October 21, 2005

**EX PARTE**

Marlene Dortch
Secretary
Federal Communications Commission
445 12th Street, S.W.
Washington, DC 20554

**Re:** ***<u>Applications for Consent to Transfer Control of Filed by Verizon Communications, Inc. and MCI, Inc.</u>*<u>, WC Docket No. 05-75</u>**

Ms. Dortch:

A recent ex parte filed by a group of CLECs repeats their prior claims that this transaction will reduce retail and wholesale competition for special access and in the mass-market.[1] The record in this proceeding, however, thoroughly refutes these claims, and this latest filing adds no new evidence or arguments that could possibly call into question the extensive showing by Verizon and MCI that this transaction is in the public interest. Therefore, there is no basis for the Commission to impose conditions on the combination of Verizon and MCI, including the specific conditions related to special access addressed yet again in their filing.

As an initial matter, these CLECs assert that this transaction "would very significantly undermine retail and wholesale competition" for special access services, simply because MCI has local fiber network facilities in Verizon's region.[2] But this claim ignores the extensive evidence that there already is competing fiber in those limited areas where Verizon and MCI have overlapping facilities. Based on the limited data available to Verizon and MCI that identifies other carriers' local fiber networks, there are at least two or more competing providers, other than MCI, in 92 percent of the 39 groupings of wire centers where MCI has local fiber that overlaps with Verizon's network, and at least one other supplier in all but one.[3] This is true even if this transaction were analyzed — and it should not be — on a building-by-building basis, as virtually all of the buildings with MCI fiber — more than 98 percent — either already are served by another fiber provider or demonstrably could be.[4] In short, there is no credible evidence that

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[1] *See* Letter from Andrew D. Lipman, Swidler Berlin LLP, to Marlene Dortch, FCC, WC Docket Nos. 05-65 & 05-75 (filed Oct. 19, 2005) ("ATX *et al.* Oct. 19, 2005 Ex Parte").

[2] *See id.* at 2-3.

[3] *See* Letter from Dee May, Verizon, and Curtis Groves, MCI, to Marlene Dortch, FCC, WC Docket No. 05-75, at 2-3 (filed Oct. 19, 2005) ("Verizon/MCI Oct. 19, 2005 Ex Parte")

[4] *See id.* at 3-5.

this transaction will result in any meaningful reduction in competition in any properly defined market.[5]

Second, these CLECs take issue with the Commission's current special access regulations, asserting that they are insufficient to protect against a litany of speculative and unsubstantiated harms.[6] As we have explained, the issue of how to regulate Verizon's special access pricing is not merger-specific and should be decided in the industry-wide rulemaking already underway.[7] Indeed, the Commission has consistently reached this conclusion in previous merger proceedings.[8] Therefore, even if the CLECs' complaints about the existing rules had merit, the Commission must address any modifications to those rules in the context of a notice and comment rulemaking, and cannot lawfully abrogate those rules in the context of this transaction.[9]

In any event, those claims fail to recognize that the Commission has previously acknowledged that its regulations provide adequate protections against price squeezes, and has rejected analogous price-squeeze claims in the past on this basis. For example, in the *Access Charge Reform Order*, the Commission held that, regardless of any incentive to engage in price squeezes, it "ha[d] adequate safeguards against such conduct."[10] The Commission explained that the "requirement that incumbent LECs offer services at tariffed rates . . . reduces the risk of a price squeeze to the extent that an affiliate's long distance prices would have to exceed their cost for tariffed services."[11] The courts, too, have held that regulatory safeguards reduce any arguable risk from price squeeze: in the seminal *Town of Concord* case, then-Judge Breyer held that, "where [an alleged monopolist's] prices are regulated at both the primary and secondary levels," a price squeeze is not only significantly less likely to occur, but even when it does occur "is not ordinarily exclusionary."[12]

In addition, the CLECs are confused about some of the regulatory safeguards already in place. For example, they speculate (at 4-5) that Verizon might offer plans that are attractive only

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[5] The California Attorney General reached a similar conclusion, finding that the majority of the MCI-lit buildings are in "areas where other CLECs operate within close proximity," and the potential entry of other competitors should be sufficient "to counteract any potential anticompetitive effects" of the merger. Opinion of the Attorney General on Competitive Effects of Proposed Merger of Verizon Communications, Inc. and MCI, Inc. at 21, *Joint Application of Verizon Communications Inc. and MCI, Inc. to Transfer Control of MCI's California Utility Subsidiaries to Verizon,* Application No. 05-04-020 (CA PUC filed September 16, 2005).

