

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

| | | |
|---|---|----------------------|
| In the Matter of |) | |
| |) | |
| Business Data Services in an Internet |) | WC Docket No. 16-143 |
| Protocol Environment |) | |
| |) | |
| Investigation of Certain Price Cap Local |) | WC Docket No. 15-247 |
| Exchange Carrier Business Data Services |) | |
| Tariff Pricing Plans |) | |
| |) | |
| Special Access Rates for Price Cap Local |) | WC Docket No. 05-25 |
| Exchange Carrier |) | |
| |) | |
| AT&T Corp. Petition for Rulemaking to |) | RM-10593 |
| Regulation of Incumbent Local Exchange |) | |
| Carrier Rates for Interstate Special Access |) | |
| Services |) | |

COMMENTS OF INCOMPAS

Karen Reidy
INCOMPAS
1200 G Street NW
Suite 350
Washington, DC 20005
(202) 296-6650

June 28, 2016

TABLE OF CONTENTS

| | |
|--------------------------------|----|
| Introduction and Summary | 1 |
| I. Competition Test..... | 5 |
| II. Rate Reform. | 9 |
| Conclusion..... | 13 |

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

| | | |
|---|---|----------------------|
| In the Matter of |) | |
| |) | |
| Business Data Services in an Internet Protocol Environment |) | WC Docket No. 16-143 |
| |) | |
| Investigation of Certain Price Cap Local Exchange Carrier Business Data Services Tariff Pricing Plans |) | WC Docket No. 15-247 |
| |) | |
| Special Access Rates for Price Cap Local Exchange Carrier |) | WC Docket No. 05-25 |
| |) | |
| AT&T Corp. Petition for Rulemaking to Regulation of Incumbent Local Exchange Carrier Rates for Interstate Special Access Services |) | RM-10593 |

COMMENTS OF INCOMPAS

INCOMPAS respectfully submits these comments in response to the Commission’s Further Notice of Proposed Rulemaking in the above referenced proceedings.¹

Introduction and Summary

Given the importance of the Business Data Services market, and despite having long advocated divergent views, INCOMPAS and Verizon have now proposed a broad framework for

¹ *Business Data services in an Internet Protocol Environment, Investigation of Certain Price Cap Local Exchange Carrier Business Data Services Tariff Pricing Plans, Special Access for Price Cap Local Exchange Carriers; AT&T Corp. Petition for Rulemaking to Reform Regulation of Incumbent Local Exchange Carrier Rates for Interstate Special Access Services*, WC Docket Nos. 16-143, 15-247, 05-25, RM-10593, Tariff Investigation Order and Further Notice of Proposed Rulemaking, FCC 16-54, rel. May 2, 2016 (“Order and Further Notice” or “Further Notice”).

reform of the Commission’s regulatory framework for Business Data Services.² The proposed framework builds upon the principles proposed by Verizon and INCOMPAS in April³ and reflects real compromises by both parties. Members of INCOMPAS are submitting comprehensive filings that support this framework and address other issues raised in the *Further Notice*. INCOMPAS submits these brief comments explaining the principles in the proposed framework for reform that we put forth with Verizon.

Business Data Services (*a.k.a.* special access services) markets comprise a \$45 billion industry in itself. Importantly, Business Data Services are a critical input to the operation of countless businesses, educational and health care institutions, government entities, and wireless providers. As Commissioner Rosenworcel has stated: “These are the high-capacity dedicated services that sustain our wireless networks, facilitate commercial transactions, and underpin communications that American businesses rely on every day.”⁴ While most consumers are not familiar with these services, they use them when they make a voice call or send a text on a mobile device, withdraw cash from an ATM, or search online reference materials on a computer at their public library. The rates, terms, and conditions on which these services are offered have a significant effect on consumer welfare. For example, as mobile providers explained, access to Business Data Services at 100 Mbps and above at reasonable prices is vital for wireless providers

² Letter from Kathleen Grillo, Senior Vice President, Public Policy and Government Affairs, Verizon, and Chip Pickering, Chief Executive Officer, INCOMPAS, to Marlene H. Dortch, Secretary, FCC, WC Docket No. 16-143 and WC Docket No. 05-25 (filed Jun. 27, 2016) (“Grillo-Pickering June Letter”).

