

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of:)
)
Special Access Rates for Price Cap Local Exchange) WC Docket No. 05-25
Carriers)

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services outside the restrictions of the current rules, while leaving price cap regulation of generally available special access rates in place where it exists today as transitional default rules that will serve as a backstop during the transition to negotiated agreements.

Since the introduction of pricing flexibility in 2001, overall special access prices have declined by 15.2 percent per year, and 16.6 percent in real terms (when inflation is taken into account). Even focusing on individual service capacities, the prices customers pay for DS1 services have dropped by 4.2 percent per year over the past three years (5.7 percent in real terms), and the prices customers pay for DS3 services have decreased by 6.1 percent per year (7.6 percent in real terms). These declines are greater than the average annual change in the "price cap index" (which dropped by 3.7 percent per year during this period), confirming that the marketplace disciplines special access pricing. Even more impressive, lower rates prevailed even against the backdrop of significantly increasing demand: while special access lines increased by approximately 15 percent per year from 2001 through 2004, special access revenues grew by only 4.8 percent annually.

To be sure, customers of any product or service always would prefer to pay even lower rates than they already do, and customers of special access services are highly sophisticated entities that are capable of using every available leverage point to obtain the lowest practical rates (including regulatory proceedings such as the present one). Indeed, when Verizon itself purchases special access services to serve customers out-of-region, it seeks to obtain the best possible price by negotiating hard and by using competitive alternatives where they are cost-effective, and it will continue to do so.

And it is just this kind of pressure from its special access customers that continually compels Verizon to develop innovative term and volume discount plans and contract tariffs to

meet its customers' needs. If Verizon does not respond promptly or satisfactorily to this pressure, its customers can and do take their business elsewhere – and they have a significant number of alternatives. Virtually everywhere that special access demand is concentrated, there are multiple alternative fiber networks as well as fixed wireless providers, cable companies, and non-traditional competitors such as systems integrators, equipment manufacturers, and applications providers. As a result, Verizon offers discounts of 40 to 70 percent off standard, month-to-month special access rates, and approximately 85 percent of Verizon's wholesale special access demand is served through these pricing plans. Moreover, these plans benefit all special access customers, large and small. Because many of the plans provide discounts for term rather than volume commitments, substantial savings are available even if a customer takes just one DS1 circuit from Verizon at a single location.

The extent of competitive entry – and the resulting downward pressure on prices – should not be surprising, because special access services are tailor-made for competitive entry. More than 80 percent of demand is generated in roughly 8 percent of Verizon's wire centers, enabling competitors to address a large portion of demand through targeted investments. And they have done exactly that. In Verizon's top 40 MSAs, there are now fiber-based collocators in *two-thirds* of the central offices accounting for 80 percent of demand for high-capacity special access services. As impressive as that statistic is, it does not even begin to show the true extent of competition. Data compiled by independent analysts – which understate the degree of entry because they rely on competitors' voluntarily disclosing details about the reach of their networks – reveal that there are many more competitive networks than there are collocators. Moreover, these data show that competitive fiber reaches directly to anywhere from several hundred to almost two thousand buildings in many of these MSAs. Still further competition comes from

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fixed wireless providers, whose services already were used by a substantial portion of business customers at the end of 2003, and from cable companies, which have deployed fiber to thousands of commercial buildings in Verizon's region. And many carriers are competing successfully using Verizon's special access services, in combination with their own networks and facilities obtained from third parties, to provide high-capacity retail services to large, medium, and small business customers.

Despite the success of the existing rules and the benefits they have produced, Verizon and its customers do share one frustration in common under the current regulations. Namely, our carrier and retail special access customers alike often express frustration that Verizon's terms and conditions are not more flexible and that Verizon cannot negotiate service plans tailored more closely to the needs of individual customers. To enable price cap LECs to respond more effectively to these demands, the Commission should move further toward a market-based approach relying upon negotiated, commercial agreements by permitting carriers to negotiate contract arrangements outside the current rules, without restriction as to location or type of service, while maintaining existing price cap regulation of general special access rates as transitional default rules that will serve as a backstop during the transition to negotiated arrangements. Such relief will benefit customers without posing any threat to competition. No customer will take service under a voluntarily negotiated, commercial agreement unless it benefits from doing so, but the added flexibility of negotiating arrangements wholly outside the existing rules will provide carriers and customers alike the ability to tailor arrangements to better meet each customer's individual needs.

Moreover, in the event the Commission retains its existing triggers for obtaining pricing flexibility, it also should modify the criteria for Phase II relief to permit price cap LECs to make

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a *prima facie* case that the triggers are satisfied by introducing evidence of competitive facilities in an MSA that are not collocated. Alternative carriers would then have an opportunity to dispute that they do in fact have fiber in an MSA, but if they fail to rebut the LEC's showing, then relief should be granted. As the Commission acknowledged in the *Pricing Flexibility Order*, the collocation-based triggers understate the degree of competition because they ignore alternative facilities that are not collocated. Because of this, Verizon has been unable to obtain Phase II pricing flexibility for end user channel terminations in some of the most competitive markets in the country, including Boston, New York, Philadelphia, and Washington, D.C.

Finally, the Commission should reject calls to impose more intrusive regulation of special access rates. The pricing and competition evidence summarized above and detailed herein shows that there is no basis for greater regulatory involvement in a functioning segment of the market.

II. COMPETITION EFFECTIVELY DISCIPLINES SPECIAL ACCESS RATES.

A. Special Access Rates Have Declined Since the Introduction of Pricing Flexibility, both Overall and for Individual High-Cap Services.

Under the pricing flexibility regime, prices have fallen, output has increased, and customers have benefited through the introduction of individualized service arrangements. Declaration of William E. Taylor ¶ 4 (Attachment C to these comments) ("Taylor Decl.") (explaining that customers of special access services "have benefited from additional competition and pricing flexibility, as demonstrated by a continued expansion of demand volumes accompanied by continued falling prices"). This experience validates the Commission's predictive judgment in the *Pricing Flexibility Order*² that satisfaction of the pricing flexibility triggers would signify sufficient competition to discipline rates: "competitive

² *Access Change Reform; Price Cap Reform for Local Exchange Carriers*, 14 FCC Rcd 14221 (1999).

pressure rather than price cap regulation has controlled the aggregate level of special access pricing.” Taylor Decl. ¶ 17.

There has been so much competitive pressure on rates that average revenues per special access line, both overall and separately for individual high-capacity special access services, have fallen significantly since the introduction of pricing flexibility. In fact, since 2001, Verizon’s average revenue per special access line has decreased by an average of 15.2 percent per year. Taylor Decl. ¶ 16, Table 1, Figure 3.³ And prices for DS1 and DS3 circuits experienced significant declines as well: “DS-1 and DS-3 special access prices fell between 2002 and 2004, averaging annual reductions of 4.2 and 6.1 percent per year respectively.” Taylor Decl. ¶ 26, Table 3.⁴ In real terms (adjusted for inflation), moreover, the decreases were even more significant: 5.7 percent for DS1 and 7.6 percent for DS3. *Id.*

Notably, rates for both special access services in the aggregate and DS1 and DS3 services individually decreased *faster* than the change in the Price Cap Index (that is, faster than inflation minus the X factor) in the post-pricing flexibility period. Taylor Decl. ¶ 16, Figure 3, Table 4.

³ These figures are calculated after removing DSL revenues from the special access category. This is a necessary and significant adjustment, since the inclusion of DSL revenues but not associated lines in the ARMIS special access category overstates revenues per line. Taylor Decl. ¶ 18. For Verizon, DSL revenues as a share of overall special access revenues have increased from [BEGIN VERIZON PROPRIETARY] [END VERIZON PROPRIETARY] over the past three years. Indeed, separating out DSL revenues, other special access revenues actually have *declined*, even as demand has continued to grow: In 2003, special access revenues (excluding DSL) decreased by about 1.3 percent, *see* Taylor Decl. Table 1, while DSL revenues increased by about 82 percent. In 2004, special access revenues (excluding DSL) remained virtually flat, *id.*, while DSL revenues increased by about 57.6 percent.

⁴ These figures look at the 2002-2004 period because data from Verizon West were not available prior to 2002. For Verizon East alone, from 2001-2004, there was an average annual reduction of 2.73 percent in DS1 prices and of 1.85 percent in DS3 prices. This was due to an initial increase in rates in 2001 followed by declines beginning in 2002. Taylor Decl. ¶¶ 25-29, Tables 3-4, Figures 4-5.

What's more, special access rates have fallen faster since 2001 than they did in the preceding five years, when ILECs operated under a strict price cap regime. *Id.* Table 1.

The rate decreases under the pricing flexibility regime occurred notwithstanding substantial growth in the number of special access lines: even though special access lines increased by approximately 15.3 percent per year from 2001-2004, special access revenues grew by only 4.8 percent annually. Taylor Decl. ¶ 14. These data thus “clearly refute any story of massive price increases for DS-1 and DS-3 services after pricing flexibility was begun in 2001.” *Id.* ¶ 29.

To the contrary, a year-by-year consideration of special access rates shows that, prior to the introduction of Phase II pricing flexibility, DS1 and DS3 rates fell “dramatically” between 2000 and 2001. Taylor Decl. ¶ 29. From this newly reduced baseline, DS3 prices rose between 2001 and 2002, while DS1 prices remained constant, “possibly associated with changes in market conditions combined with the beginning of the implementation of Phase II pricing flexibility, which allowed some previously-regulated prices to rise towards competitive market levels.” *Id.* After this initial pause in the reduction of special access prices, rates fell again between 2002-2003 and 2003-2004 – in real terms, by roughly 6 and 7.5 percent per year for DS1s and DS3s, respectively. In short, “there is no evidence of the exercise of market power in the prices charged on average for all special access services or for DS-1 and DS-3 services individually.” *Id.* ¶ 46.⁵

⁵ Attempting to ascertain whether rates in “pricing flexibility areas” have increased is both difficult and ultimately unrevealing, for several reasons. First, special access circuits are composed of different components – end-user channel terminations, POP-side channel terminations, and channel mileage – and each of these may be subject to different regulatory regimes (*i.e.*, price cap regulation, Phase I flexibility, or Phase II flexibility). Accordingly, one cannot measure whether Phase II flexibility resulted in increases in per-circuit prices for any particular circuits. Taylor Decl. ¶¶ 25, 36. Similarly, the different components of special access

B. The Reasonableness of Verizon's Special Access Rates Is Confirmed by Its Experience in Competing To Provide Special Access Services to Wholesale and Enterprise Customers.

