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

In the Matter of	)	
	)	
Special Access for Price Cap Local Exchange Carriers	)	WC Docket No. 05-25
	)	
	)	RM-10593
AT&T Corporation Petition for Rulemaking to Reform Regulation of Incumbent Local Exchange Carrier Rates for Interstate Special Access Services	)	

REPLY COMMENTS OF AT&T INC.

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Pursuant to the Commission's *Notice*,[1] AT&T Inc. ("AT&T"), on behalf of itself and its affiliates, respectfully submits these reply comments.

INTRODUCTION AND SUMMARY

The comments confirm that the Commission should re-focus this proceeding on the primary goal, which is to use the data it intends to gather to design "administratively feasible" pricing flexibility rules that rely upon readily observable metrics that can serve as reasonably accurate proxies for the presence of competitive facilities investment.[2] A relatively simple and manageable inquiry is all that is required: if the upcoming data collection effort requires *all* providers to submit detailed information about the scope and location of their networks, the Commission will be able to determine where competitors have sunk investment in network

[1] Report and Order and Further Notice of Proposed Rulemaking, *Special Access for Price Cap Local Exchange Carriers*, 27 FCC Rcd. 16318 (rel. Dec. 18, 2012) ("*Notice*").

[2] *Notice* ¶ 77.

facilities capable of serving special access customers, which will allow the Commission either to re-adopt or adjust its pricing flexibility triggers or the geographic scope of relief as appropriate.[3]

The *Notice* instead proposes free-ranging and entirely unnecessary "market power" inquiries, and a wide variety of commenters echo AT&T's concern that the complex "multi-faceted" panel regression analyses proposed in the *Notice* would raise a host of methodological and econometric difficulties that may prove insurmountable, are unlikely in the end to produce an administrable test for pricing flexibility, and would almost certainly mire the industry and the Commission in protracted and costly proceedings for years to come.

Now a handful of commenters – BT Americas, Cbeyond, Earthlink, Integra, Level 3, Sprint, Telepacific, tw telecom, and XO ("the complaining carriers") – propose to extend the *Notice*'s mission creep to an entirely new level. These commenters first urge the Commission to undertake an additional, even more burdensome inquiry: a "traditional" market power inquiry of unprecedented dimensions that would require the Commission to establish product and geographic markets and then assess market share, demand and supply elasticity, costs and other competitive factors for every transport route and customer location in the country.

Recognizing the sheer intractability of such an inquiry, the complaining carriers then propose as alternatives simplistic shortcuts based on static market shares and a conscious decision to ignore "potential," intermodal and much other competition altogether. The Commission has repeatedly and properly rejected these overly simplistic approaches,[4] and

[3] Report and Order, *Special Access for Price Cap Local Exchange Carriers*, 27 FCC Rcd. 10557, ¶¶ 7, 50, 52, 74-75, 81, 83 (2012) ("*Pricing Flexibility Suspension Order*").

[4] *Notice* ¶ 70.

imposing outdated regulation on special access on the basis of such watered-down and jury-rigged "market power" tests would be unlawful.[5]

But the complaining carriers' fatally flawed market analysis proposals appear simply to be stalking horses for their real objective – the immediate and massive reformation of virtually all special access tariffs and negotiated special access contracts to eliminate commitments those carriers made in exchange for discounts and other benefits. Indeed, they devote most of their comments to requests that the Commission abrogate existing contracts to obtain relief from allegedly "exclusionary" terms and conditions and prescribe new terms and conditions that reduce term and volume commitments, early termination fees ("ETFs"), and non-recurring charges, all while allowing them to keep the discounted rates and other favorable terms associated with those commitments. Moreover, the complaining carriers insist that the Commission immediately rewrite these scores of contracts without "await[ing] the completion of the upcoming data gathering and review process."[6] These claims are grossly premature; the Commission just held in the *Pricing Flexibility Suspension Order* that it does not have enough data on the current record to make any determinations regarding the scope and intensity of competition and the facilities-based choices available to special access customers; the forthcoming data collection effort is intended to address that deficiency.[7] But in all events, the

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[5] It should be emphasized, however, that if the Commission *does* engage in a full blown market power analysis, it will be required to apply economically sound analytical principles, not the jury-rigged proposals offered by these competitors. And such an analysis will compel a finding that AT&T is fully non-dominant in the vast majority of areas where special access demand is concentrated – a possibility even the complaining carriers expressly acknowledge. *See* Sprint at 10; TelePacific at 6.

[6] Joint Comments of BT Americas Inc., Cbeyond Communications, LLC, EarthLink, Inc., Integra Telecom, Inc. Level 3 Communications, LLC, and tw telecom inc., at 5 ("Joint CLEC Comments").

[7] *Pricing Flexibility Suspension Order* ¶¶ 3, 6, 7, 50, 52; *see also Notice* ¶¶ 13-55.

complaining carriers' claims have no basis in economic theory, the language of the contracts, or the law.

The complaining carriers have latched onto academic literature discussing theoretical competition foreclosure harms that can be associated with a very specific kind of arrangement referred to in the literature as a "loyalty contract." But the loyalty contracts addressed in this literature are not remotely analogous to the terms and conditions under which AT&T's special access services are offered, for many reasons discussed below. For one, the central element of the "loyalty contracts" model examined by this literature is that the incumbent sets a uniform rate schedule that directly links a "base rate" to the lower discounted rate available to "loyal" customers, such that lowering its "base rate" necessarily requires the incumbent to lower the discounted rate.[8] But the tariff that is the focus of the complaining carriers' argument – AT&T's Southwestern Bell FCC Tariff No. 73 and its optional Term Payment Plan ("TPP") – does not have this feature: the rates for each of the available term commitments, from one month to seven years, is separately specified in the tariff, with no linkage. More to the point, no uniform pricing schedule exists. The whole purpose of the pricing flexibility rules was to give incumbent LECs ("ILECs") the flexibility to negotiate a wide variety of terms and discounts that are tailored to each individual customer's needs. Accordingly, AT&T's special access customers, including complaining carriers, have negotiated a wide variety of alternative arrangements that reflect their own needs and priorities, many of which lack the very provisions the complaining carriers challenge and contend they are forced to accept.

Second, marketplace developments dispel any suggestion that the wide variety of available special access arrangements have collectively operated as *de facto* "loyalty"

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[8] Reply Declaration of Dennis W. Carlton and Allan Shampine, ¶¶ 7, 8 (Mar. 11, 2013) (attached hereto as Attachment A) ("Carlton-Shampine Reply Decl.").

arrangements that have "locked up" DSn demand and foreclosed entry and expansion by rival providers. The challenged terms and conditions have been in place for a decade, and far from being foreclosed, special access competitors have thrived, expanding their local networks and capturing increasing levels of special access business. Moreover, the marketplace is currently undergoing an historic shift away from legacy DSn services to competing Ethernet services.[9] Many of the complaining carriers in fact are leaders in providing Ethernet services and in winning business away from ILECs. Even without a large data collection effort and panel regressions, these historic changes are apparent to anyone paying attention: as shown in the attached declaration of Mr. Parley Casto, in the past two years alone the number of DS1 special access circuits AT&T provided to wireless providers dropped by more than 30 percent[10] – while tw telecom, to name just one example, *increased* its on-net buildings by the same percentage during the same period.[11]

The complaining carriers' focus on AT&T's TPP tariff is particularly misguided. As Professor Carlton and Dr. Shampine explain, a "loyalty" agreement actually has to have a "loyalty" term and condition – *i.e.*, the customer must agree to exclusive dealing or a volume commitment that is defined in terms of its overall purchases from *all* providers.[12] The base TPP does not remotely fit this description. It is a simple term plan. It has no exclusive dealing term or volume commitment at all. Customers can purchase individual circuits for one of six terms:

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[9] CenturyLink at 14-20; Verizon at 10-19; *see also* Letter from David L. Lawson (AT&T) to Marlene H. Dortch (FCC), WC Docket No. 05-25, at 2-6 (Mar. 28, 2012) ("AT&T 3/28/12 Letter").

[10] Reply Declaration of Parley Casto, ¶ 28 (Mar. 11, 2013) (attached hereto as Attachment B) ("Casto Reply Decl.").

[11] http://www.twtelecom.com/investor-guide/financial-reporting/quarterly-earnings/ (4th Quarter and Full Year 2012, Supplemental Slides, at 6).

[12] Carlton-Shampine Reply Decl. ¶ 8.

month-to-month, 1-year, 2-year, 3-year, 5-year, and 7 year, and, as is typical, AT&T offers lower rates for longer terms. A customer can buy as much or little from AT&T as it wants and can chose the term length it wants separately for each individual circuit. There is, of course, liability for early termination, a common business practice designed to prevent customers from signing up for the 7-year discount and canceling in 1 year, but the TPP's ETF charge is a fraction (40 percent) of the remaining monthly charges for the circuit,[13] and generally within or below the ETFs charged by competitive local exchange carriers ("CLECs").[14]

Nor can the TPP's "portability" option be considered a "loyalty" contract. The volume commitment for the portability feature is *not* set based on how much the customer purchases from rivals, but instead simply requires the customer to commit a percentage of its current DS1 purchases *from AT&T* for a three year term. Customers that make this commitment get a substantial benefit: a customer can disconnect DS1 circuits early (including disconnects made to move them to another carrier) without paying *any* ETFs. And, that commitment gives customers wide leeway to give their business to competitors, because the initial commitment under the TPP portability option does not apply to circuits that the customer already purchases from other access suppliers, allows the customer, in each portability commitment cycle, to move an additional 20 percent of the circuits committed to AT&T to rival suppliers, and does not apply at all to increases in demand above historical purchases from AT&T. Moreover, contrary to the complaining carriers' claim that they simply have no choice but to purchase under the TPP with portability option discounts, most of them have *not* opted into the TPP portability agreement in the SWBT region or primarily rely on other arrangements, and many of AT&T's customers that

[13] Casto Reply Decl. ¶ 4 & n.2.

[14] Letter from David L. Lawson (AT&T) to Marlene H. Dortch (FCC), WC Docket No. 05-25, at 11 (Aug. 8, 2012) ("AT&T 8/8/12 Letter"); Carlton-Shampine Reply Decl. ¶ 26.

have made TPP portability commitments have circuit volumes well above the minimum commitment level. In aggregate, customers that have selected the TPP option have substantial "headroom" that is fully portable to competitors today.[15]

In reality, the types of terms and conditions the complaining carriers attack are common both in the special access marketplace and in competitive industries generally. Indeed, the complaining carriers themselves and other CLECs routinely include similar terms and conditions in their access contracts, including discounts for term commitments and early termination fees. The complaining carriers' own economists acknowledge that the lower rates provided by term discount plans like the TPP *increase* consumer welfare,[16] and both the Commission and federal courts have consistently recognized that discount plans foster competition and benefit the public interest by facilitating more stable and predictable demand.[17] Although the complaining carriers claim that ILECs use these agreements to drive competitors from the marketplace, that is simply untrue, and, in all events, the Commission has already found (and the D.C. Circuit upheld) that sunk investments "make[] exclusionary pricing behavior costly and highly unlikely to succeed,"

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[15] Casto Reply Decl. ¶ 16.

[16] Declaration of Bridger M. Mitchell, ¶ 115 (Jan. 19, 2010) (attached to Comments of Sprint Nextel Corp. (Jan. 19, 2010)) ("in general, when the consumer is offered a lower price for purchasing a greater quantity of service – in quantity consumed per unit time, or length of time consumed – and chooses the larger quantity or term, his consumer surplus is increased").

[17] Report and Order, *Private Line Rate Structure and Volume Discount Practices*, 97 F.C.C.2d 923, ¶ 40 (1984); Fourth Memorandum Opinion And Order On Reconsideration, *Transport Rate Structure and Pricing*, 10 FCC Rcd. 12979, ¶ 13 (1995) (*citing* Report and Order and Notice of Proposed Rulemaking, *Expanded Interconnection with Local Telephone Company Facilities*, 7 FCC Rcd. 7369, ¶ 199 (1992)).

because "that equipment remains available and capable of providing service in competition with the incumbent, even if the incumbent succeeds in driving that competitor from the market."[18]

In the end, the complaining carriers are not really contending that contract terms such as these are inherently exclusionary – after all, they have them too – but that the Commission should simply mandate arbitrarily that ILEC volume commitments can never exceed 50 percent of historical purchase levels and that ILEC ETFs and non-recurring charges may never exceed *customer-specific* costs of service. Even assuming that the Commission were empowered to rewrite contracts negotiated by sophisticated parties, there plainly is no factual, policy, economic or legal justification for the extraordinary reformation of contracts sought by the complaining carriers here.

Finally, the complaining carriers request for regulation of terms and conditions would be patently unlawful. The Commission has no record on which to find under Section 205 of the Communications Act that any particular contract contains unjust and unreasonable terms and conditions. The complaining carriers' suggestion that the Commission could simply dispense with such statutory requirements and condemn AT&T's special access tariffs without regard to the prevalence of alternative suppliers is based on inapposite precedents. Most notably, the Commission's decision to ban exclusive cable contracts for multiple dwelling units was expressly based on Section 628 of the Act, which permits such regulations without the sort of hearing or definitive findings required by Section 205.[19] Moreover, this is not an instance in

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[18] *WorldCom, Inc. v. FCC*, 238 F.3d 449, 458-59 (D.C. Cir. 2001) (internal quotation marks omitted); *see also* Fifth Report and Order and Further Notice of Proposed Rulemaking, *Access Charge Reform*, 14 FCC Rcd. 14221, ¶ 80 (1999) ("*Pricing Flexibility Order*").

[19] Report and Order and Further Proposed Rulemaking, *Exclusive Service Contracts for the Provision of Video Services in Multiple Dwelling Units and Other Real Estate Development*, 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*").

which the Commission can simply take a red pen and draw a line through a specific provision of the incumbents' tariffs; to the contrary, the Commission would effectively be re-writing the parties' carefully crafted *quid pro quo*, allowing the complaining carriers to keep the *quid* (the discounts) while escaping the bargained-for *quo* (term or volume commitments and provisions to enforce them). The Commission would need an especially compelling justification for re-writing the balance struck in hundreds of privately negotiated contracts, and there is no such record here. As the Commission itself has held elsewhere, "[t]here is simply no justification for allowing [a party] . . . to negotiate for concessions on price, to sign a contract containing customized provisions that are the product of voluntary agreement, and then to run to the Commission to have the Commission reform a provision of the contract that was an integral part of the *quid pro quo* bargain but which subsequently produces hardship to the customer."[20]

I. THE COMMISSION SHOULD NOT AND NEED NOT CONDUCT A TRADITIONAL MARKET POWER INQUIRY.

The comments amply illustrate the importance of keeping the Commission's inquiry manageable and focused on the questions presented. The economic theory underlying the pricing flexibility rules is not at issue; the only question in this proceeding is whether and how to adjust the pricing flexibility triggers to ensure that they are reasonably accurate proxies for the presence of sunk competitive facilities. As AT&T explained, the data collection effort will give the Commission an extraordinarily detailed answer to that question, which will allow the Commission to re-adopt or adjust the triggers as necessary. The Commission, however, has proposed a far more ambitious set of panel regressions designed to determine where ILECs have "market power." The complaining carriers as a block ask the Commission to add an even more

[20] Memorandum Opinion and Order, *Ryder Commc'ns, Inc. v. AT&T Corp.*, 18 FCC Rcd. 13603, ¶ 28 (2003) ("*Ryder Order*") (internal quotation marks omitted).

difficult and unnecessary inquiry: a traditional market power analysis (*i.e.*, a full dominance/non-dominance inquiry). Before the Commission starts down a path that will lead to substantial administrative burdens and endless litigation, it should press the reset button and re-focus this proceeding on the relatively manageable inquiries that are required.

Many commenters agree that the Commission's proposed panel regression analyses would be unnecessary and difficult to perform correctly. A wide variety of commenters emphasize that the Commission will face many practical and methodological challenges in designing a model that will produce statistically valid results, and that transparency in the Commission's process in therefore critical.[21] Given the complexity of designing and performing such regressions, the Commission is almost certain to become bogged down in years of litigation over both its "scrubbing" of the data inputs and its specification of the model.[22] Indeed, the panel regressions proposed here would be much more complex than previous inquiries, such as the ill-fated attempt to design models to determine the X-Factor, that ended up in judicial reversal and years of inconclusive Commission proceedings.[23] There is no need for the Commission to start down that path. The panel regressions are not necessary to resolve the issues that have been raised about the pricing flexibility rules, nor are such regressions likely to provide results that are useful in designing new rules that are easily administrable.[24] As AT&T explained, the Commission should stay focused on the question presented in this proceeding, and use the data it collects to assess to what extent the collocation-based triggers have been

[21] *See, e.g.,* Verizon at 8-9; Joint CLEC Comments at 47-48; XO at 3; Sprint at 10-12.

[22] *See* AT&T at 21-32.

[23] *See United States Tel. Assoc.* v. *FCC*, 188 F.3d 521, 525-26 (D.C. Cir. 1999).

[24] *See, e.g.*, AT&T at 31-32.

reasonably accurate proxies for the presence of sunk competitive facilities that permit competitors to bid for and win special access business.[25]

The complaining carriers, however, would take one extremely difficult and unnecessary inquiry (the proposed regression analyses) and add a second, even more difficult and unnecessary inquiry: a traditional market power analysis.[26] They argue that the Commission should apply the Department of Justice/Federal Trade Commission Merger Guidelines and perform a full-blown dominance/non-dominance inquiry, which would require the Commission to define the relevant product and geographic markets and, for each market, analyze such issues as "market shares, concentration, demand elasticity, supply responsiveness, and cost structure."[27] Although they claim that such an inquiry would be a "reliable and efficient" means of determining the "relevant special access markets in which ILECs currently have the ability to set and maintain supra-competitive prices,"[28] in reality that type of structural inquiry, if done properly, would be far more burdensome than the Commission's proposed regression analyses.

First, the complaining carriers' focus on market power and dominance would expand the scope of this proceeding considerably. The whole point of the pricing flexibility regime is to provide pricing flexibility without the need for a traditional market power inquiry.[29] As the Commission explained in 1999, a traditional market power analysis is administratively burdensome even when the relevant markets are national, and those administrative burdens "are

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[25] *See* AT&T at 11-19.

[26] Joint CLEC Comments at 47-48, 64; Sprint at 5 (Commission should "begin with a traditional market power analysis designed to determine whether and where the ILECs continue to be dominant in the provision of special access services"); XO at 3.

[27] Sprint at 8.

[28] Joint CLEC Comments at 64.

[29] *Pricing Flexibility Order* ¶¶ 90, 151-52.

magnified when done on an MSA-by-MSA basis" and even more so for smaller geographic markets.[30] The pricing flexibility rules do not give ILECs nondominant status, and therefore an inquiry into whether ILECs remain dominant would not answer the question in this proceeding, which is whether the pricing flexibility rules are working as intended. The pricing flexibility rules are merely an incremental step within dominant carrier regulation that identify areas where ILECs may safely be given a measure of flexibility to meet competition by offering market-driven prices and entering into individualized contracts tailored to the needs of each special access customer, while still filing generally applicable tariffs.[31] That is why the D.C. Circuit has held that ILECs may be given pricing flexibility relief without a finding of nondominance.[32] The complaining carriers would subvert that purpose by conflating this proceeding with a nondominance analysis.

Moreover, they do so knowing full well that any such inquiry, if conducted properly, would be extraordinarily burdensome. For example, they all argue that the relevant geographic market for special access services is either the point-to-point route for transport or each individual building or customer location for channel terminations.[33] Obviously, performing a full, traditional market power inquiry for every transport route and customer location in the country would be completely unworkable, especially given that the Commission would have to

[30] *Id.* ¶ 152.

[31] *See, e.g.*, *WorldCom*, 238 F.3d at 460 (ILECs that have received Phase II relief must still file tariffs are still subject to, among other things, tariff filing requirements which are "the centerpiece of common carrier regulation.") (citation omitted); *Pricing Flexibility Order* ¶ 151.

[32] *WorldCom*, 238 F.3d at 459-61 (complaining carriers "offer no alternative [to collocation-based triggers] save a painstaking analysis of market conditions such as that which is required when a LEC seeks classification as a nondominant carrier or the forbearance of dominant carrier regulation")

[33] Joint CLEC Comments at 59-60; Sprint at 7; XO at 6.

assess whether each building feasibly *could* be served by competitors, not just whether a building currently happens to be served by a competitor.[34]

The complaining carriers recognize the impracticality of conducting an analysis of each such market,[35] but they have no idea how to narrow the inquiry. They merely suggest that the Commission may have some options available, such as aggregating all buildings in "wire centers or census blocks," but they make no argument for any particular alternative.[36] Any way the Commission slices it, however, a traditional market power inquiry would be enormously burdensome whether performed on a building-by-building, wire-center-by-wire-center, or census-block-by-census-block basis.[37] In all events, as AT&T previously explained, the current record in this proceeding overwhelmingly shows that there is likely little to be gained by narrowing the inquiry beyond the MSA level.[38]

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[34] *Pricing Flexibility Order* ¶¶ 78, 90, 151-52.

[35] *See, e.g.,* Joint CLEC Comments at 61 ("the Commission will need to aggregate geographic markets subject to similar levels of competition so as to make the analysis administratively feasible"); Sprint at 7-8; XO at 6.

[36] Joint CLEC Comments at 64; *see also id.* at 61 n.151 (simply referring the Commission to pleadings filed in 2010), 64 (same); XO at 6 ("While it may be impractical to analyze every point-to-point connection, the Commission can either choose to study connections in a limited geographic area (e.g. exchange or wire center) or select a random sample of circuits over the entire metropolitan area"); Sprint at 7-8 ("the Commission might choose to group customers based on the density of demand at the wire centers serving those customers," and "administrative feasibility may require that the Commission group like [interoffice transport] routes together for purposes of its analysis").

[37] *Cf. Pricing Flexibility Order* ¶ 83 (finding even the pricing flexibility triggers too burdensome if assessed on a wire center basis).

[38] *See* AT&T at 18 & n.48 (noting that Appendix D to the *Pricing Flexibility Suspension Order* shows that, in the 123 MSAs (about a third or all MSAs) where the Commission has granted Phase II relief for channel terminations, the collocation wire centers that justified the MSA-wide relief accounted for, on average, more than 93 percent of *all* of the ILEC's special access revenue in that entire MSA (and often as much as 97 or even 100 percent)). The Joint CLECs suggest (at 64) that the Commission "will likely need to conduct a market power analysis in a statistically meaningful subset of geographic units," but both the Commission and AT&T have already noted the difficulties with selecting a subset of geographic areas that is random. *See*,

Given how burdensome a true market power inquiry would be, the complaining carriers propose vastly watered-down versions of that inquiry, each of which would be patently unlawful. Most notably, almost all of the complaining carriers seem to subscribe to the simplistic proposition that a combination of static market share figures and their claim that the ILECs' contracts have "exclusionary terms and conditions" is sufficient to demonstrate market power.[39] That would be a formula for judicial reversal. In the *Notice* itself, the Commission makes clear that reliance on market share as a primary indicator of market power would be untenable.[40] Courts, too, have been adamant that static measures of market share offer no insight into the underlying competitive dynamics of the marketplace.[41] Nor do incumbents have their present customer base "locked up" with exclusionary contracts; as explained in detail in Section II below, the complaining carriers' claim has no support in either economic theory or the language of the contracts at issue.

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e.g., *Notice* ¶ 24; AT&T at 30-31 & Igal Hendel and Mark A. Israel, *Econometric Principles That Should Guide The Commission's Analysis of Competition for Special Access Service*, ¶¶ 62-64 ("Hendel-Israel Decl.") (attached to AT&T Comments).

[39] *See, e.g.,* Joint CLEC Comments at 12-14, 65-68; Sprint at 8-10; Ad Hoc at 12-13.

[40] *Notice* ¶ 70 ("a wide range of commenters . . . state that the Commission cannot gauge the extent of competition based on a single market characteristic, such as . . . market share. We agree").

[41] *See, e.g., WorldCom*, 238 F.3d at 458 ("the FCC has long held that market share is not the be-all, end-all of competition" – rather, a "loss of market share is [not] necessary to prevent an ILEC from raising prices," and "the presence of substantial sunk investment, and the resulting potential for entry into the market, can limit anticompetitive behavior by LECs"); *Capital Cities/ABC, Inc.* v. *FCC*, 29 F.3d 309, 315 (7th Cir. 1994) (Posner, J.) (it has been "many years since anyone knowledgeable about" competitive analysis "thought that concentration by itself imported a diminution in competition"); *United States* v. *Gen. Dynamics Corp.*, 415 U.S. 486, 498 (1974) (market share is imperfect measure because market must be examined in light of access to alternative supplies); *United States* v. *Syufy Enters.*, 903 F.2d 659, 665-66 (9th Cir. 1990) ("In evaluating monopoly power, it is not market share that counts, but the ability to *maintain* market share."); *United States* v. *Baker Hughes, Inc.*, 908 F.2d 981, 986 (D.C. Cir. 1990) (market share statistics "misleading" in a "volatile and shifting" market) (internal quotation marks omitted).

