Before the
Federal Communications Commission
Washington, D.C. 20554

In the Matter of	)	
	)	
Verizon Communications Inc. and MCI, Inc.	)	WC Docket No. 05-75
	)	DA 05-762
Applications for Approval of Transfer of Control	)	
	)	

REPLY COMMENTS OF
AD HOC TELECOMMUNICATIONS USERS COMMITTEE

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SUMMARY

As Ad Hoc emphasized in its comments on the SBC-AT&T merger application, the greatest single threat to the emergence of robust competition in telecommunications markets is the continuing stranglehold on the special access market exercised by incumbent local exchange carriers ("ILECs"). As was the case in WC Docket No. 05-65, the merger at issue in this docket will not only exacerbate the problems created by the lack of special access competition but create new opportunities and powerful incentives for the merged company to exploit the lack of competition. The merger therefore cannot be approved under the standard in Section 214 of the Communications Act, unless and until competition emerges in Verizon's special access markets or the merger is subject to voluntary or involuntary conditions that protect consumers and competition from the merged entity's market power.

The lack of competition in special access markets, including Verizon's, creates a two-fold problem – it can be exploited by ILECs to impede competitive entry into telecommunications markets and it allows ILECs to charge unjust and unreasonable rates to customers. Indeed, it already costs enterprise customers over $17.5 million dollars *per day* in excessive charges for special access.

Both of these effects will be magnified in Verizon's region by the merger – to the detriment of the public interest, convenience, and necessity – unless the applicants' authority to merge is conditioned by the Commission upon compliance with pro-competitive conditions, described in Section IV, below,

which include reducing Verizon's special access rates to reasonable levels and imposing incentive regulation in geographic markets that are not yet competitive.

The Bell Operating Companies ("BOCs") have repeatedly claimed that the special access market is fully competitive. They have supported their claims with compelling rhetoric, comforting economic theories, and sunny speculation regarding the market-opening potential of new and innovative technologies. But in the cold, hard light of the actual marketplace in which real enterprise customers search for competitively-priced telecom services, rhetoric and speculation provide little comfort. Ad Hoc is participating in this proceeding because the enterprise customers' marketplace experience is at odds with the rosy picture painted by the BOCs for several years in their filings with this Commission. Any merger analysis that fails to look past rhetoric to the factual record regarding the state of competition in Verizon's special access marketplace will disserve the public interest.

Unlike many other groups who claim to speak for business users, Ad Hoc admits no carriers as members and accepts no carrier funding. As substantial, geographically-diverse end users of telecommunications service nation-wide, Ad Hoc members are uniquely qualified to provide a credible, unbiased, and informed perspective on the state of competition in the telecommunications marketplace. Ad Hoc members have no commercial self-interest in the imposition of unnecessary regulatory constraints and have historically been among the first beneficiaries of the FCC's de-regulatory efforts. As a consequence, Ad Hoc has consistently advocated de-regulation for

telecommunications services as soon as a service market becomes competitive.

Unfortunately, the special access market is not sufficiently competitive for market forces to discipline prices and service levels. Yet the Commission effectively de-regulated this market six years ago on the assumption that competition would develop. As a result, Ad Hoc has repeatedly, and with increasing urgency, alerted the Commission to the lack of competition in the special access marketplace and filed supporting factual evidence and economic analyses in a variety of policy and rulemaking proceedings.

Ad Hoc members became increasingly concerned over the past few years by the mismatch between their marketplace experience and the BOCs' representations in regulatory and public policy proceedings that local markets are sufficiently competitive to be de-regulated even more. Therefore, Ad Hoc directed its economic consultants to conduct an analysis of the access services market for signs of competitive market forces. The results of that analysis are attached to this pleading and described in greater detail in Section I below. The analysis confirmed the experiences reported by members – the BOCs' record-setting prices and profits for special access demonstrate that they face little or no competition to protect consumers from exploitive rates and practices.

As discussed in Sections II and III, *infra,* the Commission must face and fix the defects in its regulation of the special access market before any further consolidation like that proposed by Verizon and MCI could be consistent with the public interest. Because established carriers and new competitors depend upon special access services in order to provide competitive alternatives to the BOCs'

interstate, interexchange, and access services, the proposed merger will result in less competition and higher prices for enterprise customers unless the merger authorization includes conditions that will keep special access prices and practices reasonable.

Supporters of the merger may attempt to argue that the Commission can take the same approach to Verizon's market power today as it did in 1999, when it changed its rules to relieve Verizon and other price caps LECs of special access regulation as soon as a CLEC entered a geographic market. Advocates of a more de-regulatory approach frequently argue that market power like Verizon's – indeed, any market power – is a temporary and self-correcting problem that does not require Commission intervention because the creamy returns carriers enjoy when they exercise their market power and raise their prices will surely attract competitive entry.

Whatever the theoretical appeal of this argument, it has, as a factual matter, been thoroughly de-bunked in the special access market. As discussed below, and as documented in the Gately Declaration attached hereto, Verizon has raised its rates and its earnings to record levels over a nine-year period – its special access rate of return has grown from 3.85% in 1996 to 15.52% in 2000 to 31.64% in 2004 – without attracting significant competitive entry. Verizon's customers during this time period will perhaps be forgiven for concluding that the concept of "potential competition" as a significant price-disciplining force is intellectually bankrupt in the context of this market.

The Commission should reject any misguided and legally incorrect suggestion that the Commission must defer special access issues to the pending special access rulemaking. Instead, the Commission must impose conditions to protect consumers and competition:

1. Verizon must reinitialize its special access rates at the Commission's last-authorized 11.25% rate of return. This should be an interim measure pending re-determination based on current conditions.

2. Verizon should be given unlimited downward pricing flexibility to respond to competition if it develops.

3. Verizon's rates must be adjusted annually by a price cap adjustment mechanism that includes a productivity adjustment and an earnings sharing component.

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REPLY COMMENTS OF THE AD HOC TELECOMMUNICATIONS USERS COMMITTEE

The Ad Hoc Telecommunications Users Committee (the "Ad Hoc Committee") submits these Reply Comments pursuant to the Commission's March 24, 2005 Public Notice in the docket captioned above.[1]

INTRODUCTION

The greatest threats to the emergence of robust competition in telecommunications markets are the continuing stranglehold on the special access market exercised by incumbent local exchange carriers ("ILECs"), and the Commission's failure to reflect that marketplace reality in its regulatory regime for special access. The merger at issue in this docket will not only exacerbate the problems created by the lack of special access competition but create new opportunities and powerful incentives for the merged company to exploit the lack of competition. The merger therefore cannot be approved under

[1] *Verizon Communications Inc. and MCI, Inc., Applications for Approval of Transfer of Control*, WC Docket No. 05-75, Public Notice, DA No. 05-762 (rel. Mar. 24, 2005).

the standard in Section 214 of the Communications Act, unless and until competition emerges in Verizon's special access markets or the merger is subject to voluntary or involuntary conditions to protect consumers and competition from the merged entity's exercise of market power over special access services.

