BOTTLENECK CONTROL ALLOWS THE BOC TO DOMINATE ADJACENT MARKETS

Control of the wholesale switched and special access bottleneck allows the BOCs to dominate all interstate and intrastate, interLATA and intraLATA long distance services.

29 When the Commission last addressed the question of whether BOCs should be considered "dominant carriers" with respect to their provision of in-region long distance services,[40] *none of the BOCs had as of that time obtained in-region long distance authority pursuant to Section 271 of the Telecommunications Act of 1996.* Thus, when the Commission determined that the BOCs were to be considered "non-dominant" with respect to in-region long distance services, their individual and collective share of the in-region long distance market was 0.0% And, as I will discuss later, although the Commission obviously expected that BOC shares would increase (above zero) once in-region authority had been attained and in-region entry had occurred, it expressed the expectation that the various operational, accounting, personnel, and transactional safeguards set forth at Section 272(b), together with the imputation and nondiscrimination requirements at Section 272(e), would be sufficient to protect consumers and competitors from the undue exercise of BOC market power Events have, of course, shown those expectations to have been unduly optimistic

40 *In the Matter of Regulatory Treatment of LEC Provision of Interexchange Services Originating in the LEC's Local Exchange Area and Policy and Rules Concerning the Interstate, Interexchange Marketplace*, CC Docket No 96-149, 96-61, *Opinion*, Rel. April 18, 1997 ("*LEC Classification Order*"), 12 FCC Rcd 15756, 15,810-11, 15,815; 15,821-22, 15,825-27, 15,829, paras 96, 103, 111, 119, 126.

30 The Commission has now acknowledged that many conditions have changed since its 1997 *LEC Classification Order*

> There have been significant changes in the competitive landscape since the Commission adopted the *LEC Classification Order*, including: (1) BOC authority to offer in-region, interLATA telecommunications services in 41 states (plus the District of Columbia), (2) an increase in bundled telecommunications services offerings, (3) increased offerings of wide-area pricing plans by mobile telephony carriers, (4) limited, but increasing, substitution of mobile wireless service for traditional wireline service, particularly for interstate calls, and (5) increased use of Internet-based applications (e g., instant messaging, email) [41]

These developments require that the considerations of BOC interLATA market power be considered in light of the manner in which the various services are being marketed to the public and the interactions between the various retail services and essential bottleneck wholesale services, principally switched and special access, for which the BOCs continue to maintain overwhelming market dominance

31 With limited exceptions, the vast majority of "in-region" long distance services are linked to the retail customer's local basic exchange access line,[42] almost all of which continue to

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41 *FNPRM*, at para 8, footnotes omitted

42 The "exceptions" here are associated primarily with so-called "calling card" services that permit the customer to place long distance calls from public telephones and other local telephone service access lines without the call either being routed to the "presubscribed interexchanged carrier" ("PIC") associated with that line or billed to the customer of record for that access line for payment

be provided by incumbent local exchange carriers, principally BOCs[43] Mass market residential and small/medium size business customers typically gain access to long distance services via "common lines" that are, as the term implies, utilized jointly for both local and long distance calling This recognition of the interaction between "in-region" long distance calling and the customer's local exchange access line was clearly recognized by Congress in enacting the 1996 law BOCs were allowed *immediately* to enter the *out-of-region* long distance market as of the date of enactment,[44] but were required to satisfy the various provisions of Section 271 prior to being authorized to offer *in-region* long distance services.

32 BOC conduct commencing with the date of enactment of the 1996 law with respect to long distance entry serves to confirm and to underscore the extraordinary and unique business value of the *linkage* between the subscriber access line provisioned by the BOC and *the subscriber's* choice of long distance service provider Although expressly *permitted* on and after February 8, 1996 to offer long distance services outside of their respective in-region footprints,

43 According to the just-released *FCC Local Competition Report* for the year ending December 2002, nationally some 96 6% of all switched access lines were either being served directly by their ILEC or by a CLEC utilizing ILEC-provided facilities (resale or UNE). CLECs also utilize ILEC-provided special access to serve many of the CLECs' business customers, so the 96.6% ILEC facilities share identified in the *FCC Report* understates the actual percentage of access lines that are served via ILEC-owned facilities For "mass market" residential and small business subscribers where few if any CLEC-owned facilities are deployed, the ILEC facilities share is undoubtedly a good deal higher *Local Telephone Competition Status as of December 31, 2002*, FCC, Industry Analysis and Technology Division, Wireline Competition Bureau, June 2003, at Tables 1, 3

