Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington D.C. 20554

AT&T Corp.	)	
Petition for Rulemaking To Reform	)	RM Docket No. 10593
Regulation Of Incumbent Local Exchange	)	
Carrier Rates For Interstate Special	)	
Access Services	)	
	)	

COMMENTS OF CABLE & WIRELESS USA, INC.

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Pursuant to the Commission's *Public Notice*,[1] Cable & Wireless USA, Inc. ("Cable & Wireless") submits these comments in support of AT&T Corp.'s Petition for Rulemaking to Reform Regulation of Incumbent Local Exchange Carrier Rates for Interstate Special Access Services ("Petition").[2]

INTRODUCTION AND SUMMARY

This is the rare Commission proceeding in which both the problem (monopoly pricing of special access services) and the solution (price cap or other Commission regulation to reduce rates to just and reasonable levels) are straightforward and obvious. The dispositive facts are largely indisputable and the Commission need not resort solely to economic theory, because the Commission now has the benefit of the actual results of a real world experiment with rate

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[1] Public Notice, *Wireline Competition Bureau Seeks Comment On AT&T's Petition for Rulemaking to Reform Regulation of Incumbent Local Exchange Carrier Rates For Interstate Special Access Services*, RM No. 10593, DA 02-2913 (released October 29, 2002).

[2] Petition of AT&T, *AT&T Corp. Petition for Rulemaking To Reform Regulation Of Incumbent Local Exchange Carrier Rates For Interstate Special Access Services*, RM No. 10593 (filed October 15, 2002 ("Petition").

deregulation that was designed to yield lower rates, but has, in fact, produced only higher rates. There is also no tension here between what the law requires and sound policy. To the contrary, by carrying out its statutory mandate to ensure that rates are just and reasonable, the Commission will in a most direct and substantial way also further its commitment to promote the deployment of advanced broadband services. In short, this is a proceeding that should receive the highest Commission priority and should produce the decisive reforms that are necessary to put an end to the enormously destructive broadband tax that the BOCs impose with their monopoly special access prices.

Cable & Wireless, like many carriers, has a vital interest in this proceeding. Indeed, special access is a critical input to next generation broadband services offered by Cable & Wireless and other carriers. Cable & Wireless operates one of the world's leading IP networks. Using this state-of-the-art facilities-based IP network, Cable & Wireless offers its customers (primarily multi-national corporations with U.S. operations) a wide variety of broadband services, including Internet access, high-speed data transmission, and video conferencing. Cable & Wireless also provides fully managed packages of broadband services, such as Internet access, web hosting, data equipment, applications and support services. In addition, Cable & Wireless offers a comprehensive range of IP/data transport, hosting, content delivery and other value added services. In short, Cable & Wireless is a prototypical 21st century broadband telecommunications firm, offering the full array of IP-based services.

Cable & Wireless' existing corporate customers are, in turn, many of the leading providers of broadband and other advanced services to consumers and small businesses. And future advanced services innovators will likewise turn to Cable and Wireless and other IP network owners for the integration and delivery of new broadband applications and services.

Special access is the largest single input cost for Cable & Wireless in providing broadband services to its customers. Although, as described below, Cable & Wireless seeks to minimize its access costs and to use competitive carriers to the maximum extent possible, in the overwhelming majority of cases, Cable & Wireless has no alternative but the incumbent access provider.

Thus, when the Bell Operating Companies ("BOCs") charge supracompetitive rates for special access – as they invariably do – Cable & Wireless' costs of providing broadband services increase dramatically. To remain profitable, Cable & Wireless, which unlike the BOCs, operates in an intensely competitive environment, must pass on those cost increases. Accordingly, excessive special access rates effectively impose a monopoly "tax" on firms that purchase broadband and IP services from Cable & Wireless and others. Those firms, too, must pass on cost increases to their consumer customers, with the inevitable result that consumers must pay more. Of course, higher prices suppress demand, and the end result is that fewer advanced services are demanded and less is invested in the broadband infrastructure required to produce those services.

The Commission should immediately address this situation by re-establishing some form of regulation of the BOCs' special access rates. As these comments show, this is important for three fundamental reasons: (1) the BOCs retain monopoly control over the vast majority of special access facilities, and the Commission's current "pricing flexibility" regime is not preventing the BOCs from using that monopoly power to impose unlawful rates and terms; (2) exorbitant special access rates are directly retarding the development of vibrant competition from nascent broadband providers like Cable & Wireless; and (3) the Commission has a statutory duty to change its regulations to enforce the Communications Act.