As discussed in many of the Comments filed in this docket,[2] ILEC special access plays a critical competitive role in the marketplace because it is, in most cases, the only "final mile" link between end users and their carriers, both interexchange carriers ("IXCs") and competitive local exchange carriers ("CLECs"). In addition, the building block transmission services required for enterprise customer voice and data networks are offered by the BOCs as special access services. As a result, the BOCs' special access rates drive the prices enterprise customers must pay to deploy nation-wide data and voice networks.

The lack of competition in the bottleneck special access market thus creates a two-fold problem – it can be exploited by the ILECs to impede competitive entry into other telecommunications markets and it allows the ILECs to extract supra-competitive prices from enterprise customers. Indeed, the lack of competition for special access, and the Commission's continuing failure to regulate this non-competitive market effectively, already costs enterprise customers over $17.5 million dollars *per day* in excessive charges for the special access services they buy.[3]

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[2] *See generally* Comments of Global Crossing North America, Inc., CompTel/ALTS, and Broadwing Communications, LLC/SAVVIS Communications Corporation, filed May 9, 2005.

[3] Attachment A, "*Competition in Access Markets: Reality or Illusion. A Proposal for*

Both of these effects will be magnified by the merger – to the detriment of the public interest, convenience, and necessity – unless the applicants' authority to merge is the subject of pro-competitive conditions, described in Part IV, below, which include reducing special access rates to reasonable levels and imposing incentive regulation in geographic markets that are not yet competitive.

The Bell Operating Companies ("BOCs") have repeatedly claimed that the special access market is fully competitive. They have supported their claims with compelling rhetoric, comforting economic theories, and sunny speculation regarding the market-opening potential of new and innovative technologies. But in the cold, hard light of the actual marketplace in which real enterprise customers search for competitively-priced telecom services, rhetoric and speculation provide little comfort. Ad Hoc is participating in this proceeding because the enterprise customers' marketplace experience is at odds with the rosy competitive picture painted by the BOCs for several years in their filings with this Commission. Any merger analysis that fails to look past rhetoric to the factual record regarding the state of competition in the special access marketplace will disserve the public interest.

The members of Ad Hoc are among the nation's largest and most sophisticated corporate buyers of telecommunications services, including interstate special access services. Fourteen of Ad Hoc's members are "Fortune

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Regulating Uncertain Markets," Economics and Technology, Inc. (August 2004) ("*ETI White Paper*"), as amended by Attachment B, Declaration of Susan M. Gately (May 24, 2005) ("Gately Declaration"). Also filed as an *ex parte* presentation in this docket. Letter from Colleen Boothby, Counsel for the Ad Hoc Telecommunications Users Committee, to Marlene H. Dortch, Sec'y, Federal Communications Commission, WCB Docket No. 05-65 (filed Apr. 22, 2005). *See also* Part I, *infra.*

500" companies, including ten of the "Fortune 100." Committee members come from a broad range of industry sectors (including manufacturing, financial services, insurance, retail, package delivery, and information technology) and maintain thousands of corporate premises in every region of the country. They estimate their combined annual spend on communications services at between two and three billion dollars per year.

Unlike many other groups who claim to speak for business users, Ad Hoc admits no carriers as members and accepts no carrier funding. As substantial, geographically-diverse end users of telecommunications service nation-wide, Ad Hoc members are uniquely qualified to provide a credible, unbiased, and informed perspective on the state of competition in the telecommunications marketplace. Because they are not competing carriers, Ad Hoc members have no commercial self-interest in the imposition of unnecessary regulatory constraints on incumbent service providers. Indeed, as high-volume purchasers of telecommunications services, Ad Hoc members have historically been among the first beneficiaries of the FCC's de-regulatory efforts. As a consequence, Ad Hoc has consistently advocated de-regulation for telecommunications services as soon as a service market becomes competitive.

Large commercial enterprises like Ad Hoc's members rely heavily on special access services for the dedicated, "final mile" connections that make up their private corporate networks, specialized data systems, and high-capacity, mission-critical transmission facilities at locations with heavy traffic volumes. Enterprise customers who purchase special access – both directly, as customers

of the BOCs, and indirectly, as customers of interexchange carriers ("IXCs") who must, in turn, purchase BOC special access to reach their customers' premises – ultimately pay the price if special access rates are not subject to competitive pressure.

Unfortunately, the special access market is not sufficiently competitive for market forces to discipline prices and service levels. Yet the Commission effectively de-regulated this market six years ago on the assumption that competition would develop. As a result, Ad Hoc has repeatedly, and with increasing urgency, alerted the Commission to the lack of competition in the special access marketplace and filed supporting factual evidence and economic analyses in a variety of policy and rulemaking proceedings.[4]

In its pleadings, Ad Hoc has described the actual market experience of its members and the absence of competitive alternatives in the geographic markets where members sought to obtain special access services, despite members'

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[4] *See, e.g.,* Comments of Ad Hoc Telecommunications Users Committee (Jan. 22, 2002) at 2-3, *Performance Measurements and Standards for Interstate Special Access Services*, CC Docket Nos. 01-321, 00-51, 98-147, 96-98, 98-141, 96-149, 00-229, Notice of Proposed Rulemaking, 16 FCC Rcd 20896 (2001); Comments of Ad Hoc Telecommunications Users Committee (Mar. 1, 2002) at 14-17, *Review of Regulatory Requirements for Incumbent LEC Broadband Services; SBC Petition for Expedited Ruling That It Is Non-Dominant in its Provision of Advanced Services and for Forbearance From Dominant Carrier Regulation of These Services,* CC Docket No. 01-337, Notice of Proposed Rulemaking, 16 FCC Rcd 22745 (2001) ("*Broadband Regulation Rulemaking")*; Reply Comments of Ad Hoc Telecommunications Users Committee (Jul. 1, 2002) at i, *Appropriate Framework for Broadband Access to the Internet Over Wireline Facilities*, CC Docket Nos. 02-33, 95-20, and 98-10, Notice of Proposed Rulemaking, 17 FCC Rcd 3019 (2002) ("*Broadband Wireline Internet Access Rulemaking*"); Comments of Ad Hoc Telecommunications Users Committee (Dec. 2, 2002) at 5, *AT&T Petition for Rulemaking to Reform Regulation of Incumbent Local Exchange Carrier Rates for Interstate Special Access Services*, RM No. 10593, 17 FCC Rcd 21530 (2002); Comments of Ad Hoc Telecommunications Users Committee (Jun. 30, 2003) at 6, *Section 272(f)(1) Sunset of the BOC Separate Affiliate and Related Requirements*, WC Docket No. 02-112, and *2000 Biennial Regulatory Review Separate Affiliate Requirements of Section 64.1903 of the Commission's Rules*, CC Docket No. 00-175, Further Notice of Proposed Rulemaking, 18 FCC Rcd 10914 (2003) ("*ILEC Broadband Dom/Non-Dom Rulemaking*").

