

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

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JUN 30 2003

FEDERAL COMMUNICATIONS COMMISSION  
OFFICE OF THE SECRETARY

In the Matter of )

Section 272(f)(1) Sunset of the BOC Separate )  
Affiliate and Related Requirements )

WC Docket No. 02-112

2000 Biennial Regulatory Review )  
Separate Affiliate Requirements of Section )  
64.1903 of the Commission's Rules )

CC Docket No. 00-175

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COMMENTS OF AT&T CORP.

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**COMMENTS OF AT&T CORP.**

AT&T Corp. ("AT&T") respectfully submits these comments in response to the Commission's Further Notice of Proposed Rulemaking in the above-captioned proceeding.<sup>1</sup>

**SUMMARY AND INTRODUCTION.**

The issue before the Commission is whether the Bell Operating Companies ("BOCs") must be regulated as dominant carriers when providing in-region long distance services on an integrated basis. The answer is straightforward. Because the BOCs control bottleneck facilities that they can use to raise long distance rivals' costs and thereby restrict total output, settled Commission precedent and basic economics compel dominant carrier classification.

Commission rules require dominant carrier regulation of all carriers with market power. In the *LEC Classification Order*,<sup>2</sup> the Commission found that the BOCs plainly control

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<sup>1</sup> FCC 03-111 (rel. May 19, 2003) ("Notice").

bottleneck inputs -- the last mile network of loops, switches and trunks that are necessary to originate and terminate long distance calls. And consistent with longstanding precedent and indisputable economic principles, the Commission concluded that because of this fact, the BOCs possess market power.

Nonetheless, the Commission declined to declare the BOCs' long distance *affiliates* dominant, finding that three factors prevented the BOCs' from exercising their market power on behalf of their affiliates. First, the Commission relied on the fact that the BOCs' affiliates were required by section 272 to be "structurally separate" from the BOCs and to "operate independently" from the BOCs.<sup>3</sup> Second, the Commission relied on rate regulation that it predicted would further constrain the BOCs' incentives and ability to exercise their market power on behalf of their separate affiliates.<sup>4</sup> Finally, the Commission relied on the fact that the BOCs' section 272 affiliates would be entering long distance markets with "zero" market shares to support a prediction that any attempt by a BOC to dominate long distance markets by cost/price squeezing rivals would fail.<sup>5</sup>

This same analytical framework now compels the classification of the BOCs themselves as dominant providers of long distance services. It is indisputable that the BOCs still

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<sup>2</sup> Second Report and Order, *Regulatory Treatment of LEC Provision of Interexchange Services Originating in the LEC's Local Exchange Area*, 12 FCC Rcd. 15756, ¶¶ 83, 158-61 (1997) ("*LEC Classification Order*"), unrelated provisions modified, Order on Reconsideration, *Regulatory Treatment of LEC Provision of Interexchange Services Originating in the LEC's Local Exchange Area*, 12 FCC Rcd. 8730 (1997).

<sup>3</sup> *Id.* ¶ 91, 112-18.

<sup>4</sup> *Id.* ¶ 91, 126-30. Indeed, the Commission opined that it believed that the risks of price squeezes going forward would be less because of its (unfulfilled) intent to push access prices towards costs. *See id.* ¶ 130.

<sup>5</sup> *Id.* ¶ 91.

retain bottleneck facilities that are essential for long distance competition. There is overwhelming evidence that incumbent market power over the local bottleneck is not significantly reduced even years after a BOC receives section 271 relief. Commission precedents make clear that such bottleneck control confers market power in all downstream markets, including all interstate and intrastate, interLATA and intraLATA retail long distance services provided within ILEC service areas. Thus, as the Commission found in the *LEC Classification Order*, absent regulation designed to prevent and detect bottleneck abuses, the BOCs could and would use those facilities to raise rivals' costs and thereby reduce competition.

At the same time, the regulation and other factors that the Commission cited in 1997 as constraining abuses of that power on behalf of a structurally separate long distance affiliate place no such constraints on the BOCs themselves under the changed circumstances relevant here and, in any event, have now been demonstrated to be based upon fundamentally flawed predictive judgements. As the Notice underscores (§ 5), the Commission's 1997 decision that BOC interLATA affiliates should be treated as nondominant "was predicated on the presence of a section 272 separate affiliate and full compliance with the structural, transactional, and nondiscrimination safeguards of section 272 and the Commission's implementing rules."

However, the Commission has signaled that it will allow the "crucially important"<sup>6</sup> section 272 safeguards designed to prevent and detect discrimination and cost misallocation to sunset. Thus, the BOCs soon will have (and in the case of Verizon in New York, already have) no obligation to maintain a "structurally" separate affiliate that must "operate independently" from the BOCs' incumbent operations and will be able to provide long

distance on an integrated basis.<sup>7</sup> Indeed, this proceeding addresses “the continued need for dominant carrier regulation of BOC in-region, interstate and international interexchange telecommunications services *after sunset of the Commission’s section 272 structural and related requirements in a state.*” Notice, ¶ 2 (emphasis added).

Likewise, since the *LEC Classification Order*, the Commission has largely deregulated the BOCs’ prices for special access services. Rather than use this new-found “pricing flexibility” to meet competition, the BOCs have almost uniformly used it to *raise* rates. As a result, the spread between the BOCs’ cost of providing access and the rates that they charge IXCs for access have increased, heightening the ability of the BOCs to price-cost squeeze their rivals. Moreover, despite the Commission’s belief that switched access rates would be decreased significantly in the future, “switched” access charges, particularly intrastate switched access charges, remain orders of magnitude above cost. The BOCs’ ability to price squeeze has also increased since 1997 as a result of consolidation in the industry. The Ameritech-Pacific Telesis-SBC-SNET and Bell Atlantic-GTE-NYNEX mergers have made it much more likely that a call that originates on a particular BOC’s network will terminate on that same BOC’s network, thereby giving the BOC an insurmountable cost advantage with regard to *both* originating and terminating access.<sup>8</sup>

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<sup>6</sup> Memorandum Opinion and Order, *Application of SBC Communications to Provide In-Region, InterLATA Services in Texas*, 15 FCC Rcd. 18354, ¶ 395 (2000).

