

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

In the Matter of)	
)	
Analytical Framework Necessary to Resolve Issues in the <i>Special Access NPRM</i>)	WC Docket No. 05-25
)	RM-10593
)	

**COMMENTS OF THE
AD HOC TELECOMMUNICATIONS USERS COMMITTEE**

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SUMMARY

As a member of the NoChokePoints Coalition, AdHoc endorses and supports in full the comments filed by the Coalition today.

Ad Hoc represents a broad cross section of businesses that depend upon special access services as the building blocks of their corporate networks, from a vast number of workhorse DS1s to the highest capacity OCns. AdHoc began challenging the Commission's special access rules nearly nine years ago, after the ILECs raised prices where they were de-regulated and began earning historically unprecedented profit levels. Since then, competition in the special access market has not improved in any substantial way, as the carriers have demonstrated by their pricing behavior and jaw-dropping profit levels.

The Commission's failed experiment with pricing flexibility rules is a sobering reminder that such initiatives must be grounded in marketplace facts. By contrast, the Commission based its pricing flexibility rules on an unsupported faith in the inevitability of competition rather than a data-driven assessment of existing, price-constraining competition.

Despite voluminous record evidence to the contrary, the ILECs have repeatedly claimed that the special access market is fully competitive and that robust competition exists for special access services (in the apparent belief that saying it is so can make it so). For neutral observers, there is no remaining question as to the fundamentally non-competitive nature of ILEC special access markets. A forthright, data-driven analysis of those markets is long overdue.

For Example # 1 in the Commission's Public Notice, Ad Hoc provides as Attachment A an expert declaration regarding "network effect" and urges the Commission to abandon traditional geographic market definition concepts.

For Example #2 and #4, Ad Hoc urges the Commission to abandon its flawed pricing flexibility triggers and revise its price caps rules in light of the cost accounting data filed by ILECs in the Commission's ARMIS system which indicates grossly excessive returns. In Attachment B of this pleading, Ad Hoc's economic consultants at Economics and Technology, Inc. describe ARMIS; demonstrate that ARMIS results are reliable and economically meaningful; and refute the challenges raised by ILECs to the use of ARMIS data.

For example #3, Ad Hoc urges the Commission to distinguish between a proper "potential competition" analysis and speculative predictions that competition will develop in the future. "Potential competition" analysis examines whether imminent competitive entry is possible and whether that possibility is substantial enough to constrain the ILECs' exercise of market power in the present. In addition, if the Commission determines that potential entry may constrain ILEC behavior, then it must also consider the effects of potential exit. Gross overpricing by the ILECs and their withholding of services like Ethernet will cause competitors to exit markets, as evidenced in the Omaha Forbearance case.

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<i>NPRM</i>)	RM-10593
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**COMMENTS OF THE
AD HOC TELECOMMUNICATIONS USERS COMMITTEE**

The Ad Hoc Telecommunications Users Committee (“Ad Hoc” or “Committee”) submits the following comments in response to the Commission’s Public Notice¹ in the dockets captioned above.

I. INTRODUCTION

As a member of the NoChokePoints Coalition, AdHoc endorses and supports in full the comments filed by the Coalition today.²

Ad Hoc represents a broad cross section of job-creating businesses that depend upon special access services as the building blocks of their corporate networks, from workhorse DS1s to the highest capacity OCns. The Committee’s

¹ *Analytical Framework Necessary to Resolve Issues in the Special Access NPRM*, WC Docket No. 05-25, RM-10593, Notice of Proposed Rulemaking, 24 FCC Rcd 13638 (2009) (“*NPRM*”).

² See NoChokePoints Coalition Comments (filed January 19, 2010) at § III.D.

members collectively spend an estimated \$2-3 billion per year on purchases of communications products and services. They represent a broad array of industries in the national economy, including financial services, automotive, manufacturing, insurance, aerospace, package delivery, information technology, and transportation/logistics.