active efforts to seek out competitive choices. Ad Hoc urged the FCC to re-establish incentive regulation for the ILECs' special access services in order to protect customers from the ILECs' exploitation of their market power through excessive rates and commercially unreasonable terms and conditions.[5]

Ad Hoc members also became increasingly concerned over the past few years by the mismatch between their marketplace experience and the BOCs' representations in regulatory and public policy proceedings that local markets are sufficiently competitive to be de-regulated even more. As Ad Hoc reported in its comments in the *Broadband Regulation Rulemaking*,[6] its members faced no competitive alternatives to ILEC services to meet their broadband business services requirements in the overwhelming majority of their service locations. [7] Yet the BOCs maintained before the Commission that they were losing ground rapidly to fierce competition in local markets, in response to which the Commission sought public comment on a variety of de-regulatory initiatives.[8]

To determine whether Ad Hoc members were somehow insulated from these allegedly pervasive competitive pressures, despite the diverse geographic locations and industry sectors in Ad Hoc's membership, Ad Hoc directed its economic consultants to conduct an analysis of the access services market and

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[5] *Id.*

[6] Comments of Ad Hoc Telecommunications Users Committee (Mar. 1, 2002) in *Broadband Regulation Rulemaking*.

[7] For locations with capacity requirements totaling four DS-1 circuits or below, members reported that viable competitive alternatives to the ILEC were available at less than 10% of their locations. *See Broadband Regulation Rulemaking*, Comments of Ad Hoc Telecommunications Users Committee (Mar. 1, 2002) at 14-17.

[8] *See Broadband Regulation Rulemaking*, *Broadband Wireline Internet Access Rulemaking,* and *ILEC Broadband Dom/Non-Dom Rulemaking, supra,* note 4.

the available data for signs of competitive market forces. The results of that analysis are attached to this pleading and described in greater detail in Section I below. Ad Hoc's economic analysis confirmed the individual experiences reported by its members – access markets, and the special access market in particular, are not competitive. Verizon's record-setting prices and profits for special access demonstrate that it faces little or no competition to protect consumers from exploitive rates and practices.

Ad Hoc shared its economic analysis with the Commission, and raised its concerns regarding the BOCs' exercise of market power over special access services, in several rulemaking dockets on special access and broadband issues. Ad Hoc proposed a set of corrective measures to return BOC prices, and the Commission's degree of regulatory oversight, to levels that would protect customers. Yet the Commission has not resolved those proceedings or taken any steps to correct its premature de-regulation of the BOCs' virtual monopoly.

If the Commission takes no action to prevent the BOCs from exploiting their market power over special access, the proposed merger of Verizon and MCI will do irreversible harm to the public interest and therefore cannot be justified under Section 214.

As discussed in Sections II and III, *infra,* the Commission must face and fix the defects in its regulation of the special access market before any further consolidation like that proposed by Verizon and MCI could be consistent with the public interest. Because established carriers and new competitors depend upon special access services in order to provide competitive alternatives to the BOCs'

interstate, interexchange, and access services, the proposed merger will result in less competition and higher prices for enterprise customers unless the merger authorization includes conditions that will keep special access prices and practices reasonable.

I. NINE YEARS AFTER PASSAGE OF "MARKET-OPENING" LEGISLATION, THE SPECIAL ACCESS SERVICES MARKET IS STILL NOT COMPETITIVE

Ad Hoc members, which include some of the largest corporate telecom purchasers in the United States, would theoretically be the first customers to experience the benefits of competition in their everyday procurement of telecommunications services – but the reality is that they do not.

In a white paper released in August, 2004, the Committee's economic consultants, Economics and Technology, Inc. ("ETI"), documented the lack of competitive alternatives available to enterprise customers and the evidence of substantial BOC market power in the special access market. In *Competition in Access Markets: Reality or Illusion. A Proposal for Regulating Uncertain Markets* ("*ETI White Paper*")[9] the Ad Hoc Committee also offered a proposal for re-targeting access prices back to competitive levels and for a self-executing regulatory paradigm that would allow the BOCs the flexibility they demand in order to respond to competition while at the same time protecting customers against excessive prices if actual competition fails to materialize.

Today, as the FCC contemplates the potential impact of merging AT&T –

[9] *See* note 3, *supra.*

likely the single largest competitor for the BOCs' special access services – with SBC, and the merger of MCI – likely the second largest special access competitor – with Verizon, the *ETI White Paper*'s evidence of the utter lack of competitive alternatives for enterprise customers could not be of greater relevance. The *ETI White Paper* presents compelling evidence that competitive alternatives simply do not exist for the "last-mile" telecommunications services enterprise customers must have to conduct business.

To many telecommunications policy makers, this reality may come as something of a surprise: The largest corporations that annually spend tens and even hundreds of millions of dollars on local and long distance, voice and data telecom services have long been assumed to be the primary beneficiaries of competition in all telecom sectors. Surprising as it may be, the *ETI White Paper* documented that, in most locations, enterprise customers have no access options other than the services and facilities that are available exclusively from ILECs. Moreover, the ILECs have exploited their market dominance by persistently imposing higher prices for last mile services in precisely those geographic and product markets where the Commission has granted regulatory flexibility because it declared (prematurely) that the markets were "competitive." ILECs confront so little competition in the special access market that they are able in some cases to earn annual returns in excess of 50% on each dollar of special access investment!

In Chapter 2 of the *ETI White Paper*, entitled *No Way Out: The Lack of Alternatives to Special Access,* ETI documented that although there is intense

competition for *interexchange* services (including both switched voice and dedicated voice and data), the ILEC monopoly persists largely unchallenged in the case of switched and dedicated *access* connections between interexchange carrier networks and individual end-user sites. Contrary to the simplistic, albeit common, assumptions regarding large users' telecommunications needs, enterprise customer locations are not confined primarily to the large buildings and commercial centers where competing service providers are most likely to target their initial market entry. Instead, corporate networks frequently involve tens of thousands of small sites – the vast majority of which are in places where the ILEC remains the only source of connectivity.