With the explosion of alternative providers of high-capacity services, Verizon faces tremendous competition in efforts to keep wholesale special access customers on its network and to win the retail business of enterprise customers. Notably, this competition stems not only from facilities-based competitors – which directly discipline Verizon's rates – but Verizon also faces relentless competition from rivals that choose to use Verizon's special access service as an element of their own retail offerings. The success of those rivals provides additional, compelling evidence that Verizon's special access rates are just and reasonable.

Looking first at the wholesale side of the business, Verizon regularly hears from its carrier customers that they are comparing Verizon's special access prices to those of other wholesalers, including traditional competitors such as AT&T, cable companies such as Cox, Comcast, or Cablevision (Lightpath), utilities, and the many other alternative providers described in Section III, below. For example, some carriers, like [CLEC PROPRIETARY BEGINS]

[CLEC PROPRIETARY ENDS], have stated that if their costs to

circuits have received Phase II flexibility in different MSAs at different times over the past four years, and “insufficient time has passed since many MSAs were reclassified to assess whether a price change was ‘substantial and sustained.’” *Id.* ¶ 34. Moreover, the lack of Phase I flexibility can cause rates to remain above where they otherwise would be, because without region-wide authority to offer contract tariffs, price cap LECs are limited to generic discounts. Yet many special access customers purchase services on a geographically widespread basis. In any event, the data show that both DS1 and DS3 rates declined in real terms in price flex areas between 2001 and 2004; for example, the prices customers actually paid for DS3 and DS1 channel terminations declined in real terms by 5.8 percent and 2.4 percent per year, respectively, even when circuits purchased at month-to-month rates are included in the calculations. *See* Taylor Decl., Table 8. Finally, even if rates had increased in pricing flexibility areas, “it is unclear what to make of a significant and sustained price increase in an MSA granted Phase II pricing flexibility, if one were to occur and it could be accurately identified,” because “[t]reating a small but significant nontransitory increase in price as an exercise of market power assumes that the initial price is a competitive market price.” *Id.* ¶ 36. As the Commission recognized in the *Pricing Flexibility Order* (at ¶ 155), “some access rate increases may be warranted, because our rules may have required incumbent LECs to price access services below cost in certain areas.”

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build their own facilities are in the range of what they would have to pay to lease facilities from Verizon, they will build the facilities themselves. In fact, **[CLEC PROPRIETARY BEGINS]**

[CLEC PROPRIETARY ENDS] has said that Verizon receives only about **[CLEC PROPRIETARY BEGINS]** **[CLEC PROPRIETARY ENDS]** percent of its business for high-capacity service. *See* Declaration of Quintin Lew ¶ 71 (Attachment D hereto) (“Lew Decl.”).

Likewise, alternative providers such as **[CLEC PROPRIETARY BEGINS]**

[CLEC PROPRIETARY ENDS] have made it clear to Verizon that they have many choices in obtaining local access services from other wholesale access providers. In response, Verizon developed a single total billed revenue plan under which these carriers can obtain an additional credit on top of the discounts available under Verizon’s other discount plans. Lew Decl. ¶ 72. Even after Verizon responded to these customers’ concerns, however, only **[CLEC PROPRIETARY BEGINS]** **[CLEC PROPRIETARY ENDS]** subscribed to the tariff. **[CLEC PROPRIETARY BEGINS]** **[CLEC PROPRIETARY ENDS]** presumably both decided to take their business elsewhere. This experience shows not only that Verizon’s contract tariffs are available to the full range of carrier customers—not just the largest users of special access—but that competition gives carriers the ability to walk away from these contract tariffs in favor of other providers.

On the retail side, Verizon competes head-to-head against a wide range of carriers, including Sprint, Qwest, XO, Time Warner Telecom, and AT&T, as well as systems integrators such as IBM, Lockheed Martin, and EDS, in seeking to win business from enterprise customers. *See* Declaration of Eric J. Bruno ¶¶ 18-30 (Attachment E hereto) (“Bruno Decl.”). Although some of Verizon’s competitors may use Verizon’s facilities in part to fill in their networks, the

same holds true for Verizon – it is very rare for an entity providing special access services to an end user to be able to provide the required services entirely over its own network. *Id.* ¶ 12.

Notably, Verizon has had limited success in competing to serve enterprise customers, even where its competitors use Verizon’s special access services as an input. Verizon’s internal analysis shows that it has only a 7 percent share of revenues for the full range of services that large enterprise and other commercial and institutional customers purchase (voice, data, CPE, and integration services, but not including wireless services), compared to 17 percent for AT&T and 49 percent accounted for by CLECs, equipment providers, systems integrators, and IP applications providers.⁶ The same holds true even in large MSAs within Verizon’s territory. Verizon’s analysis of 10 of the largest enterprise customers in New York City, Boston, Philadelphia, and Washington, D.C. found that customers purchased only 6.39 percent of their telecommunications services from Verizon. Bruno Decl. ¶ 34. And independent analysts confirm that Verizon remains a very small player in serving the enterprise customer segment. For example, Lehman Brothers has estimated that, for 2005, Verizon would have only 10.1 percent of this \$152 billion market segment, compared to AT&T’s 15.5 percent.⁷

Indeed, alternative providers have enjoyed great success using Verizon’s special access services as inputs in providing high-capacity services to the full range of business customers – not just the largest enterprises. Competitors are using Verizon’s DS1 and DS3 special access services to provide high-capacity services to tens of thousands of business end users of all types and sizes, including auto dealers, antique shops, music and book stores, financial institutions, dry

⁶ See Declaration of Jeffrey E. Taylor, WC Docket No. 05-75 (filed Mar. 11, 2005) (Appendix 1 to these comments).

⁷ See R. Dale Lynch & Blake Bath, Lehman Brothers, *Enterprise Telecom Services: A Comeback Begins* at 15 Figure 12 (Nov. 11, 2003)(attached as Bruno Ex. 35).

cleaners, florists, gas stations, hospitals, educational institutions and governmental entities. *See* Lew Decl. ¶ 46. The success of competitors in using Verizon's special access services to reach even the smallest of business users provides irrefutable evidence that Verizon's special access rates are reasonable.

For Verizon to win enterprise customers and compete in the presence of multiple alternative carriers, Verizon must offer large discounts off of its tariffed rates. In fact, fourteen of Verizon's contract tariffs were designed initially for enterprise customers; 12 were designed initially for carrier customers, and the remaining 2 were introduced as general offerings not designed for specific customers. *See* Lew Decl. ¶ 68 n. 126. Last year, for example, a major bank put out a request for bids to upgrade all of its branch office communications facilities. With pricing flexibility, Verizon was able to develop a solution that provided the customer an effective discount for these services of 24 percent off the 5-year term plan rates for DS-3s and 16 percent for DS-1s, resulting in as much as 59 percent off the monthly rates for DS-3s and 54 percent for DS-1s. Verizon had a similar experience responding to a request from a pharmaceutical retailer, where Verizon was awarded the business in competition with several other carriers after developing an offer that allowed the customer to achieve discounts of 20 percent off SONET rings and of up to 13 percent off 5-year term rates for DS-1 services. Bruno Decl. ¶¶ 35-38.

C. **Verizon's Special Access Discount Plans Benefit Consumers and Promote Competition.**

As explained in the preceding section, competition has driven Verizon to offer a wide range of special access discount plans and contract tariffs. (A detailed description of Verizon's special access discount plans and contract tariffs is set forth in the Declaration of Quintin Lew ¶¶ 58-73.) These plans have been warmly received by Verizon's customers – fully 85 percent of

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Verizon's special access wholesale demand is met through services purchased under one or more of Verizon's several dozen term and/or volume discount plans and contract tariffs. Lew Decl. ¶ 62.

These plans are both pro-consumer and pro-competitive. In particular, consumers benefit, and competition is intensified, because these discount plans allow some of the expenses associated with provisioning facilities, customer servicing, and account initialization generally to be recovered over an extended period, permitting longer-term rates to be lower than shorter-term rates. They also promote convenience and ease of administration for both the customer and the carrier; a carrier that does not have to expend resources constantly renegotiating terms of service can pass those savings on to the customer. Likewise, these discount plans provide certainty of demand and reflect economies of scale associated with providing a larger amount of service to a single customer. And, from the customer's perspective, they provide much more than just a price break: they enhance the customer's ability to plan and budget for the development of its telecommunications network, to tailor services to its precise technical and geographic needs, to spread network design and implementation costs over the period of the contract, and to justify procurement of capital-intensive customer premise and network system equipment. *See* Lew Decl. ¶ 59; Taylor Decl. ¶¶ 43, 52-53.

As is true for our competitors, Verizon's special access discount plans afford customers significant discounts off month-to-month special access rates when they agree to obtain specific services from Verizon for a set period of time (or, in some cases, when they combine both volume and term commitments). At the same time, as discussed below, customers do not need to purchase packages of services or commit large volumes of business to Verizon in order to receive large discounts. To the contrary, any special access customer can achieve significant

savings even if the bulk of its special access demand is served through its own network or circuits obtained from a supplier other than Verizon. Moreover, customers have tremendous flexibility to transition circuits off Verizon's network and onto their own or third-party alternatives.

Bundles of Services or Geographic Areas

As the Commission has long recognized, bundles can provide significant customer benefits, including the availability to consumers of "innovative packages of goods and services that will provide customers with efficiencies and pricing that they demand." *1998 Biennial Regulatory Review – Review of Customer Premises Equipment and Enhanced Services Unbundling Rules in the Interexchange, Exchange Access and Local Exchange Markets*, 16 FCC Rcd 7418 ¶ 16 (2001).⁸ Likewise, the Commission has explained that, when the components of the bundle are available separately on nondiscriminatory terms, "whether through the functioning of a competitive market for each component or through existing regulatory requirements," there is no basis for concern about "the improper extension of market power." *Id.* ¶ 18. Indeed, where the components of a bundle are subject to competition, there should be no concern that the bundles themselves are anticompetitive even if some or all of the constituent parts were not offered separately. For these reasons, special access service bundles, to the extent they exist, are pro-consumer and are not exclusionary. *Compare* NPRM ¶ 121.

Notably, many of Verizon's discount plans do not tie discounts to the purchase of bundles of services, although customers do ask for bundles, particularly in the context of

⁸ The Commission similarly explained that bundling "reduces ... transaction costs" and "eliminat[es] the time and effort needed to find products and services in the market, negotiate appropriate purchase terms, and assemble the desired combinations." *1998 Biennial Regulatory Review* ¶ 15. Although this decision related to bundles of regulated services and equipment or information services, the same benefits flow from bundles of regulated services.