AdHoc began challenging the Commission's special access rules nearly nine years ago, after the ILECs raised prices in areas subject to de-regulation and began earning historically unprecedented profit levels from their supposedly competitive services. The Commission began this rulemaking over five years ago, after incumbent local exchange carrier ("ILEC") prices and profits on special access had soared to astronomical heights under the Commission's "pricing flexibility" rules; after AdHoc and other parties repeatedly challenged the rules and the carriers' exploitation of them in filings with the FCC; and after AT&T (before it merged with an ILEC) filed a mandamus petition seeking a court order directing the FCC to address the problems in special access regulations. Since then, competition in the special access market has not improved in any substantial way. It remains a market with no meaningful competition to discipline the ILECs' behavior, as the carriers have demonstrated by their pricing behavior and jaw-dropping profit levels on these services.

Because AdHoc admits no carriers as members and accepts no carrier funding, it has no commercial self-interest in imposing unnecessary regulatory constraints on the ILECs. In fact, AdHoc has been a long-standing and enthusiastic supporter of forbearance authority for the FCC and de-regulation for

competitive telecom markets whenever a market becomes competitive. As high-volume purchasers of telecommunications services, AdHoc members have historically been among the first beneficiaries of the FCC's de-regulatory efforts in competitive markets.

AdHoc nevertheless has been urging the Commission since the first round of comments in this docket to re-vamp the special access pricing flexibility rules because special access markets simply are not competitive. When the Commission failed to revise its pricing flexibility regime to reflect that lack of competition, special access prices and profits rose steeply.

The Commission's failed experiment with pricing flexibility rules is a sobering reminder that such initiatives must be grounded in marketplace facts. By contrast, the Commission based its pricing flexibility rules upon a leap of faith – that competition was about to flower in local access markets thanks to the market-opening requirements of the 1996 amendments to the Communications Act. Instead of waiting for access markets to actually become competitive, however, the Commission eliminated regulatory protections for customers based on predictions regarding the imminence and inevitability of competition. Since then, the Commission has released a series of orders de-regulating broadband services and predicting the imminent arrival of competitors, based on an unsupported faith in the inevitability of competition rather than a data-driven assessment of existing, price-constraining competition.

The Commission's predictions proved to be wrong.

Despite voluminous record evidence to the contrary, the ILECs,

particularly the Bell Operating Companies (“BOCs”), have repeatedly claimed before this Commission that the special access market is fully competitive. But the BOCs have failed to support their claims with factual evidence, relying instead on “compelling rhetoric, comforting economic theories, and sunny speculation,” as Ad Hoc pointed out in its initial comments in this docket. Because business customers do not have the luxury of living in a theoretical world, however, the BOCs’ rhetoric and speculation can provide no substitute for actual competition.

Though the ILECs’ have repeatedly referred to the “success” of the Commission’s de-regulatory efforts, and the “robust” competition that exists for special access services (in the apparent belief that saying it is so can make it so), there is no remaining question for neutral observers as to the fundamentally non-competitive nature of ILEC special access markets. A forthright, data-driven analysis of special access markets is long overdue.

II. DISCUSSION

As noted above, Ad Hoc is a member of the NoChokePoints Coalition and supports the comments filed today by the Coalition. Ad Hoc is filing these comments only to augment the Coalition comments by expanding on specific issues of particular concern to enterprise customers.

A. Example # 1 – Factors for Assessing Market Power

Ad Hoc has long argued that any market power analysis must include geographic and product-specific market analysis. Ad Hoc generally concurs with the comments of the NoChokePoints Coalition regarding market definitions. Our

comments here go specifically to the geographic market definition for special access services, and in particular to a possible alternative approach to a traditional geographic market definition for these services.

A geographic market is generally defined as the area within which buyers buy and sellers sell. Ad Hoc agrees with the NoChokePoints Coalition comments that the relevant geographic market for special access services is the route connecting the two points that a prospective purchaser seeks to link. In other words, individual buildings or even individual floors within a building exist as separate geographic markets. Because of the network characteristics of telecommunications services, a single geographic location can be linked with other, non-contiguous geographic markets which adds a multi-dimensional aspect to the geographic market concept that does not exist for non-networked services. While individual buildings do represent discrete geographic markets, conducting a market analysis on a building-by-building basis is, at best, cumbersome and ignores the fundamental purpose of telecommunications services – which is to provide connectivity between and among *all* of the locations at which the customer has business interests. A more robust discussion of these network effects is found in the Declaration of Dr. Lee L. Selwyn, included as Attachment A to this filing.