The *ETI White Paper* relied on evidence supplied by the carriers themselves to corroborate the market experience reported by Ad Hoc members. For example, in a declaration accompanying its 2002 Petition for a rulemaking to reform special access regulation,[10] AT&T reported that it had been unable to obtain non-ILEC special access services for all but a small fraction of its special access requirements. Specifically, AT&T stated that it serves some 186,000 buildings using special access facilities and services. But it must still rely upon the ILECs' special access services for all but 5% of those cases (9,700 buildings).[11] Of the 5% of buildings for which AT&T has been able to obtain access from an alternative provider, the majority are self-provided circuits, and only about 3,700 buildings – or 2% of the total – are served using other CLECs'

[10] *AT&T Corp. Petition for Rulemaking to Reform Regulation of Incumbent Local Exchange Carrier Rates for Interstate Special Access Services*, RM-10593 (filed Oct. 15, 2002) ("*AT&T Special Access Petition").*

[11] *AT&T Special Access Petition,* Declaration of Kenneth Thomas at 1.

facilities.[12] As a CLEC, AT&T has facilities to only 6,000 of the roughly 3-million commercial buildings in the U.S. – a mere one-fifth of one percent.

Sprint Corporation has provided similar evidence, which is discussed in some detail in the *ETI White Paper*.[13] Sprint's most recent estimates of the number of commercial buildings and the number of alternative access provider connections into those buildings are both larger than AT&T's,[14] but, like AT&T's data, Sprint's results in a CLEC connectivity rate of less than 5% for the commercial buildings in the U.S. Moreover, Sprint goes on to report that in 12,000 of the buildings with alternative access provider connections (*i.e.,* for 40% of the buildings), the connection is limited to a single customer and the CLEC is unable to provide access to other customers located in the same building.[15]

More recent evidence has come from the BOCs' filings in the course of the Commission's review of its *Triennial Review Order* ("TRO").[16] The BOC evidence reveals that in the vast majority of cases, CLECs must use BOC-provided special access services to reach their customers. The *ETI White Paper* discusses this evidence in Chapter 2, which contains reproductions of two maps

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12 *Id.* at 1.

13 *ETI White Paper* at 17-18.

14 Sprint estimates the total number of US commercial buildings at just under 750, 000, and estimates that there are approximately 30,000 connected buildings. *AT&T Corp. Petition for Rulemaking To Reform Regulation of Incumbent Local Exchange Carrier Rates For Interstate Special Access Services*, RM Docket No. 10593, Comments of Sprint Corporation, filed December 2, 2002 ("*RM 10593 Sprint Comments*"), at 4.

15 *Id.,* at 4.

16 *Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers, Implementation of the Local Competition Provisions of the Telecommunications Act of 1996, Deployment of Wireline Services Offering Advanced Telecommunications Capability*, CC Docket Nos. 01-338, 96-98, 98-147, Report and Order and Order on Remand and Further Notice of Proposed Rulemaking, 18 FCC Rcd 16978 (2003) (subsequent history omitted).

prepared and submitted by Verizon in the TRO docket. The maps document that even in what many consider to be the most competitive local service markets in the country, namely, the New York and Washington metropolitan areas served by Verizon, CLECs must rely upon BOC special access loops to reach enterprise customers.[17] Similar filings were made by SBC, BellSouth, and Qwest showing the exact same patterns.[18] Excerpts from the Verizon filing can be found in the *ETI White Paper* and are discussed in the declaration of Susan M. Gately attached to these comments.

The Gately declaration contains updated data for the *ETI White Paper* where such data exists.

The paper also documents the results of a survey of Ad Hoc Committee members undertaken in 2002 which revealed that, for locations requiring four or fewer DS1 circuits, competitive alternatives to BOC special access were available less than 10% of the time.[19]

The paper's bottom line, as updated by the Gately Declaration, is inescapable. Using the most optimistic claims provided by the carriers of the number of buildings where competitive access service is available, the ILECs nevertheless remain the sole source of special access connectivity at roughly 98% of business premises nationwide, even for the largest corporate users. Figure 1 below illustrates this situation.

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17 *ETI White Paper*, at 13 – 15.

18 See Gately Declaration.

19 *ETI White Paper*, at 19-20.

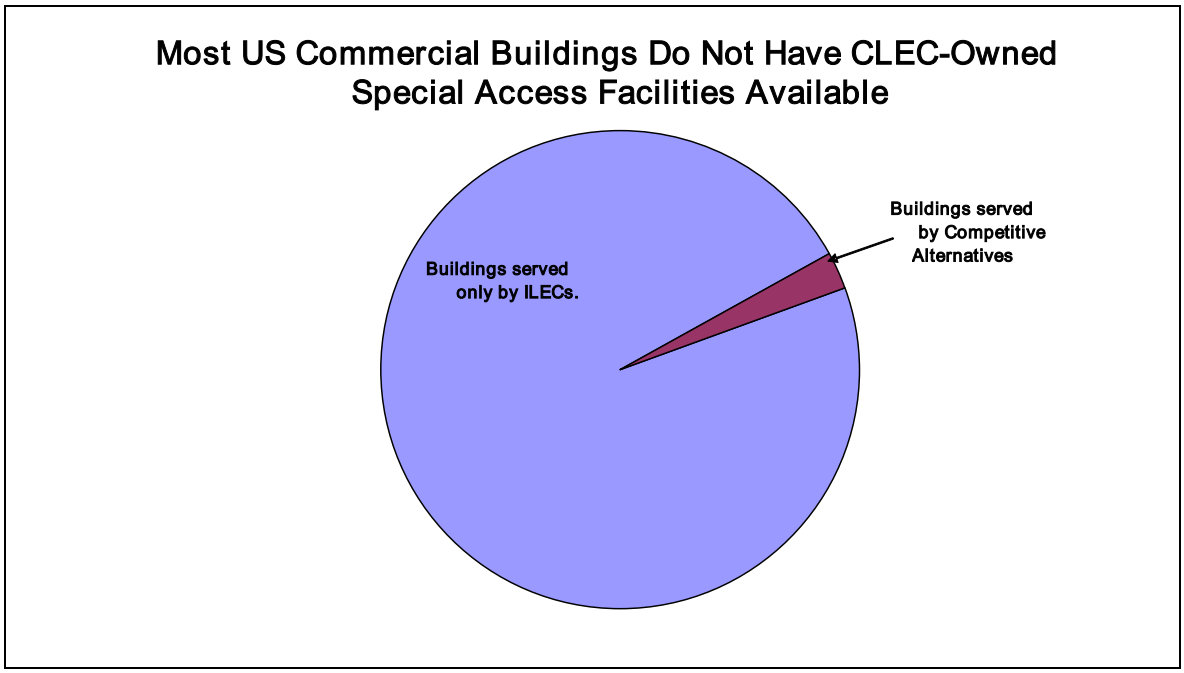

Figure 1

The *ETI White Paper* notes that the lack of competitive alternatives for high capacity access services is attributable to a variety of well-recognized barriers to competitive entry, especially the very high fixed costs and risk associated with such investments.[20] These conditions are not likely to change any time soon, for reasons described in greater detail in the paper.

