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BEFORE THE  
**Federal Communications Commission**  
WASHINGTON, D.C.

In the Matter of )  
 )  
 )  
AT&T Inc. and BellSouth Corporation ) WC Docket No. 06-74  
Applications for Approval of )  
Transfer Of Control )  
 )

**PETITION TO DENY OF TIME WARNER TELECOM**

Time Warner Telecom, Inc. (“TWTC”), by its attorneys, hereby files this petition to deny the application of AT&T Inc. and BellSouth Corporation (the “Applicants”) for approval of the proposed transfer of control in the above-referenced proceeding.<sup>1</sup>

**I. INTRODUCTION AND SUMMARY**

The proposed merger between AT&T and BellSouth will unquestionably harm consumer welfare. After the merger, the combined BellSouth-AT&T-SBC-Ameritech-PacTel-SNET behemoth would have significantly more market power over local transmission facilities and possibly over Internet backbone facilities needed to serve business (and mass market) customers, and it will have a significantly increased incentive to abuse that power by raising rivals’ costs. At the same time, the merger will deprive regulators of the tools needed to detect and punish such conduct. The combination and extent of these horizontal, vertical and regulatory effects make this merger more dangerous, at least in the business market, than either the previous RBOC mergers or the recent RBOC-IXC mergers.

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<sup>1</sup> See *Commission Seeks Comment on Application for Consent to Transfer of Control Filed by AT&T Inc. and BellSouth Corporation*, Public Notice, DA 06-904, WC Docket No. 06-74 (Apr. 19, 2006).

The changes in the business market caused by IP technology are critical to understanding the merger's consequences for consumer welfare. As the Commission well knows, the industry is fast deploying and consumers are increasingly demanding IP-based products that offer a level of scalability and flexibility that are causing IP services to quickly replace circuit-switched, TDM offerings. This is the case in the business market which is the focus of this petition. TWTC is aggressively deploying the necessary back office systems, switches, routers and multiplexers needed to offer Ethernet, IP virtual private network ("VPN") and IP voice offerings. Moreover, customers' demand patterns are changing as IP technology matures and customers and carriers exploit its efficiencies. In the past, TWTC was successful in offering partial customer solutions, for example serving a subset of a business customer's locations with Ethernet while another carrier would serve the customer's other needs. In those situations, the business customer would perform the network integration function itself. But this is changing. Customers are increasingly demanding that their service provider take advantage of the efficiencies offered by IP to integrate all of their communications needs on a single network serving all (or virtually all) customer locations. This development is causing TWTC to change its approach to designing business service products, most importantly because it must now expand the reach of its service offerings to make sure that it can serve all or virtually all of a customer's locations.

Accordingly, changes in the marketplace have increased the *number* of ILEC local loop and transport facilities that TWTC must purchase, because it is inefficient for TWTC (which deploys its own loops and transport wherever possible) to deploy its own fiber transport and loop facilities in many of the new locations that TWTC must now reach. Moreover, the demands of IP service offerings are changing the *kinds* of loop and transport facilities TWTC must obtain

from the ILECs. Like all competitors serving business customers, TWTC has long been reliant on ILEC DS1 and DS3 loops and transport. TWTC continues to need these facilities as well as interconnection for the exchange of circuit switched voice traffic, collocation and a number of other inputs from the incumbents. But now, in order to continue to provide IP-based Ethernet service, TWTC must purchase loops from ILECs that are connected to ILEC Ethernet electronics instead of TDM DS1 and DS3 electronics. Moreover, in order to comply with customer demands for appropriate class of service and quality of service requirements (i.e., appropriate prioritization of packets for voice and other latency sensitive and jitter sensitive services), TWTC must obtain ILEC commitments to comply with such requirements for traffic that traverses ILEC loop and transport facilities.

Unfortunately, the proposed merger, if approved, would make it far less likely that TWTC would be able to acquire these inputs on just, reasonable and nondiscriminatory terms and conditions. *First*, the merger eliminates AT&T as an actual competitor in the provision of facilities-based special access service in many locations in the BellSouth territory and as a potential competitor in other locations in the BellSouth territory. It also eliminates BellSouth as a potential competitor in this product market in the AT&T ILEC territory. Facilities-based special access is a highly concentrated product market throughout the country, one in which the ILEC has a monopoly in the vast majority of commercial buildings. Unlike the mass market, there are essentially no intermodal competitors in this market. The loss of AT&T as a *potential* competitor is an especially damaging, and easily overlooked, consequence in the BellSouth territory. AT&T has substantial existing network assets as well as (as it has stated itself) a powerful incentive to compete aggressively in that region absent the merger. Moreover, as ILECs with adjacent territories, AT&T and BellSouth are better placed to win customers and

exploit economies of scale to deploy local transport and loop facilities in an adjacent territory than other competitors (except perhaps Verizon). The loss of AT&T and BellSouth as competitors in the very market in which TWTC's reliance on ILEC inputs is fast increasing (and it has always been significant), poses a major threat to business competition.

*Second*, especially in light of the increased importance of the transmission of IP traffic over backbone networks, the Commission must examine the consequences of the proposed merger for Tier One IP backbone service. In particular, the Commission must assess the level of concentration and the implications for efficient outcomes in this market if all of the SBC and BellSouth Internet traffic are placed on the AT&T backbone. TWTC's own recent experience with AT&T, in which AT&T has insisted on **[proprietary begin]** **[proprietary end]** in the transport price it charges TWTC for a **[proprietary begin]**

**[proprietary end]** in transmission capacity, reflects AT&T's increasing sense of its ability to unilaterally increase prices in the market without losing market share. The effect of the merger on this problem warrants very close scrutiny.

*Third*, the merger would increase the merged entity's incentive to use its persisting (and, after the merger, increased) market power over inputs to raise rivals' costs. As the Commission found in the context of the SBC-Ameritech and Bell Atlantic-GTE mergers, the extension of an ILEC's network footprint through merger allows the merged firm to appropriate a larger share of the benefits from raising rivals' costs. This increase in the benefits from exclusionary conduct increases the merged entity's incentive to engage in this conduct. The more the network footprint expands, the more the incentive to harm competitors increases.

This will make a bad situation much worse, especially when combined with TWTC's growing need for ILEC inputs. Both AT&T and BellSouth have already raised TWTC's and

other competitors' costs by insisting on the inclusion of anticompetitive terms in existing volume-term special access agreements. Moreover, neither AT&T nor BellSouth has been eager to provide TWTC with necessary Ethernet loops. AT&T has, however, been especially resistant to TWTC requests for Ethernet loops. **[proprietary begin]**

**[proprietary end]**

By increasing the incentive of the merged entity to engage in exclusionary conduct, the merger would likely make it even more difficult to obtain needed inputs from AT&T, and it would likely cause BellSouth to become as resistant to entry as AT&T (and more so). This is all the more harmful because, as discussed, TWTC and other competitors are becoming more, not less, dependent on ILEC inputs. Customers with locations that TWTC serves in both the BellSouth and AT&T ILEC regions already account for **[proprietary begin]**

**[proprietary end]** across the two regions. This percentage will increase as TWTC must serve more of its customers' locations. A merged AT&T-BellSouth will have a more powerful incentive to discriminate against TWTC when competing for such

customers because the merged firm would be able to appropriate the benefits of such discrimination in both ILEC regions.

Furthermore, given that the inputs TWTC needs are just now becoming necessary for competitors, the ILECs have an unusually large number of opportunities to engage in exclusionary conduct. This is because there are no established regulations governing ILEC provision of wholesale inputs in the IP world. Indeed, the Commission has been disinclined to take any action to regulate ILEC IP wholesale service offerings.

*Fourth*, the merger will complete the ILECs' stranglehold over inputs by significantly reducing regulators' ability to detect and punish ILEC exclusionary conduct. This is because the merger will eliminate BellSouth as a benchmark against which to judge the conduct of other large ILECs. Given that Qwest is already significantly smaller and qualitatively different from either Verizon or AT&T (let alone a merged AT&T-BellSouth), there would only be two RBOCs available as benchmarks post-merger. This will likely eliminate entirely the critically important benchmark mechanism from regulation. That is a mechanism upon which state and federal regulators have been critically reliant since the dawn of competition. Indeed, benchmarking is so essential that the Commission stated in its review of the Bell Atlantic-GTE merger that "a merger that reduced the number of major incumbent LECs from four to three would so severely diminish the Commission's ability to benchmark, it is difficult to imagine that any potential public interest benefit could outweigh such a harm." Clearly, no such benefit exists here.

**II. THE PROPOSED MERGER WILL ELIMINATE A MAJOR ACTUAL AND TWO POTENTIAL COMPETITORS IN THE MARKET FOR TYPE I SPECIAL ACCESS SERVICES NEEDED TO SERVE BUSINESS CUSTOMERS.**

In the BellSouth and AT&T ILEC regions, as in the rest of the country, the market for Type I special access services is highly concentrated and subject to extremely high entry barriers.

