September 14, 2016

VIA ECFS

Marlene H. Dortch
Secretary
Federal Communications Commission
445 12th Street, SW
Washington, DC 20554

Re: ***Special Access Rates for Price Cap Local Exchange Carriers,* WC Docket No. 05-25; *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**

Dear Ms. Dortch:

The undersigned economists have submitted declarations and white papers in this proceeding analyzing the Commission's 2013 Business Data Services (BDS) data collection and opining on the merits of the proposed regulation of BDS.[1] Both economic theory and past experience show that rate regulation imposes significant costs and typically obstructs innovation and acts as a disincentive to investment. These significant risks outweigh the benefits of rate regulation in technology markets that are not monopolies.[2] For this reason, we are troubled by pending proposals that would impose widespread rate regulation in all markets that do not have

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1 *See, e.g.,* Declaration of Joseph V. Farrell, attached as Exhibit A to Comments of Comcast Corp. ("Comcast Comments"), WC Docket Nos. 16-143, 15-247, & 05-25 and RM-10593, ¶ 53 and §§ VI, VII, VIII, IX (filed Jun. 28, 2016) ("Farrell Decl."); Reply Declaration of Joseph V. Farrell, attached as Exhibit A to Reply Comments of Comcast Corp. ("Comcast Reply Comments"), WC Docket Nos. 16-143, 15-247, & 05-25 and RM-10593, ¶¶ 6-10, 99-100 (filed Aug. 9, 2016) ("Farrell Reply Decl."); Declaration of John W. Mayo, attached as Exhibit B to Comcast Comments, ¶ 60 ("Mayo Decl."); Reply Declaration of John W. Mayo, attached as Exhibit B to Comcast Reply Comments, ¶ 59 ("Mayo Reply Decl."); Mark Israel, Daniel Rubinfeld & Glenn Woroch, Analysis of the Regressions and Other Data Relied Upon in the Business Data Services FNPRM and a Proposed Competitive Market Test: Third White Paper, WC Docket Nos. 16-143, 05-25, RM-10593, at 6 (filed Aug. 9, 2016) ("IRW Third White Paper"); Reply Declaration of Michael Katz and Bryan Keating, attached as Exhibit A to Reply Comments of National Cable & Telecommunications Association, WC Docket Nos. 16-143 & 05-25, ¶ 85 (filed Aug. 9, 2016) ("Katz and Keating Decl.").

2 *Id.*; *see also* Andrew Sweeting, "Review of Dr. Rysman's 'Empirics of Business Data Services' White Paper," Apr. 26, 2016, at 10, *available at* https://apps.fcc.gov/edocs_public/attachmatch/DOC-340040A4.pdf (suggesting that "market power may be too limited to rationalize regulation").

either three or more, or four or more, BDS providers present.[3] These proposals lack support in economic theory, in regulatory experience, and in the record on BDS. Instead, we urge the Commission to adhere to widely accepted principles of regulatory economics that enjoy broad support in the record and in the economic literature by adopting a competitive market test targeted squarely at combating supracompetitive rents in entrenched monopoly markets, rather than regulating markets with multiple facilities-based competitors present.

The record shows that large numbers of service providers have invested billions of dollars to increase the output and quality of BDS throughout the country, and have expanded into new markets to meet growing demand.[4] Such competitive expansion is highly likely to produce competitive benefits to customers in the BDS marketplace. Indeed, Ethernet prices have been declining sharply, as have been prices for BDS more broadly.[5] Moreover, as several of us have found, the BDS marketplace exhibits multiple characteristics that promote competition in the presence of two or more facilities-based providers, including sophisticated buyers and large sunk costs combined with low incremental costs.[6] Consistent with that economic logic, the record clearly fails to show that regulation would produce more desirable outcomes than would competition in markets with two or more BDS providers.[7] Nor can Dr. Rysman's analysis serve as the basis for applying rate regulation in an effort to replicate the effects of a third or fourth competitor in a market, as the bulk of his analysis does not assess the incremental impact of adding a third or fourth competitor at the census block level.[8] And any benefits of attempting to simulate the competitive pricing effects of a third or fourth provider through ex ante price

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3 *See, e.g.*, Reply Comments of Sprint Corporation, WC Docket Nos. 16-143, 15-247, & 05-25 and RM-10593, at 2 (filed Aug. 9, 2016); Reply Comments of Windstream Services, LLC, WC Docket Nos. 16-143, 05-25 and RM-10593, at 10 (filed Aug. 9, 2016); Reply Comments of Level 3 Communications, LLC, WC Docket Nos. 16-143, 15-247, & 05-25 and RM-10593, at 39 (filed Aug. 9, 2016); Letter from Kathleen Grillo, Verizon, and Chip Pickering, INCOMPAS, to Marlene H. Dortch, Secretary, FCC, WC Docket Nos. 16-143, 05-25, RM-10593, at 3 (filed Aug. 9, 2016).

4 *See, e.g.*, Farrell Decl. ¶¶ 106-107; Mayo Reply Decl. ¶¶ 13-20.

5 *See, e.g.*, Mayo Reply Decl. ¶¶ 21-26; IRW Third White Paper at 8.

6 *See, e.g.*, IRW Third White Paper at 2; Mayo Decl. ¶ 55; Katz and Keating Decl. ¶¶ 32-33.

7 *See* Marc Rysman, "Empirics of Business Data Services," White Paper, attached as Appx. B to Tariff Investigation Order and Further Notice of Proposed Rulemaking ("FNPRM"), WC Docket Nos. 16-143, 15-247, & 05-25 and RM-10593, FCC 16-54, at 230 (rel. May 2, 2016) ("Rysman White Paper"); IRW Third White Paper, at 5, 9, 20, 24, 27.