1. The BOCs Retain Monopoly Control Over Most Special Access Facilities And Do Not Price Special Access Competitively. As Cable & Wireless and others have demonstrated in previous proceedings, and as the Petition confirms, "last mile" access to the vast majority of buildings in the United States is available *only* from the BOC or other incumbent local exchange carrier ("LEC") that serves each market. Providers of finished services to tenants of those buildings are therefore captive customers of the BOCs' special access services. That is true whether the special access purchaser provides traditional long distance services or, like Cable & Wireless, advanced Internet Protocol-based solutions to multi-national enterprise customers. Both textbook economics and longstanding Commission precedent establish that the absence of alternative facilities-based suppliers of special access gives the BOCs market power over all carriers who rely upon special access as an input to their own services. If there is no place else that special access purchasers can turn, the BOCs can, absent effective regulatory constraints, dictate their own terms.

And, absent effective regulatory constraints, the BOCs, as rational profit maximizers, *will*, of course, exercise their market power to dictate rates that exceed competitive market levels. As the Petition confirms, the existing regulatory regime plainly does not provide effective constraints. Indeed, the current regime provides virtually no protection at all, because price cap regulation has been removed from most special access service rates. The predictable result has been grossly excessive and still rising BOC special access rates (even in such ostensibly "competitive" markets as Manhattan).

Whereas rates had been trending down as a result of "X-factor" productivity reductions (albeit far too slowly), the BOCs have used pricing flexibility only to raise rates. And although the BOCs had claimed that increased flexibility would allow them to tailor special access

arrangements to reduce costs to individual special access purchasers, they have, in fact, rebuffed Cable & Wireless' attempts to negotiate reasonable terms – precisely because they know that Cable & Wireless generally has nowhere else to turn. Indeed, Cable & Wireless' experience has been that the BOCs do not lower their rates even to buildings where CLECs have established a competitive presence. The reason for this is obvious: the competition that the BOCs face is so limited that it is more profitable for them to cede to CLECs the relative handful of buildings that CLECs can serve than uniformly to lower rates to competitive levels (or even selectively to lower rates and thereby further expose the standard rates as monopoly rates).

Cable & Wireless has done everything within its power to bypass the BOCs' exorbitantly-priced special access services, but the undeniable fact is that there are rarely alternative facilities-based suppliers. Notwithstanding a policy of *always* choosing a facilities-based CLEC supplier when that is an option, Cable & Wireless remains a captive customer of the BOCs with respect to the vast majority of the buildings Cable & Wireless must reach to provide its own customers with innovative IP-based services. Although the BOCs' special access abuses – both with respect to rates and performance – have long been a problem, the situation has become intolerable in the wake of pricing flexibility.

2. Exorbitant Special Access Rates Are Retarding The Development Of Broadband Competition. This is not simply a matter of Cable & Wireless and other competitive special access purchasers subsidizing the BOCs to the tune of billions of dollars annually, although that alone would justify immediate Commission intervention to reform special access rate regulation given the Commission's core statutory mandate to protect consumers from market power abuses that produce unjust and unreasonable rates and practices. Rather, the real world effects of special access rates that are multiples of costs are massive reductions in broadband investment,

innovation and wealth creation and a much less attractive U.S. environment for businesses with large IP-based broadband communications needs (and for the carriers that supply those needs). The supply of voice, data and IP solutions to corporations is a highly competitive business. When the Bells raise their already excessive special access rates – the largest input cost of most finished services – one of two things must therefore happen. Either Cable & Wireless and other suppliers must, to remain profitable, pass on those cost increases, which necessarily reduces demand for webhosting and other bandwidth intensive data applications that are the engines for growth and innovation in the delivery of IP-based services and applications to consumers. Or, if Cable & Wireless and other suppliers of managed data services (including VOIP) cannot pass on cost increases, they must ultimately exit or scale back their own operations. In either case, the public interest is seriously harmed, and there is absolutely no offsetting public interest benefit – reduced regulation of special access rates has generally not produced rate reductions.

Regulators in other countries have recognized that last mile bottlenecks demand vigilant oversight and regulation of last mile access rates until the bottleneck disappears; indeed, Cable & Wireless's experience has been that regulators in other countries have ordered reductions in the foreign equivalents of special access rates. The opposite trend in the U.S. is extraordinarily anticompetitive and demands a forthright Commission determination that pricing flexibility reform was premature. Indeed, as explained below, the Commission's own World Trade Organization ("WTO") commitments compel Commission action to reform special access rates.

There can be no question that immediate tightening of special access rate regulation will further the Commission's broadband agenda, because the most direct way to increase the supply of broadband services and applications is to protect broadband network, service and application suppliers from last-mile monopoly abuses that necessarily reduce the supply of those facilities,

services and applications. Failure to address the systemic special access problems (both rates and performance), on the other hand, would do a great disservice to the public interest – more suppliers would exit or scale back their operations, fewer IP-based services and applications would be produced and only at higher prices, and BOC dominance could only get worse.

