

FCC Suspends Pricing Flexibility Rules For Special Access Services

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On August 22, 2012 in a split (3-2) decision, the Federal Communications Commission ("FCC" or "Commission") suspended, on an interim basis, its existing rules allowing for automatic grants of pricing flexibility for special access services provided by local exchange carriers ("LECs") operating under price cap regulation. In its Report and Order ("Order"), the FCC stated that it was taking this action in light of significant evidence that its pricing flexibility rules, adopted in 1999, are not working as predicted, resulting in harm to American consumers and businesses and hindering investment and innovation.

The Commission reaffirmed in its Order the principles underlying its special access pricing flexibility rules -- that regulation should be reduced wherever evidence demonstrates that actual or potential competition is acting as a sufficient constraint so as to ensure just and reasonable rates, terms and conditions for special access services. The FCC announced that it would collect necessary data and undertake a robust competition analysis aimed at identifying reliable proxies for competition in the market for special access services going forward so as to fashion a prospective regulatory framework regarding special access services. To that end, the Commission plans to issue a comprehensive data collection order to participants in the industry within 60 days. The data collection order will be subject to Office of Management and Budget approval before it becomes effective. Until it completes its analysis and revises its pricing flexibility rules accordingly, the Commission will make available to price cap carriers the opportunity for targeted relief through rule waiver requests and applications for forbearance under Section 10 of the 1996 Act.

Problems With Existing Pricing Flexibility Rules

In 1999, the Commission adopted its *Pricing Flexibility Order* intending that interstate access charge regulations would not unduly interfere with the operation of interstate access markets as competition developed in those markets. In the *Pricing Flexibility Order*, the Commission adopted rules allowing price cap LECs to show, in an administratively workable way, that specific geographic markets were sufficiently competitive to warrant pricing flexibility for special access services.

The Commission developed triggers designed to measure the extent to which competitors had made irreversible, sunk investment in collocation and transport facilities. For example, a price cap LEC in one metropolitan statistical area ("MSA") might be required to provide evidence that unaffiliated competitors had collocated in at least 15 percent of the LEC's wire centers within the MSA or collocated in wire centers accounting for 30 percent of the LEC's revenues from these services within the MSA. A price cap carrier that demonstrated that the triggers were satisfied in an MSA in which it operated could obtain "pricing flexibility" for that MSA, namely the ability to offer special access

services at unregulated rates through generally available and individually negotiated tariffs (*i.e.*, contract tariffs).

In the Order, the FCC held that the triggers it developed in its *Pricing Flexibility Order* have not worked as intended. As a result, the Commission concluded that its rules simultaneously prevent grants of pricing flexibility in areas that likely are competitive and allow grants of pricing flexibility in areas where it is not appropriate to do so. The FCC found evidence to support its conclusion in the record of pricing flexibility grants since the *Pricing Flexibility Order* and data on subsequent competitive developments in these areas.

Among other things, the Commission found that MSAs, which represent the geographic areas in which pricing flexibility had been granted under the prevailing regulatory framework, are unsuitable for measuring the level of competitive entry. Specifically, the FCC held that while portions of MSAs may contain demand at sufficient levels to warrant competitive entry, MSAs are sufficiently extensive that competitive entry may be considerably less likely in other portions of the same MSAs. As a result, per the Commission, the pricing flexibility rules have permitted MSA-wide relief on the basis of extremely concentrated demand in many instances. The FCC found that more than a third of the cases in which pricing flexibility was granted were premised on the existence of collocations where 65 percent or more of the special access revenue generated within the MSA came from 25 percent or fewer of the wire centers in the MSA.

The Commission also held that its pricing flexibility rules have not been as administratively simple or easy to verify as the Commission anticipated, nor have they provided bright-line guidance to industry. The FCC found that there has been confusion among petitioners regarding matters such as the applicable definition of "MSA," how to determine whether a wire center belongs to a specific MSA, and what revenues should be included in demonstrating that the trigger is satisfied. In addition, the Commission found that significant questions exist about the reliability of collocation as a proxy for facilities-based competition.

Suspension of Pricing Flexibility Rules

In the Commission's view, it would not serve the public interest to allow additional grants of pricing flexibility under the existing rules. As such, the Commission in its Order suspended operation, effective immediately, of its pricing flexibility rules on a temporary basis while it develops a better way to identify areas where special access regulatory relief is appropriate. The Commission suspended its pricing flexibility rules for both channel termination and dedicated transport. The Order did not affect the relief in areas in which pricing flexibility has already been granted to price cap LECs pursuant to the now-suspended rules.

The Commission noted that price cap LECs can still seek to modify the regulatory status of their special access services "based on a complete analysis of competitive conditions in a geographic area" while the FCC considers amendments to its pricing flexibility rules. The FCC explained that price cap LECs can petition for forbearance pursuant to Section 10 of the 1996 Act, or seek a waiver of the rules. The Commission also reiterated that it is available to resolve allegations of unjust or unreasonable rates, terms and conditions through the complaint process in the Act.

Market Analysis and Collection of Market Data

In its Order, the FCC announced that it will undertake a market analysis to assist in determining how best to assess the presence of actual and potential competition for special access that is sufficient to

discipline prices. As such, the analysis will aid the Commission in deciding where regulatory relief is appropriate and whether, in areas where regulatory relief has been granted, it should be maintained or modified. The market analysis will position the FCC to determine what specific showings price cap carriers must make in their petitions for pricing flexibility and what information they could submit to satisfy those showings. The analysis, the Order indicates, may be a one-time assessment.

The Commission intends to issue a public notice and solicit public comment on the factors to be considered in conducting the market analysis. Factors to be considered likely will include sources of intermodal and intramodal competition, potential market entrants, uncommitted entrants, carriers that self-supply their own special access, non-facilities-based competitors, and barriers to market entry. Also, the Commission stated that it will conduct the analysis in light of its broader objectives for the telecommunications industry.

The FCC's analysis will follow the collection of additional data. The Commission will release a comprehensive data collection order within 60 days, although it will become effective only after review and approval by the Office of Management and Budget, a process the Commission stated could take several months. It is anticipated that responses to the data collection inquiry will be mandatory for a wide range of industry participants, both price cap LECs and their competitors, and subject to enforcement in cases of non-compliance.

The Order states that the Commission will work to adopt final conclusions on the need for overall reform of the special access marketplace sometime in 2013.

Commissioners McDowell and Pai Dissent

Commissioners Robert M. McDowell and Ajit Pai dissented from the Commission's Order and issued separate statements explaining their rationale. Commissioner McDowell argued that "the majority has opted to suspend a thirteen-year-old special access regulatory framework without an adequate evidentiary record or market analysis, both of which are necessary to make such a sweeping rule change." Commissioner McDowell also expressed concern that the Commission's interim rule change is "constructively permanent," since the FCC tends to act on special access matters "in geologic time." Commissioner Pai raised similar objections to the Order, but was most troubled by the prospect that the Order "lays the predicate for the Commission to re-regulate fiber." In his view, "the Commission's decision will chill infrastructure investment, slow the deployment of next-generation networks, and impede job creation."

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