

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

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In the Matter of)
)
SBC Petition for Expedited Ruling)
that it is Non-Dominant in Its Provision of)
Advanced Services and for Forbearance)
from Dominant Carrier Regulation of)
Those Services)

CC Docket No. 01-337

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**SBC PETITION FOR EXPEDITED RULING THAT IT IS NON-DOMINANT IN ITS
PROVISION OF ADVANCED SERVICES AND FOR FORBEARANCE FROM
DOMINANT CARRIER REGULATION OF THOSE SERVICES**

EVAN T. LEO
MICHAEL K. KELLOGG
Kellogg Huber Hansen Todd
& Evans, P.L.L.C.
1615 M Street, NW
Suite 400
Washington, D.C. 20036
(202) 326-7900 – phone
(202) 326-7999 – facsimile

GARY L. PHILLIPS
ROGER K. TOPPINS
PAUL K. MANCINI

SBC COMMUNICATIONS INC.
1401 Eye Street, NW
Suite 400
Washington, D.C. 20005
(202) 326-8910 – phone
(202) 408-8745 – facsimile

Its Attorneys

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SBC Communications Inc., on behalf of itself and its subsidiaries (collectively referred to as “SBC”), respectfully asks the Commission to find it non-dominant in its provision of advanced services, as defined in the *SBC/Ameritech Merger Order*,¹ and to forbear from dominant carrier regulation of those services. The Commission concluded in the *SBC/Ameritech Merger Order* that SBC is presumptively non-dominant when it provides advanced services through separated affiliates. Recently, however, the District of Columbia Circuit concluded that SBC’s advanced services affiliates are successors or assigns of the SBC operating companies for

¹ *Applications of Ameritech Corp., Transferor, and SBC Communications, Inc. Transferee, for Consent to Transfer Control of Corporations Holding Commission Licenses and Lines Pursuant to Sections 214 and 310(d) of the Communications Act and Parts 5, 22, 24, 25, 63, 90, 95, and 101 of the Commission’s Rules*, 14 FCC Rcd 14712 (1999), (*SBC/Ameritech Merger Order*), App. C, Conditions at 2. SBC hereinafter uses the term “advanced services” or “broadband services” to refer to those services that meet the definition of “advanced services” in the *SBC/Ameritech Merger Order*. SBC sometimes herein also refers to advanced services used in conjunction with Internet access as “broadband Internet access services.”

purposes of section 251(c) of the Communications Act.² SBC does not believe that this decision affects the presumption of non-dominance accorded its advanced services affiliates in the *SBC/Ameritech Merger Order*. Some have suggested that, following the *ASCENT* decision, SBC's affiliates should be treated as dominant in their provision of advanced services. SBC disagrees that the *ASCENT* decision has that effect. To remove any uncertainty with respect to the matter, SBC shows herein, and asks the Commission to reaffirm, that it remains non-dominant in the provision of advanced services. In fact, SBC shows, and asks the Commission to conclude, that it is non-dominant in its provision of these services irrespective of whether it continues to provide them through a separated affiliate. Consistent with that finding, the Commission should forbear from applying dominant carrier regulation, including tariff requirements, to SBC's provision of advanced services.

SBC requests further that the Commission issue these rulings on an expedited basis. The Commission is under a statutory mandate to remove barriers to infrastructure investment and to encourage the deployment of advanced capabilities by using, among other things, its forbearance authority.³ Particularly with the economy faltering, and the high-tech industry on the skids, the Commission should take immediate measures to implement this mandate. The telecommunications industry is a key engine of the U.S. economy, and a regulatory framework that encourages investment by all telecommunications carriers will have ripple effects throughout the economy that benefit all Americans. That is why, just last week, Intel asked the Commission to deregulate all last-mile broadband facilities.

² *Association of Communications Enterprises v. FCC*, 235 F.3d 662 (D.C. Cir. 2001).

³ 47 U.S.C. § 157 (1991 & Supp. I 2001).

This forbearance petition is by no means the answer in and of itself. Even as a non-dominant provider of advanced services, SBC would still be subject to a blanket of regulations that do not apply to its larger competitors. Worse yet, the Commission is considering other proposals that would dramatically increase the cost of and revenues from broadband deployment by incumbent LECs. Unless and until the Commission, in the words of Chairman Powell, moves to “some degree of less regulation” in the broadband market that would be “*not so technology centric*,”⁴ SBC and other incumbent LECs will lack incentives to invest aggressively in broadband infrastructure or new broadband services. Thus, how the Commission decides this issue, and how quickly, will dramatically influence broadband investment and deployment decisions by SBC and other incumbent LECs.

Still, this petition offers the Commission the opportunity to take a step in the right direction, to start on the path of a more rational broadband policy that encourages investment by *all* participants in the market. The evidence that SBC is non-dominant in the competitive advanced services market is overwhelming - far more so than the evidence on which the Commission relied in declaring AT&T non-dominant. In the face of this evidence and a sinking economy that badly needs a lift from the technology sector and increased investment in the new broadband infrastructure by incumbent LECs, the Commission should prioritize SBC’s petition and expeditiously re-affirm SBC’s non-dominant status and forbear from applying dominant carrier regulation to it.

⁴ “*Cable Bureau Suggests Regulatory Forbearance for New Services*,” COMMUNICATIONS DAILY, Feb. 23, 2001 (emphasis added).