<sup>7</sup> See 47 U.S.C. § 272(b).

<sup>8</sup> See Memorandum Opinion and Order, *In re Applications of Ameritech, Transferor and SBC, Transferee*, 14 FCC Rcd. 14712, ¶ 207, (“*SBC-Ameritech Merger Order*”) (finding merger increased incentive of SBC-Ameritech to discriminate against competitors); *LEC Classification Order* ¶ 129 (relying on the fact that in 1997 that many long distance calls that originated on one  
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Lastly, entering long distance markets with a zero share has proven to be no disadvantage to the BOCs at all. In the short time since entering, the BOCs separate long distance affiliates have gained market share at an unprecedented rate. Indeed, in the less than three years since it was granted authority for its Southwestern territories, SBC's separate affiliate has already achieved "near 50 percent" penetration.<sup>9</sup>

The D.C. Circuit has made clear that where the Commission has based its existing regulatory regime on a predictive judgment, it is absolutely imperative that "the Commission . . . vigilantly monitor the consequences of its rate regulation rules."<sup>10</sup> That is particularly true when the Commission has based its original decision making on the existence of other regulation that it has subsequently permitted to lapse. Here, *none* of the bases upon which the Commission predicted that the BOCs' structurally separate affiliates would be unable to exercise market power in long distance services remains valid as applied to the BOCs themselves, and the Commission therefore must now recognize that there are no meaningful constraints on the ability of the BOCs to wield their bottleneck facilities to harm long distance competition.

Consequently, dominant carrier regulation is necessary to deter and detect such anticompetitive conduct -- and is required by core requirements of Title II and by U.S. international trade commitments to maintain "[a]ppropriate measures" to prevent "anticompetitive practices" by dominant carriers -- until the Commission carries out other

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BOC's network terminated on another BOC's network as diminishing the likelihood of a price squeeze).

<sup>9</sup> See Statement of Edward Whitacre, CEO, SBC Communications, Transcript, April 24, 2003 Conference Call Addressing First Quarter 2003 Earnings.

<sup>10</sup> *American Civil Liberties Union v. FCC*, 823 F.2d 1554, 1565 (D.C. Cir. 1987).

essential reforms to prevent BOC abuse of their local bottlenecks. As the Commission has recognized, dominant carrier tariff filing and cost support requirements help prevent price squeezes and other anticompetitive conduct. Without section 272 safeguards, and with the BOCs' heightened ability to engage in anticompetitive abuse of the local bottleneck when the same entity provides local and long distance services, the failure of the Commission to regulate the BOCs as dominant carriers would have predictable -- and devastating -- consequences for long distance competition. The BOCs "would ineluctably leverage that bottleneck control in the interexchange (long distance) market" and harm long distance competition.<sup>11</sup>

First, the BOCs can provide IXCs with access of much lower quality than they provide to their own long distance operations. As the Commission has recognized, there are myriad ways in which this can be accomplished, ranging from slow provisioning of access facilities to competitors to failure to maintain or repair facilities provided to competitors.<sup>12</sup> Second, because access charges are well-above costs, the BOCs' can price squeeze their competitors.

These are not theoretical concerns. As shown below and in the attached Declaration of Dr. Lee Selwyn ("Selwyn Dec."), there is ample evidence that BOCs already are using their above-cost switched and special access rates to price squeeze their competitors and are engaging in a variety of other anticompetitive activities to misallocate costs and discriminate

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<sup>11</sup> *United States v. Western Electric Co.*, 969 F.2d 1231, 1238 (D.C. Cir. 1992).

<sup>12</sup> *SBC-Ameritech Merger Order* ¶ 206; *LEC Classification Order* ¶ 111. See also First Report and Order and Further Notice of Proposed Rulemaking, *Implementation of the Non-Accounting Safeguards of Sections 271 and 272 of the Communications Act of 1934*, 11 FCC Rcd. 21905, ¶ 163, (1996) ("*Non-Accounting Safeguards Order*") ¶ 163 (allowing the BOCs to provide long distance and local service on an integrated basis "would inevitably afford access to the BOC's  
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against their long distance rivals. Because of the well-recognized difficulty in detecting such misconduct when local and long distance services are provided on an integrated basis, AT&T has urged the Commission not to allow any sunset of the section 272 safeguards that Congress established for that very reason. To provide essential safeguards after any section 272 sunset, the BOCs should be required to comply with the dominant carrier rules until the Commission completes reforms removing the BOC access cost advantage and limiting their ability to engage in price and non-price discrimination.

That is not to say that the Commission must maintain dominant carrier classification on the BOCs forever. As explained below, the Commission could lift dominant carrier status once the BOCs' ability to leverage their bottlenecks is effectively constrained. This recommended approach would fulfill the objectives stated by the Notice (§ 40) of "minimiz[ing] regulatory burden on the BOCs" while also "avoid[ing] the potential exposure of both ratepayers in local markets and competitors in interexchange markets to the potential risk of improper cost misallocation and unlawful discrimination."

Dominant carrier regulation will remain necessary until the Commission completes all of the following reforms to prevent incumbent leverage of the local bottleneck. First, the only effective means of preventing the BOCs from undertaking a price squeeze is to remove their ability to charge rivals above-cost rates for access. The Commission must undertake comprehensive intercarrier compensation reform to remove the BOC access cost advantage provided by the current system of interstate and intrastate access rates -- which also

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facilities that is superior to that grant to the affiliate's competitors," and "would create substantial opportunities for improper cost allocation.")

require IXCs to subsidize their BOC long distance competitors -- and establish meaningful regulatory constraints on BOC special access rates. Second, in order to prevent non-price discrimination, the Commission should adopt strong performance measures, supported by meaningful penalties for non-compliance. Third, the Commission should require an independent "PIC" administrator to stop ongoing abuses of the PIC process, and impose limits on BOC joint marketing in order to prevent the BOCs from using their dominant position to steer discriminatorily customers to the BOCs' long distance affiliates.

