Maggie McCready
Vice President
Federal Regulatory Affairs

March 2, 2015

1300 I Street, NW, Suite 400 West
Washington, DC 20005

Phone 202 515-2543
Fax 202 336-7922
maggie.m.mccready@verizon.com

Ex Parte

Ms. 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 and RM-10593

Dear Ms. Dortch:

We write today to address recent filings calling for FCC action to restrict the terms and conditions that providers offer to customers in the highly competitive special access marketplace. Although these discount plans are popular with customers and offer many benefits, some parties continue to raise concerns with certain terms and conditions in common special access plans. These parties have mischaracterized these plans for years in an effort to convince the Commission to regulate first and ask questions later. Verizon has repeatedly debunked their mischaracterizations in its comments and ex parte presentations in this proceeding.[1] In this letter we describe key provisions of our popular discount plans and respond again to several misrepresentations.

Verizon offers pro-customer voluntary discount plans that benefit both customers and Verizon. Verizon's discount plans offer customers significant discounts in exchange for term or term-and-volume commitments. As in many other competitive marketplaces, voluntary discounts in exchange for commitments of term and volume are commonplace because they enhance efficiencies and reduce transaction costs and risk for both the buyer and the seller. Verizon's discount plans do not link discounts to commitments to purchase from Verizon a percentage of the customer's total purchases from all sources. And Verizon offers customers a range of options when their voluntary discounts expire, including migrating some or all of their circuits away from Verizon.

[1] *See, e.g.*, Reply Comments of Verizon, at 18-28 (March 12, 2013); Comments of Verizon, at 28-31 (Feb. 11, 2013); Letter from Evan T. Leo, Counsel for Verizon, to Marlene H. Dortch, FCC (July 16, 2012); Letter from Maggie McCready, Verizon, to Marlene H. Dortch, FCC, at 1-5 (June 6, 2012); Letter from Donna Epps, Verizon, to Marlene H. Dortch, FCC (Apr. 25, 2012); Letter from Donna Epps, Verizon, to Marlene H. Dortch, FCC (Mar. 27, 2012); Letter from Maggie McCready, Verizon, to Marlene H. Dortch, FCC (July 14, 2011); Letter from Donna Epps, Verizon, to Marlene H. Dortch, FCC (Feb. 28, 2011).

Furthermore, no firm in the high-capacity services marketplace has market power, which Verizon expects the Commission's "one-time, multi-faceted analysis" will confirm. Until the Commission collects and properly analyzes all the data, the Commission should not take action or draw conclusions regarding terms and conditions in this competitive marketplace.

1. Verizon's voluntary discount plans reflect economic efficiencies and offer customers a variety of choices.

Verizon offers special access customers a variety of voluntary discount plans. Some of those are "term-only" plans that offer discounts in exchange for a commitment to keep specific circuits in service for specific time periods. These plans offer larger discounts for longer term commitments. Verizon also offers "term-and-volume" plans that Verizon developed in response to customer demand for greater administrative flexibility. The term-and-volume plans offer discounts in exchange for commitments to keep specified circuit levels in service for certain terms. With these plans, customers have circuit portability and can add or disconnect circuits within the discount plan while still satisfying the overall volume commitment.

With both term-only and term-and-volume plans, there is a bargain, and both sides give something to receive something. Verizon gives its customers a lower price in exchange for some certainty about its expected revenues and network utilization. Customers, on the other hand, cede some flexibility by committing to certain terms and volume levels in exchange for a lower price for special access service. And both Verizon and its customers benefit from the economic efficiencies associated with fewer individual transactions to buy or sell a specific volume.

a. Verizon's term-only plans offer customers significant discounts.

Verizon's customers can choose from term-only or term-and-volume plans. Its term-only plans – like the Term Pricing Plan[2] and the Service Discount Plan[3] – offer customers substantially discounted pricing for keeping in service a circuit that is enrolled in the plan for a specified amount of time. Customers can choose to enroll as many circuits as they would like in a term-only plan, from just one circuit to all of the circuits they purchase from Verizon. Customers can generally select the term length that best meets their needs, and because they can enroll each circuit separately in a plan, they can choose different terms for each circuit they enroll.