I. INTRODUCTION AND SUMMARY

Over the past several years, the Commission has recognized repeatedly that it should take a hands-off approach to the advanced services market. Chairman Powell, in particular, has recognized that “restraint should be the watchword for governments in any new economy driven by unrelenting currents of technological change and innovation such as communications and advanced services.”⁵ Former Chairman Kennard, as well, stressed the need for “a hands-off deregulatory approach to the broadband market.”⁶

The Commission has been true to its word with respect to some providers of advanced services. Cable operators, for example, are completely deregulated in their provision of advanced services. They may price their services as they choose, without filing tariffs, and they are under no obligation to make their services or facilities available to would-be competitors at regulatorily prescribed discounts or rates. They are immune even from “open access” obligations. This regulatory freedom has been accorded cable operators despite the fact that they were the first to provide advanced services for mass-market use and still account for about 2/3 of that market.

Also deregulated are most providers of advanced services to medium and large business customers, including the three largest providers of such services - AT&T, WorldCom, and

⁵ Michael K. Powell, Commissioner, FCC, Remarks before the Federal Communications Bar Association (Chicago Chapter), Chicago IL, June 15, 1999.

⁶ Chairman William E. Kennard, Remarks Before the Federal Communications Bar Northern California Chapter, *The Unregulation of the Internet: Laying a Competitive Course for the Future* (July 20, 1999). See also Report, *Inquiry Concerning the Deployment of Advanced Telecommunications Capability to all Americans in a Reasonable and Timely Fashion and Possible Steps to Accelerate Such Deployment Pursuant to Section 706 of the Telecommunications Act of 1996, (First Advanced Services Report)* 14 FCC Rcd 2398 (1999). See also *Implementation of the Local Competition Provisions of the Telecommunications Act of 1996*, 15 FCC Rcd 3696 (1999) (*UNE Remand Order*) ¶ 316; *First Advanced Services Report* ¶ 5 (in advanced services, “[w]e intend to rely as much as possible on free markets and private enterprise.”)

Sprint. These three companies, which collectively maintain a 70% market share for such services and which enjoy significant advantages over Bell operating companies (BOCs) in that market by virtue of their ability to provide end-to-end services, are all classified as non-dominant.

The Commission has not taken the same hands-off approach, however, to advanced services provided by incumbent LECs. Incumbent LECs must unbundle the high frequency portion of the loop and make it available to advanced services competitors at regulated rates. They must permit competitors to collocate equipment so that it is easier for such competitors to access that spectrum. They must offer wholesale discounts to their competitors on their retail advanced service offerings. They must contribute to the universal service fund when they provide broadband access. They are banned from the provision of interLATA services, including Internet backbone services, absent section 271 authority. They have been required to establish separate affiliates for their advanced services operations as conditions for merger approvals. And, of particular relevance to this petition, they are treated by the Commission as dominant carriers in the provision of advanced services both to mass market and larger business customers.

This regulatory disparity is indefensible. The Commission has long recognized that the 1996 Act is “technologically neutral and is designed to ensure competition in all telecommunications markets.”⁷ It also has repeatedly insisted that consumers, not regulators,

⁷ Order on Remand, *Deployment of Wireline Services Offering Advanced Telecommunications Capability*, 15 FCC Rcd 385 (1999), ¶ 2 (*Advanced Services Order on Remand*); *Deployment of Wireline Services Offering Advanced Telecommunications Capability*, (*Advanced Services Memorandum Opinion and Order*), 13 FCC Rcd 24011 (1998) ¶ 11. See also Report to Congress, *Federal-State Joint Board on Universal Service*, 13 FCC Rcd 11501 (1998), ¶ 98 (“We are mindful that, in order to promote equity and efficiency, we should avoid creating regulatory distinctions based purely on technology”); B. Esbin, *Internet Over Cable: Defining the Future in Terms of the Past*, Office of Plans and Policy Working Paper

should choose winners and losers in the marketplace.⁸ But the regulatory shackles under which incumbent LECs, but no other providers of advanced services, operate are anything but technologically neutral, and they have a profound impact on who succeeds and who fails in the marketplace. As the Department of Justice has aptly stated:

[a]pplying different degrees of regulation to firms in the same market necessarily introduces distortions into the market; competition will be harmed if some firms face unwarranted regulatory burdens not imposed on their rivals.⁹

Even SBC's broadband competitors have recognized that "unequal regulation harms consumers and competition."¹⁰

To be sure, the Commission has often regulated firms with market power more heavily than their competitors. But the Commission has repeatedly acknowledged that "the incumbent

No. 30, Aug. 1998 at 96 (noting the fundamental communications policy goal of "competitive and technological neutrality").

⁸ See *Advanced Services Memorandum Opinion and Order*, ¶ 2 ("The role of the Commission is not to pick winners or losers, or select the 'best' technology to meet consumer demand, but rather to ensure that the marketplace is conducive to investment, innovation, and meeting the needs of consumers"); *Implementation of the Local Competition Provisions in the Telecommunications Act of 1996*, 11 FCC Rcd 15499 (1996) (*Local Competition Order*), ¶ 993 ("[A]s a general policy matter, ... all telecommunications carriers that compete with each other should be treated alike regardless of the technology used unless there is a compelling reason to do otherwise.") See also *Implementation of Section 3(n) and 332 of the Communications Act, Regulatory Treatment of Mobile Services*, (9 FCC Rcd 1411 (1994), ¶ 19 ("Success in the marketplace should be driven by technological innovation, service quality, competition-based pricing decisions, and responsiveness to consumer needs – and not by strategies in the regulatory arena. [Thus] even-handed regulation, in promoting competition, should help lower prices, generate jobs, and produce economic growth.")

