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By Electronic Filing

Marlene H. Dortch
Secretary
Federal Communications Commission
445 12th St., SW
Washington, D.C. 20554

Re: CC Docket Nos. 01-338, 96-98, 02-33, 98-147

Dear Ms. Dortch:

I write on behalf of AT&T Corp. ("AT&T") to respond to the May 17, 2004 *ex parte* letter and attached white paper filed by Verizon in the above-captioned proceeding.[1] Because unregulated monopolies and duopolies obviously cannot be expected to ensure "just and reasonable" rates, "protect[] consumers" and "promote competitive market conditions," 47 U.S.C. §§ 10(a), (b), Verizon now struggles to convince the Commission simply to ignore obvious market power abuse implications of its forbearance decisions. Under this view, the Commission is free to deregulate at the "wholesale" level under § 10 (and thereby create unregulated monopolies and duopolies) without even *addressing* whether the statutory requirements from which forbearance is sought remain necessary to protect wholesale customers from market power abuses. According to Verizon, that is so, because it is established under the antitrust laws that "there is no separate wholesale market for broadband services." Verizon White Paper at 2. Verizon's argument is both irrelevant and untrue.

Verizon's argument is irrelevant because, whatever the scope of the antitrust laws, the controlling language of § 10 requires the Commission to assess whether, absent the regulation Verizon seeks to eliminate, Verizon would be able to engage in unreasonable and

[1] *See Ex Parte* Letter from Dee May, Verizon, to Marlene H. Dortch (filed CC Docket No. 01-338, *et seq.*, May 17, 2004) (attaching *Ex Parte* Letter from Dee May, Verizon, to Marlene H. Dortch (filed CC Docket Nos. 01-337, *et seq.*, Nov. 13, 2003) (hereinafter "Verizon White Paper")).

discriminatory practices directed to wholesale customers. Section § 10(a)(1) clearly encompasses *all* "charges, practices, classifications, or regulations" "for, or in connection with" the "telecommunications carrier" or "telecommunications service" for which forbearance is sought. In this regard, the applicable test – requiring the Commission to determine whether charges will be "just and reasonable" and not "unjustly or unreasonably discriminatory" – is derived from § 201 and § 202, which the Commission has always applied to both wholesale and retail services.

Indeed, the Commission has already squarely held that a forbearance request must be denied if "forbearance would be likely to raise prices for interconnection and UNEs (particularly those that may constitute bottleneck facilities), [wholesale] inputs competitors must purchase from incumbent LECs in order to provide competitive local exchange service." *1998 Biennial Review - Depreciation Requirements*, 15 FCC Rcd. 242, ¶¶ 54, 63, 68 (1999). Thus, the Commission denied requests for forbearance of dominant LEC depreciation requirements, because "result of forbearance" would "be higher costs for competitive LECs which could impair their ability to enter and compete in local markets" and would "adversely affect competition by raising input prices that competitors pay," thereby "retard[ing] competition." *Id.*

Thus, in order to obtain the relief that it seeks, Verizon must show that market forces would be sufficient to ensure that its "charges and practices" with respect to leasing last-mile, broadband-capable transmission would be "just and reasonable" and not "unjustly or unreasonably discriminatory" absent the § 271 requirements that Verizon seeks to eliminate. It is undisputed, however, that there are generally *no* other suppliers of these telecommunications services. Proving with hard evidence that its wholesale broadband transmission rates would be just and reasonable absent regulation is not the only pre-condition to granting Verizon's forbearance petition – Verizon must also, for example, prove that relieving it of statutory unbundling obligations with respect to broadband-capable loops will not reduce competition and raise rates for narrowband voice services that are routinely bundled with broadband services – but proving that wholesale rates will remain just and reasonable plain is *a* pre-condition to the forbearance relief that Verizon seeks.