³ Letter from Kathleen Grillo, Senior Vice President, Public Policy and Government Affairs, Verizon, and Chip Pickering, Chief Executive Officer, INCOMPAS, to Marlene H. Dortch, Secretary, FCC, WC Docket No. 05-25 and RM-10593 (filed Apr. 7, 2016) (“Grillo-Pickering April Letter”).

⁴ Statement of Commissioner Jessica Rosenworcel, *Order and Further Notice*, FCC 16-54.

to meet the current demand for wireless broadband services and to build next generation mobile broadband networks.⁵ Businesses, schools and libraries, health care facilities and government entities use Business Data Services as vital inputs to their operations. As a consequence, the economic impact these services generate is significantly greater, estimated to be in the range of \$75 billion annually.⁶ Ensuring Business Data Services markets functions properly and are governed by the right policies is of utmost importance.

The Business Data Services marketplace is in urgent need of meaningful reform. In structuring its reform, the Commission must acknowledge the current state of the market. The Commission has found that “concentration by any measure appears high in this industry.”⁷ Virtually no commercial buildings are subject to significant actual competition. Indeed, 99 percent of commercial buildings with demand for Business Data Services were served by one or two facilities-based competitors as of 2013.⁸ These markets remain highly concentrated as “costs and conditions exist in the [Business Data Service] market with enough significance in any measure of a geographic market to deter rapid competitive entry or expansion, including high capital expenditures, large sunk costs, long lead times, scale economies, and cost disadvantages.”⁹ Recently, the Consumer Federation of American found that the overcharges

⁵ Letter from Steven Berry, President and CEO, Competitive Carriers Assoc., Chip Pickering, CEO, INCOMPAS, Vonya McCann, Senior VP, Govt. Affairs, Sprint, Kathleen O’Brien Ham, Senior VP, Govt. Affairs, T-Mobile, and Grant Spellmeyer, VP, Fed. Affairs and Public Policy, U.S. Cellular to Marlene H. Dortch, Secretary, FCC, WC Docket No. 05-25, RM-10593, at 1 (filed Apr. 21, 2016)(“Joint Wireless Letter”).

⁶ *Further Notice* at ¶ 44.

⁷ *Id.* at ¶ 216-224.

⁸ *See id.* ¶ 220.

⁹ *Id.* at ¶ 224.

resulting from the market failure in the Business Data Services markets have costs consumers over \$150 billion over the past five years.¹⁰

The Commission has an obligation under Sections 201 and 202 of the Communications Act to prevent carriers from charging unjust and unreasonable prices for Business Data Services. The Commission's goal must be to promote consumer welfare, not to protect any particular carrier or class of carrier from the consequences of appropriate constraints placed on their supra-competitive prices. As Public Knowledge explains, a "regulatory regime that continues to permit unjust and unreasonable rates to flourish, albeit to a lesser degree, will nonetheless continue to allow dominant providers to harm customers and consumers."¹¹ The possibility, as some have suggested, that incumbent LECs might earn less money from the sale of Business Data Services should not prevent the Commission from adopting appropriate regulations.

In any event, there is no basis for the claim that appropriate protections against the abuse of market power will somehow result in serious harm to incumbent LECs. *First*, this does not reflect the view of the incumbent LECs as a whole. Incumbents that are looking toward the future and want to expand beyond their protected incumbent territories, understand the importance of sound policies that ensure just and reasonable rates. *Second*, the incumbent LECs' assumption that they will incur huge losses under a reasonable regulatory regime appears to be vastly overstated given ever-increasing demand for Ethernet services and the likely increase in

¹⁰ Mark Cooper, the Consumer Federation of America, "The Special Problem of Special Access: Consumer Overcharges and Corporate Excess Profits," at 33-35, Apr. 2016, *available at*: <http://consumerfed.org/wp-content/uploads/2016/04/4-16-The-Special-Problem-of-Special-Access.pdf>

¹¹ Letter of Phillip Berenbroick, Counsel, Government Affairs, Public Knowledge, WC Docket No. 16-143 *et al*, at p. 3, filed Jun. 16, 2016.

the volume of Ethernet demand if prices are reduced. For example, BT Americas submitted information in the record showing that BT plc's Ethernet revenues increased during 2012-2014 even though annual price cap reductions of RPI-11.5% were in place. BT plc's Ethernet revenues fell a little in 2015 but even in 2015 BT plc's margin on Ethernet service revenues was a very healthy 24%.¹²

There is therefore no reason for the Commission to delay the adoption of comprehensive reform for the Business Data Services market. The framework put forth by Verizon and INCOMPAS takes a pragmatic approach to enhancing choice, lowering prices where there is a lack of adequate competition, and incentivizing all network builders to deploy new, advanced networks.