Verizon's contract tariffs. Accordingly, customers are free to obtain whatever special access services from Verizon that they wish, without also having to purchase additional kinds of services in order to receive discounts. Indeed, many of Verizon's discount plans are circuit-specific term plans, which provide discounts on individual circuits that vary depending on the length of the term to which the customer wishes to commit. Nothing in those plans obligates customers to purchase a package of different kinds of special access services in order to receive a discount.⁹ See Lew Decl. ¶ 84.

Moreover, although the vast majority of Verizon's special access discount plans are *available* throughout a broad geographic area, there is no requirement that the customer take service from Verizon throughout that entire area in order to receive a significant discount. In fact, because most of Verizon's discount plans are circuit-specific, which means that they have no volume component, customers can receive substantial discounts even if they take only a single DS1 from Verizon at a single location. Moreover, the plans that do have a volume component may be satisfied through services obtained at a small number of locations or throughout the customer's entire service area, at the customer's option. See Lew Decl. ¶ 88.

Volume Commitments

Fewer than a handful of Verizon's several dozen special access plans oblige a customer to commit to maintain a minimum percentage of its pre-existing special access expenditures with Verizon in order to receive a discount, and most of these plans provide no greater discount than

⁹ Nor do many of Verizon's non-circuit specific plans require the purchase of a bundle of services in order to obtain a discount. Although these plans may require particular volume commitments, the customer need not purchase specific packages of special access services to satisfy those commitments. Likewise, Verizon's promotional contract tariffs apply discounts to specific types of services, not service packages, and many of its total billed revenue contract tariffs do not require the purchase of a narrow bundle of services either.

is available under plans that do not contain such a requirement. *See* NPRM ¶ 122. These plans do, however, offer customers valuable flexibility. In particular, because the plans are not circuit-specific, the carrier may remove individual circuits as it chooses, without termination liability, as long as it meets the minimum service period and maintains the minimum volume level. For example, a carrier could reduce the number of special access circuits in one area as it builds out its own facilities, while adding special access circuits in another area as it begins to build a customer base there in advance of deploying facilities there as well. *See* Lew Decl. ¶ 93.

Termination Liability

As the Commission has recognized, termination liabilities serve a valid purpose in a competitive market:

The Commission has consistently allowed carriers to include provisions in their tariffs that impose early termination charges on customers who discontinue service before the expiration of a long-term discount rate plan Many of these provisions required individual customers . . . to pay charges similar, if not equivalent to, the charges that the customers would have paid had they continued service and fulfilled their minimum volume commitments. In approving these provisions, the Commission recognized implicitly that they were a valid *quid pro quo* for the rate reductions included in long-term plans. The Commission has acknowledged that, because carriers must make investments and other commitments associated with a particular customer's expected level of service for an expected period of time, carriers will incur costs if those expectations are not met, and carriers must be allowed a reasonable means to recover such costs. In other words, the Commission has allowed carriers to use early service termination provisions to allocate the risk of investments associated with long term service arrangements with their customers.¹⁰

¹⁰ *Ryder Communications, Inc. v. AT&T Corp.*, 18 FCC Rcd 13603 ¶ 33 (2003) (citations omitted).

In other words, imposing termination liability when a customer discontinues service under a term plan prior to its expiration is a legitimate means of assuring that a service provider recovers the costs incurred in initiating and continuing to provide service to customers that receive discounts in exchange for term commitments. For example, termination liabilities enable carriers to recover facility costs and up-front sunk costs involved in provisioning circuits to a special access customer. Likewise, when a customer agrees to a term commitment in exchange for a greater discount, termination liability assures that the service provider gets the benefit of the bargain if the customer terminates prior to expiration of the agreement. Customers benefit from termination liability provisions because they make term discounts possible; without termination liabilities, carriers would have to seek more onerous obligations (such as substantial up-front payments or deposits) or discontinue term discounts altogether.

Against this background, the termination liabilities in Verizon's special access discount plans are both pro-consumer and pro-competitive. *See* NPRM ¶ 123. First of all, Verizon's discount plans come in a variety of terms, ranging from one to ten years. Customers that wish to move their special access circuits to another provider or to their own facilities in the relatively near future can opt for shorter-term plans and still receive discounts off Verizon's month-to-month rates. More importantly, all of Verizon's special access discount plans contain reasonable termination liability provisions. In general, under these provisions, the customer generally is no worse off than if it had signed up for the term equivalent to the time the circuit actually remained in service. *See* Lew Decl. ¶ 96.

D. Claims That Special Access Rates Are Excessive Are Without Foundation.

As the foregoing discussion of pricing trends and discount plans illustrates, there can be no question that "competitive pressure ... has controlled the aggregate level of special access

prices.” See Taylor Decl. ¶ 17. Plainly, none of the indicia of market power – an ability to increase prices or restrict supply – is present with respect to special access services. To the contrary, the facts show that prices are falling and output is expanding, market conditions which ameliorate any concern that intrusive regulation of price cap carriers’ special access rates is needed to promote competition and protect consumers.

Nonetheless, the NPRM seeks comment on claims that ARMIS accounting rates-of-return, the rapid growth in special access revenues, and selected increases in month-to-month rates evidence market power. These factors show nothing of the sort.

1. ARMIS Accounting Rates of Return Cannot Serve Any Ratemaking Purpose.

The Commission has long recognized that accounting rates of return reported in ARMIS “do not serve a ratemaking purpose.” *Policy and Rules Concerning Rates for Dominant Carriers*, 6 FCC Rcd 2637 ¶ 194 (1991). Moreover, the Commission has acknowledged that progressive regulation should avoid consideration of accounting rates of return: “reducing our regulatory reliance on earnings calculations based on accounting data is essential to the transition to a competitive marketplace.” See *Price Cap Performance Review for Local Exchange Carriers*, 12 FCC Rcd 16642 ¶ 150 (1997).¹¹ As this statement indicates, reverting to rate-of-return regulation would be a giant, and wholly unnecessary, step backwards.

The key question in this proceeding is not what rate of return LECs are earning on their special access services (assuming for the moment that an economically meaningful rate of return could even be calculated). It is whether the market is driving price changes and supply is

¹¹ Moreover, while ARMIS accounting reports and data serve certain oversight and regulatory purposes for the Commission, the agency well understands that evaluating the reasonableness of price cap rates is neither an intended nor a possible purpose for those data. See generally, *1998 Biennial Regulatory Review*, 14 FCC Rcd 11443, 11448 (1999).

increasing commensurate with demand. As the Commission has observed, “determinations [of] whether rates fall within [the zone of reasonableness required by Section 201(b)] are *not* dictated by references to carriers’ costs and earnings, but may take account of non-cost considerations such as whether rates further the public interest by tending to increase the supply of the item being produced and sold.” *Petition on Behalf of the State of Hawaii, Public Utility Commission, for Authority To Extend Its Rate Regulation of Commercial Mobile Radio Services in the State of Hawaii*, 10 FCC Rcd 7872 ¶ 7 (1995) (emphasis added) (footnotes omitted).¹² In fact, the Commission has emphasized that “evidence concerning dynamic factors” such as “growth and investment” is a “more persuasive market indicator than evidence concerning static factors” such as “prices or rates of return.” *Id.* ¶ 26. This point is particularly relevant to special access services, where there has been tremendous supply growth and no indication that carriers have been “restricting the output of [that] service in order to increase its price.” *Id.* ¶ 25.

Consistent with the Commission’s longstanding understanding of the limitations of the ARMIS data, the NPRM correctly questions any “reliance on accounting rate of return data to draw conclusions about market power.” NPRM ¶ 129.¹³ This skepticism regarding the utility of

¹² In making this statement, the Commission relied on two Supreme Court decisions confirming that rate of return is not the determinant of whether rates are just and reasonable. *See FERC v. Pennzoil Producing Co.*, 439 U.S. 508, 517 (1979) (zone of reasonableness is not defined by a “rigidly ... cost-based determination of rates, much less ... one that bases each [carrier’s] rates on its own costs”); and *Mobil Oil Corp. v. Fed. Power Comm’n*, 417 U.S. 283, 316 (1974) (rejecting the argument that rates “must be based entirely on some concept of cost plus a reasonable rate of return” and noting that agencies can consider “additional non-cost incentives” intended to increase supply).

¹³ *See also* NPRM n.167 (“Financial managers are frequently misled when they focus on the accounting definition of profit”) (quoting Franklin M. Fisher & John J. McGowan, *On the Misuse of Accounting Rates of Return to Infer Monopoly Profits*, 73 AMERICAN ECON. REV. 82, 83 (1983); Thomas E. Copeland & J. Fred Weston, FINANCIAL THEORY AND CORPORATE POLICY 22-25, 28 (3d ed. 1988)); *id.* ¶ 62 (“Even if the overall accounting rate of return has evidentiary value ... we also seek comment on whether an accounting rate of return for a subset of services, *i.e.*, the special access basket of services, is meaningful to this inquiry”); *id.* ¶¶ 29, 59 (observing that parties have argued that “accounting rates of return are meaningless”).

ARMIS rate-of-return data is well-warranted, particularly given the direct marketplace evidence of declining special access rates and robust competition.

The arbitrary nature of the ARMIS category-specific data is evident from examining the special access and switched access rates of return over time, presented in Table 1 below.

Table 1

Year	Price Cap Interstate Return	Traffic Sensitive Basket "Return"	Special Access Basket "Return"
2004	15.83 percent	1.79 percent	31.48 percent
2003	12.40 percent	1.77 percent	22.99 percent
2002	15.10 percent	4.41 percent	23.81 percent
2001	17.08 percent	7.81 percent	21.72 percent
2000	17.24 percent	20.70 percent	15.55 percent

Source: 2000-2004 Verizon ARMIS Reports 43-01

While Verizon's overall interstate rate of return remained within a fairly narrow and reasonable range between 2000 and 2004, the reported special access returns increased somewhat and the switched access returns dramatically declined. Accordingly, if the Commission were to give weight to service-specific rates of return, it would have to ameliorate the apparently confiscatory returns in the switched access category. As the Supreme Court has long instructed regulators, utilities must be permitted to charge rates that enable them to recoup a reasonable return on their investments. Moreover, cutting special access rates while failing to adjust the bare-bones rate of return for switched access services would amount to an unconstitutional "taking" because the Commission must allow a reasonable return for services within its jurisdiction. *Smith v. Illinois Bell Tel. Co.*, 282 U.S. 133, 160-61 (1930). It therefore

cannot slash prices for one set of services without allowing increases in others, where the failure to do so would be confiscatory.