44 47 U S C §271(b)(2)

none of the BOCs elected to do so other than with respect to entirely *incidental* (primarily calling card and collect calling) services entirely unrelated to the subscriber access lines in such out-of-region areas Out of region, a BOC long distance venture gains no particular competitive advantage from the BOC affiliation, and is thus not unlike any other non-BOC-affiliated IXC in terms of its ability to attract and retain customers Had any of the BOCs chosen to actively pursue out-of-region long distance services, they would have been competing with the preexisting *non-BOC* interexchange carriers (e.g , AT&T, MCI, Sprint) *on essentially an equal basis* Without their position as the "incumbent local exchange carrier," a BOC offering out-of-region long distance services would have had to engage in the same types of costly media advertising, direct mail, telemarketing, and promotions (such as sign-up payments or airline mileage offers) as did the non-BOC IXCs *Without exception, none of the BOCs chose to focus on out of region long distance entry* Indeed, even now, when BOCs have obtained Section 271 in-region authorization in some 42 states,[45] they still do not actively market services to local service subscribers outside of their own in-region footprints.[46] Hence, from the perspective of the BOCs and as amply demonstrated by their conduct, BOCs *only compete in-region*, where their local dominance and incumbency afford them competitive advantages and opportunities that no other IXC *or out-of-region BOC* can possibly hope to replicate

45. Having granted Section 271 authority in Minnesota on June 26, 2003, the Commission has now approved long distance reentry in 41 states, plus the District of Columbia

46. In fact, SBC will not even *accept* an order for long distance service from a customer that is served by a non-SBC LEC (which includes both independent telcos *and* CLECs) *even within one of the thirteen states comprising the SBC "region " See* fn 74, *infra.*

33 The real proof of the incumbency advantage is in the results. In the *FNRPM* herein, the FCC cited long distance market shares for the BOCs at between 0.2 and 9 3 percent.[47] However, such figures are misleading Inasmuch as the BOCs do not actively compete out-of-region for long distance customers, the only *relevant* shares for purposes of the matters before the Commission in this proceeding are the BOC *in-region* long distance shares Actual BOC market penetration results as reported by BOCs in states where in-region interLATA entry has been authorized demonstrate the dramatic and unprecedented success that the BOCs have achieved, often within mere months following their initial entry.

34 After approximately twelve months following its receipt of Section 271 authority in New York, Verizon Long Distance reported a New York residential share of 20%.[48] Nine months after receiving 271 authority in Massachusetts, Verizon reported a long distance share of more than 20%, and indicated that sales results for Pennsylvania, where Verizon began marketing long distance services in late October 2001, were in line with early success rates in other Verizon states [49] In Texas, where SBC received interLATA authority in June of 2000,

47 *FNRPM*, at fn 61

48 See Verizon Press Release, "Verizon Communications Post Strong Results for Fourth Quarter and 2000," February 1, 2001

49 See Verizon Press Release, "Verizon Communications Post Strong Results for Fourth Quarter, Provides Outlook for 2002," January 31, 2002

SBC reported that after less than nine months its long distance affiliate, SBCS, had acquired 2.1-million of SWBT's 10-million local customers, representing a 21% share in the state.[50]

35 In a recent analyst conference call, SBC released the growth rates for its long distance services in states where it has received long distance authority (see Figure 1 below)

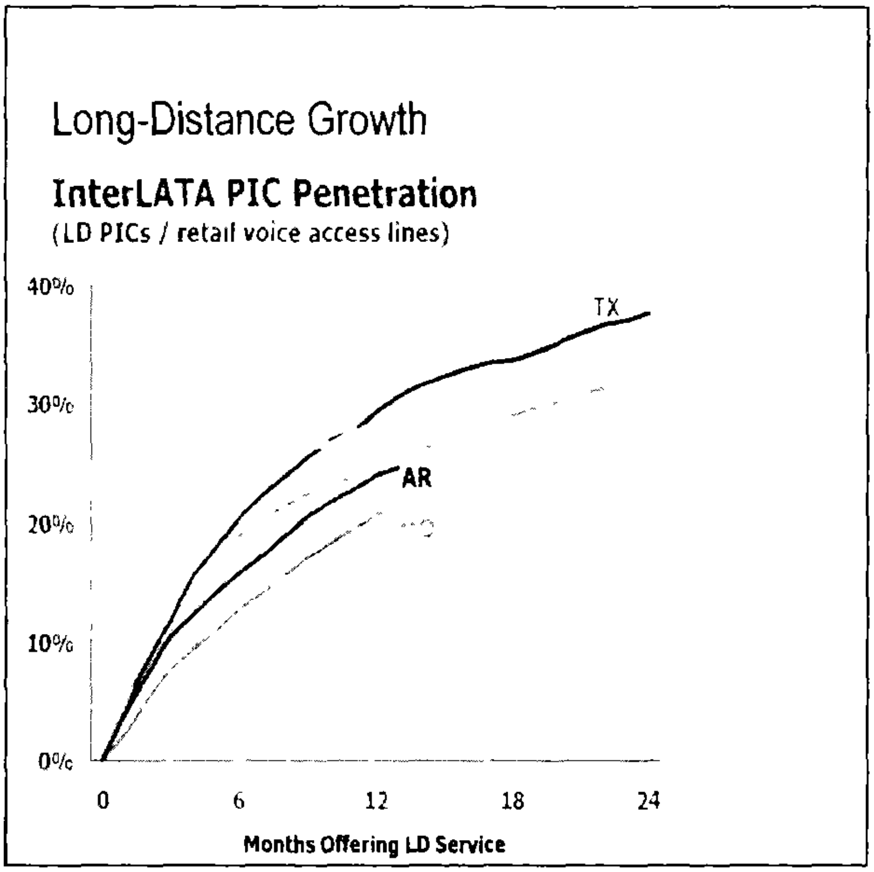

Figure 1. SBC Long Distance Growth

50 *SBC Investor Briefing*, April 23, 2001, at 7

The following quarter, SBC announced that it has achieved "near 50 percent" penetration for the consumer long distance market in its Southwestern territories[51] SBC has reported acquiring a 60% share of the Connecticut long distance services after approximately five years since SNET began actively marketing interLATA services, and has advised investors that a similar share can be expected for each of SBC's other Section 271 jurisdictions.[52] Some BOCs, including Verizon, have stopped releasing long distance share figures on a state-by-state basis, making further state-level analyses no longer possible I urge the Commission to obtain the current state-by-state in-region long distance shares for each of the BOCs, even if this information cannot be publicly disclosed