⁹ Reply Comments of the Department of Justice, *Competition in the Interstate Interexchange Marketplace*, CC Docket No. 90-132, filed Sept. 29, 1990, at 26, n. 42.

¹⁰ AT&T *ex parte* presentation in support of its Motion for Reclassification as a Nondominant Carrier, CC Docket No. 79-252, April 20, 1995, at 38.

LEC does not retain a monopoly position in the advanced services market,”¹¹ and its reports document that fact.¹² Indeed, they show that SBC is dwarfed by its competitors in the provision of advanced services. Far from limiting the exercise of market power, the Commission’s ILEC-centric regulations only add to the clout of the largest providers in the market.

SBC has urged the Commission to address this anomaly in holistic fashion. It has asked the Commission to establish a new, overarching regulatory paradigm for all providers of advanced services – one that is appropriate to nascent markets in which the “preconditions for monopoly appear absent,”¹³ and one that is consistent with the deregulatory principles embodied

¹¹ *UNE Remand Order*, ¶ 308. See also *Rulemaking to Amend Parts 1, 2, 21, and 25 of the Commission’s Rules to Redesignate the 27.5-29.5 GHz Frequency Band, to Reallocate the 29.5-30.0 GHz Frequency, to Establish Rules and Policies for Local Multipoint Distribution Service and for Fixed Satellite Services; Hyperion Communications Long Haul, L.P., Application for Expedited Review*, 15 FCC Rcd 11857 (2000) (*Fixed Wireless Competition Order*), ¶ 19 (“The record before us, which shows a continuing increase in consumer broadband choices within and among the various delivery technologies – xDSL, cable modems, satellite, fixed wireless, and mobile wireless, suggests that no group of forms or technology will likely be able to dominate the provision of broadband services.”); *First Advanced Services Report*, ¶ 48 (the “preconditions for monopoly appear absent” in the consumer broadband market). And see *Open Network Architecture Tariffs of Bell Operating Companies*, Order, 9 FCC Rcd 440 (1993) (holding that Southwestern Bell was not required to file cost support information for any of the Basic Service Elements used to provide its packet switching services because the “packet switching services market is still highly competitive” and such policies would therefore serve “little value in promoting our procompetitive policies”); *Southwestern Bell Telephone Company; Petition for Waiver of Section 64.702 of the Commission’s Rules and Regulation to Provide and Market Asynchronous Conversion on an Unseparated Basis, (Southwestern Bell Protocol Conversion Waiver Review Order)*, 5 FCC Rcd 161, ¶ 19 (1990) (finding that detailed cost support rules of 61.38 should not apply to Southwestern Bell’s MicroLink II a packet switching service, because “Southwestern entered the [packet switching] market with a zero share of the business and strong established competitors.”)

¹² For the most recent report see *Trends in Telephone Service*, Industry Analysis Division, Common Carrier Bureau, August 2001 at Table 2.1 (as of December 2000, there were 3.6 million cable modem lines in service versus 2 million ADSL lines).

¹³ *First Advanced Services Report*, ¶ 48. This statement was made by the Commission with particular reference to the consumer broadband market. In that same report, however, the Commission noted, with approval, BellSouth’s statement that “[h]igh-end business users, especially in densely populated areas, already have access to a wide array of broadband networking and access capabilities.” *Id.* ¶ 26. And, as noted, the Commission has elsewhere observed that there is significant competition in the provision of advanced services to larger businesses.

in the 1996 Act and section 706 in particular.¹⁴ SBC continues to believe that a comprehensive approach to the advanced services market is the best way to achieve a coherent and rational framework for that market. In the meantime, however, it is imperative that the Commission at least provide equal treatment with respect to its tariff requirements.

As demonstrated below, and in the Declaration of Robert W. Crandall and J. Gregory Sidak, SBC is non-dominant in both of the relevant markets for the provision of advanced services: the mass market and the larger business market. In fact, it is non-dominant in these markets irrespective of whether it provides advanced services through a separate subsidiary.

In the provision of advanced services for mass-market use, SBC's market share is about 30-35%, and no longer growing. Moreover, the own-price elasticity of demand (the percent change in demand for every one percent increase in price) is somewhere between -1.2 and -1.45, a level that is incompatible with the exercise of market power by SBC. This high level of demand elasticity is confirmed by the very type of evidence, including, but not limited to, churn rates, on which the Commission has previously relied in finding other carriers non-dominant in their respective markets. Supply elasticities, as well, are high. In fact, there is so much unused cable modem capacity that SBC's cable modem competitors alone could absorb immediately many, if not all, of the consumers who currently use DSL transport service provided by SBC. And far from enjoying advantages that effectively preclude the effective functioning of the market, SBC faces significant cost and other disadvantages vis-à-vis its cable modem competitors.

In the larger business market, the story is no less compelling. The Commission recognized eight years ago that the market for packet-switched business services is "highly

¹⁴ See, e.g., Comments of SBC Communications Inc. and BellSouth Corp, GN Docket No. 00-185, December 1, 2000.

competitive,” and it substantially deregulated the provision of such services by incumbent LECs, removing them from price cap regulation and eliminating cost support requirements.¹⁵ The market today remains equally dominated by the largest interexchange carriers. Thus, whereas AT&T, WorldCom, and Sprint collectively account for two thirds of the market within SBC’s region, SBC accounts for only about 12%. Moreover, its market share is static.