Perhaps most startling is the complaining carriers' argument that the Commission should ignore potential competition altogether.[42] Here again, the Commission has already rejected this argument in the *Notice*, explicitly acknowledging that any coherent analysis of the special access marketplace must account for potential competition.[43] In that regard, the *Notice* is consistent with longstanding judicial and Commission precedent, which require consideration of the potential for entry when analyzing the competitiveness of a marketplace.[44]

As AT&T has previously explained, what is often called "potential" competition in the special access marketplace is really actual competition that cannot be ignored or discounted.[45] The complaining carriers have built extensive fiber networks that are located within a short distance of the vast majority of special access demand. Contrary to the complaining carriers'

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[42] *See, e.g.*, Joint CLEC Comments at 74-75; TelePacific at 4-5 ("Commission should only look at competition where facilities have been deployed and either are already in service or can quickly be put into service by a competitor (within a month)").

[43] *See, e.g.*, *Notice* ¶ 69 n.152 ("We agree . . . that the Commission's analysis must take account of both actual and potential competition"); *see id.* ¶¶ 68, 71.

[44] *WorldCom*, 238 F.3d at 458; *Qwest Corp.* v. *FCC*, 689 F.3d 1214, 1221 (10th Cir. 2012) (traditional market power analysis requires consideration of the "potential for competitive market entry is sufficient to constrain an incumbent carrier's ability to maintain prices above competitive levels"); *Verizon Tel. Cos.* v. *FCC*, 570 F.3d 294, 303 (D.C. Cir. 2009) ("the FCC has consistently considered both actual and potential competition in assessing whether a marketplace is sufficiently competitive to warrant UNE forbearance"); *Covad Commc'ns Co.* v. *FCC*, 450 F.3d 528, 540 (D.C. Cir. 2006) (approving unbundling order because Commission "repeatedly justifies its unbundling determinations on the basis of both actual and potential competition"); Order on Remand, *Unbundled Access to Network Elements*, 20 FCC Rcd. 2533, ¶ 87 (2005) (unbundling unnecessary where conditions indicate that "reasonably efficient competitive LECs are capable of duplicating the ILEC's network"); Order, *Motion of AT&T Corp. to Be Reclassified as a Non-Dominant Carrier*, 11 FCC Rcd. 3271, ¶ 68 (1995) ("whether a firm possesses market power" depends in part on "conditions of entry"); Order and Notice of Proposed Rulemaking, *Comsat Corporation Petition Pursuant to Section 10(c) of the Communications Act of 1934, as Amended, for Forbearance from Dominant Carrier Regulation and for Reclassification as a Non-Dominant Carrier*, 13 FCC Rcd. 14083, ¶ 78 (1998) ("*Comsat Order*").

[45] AT&T at 16.

contention,[46] a competitor does *not* have to build extensions to a customer location before it can reasonably bid for business in that building.[47] To the contrary, most special access competition consists of existing facilities-based competitors participating in a bidding process to win the right to build an as-yet-"potential" direct connection to a location.[48] The Department of Justice has routinely acknowledged this reality in merger proceedings, and has found that special access competition from traditional CLECs constrains ILEC prices in any building that is sufficiently near, but not necessarily already connected to, their competitive sunk network facilities.[49]

For these reasons, the Commission should reject the complaining carriers' argument that the Commission should treat an alternative special access provider as an active competitor only if it has *already* built a "last-mile" connection to a building.[50] The complaining carriers contend that "it is simply not plausible that any firm or group of prospective entrants" could meet the preconditions for deploying new transmission facilities, and therefore the Commission should

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[46] *See, e.g.,* Joint CLEC Comments at 74-81.

[47] *See, e.g.*, Report and Order and Order on Remand and Further Notice of Proposed Rulemaking, *Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers*, 18 FCC Rcd. 16978, ¶ 316 (2003) ("*Triennial Review Remand Order*"), *aff'd*, *Covad Communications Co.* v. *FCC*, 450 F.3d 528 (D.C. Cir. 2006) (customers often "enter into long-term contracts committing to revenue streams and associated early termination charges that provide the ability for carriers to recover their substantial non-recurring 'set-up' or construction costs" of deploying facilities).

[48] *See also WorldCom*, 238 F.3d at 458 ("the presence of substantial sunk investment, and the resulting potential for entry into the market, can limit anticompetitive behavior by LECs") (*citing Pricing Flexibility Order* ¶ 80); *see also* Declaration of Dennis W. Carlton and Hal S. Sider, at ¶ 29 ("Carlton-Sider 2009 PN Decl.") (attached to Comments of AT&T Inc. (Jan. 19, 2010) ("AT&T 2009 PN Comments")) ("Firms with facilities that can profitably be extended to serve a building are properly considered to be actual competitors to a LEC").

[49] *See, e.g., AT&T-BellSouth Merger Order*, 22 FCC Rcd. 5662, ¶¶ 41-42, 46 & nn.111-14 (2007) (describing and adopting "screens" employed by DOJ to determine whether a building could be served by alternative facilities, which recognize that competitors with facilities near a building can and do compete for customers in that building).

[50] *See, e.g.,* Joint CLEC Comments at 62, 74-75.

"forego" any effort to account for such competition.[51] This argument is absurd on its face. Non-ILEC special access competitors have already built direct connections to enormous numbers of buildings nationwide and, as shown below, they continue to expand significantly the number of directly-connected buildings they serve. The notion that the Commission should assume for purposes of its analysis that no competitor will ever build a new direct connection again is preposterous.

The complaining carriers propose to rig their proposed market power analysis further by excluding competition from cable providers.[52] The complaining carriers concede that when cable companies serve business customers using fiber, that counts as "real" competition,[53] and the comments confirm that cable companies have been rapidly expanding their fiber-based offerings.[54] Accordingly, the only dispute concerns services provided over HFC facilities on a "best efforts" basis.[55] Even with respect to HFC-based services, however, cable companies have begun to offer Ethernet services over coaxial cable using DOCSIS.[56] The complaining carriers

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[51] Joint CLEC Comments at 74-75, 81.

[52] *See, e.g.,* Joint CLEC Comments at 50-57; Sprint at 20-23.

[53] *See* Sprint at 22 & n.69.

[54] *See, e.g.,* Verizon at 12-13, 21-23; CenturyLink at 23-27.

[55] Sprint at 20-22.

[56] *See, e.g.*, Letter from Maggie McCready (Verizon) to Marlene Dortch (FCC), WC Docket No. 05-25 (Dec. 7, 2012); *see also* John Lombardi and Bradley Bignall, "Ethernet Over DOCSIS," Communications Technology, Aug. 1, 2008, *available at* http://www.cable360.net/ct/strategy/businesscases/31019.html; Jeff Baumgartner, "Comcast Meshes Ethernet with Docsis 3.0," Light Reading, Dec. 6, 2012, *available at* http://www.lightreading.com/ethernet-services/comcast-meshes-ethernet-with-docsis-30/240144901 ("In addition to giving Comcast a better T1 replacement strategy, the higher speeds will also come in handy as operators tie in more cloud-based services tailored for business customers. After targeting small businesses, Comcast more recently has been moving up-market to pursue deals with businesses with up to 500 employees …. Its Ethernet-over-coax deployment doesn't deliver quite as much speed, but it will enable it to vastly expand its

cannot seriously dispute that such services are substitutes for ILEC-provided special access services.

Moreover, as a number of commenters note, the marketplace evidence demonstrates that cable companies are successfully using even "best efforts" services to win business away from ILECs. Indeed, Verizon and CenturyLink detail the cable companies' dramatic growth in serving small businesses with services that are substitutes for the ILECs' special access services.[57] Indeed, cable companies heavily market their "best efforts" services as superior substitutes for ILEC DS1 services.[58] The mere fact that the cable companies' "best efforts" services may have some quality differences from the ILECs' services does not mean that the two services must be in separate product markets.[59] The issue is substitutability from the viewpoint of the consumer, and the evidence shows that many business customers are willing to switch from DSn-based service to "best efforts" services provided by cable companies.[60] In all events,

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Ethernet-capable footprint, extend Ethernet-style service level agreements (SLAs) to more business customers, and siphon away more revenues from incumbent telcos.").

[57] CenturyLink at 23-27; Verizon at 13, 21-23; Letter from Glenn T. Reynolds (US Telecom) to Marlene H. Dortch (FCC), WC Docket No. 05-25 (Dec. 3, 2012).

[58] Letter from Glenn T. Reynolds (US Telecom) to Marlene H. Dortch (FCC), WC Docket No. 05-25 (Nov. 29, 2012).

[59] *See, e.g.*, *Murrow Furniture Galleries, Inc.* v. *Thomasville Furniture Indus., Inc.*, 889 F.2d 524, 528 (4th Cir. 1989) ("Courts have repeatedly rejected efforts to define markets by price variances or product quality variances") (internal quotation marks omitted); *In re Super Premium Ice Cream Distrib. Antitrust Litig.*, 691 F. Supp. 1262, 1268 (N.D. Cal. 1998), *aff'd*, 895 F.2d 1417 (9th Cir. 1990) (same).

[60] *See, e.g.*, *United States* v. *E.I. du Pont Nemours & Co.*, 351 U.S. 377, 395 (1956); *Hayden Publ'g Co.* v. *Cox Broad. Corp.*, 730 F.2d 64, 70 (2d Cir. 1984); *FTC* v. *Arch Coal, Inc.*, 329 F. Supp. 2d 109, 122 (D.D.C. 2004). Thus, contrary to complaining carriers' suggestion, mere price differences are by themselves insufficient to demonstrate that products are in different markets. *See, e.g.*, *du Pont*, 351 U.S. at 401; *United States* v. *Continental Can Co.*, 378 U.S. 441, 455 (1964); *Apple Inc.* v. *Psystar Corp.*, 586 F.Supp.2d 1190 (N.D. Cal. 2008).

there is certainly no basis for categorically concluding that such services are irrelevant before the Commission has even collected any data.[61]

Finally, it should be emphasized that if the Commission were to expand this proceeding to conduct a traditional dominance/non-dominance inquiry, the Commission would be obligated to follow that analysis wherever it may lead. As the complaining carriers themselves recognize, the Commission must completely deregulate the ILECs' special access services wherever it finds no market power. For example, as Sprint acknowledges, "[o]nce it has made that determination, the Commission should relieve the incumbent LECs of dominant carrier pricing regulation in areas where they are subject to sufficient competition to constrain their prices."[62] Under any rigorous market power analysis, however, the Commission will find that numerous facilities-based competitors have deployed fiber networks that compete directly today for the vast majority of special access demand. Accordingly, the end result of a properly conducted market power analysis should be broad and complete deregulation of ILEC special access well beyond even the relief afforded by the pricing flexibility rules. That is particularly true given that, as the comments confirm, the special access marketplace is currently undergoing an historic shift away from legacy TDM-based DSn services to Ethernet services in which many of the complaining carriers are leading providers.[63] But the Commission can leave that inquiry for another day; for

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[61] *See Notice* ¶ 76.

[62] Sprint at 10; *see also* TelePacific at 6 (acknowledging that the "the results of [the Commission's findings based on this rigorous analysis could prompt a finding that an ILEC is non-dominant for a particular service in a particular area").

[63] AT&T Comments at 29-30; Letter from David L. Lawson (AT&T) to Marlene H. Dortch (FCC), WC Docket No. 05-25 (March 28, 2012); Letter from Frank Simone (AT&T) to Marlene H. Dortch (FCC), WC Docket No. 05-25 (June 6, 2012); CenturyLink at 14-18; Verizon at 10-26.

present purposes, the Commission need only undertake the more manageable inquiry described above and in AT&T's initial comments.

II. THE "TERMS AND CONDITIONS" OF AT&T'S SPECIAL ACCESS TARIFFS DO NOT FORECLOSE SPECIAL ACCESS COMPETITION.

The complaining carriers claim that certain optional term and volume commitment provisions of ILEC special access tariffs are a form of "loyalty contract" that "lock up" customers and foreclose rivals from competing for those customers.[64] This argument fails at every turn. As shown below, AT&T's customers have multiple options for obtaining special access or substitute services. Indeed, many of the complaining carriers do not purchase special access under the terms they claim are exclusionary. With regard to the specific AT&T tariff the complaining carriers challenge, that tariff is not a "loyalty" contract – it imposes no volume commitment for discounted rates and provides a portability option that allows a customer to shift a significant volume of demand to rival providers without incurring any ETFs.

Marketplace developments soundly refute the complaining carriers' theory. AT&T's special access tariffs have been in place for many years, yet the complaining carriers and other CLECs have been able to enter the market and substantially expand their networks. Indeed, while AT&T's DS1 channel termination sales to its most important customer segment, wireless providers, have fallen by over 30 percent since early 2011, tw telecom's "on net" buildings have *increased* by that same percentage.[65] This should not be a surprise. As the Commission correctly observed in the *Pricing Flexibility Order*,[66] once a carrier had deployed sunk network facilities, it cannot be driven out of the market by "exclusionary" conduct.

[64] Joint CLEC Comments at 20-30; Sprint at 23-37; TelePacific at 12-15; XO at 8-17.

[65] tw telecom Q4 and 2012 Earnings Report, Supplemental Slides at 6.

[66] *Pricing Flexibility Order* ¶ 80.

The remedies the complaining carriers seek are equally inappropriate and would be unlawful on this record. Although the complaining carriers actually challenge only a few provisions in a few tariffs, they ask the Commission to extensively rewrite all existing ILEC special access tariffs and contract tariffs to eliminate any term or condition that might possibly impose a significant obligation on them in return for lower rates or other benefits.[67] The discounted rates and portability benefits provided by ILEC special access tariffs can only be achieved through the use of enforceable commitments, which is also why the complaining carriers routinely include such terms and conditions in their own special access offerings as a condition for obtaining discounted rates.[68] Eliminating any obligation on a customer to honor its part of the bargain will result in no (or a less favorable) bargain being offered in the first instance.

A. The Complaining Carriers' "Loyalty" Theory Has No Application To The Special Access Marketplace.

The complaining carriers contend that ILEC special access tariffs impose an anticompetitive "loyalty" mandate.[69] In particular, they rely on academic literature that purports to show that, under very restrictive conditions and assumptions, an incumbent monopolist can use certain "loyalty" contract terms to exclude rivals.[70] This literature defines a "loyalty contract" in a very specific way: an incumbent monopolist offers discounts off the base rates that require the customer to agree to purchase a significant percentage (or all) of its requirements

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[67] Joint CLEC Comments at 42-46.

[68] *See* AT&T 8/8/12 Letter at 10-12; Comments of AT&T Inc., at 81 (Jan. 19, 2010) ("AT&T 2009 PN Comments); Declaration of James A. Anderson ¶¶ 13-14 (attached to XO Comments) ("XO Anderson Decl.").

[69] Joint CLEC Comments at 20-30; Sprint at 23-37; Telepacific at 12-15; XO at 8-17.

[70] *See, e.g.*, Stanley M. Besen and Bridger M. Mitchell, *Anticompetitive Provisions of ILEC Special Access Arrangements*, ¶¶ 13, 36-37, 46 (attached to Joint CLEC Comments) (Besen-Mitchell Decl."); Sprint at 27.

from the incumbent (the "loyalty" provision). Under such a provision, the literature posits that in equilibrium all (or almost all) customers will become "loyal" customers and entry by rivals will not be possible because the customers are locked up.[71] The "loyalty contract" induces loyalty because it treats all its customers uniformly; the "low" prices are only available for "loyal" customers.[72]

Although the complaining carriers suggest that all of AT&T's special access tariffs are "loyalty arrangements," their analysis focuses on a single tariff option: AT&T's SWBT Tariff No. 73 and its term payment plan ("TPP").[73] However, that tariff on its face does not include any "loyalty" term. The TPP instead provides for lower DS1 special access rates for customers that agree to make term commitments for individual circuits.[74] AT&T's TPP also provides a portability option.[75] In return for a volume commitment based on its current DS1 purchases with AT&T, a customer is entitled to cancel up to 20 percent of its commitment without incurring any ETFs.[76]

As Professor Carlton and Dr. Shampine explain, the loyalty contract theory has no application to the types of special access services at issue here for at least two fundamental reasons.[77] *First*, while the complaining carriers focus on AT&T's SWBT Tariff No. 73 and its TPP provisions, that tariff is only one of many ways in which customers can obtain dedicated access from AT&T and other ILECs – thus fatally undermining a central assumption of the

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[71] Carlton-Shampine Reply Decl. ¶¶ 7-8.

[72] *Id.* ¶¶ 7-8, 11-15.

[73] *See, e.g.*, Joint CLEC Comments at 20, 22, 24, 27-30; Sprint at 31; XO at 13.

[74] Casto Reply Decl. ¶ 3.

[75] *Id*. ¶ 5.

[76] *Id.*

[77] Carlton-Shampine Reply Decl. ¶¶ 7-15.

loyalty contract theory that an incumbent provider treats its customers uniformly. As envisioned by the Commission's pricing flexibility rules, AT&T has negotiated individualized contract tariffs that are tailored to customers' specific needs.[78] In some instances, AT&T customers have been able to continue to purchase under "grandfathered" tariffs that, although no longer available to new subscribers, were extended for an additional period of time.[79] Ethernet services, which are a substitute for DSn-level special access, are not included in AT&T's special access tariffs but instead are non-tariffed offerings that are frequently provided pursuant to individually negotiated broadband services agreements.[80] Finally, many carriers are able to forego DSn-level special access altogether by purchasing unbundled network elements ("UNEs").[81]

Customers often mix and match these options even within the same region. For example, one complaining carrier has negotiated an agreement with AT&T such that in return for meeting a certain minimum annual revenue commitments ("MARC") based on a broad range of services, that carrier, instead of asking for circuit portability, obtained a substantial annual lump sum credit for meeting the MARC.[82] Another complaining carrier has no less than three contract tariffs with AT&T, two of which provide for portability options outside of the TPP.[83] The third gives the carrier an additional, significant lump sum discount for meeting a minimum annual

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[78] Casto Reply Decl. ¶ 16. In fact, AT&T has more than 25 pricing flexibility arrangements covering DSn special access in just the SWBT region alone. *Id.*

[79] *Id.* ¶ 18.

[80] *Id.* ¶ 17.

[81] *Id.* ¶ 18.

[82] *Id.* ¶ 20. As Mr. Casto notes, the terms of nondisclosure agreements that AT&T has with the complaining carriers could be read to preclude identification of these carriers by name, but should the Commission desire that information, AT&T will endeavor to obtain consent for the release of this information from those carriers, subject to the requirements of the applicable protective agreements. *Id.* ¶ 6.

[83] *Id.* ¶ 21.

revenue commitment.[84] Another complaining carrier has negotiated an arrangement that gives it flexibility to convert DS1 circuits subject to term commitments to AT&T Ethernet service.[85]

Yet another complaining carrier purchases special access services in the Southwest region out of an entirely different tariff – the High Capacity Term Payment Plan ("HC-TPP"). Under this plan, the carrier does not have to pay an ETF on any individual disconnect and pays no shortfall charges so long as it meets a minimum monthly revenue commitment ("MMRC") – a commitment level that the carrier itself had the flexibility to establish.[86] Notably, this carrier elected to continue to take service under this tariff even after its initial term had lapsed and it had the option of purchasing under the TPP.[87]

Finally, several complaining carriers are "UNE-first" customers that serve customers mostly through unbundled network elements ("UNEs") rather than special access services.[88] Obviously, the terms of the TPP have no bearing on their ability to use those facilities to offer services in competition with the DSn-level offerings at issue here.

Second, as noted, a central premise of the loyalty literature is that a monopolist incumbent uses loyalty arrangements to ensure that rivals do not enter and compete – but that is clearly not the case here.[89] Indeed, the literature relied upon by the complaining carriers assumes that a dominant incumbent has the ability to lock up customers before rivals have the ability to enter.[90] In fact, while AT&T has had "discounted" tariff plans for over a decade, entry has

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[84] *Id*.

[85] *Id*. ¶ 22.

[86] *Id*. ¶ 23.

[87] *Id*.

[88] *Id.* ¶ 24; CenturyLink at 29-30.

[89] *See also* Carlton-Shampine Reply Decl. ¶ 15.

[90] *Id*.

clearly not been foreclosed. To the contrary, as CenturyLink and Verizon confirm in their comments, complaining carriers and other CLECs have thrived, capturing increasing levels of special access and substantially expanding their local networks.[91]

This trend will only accelerate as the market transitions away from legacy TDM-based services to next generation-IP based services such as Ethernet.[92] The drive to Ethernet is particularly pronounced for wireless providers, which have traditionally been AT&T's largest DSn special access customers. "All wireless providers are actively migrating from TDM-based services to fiber-based backhaul, and wireless providers are actively upgrading capacity between major facilities to support increased capacity .... Wireless providers will gradually decommission DS3 and below cell-site backhaul solutions as they upgrade to Ethernet-based services."[93]

There is intense competition in the marketplace for this new technology. CLECs in particular have thrived as the market for Ethernet has continued its double-digit growth through 2012, with a 24 percent rise in ports.[94] The most recent data confirm that CLECs continue to have a substantial presence in this space, with tw telecom being the third-largest Ethernet provider in 2012 by port share and with complaining carriers Level 3 and XO Communications being among the top 10 Ethernet providers.[95] AT&T and Verizon's combined market share

[91] CenturyLink at 20-32; Verizon at 10-26.

[92] CenturyLink at 14-20; Verizon at 10-19.

[93] Wireless Backhaul, *Special Analyst Partner Report*, Virgo Communications, at 7-12 (Jan. 2012).

[94] Vertical Systems Group, Retail Ethernet Port Share Report, Year End 2012 ("Vertical YE 2012 Report").

[95] *Id.*

continues to fall.[96] Indeed, ILEC Ethernet share has fallen from 61% to 48% since 2005, with cable and CLECs increasing their share.[97]

Outside this proceeding, complaining carriers trumpet the expansion of their local networks – growth that has occurred during the time period in which the TPP has been in effect. For example, tw telecom now has nearly 18,000 on-net buildings and more than 29,000 fiber miles,[98] a 30 percent increase over the last two years.[99] Level 3 touts its 30,000 metropolitan route miles.[100] XO Communications tells investors that it has more than 3,300 on-net buildings with 1 million fiber miles.[101] Cbeyond has fiber to about 1000 buildings.[102] And Integra emphasizes its ongoing investment in local networks – investment that has allowed it to bring its on-net building count to 2,193, a 26 percent increase year-over-year.[103]

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[96] *Id.*

[97] Vertical Systems Group, Year End Ethernet Port Share Reports 2005-2012.

[98] tw telecom Press Release, "tw telecom Leads All Competitive Providers in Delivering Business Ethernet Services," Feb. 1, 2013, *available at* http://www.marketwatch.com/story/tw-telecom-leads-all-competitive-providers-in-delivering-business-ethernet-services-2013-02-01; *see also* tw telecom, Investor Presentation, at 4, 9 (March 2013), *available at* http://www.twtelecom.com/PDFs/Investors/Financial-Reporting/TWTC-Investor-Presentation-March-2013/.

[99] *See* tw telecom Q4 and 2012 Earnings Report, Supplemental Slides at 12.

[100] Level 3 Communications, Investor Presentation, at 5, *available at* http://files.shareholder.com/downloads/LVLT/2332228062x0x615488/56994029-e535-497c-8c62-28698d304770/Level%203%20Investor%20Presentation_Nov%202012.pdf.

[101] XO Communications, Network Overview, *available at* http://www.xo.com/about/network/Pages/overview.aspx; "XO Communications' Meteoric Rise Tied to Ethernet," Carrier Ethernet News, June 28, 2011, *available at* http://www.carrierethernetnews.com/articles/256186/xo-communications-meteoric-rise-tied-to-ethernet/.

[102] CenturyLink at 22.

[103] Integra Telecom, Q1 2012 Financial Results (May 11, 2012) *available at* http://www.integratelecom.com/resources/Assets/integra-q1-2012-earnings-presentation.pdf; Integra Telecom, Q3 2012 Financial Results (Nov. 8, 2012), *available at* http://www.integratelecom.com/resources/Assets/Integra-Q3-Earnings-Supplement-

The impact on AT&T's DSn services has been dramatic. As shown in the attached declaration of Mr. Parley Casto, in the preceding seven quarters, the number of DS1 special access circuits AT&T provided to wireless providers dropped by more than 30 percent.[104] Indeed, over that same period, DS1 circuits provided to two of AT&T's largest wireless customers have both fallen by over 50 percent.[105] AT&T's sales of DS1 circuits to wireline customers has likewise begun to decline.[106] Most of these losses are conversions to the newer, more efficient Ethernet technology, and demand for Ethernet service is increasingly captured by CLECs.