36 There can be no denying that there is an enormous distinction between "in-region" and "out-of-region" BOC dominance In assessing the extent of BOC dominance, it is essential that for any given BOC, the geographic limits for purposes of market power analysis be no greater than that BOC's service area within a given state jurisdiction. And to further emphasize the importance of this "local service area" geographic definition, it is instructive to examine that same BOC's share of the long distance market both out-of-region *and* out-of-footprint within those states for which the BOC has attained Section 271 in-region authority

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51 Statement of Edward Whitacre, CEO, SBC Communications, Transcript, April 24, 2003 SBC Conference Call Addressing First Quarter 2003 Earnings

52 SBC Investor Briefing analyst conference call, January 28, 2003

37 The stark contrast between each of the BOCs' extraordinary success in rapidly acquiring share (following its receipt of Section 271 authority) within its local service footprint vis-a-vis its utter absence from the market in areas served by other ILECs *within those very same states* confirms the critical importance to the BOCs of their ability to exploit legacy monopoly relationships with their existing base of local service subscribers as *the primary means* for rapidly acquiring customers for their long distance services. It also underscores the equally important point that where the BOCs do not possess this unique market advantage — i.e , where they would have to compete for long distance business on the same basis as their non-affiliated IXC rivals — *they don't even bother to try*

BOC dominance and pricing strategies do not differentiate between interstate and intra-state jurisdictions, and for this reason the Commission cannot rationally limit its analysis to interstate services.

38 While interstate services may represent the limit of the Commission's traditional regulatory authority, from the customer's perspective any delineations or distinctions as between interstate and intrastate calling that may have existed in the past have become blurred almost to the point of sheer extinction For starters, customers do not make separate choices as to interstate vs intrastate long distance carriers Only one interLATA "PIC" is available A "common line" customer (residential or business) in Los Angeles who selects SBC as her presubscribed long distance carrier with respect to interstate calling will concurrently be choosing SBC for intrastate interLATA calls, such as from Los Angeles to San Francisco or San Diego, as well. Customers cannot and do not make separate service provider selections

notwithstanding the fact that the two services are subject to different regulatory treatment by different regulatory authorities and may be offered at different prices. Indeed, even the transactional distinction between intrastate and interstate interLATA calling (resulting from the treatment of each individual call as a distinct "purchase" of service) is in the process of being supplanted by service "bundles" that provide either flat-rate or "block-of-time" pricing for *combined* interstate and intrastate usage

39 A case in point can be found in that portion of the recently-introduced service bundle that is being offered by Verizon's Section 272 affiliate, Verizon Long Distance ("VLD") VLD is offering residential subscribers an unlimited intrastate/interstate interLATA-plus-Canada calling plan known as "Veriations Freedom℠" for a flat rate of $15 per month.[53] And unlike traditional by-the-call pricing, selection of the service bundle is accomplished in a single purchase transaction that remains in effect from month to month unless affirmatively discontinued by the customer Not only does "jurisdiction" (state vs interstate vs. international) have no bearing upon the manner in which the purchase transaction is effected, it also has no bearing upon the price that the customer is charged for the particular (jurisdictional) mix of calling that may be involved

53 Bell Atlantic Communications d/b/a Verizon Long Distance, RTC No. 1– Interstate, Section 3.6 10,fourth revised page 48 6, first revised page 58.7, first revised page 58.8, first revised page 58.0, original page 58.9.1, original page 58.9.2, all effective April 27, 2003; original page 58 10, effective January 27, 2003, second revised page 58 11, effective June 20, 2003

40 Although "common line" customers are permitted, as a mechanical matter, to make separate selections of intraLATA and interLATA PICs, the introduction of long distance service bundles and block-of-time pricing plans by BOCs works to blur even this distinction as well. For example, in order for a customer to qualify to purchase the Verizon Long Distance $15-per-month interLATA "Veriations Freedom[SM]" service bundle, the customer is *required* to also purchase a "qualifying" package of "local" services that must include unlimited *intraLATA* calling [54] Depending upon the state and package, these "qualifying" Verizon BOC packages are priced at between $34 95 and $54 95 per month [55] Indeed, although a Verizon BOC customer is permitted to purchase the BOC local/intraLATA bundle *without also having to purchase the VLD $15-per-month interLATA bundle*, the packages are not separately marketed, and the customer would have to expressly specify the BOC local/intraLATA bundle during a phone contact with a Verizon (BOC) customer service representative in order to purchase it [56]