This in itself is dispositive. Given its paltry market share, SBC could not possibly dictate price in the larger business market for advanced service by restricting output. Other evidence, though, further confirms SBC’s lack of market power in this market. With respect to demand elasticity, the Commission has already twice found that larger business customers are highly demand elastic, and that conclusion is equally applicable here. Moreover, given SBC’s low market share, there can be little doubt that its competitors could absorb immediately a large portion of SBC’s business without significant expense. On top of all this, SBC faces significant disadvantages in this market, the most notable of which is that it cannot provide the end-to-end service that many customers demand.

While it is evident that SBC thus has no market power in the provision of advanced services to mass market or larger business customers, it is equally evident that SBC could not quickly acquire market power through cross-subsidization, discrimination, or the effectuation of a price squeeze (even if it were inclined to, which it is not). The Commission has previously rejected arguments that a BOC could gain market power through cross-subsidization, noting that such would be possible only if the cross-subsidization permitted the BOC to set prices at predatory levels, drive out its competitors, and then sustain prices significantly above

¹⁵ See note 11 *supra*.

competitive levels.¹⁶ The Commission found five years ago that the BOCs could not effect such a strategy,¹⁷ and it is even more inconceivable today, particularly given that the ostensible source of such cross-subsidization – the BOCs’ access rates – have sharply declined as a result of price cap regulation and, more recently, the *CALLS Order*.¹⁸ Moreover, in the mass market context, SBC’s Internet service provider generally price its broadband internet service product at a *higher* price than cable modem service due to the higher costs of deploying DSL service, and SBC does not control the rates charged consumers by unaffiliated Internet service providers. Under the circumstances, there is no credible risk of predatory pricing.

Nor could SBC quickly acquire market power through discrimination or a price squeeze. In the mass-market context, SBC’s largest competitors — cable television franchise holders — do not even rely on SBC’s facilities. Thus neither discrimination nor a price squeeze is even theoretically possible. As for the larger business context, SBC has been competing in that market since the early-to-mid 1990s, but its market share within its region has remained static at approximately 12 percent; that in itself is proof that SBC could not possibly quickly gain market power in this market through illegal conduct.

In this Petition, we begin our analysis by describing the FCC’s analytical framework for assessing dominance and non-dominance. We then show that the advanced services market, as defined in the *SBC/Ameritech Merger Order*, is a relevant product market that encompasses two

¹⁶ *Regulatory Treatment of LEC Provision of Interexchange Services Originating in the LEC’s Local Exchange Area and Policy and Rules Concerning the Interstate, Interexchange Marketplace*, 12 FCC Rcd 15756 (1997) (*BOC Classification Order*), ¶ 103.

¹⁷ *Id.*, ¶ 104-108.

¹⁸ *Access Charge Reform, Price Cap Performance Review for Local Exchange Carriers, Low-Volume Distance Users; and Federal-State Joint Board on Universal Service*, 15 FCC Rcd 12962 (2000)

discrete sub-markets: the provision of advanced services for use by mass market (residential and small business) customers; and the provision of advanced services to medium and large business customers (hereinafter the “larger business market”). We show, further, that for purposes of this analysis, the Commission should treat SBC’s in-region territory as the relevant geographic market for both of these product markets. We then show that SBC is non-dominant in each of these markets.

II. THE FCC’S FRAMEWORK FOR ASSESSING NON-DOMINANCE.

A. Definition of Dominance and Non-Dominance.

The Commission defines a dominant carrier as “a carrier that possesses market power” and a non-dominant carrier as “a carrier not found to be dominant (that is, one that does not possess market power.)”¹⁹ The Commission has held that, for purposes of this analysis, market power is the “ability to raise and maintain price above the competitive level without driving away so many customers as to make the increase unprofitable.”²⁰

In so holding, the Commission specifically rejected the notion that a BOC affiliate should be treated as dominant in the provision of a service if there was a risk that it could obtain advantages over its competitors by virtue of its affiliation with the BOC. Agreeing with the Department of Justice, the Commission held that dominant carrier regulation was designed to prevent the affiliate from raising its prices by restricting its output, and that dominant carrier

(CALLS Order), aff’d in part and rev’d and remanded in part, Texas Office of Public Utility Counsel v. FCC, No. 00-60434 (5th Cir. 2001).

¹⁹ 47 CFR §§ 61.3(q), 61(y).

²⁰ Fourth Report and Order, *Policy and Rules Concerning Rates for Competitive Common Carrier Services and Facilities Authorizations Therefor*, 95 FCC 2d 554 (1983), ¶ 7; *BOC Classification Order*, ¶ 85.

regulation was “at best a clumsy tool for controlling vertical leveraging” by the BOC itself.²¹ Moreover, the Commission noted, “regulations associated with dominant carrier classification can ... have undesirable effects on competition.”²² Accordingly, the Commission does not treat a carrier as dominant in the provision of a service unless the carrier can raise the market price of that service by restricting its output of it. It does not, as Crandall and Sidak point out, “impose dominant carrier status simply to ensure what some refer to as a ‘level playing field.’”²³ If it has concerns about leveraging of market power in particular services, it addresses those concerns directly through its regulation of those services.

B. Definition of Relevant Markets.

In order to assess market power, it is first necessary to define the relevant product and geographic markets.²⁴ Since the *BOC Classification Order*, in 1996, the Commission has followed the *Merger Guidelines*²⁵ in defining product and geographic markets.²⁶ Under those guidelines, product markets are defined primarily with reference to demand cross-elasticities. Specifically, two services are deemed to be in the same product market if a small but non-transitory price increase by a monopoly provider of one of these services would cause enough

²¹ *Id.*, ¶¶ 85, 91.