The proposed merger would make that market even more concentrated by (1) eliminating AT&T as a significant actual competitor in certain geographic areas and as one of the two (along with Verizon) most significant potential competitors in other geographic areas and (2) eliminating BellSouth as a potential competitor in the AT&T ILEC region.

**A. Type I Special Access Services Constitute A Distinct Product Market.**

The Commission has defined the special access market many times in the context of mergers, most recently in its review of the merger of SBC and the legacy AT&T.<sup>2</sup> Special access consists of dedicated transmission links between two locations within the same local exchange, most often provisioned via high-capacity circuits. *SBC/AT&T Order* ¶¶ 25-27. Such services are used for various purposes, such as direct connections between tenants of commercial buildings and a competing carrier's network or between different locations of the same business customer. Both voice and data may be carried using special access services.

The Commission has recognized that there are at least two separate product markets for special access services: "Type I" special access services, which are offered wholly over a carrier's own facilities, and "Type II" special access services, which are offered using a combination of the carrier's own facilities and facilities leased from a wholesale carrier. A carrier providing services solely over its own facilities can deliver higher quality service than a carrier that must rely on a combination of its own facilities and those of another carrier. *Id.* ¶ 26. When purchasing special access from other carriers, TWTC purchases almost exclusively Type I service (i.e., services provided to TWTC by a wholesale carrier exclusively over the wholesaler's

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<sup>2</sup> *SBC Communications Inc. and AT&T Corp. Applications for Approval of Transfer of Control*, Memorandum Opinion & Order, 20 FCC Rcd 18290, ¶¶ 25-27 (2005) ("*SBC/AT&T Order*").

own facilities). For this reason, this filing focuses on Type I special access services. Subsequent references to special access in this filing refer to Type I service only.

**B. In Assessing The Relevant Geographic Market, The FCC Should Focus On Both The Building-By-Building Concentration Levels And The Implications Of Such Concentration For ILEC MSA-Wide And Regionwide Pricing.**

A business located in a given building and wishing to procure telecommunications services cannot substitute special access provided to a different building (or indeed a different floor of the same building) in response to an increase in the price of special access services to its existing location. For a business with established premises, such substitution would involve costly relocation.<sup>3</sup> As a result, a building-by-building inquiry is a necessary component of any examination of the competitiveness of the special access market.

However, the FCC must also consider the effects of the merger across larger geographic areas. The record in prior Commission proceedings indicates that many customers do not make purchasing decisions based on a building-by-building basis.<sup>4</sup> This is true, because ILECs generally price their special access offerings on an MSA-wide basis.<sup>5</sup> Most importantly, the ILECs only offer discounts off of high monthly rates to purchasers that agree to enter into volume-term agreements that cover one or more MSA. Once an ILEC has been granted pricing flexibility on an MSA basis, it is free to offer term and volume commitments for special access

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<sup>3</sup> Declaration of Joseph Farrell ¶ 10, attached to Opposition of Global Crossing North America, Inc., WC Dkt. No. 05-65 (Apr. 25, 2005) (“*Farrell Decl.*”).

<sup>4</sup> See, e.g., SBC Communications, Inc. Reply Comments, WC Dkt. No. 05-25, at 26 (July 29, 2005) (stating that “the overwhelming majority of special access circuits are purchased by customers that bargain for substantial term, volume, and overlay discounts”) (internal citations omitted).

<sup>5</sup> See, e.g., SBC Communications, Inc. Comments, WC Dkt. No. 05-25, at 53 n.176 (June 13, 2005) (stating that “[special access] contract tariffs vary in their scope, covering a single MSA, multiple MSAs, or SBC’s entire service territory”).

services across an MSA or indeed all MSAs in which it has received pricing flexibility in its region in exchange for discounts from the posted monthly rates. It is safe to assume that BellSouth's and AT&T's ILEC special access facilities reach virtually every building in every MSA in which those ILECs have received pricing flexibility, including locations in which they face competition and locations in which they do not face competition. Elimination of AT&T as a significant actual and potential competitor from building-specific locations in a BellSouth region MSA is particularly likely to affect the MSA-wide and regionwide prices that BellSouth charges. As one former FCC Chief Economist has explained, an MSA-wide competitive analysis is needed to account for this effect. Farrell Decl. ¶ 18. Accordingly, the Commission should give special consideration to the effect of the proposed merger on BellSouth's MSA-wide and regionwide volume-term discount prices as well as on competition in particular buildings.

The Commission and the Department of Justice ("DOJ") have acknowledged the need for this approach. In its Complaint opposing the merger of SBC and AT&T, the DOJ stated that the relevant geographic market for special access was "no broader than each metropolitan area and no more narrow than each individual building."<sup>6</sup> Similarly, in the *SBC/AT&T Order*, the FCC concluded that the appropriate geographic market was the specific customer's location, but it recognized that "[b]ecause SBC has gained Phase II pricing flexibility for its special access services in some metropolitan statistical areas (MSAs), but not others, SBC's rates for special access may vary from MSA to MSA. Accordingly, we will also examine on an MSA basis how

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<sup>6</sup> *United States v. SBC Communications, Inc. and AT&T Corp.*, Case No. 1:05CV02102, Complaint ¶ 24 (D.D.C. filed Oct. 27, 2005) ("*SBC/AT&T DOJ Compl.*").

the merger is likely to affect SBC's special access prices.”<sup>7</sup> This same dual inquiry is appropriate here.

**C. The Special Access Services Market Is Characterized By High Entry Barriers, Low Supply Elasticity And ILEC Unilateral Pricing Power.**

The Commission has repeatedly held that the entry barriers associated with constructing local transmission facilities prevent such construction in the vast majority of locations.<sup>8</sup> As the Commission has found, these barriers include the ILECs' first mover advantages, the unwillingness of many customers to wait until a competitor has completed its construction before receiving service, the inability to gain access to public and private rights-of-way (including building access) and the ILECs' economies of scale and cost advantages.<sup>9</sup> Moreover, the “sunk” character of the high capital costs associated with deployment of competitive fiber is perhaps the most significant entry barrier. The FCC has concluded that “[s]unk costs, particularly when

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<sup>7</sup> *SBC/AT&T Order* ¶ 29 (footnotes omitted).

<sup>8</sup> *See Unbundled Access to Network Element; Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers*, Order on Remand, 20 FCC Rcd 2533, ¶ 154 (2005) (“*TRRO*”).

<sup>9</sup> *See, e.g., id.* ¶ 151 (“In addition to the substantial fixed and sunk costs involved in deploying competitive fiber, competitive LECs also face substantial operational barriers to constructing their own facilities. As we found in the *Triennial Review Order*, the construction of local loops generally takes between six to nine months absent unforeseen delay .... Often these delays are attributable to problems in securing rights-of-ways from local authorities in order to dig up streets prior to laying fiber, including lengthy negotiations with local authorities over the ability to use public rights-of-way and obtaining building and zoning permits. Moreover, commenters note that many local jurisdictions impose construction moratoriums which prevent the grant of a franchise agreement to construct new facilities in the public rights-of-way.”); *Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers, Implementation of the Local Competition Provisions of the Telecommunications Act of 1996, Deployment of Wireline Services Offering Advanced Telecommunications Capability*, Report and Order, 18 FCC Rcd 16978, ¶¶ 87-91 (2003) (“*TRO*”), judgment vacated in part, *U.S. Telecom Ass'n v. FCC*, 359 F.3d 554 (D.C. Cir.), cert. denied, 543 U.S. 925 (2004).

combined with scale economies, can pose a formidable barrier to entry.”<sup>10</sup> Sunk costs increase substantially the likelihood that the incumbent will engage in strategic anticompetitive behavior.<sup>11</sup>

In the vast majority of situations, entry barriers prevent competitive carriers from deploying fiber to end-user locations. For example, BellSouth stated in a filing with other ILECs that competitive carriers have deployed fiber serving only approximately 30,000 of the more than 700,000 commercial office buildings in the nation.<sup>12</sup> Moreover, there is no basis for concluding that the entry barriers in the BellSouth territory are any lower than those in the legacy SBC and Verizon territories in which the DOJ concluded that only the ILEC serves the “vast majority of commercial buildings.”<sup>13</sup> Thus, contrary to the Commission’s assumption in the pricing

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<sup>10</sup> *TRO* ¶ 88; see also Patrick Bolton *et al.*, *Predatory Pricing: Strategic Theory and Legal Policy*, 88 Geo. L.J. 2239, 2265 (2000) (“[I]f challenged by new entry, the incumbent will rationally disregard such [sunk] costs in its pricing decisions rather than lose the business. The entrant ... must now incur such costs, and therefore faces risk of underpricing by an incumbent with sunk costs. Thus, as a result, sunk costs may act as an entry barrier, giving the incumbent the power to raise price above the competitive level.”).