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54. *Id* Second revised page 58 11, effective June 20, 2003 states, "When service is used for both interstate and intrastate calling, the MRC specified below applies only once, unless otherwise stated in the corresponding tariff"

55 *See, e.g* Verizon South, Inc. Virginia General Customer Services Tariff, section 16, original pages 17-18, effective February 3, 2003, Verizon New York, Inc. PSC NY No 1, Section 2, original page 220, effective July 26, 2002, first revised page 221, effective February 1, 2003, original page 57, effective July 26, 2002

56 The specific Verizon BOC "qualifying" local/intraLATA service bundles are not separately identified or disclosed on Verizon's website or in promotional direct mail materials being sent to Verizon subscribers (see Attachment 2). The billing insert included with June 2003 Verizon Massachusetts residential bills details certain rate increases for various *other* ("non-qualifying") service bundles, but makes no mention of the "Local Package Basic" or "Local Package Plus" bundles whose purchase is required for a customer to qualify for the VLD $15

(continued ..)

41 SBC, BellSouth and Qwest do not even bother to make the facial distinction between their BOC and long distance affiliates with respect to their unlimited long distance calling bundles. Whereas Verizon has created a bifurcated offering, with the intraLATA service being provided by the BOC and the interLATA by the Section 272 affiliate, the other RBOCs' counterpart service bundles are in each case provided solely by the Section 272 long distance affiliate, and embrace both the intraLATA *and* the interLATA components. Customers selecting one of these bundles are required to select the Section 272 affiliate as both the interLATA PIC *and* the intraLATA PIC ("LPIC") in order to obtain the full benefit of the service bundle price

42 In addition to the "common line," as an integrated local and long distance provider, the BOC also provides a common bill, without separate line items for local and long distance service, making it difficult for a customer to determine whether the price increase on her bill is a result of a local or long distance rate hike The BOCs' market power in the local market assures that it could increase *local* rates without suffering a decrease in demand, and if the customer cannot determine if an increase is a *local* rate increase or a *long distance* increase, it follows that the

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56 (continued)
unlimited interLATA/Canada offering What is particularly noteworthy is that several of these other "non-qualifying" pricing plans whose rates are being increased actually provide *fewer features* that the "qualifying" packages (whose prices are not being increased), yet carry higher monthly rates For example, Verizon's "Local Package Basic" (whose availability separate from the VLD $15 bundle is not generally disclosed) is priced at $39 95 and includes unlimited local and LATA-wide toll calling plus several vertical features (including call waiting and caller ID) The "Local & Toll Packages" (priced at $47 93 for western Massachusetts and $54 93 for eastern Massachusetts) include unlimited local and LATA-wide toll calling but *no vertical features*. The "Local Package - Metropolitan" includes some features but does not include LATA-wide calling, and is priced at $42 93 (see Attachment 2)

BOC's market power in the local market would enable the company to raise prices in *either the local or the long distance markets* if the services are jointly and indistinguishably billed.

The BOCs' can impose a price squeeze upon competing IXCs.

43 Prior to the BOCs' entry into in-region long distance, the purchase of local exchange service and the purchase of long distance service involved entirely separate and separable transactions, one's choice of service provider and pricing plan with respect to either one of these services had no bearing upon the choice or price of the other That has now changed. Customers are being confronted with strong economic incentives to combine their acquisition of local and long distance telephone service into a single purchase transaction BOCs and their long distance affiliates are marketing aggressively priced long distance plans — including plans providing *unlimited* nationwide long distance calling – but only to customers who *also* purchase relatively high-priced bundles of basic local exchange service and vertical calling features, such as call waiting, three-way calling, caller ID, and voice mail Although similar local/long distance packages are also being offered by IXCs in those areas where the IXC also offers local service, the BOCs' persistent and overwhelming dominance of the residential/small business "mass market" affords them the unique ability to leverage their market power with respect to local services to rapidly come to dominate the long distance market as well

44 Any assessment of the extent of BOC market dominance that is confined solely to the interstate jurisdiction would be woefully insufficient as a basis for policymaking In its *ISP*

Remand Order,[57] the Commission has determined that the rate cap applicable for the termination by an ILEC of a local call handed-off to it by a CLEC is $0 0007 (i e , seven one-hundredths of a cent) per minute, a rate that is presumably based upon the Total Element Long-Run Incremental Cost ("TELRIC") of that function [58] Under the Commission's *CALLS* order,[59] the average target price for interstate terminating switched access is $0.0055 per minute, or roughly 700% above the TELRIC-based intercarrier reciprocal compensation rate *for what amounts to the identical service and functionality*. In the case of an interstate toll call carried by an IXC but originated from and terminated to BOC "common line" subscribers, the average *CALLS*-based access charge would be roughly $0 011 for both ends of the call While still many multiples of the applicable TELRIC for that access service, the interstate access charge level is substantially less than that for corresponding *intrastate* switched access service which, in some cases, may be as much as ten times as high as in the interstate jurisdiction [60]

57. *Implementation of the Local Competition Provisions in the Telecommunications Act of 1996*, CC Docket No 96-98, Intercarrier Compensation for ISP-Bound Traffic, CC Docket No 99-68, *Order on Remand and Report and Order*, Rel. April 27, 2001, at para. 85 The Commission explains that the $0 0007 rate was taken from an interconnection agreement between Level 3 and SBC That agreement, which was effective March 2000 through May 2003, was presumably made in compliance with 47 U.S.C §252(d), which the Commission has interpreted to require that rates for UNEs be based upon TELRIC.

