

FCC Issues Tariff Investigation Order and NPRM Which Proposes to Substantially Revise and Expand the Regulation of Business Data Services

May 25, 2016

In May 2016, after several years of prolonged investigation and data collection into the \$45 Billion per year market for “special access” services, which the FCC now calls the dedicated business data services (“BDS”) market, the FCC has issued a combined [Tariff Investigation Order \(“Order”\)](#) and [Further Notice of Proposed Rulemaking \(“NPRM”\)](#). Both the Order and the NPRM are highly significant for both BDS providers and customers.

In its Order, the Commission found unjust and unreasonable 18 existing BDS tariff plans offered by AT&T, CenturyLink, Frontier, and Verizon. The Commission ordered that the “all or nothing” provisions be removed from those tariffs, and ordered the carriers to submit tariff revisions consistent with its Order. In addition, the FCC found that certain shortfall and early termination provisions of several of the tariffs were unjust and unreasonable.

In the NPRM, the Commission begins with the premise that business data services are telecommunications services, regardless of provider, and that it views all BDS providers as common carriers subject to Title II of the Communications Act (with the limited exception of Verizon which was granted special forbearance from such regulation for its IP-based, packet-switched BDS services). The NPRM proposes to sweep all BDS providers, including those whose BDS offerings have historically been unregulated (with the exception of Universal Service Fund contribution requirements applicable to both common carriers and other providers of interstate telecommunications), into a new BDS regulatory regime.

As one example, historically, when cable television companies provided symmetrical data transport services between two or more points at a rate of at least 1.5 Mbps with performance guarantees the service offerings were not regulated by the FCC. The NPRM now proposes to regulate these types of cable offerings as BDS subject to Title II of the Act, just as traditional incumbent LEC TDM special access services have been.

At a high level, the NPRM proposes to apply what are termed “limited requirements” to the provision of BDS in all markets, competitive and non-competitive alike, with additional requirements proposed, including price-related regulation, for non-competitive markets. The Commission also proposes a Competitive Market Test, a new approach for assessing whether a particular market is competitive or non-competitive.



The Commission has typically treated the provision of BDS by incumbent local exchange carriers (“ILECs”) in competitive markets differently than it has treated their offerings in non-competitive markets. The Commission in both the Order and NPRM concludes that its prior tests for competitive and non-competitive markets did not accurately reflect market realities. Accordingly in the NPRM, to evaluate whether a market is competitive, the Commission proposes Competitive Market Test criteria of (a) business density; and (b) number of facilities-based competitors in a to-be-determined geographic area. The Commission asks whether it should require the presence of more than two facilities-based competitors in a given geographic area for a competitive trigger to exist, and whether it should weigh competition from a cable company differently than that from a competitive local exchange carriers (“CLEC”).¹

The NPRM proposes a more hands-off regulatory framework of “just and reasonable charges and practices” under Section 201(b) of the Act for services in competitive markets, while maintaining a price cap regime for legacy, circuit switched TDM services in non-competitive markets.

Given these proposed large-scale changes in the regulatory ecosystem, the business of all providers and users of BDS could be profoundly affected. Comments on the NPRM are due **June 28, 2016**, with reply comments due **July 26**.

Below please find a more detailed examination of the Order and NPRM

The Business Data Services Market

The Commission found that BDS are essential building blocks to establish private or virtual private networks. BDS includes, among other things: (i) high speed Internet access and data traffic needed at all locations of an enterprise business; (ii) backhaul networks to support ubiquitous 4G and 5G wireless service; and (iii) access to high-speed wireline data connections. BDS customers include: Wireless carrier networks needing to backhaul voice and data traffic from their cell sites to mobile switching centers; bank branches and gas stations using ATMs; credit card readers; multi-location businesses needing Internet access; data storage from a cloud hosting service; videoconferencing services; or secure, remote employee access. The Commission describes an enormous \$45 billion market (revenues reported in 2013 alone) for these dedicated “special access” services. The BDS market could exceed \$75 billion annually under the projections of an FCC White Paper. The economic consequences of ensuring that this market remains competitive and that the transition to IP services (including continued growth of the more scalable and cost-effective Ethernet services) continues to develop, are key objectives of the FCC in this proceeding.