Moreover, even if the scope of the § 10 inquiry was limited to the strict application of antitrust principles, these principles would themselves foreclose Verizon's position. The centerpiece of Verizon's argument is that there is no such thing as a "wholesale market" under the antitrust laws. Verizon purports to rely principally on the *Horizontal Merger Guidelines*, Verizon White Paper at 2, but it does not even discuss the *Guidelines'* test for identifying relevant product markets. The "Agency will begin with each product (*narrowly defined*) produced or sold by each merging firm and ask what would happen if a hypothetical monopolist of that product imposed at least a 'small but significant and nontransitory' increase in price." U.S. Department of Justice and the Federal Trade Commission, *Horizontal Merger Guidelines* § 1.11 (issued April 2, 1992). The Department of Justice ("DOJ") or Federal Trade Commission ("FTC") would therefore ask whether, if a theoretical monopoly provider of wholesale local wireline transmission facilities used to provide local voice and data services raised its prices by 5%, would that price increase be defeated by wholesale customers turning to other substitute products. The answer is clearly no. As explained in greater detail below, there are today *no* alternative facilities that competitive carriers can use to provide the voice and data services that they seek to offer. Thus, under the very principles on which Verizon purports to rely, there is plainly a relevant market for wholesale services.

Applying these principles, the antitrust agencies have repeatedly sued to block mergers that would create power in relevant wholesale markets, and the courts have routinely endorsed the application of antitrust laws to address wholesale market power. For example, the FTC sued to block the Time Warner-AOL merger alleging the existence of a wholesale market for broadband Internet access provided to ISPs. Complaint, *Matter of America Online Inc. and Time Warner Inc.*, Docket No. C-3989 (FTC Dec. 14, 2000). Similarly, in *FTC* v. *Cardinal Health, Inc.*, the FTC sued to block a merger of competing drug wholesalers, successfully arguing that this was a relevant market. 12 F. Supp.2d 34 (D.D.C 1998). And in *Otter Tail Power Co.* v. *United States* the Supreme Court upheld a district court finding of market power where an energy company "ha[d] 'a strategic dominance in the transmission of power in most of its service area' and . . . used this dominance to foreclose potential entrants into the retail area from obtaining electric power from outside sources of supply." 410 U.S. 366, 377 (1973).

The Commission, too, has repeatedly examined whether mergers would eliminate competition in relevant wholesale markets analogous to the markets at issue here. "We note that, in defining relevant markets, we may distinguish 'end-user markets,' where the product or service is sold to end-user customers, and 'input markets,' where the product or service is sold to firms for use as an input to supply other products or services." *Motorola-American Mobile Satellite Merger Order*, 13 FCC Rcd. 5182, ¶ 11 (1998). Applying this standard, the Commission has concluded that wholesale markets for access transmission facilities are relevant markets. *See, e.g., Bell Atlantic-NYNEX Merger Order*, 12 FCC Rcd. 19985 ¶ 51 (1997); *British Telecom-MCI Order Merger*, 12 FCC Rcd. 15351, ¶ 52 (1997).

Verizon complains that "vertically integrated" firms that currently do not sell at wholesale should be treated as potential entrants into the relevant wholesale market "to the extent that such inclusion accurately reflects their competitive significance in the relevant market." Verizon White Paper at 2 (citing *Horizontal Merger Guidelines* § 1.31). But here, there are no such "self suppliers" that have been shown able "easily [to] switch production to serve other customers" should Verizon deny competitive carriers access to last mile broadband-capable loop facilities. *Id.* Notably, the only "vertically integrated" entities that Verizon can point to as potential wholesale entrants are cable companies,[2] but Verizon offers nothing more than *ipsi dixit* to support its claim that cable companies could, in fact, "easily switch to serve" competitive carriers. *Id.* at 5. In reality, not a single cable company provides such wholesale access to competitive carriers today;[3] most cable companies do not even provide local telephone services;

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[2] Verizon makes no claim that fixed wireless or satellite providers could easily provide wholesale access to competitive carriers.