Urgent action is particularly appropriate because the BOCs' conduct threatens the deployment of next generation broadband services by Cable & Wireless and other carriers. In section 706(a) of the Telecommunications Act of 1996, Congress specifically directed the Commission to eliminate barriers that impede the deployment of advanced services. The Commission has repeatedly stated that it "will not hesitate to reduce barriers to infrastructure investment and to promote competition so that companies in all segments of the communications industry will have market-based incentives to innovate and invest in new technologies and facilities,"[3] and that it stands "alert and ready to act against anticompetitive risks and discriminatory provisioning by dominant providers" that could threaten broadband competition.[4] This proceeding provides a unique opportunity for the Commission to demonstrate that it meant what it said.

Immediate tightening of special access rate regulation – and repeal of the remarkably anticompetitive Commission regulations that prevent purchasers from utilizing unbundled network elements purchased at forward-looking cost-based prices to avoid monopoly-priced special access services – is likewise fully consistent with the Commission's laudatory goal of

[3] First Report, *Inquiry Concerning the Deployment of Advanced Telecommunications Capability to All Americans in a Reasonable and Timely Fashion, and Possible Steps to Accelerate Such Deployment Pursuant to Section 706 of the Telecommunications Act of 1996*, 14 FCC Rcd 2398, ¶ 8 (1999) ("*First 706 Report*").

removing regulation that is not necessary to constrain market power. Special access market power is plainly alive and well.

3. The Commission Has A Statutory Duty To Reform Its Special Access Regulations. The Communications Act demands that "*[a]ll* charges . . . and regulations for and in connection with . . . communications service . . . shall be just and reasonable."[5] Any charge or regulation that is "unjust or unreasonable is . . . unlawful."[6] And because the Commission has a "duty to execute and enforce the provisions of the Communications Act," the Commission must ensure that BOC rates for access services are "just, fair, reasonable and nondiscriminatory."[7] It is therefore clear that the Commission not only should not but cannot remain idle while the BOCs continue to impose monopoly charges.

The facts were not as the BOCs painted them. The BOCs have had every chance to validate their claim that, notwithstanding settled economic theory and precedent to the contrary, the public would benefit from rate deregulation of markets that the BOCs continue to dominate. There is now an overwhelming record that deregulation was premature and that premature deregulation has already caused great harm to the public interest and threatens even greater harm. Immediate reform is imperative.

(. . . continued)

[4] Notice of Proposed Rulemaking, *Appropriate Framework for Broadband Access to the Internet Over Wireline Facilities, et. al.*, 17 FCC Rcd. 3019, ¶ 5 (2002) ("*Wireline Broadband Classification NPRM*").

[5] 47 U.S.C. § 201(b) (emphasis added).

[6] *Id.*

[7] *See, e.g., American Tel. & Tel. Co.* v. *FCC,* 572 F.2d 17, 25 (2d Cir. 1978).

I. THE BOCS RETAIN OVERWHELMING SPECIAL ACCESS MARKET POWER AND ARE EXPLOITING RATE DEREGULATION TO CHARGE INCREASINGLY UNJUST AND UNREASONABLE RATES.

The Petition compiles a wide variety of evidence that the BOCs retain substantial market power in the provision of special access services. But that should be self-evident by now. In a wide range of proceedings, from the still unresolved special access performance measures proceeding to the ongoing triennial review of the Commission's network element rules, Cable & Wireless and other access purchasers have submitted overwhelming evidence of the single dispositive fact: there are simply *no* alternative facilities-based suppliers of special access to the vast majority of buildings in the United States. The BOCs' much exaggerated musings on the prevalence of fiber rings and collocations may be of interest in other contexts,[8] but they are no answer to the problem faced by special access purchasers in *every* U.S. market today – *i.e.*, with rare exceptions, the BOC is the only entity that actually owns a last mile link to the building and thus anyone that wants to serve that building is a captive customer of the BOC.

If Cable & Wireless wants to use its IP network to provide services to customers, it *must* deal with the BOCs. For the vast majority of buildings, there is simply no one else out there. Cable & Wireless detailed its own lack of alternative suppliers in its special access performance

[8] One example of the BOCs' misrepresentations is their claim in the Triennial Review proceeding that Exodus (which is now owned by Cable & Wireless) is a major "collocation hotel," in which many CLECs have established collocation of their own transport facilities and which allows these CLECs to hand off access traffic to one another. *See* "UNE Fact Report," pp. III-4 – III-5, *Review of the Section 251 Unbundling Obligations of the Incumbent Local Exchange Carriers*, CC Docket No. 01-338 (filed April 5, 2002, as attachment to the Comments of the BOCs). In fact, Exodus provides primarily web hosting services and does not provide the more extensive kind of collocation services that would be required to support CLEC transport providers.

measures comments and reply comments last year.[9] The competitive situation has only worsened in the wake of the bankruptcies of many of the largest competitive providers of special access (and the increasing unwillingness of customers to purchase services from Cable & Wireless that rely upon circuits supplied by bankrupt or financially weak companies).

