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

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

Comments of the AdHoc Telecommunications Users Committee

Susan M. Gately
Economics and Technology, Inc.
One Washington Mall, 15th Floor
Boston, MA 02108-1906
617-227-0900

Economic Consultant

Colleen L. Boothby
Levine, Blaszak, Block & Boothby, LLP
2001 L Street, NW, Suite 900
Washington, D.C. 20036
202-857-2550

Counsel for
AdHoc Telecommunications
Users Committee

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Appendix 2, Declaration of Susan M. Gately.

SUMMARY

The Commission began this rulemaking over two and a half years ago, after incumbent local exchange carrier ("ILEC") prices and profits on special access had soared to historically unprecedented heights under the Commission's "pricing flexibility" rules; AdHoc and other parties had repeatedly challenged the rules and the carriers' exploitation of them before the FCC; and 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.

Over two years have passed since the pleading cycle closed in this docket and the FCC has now asked whether subsequent developments in the industry have changed parties' positions since they filed their comments.

AdHoc's positions have not changed because the state of 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 own behavior. The Bell Operating Companies ("BOCs") are charging special access rates so high that they produced jaw-dropping returns of 52% to 132%, as of year end 2006. Put differently, the Commission's failure to act in the face of the carriers' overcharges is now costing business customers *$22.7 million* per day, based on the most recent data filed by the carriers. Those numbers would be impossible to achieve in a competitive market.

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 de-regulation for competitive telecom markets and forbearance authority for the FCC 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 urged the Commission in the first round of comments to re-vamp the special access pricing flexibility rules because special access markets simply are not competitive. Because the Commission has refused to revise its pricing flexibility regime to reflect that lack of competition, special access prices and profits have risen 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 price caps protections for customers based on its predictions regarding the imminence and inevitability of competition.

The Commission's predictions proved to be wrong.

Despite the 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" regarding new and innovative technologies that have yet to be deployed. 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.

Appendix 2 to this pleading updates the pricing and rate of return information previously filed by AdHoc in this docket. The appendix compares prices still regulated under price caps with the carriers' pricing flexibility rates. The data confirms that prices remain far *higher* in pricing flexibility areas where the market is supposed to be more competitive. In other words, the ILECs continue to use the pricing flexibility rules to *raise* prices, not lower them.

The comments also respond to specific issues raised by the notice.

Merger Impact. The comments conclude that the mergers have reduced competition for special access and that the divestiture conditions in the merger orders have done nothing to counteract that.

Projected deployment costs. The Commission must ensure that the ILECs do not include in their special access cost data the costs of services that were re-classified as non-common carriage in the *Wireline Broadband Internet Access Rulemaking,* as the Order in that docket requires. The dollar value of those costs is likely to be significant since it covers Verizon's FiOS and AT&T *Project Lightspeed* investments in broadband facilities for non-regulated video services. This issue is discussed in greater detail in Appendix 1.

New regulatory scheme. The *Notice* asks parties to provide specific proposals for a new regulatory scheme that would ensure reasonable rates and conditions for special access. AdHoc continues to support a combination of updated incentive regulation (price caps) and unlimited *downward* pricing flexibility for the ILECs to respond to competition. The Commission should also re-initialize special access rates at the Commission's authorized level of 11.25%.

GAO Report. The Notice asks parties to comment on the November, 2006 GAO report critiquing the Commission's regulation of special access. The report confirms AdHoc's conclusions that there is no meaningful competition in special access markets, price have increased in pricing flexibility areas, and the pricing flexibility rules, particularly the competitive "triggers," are fundamentally flawed. Appendix 1 contains a detailed analysis of the GAO report.

In short, the Commission must conclude that competition has failed to emerge in the ILECs' special access markets. In the absence of competition, the Commission's pricing flexibility rules have allowed the ILECs to exploit end users with unjust and unreasonable rates and impede the development of competition by imposing anti-competitive terms and conditions on nascent competitors. It is past time for the Commission to replace its pricing flexibility rules with the

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Comments of the AdHoc Telecommunications Users Committee

The AdHoc Telecommunications Users Committee ("AdHoc" or the "Committee") hereby submits its comments filed in response to the July 9, 2007 Public Notice ("*Notice*") in the docket captioned above.[1]

INTRODUCTION

The Commission began this rulemaking over two and a half years ago, at a time when incumbent local exchange carrier ("ILEC") prices and profits on special access had risen to historically unprecedented levels under the Commission's "pricing flexibility" rules; after AdHoc and other parties had repeatedly challenged the rules and the carriers' exploitation of them before the FCC; and in response to a mandamus petition filed by AT&T (before its merger with an ILEC, of course) with the D.C. Circuit Court of Appeals seeking

[1] Public Notice, *Parties Asked to Refresh Record in the Special Access Notice of Proposed Rulemaking,* WC Docket No. 05-25, FCC 07-123 (rel. Jul. 9, 2007) ("*Notice*").

immediate action by the FCC to re-examine its pricing flexibility regime.[2] The FCC initiated this docket and cited it to the Court to justify dismissal of the mandamus petition as moot. Ironically, throughout this same time period, the Commission repeatedly emphasized the economy-wide importance of broadband services such as the business broadband services that constitute special access.

Over two years have passed since the close of the initial pleading cycle in this docket and the FCC has now asked whether subsequent developments in the industry have changed parties' positions since they filed their comments.

AdHoc's positions have not changed because the state of 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 ILECs have demonstrated conclusively through their continuation of the unjust and unreasonable prices, profits, and practices precipitating this proceeding.

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 de-regulation for competitive telecom markets and forbearance authority for the FCC 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.

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[2] *In re* AT&T Corp., *et al*, No. 03-1397 (D.C. Cir.), *dismissed as moot*, Feb. 4, 2005 ("*AT&T Mandamus Petition*").