58. *Id* , at para 8

59. *Access Charge Reform*, CC Docket No 96-262, *Sixth Report and Order*, eff. July 1, 2000, 15 FCC Rcd 12962

60 Compared to a calculated Washington state intrastate access charge of $0.0989. *See*, *AT&T Communications of the Pacific Northwest v. Verizon Northwest, Inc.* Docket No. UT-020406, Before the Washington Utilities and Transportation Commission, Direct Testimony of
(continued.)

45 Consider Verizon Long Distance's unlimited interLATA tariffed service option[61] VLD filed interstate and intrastate (where required) tariffs for this offering. However, the tariff filings fail to break down the charges for the separate interstate and intrastate jurisdictions Both of these tariffs note that "[w]hen service is used for both interstate and intrastate calling, the MRC [monthly recurring charge] specified below applies only once"[62] Thus, from these tariff filings, it is impossible to determine whether the $15 unlimited plan satisfies imputation requirements.

46 Based upon the $0 011 *interstate* switched access payments that a non-BOC IXC would be required to make for each minute of interstate calling initiated by one of its customers and ignoring (for the moment) any *non-access* costs that the IXC might incur, that $15 would "buy" some 1363 minutes of (originating and terminating) interstate switched access. However, what if the only usage that the customer makes of that service is for *intrastate* calling in a state where *intrastate access charges* (originating plus terminating) average $0.10 per minute? In that case (and, again, ignoring for the moment any non-access costs that the IXC would necessarily incur),

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60 (.continued)
Lee L Selwyn on Behalf of AT&T Communications of the Pacific Northwest, Inc., September 30, 2002, at Appendix 3

61 Despite the sunset of the Section 272 separate affiliate requirement in New York, Verizon appears to continue to provide service in that state through the Verizon Long Distance entity The Verizon Freedom plan for New York notes, "[y]ou must select and retain Verizon as your local provider, and Verizon Long Distance for long distance service." *See,* http //www22 verizon.com/Foryourhome/SAS/FreedomLongDesc asp?ID=FLD&State=NY (accessed June 27, 2003)

62 See Attachment 2

the $15 retail price would "buy" only 150 minutes worth of switched access service. An analysis as to whether Verizon's $15 price creates a price squeeze cannot be limited solely to the *interstate* jurisdiction *precisely because Verizon does not offer a "stand-alone" interstate or jurisdictionally allocated version of this unlimited long distance calling bundle*.

47 In order to determine whether or not Verizon's price for unlimited long distance calling satisfies the applicable imputation and price floor requirements, it is necessary to know something about the level of usage that Verizon anticipates customers subscribing to the unlimited calling plan will make of the service. Verizon's tariff filings contain no publicly available information on this critically important point, however, it is possible to estimate Verizon's costs for this package. Usage level information is provided on Verizon's corporate website in connection with its marketing of the Veriations Freedom℠ package and in direct mail and other marketing literature promoting the service. Attachment 3 to this Declaration contains sample Verizon web pages describing the Veriations Freedom℠ service. In each of these state-specific web pages, Verizon advises its prospective Veriations Freedom℠ customers that they will realize "more than $240 a year in savings" (or slightly different words to that same effect) by signing up for the Veriations Freedom℠ package. Verizon has also sent direct mail solicitations to its customers containing the very same $240 in annual savings claim (see Attachment 2). Each of the individual state web pages, as well as the direct mail piece, contain the very same "fine print" text and, more importantly, the very same *usage levels*, as the basis for the $240 annual savings estimate.

> Savings based on purchasing Veriations Freedom Package versus purchasing equivalent Verizon local and long distance services and features at individual, standard rates *Long distance savings comparison based on 350 minutes of monthly usage on Timeless Plan, regional toll savings based on approximately 300 minutes of monthly usage on Sensible Minute™ plan* Savings vary by individual and by state

Emphasis supplied Note that, while Verizon does state (in the "fine print") that "[s]avings vary by individual and by state," its large print representation, at the top of each of the web pages and direct mail piece, is that customers will realize savings of "*more than* $240 a year" On this basis, it is reasonable to assume that the 300 minutes of intraLATA ("regional toll") calling and the 350 minutes of "Timeless Plan" interLATA calling represent *minimum* usage levels that Verizon anticipates for this service

48 Using the $15 price for the unlimited interLATA calling bundle and the minimum usage level given of 350 minutes of interLATA calling as specified by Verizon, the average price per minute works out to roughly $0 043 for interstate and intrastate calling combined. While this $0 043 is above the $0.011 *interstate* switched access rate level, it is below the *intrastate* switched access rates in effect in a number of BOC jurisdictions — and even further below the average intrastate switched access charge applicable to non-BOC IXCs when the often-higher non-Bell ILEC and CLEC access charge levels are included in the analysis [63] Like the parable