<sup>11</sup> See *Implementation of Section 19 of the Cable Television Consumer Protection and Competition Act of 1992; Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming*, First Report, 9 FCC Rcd 7442, App. H ¶ 37 (1994) (“If entry into an industry requires large sunk costs, the value of incumbency can be substantial. Incumbent systems may be able to use their incumbency to forestall or deter competitive entry via a number of entry deterring strategies. In general, economic models of entry deterrence stress the inherent advantage in making the ‘sunk’ investments first, thereby limiting the opportunities for profitable entry later.”).

<sup>12</sup> See *TRO* ¶ 298 n.856 (stating that both “competitive LECs and incumbent LECs report that approximately 30,000, *i.e.*, between 3% to 5%, of the nation’s commercial office buildings are served by competitor-owned fiber loops”); see also *TRRO* ¶ 157 (stating that the record indicates that there are between 700,000 and 3 million commercial buildings in the nation (citing Loop and Transport Coalition Comments and Sprint Comments)).

<sup>13</sup> *SBC/AT&T DOJ Compl.* ¶ 15.

flexibility order,<sup>14</sup> competitive carriers are largely unable to rapidly increase supply to counter high ILEC special access prices. In other words, the combination of limited CLEC capacity and very high entry barriers means that the elasticity of supply for high capacity loops is extremely low, enhancing the ILECs' market power.

The ILECs' pricing practices confirm their market power in the provision of special access. The ILECs have taken advantage of premature grants of pricing flexibility in over 150 markets to raise rates.<sup>15</sup> Rates have increased in Phase II areas both on month-to-month tariffs as well as on standard tariffed long-term commitment plans.

The increase in special access rates under pricing flexibility has been studied and documented in detail. Most notably, in 2004, FCC economists Paul R. Zimmerman and Noel D. Uri conducted an extensive study that demonstrated that ILECs continue to exercise market power over special access services in those areas where they have been granted pricing flexibility. Indeed, the ILECs' rate of return in the pricing flexibility markets well exceeds what would be expected in a competitive marketplace. Zimmerman and Uri note that, while special access provided only a 7.4% rate of return to the ILECs in 1996, this had climbed to 37.1% in 2003. *See Zimmerman* at 126. Moreover, ILEC special access revenues nearly quadrupled from \$3.1 billion in 1996 to \$12 billion in 2002. *See id.* Over this same time period, special access

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<sup>14</sup> *Access Charge Reform; Price Cap Performance Review for Local Exchange Carriers; Interexchange Carrier Purchases of Switched Access Services Offered by Competitive Local Exchange Carriers*, 14 FCC Rcd 14221, ¶ 144 (1999) (“Pricing Flexibility Order”) (“If an incumbent LEC charges an unreasonably high rate for access to an area that lacks a competitive alternative, that rate will induce competitive entry, and that entry will in turn drive down rates.”).

<sup>15</sup> As of 2004, LEC pricing flexibility for channel terminations had been granted for more than 158 MSAs while more than 186 MSAs had been granted pricing flexibility for transport (channel mileage). *See Noel D. Uri & Paul R. Zimmerman, Special Access Service and its Regulation in the United States*, 6 J. of Policy, Regulation, and Strategy for Telecommunications 122, 125 (2004) (“Zimmerman”).

lines grew as a percentage of all access lines from 8.9 percent to 41 percent. *See id.* As Messrs. Zimmerman and Uri note, it runs counter to economic theory that prices would continue to rise as output increases in a market (such as special access) characterized by substantial economies of scale and scope.<sup>16</sup> The only reasonable inference is that the special access market is not competitive and ILECs are acting on their incentives to discriminate on price in the special access market. *See id.* at 157.

By scrutinizing DS1 and DS3 channel mileage and termination rates (not merely rates of return), Zimmerman and Uri were able to determine that rates under pricing flexibility increased substantially for almost every BOC, in almost every pricing flexibility market, for both month-to-month offerings as well as for rates subject to long term commitments. *Id.* at 156-57. They concluded that “LECs subject to price caps who have been granted pricing flexibility have taken advantage of the opportunity.... To a greater or lesser degree, depending on the individual LEC, rates have been raised by LECs in an environment where these LECs are already earning rates of return substantially in excess of what they would earn in a competitive market.” *Id.* at 157. Substantial evidence indicates that rates have nearly universally increased under pricing flexibility, particularly in areas controlled by AT&T. For example, as of 2004, SBC’s tariffed long term, 5 year rates for channel terminations in the “most competitive” zone 1 were more than

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<sup>16</sup> *See id.* at 157 (“[I]n a competitive market with the demand for special access service growing, as characterized by the growth in special access revenue, this should result in the rates actually falling. The fact that no rates have declined and that many have increased is further evidence that the price cap LECs are exercising market power and that the market for special access service is not competitive.”).

11% higher in areas where it has been granted pricing flexibility.<sup>17</sup> PacBell's 36 month 10 mile DS3 price cap rate dropped 15% from July 2001 to 2005, while the rates in pricing flexibility areas have remained the same over that period.<sup>18</sup> The fact that ILECs' mileage rates for transport bear no relation to the costs of deployment demonstrates that ILECs are exercising their market power. For example, in Texas, on a one year contract, a single DS3 circuit costs \$90 per mile, a three DS3 circuit costs \$270 per mile, a six DS3 circuit costs \$540 per mile and a twelve DS3 circuit costs \$1,080 per mile.<sup>19</sup> Yet, the capacity of a circuit has little to do with the costs of extending a circuit for a longer distance.<sup>20</sup>

The RBOCs often argue that these tariffed rates are irrelevant because the availability of volume and term discount plans permits most competitors to purchase special access services at reasonable rates. However, many carriers, such as Covad and BayRing, have indicated that they are too small to qualify for these discounts,<sup>21</sup> making them unavailable to a whole class of carriers.

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<sup>17</sup> See Reply Declaration of Michael Pelcovits and Chris Frentrup ¶ 19, attached to Letter of Thomas Cohen, Principal, KDW Group, to Marlene H. Dortch, Secretary, FCC, WC Dkt. Nos. 04-313 *et al.* (Oct. 19, 2004).

<sup>18</sup> Letter from Teresa D. Baer, Global Crossing North America, Inc., to Marlene H. Dortch, Secretary, FCC, WC Dkt. Nos. 05-65, 05-75 at 15 (June 2, 2005).

<sup>19</sup> See SWBT Tariff FCC No. 73 § 20.5.4(M). Other states and zones in SBC's region have comparable rates.

<sup>20</sup> As the RBOCs note, when carriers build fiber routes, they typically add additional strands that can be lit to easily increase capacity. See *TRO* ¶ 312. The marginal cost of adding an additional fiber strand when the route is first constructed is minimal. *Id.*

<sup>21</sup> Covad Reply Comments, WC Dkt. Nos. 04-313 *et al.*, at 34 (Oct. 19, 2004); Declaration of Steven A. Wengert on behalf of BayRing ¶ 16, attached to Comments of ATX *et al.*, WC Dkt. Nos. 04-313 *et al.* (Oct. 4, 2004) ("BayRing does not use special access circuits more widely because the pricing makes them uneconomic except as a short-term transition device."); *see also*

For those carriers such as TWTC that are able to take advantage of these contracts, they represent a Faustian bargain: competitors are usually able to obtain a lower price, but must submit to onerous terms and conditions. For example, AT&T<sup>22</sup> conditions its volume and term contracts on the customer agreeing to (1) eliminate its purchases from a competitive carrier wholesaler;<sup>23</sup> (2) pay special fees where a purchaser seeks to move circuits from the incumbent to a CLEC;<sup>24</sup> (3) only transfer an apparently artificially limited number of circuits to competitors per day.<sup>25</sup> Competitors would never agree to such conditions in a competitive special access

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Declaration of Richard Batelaan on behalf of Cbeyond Communications LLC ¶ 8, attached to Comments of ALTS *et al.*, WC Dkt. Nos. 04-313 *et al.* (Oct. 4, 2004).

<sup>22</sup> As discussed in more detail in Section V below, the terms of BellSouth's volume/term offerings are, in certain respects, less onerous than AT&T's. This is unsurprising given that BellSouth's footprint is smaller than AT&T's.

<sup>23</sup> See CompTel/ALTS, Global Crossing North America, Inc., and NuVox Communications Comments, WC Dkt. No. 05-25, at 18 (June 13, 2005) (noting that SBC Tariff No. 15 "requires that a 'minimum of 4% of [the annual commitment] must come from services previously provided by a carrier other than Southwestern Bell Telephone Company and its affiliates.' Failure to document this 4% minimum transfer of service will require customers to suffer the full termination penalty under the tariff – repayment of all discounts given plus 25% of the committed revenue for each remaining year.").

<sup>24</sup> For example, as WilTel notes, "In PacBell territory, for example, the one time charge for moving a circuit from PacBell to another carrier can be almost \$5,000 per circuit." Initial Comments of WilTel Communications, WC Dkt. No. 05-25, at 15 (June 13, 2005) ("*WilTel Comments*"); see also Comments of Sprint Corp., WC Dkt. No. 05-25, at n.10 (June 13, 2005) ("*Sprint Comments*") ("Verizon, for example, has a \$380.00 'Coordinated Retermination' nonrecurring charge per channel termination (*see* Tariff No. 1, Section 7.5.9(a)(1)). In contrast, its installation NRC for many services that Sprint purchases is only \$1.00 per channel termination (*see, e.g.,* Tariff 1, Section 7.4.1(c)(1)).").