AdHoc nevertheless urged the Commission to re-visit the special access pricing flexibility rules for the simple reason that special access markets are not competitive. The Commission has heard this repeatedly, over the past several years, from AdHoc and a broad range of other special access customers who have challenged the ILECs' anti-competitive practices and their steady price increases for special access that have produced mind-boggling profit levels.

Under the current pricing flexibility regime for special access, the Commission effectively de-regulated the vast majority of special access services in the most important metropolitan markets and effectively eliminated productivity-based price cap rate adjustments for the remaining special access and switched access services still (in principle) subject to price constraints. As a result, special access prices have risen steeply for the past several years. And the ILECs' special access profits are at historically unprecedented heights. AdHoc's economic analysis, discussed below, continues to confirm the individual experiences reported by its members – special access markets simply are not competitive. The ILECs are continuing to increase prices and earn record-setting profits for special access.[3]

The ILECs' continuing stranglehold on the special access market remains the greatest single threat to the emergence of robust competition across all

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[3] The ILECs' stunning prices and profits for their business broadband (special access) services are reviewed and analyzed in two appendices to this pleading. The first, Appendix 1, is a white paper entitled "*Special Access Overpricing and the U.S. Economy – How Unchecked RBOC Market Power Is Costing U.S. Jobs and Impairing U.S. Competitiveness*," prepared by AdHoc's economic experts at Economics and Technology, Inc. ("ETI"). The second, Appendix 2, is a declaration prepared by Susan Gately of ETI. Both Appendices are discussed in greater detail below.

telecommunications markets, as AdHoc has repeatedly emphasized in its pleadings before this Commission. By refusing to revisit the 1999 pricing flexibility rules, which were premised on a (now discredited) Commission prediction that competition was imminent and inevitable in this market, the Commission has exacerbated the problems created by the competitively dysfunctional special access market.

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 and the Commission's rules implementing those amendments. Instead of applying revised regulations once access markets actually became competitive, however, the Commission assumed that competition would inevitably flourish once a competitive LEC ("CLEC") took certain steps to enter a market. Based on this "predictive judgment," the Commission's pricing flexibility rules eliminated price caps protection for customers of ILECs once the ILEC demonstrated that CLECs had taken the requisite steps to collocate in a specific number of end offices.

The Commission's predictions regarding the emergence of competition in access markets proved to be wrong, and its standards for ascertaining "irreversible market entry" by competitors proved to be misguided. AdHoc and various other parties have repeatedly cited the egregiously high prices and rates

of return collected by ILECs on their special access services under the Commission's deeply flawed pricing flexibility regime.[4] Those prices and profits have continued to rise while this proceeding has been pending at the Commission, with the Bell Operating Companies ("BOCs") charging rates so high that they are earning historically unprecedented returns of 52% to 132% as of

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[4] *See, e.g.,* Comments of AdHoc Telecommunications Users Committee (Jan. 22, 2002) at 2-3, *filed in Performance Measurements and Standards for Interstate Special Access Services*, CC Docket Nos. 01-321, 00-51, 98-147, 96-98, 98-141, 96-149, 00-229, Notice of Proposed Rulemaking, 16 FCC Rcd 20896 (2001) ("*Performance Standards rulemaking*"); Comments of AdHoc Telecommunications Users Committee (Mar. 1, 2002) at 14-17, *filed in Review of Regulatory Requirements for Incumbent LEC Broadband Services; SBC Petition for Expedited Ruling That It Is Non-Dominant in its Provision of Advanced Services and for Forbearance From Dominant Carrier Regulation of These Services,* CC Docket No. 01-337, Notice of Proposed Rulemaking, 16 FCC Rcd 22745 (2001) ("*Broadband Regulation Rulemaking")*; Reply Comments of AdHoc Telecommunications Users Committee (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) ("*Wireline Broadband Internet Access Rulemaking*"); Comments of AdHoc Telecommunications Users Committee (Dec. 2, 2002) at 5, *filed in AT&T Petition for Rulemaking to Reform Regulation of Incumbent Local Exchange Carrier Rates for Interstate Special Access Services*, RM No. 10593 ("*AT&T Special Access Rulemaking Petition*"); Comments of AdHoc Telecommunications Users Committee (Jun. 30, 2003) at 6, *filed in Section 272(f)(1) Sunset of the BOC Separate Affiliate and Related Requirements*, WC Docket No. 02-112, and *2000 Biennial Regulatory Review Separate Affiliate Requirements of Section 64.1903 of the Commission's Rules*, CC Docket No. 00-175, Further Notice of Proposed Rulemaking, 18 FCC Rcd 10914 (2003) ("*ILEC Separate Affiliate Dominant/Non-Dominant Rulemaking* "); Reply Comments of AdHoc Telecommunications Users Committee (September 23, 2004) at 3-14, *filed in Petition of Qwest Corporation for Forbearance Pursuant to 47 U.S.C. § 160(c) in the Omaha Metropolitan Statistical Area*, WC Docket No. 04-223, Memorandum Opinion and Order, FCC 05-170 (rel. Dec. 2, 2005) ("*Qwest Omaha Forbearance Petition* "); Reply Comments of AdHoc Telecommunications Users Committee (May 10, 2005), *filed in SBC/AT&T Merger Proceeding;* Reply Comments of AdHoc Telecommunications Users Committee (May 24, 2005) at pp. 8-23, *filed in Verizon Communications Inc. and MCI, Inc. Applications for Approval of Transfer of Control*, WC Docket No. 05-75 ("*Verizon/MCI Merger Proceeding*"); Comments and Reply Comments of AdHoc Telecommunications Users Committee (June 13, 2005 and July 29, 2005), *filed in Special Access Rates for Price Cap Local Exchange Carriers; AT&T Corp. Petition for Rulemaking to Reform Regulation of Incumbent Local Exchange Carrier Rates for Interstate Special Access Services*, WC Docket No. 05-25, RM-10593, Order and Notice of Proposed Rulemaking, 20 FCC Rcd 1994 (2005) ("*Special Access Rulemaking*"); Comments of AdHoc Telecommunications Users Committee (February 22, 2006), *filed in Petition of Qwest Communications International Inc. for Forbearance from Enforcement of the Commission's Dominant Carrier Rules as They Apply After Section 272 Sunset Pursuant To 47 U.S.C. § 160*, WC Docket No. 05-333 ("*Qwest § 272 Forbearance Petition*"), Letter from Colleen Boothby, Counsel for AdHoc Telecommunications Users Committee, to Marlene Dortch, Secretary, FCC, WC Docket No. 04-440 (filed Mar. 16, 2006).