The *ETI White Paper* also examined the marketplace conduct of the dominant ILECs, which revealed a pattern of significantly higher prices in precisely those geographic areas in which the Commission has given the BOCs pricing flexibility because it presumes competition has materialized. The pricing pattern thus confirms the absence of actual competition in those areas.

In the chapter entitled *Undisciplined Pricing and Limitless Earnings in the*

[20] *ETI White Paper* at 24-26.

Face of Only Putative Competition, the *ETI White Paper* points out that the BOC's pricing behavior confirms the numerical evidence, discussed above, of the lack of competitive alternatives. Worse yet, the BOCs' pricing behavior demonstrates that the *threat* of future competition is not disciplining BOC pricing either.

If users confronted actual competitive choices for BOC switched and special access services, or if the BOCs believed that such competitive alternatives could materialize, they would be lowering their prices in purportedly competitive markets, and their earnings would be moving down toward competitive levels. But that is not happening. ETI's pricing review for the *ETI White Paper* revealed that, in the markets where the FCC's pricing flexibility "triggers" have been satisfied, ILEC prices are ***higher*** than those in regulated "monopoly" areas, while ILEC profits (as reflected in realized rates of return) for special access services have risen to astronomical heights.

At the time that the *ETI White Paper* was released, the most recent BOC statistics (year-end 2003) revealed average earnings across the BOCs in the special access category of a jaw-dropping 43.7%.[21] Figure 2, below, taken from the Gately Declaration attached to this pleading,[22] documents that the average special access return has now increased to an awe-inspiring 53.7%, with earnings for the individual BOCs ranging from 31.6% for Verizon to *81.9%* for BellSouth.

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21 *ETI White Paper* at 28.

22 See Gately Declaration.

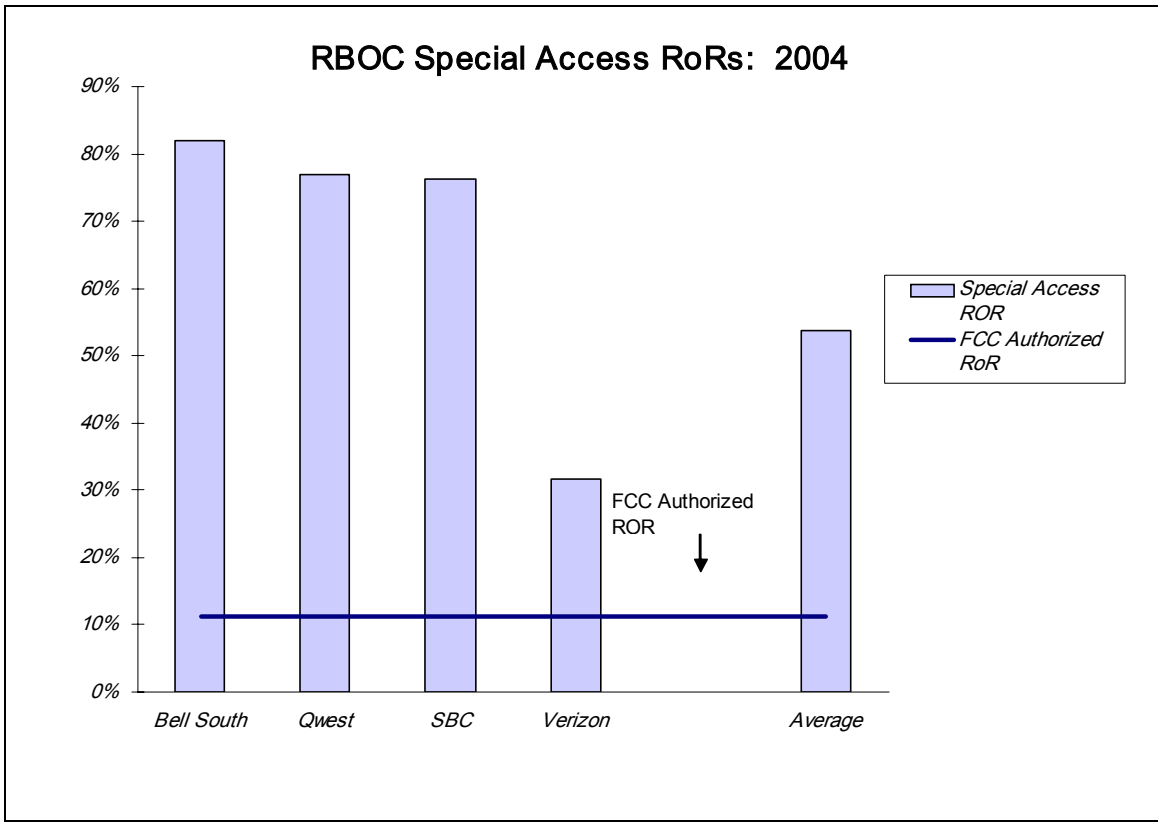

Figure 2

Further analysis of updated pricing evidence is no less compelling. As documented in the Gately Declaration, Verizon prices are *higher* in areas in which pricing flexibility has been granted than in the areas where Verizon has not qualified for pricing flexibility. Figure 3 below reveals that while the price Verizon charges for a DS1 special access facility of 10-miles in length in areas regulated under price caps has decreased from 2001 to 2004, the price for an identical circuit located in a supposedly competitive area for which pricing flexibility has been granted has *increased*, such that the "competitive" price is now more than 23% higher than the price caps regulated circuit.