<sup>25</sup> "For an IXC to move 100 circuits off SBC's and onto a competing network, for example, SBC would allow a special access purchaser to groom only 8 circuits per day, resulting in at least a 13 day grooming process." WilTel Comments at 15; Comments of Broadwing Comm., LLC, and SAVVIS Comm. Corp., WC Dkt. No. 05-25, at 25 (June 13, 2005) ("*Broadwing Comments*") ("[M]any of the ILECs have placed arbitrary limitations on the number of circuit migrations they will perform."); Sprint Comments at 6 ("[S]ome RBOCs limit the quantities of circuits that can be migrated per night or by type of service.").

market. In addition, volume and term contracts often do not ever prevent ILECs from raising special access rates during the term of the contract, because the contract prices are generally pegged to a percentage discount off of the tariff rate. The tariff rate can be increased unless the Commission prevents such an increase.

**D. The Proposed Merger Would Harm Special Access Competition By Eliminating An Actual Competitor In Some Locations And Potential Competitors In Other Locations.**

The proposed merger would eliminate AT&T as a significant actual and potential competitor in the BellSouth region, and it would eliminate BellSouth as a potential competitor in the AT&T ILEC region. As ILECs with adjacent territories, these companies have special advantages over other types of competitors and their elimination as actual (in the case of AT&T) and potential competitors would result in an especially serious harm to consumer welfare.

AT&T currently competes in the special access market in the BellSouth territory. *See Public Interest Statement* at 55-56. The application indicates that AT&T has local fiber networks in 11 BellSouth MSAs with approximately 330 buildings served by both AT&T and BellSouth, most of which are concentrated in the Atlanta and Miami/Fort Lauderdale MSAs. *See id.* at 55.

Furthermore, the loss of AT&T as a potential competitor in the special access market in the BellSouth territory is highly significant. The legacy AT&T's aggressive competitive posture prior to the SBC merger included its expansion wherever possible into new geographic markets. After its merger with SBC, AT&T poses an even greater threat to BellSouth as a potential competitor. AT&T and SBC stated that their decision to merge was motivated largely by their

desire to compete aggressively out-of-region.<sup>26</sup> As SBC and AT&T stated at the time, “If the combined company were to redirect its focus to SBC’s region and serve only a portion of these customers’ locations – which it can already do today – it could expect to lose these customers to the multitude of competitors, including traditional IXCs, new long distance network operators, CLECs, and system integrators, among others. The opponents’ suggestion that SBC will spend \$16 billion simply to continue to operate as it does today is fanciful and inconsistent with simple economics.” AT&T/SBC Reply to Opposition at 134. The claimed efficiencies of the SBC-AT&T merger would seem to support the conclusion that AT&T would be at least as aggressive in this regard after the SBC merger as before, and, in fact, the FCC relied on the new AT&T’s promise to develop competition out-of-region in approving its merger.<sup>27</sup>

As the largest telecommunications company in the nation with ILEC territories adjacent to BellSouth, AT&T is the competitor that is best-positioned (or one of the two best-positioned along with Verizon) to overcome the substantial entry barriers associated with deploying local transmission facilities in the BellSouth region. AT&T can take advantage of its enormous scale and scope economies to extend its existing local transmission facilities in the BellSouth region. AT&T also is almost uniquely positioned to win business customers in the BellSouth territory because of the combination of its (1) significant existing network assets in that territory, (2) position as an ILEC in a contiguous region, (3) community of interest among businesses with multiple locations throughout the BellSouth and the legacy SBC regions, and (4) unmatched

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<sup>26</sup> AT&T/SBC Reply to Opposition at 134-38.

<sup>27</sup> See *SBC/AT&T Order* ¶ 206, see also Statement of Commissioner Jonathan S. Adelstein, *SBC/AT&T Order* at 143 (“We also state our expectation for vigorous out-of-region competition by the Applicants. Unfortunately, the record on meeting past commitments on out-of-region competition is not what it could be. So, it is imperative that this Commission commit to monitor and vigorously enforce the terms of these merger orders.”).

brand name and reputation for providing high quality business services. Moreover, BellSouth shares many of these advantages as a potential entrant into the AT&T ILEC region.

In its analysis of previous RBOC mergers, the Commission has cited the advantages that adjacent ILECs have as potential competitors: sufficient capital, existing resources in an adjacent territory, the ability to acquire a critical mass of customers, and brand name recognition in the relevant market.<sup>28</sup> All of these have led the Commission to conclude that the loss of an adjacent ILEC competitor poses a uniquely significant harm to competition. *Bell Atlantic/GTE Order* ¶ 122; *SBC/Ameritech Order* ¶ 99; *NYNEX/Bell Atlantic Order* ¶ 100. For example, the Commission has recognized that brand name assets are particularly costly and time-consuming to duplicate. *NYNEX/Bell Atlantic Order* ¶ 107. Moreover, the Commission has previously held that ILECs possess special advantages in entering out-of-region markets because of, among other things, “their intimate knowledge of local telephone operations.” *SBC/Ameritech Order* ¶ 84; *see also Bell Atlantic/GTE Order* ¶ 107; *NYNEX/Bell Atlantic Order* ¶ 107. Accordingly, the FCC found the elimination of a large, well-financed contiguous ILEC as an actual and potential competitor in the local market (a market, like the special access market, characterized by high entry barriers and high concentration) resulted in very substantial harms to consumer welfare and

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<sup>28</sup> *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 a Submarine Cable Landing License*, Memorandum Opinion and Order, 15 FCC Rcd 14032, ¶¶ 106-108 (2000) (“*Bell Atlantic/GTE Order*”); *Applications of Ameritech Corp. and SBC Comm. Inc. 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*, Memorandum Opinion and Order, 14 FCC Rcd 14712, ¶ 74 (1999) (“*SBC/Ameritech Order*”); *Applications of NYNEX Corp. and Bell Atlantic Corp. For Consent to Transfer Control of NYNEX Corp. and Its Subsidiaries*, Memorandum Opinion and Order, 12 FCC Rcd 19985, ¶¶ 62, 84, 88, 93 (1997) (“*NYNEX/Bell Atlantic Order*”).

the deregulatory goals of the 1996 Act. *Bell-Atlantic/GTE Order* ¶ 122; *SBC/Ameritech Order* ¶ 99; *NYNEX/Bell Atlantic Order* ¶ 100.

The instant merger poses the same threat in the special access market. However, a full examination of the scope of that harm cannot be conducted without access to further information regarding AT&T's and BellSouth's business plans to compete in each other's ILEC territories, information regarding BellSouth's and the AT&T ILEC's pricing decisions for special access and the extent to which firms other than AT&T have deployed facilities in the BellSouth territory. The Commission must acquire this information from the Applicants so that interested parties can conduct an appropriate analysis. But even without this information, it is clear that the market concentration levels for special access will increase in all of the buildings and along all of the transport routes in which AT&T has deployed facilities in the BellSouth territory, and the threat of AT&T's network expansion will be eliminated in areas that are near its existing network assets in the BellSouth territory. Eliminating AT&T will enhance the merged firm's ability to increase prices across entire MSAs, and it will deprive end user business customers and potential wholesale customers of AT&T the benefits of its future investment and innovation.

Furthermore, the discussions in Sections IV and V below shows that changes in business customer demand patterns along with merger-specific effects make it unlikely that any entrant will replace AT&T's local transmission facilities in the BellSouth region. As explained below, the need to provide IP service offerings to all or most of a business customer's locations is making competitors more reliant on ILEC transmission facilities. Even if it is possible for a competitor to construct loops to one or more of a business customer's locations, the competitor will need to obtain ILEC loops to serve the remaining locations. Without access to ILEC inputs, competitors are increasingly unlikely to be able to serve the customer at all and are therefore less

likely to construct facilities even to the largest of the customer's locations. Moreover, the increased incentive of the merged entity to exploit this growing competitor dependence on ILEC inputs combined with regulators' diminished ability to regulate ILECs caused by the merger (both of which are explained below), mean that the merger will reduce the availability of ILEC inputs. The result is likely to be fewer opportunities for competitors to deploy loops to businesses in the BellSouth (or AT&T ILEC) region.

Amazingly, the Applicants conclude that no remedy is warranted to address the harms caused by the merger to the special access market. In support of this conclusion, the Applicants conducted a building-level analysis of special access in the BellSouth territory. They concluded that a total of 70 buildings meet the standard for divestiture used by the DOJ in the Bell-IXC merger orders for determining whether sufficient competition existed. *Public Interest Statement*, Carlton/Sider Decl. ¶¶ 109-112. With a wave of the hand, the Applicants then state that 70 is too small a number of buildings to warrant a remedy.