year end 2006.[5] Put differently, the Commission's failure to act in the face of the carriers' overcharges is now costing business customers $22.7 million per day, based on the most recent data filed by the carriers.[6] Earnings of this magnitude, with uninterrupted growth and steady price increases disrupted only by Commission intervention (*e.g.*, merger conditions), demonstrate the existence of persistent market power, not a market that can be described as even modestly competitive.

Despite the 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. As AdHoc detailed in its June 13, 2005 Comments in this docket ("*June 13 Comments")*,[7] the BOCs have failed to support their claims with factual evidence, relying instead on what AdHoc has characterized as "compelling rhetoric, comforting economic theories, and sunny speculation"[8] regarding the market-opening potential of new and innovative technologies that have yet to be deployed. 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 competitive alternatives. AdHoc's *June 13 Comments* pointed out that the

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5 Appendix 2 at p. 6, para. 10.

6 *Id.* at pp. 4-5, para. 6.

7 Comments of AdHoc Telecommunications Users Committee (June 13, 2005) at 6-10 ("*June 13 Comments*").

8 Comments of AdHoc Telecommunications Users Committee (May 10, 2005), *SBC Communications Inc. and AT&T Corp., Applications for Approval of Transfer of Control*, WC Docket No. 05-65.

marketplace experience of enterprise customers was entirely inconsistent with the rosy competitive picture painted by the BOCs in their filings with this Commission and that continues to be the case.

AdHoc's *June 13 Comments* also described the actual market experience of AdHoc's members, previously reported to the Commission, and factors that impede the development of effective competition in the exchange access market:

- The pricing flexibility rules have resulted in price *increases* for special access services, despite record earnings by the ILECs, a result that is fundamentally inconsistent with the outcome of a market with effective competition.

- AdHoc's members – whose high-volume purchases make them the first customers new entrants would seek out – have in fact experienced few competitive alternatives for their exchange and exchange access service requirements.

- Intermodal competition via cable modem service is not a factor for large business users due to the limited deployment of cable infrastructure in business areas and the severe security and reliability concerns raised by cable-based services and technologies.

- Meanwhile, the capital markets for competitive LECs ("CLECs") as a whole have crumbled over the past few years, driving many CLECs out of the market or into bankruptcy and placing severe restrictions on the ability of the few remaining CLECs to stay in the market, let alone expand their service capabilities.

- By contrast, the financially secure ILECs have refrained from aggressively pursuing out-of-region local markets, notwithstanding the specific "commitments" by both SBC and Verizon to do so in exchange for FCC approval of their respective merger applications.[9]

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[9] *See, e.g., Applications of Ameritech Corp., Transferor, and SBC Communications Inc., Transferee, For Consent to Transfer Control of Corporation Holding Commission Licenses and Lines Pursuant to Sections 214 and 310(d) of the Communications Ace and Parts 5, 22, 24, 25, 63, 90, 95 and 101 of the Commission's Rules*, CC Docket 98-141, Memorandum Opinion and Order, 14 FCC Rcd 14712 (1999).

June 13 Comments at 8-9. AdHoc members report that their experiences in today's special access marketplace are no different.

AdHoc's *June 13 Comments* also reported on the mismatch between the actual marketplace experiences of enterprise customers and the BOCs' representations in regulatory and public policy proceedings that special access is sufficiently competitive to be de-regulated even more. AdHoc members could find no competitive alternatives to ILEC services to meet their broadband business services requirements in the overwhelming majority of their service locations.[10] Yet the BOCs maintained before the Commission that they were losing ground rapidly to fierce competition in local markets, in response to which the Commission sought public comment on a variety of de-regulatory dockets and initiatives.

To determine whether AdHoc members were somehow insulated from these allegedly pervasive competitive pressures, despite the numerous and diverse geographic locations and industry sectors represented in AdHoc's membership, AdHoc directed its economic consultants to analyze the access services market and the available data for signs of competitive market forces. AdHoc reported the results of that analysis in a white paper prepared by AdHoc's economic consultants, Economics and Technology, Inc. ("ETI") which appears as

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[10] For locations with capacity requirements totaling four DS-1 circuits or below, members reported that viable competitive alternatives to the ILEC were available at less than 10% of their locations. *See* Comments of AdHoc Telecommunications Users Committee (Mar. 1, 2002), *Review of Regulatory Requirements for Incumbent LEC Broadband Services; SBC Petition for Expedited Ruling That It Is Non-Dominant in its Provision of Advanced Services and for Forbearance From Dominant Carrier Regulation of These Services,* CC Docket No. 01-337, Notice of Proposed Rulemaking, 16 FCC Rcd 22745 (2001) ("*Broadband Regulation Rulemaking*") at 14-17.