I. The Competition Test

The Commission must structure its reform in a manner that recognizes the absence of existing competition in the vast majority of commercial locations and the significant economic challenges to new facilities-based deployment, while at the same time encouraging new entry, innovation and, where economically feasible, network deployment. The first step is to identify which markets are sufficiently competitive to ensure just and reasonable rates, terms and conditions, and which markets are not sufficiently competitive. Doing so requires a realistic assessment of the likelihood, at the various levels of bandwidths, that a reasonably efficient competitor could deploy connections to serve customers. The capacity of service demanded by a customer can determine whether a competitor has any ability to economically deploy a connection from a splice point on the competitor's network to the customer's location. Consequently, the most reasonable means of defining relevant Business Data Service product

¹² Reply Comments of BT Americas, WC Docket No. 05-25, filed Feb. 19, 2016, *attachment WIK-Consult Report*, "Ethernet leased lines: An international benchmark" at 38-39 (Feb. 2016).

markets is by the capacity of service demanded by the customer. For administrative ease, we found it appropriate to treat multiple capacities as belonging to the same product market for purposes of the competition test to the extent that the prospects for connection deployment are reasonably similar among the grouped capacities.

The following approach balances precision and commercial practicality with administrative ease for determining the likelihood, at the various levels of bandwidth, that a reasonably efficient competitor could deploy connections to serve customers:

- Business Data Services at or below a specified threshold should be deemed non-competitive in all census blocks. The specified threshold should be no lower than 50 Mbps;
- Business Data Services above 1 Gbps should be deemed competitive; and
- Business Data Service between the thresholds specified above should be subject to a competition test.

As the Commission found, high costs and other conditions in the Business Data Services markets pose significant barriers that deter rapid competitive entry or expansion.¹³ Given the economic challenges to new facilities-based entry, reasonably efficient Business Data Service competitors cannot generally deploy loops to customers with demand at or below a certain bandwidth. As of 2013, less than one percent of commercial buildings with demand for Business Data Services had at least four competitors that had deployed connections to the customer's location. Given this market data, and the fact that there is no realistic prospect that reasonably efficient competitors could deploy connections to serve at or below a certain bandwidth, the Commission should establish a bandwidth threshold at or below which services will be classified as non-competitive. A test that draws a bright line of non-competitive for service levels where

¹³ *Further Notice* at ¶ 224.

competitive overbuild for the most part is not viable strikes a fair balance of precision and administrative feasibility.

It would also be reasonable for the Commission to infer that a reasonably efficient competitor can often efficiently deploy connections to locations where the customer demands Business Data Services *above* a Gigabit of capacity. While this may not be true in every circumstance, just as with threshold described above, adoption of a bright line rule strikes the right balance of precision and administrative ease.

In the product market between these thresholds, where a reasonably efficient competitor can sometimes deploy connections to serve customers, the Commission should apply a Competition Test. This test should assess the prospects of connection deployment and be applied on a geographic market-by-geographic market basis. In addition to customer demand (bandwidth), this build/buy decision is based on, among other factors, distance to deploy to the potential customer location.

As stated above, the Commission should use census blocks as the geographic area for this market competition test. While INCOMPAS believes a building-by-building analysis is feasible and would provide a more accurate depiction of the state of competition, INCOMPAS also believes, for purpose of greater administrative ease, a census block-based test would be reasonable. Since Business Data Service providers now often set prices and define the availability of services on a building-by-building basis, it would not be difficult for either Business Data Service providers or customers to conduct business under a census block test. Moreover, census blocks are smaller, and therefore more precise, than other standardized geographic units such as census tracts, counties, or zip codes. This is important because, as the Commission has found, the “distance competitive LECs are generally willing to extend their

facilities to reach potential customers beyond locations they currently reach are quite short”¹⁴ and, in particular, found census tracts to be large relative to the build-out distances.¹⁵

As stated in the Joint Letter, INCOMPAS further agrees that a census block should be deemed competitive by measuring the number of facilities-based providers in the census block. Although we have not come to agreement with Verizon on what constitutes such a provider, for purposes of applying this test, the ILEC, including its affiliates, would be deemed to be a single facilities-based provider in all census blocks within the ILEC’s service area, and a provider only utilizing UNEs or offering best-efforts services would not.