There is currently inadequate information on the record to determine if any remedy short of blocking the merger could adequately address the harms it would cause to the special access market. Moreover, when considered along with other serious harms discussed in subsequent Sections, it is not clear that any conditions could make this merger comport with the public interest. In all events, however, it is certain that the Commission must reject the framework proposed by the Applicants for identifying harms to consumer welfare in the special access market. *First*, in conducting their analysis of harms to the special access market, the Applicants assumed that only merger to monopoly in a building would harm consumer welfare enough to raise concerns. This is clearly contrary to sound policy.

At the very least, the Applicants' approach fails to account for the harmful effects of merger to duopoly. Coordinated effects will be exacerbated when there are particularly high barriers to entry and when no other competitor exists to take on the role of a "maverick."<sup>29</sup> The FCC has concluded that a merger that results in a duopoly is contrary to the public interest.<sup>30</sup> Courts have also generally condemned mergers that result in duopoly. In *FTC v. H.J. Heinz Co.*, for example, the D.C. Circuit rejected the district court's finding that the merger of the second and third largest firms in a three-firm baby-food market would increase the ability of the merged firm to compete with the number one firm.<sup>31</sup> Noting the district court's finding that "there had been no significant entries in the baby-food market in decades and that new entry was 'difficult and improbable,'" the court of appeals stated that "[a]s far as we can determine, no court has ever approved a merger to duopoly under similar circumstances." 246 F.3d at 717.

The Commission has imposed structural remedies where more than two competitors remained in the market post-merger.<sup>32</sup> In its review of the Cingular-AT&T WS merger, the Commission concluded that, where the merged entity's market share was too high, even four

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<sup>29</sup> *Merger Guidelines* § 2.12. ("In some circumstances, coordinated interaction can be effectively prevented or limited by maverick firms – firms that have a greater economic incentive to deviate from the terms of coordination than do most of their rivals (e.g., firms that are unusually disruptive and competitive influences in the market).")

<sup>30</sup> *Applications of EchoStar Comm. Corp., General Motors Corp., and Hughes Electronics Corp. and EchoStar Comm. Corp.*, Hearing Designation Order, 17 FCC Rcd 20559, ¶¶ 103, 275-276 (2002) ("*Echostar/DirectTV Order*").

<sup>31</sup> *FTC v. H.J. Heinz Co.*, 246 F.3d 708 (D.C. Cir. 2001).

<sup>32</sup> *Applications of AT&T Wireless Services, Inc. and Cingular Wireless Corp. for Consent to Transfer Control of Licenses and Authorizations et al.*, Memorandum Opinion & Order, 19 FCC Rcd 21522, ¶ 193 (2004).

competitors post-merger would be insufficient to discipline the new entity's prices.<sup>33</sup> The Commission can only conclude the same of the special access market in the BellSouth territory.

Moreover, the Applicants' discussion of the purported benefits of the merger in the market for video services implicitly illustrates the harm of mergers that reduce the number of competitors in the market from four to three. Applicants argue strenuously that the merged firm's entry into the video services market as the fourth competitor would result in substantial consumer gains.<sup>34</sup> At the very least, Applicants clearly imply that the *elimination* of AT&T as the fourth special access competitor in any particular location would harm consumer welfare.

In fact, the only appropriate market concentration test would be one that hews closely to the DOJ's Horizontal Merger Guidelines. Those guidelines require close examination of increases in market concentration where, as here, entry barriers are high, elasticity of supply is low, and the competitor that would be eliminated by the merger is a substantial competitor in the

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<sup>33</sup> *Id.* ¶¶ 191-195 & n.473; *see also* Separate Statement of Commissioner Michael J. Copps (stating “[i]n one market, for example, the merged entity’s post-transaction market share would be close to 60 percent. Other substantial national carriers compete in this market; one with 18 percent, a second with 17 percent, and a third with 4 percent. In this market, despite the presence of competing carriers, the order concludes that competitors would not be able to discipline the merged entity’s behavior.”).

<sup>34</sup> *Public Interest Statement* at 25-28. Applicants argue that its entry into the video programming market will “help check the incumbent cable provider’s market power with respect to video programming. Because competition introduces greater discipline into the market generally, the presence of a new competitor should improve the bargaining power of new, smaller and regional programmers that are not affiliated with an MVPD, in their negotiations with the large national MVPDs.” *Id.* at 27. The FCC has previously determined that three competitors currently exist in the video services market, with satellite providers capturing an unprecedented over 28 percent of that market. *See Echostar/DirecTV Order* ¶ 119 (defining the geographic market for video programming services to be the local franchise area, because “customers within that franchise area have the choice between the incumbent franchised cable company and the two DBS providers”).

market.<sup>35</sup> Where these factors are present, the Department's guidelines regard a market with a post-merger Herfindahl-Hirschman Index ("HHI") of 1800 or above to be highly concentrated.<sup>36</sup> Mergers that yield HHI levels in excess of 1800 are presumed to result in harm to consumer welfare.

In light of this standard, it is clear that the proposed merger would harm consumer welfare in any geographic area in which there would be fewer than four competitors and the ILEC providing facilities-based special access post-merger. In other words, in a five-firm market where each supplier has a 20 percent market share (a conservative working assumption in this case),<sup>37</sup> the HHI would be 2000. This level falls only slightly above the Department's 1800 cut-off and is therefore probably adequate. Moreover, game theory teaches that the probability of anticompetitive coordinated interaction by up to four competitors is high.<sup>38</sup> By contrast, the probability of this anticompetitive behavior drops to 22 percent with the addition of a fifth competitor in the market. *See Spectrum Cap Order* ¶ 30. The difference between four and five competitors is therefore very significant.

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<sup>35</sup> *Merger Guidelines* § 1.52.

<sup>36</sup> *Id.* § 1.5.

<sup>37</sup> In most cases, it is obviously unlikely that actual market share will be equal, since the ILECs control overwhelming market share in every relevant category of service. But where alternative sources of supply have actually been deployed in the market, available capacity is the most appropriate indicator of a firm's future competitive significance. *See Motion of AT&T Corp. to be Reclassified as a Non-Dominant Carrier*, Order, 11 FCC Rcd 3271 (1995) (relying on alternative sources of supply, rather than market share); *Merger Guidelines* § 1.41 (stating that "[m]arket shares [should] be calculated using the best indicator of firms' future competitive significance").

<sup>38</sup> *See 1998 Biennial Regulatory Review Spectrum Aggregation Limits for Wireless Telecommunications Carriers*, Report and Order, 15 FCC Rcd 9219, ¶ 30 (1999) ("*Spectrum Cap Order*") (citing Reinhard Selten, *A Simple Model of Imperfect Competition, Where 4 Are Few And 6 Are Many*, Int'l J. of Game Theory, at 141-201 (1973)).

*Second*, the Applicants wrongly suggest that the availability of transport near buildings with sufficient demand for telecommunications services serves as a rational proxy for special access competition in particular building locations. This is the same tired argument that the ILECs have repeatedly made and that the Commission has repeatedly rejected. In fact, Commission precedent demonstrates that the availability of transport is a necessary but not sufficient precondition for serving a building. This is particularly true with regard to customers demanding DS1 or a single DS3 level of service who are located in a same building as larger consumers of telecommunications services. In the *TRRO*, the FCC concluded that it is not even possible for competitors to deploy DS1 and individual DS3 loops to buildings located in wire centers in which competitors have deployed their own transport facilities. *TRRO* ¶¶ 171-173. This is true regardless of whether the customer demanding DS1 or individual DS3 service is located in a building with significant overall telecommunications demand. Indeed, the elimination of AT&T as a potential source of connectivity from its transport network to a building with large demand for telecommunications services must, under this analysis, be considered a significant merger-specific harm.

But even if a competitor could be assumed to be able to serve a building with sufficient telecommunications services demand that is located close to the competitor's transport network, the existence of one such competitor after the merger is clearly insufficient to protect consumers. The Commission must at least ensure that there is adequate potential supply by applying the HHI-based market concentration test above and insisting on the presence of four competitors in addition to the merged firm.

In all events, as discussed, the Commission must be careful to assess the broader implications of the elimination of AT&T as an independent competitor in the provision of

special access in the BellSouth territory and also the elimination of BellSouth as a potential competitor in the AT&T ILEC region. Exclusive focus on the specific buildings in which AT&T has actually deployed local transmission facilities will cause the Commission to lose sight of critically important merger consequences of the elimination of AT&T as an actual and AT&T and BellSouth as potential competitors throughout MSAs and across entire ILEC regions.

**III. THE PROPOSED MERGER POSES A SIGNIFICANT THREAT TO COMPETITION IN THE MARKET FOR INTERNET BACKBONE SERVICES.**

Although the Commission concluded in the Orders approving the *SBC/AT&T* and *Verizon/MCI* mergers that the Internet backbone market is “sufficiently competitive,” (*SBC/AT&T Order* ¶ 132; *Verizon/MCI Order* ¶ 133) there is a risk that AT&T’s proposed acquisition of BellSouth will cause that market to become substantially more concentrated. Such an increase in concentration threatens to tip the market into one in which the merged firm acquires the incentive and ability to refuse to peer, increase prices and/or degrade the quality of its interconnections with rival networks.

