



# BUSINESS AS USUAL? NOT ANY MORE

The US FCC is proposing a new name and a new regulatory framework for 'special access' services, as **JONATHAN JACOB NADLER** explains

For as long as anyone can remember, the US Federal Communications Commission (FCC) has referred to the provision of the dedicated telecoms lines that enable retailers, financial institutions, mobile network operators, and other customers to move large amounts of data as 'special access' service. And, for as long as anyone can remember, the FCC has regulated the provision of special access by the historic monopoly providers – the incumbent local exchange carriers (ILECs) – with a hodgepodge of rules. These rules classified the ILECs as dominant carriers, required them to file tariffs, and generally assessed the lawfulness of filed rates based on a price cap methodology.

Over time, however, the FCC adopted so many exceptions that even the agency concedes that the rules “now have limited application”.<sup>1</sup> At the same

time, new entrants into the market, such as cable system operators, have been largely unregulated.

The FCC has now proposed not only to rename special access services as 'business data services' (BDS), but also to fundamentally alter the existing regulatory regime applicable to this \$45 billion market. The proposal, issued in May 2016, over the objection of the agency's two Republican commissioners, would:

- Bar numerous contractual provisions that the agency believes decrease competition and impede customers from transitioning from legacy time division multiplex (TDM) circuit-switched services (such as DS 1 and DS 3 lines) to new internet protocol (IP) packet-based offerings (such as Ethernet connections)



- Adopt a more granular, multi-factor definition of the relevant product and geographic markets
- Replace the established practice of imposing asymmetrical regulation on dominant operators with a new regime that would impose the same regulation on all entities that provide business data services in any market deemed non-competitive
- Eliminate the tariff filing requirement, while revising the price cap rules to require BDS providers in non-competitive markets to reduce prices to reflect productivity gains during the last decade.

**FROM SPECIAL ACCESS TO BUSINESS DATA SERVICES**

Because special access services are telecoms services, they are subject to regulation under Title II of the US Communications Act, which requires that carriers provide telecoms services on prices, terms and conditions that are just, reasonable and non-discriminatory. Between 1987 and 1999, the FCC used a price cap methodology to determine whether the prices charged by most ILECs met this requirement. Under the price cap regime, the FCC established the maximum price that an ILEC could charge for special access services. The FCC adjusted the cap annually based on the rate of inflation minus an ‘X-factor’, which was intended to reflect cost savings from expected productive gains.

In 1999, in an effort to spur competition, the FCC eliminated price cap rate regulation in any metropolitan area in which an ILEC allowed new market entrants to collocate facilities in a sufficient number of its wire centres. The next year, the FCC adopted the ‘CALLS Plan’, which changed the way the price cap regime was applied to those ILECs that remained subject to rate regulation. The CALLS Plan provided that the X-factor would be set in a manner that, regardless of productivity levels, would reduce special access rates by a cumulative 21.5% (adjusted for inflation) over a four year period.

In 2004, the X-factor was set at the same level as the inflation rate – and has remained so until the present day. As a result, the special access price cap effectively has been frozen for more than a decade, despite the significant increase in productivity that has occurred during this period.

Starting in 2006, the FCC granted requests, filed by several ILECs, to ‘forbear’ from applying Title II and other regulatory requirements to special access service. The FCC based this decision on its conclusion that the market for special access services is nationwide and that the ILECs were facing increasing competition from new market entrants, such as cable system operators and competitive local exchange carriers (CLECs).

Six years later, however, the FCC changed course and suspended further application of its 1999 ‘pricing flexibility’ rules to ILECs still subject to price caps on the grounds that the number of collocations at an ILEC wire centre was a poor indicator of the level of special access competition. The FCC subsequently undertook a massive effort to collect data regarding the actual level of competition in the special access market. That data provided the basis for the agency’s current proposals.

**PROHIBITION OF ‘UNREASONABLE’ CONTRACTUAL TERMS**

Historically, the FCC has been reluctant to interfere in the non-price terms of agreements between operators and large business customers. However, following an investigation of several ILECs’ tariffs for TDM-based special access services, the FCC declared three types of provisions contained in those tariffs to be unlawful:

- ‘All-or-nothing’ provisions. These provisions require customers to make all purchases of a specific type of special access service from a single pricing plan. The FCC found that such provisions “preclude customers from managing their business data services purchases in an economically efficient manner” by restricting their ability to purchase special access services from multiple plans offered by the same ILEC, or to “consider competitive alternatives”, and that these restrictions “have not otherwise been justified by reasonable business concerns.”

- ‘Shortfall’ provisions. Carriers often provide significant discounts to customers who agree to purchase a minimum amount of service. Carriers typically require customers who do not meet the “minimum commitment level” to make a shortfall payment. While allowing carriers to impose cost-based shortfall payment obligations, the FCC found that “a shortfall penalty that permits a carrier to recover more than the amount of revenue that a customer would have paid had it met its

minimum commitment is unreasonable”.