The Commission seeks to define geographic markets for special access services in order to evaluate competitive conditions in the special access market, and to fashion a solution in the event it is found that the existing rules are not ensuring just and reasonable prices. There is a temptation to group the

individual route geographic markets into larger geographic units by, for example, combining all of the contiguous individual markets in a single downtown area, or even MSA into a single 'market' for analysis purposes based upon an assumption that buildings in those areas will exhibit similar competitive characteristics. Tempting as it may be to consolidate contiguous geographic markets, there is no basis for assuming that markets which are contiguous to each other will exhibit similar demand or supply characteristics.

Accordingly, AdHoc urges the Commission to consider abandoning the traditional concept of a geographic market, which has utility for analyzing non-networked products, and instead define markets by the supply and demand conditions (actual and potential competitive conditions) extant at individual locations. Preliminarily, there appear to be a limited number of cases:³

- 1) buildings with a single provider and with insufficient demand to warrant entry by a competitive supplier;
- 2) buildings with a single provider, but with demand sufficient to warrant entry by additional competitive suppliers; and
- 3) buildings with multiple providers.

Focusing upon the differences, if any, that exist in the ILECs' pricing and service offerings for the different supply and demand categories described above will simplify the Commission's analytically task and defines markets in a manner that is more meaningful to special access services.

³ Additional categories that incorporate network concepts could be added to these without hampering the basic construct.

B. Example # 2 – Relevance of Current Pricing Flexibility Triggers

Ad Hoc endorses the discussion of the current pricing flexibility triggers in the comments filed today by the NoChokePoints Coalition. Ad Hoc agrees with the Coalition that the current pricing flexibility rules are deeply flawed because the regulatory trigger for reduced regulation is the presence of competitors collocating in an ILEC end office (where they presumably provide end office services), not the presence of competitors providing special access services. In other words, the rules currently de-regulate one service based upon the emergence of competition for a different service. Moreover, the rules make no provision for retracting (or at least re-examining) a grant of pricing flexibility should the collocator whose presence triggered the de-regulation disappear due to mergers, bankruptcy, or an economic meltdown like that experienced by the telecom industry within a year of the Commission's adoption of this rule.⁴

Instead of basing its pricing flexibility rules upon competitive presence in ILEC end offices, the Commission should base any grant of pricing flexibility upon competitive changes in the special access service market being de-regulated. For that market, the Commission has an accurate and readily available barometer of competitive health in the form of the ILECs' financial results filed with the Commission, particularly their rates of return. If the ILECs' profits on special access services are persistently excessive, then their prices have failed to track costs closely, which is the *sine qua non* of pricing in a

⁴ Peter Elstrom, *Telecom Meltdown*, BUSINESSWEEK, Apr. 23, 2001, at 100 ("The telecom industry plays such a big role in economic growth that its troubles could wind up toppling other industries like dominoes.")

competitive market. In a competitive market, prices are driven to cost-based levels, even for essential services with low demand elasticity. And the obverse is also true: in a *non-competitive* market, prices will grossly exceed cost-based levels for essential services.

As Ad Hoc has pointed out repeatedly, in this docket⁵ and others,⁶ the BOCs' excessive returns on investment provide stark, probative evidence that competition has failed to emerge and discipline their pricing in special access markets. Accordingly, the Commission should review the cost accounting data available in its ARMIS reports and assess the magnitude of the BOCs' rates of return.

Attachment B to these comments is a white paper prepared by Economics and Technology, Inc, Ad Hoc's economic consultants. The paper describes the Commission's accounting and cost allocation rules applicable to special access and its ARMIS data base in which the BOCs file the results of their compliance with those rules. The paper describes and refutes the BOCs' arguments that ARMIS is not useful or is an inaccurate indicator of their market power. As the

⁵ Comments and Reply Comments of Ad Hoc Telecommunications Users Committee (filed June 13, 2005 and July 29, 2005), and Comments of the Ad Hoc Telecommunications Users Committee (filed Aug, 8, 2007).