While these reforms would not provide all the safeguards of section 272 or dominant carrier regulation, they would provide a basis to revisit the dominant status of BOC interLATA services by diminishing the BOCs' ability to leverage the local bottleneck. However, any grant of any nondominant treatment of those services before these necessary reforms are fully implemented would be highly premature and would merely encourage BOC anticompetitive abuse that would inevitably lead to the remonopolization of the U.S. long distance industry. As described by Dr. Selwyn, "[a]bsent the kind of affirmative regulatory oversight that is only possible where the BOCs are treated as dominant carriers, they will be able to crush their non-integrated rivals."<sup>13</sup>

The separation requirements currently applicable to the incumbent independent LECs are not subject to any sunset provision and, accordingly, may continue to provide a basis for nondominant treatment of these carriers' long distance services.

**I. THE ILECS REMAIN DOMINANT CARRIERS BECAUSE OF THE OVERWHELMING MARKET POWER CONFERRED BY THEIR CONTINUING CONTROL OF THE LOCAL BOTTLENECK.**

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<sup>13</sup> Selwyn Dec., ¶ 103.

Under the Commission's rules, dominant carrier regulation is required for any carrier that can exercise market power in a relevant market.<sup>14</sup> As the Commission recognized in the *LEC Classification Order*, an entity that controls bottleneck facilities that are key inputs into a finished service plainly has the ability to exercise market power over that downstream service. "A carrier may be able to unilaterally raise prices by increasing its rivals' costs or by restricting its rivals' output through the carrier's control of an essential input, such as access to bottleneck facilities, which its rivals need to offer their services."<sup>15</sup> For that reason, analysis of whether control of bottleneck inputs could be used to impede competition in downstream markets has always played a central role in the Commission's dominance/nondominance determinations.<sup>16</sup>

The *LEC Classification Order* found that "the BOCs currently possess market power in the provision of local exchange and exchange access in their respective regions" and that the incumbent independent LECs ("independent LECs") similarly have "control over local

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<sup>14</sup> 47 C.F.R. §§ 61.3(q), 61.31. Market power is the "power to control prices," *id.*, § 61.3(q), meaning "the ability to raise and maintain price above the competitive level without driving away so many customers as to make the increase unprofitable." Fourth Report and Order, *Policy and Rules Concerning Rates for Competitive Common Carrier Services & Facilities Authorizations Therefor*, 95 FCC 2d 554, ¶ 8 (1983). See also, Department of Justice and Federal Trade Commission, Horizontal Merger Guidelines, 57 Fed. Reg. 41552 (1992) reprinted in 4 Trade Reg. Rep. (CCH) ¶ 13104 (April 2, 1992) §0.1 ("1992 Merger Guidelines") ("Market power to a seller is the ability profitably to maintain prices above competitive levels for a significant period of time").

<sup>15</sup> Notice ¶ 5 n.10 (citing *LEC Classification Order*, ¶¶ 83, 158-61).

<sup>16</sup> See, e.g., Order, *Motion of AT&T to be Reclassified as a Non-Dominant Carrier*, 11 FCC Rcd. 3271, ¶ 32 (1995) ("*AT&T Reclassification Order*"); Order, Authorization and Certificate, *In the Matter of British Telecom North America*, 12 FCC Rcd. 1985, ¶ 7 (1997); Memorandum Opinion and Order, *Merger of MCI Communications and British Telecommunications*, 12 FCC Rcd. 15351, ¶ 286, (1997); Memorandum Opinion and Order, *Application of WorldCom and MCI Communications for Transfer of Control of MCI Communications to WorldCom*, 13 FCC Rcd. 18025, ¶¶ 41-2, (1998).

bottleneck facilities.”<sup>17</sup> There has been no significant diminution in their market power since then. Seven years after passage of the Telecom Act, the ILECs still provide 87 percent of the exchange and exchange access services, and their local loops, switches, and transport facilities are essential inputs in all but a small fraction of the exchange services that are now offered by CLECs.<sup>18</sup> Accordingly, the Commission again found in 2001 that “incumbent LECs retain market power in the provision of local services within their respective territories.”<sup>19</sup>

All of the ILECs -- even the BOCs that the Commission has determined met the market-opening requirements of section 271 more than three years ago -- undoubtedly remain dominant today and retain the ability not only to raise prices above competitive levels, but to engage in cost misallocations and to discriminate against their rivals. State commissions in states where the BOCs long ago satisfied the section 271 competitive checklist have affirmed that the BOCs continue to maintain substantial market power in those states.<sup>20</sup> Even where the BOCs have won approval pursuant to section 271, the competing carriers that have entered the BOCs’ local markets have yet to make effective strides to erode the BOCs’ dominance, and do not provide reliable and ubiquitous alternative sources of supply that would *constrain the BOCs’* ability to misallocate costs or discriminate against rivals. The continuing ILEC control of their

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<sup>17</sup> *LEC Classification Order*, ¶¶ 100, 143.

<sup>18</sup> Selwyn Dec, ¶ 11.

<sup>19</sup> Report and Order, *1998 Biennial Regulatory Review*, 16 FCC Rcd. 7418, ¶ 33 (2001).

<sup>20</sup> See Texas Public Utilities Commission Letter, at 1, WC Docket 02-112 (filed May 22, 2003) (“SBC Texas continues to have dominant market share over local exchange and exchange access services”; Comments of Missouri Public Utilities Commission at 3, WC Docket 02-112 (filed July 18, 2002) (stating that “competition from widely available CLEC-owned facilities did not exist for business or residential basic local service”); *id* (“SWBT was the dominant provider of exchange access services within its service territory” and those services are “not subject to effective competition”).

switched and special access bottlenecks within their in-region state jurisdictions allows them to exert market power in the downstream market, which includes all interstate and intrastate, interLATA and intraLATA retail long distance services provided within their service areas in those jurisdictions.

Because of the absence of adequate market constraints on the potential abuse of ILEC market power, following any sunset of section 272 requirements -- which are the key predicates for the Commission's present non-dominant treatment of BOC long distance services - - the BOCs should be subject to dominant carrier regulation until the Commission adopts more far reaching reforms to limit harm to competition from the BOC provision of local and long distance services through an integrated entity.