If this were to occur, TWTC is one of the entities most likely to suffer harm. TWTC provides broadband Internet access and IP voice services transmitted over its own Internet backbone and other interconnected Internet backbones to business customers in each of the 44 metropolitan areas that it serves. TWTC’s customer base is comprised of two relevant types of customers: businesses that demand bandwidth-intensive connectivity and IP voice services and ISPs that purchase wholesale local transmission to connect to Internet backbone provider points of presence (“POPs”). Continual and redundant access to Internet backbone transmission is a critical input for providing these services. Consequently, it is imperative that TWTC has a sufficient number of peering agreements in place to guarantee that its customers can access the full panoply of content, services, and applications that the Internet has to offer. As discussed

below, the terms of these peering agreements could change dramatically if the Commission approves the proposed merger.

**A. Backbone Services Constitute A Separate Relevant Product Market.**

On numerous previous occasions, the Commission has determined that Internet backbone services comprise a separate product market. *See, e.g., SBC/AT&T Order* ¶ 112; *Verizon/MCI Order* ¶ 113; *MCI/WorldCom Order* ¶ 148. In reaching this conclusion, the Commission explained that three classes of entities participate in transmitting information across the Internet: end users that originate and receive IP packet traffic; ISPs that transport packets short distances between end users and the Internet network node in closest proximity; and Internet backbone providers that use high-capacity pipes to retrieve packets from ISPs and transmit them for last mile delivery to end users by an ISP.<sup>39</sup> According to the Commission, no substitutes exist for so-called “Tier 1” connectivity services. *See SBC/AT&T Order* ¶ 112; *Verizon/MCI Order* ¶ 113. The Commission has found on at least two occasions, and the Department of Justice on at least three, that concentration in the Tier 1 Internet backbone market would be seriously detrimental to consumers and the public interest.<sup>40</sup>

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<sup>39</sup> *See Application of WorldCom, Inc. and MCI Comm. Corp. for Transfer of Control of MCI Comm. Corp. to WorldCom, Inc.*, Memorandum Opinion and Order, 13 FCC Rcd 18025, ¶¶ 143-44 (1998) (“*MCI/WorldCom Order*”).

<sup>40</sup> *See, e.g., Intermedia Comm., Inc., Transferor, and WorldCom, Inc., Transferee, for Consent to Transfer Control of Corporations Holding Commission Licenses and Authorizations Pursuant to Sections 214 and 310(d) of the Communications Act and Parts 21, 63, 90, and 101*, Memorandum Opinion and Order, 16 FCC Rcd 1017 (2001); *United States v. WorldCom, Inc. and Intermedia Communications, Inc.*, Case No. 1:00CV02789, Competitive Impact Statement, at 9-10 (D.D.C. filed Dec. 21, 2000) (“*DOJ Intermedia Competitive Impact Statement*”) (observing that “WorldCom’s wholly owned subsidiary, UUNET, is by far the largest Tier 1 IBP ... and is already approaching a dominant position in the Internet backbone market.... Given UUNET’s current position in the IBP market, a significant increase in UUNET’s size relative to other IBPs would create an unacceptable risk of anticompetitive behavior.”), *available at*

**B. The FCC Must Carefully Assess The Extent To Which The Proposed AT&T/BellSouth Merger Would Create Merger-Specific Internet Peering Harms.**

The proposed merger threatens to cause the Internet backbone services market to become dominated by one or more “mega-peers,” a classification likely to include AT&T/BellSouth. These mega-peers could well be positioned to exploit their growing market power and take anticompetitive actions against smaller Internet backbone and transit providers. As explained in the Commission’s *SBC/AT&T* and *Verizon/MCI Orders*, there are six to eight *similarly-sized* Tier 1 Internet backbone providers.<sup>41</sup> These providers reciprocally engage in settlement-free peering and compete for customers. The current level of competition enables end users to receive low-cost and high-quality access to the Internet without government intervention.

As the DOJ has acknowledged, if Internet backbone providers remain relatively equivalent in size, they will retain adequate incentives to peer with other backbone providers.<sup>42</sup> Universal connectivity for consumers at low costs will result. However, the economic incentive to continue to engage in this behavior would disappear once a small number of backbone

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<http://www.usdoj.gov/atr/cases/f7100/7183.pdf>; *United States v. WorldCom, Inc. and Sprint Corp.*, Compl. ¶ 35 (D.D.C. filed June 26, 2000) (noting that “the combined entity (‘UUNET/Sprint’) will have the incentive and ability to impair the ability of its rivals. As a result of the merger, UUNET/Sprint’s rivals will become increasingly dependent upon being connected to the combined entity and the combined entity will exploit that advantage. Such behavior will likely enhance the combined market power of the firm and ultimately facilitate a ‘tipping’ of the Internet backbone market that will result in a monopoly.”) (“*DOJ Sprint Compl.*”), available at <http://www.usdoj.gov/atr/cases/f5000/5051.pdf>.

<sup>41</sup> *SBC/AT&T Order* ¶ 115 (emphasis added); *Verizon/MCI Order* ¶ 116 (emphasis added).

<sup>42</sup> *DOJ Sprint Compl.* ¶ 34 (explaining that “[t]wo networks will have incentives to enter into peering arrangements when, for each, the cost of terminating the other’s traffic is roughly comparable to the benefit of having its own traffic terminated by the other.... As long as there are a sufficient number of large IBPs of roughly comparable size, there exist sufficient incentives for these IBPs to peer privately with each other at the necessary capacity levels.”).

providers become significantly larger than the others or develop a superior negotiating position.<sup>43</sup> These providers could refuse outright to accept terminating and transiting traffic, make onerous demands for “paid for” peering or transit (even from other Tier 1 peers), or degrade the quality of service they provide to other backbone providers. In all of these cases, the victims’ customers would quickly defect to other providers of backbone Internet services (likely to the small number of larger backbones).

In the *DOJ Intermedia Competitive Impact Statement*, the Department of Justice stated that an entity possessing a 37 percent market share (measured by Internet traffic carried by all backbone providers) should not be permitted to meaningfully increase its market share through a merger.<sup>44</sup> Thus, according to the Department of Justice, an entity with this market share would possess enough power to tip the Internet backbone market. Unfortunately, neither the Department of Justice nor the Commission to date has clarified whether this figure presents the ceiling level of acceptable market concentration. In other words, it is possible that an entity with a market share of less than 37 percent could tip a market towards dominance by a small number of mega-peers.

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<sup>43</sup> The FCC and DOJ have generally contemplated three ways of measuring backbone market shares: revenue, end-user connections (or “eyeballs”) and traffic balances. *See, e.g., SBC/AT&T Order* ¶ 122; *Verizon/MCI Order* ¶ 123.

<sup>44</sup> *DOJ Intermedia Competitive Impact Statement* at 9-10 (noting that “UUNET’s share of all Internet traffic sent to or received from the customers of the 15 largest Internet backbones in the United States was about 37%, more than twice the share of the next-largest Tier 1 IBP.... Given UUNET’s current position in the IBP market, a significant increase in UUNET’s size relative to other IBPs would create an unacceptable risk of anticompetitive behavior.”).

The merger contemplated here pushes AT&T closer to the 37 percent tipping point and augments its bargaining power.<sup>45</sup> To determine the combined AT&T/BellSouth's market power, the Commission must obtain measurements from the Applicants detailing AT&T's and BellSouth's actual shares of Internet traffic carried on their respective backbones pre-merger and their estimates of traffic carriage post-merger.<sup>46</sup> AT&T and BellSouth must also provide data relating their pre-merger and post-merger backbone revenue projections. Finally, the FCC must obtain information about the amount of BellSouth traffic that will be moved post-merger to the AT&T backbone from other Internet backbones with which BellSouth currently has peering agreements; simple addition of AT&T's and BellSouth's respective market shares might exclude this traffic and provide a distorted view of the combined entity's market power. Obtaining this data will enable the Commission to discern how dramatically AT&T/BellSouth's incentives to engage in anticompetitive behavior in the Internet backbone services market will increase post-transaction.

It is likely that TWTC's Internet backbone operations will be adversely affected by increased de-peering, resulting in higher transit costs if the proposed transaction were allowed to take effect. **[proprietary begin]**

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<sup>45</sup> The FCC already found that the combined AT&T/SBC would have a combined market share, based on backbone revenues, among Tier 1 backbone providers of 40 percent after the AT&T/SBC merger. *See SBC/AT&T Order* ¶ 135. These percentages will likely rise post-transaction.

<sup>46</sup> AT&T and SBC provided information concerning their Internet traffic shares in the materials supporting their merger application. *See AT&T/SBC Public Interest Statement*, Dkt. No. 05-65, Declaration of Marius Schwartz, at 10, Table 2 (Feb. 22, 2005). To date, Applicants in the instant proceeding have not provided similar information.