Term-only plans offer customers greater discounts when they choose to make longer term commitments. For example, the Term Pricing Plan offers 2, 3, 5, and 7-year term commitments for DS1 special access service.[4] The discounts range from 8 to 52 percent off of Verizon's tariffed "rack rate," depending on the length of the term and the rate element.[5] And Verizon's term-only plans allow a customer to disconnect a circuit at one location without penalty as long as the customer replaces it with a

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[2] FCC No. 1, Sections 7.4.13 and 7.4.17.

[3] FCC No. 11, Section 7.4.10.

[4] FCC No. 1, Section 7.4.17(B)(1).

[5] *See, e.g.*, FCC No. 1 Sections 7.5.9(B)(1) and 7.5.16(D).

circuit obtained at another location.[6] This option offers a level of portability for term-only customers, although they may choose to purchase term-and-volume plans if they decide they need more portability.

For Verizon, term-only plans provide some certainty that the revenue from the leased circuit over the course of the committed term will cover Verizon's provisioning costs, including labor and material costs. For many of Verizon's customers, the tariffed nonrecurring charge for special access service is negligible, so the term-based discount plans increase the likelihood that the circuit will be in service long enough for Verizon to cover its up-front provisioning costs.

b. Verizon developed term-and-volume discount plans to make circuit management easier for customers.

Over time, as Verizon's customers sought additional flexibility, Verizon developed term-and-volume discount plans to make circuit management easier for customers. Unlike term-only plans, term-and-volume plans allow customers to move some circuits to other providers or move purchases to different locations while still honoring contractual commitments.

One of Verizon's more popular discount plans is the Commitment Discount Plan (CDP), a regional plan that offers customers a choice between terms ranging from two to seven years for DS1 and DS3 special access.[7] Discounts under the CDP range from 5 to 52 percent.[8] The CDP is available in the former NYNEX and Bell Atlantic regions, and customers can choose to enroll in CDPs in both regions or in just one. Verizon's customers that subscribe to a CDP must include in the CDP all of the DS1 and DS3 channel terminations that they choose to purchase from Verizon in the region in which they enroll. No Verizon plan, however, requires the customer to commit a certain percentage or all of its total high-capacity purchases from all sources. Customers receive a discount based on the length of the term commitment they choose to make, and the longer the term commitment, the larger the discount the customer receives.

A customer may lower its volume commitments under Verizon's most popular plans including the CDP when the term of the plan ends. For example, during the term of the CDP plan, customers commit to maintain a volume of at least 90 percent of the initial enrollment. That is, if a customer has 1,000 circuits in the CDP when it enrolls, over the course of the plan, that customer commits to maintain a minimum volume of 900 circuits. But when the plan expires, if the customer chooses to enroll in a new plan at a lower volume, it can do so. The plans do not "lock in" amounts previously purchased. For instance, suppose a customer has 900 circuits enrolled in the CDP when its term expires. This customer has several options if it wants to continue to receive discounted pricing from Verizon, including:

<u>Option 1</u>: The customer could choose to enroll all 900 circuits in a new CDP, which would have a minimum volume commitment of 810 circuits (90 percent of 900).

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[6] *See*, *e.g.*, FCC No. 1, Sections 7.4.13(C) and 7.4.17(E)(4).

[7] FCC Nos. 1 and 11, Section 25.1.

[8] FCC No. 1, Sections 7.4(13)(B), 7.5.9, 7.5.16, 25.3.5(B); FCC No. 11, Sections 7.4.10(B), 25.2.5(B).

Option 2: The customer could choose to switch into a term-only plan some or all of the circuits that it wants to keep with Verizon. This is what [**BEGIN HIGHLY CONFIDENTIAL]** [**END HIGHLY CONFIDENTIAL]** did when its CDP expired in 2012.

Option 3: The customer could choose to enroll a smaller volume in a new CDP plan. **[BEGIN HIGHLY CONFIDENTIAL]** **[END HIGHLY CONFIDENTIAL]** did this when its CDP expired in 2013. Customers have a two-month grace period when a CDP plan expires, during which Verizon will continue to apply the customer's CDP discounts.[9] If the customer needs more time to terminate or migrate some of its circuits in order to reach a lower volume level with Verizon, there are ways to do that. For example, after a CDP expires, the customer may subscribe the circuits it intends to migrate to other providers under a term-only or month-to-month basis until the customer is ready to migrate those circuits away from Verizon. The customer could then subscribe the remaining circuits under a new CDP term.