¹ NPRM, para. 294.

BDS Purchasers

The Commission observes that the three main categories of BDS purchasers are (1) the retail segment (businesses, government entities and non-profits); (2) the carrier or wholesale segment of CLECs who purchase BDS for resale to complement their own facilities-based services; and (3) mobile wireless providers, who principally purchase BDS for cell site backhaul. The ten largest purchasers of BDS when evaluating 2013 expenditures were all carriers, spending a total of \$10 Billion. The 15 wireless carriers reported separately as having more than 237,000 cell sites in 2013 and spending more than \$5.6 Billion on BDS for wireless backhaul.

Increasing demand for bandwidth applications such as data center connectivity, video conferencing, cloud-based services including data storage, M2M communications, and the Internet of Things means that business IP traffic demands are growing at a rapid rate. Mobile data demand is exploding. Wireless carriers are preparing for deployment of new, higher-speed 5G services, which could debut as early as 2020. This could further increase demand for BDS because it will require new macro cell sites and small cell site densification. According to one analyst's prediction, the mobile backhaul transport market could grow \$5.3 Billion annually over the next 5 years (representing 25% of backhaul revenue).² Because Ethernet services, especially when offered over fiber, can scale necessary bandwidth to meet symmetrical transmission speeds far more cost effectively than TDM services, this has increased demand for Ethernet over traditional copper-based TDM facilities. The FCC notes that 40% of the \$45 billion BDS market in 2013 was for packet-based services.³ For example, one national wireless carrier reports that 95% of its 4G LTE cell sites and a total of 32,000 sites have been converted to fiber backhaul, even as of 2012.⁴

Recent Regulatory History

In 1999, the FCC established a process for granting pricing flexibility, in phases, for price cap incumbent LECs to offer BDS across a metropolitan statistical area ("MSA")(e.g. Minneapolis-Saint Paul or Dallas-Fort Worth) and non-MSAs when certain competitor collocation regulatory triggers in wire centers were satisfied. These collocation triggers were considered a proxy for "potential competition" in a given MSA, and under Phase I relief, price cap ILECs could lower their rates through contract tariffs and volume/term discounts, while otherwise keeping generally available price-capped rates in place to protect customers in areas lacking competitive alternatives. Phase II flexibility, requiring a higher level of collocation, allowed ILECs to raise or lower rates in an area without any limitations under the price cap regulations. The FCC allowed price cap ILECs to obtain Phase I and II flexibility on BDS segments involving channel terminations (last mile, local loop connections to end user locations) and dedicated transport (higher capacity connections between middle mile, network aggregation points, such as a tandem switch).

² Order, para. 79.

³ *Id.*, para. 81.

⁴ *Id.*, para. 82.



By 2006, a GAO report found that facilities-based competition was unevenly distributed throughout many ILEC markets, and that in general, the prices and revenues of price cap ILECs had increased in areas where the FCC had granted Phase II pricing flexibility in a particular MSA. The GAO Report recommended that the FCC revisit the issues and identify a more precise measure of “effective competition” than the collocation triggers it was using, and to collect “meaningful data”.

During the period of 2004-2008, many of the price cap incumbent LECs, including AT&T, Verizon, CenturyLink, Frontier and Qwest received forbearance from the FCC from dominant carrier regulation – including tariffing and rate regulation—for their BDS services. In contrast, these tariffing and rate regulation safeguards only continued with regard to provisioning of legacy copper-based TDM services over DS1s and DS3s.⁵ Forbearance included the then-existing packet-based services, such as those using Ethernet technology protocol and optical carrier transmission services.