The flaws in the category-specific ARMIS rate-of-return data stem from wholly arbitrary allocations of costs among categories of interstate services. *See generally* Taylor Decl. ¶¶ 93-95 (explaining the “impossibility” of “assigning fixed common costs and network investment in any economically meaningful way”). In addition, there are mismatches between revenues and costs among the ARMIS categories. For example, marketing expenses related to all interstate categories are recovered predominantly through common line rates, and expenses and revenues associated with universal service contributions and other regulatory surcharges are booked to different categories. There may be perfectly good reasons for such misallocations; because rates are no longer determined by category-specific rate-of-return calculations, there is no longer any need to preserve any semblance of alignment between costs and rates in any particular category. However, having proceeded on that basis, the Commission cannot now determine that the rate of return for any specific category has any meaning.

While acknowledging the considerable limitations of the ARMIS rate of return data, the NPRM (at ¶ 29) nevertheless suggests that those data can be used to “examin[e] the relationship between demand growth and growth in expenses and investment,” and speculates that this relationship “should not be significantly affected by the cost allocation issues these parties raise.” NPRM ¶ 28. This is incorrect: “it is not at all clear what the effect of an increase in special access lines has been on the economic costs of special access services. ... [F]ully-distributed costs for particular services are not necessarily related to the economic costs of the service.” Taylor Decl. ¶ 70. More telling is the fact that prices are continuing to decline even as demand is continuing to increase. That, in and of itself, demonstrates that special access prices are

competitively disciplined and that regulatory intervention would be unwarranted and counter-productive.

2. Neither the Growth in Special Access Revenues nor Increases in Certain Rates Show that Special Access Rates Are Unreasonably High.

The NPRM (at ¶ 19) observes that parties have alleged that the rapid growth in BOC special access revenues and purported increases in special access rates demonstrate that the pricing flexibility regime permits BOCs to charge excessive special access rates. Such allegations are incorrect.

Looking first at revenue growth, it is quite true that special access revenues have increased substantially over time. However, analyzing the sources of that growth undercuts any suggestion that unreasonably high special access rates are to blame. As Dr. Taylor explains, “the growth in special access lines [for large ILECs] far outstripped the growth in revenues.” Taylor Decl. ¶ 14; *see also* NPRM ¶ 28. In other words, special access revenue growth is a product of new demand for special access services – particularly from data and wireless services – rather than increased rates. Taylor Decl. ¶¶ 9, 14.¹⁴

Moreover, the ARMIS data overstate the ratio between special access revenues and special access lines because they count DSL revenues but not DSL lines. That is, the gap between line growth and revenue growth is even greater than the ARMIS numbers indicate. *See* Taylor Decl. ¶ 15. In fact, excluding DSL revenues reveals that Verizon’s total special access revenues (as opposed to per-line revenues) actually *fell* by one percent in 2003 and remained essentially flat in 2004 (and fell in both years in inflation-adjusted terms), even as the number of special access lines continued to expand (from roughly 25 million in 2001 to more than 39

¹⁴ Verizon’s special access revenues attributable to wireless demand increased by 218 percent between 2000 and 2004. *See* Lew Decl. ¶ 79, n.133.

million in 2004). *See id.* Table 1; NPRM ¶ 63 (noting the problems caused by the inconsistent treatment of DSL revenues and lines).

Similarly, it would be inappropriate to draw conclusions about special access rate levels based on the fact that some rates have increased (particularly in Phase II areas). Such increases should be expected in competitive areas. As the market becomes increasingly competitive, there is a greater risk that customers will leave for other suppliers before the incumbent LEC has recovered all of the up-front costs of providing service. Under these conditions, both the incumbent LEC and its competitors will seek to charge higher short-term rates in order to minimize the risk of stranded investment. Taylor Decl. ¶ 41 (“month-to-month service entails higher costs to all suppliers of the service, so that in effectively competitive markets, we would expect to see higher prices for such services. In particular, the higher churn rate of month-to-month customers means that any supplier would have to charge a higher price to amortize significant up-front, non-recurring costs over the shorter expected tenure of the customer.”).

In any event, the actual rates that customers pay – not “list prices” – are the appropriate starting point for any pricing analysis. And the significant majority of Verizon’s special access demand – 85 percent – is satisfied through discount plans that provide substantial discounts off month-to-month rates. Moreover, revenues per line for DS1 and DS3 services are continuing to decline by roughly 4 to 6 percent per year (5.7 to 7.5 percent per year when inflation is considered), regardless of changes in individual short-term rates or rate elements.

III. THERE IS EXTENSIVE FACILITIES-BASED COMPETITION WHEREVER APPRECIABLE SPECIAL ACCESS DEMAND EXISTS.

As one would expect given the pricing evidence discussed above, competition in the provision of special access services is widespread. Even the limited information that is available to Verizon – given the reluctance of competitors to disclose in regulatory proceedings the extent

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of their networks and operations – confirms that such competition exists virtually everywhere that there is significant demand for special access, regardless of whether those areas have met the pricing flexibility triggers.¹⁵ And it comes from a multitude of sources, including fiber-based CLECs (which sell services directly to end users and make capacity on their networks available to other competitors) and inter-modal alternatives such as fixed wireless and cable.

Such a result is not surprising, given the concentrated demand for such services. As Verizon has detailed elsewhere, more than 80 percent of the demand for Verizon’s high-capacity access services is concentrated in a little over 8 percent of the Verizon wire center locations contributing to Verizon’s high-capacity local access revenue. *See* Lew Decl. ¶ 10 and Exs. 1-3. Put simply, it is hard to conceive of a market more tailor-made for competitive entry than special access – and, as a result, competitors have been serving that market for the past quarter-century, and the level of competition continues to intensify with each passing year.¹⁶

A. Fiber-Based CLECs

Even the least inclusive measure of special access competition – data regarding collocation by fiber-based CLECs – reveals that there is competitive fiber in nearly *two-thirds* of the Verizon wire centers that account for 80 percent of the demand for high-capacity special access services. Lew Decl. ¶ 10. And in central offices with 5,000 or more business lines, there

¹⁵ Under well-established precedent, the Commission must infer that data that competitors obviously maintain but have purposely withheld are unfavorable to them. *See, e.g., Int’l Union, UAW v. NLRB*, 459 F.2d 1329, 1336 (D.C. Cir. 1972) (“[W]hen a party has relevant evidence within his control which he fails to produce, that failure gives rise to an inference that the evidence is unfavorable to him.”).

¹⁶ To ascertain the level of facilities-based competition for special access services, Verizon analyzed data from three separate sources: collocation inspections in 480 Verizon wire centers within the top 40 MSAs in Verizon’s territory, data compiled by independent analysts (GeoTel and GeoResults) regarding deployment of competitive fiber facilities and buildings served by facilities-based CLECs, and evidence from competitive carriers themselves. *See* Lew Decl. App. A.

is still more competition, with collocated fiber in wire centers accounting for nearly *three-quarters* of all high-capacity special access revenues generated in those central offices. *Id.* Moreover, both large and small competitors have multiple collocations in the MSAs accounting for the vast majority of Verizon's special access demand, with individual CLECs collocating in anywhere from several dozen to well over 100 central offices just in the top 40 MSAs. *Id.* ¶¶ 11-12.¹⁷

As compelling as they are, these collocation statistics do not begin to reveal the full extent of competition by fiber-based CLECs, since they exclude both the many CLECs that bypass Verizon's switches yet have substantial local fiber networks, and competition from inter-modal alternatives, such as fixed wireless and cable providers.¹⁸ The GeoTel data show that alternative carriers (not including MCI and Verizon Wireless) collectively have deployed dozens of networks in many of Verizon's top 40 MSAs with their own fiber. *See* Lew Decl. ¶¶ 15-20.

Indeed, comparing Verizon's collocation inspection results with the GeoTel data on carriers with fiber underscores how underinclusive the collocation data and corresponding pricing flexibility triggers are. In each of the MSAs in the following table, Verizon has not received Phase II pricing flexibility for end-user channel terminations because it has not met the

¹⁷ The MSA data initially were collected and analyzed during Verizon's preparation of responses in the 2004 *Triennial Review Remand* proceeding. As such, these data depend on more recent MSA definitions than the definitions used in the 1999 *Pricing Flexibility Order*. Nonetheless, revisions to the MSA boundaries do not alter the fact that special access competition is robust wherever there is appreciable demand throughout Verizon's region.

¹⁸ In addition, collocation has increased only very slightly since 2002, even as fiber deployment has increased substantially. In 2002, there were 4844 collocation arrangements in Verizon East and 998 in Verizon West. The corresponding figures for 2005 are 4922 and 1158. Notably, collocation actually remains well below 2001 levels, notwithstanding the tremendous growth in alternative fiber networks. (In 2001, there were 6293 collocation arrangements in Verizon East and 1224 in Verizon West.)

collocation-based triggers. Yet the GeoTel data show that there are many carriers with their own fiber serving these MSAs, in addition to those identified in Verizon's collocation inspections:

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Table 2: Comparison of Collocation Inspection and GeoTel Data*

MSA	Total Carriers With Fiber Not Collocated in Verizon Central Offices	Total Route Miles for Such Carriers from GeoTel Data
Baltimore	5 Carriers (Plus 13 collocators)	86.9 Route Miles
Boston	6 Carriers (Plus 18 collocators)	645.59 Route Miles
Los Angeles	15 Carriers (Plus 8 collocators)	1803.9 Route Miles
New York	10 Carriers (Plus 28 collocators)	1880.56 Route Miles
Philadelphia	10 Carriers (Plus 20 collocators)	1112.7 Route Miles
Washington, D.C.	11 Carriers (Plus 21 collocators)	427.8 Route Miles

**Both the collocation and the GeoTel data exclude MCI and Verizon Wireless*

Notably, the GeoTel data are far from comprehensive. Lew Decl. ¶ 20. After all, there is no compulsion for competitive special access providers to report the full extent of their operations, and these entities may have reasons for withholding such information from data-gathering organizations whose work product will be used in regulatory proceedings.