²² *Id.*, ¶ 90.

²³ See Declaration of Robert W. Crandall and J. Gregory Sidak, Attachment 1 (*Crandall/Sidak Declaration*) ¶ 84.

²⁴ See *BOC Classification Order*, ¶ 16.

²⁵ United States Dept. of Justice Antitrust Div., and Federal Trade Commission, 1992 *Horizontal Merger Guidelines*, 57 Fed. Reg. 41552 (1992) (*Merger Guidelines*).

²⁶ See *BOC Classification Order*, ¶ 26 (adopting guidelines). See also e.g., *Application of WorldCom, Inc. and MCI Communications Corporation for Transfer of Control of MCI Communications Corporation to WorldCom, Inc.*, 13 FCC Rcd 18025 (1998) (*WorldCom/MCI Merger Order*), ¶¶ 24-31 (applying guidelines).

buyers to shift their purchases to the second service as to render the increase unprofitable.²⁷ Two geographic areas are in the same geographic market if a small, but non-transitory price increase for a service in one area would cause customers to switch to the same service offered at a lower price in the other area.²⁸

Although the Commission defines product markets primarily with reference to demand elasticity, the Commission has held, consistent with the *Merger Guidelines*, that if “production substitution among a group of products is nearly universal among the firms selling one or more of those products,” it may consider that group of products to be in the same product market. In other words, if the facilities of most competitors are capable of providing a group of services, those services may be considered, for purposes of administrative convenience, to be in the same product market.²⁹

The Commission has recognized that it may not be practicable to identify and analyze every single product and geographic market in a particular regulatory proceeding.³⁰ Accordingly, for purposes of assessing market power it will conduct a separate analysis for two different services or two different geographic areas only if there is credible evidence that there is or could be a lack of competitive performance with respect to one of those services or areas.³¹

²⁷ See also *BOC Classification Order*, ¶ 28; *Crandall/Sidak Declaration*, ¶ 32. *Merger Guidelines*, § 1.0.

²⁸ *BOC Classification Order*, ¶ 28.

²⁹ *Application of WorldCom, Inc. and MCI Communications Corp. for Transfer of Control of MCI Communications Corporation to WorldCom, Inc.*, 13 FCC Rcd 18025 (1998) (*WorldCom/MCI Merger Order*), ¶ 27.

³⁰ *BOC Classification Order*, ¶¶ 31, 56.

³¹ *Id.*, ¶¶ 42-43.

C. Framework for Assessing Market Power.

The Commission has generally looked at four factors in determining whether a carrier has market power in the provision of a service: (1) market share and changes therein; (2) demand elasticity; (3) supply elasticity; and (4) disparities in size, resources, financial strength, and cost structures among the market participants.³² With respect to the fourth factor, the Commission has repeatedly held that the focus of its inquiry is not on whether the firm at issue has certain advantages in the relevant market but “whether any such advantages are so great to preclude the effective functioning of a competitive market.”³³

In the *BOC Classification Order*, the Commission added to this test. The Commission readily concluded that the BOC long-distance affiliates would not have market power when they first entered the long-distance market. Theorizing, though, that this initial lack of market power might merely reflect the fact that the BOCs had previously been excluded from the market, the Commission went on to address whether, “upon entry or shortly thereafter,”³⁴ the BOC affiliates could acquire market power by leveraging any market power of the operating company.

This additional inquiry is superfluous with respect to SBC’s advanced services. SBC is not a new entrant in the advanced services market; it has been providing DSL service for use by mass market customers for at least two years, and it has been providing advanced services to larger business customers for far longer. Thus the Commission need not speculate on whether

³² *Motion of AT&T Corp. to be Reclassified as a Non-Dominant Carrier*, 11 FCC Rcd 3271 (1995) (*AT&T Reclassification Order*); *Competition in the Interstate Interexchange Marketplace*, 6 FCC Rcd 5880 (1991), (*AT&T Streamlining Order*). See also *COMSAT Corp. Petition Pursuant to Section 10(c) of the Communications Act of 1934, as amended, for Forbearance From Dominant Carrier Regulation and for Reclassification as a Non-Dominant Carrier*, 13 FCC Rcd 14083 (1998).

³³ *AT&T Reclassification Order*, ¶ 73; *AT&T Streamlining Order*, n. 187.

³⁴ *BOC Classification Order*, ¶ 96.

SBC could “upon entry or soon thereafter” acquire market power in these services; in two-plus years, it has not done so. In fact, as shown below, it has not even come close. Nevertheless, out of an abundance of caution, SBC shows below, not only that it currently lacks market power in its provision of advanced services, but also that it could not quickly acquire market power.

III. MARKET DEFINITION.

As noted, the *Merger Guidelines* define markets primarily based on demand cross-elasticities. Because quantitative evidence of demand cross-elasticities between two services is often unavailable, however, courts and the Commission have generally relied on qualitative evidence designed to elicit whether two services are “reasonably interchangeable” in their use.³⁵

Based on such analysis and Commission precedent, we show below that advanced services are not reasonably interchangeable with other services. We then show that there are two relevant submarkets within the market for advanced services: the provision of advanced services for use by mass market customers (the “mass market”) and the provision of advanced services to medium and large business customers (the “larger business” market). We show further that there are no additional relevant submarkets within these markets. Consistent with the *BOC Classification Order*, we assume, for purposes of analysis, that the relevant geographic market is SBC’s in-region territory.