Attachment A to the *June 13 Comments.* ETI's analysis confirmed the individual experiences reported by AdHoc's members – access markets, and the special access market in particular, were simply not competitive.[11]

AdHoc has previously observed that some policy makers find the dearth of competitive alternatives for enterprise customers to be counter-intuitive. Decision-makers understandably assume that the largest corporations – companies that annually spend tens or hundreds of millions of dollars on local and long distance, voice and data telecom services – are the primary beneficiaries of competition in all telecom sectors. As documented by AdHoc in its *June 13 Comments*, however, large enterprise customers at virtually all commercial locations have no access options other than the services and facilities available from ILECs.

That continues to be the case. Since the filing of AdHoc's *June 13 Comments,* AdHoc has periodically updated its analysis to reflect the most recent data and provided that updated information to the Commission.[12] Attached to these comments as Attachment 2 is a declaration by Susan Gately of ETI ("*Gately Declaration*") updating the analysis in the ETI white paper once again to reflect current data. The data confirms what AdHoc members are experiencing

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[11] *See* "*Competition in Access Markets: Reality or Illusion. A Proposal for Regulating Uncertain Markets*," Economics and Technology, Inc. (August 2004).

[12] *See, e.g.,* Comments of AdHoc Telecommunications Users Committee (June 20, 2006) *filed in AT&T Inc. and BellSouth Corporation Applications for Approval of Transfer of Control*, WC Docket No. 06-74, Memorandum Opinion and Order, FCC 06-189 (Mar. 26, 2007) ("*AT&T/BellSouth Merger Order*").

in the marketplace: there has been no meaningful improvement in competitive alternatives for the special access services they use.

As a result, there can be no question that the current pricing flexibility rules were applied prematurely to the special access market. Though the ILECs' have repeatedly referred to the "success" of the Commission's pricing flexibility plan, 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 monopolistic nature of ILEC special access services. The ILECs' dogged persistence in asserting that, despite all factual evidence to the contrary, special access is nevertheless "robustly" competitive simply has no support in this record.

DISCUSSION

The July 9, 2007 *Notice* in this docket identified specific issues for which the Commission is seeking input. AdHoc responds to those on an issue-by-issue basis in the paragraphs which follow. Some of the questions raised by the *Notice* required information and expertise that is uniquely available to carriers rather than end users like AdHoc's members (*e.g.,* vendor prices for the high capacity transmission equipment, outside plant, fiber, and fiber installations needed to provide special access). This pleading will not address those issues.

No 'refreshing of the record" would be complete, of course, without updated information on the current relationship between prices for special access services offered in areas still nominally regulated by price caps, and those that are regulated pursuant to the pricing flexibility rules. AdHoc previously submitted

information documenting the fact that prices are *higher* in those areas subject to pricing flexibility (areas where the market is purportedly the most competitive) in its *June 13 Comments*. The Gately Declaration attached as Appendix 2 hereto updates that analysis.[13]

AdHoc's *June 13 Comments* demonstrated that ILECs had used their pricing flexibility for supposedly more competitive MSAs to *raise* prices, not lower them. ILECs charged higher rates in pricing flexibility areas than they charged in areas that remained under price caps.

The Gately Declaration reveals the situation to be much the same as it was when AdHoc filed its *June 13 Comments*, with one difference. Pursuant to the conditions imposed by the Commission's order approving the AT&T/BellSouth merger,[14] prices in pricing flexibility MSAs across the new AT&T territory have been 'rolled back' to price caps levels for the period from April 5, 2007 to June 30, 2010. As a result, there is no price caps/pricing flexibility differential throughout AT&T's twenty-two state region. AT&T has made it clear, however, that this is a temporary condition, and that it's prices will revert to the previous, higher levels, when the condition expires in June of 2010. As evidence of AT&T's commitment to higher prices, the Gately Declaration includes two pages from AT&T's special access tariff for the Bell South Region. One page is captioned "Rates on this page are in effect April 5, 2007 through June 30,

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[13] The Declaration includes a full analysis of 10-mile sample circuit prices for the twenty states with the highest population for month-to-month, one year, three year and five year contracts.

[14] *AT&T/BellSouth Merger Order,* note 11, *supra.*

2010"[15] and a second sheet containing higher prices for the very same service elements is captioned "Restored rates on this page effective July 1, 2010." The sheets demonstrate AT&T's clear intent to revert to the higher pre-merger Commitment price levels as soon as possible.

Tables 1 and 2, below, contain a snapshot of the pricing information contained in the Gately Declaration. The tables demonstrate that prices in pricing flexibility areas continue to be higher than those in pricing flexibility areas.

	DS1 Sample - Month to Month Pricing		
	Price Caps Sample	Pricing Flexibility Sample	% by which Price Flex rate exceeds Price Caps Levels
Arizona - Qwest	$394.60	$582.00	47%
California - AT&T	$410.00	$410.00	n/a (1)
Florida - AT&T	$571.00	$571.00	n/a (1)
Georgia - AT&T	$571.00	$571.00	n/a (1)
Illinois - AT&T	$881.50	$871.50	n/a (1)
Indiana - AT&T	$917.00	$917.00	n/a (1)
Maryland - Verizon	$1,107.00	$1,097.00	n/a (1)
Massachuusetts - Verizon	$632.82	$779.96	23%
Michigan - AT&T	$914.00	$904.00	n/a (1)
Missouri - AT&T	$609.00	$609.00	n/a (1)
New Jersey - Verizon	$632.36	$779.96	23%
New York - Verizon	$593.06	$716.68	21%
North Carolina - AT&T	$571.00	$571.00	n/a (1)
Ohio - AT&T	$914.00	$904.00	n/a (1)
Pennsylvania - Verizon	$632.36	$779.96	23%
Tennessee - AT&T	$571.00	$571.00	n/a (1)
Texas - AT&T	$609.00	$609.00	n/a (1)
Virginia - Verizon	$632.36	$779.96	23%
Washington - Qwest	$394.60	$582.00	47%
Wisconsin - AT&T	$917.00	$917.00	n/a (1)

(1) Price Flex prices "temporarily reduced" until June, 2010 in compliance AT&T/BellSouth Merger Commitment 6.