Nonetheless, Verizon’s own market research, based in large part on information in carriers’ public web sites, reveals that there are numerous competitors that are not captured in either the GeoTel or the collocation data. For example:

ITC Deltacom (“ITC”). Through Interstate Fibernet, ITC offers wholesale DS-1 to OCn level services as well as ATM, Frame Relay, and Private Line high-capacity services to CLECs,

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LECs, ILEC, and wireless carriers. Lew Decl. ¶ 14. ITC reports that its network spans 14 states and consists of 236 POPs and 14,488 miles fiber optic infrastructure. *Id.* According to its network maps, ITC serves many areas in Verizon’s region, including New York Metro, Philadelphia, Raleigh, Richmond, Tampa, and Washington, D.C. *Id.* **[CLEC PROPRIETARY BEGINS]**

[CLEC

PROPRIETARY ENDS]

NTS Communications (“NTS”). NTS states that it offers “dedicated point-to-point transport, and wholesale internet access services to wholesale carrier customers from every corner of the United States.” Lew Decl. ¶ 14. NTS also reports that it has an extensive fiber network in many of the areas within Verizon’s region including Boston, Providence, Buffalo, Newark, New York Metro, and Philadelphia. *Id.* **[CLEC PROPRIETARY BEGINS]**

[CLEC PROPRIETARY ENDS]

WilTel Communications (“WilTel”). WilTel is a facilities-based competitor that provides wholesale high-capacity DS-1s, DS-3s, OCns, Private Line, SONET, ATM, and Frame Relay facilities to other telecommunications providers. Lew Decl. ¶ 14. WilTel reports that its network links more than 100 U.S cities and that its “relationships with more than 40 non-RBOC vendors and 12,000 off-net locations for ubiquitous coverage.” *Id.* **[CLEC PROPRIETARY BEGINS]**

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[CLEC PROPRIETARY ENDS]

Importantly, the above examples are just a small sampling of fiber-based competitors. See Lew Decl. ¶¶ 15-23 (providing information about almost three dozen special access competitors). Moreover, these data do not even include companies which compete successfully by reselling Verizon special access as well as capacity obtained from alternative providers. As explained in section II.B, above, competitors using Verizon special access have been able to capture much greater amounts of business from enterprise customers than Verizon itself.

B. Inter-Modal Alternatives

Competitors also note that they increasingly are using fixed wireless and cable as alternatives to wireline special access. Cable broadband can substitute directly for traditional private line services used by small and medium businesses,¹⁹ and cable operators aggressively are extending their fiber to the premises of office buildings.²⁰ In fact, *Communications Daily*

¹⁹ C. Munroe, IDC, *U.S. Private Line Forecast and Analysis, 2002-2007* at Table 2 (Dec. 2003) (“Broadband [*i.e.*, cable modem and DSL] substitution for sub-T1 and T1 lines will account for over \$3 billion in lost private line revenue” between 2003 and 2007.); K. Burney, *et al.*, In-Stat/MDR, *Cash Cows Say “Bye-Bye”: The Future of Private Line Services in US Businesses* at Table 15 (Dec. 2003) (“*In-Stat/MDR Private Line Report*”) (77 percent of “enterprise” respondents and 55 percent of “middle market” respondents were considering replacing or had plans to replace their T1 line with a cable modem or DSL connection.).

²⁰ The GeoTel data reveal that cable companies already have deployed a great deal of fiber to commercial buildings, including many in smaller MSAs. [VENDOR PROPRIETARY BEGINS] [VENDOR PROPRIETARY ENDS] for example, has facilities to [VENDOR PROPRIETARY BEGINS]

[VENDOR PROPRIETARY ENDS] Similarly, [VENDOR PROPRIETARY BEGINS] [VENDOR PROPRIETARY ENDS] has facilities to [VENDOR PROPRIETARY BEGINS] [VENDOR PROPRIETARY ENDS]. See Lew Decl. ¶ 43.

recently reported that “executives from Comcast, Time Warner Cable, Cox and Cablevision Systems [have] spelled out ambitious plans to expand rapidly in commercial-sector telecom services over the next 18 months.” Lew Decl. ¶ 36.

In fact, every major cable company has a portion of its web site dedicated to services for business customers.²¹ Lew Decl. ¶ 34. In addition, cable companies also have separate web sites dedicated to small, medium, and large business customers, with targeted advertising for each audience. *Id.* Cox Communications, for example, not only touts that it “has solutions” for small business customers, will “help your medium-sized business reach extra-large goals,” and that it is the “ideal communications partner” for large business customers with Cox’s high capacity voice and data solutions, but it also includes web sites dedicated for various types of industries –

²¹ Cable companies have created websites dedicated to advertising the availability of voice and data services to business customers. *See e.g.*, Cox Communications, *Small Business*, <<http://www.coxbusiness.com/smbusiness/>> (last visited June 10, 2005); Cox Communications, *Medium Business*, <<http://www.coxbusiness.com/mdbusiness/>> (last visited June 10, 2005). Cox Communications, *Large Business*, <<http://www.coxbusiness.com/lgbusiness/>> (last visited June 10, 2005); Cox Communications, *Specific Industries*, <<http://www.coxbusiness.com/industries/>> (last visited June 10, 2005); <http://work.comcast.net/commuter.asp>; Cablevision Lightpath, *Our Network Built for Business*, <http://www.lightpath.net/> (last visited June 10, 2005); *See* Cablevision Lightpath, *Healthcare*, <<http://www.lightpath.net/Interior18.html>>; *Education and Government*; <<http://www.lightpath.net/Interior19.html>>; *Financial Services*; <<http://www.lightpath.net/Interior20.html>>; *Carriers and ISPs*; <<http://www.lightpath.net/Interior21.html>> (last visited June 10, 2005; Time Warner Cable, *Private Network*, http://www2.twnyc.com/index2.bus.cfm?c=new_bus/privatenetwork).

Cable companies also have web sites touting cable modem services for business customers. *See e.g.*, Comcast, *Business Products, Small Business*, <<http://www.work.comcast.net/smallbusiness.asp>> (last visited June 10, 2005); Cablevision Lightpath, *Business Class Optimum Online*, <http://www.lightpath.net/Interior98.html> (last visited June 10, 2005); Time Warner Cable, *Small and Middle-Sized Business Solutions*, http://www.rrbiz.com/RoadRunner/sec_formatted.asp?TRACKID=&CID=16&DID=21 (last visited June 10, 2005); Time Warner Cable, *Enterprise Solutions*, http://www.rrbiz.com/RoadRunner/sec_enterprise.asp?TRACKID=&CID=17&DID=22 (last visited June 10, 2005); Cox Communications, *Cox Business Internet*, <http://www.coxbusiness.com/products/data/businessinternet.html> (last visited June 10, 2005).

including government, education, healthcare, and hospitality. *Id.* Cablevision Lightpath likewise has websites dedicated to specific industries, as well as web sites for carrier customers purchasing Cablevision Lightpath's wholesale services. *Id.*

Moreover, Cox Communications advertises to business customers that it is a "facilities-based provider of advanced voice, data and video products and services," and that "[t]housands of miles of fiber-optic cable make up the Cox system, designed with self-healing, fault tolerant SONET architecture for enhanced dependability." *Lew Decl.* ¶ 35. Similarly, Time Warner Cable ("TWC") tells businesses that, in New York City, it "has access into all major commercial buildings in Manhattan and with [its] Hybrid Fiber Network (HFC)" and provides businesses a range of services, including OC-n (OC-3 to OC-192), high-end video transport, high-speed Ethernet for private line, VLAN, Internet and Storage protocol. *Id.* Time Warner Cable further advises businesses that it "is not your typical communications company" because it offers "a completely diverse network independent of the ILEC network" and has its "own fiber throughout the New York Metro area and access to over 2500 commercial buildings in our footprints." *Id.* And Comcast informs businesses that it "has been delivering service to commercial organizations since 1995 and has thousands of customers leveraging the Comcast network for critical business applications." *Id.*

The cable companies' local fiber networks are extensive, and they have enjoyed great success in utilizing those networks to serve businesses as well as other carriers. For example, Cablevision Lightpath, which markets commercial and wholesale transport services ranging from Ethernet and DS-1s to OC-192, operates a fully-redundant optical network facility that is comprised of over 400 SONET rings and over 1,600 on-net buildings. *Lew Decl.* ¶ 37. Cablevision Lightpath's fourth quarter 2004 and full-year 2004 earning statement attributes its

20 percent increase in revenues in large part to “growth in data revenue from both Optimum Online for business and Lightpath.net and other data transport services over Lightpath’s fiber infrastructure.” *Id.* Cablevision reports that it has approximately 154,000 access lines in the New York, New Jersey, Connecticut region and states that it has become “the preferred provider of voice, data, and Internet services for more than 4,000 businesses throughout Long Island, Westchester County, New York City, Connecticut, and New Jersey.” *Id.* ¶ 38.

Likewise, Cox Communications, which has “[t]housands of miles of fiber-optic cable” and has facilities in 46 markets through Verizon’s territory, reported an “increase in Cox Business Services customers” for both the fourth quarter of 2004 and the full year. Time Warner similarly has highlighted its “opportunity to go more aggressively after the enterprise business,” and already provides service to many large business customers, such as L.L. Bean and Fairchild Semiconductor International. *Lew Decl.* ¶¶ 39-41. Comcast states that it “has been delivering service to commercial organizations since 1995 and has thousands of customers leveraging the Comcast network for critical business applications,” and Charter reports that its fourth quarter and year-end 2004 “[c]ommercial revenues increased \$12 million, or 24 percent” and saw “increased high-speed data (HSD) revenues [of] \$53 million, or 35 percent.” *Id.* ¶ 42.

Cable companies also offer these services on a wholesale basis to other carriers. For example, Cox Cable markets “a pure point-to-point fiber optics connection from our network directly to your customers over a system architecture that ensures enhanced security, reliability, and speed” in 23 different markets. *Lew Decl.* ¶ 44. Cox also advertises that it can “[c]onnect your own points of presence or interconnect to another carrier, whether that carrier is an ISP, ILEC, IXC, CLEC, BLEC, or wireless provider,” and that Cox Cable’s “Customer End Loops . . . are available in DS-1, DS-3, OC-3 and OC-12 bandwidths.” *Id.*

Finally, fixed wireless enables carriers to extend their existing fiber networks quickly and cheaply to off-net customers, Lew Decl. ¶¶ 25-32, and, as XO has stated, to “bypass the Regional Bell Operating Companies (RBOCs) and provide direct access to our end customers.” *Id.* ¶ 29.²² Indeed, a December 2003 study found that 40 percent of enterprise customers and 23 percent of small business customers used fixed wireless for some high capacity service, with those numbers projected to have grown to 54 percent and 35 percent, respectively, by December 2004. *Id.* ¶ 27.

C. Verizon’s Experience Out-of-Region

Verizon’s experience out-of-region confirms that there are a multitude of alternative suppliers of wholesale special access wherever substantial demand exists. Specifically, in 2003, a Verizon long distance affiliate issued requests for proposal for high-capacity access services in 28 out-of-region markets. Verizon received responses from eight carriers in addition to the incumbent LEC (but excluding MCI). In evaluating the proposals, Verizon considered the geographic coverage offered by a given provider, price, the bidding carrier’s ability to provide interconnection at the Verizon POP, and the bidding carrier’s ability to meet Verizon’s operational and provisioning requirements.