Cable & Wireless has a very aggressive program to reduce special access costs by purchasing from non-ILEC suppliers whenever and wherever that is possible. Specifically, Cable & Wireless has a system for identifying and using CLEC alternatives as the first option. Before placing an order with an ILEC, Cable & Wireless personnel first check whether the services can be provisioned by a competitive access provider. If such facilities exist, Cable & Wireless' policy has been to place the order with the non-ILEC vendor. In making this determination, Cable & Wireless seeks what it refers to as a "Type 1" facility, meaning that the alternative provider can provision the circuit to the specified address entirely through the provider's own facilities. If the alternative provider has the necessary Type 1 facility, then Cable & Wireless places the order with the non-ILEC vendor. In other words, in all instances where an alternative provider can provision a circuit to the specified location using its own facilities, Cable & Wireless' policy has been to place its order with that provider.

Despite the fact that Cable & Wireless purchases access from CLECs whenever it has the opportunity to do so, Cable & Wireless nonetheless is generally forced to purchase special access circuits from the BOCs and other incumbent LECs due to lack of available alternatives. The unfortunate reality is that alternative vendors have fully-independent fiber facilities to only a tiny

[9] *See* Comments of Cable & Wireless, *Performance Measures and Standards for Interstate Special Access Services*, CC Docket No. 01-321 (filed January 2002); *id.*, Reply Comments of Cable & Wireless (filed February 2002).

percentage of existing office buildings. Thus, in many instances, an alternative provider will notify Cable & Wireless that it can provision only a "Type 2" circuit to the desired location – *i.e.*, that the vendor requires the use of the BOC's facilities for all or part of the circuit (usually the loop or channel termination). A Type 2 "alternative" obviously does nothing to curb BOC market power; if the BOC has a bottleneck over any link in the access chain, it can and will charge monopoly prices. For these reasons, non-ILEC vendors have accounted for only approximately 10% of Cable & Wireless's new installations for the year 2002, *down* from approximately 13 percent in 2001. For all practical purposes, Cable & Wireless is and will remain a captive customer of the BOCs in almost every case.

And these figures likely overstate the true availability of competitive alternatives on a going forward basis. In the past year and a half, many CLECs have filed for bankruptcy or remain in precarious financial condition. Cable & Wireless' retail customers use Cable & Wireless' services for mission critical projects and demand reliable and high quality service. Thus, Cable & Wireless can only rely on competitive carriers that it can be confident will remain viable. And given the financial troubles that have swept this segment of the industry, Cable & Wireless increasingly must forego using a nominally available competitive alternative because of concerns (that are increasingly being voiced by Cable & Wireless' own customers) that the carrier is not sufficiently reliable.

For all of these reasons, Cable & Wireless and other carriers are and will remain dependent on the BOCs for special access for the foreseeable future. Under any meaningful standard, such a dearth of alternatives unquestionably provides the BOCs with market power over Cable & Wireless and other access purchasers – even the largest access customers, like

AT&T, that purchase billions of dollars of access services annually from each of the BOCs. The only question then is the right regulatory response to such market power.

That too should be obvious. Economics, experience and a long line of Commission and court decisions all recognize that profit-motivated bottleneck owners will, if allowed, charge supracompetitive prices, and that effective rate regulation is therefore a necessity to protect the public interest and ensure that rates are just and reasonable. Although the Petition catalogs a mountain of evidence that the BOCs have, in fact, acted upon their profit incentives, setting special access rates at levels that produce massive windfalls to the BOCs (and impose massive competition-reducing costs on special access purchasers), it should not be the burden of special access purchasers to prove that the BOCs have behaved rationally. Rather, the Commission must *presume* that the BOCs will charge as much as they can, and that, in the absence of alternative suppliers, they will charge rates that exceed competitive market levels unless regulation prevents that.

The Petition conclusively demonstrates that the current regulatory regime – in which most BOC special access services are no longer subject to price cap regulation – is not up to the job of preventing the BOCs from abusing their bottleneck monopolies and charging monopoly rates. All of the BOCs' rates of return on special access are uniformly several times higher than 11.25%, which is the rate of return that the Commission found just and reasonable for dominant ILEC services in 1990, a period in which interest rates were much higher than today.[10] The returns are so high that they yield windfalls of literally *billions* of dollars annually.[11] Moreover,

[10] Petition at 8 & Friedlander Declaration.

[11] Petition at 8.

all of the trends with respect to special access demonstrate that the BOCs' rates are becoming more and more unlawful.

Perhaps the starkest evidence that the BOCs have, and will exercise, market power is their actual pricing behavior in the wake of pricing flexibility, particularly as compared to the pricing behavior of CLECs with respect to the small minority of buildings to which there are multiple suppliers. For example, in the limited instances in which CLECs have their own optical facilities-based access alternatives, Cable & Wireless has been successful in negotiating significant price decreases. To meet the competition (from other CLECs), CLECs routinely provide one-year contracts, which minimize the extent to which Cable & Wireless is locked into a rate for an extended period of time. Moreover, CLECs' prices for optical services have, in many cases, declined as these agreements are re-negotiated. Although CLECs provide such alternatives in only a limited number of locations, where they exist CLECs provide superior service (including provisioning service) and substantially better prices than the BOCs.