In August, 2012, the Commission suspended further grants of pricing flexibility for the price cap ILECs, concluding that collocation triggers were both over- and under-inclusive as predictors of competition and a “poor proxy”. This, coupled with the Commission’s initiation of its *Technology Transitions* rulemaking in November 2014,⁶ and a mandatory special access data collection directed to all providers of dedicated data services in ILEC price cap markets (as well as certain purchasers of dedicated service in these areas of more than \$5 Million in 2013), set the stage for the reforms taken in this Order and proposed in the NPRM.

Tariff Investigation Order

Following a multiyear investigation and collection of data relating to the special access market that began in December, 2012, the Commission declared unlawful the following terms and conditions in certain AT&T, CenturyLink, Frontier and Verizon tariff pricing plans that it found “unjust and unreasonable” under the Communications Act, directing the affected price cap carriers to remove them and submit new tariff provisions consistent with the Order:

- “All or nothing” volume/term contracts that require a customer to make all of its purchases through a single supplier during the term of the commitment.⁷ The Commission found these contracts have excessive penalties, observing that no cost data was filed by any of the price cap ILECs in support of the use of all-or-nothing provisions, and they prevent a customer from switching from traditional TDM services to a competitor’s IP-based business services.

⁵ DS1s and DS3s are essentially copper lines equivalent to 1.544 Mbps and 44.736 Mbps, respectively.

⁶ See, *Technology Transitions et al.*, GN Docket No. 13-5 *et al.*, Notice of Proposed Rulemaking and Declaratory Ruling, 29 FCC Rcd 14968, 14973-74 (2014)(“Emerging Wireline NPRM”) In this NPRM, the Commission recognizes that the future of the BDS market lies in IP-based, packet-switched communications.

⁷ These include all-or-nothing tariff provisions in the Verizon CDPs, NDPs, and TVPs, the Ameritech DCP, the Southwestern Bell and Pacific Bell DS1 TPPs, the CenturyLink RCP, and the Frontier DS1 OPP and TPP, TVPs and NDPs. Order, para. 110.



- The Commission requests comment on Level 3’s request that the Commission mandate a “fresh look” for BDS customers to “adjust their volume commitments under a lock-up plan without terminating the plan.” The FCC believes this approach “warrants serious consideration” but because of conflicting views in the record and the “interrelated” nature of agreements that certain parties have entered into for the purchase of BDS the FCC wishes to proceed cautiously before moving forward to make certain it takes into account the interests of all parties.⁸ Moreover, to avoid possible market disruption, the FCC invites ILECs and their enterprise and carrier customers to “jointly to explore a reasonable approach to implementing the prohibition on all-or-nothing provisions in existing agreements and to include any such approach in the record of this proceeding.”⁹
- Unreasonable shortfall and early termination charges which include penalties that exceed “expectation damages, or the amount the purchaser would have paid if it had met its minimum commitment level.”¹⁰ The FCC feels shortfall charges above the ILECs’ “benefit of the bargain” are unreasonable, and that such charges have policy implications given trends confirming the rapid growth in IP-based BDS is at the expense of TDM services, and that shortfall charges under older TDM agreements are impeding the transition to IP services.¹¹
- The FCC determined that while early termination fees assessed by ILECs during the same period (\$60 Million) were substantially less than shortfall charges, it still found them unreasonable and of concern given that declining demand for TDM services could expose purchasers to even greater early termination liability. The FCC accordingly found that early termination fees are unreasonable when they exceed the ILEC’s opportunity cost incurred as a result of early termination.¹² The FCC determined that the *lesser* of either of the following two methods of determining maximum termination charges is reasonable: (1) calculating the revenues under the remaining monthly commitment to be paid by the purchaser for the remaining term; or (2) the difference between the discounted rates actually paid by the purchaser and the rates it would have paid for the actual amount of time of the shorter service term.¹³

⁸ *Id.*, para. 112.

⁹ *Id.*, para. 113. (Emphasis added).