In defining “provider,” in INCOMPAS’ view, mere fiber presence is a poor proxy for competition in the provision of Business Data Services. As the Commission correctly observes in the *Further Notice*, “[t]he distance to a fiber splice point, as opposed to fiber in general, is an important determining factor in build/buy decisions.”¹⁶ The fact that a competitor has deployed fiber that runs near a building does not mean that the competitor has a splice point close enough to deploy a connection to a customer. Thus, the presence of fiber in the vicinity of a customer location provides no indication as to whether the carrier has any ability to, or interest in, using the fiber facility to serve the customer. In fact, an analysis of the fiber deployment data provided in response to the mandatory data request shows that there are four or more competitors with fiber in over 540,000 census blocks in which no customer purchased even a single Business Data Service circuit as of 2013.

¹⁴ *Further Notice* at ¶ 211.

¹⁵ *Id.* at ¶ 214.

¹⁶ *Id.* at ¶ 211 n.553; *see also id.* ¶ 212 n.558 (observing that “Fiber splice points are critical” to the build/buy analysis).

It is crucial that the competition test utilize a reliable means of identifying competitive markets. In 2012, the Commission suspended its rules for further grant of pricing flexibility to incumbent LECs because it found that the triggers it had established as a proxy for the presence of competition failed to accurately reflect competition in today's Business Data Services market. In particular, the Commission found that the triggers did not accurately predict the build out of facilities to end-user locations, finding that "in many instances, the scope of competitive entry has apparently been far smaller than predicted."¹⁷ This meant that the Commission had granted pricing flexibility in markets that lack sufficient competition to protect consumers from providers exercising their market position to extract unjust and unreasonable pricing. The Commission does not want to repeat, and the economy cannot afford, a similar error in predictive judgement. Certain compromises to precision may be appropriate for administrative ease, but should be minimized.

The Commission should periodically review the extent to which the framework (including the two different bandwidth thresholds and the census block test) accurately classifies services as non-competitive and competitive. If the Commission determines that its framework does not achieve this objective, it should adjust the framework so that it aligns more closely with market conditions.

II. Rate Reform

For markets that lack sufficient competition to ensure just and reasonable pricing, the Commission must establish pricing mechanisms that simulate a competitive market. Specifically, the mechanisms established for implementing the policies should reduce today's

¹⁷ See *Further Notice* at ¶ 28.

prices for Business Data Services in non-competitive area to reflect a level that should prevail in an efficiently competitive marketplace.

Pricing for TDM-Based Services. As reflected in our Joint Letter, INCOMPAS supports the application of price caps to TDM-based Business Data Services in areas served by price cap incumbent LECs, with a one-time reduction to these rates (implemented over no more than a two-year period) to account for the freeze in rates under the *CALLS Order*. Price cap regulation can provide strong incentives for innovation, cost reduction, and productivity growth. An important function of price cap regulation is to replicate the discipline of competitive markets when that discipline is lacking.

A key aspect of competition is that it drives prices to the level of efficient production costs. In particular, competition compels industry suppliers to pursue productivity gains and to pass these gains on to consumers in the form of lower prices. One manner in which the price cap regime mimics competition is through adjustments to the price cap index to reflect an estimate of the extent to which the relevant price cap carriers are likely to experience productivity gains in excess of input price increases in the supply of Business Data Services than that of other firms in the U.S. economy in the near future. This is referred to as the X-factor. The price cap index should change each year by inflation minus the X- factor.