For *all* of the locations that Verizon evaluated, Verizon had a choice of viable competitors capable of providing strong coverage in areas of highly concentrated demand. In many areas, Verizon determined that at least two viable competitive carriers were capable of providing access services in areas of highly concentrated demand. For example, in Houston, Verizon found two carriers, serving between 100 and 200 buildings, offered strong coverage in

²² Likewise, TowerStream advertises that its services offer a means of “bypass[ing] the ILEC’s wires altogether,” noting that it “provides business-class wireless Internet access to over 700 businesses in five major metropolitan areas, and other broadband fixed wireless providers.” Lew Decl. ¶ 28.

the city. Likewise, in Chicago, Verizon found providers that were capable of providing access to more than 70 buildings. Even in smaller locations, there were frequently two or more competitive carriers that provided strong coverage in areas of highly concentrated demand. In Cleveland, three carriers (serving between 40 and 80 buildings) provided solid coverage in areas of highly concentrated demand. *See* Declaration of Robert F. Pilgrim ¶¶ 14-15 (Attachment F hereto) (“Pilgrim Decl.”).

In nineteen of the twenty-eight areas for which it selected a primary access provider, Verizon contracted with a competitive carrier to be its primary access provider. In three of the six areas in which it also selected a secondary access provider, Verizon chose a competitive provider to be its secondary access provider. Through these carriers, Verizon is now offering high capacity services on a competitive basis in at least twenty-six out-of-region states. *See* Pilgrim Decl. ¶¶ 17-21.

IV. THE COMMISSION SHOULD ALLOW CARRIERS AND THEIR CUSTOMERS TO ENTER INTO VOLUNTARILY NEGOTIATED COMMERCIAL AGREEMENTS OUTSIDE THE SCOPE OF THE CURRENT RULES.

For the past 20 years – since the first competitive access providers appeared shortly after divestiture – the Commission gradually has lessened regulation of ILEC special access rates in response to burgeoning competition. The 1999 *Pricing Flexibility Order* was another incremental step along that exceedingly cautious path. Now, the time has come to move further toward a market-based approach relying upon negotiated, commercial agreements. Indeed, Verizon’s special access customers – carriers and end users alike – have expressed significant frustration that Verizon lacks greater flexibility to tailor its special access offerings to their individualized needs. *See* Lew Decl. ¶ 54; Bruno Decl. ¶ 39.

In particular, the Commission should take four steps to assure that there are no unwarranted regulatory obstacles to full and fair special access competition.

First, the Commission should permit LECs to enter individually negotiated agreements, outside the current rules, for all access services throughout their serving territories. Relying upon negotiated, commercial agreements is the best long-term solution to ensuring efficient, competitive results, and provides inherently more flexibility to meet the needs of customers in the face of rapidly emerging technologies and an increasingly competitive market. Price cap regulation of special access rates, where it exists today, could serve as a default backstop during the transition to negotiated arrangements. This relief would merely allow LECs to negotiate additional alternatives tailored to the needs of particular customers and would produce significant customer benefits. After all, customers will only agree to a negotiated arrangement if it will yield benefits compared to generally available special access offerings, including lower rates and more flexible service terms.²³

Today, Verizon's competitors are able to craft individualized deals for every customer, no matter what services the customer needs and where it is located. Verizon has no such flexibility. Rather, at best Verizon can file a contract tariff, and if a potential customer requires services for which Verizon has not obtained contract tariff authority, Verizon must serve that customer at least in part pursuant to its generally available tariffs. While those tariffs contain significant volume and term discounts, the lack of authority to negotiate commercially-driven, individualized service arrangements precludes Verizon from offering additional price breaks or

²³ See Taylor Decl. ¶ 5 (“this flexibility would create no risk that customers would suffer from the exercise of market power if competition turned out to be insufficient to control prices.”).

more tailored service terms, seriously impairing Verizon's ability to compete and harming customers.

Second, to the extent the Commission retains the pricing flexibility triggers, it should allow price cap LECs to secure Phase II relief using evidence of both fiber-based collocation and the existence of alternative, non-located special access alternatives. Specifically, LECs should be able to satisfy the Phase II triggers by submitting evidence of alternative fiber in the area served by specific wire centers – whether obtained from competing carriers' web sites, independent companies such as GeoTel, documented internal surveys, or other sources – without regard to whether that fiber is collocated in the relevant wire centers. Rather, evidence of the existence of such fiber within the area served by the wire center would establish *prima facie* compliance with the triggers. Of course, the Commission will still lack the most complete and direct evidence of the scope of competitive facilities deployment – the network information maintained by the competitors themselves. Accordingly, the Commission should consider requiring competitors to provide complete network maps in order to assure that it has as comprehensive a record as possible. At a minimum, any competitor objecting to grant of the petition should be obligated to provide full network maps – for the subject wire centers as well as the remainder of the price cap LEC's region – showing where it does and does not have fiber. In the absence of such persuasive rebuttal evidence, the LEC would be entitled to Phase II relief.

In the *Pricing Flexibility Order* ¶ 79, the Commission explained that “irreversible, or ‘sunk’ investment in facilities used to provide competitive services is the appropriate standard for determining when pricing flexibility is warranted.” Yet rather than looking at the entire universe of competitive facilities, the Commission adopted pricing flexibility triggers that considered only fiber providers that collocated in an ILEC central office. In doing so, it

acknowledged – and the D.C. Circuit expressly agreed – that “evidence of collocation may underestimate the extent of competitive facilities within a wire center, because it fails to account for the presence of competitors that do not use collocation and have wholly bypassed incumbent LEC facilities.” *Id.* ¶ 95; *aff’d*, *WorldCom, Inc. v. FCC*, 238 F.3d 449, 459 (D.C. Cir. 2001). As discussed in section III above, marketplace realities reveal the Commission’s assessment to be a considerable understatement.

In particular, competition in the provision of special access services has continued to grow since adoption of the pricing flexibility rules, but many competitors do not collocate extensively in LEC central offices. In fact, as explained in Section III, the amount of collocation appears to have leveled off since 2001 notwithstanding the continued growth of alternative fiber networks. As a result, Verizon lacks needed flexibility in many highly competitive urban areas, as well as numerous smaller markets. For example, Verizon has not received *any* pricing flexibility for end user channel terminations in Houston and Los Angeles. And Verizon has received only Phase I relief for these facilities in Boston, New York, Philadelphia, Baltimore, and Washington, D.C., even though (as shown in Table 2, *supra*), there are many non-located alternative fiber providers (with dozens, hundreds, or even thousands of miles of fiber) in each of these MSAs – and even those data seriously understate the extent of fiber-based competition and ignore the widespread availability of inter-modal special access alternatives from fixed wireless and cable providers.

Regardless of whether they are collocated, “[f]iber networks in an MSA ... represent irreversible investment in providing competitive special access services.” Taylor Decl. ¶ 55. Accordingly, the Commission should permit price cap LECs to satisfy the Phase II triggers through evidence of all competitive alternatives in an MSA, not just those that happen to be

collocated. The overly narrow focus of the current triggers effectively forces Verizon to pull its competitive punches, sacrificing potential consumer benefits and constraining free competition.

Third, the Commission should eliminate the service categories and sub-categories within the special access basket, which unduly “inhibit [price cap LECs’] ability to compete by offering packages of services in whatever combinations customers want.” Taylor Decl. ¶ 73. Adopting a unitary special access price cap with no service categories and categories would assure that Verizon could “restructure rates in response to market forces — recognizing that the market forces in question would likely be imposed by regional, national or global price competition that may have little to do with the circumstances of a particular price-capped MSA where few customers — and thus few competitors — are located.” *Id.* ¶ 75. And consumers, of course, benefit most when all competitors can respond immediately to market pressures without regulated rate structures that “have no claim to efficiency.” *Id.* ¶ 76.

Fourth, the Commission should continue to exclude packet-switched services from price cap regulation, and instead move forward with removing any price regulation of these services. See NPRM ¶ 52.²⁴ Packet-switched services include, for example, DSL, frame relay, ATM, and IP-VPN, all of which are highly competitive offerings that the Commission is considering deregulating in whole or in part in the *Broadband Title I* and *Broadband Title II* proceedings.²⁵

²⁴ See also *Petition for Waiver of the Commission’s Price Cap Rules for Services Transferred from VADI to the Verizon Telephone Companies*, DA 05-1335, WCB/Pricing File No. 05-17 (rel. May 11, 2005) (extending a waiver permitting Verizon to keep advanced services transferred from Verizon Advanced Data Inc. to the Verizon telephone operating companies out of price cap regulation).

²⁵ See *Review of Regulatory Requirements for Incumbent LEC Broadband Services*, 16 FCC Rcd 22745 (2001); *Appropriate Framework for Broadband Access to the Internet over Wireline Facilities*, 17 FCC Rcd 3019 (2002).

ILECs also have pending petitions for forbearance for these services.²⁶ It would make no sense to impose new regulations on these services while the Commission evaluates whether Title II regulations are appropriate at all.

V. THERE IS NO BASIS FOR IMPOSING MORE INTRUSIVE REGULATION OF SPECIAL ACCESS RATES ON EITHER AN INTERIM OR PERMANENT BASIS, AND DOING SO WOULD BE INIMICAL TO COMPETITION AND THE INTERESTS OF CONSUMERS.

The NPRM (at ¶¶ 59-106) asks a series of questions regarding special access investment, expenses, demand, and supply, which would be relevant only if there were an incontrovertible need to unravel decades of increasing reliance on market forces and return to the agonizingly protracted private line rate proceedings the Commission has not conducted since the 1970s.²⁷ As documented above, there is no such need: all the cost studies in the world cannot change the fact that special access competition is robust and the marketplace is working. Accordingly, there

²⁶ See Public Notice, *Comments Invited On Petition For Forbearance Filed By The Verizon Telephone Companies With Respect To Their Broadband Services*, WC Docket 04-440, DA 04-4049 (rel. Dec. 20, 2004); See also Public Notice, *Comments Invited on Petition for Forbearance Filed by BellSouth Telecommunications, Inc. Regarding Incumbent LEC Provision of Broadband*, WC Docket No. 04-405, DA 04-3507 (rel. Nov. 3, 2004); Public Notice, *Wireline Competition Bureau Extends Reply Comment Deadline for Petition for Forbearance Filed by BellSouth Telecommunications, Inc. Regarding Incumbent LEC Provision of Broadband*, WC Docket No. 04-405, DA 04-3988 (rel. Dec. 20, 2004).