63 To the extent that BOCs limit the marketing of their long distance services to BOC local customers, the BOCs would be subject only to imputed access charges at the originating end of each call, and would have to pay terminating access to the local service provider terminating the long distance call However, as more BOCs receive region-wide interLATA authority, the BOC (continued..)

about the three blind men asked to describe an elephant each one of whom gives a picture of only one small part of the animal, a market power analysis that is confined solely to the interstate side of these service bundles would fail to capture the entire picture and, as a result, would reach an erroneous conclusion as to the BOCs' ability to squeeze non-affiliated rivals out of the long distance market

49 The BOCs themselves have admitted that their presence in the long distance market has changed the competitive landscape to one heavily favoring incumbent local carriers. In its June 6, 2003 Answer to the May 8, 2003 *Petition* filed by AT&T with the Virginia State Corporation Commission seeking reductions in Verizon's intrastate access charges,[64] Verizon retorted that

> IXCs, including AT&T, however, ***can and do*** compete with the "free long distance" plans of wireless providers and Verizon Long Distance's calling plans under the current access regime For example, through its "The Neighborhood" package, MCI is competing in today's market. Introduced in Virginia many months prior to Verizon's entry into the long distance market, "The Neighbor-hood Complete" plan offers unlimited local, long distance, and local toll calls, plus call waiting, caller ID, speed dial, personal voice mail, and 3-way calling for only $49.99 per month Similarly, Cavalier has announced its "Unlimited Basic Package," which at a price of $49 95 provides unlimited long distance, unlimited local calling, caller ID, voice mail, 900 toll block, call-waiting or talking call waiting, 3-way calling, speed dial, *69, Anonymous Call Rejection, Call-Forwarding, Remote Call-Forwarding, *66, 900 Toll Block, Call Block, and local

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63 (. continued)
is increasingly likely to be the originating *as well as* the terminating local service provider, and as such would merely impute access charges for both ends of the call.

64 *AT&T Communications of Virginia, LLC, v Verizon Virginia Inc , et al*, Virginia State Corporation Commission Case No PUC-2003-00091, filed May 8, 2003

> number portability. Likewise, Sprint has its own bundled package offering in Virginia, the "Sprint Complete Sense Unlimited" plan offers consumers unlimited local calling, unlimited local toll, unlimited domestic long distance, Call waiting, Caller ID, 3-way calling, Speed Calling, Enhanced Voice Mail, Find Me Call Forwarding, Notify Me, and Sprint FONCARD for $54.99.[65]

In advancing this argument, Verizon conveniently neglects to point out that in order for IXCs to provide such "bundles" of their own, *they must themselves also be CLECs* offering local exchange service within the same jurisdiction and to the same base of subscribers that are being served by the dominant ILEC, Verizon in this instance. *Yet that is precisely the point.* By Verizon's own admission, only IXCs that bundle local and long distance services together into the same service package can compete with its "free" long distance calling plans. *Nowhere in Verizon's Answer does the BOC suggest that an IXC providing long distance service on a stand-alone basis can compete with Verizon's Variations^{SM} packages.* In so responding, Verizon has articulated precisely the inextricable linkage between the local exchange services being provided by dominant BOCs and the long distance services being offered by the affiliates of those dominant BOCs, a linkage that *requires* that the BOC long distance affiliates themselves be classified *and regulated* as dominant carriers.

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65. *Id.*, Verizon's Motion to Dismiss, Answer, and Affirmative Defenses of the Defendants, June 6, 2003, at 5-6.

Prior to the breakup of the former Bell System, BOCs had the ability to extend their local monopoly into the long distance market, and unless constrained by dominant carrier regulation, that same concern has now reemerged as a result of BOC long distance reentry.

50 The instant consideration of regulating monopoly local carriers providing local and long distance services on a combined basis must be made in the context of the history and background that gave rise to the BOCs' reentry into the long distance business, as contemplated in the 1996 federal legislation That history begins with the U.S Department of Justice's ("DOJ") 1974 antitrust case against the pre-divestiture Bell System[66] in which the DOJ alleged, *inter alia*, that the Bell companies were using their local service monopoly to prevent competition in the adjacent long distance market The *Modification of Final Judgment* ("MFJ"), the 1982 Consent Decree under which the former Bell System was broken up and the Bell Operating Companies were divested from AT&T,[67] prohibited the divested BOCs from offering interLATA long distance services This remedy was adopted specifically to prevent the BOC local service monopolies from using their monopoly market power in the local services market to block competition in the adjacent long distance market And because the BOCs were themselves precluded from providing long distance services, they were made to be *indifferent* as to which long distance carrier their customers might individually select. Section 271 of the 1996 Act replaced the MFJ long distance "line of business" restriction with a process by which BOCs

66 *United States v Western Electric Company, Inc , et al*, Civil Action No 74-1698 (D D C)

67. *U S v Western Electric Co et al* , 552 F. Supp. 131 (D. D C., 1982), *aff'd sub nom Maryland vs U S* , 460 U S 1007 (1983), and *Modification of Final Judgment*, sec VIII.B

could enter the "in-region" long distance market, provided that they implemented a series of specific measures that, in principle, would have the effect of irreversibly opening their previously monopolized local telecommunications markets to competitive entry [68] The notion here was that, to the extent that the *local* market itself becomes competitive, the BOCs' ability to exert market power in the adjacent long distance market could be attenuated Conversely, when a BOC is allowed to offer in-region long distance service in a less-than-fully-competitive local market, then the BOC acquires both the ability and the incentive to engage in precisely the same type of anticompetitive conduct that the *MFJ* was intended to prevent.