**1. BOCs Retain Significant Market Power Years After Section 271 Approval.**

Under the Commission's precedents, "control of bottleneck facilities" is "[a]n important structural characteristic of the marketplace that confers market power upon a firm" and is "prima facie evidence of market power."<sup>21</sup> That is so irrespective of the market share held in any downstream market for which those facilities are an essential input. Thus, the Commission applies Section 63.10 dominant carrier rules to all U.S. affiliates of foreign carriers with market power on the foreign end of U.S. international routes, without regard for the affiliates' U.S.

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<sup>21</sup> First Report and Order, *Policy and Rules Concerning Rates for Competitive Common Carrier Services and Facilities Authorizations Therefor*, 85 F.C.C.2d 1, ¶ 58 (1980). Thus, when the Commission first concluded that "AT&T must be treated as dominant," it did so, in part, because it concluded that "many of AT&T's competitors must have access to [AT&T's] network if they are to succeed." *Id.* ¶ 62. Conversely, when the Commission later reclassified AT&T as non-dominant, it did so, in part, because, "as a result of divestiture, AT&T no longer own[ed] bottleneck local access facilities." *AT&T Reclassification Order*, ¶ 32.

market shares.<sup>22</sup> The Commission also applies similar competitive safeguards to all U.S. international submarine cable applicants affiliated with foreign carriers that possess market power in a destination market.<sup>23</sup>

It is well established that market power over the local exchange bottleneck allows the incumbent carrier to undermine long distance competition through discrimination and other anticompetitive conduct.<sup>24</sup> The Commission concluded in the *LEC Classification Order* that “a

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<sup>22</sup> 47 CFR §. 63.10; *Rules and Policies on Foreign Participation in the U.S. Telecommunications Market*, 12 FCC Rcd. 23891, ¶ 161 (1997) (“*Foreign Participation Order*”). In determining whether a carrier has market power at the foreign end of a U.S. international route, the Commission presumes that carriers with greater than 50 percent market shares in any relevant foreign-end market, including international transport facilities or services, inter-city facilities or services, and local access facilities, including all incumbent local exchange carriers, possess market power. *Id.* & n. 312. See also, Public Notice, *The International Bureau Revises and Reissues the Commission’s List of Foreign telecommunications Carriers that are Presumed to Possess Market Power in Foreign Telecommunications Markets*, DA 03-1812, Jun. 5, 2003.

<sup>23</sup> *Review of Commission Consideration of Applications under the Cable Landing License Act*, 16 FCC Rcd. 22,167, ¶¶ 30-37 (2001). See also, *Bell Canada Petition for Declaratory Ruling*, 16 FCC Rcd. 12465, ¶¶ 1&10 (2001) (finding that Bell Canada, which controls “more than 95 percent of local access lines in its franchise area,” failed to demonstrate that it lacks market power). See also, *id.* (“Bell Canada has the ability to discriminate against and among U.S. carriers seeking to terminate traffic in Canada by, for example, raising the price of, or withholding or degrading the quality of, terminating access its region.”)

<sup>24</sup> In filing the antitrust suit in 1974 that led to the break-up of the Bell System, the Government “alleged that AT&T used its control over its local monopoly to preclude competition in the intercity market,” and the court found “ample evidence to sustain” this contention. *United States v. AT&T Co.*, 552 F. Supp. 131, 161, 195 (D. D.C. 1982), *aff’d sub nom.*, *Maryland v. United States*, 460 U.S. 1001 (1983). Because local monopolies controlled a “strategic bottleneck position,” there were “many ways in which” the Bell System “could discriminate against competitors in the interexchange market.” *Id.* at 171, 188. The local monopolies also had an obvious “incentive to discriminate”: “[T]hey would stand to gain business if other carriers were disadvantaged by poor access arrangements and high tariffs.” *Id.* at 188. The break-up of the Bell System was intended to remove those incentives, and BOC line of business restrictions were to be removed only “upon a showing that there is no substantial possibility that [a BOC] could use its monopoly power to impede competition.” *Id.* at 165, 195. See also, Selwyn Dec., ¶ 50 (the 1982 Consent Decree prohibition on the BOCs offering interLATA long distance services “was adopted specifically to prevent the BOC local service monopolies from using their  
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local exchange carrier's control of the local bottleneck constitutes credible evidence that there could be a lack of competitive performance in point-to-point markets that originate in-region."<sup>25</sup>

The Commission similarly observed in the *Non-Accounting Safeguards Order* that the BOCs were "the dominant providers of local exchange and exchange access services in their in-region states" and, accordingly, "a BOC may have an incentive to discriminate in providing exchange access services and facilities that its affiliate's rivals need to compete in the interLATA telecommunications services and information services markets."<sup>26</sup> As the Supreme Court explained, "[i]t is easy to see why a company that owns a local exchange . . . would have an almost insurmountable competitive advantage, not only in routing calls within the exchange, but, through its control of this local market, in the market[] for . . . long-distance calling as well." *Verizon Communications, Inc. v. FCC*, 122 S. Ct. 1646, 1662 (2002).

ILEC dominance extends to all local markets and services, but their enduring market power over access services is the direct source of their ability to impede competition in the retail market for long-distance services. Throughout the nation, AT&T and other interLATA providers remain heavily dependent upon the ILECs for access to bottleneck facilities.<sup>27</sup> ILECs

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monopoly power in the local services market to block competition in the adjacent long distance market") & ¶ 52("BOC entry into the interLATA long distance market has created precisely the same incentive for anticompetitive conduct and market advantage as prevailed at the time the [Consent Decree] was entered.")

<sup>25</sup> *LEC Classification Order*, ¶ 76.

<sup>26</sup> *Non-Accounting Safeguards Order*, ¶¶ 10, 11.