⁶ Reply Comments of Ad Hoc Telecommunications Users Committee (filed Jul. 1, 2002) at i, *filed in Appropriate Framework for Broadband Access to the Internet Over Wireline Facilities*, CC Docket Nos. 02-33, 95-20, and 98-10, Notice of Proposed Rulemaking, 17 FCC Rcd 3019 (2002); Reply Comments of the Ad Hoc Telecommunications Users Committee (filed Aug. 31, 2006), *filed in Qwest Petition for Forbearance Under 47 U.S.C. § 160(c) from Title II and Computer Inquiry Rules with Respect to Broadband Services; Petition of AT&T Inc. for Forbearance Under 47 U.S.C. § 160(c) from Title II and Computer Inquiry Rules with Respect to its Broadband Services; Petition of BellSouth Corporation for Forbearance Under Section 47 U.S.C. § 160(c) from Title II and Computer Inquiry Rules with Respect to Its Broadband Services; and Petition of the Embarq Local Exchange Operating Companies for Forbearance Under 47 U.S.C. § 160(c) from Application of Computer Inquiry and Certain Title II Common-Carriage Requirements*, WC Docket No. 06-125, Order, 21 FCC Rcd 6880 (2006).

paper points out, ARMIS is a long-standing and widely-accepted data set that exposes the excessive earnings produced by the misguided regulatory regime which currently applies to the BOCs' special access services.

C. Example # 3 – Existence and Efficacy of Potential Competition

An inquiry into the probability that potential competition ensures special access rates remain just and reasonable can be resolved without regard to the quantitative measures of entry barriers and entry costs that typically (and correctly) accompany a forward-looking analysis of “potential competition.” It is already clear from the excessive level of special access rates that the threat of competitive entry is not, and has not been, sufficient to constrain special access pricing. Absent substantial structural changes to the market that ease entry conditions, the “potential competition” that has failed to discipline ILEC pricing to date cannot reasonably be expected to discipline prices going forward. The pricing and earnings evidence that has repeatedly been provided to the Commission by Ad Hoc and others is conclusive evidence that “potential competition” is not disciplining special access pricing today.⁷ Collection and analysis of redundant evidence regarding the failure of “potential competition” to discipline pricing would merely introduce unnecessary delay and procedural burdens on the Commission and interested parties to this proceeding.

⁷ See Comments and Reply Comments of Ad Hoc Telecommunications Users Committee (filed June 13, 2005 and July 29, 2005), and Comments of the Ad Hoc Telecommunications Users Committee (filed Aug, 8, 2007). The kind of evidence the Commission solicits in Example # 3 is therefore not a necessary component of the Commission's efforts to determine whether its pricing flexibility rules are working.

In order for "potential competition" to exert price-constraining pressure upon the BOC's special access service offerings, existing market structures must create the potential for that competition to arrive in a timely and wide-spread manner. As an organization of end users, not ILEC competitors, Ad Hoc leaves the development of evidence regarding realistic conditions for entry into various geographic and product markets, and related "build/buy" assessments, to the service providers in the NoChokePoints Coalition. Ad Hoc's comments are limited to definitional issues.

1) Constraining special access prices with potential competition

In comments filed in a proceeding raising related issues, AT&T instructed the Commission to avoid "a single-minded reliance on static market share" and to "account for all factors that constrain ILEC market power."⁸ AT&T and its fellow ILECs are likely to offer the same perspective in response to this notice as well. Ad Hoc concurs that if "potential competition"⁹ were acting to constrain the ILECs' exercise of market power (and therefore were ensuring just and reasonable special access prices), it would be appropriate for the Commission to take its effects into account. It is clear from the voluminous record already compiled in this proceeding, however, that neither actual nor "potential" competition is

⁸ Comments of AT&T Inc., (filed Sept 21, 2009) at 2 and 6, *filed in Qwest Corporation's Petition for Forbearance in the Phoenix, Arizona Metropolitan Statistical Area*, WC Docket No. 09-135.