A. Advanced Services are Not Reasonably Interchangeable with Other Services.

The Commission has consistently recognized that advanced services comprise a discrete product market. The Commission first made this determination shortly after incumbent LECs began providing high-speed packet switching services, in the early 1990s. The Commission

³⁵ *Crandall/Sidak Declaration*, ¶ 34 (citing *Brown Shoe Co. v. United States*, 370 U.S. 294, 325 (1962), ABA Antitrust Section, Antitrust Law Developments 200 (3d ed. 1992).

recognized at that time that, because packet switching services were provided over brand new networks, these services should be regulated differently than services provided over the legacy circuit-switched telephone network. Accordingly, the Commission held that “packet-switched service . . . should . . . be excluded” from the price-cap regulation that the Commission adopted for traditional ILEC services.³⁶ The Commission also concluded that incumbent LECs should not be required to file detailed cost-support information for “packet-switched services” given that “[t]he packet switching services market is . . . highly competitive.”³⁷ It likewise justified the decision not to investigate an ILEC’s packet-switching rates on the fact that the ILEC was “a new entrant in the *packet switching market*, which is currently dominated by a relatively small number of well-established service providers.”³⁸

Until very recently, advanced services were provided exclusively to business customers. In the late 1990s, however, several new technologies were introduced that enabled advanced services to be provided to mass-market consumers for the first time. As explained below, these new advanced services were designed primarily for broadband Internet access service. Consistent with its earlier determinations, the Commission found that the provision of these new

³⁶ *Policy and Rules Concerning Rates for Dominant Carriers*, Second Report and Order, 5 FCC Rcd 6786, ¶ 195 (1990).

³⁷ *Open Network Architecture Tariffs of Bell Operating Companies*, Order, 9 FCC Rcd 440 (1993), ¶ 68 (emphasis added). See also *Southwestern Bell Protocol Conversion Waiver Review Order*, ¶ 19 (1990) (finding that detailed cost support rules of 61.38 should not apply to Southwestern Bell’s MicroLink II a packet switching service, because “Southwestern entered the [packet switching] market with a zero share of the business and strong established competitors.”)

³⁸ *Bell South Corporation on Behalf of Southern Bell Telephone and Telegraph Company, Petition for Waiver of Section 64.702 of the Commission’s Rules and Regulations To Authorize Protocol Conversion Offerings*, 3 FCC Rcd 6961, ¶ 9 (1988) (emphasis added).

advanced services should also be treated as a distinct relevant product market.³⁹ The Commission based this determination on the fact that these new services “include features unavailable” over conventional narrowband networks, “such as access to high-bandwidth content” and “always on” connections; that there are “high consumer costs involved in switching to high-speed platforms” compared to traditional services; and that “[p]reliminary quantitative studies indicate that narrowband and high-speed access services occupy separate markets.”⁴⁰

The Commission’s consistent holding that advanced services are not reasonably interchangeable with other services is obviously correct. Consumers use advanced services for very different purposes than other services, particularly those provided over the circuit-switched telephone network. Consumers use advanced services primarily for high-speed data transmission.⁴¹ Although it has recently become possible to provide virtually real time voice communications over packet switching networks, customers still overwhelmingly use these networks for transmitting stored data.⁴² In contrast, the vast majority of revenue generated on circuit switched networks still comes from the provision of voice services.⁴³

³⁹ See *Applications for Consent to the Transfer of Control of Licenses and Section 214 Authorizations by Time Warner Inc. and American Online, Inc., Transferors, to AOL Time Warner Inc., Transferee*, 16 FCC Rcd. 6547, ¶ 69 (2001).

⁴⁰ *Id.*, ¶¶ 69-71.

⁴¹ See *Crandall/Sidak Declaration*, ¶ 35 and notes 42 and 97.

⁴² *Id.*, ¶ 98.

⁴³ See, e.g., P. Johnson, Robertson Stephens, Investext Rpt. No. 8080509, Sonus Networks Inc. - Company Report at *6 (July 12, 2001) (“Carrier revenues from voice services currently dwarf revenues from data services by as much as 5 to 1. Virtually every carrier in the world hopes to capture a portion of this revenue stream.”); M. Brown, Dain Rauscher Wessels, Investext Rpt. No. 2311326, Sonus Networks Inc. - Company Report at 5 (Oct. 3, 2000) (“Carriers have invested huge amounts of capital on their circuit-switched networks over the years. In 1999 alone, the estimated investment on circuit-switched equipment was roughly \$45 billion. The investment in circuit-switched equipment has allowed carriers to capitalize on the massive revenue opportunity for voice services, which recently represented approximately 90% of sales.”).

The significant disparity in the way customers use advanced services and circuit switching services reflects the fact that these services are provided using different network architectures with very different underlying technologies.⁴⁴ As the Commission has recognized, packet switching networks are much more efficient than circuit switching networks for carrying data traffic: “In contrast to circuit-switched networks, packet-switched networks do not require that a dedicated end-to-end transmission path (or circuit) be opened for each transmission. Rather, each router calculates the best routing for a packet at a particular moment, given current traffic patterns, and sends the packet to the next router through a process known as ‘dynamic routing.’”⁴⁵ Moreover, packet switching networks have other desirable features for data transmission – including highly developed error correction capabilities and rapid connect times – that typically are unavailable with circuit switching networks.⁴⁶

⁴⁴ See, e.g., *Inquiry Concerning Deployment of Advanced Telecommunications Capability to All Americans in a Reasonable and Timely Fashion, and Possible Steps To Accelerate Such Deployment Pursuant to Section 706 of the Telecommunications Act of 1996*, Notice of Inquiry, 15 FCC Rcd 16641, App. A ¶ 8 & fn.29 (2000) (“a circuit switch is now the typical switching mechanism in a telecommunications network designed to carry voice traffic,” whereas “a packet switch [] is the typical switching mechanism in telecommunications networks designed to carry data traffic.”).