[6] *See* ATX *et al.* Oct. 19, 2005 Ex Parte at 3-5.

[7] *See, e.g.*, Joint Opposition and Reply at 41.

[8] *See*, *e.g.*, *AT&T Wireless/Cingular Order* ¶ 183.

[9] *See* Verizon/MCI Oct. 19, 2005 Ex Parte at 7, 9-10.

[10] First Report and Order, *Access Charge Reform*, 12 FCC Rcd 15982, ¶ 278 (1997) ("*Access Charge Reform Order*"); *see also SBC/PacTel Order* ¶ 53 ("Price discrimination . . . is relatively easy for [the Commission] and others to detect, and is therefore unlikely to occur.").

[11] *Access Charge Reform Order* ¶ 279; *see also Bell Atlantic/GTE Order* ¶ 198 n.454 (same).

[12] *Town of Concord v. Boston Edison Co.*, 915 F.2d 17, 22 (1st Cir. 1990).

to MCI. In fact, the Commission's rule is that Verizon cannot provide a new contract tariff for special access service to one of its long-distance affiliates until Verizon "certifies to the [FCC] that it provides service pursuant to that contract tariff to an unaffiliated customer."[13]

Even ignoring regulatory safeguards, the marketplace conditions in the locations where MCI has deployed fiber in Verizon's region would make it impossible for the combined entity successfully to execute a price squeeze. These CLECs claim that the combined entity could effectuate a price squeeze by raising its special access service prices enough so that competitors could no longer compete successfully using Verizon's special access services.[14] But contrary to their assertion that we "ignore[d]" this concern, we explained long ago that there is no merit to such claims.[15] As an initial matter, their claim is based on the erroneous premise that the combined entity could raise special access prices without suffering lost profits. But that ignores the extensive local fiber known to be deployed by other carriers in the same areas in Verizon's region where MCI has deployed its local fiber networks, which are the only areas relevant to this transaction. Increased special access rates would result in Verizon losing even more business to these other networks.[16] And, because wholesale sales to Verizon's carrier customers make up 80 percent of Verizon's interstate special access revenues,[17] the CLECs' claim reduces to the speculative assertion that Verizon/MCI would forgo profitable short-term sales of special access in the hope of longer-term profitability. But that can occur only if the combined entity could (1) force competitors from the market and (2) later raise prices enough in the retail market to recoup the lost short-term profits.[18] The first pre-condition cannot be satisfied here precisely because of the extensive facilities deployed by other carriers in the areas where MCI currently has deployed local fiber facilities. The second pre-condition cannot be satisfied because re-entry would be possible using the sunk facilities that would remain in place from any competitors who exited.[19] In short, the combined company will not have the ability to drive all competition from the market

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[13] 47 C.F.R. § 69.727(a)(2)(iii) (emphasis added).

[14] *See* ATX *et al.* Oct. 19, 2005 Ex Parte at 3.

[15] *See* Joint Opposition and Reply at 44-46.

[16] The CLECs (at 3) assert that "ILECs are currently raising special access prices," but point only to increases by SBC. Verizon has explained that its average revenue per special access line has decreased by an average of 15.2 percent per year since 2001. And Verizon has shown that average revenue per special access line for DS1 and DS3 circuits experienced significant declines as well, averaging annual reductions of 4.2 and 6.1 percent per year respectively between 2002 and 2004. Indeed, Verizon has stated that average revenue per line 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. *See* Lew Reply Decl. ¶ 37.

[17] *See* Special Access White Paper at 7, *attached to* Letter from Dee May, Verizon, and Curtis Groves, MCI, to Marlene Dortch, FCC, WC Docket No. 05-75 (filed Aug. 25, 2005) ("Special Access White Paper").