For more than the past ten years, the special access X-factor was set equal to inflation (i.e., the price cap indices would remain unchanged, given that the annual change is determined by subtracting the X-factor from the rate of inflation). As the Commission has yet to replace the interim *CALLS Plan* X-factor, price cap LECs' special access rates have essentially remained frozen at 2003 levels.¹⁸ All studies, e.g., KLEMS, have found that productivity in the telecom

¹⁸ See *Further Notice* at ¶ 19.

industry is substantially greater than the economy as a whole, which means the X-Factor must be greater than inflation. Therefore the FCC's use of a productivity factor that equals inflation has resulted in price-cap rates for Business Data Services being significantly higher than what a competitive market would have produced. There should be a one-time adjustment to these rates (implemented over no more than a two-year period) to account for the freeze in rates under the *CALLS Order*. This one-time adjustment would merely bring the current rates in line with what they should be had the Commission used the productivity factor supported by current data on industry productivity for the last ten years.

Going forward the price cap index should be adjusted annually to account for inflation minus an X-factor of 4.4 percent. This value of the X-factor represents a conservative estimate of the extent to which the price cap LECs are likely to experience more rapid productivity growth and less rapid input price growth than other firms in the U.S. economy in the near future.

Pricing for Packet-Based Services. The Commission must take action to reduce the rates for packet-based Business Data Services deemed non-competitive. As the Commission found, the “barriers to entry do not materially differ whether the technology being deployed is TDM- or Ethernet-based.”¹⁹ When there is insufficient facilities-based competition the Commission must adopt policies to ensure just and reasonable pricing regardless of the type of dedicated transmission service provided over the facility. Indeed many businesses, anchor institutions (such as schools, libraries, and universities) and wireless entities rely on packet-based services. As wireless providers have stated, 5G networks “will require thousands of new cell sites [] and

¹⁹ *Id.* at ¶ 226.

an increase in dedicated wireline access, including access to large bandwidth Ethernet services of 100 Mbps or more.”²⁰

As stated in its letter with Verizon, INCOMPAS would support accomplishing reductions in packet-based Business Data Services through a benchmark price approach for such Business Data Services that satisfies the objectives of Sections 201 and 202 of the Communications Act; is applied in a way that is technology-neutral and that does not discourage new entrants from entering markets and building facilities to compete with existing providers; and which may recognize differences in bandwidth, term, and class of service. The benchmarks should be reduced annually by 4.4 percent minus inflation to reflect increased efficiencies. The Commission should review this periodically to account for market conditions.

The Commission’s rules should also include measures to prevent a provider from exercising its market position in a non-competitive market to engage in price squeeze. When Business Data Service providers price their wholesale services higher than their retail services, this can prevent a wholesale customer from being able to compete in the sale of Business Data Services to end users. The Commission has previously recognized the ability of a provider to “strategically manipulate the price of their direct competitors’ wholesale inputs to prevent competition in the downstream retail market.”²¹

The forbearances granted by the Commission do not preclude the adoption of new regulations pursuant to the Commission’s statutory authority. In its *Broadband Forbearance Orders*, the Commission did not grant relief from Sections 201 and 202 of the Act. Business Data Services are telecommunications services and therefore providers of Business Data

²⁰ *Joint Wireless Letter* at 1.

²¹ *See Further Notice* at ¶ 442.

Services are common carriers subject to, among other things, the duties to deal as defined in Sections 201 and 202 of the Communications Act and the complaint procedures set forth in Section 206-208 of the Act.²²

Conclusion

As the record in this proceeding demonstrates, there is urgent need for the Commission to adopt reform in the Business Data Services market to ensure competitors access to these services at reasonable rates, terms, and conditions—regardless of the electronics on those facilities. The framework proposed by INCOMPAS and Verizon would immediately help all customers, using a variety of speeds, obtain affordable service, while at the same time provides incentives to all network builders to deploy new, advanced networks.

Respectfully submitted,

/s/ Karen Reidy

Karen Reidy
INCOMPAS
1200 G Street NW, Suite 350
Washington, DC 20005
(202) 296-6650

June 28, 2016

²² See *United States Telecom Association v. FCC*, USCA #15-1063, at 50 (DC Cir. Jun. 14, 2016). See also, Grillo-Pickering April Letter at 2 (Verizon has stated that subject to clarification on this matter by the Commission, “Verizon would not oppose an order placing Verizon on the same footing today with regard to Ethernet services as cable companies, competitive providers and other incumbent LECs that have received forbearance relief from dominant carrier regulation and is adopted at the same time as an order adopting a permanent framework.”)