⁹ "Potential competition" as an economic concept is embodied in the Horizontal Merger Guidelines issued by the U.S. Department of Justice and the Federal Trade Commission. See U.S. DEP'T OF JUSTICE & FED. TRADE COMM'N, HORIZONTAL MERGER GUIDELINES 2 (rev. 1997) (available at: <http://www.usdoj.gov/atr/public/guidelines/hmg.htm>) at § 1.11, 1.12, 1.21.

constraining those prices and that devoting Commission resources to an analysis of forces that do not pertain to this market would be wasteful.

If and to the extent that the Commission nonetheless decides to include an assessment of “potential competition” in its analysis, it must evaluate not merely whether *some* potential for competition exists in the future but whether that potential is substantial enough to constrain the ILECs’ exercise of market power in the present.

In the same proceeding referenced above, AT&T quoted antitrust scholar Herbert Hovenkamp stating that it would be possible for a provider with 100% of a market’s demand to be without market power:

“Suppose we observe a firm accounting for 100 percent of a well-defined market but charging a price at the competitive level....Most likely, it has no market power: demand may be so responsive or entry so easy that lower output at higher prices would be immediately or quickly unprofitable.”¹⁰

Hovenkamp’s observation is dependent upon a specific set of circumstances that does not exist in the market for special access facilities. First, as the evidence discussed above demonstrates, the providers (ILECs) are charging supra-competitive prices¹¹ – not “a price at the competitive level.”¹² Second, the ILECs have increased prices yet demand has not been “so responsive” as to make the

¹⁰ Comments of AT&T Inc. (filed Sept 21, 2009), at 4, *filed in Qwest Corporation’s Petition For Forbearance in the Phoenix, Arizona Metropolitan Statistical Area*, WC Docket No. 09-135, citing 2B Philip E. Areeda, Herbert Hovenkamp, & John L. Solow, *Antitrust Law: An Analysis of Antitrust Principles and Their Application* ¶ 508 (3d ed. 2006).

¹¹ See. § 2.B, *supra*.

¹² It should also be noted that the market for special access services could hardly be called “well-defined.” If it were, the instant notice specifically inquiring into how to define the special access market would be unnecessary.

services “immediately or quickly unprofitable.”¹³ Finally, as the NoChokePoints Coalition points out in its comments, entry is far from easy.¹⁴ While ease of entry or response are almost always cited as the defining characteristics of the markets that can be constrained by “potential competition,”¹⁵ “difficult” is the best descriptor of entry conditions in the case of special access facilities. There may be a potential for some competition for special access service to develop in some of the individual geographic markets (*i.e.*, buildings) but the market behavior of the ILECs demonstrates that that potential is not substantial enough to constrain their actual pricing.

Finally, if the Commission determines that potential entry into the special access market may have price constraining effects on ILEC market power that should be given weight in designing a solution to the special access problem, then the effects of potential exit must be considered as well. To the extent that the Commission continues to allow ILECs to grossly overprice the special access services competitors need to fill-out their networks, and continues to allow the ILECs to withhold services like Ethernet from competitors on a wholesale basis, it can expect competitors to exit markets. Both actual competition and the price-constraining effect of the threat of entry by competitors will be reduced. While the potential for entry is speculative or predictive at best, the potential for exit is

¹³ See § D; and NoChokePoints Coalition Comments (filed January 19, 2010), at § IV.B.

¹⁴ See NoChokePoints Coalition Comments (filed January 19, 2010), at § III.C.

¹⁵ See, *e.g.*, 2 Earl W. Kintner & Joseph P. Bauer, *Federal Antitrust Law* § 14.4 (1989) (“Although relevant to monopoly power, market share cannot be the whole story, because even a very high market share confers no monopoly power if, for example, other firms could easily enter or expand existing output in response to an increase in price.”)

very real. As the Arizona Corporation Commission observed in its Comments on Qwest's recent Petition for Forbearance in the Phoenix MSA, elimination of the 251(c)(3) requirements in just nine of the ** wire centers in the Omaha MSA led McCleodUSA to stop offering service throughout the entire Omaha MSA.¹⁶