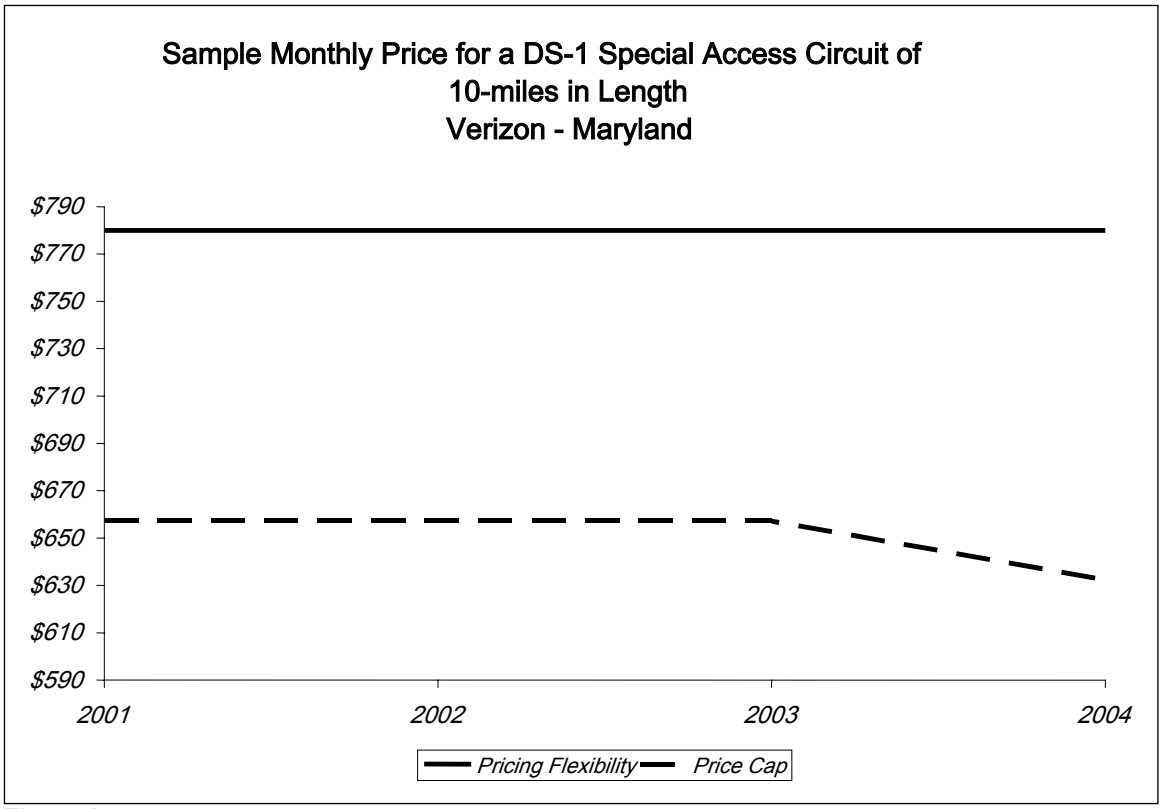

Figure 3

Debates over whether competitive entry is possible or whether entry barriers exist to prevent competitive entry cannot ignore these facts. The BOCs' returns on special access services have been excessive for more than five years and yet no entry has been stimulated. Figure 4 below documents the steady climb in special access return levels from 1996 through year-end 2004. Carrier claims that excessive rates and profits should be tolerated because they will stimulate competitive entry have been conclusively disproved by the test of time.

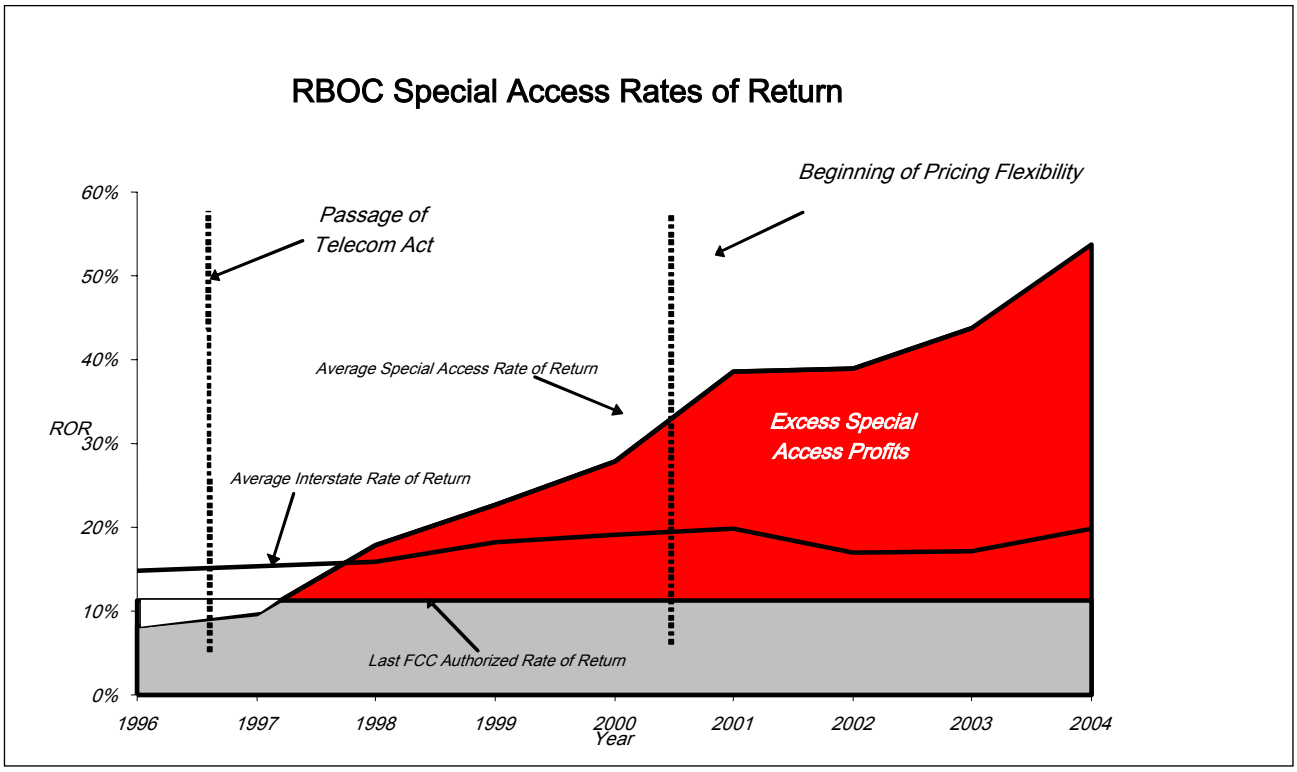

Figure 4

The lack of competitive alternatives documented by Ad Hoc in the *ETI White Paper*, would, of course, be exacerbated by the merger of Verizon and MCI. Global Crossing correctly states that "Verizon is, by far, the largest provider of special access services in its BOC service territories."[23] It also notes that "[w]here Global Crossing has any choice at all, MCI sometimes serves as one of the only competing providers of special access services to reach a particular end user. Indeed, Global Crossing purchases more special access services from Verizon and MCI than any other carrier in Verizon's region."[24]

According to Global Crossing, MCI is able to use its buying power to make volume purchases at discount levels that smaller customers, like Global

[23] Comments of Global Crossing North America, Inc. (filed May 9, 2005) at 13.