²⁷ Indeed, the complexity and intrusiveness of the inquiries in the notice are reminiscent of the infamous Docket 18128, which traced its roots to an investigation of AT&T private line rates that was initiated in 1961, continued through the “Seven-Way Cost Study” of 1965, morphed into a new proceeding in 1968, spun off various satellite dockets as new rates for specific private line services were filed, and generated testimony from 53 witnesses and 27,000 pages of hearing transcripts and exhibits, before finally culminating in a *Memorandum Opinion and Order* in 1976 that directed AT&T to eliminate its TELPAK bulk private line offering. See *American Telephone & Telegraph Company, Long Lines Department, Revisions of Tariff FCC No. 260 Private Line Services, Series 500 (TELPAK)*, 61 F.C.C.2d 587, ¶¶ 11-30 (1976). One year later, the Commission reversed itself on reconsideration, finding that AT&T did not have to withdraw TELPAK but declaring unlawful various revisions to private line rates and rate structures. 64 F.C.C.2d 971 (1977). After all that, in 1980, the D.C. Circuit vacated the Commission’s decisions in large part. *Aeronautical Radio, Inc. v. FCC*, 642 F.2d 1221, 1231 (D.C. Cir. 1980), cert. denied, 451 U.S. 920 (1981). Needless to say, the Commission should not head down the same road here.

is no basis for reinitializing price cap rates, adopting a special access X factor, imposing a “g” factor, or engaging in any other form of intrusive regulatory intervention – on either an interim or a permanent basis.

A. **Re-initializing Price Cap Rates Is Unnecessary, Unlawful, and Irreconcilable with Proper Oversight of the Telecommunications Industry.**

Fifteen years ago, the Commission adopted price cap regulation in order to sever the relationship between rates and costs and replicate the efficiency incentives of a competitive market. *Policy and Rules Concerning Rates for Dominant Carriers*, 5 FCC Rcd 6786 (1990) (“*LEC Price Cap Order*”). Ten years ago, when special access competition was far less expansive than it is today, the Commission asked “whether high-capacity special access services ... should be removed immediately from price cap regulation.” *Access Charge Reform Price Cap Performance Review for Local Exchange Carriers*, 11 FCC Rcd 21354 ¶ 153 (1996) (hereinafter “*Access Reform Order*”). Now, in contrast, various parties are urging the Commission to “reinitialize” special access rates to earn no more than a specific rate of return. See NPRM ¶¶ 59-68. The Commission must reject this invitation.

Reinitialization based on current market conditions would have no factual, legal, or policy basis and would undermine the credibility of the Commission’s regulatory processes.²⁸ As an initial matter, accounting rate-of-return data cannot serve any ratemaking function, and using the ARMIS data as justification for reinitializing rates accordingly would be arbitrary and capricious. See Section II.D, above. Moreover, reinitializing rates would punish price cap LECs for acting on the very incentives that price cap regulation was intended to create. Price cap

²⁸ The NPRM properly rejected AT&T’s request to reinitialize special access rates to earn no more than 11.25 percent on an interim basis, noting that doing so would “go well beyond restoring the rate levels that would have been in place had the Commission never adopted the pricing flexibility rules that have been challenged.” NPRM ¶ 130.

regulation is supposed to reward carriers with higher returns if they are able to increase efficiencies, develop new products, and reduce their costs, as long as their rates are set at or below a cap. Certainly, there is no evidence that any carrier's special access rates exceed the cap; no carrier could charge above-cap rates unless it first went through a painstaking demonstration of need that, to Verizon's knowledge, has never even been attempted. *See* 47 C.F.R. § 61.49(d). Thus, as the Commission has acknowledged, "to the extent commenters argue in favor of traditional rate of return review of special access rate changes, their quarrel is fundamentally with price cap regulation." *LEC Price Cap Order*, ¶ 221. That is a quarrel that was laid to rest 15 years ago and should not be resurrected.

What is more, a flash cut in special access rates to an arbitrary cost benchmark would contravene the Act. The Commission's "authority to prescribe rate reductions under Section 205(a) depends upon a finding that current rates are or will be unreasonable." *Id.* ¶ 235. Yet there is no basis upon which the Commission possibly could make such a finding, given the tremendous competition in the provision of special access services and the compelling evidence of declining rates.²⁹

Finally, from a policy perspective, seizing the efficiency gains of carriers under price caps would undermine the credibility of an incentive-based system – and of Commission regulation generally – on a going-forward basis. Prescriptive rate cuts would stifle further efficiencies and innovation. *See Access Reform Order*, ¶ 230 ("reinitializing indices could have a negative effect on the productivity incentives of the LEC price cap plan."); *see also* Taylor Decl. ¶ 97 ("Price cap regulation is intended ... to reward efficient behavior and punish

²⁹ The Commission also has cautioned that the procedure by which any reinitialization would occur is unclear, and that any such effort would pose significant administrative complications. *Access Reform Order*, ¶ 230.

inefficient behavior. If the Commission deviates from the process by setting prices lower because the firm has been able to reduce its costs and earn above some benchmark ... [t]he firm will have less incentive to reduce costs because the gains will be periodically or randomly reduced, and investors will be less willing to provide capital because returns over the long term will be reduced, and the risks will be increased”). Indeed, even competitive access providers have cautioned that “the development of competition over the long term would be more beneficial than the short term benefits of prescription.” Comments of Time Warner, CC Docket No. 96-262, at 19 (Jan. 29, 1997). In short, represeting special access rates would have dramatic, long-lasting repercussions for all Commission regulatees; never again could a carrier make investments without the fear that the Commission might appropriate some of the rewards years down the road. *See Access Reform Order*, ¶ 292 (recognizing that a rate prescription would “mak[e] carriers less confident in the constancy of regulatory policies”).

B. The Commission Should Not Increase the CALLS X-Factor for Services Remaining Under Price Cap Regulation.

As a result of the *CALLS Order*, the current special access X factor is set equal to inflation. Importantly, that does not mean that special access rates are frozen. To the contrary, it assures that price cap-regulated special access rates will decline in real terms, even if nominal rates remain constant. That is, because rates will remain the same in the face of inflation, special access customers will be able to buy more special access services with each dollar spent.

The Commission should continue to apply an X factor no higher than the rate of inflation to those special access services that remain under price cap regulation, for the same reasons that it adopted this approach in the first place. In particular, in the *CALLS Order*, the Commission recognized that the protracted proceedings and uncertainty surrounding efforts to develop a productivity-based X-factor “disrupt[] business expectations and investment decisions of both

LECs and new entrants.” *Access Charge Reform*, 15 FCC Rcd 12962 ¶ 174 (2002)(“*CALLS Order*”); *see also USTA v. FCC*, 188 F.3d 521, 530 (D.C. Cir. 1999). That same concern holds equally true today, if not more so given the growth in special access competition over the past five years. Accordingly, as proposed by the CALLS coalition, the Commission adopted a special access X factor that was not tied to productivity and, beginning in 2004, would be set equal to inflation. Notably, the rationale for setting the X factor equal to inflation, as explained by the CALLS coalition (which included AT&T and other large purchasers of special access), was to “encourage additional investment in those areas remaining under price caps.” *Ex Parte Presentation of CALLS*, CC Docket No. 94-1, at 15 (Mar. 8, 2000). Once again, that same rationale continues to apply today, particularly following the industry “meltdown” during the early years of this decade.

In addition, it is inherently arbitrary to apply a productivity-based X factor to a specific category of services. Productivity factors are company-wide measurements, which are not limited to specific services and cannot rationally be tied to a single jurisdiction. *Price Cap Performance Review of Local Exchange Carriers*, ¶ 110. To measure productivity growth for a single service of a firm,

one would thus have to measure the growth in all of the inputs that were necessary to supply that service and no other service. But that calculation is impossible, both in practice and in principle. Special access services are not produced on a stand-alone basis; they use the same network facilities and managerial functions as all of the other outputs of a telecommunications firm. Because there is no economically meaningful way to measure the growth of inputs assigned exclusively to interstate special access services, it is impossible to calculate an economically meaningful productivity offset for special access services. Taylor Decl. ¶ 66.

Finally, if the Commission were to expend the significant resources to develop a new firm-wide productivity factor, it would likely be set at or around the current level of inflation in

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any event, making the effort a waste of regulatory and industry resources. Long-run estimates of telecommunications industry total factor productivity “are frequently in the range between 2 and 3 percent per year,” and “[t]he recent collapse of the industry, [and] the reduction in ILEC local exchange volumes and wireline long distance volumes suggests that updated productivity growth estimates should probably be lower.” Taylor Decl. ¶ 68.³⁰

C. The Commission Should Not Adopt a “g” Factor.

There is no basis for imposing a special access “g” factor. The “g” factor is a regulatory artifact that was a targeted response to an anomaly with respect to carrier common line charges – specifically, that LECs recovered non-traffic sensitive costs on a traffic-sensitive basis. The purpose of the “g” factor was to share with switched access customers a portion of the benefits of the growth in switched access minutes, based on the per-minute growth per access line. *See LEC Price Cap Order*, ¶¶ 55-73. There is no such anomaly with respect to special access rates, which recover non-traffic sensitive costs on a non-traffic sensitive basis. *See Taylor Decl.* ¶ 71 (“The g-factor was added to the common line basket price cap formula to attempt to split the returns from such increases in usage between the LECs and the long distance carriers. That case does not apply here, because there is no special access rate element that is set to recover a non-traffic sensitive cost on a per-minute basis.”). Moreover, as discussed above, it is unreasonable to conclude based on the ARMIS data that the growth in special access lines does not produce a proportionate increase in special access costs. Taylor Decl. ¶ 70. Finally, even if special access lines grew faster than special access costs, that might be due to the presence of fixed costs (costs

³⁰ There is certainly no basis for adopting an interim X factor of 5.3 percent or any other number. Although the 5.3 percent figure was judicially upheld in 1996 (as one of three choices given to price cap LECs), it was based on a record compiled more than ten years ago. There is no record evidence upon which the Commission could conclude today that incumbent LECs enjoy productivity levels significantly greater than the economy as a whole.

that do not vary with the number of access lines). In these circumstances, including “the g-factor in a price cap index with a conventionally-calculated X [*i.e.*, an X that “embodies whatever economies of scope and scale pertain to the industry”] would effectively double-count the productivity growth associated with economies of scale in special access services.” Taylor Decl. ¶ 72; *see also* NPRM ¶ 38 (there is no way to ensure that “the X-factor does not also count demand growth-related efficiencies”).