⁴⁵ B. Esbin, Cable Services Bureau, FCC, *Internet Over Cable: Defining The Future In Terms Of The Past*; OPP Working Paper No. 30 (Aug. 1998); see also *Deployment of Wireline Services Offering Advanced Telecommunications Capability and Implementation of the Local Competition Provisions of the Telecommunications Act of 1996*, Third Report and Order in CC Docket No. 98-147, Fourth Report and Order in CC Docket No. 96-98, 14 FCC Rcd 20912, ¶¶ 7-8 (“The circuit-switched public telecommunications network (PSTN), which interconnects virtually every home and business, was designed to provide superior voice telephony. . . . Although this is an efficient technique for transmitting ordinary voice telephony, it is not efficient for transmitting digital information. . . . Combining xDSL-based technology with packet switching is more efficient than circuit-switched networks for the transmission of packetized data”).

⁴⁶ See, e.g., *Decreased Regulation of Certain Basic Telecommunications Services*, Notice of Proposed Rulemaking, 2 FCC Rcd 645, ¶ 20 (1987); E.C. Zimits et al., Chase Hambrecht & Quist Inc., Investext Rpt. No. 2151688, Ulticom Inc.: Initiating Coverage – Company Report at *5 (May 2, 2000) (“The cost and performance superiority of packet switching has led many traditional and new ‘competitive carrier’ service providers to build packet networks to handle data traffic. It has also led service providers to explore the interoperability or convergence of voice and data networks and the transmission of voice communications over packet networks.”); M. Shah, IPO Maven, Investext Rpt. No.

B. Services Provided To Larger Businesses Are In A Separate Product Market From Those Provided To Mass Market Customers.

The Commission has held that interLATA services provided to mass-market customers are distinct from those provided to large business customers given that “larger business users often demand advanced long distance features (advanced features), such as frame relay, virtual private networks (VPN), and enhanced 800 services (E800 services), that differ from the services generally demanded by mass market consumers.”⁴⁷ The Commission also has determined that it is appropriate to distinguish the local exchange and exchange access services provided to mass-market customers from those provided to business customers because “mass-market customers have a different decision-making process than do larger business customers” since “residential and small businesses are served primarily through mass marketing techniques including regional advertising and telemarketing, while larger businesses tend to be served under individual contracts and marketed through direct sales contacts.”⁴⁸

The Commission’s holdings with respect to interLATA and local services generally are just as obviously correct with respect to advanced services. Larger businesses demand advanced services with different features than those demanded by mass-market customers. For example,

2905227, Net2Phone: Initiating Coverage – Company Report at *2 (July 1, 1999) (Net2Phone “offers high voice quality through its proprietary voice and data compression and packet-switching technologies, which reduce packet loss and delay, route packets efficiently and perform quality enhancing functions, such as echo cancellation.”); *GPRS Technology Parameters*, PC Magazine: UK Network Edition (Oct. 1999), <http://www.zdnet.co.uk/pcmag/ne/tech/1999/10/gprs/02.html> (“Packet-switched services have almost zero call setup time (as opposed to 5 to 30 seconds setting up a circuit-switched call) and can be tariffed on volume of data transmitted, not on connection time. This means that keeping a connection up permanently is economical, if you want to be able to receive data at any hour of the day or night; conversely, making a quick connection just to deliver a few packets (an alert, possibly) is also feasible.”)

⁴⁷ *WorldCom/MCI Merger Order*, ¶ 26.

⁴⁸ *Application of GTE Corp. and Bell Atlantic Corp. for Consent to Transfer Control of Domestic and International Sections 214 and 310 Authorizations and Application to Transfer Control of Submarine Cable Landing License*, 15 FCC Rcd 14032 (1999), ¶ 102 and n. 253; *SBC/Ameritech Merger Order*, ¶ 68.

they typically demand services with greater bandwidth, higher levels of reliability, higher levels of service and support, and higher levels of security. Indeed, the network architectures and technologies used to serve larger business customers and mass-market customers are entirely different. As discussed below, the main advanced services provided to larger business customers are Frame Relay, ATM, and Gigabit Ethernet, whereas the main services provided for use by mass-market customers are DSL, cable modem service, and satellite.

The increased features demanded by business customers also come at a considerably higher price, which mass-market customers generally are unwilling to pay. For example, whereas the average advanced service provided to mass-market customers costs approximately \$50 per month, the average larger business customer often spends several thousand dollars per month for advanced services.⁴⁹ Moreover, larger business customers' purchase advanced services in a much different manner than mass-market customers. As described in more detail below, most larger business customers enter into long-term contracts for service, and many look for service providers through a competitive bidding process.⁵⁰ In contrast, most mass-market customers of advanced services purchase their service on a monthly basis.