- ‘Early termination’ provisions. Carriers also provide significant discounts to customers who agree to purchase service for a specific time period, while requiring customers who want to discontinue use of one or more circuits before the end of the term to make

an ‘early termination’ payment. While allowing carriers to impose cost-based early termination provisions, the FCC found that early termination provisions that allow an operator to receive more revenue that it would have received had the customer either continued service until the end of the contract period, or accepted a lower discount in return for committing to a shorter service period, are unreasonable.

The FCC expressed particular concern that such provisions harm competition by preventing customers “from making cost-based choices about whether and when to transition their TDM purchases to Ethernet services”.

The FCC ordered the ILECs whose tariffs were under investigation to remove the unlawful provisions from their tariffs. It also sought comment on whether to extend these prohibitions to all business data services, whether provided subject to filed tariffs or commercial agreements, and whether such prohibitions should apply in all markets or only in those markets found to be non-competitive.



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## NARROWER PRODUCT AND GEOGRAPHIC MARKET DEFINITIONS

The FCC has long assessed the state of special access competition based on broad product and geographic markets. It is now proposing a far more granular approach to market definition for business data services.

The FCC proposes to define BDS as a telecoms service that “transports data between two or more designated points at a rate of at least 1.5 Mbps in both directions ... with prescribed performance requirements”. BDS would include both TDM- and IP-based services, but would exclude ‘best efforts’ mass market services, such as DSL and cable modem services. In summary:

**PRODUCT MARKET.** The FCC proposes to define multiple narrow BDS product markets, based on customer classes. For example, the FCC might define product markets based on factors such as the size of the customer (small, mid-sized, and national enterprises) or the type of customer (wholesale, retail, or mobile backhaul). It could further subdivide each customer class based on the bandwidth purchased (up to 50 Mbps and above 50 Mbps).

**GEOGRAPHIC MARKETS.** The FCC also proposes to define the geographic markets narrowly. Rather than assessing competition on a nationwide or metropolitan-area-wide basis, the agency would assess competition within given census blocks<sup>2</sup> or even on a building-by-building basis. As the FCC recognises, this approach would “create a ... patchwork of geographic areas with different regulatory treatment”.

Once it has defined the relevant markets, the FCC would assess the level of competition within each geographic market, based on factors such as the extent of business density within a census tract (on the assumption that greater density is correlated with greater competition) or the number of competing providers within the geographic area. Based on this assessment, the FCC would generate a list of geographic areas deemed competitive and those deemed non-competitive.

Given that there are almost 12 million census blocks in the US, this would be a massive undertaking. The FCC further proposes to update the list every three years. Interested parties would have the opportunity to challenge any competitive determination.

## THE END OF ASYMMETRICAL REGULATION

Since the advent of competition in the 1980s, the FCC has sought to impose greater regulation on telecoms providers deemed to be ‘dominant’ in a given market based on their ability to exercise significant market power in that market. So, for example, the FCC initially required dominant operators in the long-distance market to file tariffs, while allowing ‘non-dominant’ operators to provide services subject to individualised commercial contracts. This asymmetrical approach has been adopted, with varying degrees of theoretical rigour, by regulators around the world.

The FCC now proposes to replace asymmetrical

regulation with a new ‘competitive market test’ approach, which would impose comparable regulatory requirements on all BDS providers within a given BDS market – whether ILECs, CLECs, cable system operators, or other providers – based on whether the FCC had determined that the market was competitive or non-competitive:

**COMPETITIVE MARKETS.** Providers in competitive markets would be subject to minimal regulation. They would be required to provide service on just, reasonable and non-discriminatory terms and would be barred from entering into non-disclosure agreements that would prevent the sharing of market information with the FCC and other government entities. The FCC might prohibit

participants in these markets from imposing the ‘all-or-nothing’, ‘shortfall’ and ‘early termination’ requirements discussed above.

**NON-COMPETITIVE MARKETS.** By contrast, providers in markets deemed non-competitive



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would be subject to significantly greater regulations. These providers, like those in competitive markets, would be required to provide service on just, reasonable and non-discriminatory terms and would be barred from entering into non-disclosure agreements that would prevent the sharing of market information with the FCC and other government entities. They also would be prohibited from imposing ‘all-or-nothing’, ‘shortfall’ and ‘early termination’ requirements on their customers. The FCC might bar additional practices, such as requiring a customer to agree to: purchase services for the provider for a minimum term; buy a specific percentage of its BDS services from the provider; pay an ‘overage’ penalty if the customer exceeds its volume commitment; or have the agreement automatically renew at existing terms for a specified period or renew on a month-to-month basis at undiscounted levels.

Providers in non-competitive markets also would be subject to restrictions on ‘tying’. Specifically, they would not be allowed to “condition the sale of business data services in a non-competitive market on the sale of such services in a competitive market”. This potentially would preclude three types of provisions:

- IP migration provisions, which allow customers to count Ethernet purchases towards fulfilling their TDM commitments
- Provisions that leverage a pricing plan penalty liability (such as a shortfall penalty) applicable to TDM services to induce a customer to purchase the provider’s Ethernet services
- Provisions that require a customer that wants to purchase BDS services in a geographic area that is not subject to effective competition to agree to purchase BDS services from the same provider in geographic areas that are subject to effective competition.