Table 1: Comparison of DS1 sample prices (Month to Month pricing for 10 mile circuit in the mostly densely populated Zone) in Price Caps and Pricing Flexibility areas for the 20 states with the highest US population

[15] Sou

	DS3 Sample - 5 year term pricing		
	Price Caps Sample	Pricing Flexibility Sample	% by which Price Flex rate exceeds Price Caps Levels
Arizona - Qwest	$394.60	$582.00	47%
California - AT&T	$410.00	$410.00	n/a (1)
Florida - AT&T	$571.00	$571.00	n/a (1)
Georgia - AT&T	$571.00	$571.00	n/a (1)
Illinois - AT&T	$881.50	$871.50	n/a (1)
Indiana - AT&T	$917.00	$917.00	n/a (1)
Maryland - Verizon	$1,107.00	$1,097.00	n/a (1)
Massachuusetts - Verizon	$632.82	$779.96	23%
Michigan - AT&T	$914.00	$904.00	n/a (1)
Missouri - AT&T	$609.00	$609.00	n/a (1)
New Jersey - Verizon	$632.36	$779.96	23%
New York - Verizon	$593.06	$716.68	21%
North Carolina - AT&T	$571.00	$571.00	n/a (1)
Ohio - AT&T	$914.00	$904.00	n/a (1)
Pennsylvania - Verizon	$632.36	$779.96	23%
Tennessee - AT&T	$571.00	$571.00	n/a (1)
Texas - AT&T	$609.00	$609.00	n/a (1)
Virginia - Verizon	$632.36	$779.96	23%
Washington - Qwest	$394.60	$582.00	47%
Wisconsin - AT&T	$917.00	$917.00	n/a (1)

(1) Price Flex prices “temporarily reduced” until June, 2010 in compliance AT&T/BellSouth Merger Commitment 6

Table 2: Comparison of DS3 sample prices (5 year term pricing for 10 mile circuit in the mostly densely populated Zone) in Price Caps and Pricing Flexibility areas for the 20 states with the highest US population

1. Impact of industry consolidation

The Public Notice seeks comment on the effect of the "post *Special Access NPRM* mergers and other industry consolidations" on the availability of special access facilities and providers.

Two of the mergers have, quite obviously, reduced the level of competitive special access alternatives by eliminating from the market the two largest special access competitors of the ILECs: pre-merger AT&T and pre-merger MCI. Though the Commission and the Justice Department in their proceedings on the mergers recognized the adverse impact of removing AT&T and MCI as competitors, they concluded that conditions imposed by the Justice Department as part of its settlement of the antitrust complaints filed against the mergers were sufficient to address the competitive harm. Those conditions do not, however, resolve the competitive issues in this proceeding.

As the Commission is aware, the Department of Justice filed complaints challenging the SBC/AT&T and Verizon/MCI 2005 merger applications and alleging that the mergers would "substantially lessen competition" in the relevant product and geographic markets.[16] The Department defined those markets to be "(a) Local Private Lines, and (b) voice and data telecommunications services that

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[16] *United States of America vs. SBC Communications Inc. and AT&T Corp,* No. 1:05CV02102(EGS) (D.D.C.); *United States of America, v. Verizon Communications Inc. and MCI, Inc.*, No. 1:05CV02103 (EGS) (D.D.C.).

rely on Local Private Lines" covering geographic areas "no broader than each metropolitan area and no more narrow than each individual building."[17]

The "local private lines" referenced in the Justice complaints are nothing more than special access. Unfortunately, although the complaints defined the "relevant product market" to include "voice and data telecommunications services that rely on Local Private Lines" and the relevant geographic market as potentially embracing "each metropolitan area" where the relevant products are offered, Justice limited its ensuing investigation and its proffered solution to Local Private Lines furnished to a handful of the least competitively desirable of all commercial buildings within each metropolitan area. In so doing, Justice ignored altogether key components of the relevant product and geographic markets as it had itself defined them. As a result, the Justice Department's solutions do not address a substantial portion of the competitive alternatives lost as a result of the mergers

In addition, the specific remedy incorporated by Justice in the *Proposed Final Judgments* ("*PFJs*") submitted in both cases was limited to the divestiture of a portion of the spare, non-revenue-producing capacity at a handpicked subset of all "2-to-1 buildings"[18] within the SBC and Verizon regions where the Department recognized entry would be unlikely. No customers or revenues were divested as part of this remedy. Justice explained that "it determined which buildings needed

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[17] *See, e.g., Complaint, United States of America vs. SBC Communications Inc. and AT&T Corp.,* No. 1:05CV02102(EGS) (D.D.C.) (Oct. 27, 2005) at para. 19-33.

[18] The "2 to 1" buildings are those for which the merger would reduce the number of providers from two (SBC and AT&T) to one (the newly merged entity).

to be subject to the remedy using extensive data gathered via compulsory process in a *building-by-building analysis*."[19]

A "building-by-building analysis" – essentially a "five-foot view" of the market – is neither a reasonable nor an appropriate basis upon which to consider the competitive harms arising from these mergers because telecommunications is fundamentally a network-based business. The more extensive a carrier's own network, the greater the likelihood that the carrier will have facilities of its own available at both endpoints of any point-to-point connection.[20] Justice's approach ignored such network effects, assuming away the interdependence of the multiple locations that exist. It applied the same type of building-by-building remedy that might, perhaps, be appropriate for a merger of two coffee shop chains or two supermarket chains where interconnectedness is not a factor. As a result, the partial divestiture of a limited amount of non-revenue-producing spare dark fiber capacity at a handful of commercial locations where, by Justice's own analysis, entry is least likely to occur, did nothing to address or prevent even the narrow and specific competitive harms alleged in the *PFJs*, let alone the competitive harms that will emerge in the relevant markets of voice and data telecommunications services that rely on Local Private Lines.