B. AT&T's TPP Is Not A Loyalty Arrangement.

The TPP is clearly not a "loyalty" contract. As Professor Carlton and Dr. Shampine explain, the loyalty contract literature cited by complaining carriers assumes the existence of contracts that: "1) have either exclusive dealing or a volume commitment referencing the customer's total purchases *including* those from rivals; and 2) have the property that the discounted rate is linked to the base rate so that the discounted rate cannot fall unless the base rate falls."[107]

Nov2012.pdf. Cable companies are also expanding their networks. Cox Communications now has more than 22,000 fiber-lit locations and more than 40,000 near-net locations utilizing more than 25,000 miles of route fiber. Comptel Plus Spring 2012 Convention + Expo, *Cable Wholesale: Your Guide to Solutions that Will Shape the Market* (Apr. 16, 2012), http://www.nprg.com/Media/PDF/28-cable-wholesale-your-guide-to-solutions-that-will-shape-the-market. Time Warner Cable has more than 10,000 lit buildings and is competing in the wholesale mobile backhaul market. *Id.* Charter has more than 5,500 fiber lit buildings, 8,000 near-net buildings, and 55,000 fiber route miles. *Id.*

[104] Casto Reply Decl. ¶ 28.

[105] *Id.*

[106] *Id.* ¶ 29.

[107] Carlton-Shampine Reply Dec. ¶ 8. A "classic" loyalty contract is one that requires a customer to buy a certain percentage of all of its inputs from the seller or pay a higher price for the inputs, or conditions the availability of a discount on the purchase of a certain percentage of

The TPP lacks both features. It is a simple term plan. Thus, under the SWBT Tariff No. 73 and the TPP, customers can purchase individual circuits for one of six terms: month-to-month, 1-year, 2-year, 3-year, 5-year, and 7 year terms. In return for the demand certainty and other benefits of longer terms, AT&T offers lower rates for longer terms. A customer can buy as much or little from AT&T as it wants and can chose the term length it wants.[108]

There is, obviously, liability for early termination – without sufficient ETFs, customers could sign up for the 7-year discount but cancel after just 1 year, thus gaining the discount and denying AT&T its benefit of the bargain.[109] Under the TPP, the term liability is a fraction (40%) of the remaining monthly charges for the circuit.[110] AT&T's ETFs are generally within or below those charged by at least some CLECs. For example, at least one CLEC has reported it imposes ETFs equal to 50% of the remaining monthly charges for the circuit.[111]

Nor does the TPP portability option require a "loyalty" commitment.[112] The TPP portability option allows a customer to move as many DS1 circuits from one location to another as it wants without incurring ETFs.[113] The volume commitment for the portability feature is *not* set by reference to dealings with a rival but, to get this option, a customer must commit its

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all inputs from the seller. Dennis W. Carlton and Patrick Greenlee, *Assessing the Anticompetitive Effects of Multiproduct Pricing*, Research Symposium on Antitrust Economics and Competition Policy, at 11 (Sept. 26, 2008), *available at* http://www.law.northwestern.edu/searlecenter/papers/Greenlee_Multiproduct_Pricing.pdf.

[108] Casto Reply Decl. ¶ 3.

[109] *Id.* ¶ 4; Carlton-Shampine Reply Decl. ¶¶ 24-25.

[110] Casto Reply Decl. ¶ 4 & n.2. Notably, in many circumstances, AT&T's TPP tariff do not impose an ETF where the CLEC transfers one end of the circuit to another location in the same LATA as the existing customer. *Id*. ¶ 13 & n.5.

[111] AT&T 8/8/12 Letter at 11.

[112] Carlton-Shampine Reply Decl. ¶ 11.

[113] Casto Reply Decl. ¶ 5.

historical DS1 channel termination volumes *with AT&T* for a three year term.[114] Customers who make this commitment get a substantial benefit: a customer can disconnect up to 20 percent of its DS1 circuits (including disconnects made to move them to another carrier) over the term of the portability plan without paying any ETFs.[115] In addition, the initial commitment under the TPP portability option does not apply to demand the customer has already placed with other access suppliers.[116] Nor does the customer have any obligation to provide AT&T with any increased demand over the three year term of the portability arrangement; any such incremental demand is free to be shifted to a supplier of the customer's choosing.[117]

AT&T's SWBT Tariff No. 73 and TPP also do not "tie" a "discounted" rate to a "base" rate – another critical assumption of the loyalty contract theory.[118] The loyalty theory relied upon by complaining carriers predicts that, by linking a "loyalty rate" uniformly with the "non-loyalty rate," a dominant firm has less incentive to compete for non-loyalty customers because reducing rates for those customers requires reducing rates for all loyalty customers as well.[119] But, as explained above, there is no analog to this in AT&T's SWBT Tariff No. 73. The rate available under the TPP is determined exclusively by the term selected by the customer.[120] Moreover, the TPP is only one of several vehicles for obtain special access or its substitute, and

[114] *Id.*

[115] *Id*. Although AT&T has a tariffed portability plan for DS3 circuits in the SWBT region, generally speaking, portability for DS3 circuits is provided through individualized negotiation and the contract tariff process. *Id.* ¶ 5 n.3.

[116] *Id*. ¶ 5.

[117] *Id.*

[118] Carlton-Shampine Reply Decl. ¶ 12.

[119] *Id.*

[120] Casto Reply Decl. ¶ 3.

changing a TPP rate would not reduce the rate for customers that purchase special access or its substitutes service under other tariffs or as UNEs or Ethernet.

C. AT&T's TPP Is Not A *De Facto* Loyalty Arrangement.

Given that the TPP contains no actual loyalty provision, complaining carriers advance a contrived theory that the TPP can be considered a *de facto* loyalty contract. They argue that: i) CLECs are forced to buy special access services with the longest possible term in order to get viable rates; ii) because the TPP imposes excessive ETFs and because CLECs face churn in their retail services, they cannot satisfy lengthy term commitments; iii) to avoid "excessive" ETFs and obtain the discounts they need to compete, CLECs are forced to agree to the TPP's "portability" option; and iv) the volume commitments associated with the TPP's portability option effectively "locks up" special access demand.[121] Each step in this convoluted theory is factually incorrect, and has no support in the literature or cases they cite.[122]

[121] Joint CLEC Comments at 20-30.

[122] *See generally* Carlton-Shampine Reply Decl. ¶¶ 16-19. For example, in *ZF Meritor, LLC* v. *Eaton Corporation*, the Third Circuit expressly recognized that above-cost discounts "are not anticompetitive" even when conditioned "on the customer's purchasing of a specified volume or a specified percentage of its requirements from the seller." 696 F.3d 254, 275 (3d Cir. 2012). The court upheld the jury verdict because plaintiff "did not rely solely on the exclusionary effect of Eaton's prices," but instead introduced evidence that Eaton "block[ed] customer access to Plaintiffs' products"; terminated not only price rebates but access to Eaton's essential products if customers failed to meet market share purchasing requirements; and achieved preferential prices "by artificially increasing the prices of Plaintiff's products." *Id.* at 277-78, 288. Similarly, in its administrative complaint against Intel, the FTC did not rely on mere volume and term discount programs, but instead alleged that Intel's discounts prices were predatory. Administrative Complaint, *In the Matter of Intel Corporation*, FTC Docket No. 9341, ¶ 53 (Dec. 16, 2009). Moreover, the agency alleged that Intel deployed its predatory discount pricing selectively in conjunction with (1) threats to those who purchased competitor products and (2) promises to those who bought exclusively from Intel of highly favorable treatment including "a slush fund of hundreds of millions of dollars to be used in competitions against [entities] that offered non-Intel-based computers." *Id.* ¶¶ 52, 54. No similar facts are present in the case of AT&T's TPP or any other aspect of its special access contracts or tariffs.

Customers are not compelled to agree to the longest term special access rate. The first link in complaining carriers' theory of foreclosure is that, to compete in the retail marketplace, CLECs must agree to the longest term rate for special access services. Under the TPP, that is the seven-year term rate. In fact, very substantial discounts are achieved under the TPP with a term as short as three years.[123] Terms longer than three years tend to provide relatively smaller incremental discounts.[124] Indeed, there is only a $2 a month difference for DS1s between a five year and seven year term.[125]

Marketplace experience confirms that customers need not purchase the longest term to compete. Carriers – including some of he complaining carriers – frequently opt for shorter terms.[126] Customers can match the duration of the term of their special access purchases from AT&T with the term of their retail offerings and thereby mitigate the risk of incurring any term liability. For example, XO states in its comments that it buys special access in the SWBT region exclusively under a three-year term commitment, which matches the terms of XO's retail contracts.[127]

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[123] Casto Reply Decl. ¶ 8. For DS1 special access purchased in MSAs subject to pricing flexibility, AT&T's rate-term combination under the TPP in the SWBT region for zone 1 are as follows: month-to-month: $215; 1 Year: $200; 2 Year: $145; 3 Year: $112; 5 Year: $92; 7 Year: $90. *Id*. AT&T's DS1 rates in price-capped areas in the SWBT region for zone 1 follow the same pattern: month to month: $195; 1 Year: $160; 2 Year: $145; 3 Year: $92; 7 Year: $90. *Id*. ¶ 8 n.4. The TPP rates for density zones 2 and 3 follow the same pattern. *Id.* ¶ 8.

[124] *Id*. For example, in areas where AT&T has pricing flexibility, AT&T's DS1 month to month rate is $215, its 3 year term rate is $112 and its 7 year term rate is $90. *See supra* n.123. Thus, the 3 year term rate allows a customer to achieve over 82 percent of the discount earned from a 7 year term. Carlton-Shampine Reply Decl. ¶ 17 n.32.

[125] Casto Reply Decl. ¶ 8; *see also* Carlton-Shampine Reply Decl. ¶ 17.

[126] Casto Reply Decl. ¶ 9.

[127] XO Anderson Decl. ¶¶ 12-13 ("XO's commercial agreements with its retail customers tend to have longer terms, on the order of three years."); *see also* tw telecom Q4 and 2012 Earnings Report, Supplemental Slides at 12 (asserting the substantial majority of tw telecom's revenues are associated with services having a term of three years or greater).

Other customers buy circuits with a range of terms, presumably to give themselves the option to shift some circuits to alternative providers while maintaining a base of circuits at lower rates. For example, one complaining carrier purchases significant volumes of DS1s in the SWBT region at month-to-month, three-year, and five-year terms, and purchases only a trivial number of DS1s at a seven-year term.[128] Finally, AT&T's customers (including some complaining carriers) sometimes buy at month-to-month rates, preferring to have the flexibility of no term commitment – clearly belying the claim that long term discounts are essential.[129]

The complaining carriers have failed to show that AT&T's ETFs are inappropriate. Complaining carriers acknowledge, as the Commission previously has, that ETFs are a legitimate means of enforcing the bargain struck when AT&T provides special access at term discount.[130] Indeed, XO itself states that it will "require [its customers] to make the purchases they bargained for" in order to "get the discounts they negotiated."[131] tw telecom touts that the majority of its revenues are associated with term arrangements of at least three years.[132] Nonetheless, without seeking to justify their own ETFs under this standard, and without explaining how the Commission could possibly undertake this inquiry,[133] complaining carriers contend that ETFs

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[128] Casto Reply Decl. ¶ 9.

[129] *Id.*

[130] Joint CLEC Comments at 23, n.44; Besen-Mitchell Decl. ¶¶ 56-57; *see also Triennial Review Remand Order* ¶ 698 ("[w]e note that linking a price discount to a contractual term is a reasonable, accepted practice, both inside and outside of the telecommunications industry").

[131] XO Anderson Decl. ¶ 13.

[132] *See* tw telecom Q4 and 2012 Earnings Report, Supplemental Slides at 12.

[133] The Commission could not feasibly conduct the fact-bound "cost of service" inquiry suggested by complaining carriers, as it would require the Commission to evaluate "customer-specific sunk costs" each and every time an ETF is imposed.

should be no more than the amount necessary to "recover[] any unrecovered customer-specific sunk costs of providing the service."[134]

Complaining carriers are correct that one of the efficiency benefits achieved by ETFs is to ensure that a special access supplier does recover any customer-specific costs it incurs in providing service. But the justification for ETFs is much broader than this. Absent an ETF, a customer would always obtain the long term rate but would have no obligation to maintain service for the duration of that term.[135] AT&T would thus lose revenues while also losing the demand certainty and associated benefits that term commitments provide. ETFs are thus an essential part of the package of trade-offs that make term discounts possible.[136]

AT&T's customers are not compelled to accept the TPP portability option. Complaining carriers' argue that AT&T's customers have no choice but to accede to AT&T's portability option,[137] but many AT&T customers have not opted for TPP portability.[138] Only a small fraction of AT&T's non-affiliated DSn level special access customers are purchasing under the TPP portability option in the SWBT region.[139] Notably, the majority of complaining carriers have not opted for TPP portability in the SWBT region or do not use that feature for the majority of their special access needs.[140] In aggregate, there are tens of thousands of DS1 circuits

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[134] Joint CLEC Comments at 45; *see also* Besen-Mitchell Decl. ¶¶ 56-57.

[135] Carlton-Shampine Reply Decl. ¶¶ 24-25; *see also* Casto Reply Decl. ¶ 4.

[136] Carlton-Shampine Reply Decl. ¶¶ 24-25, 38.

[137] Joint CLEC Comments at 24-26.

[138] One reason might be the ability under the base TPP to transfer one end of a circuit to a different location in the same LATA. Casto Reply Decl. ¶ 15 n.5.

[139] *Id.* ¶ 12.

[140] *Id.* ¶ 11.

provided to non-affiliated customers that are not associated with a TPP portability commitment – a substantial volume of circuits.[141]

Substantial volumes of special access demand can be shifted to AT&T's rivals. AT&T's tariffed portability options provide carriers with a substantial benefit. Under the TPP's portability option, a carrier can shift 20 percent of its existing traffic, as well as any new demand, to alternatives over the term of the plan (3 years) without incurring any liability.[142] The TPP thus ensures that rival providers have an opportunity to compete for special access even from those customers that have made a portability commitment. Again, while complaining carriers raise broad claims about the type of portability options offered by AT&T, they ultimately concede that volume commitments are legitimate.[143] Instead, their complaint boils down to the claim that rather than, for example, allowing a customer shift at least 20 percent of its traffic over the term of a portability arrangement, AT&T should be required to allow a higher percentage.[144]

Complaining carriers offer no theory or justification for why the substantial amount of traffic that can be ported to rival suppliers under the TPP is insufficient, and it would be arbitrary for the Commission to adopt such an unsupported requirement.[145] Certainly, complaining

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[141] *Id*. ¶ 12. Thus, the amount of special access demand in excess of TPP portability commitments is many multiples of the *entirety* of many CLECs' special access purchases from AT&T. *Id.*

[142] *Id*. ¶ 5. The TPP's requirement of a volume commitment (and associated shortfall fees for failing to meet the volume commitment) as a condition of portability is reasonable. Otherwise, a customer would be getting a substantial benefit for nothing that would undermine the term structure. *Id.* Portability absent any volume commitment would allow a customer to sign for the longest term knowing it intended to disconnect at an earlier date. *Id*.

[143] Joint CLEC Comments at 43; Besen-Mitchell Decl. ¶ 50.

[144] *See* Joint CLEC Comments at 43 ("The limit for such commitments should be set at a level that would allow purchasers to shift a material amount of their special access purchases to alternative wholesale providers without incurring substantial penalties.").

[145] *United States Tel. Ass'n v. FCC,* 188 F.3d 521, 525 (D.C. Cir. 1999).

carriers offer no evidence that foreclosure is occurring under AT&T's portability option, especially given that no customer is required to make a volume commitment to obtain discounted rates, many customers have not opted for portability, and there are numerous other vehicles for purchasing special access other than the TPP. Indeed, complaining carriers claim they are only looking to shift incremental demand to AT&T's rivals,[146] yet they can already do this under AT&T's TPP.

The fact that many of AT&T's customers – including complaining carriers – have circuit volumes well above the minimum commitment level is fatal to their claims.[147] Under the TPP portability option these customers are free to shift substantial volumes of circuits to CLECs (or their own networks) but have chosen not do so. In aggregate, customers that have selected the TPP portability option have "headroom" of over 20 percent of the associated minimum TPP portability commitments.[148] All of this substantial demand is "portable" and can be shifted without incurring an ETF.[149]

D. Complaining Carriers Fail To Demonstrate That AT&T's Special Access Tariffs Are Harmful On Balance.

Even to the extent complaining carriers could show that AT&T's tariffs contained terms and conditions that had some "loyalty" aspects, that would be patently insufficient to justify the regulatory relief they seek. As the Commission found nearly a decade ago, the type of terms and conditions attacked by complaining carriers are common both in the industry and in competitive

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[146] Joint CLEC Comments at 28.

[147] Casto Reply Decl. ¶¶ 14-15.

[148] *Id.* ¶ 15.

[149] *Id.* ¶ 5.

industries throughout the country.[150] Indeed, complaining carriers and other CLECs have similar terms and conditions in their access contracts.[151] CLECs provide lower rates for term commitments, impose early termination fees for circuits terminated prior to the end of the commitment and have negotiated portability arrangements.[152]

The reason why these types of terms are so ubiquitous is because of the benefits and efficiencies enabled by their use. Complaining carriers' own economists acknowledge – as they must – that the lower rates provided by term plans like the TPP increase consumer welfare.[153] Term arrangements enable lower special access rates because they create more stable and predictable demand that make it easier for a special access supplier to maintain a network that most efficiently serves future demand.[154] This is particularly important with regard to special access networks that require dedicated and sunk facilities. As competing carriers acknowledge, term arrangements also allow a special access supplier to recover any costs it incurs in serving specific customers.[155]

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[150] *Triennial Review Remand Order* ¶ 698; Besen-Mitchell Decl. ¶ 13; *see also* Carlton-Shampine Reply Decl. ¶ 26.

[151] AT&T 8/8/12 Letter at 10-12; AT&T 2009 PN Comments at 81; XO Anderson Decl. ¶¶ 13-14.

[152] As AT&T has explained however, the early termination fees in the TPP "appear to be both lower and more flexible than those imposed by at least some CLECs." AT&T 8/8/12 Letter at 11.

[153] Declaration of Bridger M. Mitchell, ¶ 116 (Jan. 19, 2010) (attached to Comments of Sprint Nextel Corp. (Jan. 19, 2010)) ("In general, when the consumer is offered a lower price for purchasing a greater quantity of service – in quantity consumed per unit time, or length of time consumed – and chooses the larger quantity or term, his consumer surplus is increased.").

[154] Carlton-Shampine Reply Decl. ¶¶ 24-25; Casto Reply Decl. ¶ 4.

[155] Besen-Mitchell Decl. ¶ 56.

Thus, the Commission and federal courts have long recognized that discount plans foster competition and benefit the public in the provision of private line and special access services.[156] Indeed, the economic literature cited by complaining carriers recognizes that even "true" loyalty mandates have strong efficiency justifications and are presumptively pro-competitive.[157] The "plethora of efficiencies [that] can be attributed to loyalty rebates ... include the elimination of double marginalization, the efficient recovery of fixed costs, the stimulation of dealers' sales efforts, and the prevention of free riding on prior manufacturer investment."[158] Loyalty programs can also "allow the incumbent to achieve economies of scope or economies of scale, to market or introduce new products, or to manage demand efficiently."[159] And "[l]oyalty rebates

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[156] Report and Order, *Private Line Rate Structure and Volume Discount Practices*, 97 F.C.C.2d 923, ¶ 40 (1984); Fourth Memorandum Opinion And Order On Reconsideration, *Transport Rate Structure and Pricing*, 10 FCC Rcd. 12979, ¶ 13 (1995) (citing Report and Order and Notice of Proposed Rulemaking, *Expanded Interconnection with Local Telephone Company Facilities*, 7 FCC Rcd. 7369, ¶ 199 (1992)); Notice of Proposed Rulemaking, Third Report and Order, *Access Charge Reform*, 11 FCC Rcd. 21354, ¶ 187 (1997).

[157] Hans Zenger, *Loyalty Rebates and the Competitive Process*, Journal of Competition Law & Economics, at 1 (Mar. 9, 2012) ("[L]oyalty rebates are an efficient and healthy form of competition."), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2019185; Gianluca Faella, *The Antitrust Assessment of Loyalty Discounts and Rebates*, at 5 (October 11, 2007), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1079504 ("[I]n many cases, [loyalty discounts] may benefit not only producers but also consumers."); *id.* at 29-30 (loyalty discounts are "inherently competitive" and a "non-predatory discounts should be presumed lawful"); Damien Geradin, *Separating Pro-Competitive from Anti-Competitive Loyalty Rebates: A Conceptual Framework*, Paper for the Asia International Competitive Conference, Seoul, at 4 (Sept. 4, 2008), *available at* http://ssrn.com/abstract=1259830 or http://dx.doi.org/10.2139/ssrn.1259830 ("While loyalty rebates may in limited circumstances be granted for exclusionary purposes, this is the exception rather than the rule."). The literature also recognizes that loyalty arrangements can provide substantial benefits even when used by a dominant incumbent. *See* Carlton-Shampine Reply Decl. ¶ 29 (citing literature).

[158] Zenger, *Loyalty Rebates and the Competitive Process*, *supra*, at 7.

[159] Fiona Scott-Morton, *Contracts that Reference Rivals*, Presented at Georgetown Univ. Law Center Antitrust Seminar, at 11 (Apr. 5, 2012), *available at* http://www.justice.gov/atr/public/speeches/281965.pdf; *see also* Geradin, *Separating Pro-Competitive from Anti-Competitive Loyalty Rebates*, at 21 (loyalty programs "allow suppliers to achieve a range of efficiencies" including "economies of scale and faster fixed cost recovery"

enable firms that have created an enhanced product or a more efficient production technology to earn a higher reward for their creative efforts, which encourages firms to provide those efforts in the first place."[160]

Finally, these types of arrangements can facilitate competition at the margin.[161] Loyalty rebates allow incumbent providers to compete more intensely than "uniform" prices would allow.[162] And, of course, rebates that reduce prices are a "direct benefit [to] consumers."[163]

At the same time, where customers have reasonable alternatives for special access, even nakedly exclusionary contracts cannot be used to harm competition and consumer welfare.[164] Where "customers can avail themselves of . . . competitive options" a supplier cannot force the customer to accept unreasonable terms and conditions.[165] Indeed, this is the (unchallenged) economic foundation of the *Pricing Flexibility Order.* Where alternative providers have made sunk investment in network facilities capable of providing dedicated access services to customers served by the incumbent such investment ensures that ILECs and new entrants will compete on price and other terms, because an incumbent has little hope of driving its competitors out of the market through exclusionary conduct. For these reasons, the Commission found in 1999 that "the presence of facilities-based competition with significant sunk investment makes

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and "economies of scope and reduction of transaction costs"); Faella, *Antitrust Assessment of Loyalty Discounts and Rebates*, *supra*, at 6 (loyalty rebates allow for better recovery of "relationship-specific investments").

[160] Zenger, *Loyalty Rebates and the Competitive Process*, *supra*, at 49.

[161] *Id.* at 21.

[162] *Id.* at 21; *see also* Faella, *Antitrust Assessment of Loyalty Discounts and Rebates, supra*, at 6.

[163] Geradin, *Separating Pro-Competitive from Anti-Competitive Loyalty Rebates, supra*, at 21.

[164] Carlton-Shampine Reply Decl. ¶ 20.

[165] *Id.*

exclusionary pricing behavior costly and highly unlikely to succeed."[166] The D.C. Circuit agreed with this reasoning, observing that the "presence of facilities-based competition with significant sunk investment makes exclusionary pricing behavior costly and highly unlikely to succeed, [because] that equipment remains available and capable of providing service in competition with the incumbent, even if the incumbent succeeds in driving that competitor from the market.[167]

The literature relied upon by complaining carriers,[168] as well as their own economists, effectively concede this point.[169] Yet complaining carriers make no serious effort to demonstrate that they have no viable alternative but to accept the conditions demanded by AT&T and other ILECs. No serious assessment of whether AT&T and other ILECs can impose anticompetitive tariff provisions can be made without analyzing the extent to which CLECs have deployed alternative networks in proximity to locations where special access demand is concentrated. As the Commission concluded in the *Pricing Flexibility Order*, if competitors have entered the market with sunk facilities, the ability of AT&T to foreclose competition through use of contract is entirely eliminated.[170]

That, of course, is exactly what the Commission is attempting to determine in this proceeding. Indeed, the Commission has recognized that it currently lacks the data to make an

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[166] *Pricing Flexibility Order* ¶ 80.

[167] *WorldCom*, 238 F.3d at 458-59; *see also* Carlton-Sider 2009 PN Decl. ¶ 59.