[18] *See* 3A *Areeda* ¶ 767c, at 126-27 (explaining that, of the various types of price squeezes, "[m]ost" are "beyond reproach" and that "[o]nly" a price squeeze that involves "predatory pricing" "raises a question of unlawful conduct").

[19] *Cf. MCI/BT Order* ¶ 162 (predatory strategy profitable only if the carrier can "raise the downstream price of the end-user service long enough to recoup its losses after its rivals had exited the market, without inducing new entry").

for the services at issue here, let alone to preclude re-entry, which is essential for any alleged price squeeze to succeed.[20]

Finally, the CLECs assert (at 5) that the effects of the transaction should be measured using HHI calculations and that the importance of intermodal competition is "grossly exaggerate[d]." But as we have previously explained, there is little reason to believe that HHI calculations would provide any probative information concerning this transaction. *See, e.g.*, Letter from Dee May, Verizon and Curtis Groves, MCI to Marlene Dortch, Secretary, FCC, WC Docket No. 05-75, at 5-6 (Sept. 14, 2005) ("VZ/MCI Sept. 14 Ex Parte"); Letter from Dee May, Verizon and Curtis Groves, MCI to Marlene Dortch, Secretary, FCC, WC Docket No. 05-75, at 13-14 (Sept. 9, 2005) ("VZ/MCI Sept. 9 Ex Parte"). As a general matter, the HHI does not capture all aspects of market structure and at best serves only as a limited aid in interpreting market data. *See, e.g.*, *id.*; DOJ/FTC Guidelines § 1.5. Moreover, its utility is particularly limited here because the question whether a transaction will injure competition is necessarily predictive and forward-looking, and where, as here, markets are characterized by rapid technological and other changes, past share data is unlikely to be useful. *See, e.g.*, VZ/MCI Sept. 14 Ex Parte at 5-6; VZ/MCI Sept. 14 Ex Parte at 13-14; DOJ/FTC Guidelines § 0 ("[T]he picture of competitive conditions that develops from historical evidence may provide an incomplete answer to the forward-looking inquiry of the Guidelines.").

The CLECs' claim (at 5) that the market here is static because intermodal competition is inconsequential is belied by the record. As we have demonstrated, facilities-based intermodal alternatives such as cable, wireless, and VoIP provide extensive and increasing competition for mass-market customers, and this transaction will not affect that competition. *See, e.g.*, Public Interest Statement at 39-45; Reply at 49-60; Letter from Dee May, Verizon and Curtis Groves, MCI to Marlene Dortch, Secretary, FCC, WC Docket No. 05-75, Attachment at 27-52 (Sept. 1, 2005) ("Mass Market White Paper"). While the CLECs assert that VoIP is unimportant because few households allegedly have adopted VoIP, that is both wrong and misses the point. It is wrong because, as we have shown, cable companies have attracted 20-40% of subscribers in some markets where they offer service, and industry experts forecast that cable and VoIP will have almost 7 million subscribers by year end and that in five years 45% of U.S. households will either be wireless only or subscribe to VoIP rather than wireline service. *See, e.g.*, Letter from Dee May, Verizon and Curtis Groves, MCI to Marlene Dortch, Secretary, FCC, WC Docket No. 05-75, at 4 (Sept. 12, 2005). In any case, from an economic standpoint, the key issue is not the number of subscribers, but whether the service is *available* to a sufficient number of customers to discipline prices. And, as we have demonstrated, VoIP (from both cable companies and other providers), wireless, and other technologies are widely available on a national basis. *See, e.g.*, Mass Market White Paper at 27-52.

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[20] *See* Robert W. Crandall & Hal J. Singer, *Are Vertically Integrated DSL Providers Squeezing Unaffiliated ISPs (and Should We Care)?*, at 17 (Apr. 25, 2005), *available at* http://www.criterioneconomics.com/docs/crandall_singer_pricesqueeze.pdf.

For the foregoing reasons, as well as those we have set forth in record previously, the CLECs' latest filing does nothing to call into question our showing that this transaction is in the public interest and provides no basis for the remedies that they seek to have imposed.

Sincerely,

Dee May — Curtis Groves

Dee May
Verizon

Curtis Groves
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cc: Michelle Carey
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