Verizon developed its term-and-volume plans as a response to customers seeking additional flexibility to move circuits to and from Verizon. Unlike term-only plans, term-and-volume plans like the CDP do not require that any particular circuit remains in service during the term the customer selects. Customers can disconnect and move circuits region-wide within Verizon's term-and-volume plans.

In addition, Verizon customers that subscribe to term-and-volume plans can switch from DS1 and DS3 service to higher-capacity services including Ethernet regardless of the number of circuits the customer wants to transition.[10] Demand for business Ethernet and wireless backhaul has exploded, and Verizon's plans provide customers the flexibility to upgrade to services fueled by new technologies. In 2014, demand for high-capacity services drove U.S. Ethernet port installations to increase by 23 percent, and Level 3 finished the year as the second largest Ethernet provided in the U.S., surpassing Verizon.[11] And in 2012, when Verizon bid to supply Sprint with wireless backhaul services within Verizon's region to support Sprint's aggressive network expansion, Verizon won *fewer than six percent* of the sites within its region, and Sprint announced that it had selected 25 to 30 other significant providers – including cable operators and fixed wireless providers – to provide wireless backhaul. Sprint was able to upgrade from TDM-based special access to Ethernet service, and it was able to select other providers to provision the service. By utilizing Ethernet services for backhaul Sprint has been able to lower its infrastructure costs.[12] And there is no evidence in the record that suggests other providers could not follow a similar approach.

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[9] *See, e.g.*, FCC Tariff No. 1, Section 25.1.8(C)(2).

[10] *See* Verizon Telephone Companies, Tariff FCC No. 1, Section 2.9.6; Verizon Telephone Companies, Tariff FCC No. 11, Section 2.10.5; Verizon Telephone Companies, Tariff FCC No.14, Section 2.10.5; Verizon Telephone Companies, Tariff FCC No. 16, Section 2.9.4.

[11] *See* 2014 U.S. Carrier Ethernet LEADERBOARD, http://www.verticalsystems.com/vsglb/2014-u-s-carrier-ethernet-leaderboard/ (Feb. 19, 2015).

[12] *See* Sprint Corp., Form 10-Q, at 22 (SEC filed Feb. 2, 2015), http://www.sec.gov/Archives/edgar/data/101830/000010183015000005/sprintcorp12-31x1410q.htm (quarterly report for the period ending Dec. 31, 2014).

In exchange for the benefits customers receive under Verizon's discount plans, the customers agree to maintain volume levels. If customers do not maintain those levels, they are subject to shortfall charges. Shortfall charges typically result in the customer paying only what it would have paid had it not been for the shortfall. And, even when customers pay shortfall charges, they generally retain a significant amount of the discounts they had already received.[13] Verizon bases shortfall charges on the shortfall amount, not on the discount plan's base. That is, if a customer falls one circuit short of its commitment level, Verizon will compute the shortfall charge on that one circuit, not on a larger base.

2. Verizon's voluntary discount plans are efficient and procompetitive.

Contracts that include term and volume commitments are common in many industries. When buyers and sellers commit to an ongoing relationship without engaging in a series of transactions that each involves risk and transaction costs, they create efficiencies and value. As is the case with real estate leases, high-volume retailers that require memberships, and many other arrangements, Verizon's discounted offerings for customers that commit to buy DS1 and DS3 service for certain terms or certain volumes reflect an economic efficiency in which a seller offers a lower price in exchange for the certainty of a guaranteed revenue stream or sales volume over a given timeframe.[14]

Of course along the way one party to a long-term commercial agreement may have incentives to reinterpret, renegotiate, or otherwise not honor the terms of the deal it struck. For example, a party to a one-year apartment lease for a two-bedroom apartment may decide during that year that it wants to downgrade to a smaller, less expensive apartment. Without contractual terms to prevent that party from reneging on the lease, it might have economic incentives to do so. If faced with that risk, the apartment owner might demand higher rental prices in the first place. Enforceable long-term contracts are a well-established way to mitigate these risks, allowing both parties to a transaction to commit to a more efficient arrangement.[15]