2) “Predictions” of competition vs. “potential” competition

In evaluating the power of “potential competition” to ensure special access prices that are just and reasonable, the Commission must distinguish between predictions that competition will develop at some point in the future and “potential competition” as an economic concept. Except in the rare circumstance of an absolute barrier to any entry (as when competition is prohibited by law), there is always the “potential” for competition to develop in the future in a particular market. In recent decisions, the Commission has relied heavily on predictions of imminent competition – from satellite services, from wireless providers, from broadband over power line technologies, or even from as yet unimagined technological change – to declare that regulation was no longer necessary in particular markets.¹⁷ These predictions proved to be overly optimistic, if not

¹⁶ Comments of the Arizona Corporation Commission (filed Sept 21, 2009), at 7, *filed in Qwest Corporation's Petition For Forbearance in the Phoenix, Arizona Metropolitan Statistical Area*, WC Docket No. 09-135.

¹⁷ See, e.g., *Qwest Petition for Forbearance Under 47 U.S.C. § 160(c) from Title II and Computer Inquiry Rules with Respect to Broadband Services*; *Petition of AT&T Inc. for Forbearance Under 47 U.S.C. § 160(c) from Title II and Computer Inquiry Rules with Respect to its Broadband Services*; *Petition of BellSouth Corporation for Forbearance Under Section 47 U.S.C. § 160(c) from Title II and Computer Inquiry Rules with Respect to Its Broadband Services*; and *Petition of the Embarq Local Exchange Operating Companies for Forbearance Under 47 U.S.C. § 160(c) from Application of Computer Inquiry and Certain Title II Common-Carriage Requirements*, WC Docket No. 06-125, Order, 21 FCC Rcd 6880 (2006); and Reply Comments of Ad Hoc Telecommunications Users Committee (filed Jul. 1, 2002) at i, *filed in Appropriate Framework for Broadband Access to the Internet Over Wireline Facilities*, CC Docket Nos. 02-33, 95-20, and 98-10, Notice of Proposed Rulemaking, 17 FCC Rcd 3019 (2002).

wildly unrealistic. But even if they had been more accurate, they are not what antitrust experts, the courts, and economic treatises are referring to when they discuss the “potential competition” that constrains market power. The reference is to existing suppliers or other present day marketplace forces that are capable of introducing competition in response to the behavior of a dominant company, not to imaginary providers or theoretical possibilities that may or may not emerge in an undefined future.

In the special access market today, there are actual competitors – many of whom are members of the NoChokePoints coalition – whose presence has not constrained the ILECs’ power in the special access market. While the potential exists for additional competitors to emerge in the future and enter the market, or for the existing competitors to expand their operations, the structural characteristics of the special access market (scale economies, entry barriers, etc.) mean that the potential for competitive entry is no more price-constraining than the actual competition that exists today. When it evaluates comments filed in response to the public notice and analyzes competitive conditions in the special access market, the Commission should not confuse predictions based on an unsupported faith in the inevitability of competition with a data-driven assessment of existing, price-constraining “potential competition” as described in the Merger Guidelines.

D. Example # 4 – Evaluating Price Caps Rates with ARMIS data

In Example #4 of the Public Notice, the Commission observes that parties to this proceeding have debated whether special access profits are unreasonable

and whether the cost and revenue data filed by the incumbent LECs pursuant to the ARMIS rules, which indicates grossly excessive returns, are reliable and economically meaningful. The Commission asks parties who support the use of ARMIS data to explain why challenges to the data are baseless or how any problems could be addressed.

As noted in Section I.B, *supra*, Ad Hoc supports the Commission's use of the data filed by ILECs in the ARMIS database for purposes of evaluating the ILECs' special access prices. In Attachment B of this pleading, Ad Hoc's economic consultants at Economics and Technology, Inc. review and refute the challenges raised by ILECs to the integrity of the ARMIS results and suggest how the data could be adjusted if adjustments are necessary to correct for ILEC misallocations of nonregulated costs to regulated service categories.

CONCLUSION

For the reasons discussed above, the Commission should use the analytical framework identified in this pleading and in that filed today by the

NoChokePoints Coalition, analyze the state of competition in the special access marketplace, and revise its rules to protect customers and competition from the market power of the incumbent LECs.

Respectfully submitted,

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