The competitive insignificance of the specific "assets" that Justice required AT&T and Verizon to divest is compellingly demonstrated by an analysis of the

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[19] Reply of the United States to ACTel's Opposition to the United States' Motion for Entry of the Final Judgments, *United States of America vs. SBC Communications Inc. and AT&T Corp.,* No. 1:05CV02102(EGS) (D.D.C.) (May 31, 2006) at 20, emphasis added.

[20] For a more detailed discussion of these networking "externalities" see the discussion in Appendix 3 of the ETI white paper attached hereto as Appendix 1, at pages A-17 to A-20.

purchase and sale agreements entered into by AT&T and the several "acquirers" of the "divestiture assets."[21] The IRUs or "Service Agreements" reportedly cover only 383 building laterals in the eleven MSAs in which AT&T had deployed fiber rings within the SBC footprint. Justice did not submit corresponding agreements between Verizon and the acquirers of its excess fiber strands if, indeed, Verizon had even found buyers for these "divestiture assets."

Justice's "building-by-building analysis" also ignores customers' requirements for single-source connectivity among multiple locations. The integration of the AT&T and SBC – and MCI and Verizon – networks made possible by the mergers *enhances* the single-source connectivity that each post-merger entity could offer, further reducing the competitive value of isolated dark fiber strands in a handful of the least desirable buildings in each of the in-region MSAs. If there were even a remote possibility that these assets in the hands of small CLECs would create a serious competitive challenge to the post-merger AT&T and Verizon – if those assets had any "going concern" value at all – the prices that these "divestiture assets" would realize in arm's length transactions with acquirers would have been far greater than what have been described as the "rummage sale prices" at which these transactions were consummated.[22]

As a result of the less-than-aggressive remedial measures which Justice agreed to in its settlements with AT&T and Verizon related to the 2005 merger

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[21] *See* Declaration of Lee L. Selwyn, submitted on behalf of the National Association of State Utility Consumer Advocates (NASUCA), in *United States of America v. SBC Communications Inc. and AT&T Corp,* No. 1:05CV02102(EGS) (D.D.C.) (Sept. 5, 2006).

[22] *Id.* at iii.

applications, and the absolute lack of remedial measures applied to the 2006 AT&T /BellSouth merger, these mergers have 'substantially lessened competition' across a broad spectrum of telecommunications markets nationwide.

In 2007 there remains no consequential amount of facilities-based competition for "last mile" special access type services. The experience of most business broadband customers is that there is no material competition for "last mile" special access services (as was discussed above).

This characterization is consistent with the data the ILECs themselves have provided. In 2005, SBC and the then separate AT&T painted bleak competitive picture in order to support their merger application, dismissing AT&T's provision of local services as having no competitive consequence. As the Commission noted in the *SBC/AT&T Merger Order*,[23]

> [i]n the 19 in-region MSAs where AT&T has local facilities, SBC identifies over 240,000 commercial buildings with more than 10 DS0 line equivalents…AT&T provides Type I service to only 1,691 buildings…using its own facilities – only 0.7%.[24]

The post-merger environment resulting from the 2005 and 2006 mergers of SBC/AT&T/BellSouth and Verizon/MCI only exacerbated the dismal state of competitive affairs. AT&T controls somewhere between 40% and 50% of all wireline access lines in the U.S. and just under 30% of nationally-based CMRS

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[23] *SBC Communications Inc. and AT&T Corp. Applications for Approval of Transfer of Control*, WC Docket No. 05-65, Memorandum Opinion and Order, 20 FCC Rcd 18290 (2005) ("*SBC/AT&T Merger Order*").

[24] *Id.*, n. 98.

carrier wireless phones.[25] Verizon, controls close to another 40% of the nation's wireline access lines and also approximately 30% of all wireless phones. Competition between AT&T and Verizon for mass market services outside of their respective ILEC footprints has been minimal to nonexistent.

Meanwhile, both AT&T and Verizon continue to have powerful incentives to maintain their currently excessive special access rate levels in order to impose excessive costs of doing business upon their would-be rivals for enterprise customers (companies such as Sprint, Qwest, XO, Level3, and others) and constrain their rivals' activities within the combined AT&T and Verizon footprints. As long as AT&T and Verizon are allowed to set special access prices without limit or constraint, they will be able to block or seriously retard entry by other companies into their respective (and growing) regions. While there can be no assurance that requiring cost-based special access rates will make the enterprise market competitive, there can be no question but that, with special access rate levels continuing at their present excessive levels, there is no realistic possibility that competition for enterprise customers will develop or be sustained. And in

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25 There are approximately 136-million ILEC switched access lines. AT&T currently has 44-million switched access lines. BellSouth has 18.8-million switched access lines. Verizon has 48.6-million switched access lines. ARMIS Report 43-08, Operating Data Report: Table III, YE 2005, available at http://www.fcc.gov/wcb/eafs (accessed June 19, 2006). Following the merger, AT&T/BellSouth will control 46%, and Verizon will control 35.7%, of all ILEC lines. Cingular wireless has approximately 54-million customers. http://www.cingular.com/about/company_overview (accessed June 19, 2006) ("Cingular website"). Verizon Wireless has approximately 53-million customers. http://aboutus.vzw.com/ataglance.html (accessed June 19, 2006) ("Verizon Wireless Website"). Wireless carriers with a nationwide presence have approximately 195-million wireless subscribers. Verizon Wireless Website, Cingular Website, Sprint 1Q 2006 Investor Briefing (http://www.sprint.com/investors/ accessed June 20, 2006) T-Mobile 1Q 2006 Investor Briefing (http://www.t-obile.com/Company/InvestorRelations.aspx?tp=Abt_Tab_InvestorRelations, accessed June 20, 2006), Alltel website http://alltel.com/corporate/ (accessed June 19, 2006). Cingular thus controls a 27.7% market share, Verizon Wireless enjoys a 27.2% market share.

that case the promise of 1996, which remained unfulfilled in 2005, and is still unfulfilled in 2007, will likely remain so forever.