¹⁰ *Id.* paras. 115, 132 Total shortfall penalties were more than \$200 Million from 2012-2014, more than doubling from \$47.5 Million in 2012 to \$94 Million in 2014. Para. 116. The Commission found the shortfall provisions in the AT&T Southwestern Bell and Pacific Bell DS1 TPP, Frontier’s OPP and NDP, and Verizon’s CDP and NDP to be unjust and unreasonable. *Id.*, para. 140.

¹¹ *Id.*, para. 117.

¹² *Id.*, paras. 141, 158. The FCC found that the early termination provisions in the AT&T Pacific Bell and Southwestern Bell DS1 TPP, and Frontier OPP are unjust and unreasonable, allowing the ILEC to recover more than opportunity cost in the event of a breach.

¹³ *Id.*, para. 156. The FCC cautioned that these reasonable approaches should not be the basis for raising a lesser termination fee to a higher one that meets this standard.



- The Commission directed that tariffs with the identified provisions in violation be amended and appropriate tariff revisions be filed by **July 1, 2016**, to be effective between 1-15 days' notice. AT&T has already filed a petition for review of the Order.¹⁴
- The Commission requests comment on how the finding that these provisions are unlawful prospectively should be implemented for existing volume/term agreements under these incumbent LEC plans.¹⁵

Further Notice of Proposed Rulemaking

In its NPRM, the FCC shares its analysis of its 2015 data collection, by product and geographic market. It then requests comment on a number of proposals to establish a new regulatory paradigm for BDS to address the shift that has already occurred in the data services market to IP-based services, and to encourage its continued evolution.

FCC Overview of its Competition Analysis

Based upon its analysis of its 2015 data collection and comments of participants, the FCC summarizes and requests comment on these “key beliefs” relating to the BDS Market:

Product Market

- “Best Efforts” services (i.e. residential DSL or cable modem services without symmetric bandwidth speeds or other SLAs) are not competitive substitutes for BDS.
- Packet-based BDS, including hybrid fiber coaxial (“HFC”) service offered by CATV providers, is a “good substitute” for TDM BDS, and can constrain TDM prices, though switching costs can “limit that effect”.
- Product markets are segmented by other customer requirements such as a need for multi-location services and minimum performance characteristics needed (limiting the field of competitive options especially in areas with lower density BDS demand).

Geographic Markets

- Fiber-based competitive suppliers within at least half a mile has a “material effect” on prices of BDS with bandwidths of 50 Mbps or less, even when there is unbundled network element (“UNE”)-based TDM and hybrid-fiber coaxial (“HFC”) competition nearby.

¹⁴ Communications Daily, May 18, 2016.

¹⁵ Order, para. 96.



- Supply of BDS in excess of 50 Mbps “tends to be more competitive” than supply at lower bandwidths.
- ILEC contract tariffs benefit BDS purchasers and suppliers.¹⁶

The Commission asks at a high level in connection with some of the most important competitive analysis matters in this rulemaking, which are also discussed in more detail below:

- (1) How many competitive choices are necessary to ensure supply is materially competitive, and does it depend on the identity of the competing suppliers and vary by type of BDS? Should there be more than two, and if so, how many?
- (2) How important is potential competition to the analysis? Does facilities-based competitive supply beyond half a mile have a material effect on prices of BDS?
- (3) Does the impact of competitive facilities on BDS prices vary by type of competitive supply, broadband speeds and whether they are symmetric (i.e. fiber network, vs. HFC, leased dark fiber or UNEs)? How should CATV competitive supply of BDS be weighed against that of incumbent LECs or competitive LECs? Does a minimum broadband speed at a level of Ethernet service at symmetrical speeds in excess of 10 Mbps with performance guarantees (requiring fiber at the location and not available currently via HFC networks),¹⁷ have a greater impact on competition or would a lesser service threshold?

Competitive Market Test

As discussed above, the Commission proposes to replace the 1999 pricing flexibility regime for price cap ILECs (for which the FCC has already largely forborne from regulating non-TDM BDS services) with a new regulatory framework that will determine whether a relevant market is competitive or non-competitive. Where a market is determined competitive, the Commission will subject it to minimal regulation and rely on market forces to constrain rates, terms and conditions. It proposes to modernize its competitive triggers to better capture all competitive entrants through a multi-factor Competitive Market Test.