<sup>27</sup> This is true regardless of the nomenclature used to describe those facilities (*i.e.*, "transport" and loops" where competitors seek unbundled elements, versus "channel mileage" and "channel terminations" in the case of special access). Comments of AT&T Corp., at 19-50, CC Docket 01-337 (filed March 1, 2002) ("AT&T Broadband Dominance Comments"); Comments of (continued . . .)

control the local network facilities necessary to originate long distance calls from, and complete long distance calls to, virtually every mass-market customer located in their territories, as well as to the large majority of enterprise customers. Moreover, as the Commission has frequently recognized, the mere fact that a local market is technically “open” does not rid the ILEC of market power or mean that the local market is fully competitive. Rather, section 272 was premised on the fact that section 271 allows BOCs to enter long distance markets while they still possess overwhelming market power and thus “have both the incentive and ability to discriminate against competitors in incumbent LECs’ retail markets.”<sup>28</sup>

Nor will that market power evaporate with any sunset of section 272. Even in the largest and most competitively-advanced markets in the country, BOCs, including those that have long had interLATA authority, have been found to “continue[] to dominate the market overall” and to control “bottleneck” facilities that BOC “competitors [must] rely on.”<sup>29</sup> Although

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AT&T Corp., at 3-13, CC Docket No. 01-321 (filed Jan. 22, 2002) (“AT&T Special Access Comments”) at 3-13.

<sup>28</sup> *SBC-Ameritech Merger Order*, ¶ 190; *Non-Accounting Safeguards Order*, ¶ 9. See also, Selwyn Dec., ¶¶ 58-60.

<sup>29</sup> *Opinion and Order Modifying Special Services Guidelines for Verizon New York Inc., Conforming Tariff, and Requiring Additional Performance Reporting*, Case 00-C-2051, (NYPSC June 15, 2001) (“NYPSC Special Access Order”) at 9; see also *Draft Decision*, Rulemaking R.93-04-003 (filed July 23, 2002) (“California ALJ Decision”) at 258 (“actual competition in California” has maintained its “current anemic pace”); Comments of Texas Office of Public Utility Counsel, WC Docket No. 02-148 (filed July 17, 2002) at 2-3 (describing the “extremely low levels of competitive entry in Texas” and concluding that “circumstances have not changed” because “BOCs still retain monopoly control”). See also Declaration of Robert Willig ¶ 13 (“Willig Decl.”) (submitted in Docket No. 01-337) (March 1, 2002). In a number of ongoing proceedings before the Commission, AT&T has demonstrated that ILECs maintain market power in local markets by virtue of their control over bottleneck facilities. For example, in response to the Commission’s NPRM regarding the regulatory treatment of various ILEC broadband services, AT&T submitted extensive comments and testimony (including Professor Willig’s declaration) demonstrating that the ILECs possess market power in local markets that they can  
(continued . . .)

AT&T and other competitive carriers would prefer to self-provide last-mile facilities, or obtain them from non-incumbent sources, ILECs remain the only sources for these facilities within their territories in the overwhelming majority of situations.<sup>30</sup> As the Commission recognized in the *UNE Remand Order*, self-provisioning is not a viable alternative because “replicat[ion of] an incumbent’s vast and ubiquitous network would be prohibitively expensive and delay competitive entry.”<sup>31</sup> The ILECs have ubiquitous transport facilities that connect 14,000 local serving offices and over 220 million loops.<sup>32</sup> No CLEC or IXC can hope to replicate this network.<sup>33</sup>

Indeed, according to the just-released *FCC Local Competition Report* for the year ending December 2002, nationally some 96.6 percent of all switched access lines were either

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use to harm their rivals in the broadband market. See *AT&T Broadband Dominance Comments*, at 19-36. Likewise, in urging the Commission to adopt performance measures for ILECs’ provision of special access services, AT&T demonstrated that the ILECs retain market power with respect to those services. *AT&T Special Access Comments*, at 3-13.

<sup>30</sup> In the Commission’s Triennial Review proceeding, AT&T has provided substantial evidence and testimony explaining why ILECs control these facilities, and the difficulties competing carriers face in replicating them. See, e.g., *Reply Comments of AT&T Corp.*, CC Docket No. 01-338, at 144-87, 244-68 (filed July 17, 2002) (“AT&T Triennial Review Reply Comments”); *id.* Exh. C, *Reply Declaration of Anthony Fea and Anthony Giovannucci*, (“Fea/Giovannucci Reply Dec.”); see also *Declaration of Anthony Fea and William Taggart*, CC Docket No. 96-98 (filed April 30, 2001, appended to *Comments of AT&T*) (“Fea/Taggart Dec”).

<sup>31</sup> *Third Report And Order And Further Notice Of Proposed Rulemaking, Implementation of the Local Competition Provisions of the Telecommunications Act of 1996*, 15 FCC Rcd. 3696, ¶ 182 (1999) (“*UNE Remand Order*”); see also *AT&T Triennial Review Reply Comments* at 144-87, 244-68; *Fea/Giovannucci Reply Dec.*

<sup>32</sup> See *Federal-State Joint Board, Universal Service Monitoring Report*, CC Docket 96-45, Tables 10.1, 10.2 (Oct. 2001).

<sup>33</sup> See *Verizon*, 122 S. Ct. at 1662. See also, *Selwyn Dec.*, ¶ 16-17 (explaining higher costs faced by CLECs in constructing facilities) & ¶ 17 (“subscriber loops are a ‘natural monopoly’ by any traditional standard”).

being served directly by their ILEC or by a CLEC utilizing ILEC-provided facilities (resale or UNE).<sup>34</sup> Accordingly, there are not yet significant alternative sources of supply to the incumbents' bottleneck facilities. Additionally, the UNE-based competition that the 1996 Act was intended to foster has been stifled by the BOCs' high UNE rates and poor provisioning, and in recent years, bankruptcy has been more prevalent than new market entry among CLECs.

Nor does out-of-region entry into local markets by adjacent BOCs appear at all likely. As Dr. Selwyn describes, since the 1996 Act, the BOCs have notably declined all opportunities to compete with other BOCs on an out-of-region basis, except for services like calling cards that may be marketed to in-region customers, and have only offered local and long-distance services on an in-region basis where they may leverage their local bottlenecks.<sup>35</sup> Moreover, by not competing against other BOCs, each BOC avoids provoking competition from other BOCs in its own monopoly markets.<sup>36</sup>

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<sup>34</sup> Selwyn Dec., ¶ 11.

<sup>35</sup> Selwyn Dec., ¶¶ 56-57. Indeed, SBC does not even offer long distances services to customers of other LECs or CLECs within its section 271-authorized states. *Id.*, ¶ 57.