[24] *Id.,* at 13.

Crossing, can not achieve on their own. MCI then resells Verizon special access to smaller customers, passing along some of its discount, offering service at a lower price than Verizon. Other CLEC's filing in the initial round of this proceeding make a similar point. In a declaration filed by Dr. Simon Wilke appended to the Comments of Cbeyond *et al.*, estimates are presented showing that the elimination of AT&T and MCI as a competitive special access provider (over both owned and resold special access facilities) would result in a decline of from 70% to 80% in the number of buildings with competitive alternatives to Verizon.[25]

In Global Crossing's words, "[t]he availability of MCI's special access services as a lower cost alternative to Verizon will end upon the consummation of the proposed merger, as the merged entity will have no incentive to use its integrated assets to compete with itself."[26] Ad Hoc couldn't agree more.

II. THE PROPOSED MERGER IS INCONSISTENT WITH THE PUBLIC INTEREST SO LONG AS SPECIAL ACCESS REMAINS NON-COMPETITIVE AND UNREGULATED

In light of the competitive conditions described in the previous section, the proposed merger would be inconsistent with the public interest so long as Verizon continues to wield market power in its special access markets and is permitted by a lax regulatory scheme to charge unreasonable prices and earn record profits on those services.

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[25] See Comments of Cbeyond Communications, Conversent Communications, Eschelon Telecom, NuVox Communications, TDS Metrocom, and XO Communications (filed May 9, 2005), Declaration of Simon J. Wilke, at 9-11.

[26] Comments of Global Crossing North America, Inc. (filed May 9, 2005) ("Comments of Global Crossing") at 14.

The Commission's failure to regulate special access markets where there is no effective competition has already had an adverse impact on the public interest in the current environment by allowing carriers with market power to drive up both the cost of doing business for unaffiliated IXCs and the price of service for end users, whether the end user is a direct or indirect purchaser of special access. Similarly, for purposes of the instant merger proceeding, the adverse impacts of the non-competitive, price de-regulated *status quo* in Verizon's special access market makes it impossible to conclude that the proposed merger would serve the public interest.

Supporters of the merger may attempt to argue that the Commission can take the same approach to Verizon's market power today as it did in 1999, when it changed its rules to relieve Verizon and other price caps LECs of special access regulation as soon as a CLEC entered a geographic market. [27] Advocates of a more de-regulatory approach frequently argue that market power like Verizon's – indeed, any market power – is a temporary and self-correcting problem that does not require Commission intervention because the creamy returns carriers enjoy when they exercise their market power and raise their prices will surely attract competitive entry.

Whatever the theoretical appeal of this argument, it has, as a factual matter, been thoroughly de-bunked in the special access market. As discussed above and as documented in the Gately Declaration, Verizon has raised its rates

[27] *See Access Charge Reform,* CC Docket No. 96-262, Fifth Report and Order, 14 FCC Rcd 14221 (1999) ("*Pricing Flexibility Order*"), *aff'ed, WorldCom, Inc. v. FCC*, 238 F.3d 449 (D.C. Cir. 2001).

and its earnings to record levels over a nine-year period – its special access rate of return has grown from 3.85% in 1996 to 15.52% in 2000 to 31.64% in 2004 – without attracting significant competitive entry. Verizon's customers during this time period will perhaps be forgiven for concluding that the concept of "potential competition" as a significant price-disciplining force is intellectually bankrupt in the context of this market.

In the absence of competitive alternatives, IXCs who compete with MCI and CLECs who compete with Verizon will remain dependent upon Verizon's special access to provide their services. As commenters in this docket have pointed out, that dependence raises the specter of two anti-competitive scenarios that will result if the merger is approved without regulatory intervention on Verizon's special access pricing.

First, Verizon's proposed merger with MCI will remove what appears to be the only source of downward pricing pressure for Verizon's special access prices, namely, MCI's competing facility-based services, where they exist, and the volume and term discounts on Verizon's services for which MCI qualifies as the largest purchaser of special access in Verizon's region. In their comments, Global Crossing[28] and Broadwing/SAVVIS[29] identify a number of discount pricing mechanisms offered by Verizon for which only MCI is eligible because of its size. MCI uses those discount mechanisms in part to resell service to other competitors at prices that are lower than Verizon's prices to those competitors.

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[28] Comments of Global Crossing at 12-13.

[29] Comments of Broadwing Communications, LLC/SAVVIS Communications Corporation (filed May 9, 2005) ("Comments of Broadwing and SAVVIS") at 22-25.

As Broadwing and Savvis point out in their comments, "[w]hile imperfect, the competition provided by AT&T and MCI has had some disciplining effect on the special access rates charged by the BOCs."[30] If the Commission allows the merger to proceed and does nothing to regulate Verizon's special access services, MCI will be eliminated as a source of special access price reductions, which will allow Verizon's already unreasonable prices to drift even higher.

The second anti-competitive scenario that the merger would facilitate, absent regulatory intervention in special access markets, results from the IXCs' dependence upon special access to originate and terminate their interstate interexchange traffic. As Global Crossing observed in its comments, the merger will marry the special access market power that Verizon can use to undermine competitors in the interexchange market with MCI's incentive as an IXC to do so.[31] In particular, commenters have identified "price squeeze" behavior as nearly inevitable should the Commission approve the merger application without re-visiting its failed regulatory approach to special access.

Three factors suggest that price squeezing special access rate increases would be unavoidable if special access prices are unregulated when a merger occurs.

First, as noted above, BOC-IXC mergers combine for the first time the BOCs' ability to raise special access prices at will with the IXCs' incentive to use

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30 Comments of Broadwing and SAVVIS at 22.

31 Comments of Global Crossing at 17.

that market power to discourage in-region competition from other IXCs, who have no access alternative to the BOCs' services.