C. Advanced Services Provided To Mass Market Customers Represent A Discrete Product Market Without Relevant Sub-markets.

Advanced services provided for use by mass market consumers are used almost exclusively for a single application: high-speed access to an Internet service provider's point of presence. There are at least four different platforms used to offer this service: DSL, cable modem, satellite, and fixed wireless. These platforms also can be used by consumers to obtain

⁴⁹ See *Crandall/Sidak Declaration*, ¶ 100.

⁵⁰ *Id.*, ¶ 115.

high-speed access to information stored in databases outside the Internet.⁵¹ Indeed, cable operators already have deployed such applications, although SBC has not.⁵² Because these applications are based on the same platforms and use the same technology that is used for high-speed Internet access services, the “product substitution among them is ‘nearly universal.’” These applications, therefore, should be considered to be interchangeable with broadband Internet access services used by mass-market customers.⁵³

There is broad consensus that broadband services for mass-market use belong to a discrete product market. The Department of Justice,⁵⁴ the Federal Trade Commission,⁵⁵ and

⁵¹ As noted *infra*, they also, although rarely, are used by businesses to connect their employees to corporate local area networks (LANs).

⁵² See Excite@Home Press Release, “Excite@Home Announces Exite ClickVideo, a Broadband Video Entertainment and News Application, With Premier Content Providers,” June 26, 2000 (“Excite video content is cached on servers in Excite@Home’s regional data centers and cable head-ends closest to the @Home subscriber, helping to deliver fast, on-demand downloads with minimal backbone delays. This is designed to give @Home broadband subscribers consistently high-quality video content in a large video window (320X240) at up to 15 frames per second and at data rates up to 500 kbps.”). See also AOL Time Warner Press Release, “Joseph J. Collins Named Chairman and CEO of New Interactive Video Division,” Aug. 16, 2001. Road Runner’s web site states: “The Road Runner Online Service organizes content into “channels” labeled with favorite consumer categories such as news, entertainment and sports. Within these channels Road Runner users can instantly find all the local and national information and entertainment they are looking for without going out onto the Internet - however, the Internet is also only a click away.” See <http://www.roadrunner.com/rdrun> (Residential Services: Features), visited Sept. 20, 2001.

⁵³ *WorldCom/MCI Merger Order*, ¶ 27, citing *Merger Guidelines*, § 1.32, n. 14.

⁵⁴ Competitive Impact Statement at 9, *United States v. AT&T Corp.*, Civil No. 00-CV-1176 (D.D.C. filed May 25, 2000) (“A relevant product market affected by [the AT&T/MediaOne] transaction is the market for aggregation, promotion, and distribution of broadband content and services.”).

⁵⁵ Complaint, *AOL, Inc. v. Time Warner, Inc.*, Docket No. C-3989 (FTC filed Dec. 14, 2000) at ¶ 21 (“The relevant product market in which to assess the effects of the proposed merger is the provision of residential broadband internet access service.”).

academicians⁵⁶ have all previously so concluded, and so too has the Commission. For example, in the *First Advanced Services Report*, the Commission stated:

we see the potential for [the consumer broadband] market to accommodate different technologies such as DSL, cable modems, utility fiber to the home, satellite and terrestrial radio. The fact that different companies are using different technologies to bring broadband to residential consumers and that each existing broadband technology has advantages and disadvantages as a means of delivery to millions of customers opens the possibility of intermodal competition, like that between trucks, trains, and planes in transportation.⁵⁷

Likewise, in its 2000 Report to Congress on the status of competition in the market for video programming, it stated: “[A]lthough wireless and satellite broadband technologies continue to be deployed, telephone company DSL technologies remain the most significant competitors to Internet over cable.”⁵⁸ And in the *AOL/Time Warner Merger Order*, the Commission concluded that high-speed Internet access services constitute the relevant product market in determining the effects of the proposed merger on the public interest.⁵⁹ The Commission also observed that “[t]he

⁵⁶ See Jerry A. Hausman, J. Gregory Sidak & Hal J. Singer, *Cable Modems and DSL: Broadband Internet Access for Residential Customers*, 91 AM. ECON. ASS’N PAPERS & PROC. 302 (2001) [hereinafter Hausman, Sidak & Singer, *Cable Modems and DSL*]; Jerry A. Hausman, J. Gregory Sidak & Hal J. Singer, *Residential Demand for Broadband Telecommunications and Consumer Access to Unaffiliated Internet Content Providers*, 18 YALE J. ON REG. 129 (2001) [hereinafter Hausman, Sidak & Singer, *Residential Demand for Broadband*].

⁵⁷ *First Advanced Services Report*, 2398, 2423-24 (1999). In that same report, the FCC noted that “whether a capability is broadband does not depend on the use of any particular technology or the nature of the provider.” *Id.* at 2407.

⁵⁸ Seventh Annual Report, *Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming*, 16 FCC Rcd. 6005 (2001), ¶ 51. See also *Broadband Today*, FCC Staff Report (Oct. 1999) at 42 (“[a]s deployment of DSL, satellite, and wireless advances, in large part spurred by rapid cable modem deployment, consumers will have alternative platforms to use for high-speed data access[.]”). And see *Fixed Wireless Competition Order*, ¶ 18-19 (noting growing competition among different broadband Internet access platforms).

⁵⁹ See *AOL/Time Warner Merger Order*, ¶ 312. Although the Commission suggested that its finding that residential high-speed Internet access services constitute a discrete product market might be limited to the specific context in which the issue had been raised, *id.*, n.202, we are not aware of any basis upon which application of the *Merger Guidelines* could yield different product market definitions in different proceedings. In any event, the Commission has never, formally or informally, deviated from the view that