<sup>36</sup> *Id.*, ¶ 28. Qwest Chairman (and former Ameritech Chairman) Richard Notebaert has stated that competing for local customers currently served by Ameritech "might be a good way [for Qwest] to turn a quick dollar" but "that doesn't make it right." Chicago Tribune, 'Ameritech Customers Off-Limits: Notebaert,' Oct. 31, 2002. Likewise, in an analyst conference call held the same week, Mr. Notebaert was asked why, if the rules implementing the Telecom Act were so favorable to new entrants, Qwest was not taking advantage of them to enter adjacent local markets. Mr. Notebaert responded that because Qwest was now opposing these rules, it would be "contradictory for us to take advantage of it" and compete with the other Bells. Fair Disclosure Wire, 'Brief of Qwest Third Quarter 2002 Earnings Conference Call,' October 30, 2002. Verizon and SBC-Ameritech, despite commitments to engage in such competition as a condition of their merger approvals, have similarly failed to compete meaningfully in out-of-region local markets. Selwyn Dec., ¶ 28. See also Memorandum Opinion and Order, *In re Application of GTE Corp, Transferor and Bell Atlantic, Transferee*, 15 FCC Rcd. 14032, ¶¶ 319-323, (2000); *SBC/Ameritech Merger Order*, ¶¶ 398-399, ¶ 60 of Appendix C

There are no meaningful alternative platforms that would replace the ILEC local bottleneck. Although cable-delivered telephone service holds promise, it is available in few communities today.<sup>37</sup> And, with very limited and marginal exceptions, consumers are not replacing their wireline phones with wireless phones. Most consumer and business end-users who subscribe to wireless service also subscribe to wireline service. This is evidenced by the fact that Verizon and SBC/Cingular are offering bundled packages including wireline and wireless service.<sup>38</sup>

In New York, where it has been more than three years since the BOC was granted section 271 authority, the most recent FCC *Local Competition Report* shows that CLEC market share growth has not progressed in the past year.<sup>39</sup> Moreover, CLECs serve less than 4 percent of end-user switched access lines in New York with CLEC-owned facilities.<sup>40</sup> The Texas PUC reported last year that the level of market penetration was “too low to declare that full competition has arrived.”<sup>41</sup> Further, “a number of key competitors” were forced by market

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<sup>37</sup> Cable service is available to many (but not all) residential customers; it is generally not available to businesses because cable systems generally do not extend to business districts. See Declaration of Robert Willing appended as Exhibit A to AT&T’s Comments in *Review of Regulatory Requirements for Incumbent LEC Broadband Telecommunications Services*, CC Docket No. 01-337, March 1, 2002 ¶¶ 10, 13.

<sup>38</sup> See *U.S. Regional Bell Operating Companies in Long Distance, 2003-2008*, Atlantic ACM, at 0 (2003).

<sup>39</sup> *Local Telephone Competition: Status as of December 31, 2002*, FCC Wireline Competition Bureau, Industry Analysis and Technology Division, June 2003, Table 7 (CLEC share of end-user switched access lines remained at 25 percent from December 2001 through December 2002).

<sup>40</sup> See *id.*, Tables 6 & 10.

<sup>41</sup> See Comments of Texas Office of Public Utility Counsel, WC Docket No. 02-148, at 2 (filed July 17, 2002) (quoting Report to the 77<sup>th</sup> Texas Legislature, *Scope of Competition in Telecommunications Markets of Texas*, January 2001, p. ix-x).

conditions to “limit[] their entry” and have “not been offering substantial competition” in bundled offerings of services.<sup>42</sup> Under these conditions, new entrants can do little to constrain anticompetitive practices of the dominant BOC.

Critically, Verizon retains its dominance in New York, where section 272 has already sunset, and SBC retains its dominance in Texas, where section 272 is poised to sunset unless extended by the Commission, although these states are among the country’s most active markets and ones in which state regulators have demonstrated a strong commitment to fostering local competition. But in many other states where the BOC has section 271 authority, competitive entry has been more limited. For example, in three of the five states in which BOCs won section 271 approval in 2001, Arkansas, Connecticut and Missouri, CLEC market shares are 10 percent or less.<sup>43</sup> And nationwide, only about a quarter of CLEC-served end user switched access lines are served by CLEC-owned facilities.<sup>44</sup>

Therefore, any expectation that BOC market power will entirely – or even significantly -- dissipate by the time of any sunset of the Commission’s section 272 requirements does not reflect actual marketplace conditions. In fact, the overwhelming real world evidence demonstrates the opposite: that BOC local market power is not significantly reduced, even years after they win approval pursuant to section 271 to offer in-region, interLATA services.

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<sup>42</sup> *Id.*; Texas Public Utility Commission Letter, at 1 (“Two years [after SBC Texas was granted 271 authorization], competition in the local market is still emerging, and many competitors are struggling to remain financially viable” (quoting Report to 78<sup>th</sup> Texas Legislature, *Scope of Competition in Telecommunications Markets of Texas*, January 2003, at 37)).

<sup>43</sup> *Local Telephone Competition: Status as of December 31, 2002*, FCC, Wireline Competition Bureau, Industry Analysis and Technology Division, June 2003, Table 7.

<sup>44</sup> *See id.*, Table 10.

## **2. ILEC Control of the Local Bottleneck Confers Market Power In All Downstream Markets.**

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IXCs can compete effectively against an ILEC offering both local and long distance services *only* if they receive access on the same terms and conditions and at the same economic cost as ILEC long distance services.<sup>45</sup> Both the switched access services used by IXCs to provide long distance services to mass market and enterprise customers, and the special access services for the dedicated, high capacity network facilities used to supply long distance services to many enterprise customers, provide the incumbents with artificial cost and other competitive advantages that allow them to leverage their local bottlenecks into long distance markets.

*Switched Access.* IXCs still generally have no alternative to the incumbents' switched access services, which remain far above economic cost -- both for interstate calls, where current BOC access charges are far above cost-based levels, as well as for intrastate long-distance (interLATA) calls, where current access charges are as much as *ten times* greater than cost than interstate charges.<sup>46</sup> Because Commission rules allow IXCs to use UNEs to originate and complete long distance calls *only* where they use UNEs to provide local service to the relevant calling and called numbers, and each IXC has only a small fraction of local service customers, IXCs must continue to purchase originating and terminating switched access services to originate and/or complete virtually all of their customers' long distance calls.