51 The specific focus, at that time, was on the matter of *access* by competing long distance carriers to originate and terminate calls on the BOCs' *local* networks Prior to the break-up, the Bell System local companies provided their long distance affiliate with a far superior quality of access to their local networks and customers than was being offered to the nonaffiliated "Other Common Carriers" ("OCCs") [69] For example, calls placed by BOC customers were in all cases automatically routed to their long distance affiliate whenever the customer dialed a call on a "1+" basis, OCC customers were forced to dial lengthy "access codes" and manually enter their billing account information Additionally, the interconnection arrangements being provided by the BOCs to their long distance affiliate were far superior in a number of other qualitative respects, for example, BOC local and long distance billing was handled on an entirely integrated

68 *See, e g., Bell Atlantic New York Order*, 15 FCC Rcd 3953, 4164.

69 The term "Other Common Carriers" ("OCCs") was used to refer to interexchange carriers other than AT&T

basis, and the BOC billing system was provided with "answer supervision" by the terminating carrier indicating when the called party answered the call as well as when the called party terminated the conversation by hanging up the phone The BOC-affiliated long distance carrier was thus able to provide accurate long distance billing to its customers, whereas OCCs, whose interconnection arrangements with the BOCs typically did not include "answer supervision," would often bill for calls that were not answered or fail to bill for short calls that were BOC reentry into the in-region *interLATA* long distance market has created precisely the same incentive and capability for the BOCs to pursue the very same kind of discrimination, anticompetitive conduct, and unfair market advantage as had prevailed at the time the MFJ was entered. Unless such conduct is constrained by regulation of the BOCs as dominant long distance carriers, the enormous competitive gains and long distance price decreases achieved over the past two decades would soon be reversed

The BOCs' ability to grow long distance market share at unprecedented rates is a direct result of their unique ability to leverage their local market power through "joint marketing" of local and long distance services.

52 I have previously noted the unprecedented in-region market shares gained by the BOCs in their first few years of interLATA service The BOCs' ability to grow long distance market share is a direct result of their ability to engage in "joint marketing" of long distance service to its *local* customers Presumably, the principle/theory driving the FCC's and Congress' acquiescence in such "joint marketing" is that *if the local market is competitive* and as such if customers are given real choices as to whom they contact for local service (which is the

presumption once the "Competitive Checklist" has been satisfied), the RBOC then no longer enjoys any advantage vis-a-vis CLECs with respect to selling customers long distance service either, because CLECs are also free to sell long distance service to *their* local service customers The principle/theory breaks down, of course, if the local market is not actually competitive, i e , if customers have no choice but to contact the BOC for local service and if the BOC retains the right to preemptively market long distance service to those customers, then other long distance providers will be blocked from addressing these customers. Put another way, the larger the BOC's share of the *local* market, the greater will be its opportunity to preemptively market its affiliate's long distance service And if customers exhibit a disproportionate propensity to select the BOC as their long distance carrier as a result of this "first to get there" opportunity, then over time the BOC's long distance market share would also be expected to grow *directly and specifically as a consequence of its ability to preempt competing long distance carriers in signing up new customers*

53 The economic value of this preemption advantage being enjoyed uniquely by BOC affiliates acquiring interLATA customers is graphically illustrated when one considers the speed and ability of OCCs to gain interLATA market share without similar preemptive advantages. The transition to interLATA equal access began in 1985 and was substantially complete by the end of 1988 The 1985 beginning of the transition to equal access can be thought of as the date at which the elimination of economic barriers to interLATA long distance entry began. That event is then analogous to the BOCs' initial satisfaction of the 14-point checklist which, presumably, eliminated the economic barriers to entry into the local market. But the conse-

quences of these otherwise comparable policy initiatives have been dramatically different. By the end of the fifth year (i.e., by the end of 1990) following the commencement of interLATA equal access, all of the non-AT&T IXCs *combined* had collectively acquired 22.92% of presubscribed lines nationwide,[70] even with the aid of such "jump-start" market development measures as "equal access balloting" and automatic assignment of nonresponding subscribers to a non-AT&T carrier. Of course, what the OCCs did not have then, but which the BOCs do have now, is the massive legacy customer base to exploit. It is thus not surprising that in just two years following its entry into the New York interLATA market, Verizon was able to capture 34.2% of its New York in-franchise local service customers, a level of market share that *no single OCC has ever reached*[71] and that took *all of the OCCs combined* some 10 years (following the 1985 commencement of equal access) to accomplish.[72]

54. In view of the strong parallels between OCC entry in the 1980s and BOC entry today, I believe that the *results* of the earlier policy paradigm offer a useful and reasonable standard against which the current policy initiatives relative to BOC entry can be evaluated. That is, but

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70. Federal Communications Commission, Wireline Competition Bureau, Industry Analysis Division, *Long Distance Market Shares, Fourth Quarter 1998*, March, 1999, ("*Long Distance Market Share Report*"), Table 2.1

71. According to the most recent (2001) FCC IXC market share report, the largest non-AT&T IXC, MCI Worldcom, had a year-end 1999 residential market share of 16%, well below Verizon's two-year New York share of 34.2%. FCC Industry Analysis and Technology Division, *Statistics of the Long Distance Telephone Industry*, January 2001 (Data as of 1999), Table 24.