2. Projected deployment costs

The *Notice* asks parties to comment on projected costs per customer to deploy facilities for high capacity services. This is one of the issues discussed above that requires information and expertise that is uniquely available to carriers rather than end users like AdHoc's members. As part of any evaluation of special access costs claimed by the carriers, however, the Commission must ensure that the ILECs do not include in their special access cost data the costs of the broadband services that were re-classified as non-common carriage in the *Wireline Broadband Internet Access Rulemaking*[26]. In that proceeding, the Commission recognized that the cost allocation rules require the costs of non-regulated services to be separated from the costs of regulated services (to prevent ILECs from creating anti-competitive subsidies of their non-regulated services by overstating the costs and thus the prices for their regulated services). The Commission expressly permitted ILECs to retain the costs of their newly de-regulated broadband activities in their cost accounts for regulated services, despite the requirements of the Commission's Rules, but only until such time as the Commission would need valid cost and revenue data. Thus, carriers are

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[26] *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); Report and Order and Notice of Proposed Rulemaking, 20 FCC Rcd 14853 (2005) ("*Wireline Broadband Internet Access Rulemaking*")

required to remove the costs for purposes of earnings determinations and price caps low end adjustments.[27]

Accordingly, regardless of the particular cost methodology the Commission may choose to use to estimate special access costs and for whatever cost projections the ILECs may provide in this docket, the Commission must direct carriers to remove any costs of non-regulated services that they have included in their regulated accounting costs in accordance with the *Wireline Broadband Internet Access Rulemaking* Order's temporary permission to include them.

The dollar value of the "true up" described in the preceding paragraph is likely to be significant given the level of investment some ILECs claim to be making in non-regulated broadband facilities. This issue is discussed in greater detail in Appendix 1 of the ETI white paper attached hereto as Appendix 1, at pages A-5 to A-10. As discussed in Appendix 1, the data supplied by Verizon for its *FiOS* initiative and by A&T for its *Project Lightspeed* services indicate that billions of dollars in costs for these non-regulated services have been booked to regulated accounts even though the associated revenues are not. The resulting overstatement of costs for special access services allows carriers to report earnings on regulated special access services that are far lower than their earnings actually are thanks to the price increases they have implemented under the pricing flexibility regime.

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[27] *Id.* at para. 137.

3. Appropriate regulatory scheme to assure reasonable special access rates and conditions

The *Notice* asks parties to provide specific proposals for an appropriate regulatory scheme to assure reasonable rates and conditions for special access services. In its *June 13 Comments,* AdHoc urged the Commission to replace its flawed pricing flexibility regime with a system that can serve two objectives simultaneously. First, the Commission's rules must protect end users and competition from exploitive rates and the anti-competitive exercise of the ILECs' market power. Second, and equally important, however, the Commission's regulatory regime must accommodate changes in marketplace competition and enable carriers to respond to competition (should it emerge) as quickly and efficiently as possible.

To protect end users and competition from the ILECs' market power while simultaneously giving the ILECs flexibility to respond competitively when warranted, AdHoc proposed a regulatory solution in its *June 13 Comments* that would protect consumers and competition with incentive regulation while granting the ILECs unlimited *downward* pricing flexibility to respond to competition. The key elements of AdHoc's solution are reviewed below. AdHoc stands by its earlier analysis, however, and remains convinced that the regulatory regime detailed in its earlier comments is the appropriate regime for today's special access market.

▪ Re-initialize special access rates, including both “pricing flexibility” rates and rates in areas still subject to price caps, at levels that would produce earnings at the Commission’s authorized level of 11.25%.

The current 11.25% authorized return level is the appropriate benchmark for retargeting revenues in this proceeding. It was prescribed by the FCC in 1990 following a complete and thorough review of an extensive record,[28] using the Part 65 methodology prescribed by the Commission’s rules for setting an interstate rate of return. The methodology recognizes the distinction between the ILECs and non-regulated businesses and uses a broad range of sophisticated economic evidence (*e.g.*, Weighted Average Cost of Capital calculations using two different “historic” Discounted Cash Flow methodologies relying on two different costs of equity) to calculate a generous range of reasonableness for the ILECs’ return rates. The rules also allow additional relevant evidence to be requested by the Commission, or provided by the ILECs.

As a result of this analysis, the Commission prescribed a rate of return (“RoR”) of 11.25%. This RoR reflects a cost of debt of 8.8%, a debt/equity capital structure of 44.2%/55.8%, and an implied cost of equity of 13.2%.[29] At that time, the prime rate was 10% and the 10-year Treasury Bond rate was 8.89% (September,1990), far higher than the equivalents rates today. Thus, if the Commission were to actively reset its authorized return level today, it would

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28 *Represcribing the Authorized Rate of Return for Interstate Services of Local Exchange Carriers*, CC Docket No. 89-624, Order, 5 FCC Rcd 7507, 7507 at para. 1. (“*Represcription Order*”)

29 *Represcription Order*, 5 FCC Rcd 7532, para. 216.

most likely be lower (which would be consistent with state-authorized RoRs, as surveyed in the *June 13 Order).*

- Apply price caps rules to the ILECs' special access services, with an updated productivity offset and provisions for sharing ILEC earnings that exceed a specified reasonable level.