[168] Geradin, *Separating Pro-Competitive from Anti-Competitive Loyalty Rebates*, *supra*, at 9; *see also* Carlton and Greenlee, *Assessing the Anticompetitive Effects of Multiproduct Pricing*, *supra*, at 25; Morton, *Contracts that Reference Rivals*, *supra*, at 5. A showing that the challenged tariff terms are sought by a carrier with market power is necessary but not sufficient to establish that the tariff terms are anticompetitive. Carlton-Shampine Reply Decl. ¶¶ 27-30. It is still necessary to show that the tariff terms exclude rivals and that such harm outweighs any benefits that flow from the terms. *Id*. ¶ 28.

[169] Besen-Mitchell Decl. ¶ 13.

[170] Carlton-Shampine Reply Decl. ¶¶ 20-21.

informed decision about the full extent of competitive alternatives to ILEC special access services.[171] Moreover, as noted, it is undisputed that complaining carriers include the same types of terms and conditions in their tariffs as the ones they are now attacking. It would be clearly inappropriate to condemn tariff provisions that are presumptively beneficial and similar to what regulation proponent themselves offer before determining the scope of competitive deployment.[172]

III. THE COMMISSION CANNOT LAWFULLY GRANT PROPONENTS' REQUEST FOR IMMEDIATE REFORMATION OF AT&T's TARIFFED OFFERINGS.

Finally, the wholesale reformation of scores of contracts to eliminate allegedly exclusionary terms and conditions would be patently unlawful. Complaining carriers argue that, before the Commission has even collected data to determine the scope of sunk investment in special access network facilities, the Commission should drastically modify *all* existing ILEC tariffed offerings and contracts for special access services. The breathtaking nature of this request is hard to overstate. AT&T alone has dozens of service options and contracts in just the SWBT region, many of them custom-tailored after individualized negotiations. Yet, based on misleading and inaccurate characterizations of one AT&T tariff, the complaining carriers ask the Commission to bar enforcement of all AT&T tariffs and contracts that include commitments to

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[171] *Notice* ¶¶ 66-71; *Pricing Flexibility Suspension Order* ¶¶ 3, 6, 7, 50, 52.

[172] With no hint of irony, the complaining carriers also argue that AT&T is unfairly *reducing* the price of its special access services to gain dominance in the highly-competitive broadband services markets. Specifically, complaining carriers argue that AT&T is "tying" its broadband services to its special access services by offering steep discounts for the bundled offering. Joint CLEC Comments at 30-32. But the complaining carriers never even attempt to establish the fundamental prerequisite to a tying claim – that AT&T has refused to sell its special access services unless a customer also agreed to purchase other broadband business services. *Sports Racing Services, Inc.* v. *Sports Car Club of Am., Inc.*, 131 F.3d 874, 886 (10th Cir. 1997) ("Critical to a tying claim is the fact that the seller forced the buyer to purchase the tied product in order to get the tying product"); *Eastman Kodak Co.* v. *Image Technical Services, Inc.*, 504 U.S. 451, 461 (1992); *United States* v. *Microsoft Corp.*, 253 F.3d 34, 85 (D.C. Cir. 2001).

purchase more than 50 percent of the amount that a customer previously spent (or is currently committed to spend) on special access services from AT&T.[173] These carriers also ask the Commission to invalidate all tariffs and contracts that include a term commitment "longer than needed to recover any customer-specific sunk costs" and an early termination fee "higher than the unrecovered customer-specific sunk costs."[174] They also seek imposition of "most favored nation"-type clauses such that, if an ILEC offers "smaller termination penalties" in "one part of its territory, it must offer those same terms throughout its entire territory."[175] At the same time, the complaining carriers demand that the parts of the contracts that they like – especially the discounted rates – should remain intact and enforceable.[176]

A request for such drastic and one-sided modifications of potentially hundreds of bilateral contracts – most of which the complaining carriers have not even mentioned or described in their pleadings – would be remarkable in any setting. But it is truly extraordinary here. The Commission, the courts, and economists uniformly recognize that price discounts are pro-competitive. Indeed, as noted above, economists recognize that even classic "loyalty" contracts, which are more restrictive than AT&T's tariffed offerings, are presumptively beneficial. Complaining carriers themselves offer the same types of contract terms that they ask the Commission to excise from AT&T's contracts. And, in an earlier stage of this very proceeding, the Commission recognized that "the presence of facilities-based competition with significant sunk investment makes exclusionary pricing behavior costly and *highly unlikely to succeed*."[177]

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[173] Level 3 at 10.

[174] Besen-Mitchell Decl. ¶ 55.

[175] *Id.* ¶ 69.

[176] Level 3 at 10.

[177] *Pricing Flexibility Order* ¶ 80.

Yet, the complaining carriers ask the Commission to invalidate presumptively pro-competitive terms when offered by ILECs – but not when offered by others – before the Commission collects data on whether sunk investment renders exclusionary use of such discounts "highly unlikely."

In these circumstances, the Commission cannot grant the relief complaining carriers seek without violating Section 205 of the Communications Act and the requirements of reasoned decision-making. Under Section 205, the Commission cannot modify tariffs until it conducts a hearing and make express findings that the terms of a tariff are unjust and unreasonable – and under the complaining carriers' proposal, categorically unreasonable, regardless of the intensity of competition and regardless of other terms and circumstances – and prescribes the just and reasonable terms that must be used instead. Complaining carriers' argument that these requirements do not apply here is baseless. And, the record of this proceeding provides no basis for the Commission to make the findings required by Section 205 in any principled and reasoned way.

A. The Commission Cannot Alter The Terms Of AT&T's Tariffed Offerings Without Complying With The Requirements Of Section 205.

Title II of the Communications Act establishes a scheme of carrier-initiated rates embodied in tariffs that have the force of law, and the Commission cannot override or change the terms of such tariffs unless and until it satisfies the requirements of Section 205 of the Act. Once carrier-initiated tariffs take effect, Section 205 provides that the Commission may order a carrier to change the rates or terms of its offer only *after* it has conducted a hearing and (1) made definitive findings that the carrier's existing charge or practice "is or will be in violation of any provisions of this Act" and (2) determined "what will be the just and reasonable" charge or practice "to be thereafter followed." 47 U.S.C. § 205.[178] As the courts have repeatedly held, and as the Commission itself has repeatedly recognized, these statutory requirements apply to all prescriptions, whether they are permanent or "interim." When the Commission lacks an adequate record to make such findings, it must "leave the matter of prescription for resolution on an adequate record after further proceedings."[179]

Here, the Commission has acknowledged that it lacks information "sufficient to evaluate current conditions in the special access market."[180] Tacitly recognizing that, as a result, the Commission cannot possibly satisfy Section 205's requirements, complaining carriers claim, in essence, that the Commission should simply ignore them. None of the precedents they cite, however, justifies their claim that the Commission can alter AT&T's tariffed offerings without complying with Section 205's mandates.

The Complaining carriers rely principally on the Commission's *Video Nonexclusivity Order*, which addressed contracts in which owners of multiple dwelling units ("MDUs"), such as

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[178] *AT&T Co.* v. *FCC*, 487 F.2d 865, 872-80 (2d Cir. 1973) (a "full opportunity for hearing" and express Commission findings that the carrier-initiated rate is unjust and unreasonable and the prescribed rate is just and reasonable "are essential to any exercise by the Commission of its authority" to prescribe rates); *Southwestern Bell Corp.* v. *FCC*, 43 F.3d 1515, 1519 (D.C. Cir. 1995) (the "Commission is not free to circumvent or ignore th[e] balance [created by Congress in § 205]. Nor may the Commission in effect rewrite this statutory scheme on the basis of its own conception of the equities of a particular situation").

[179] *See AT&T Co.* v. *FCC*, 449 F.2d 439, 451 (2d Cir. 1971) (striking down interim prescription; since record was insufficient, "§ 205(a) required the Commission to leave the matter of prescription for resolution on an adequate record"); *American Telephone and Telegraph Company Revisions to Tariff F.C.C. No. 259, Wide Area Telecommunications Service (WATS),* 86 FCC 2d 820, ¶ 88 (1981) (rejecting interim phase-in" proposal, because "we now have no record on which to base such a prescription. Section 205 of the Act, 47 U.S.C. § 205, permits the Commission to prescribe just, fair, and reasonable charges, regulations or practices only after hearing. Since we have not yet investigated NTS costs, we are not in a position to determine whether such proposals are reasonable").

[180] Opposition of the Federal Communications Commission to Petition for Writ of Mandamus, *In re COMPTEL, et al.*, D.C. Cir. No. 11-1262, at 1-2 (filed Oct. 6. 2011) ("FCC *COMPTEL* Opp.").

apartment complexes, granted multichannel video programming distributors (MVPDs) the exclusive right to provide such programming to the residents of their MDUs.[181] The Commission found that these contracts were "a complete bar to entry" and caused a variety of competitive harms to the MDU residents, who had no say in the exclusivity arrangements that dictated who their provider was.[182] Exercising its power under section 628 of the Act, the Commission barred the execution or enforcement of these contracts.[183]

This ruling plainly does not establish that the Commission can modify AT&T's tariffed offerings without complying with Section 205. In stark contrast to the statutory scheme here, Section 628(c)(1) expressly empowers the Commission to promulgate regulations that prohibit particular conduct under Section 628(b) without conducting a hearing and without making the definitive findings that Section 205 requires.[184] Indeed, the Commission relied on its distinct authority under Section 628(c)(1) to reject the argument that it could not invalidate exclusivity contracts for multichannel video programming services unless it held adjudicative proceedings.[185]

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[181] *See* Joint CLEC Comments at 12 n.9 (citing Report and Order and Further Proposed Rulemaking, *Exclusive Service Contracts for the Provision of Video Services in Multiple Dwelling Units and Other Real Estate Developments*, Report and Order and Further 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*"); Level 3 at 5-7 (same).

[182] *Video Nonexclusivity Order* ¶¶ 9, 12-13, 17-22.

[183] *Id.* ¶¶ 30-31, 40-51.

[184] *See* 47 U.S.C. § 548(c)(1). Instead, a hearing is an optional method by which an aggrieved MVPD can seek review of conduct alleged to violate Section 628(b). *See id.* § 548(d).

[185] *Video Nonexclusivity Order* at n.156.

Recognizing this, Level 3 now invokes decisions in the *Promotion of Competitive Networks* proceedings.[186] There, the Commission exercised its authority under Section 201(b) to prohibit common carriers from executing exclusivity contracts with owners of commercial multiple tenant environments ("MTE") for telecommunications services,[187] then extended that prohibition to predominantly residential MTEs based on the rationale of its *Video Nonexclusivity Order*.[188] Level 3 overlooks the critical fact, however, that the exclusivity contracts at issue in the *Promotion of Competitive Networks* proceedings were *not* tariffed offerings. Indeed, they were not contracts with customers at all. Those contracts thus fell outside the Title II scheme governing carrier-initiated rates embodied in tariffs, and were not governed by Section 205's requirements for modifying tariffed charges. Here, by contrast, complaining carriers indisputably seek modification of AT&T tariffs and contract tariffs. Section 205 is thus directly applicable.

In short, the complaining carriers cite no ruling or order in which the Commission has ever modified the terms and prices of tariffed telecommunications offerings without conducting a

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[186] *See* Level 3 at 6-7; *see also* Letter from Erin Boone (Level 3) to Marlene H. Dortch (FCC), WC Docket No. 05-25 (Oct. 31, 2012) at 7-9.

[187] First Report and Order and Further Notice of Proposed Rulemaking, *Promotion of Competitive Networks in Local Telecommunications Markets*, WT Docket No. 99-217; Fifth Report and Order and Memorandum Opinion and Order, *Implementation of the Local Competition Provisions in the Telecommunications Act of 1996*, CC Docket No. 96-98; Fourth Report and Order and Memorandum Opinion and Order, *Review of Sections 68.104 and 68.213 of the Commission's Rules Concerning Connection of Simple Inside Wiring to the Telephone Network*, CC Docket No. 88-57, 15 FCC Rcd. 22983, ¶¶ 160-64 (2000).

[188] Report and Order, *Promotion of Competitive Networks in Local Telecommunications Markets*, 23 FCC Rcd. 5385 (2008) ("*Promotion of Competitive Networks Order*").

hearing and making the findings required under Section 205.[189] If the Commission were to take such a step here, it would act in clear violation of the statutory scheme.

B. The Current Record Does Not Permit The Commission To Alter The Terms And Conditions Of AT&T's Tariffed Offerings In A Reasoned Manner.

The complaining carriers' efforts to evade the requirements of Section 205, while unavailing, are certainly understandable: on the present record, the Commission cannot possibly make the necessary findings that would allow it to actively rewrite provisions in scores of ILEC contracts that are not even part of this record. To engage in reasoned decision-making, the Commission must be able to account for (1) the longstanding consensus (shared by the Commission itself) that price discounts are pro-competitive; (2) the fact that CLECs, including complaining carriers, include in their own contracts the very terms they ask the Commission to condemn; (3) the fact that the complaining carriers' own economists and the literature they rely upon recognize that "exclusionary" contracts do not raise concerns where suppliers face competition; and (4) the Commission's own recognition that sunk investment largely precludes exclusionary use of discount pricing. On the present record – which does not yet contain the data necessary to assess the extent of sunk investment – the Commission cannot offer a reasoned explanation for the eat-their-cake-and-have-it-too relief proponents request.

[189] The Joint CLECs also quote the Commission's statement that it can enforce Sections 201 and 202 through regulations "even when competition exists in a market." Joint CLEC Comments at 12 (*quoting* Memorandum Opinion and Order and Notice Proposed of Rulemaking, *Personal Communications Industry Association's Broadband Personal Communications Services Alliance's Petition for Forbearance for Broadband Personal Communications Services*, 13 FCC Rcd. 16857, ¶ 17 (1998)). This statement plainly does not establish that the Commission can modify tariffed offerings without complying with Section 205.

1. Commission and Judicial Precedent Overwhelmingly Recognize That Price Discounts Are Pro-Competitive.

The Commission has long recognized that "both volume and term discounts [are] generally legitimate means of pricing special access facilities so as to encourage the efficiencies associated with larger traffic volumes and the certainty associated with longer-term relationships."[190] Indeed, the Commission has stated that volume and term "discounts should be permitted . . . because they encourage efficiency and full competition."[191] Accordingly, the Commission has recognized that it is improper to bar an incumbent from offering discounts made possible by its "resource advantages [or] scale economies" and thereby "deny [it] the efficiencies its size confers in order to make it easier for others to compete."[192]

The Commission's own determinations on this point parallel – and draw additional support from – the equally well-settled judicial conclusions that price discounts are pro-competitive even when they are offered by monopolists, as long as the discounted prices are not below cost. As the Supreme Court has explained, "'[l]ow prices benefit consumers regardless of

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[190] Fourth Memorandum Opinion and Order on Reconsideration, *Transport Rate Structure and Pricing*, 10 FCC Rcd. 12979, ¶ 13 (1995) (*citing* Report and Order and Notice of Proposed Rulemaking, *Expanded Interconnection with Local Telephone Company Facilities*, 7 FCC Rcd. 7369, ¶ 199 (1992)). *See also, e.g.*, Report and Order, *Private Line Rate Structure and Volume Discount Practices*, 97 F.C.C.2d 923, ¶ 40 (1984) ("[g]reater pricing flexibility in volume discounts may benefit large as well as small users, not injure competition, and not be discriminatory").

[191] Notice of Proposed Rulemaking, Third Report and Order, and Notice of Inquiry, *Access Charge Reform*, 11 FCC Rcd. 21354, ¶ 187 (1997).

[192] Report and Order, *Competition in the Interstate Interexchange Marketplace*, 6 FCC Rcd. 5880, ¶ 60 (1991). *See also SBC Commc'ns, Inc.* v. *FCC*, 56 F.3d 1484, 1491 (D.C. Cir. 1995) (Commission may not use its authority to "subordinate the public interest to the interest of equalizing competition among competitors") (internal quotations omitted); *W.U. Telephone Co.* v. *FCC*, 665 F.2d 1112, 1122 (D.C. Cir. 1981) ("equalization of competition is not itself a sufficient basis for Commission action"); *United States* v. *Western Elec.*, 969 F.2d 1231, 1243 (D.C. Cir. 1992) (Commission has no public interest authority to "aid the minnows against the trout").

how those prices are set, and so long as they are above predatory levels [*i.e.*, above-cost], they do not threat competition.'"[193] The D.C. Circuit has likewise recognized that, "[t]he rare case of price predation aside, the antitrust laws do not condemn even a monopolist for offering its product at an attractive price."[194] And, as noted above, the economic literature widely recognizes that, because of the presumptively pro-competitive features, even true "loyalty" arrangements should be condemned *only* when used by a firm that "holds substantial market power."[195]

In light of this consensus, there can be no presumption that the price discount provisions proponents challenge are presumptively anti-competitive; to the contrary, they should be presumed to be pro-competitive. Indeed, CLECs, including some complaining carriers, provide discounts on the same terms. Moreover, as noted, the Commission recognized in an earlier stage of this very proceeding that "the presence of facilities-based competition with significant sunk investment makes exclusionary pricing behavior costly and *highly unlikely to succeed*"[196] – a view the D.C. Circuit has endorsed.[197] There is thus significant reason to doubt the very viability of complaining carriers' foreclosure theory.

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[193] *Brooke Grp., Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209, 223 (1993) (quoting *Atlantic Richfield Co. v. USA Petroleum Co.*, 495 U.S. 328, 340 (1990)).

[194] *United States v. Microsoft Corp.*, 253 F.3d 34, 68 (D.C. Cir. 2001); *see also ZF Meritor, LLC*, 696 F.3d at 273 ("[l]ow, but above-cost, prices are generally procompetitive because 'the exclusionary effect of prices above a relevant measure of cost [generally] reflects the lower cost structure of the alleged predator, and so represents competition on the merits'") (quoting *Brooke Grp.*, 509 U.S. at 223).

[195] Geradin, *Separating Pro-Competitive from Anti-Competitive Loyalty Rebates*, at 9; *see also* Carlton and Greenlee, *Assessing the Anticompetitive Effects of Multiproduct Pricing*, at 25; Fiona Scott-Morton, *Contracts that Reference Rivals*, at 5.

[196] *Pricing Flexibility Order* ¶ 80 (emphasis added).

[197] *WorldCom*, 238 F.3d at 458-59; *see also* Carlton-Sider 2009 PN Decl. ¶ 59.

2. On the Record of this Proceeding, the Commission Cannot Provide a Reasoned Explanation for the Extraordinary Relief the Complaining Carriers Seek.

Notwithstanding the consensus that price discounts are presumptively pro-competitive even when offered by incumbents and monopolists, the complaining carriers ask the Commission to declare that special access price discounts in hundreds of contracts that ILECs have executed throughout the country (and that are not even part of the record in this proceeding) are categorically unjust and unreasonable. Assuming the Commission could ever grant such extraordinary, blunderbuss relief, it plainly cannot do so on the current record. The question whether the complaining carriers' foreclosure theory is even viable depends on the extent of sunk investment in the market, and the Commission is in the process of collecting the data necessary to make that very determination. In the absence of such evidence, there is no reasoned basis for declaring provisions in myriad ILEC contracts illegal, while permitting CLECs to employ the same provisions.

In this regard, the decisions in the *Video Nonexclusivity* and the *Promotion of Competitive Networks* proceedings are instructive – though not for the reasons complaining carriers trumpet. Although, as AT&T has just explained, the Commission was not required in those proceedings to hold hearings and make explicit findings of justness and reasonableness, the Commission nevertheless did not (as petitioners urge here) grant relief first and collect data afterwards. Instead, after collecting the relevant information, the Commission found that the exclusivity arrangements at issue in those proceedings operated as complete bars to entry and had virtually no countervailing benefits.[198] On the strength of these evidence-based findings, the Commission prohibited enforcement of *all* exclusivity clauses – including those executed by new

[198] *Video Nonexclusivity Order* ¶¶ 16-29; *Promotion of Competitive Networks Order* ¶¶ 8-13, 17.

entrants.[199] Thus, the Commission did not distinguish the legality of contract provisions based on whether an incumbent or new entrant was a party to the contract. It announced a flat ban, and had both a reasoned basis and actual evidence to support that ban.

Here, by stark contrast, the complaining carriers ask the Commission to declare that certain contract terms and conditions are always unjust and unreasonable when offered by ILECs, but are legal when offered by others, and to make this declaration *before* it collects the market data necessary to justify such a line. There can be no reasoned basis for such a cart-before-the-horse judgment, particularly when price discounts are presumptively beneficial and the Commission has not even collected the competitive facilities data. Indeed, the Commission itself has acknowledged "that it should make no decisions about revising its special access rules before it has compiled and analyzed an adequate evidentiary record."[200]

Moreover, in the *Video Nonexclusivity* and the *Promotion of Competitive Networks* proceedings, the Commission simply declared exclusivity clauses illegal. It did not purport to readjust the bargains struck in the underlying contracts by excising some terms, mandating the inclusion of other terms, and leaving still other terms unaffected. Here, by contrast, complaining carriers brazenly ask the Commission to retroactively modify the bargains they struck so that they can retain all of the *quid* (significant discounts) while escaping the various *quo*'s (term and/or volume commitments with associated ETFs). The Commission would need a cogent explanation for why it decided to recalibrate the balance struck in hundreds of privately

[199] *Video Nonexclusivity Order* ¶¶ 33, 35, 38-39; *Promotion of Competitive Networks Order* ¶ 13.

[200] FCC *COMPTEL* Opp. at 19; *see also Video Nonexclusivity Order* ¶ 32 (excluding Direct Broadcast Satellite and private cable operators from prohibition on exclusivity clauses "because we do not have an adequate record on which to decide whether such a prohibition is warranted for non-cable operators").

negotiated contracts in the various ways proponents request, yet the current record is notably devoid of evidence-based reasons.

The complaining carriers claim, for example, that linking a portability benefit to an 80 percent historic volume commitment is unlawful, and that a 50 percent volume commitment should be mandated instead.[201] But they cite no data whatsoever to justify their choice of 50 percent over 80 percent, nor any evidence supporting their claim that the former threshold "would allow purchasers to shift a material amount of their special access purchases to alternative wholesale providers," while the latter threshold would not.[202] Indeed, they do not even define what constitutes a "material amount" of special access services, much less identify evidence to support that definition.[203]

Similarly, the complaining carriers ask the Commission to mandate term commitments that are "no longer than is needed to recover the customer-specific sunk costs of providing the circuit," and associated ETFs that are "no higher than the unrecovered customer-specific sunk costs of providing the circuit."[204] The only "support" they offer for these formless and utterly unworkable standards is the unadorned statement that "[t]erm commitments . . . in special access contracts are *presumably* justified by the need for a carrier to recover its customer-specific sunk

[201] Level 3 at 10; Joint CLEC Comments at 43 & Besen-Mitchell Decl. ¶¶ 50, 54.

[202] Joint CLEC Comments at 43.

[203] Level 3 asserts that it "has cited numerous cases in which contracts imposing market foreclosure of less than 50% have been held to have violated the antitrust laws." Level 3 at 9 n.34. But proponents have not demonstrated that ILECs' tariffs have foreclosed *any* percentage of the market; indeed, no such showing can be made before evidence is actually collected. Moreover, a 50 percent volume commitment for AT&T's portability feature would plainly not "lock up" 50 percent *of the market*. As AT&T has shown, the volume commitment does not even apply to all of AT&T's own customers, much less the entire market; the commitment does not restrict the ability of AT&T customers to shift any increased demand to other providers; and the commitment does not cover demand that AT&T's customers have already placed with other providers.

[204] Besen-Mitchell Decl. ¶ 55.

costs."[205] That presumption, however, is baseless. As discussed above, ETFs serve a broader purpose than recovery of customer-specific sunk costs, deterring a customer from obtaining the long-term rate and then failing to maintain service for the duration of that term.[206] ETFs are thus an essential part of the package of trade-offs that make term discounts possible, because they provide some certainty for business planning and network management.[207] A carrier will share some of the benefits of that certainty to persuade customers to agree to the commitments (hence, the discounts).[208] But when a carrier provides a term discount, it makes planning and operational decisions in reliance on the committed volume and may face additional costs to change plans.[209] Those costs are different than the costs incurred to serve the specific customer.[210]

Ultimately, the "justifications" for all of the complaining carriers' proposed modifications are simply bald assertions that ILECs have "high market shares in the provision of DS1 and DS3 services," there are "high entry barriers associated with providing these services," and that there is an "absence of plausible efficiencies associated with . . . loyalty contracts."[211] But the Commission does not yet have the data necessary to determine the ILECs' market shares.[212] And even if complaining carriers' assertion of high market shares is true, the Commission "has long held that market share is not the be-all, end-all of competition," and that a

[205] *Id.* ¶ 56 (emphasis added).

[206] Carlton-Shampine Reply Decl. ¶ 38.

[207] *Id.* ¶ 24.

[208] *Id.*

[209] *Id.* ¶ 38 & n.106.

[210] *Id.* ¶¶ 24, 38.