The BOCs, by contrast, have generally refused to negotiate better deals with Cable & Wireless, despite persistent efforts by Cable & Wireless. Indeed, the BOCs have not lowered their rates at all except as the X-Factor requires them to do in the increasingly limited areas in which they are still governed by price caps.[12] Where they have received Phase II pricing "flexibility," they have kept their rates at pre-pricing flexibility levels or, in some instances, actually raised them.[13] And Cable & Wireless has no choice but to pay those "off the rack" rates.

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[12] The Petitioner calculates that, as of the 2002 tariff filings, approximately 59 percent of the BOCs' special access revenues (excluding GTE) are no longer subject to price cap regulation. Petition at 11.

[13] *See* Petition at 11-13 & Stith Declaration (detailing price increases of Verizon and BellSouth). This evidence is more than enough to establish the existence of market power under well-

(continued . . .)

Even if Cable & Wireless had enough traffic to qualify for tariffed volume and term discounts, the BOCs' tariffs typically would require Cable & Wireless to commit to provide that traffic to the BOC for five years, which would force Cable & Wireless to incur an unacceptable level of risk and deny Cable & Wireless the ability to take advantage of any new competitive alternatives that emerge. In other words, a simple comparison of the CLEC and BOC rates does not tell the whole story, because even the BOCs' "discounted" rates come freighted with the baggage of five-year lock-ins and other unacceptable conditions.

But what is most shocking about the BOCs' pricing behavior is that the BOCs do not lower their rates even in the MSAs in which CLECs have established a presence. Even in the largest cities, where CLECs have established facilities-based connections to some number of buildings, the BOCs maintain their supracompetitive off-the-rack rates for all locations in that MSA. Indeed, there is no correlation whatsoever between the BOCs' rates and the MSAs in which they have been awarded pricing flexibility. If anything, as the Petition shows, the BOCs' rates are often higher where they have obtained pricing flexibility, notwithstanding that many of those areas are dense, lower cost urban areas.[14]

The BOCs' severe deficiencies in provisioning performance provide yet additional confirmation of the BOCs' overwhelming market power and their willingness to abuse that

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established antitrust authorities. Specifically, under the *Horizontal Merger Guidelines*, the Department of Justice and the Federal Trade Commission test for the existence of market power by examining whether an entity will be able to raise prices by five percent or whether the price increase will induce entry that will undercut the price rise. *Horizontal Merger Guidelines* §§ 0.1, 3.0. Here, despite substantial price increases, the BOCs have maintained their market dominance. Indeed, they have even enjoyed increased special access demand.

power.[15] Cable & Wireless pays the BOCs grossly excessive rates for the privilege of receiving terrible service. Although Cable & Wireless has sought agreements with the BOCs in which the BOC would guarantee a certain level of service with penalties – agreements that Cable & Wireless routinely obtains from CLECs – the BOCs have largely refused to negotiate such arrangements with Cable & Wireless.

Put simply, neither the existence of BOC market power nor its abuse is subject to serious debate. And nothing short of active Commission oversight and tightened rate regulation can constrain the BOCs from continuing to charge unjust and unreasonable special access rates. Cable & Wireless respectfully urges the Commission to take immediate action to reform special access rate regulation. In addition, because the BOCs' performance in provisioning special access services has remained at unacceptable levels for a sustained period of time, Cable & Wireless respectfully urges the Commission promptly to conclude the special access performance measures proceeding as well.

II. CABLE & WIRELESS' EXPERIENCE CONFIRMS THAT THE BOCS' ANTICOMPETITIVE SPECIAL ACCESS PRICING DOES GREAT HARM TO THE PUBLIC INTEREST AND THE COMMISSION'S BROADBAND POLICIES.

It is imperative that the Commission recognize that the public interest injuries inflicted by monopoly pricing of special access go well beyond harm to AT&T or to competition for traditional long distance services. In particular, the BOCs' special access abuses pose one of the most significant impediments to the deployment of broadband and other advanced infrastructures

(. . . continued)
[14] Petition at 12-13.

and services, and immediate reform of special access rate regulation will do much more to further the Commission's mandate to remove impediments to the deployment of advanced services than any of the initiatives proposed in other proceedings.

Special access is a critical – and the costliest – input into the next generation broadband services that Cable & Wireless offers in the United States. As noted, Cable & Wireless owns and operates a state-of-the-art IP network and offers innovative, global broadband services to multinational customers with U.S. locations.[16] Cable & Wireless must rely on the BOCs for last-mile access, however, and the BOCs' unlawfully exorbitant special access rates greatly increase Cable & Wireless' costs – in effect, levying a "tax" on broadband users and inhibiting the development of broadband competition.