The Commission's adoption of "incentive regulation" or price caps for the ILECs was a revolutionary (and highly controversial) abandonment of the FCC's 60-year legacy of rate of return regulation. "Incentive regulation" eliminates traditional "cost plus" rate of return regulation, which rewards inflated carrier rate bases, and replaces it with a system that rewards, and thus creates incentives for, efficiency-maximizing investment and operations by the ILECs. Indeed, the ILECs fought long and hard to be included in the Commission's incentive regulation plans after the Commission limited application of the new rules to the interexchange market. In its *June 13 Comments*, AdHoc provides a detailed discussion of the relatively arcane elements in the Commission's price caps rules and methodologies for updating the various price caps formulae to be consistent with today's market realities, including the development of a new productivity or "X" factor, development of a growth or "G" factor, and re-specification of appropriate baskets and bands. AdHoc remains convinced that an updated system of incentive regulation is the most appropriate way to regulate ILEC special access rates pending the emergence of competition.

- Grant price caps ILECs unlimited downward pricing flexibility to respond to competition.

AdHoc argued in its *June 13 Comments* that the Commission should eliminate its existing pricing flexibility rules with their burdensome, time-consuming, and flawed assessments of marketplace competition and replace them with a regime that permits the ILECs to exercise pricing flexibility wherever they believe competition exists. The Commission should reinstitute incentive regulation but in combination with a grant of unlimited *downward-only* pricing flexibility.

By combining incentive regulation with unlimited flexibility to make only downward price adjustments, the Commission would protect consumers from exploitive rates while granting ILECs the unfettered ability to compete effectively in areas where they deem it necessary, without the burden and delays of the marketplace assessment proceedings required under the current rules.

Downward-only pricing flexibility thus provides a *self-executing regulatory mechanism* that will enable ILECs to respond to competition without FCC intervention. By combining that flexibility with price caps, ILECs would be free to reduce prices in response to competition but would not be able to impose offsetting price increases on customers in less competitive markets. Services for which the carriers choose to exercise downward only pricing flexibility would be pulled out of the relevant price caps basket for purposes of determining the actual price index ("API") and price caps index ("PCI") for the affected basket in order to prevent implicit or anti-competitive cross-subsidization between competitive and non-competitive services.

Allowing unlimited flexibility only to implement rate reductions eliminates the need for the Commission to evaluate the presence of competition or utilize the existing (and faulty) competitive "triggers" as a procedural short-cut in lieu of more detailed examinations of marketplace competition. Under AdHoc's approach, ILECs would not be required to make a "competitive necessity" showing or provide any justification for rate reductions beyond a routine price caps filing to adjust applicable basket indices. This "self-executing" form of deregulation takes the Commission out of the debate over the actual level of competition, and offers all stakeholders – ILECs, CLECs, IXCs *and customers* – a level of regulatory certainty that exceeds anything that presently exists.

Moreover, a downward pricing flexibility plan can operate effectively whether or not actual competition exists. AdHoc's plan is self-executing in that, if competition is present and robust enough to force prices lower, downward pricing flexibility will guarantee that ILECs have the independent ability and opportunity to respond to those competitive pressures rapidly and efficiently. In the absence of actual and effective competition, the price cap mechanism would operate to protect consumers from excessive or exploitive prices.

4. Government Accountability Office Report

Finally, the Notice asks parties to comment on the analysis and findings in the Government Accountability Office's ("GAO's") assessment of the special access market and critique of the Commission's competitive analyses of the

market in its November, 2006 report.[30] The report confirms AdHoc's assessment of competition in special access markets, price increases in pricing flexibility areas, and flaws in the pricing flexibility rules, particularly the competitive "triggers." A detailed analysis of the report appears in Appendix 3 of the ETI white paper attached to this pleading as Appendix 1.

CONCLUSION

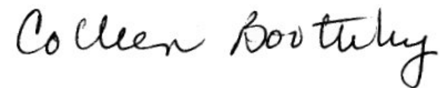
For the foregoing reasons, the Commission should conclude that competition has failed to emerge in the ILECs' special access markets. In the absence of competition, the Commission's pricing flexibility rules have allowed the ILECs to exploit end users with unjust and unreasonable rates while impeding the development of competition through their imposition of anti-competitive terms and conditions on nascent competitors. Accordingly, the Commission should revise its pricing flexibility rules and apply incentive regulation in the manner described above to ensure just and reasonable rates for

[30] Government Accountability Office, *FCC Needs to Improve its Ability to Monitor and Determine the Extent of Competition in Dedicated Access Services,* Report 07-80 (Nov. 2006)("GAO Report").

end users and flexibility for ILECs to respond to competition should it emerge in the special access market.

Respectfully submitted,

ADHOC TELECOMMUNICATIONS
USERS COMMITTEE
By:



Susan M. Gately
Economics and Technology, Inc.
One Washington Mall, 15th Floor
Boston, MA 02108-1906
617-227-0900

Economic Consultant

Colleen L. Boothby
Levine, Blaszak, Block & Boothby, LLP
2001 L Street, NW, Suite 900
Washington, D.C. 20036
202-857-2550

Counsel for
AdHoc Telecommunications
Users Committee

August 8, 2007

CERTIFICATE OF SERVICE

I, Dorothy Nederman, hereby certify that true and correct copies of the preceding Comments of AdHoc Telecommunications Users Committee were served this 8th day of August, 2007 via the FCC's ECFS system with a copy to Best Copy and Printing, Inc.

Dorothy Nederman
Legal Assistant

August 8, 2007