of the contract. We ask the Commission to do just that.

In a recent ex parte,[28] AT&T argues that the *Video Nonexclusivity Order* is inapposite since Section 628 of the Act does not apply to carriers. AT&T misses that in 2001 and again in 2008, the Commission extended virtually identical principles of the *Video Nonexclusivity Order* to telecommunications services, similarly prohibiting the enforcement of contracts that restrict the access of other carriers to provide telephone service in commercial multi-tenant buildings (in 2001)[29] and in residential multi-tenant buildings (in 2008).[30] In the later proceeding, which the Commission observed was based on the reasoning of the *Video Nonexclusivity Order*, the Commission took "similar action in the telecommunications services context to prohibit carriers from entering into and enforcing . . . exclusivity clauses with premises owners in predominantly residential [multi-tenant environments]."[31] Qwest was a vocal objector to these practices: "Qwest reports that it is increasingly encountering residential buildings where it is prohibited to sell its voice services."[32]

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[27] *Id*. at ¶ 37, fn. 112.

[28] *See* AT&T August 8 Ex Parte at 14.

[29] *Promotion of Competitive Networks in Local Telecommunications Markets*, First Report and Order and Further Notice of Proposed Rulemaking in WT Docket No. 99-217, Fifth Report and Order and Memorandum Opinion and Order in CC Docket No. 96-98, Fourth Report and Order and Memorandum Opinion and Order in CC Docket No. 88-57, 15 FCC Rcd 22983, 23052-53, ¶¶. 160-64 (2000).

[30] *Promotion of Competitive Networks in Local Telecommunications Markets*, Report and Order, WT Docket 99-217 (March 21, 2008) ("*2008 Promotion of Competitive Networks Order*"); *see* 47 C.F.R. § 64-2500(b). The Commission has also altered the terms of previously approved interconnection agreements based on changes in F.C.C. policy positions. *See e.g. BellSouth Telecommunications, Inc., v. MCIMetro Access Transmission Services, LLC,* 425 F. 3d 964 (11th Circ. 2005).

[31] *Id*. at ¶ 2

[32] *Id*. at ¶ 12

The Commission found that "such exclusivity contracts are unjust and unreasonable practices pursuant to Section 201 because they perpetuate barriers to facilities based competition that the 1996 Act was designed to eliminate."[33] "Thus, we find that a carrier's execution or enforcement of such an exclusive access provision is an unreasonable practice and implicates our authority under Section 201(b) of the Act to prohibit unreasonable practices."[34] The Commission also noted: 1) its authority to modify provisions of private contracts when necessary to serve the public interest;[35] and 2) that carriers had been on notice for more than seven years that it might prohibit both the entering into, and the enforcement of, such exclusivity provisions.[36]

In short, in its *2008 Promotion of Competitive Networks Order*, the Commission extended the rationale of the *Video Nonexclusivity Order* to telecommunications services, and prohibited the enforcement of exclusivity clauses under Section 201 of the Act, the very provision Level 3 asks the Commission to enforce to limit the scope of the price-cap LECs demand lock-up arrangements. Specifically, and directly contrary to what AT&T argues in its August 8 Ex parte,[37] in the *2008 Promotion of Competitive Networks Order*, the Commission states that it "has exercised [its] authority [to modify private contracts] previously when private contracts violate sections 201 *through 205* of the Act [emphasis added]."[38]

As shown above, the Commission could completely excise the lock-up provisions of the price-cap LEC tariffs and contracts that condition discounts on a purchaser's commitment to buy a certain percentage of past (or existing) purchases (or spend a specified number of dollars or buy a specified number of circuits, either of which is based on the customer's past purchases). In other words, the Commission could reduce the price-cap LECs' "lock-up percentages" *to zero*. However, Level 3 does not ask the Commission to go that far. Rather, Level 3 would be satisfied, as a lesser alternative, with an order that placed a ceiling on commitments at 50% of past (or existing) purchases.[39] The Commission could allow such a lock-up provision, as long as

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33 *Id*.

34 *Id*. at ¶ 15

35 *Id*. at ¶ 17

36 *Id*. at ¶ 13

37 *See* AT&T August 8 Ex Parte at 16.