[3] A few cable companies supply wholesale ISP access, but that is not the type of access that

and, in other contexts, cable companies have made detailed showings that they cannot easily switch to wholesale provision of services.[4] There is, accordingly, no record basis for any finding that, in response to a price increase (or complete refusal to deal) from Verizon and other incumbent LECs, competitive carriers could expect to be able to obtain wholesale access from cable companies.[5]

There are likewise few wholesale alternatives to the facilities leased by competitive carriers to provide services to enterprise business customers. As noted, cable companies do not serve this market. Instead, to the extent "facilities-based" competition exists, it is from competitive carriers that have deployed their own last-mile loop and transport facilities. But as the Commission found in the *Triennial Review Order*, the ability of competitive carriers to deploy such bypass facilities is limited to the highest capacity facilities, because of natural monopoly entry barriers such as economies of scale, sunk costs, and first-mover advantages. *Triennial Review Order*, 18 FCC Rcd. 16978, ¶¶ 237-39, 311-27, 371, 380-93 (2003).

This Commission-confirmed lack of alternatives to the incumbents' last-mile facilities also is the complete answer to the cases cited by Verizon in which the Commission declined to impose certain wholesale access obligations. In each of those cases, there was "eas[y] . . . entry" into the wholesale market by companies that currently did not serve the market, and therefore little chance that existing wholesale providers could exercise market power. *See* Verizon White Paper at 3-4. Here, by contrast, there is not "easy entry" into the market for supplying wholesale transmission services that can be used to provide the full panoply of retail voice and data services.

Verizon devotes the remainder of its white paper to attempts to support another insupportable position: that the Commission can ignore variations in the levels of retail

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competitive carriers would seek. Rather, consistent with the 1996 Act, CLECs seek the ability to use local facilities to provide voice and data services.

[4] *See, e.g., Inquiry Concerning High-Speed Access to the Internet Over Cable and Other Facilities*, 17 FCC Rcd. 4798, ¶ 15 (2002).

[5] As AT&T has explained, consumers are increasingly demanding voice/data bundles and incumbent LECs are making that a centerpiece of their business strategies. *See,* e.g., *Ex Parte* Letter from David L. Lawson, AT&T, to Marlene H. Dortch, at 8 (filed in CC Docket Nos. 01-338, *et seq.*, March 3, 2004); *Ex Parte* Letter from David L. Lawson, AT&T, to Marlene H. Dortch, at 7 (filed in CC Docket Nos. 01-338, *et seq.*, April 15, 2004); Reply Comments of Verizon, Kahn-Tardiff Reply Dec. ¶ 39, (filed CC Docket No. 01-338, July 15, 2002) (stating that "competitors will need to offer both voice and broadband services" and that they have "long agreed with [AT&T's] position that carriers need to offer packages of services if they are to compete successfully"); Merrill Lynch, *Everything over IP*, at 49 (March 12, 2004) ("Bundling remains a key element in SBC strategy. Management noted on 4Q03 call that 44% of customers have a 'key product bundle' including one or more of LD, DSL or wireless, up from 36% last quarter and 19% a year ago.").

competition that Verizon faces in relevant local geographic markets as well as variations in competition between small business and consumer markets. *See* Verizon White Paper at 7-17.

The relevant geographic markets are undeniably local. Again, the *Horizontal Merger Guidelines*, on which Verizon purports to rely, foreclose its argument. Under the *Horizontal Merger Guidelines*, the antitrust agencies assume the most narrow geographic market and ask whether a price increase by a theoretical monopolist in that market would be defeated by customers turning to suppliers of that product in adjacent areas. *Id.* § 1.21. Here, an incumbent voice/data customer in location A obviously cannot purchase voice/data service from competitors that serve only location B. The local networks used to provide voice and data service simply cannot be picked up and moved to serve demand in different locations. *Triennial Review Order* ¶ 401. The Bells' own economists have made this point. *See, e.g.*, Declaration of Robert Harris ¶ 6 (filed CC Docket No. 01-337, Apr. 22, 2002)) ("[t]he geographic scope of the market for broadband access is local.").

Verizon suggests that the Commission can nonetheless ignore local variations in competition, because it is "impracticable" for Verizon to "market" DSL services "with prices and terms that vary from area to area." Verizon White Paper at 10. The Commission rejected this precise claim in the *Echostar-DirecTV Merger Order*, 17 FCC Rcd. 20559, ¶¶ 119, 125 (2002). There, the parties contended that the Commission could ignore that the merger would create some monopoly markets because the parties advertised and priced nationally and faced competition from cable in many other markets. *Id.* ¶ 118. The Commission, however, recognized that even parties that advertise nationally can set market-specific prices through use of selective "promotions" and other discounting. *Id.* n.349. Moreover, unlike Verizon, the merging parties in that proceeding had made firm commitments to refrain from offering market-specific terms for their services, and the Commission still found that proffer insufficient to address market power concerns. *Id.* ¶ 23.