Even the development of local facilities-based competition fails to constrain the incumbents' high switched access charges. Many competitive carriers that have entered local markets have imposed higher switched access rates than those charged by the BOCs -- causing

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<sup>45</sup> See Selwyn Dec., ¶109.

<sup>46</sup> *Id.*, ¶ 44.

the Commission to limit the switched access rates that CLECs may charge.<sup>47</sup> Under these market conditions, where even many CLECs are pricing at supracompetitive rates, there can be no doubt that competitive entry in local services provides no constraint on the incumbents' ability to use switched access to discriminate against competing IXCs. Therefore, the ILECs undoubtedly maintain market power over switched access services.

*Special Access.* As AT&T has amply demonstrated, in the vast majority of cases there are no alternatives to the BOCs' and other ILECs' special access services that AT&T and other IXCs must use to provide services to enterprise customers.<sup>48</sup> ILEC special access services also are a critical input for suppliers of local, wireless and broadband services.<sup>49</sup> The facilities-based competition the Commission anticipated in allowing pricing flexibility for these services has not materialized, and is unlikely to do so, and CLEC alternatives exist in only a very small

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<sup>47</sup> Seventh Report and Order and Further Notice of Proposed Rulemaking, *Access Charge Reform*, 16 FCC Rcd. 9923, ¶¶ 2, 22, 45 (2001). *See also, id.*, ¶ 30 (finding that even those carriers obtain a "series of bottleneck monopolies over access to each individual end user").

<sup>48</sup> *See* AT&T Petition for Rulemaking (filed Oct. 15, 2002), RM No. 10593, at 25-28; AT&T Reply Comments (filed Jan. 23, 2003), RM No. 10593, at 10-20. AT&T incorporates its Petition and Reply Comments, and their attachments, herein by reference. *See also, e.g.*, Comments of Sprint Corporation, *Performance Measurements and Standards for Interstate Special Access Services*, CC Docket No. 01-321, at 5-6 (Jan. 22, 2002) (noting that it "continues to rely upon the ILECs for approximately 93% of its total special access needs despite aggressive attempts to self-supply and to switch to facilities offered by alternative access vendors (AAVs) whenever feasible"); Comments of WorldCom, Inc., CC Docket No. 01-321, at 9-10 (Jan. 22, 2002) (explaining that "[i]n the past year, approximately 90 percent of . . . [its] off-net special access circuit needs were provisioned by the incumbent LECs, even though it is . . . [its] policy to use the local facilities of WorldCom or other competitive carriers whenever such facilities are available"); Comments of VoiceStream Wireless Corporation, CC Docket No. 01-321, at 3 (Jan. 22, 2002) ("CMRS carriers remain heavily dependent on the special access facilities provided by the ILECs."); Reply Comments of Sprint Corporation, CC Docket No. 01-321, at 2 (Feb. 12, 2002) ("There is virtual unanimity among commenting IXCs, CLECs, CMRS providers, and large end users that ILECs remain dominant in the provision of special access services"); Reply Comments of Cable & Wireless USA, Inc., CC Docket No. 01-321, at 2-11 (Feb. 12, 2002).

percentage of cases.<sup>50</sup> BOC claims to the contrary have been shown to be wildly exaggerated and based in part on a methodology that treats CLEC purchase of special access as CLEC self-deployment of their own loops, thus vastly inflating the “CLEC share” of deployed facilities.<sup>51</sup> In most cases, it is simply not feasible for competitors to build facilities directly to the end user’s premises.<sup>52</sup>

Even Verizon has admitted in the Special Access proceeding that CLEC-owned facilities serve at most 30,000 buildings nationwide -- a tiny fraction of the commercial buildings in the United States.<sup>53</sup> In the largest cities with the most competitive entry, the BOC remains the only facilities-based option in the vast majority of buildings. Indeed, Verizon is the only available facilities-based option in 85.9 percent of the buildings served by AT&T in New York<sup>54</sup>

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<sup>49</sup> AT&T Reply Comments, RM No. 10593, at 43-46.

<sup>50</sup> *Id.*, at 13.

<sup>51</sup> *Id.* at 12-19 & Reply Dec. of Lee L. Selwyn, ¶ 42.

<sup>52</sup> New network construction typically requires cooperation from localities, other carriers, and building owners and can take months or even years to complete. Most end users are unwilling to deal with these delays. Even in those limited instances in which it is economically feasible to deploy facilities, CLECs face a number of hurdles that frustrate the self-deployment of facilities, including the need to obtain access to rights-of-way and buildings, existing ILEC volume or term commitments, exhaustion of collocation capacity, and long distances between points of presence and ILECs’ end offices. AT&T Petition for Rulemaking, RM No. 10593, at 28-32. *See also*, Fea/Taggart Dec., ¶¶ 30-31; AT&T Triennial Review Reply Comments at 144-87, 244-68; Fea/Giovannucci Reply Dec.

<sup>53</sup> AT&T Reply Comments, RM No. 10593, at 12-13.

<sup>54</sup> *Id.*, Reply Declaration of Lee L. Selwyn, ¶ 20. The findings of the New York Public Service Commission (“NYPSC”) that Verizon remains the “dominant” provider of special access services in *all* of that state, *including* lower Manhattan – the area that is generally regarded as the *most* competitive in the United States – is compelling proof of the BOCs’ continuing market power. *NYPSC Special Access Order* at 6-9. The NYPSC carefully analyzed a detailed record regarding route miles of fiber, numbers of buildings passed and especially numbers of buildings actually *connected* to ILEC competitors, and concluded that “Verizon’s combined market share  
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and 86.5 percent of the buildings served by AT&T in Boston, and SBC is the only available facilities-based option in 95.4 percent of the buildings served by AT&T in Los Angeles and 94 percent of the buildings served by AT&T in Chicago.<sup>55</sup>