8 *See* Farrell Reply Decl. ¶¶ 45-54 (noting that none of Dr. Rysman's price regressions presents a "straightforward" basis for "determin[ing] the incremental effects of different numbers of competitors to the ILEC beyond the first").

regulation very likely would be outweighed by the costs and disincentive effects discussed at length in this proceeding.[9]

As commenters across the spectrum rightly acknowledge, the rationale for ex ante rate regulation hinges entirely on protecting customers from a dominant provider's abuse of market power; in turn, there is no plausible argument for regulating BDS providers that lack market power.[10] No party has suggested—let alone demonstrated—that competitive BDS providers exercise significant market power.[11] Moreover, some of the undersigned economists have examined marketplace data regarding the current state of BDS competition and have found that such data do not support claims that incumbent LECs exercise market power broadly in the provision of BDS.[12] Dr. Rysman's regressions, which the Commission relies upon as the primary record support for proposed regulation of incumbent LECs' BDS prices, suffer from numerous fundamental flaws,[13] including (i) a severe endogeneity problem; (ii) use of outdated, incomplete, and incorrect data on pricing and the number of competitors; and (iii) mismatches in

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9 *See, e.g., supra* note 1; Mark Israel, Daniel Rubinfeld & Glenn Woroch, Analysis of the Regressions and Other Data Relied Upon in the Business Data Services FNPRM And a Proposed Competitive Market Test: Second White Paper, WC Docket Nos. 16-143, 05-25, RM-10593, at 40 (filed Jun. 28, 2016); Farrell Decl. at §§ VI, VII, VIII, IX; Mayo Decl., Exhibits 4-9; Katz and Keating Decl. at 9-21 (discussing the numerous costs of price regulation and concluding that "ex ante price regulation—especially if applied to all BDS providers in a large number of markets declared to be non-competitive markets—would very likely impose greater costs than benefits").

10 *See, e.g.,* Comments of Level 3 *et al.*, WC Docket Nos. 16-143, 15-247, & 05-25 and RM-10593, at 59 (filed Jun. 28, 2016) ("[I]t is unnecessary and even potentially harmful to apply *ex ante* rate regulation to competitors without market power."); Comments of Public Knowledge *et al.*, WC Docket Nos. 16-143, 15-247, & 05-25 and RM-10593, at 8 (filed Jun. 28, 2016) (proposing that the Commission apply rate regulation to multiple providers in a market only insofar as it "finds that multiple providers in a market it deems to be non-competitive have market power"); Comments of Lightower Fiber Networks, WC Docket Nos. 16-143, 15-247, & 05-25 and RM-10593, at 3 (filed Jun. 28, 2016).

11 *See* Comcast Reply Comments at 3, 10.

12 *See* IRW Third White Paper at 5-7.

13 *See, e.g.,* Letter from Christopher Shenk, Counsel for AT&T, to Marlene H. Dortch, at 3-6 (filed Aug. 22, 2016) (collecting some economists' criticisms of Dr. Rysman's regressions); Mark Israel, Daniel Rubinfeld & Glenn Woroch, Analysis of the Revised Regressions Disclosed by FCC Staff on August 22, 2016: Fourth White Paper, WC Docket Nos. 16-143, 05-25, RM-10593, at 1-11 (filed Sep. 8, 2016) ("IRW Fourth White Paper") (discussing both Dr. Rysman's regressions as well as further regressions the Commission's Staff performed based on Dr. Rysman's regressions that "embody the same core shortcomings as the prior regressions"); IRW Third White Paper at 11-26 (same); Mayo Decl. ¶¶ 50-78; Farrell Reply Decl. ¶¶ 45-54, 72-88, 98-143; Katz and Keating Decl. at 26-43.

the pricing and competitor data.[14] To the extent that Dr. Rysman's flawed regressions produce some statistically significant results for low-bandwidth TDM BDS, those estimated price effects are too small[15] to warrant ex ante price regulation in light of the significant costs, including disincentives to investment and entry, that such regulation would entail.[16]

To the degree there are some BDS markets with persistent monopoly power, we agree that it could be economically justified and welfare enhancing to reduce monopoly rents in such markets to a best approximation of competitive levels, to the extent such a goal can be achieved without imposing large costs on providers or disincentivizing investment. The Commission should limit any such regulation to markets characterized by monopoly power that are unlikely to become effectively competitive in the near future. To that end, the Commission should regulate BDS rates for legacy services only in geographic BDS markets where only a single facilities-based provider is present or nearby. We believe such a framework would effectively operationalize the basic insight that "[s]ince price regulation is likely to have many unfortunate unintended effects … the Commission should tread lightly in markets where market power is uncertain, modest, or fragile."[17] By limiting price regulation to legacy services in enduring monopoly markets, the Commission would appropriately reserve such regulation for the markets where the benefits of price regulation are most likely to exceed its substantial costs.

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14 *See, e.g.,* IRW Fourth White Paper at 1; Mayo Reply Decl. ¶¶ 36-43.

15 *See, e.g.*, Rysman White Paper at 228 (the results for DS1 services are "not especially large by the standards of competition analysis").

16 *See, e.g.*, IRW Third White Paper at 25; Katz and Keating Decl. at 9-21; Farrell Decl. at §§ V, VI; Farrell Reply Decl. ¶¶ 30-42.

17 Farrell Decl. ¶ 59; *see also* Katz and Keating Decl. at 3-8 (stating that "[t]he ability of regulation to improve market performance is highly uncertain in a marketplace as complex as the one for BDS" and that any regulatory approach that seeks to promote the public interest "must account for the inevitable costs and imperfections of regulation").

Respectfully submitted,

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