[211] Besen-Mitchell Decl. ¶ 49.

[212] *See Pricing Flexibility Suspension Order* ¶ 50.

"loss of market share is [not] necessary to prevent an ILEC from raising prices."[213] Indeed, as one court has noted, it has been "many years since anyone knowledgeable about" competitive analysis "thought that concentration by itself imported a diminution in competition."[214] In all events, broad-brush assertions are not a reasoned basis for invalidating presumptively pro-competitive provisions and retroactively altering hundreds of contracts *before* the Commission collects the data necessary to determine whether market conditions preclude use of pricing discounts for exclusionary purposes.

In fact, because such retroactive alteration of commercial contracts is extraordinary and drastic relief, it requires a particularly clear and compelling justification. Under the *Sierra-Mobile* doctrine,[215] the Commission may "abrogate existing contracts only where the public interest 'imperatively demands' such action."[216] The Commission quite obviously cannot determine that the public interest "imperatively demands" abrogation of all ILEC term and volume discounts before it collects the data necessary to determine whether market conditions would permit successful use of such terms to exclude competition.

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[213] *WorldCom, Inc.*, 238 F.3d at 458.

[214] *Capital Cities/ABC, 2*9 F.3d at 315; *see also Comcast Corp. v. FCC*, 579 F.3d 1, 6 (D.C. Cir. 2009) (whether a provider "can exercise 'bottleneck monopoly power' depends …. 'not only on its share of the market, but also on the elasticities of supply and demand, which in turn are determined by the *availability* of competition'" (emphasis in original) (quoting *Turner Broad. Sys.* v. *FCC*, 512 U.S. 622, 661 (1994); *Time Warner Entm't Co.*, 240 F.3d at 1134; *United States* v. *Gen. Dynamics Corp.*, 415 U.S. 486, 498 (1974) (market share is imperfect measure because market must be examined in light of access to alternative supplies); *United States* v. *Syufy Enters.*, 903 F.2d 659, 665-66 (9th Cir. 1990) ("In evaluating monopoly power, it is not market share that counts, but the ability to *maintain* market share.") (emphasis in original); *United States* v. *Baker Hughes, Inc.*, 908 F.2d 981, 986 (D.C. Cir. 1990) (market share statistics "misleading" in a "volatile and shifting" market).

[215] *FPC* v. *Sierra Pac. Power Co.*, 350 U.S. 348, 353-55 (1956); *United Gas Pipe Line Co.* v. *Mobile Gas Serv. Corp.*, 350 U.S. 332, 344 (1956).

[216] *Union Pacific Fuels, Inc. v. FERC*, 129 F.3d 157, 161 (D.C. Cir. 1997) (quoting *Metropolitan Edison Co. v. F.E.R.C.,* 595 F.2d 851, 856 n.29 (D.C. Cir. 1979)).

As the Commission itself has held elsewhere, "[t]here is simply no justification for allowing [a party] . . . to negotiate for concessions on price, to sign a contract containing customized provisions that are the product of voluntary agreement, and then to run to the Commission to have the Commission reform a provision of the contract that was an integral part of the *quid pro quo* bargain but which subsequently produces hardship to the customer."[217] There is likewise "simply no justification for" complaining carriers' request for immediate reformation of AT&T's tariffed offerings, before the Commission even determines whether sunk investment precludes anticompetitive price discounting.

CONCLUSION

For the foregoing reasons, the Commission should proceed as described above.

Respectfully submitted,

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March 12, 2013

[217] *Ryder Order* ¶ 28 (internal quotation marks omitted).

Attachment A

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Special Access for Price Cap Local Exchange Carriers	)	WC Docket No. 05-25
	)	
AT&T Corp. Petition for Rulemaking to Reform Regulation of Incumbent Local Exchange Carrier Rates for Interstate Special Access Services	)	RM-10593

Reply Declaration of

Dennis W. Carlton

and

Allan L. Shampine

March 12, 2013

I. QUALIFICATIONS AND SUMMARY OF OPINIONS

A. DENNIS W. CARLTON

1. I am the David McDaniel Keller Professor of Economics at the Booth School of Business of The University of Chicago. I received my A.B. in Applied Mathematics and Economics from Harvard University and my M.S. in Operations Research and Ph.D. in Economics from the Massachusetts Institute of Technology. I have served on the faculties of the Law School and the Department of Economics at The University of Chicago and the Department of Economics at the Massachusetts Institute of Technology. I specialize in the economics of industrial organization. I am co-author of the book *Modern Industrial Organization*, a leading text in the field of industrial organization, and I also have published over 100 articles in academic journals and books. In addition, I am Co-Editor of the *Journal of Law and Economics*, a leading journal that publishes research applying economic analysis to industrial organization and legal matters, serve on the Editorial Board of *Competition Policy International*, a journal devoted to competition policy, and serve on the Advisory Board of the *Journal of Competition Law and Economics*. I have also served as an Associate Editor of the *International Journal of Industrial Organization* and *Regional Science and Urban Studies*, and on the Editorial Board of *Intellectual Property Fraud Reporter*.

2. In addition to my academic experience, I served as Deputy Assistant Attorney General for Economic Analysis, Antitrust Division, U.S. Department of Justice, from October 2006 through January 2008. I also served as a Commissioner of the Antitrust Modernization Commission, created by Congress to evaluate U.S. antitrust laws. I have served as a consultant to the Department of Justice and Federal Trade Commission on the Horizontal Merger Guidelines, as a general consultant to the Department of Justice and Federal Trade Commission

on antitrust matters, and as an advisor to the Bureau of the Census on the collection and interpretation of economic data. I also am a Senior Managing Director of Compass Lexecon, a consulting firm that specializes in the application of economics to legal and regulatory issues, and of which I served as President (of Lexecon) for several years. I have provided expert testimony before various U.S. state and federal courts, the U.S. Congress, a variety of state and federal regulatory agencies and foreign tribunals. I have published papers on telecommunications and have submitted testimony before the FCC on several matters including special access. A copy of my curriculum vitae is attached as Exhibit 1 to this Declaration.

B. ALLAN L. SHAMPINE

3. I am a Senior Vice-President of Compass Lexecon. I received a B.S. in Economics and Systems Analysis *summa cum laude* from Southern Methodist University in 1991, an M.A. in Economics from the University of Chicago in 1993, and a Ph.D. in Economics from the University of Chicago in 1996. I have been with Compass Lexecon (previously Lexecon) since 1996. I specialize in applied microeconomic analysis and have done extensive analysis of network industries, including telecommunications and payment systems. I am the editor of the book *Down to the Wire: Studies in the Diffusion and Regulation of Telecommunications Technologies,* and I have published a variety of articles on the economics of telecommunications and network industries and on antitrust issues. I am an editor of the American Bar Association journal *Antitrust Source*. In addition, I have previously provided economic testimony on telecommunications issues on a variety of matters before a variety of regulatory agencies and tribunals including the European Commission, the United States Federal Communications Commission, the Australian Competition & Consumer Commission and state public utility commissions. A copy of my curriculum vitae is provided as Exhibit 2.

C. SUMMARY OF COMPLAINTS AND PROPOSED REMEDIES

4. We have been asked by counsel for AT&T Services, Inc. ("AT&T") to review and respond to comments submitted to the Federal Communications Commission ("FCC" or "the Commission") by BT Americas, Cbeyond, Earthlink, Integra, Level 3, Sprint Nextel, TelePacific Communications, tw telecom and XO Communications (collectively, "Complainants")[1] and the declaration of Stanley Besen and Bridger Mitchell submitted on behalf of some of the Complainants,[2] who argue that certain terms and conditions in incumbent local exchange carrier ("ILEC") special access tariffs are anticompetitive. We have previously filed reports in this proceeding on January 19, 2010 and February 24, 2010 in which we discuss related issues and Professor Carlton spoke at the July 19, 2010 FCC staff workshop on special access.[3] We extend our analysis in this declaration.

5. Complainants generally argue that they and other buyers of special access are forced into accepting AT&T services with relatively uniform and onerous terms and as a result so much business is "locked up" that there is insufficient demand to support the entry of a rival to AT&T in special access. Although there are in fact many different types of arrangements for obtaining special access from AT&T and others, Complainants have focused on AT&T's

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1. Comments of BT Americas, Cbeyond, Earthlink, Integra, Level 3 and tw telecom, WC Docket No. 05-25, February 11, 2013 (hereinafter *BT Americas et al. Comments*). Comments of Sprint Nextel Corporation, WC Docket No. 05-25, February 11, 2013 (hereinafter *Sprint Comments*). Comments of XO Communications, LLC, WC Docket No. 05-25, February 11, 2013 (hereinafter *XO Comments*). Comments of TelePacific Communications, WC Docket No. 05-25, February 11, 2013 (hereinafter *TelePacific Comments*).

2. Declaration of Stanley Besen and Bridger Mitchell, "Anticompetitive Provisions of ILEC Special Access Arrangements," February 11, 2013, attached as Appendix A to *BT Americas et al. Comments* (hereinafter *Besen-Mitchell Declaration*).

3. Declaration of Dennis W. Carlton and Hal S. Sider in Support of AT&T Inc., WC Docket No. 05-25, January 19, 2010 (hereinafter *Carlton-Sider Declaration*); Reply Declaration of Dennis W. Carlton, Allan L. Shampine and Hal S. Sider in Support of AT&T Inc., WC Docket No. 05-25, February 24, 2010 (hereinafter *Carlton-Shampine-Sider Reply Declaration*).

Southwestern Bell Tariff No. 73 Term Payment Plan ("TPP") with the "portability" option.[4] Complainants claim that the terms and conditions in that tariff are analogous to the "loyalty contracts" that have been examined in the economics literature and that have been shown to be anti-competitive under some specific circumstances.[5] More specifically, Complainants claim that the tariffed "rack rates" are "supra-monopolistic,"[6] and, in combination with large "loyalty" discounts, high early termination fees ("ETFs") and "[o]nerous circuit migration charges and restrictions," exclude entrants by "locking up" so much business that entrants into the provision of special access are unable to achieve minimum viable scale.[7]

6. Complainants have requested that the FCC undertake extensive regulation of ILEC special access tariffs by setting permissible levels and forms of term and volume commitments, ETFs, non-recurring charges ("NRCs") and other terms and conditions (or, alternatively, eliminate such restrictions altogether).[8] For example, Complainants request that the Commission limit volume commitments to levels that will allow purchasers to shift a

4. *See, e.g., BT Americas et al. Comments*, p. 20 ("For the purposes of illustration, we focus predominantly on two tariffed discount plans: (1) the Term Payment Plan (including its optional 'portability commitment'), which AT&T offers in legacy Southwestern Bell and Pacific Bell territories [and a Verizon plan]."); *Sprint Comments*, pp. 25, 29, 31, 34; *Besen-Mitchell Declaration*, ¶¶24, 26, 29 (citing the tariff as a "particularly egregious example").

5. *See, e.g., Besen-Mitchell Declaration*, Section III: The Effect of ILEC Loyalty Contracts on Special Access Competition, Section IV: How Loyalty Contracts Work, and Section VI: How ILEC Loyalty Contracts Lead to Higher Special Access Rates. *TelePacific Comments,* p. 13. *Sprint Comments,* p. 27.

6. *Sprint Comments*, pp. 36-37 ("Purchasers can pay unreasonably high 'rack rates' that will put them out of business, or pay somewhat lower but still hugely inflated rates and accept competition-killing conditions" "When a monopolist sells most or all of its product at a 'discount,' it has the incentive to set the 'discount' price to the monopoly price, while raising the 'undiscounted' price to a *supra-monopoly* price." Emphasis in original.). *TelePacific Comments*, p. 14 ("Very high rack rates, *i.e.*, list prices, which customers rarely pay"). *BT Americas Comments*, p. 22 ("These rates are so high as to be cost prohibitive for competitors seeking to provide services to retail business customers."). Similarly, Besen & Mitchell claim that incumbents raise rack rates when offering discounts. *Besen-Mitchell Declaration,* ¶12.

7. *TelePacific Comments*, p. 14. *Sprint Comments,* p. 23. *BT Americas et al. Comments*, pp. 21-29.

8. TelePacific and XO Communications endorse remedies proposed by Level 3, one of the parties sponsoring the *BT Americas et al. Comments* and its attached *Besen-Mitchell Declaration*. *TelePacific Comments*, p. 18. *XO Comments*, pp. 17-18.

"material" amount of purchases to alternative suppliers and limit the level of the ETFs charged to a purchaser that fails to meet its term commitment to be no more than the ILEC's customer-specific sunk costs of providing service.[9] Also, Complainants request that ILEC tariffs be required to satisfy "benchmarks" created by using for each term and condition the one that is most favorable to Complainants across all ILECS (or across all regions of a single ILEC).[10] At the same time, Complainants request that the most favorable rates and terms in their existing service arrangements with ILECs be retained while the associated conditions are regulated or eliminated.[11]

D. Summary of Conclusions

7. We conclude that:

- Complainants' claims that certain special access terms and conditions are necessarily anti-competitive are based on neither sound theory nor empirical evidence. To the contrary, the challenged terms and conditions are commonly observed, used by Complainants themselves, and can provide significant efficiency benefits. Moreover, Complainants' proposed "relief" – extensive and detailed regulation of rates, terms and conditions and eliminating terms that Complainants do not like from existing contracts while retaining terms that Complainants do like – is unjustified and would itself create regulatory costs and inefficiencies.

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9. *Besen-Mitchell Declaration*, ¶¶50, 55, note 62. *BT Americas et al. Comments*, pp. 43-44. *Sprint Comments*, pp. 39, 42.

10. *Besen-Mitchell Declaration*, ¶¶68-69. *BT Americas et al. Comments*, p. 46.

11. *Besen-Mitchell Declaration*, ¶54. *Sprint Comments*, p. 40.

- Complainants attempt to show the possibility of anticompetitive effects from certain terms and conditions by citing literature on possible exclusionary effects from “loyalty contracts.” However, the possible anticompetitive effects discussed in that literature rely upon models that make a variety of assumptions that do not apply here. For example, the models assume, among other things, that the “loyalty contracts” 1) have either exclusive dealing or a volume commitment referencing the customer’s total purchases *including those from rivals*; and 2) have the property that the discounted rate is linked to the base rate so that the base rate cannot fall unless the discounted rate falls. But AT&T’s TPP does not have either of these characteristics. AT&T’s tariff, which offers optional circuit-by-circuit term discounts at rates specified in the tariff with an optional volume commitment for “portability” (the benefit of avoiding ETFs when the purchaser terminates circuits before the end of the terms the purchaser committed to), does not reference a customer’s purchases from rivals, require exclusive dealing or have explicit linkages to a “base” rate.
- More generally, the TPP is only one of a variety of ways to obtain special access from AT&T. For example, AT&T has negotiated individualized arrangements with many customers, including some Complainants, and some Complainants purchase special access under different tariff provisions or as unbundled network elements. Also, other technologies such as Ethernet are being used as alternatives to special access. The ability to obtain special access through alternatives to the TPP, absent a showing that those alternatives have the same undesirable features that Complainants challenge, provides another reason why the “loyalty contract”

literature does not support Complainants' challenges to the optional TPP tariff provisions.

- Another way in which the specifics of this industry differ from the "loyalty contract" literature is that at least one of the models in the literature that Complainants cite assumes that an incumbent can tie up all available demand before rivals get a chance to bid, thus foreclosing their entry. However, the challenged terms and conditions have been in place longer than the periods for the available commitments, and, as discussed above, the commitments are not exclusive. Thus, rivals *have* had opportunities to bid for business. Complainants' own success and that of others also undermines the claim that the challenged terms and conditions have had the effect of excluding entry. Even though the challenged terms and conditions have been in place for many years, the empirical evidence indicates that there is significant and ongoing entry, with many Complainants themselves reporting ongoing and rapid growth.
- The purchasing patterns of AT&T's special access customers also contradict Complainants' claim that even though AT&T's tariff terms may not exactly match the properties of a "loyalty contract" their effects are the same because they are *de facto* mandatory exclusive dealing contracts. The available evidence demonstrates that the TPP is neither exclusive nor mandatory. There is no "exclusive" TPP arrangement, only an optional volume commitment in exchange for "portability," and many of the Complainants themselves purchase from AT&T without opting for TPP portability and its associated volume commitment. Moreover, any customer that does choose to make the three year volume

commitment under the TPP portability option has the ability to switch up to 20 percent of its initial commitment to another provider, and customers that have already met their volume commitment can shift even more of their business to rivals. For example, a customer with a volume requirement of 100 units may be purchasing 120 units in which case it could switch 40 (20+20) units away from AT&T to rivals. Finally, AT&T customers are not required to provide AT&T with any growth in demand above the initial commitment. The entirety of such volume can be placed with rivals to AT&T.

- As a matter of economic theory, terms and conditions offered by a firm generally raise competitive concerns only if two conditions are present.
    - First, as a matter of economic theory, the firm must possess market power. As a matter of practical implementation, however, the FCC has determined, reasonably, that the market power must be significant enough to justify the costs of regulation, and so has chosen to intervene only in those situations in which customers do not have what the FCC considers to be a sufficient choice of alternatives. We understand that Complainants themselves generally acknowledge that "dominant" carrier regulation is inappropriate in such circumstances. The Commission, however, has stated that it currently lacks sufficient evidence to determine the full extent to which alternative providers have deployed local network facilities. One of the purposes of this proceeding is to collect the data to draw such conclusions. Indeed, contrary to Complainants' assumption, the Commission has previously found significant competition in many areas

and has indicated that, consistent with evidence submitted by various parties in this proceeding, competition may be even more widespread than the Commission has previously determined.

  - Second, even if there is not a sufficient choice of reasonable alternatives, the challenged terms and conditions are anticompetitive only if the anticompetitive effects (if any) outweigh the pro-competitive effects.

- Regardless of how the terms and conditions are characterized, it is well understood that contractual provisions that restrict subsequent customer choice can be pro-competitive. For example, ETFs can promote efficiency by providing contractual incentives for parties to meet their obligations under a contract, and term and volume commitments can encourage parties to make the appropriate level of investments in capacity, encourage efficient order size and encourage innovation. ETFs and term and volume commitments are widely used, including by Complainants, and typically are pro-competitive.
- Even if the Commission concluded that some areas lacked reasonable alternatives, theory and empirical evidence both show that the terms and conditions at issue here can be pro-competitive. The pro-competitive benefits just discussed can apply regardless of the presence of competitive alternatives, and the "loyalty contract" literature cited to by Complainants recognizes that such contracts can be efficient even when used by "dominant" firms.
- The "remedies" proposed by Complainants can be viewed as an attempt to use the regulatory process to obtain lower rates rather than to address any demonstrated competitive concern. As the Commission has recognized, regulation imposes

costs on carriers and the public, and Complainants' proposed regulatory micro-management is likely to have costs and inefficiencies itself. In particular, such regulation could well result in lower discounts and higher rates to customers, not lower rates, if ILECs were forced to offer only one uniform contract to all customers with the precise rates and thresholds determined by the FCC, thus eliminating pro-competitive individualized special access arrangements. In any event, Complainants do not justify the particular thresholds they propose, and those thresholds make no attempt to account for the efficiencies associated with volume and term discounts and related provisions designed to encourage customers to meet their commitments. For example, Complainants wish to set ETFs at no more than the customer-specific sunk costs of providing service, but ignore the important role of ETFs as contract enforcement mechanisms and provide no analysis of the difficulty of administering such a regulatory rule. Finally, Complainants' "benchmarking" proposal would allow Complainants to cherry pick across ILECs' contracts and choose individual terms and conditions they favor to create a "benchmark," but that is not a sensible approach when terms and conditions are interrelated. Indeed, many of Complainants' own contracts would fail to meet such a benchmark created from their own array of contracts.

II. AT&T'S TARIFFS ARE NOT THE "LOYALTY CONTRACTS" AS DESCRIBED IN THE LITERATURE THAT COMPLAINANTS CITE

8. As described earlier, Complainants advance a foreclosure theory based on the literature concerning "loyalty contracts" in which the use of such contracts harms competition by

preventing entry of rivals.[12] This literature, though related to the more traditional exclusionary conduct literature, uses models relying on a variety of specific assumptions to find potential exclusionary effects. In particular, the models in the "loyalty contracts" literature cited by Complainants[13] 1) have either exclusive dealing or a volume commitment referencing the customer's total purchases *including* those from rivals; and 2) have the property that the discounted rate is linked to the base rate so that the base rate cannot fall unless the discounted rate falls.[14] However, AT&T's TPP with portability option focused on by Complainants[15] does not satisfy these properties and so is not a "loyalty contract" as described in the literature that Complainants cite.

9. The TPP applies to DS1 special access circuits in AT&T's five state legacy Southwestern Bell Telephone region. The TPP provides for lower special access rates for individual circuits for a customer that makes a term commitment for that circuit.[16] The month-to-month rate specified in Tariff No. 73 for DS1 channel terminations is $215 per month. Under the TPP, customers can sign up to purchase individual channel terminations (*i.e.*, without any

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12. *See, e.g., Besen-Mitchell Declaration*, Section III: The Effect of ILEC Loyalty Contracts on Special Access Competition, Section IV: How Loyalty Contracts Work, and Section VI: How ILEC Loyalty Contracts Lead to Higher Special Access Rates. *Sprint Comments*, p. 27.

13. There is an extensive literature on restrictive contracts in general and "loyalty contracts" in particular. We do not attempt to discuss all of the ways in which this industry differs from each model cited to by Complainants, but rather focus on a few key differences between the challenged AT&T special access terms and conditions and the "loyalty contracts" in the cited literature. We also discuss later the fundamental requirement that competitive harm can occur only in the presence of market power.

14. *See, e.g.*, Fiona Scott-Morton, "Contracts that Reference Rivals," Presentation at Georgetown University Law Center, April 5, 2012, cited in *Besen-Mitchell Declaration*, ¶13. Einer Elhauge and Abraham Wickelgren, "Robust Exclusion Through Loyalty Discounts," John M. Olin Center for Law, Economics, and Business, Discussion Paper No. 662, 2010, cited in *Sprint Comments*, p. 27. *Besen-Mitchell Declaration*, ¶12.

15. *See, e.g., BT Americas et al. Comments*, p. 20 ("For the purposes of illustration, we focus predominantly on two tariffed discount plans: (1) the Term Payment Plan (including its optional 'portability commitment'), which AT&T offers in legacy Southwestern Bell and Pacific Bell territories [and a Verizon plan]."); *Sprint Comments*, pp. 25, 29, 31, 34; *Besen-Mitchell Declaration*, ¶¶24, 26, 29 (citing the tariff as a "particularly egregious example").

16. Reply Declaration of Parley Casto (hereinafter *Casto Reply Declaration*), ¶3.

volume commitment) for the following terms: one year ($200 per month), two years ($145 per month), three years ($112 per month), five years ($92 per month) or seven years ($90 per month).[17] The term commitments are circuit specific and can vary between circuits. A customer that cancels a contract for a circuit early must pay an ETF as specified in the tariff.

10. The TPP also provides a "portability option" that allows TPP customers to avoid ETFs. Under this option, so long as the customer continues, during a three year portability term, to purchase at least 80 percent of the number of DS1 channel terminations it purchased from AT&T at the time of the portability commitment, it can disconnect or move individual circuits with no early termination fee.[18]

11. The TPP does not satisfy the properties in the "loyalty contract" models. With respect to exclusive dealing or volume commitments referencing total purchases including those from rivals, the TPP has neither a volume commitment nor an exclusive dealing requirement to obtain the specified rates. The portability option does have a volume commitment, but it is not based on customers' total purchases, does not reference rivals, and does not require exclusivity.[19] We also show below that the tariff does not amount to a *de facto* exclusive dealing requirement.

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17. *Casto Reply Declaration*, ¶8. These rates are for rate zone 1 in areas where AT&T has pricing flexibility. We understand that the rates for the other two rate zones follow the same pattern, as do AT&T's rates for areas that remain subject to price caps.

18. *Casto Reply Declaration*, ¶5.

19. Complainants may argue that there is an implicit relationship to purchases from rivals, but that argument can be made for any quantity discount and the literature therefore distinguishes between explicit and implicit references. For example, Scott-Morton notes that "Some CRRs are more implicit and may operate with less precision as a result. For instance, pure quantity discounts involve contract terms that provide a discount for purchasing a certain quantity. *They are common and often efficient because they can enable economies of scale or price discrimination.* But the particular thresholds at which discounts kick in may also mimic market-share discounts, and thus make the contract similar to a CRR. However, quantity discounts can be substantially less precise than market share discounts in some settings, and for this reason *we may expect them to be less effective for anticompetitive purposes*." Fiona Scott-Morton, "Contracts that Reference Rivals," Presentation at Georgetown University Law Center, April 5, 2012 (cited in *Besen-Mitchell Declaration*, ¶13), p. 4. Emphasis added.