Moreover, as described by Dr. Selwyn, because access line facilities are not fungible from one location to another, CLEC ownership of facilities to specific buildings in a zip code does not make those facilities ubiquitously available throughout that or any other zip code.<sup>56</sup> These low supply elasticities mean that CLECs cannot respond rapidly or often at all to ILEC price increases by expanding their own facilities, and therefore cannot constrain ILEC price increases.<sup>57</sup>

For confirmation of the incumbent-controlled special access bottleneck, the Commission need look no further than New York, which is generally thought to be the most competitive market in the U.S. If competitors cannot self-deploy loop and transport facilities in

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data demonstrates its continued dominance in *all* geographic areas. . . . In [New York City], for example, Verizon has 8,311 miles of fiber compared to a few hundred for most competing carriers; Verizon has 7,364 buildings on a fiber network compared to less than 1,000 for most competing carriers.” *Id.* at 7. Verizon’s own data show that “a maximum of 900 buildings [are] served by individual competitors’ fiber facilities,” but New York City has “775,000 buildings in the entire city, over 220,000 of which are mixed use, commercial, industrial, or public institutions.” *Id.* at 7-8 (citing to Land Use Facts, Department of City Planning). The NYPSC further concluded that claims regarding “buildings passed” by competitors’ facilities were virtually meaningless as evidence of a competitive market because “the data do not reflect how often fiber actually enters those buildings.” *Id.* at 9. “Because competitors rely on Verizon’s facilities, particularly its local loops,” the NYPSC found, “Verizon represents a bottleneck to the development of a healthy, competitive market for Special Services.” *Id.* The NYPSC thus concluded that “Verizon’s combined market share data demonstrate its continued dominance in *all* geographic areas” *Id.* at 9 (emphasis added).

<sup>55</sup> AT&T Reply Comments, RM No. 10593 at 14; *id.*, Reply Declaration of Lee L. Selwyn, ¶ 20.

<sup>56</sup> Selwyn Dec., ¶ 14.

<sup>57</sup> *Id.*

New York City, they are likely to be even more dependent upon incumbent facilities in other parts of the United States. The New York Public Service Commission characterized Verizon as the “dominant” provider of special access services, based on an examination of route miles of fiber, numbers of buildings passed, and the number of buildings actually connected to the non-ILECs. The New York Commission found that Verizon “continues to occupy the dominant position in the Special Services [*i.e.*, special access] market, and its dominance is a controlling factor in that market. *Because competitors rely on Verizon’s facilities, particularly its local loops, Verizon represents a bottleneck to the development of a healthy, competitive market for Special Services.*”<sup>58</sup>

The continuing ILEC control of the local bottleneck, whose persistence is assured by the near-zero supply-elasticity of competing local service providers, confers market power in all downstream markets irrespective of how those downstream markets are defined and allows the ILECs to raise price and restrict output in all those downstream markets.<sup>59</sup> As Dr. Selwyn demonstrates, under the criteria identified in the 1992 Merger Guidelines,<sup>60</sup> control of the access bottleneck allows the BOCs to dominate all interstate and intrastate, interLATA and intraLATA

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<sup>58</sup> NYPSC Special Access Order, at 9 (emphasis added).

<sup>59</sup> Selwyn Dec., ¶ 18 (“[N]ear-zero CLEC supply elasticity affords the BOCs the ability to control and limit output in the downstream market by raising the costs of downstream competitors’ inputs, which also forces retail prices being charged by downstream firms to be higher than they would otherwise be. This, in turn, provides the BOCs with a price umbrella for their own retail services, resulting in higher BOC rates and reduced BOC output as well”).

<sup>60</sup> The Commission has adopted the approach taken in the *1992 Merger Guidelines* for the purposes of defining markets, *LEC Classification Order*, ¶ 25 noting that the differing objectives of regulation and antitrust enforcement may affect the application of the market definition in these contexts. *See*, Sections 2.12 and 2.32 of the Merger Guidelines for the relevant evidence to be considered in defining product and geographic markets.

long distance services, within their in-state and in-region footprint.<sup>61</sup> His conclusion is based, *inter alia*, on technical considerations (the common line), and buyers' and sellers' perceptions and conduct, particularly BOCs' self-limitation of their competitive activities to in-region footprint, and their offering, by state, of single flat-rate offerings for bundled intrastate, interstate, intraLATA and interLATA (and in some cases international) services, and customers' inability to make separate PICs for *interstate* and *intrastate* interLATA services.<sup>62</sup>

It is also clear that non-wireline alternatives do not in any way detract from ILEC bottleneck market power. As noted above, although cable-delivered telephone service holds promise, it is available in few communities today. And, as noted above, few consumers have substituted wireless for wireline phones.

## **II. ILEC CONTROL OF BOTTLENECK FACILITIES CONFERS THE MARKET POWER TO ENGAGE IN PRICE SQUEEZES, MISALLOCATE COSTS AND DISCRIMINATE AGAINST UNAFFILIATED INTERLATA COMPETITORS.**

The incumbents' market power over access facilities allows them to leverage that power to favor their own long distance (and local) services and disfavor those of competitors.

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<sup>61</sup> See Selwyn Dec., ¶ 14 (“BOCs must continue to be classified as *dominant* carriers with respect to *any service* that is linked to the access line platform, including and especially any long distance services that are bundled with basic local exchange under a single package.”)

<sup>62</sup> *Id.*, ¶¶ 14, 31-33, 37-44. See also, *id.*, ¶ 38 (noting that “[c]ustomers cannot and do not make separate service provider selections *notwithstanding the fact that the two services are subject to different regulatory treatment by different regulatory jurisdictions and may be offered at different prices.*”) It is also sometimes useful to distinguish between the “mass market” (residential and small business), which IXCs generally serve by using ILEC switched access services, and the “business enterprise” market, which IXCs generally serve by using ILEC special access services, although, as described above, the ILECs have bottleneck control over both switched and special access. Notice, ¶ 10. Because the ILEC bottleneck also confers market power over international long distance services, no separate analysis is necessary for international services. See Notice, ¶ 16. The substitution of Internet-based services for international services provided by wireline operators, *id.*, has been very limited and does not prevent ILEC leverage of their local bottlenecks against downstream wireline providers.