The BOCs' special access broadband tax is contrary to both the 1996 Act and Commission policy of promoting deployment of broadband services. Section 706(a) of the Telecommunications Act of 1996 specifically directs the Commission to eliminate barriers that impede the deployment of advanced services. As the Commission has recognized, Congress enacted Section 706 in recognition of the fact that "[w]idespread access to broadband capability

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[15] *See Performance Measures and Standards for Interstate Special Access Services*, CC Docket No. 01-321, Notice of Proposed Rulemaking (rel. Nov. 19, 2001); *id.*, Comments of Cable & Wireless (filed January 2002) & Reply Comments of Cable & Wireless (filed February 2002).

[16] In the United States alone, Cable & Wireless has invested more than a half billion dollars a year in recent years, much of which was used to transform a legacy IP infrastructure acquired from MCI into one of the largest and most advanced IP backbone networks in the world. Cable & Wireless has replaced the MCI infrastructure with a state-of-the-art network that offers 16 times more capacity than the original offered in 1998. Currently, this network has 51 nodes in operation (23 in the U.S. alone), and operates at OC-192 (9.6 Gps) capacity.

can increase our nation's productivity and create jobs. Access to broadband can also meaningfully improve our educational, social, and health care services."[17]

The Commission has stressed that it "will not hesitate to reduce barriers to infrastructure investment and to promote competition so that companies in all segments of the communications industry will have market-based incentives to innovate and invest in new technologies and facilities."[18] Most relevant here, the Commission stands "alert and ready to act against anticompetitive risks and discriminatory provisioning by dominant providers" that could threaten broadband competition.[19] This proceeding presents an unrivalled opportunity for the Commission to do just that.

The BOCs' supracompetitive prices for special access services are *retarding* infrastructure investment in next generation broadband networks by Cable & Wireless and other competitive carriers. And now that the BOCs have gained the authority to enter long distance markets, the problem will only grow worse. So long as the BOCs "enjoy a monopoly on local calls," economic theory and history demonstrate that they will "ineluctably leverage that bottleneck control in the interexchange (long distance) market."[20] If carriers such as Cable & Wireless cannot obtain local exchange facilities at their economic cost and are required to pay inflated access charges, competition will be significantly impeded. Thus, in order to "preserve opportunities for broadband competition,"[21] the Commission must subject BOC special access

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[17] *First 706 Report* ¶ 2.

[18] *Id.* ¶ 8.

[19] *Wireline Broadband Classification NPRM* ¶ 5.

[20] *United States* v. *Western Elec. Co.*, 969 F.2d 1231, 1238 (D.C. Cir. 1992).

[21] *Wireline Broadband Classification NPRM* ¶ 6.

services to regulation that ensures that carriers are able to purchase special access at just and reasonable rates.

Allowing the BOCs to charge prices for special access services that are not only above true economic costs, but are *vastly* above costs, plainly robs customers of the benefits of broadband deployment by reducing the overall supply of broadband services that rely on special access. As the BOCs increase their access charges, Cable & Wireless must increase its retail broadband service prices in order to remain profitable. And it is textbook economics that increasing the price for broadband services will decrease demand.[22] Accordingly, in direct contravention of section 706(a), allowing the BOCs to charge high special access rates *dis*courages the "deployment on a reasonable and timely basis of advanced telecommunications capabilities to all Americans."

The BOCs' anticompetitive special access prices also deter competitive investment in new innovative services. As with any investment decision, firms will divert more capital to developing new innovative broadband products if the potential returns from those investments are higher.[23] The BOCs' inflated special access charges, however, substantially decrease the returns that are available to carriers that develop and deploy new services that rely on the BOCs' special access services as an input. Thus, the BOCs' inflated special access charges plainly reduce carriers' incentives to engage in the development of innovative broadband services.

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[22] *See, e.g.*, Edgar K. Browning & Mark A. Zupan, MICROECONOMIC THEORY AND APPLICATIONS (5th ed. 1996), at 260-61.

[23] *See, e.g.,* Dennis W. Carlton & Jeffrey M. Perloff, MODERN INDUSTRIAL ORGANIZATION (1990), at 653-93 (describing various ways to increase returns on research and development in order to provide firms with incentives to engage in research and development).

The BOCs' market power abuses ultimately harm consumers. Like any tax, a large portion of the BOCs' excessive special access charges must be passed on to the purchasers of broadband services that use special access as an input. That, in turn, reduces the ability of companies to use broadband services in new and innovative ways within their own industries and places such companies at a competitive disadvantage relative to their foreign competitors. Further, by elevating the price for broadband services, there will clearly be businesses at the margins that will either not be able to afford to purchase broadband services, or will consume less than they otherwise would were the BOCs to reduce special access to cost-based levels.