◀ Finally, as discussed further below, providers in non-competitive markets would be subject to rate regulation.

These rules would apply to all BDS providers in a non-competitive market. As a result, some providers that operate in non-competitive markets – such as cable system operators – would be subject to significantly more regulation than they now are, even if they lack market power in that market. This, not surprisingly, has led to significant opposition by newer entrants into the market.

### MAKE AMERICA RATE REGULATE AGAIN

The FCC also proposes to fundamentally alter the way it regulates BDS rates in those markets that it finds non-competitive. First, it would eliminate the remaining tariff filing requirements in the BDS market. Second, the FCC would update and expand the application of price cap regulation to ILEC-provided TDM-based BDS. And, finally, it would regulate the rates of all providers of packet-based BDS using a ‘benchmark’ approach. In more detail:

**ELIMINATION OF TARIFFING.** While the FCC has relieved many ILECs from the obligation to file tariffs for BDS services, some carriers remain subject to this requirement. The FCC now proposes to eliminate BDS tariffing completely. It reasons that this “will allow for greater use of commercial negotiations, which will facilitate innovative integrated service offerings designed to meet changing market conditions and will increase customers’ ability to obtain service arrangements that are specifically tailored to their individualised needs”. At the same time, BDS providers would have to “publicly disclose their generally available rates, terms, and conditions”.

### MORE PRICE CAPS FOR TDM-BASED BDS.

The FCC proposes to significantly expand the use of price cap regulation. The agency would continue to apply price caps to those TDM-based BDS currently subject to that regime, while re-imposing price caps on TDM-based BDS that are currently exempt pursuant to the agency’s 1999 pricing flexibility rules. It also would end the price ‘freeze’ that has been in effect since 2004 by adjusting the ‘baseline’ against which the price cap is calculated, and by calculating the X-factor based on the expected increases in ILEC productivity, rather than simply mirroring the rate of inflation. The FCC has sought comment regarding three different methodologies for calculating the X-factor that appropriately balance “precision with administrative feasibility”. Regardless of the methodology chosen, because the FCC believes that ILEC productivity has increased far more than the rate of inflation, the practical effect would be to force BDS rates down.

### BENCHMARKS FOR PACKET-BASED BDS.

The FCC proposes a different approach for packet-based services, which generally have not been subject to price caps. Specifically, the agency would establish a benchmark for assessing the reasonableness of packet-based BDS services offered by any provider in a non-competitive market based on “the price of the most comparable legacy TDM technology”. Over time, as providers phase out

TDM-based BDS, the packet-based BDS rates established using this methodology would become the benchmark against which future rates would be measured.

### DECISION DAY IN DECEMBER?

The FCC’s public comment period ended in August. The comments showed significant disagreements among market participants. Most wireless providers, CLECs, business customers, and consumer advocates contend that greater FCC regulation of the BDS market is appropriate given the ILECs’ residual market power. By contrast, ILECs argue that, given the growth of competition, greater regulation is unnecessary and, indeed, would deter further investments. Cable interests generally support greater regulation of the ILECs but argue that, as new entrants, they should not be subject to increased regulatory requirements.

FCC officials continue to meet with industry and

user representatives. FCC chairman Tom Wheeler, who has been the major proponent of this proposal, has stated that he would like to issue new rules by the end of 2016.<sup>3</sup> This will prove challenging given the complexity of the proposed rules, and the significant difference of opinion both within industry and among the FCC commissioners. Any agency decision is almost certain to be appealed to the courts.

### REGULATE LOCALLY/AFFECT GLOBALLY

While the FCC’s new rules will apply only to facilities located within the US, they could affect the global telecoms market. By reducing the wholesale price of high-capacity data lines, the FCC could make it easier for non-US operators to provide global services to customers with operations in the country. The rules also could encourage a non-US operator to enter the US mobile market.

At the same time, the FCC proposals suggest that the gap between US and European regulators may be narrowing. For many years, the FCC employed light touch regulation of broadband services in order to create incentives for facilities deployment, while European regulators imposed greater regulatory obligations designed to foster services-based competition. The FCC’s proposal, like its earlier actions on network neutrality, appears to reflect a greater willingness to impose regulation on facilities-based providers in markets that it concludes are not effectively competitive.

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**REFERENCES** **1** FCC (2016). Business data services in an internet protocol environment; investigation of certain price cap local exchange carrier business data services tariff pricing plans. Tariff investigation order and further notice of proposed rulemaking. [fcc.us/2bv54wm](http://fcc.us/2bv54wm)  
**2** A census block is the smallest measure used by the US government for statistical collection, with an average size of one-seventh of a square mile (0.40 square kilometres). **3** Following custom, regardless of who is elected president in November 2016, the chairman, a Democrat, is expected to resign when the next president is inaugurated on 20 January 2017.



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