72. *Long Distance Market Share Report*, at Table 2.2

for the BOCs' ability to exploit their inbound marketing channel and offer pricing plans ignoring the cost of access, there is no *a priori* reason to expect their rate of market share growth to differ materially from that of the OCCs in the initial years following "equal access." Conversely, evidence of substantially greater BOC long distance market share growth serves to confirm the enormous value that Verizon and other BOCs obtain solely by virtue of their status as dominant local exchange carriers

55 The extraordinary marketing advantage uniquely available to BOCs stemming from their market power in the local market and therefore their ability to use the "inbound channel" has not been overlooked by Wall Street As a February 8, 2001 Credit Suisse First Boston ("CSFB") report commented

> We've been watching this industry for almost 20 years and we have never seen consumer share gained at the rate of VZ in NY and SBC in TX (the former 20% share in 12 mos and the latter 18% share in 6 months).[73]

When a BOC obtains Section 271 authority, and certainly after Section 272 is allowed to sunset for that carrier in the affected state, it gets not simply the right to enter yet another isolated line of business, but the right to *integrate* local and long distance service into a single package, to make the two services essentially indistinguishable from the consumer's perspective, and to

73 "VZ Analyst Mtg Provides Comprehensive '01 Outlook," Credit Suisse First Boston, 09 47am EST, 8-Feb-01 ("*Credit Suisse First Boston Report*")

leverage its dominance of the local market to similarly come to dominate the long distance market as well.

56 It is abundantly apparent that the *entire foundation* of the BOCs' long distance entry strategy rests upon their ability to exploit their local market power, pricing advantages with respect to access and "joint" services, and their legacy relationships with existing BOC local service customers. *De facto*, and ultimately *de jure*, integration of the BOC local and long distance services regardless of the requirements of Section 272 or any other Commission safe-guard, is a critical element of this strategy Lest there be any doubt about this, the Commission should recall that although BOCs have been permitted into the *out-of-region* long distance market since the enactment of the 1996 *Act* (i.e., February 8, 1996), *none of the RBOCs* (with the exception of Qwest, which was already providing "out-of-region" long distance prior to its merger with US West) *availed themselves of this opportunity* except with respect to certain out-of-region services, such as Calling Card services, that could be marketed to their *in-region* local service customers Moreover, rather than compete out-of-region, both SBC and Bell Atlantic chose instead to *acquire* via merger out-of-region BOCs, expressly foregoing their opportunity for *immediate* long distance entry in those states but without the opportunity to leverage the ILEC subscriber base, for eventual long distance entry following Section 271 approval when they could pursue the fully integrated joint marketing strategy

57 That SBC's marketing plans with respect to its long distance service are intimately linked to its legacy local service customer base is further confirmed by the fact that SBC's policy

in its Section 271 states is to limit the availability of SBC long distance service to SBC local service customers only,[74] i.e., to not even offer or provide long distance service to customers of other ILECs or of CLECs where they do not already have a significant cost advantage. Thus, not only has SBC maintained its policy of not pursuing any out-of-region long distance entry, it does not even offer long distance service either to CLEC customers or to Non-SBC ILEC customers *within the states in which SBC has received Section 271 authority* Such revealed conduct compels the inescapable conclusion that the opportunity to engage in these practices appears to be the sole driver of SBC's interest in the long distance business Credit Suisse First Boston makes the point profoundly clear in its comparison of (pre-merger) GTE's approach to selling long distance services through a separate CLEC affiliate vs Verizon's and SBC's ability to offer long distance services directly to their ILEC customers

> In stark contrast to Verizon's huge and quick 20% consumer LD share gains in NY State, LD subscribership was flat in the GTE franchise areas in '00 despite GTE's benefitting from similar pre-established branding and billing relationships The difference is that GTE has not leveraged the inbound channel and also had been running its LD effort through its "CLEC", in effect forcing customers to switch to the GTE CLEC both their local service from GTE's ILEC and their LD service from another LD customer Not very successful if you ask us and certainly worthy of change given the empirical evidence that VZ's and SBC's use

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74 SBC's long distance package offers on its website contain the note, "SBC Long Distance provides direct-dialed service in the SBC local service areas where FCC approval has been given Requires subscription to SBC local service " *See, e g* http.//www02.sbc.com/Products_Services/Residential/ProdInfo_1/1,,1094--1-3-13,00.html (Accessed June 27, 2003).

of the inbound channel and separate LD sub (but not bundled with local) have been extraordinarily successful [75]

75 *Credit Suisse First Boston Report*