Absent prompt Commission action, the BOCs will soon be able to threaten competition for broadband services themselves. Historically, the BOCs have been barred from offering long distance services like those provided by Cable & Wireless. Recently, the BOCs have been able to secure authority to enter this line of business and they have announced plans aggressively to market "enterprise" services to multi-location business customers.[24]

Unless special access rates are reduced dramatically, the BOCs will be able to undertake a classic strategy of raising rivals' costs and leverage their local monopolies into the enterprise services markets.[25] The BOCs incur only the economic cost of access – which is half or less of what Cable & Wireless must pay. As the Commission has recognized, by increasing access charges above their economic costs, the BOCs can "price squeeze" their way to market

[24] *See* http://newscenter.verizon.com/proactive/newsroom/release.vtml?id=77993.

[25] *See generally Premier Elec. Constr. Co.* v. *National Elec. Contractors Ass'n*, 814 F.2d 358, 368 (7th Cir. 1987) (citing T. Krattenmaker & S. Salop, *Anticompetitive Exclusion: Raising Rivals' Costs to Achieve Power over Price*, 96 Yale L.J. 209 (1986)) (explaining the ability to obtain or preserve market power from raising rivals' costs).

dominance (as they have already done with respect to intraLATA frame relay, ATM and other enterprise services):

> Absent appropriate regulation, an incumbent LEC and its interexchange affiliate could potentially implement a price squeeze once the incumbent LEC began offering in-region, interexchange toll services. . . . The incumbent LEC could do this by raising the price of interstate access services to all interexchange carriers, which would cause competing in-region carriers to either raise their retail rates to maintain their profit margins or to attempt to maintain their market share by not raising their prices to reflect the increase in access charges, thereby reducing their profit margins. If the competing in-region, interexchange providers raised their prices to recover the increased access charges, the incumbent LEC's interexchange affiliate could seek to expand its market share by not matching the price increase. The incumbent LEC affiliate could also set its in-region, interexchange prices at or below its access prices. Its competitors would then be faced with the choice of lowering their retail rates for interexchange services, thereby reducing their profit margins, or maintaining their retail rates at the higher price and risk losing market share[26]

Thus, the BOCs will be able to gain market share, not because they are more efficient or offer higher quality, but simply because they control bottleneck local facilities. And even if the Commission could be reasonably certain that the cost advantage that the BOCs would enjoy would not necessarily allow them to gain dominance in the broadband services segment, the D.C. Circuit recently made clear that regulation is appropriate so long as the BOCs can "exert[] *any* anticompetitive effects" in adjacent long distance markets.[27] Although Cable & Wireless welcomes competition, it must be competition on the merits, not competition that is the manifestation of market power and that will therefore harm, not help, consumers.

Cable & Wireless' actual experience confirms that price squeeze concerns are not just theoretical. Not infrequently, the availability of a CLEC alternative can make the difference in

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[26] First Report And Order, *Access Charge Reform et. al.,* 12 FCC Rcd. 15982, ¶ 277 (1997) ("*Access Reform Order*").

whether Cable & Wireless can compete for a customer. For example, in the limited number of buildings in which they exist, CLECs' rates for OC-48 circuits are substantially less than that of the BOC. If there is no CLEC in a building and Cable & Wireless must rely on the BOC's OC-48 circuits, Cable & Wireless often will not win that customer, because the BOC's special access rates are simply too high for Cable & Wireless to fashion an overall package that can be priced competitively. In this way, the BOCs' special access rates are severely anticompetitive; indeed, they effectively preclude competition.

In this regard, it is notable that while the Commission has freed the BOCs to exploit their local market power, regulators elsewhere have moved aggressively to ensure that competitive carriers are able to obtain access to last mile bottleneck facilities at just, reasonable and non-discriminatory terms. Cable & Wireless is a global carrier that purchases the equivalent of special access in many countries around the world, and other countries have done far more to restrain the ability of local incumbents to engage in monopoly pricing of access. To the best of Cable & Wireless' knowledge, the United States is the only country that is eliminating price regulation of these monopoly services, and as a result, the BOCs' special access rates impose a far greater burden on Cable & Wireless's ability to provide its services in this country than in other countries.

In short, because special access is a critical – and the costliest – input into a wide variety of telecommunications and advanced services, the BOCs' excessive special access rates are artificially and substantially raising the cost of providing these important end-user services. The

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(. . . continued)
[27] *WorldCom Inc.* v. *FCC*, 308 F.3d 1, 9 (D.C. Cir. 2002) (quoting *Anaheim* v. *FERC*, 941 F.2d 1234, 1238 (D.C. Cir. 1991)).

BOCs' monopoly rates are imposing a substantial deadweight loss on society, and raising the costs of services that are critical to a number of important American industries. Thus, the BOCs' excessive rates have consequences far beyond AT&T or traditional telecommunications services. They are a drag on innovation at all levels of communications competition – from global broadband services to local services – and as the BOCs are awarded authority to offer such services themselves, high access charges will obviously impede competition itself. Addressing this growing problem with effective rate regulation should be the highest of Commission priorities.