<sup>47</sup> **[proprietary end]** The Commission must examine the instant transaction closely to ensure that the addition of BellSouth's traffic to the AT&T backbone does not result in further damage to the market.

**C. The Instant Transaction Is Different From The AT&T/SBC And Verizon/MCI Transactions And Requires Different Treatment By The Commission.**

The Applicants argue that their merger will not create a dominant Tier 1 backbone provider and, therefore, that the Commission should take no action in this proceeding to protect the Internet backbone services market. *See Public Interest Statement* at 98-99. The Applicants' arguments are grounded in the fact that the Commission declined to take any ameliorative action

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regarding the Internet backbone market in its recent Orders approving the SBC/AT&T and Verizon/MCI transactions. *See id.* There, the Commission found that the mergers did not eliminate a Tier 1 competitor and that the continued presence of other Tier 1 Internet backbone providers would prevent the merged entity from being able to de-peer larger rivals.<sup>48</sup> While BellSouth is not a Tier 1 Internet backbone provider, the Applicants admit that the instant transaction will give the combined AT&T/BellSouth control of almost 23 percent of the nation's total residential and small business broadband lines (eyeballs).<sup>49</sup> Importantly, however, AT&T and BellSouth do not provide a figure for the unknown and presumably substantial percentage of the total medium and large business lines that they will control post-transaction. This information is crucial to determine the potential public interest harms of the transaction, and the Commission should therefore demand that the Applicants provide such information.

One of the Applicants' claimed efficiencies from the transaction is the ability to move all of BellSouth's Internet traffic on to AT&T's backbone. Once the BellSouth Internet traffic is completely migrated to AT&T's Internet backbone, AT&T's need to peer with other backbone providers will diminish and its bargaining power with respect to other backbone providers will again increase further. In addition, if any significant portion of AT&T/BellSouth's voice traffic is converted to VoIP traffic, its share of the Internet market could potentially increase dramatically as that VoIP traffic is retained on-net. As a result, the merged AT&T/BellSouth could be positioned to deal with every other backbone provider, including current Tier 1 peers, as transit customers. TWTC's experience discussed above provides ample reason for the

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<sup>48</sup> *SBC/AT&T Order* ¶¶ 127-132; *Verizon/MCI Order* ¶¶ 127-134.

<sup>49</sup> *See Public Interest Statement* at 103.

Commission to be concerned, to seek more information from the Applicants regarding the effect of the SBC merger and the likely consequences of placing the BellSouth traffic on the AT&T backbone.

Finally, it is worth noting that, even as the Commission declined to impose specific Internet backbone conditions on the AT&T/SBC and Verizon/MCI mergers, it appeared to express reservations about the potential for anticompetitive abuses of the Internet backbone market. The Commission admitted that it took “comfort” in the merging firms’ commitments to post their peering policies on their websites, maintain equivalent number of settlement-free peering agreements post-merger, and abide by the principles in the Commission’s broadband Internet access policy statement.<sup>50</sup> Unfortunately, it is the very principles in the Commission’s policy statement that are threatened here – specifically, consumers’ abilities to “access the lawful Internet content of their choice” and to experience “competition among network providers.”<sup>51</sup>

**IV. THE INCREASE IN THE MERGED ENTITY’S LOCAL MARKET WOULD INCREASE ITS INCENTIVES TO DENY, DELAY AND DEGRADE COMPETITORS’ ACCESS TO INPUTS NEEDED TO SERVE THE BUSINESS MARKET.**

Perhaps the most serious harm caused by the proposed merger is that combining the incumbent local operations of AT&T and BellSouth would give the merged entity a greater

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<sup>50</sup> See *SBC/AT&T Order* at Appendix F; *Verizon/MCI Order* ¶ 24 and Appendix G.

<sup>51</sup> *In re Appropriate Framework for Broadband Access to the Internet over Wireline Facilities; Review of Regulatory Requirements for Incumbent LEC Broadband Telecommunications Services, Computer III Further Remand Proceedings: Bell Operating Company Provision of Enhanced Services; 1998 Biennial Regulatory Review – Review of Computer III and ONA Safeguards and Requirements; Inquiry Concerning High-Speed Access to the Internet Over Cable and Other Facilities; Internet Over Cable Declaratory Ruling; Appropriate Regulatory Treatment for Broadband Access to the Internet Over Cable Facilities*, Policy Statement, 20 FCC Rcd 14986, ¶ 4 (2005).

incentive to overprice, deny, delay or degrade competitors' access to needed inputs than is the case with either AT&T or BellSouth today. The Commission has already held that ILEC mergers result in such harms.<sup>52</sup> Moreover, despite the Applicants' assertions to the contrary, the proposed merger will result in even greater harms than was the case in the SBC-Ameritech and Bell Atlantic-GTE mergers since the combination of BellSouth and AT&T would result in a combined ILEC footprint that is far larger than the footprint created by the previous BOC mergers. As explained below, the instant merger would have serious anticompetitive effects with respect to interconnection, exchange of IP voice traffic and access to local transmission facilities needed to serve the business market.

**A. AT&T And BellSouth Have The Incentive And Opportunity To Overprice, Deny, Delay And Degrade Competitors' Access To Inputs Needed To Compete In The Business Market.**

AT&T and BellSouth control interconnection and local transmission services needed to provide downstream business services (among other services). The ILECs can exploit their market power either by raising the price of or degrading the quality of necessary inputs needed by TWTC and other competitors to provide retail service to business customers. *See Bell Atlantic/GTE Order* ¶ 96. Because of the existence and threat of price regulation for certain transmission facilities<sup>53</sup> and for the exchange of circuit switched traffic,<sup>54</sup> non-price exclusionary

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<sup>52</sup> *See SBC/Ameritech Order* ¶ 186 (“We conclude that incumbent LECs, such as SBC and Ameritech, have the incentive and ability to discriminate against competitors in the provision of advanced services, interexchange services, and circuit-switched local exchange services, and that such incentive and ability will increase as a result of the merger. This increased incentive to discriminate will result in a public interest harm, because it will adversely affect national competitors’ provision of services in the new, combined region, and, as a further result, will harm consumers who ultimately will be forced to pay more for retail services, with reduced quality and choice.”); *Bell Atlantic/GTE Order* ¶ 173.

<sup>53</sup> Regulation is merely a threat in the special access market in most urban areas because, as early as 2004, “LEC pricing flexibility for channel terminations ha[d] been granted for more than 158

behavior is often a more attractive strategy for ILECs and is far more difficult to regulate and correct.

*First*, there is no question that AT&T and BellSouth presently have market power over inputs that TWTC and other competitors need in order to compete in the business market. As explained in Section II, both AT&T and BellSouth possess the only loops serving the vast majority of commercial buildings in their respective regions. Given the steep entry barriers associated with deploying local transmission facilities, competitors have few or no alternatives to leasing such facilities from the ILECs to serve end users in these commercial buildings. As also explained in Section II, the proposed elimination of AT&T as an actual and AT&T and BellSouth as potential competitors in the provision of special access, including loops, needed to serve the business market would only increase the merged company's market power within the merged ILEC's region.

The Applicants' only attempt to show that they lack market power over local transmission facilities is their claim that the Commission's recent *Wireline Broadband Order* shows that ILECs no longer maintain bottleneck control over the last mile facilities used to serve business customers. *See Public Interest Statement* at 117-18. But the *Wireline Broadband*

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MSAs while more than 186 MSAs ha[d] been granted pricing flexibility for transport (channel mileage)." *See Zimmerman* at 125.

<sup>54</sup> *See generally Access Charge Reform; Price Cap Performance Review for Local Exchange Carriers; Low-Volume Long-Distance Users; Federal-State Joint Board on Universal Service*, Sixth Report and Order in CC Dkt. Nos. 96-262 and 94-1, Report and Order in CC Dkt. No. 99-249, Eleventh Report and Order in CC Dkt. No. 96-45, 15 FCC Rcd 12962 (2000), *subsequent history omitted* (setting rates for the exchange of interstate traffic) ("*CALLS Order*"). States regulate the pricing of the exchange of local traffic in accordance with TELRIC. *See Implementation of the Local Competition Provisions in the Telecommunications Act of 1996*, First Report and Order, 11 FCC Rcd 15499, ¶ 1067 (1996), *subsequent history omitted* ("*Local Competition First Report and Order*").

*Order* does not support this conclusion.<sup>55</sup> In that order, the Commission eliminated the ILECs' duty to offer as Title II services the transmission inputs used to provide broadband Internet access service. The Commission relied exclusively on mass market competition as the basis for granting this relief. The Commission did not discuss the business market, in which, as explained, the ILECs maintain overwhelming dominance in the provision of local transmission facilities. In fact, the *Wireline Broadband Order* does not include even a *single reference* to "enterprise" or "business customer" services. Moreover, in the *Qwest Omaha Order*, released after the *Wireline Broadband Order*, the Commission held that Qwest remained dominant in the special access market despite what it believed was extensive deployment of broadband loops needed to serve the business market by Cox.<sup>56</sup> Of course, the Omaha market is anomalous. While cable operators, wireless and satellite service providers compete in the provision of various services demanded by mass market customers, they generally have not deployed local transmission facilities needed to serve the business market. In the *TRRO*, the latest instance where the FCC fully scrutinized intermodal competition in the business market, the Commission found that cable, wireless and satellite were not substitutes for wireline loops serving business customers. See *TRRO* ¶¶ 39, 193-194, n.508.