12. The TPP also does not "tie" a "discounted" rate to a "base" rate. The basic economic point in the "loyalty contracts" model with respect to such a tie is that by linking the "loyalty rate" with the "non-loyalty rate," the firm can reduce its own incentives to compete for non-loyalty customers because reducing rates for those customers requires reducing rates for loyalty customers as well.[20] But this is not how AT&T's tariff operates. Each of the term discount rates is separately specified in the tariff with no linkage to any "base" rate, and customers that choose the portability option obtain no additional discount off those tariffed rates.

13. Indeed, because AT&T's tariff is so dissimilar to the types of contracts assumed in the "loyalty contract" literature, it is difficult to determine what the real world analogs to the "loyalty rate" and the "non-loyalty rate" would even be, but what Besen & Mitchell appear to have in mind is that the "loyalty" customers are those that made circuit specific term commitments and a volume commitment under the TPP portability option to obtain waiver of ETFs associated with the term commitments.[21] The "non-loyalty" customers would then be those customers that have *not* accepted the term and volume commitments, *i.e.*, customers purchasing circuits on a month-to-month basis.[22] However, as noted above, the month-to-month rates are not "tied" to the rates for any given term commitment. Thus, AT&T could lower the

20. *See, e.g.*, Elhauge & Wickelgren (2010), p. 2 ("This seller commitment reduces the seller's incentive to compete for buyers free of a loyalty agreement because lowering the price to free buyers requires lowering the price to loyal buyers who have already agreed to buy from the seller.").

21. *Besen-Mitchell Declaration*, ¶8 ("[T]he provisions in ILEC special access loyalty contracts take a number of forms. Some provisions provide rate discounts for a single circuit only if a customer commits to a *minimum contract term* for that circuit. Others condition circuit portability … on a customer's commitment to maintain a significant share of its historic purchase levels from the ILEC. … Many special access contracts contain a combination of these types of provisions."). Emphasis in original. See also ¶24 under "Examples of Loyalty Provisions in ILEC Special Access Contracts," ("Customers can purchase special access services at rates that are lower than the ILECs' extremely high month-to-month rates only by making *term commitments*, that is, by committing to purchase individual circuits for a fixed number of years."). Emphasis in original.

22. Besen & Mitchell may be suggesting that either term commitments or the portability option alone could also constitute a "loyalty contract." If term commitments alone constituted a "loyalty contract", then the "non-loyalty" rate would still be the month-to-month rate. We address the portability option by itself next.

month-to-month rate without, for example, making any change to the three year term commitment rate. Even if Besen & Mitchell were referring strictly to the waiver of ETFs under the TPP portability option as being the discounted "loyalty rate" (as the portability option is the only component of the tariff with a volume commitment), that discounted "loyalty rate" (the ETF) is simply set at zero – a level that does not change with relation to the ETFs charged to other customers (*i.e.*, the undiscounted ETF rate is the "non-loyalty" rate and it is set independently of the discounted ETF rate of zero). AT&T could lower the ETF for customers that have not accepted the TPP portability option ("non-loyalty" customers) without making any change to the "rates" paid by "loyalty" customers. Thus, under either interpretation, AT&T's tariffs lack the linkage between "loyalty rates" and "non-loyalty rates" assumed in the literature cited by Complainants.[23]

14. More generally, the TPP is only one of a variety of ways to obtain special access (or substitute services) from AT&T. For example, one of the Complainants purchases special access under a different tariff. Others obtain access by purchasing unbundled network elements that are available at cost-regulated prices and are provided strictly on a month-to-month basis. Also, many customers negotiate contract tariffs or other carrier-specific arrangements governing the purchase of special access.[24] The ability to obtain special access through alternatives to the TPP means that, contrary to what the "loyalty contract" literature assumes in order to find the possibility of anticompetitive effects, AT&T can offer a lower rate to one customer without lowering the rates to all other customers.

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23. Complainants may point to contract tariffs that specify a particular discount relative to the month-to-month rate. However, it would be incorrect to look at these as examples of the kinds of linkage described in the "loyalty contract" literature. AT&T has other means to provide a discount to a month-to-month customer without impacting the rates paid under other contract tariffs. For example, AT&T could negotiate a contract tariff with the month-to-month customer providing a discount not linked to any volume commitment, or it could use one of the other alternatives discussed in the next paragraph.

24. *Casto Reply Declaration*, ¶16.

15. Another way in which the specifics of this industry differ from at least one of the models in the "loyalty contracts" literature that Complainants cite is that the exclusion in the model occurs due in large part to entrants being assumed to be unable to compete upfront for customers' business.[25] That is, the model assumes that an incumbent can tie up all available demand before the entrant gets a chance to bid, thus foreclosing entry. However, in this industry, the challenged terms and conditions have been in place for many years, longer than the periods for the available term and volume commitments.[26] Thus, entrants have had opportunities to bid for business. Furthermore, as described below, even with volume commitments, TPP portability customers can switch 20 percent of their volume commitments as well as all of the growth in demand above the initial volume commitments to rivals, so entrants can bid for that business.

16. Complainants also suggest that even though the TPP on its face may not match the "loyalty contract" literature to which they appeal, the tariff's terms are such that they are *de facto* mandatory exclusive dealing contracts because customers cannot commercially operate without accepting them, and, once accepted, cannot divert any meaningful portion of their

25. *See, e.g.*, Elhauge & Wickelgren (2010), pp. 5-6.

26. The TPP has been in place since 2003. *Casto Reply Declaration*, ¶26. The portability option commitment period is three years, and the longest available term commitment is seven years. However, as discussed below, there are significant volumes with shorter term commitments, including month-to-month.

business to the ILECs' rivals.[27] However, the purchasing patterns of AT&T's special access customers, including Complainants themselves, contradict this claim, as we now show.[28]

17. Despite suggestions that Complainants must take the maximum available term discounts (which for the TPP is seven years) to feasibly offer service,[29] customers, including Complainants, purchase significant volumes of DS1s on a month-to-month basis, as well as for other terms shorter than seven years.[30] For example, XO Communications, one of the Complainants, has reported in this proceeding that it purchases from AT&T using three year term commitments.[31] This fact should not be surprising as a three year term commitment realizes more than 80 percent of the savings available from a term commitment, and the difference between a five year and a seven commitment is only $2 per month, or roughly 1 percent of the

27. *Sprint Comments*, pp. 24, 36 ("But participation in incumbent LEC 'discount plans' is not 'voluntary' in any meaningful sense of the word." "[P]aying exorbitant rack rates" would not "allow Sprint to continue to do business."). *BT Americas et al. Comments*, p. 22 ("These [base] rates are so high as to be cost prohibitive for competitors seeking to provide services to retail business customers.") and pp. 38-40, stating that ILEC terms and conditions "bear a close resemblance" to *de facto* exclusive dealing contracts examined by courts with market share requirements close to but lower than 100%. Declaration of James A. Anderson, attached to *XO Comments*, at 2-3 ("In a nutshell, when XO purchases special access from price cap LECs such as AT&T and Verizon, it must enter into certain onerous terms and conditions in order to obtain a discounted price to make it possible to compete as a provider where it does not have its own facilities.").

28. The examples discussed here all concern DS1 circuits.

29. *BT Americas et al. Comments*, p. 24 ("Note that the competitor commits to a seven-year term in order to obtain a low enough price to compete in the downstream retail market."). *See also Besen-Mitchell Declaration*, ¶24 ("The discounts associated with term commitments are substantial. … [A]pproximately 50 percent off of the month-to-month rate in legacy Southwestern Bell territory if the customer agrees to a five-year term commitment.").

30. *Casto Reply Declaration*, ¶9.

31. *XO Comments*, attached Declaration of John T. Dobbins, ¶12 ("XO has long term volume and commitment plans with AT&T … under three-year deals in the former PacBell (California) and Southwestern Bell Telephone regions").

month-to-month rate.[32] Likewise, some Complainants purchase *primarily* month-to-month circuits in AT&T's Southwestern region.[33]

18. Despite suggestions that Complainants cannot do business without portability,[34] *most* of the Complainants either do not take the TPP portability option in the Southwestern region or do not use it to a significant degree.[35] Indeed, only a small fraction of AT&T's non-affiliated customers in the entire Southwestern region purchase under the TPP portability option.[36]

19. Finally, the claim that the portability option's volume commitment "locks up" essentially all volume and excludes entry is clearly incorrect. In the Southwestern region alone, AT&T currently provides tens of thousands of DS1 circuits that are in excess of the volumes covered by TPP portability commitments.[37] To put this number into context, it represents several times the entirety of many CLECs' special access purchases.[38] However, even those customers that have made volume commitments under the TPP portability option can still divert large volumes to other firms because the commitment calls for the customer to maintain only 80 percent of the volume from the year prior to the commitment being made. Customers whose purchases from AT&T have grown since that time may also be able to divert greater than 20

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32. As noted earlier, the price flex, zone 1 month-to-month rate for a DS1 channel termination is $215. The rate with a three year commitment is $112, for a savings of $103. The five year rate is $92 and the seven year rate is $90, for a maximum available savings of $125. $103 is 82.4 percent of $125.

33. *Casto Reply Declaration*, ¶9.

34. *BT Americas et al. Comments*, p. 25 ("If [competitors] wish to serve a large number of retail customers, competitors must often select the latter option [a portability plan with volume commitment]."). Brackets added.

35. *Casto Reply Declaration*, ¶11. One Complainant purchases a small portion of its circuits under the TPP through a legacy contract of a company it purchased.

36. *Casto Reply Declaration*, ¶12.

37. *Casto Reply Declaration*, ¶12.

38. *Casto Reply Declaration*, ¶12.

percent of their current volume. Collectively, customers with TPP portability volume commitments in the Southwestern region exceed their minimum TPP portability commitments by over 20 percent.[39] Also, the TPP portability option volume commitment, unlike an exclusive dealing requirement, does not restrict customers' ability to obtain new circuits from other firms.

III. COMPLAINANTS HAVE NOT DEMONSTRATED THE EXISTENCE OF THE MARKET CONDITIONS THAT COULD RAISE COMPETITIVE CONCERNS

20. As a matter of economic theory, terms and conditions offered by a firm generally raise competitive concerns only if two conditions are present, the first of which is that the firm must possess some market power. As a matter of practical implementation, the FCC has determined, reasonably, that the market power must be significant enough to justify the costs of regulation, and so has chosen to intervene only in those situations in which special access customers do not have what the FCC considers to be a sufficient choice of alternatives.[40] When sufficient alternatives exist customers can then avail themselves of the competitive options available and thereby protect themselves from potential anticompetitive effects from the challenged terms and conditions. Therefore, Complainants' condemnation of the incumbents' terms and conditions assumes that customers lack reasonable alternatives.[41] Indeed, the articles cited by Complainants explicitly acknowledge that there can be no competitive harm from the

39. *Casto Reply Declaration*, ¶15.

40. *See, e.g.*, FCC, Fifth Report and Order and Further Notice of Proposed Rulemaking, CC Docket No. 96-262, FCC 99-206, August 27, 1999, ¶90.

41. Complainants also claim that ILECs tie products and areas that do and do not have competitive alternatives. *See, e.g., BT Americas et al. Comments*, pp. 31-32. To be clear, if area A is monopolized and area B is not, a firm may tie sales in the two areas. However, customers are not harmed unless the effect of the tie is to reduce competition in area B, creating market power that the firm then exploits. If there is robust competition (*i.e.*, the firm lacks market power) in area B, then customers are not worse off whether sales are tied or not. The same applies with respect to products.

terms and conditions in contracts in the absence of market power,[42] and we understand that Complainants generally acknowledge that dominant carrier regulation is inappropriate in such circumstances.[43]

21. The Commission's original pricing flexibility findings concluded generally that where its collocation-based triggers were satisfied, there would be sufficient competition "to preclude the incumbent from exploiting any monopoly power over a sustained period," and, specifically, to "discourag[e] incumbent LECs from successfully pursuing exclusionary strategies."[44] Although we understand that Complainants claim that the Commission's pricing flexibility triggers did not work as intended and that those triggers granted regulatory relief in locations where alternatives to ILECs for special access did not exist, we also understand that this proceeding is intended to resolve this factual debate. The Commission has stated that currently "there is insufficient evidence in the record upon which to base general or categorical conclusions as to the competitiveness of the special access market."[45] Therefore, the Commission has decided to gather evidence regarding marketplace conditions, including detailed evidence regarding the scope of alternative local networks.[46] The results of the data gathering exercise may be to find that competition is even more widespread than the Commission has previously concluded. For example, the Commission has stated that there appears to be competition that was not previously captured by the Commission's approach, and, as a result, the

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42. *See, e.g.*, Jonathan Jacobson, "A Note on Loyalty Discounts," The Antitrust Source, June 2010, p. 4, cited in *Besen-Mitchell Declaration,* note 10 ("If the supplier lacks market power, for example, exclusivity – whether induced by loyalty discounts or not – will not be problematic. Even where the supplier has market power, application of standard exclusive dealing analysis will condemn only those arrangements that lack significant efficiencies and have the actual or probable effect of causing significant consumer harm.").

43. *See, e.g., Sprint Comments*, p. 10; *TelePacific Comments*, p. 6.

44. FCC, Report and Order FCC 12-92, WC Docket No. 05-25, August 22, 2012, ¶¶24-25.

45. FCC, Report and Order and Further Notice of Proposed Rulemaking FCC 12-153, WC Docket No. 05-25, December 18, 2012, ¶69.

46. *Id.*, Appendix A (Data Collection).

Commission may well grant pricing flexibility in additional areas based on exploring such types of competition.[47]

22. Also contrary to Complainants' assumption, we have previously cited evidence that "a variety of firms, including cable and fixed wireless companies, have represented to their investors that their services are viable commercial alternatives to LEC services and that they continue to invest in offering those services."[48] Subsequent to our prior reports, AT&T, CenturyLink and Verizon, among others, have continued to submit evidence of competition and continued entry for special access.[49]

23. The second condition required for terms and conditions to raise competitive concerns is that, even if customers lack competitive alternatives, such terms and conditions are anti-competitive only if the anticompetitive effects (if any) outweigh the pro-competitive effects. As we show in the next section, Complainants have also failed to establish this second condition.

IV. COMPLAINANTS HAVE NOT SHOWN THE CHALLENGED TERMS AND CONDITIONS ARE HARMFUL ON BALANCE

A. TERM AND VOLUME COMMITMENTS AND ETFS ARE COMMON IN COMPETITIVE INDUSTRIES AND CAN HAVE SIGNIFICANT PRO-COMPETITIVE BENEFITS

24. Regardless of how the challenged terms and conditions are characterized, it is well understood that contractual provisions that restrict subsequent customer choice can be, and typically are, pro-competitive. More generally, the economics literature explains how many

47. FCC, Report and Order FCC 12-92, WC Docket No. 05-25, August 22, 2012, ¶¶73-74, 103. Of course, the possibility also exists that the Commission may find some areas have less competition than was previously estimated.

48. *Carlton-Shampine-Sider Reply Declaration*, ¶44.

49. *See, e.g.*, Letter from Sidley Austin LLP on behalf of AT&T to the FCC, WC Docket No. 05-25, August 8, 2012; Comments of CenturyLink, Inc., WC Docket No. 05-25, February 11, 2013; Comments of Verizon and Verizon Wireless, WC Docket No. 05-25, February 11, 2013.

types of contractual restrictions such as exclusive dealing can promote efficiency.[50] We have described such efficiencies in our prior declarations. For example, discounts based on volume, term commitments, and incentives to meet those commitments, are commonplace and typically are pro-competitive.[51] The essence of such arrangements is that the supplier gains the efficiency benefits from the committed term and volume, and in exchange the customer gains lower rates (as in the TPP) or other valuable consideration (such as waiving ETFs in the portability option). Discounts and price reductions typically enhance consumer welfare and the fact that a rival loses sales to a discounter typically does not imply harm to competition. To the contrary, discounting and price reductions are key benefits of competition.[52] For example, a term discount coupled with an early termination fee can promote efficiency. Given a contract committing a purchaser to a particular term, the presence of contractual incentives for parties to meet their obligations under a contract (*i.e.*, early termination fees) is commonly observed and unremarkable. Indeed, if breaking a contract had no consequences, there would be no reason to sign the contract in the first place, and the benefits of the arrangement would be lost.[53] Early termination fees can thus serve an important economic role, as can other contract terms such as term commitments and volume commitments.[54]

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50. For further discussion, see Dennis W. Carlton and Jeffrey M. Perloff, MODERN INDUSTRIAL ORGANIZATION (4th Edition, 2005), Chapter 12: Vertical Integration and Vertical Restrictions.

51. *Carlton-Sider Declaration*, ¶89.

52. *Carlton-Sider Declaration,* ¶88.

53. Indeed, a special access supplier that provides a term discount or volume commitment and makes investment and network management decisions based on the committed demand may be worse off if the customer fails to keep the commitment than if no commitment were made in the first place.

54. *Carlton-Shampine-Sider Reply Declaration*, ¶80. Besen & Mitchell claim that there is no possible "efficiency justification for tying a customer's early termination penalty to the *revenues* that would have been received if the customer had completed its contract term" (*Besen-Mitchell Declaration,* ¶64), but they neglect the importance of contract enforcement mechanisms.

25. Term rates (*i.e.*, lower rates in exchange for term commitments) and volume commitments such as the TPP with its portability option can encourage the parties to make the appropriate level of investments in capacity, encourage efficient order size and encourage innovation.[55] Volume commitments can also enhance efficiency by "giving both parties greater security and predictability in the flow of orders."[56]

26. The presence of the challenged terms and conditions in contracts in competitive industries and in Complainants' own contracts is evidence that those terms and conditions can be economically efficient. For example, XO Communications, one of the Complainants who presumably would claim that it lacks market power, itself signs customers to term and volume commitments,[57] and tw telecom reports that more than sixty percent of its revenues come from three year or longer contracts.[58] AT&T has also previously documented that competitive local exchange carriers ("CLECs"), including Complainants, offer term discounts, have ETFs, and offer portability options based on volume commitments, just as AT&T does.[59] Indeed, we understand that the ETFs charged by CLECs sometimes exceed those charged by AT&T. For example, while the ETF under AT&T's TPP is 40 percent of the remaining monthly charges,[60] the ETFs charged to AT&T by some CLECs go as high as 100 percent of the remaining monthly charges.[61] Complainants have acknowledged the widespread use of such terms and conditions.

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55. *Carlton-Shampine-Sider Reply Declaration*, ¶80.

56. William Tom, David Balto and Neil Averitt, "Anticompetitive Aspect of Market-Share Discounts and Other Incentives to Exclusive Dealing," 67 Antitrust Law Journal 615, p. 629.

57. Declaration of James A. Anderson, ¶13, attached to *XO Comments*, noting XO Communications' use of term and volume commitments, and that terms for retail customers are "on the order of three years."

58. tw telecom, Supplemental Earnings Information, Fourth Quarter 2012, p. 12.

59. Letter from Sidley Austin LLP on behalf of AT&T to the FCC, WC Docket No. 05-25, August 8, 2012, and Comments of Verizon and Verizon Wireless, WC Docket No. 05-25, February 11, 2013, pp. 10-13.

60. *Casto Reply Declaration*, ¶4.

61. Discussions with AT&T personnel.

For example, Besen & Mitchell note that "the types of contracts that are offered by ILECs are similar to those that are offered in other, more competitive markets."[62] Similarly, "TelePacific recognizes that volume and term commitments may in the abstract represent a typical way of doing business in any industry – buy in bulk or buy for longer, and therefore buy cheaper."[63] Kobayashi, cited by Complainants, also notes that "programs called 'loyalty programs' are ubiquitous" and that "they also can be a powerful and natural instrument of competition."[64]

B. EVEN WHERE CUSTOMERS LACK COMPETITIVE ALTERNATIVES, "RESTRICTIVE" TERMS AND CONDITIONS CAN BE PRO-COMPETITIVE.

27. While there is a theoretical possibility of anticompetitive effects from restrictive terms and conditions when customers lack competitive alternatives, even in those circumstances it does not follow that restrictive terms and conditions are always, or even are likely to be, exclusionary.[65] The simple point is that the theoretical possibility that there *can* be harm from certain contractual provisions does not imply that there *is* harm. These provisions can have offsetting benefits and Complainants have ignored that possibility as well as the possibility that customers do have competitive alternatives to ILECs.[66]

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62. *Besen-Mitchell Declaration,* ¶13.

63. *TelePacific Comments*, pp. 12-13.

64. *See, e.g.*, Bruce Kobayashi (cited in *Besen-Mitchell Declaration*, note 59), "The Economics of Loyalty Discounts and Antitrust Law in the United States," George Mason University School of Law, Law and Economics Working Paper Series 05-26, pp. 2, 5 ("As is the case with vertical control practices generally, firms' use of loyalty discounts have the potential to be used for both pro and anticompetitive purposes. … At the retail level, programs called 'loyalty programs' are ubiquitous. … While loyalty discounts can increase switching costs or be exclusionary, they also can be a powerful and natural instrument of competition.").

65. For further discussion, see Dennis W. Carlton and Jeffrey M. Perloff, MODERN INDUSTRIAL ORGANIZATION (4th Edition, 2005), Chapter 12: Vertical Integration and Vertical Restrictions.

66. *See also* Bruce Kobayashi, "The Economics of Loyalty Discounts and Antitrust Law in the United States," George Mason University School of Law, Law and Economics Working Paper Series 05-26, p. 27 (cited in *Besen-Mitchell Declaration,* note 59), noting that "the literature on loyalty discounts is almost exclusively theoretical, and the models and their specific assumptions have not been subjected to rigorous empirical testing. Moreover, these theoretical models, and the academic literature in general, has not rigorously examined procompetitive reasons firms might use loyalty programs."

28. The pro-competitive efficiencies discussed earlier can apply regardless of the presence of competitive alternatives in any given area. Restrictive terms and conditions will only be anticompetitive if the anticompetitive effects (if any) outweigh the pro-competitive effects. For example, Balto *et al.* ask "Are these kinds of arrangements anticompetitive? Not necessarily, of course, and probably not even usually." They go on to point out that partial exclusive dealing contracts "are less restrictive and will raise fewer questions than total exclusivity contracts do."[67]

29. Even if one accepted Complainants' characterization of the tariffs as "loyalty contracts," the articles cited by Complainants recognize that such contracts can be efficient even when used by "dominant" firms. For example:[68]

- Zenger: "The adoption of loyalty rebates is a direct consequence and a vital expression of the competitive process."[69] "That is, *both the dominant firm and its competitor charge* lower *average prices for their products if loyalty rebates are allowed than if they are not.* That is, contrary to our initial conjecture, a condemnation of loyalty rebates would have the counterproductive effect of dampening competition and raising all prices for consumers."[70] "Hence, the conclusion from our simple rebate model is that *competition in loyalty rebates between a dominant firm and an appreciable competitor is more intense than competition in uniform prices*. Prohibiting the adoption of loyalty rebates

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67. William Tom, David Balto and Neil Averitt, "Anticompetitive Aspect of Market-Share Discounts and Other Incentives to Exclusive Dealing," 67 Antitrust Law Journal 615, p. 622.

68. Besen & Mitchell cite these three articles in support of their argument that "ILECs are the types of dominant firms for which the use of loyalty contracts are likely to be anticompetitive." *Besen-Mitchell Declaration,* ¶13.

69. Hans Zenger, "Loyalty Rebates and the Competitive Process," Journal of Competition Law & Economics, 2012, abstract.

70. *Id.*, p. 20. Emphasis in original.

therefore immediately implies that price competition will be less intense than would otherwise be the case."[71]

- Greenlee & Reitman: While dominant firms "may use loyalty programs with an eye toward weakening or excluding rivals" "the overall surplus effects depend in part on brand preferences, [and] *one cannot conclude that such pricing strategies are necessarily anti-competitive*."[72]
- Scott-Morton: "As I noted at the outset, *I will not provide a simple rule describing when this type of vertical contract [loyalty pricing] is anticompetitive. This is because a number of efficiencies have the potential to flow* from these types of CRRs [contracts referencing rivals], depending on the specifics of the situation."[73]

30. Besen & Mitchell also seem to treat tie-in sales as a type of loyalty contract whose use can harm competition. Indeed they cite an article by one of us to the effect that tying can be used to exclude rival firms.[74] Again, while we agree that there is the theoretical possibility of harm from the use of tie-in sales under some circumstances, Besen & Mitchell fail to mention that we also recognized in our article "that there frequently are pro-competitive rationales" for such behavior.[75] As another example, Greenlee and Reitman, two other authors cited by Besen & Mitchell, in talking about bundled loyalty discounts say that "bundled

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71. *Id.*, p. 21. Emphasis in original.

72. Patrick Greenlee and David Reitman, "Competing with Loyalty Discounts," U.S. Department of Justice EAG Discussion Paper 04-2, February 4, 2005, p. 23. Emphasis and brackets added.

73. Fiona Scott-Morton, "Contracts that Reference Rivals," Presentation at Georgetown University Law Center, April 5, 2012, p. 10. Brackets and emphasis added.