Second, an IXC who might have challenged any excessive, "price squeezing," special access rates charged by other BOCs will lose any incentive to do so once it is acquired by a BOC who engages in the same over-pricing of its own special access. Any excessive out-of-region special access prices paid by the merged entity will be offset by that entity's collection of excessive prices for its own in-region services. Unlike stand-alone IXCs, or enterprise customers who purchase special access, companies who both pay and collect special access charges are not hurt by market-wide price increases. Indeed, they will have powerful incentives to tacitly coordinate such market-wide price increases because doing so undermines the financial health of their IXC competitors, who pay but do not collect, with no impact on themselves if their traffic is roughly in balance. Ad Hoc is concerned not only that merged entities would exchange discriminatory decreases in special access prices; Ad Hoc is just as concerned by the likelihood of mutually painless price increases.

Finally, the BOCs already have particularly discouraging track records when it comes to challenging excessive special access charges. Despite the fact that they purport to compete now as interexchange service providers and thus must pay any excessive special access charges imposed by another BOC when they provide interexchange service outside their own region, they have yet to challenge the high prices and excessive profits for the special access services

they are required to buy, demonstrating quite clearly how compromised they are on this issue when they act as both an IXC and an ILEC.

III. THE MERGER CANNOT BE APPROVED WITHOUT ADEQUATE CONDITIONS TO ADDRESS THE LACK OF COMPETITION IN SPECIAL ACCESS MARKETS

The proposed merger will reduce what little competition exists in Verizon's special access markets and create powerful incentives for the merged entity to use Verizon's special access market power to reduce or impede competition in other markets. Under these conditions, the merger cannot serve the public interest and cannot be approved without adequate conditions to protect competition and customers from unjust and unreasonable special access rates and practices. Specifically, the Commission must revisit and revamp its regulation of Verizon's special access services.

Verizon and MCI argue in their application that the Commission need not and should not concern itself with the competitive problems in the special access market as part of this merger proceeding. Verizon asserts in its application that any problems with the current regulatory scheme must be addressed on an industry-wide basis in other proceedings to be consistent with Commission precedent. [32]

Verizon's position is misguided, and its characterization of Commission precedent is faulty, for several reasons. First, when the Commission deferred issues to rulemaking proceedings in prior merger decisions, the Commission

[32] *Verizon Communications Inc. and MCI, Inc., Applications for Approval of Transfer of Control*, WC Docket No. 05-75, Merger application, Exhibit 1 at note 33.

made a preliminary determination that the merger under consideration did not, by itself, pose any particular harm.[33] By contrast, the instant merger would create significant and immediate harm to customers of special access, as Ad Hoc and several other commenters have explained.[34] Under Section 214, the Commission must consider these issues and adopt appropriate merger conditions as part of any order approving the merger, and apart from any general rulemaking the Commission may have opened.

Second, the mere fact that the Commission has opened a rulemaking on issues associated with special access does not relieve it of its obligations under Section 214 to address the unique threat to competition presented by the merger of Verizon and MCI.[35] To the extent that the Commission has a specific application before it which must be considered pursuant to Section 214, the Commission cannot defer disposition of the Section 214 issues raised by this particular merger simply because similar issues might be addressed on an

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[33] Verizon ignores this important prerequisite. In precedent on this point, the Commission first affirmatively concluded that the merger then before it would not pose a particular harm. *See, e.g., Applications for Consent to the Transfer of Control of Licenses and Section 214 Authorizations from Tele-Communications, Inc., Transferor To AT&T Corp., Transferee, CS Docket 98-178, Memorandum Opinion and Order,* 14 FCC Rcd 3160, 3183 at ¶ 43 (1999) ("The evidence in the record does not demonstrate that the proposed merger will adversely affect the development of digital broadcast signal carriage."); *Applications of AT&T Wireless Services, Inc. and Cingular Wireless Corporation For Consent to Transfer Control of Licenses and Authorizations,* WT Docket 04-70, Memorandum Opinion and Order, 19 FCC Rcd 21522, 21592 at ¶ 183 n.465 (2004) ("There is no evidence that AT&T [Wireless] is a significant purchaser of competitively provided special access services and, even if it were, we do not believe that its acquisition by Cingular will affect the special access market.").

[34] *See, e.g.,* Opposition of Broadwing Communications, LLC, and SAVVIS Communications Corp., WC Docket 05-65 (filed May 9, 2005) at Part V; Comments of Global Crossing at Part II.

[35] In *AT&T v. FCC*, the court held that the FCC could not avoid adjudicating a complaint properly brought by AT&T by considering the general problem raised by the complainant (AT&T) in a separate (and inchoate) rulemaking. 978 F.2d 727 (D.C. Cir. 1992). The instant case is analogous.

industry-wide basis in an open rulemaking.

Third, as at least one other commenter has noted, the Commission has, in fact, imposed merger conditions in the past even though it was considering in another proceeding industry-wide issues similar to the subject of the merger conditions imposed.[36] Verizon's implicit suggestion that the Commission is proscribed from imposing specific merger conditions to prevent harm caused by the merger itself simply because it is dealing with potentially related industry-wide issues in the special access rulemaking is thus not supported by prior Commission action and precedent.

Accordingly, before the Commission can approve this merger, it must impose conditions to protect consumers from the merged entity's heightened incentives and ability to exploit Verizon's special access market power, including the following requirements:

1. Verizon must reinitialize its special access rates at the Commission's last-authorized 11.25% rate of return. Because that authorization was based on stale economic data, this should be only an interim measure pending a Commission re-determination of a reasonable rate of return based on current economic conditions.

2. Verizon should be given unlimited downward pricing flexibility to respond to competition if it develops.

3. To ensure that Verizon's special access prices remain at competitive levels in those areas where actual and effective competition does not develop, Verizon's rates must be adjusted annually by a price cap adjustment mechanism that includes a productivity adjustment and an earnings sharing component.

[36] *See* Comments of Global Crossing at 19-20 (citing *Applications of NYNEX Corp. and Bell Atlantic Corp. for Consent to Transfer Control of NYNEX Corp. and its Subsidiaries,* 12 FCC Rcd 19985, 20057-20058 at ¶ 145 (1997).

CONCLUSION

For the foregoing reasons, the Commission should not approve the Verizon-MCI merger as proposed but should instead require Verizon to comply with the requirements identified above as a condition of merger approval.

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Certificate of Service

I, Michaeleen Terrana, hereby certify that true and correct copies of the preceding Comments of Ad Hoc Telecommunications Users Committee were filed this 24th day of May, 2005 via the FCC's ECFS system,

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