*Second*, AT&T and BellSouth both possess market power in the provision of interconnection and the exchange of traffic, both circuit switched and IP-based. The Applicants' market power over interconnection is a function of network effects. Network effects exist where

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<sup>55</sup> See *Appropriate Framework for Broadband Access to the Internet Over Wireline Facilities et al.*, Report and Order and Notice of Proposed Rulemaking, 20 FCC Rcd 14853 (2005) ("*Wireline Broadband Order*").

<sup>56</sup> See *Petition of Qwest for Forbearance Pursuant to Section 47 U.S.C. 160(c) in the Omaha Metropolitan Statistical Area*, Memorandum Opinion and Order, 20 FCC Rcd 19415, ¶ 50 (2005) ("*Qwest Omaha Order*").

the value of a network increases with the number of users that use the network.<sup>57</sup> AT&T and BellSouth continue to serve many more customers than any other competitor or than all competitors combined. *See RBOC Market Share Chart* attached as Appendix B. Because their networks serve many more customers than competitor networks in their regions, interconnection with the AT&T and BellSouth networks in their regions is far more valuable than interconnection with non-ILEC networks.

The Commission held at the time of the Bell Atlantic/GTE merger order that competitors had “little to offer the incumbent,” and that is still the case today.<sup>58</sup> The most recent statistics indicate that *all competitors combined* serve 34.1 million switched access lines or 19.1 percent of the total market while ILECs serve over 144 million switched access lines. Each individual competitor has a very small portion of even the 19.1 percent market share held by competitors collectively. This national data indicates that ILECs continue to have an 80 percent share of the access lines in an “average” local exchange market. Although some local markets may be more concentrated and some less so, the conclusion is inescapable that ILECs continue to dominate

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<sup>57</sup> *See Newton's Telecom Dictionary* 564 (CMP Books 20th ed. 2004).

<sup>58</sup> *See Bell Atlantic/GTE Order* ¶ 120 (“As the Commission found in earlier orders, incumbent LECs still dominate the market for local exchange and exchange access services sold to larger business customers in their regions and are therefore most significant market participants.”); *Local Competition First Report and Order* ¶ 141 (“As discussed [], the requirements in section 251 obligate incumbent LECs to provide interconnection to competitors that seek to reduce the incumbent’s subscribership and weaken the incumbent’s dominant position in the market. Generally, the new entrant has little to offer the incumbent. Thus, an incumbent LEC is likely to have scant, if any, economic incentive to reach agreement.”).

nearly every local exchange market.<sup>59</sup> It is clear therefore that TWTC has “little to offer the incumbent” when seeking to interconnect for the exchange of traffic.

AT&T’s and BellSouth’s market power over upstream inputs needed to compete in downstream markets gives those companies the incentive and ability pre-merger to deter new entry. As the Commission has explained,

Incumbent LECs in general have both the incentive and ability to discriminate against competitors in incumbent LECs’ retail markets. This observation is the fundamental postulate underlying modern U.S. telecommunications law. The divestiture of AT&T rested principally on this observation. Two key sections of the 1996 Act – sections 251 and 271 – rest entirely on this point. Incumbent LECs have an incentive to discriminate against rivals to gain the business that these rivals lose as a result of such discrimination. This incentive exists in all retail markets in which they participate. Incumbent LECs’ ability to discriminate against retail rivals stems from their monopoly control over key inputs that rivals need in order to offer retail services.

*SBC/Ameritech Order* ¶ 190. As the Commission has concluded, “an incumbent’s ability successfully to engage in non-price discrimination . . . is subtle and not readily detectable,” *Bell Atlantic/GTE Order* ¶ 202-204, and will be profitable for an ILEC so long as its gains in the downstream retail market exceed whatever revenues it foregoes from wholesale interconnection with rivals, *see SBC/Ameritech Order* ¶ 238; *Bell Atlantic/GTE Order* ¶ 201. Thus, the ability and incentive to discriminate, coupled with the difficulty to detect such discrimination, makes competitors especially vulnerable to discrimination by the ILECs.

The Applicants argue that this conclusion is no longer valid, because “sections 251 and 271 have been fully implemented,” and “local markets are fully and irreversibly open to competition.” *Public Interest Statement* at 122. This assertion wildly overstates the current or potential effectiveness of regulation. To begin with, the Commission has decided not to apply

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<sup>59</sup> To the extent that the Applicants argue that the ILECs’ national market share data do not reflect concentration in individual local markets, they are free to offer such information into the record.

the requirements of Sections 251 and the Section 271 checklist to the packetized local transmission services and traffic exchange arrangements needed by competitors to provide newly developing advanced services.<sup>60</sup> Full implementation of those provisions therefore hardly reduces the ILECs' opportunities to discriminate.

Indeed, there is considerable doubt as to whether the Commission will exercise its authority to apply any part of Title II (let alone Sections 251 and 271) to IP services such as VoIP and other applications.<sup>61</sup> Current regulation of ILEC price and non-price behavior is governed almost exclusively under Title II. If the Commission decides to exclude IP-enabled services from Title II, it is unlikely that the FCC would have authority under its ancillary jurisdiction to mandate, for example, interconnection for VoIP or other IP traffic.<sup>62</sup> Also unresolved are issues such as whether to distinguish between services based on whether they connect with the PSTN or utilize traditional NANPA-administered telephone numbers, whether and how to distinguish peer-to-peer IP-based services from other services, and whether to differentiate services based on the platform on which they are provided. *See IP-Enabled Services NPRM* ¶ 37.

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<sup>60</sup> *See TRO* ¶¶ 272-301 (eliminating unbundling for FTTH loops and the packetized functionality of hybrid loops). The FCC later included FTTC loops within this scope of relief. *See Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers et al.*, Order on Reconsideration, 19 FCC Rcd 15856 (2004). Nor are ILECs required to offer these elements as part of their Section 271 checklist obligations. *See Petition for Forbearance of the Verizon Telephone Companies Pursuant to 47 U.S.C. § 160(c) et al.*, Memorandum Opinion and Order, 19 FCC Rcd 21496 (2004).

<sup>61</sup> *See IP-Enabled Services*, Notice of Proposed Rulemaking, 19 FCC Rcd 4863, ¶ 35 (2004) (“*IP-Enabled Services NPRM*”).

<sup>62</sup> Time Warner Telecom explained the obstacles the FCC would face in employing its ancillary jurisdiction to regulate IP-enabled services. *See Comments of Time Warner Telecom*, WC Dkt. No. 04-36, at 34-36 (May 28, 2004).

In addition, local transmission facilities that utilize so-called packetized transmission technology are also subject to substantial regulatory uncertainty. As mentioned, the Commission has decided to eliminate the ILECs' duty to make the transmission inputs used to provide broadband Internet access service available as Title II offerings. *See Wireline Broadband Order* ¶ 98. In addition, the Commission recently allowed a Verizon petition for forbearance from all Title II regulation for many of Verizon's packetized transmission services to be granted by default.<sup>63</sup> The packetized local transmission facilities that have been deregulated in the Verizon region as a result of this petition include Ethernet loop facilities that, as discussed below, TWTC must purchase from ILECs in order to provide advanced services demanded by business customers. Soon after the default grant of the Verizon petition, AT&T announced that it would file a similar petition.<sup>64</sup> If such a petition were granted, AT&T's Ethernet and VPN loops would not be subject to rate regulation such as price caps<sup>65</sup> or service quality regulation such as performance metrics.<sup>66</sup>

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<sup>63</sup> *See* FCC News Release, Dkt. No. 04-440, Verizon Telephone Companies' Petition for Forbearance from Title II and Computer Inquiry Rules with Respect to Their Broadband Services Is Granted by Operation of Law (rel. Mar. 20, 2006).

<sup>64</sup> *See* Carol Wilson, *TELECOMNEXT: AT&T Seeking Broadband Relief*, Telephony Online (Mar. 21, 2006), available at [http://telephonyonline.com/broadband/news/att\\_broadband\\_relief\\_032106/](http://telephonyonline.com/broadband/news/att_broadband_relief_032106/).

<sup>65</sup> For example, in the *Wireline Broadband Order*, the FCC held that because it was removing Title II regulation from the broadband transmission used as an input for broadband internet access, ILECs would have to account for the change in their PCI because these services would no longer be subject to price caps. *See Wireline Broadband Order* ¶ 135.

<sup>66</sup> *Id.* *See, e.g.*, 47 U.S.C. § 272(e)(4) (requiring RBOCs to make facilities or services available to all carriers at the same rates, terms and conditions that they are made available to the RBOCs' interLATA affiliates).