38 *Id* at ¶ 17; citing *Expanded Interconnection with Local Telephone Company Facilities*, CC Docket No. 91-141, Memorandum Opinion and Order, 9 FCC Rcd 5154, 5207-10, paras. 197-208 (1994), *remanded on other grounds, Pacific Bell v. FCC*, 81 F.3d 1147 (D.C. Cir. 1996) (limiting termination liabilities in current contracts on the grounds that "certain long-term special access arrangements may prevent customers from obtaining the benefits of the new, more competitive access environment").

39 Similar contracts foreclosing less than 50% of the market have been held to violate the antitrust laws. *U.S. v. Microsoft Corp.*, 253 F.3d 34, 70 (D.C. Cir. 2001) (violation "even though

it did not require the customer to purchase, directly or indirectly, more than 50% of its past (or existing) purchases from the price cap LEC. Such a commitment would allow the customer to find other sources of supply for one-half of its needs, which would be a reasonable way to provide for competition while still ensuring the price cap LEC that the customer would purchase a substantial amount of service from the price cap LEC. Should it so chose, the Commission could also affirmatively note that a price cap LEC may, at its option, provide for volume discounts (on a non-commitment basis) for spending in excess of the minimum commitment, provided that it does so on a non-discriminatory basis such that substantially similar terms and conditions are made available to other similarly situated special access customers.

Regardless of how its order is structured, the Commission should clearly declare, as it did in footnote 112 of the *Video Nonexclusivity Order*, that its order does not, on its own terms, purport to affect any other provisions in agreements containing demand lock-up clauses, and that the effect of the elimination or modification of the lock-up provisions on the other terms of the arrangement, if any, would be determined by the other provisions of the agreement and state law.

Conclusion

In the *Video Nonexclusivity Order* and the *Promotion of Competitive Networks Orders*, AT&T, Verizon and Qwest were among the most vocal objectors to the exclusivity practices of incumbents designed to keep them out of the video and/or telephony markets. They prevailed.

The shoe is now squarely on the other foot. The incumbent phone companies, AT&T, Verizon and Qwest/CenturyLink, must now be made to stop practices similar to those they themselves objected to in the *Video Nonexclusivity Order* and the *Promotion of Competitive Networks Orders*, for the same and for additional reasons.

Level 3 asks that the Commission further analyze the data in the record before it and move ahead to quickly implement the remedies noted on pages 2-3 above so that Level 3, along with many other competitive providers, can move forward and begin to realize the hundreds of

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the contracts foreclose less than the roughly 40% or 50% share usually required in order to establish a § 1 violation"); *Natchitoches Parish Hosp. Serv. Dist. v. Tyco Int'l, Ltd*, 2009 U.S. Dist LEXIS 108858; 2009-2 Trade Cas. (CCH) ¶ 76,815 (foreclosure of 32-39% of market was sufficient); *E.I.Du Pont de Nemours and Co. v. Kolon Industries, Inc.*, 683 F.Supp. 2d 401 (E.D. Va. 2009) (court observed that if it had adopted plaintiff's market definition, foreclosure would have been 43%, which would have been sufficient to support an antitrust violation); *Tele Atlas N.V. v. NAVTEQ Corp.*, 2008 WL 4809441 (N.D. Cal.) (denial of defendant's summary judgment motion; contracts lasting multiple years could be viewed by a jury as exclusive dealing contracts where there were "outs" that were difficult to invoke and buyers treated them as exclusive; contract foreclosing over 35% of market "warrant[ed] heighted scrutiny" because it involved "a concentrated product market with high sunk costs, zero marginal costs, and high switching costs").

millions of dollars in annual savings that can be achieved by those carriers being able to freely buy from competitive suppliers, and start passing those savings on to American consumers. While Level 3 fully supports the Commission's data gathering process towards full reform of the special access marketplace, we remain hopeful that the market does not have to wait until the end of that process before competition is allowed to materialize.

Sincerely,

/s/ Michael J. Mooney

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Michael J. Mooney
General Counsel, Regulatory Policy
Level 3 Communications, LLC