A. Business Data Service Definition:

The FCC proposes to define BDS as a telecommunications service that:

transports data between two or more designated points at a rate of at least 1.5 Mbps in both directions (upstream/downstream) with prescribed performance requirements that typically include bandwidth, reliability, latency, jitter,

¹⁶ NPRM, paras. 160-163.

¹⁷ *Id.* para. 62.



and/or packet loss. BDS does not include “best effort” services, e.g. mass market BIAS such as DSL and cable modem broadband access.¹⁸

The FCC requests comment on this definition, asking whether it should include minimum performance guarantees, such as 99.99 percent reliability, and whether it should reduce the minimum symmetrical speed to 1 Mbps to include other dedicated service offerings.

B. Multi-factor Competitive Market Test

The FCC is considering a relevant market for applying a competitive market test along customer classes and different bandwidths in geographic areas of census blocks, and groupings of census blocks. The proposed criteria focus on business density and number of providers in the relevant market area.¹⁹

Relevant Products (including customer classes) and Geographic Areas for Evaluating Competition

The FCC asks if it should apply its Competitive Market Test based on different BDS customer classes (i.e. CLECs vs. wireless backhaul vs. retailer or financial institution processing credit or financial transactions) at varying bandwidths and whether and how the Commission should separate product market by customer type and bandwidth.²⁰

The FCC has also concluded that it was mistaken in 1999 in granting pricing flexibility on an MSA-wide basis since business demand can vary widely across it. It now seeks comment on whether using census blocks or a more “granular” area such as a building or cell site, or larger geographic area, would be appropriate for applying the Competitive Market Test. Use of the building approach might limit the difficulty of determining proximity to fiber, though areas adjacent to a census block should, according to the FCC, have “similar business density and facilities-based competitor characteristics...”²¹

Competitive Market Test Criteria

The FCC has identified two possible “bright-line criteria” to determine whether actual or potential BDS competition is insufficient.

- (1) Business Density - The FCC analysis shows a “significant correlation” between business density and the presence of competition. It therefore requests comment on the appropriate business density metric for the Competitive Market Test. Should it be number of business establishments in a defined geographic area, number of employees, or for example, any census block with a defined minimum number of business establishments per square mile? When evaluating a

¹⁸ NPRM, para. 279.

¹⁹ *Id.*, para. 280.

²⁰ *Id.*, para. 284.

²¹ *Id.*, para. 289.



mobile backhaul market, should the Commission focus on the density of existing cell sites in a census block area or some other more appropriate metric for a wireless network?

- (2) Number of Competitors in the Relevant Geographic Area – Should the Commission require more than two facilities-based competitors in any area for a competitive trigger to exist, given that the Commission has considered a duopoly insufficiently competitive? Are there exceptions to that rule? Should the weighting given to a cable company with DOCSIS 3.0 coverage in an area provided over a hybrid-fiber coax (“HFC”) network (and the bandwidth speeds and SLAs available for BDS services) be weighted differently than one with Metro-Ethernet capable nodes?

The Commission seeks comment on how the Competitive Market Test Matrix on how the lists of census block or other geographic areas adopted for each relevant market determined competitive and non-competitive will be disclosed. Should there be a central repository with an interactive map, which reviewers could filter by product class, like the National Broadband Map? Should there be a searchable database in addition to or in lieu of the map? Should the Competitive Market Test be re-applied across all areas served by price cap carriers every three years to account for market changes?

Post-Determination Process

- Should providers and purchasers have an opportunity to challenge the determinations resulting from the process?
- What should be the timing and process?
- Should it be similar to or adopt any of the lessons of the Connect America Fund challenge process, in which parties could make a prima facie case that a census block should be treated as “served” by fixed broadband service and therefore a particular census block should be ineligible for designation for Connect America Phase II USF broadband support?