74. *Besen-Mitchell Declaration*, ¶36, citing D.W. Carlton, P. Greenlee, and M. Waldman, "Assessing the Anticompetitive Effects of Multiproduct Pricing," 53 Antitrust Bulletin 587 (2008).

75. Dennis W. Carlton, Patrick Greenlee and Michael Waldman, "Assessing the anticompetitive effects of multiproduct pricing," 53 The Antitrust Bulletin 3 (Fall 2008), p. 610. Moreover, this paper is not relevant to the current situation because the potential anticompetitive harm arises from exclusion, which, as we describe later, is inconsistent with the evidence here.

discounts can induce exit or deter entry, they have the potential to be anti-competitive by most mainstream interpretations of Section 2. … However, the conditions that determine whether aggregate consumer welfare rises or falls are subtle and likely hard to measure in practice. This suggests that prospective antitrust enforcement for bundled discounts is difficult."[76]

31. Complainants appear to agree that term and volume commitments and ETFs can be efficient even when used by the ILECs since, as described earlier, they indicate they would be satisfied for such commitments and terms to continue but with the specific thresholds and rates regulated by the FCC. We address the shortcomings with such proposed regulation when we discuss their proposed relief.

C. COMPLAINANTS DO NOT PROVIDE ANY EMPIRICAL SUPPORT FOR THEIR CLAIM THAT THERE IS HARM TO COMPETITION FROM THE CHALLENGED CONTRACTUAL PROVISIONS.

32. Complainants do not provide any empirical evidence that the challenged terms and conditions have increased prices. For example, they fail to show that in areas or regions or time periods without the challenged terms and conditions, prices are lower compared to those areas or time periods with the challenged terms and conditions.[77] More generally, many of the models cited to by Complainants discuss market power gained or maintained through exclusion of rivals, but the available evidence indicates that there has been substantial and ongoing entry and expansion by rivals. As the D.C. Circuit and the FCC have both noted, "[t]he presence of facilities-based competition with significant sunk investment makes exclusionary pricing behavior costly and highly unlikely to succeed," because "that equipment remains available and

76. Patrick Greenlee, David Reitman and David Sibley, "An Antitrust Analysis of Bundled Loyalty Discounts," October 30, 2006 working paper, p. 33.

77. Complainants have submitted evidence in this proceeding that they claim bears on whether rates are too high or have increased with pricing flexibility, but we are not aware that they have empirically established a relationship between the claimed elevated prices and the use of the challenged terms and conditions

capable of providing service in competition with the incumbent, even if the incumbent succeeds in driving that competitor from the market."[78]

33. Sprint claims that the challenged terms and conditions have prevented entry.[79] Despite the fact that the terms and conditions challenged by Complainants have been present for many years (for example, AT&T's TPP has been in place since 2003),[80] available evidence indicates that entry *has* occurred. For example, between June 2011 and June 2012, the CTIA estimates the number of cell sites for providing wireless services in the United States grew by roughly 11 percent and mobile data traffic grew 104 percent year over year.[81] Despite this growth, AT&T's provision of DS1 circuits to wireless providers dropped by more than 30 percent between March 2011 and December 2012.[82] The new connections to handle the growth and the circuits lost by AT&T appear to be going to a variety of competitors, including competitors using alternative technologies such as fixed wireless or Ethernet.[83]

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78. *WorldCom, Inc. v. FCC*, 238 F.3d 449 (D.C. Cir. 2001) at 458-459. *See also* FCC, Fifth Report and Order and Further Notice of Proposed Rulemaking, CC Docket No. 96-262, FCC 99-206, August 27, 1999, ¶80 ("Once multiple rivals have entered the market and cannot be driven out, rules to prevent exclusionary pricing behavior are no longer necessary. Investment in facilities, particularly those that cannot be used for another purpose, is an important indicator of such irreversible entry. If a competitive LEC has made a substantial sunk investment in equipment, that equipment remains available and capable of providing service in competition with the incumbent, even if the incumbent succeeds in driving that competitor from the market. … In telecommunications, where variable costs are a small fraction of total costs, the presence of facilities-based competition with significant sunk investment makes exclusionary pricing behavior costly and highly unlikely to succeed.").

79. *Sprint Comments*, p. 39.

80. *Casto Reply Declaration*, ¶26.

81. CTIA, Background on CTIA's Semi-Annual Wireless Industry Survey, available at http://files.ctia.org/pdf/CTIA_Survey_MY_2012_Graphics-_final.pdf. June 2011 cell sites were 256,920. June 2012 cell sites were 285,561.

82. *Casto Reply Declaration*, ¶28.

83. *Casto Reply Declaration*, ¶¶27-29. *Carlton-Sider Declaration*, ¶¶46-47. *Carlton-Shampine-Sider Reply Declaration*, ¶¶43-45.

34. We have previously submitted evidence concerning billions of dollars of investments by cable companies,[84] entry and investment by multiple providers of fixed wireless services marketed as an alternative to special access,[85] industry reports of dozens of firms deploying fiber within the top 50 MSAs,[86] and that these firms were gaining increasing volumes of business.[87] As we noted previously, additional evidence has been submitted in this proceeding that such entry has continued to occur.[88] This entry has occurred in a variety of areas and products, including for products being offered as alternatives to special access.

35. Sprint also claims that "[t]he combination of these [ILEC special access] terms and conditions effectively blocks new entry by preventing potential competitors from achieving minimum viable scale."[89] However, Complainants themselves continue to tell their investors that they have been able to achieve desirable scale and are growing rapidly. For example, tw telecom, one of the Complainants and a rival to AT&T, currently operates in 75 markets, 4 of which do not have pricing flexibility for channel terminations, 15 of which have Phase 1 pricing flexibility, and 56 of which have Phase 2 pricing flexibility.[90] Despite the claimed exclusionary effects enabled by pricing flexibility, tw telecom has told investors that 25 of its markets are "Highly Scaled," and another 25 are "Scaling" and "Accretive" to margins.[91] In the remaining 25 markets, tw telecom still reports rapid growth, with M-EBITDA increasing by roughly 2.5

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84. *Carlton-Sider Declaration*, ¶45.

85. *Carlton-Sider Declaration*, ¶46.

86. *Carlton-Sider Declaration*, ¶48. *Carlton-Shampine-Sider Reply Declaration*, ¶46.

87. *Carlton-Sider Declaration*, ¶45. *Carlton-Shampine-Sider Reply Declaration*, ¶¶44-45.

88. *See, e.g.*, Letter from Sidley Austin LLP on behalf of AT&T to the FCC, WC Docket No. 05-25, August 8, 2012; Comments of CenturyLink, Inc., WC Docket No. 05-25, February 11, 2013; Comments of Verizon and Verizon Wireless, WC Docket No. 05-25, February 11, 2013.

89. *Sprint Comments*, p. 39. Brackets added.

90. tw telecom Investor Presentation, February 2013, p. 4.

91. tw telecom Investor Presentation, February 2013, p. 23.

times between 2008 and 2012.[92] tw telecom's on-net buildings have increased by more than 30 percent over the last two years.[93] For Denver and Las Vegas, the two "bottom 25" markets specifically reported on by tw telecom, tw telecom informed investors that the number of on-net buildings more than tripled between 2008 and 2012.[94] Similarly, Integra, another Complainant, has reported that it has "a substantial next-generation fiber optic network" that provides "scalability to allow us to add customers at very low cost."[95] Integra has also reported that it is "making investments in our network … with a majority of such investment being tied to securing new customer contracts or increasing capacity in the network."[96] Sprint has reported being able to shift substantial amounts of its wireless backhaul traffic to fixed wireless and Ethernet services provided by CLECs and other alternative providers.[97] For example, Verizon reports being awarded the backhaul business at less than six percent of Sprint's wireless sites in Verizon's incumbent territory.[98]

V. COMPLAINANTS' PROPOSED RELIEF IS INAPPROPRIATE

36. Fundamentally, the "relief" requested by Complainants (for claimed competitive harms they have not established) is about setting new, lower regulated rates across the country without regard to the level of competition faced by ILECs or the costs of imposing detailed new regulation. That would be a major reversal of the FCC's policy of deregulation. The proposal to

92. tw telecom Investor Presentation, February 2013, p. 23.

93. tw telecom, Supplemental Earnings Information, Fourth Quarter 2012, p. 6.

94. tw telecom Investor Presentation, February 2013, p. 24, showing an increase from 119 to 373 buildings.

95. Integra Telecom, Inc. and Subsidiaries, Condensed Consolidated Financial Statements, September 30, 2012, p. 29.

96. Integra Telecom, Inc. and Subsidiaries, Condensed Consolidated Financial Statements, September 30, 2012, p. 30.

97. Comments of Verizon and Verizon Wireless, WC Docket No. 05-25, February 11, 2013, pp. 17-19.

98. Comments of Verizon and Verizon Wireless, WC Docket No. 05-25, February 11, 2013, p. 18.

eliminate terms that Complainants do not like from existing contracts while retaining terms that Complainants do like is also economically unjustified. As explained, Complainants provide no convincing justification for their position that the challenged terms and conditions must be eliminated (or regulated) everywhere – even where there has been significant entry – and that rates should be regulated down to the most favorable discounts granted under those terms and conditions other than the obvious one that they want lower rates.

37. As the Commission has recognized, regulation "imposes costs on carriers and the public,"[99] and there are many examples where regulations have been counterproductive.[100] Complainants are asking for detailed regulation of rates and terms, but such regulation can itself create distortions, costs and inefficiencies. For example, Complainants' "benchmarking" proposal and specification of particular terms and conditions would tend to lead to uniform, homogeneous arrangements, potentially making all parties worse off.[101] Indeed, this "benchmarking" proposal would discourage individually negotiated access agreements, as an ILEC that agreed to more favorable terms with a customer in return for the customer agreeing to certain obligations could find itself having to provide the same favorable terms to other customers but without the corresponding obligations. Benchmarking of the type proposed by

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99. FCC, Fifth Report and Order and Further Notice of Proposed Rulemaking, CC Docket No. 96-262, FCC 99-206, August 27, 1999, ¶90.

100. *See, e.g.*, Alfred Kahn, WHOM THE GODS WOULD DESTROY, OR HOW NOT TO DEREGULATE, AEI-Brookings Joint Center for Regulatory Studies, 2001, pp. 1-2 ("The consequent need, oxymoronically, for a regulated transition to 'unregulation' has provided the occasion for pervasive demonstrations of the very propensities of regulation that are the principal reasons for its abandonment – propensities to micromanage the process; to prescribe the results that, it is anticipated, the Almighty would have produced if He or She were in full possession of the facts; to handicap the competitive process to produce visible competitors; and, opportunistically, to produce visible price reductions.").

101. One way to see this is to think of the *quid pro quo* involved in a contract negotiation. If a firm is prohibited from asking for the *quo*, it will not offer the *quid*. More generally, one-size-fits-all policies run the risk of not fitting any party particularly well.

Complainants could thus ultimately harm special access customers by reducing the incentives for ILECs to tailor special access arrangements to customers' individualized needs.

38. As previously discussed, Complainants effectively acknowledge that the challenged terms and conditions can have important efficiency benefits as they would allow the challenged terms and conditions to remain but only with new thresholds specified by Complainants or with new regulations[102] – for example, limiting a volume commitment to no more than 50 percent of the prior year's volume,[103] limiting ETFs to no more the ILEC's customer-specific sunk costs of providing the particular circuit, or allowing the regulator to choose the appropriate maximum termination fee.[104] However, Complainants do not justify the particular threshold levels suggested, and it is hard to believe that regulatory micro-management undertaking, for example, to determine a "forward-looking, cost-based showing of [ILECs'] customer-specific sunk costs,"[105] would improve matters. Other than suggesting the Commission adopt their flawed proposal for "benchmarking," Complainants do not address the difficulty of administering such a regulatory rule. More generally, Complainants' effort to limit ETFs to no more than the level of such costs ignores and would undermine the important role of ETFs as contract enforcement mechanisms, as discussed earlier.[106]

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102. Complainants also suggest eliminating the terms and conditions entirely but retaining the lower rates and other concessions granted by the ILECs. *See, e.g.*, *Sprint Comments*, p. 40 and *Besen-Mitchell Declaration*, ¶54. Such a proposal, which Complainants wish to apply nationwide, would generate the obvious inefficiency of eliminating the benefits associated with those terms and conditions even in areas where the FCC has determined there is no market power.

103. *Besen-Mitchell Declaration*, ¶50, note 62. *BT Americas et al. Comments*, p. 43. *Sprint Comments*, p. 39.

104. *BT Americas et al. Comments*, pp. 44-45. *Sprint Comments*, pp. 42-43.

105. *BT Americas et al. Comments*, p. 45.

106. For example, firms may make investment and network management decisions in reliance on the committed business. The costs to the firm of a customer breaching that contract may thus exceed the measured local customer-specific sunk costs of serving that customer.

39. With respect to volume commitments, Complainants state that "[t]he limit for such commitments should be set at a level that would allow purchasers to shift a material amount of their special access purchases to alternative wholesale providers without incurring substantial penalties."[107] Complainants do not explain why the TPP's 80 percent threshold is anticompetitive but 50 percent would be pro-competitive. As we described earlier, purchasers *are* able to shift a material amount of special access purchases today, and have in fact done so, with AT&T losing 30 percent of its DS1 circuits sold to the wireless industry in under two years despite an increase in industry demand.

40. Finally, the proposal to "benchmark" new tariffs by taking the pieces from each regional tariff most favorable to Complainants and combining them together to create a "benchmark" ignores the fact that tariff terms are not set in isolation and is thus contrary to sound economics. Combining the most favorable terms from different tariffs is not an economically sensible way to create a "benchmark" when terms and conditions are interrelated. This can be readily seen by applying Complainants' proposal to their own terms and conditions. We understand that it is frequently the case that one Complainant offers a particular term that is more favorable to a customer than the corresponding term of another Complainant. If one used Complainants' own contracts and applied Complainants' proposal of taking the most favorable terms in contracts to create a "benchmark," all Complainants would fail to meet the benchmark, even though Complainants will presumably claim that none of them has any market power.

107. *BT Americas et al. Comments*, p. 43.

VERIFICATION PAGE

I declare under penalty of perjury that, based on the information available to me, the foregoing is true and correct to the best of my knowledge.

Dennis W. Carlton

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Dennis W. Carlton

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Allan L. Shampine

Dated: March 12, 2013

EXHIBIT 1

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EDUCATION

Ph.D., MASSACHUSETTS INSTITUTE OF TECHNOLOGY, Cambridge, Massachusetts: Economics, 1975.

M.S., MASSACHUSETTS INSTITUTE OF TECHNOLOGY, Cambridge, Massachusetts: Operations Research, 1974.

A.B., HARVARD UNIVERSITY (Summa cum laude): Applied Math and Economics, 1972.

EMPLOYMENT

COMPASS LEXECON (formerly Lexecon), Chicago, Illinois (2008 – present) Senior Managing Director; LEXECON INC., (1977 – 2006), President 1997 – 2001, Senior Managing Director 2003 - 2006

UNIVERSITY OF CHICAGO, Booth School of Business, David McDaniel Keller Professor of Economics (2011 – present); Katherine Dusak Miller Professor of Economics (2008 – 2011); Professor of Economics (1984 – 2008); Law School, Professor of Economics (1980 – 1984); Department of Economics, Assistant Professor (1976 – 1979); Associate Professor (1979).

U.S. DEPARTMENT OF JUSTICE, Washington, District of Columbia (2006 – 2008) Deputy Assistant Attorney General for Economic Analysis, Antitrust Division

MASSACHUSETTS INSTITUTE OF TECHNOLOGY, Cambridge, Massachusetts, Department of Economics (1975 – 1976) Instructor in Economics

OTHER PROFESSIONAL EXPERIENCE

HARVARD UNIVERSITY, Public Policy Summer Course in Economics (1977), Professor

BELL TELEPHONE LABORATORIES (Summers 1976, 1977)

JOINT CENTER FOR URBAN STUDIES OF M.I.T. AND HARVARD UNIVERSITY, Cambridge, Massachusetts (1974 - 1975)

CHARLES RIVER ASSOCIATES, Cambridge, Massachusetts (Summers 1971, 1972) Research Assistant

FIELDS OF SPECIALIZATION

Theoretical and Applied Microeconomics
Industrial Organization

ACADEMIC HONORS AND FELLOWSHIPS

Panelist, Concurrences "New Frontiers of Antitrust" Conference, Paris, February 2011.
Presenter, MIT "Economics of Antitrust" Symposium, January 2011
Keynote Speaker, 21st Annual Workshop of the Competition Law & Policy Institute of New Zealand, 2010
Keynote Speaker, Japanese Symposium on Competition, sponsored by Japan Fair Trade Commission, 2009
Recipient of Inaugural Robert F. Lanzilotti Prize, awarded by the International Industrial Organization Society for Best Paper in Antitrust Economics, 2008
Keynote Address to Israel Antitrust Conference, 2008
Lewis Bernstein Memorial Antitrust Lecture, Washington, D.C., 2006
Distinguished Visitor, University of Melbourne, April 2005
Milton Handler Lecture, New York, 2004
Keynote Address to the International Competition Network, Mexico, 2004
Alexander Brody Distinguished Lecture, Yeshiva University, 2000
Ph.D. Thesis chosen to appear in the Garland Series of Outstanding Dissertations in Economics
Recipient of the 1977 P.W.S. Andrews Memorial Prize Essay, best essay in the field of Industrial Organization by a scholar under the age of thirty
National Science Foundation Grant, 1977 - 1985
Recipient of Post-doctoral Grant from the Lincoln Foundation, 1975
National Science Foundation Fellowship, 1972 - 1975
Phi Beta Kappa, 1971
John Harvard Award, 1970
Detur Book Prize, 1969
Edwards Whitacker Award, 1969
M.I.T., National Scholar Award, 1968

PROFESSIONAL AFFILIATIONS AND ACTIVITIES

Appointed Member of the ABA Transition Task Force, Antitrust and Consumer Protection, 2012
Advisory panel to the Department of Justice and the FTC on the merger guidelines, 2010
Co-editor, Journal of Law and Economics, 1980 - present
Visiting Committee, MIT, Department of Economics, 1995 - 2011
Member, Advisory Board, Economics Research Network, 1996 - present
Member, Advisory Board of Antitrust and Regulation Abstracts, Social Science Research Network, 1998 - present
Advisory Board, Massachusetts Institute of Technology, Department of Economics, 1999 - present
Editorial Board, Competition Policy International (CPI), 2010 – present, Co-Editor, Competition Policy International (CPI), 2004 – 2009
Member, Economic Task Force – Antitrust Division, American Bar Association, 2010 – present
Advisory Board, Journal of Competition Law and Economics, 2004- present
Adjunct Scholar, American Enterprise Institute for Public Policy Research, 2007 – present
Deputy Assistant Attorney General for Economic Analysis, Antitrust Division, U.S. Department of Justice, 2006 - 2008
Presidential Appointment to the Antitrust Modernization Commission, 2004 - 2007
Invited Panelist at Public Hearing on the Retail Banking Sector Inquiry: Payment Cards, before the European Commission in Brussels, Belgium, July 17, 2006.
Consultant on Merger Guidelines to the FTC, 2003
Professor, George Mason Institute for Judges, October 2001
Chairman, FTC Round Table on Empirical Industrial Organization (September 11, 2001)

Participant in the Round Table on the Economics of Mergers Between Large ILECS before the Federal Communications Commission, February 5, 1999
Member, Steering Committee, Social Science Research Council, Program in Applied Economics, 1997 - 1999
Participant in roundtable discussions on "The Role of Classical Market Power in Joint Venture Analysis," before the Federal Trade Commission, November 19, 1997 and March 17, 1998.
Participant in meetings with Committee of the Federal Reserve on Payment Systems, June 5, 1997
Associate Editor, Regional Science and Urban Economics, 1987 - 1997
Resident Scholar, Board of Governors of the Federal Reserve System, Summer, 1995
Accreditation Committee, Graduate School of Business, Stanford University, 1995
Associate Editor, The International Journal of Industrial Organization, 1991 - 1995
Editorial Board, Intellectual Property Fraud Reporter, 1990 - 1995
Consultant on Merger Guidelines to the U.S. Department of Justice, 1991 - 1992
Member, Advisory Committee to the Bureau of the Census, 1987 - 1990
National Bureau of Economic Research, Research Associate
Member, American Economics Association, Econometrics Society

BOOKS

Market Behavior Under Uncertainty, Ph.D. Thesis, Massachusetts Institute of Technology (September 1975); Garland Publishing (1984).

Modern Industrial Organization, Scott, Foresman & Co., co-authored with Jeffrey Perloff, first edition (1990), (Chapter 17 of first edition reprinted as “The Economics of Information” for the University of Connecticut, Food Marketing Policy Center (1989)), second edition (1994), translated into Chinese, French, Hungarian and Italian; Addison Wesley Longman, third edition (2000), fourth edition (2005), translated into Chinese (2009).

RESEARCH PAPERS

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"Theories of Vertical Integration," presented at Fourth Annual Telecommunications Conference. Appears in a volume of Proceedings of the Fourth Annual Telecommunications Conference, Office of Telecommunications Policy, (April 1976).

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"Market Behavior with Demand Uncertainty and Price Inflexibility," American Economic Review, (September 1978).

"Vertical Integration in Competitive Markets Under Uncertainty," Journal of Industrial Economics, (March 1979). Awarded the P.W.S. Memorial Prize for the best essay in the field of Industrial Organization by a scholar under the age of thirty.

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"The Competitive Effects of Fannie Mae," (with D. Gross and R. Stillman) in Housing Matters: Issues in American Housing Policy, Fannie Mae (January 2002, reprinted 2004).

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Expert Report of Dennis W. Carlton in Re: Rail Freight Fuel Surcharge Antitrust Litigation, MDL No. 1869, Misc. No. 07-489 (PLF), January 22, 2013.

EXHIBIT 2

ALLAN SHAMPINE **February 2013**

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EDUCATION

Ph.D. UNIVERSITY OF CHICAGO: Economics, 1996
(Full scholarship from the University)
(Thesis: *An Evaluation of Technology Diffusion Models and Their Implications*)
(Field specializations: urban economics, agricultural economics)

M.A. UNIVERSITY OF CHICAGO: Economics, 1993
(Full scholarship from the University)

B.S. SOUTHERN METHODIST UNIVERSITY: Economics and Systems Analysis, Mathematics Minor, 1991
(Summa Cum Laude, Honors, Departmental Distinction)

PROFESSIONAL EXPERIENCE

Compass Lexecon (formerly Lexecon), Chicago, Illinois: Senior Vice President (2012 – Present)
Vice President (2003 – 2012), Economist (1996 – 2003)

Editor for *The Antitrust Source,* American Bar Association (2011 – Present)

PUBLICATIONS

BOOKS

<ins>Down to the Wire: Studies in the Diffusion and Regulation of Telecommunications Technologies</ins>, (Editor) Nova Science Press (2003).
(Contributors include Debra Aron, Johannes Bauer, Peter Bernstein, David Burnstein, Robert Crandall, Nicholas Economides, Wayne Fu, Shane Greenstein, Charles Jackson, Junghyun Kim, Donald Kridel, Mercedes Lizardo, Paul Rappoport, Pablo Spiller, Lester Taylor and Steven Wildman)

ARTICLES

"The Role of Behavioral Economics in Antitrust Analysis," forthcoming in *Antitrust.*

"Testing Interchange Fee Models Using the Australian Experience," proceedings of the Bank of Canada Economics of Payments VI conference, May 24, 2012

Review of "Why (Ever) Define Markets? An Answer to Professor Kaplow," (by Gregory Werden), *Antitrust Source,* April 2012.

Review of "An Empirical Study of the Effects of *Ex Ante* Licensing Disclosure Policies on the Development of Voluntary Technical Standards," (by Jorge Contreras), *Antitrust Source*, February 2012.

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"Boom and Bust in Network Industries: Rising from the Ashes," with Hal Sider, *International Journal of Business & Economics, Proceedings* (2006).

"The Economics of Interchange Fees," with Alan Frankel, 73 *Antitrust Law Journal* 3 (2006).

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"The Evolution of Telecommunications Switching in the Central Office," in <u>Down to the Wire: Studies in the Diffusion and Regulation of Telecommunications Technologies</u>, Nova Science Press (2003).

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"Determinants of the Diffusion of U.S. Digital Telecommunications," *Journal of Evolutionary Economics* 11 (2001).

"Compensating for Information Externalities in Technology Diffusion Models," 80 *American Journal of Agricultural Economics* 2 (1998).

Contributor to Guide to the Western Ephemera Collection at the DeGolyer Library, Southern Methodist University, 1993, edited by Kristin Jacobsen.

"The Impact of Technology on the Modern Labor Market," 11 *Southwestern Journal of Economic Abstracts* 1 (1990).