In the same way, Verizon's voluntary discount plans allow Verizon and its customers to commit to doing business over a multi-year period. Verizon benefits by avoiding transaction costs and risks. For its term-only plans, Verizon avoids the risk that its circuits might not generate revenue in subsequent years.[16] For its term-and-volume plans, Verizon not only minimizes risks associated with revenue but also realizes scale economies and spreads fixed costs over a larger customer base.[17] And customers benefit both from the discounted pricing that Verizon is able to offer and from the decreased volatility and increased predictability. Customers know that they will have circuits available at a certain price for

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[13] *See* Reply Comments of Verizon and Verizon Wireless, at Exhibit B: Declaration of Quintin Lew and Anthony Recine, ¶¶ 29-32, 40 (Feb. 24, 2010; re-filed Mar. 19, 2010); *see also* Letter from Donna Epps, Verizon, to Marlene H. Dortch, FCC, at 8 (Aug. 16, 2010).

[14] *See* Reply Comments of Verizon, at Attachment A: Declaration of Kevin W. Caves and Jeffrey A. Eisenach, ¶¶ 31-32 (March 12, 2013) ("*Caves and Eisenach Declaration*").

[15] *Id.*, ¶ 33.

[16] *Id.* ¶ 34.

[17] *Id.* ¶ 37.

the extended time that they chose without having to renegotiate terms, renew contracts, or change providers more frequently.[18]

3. The Commission should wait until it completes its market analysis before drawing conclusions about LECs' voluntary discount plans.

The Commission should reject requests to prejudge the special access proceeding by acting to limit the terms and conditions in LEC voluntary discount plans before it completes its market analysis. Many providers in the high-capacity services marketplace – including many of the providers that now encourage the Commission to act prematurely on terms and conditions – offer voluntary discount plans. No one suggests that the Commission should investigate those plans – which like Verizon's plans are motivated by efficiencies – because only if a firm has market power would it make sense to consider whether that firm's discount plans are anticompetitive.[19] And the Commission cannot make a judgment about market power unless and until it collects and analyzes all the relevant data. The Commission itself has noted the need to "identify areas where market power exists" before it "determine[s] whether a particular term or condition is unreasonable in a given area."[20]

When it does collect and review all the relevant data, the Commission will find that no firm in the high-capacity services marketplace has market power. Cable companies, CLECs, and many other providers provide business customers with Ethernet and similar services that they tout as competitive alternatives to special access.[21] We expect the data the Commission receives in response to the *Data Collection Reconsideration Order*[22] will confirm this marketplace reality. At a minimum, though, until the Commission collects all the data and properly analyzes it, the Commission should not take action or draw conclusions regarding special access terms and conditions.

The Commission itself has confirmed that the record as it exists does not support regulatory intervention. When it ordered the data collection, the Commission said "there is insufficient evidence in the record upon which to base general or categorical conclusions as to the competitiveness of the special access market."[23] That's why the Commission has committed to conduct a "one-time, multi-faceted market analysis" that includes an analysis of the responses to the data collection.[24]

The Commission should focus its efforts on the market analysis – and allow the parties to focus their efforts on it as well – without the burden and distraction of premature activity regarding discount plans.

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[18] *Id.* ¶¶ 35-37.

[19] *See Caves and Eisenach Declaration*, ¶¶ 46-48.

[20] *Special Access for Price Cap Local Exchange Carriers*; *et al.*, Report and Order and Further Notice of Proposed Rulemaking, 27 FCC Rcd 16318, ¶ 93 (2012) ("*Data Collection Order*").

[21] *See, e.g.*, Letter from Maggie McCready, Verizon, to Marlene H. Dortch, FCC (Feb. 5, 2015).

[22] *Special Access for Price Cap Local Exchange Carriers*; *et al.*, Order on Reconsideration, 29 FCC Rcd 10899 (2014) ("*Data Collection Reconsideration Order*").

[23] *Data Collection Order*, ¶ 69.

[24] *See, e.g.*, *Data Collection Reconsideration Order*, ¶ 4.

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The Commission only now is beginning to gather the evidence it needs to analyze the special access marketplace. Meanwhile no one can seriously challenge that demand for high-capacity services has been rising rapidly and that new forms of competitors – like cable providers – have emerged to satisfy that demand. The Commission should continue its current course of collecting marketplace data and analyzing it, and it should not take action on terms and conditions unless and until it can prove that the data show that regulation and not market forces are needed to protect customers.

Sincerely,

Maggie McCready