Rules That Would Apply to BDS In All Markets Whether Competitive or Non-Competitive

The Commission proposes, and seeks comment on, the following requirements for the provision of BDS in all markets, consistent with its regulation of BDS providers as common carriers subject to Sections 201 and 202 of the Act:

- (1) Should the prohibitions on all or nothing contracts, unreasonable shortfall and unreasonable early termination terms be prohibited in all commercial agreements for BDS services, including those of cable TV providers and other competitive BDS providers, not just ILEC pricing plans?
- (2) Should the Commission prohibit the use of Non-Disclosure Agreements by BDS providers to block customer from sharing the terms of BDS service agreements with the Commission? Do such



NDA, for example, unfairly impact the ability of companies, including competitive carriers, from participating in the rulemaking process?

Retention of Price Cap Regulation in Non-Competitive Markets

The FCC believes it should continue to apply price caps to TDM BDS that fail to meet the Competitive Market Test, and allow for providers to enter into individually negotiated agreements for such services on a non-tariffed basis. The Commission seeks comment on this proposal.

The Commission also asks how non-competitive BDS markets in which TDM is no longer available should be regulated.

Anchor or Benchmarking Pricing

The FCC adopted an interim rule in its August, 2015 *Emerging Wireline Order*²² which requires that ILEC BDS providers which discontinue legacy TDM services provide competitive LECs with wholesale Ethernet service pricing at reasonably comparable rates, terms and conditions.²³ This applies to BDS services at DS1 speed and above, and commercial wholesale platform services such as AT&T's Local Service Complete and Verizon's Wholesale Advantage.

The FCC proposes an anchor pricing or benchmarking approach to replace this interim rule which would incorporate one of three options:

- (1) Regulated TDM benchmark service prices for the most comparable level of service to anchor prices of similar packet services (i.e. DS1 for a 5Mbps Ethernet service);
- (2) One regulated price for packet-based BDS, such as 10 Mbps Ethernet service, to anchor other geographically close bandwidth packet-based BDS;
- (3) Reasonably comparable prices for regulated TDM services²⁴

Over time, as TDM benchmarks are discontinued, packet-based BDS rates established as being fair and reasonable would serve as a continuing benchmark.²⁵ The FCC seeks comment on this proposal and how it should be implemented. Will this be workable and ensure that packet-based BDS rates are just and reasonable? If not, what alternative solutions should be considered?

²² *Emerging Wireline Order* in its *Technology Transitions rulemaking*

²³ Order & NPRM, paras. 38, 421.

²⁴ NPRM, para. 422.

²⁵ *Id.*, para 430.



Should BDS providers affected by proposed anchor or benchmark pricing be required to disclose their generally available rates, terms and conditions? How should the disclosure of rates be implemented? Is posting on a carrier website sufficient?

Terms and Conditions

- I. The Commission asks how should IP migration provisions in ILEC pricing plans be treated?
 - Are IP migration provisions in pricing plans potentially unlawful tying arrangements or do they instead encourage migration to Ethernet and other IP services to facilitate the technology transition?
 - Should customers be allowed a “fresh look” to reevaluate their tariff commitments or to adapt their purchasing agreements?
- II. Other Terms and Conditions

The Commission also seeks comment on the reported use by incumbent LECs in their tariff pricing plans of: (1) percentage commitments (based on a purchaser’s historical or existing levels of purchase); (2) term commitments; (3) upper percentage thresholds for premature disconnections and increased usage above a minimum volume commitment at discounted pricing; (4) overage penalties; and (5) automatic renewal and evergreen provisions. For example, should a 7 year tariff pricing term be automatically renewed if the customer fails to give notice of its decision within a two month extension period? Should automatic reversion to undiscounted month-to-month pricing be permitted? Do they force customers to be locked up into another long term pricing plan to avoid a potentially significant price increase? The FCC seeks comment on these terms and conditions.

Comments are due by **June 28, 2016**. Reply Comments are due **July 26, 2016**.

Contact Information

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