III. THE COMMISSION HAS A CLEAR LEGAL OBLIGATION TO REFORM SPECIAL ACCESS RATE REGULATION.

The Commission cannot ignore the BOCs' unlawful rates. The Communications Act requires that "*[a]ll* charges . . . and regulations for and in connection with . . . communications service . . . shall be just and reasonable."[28] Any charge or regulation that is "unjust or unreasonable is . . . unlawful."[29] Further, the Commission has an affirmative "duty to execute and enforce the provisions of the [Communications] Act."[30] Indeed, both the courts and the Commission itself have recognized that the Act's principal purpose is to prevent the exercise of market power by carriers such as the BOCs.[31] In short, the Commission has a legal obligation to act, and to act promptly.

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[28] 47 U.S.C. § 201(b) (emphasis added).

[29] *Id.*

[30] 47 U.S.C. § 151; *see also MCI Telecommunications Corp.* v. *FCC*, 765 F.2d 1186, 1192 (D.C. Cir. 1985); *American Tel. & Tel. Co.* v. *FCC.,* 572 F.2d 17, 25 (2d Cir. 1978).

[31] *See, e.g., SBC Communications Inc.* v. *FCC*, 154 F.3d 266, 231-32 (D.C. Cir. 1998).

The Commission found that its pricing flexibility regime satisfied its statutory obligations based on its predictive judgment that the presence of some collocations would constrain BOC market power. Now that the Commission and the industry have had actual experience with that regime, that predictive judgment has been proved to be flawed. The evidence is that the BOCs still retain enormous market power, even in the largest cities, and they are using that market power to maintain and increase their rates. It would be arbitrary and capricious for the Commission to ignore this hard evidence and stand idly by while the BOCs continue these practices.[32]

Further, as explained above, the Commission is obligated to prevent the BOCs' market power abuses because they are thwarting the deployment of and competition for broadband services in contravention of Sections 230(b)(2) and 706(a). Special access is a critical input to many services, including the broadband services that Cable & Wireless seeks to offer. As discussed above, the BOCs' exorbitant rates artificially raise Cable & Wireless' costs, and indeed, in some instances they price Cable & Wireless' broadband services out of the market. The Commission must act, and act soon, to eliminate these unlawful impediments to broadband competition.

Finally, inaction by the Commission would raise a serious question as to whether the United States would be in violation of its commitments under the WTO and the Basic Telecom Agreement. The United States, along with numerous other companies, pledged to adopt pro-

[32] For example, in *California* v. *FCC*, 905 F.2d 1217 (9th Cir. 1990), the court of appeals reversed the Commission's attempt to eliminate structural separation rules. The court found that the Commission acted arbitrarily because it ignored compelling evidence that, absent regulation, the BOCs would be able to exploit their local market power by cross-subsidizing their advanced services operations.

competitive regulations that would prevent incumbent providers from anticompetitively maintaining their dominant position.[33] In undertaking this obligation, the United States committed to "ensure that international carriers serving the United States compete on the basis of 'superior business acumen, responsiveness to customers, [and] ... technological innovation'" and therefore that "U.S. consumers of international services will receive the maximum benefits of reduced rates and increased quality, choice, and innovation."[34] But, as the Commission has recognized, the ability of carriers to "offer international service on an end-to-end basis to and from the United States and among foreign countries" depends critically on the ability to obtain last mile transport upon reasonable terms and conditions both in the United States and in the foreign country.[35] Thus, the Commission has reserved the right to deny or condition a carrier's participation in the United States market if it can be shown that the carrier is affiliated with a dominant foreign carrier that could use control over bottleneck facilities to raise its rivals costs and gain an unfair advantage in international services.[36]

In this regard, the Commission has stressed:

> The success of the WTO Basic Telecom Agreement depends on implementation of the market-opening commitments of our trading partners. The United States must lead the way in prompt, effective implementation of our commitments. If the United States is perceived as failing to implement its commitment, other countries would likely limit implementation of their own commitments. We find such a result would deny the benefits of open global markets and increased

[33] *See Foreign Participation NPRM* ¶¶ 30-40; *see also Foreign Participation in the U.S. Telecommunications Market*, 12 FCC Rcd. 23891, ¶¶ 25-29 (1997) ("*Foreign Participation Order*").

[34] *Foreign Participation NPRM* ¶ 30.

[35] *Id.*

[36] *Foreign Participation Order* ¶ 50.

competition to U.S. carriers and consumers, and is not in the public interest.[37]

As described above, while the United States was initially among the leaders in opening markets to competition, it has since reversed course by deregulating the BOCs' access charges notwithstanding clear BOC market power.

[37] *Id.* ¶ 40.

CONCLUSION

For the foregoing reasons, the Commission should immediately reform its regulation of special access rates to reduce rates to just and reasonable levels and to prevent future monopoly abuses.

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CERTIFICATE OF SERVICE

I, James P. Young, do hereby certify that on this 2nd day of December, 2002, a copy of the foregoing comments were served by U.S. first class mail, postage prepaid, on the parties named below.

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