Verizon makes no attempt to show that it has satisfied the § 10 criteria in any relevant geographic or product market, let alone each and every such market. Nor could it. Verizon's own filing underscores that there are still parts of its vast service area where it enjoys broadband monopolies. Even using the most aggressive assumptions and stale data that understate DSL deployment, Verizon is forced to concede that approximately 8% of households in a cherry-picked study area had only Verizon DSL as a broadband option. Verizon White Paper at 9 & n.18. However, the overall Verizon percentage is certainly higher, because Verizon based its study on only the states that comprise the former Bell Atlantic territory, and not the more rural GTE and NYNEX territories where cable systems are less likely to provide competing services. Verizon further biased the results by making patently improper assumptions. Buried in a footnote, Verizon concedes that it assumed that in any census block where a cable system provided cable modem services to just *one* customer, it provided cable modem services to *every* customer in that census block. *Id.* In so doing, Verizon incorrectly assumes that a cable company provides service in areas beyond that company's territory and Verizon incorrectly assumes a cable company provides cable modem services uniformly throughout a service territory even when, in fact, some systems are only partially upgraded. Once these numerous errors are corrected, the true extent of Verizon's DSL monopoly is far greater than Verizon's estimate.

That Verizon has understated the extent of its DSL service (and thereby understated the extent to which there are customers that can only obtain that service but not cable modem service), can be demonstrated as a matter of mathematics. Verizon says that 37% of its subscribers have access to neither cable nor DSL and that another 10% have no access to DSL (but do have access to cable). Verizon White Paper at 9. Thus, Verizon's analysis assumes that only 53% of subscribers in its territory have access to DSL service (100% - 37% - 10%). But Verizon elsewhere concedes that at least 70% of households in its territory can obtain DSL service. *Id.* at 8. Verizon's internally inconsistent study is entitled to no weight.

And while Verizon asserts that the number of customers that are likely to have only the option of Verizon's DSL service is likely to shrink in the future, *id.* at 10, the very statistics Verizon reports show the opposite. Verizon has in place local telephone facilities to serve virtually every customer in its service territory. In contrast, cable companies do not serve all rural areas and, thus, do not serve many households that Verizon currently serves. Further, as Verizon notes, cable companies have largely finished upgrading their cable systems, whereas Verizon estimates that it has deployed DSL technology to about 60 to 70% of households in its territories. Verizon White Paper at 9. These facts mean that, as Verizon continues to upgrade its networks, Verizon will increasingly serve homes that today have neither DSL nor cable service as an option. *See id.* (estimating this to be approximately 10% of customers in Verizon's territory).[6]

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[6] Verizon's emphasis on cable competition is understandable. Although Verizon points to competition from satellite, broadband powerline and fixed wireless, the hype for these services has not matched their performance. *See, e.g., Ex Parte* Letter from David L. Lawson, AT&T to Marlene H. Dortch, at 8-9 (filed in CC Docket Nos. 01-338, *et seq.*, April 15, 2004); *Ex Parte* Letter from David L. Lawson, AT&T, to Marlene H. Dortch , at 7-8, (filed in CC Docket Nos. 01-338 *et seq.*, Feb. 4, 2004). Combined, these platforms have only a *de minimis* share of broadband services. *See, e.g., High Speed Services for Internet Access: Status as of June 30 2003,* FCC Industry Analyst and Technology Division, Tables 1, 3 & 4 (rel. Dec. 22, 2003). Until these platforms can be shown to be a viable alternative to cable modem service and DSL service, they cannot be considered to place any competitive constraint on Verizon's DSL service. *Horizontal Merger Guidelines* §§ 3.0-3.4 (explaining that the only entry relevant to a market power analysis is that which would be "timel[y], likel[y], and sufficien[t]."); *id.* § 3.4 ("entry . . . will not be sufficient if, as a result of incumbent control, the tangible and intangible assets required for entry are not adequately available for entrants to respond fully to their sales opportunities. In addition, where the competitive effect of concern is not uniform across the relevant market, in order for entry to be sufficient, the character and scope of entrants' products must be responsive to the localized sales opportunities that include the output reduction associated with the competitive effect of concern").