D. The Commission Should Not Re-Impose a Sharing Mechanism.

The NPRM (at ¶ 44) correctly concludes that it would be inappropriate to reintroduce a sharing mechanism into price caps for special access services. In 1997, the FCC eliminated sharing based on the recognition that it “severely blunts the incentives of price regulation,” and there is no policy or factual basis for revisiting that determination. *See id.* ¶ 43, *citing* 1997 *Price Cap Review Order*, ¶ 148. As the FCC explained a decade ago, “the sharing mechanism deprives LECs and their customers of the full benefits of lower prices and improved efficiency that a pure price cap scheme can offer.” *Price Cap Performance Review for Local Exchange Carriers*, 10 FCC Rcd 8961 ¶ 191 (1995). Sharing has this pernicious effect because it “reduces the incentives to operate the least-cost technology and leads to distorted diversification incentives,” it “can have devastating effects on the incentives to invest,” and it deprives the regulated firm of the “most efficient form of capital investment” – internally generated funds. Taylor Decl. ¶¶ 85-87.

E. The Commission Should Not Apply Pricing Flexibility Triggers to Areas Smaller Than an MSA.

In the *Pricing Flexibility Order* (at ¶ 72), the Commission decided that “MSAs best reflect the scope of competitive entry, and therefore are a logical basis for measuring the extent of competition.” As the Commission recognized, *id.* ¶ 74, “defining geographic areas smaller

than MSAs would force incumbents to file additional pricing flexibility petitions, and, although these petitions might produce a more finely-tuned picture of competitive conditions, the record does not suggest that this level of detail justifies the increased expenses and administrative burdens associated with these proposals.” On review, the D.C. Circuit explicitly affirmed the use of MSAs, noting the Commission’s observation that any more narrow geographic focus would require a “painstaking analysis of market conditions.” *WorldCom v. FCC*, 238 F.3d at 459.

There is no basis for reopening this issue, for example by considering competitive entry on a UNE zone basis or basing grants of flexibility on special access line density. See NPRM ¶¶ 87-93.³¹ Indeed, to the extent pricing flexibility triggers are retained at all, there is even less point in looking at areas smaller than an MSA today than there was in 1999. Not only has there been tremendous growth in fiber (and fixed wireless) deployment in the past six years, but the nature of special access demand shows that the use of MSAs *understates* the extent of competition. In particular, special access customers – both wholesale and end user – operate across broad geographic areas (extending well beyond Verizon’s territory) and solicit bids from companies operating on a regional or national basis. Lew Decl. ¶ 79. Accordingly, a current lack of alternative providers in a particular set of buildings, or even in an entire group of wire centers, does not indicate that price cap LECs can exercise market power in those areas. There is sufficient competition in the market, and customers are sophisticated and powerful enough, that

³¹ Nor should the Commission subdivide special access into product markets determined by bandwidth or customer type. See NPRM ¶¶ 81-85. Supplying special access “requires a large investment in a fiber backbone network followed by smaller and fungible investments in the electronics that actually define the services provided on the backbone. In economic terms, the cross-elasticity of supply among services of different bandwidths ... is quite high because the same fiber can be configured to provide services of all different bandwidths. ... [C]ompetitors can rapidly shift capacity [from one type of service to another] without incurring such high fixed costs that the substitution would be unprofitable.” Taylor Decl. ¶ 50.

Verizon's special access rates are competitively disciplined throughout its entire region, regardless of the extent of entry in any specific location.

VI. CONCLUSION

The Commission should allow negotiated alternatives to price cap services, permit price cap LECs to secure Phase II relief using evidence of both collocation-based and non-collocated competition, eliminate all special access service categories and sub-categories, and decline to adopt an interim increase in the special access X factor.

Respectfully submitted,

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Attachment A

THE VERIZON TELEPHONE COMPANIES

The Verizon telephone companies are the local exchange carriers affiliated with Verizon Communications Inc. These are:

Contel of the South, Inc. d/b/a Verizon Mid-States
GTE Southwest Incorporated d/b/a Verizon Southwest
The Micronesian Telecommunications Corporation
Verizon California Inc.
Verizon Delaware Inc.
Verizon Florida Inc.
Verizon Maryland Inc.
Verizon New England Inc.
Verizon New Jersey Inc.
Verizon New York Inc.
Verizon North Inc.
Verizon Northwest Inc.
Verizon Pennsylvania Inc.
Verizon South Inc.
Verizon Virginia Inc.
Verizon Washington, DC Inc.
Verizon West Coast Inc.
Verizon West Virginia Inc.

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Attachment B

Proposed Rules

1. Revise § 1.774 to read as follows:

§ 1.774 Pricing flexibility.

(a)(1) ...

(2) ...

(3) ...

(i) ...

(ii) The number and location of the wire centers in which competitors have collocated, or within the geographic boundaries of which competitors have deployed fiber, in the relevant MSAs or non-MSA parts of a study area, as described in § 69.707 of this chapter;

(iii) In each wire center on which the price cap LEC bases its petition, the name of either (A) at least one collocator that uses transport facilities owned by a provider other than the price cap LEC to transport traffic from that wire center, or (B) at least one unaffiliated entity that has deployed fiber; and

(iv)(A) The aggregate percentage of the wire centers in the relevant MSA or non-MSA area, as described in § 69.707 of this chapter, in which competitors either (1) have collocated and use transport facilities owned by a provider other than the price cap LEC to transport traffic from that wire center or (2) within the geographic boundaries of which competitors have deployed fiber; or

(B) The aggregate percentage of total base period revenues generated by the services at issue in the petition that are attributable to wire centers in the relevant MSA or non-MSA area, as described in § 69.707 of this chapter, in which competitors either (1) have collocated and use transport facilities owned by a provider other than the price cap LEC to transport traffic from that wire center or (2) within the geographic boundaries of which competitors have deployed fiber.

(4) [Intentionally deleted]

....

(f)

(2) [Intentionally deleted]

2. Revise § 61.42 to read as follows:

§ 61.42 Price cap baskets and service categories

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....

(e) ...

...

(3) The special access basket shall contain special access services as the Commission shall permit or require, but shall not contain any service categories or subcategories.

(f)

3. Revise § 61.47 to read as follows:

§ 61.47 Adjustments to the SBI; pricing bands.

....

(e) ...

(1) ...

...

(viii) Voice Grade (trunking basket)

(ix) [Intentionally deleted]

(x) Total High Capacity (trunking basket)

(xi) DS1 Subservice (trunking basket)

(xii) DS3 Subservice (trunking basket)

(xiii) [Intentionally deleted]

....

4. Revise § 69.709 to read as follows:

§ 69.709 Dedicated transport and special access services other than channel terminations between LEC end offices and customer premises

(a) *Scope.* ...

(b) [Intentionally deleted]

(c) *Phase II triggers.* To obtain Phase II pricing flexibility, as specified in § 69.727(b) of this part, for the services described in paragraph (a) of this section, a price cap LEC must show that,

in the relevant area as described in § 69.707 of this part, competitors unaffiliated with the price cap LEC have:

(1) either collocated in or deployed fiber within the geographic boundaries of 50 percent of the petitioner's wire centers, and, in the case of collocation, that at least one such collocator in each wire center is using transport facilities owned by a transport provider other than the price cap LEC to transport traffic from that wire center; or

(2) either collocated in or deployed fiber within the geographic boundaries of wire centers accounting for 65 percent of the petitioner's revenues from dedicated transport and special access services other than channel terminations between LEC end offices and customer premises, determined as specified in § 69.725 of this part, and in the case of collocation, that at least one such collocator in each wire center is using transport facilities owned by a transport provider other than the price cap LEC to transport traffic from that wire center.

(d) In making the showing required in paragraph (c), the petitioner may aggregate wire centers in which competitors have collocated and wire centers within the geographic boundaries of which competitors have deployed fiber.

5. Revise § 69.711 to read as follows:

69.711 Channel terminations between LEC end offices and customer premises

(a) *Scope.* ...

(b) [Intentionally deleted]

(c) *Phase II triggers.* To obtain Phase II pricing flexibility, as specified in § 69.727(b) of this part, for the services described in paragraph (a) of this section, a price cap LEC must show that, in the relevant area as described in § 69.707 of this part, competitors unaffiliated with the price cap LEC have:

(1) either collocated in or deployed fiber within the geographic boundaries of 65 percent of the petitioner's wire centers, and in the case of collocation, that at least one such collocator in each wire center is using transport facilities owned by a transport provider other than the price cap LEC to transport traffic from that wire center; or

(2) either collocated in or deployed fiber within the geographic boundaries of wire centers accounting for 85 percent of the petitioner's revenues from channel terminations between LEC end offices and customer premises, determined as specified in § 69.725 of this part, and in the case of collocation, that at least one such collocator in each wire center is using transport facilities owned by a transport provider other than the price cap LEC to transport traffic from that wire center.

(d) In making the showing required in paragraph (c), the petitioner may aggregate wire centers in which competitors have collocated and wire centers within the geographic boundaries of which competitors have deployed fiber.

6. Revise § 69.713 to read as follows:

69.713 Common line, traffic-sensitive, and tandem-switched transport services.

(a) *Scope.* ...

(b) [Intentionally deleted]

7. Revise § 69.725 to read as follows:

§ 69.725 Attribution of revenues to particular wire centers

If a price cap LEC elects to show, in accordance with § 69.709 or § 69.711, that competitors have collocated in or deployed fiber within the geographic boundaries of wire centers accounting for a certain percentage of revenues from the services at issue, the LEC must make the following revenue allocations:

....

4. Revise § 69.727 to read as follows:

§ 69.727 Regulatory relief

(a) *Phase I relief.* Effective [30 days after public notice of the order in this proceeding], all price cap LECs shall be permitted to enter individually negotiated service agreements, on a non-tariffed basis and without regard to the requirements of Parts 61 and 69 of the Rules, for the services specified in §§ 69.709(a), 69.711(a), and 69.713(a).

(1) In areas where a price cap LEC has not yet obtained Phase II flexibility for a particular service, it shall continue to offer generally available special access services subject to price cap regulation.

(2) All individually negotiated service agreements shall be excluded from price cap regulation pursuant to § 61.42(f) of this chapter.

(3) Before the price cap LEC provides an individually negotiated service arrangement to one of its long-distance affiliates, as described in section 272 of the Communications Act of 1934, as amended, or § 64.1903 of this chapter, the price cap LEC certifies to the Commission that it provides service pursuant to that arrangement to an unaffiliated customer.

(b) ...

(1) ...

(2) ...

(3) Detariffing of all special access rates.