RESEARCH PAPERS

"An Evaluation of the Social Costs of Payment Methods Literature" (2012 – SSRN)

"Testing Interchange Fee Models Using the Australian Experience" (2012 – SSRN)

"An Evaluation of Online Investment Bank Research," with Rajiv Gokhale (2011).

"A New Direction in Mixed Income Housing," submitted to Chicago Housing Authority (1993).

"A Survey of the Economics of Information, Focusing on Water" (1992).

"Petroleum Price Shocks and Rationality," B.S. Honors Paper (1991).

OTHER PROFESSIONAL EXPERIENCE

Interviewed by *IEEE Spectrum* for "The High Cost of Taking Your Money" (June 2012).

"Testing Interchange Fee Models Using the Australian Experience," presented as part of a special session "Interchange Fees: Regulation and Implications" at Economics of Payments VI conference, Bank of Canada, May 24, 2012.

Interviewed by *The Oregonian* for "Those credit card rewards cost us a lot of cash" (July 31, 2010).

Participant in "The Law and Economics of Interchange Fees and Credit Card Markets" symposium sponsored by International Center for Law & Economics (December 8-9, 2009).

"The Evaluation of Social Welfare for Payment Methods," 2009 Oxford Business & Economics Conference (June 24-26, 2009).

Interviewed by *Cards Insider* for "Payments: Cash Replacement, Anonymity provides lifeline for cash over cards" (January 28, 2008).

"Boom and Bust in Network Industries: Rising from the Ashes," 6th Global Conference on Business & Economics, Harvard University (October 15-17, 2006), with Hal S. Sider.

"House of Cards: The Economics of Interchange Fees," Presentation to the Federal Reserve Bank of New York Conference, *Antitrust Activity in Card-Based Payment Systems: Causes and Consequences* (September 16, 2005), with Alan S. Frankel.

"The Impact of Technology on the Modern Labor Market," 68th Annual Meeting of the Southwestern Social Science Association (March 29, 1990)

Presented papers on information externalities and technology diffusion at the *Economics and Public Policy Workshop* (3) and *Price Theory Workshop* (1), University of Chicago (1995, 1996)

Coordinated the *Conference on Valuing Non-Market Goods*, University of Chicago (July 21-22, 1995)

Assisted in coordinating the *Conference on Research in Health Economics*, University of Chicago (October 21-22, 1994)

Assisted in organizing the *Economic Policy and Public Finance Workshop*, University of Chicago (1993 - 1996)

Member of the *American Economics Association*

Associate member of the *American Bar Association*

Referee for the *Agricultural and Resource Economics Review, American Journal of Agricultural Economics*, *Antitrust Law Journal, Journal of Business* and *Journal of Evolutionary Economics*.

Finance Committee (2010 – Present), Vestry (2007-2009), Treasurer (2006), St. Mary's Episcopal Church, Park Ridge

TESTIMONY

Supplemental Declaration before the Federal Maritime Commission, Docket No. 11-12, Hanjin Shipping Co., Ltd. et al., v. the Port Authority of New York and New Jersey, January 31, 2013 (with Fredrick Flyer).

Reply Declaration in the Matter of Policies Regarding Mobile Spectrum Holdings, Before the Federal Communications Commission, WT Docket No. 12-269, January 3, 2013.

Declaration in the Matter of Policies Regarding Mobile Spectrum Holdings, Before the Federal Communications Commission, WT Docket No. 12-269, November 26, 2012.

Expert Report to the Australian Competition & Consumer Commission with regards to the regulatory treatment of the National Broadband Network, September 24, 2012 (with Janusz Ordover).

Report in the Matter of Promoting Interoperability in the 700 MHz Commercial Spectrum, Interoperability of Mobile User Equipment Across Paired Commercial Spectrum Blocks in the 700 MHz Band, Before the Federal Communications Commission, WT Docket No. 12-69, July 16, 2012 (with Mark Israel and Michael Katz).

Declaration in the Matter of Joseph I. Marchese on Request for Inspection of Records, Comments of Deutsche Telekom AG and T-Mobile USA, Inc., FCC FOIA Control No. 2012-12, filed November 14, 2011.

Declaration in the Matter of Joseph I. Marchese on Request for Inspection of Records, AT&T Inc.'s Opposition to Bursor & Fisher, P.A.'s FOIA Request, FCC FOIA Control No. 2012-12, filed November 14, 2011.

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Declaration, In Re Bursor & Fisher, P.A., v. Federal Communications Commission, Case No. 1:11-cv-05457-LAK, U.S. District Court, SDNY, August 26, 2011.

Reply Declaration, in Re: the Merger of AT&T with T-Mobile: Before the Federal Communications Commission, WT Docket No. 11-65, June 9, 2011 (with Dennis Carlton and Hal Sider).

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Supplemental Declaration to the Federal Communications Commission, in the Matter of Implementation of Section 224 of the Act; A National Broadband Plan for Our Future (WC Docket No. 07-245), November 2, 2010 (with Jonathan Orszag).

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Declaration, In Re Gabapentin Patent Litigation (MDL No. 1384, Master Docket No. 00-CV-2931 (FSH)), March 29, 2010.

Reply Declaration to the Federal Communications Commission, In the Matter of Special Access Rates for Price Cap Local Exchange Carriers (WC Docket No. 05-25), February 24, 2010 (with Dennis Carlton and Hal Sider).

Reply Declaration to the Federal Communications Commission, Verizon Wireless / ALLTEL transaction (WT Docket No. 08-95), August 19, 2008 (with Dennis Carlton and Hal Sider).

Declaration to the Federal Communications Commission, Verizon Wireless / ALLTEL transaction (WT Docket No. 08-95), June 13, 2008 (with Dennis Carlton and Hal Sider).

Ex parte filing before the Federal Communications Commission on behalf of Verizon, "Verizon/MCI Merger: Analysis of Special Access," September 9, 2005 (with Gustavo Bamberger and Dennis Carlton).

Comments to the New York Public Service Commission, In the Matter of the Joint Petition of Verizon Communications, Inc. and MCI, Inc. for a Declaratory Ruling Disclaiming Jurisdiction Over or, in the Alternative, for Approval of Agreement and Plan of Merger; and Joint Petition of SBC Communications Inc., AT&T Corporation, Together with its Certificated New York Subsidiaries, for Approval of Merger (CASE 05-C-0237 and CASE 05-C-0242), August 5, 2005 (with Gustavo Bamberger and Dennis Carlton).

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Declaration to the Federal Communications Commission in the Matter of 2000 Biennial Regulatory Review Spectrum Aggregation Limits for Commercial Mobile Radio Services, Docket No. 01-14, April 13, 2001, (with Robert Gertner).

Report to Directorate General IV of the European Commission: "Remedies in the United States," in *Remedies in the United States,* in *Remedies in EU Competition Law: The Policy and Practice of the European Commission, A Report for Directorate General IV of the European Commission*, July 1998, Report (with James Langenfeld).

ACADEMIC HONORS

Undergraduate:
Graduated Summa Cum Laude, Honors, Departmental Distinction
Award for Excellence (given to the outstanding senior in the Economics Department as decided by the vote of the faculty)
Presidential Scholarship (full scholarship)
National Merit Scholar (honorary)
Hyer Society (honorary society of Southern Methodist University)
Honor Roll (1987-1991)
Phi Beta Kappa
Alpha Lambda Delta (Treasurer, honorary society recognizing academic achievement)
Phi Eta Sigma (honorary society recognizing academic achievement)
Omicron Delta Epsilon (international honor society in economics)
Kappa Mu Epsilon (honor society in mathematics)

Graduate:
Full Scholarship (tuition and stipend)

Attachment B

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

In the Matter of	)	
	)	
Special Access Rates for Price Cap Local Exchange Carriers	)	WC Docket No. 05-25
	)	
	)	
	)	
AT&T Corporation Petition for Rulemaking to Reform Regulation of Incumbent Local Exchange Carrier Rates for Interstate Special Access Services	)	RM-10593

REPLY DECLARATION OF PARLEY C. CASTO

1. My name is Parley C. Casto. My title is Assistant Vice President – Strategic Pricing – Business Marketing for AT&T Inc. ("AT&T"). I am responsible for pricing for AT&T Wholesale products and services, including TDM special access and Ethernet services, provided to interexchange carriers, wireless carriers, content providers, competitive local exchange carriers ("CLECs") and ISPs. My previous positions included Sales Vice President for AT&T Wholesale and Executive Director – Industry Markets Special Access Product Management for SBC. In the latter position, I was responsible for product management, rate development, policy development, and tariff management for the wholesale special access business of SBC on an enterprise-wide basis. Prior to holding these positions, I served as a Director of various other product management organizations within SBC. In those positions, I supervised product management teams responsible for switched access, advanced services, special access, and unbundled network elements. I received my BA from DePaul University in Chicago, Illinois in

1999 and my MBA from DePaul University in 2002. I began working for Illinois Bell Telephone Company in 1992 in the network services organization in Chicago, Illinois.

2. The purpose of this declaration is to respond to claims advanced by nine carriers—BT Americas, Cbeyond, Earthlink, Integra, Level 3, Sprint, TelePacific, tw telecom and XO (hereinafter, "complaining commenters")—that AT&T's special access tariffs unfairly "lock up" customers such that they are unable to take advantage of rival suppliers. In particular, I have been advised by counsel that the complaining commenters focus on AT&T's Tariff No. 73 Term Payment Plan ("TPP") that is in effect for the 5-state legacy Southwestern Bell Telephone ("SWBT") region and the provisions of that tariff that govern the purchase of DS1 special access circuits.[1] As I explain in greater detail below, the facts show that the TPP does not foreclose customers from shifting significant special access demand to rival providers and, more broadly, customers have a wide variety of options for purchasing special access from AT&T in the SWBT region and are not limited to the TPP.

3. Before turning to the specific arguments advanced by the complaining commenters, it is important to correct a fundamental misapprehension as to how the TPP operates. Under the "base" TPP, customers can sign up to purchase individual circuits for one of five terms: 1-year, 2-year, 3-year, 5-year, and 7-year terms or they can choose a month-to-month option under the general tariff. In return for providing AT&T with the certainty and other benefits associated with longer term commitments, AT&T offers lower rates.

[1] The TPP is also available in the legacy PacBell region via a separate tariff. As noted, complaining carriers focus on the SWBT region, which is accordingly the focus of this declaration.

No volume commitment is necessary to obtain the lower rates. A customer is free to commit as few or as many circuits as it chooses to any of the available terms. In this respect, TPP customers have the opportunity on a circuit-by-circuit basis to make circuit-specific term commitments that can help them match the terms of their DS1 inputs with the terms of their end user retail service contracts.

4. To ensure that AT&T gets the benefits associated with a term discount arrangement—*e.g.*, committed revenues and more accurate knowledge of future demand that allows AT&T to more efficiently design and operate its local access networks—AT&T's special access term plans, including the TPP, include early termination fees ("ETFs"). ETFs deter a customer from engaging in arbitrage by signing for a long-term plan, obtaining the maximum discounts, and then terminating the circuit before the term ends. That said, a TPP customer who cancels early and incurs an ETF will pay less in total charges than if it had maintained the circuit for the full term at its contracted rate.[2]

5. Tariff No. 73 also provides an additional option—called the portability option—that allows a TPP customer to avoid ETFs altogether for DS1 circuits. Under this option, so long as the customer continues, during a three-year portability term, to purchase at least 80 percent of the number of DS1 channel terminations it purchased from AT&T at the time the carrier entered into the portability commitment, it can disconnect or move individual circuits with no ETFs. The customer is under no obligation to buy special access from AT&T for any additional customer demand that develops over the period, and the customer is free to move circuits to rival suppliers without fee, subject only to the

[2] Under the TPP, the fee for early termination is 40 percent of the recurring charges for the remaining months of the customer's term.

80 percent commitment. A customer that fails to satisfy the minimum commitment level incurs a shortfall fee under the TPP portability option. The minimum commitment level is thus a *quid pro quo* for AT&T agreeing to waive ETFs for circuits purchased pursuant to TPP term commitments. Again, this commitment strikes an appropriate balance between a special access customer's desire to obtain maximum flexibility in arranging its service arrangements to its own end user customers while avoiding ETFs and AT&T's need to prevent arbitrage and reasonably manage the demand for our network facilities—without it, a TPP portability customer could bind AT&T to provide all of the customers' circuits at the most heavily discounted rates even if it planned to keep them in service for a relatively short time.[3]

6. I now address and correct several of the specific claims made by the complaining commenters about the TPP and their ability to obtain special access from AT&T and rivals. Given potentially applicable confidentiality agreements and restrictions, I do not identify those carriers by name in association with the specific tariff or other wholesale arrangements under which they receive service from AT&T. Should the Commission desire that information, however, AT&T will endeavor to obtain its customers' consent to provide this information, subject to the requirements of the applicable protective agreements.

[3] The TPP provides a portability option only for DS1 circuits. Customers that desire some form of portability for DS3 circuits typically negotiate terms tailored to their individual needs through the contract tariff process.

I. CUSTOMERS ARE NOT COMPELLED TO COMMIT TO A SEVEN-YEAR TERM UNDER THE TPP.

7. I understand that the complaining commenters suggest that they are effectively forced to purchase special access at the longest term (seven years, for the TPP) to get rates that allow them to be viable competitors. The reality is that customers are not forced to make the maximum term commitment to be successful retail competitors.

8. As is typical of term discounts, AT&T's tariffed DS1 rates decline as the length of the term commitment increases. However, the bulk of the term discount is achieved with a term as short as three years. Under Tariff No. 73 for the TPP and the general month-to-month option, the available rate-term combinations for a DS1 channel termination in rate zone 1 of the SWBT region where AT&T has pricing flexibility are as follows:

- Month-to-month: $215 / mo.
- 1 year: $200 / mo.
- 2 year: $145 / mo.
- 3 year: $112 / mo.
- 5 year: $92 / mo.
- 7 year: $90 / mo.

Rates for the two other density zones follow the same pattern.[4]

9. Although some of AT&T's customers commit to seven year terms for some DS1 circuits, customers frequently opt for shorter terms. This is true of the complaining commenters.

[4] Where AT&T's DS1 services in the SWBT region remain subject to price caps, the month-to-month and 1 year term rates are different than in areas that are subject to pricing flexibility. For example, for DS1 channel terminations in rate zone 1, AT&T's month-to-month rate is $195 per month and its one-year term rate is $160 per month. But regardless of rate zone and whether or not a pricing flexibility or price capped area, the substantial majority of the discount associated with term rates is earned with a three year term commitment.

For example, one complaining commenter buys special access in the SWBT region exclusively under three-year term commitments. Other customers buy circuits with a mix of terms, presumably to give the customer flexibility to shift circuits to the lowest cost provider but while at the same time having a base of circuits at lower rates available for longer term commitments. Again, this is true of complaining commenters. In fact, one currently purchases significant volumes of DS1s in the SWBT region at month-to-month, three-year, and five-year terms, but purchases only an insignificant number of DS1s at a seven-year term. Finally, some of AT&T's customers primarily buy month-to-month circuits to have maximum flexibility. And again, one of the complaining commenters takes this approach, buying the substantial majority of its DS1 special access circuits under month-to-month terms.

II. AT&T'S SPECIAL ACCESS CUSTOMERS ARE NOT COMPELLED TO AGREE TO THE TPP PORTABILITY OPTION AND MANY DO NOT.

10. The complaining commenters, I understand, also contend that they must agree to the TPP portability option (to avoid ETFs associated with term commitments) and, therefore, are forced to commit substantial volumes to AT&T, which precludes them from shifting traffic to AT&T's rivals. Again, the facts tell a different story.

11. Most of the complaining commenters have foregone the TPP portability option altogether in the SWBT region or do not utilize it for the majority of their access needs. Several of the complaining commenters do not currently buy *any* DS1 circuits in the SWBT region under the TPP's portability option. (Indeed, one does not buy special access from AT&T at all.) Another purchases only a relatively small fraction of its total DS1 circuits in the SWBT region under the TPP portability option. That carrier instead primarily uses a

grandfathered tariff, the High Capacity Term Payment Plan ("HC-TPP"), that has no circuit-specific term commitments (and thus no ETFs) and under which the customer has instead made a revenue commitment to obtain rates that it has apparently determined, given its particular business plans and strategies, are superior to the rates it could have obtained under the TPP or other tariff or contract tariff options.

12. In this regard, the complaining commenters are similarly situated to many of AT&T's other customers. Currently, only a small fraction of AT&T's non-affiliated DSn level special access customers are purchasing under the TPP portability option in the SWBT region. Overall, AT&T provides tens of thousands of DS1 circuits in the SWBT region in excess of aggregate TPP portability commitments in that region. This is a substantial volume of DS1s and represents several times the *entirety* of many CLECs' special access purchases.

13. But even as to customers that do take advantage of the TPP portability option, there is no "lock in." As noted, a customer that takes the portability option has the flexibility to shift up to 20 percent of its committed base of traffic to other carriers over the term of the plan without any fee whatsoever.[5] Moreover, there is no requirement under the TPP that a customer use AT&T for incremental demand (*i.e.*, demand in addition to the original base purchase), and the entirety of any such increased demand can be obtained from alternative providers if the customer elects to do so. Finally, it is also the case that at the time that a customer makes a TPP portability commitment to AT&T, any demand it has

[5] In addition, even under the TPP without a portability option, a customer can move one end of a DS1 circuit to another location in the same LATA and keep the DS1 TPP in force so long as it meets a minimum in-service period at the original location and the move is accommodated on a single customer order. Several of AT&T's customers take advantage of this feature of the TPP.

with other carriers does *not* count towards its commitment and may be maintained (or increased) with the other carrier.

14. Notably, the complaining commenters that actually have elected the TPP portability option in the SWBT region currently have "headroom" (that is, their DS1 purchases exceed the minimum portability commitment level) and could shift DS1s to other providers if they chose to do so without incurring any ETFs or shortfall fees. The amount of headroom is substantial. One of the complaining commenters currently exceeds its minimum DS1 circuit commitment for the TPP portability option in the SWBT region by approximately 40 percent and could immediately shift thousands of DS1 circuits from AT&T to a rival supplier of DSn or Ethernet services without incurring any ETF or shortfall fee. Two others that have opted into the TPP portability in the SWBT region have headroom in excess of 20 percent of their minimum commitment levels.

15. Again, the complaining commenters reflect AT&T's TPP customers generally. Of the (relatively few) AT&T customers that have elected the TPP portability option in the SWBT region, many have "headroom," and in several cases the headroom is substantial. Overall, customers that have elected TPP portability in the SWBT region exceed in aggregate the associated minimum commitment level by more than 20 percent.

III. CUSTOMERS THAT SEEK TO PURCHASE SPECIAL ACCESS SERVICES FROM AT&T HAVE MANY ALTERNATIVES TO THE TPP.

16. To the extent the complaining commenters are suggesting that the only competitively viable mechanism for obtaining special access (or substitutes) is AT&T's base TPP tariff, they are mistaken. In fact, the TPP is only one of several options utilized by the complaining commenters (and other customers) in the SWBT region. For example, the

Commission's pricing flexibility rules allow special access suppliers and their customers to negotiate individualized contract tariffs that are tailored to the customer's specific needs. These arrangements can include, for example, portability, wavier of ETFs or revenue-based discounts that customers determine to be superior to the existing TPP "base" tariff. Negotiated arrangements can also potentially include portability based on maintaining a certain minimum revenue commitment derived from an array of dedicated access services (as opposed to a commitment set with reference to a certain level of DSn circuits). AT&T currently has in place more than 25 contract tariffs governing the purchase of DSn-level special access in the SWBT region.

17. Ethernet services, which are increasingly being used by AT&T's customers as a substitute for DSn service, are not provided pursuant to tariff. In many cases, the services are provided pursuant to an individualized agreement with the customer.

18. In some instances, customers have been able to continue to purchase under "grandfathered" tariffs that, although no longer available to new subscribers, were extended for an additional period of time. Finally, many carriers forego DSn-level special access and purchase unbundled network element ("UNE") substitutes. The wide variety of options confirms that customers are able to obtain terms that are consistent with their needs. Indeed, many customers are able to utilize multiple options even within the same region through ownership of affiliates that obtain special access under a different arrangement than the parent.

19. The diversity of options exists not only within a region, but across regions as well. Thus, for example, AT&T offers different special access pricing plans in the legacy Ameritech

and BellSouth regions. For example, in the BellSouth region, the Area Commitment Plan allows the customer to determine the volume commitment for portability. In the Ameritech region, the Discount Commitment Program sets the initial commitment equal to 90 percent of in-service channel terminations and provides for ETFs that are based on payback of savings.

20. The arrangements actually used by the complaining commenters illustrate the diversity of options available. For example, one complaining commenter in the SWBT region decided to forego portability and instead negotiated an agreement that provided for substantial lump sum discounts in return for meeting a minimum annual revenue commitment ("MARC") based on a broad range of services that carrier purchases from AT&T, including DSn-level services and non-tariffed broadband services.

21. Another complaining commenter, in addition to purchasing under the TPP, currently has three pricing flexibility contracts with AT&T. In two of these contracts, the complaining commenter not only negotiated reduced DS1 rates, but also for different portability options—one provides for portability so long as the customer maintains a certain minimum level of circuits (a commitment level set through negotiations) and the second provides for portability so long as a minimum annual revenue commitment is met (again, a commitment level set through negotiations). The third contract tariff provides additional lump sum credits if the customer's aggregate special access spend exceeds a particular level.

22. Another complaining commenter has negotiated an agreement with AT&T that provides it with additional flexibility to convert DSn-level circuits that are subject to term commitments to AT&T Ethernet services.

23. Another complaining commenter has largely bypassed the TPP and instead purchases pursuant to the grandfathered HC-TPP tariff arrangement. Under the HC-TPP, the customer does not have to pay an ETF on any individual disconnect and pays no shortfall charges so long as it meets a minimum monthly revenue commitment—a commitment level that the carrier itself had the flexibility to establish. Notably, that customer elected to continue to take service under the HC-TPP even after its initial term had lapsed and it had the option of purchasing under the TPP.

24. Several of the complaining commenters are "UNE-first" customers that typically purchase UNEs rather than special access services where possible. The TPP tariff has no applicability to such UNE purchases and does not preclude in any way these carriers from shifting traffic to a rival of AT&T.

25. Finally, as noted, several of the complaining commenters that have actually elected the TPP portability option are purchasing at levels well above the minimum TPP portability option commitment level and thus have the ability to transfer those circuits to another provider without incurring any additional charge.

IV. AT&T'S RECENT MARKETPLACE EXPERIENCE DEMONSTRATES THAT THE COMPLAINING COMMMENTERS' FORECLOSURE CLAIMS ARE UNFOUNDED.

26. The notion that AT&T has been able to "lock up" significant special access demand is clearly contrary to the marketplace facts. The TPP was put in place in 2003 in the SWBT

region and since that time AT&T's rivals have been quite successful in winning access business away from AT&T.

27. Most notably, wireless providers are among AT&T's largest and most significant special access customers. These providers purchase special access to "backhaul" traffic from wireless towers to their switches. In part because of increased demand for mobile wireless service and, hence, increased need for backhaul, wireless providers have transitioned a substantial amount of their backhaul from DSn-level circuits to IP-based Ethernet services.

28. Rather than being "locked in," wireless providers have been able to eliminate tens of thousands of DSn-level circuits and shift those circuits to Ethernet—and in many cases, to AT&T's competitors. In the period from March 2011 to December 2012, the number of DS1 special access circuits AT&T provided to wireless providers in its incumbent territories dropped by more than 30 percent. AT&T's provision of DS1 circuits to wireless providers in the SWBT region likewise fell by over 30 percent. Indeed, over that same period, DS1 circuits provided to two of AT&T's largest special access customers have both fallen by over 50 percent in AT&T's incumbent territories. Although in some instances AT&T was able to win the provider's Ethernet business, in many instances the wireless provider selected an alternative Ethernet provider for its backhaul needs. In other words, notwithstanding increasing backhaul demand and notwithstanding AT&T's supposed ability to maintain special access traffic on its network by using "lock up" tariffs, AT&T lost substantial DS1 volumes over the course of the last two years.

29. In this regard, AT&T is also facing increasing competition from CLECs, cable companies and wireless broadband providers both for DSn-level service and increasingly for IP-based access services. Customers increasingly tout the availability of alternative suppliers and demand greater discounts or other non-price benefits. Indeed, several CLECs (tw telecom, Level 3 and XO) are among the largest suppliers of Ethernet-based services and provide AT&T with stiff competition in this space. Cable companies have likewise become leading providers of Ethernet services. AT&T's overall provision of DS1 circuits has begun to decline since March 2011 even as to wireline customers, and this trend is only likely to accelerate going forward.

VERIFICATION PAGE

I declare under penalty of perjury that, based on the information available to me, the foregoing is true and correct to the best of my knowledge.

Parley C. Casto

Dated: March 12, 2013