Verizon should be equally ashamed in renewing its claim that cable modem services are ubiquitously available to small businesses.[7] Verizon continues to rely on outdated analyst projections that it knows full well have been repudiated. For example, Verizon trumpets the Yankee Group's 2003 prediction that cable was poised to take off in the small business market, Verizon Letter at 12, but the Yankee Group itself has now concluded that these predictions were, to say the least, wildly optimistic. "We projected cable modem would surpass DSL in this [the small business] segment by year-end 2003. However, cable modem penetration *dropped precipitously* in the small business market, or businesses with between 20 and 99 people. Cable operators also achieved limited success in the remote office market, reaching only 4.2 percent of the market in 2003"). Yankee Group, *Cable and DSL Battle for Broadband Dominance* (February 2004), at 4-5 (emphasis added). As the Yankee Group now recognizes, "*DSL operators dominate* the U.S. [small business] broadband and enterprise remote-office broadband market." *Id.* at 4 (emphasis added). The Yankee Group further acknowledges that its earlier predictions failed to account for the reluctance of business to purchase cable modem services because they are viewed as less secure and because cable does not offer "symmetrical" services. *Id.* at 5.

Unable to demonstrate that cable companies are actually serving significant numbers of small business customers, Verizon claims that they could potentially do so. Verizon Letter at 12. However, a careful reading of analyst snippets relied upon by Verizon reveals that today only 25% of small businesses actually have a cable drop. Verizon White Paper at 12. Verizon tries to make much of the fact that many more businesses are within a few hundred feet of a cable system, but that only reinforces AT&T's point. (And even then, Verizon concedes that fully 40% of businesses are beyond this threshold).[8] There are significant barriers preventing cable companies from easily expanding their networks to reach these customers – which is why it has not already happened. The last mile of construction is the most expensive and time consuming. The costs of such construction are sunk and cannot be recovered if demand fails to materialize. And businesses generally do not purchase video programming services; the economies of scope available to cable companies in serving residential customers are therefore largely unavailable in the business context.

But even if Verizon were correct that it faced competition from cable modem services ubiquitously, Verizon has no explanation as to why mere duopoly competition can be considered sufficient to ensure that all "charges, practices, classifications, or regulations" at issue will be "just and reasonable" and not "unjustly or unreasonably discriminatory." As the Commission made clear in the *EchoStar-DirecTV Merger Order* at ¶ 103 , "existing antitrust

[7] Verizon does not contest that under § 10 the Commission must separately analyze the impact of forbearance on residential and small business markets.

[8] According to Verizon's data, there are approximately 10.5 million small and medium businesses nationwide and cable companies have infrastructure "within a few hundred feet" of approximately six million such businesses. Verizon White Paper at 12.

doctrine suggests that a merger to duopoly . . . faces *a strong presumption of illegality*" (emphasis added). Duopolies "inevitably result in less innovation and fewer benefits to consumers" which "is the antithesis of what the public interest demands." *Id.* (separate statement of Chairman Powell). In this regard, duopoly "competition" is problematic not just because the firm with the larger market share may exercise market power, but because *both* participants are likely to have the incentive and ability to maintain prices above competitive levels rather than attempting to ruthlessly compete with the other, as they would need to do in a market with multiple firms. *Horizontal Merger Guidelines* § 2. That is why, in its *Mass Media Ownership Order*, the Commission held that "both economic theory and empirical studies" indicate that "five or more relatively equally sized firms" are necessary to achieve a "level of market performance comparable to a fragmented, structurally competitive market." 18 FCC Rcd. 13620, ¶ 289 (2003).

Respectfully submitted,

/s/ David L. Lawson

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