

June 6, 2006

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JUN - 5 2006

Federal Communications Commission  
Office of Secretary

Ms. Marlene H. Dortch  
Secretary  
Federal Communications Commission  
445 Twelfth Street, S.W.  
Washington, D.C. 20554

Re: **CONFIDENTIAL INFORMATION - SUBJECT PROTECTIVE ORDER IN WC  
DOCKET NO. 06-74**, In re AT&T Inc. and BellSouth Corporation Applications for  
Approval of Transfer of Control, WC Docket No. 06-74

Dear Ms. Dortch:

Please find enclosed Time Warner Telecom's Petition to Deny the transaction that is the subject of the above-captioned proceeding. Due to the fact that Time Warner Telecom maintains some of the information contained within its Petition to Deny in the strictest of confidence and does not release it to the public in the ordinary course, Time Warner Telecom is submitting the Petition to Deny pursuant to the Protective Order in the docket.<sup>1</sup>

As required by the Protective Order, Time Warner Telecom is submitting one copy of the filing in unredacted form to you. Time Warner Telecom also is delivering two copies of the unredacted filing to Gary Remondino of the Wireline Competition Bureau. According to the terms of the Protective Order, these documents should not be placed in the public record in this proceeding. By separate cover and as required by the Protective Order and the Public Notice in this proceeding, Time Warner Telecom is filing simultaneously two copies of the redacted version of this filing for the public record.<sup>2</sup>

<sup>1</sup> See *In re AT&T Inc. and BellSouth Corporation Applications for Approval of Transfer of Control*, Order, DA 06-1032, WC Dkt. No. 06-74 (rel. May 12, 2006) ("Protective Order").

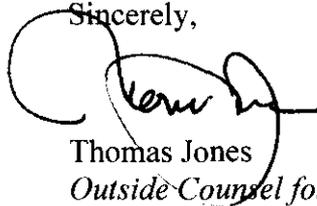
<sup>2</sup> See *Protective Order ¶ 5; Commission Seeks Comment on Application for Consent to Transfer Control Filed by AT&T Inc. and BellSouth Corporation*, Public Notice, DA 06-904, WC Dkt. No. 06-

Marlene Dortch  
June 6, 2006  
Page 2

The unredacted version of the filing is available for inspection, pursuant to the terms of the Protective Order, at the Washington, D.C. office of Willkie Farr & Gallagher LLP.

Please contact me with any questions concerning the enclosed materials.

Sincerely,

A handwritten signature in black ink, appearing to read 'Thomas Jones', written over a large, stylized circular flourish.

Thomas Jones  
*Outside Counsel for Time Warner Telecom*

Enclosures

cc: Best Copy and Printing, Inc.  
Gary Remondino  
Nick Alexander  
Bill Dever  
Renée R. Crittendon  
Donald Stockdale  
Mary Shultz  
John Branscome  
Erin McGrath  
Jeff Tobias  
David Krech  
JoAnn Lucanik  
Sarah Whitesell  
Tracy Waldon  
Jim Bird  
Leslie Marx

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74 (rel. Apr. 19, 2006), at 8. Pursuant to the Public Notice's terms regarding electronic filing, Time Warner Telecom has filed the redacted version of this filing via ECFS.

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

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Federal Communications Commission  
Office of Secretary

In the Matter of )  
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AT&T Inc. and BellSouth Corporation )  
Applications for Approval of )  
Transfer Of Control )  
)  
)  
)

WC Docket No. 06-74

**PETITION TO DENY OF TIME WARNER TELECOM**

Willkie Farr & Gallagher LLP  
1875 K Street, N.W.  
Washington, D.C. 20006  
(202) 303-1000

ATTORNEYS FOR TIME WARNER TELECOM

June 5, 2006

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BEFORE THE  
Federal Communications Commission  
WASHINGTON, D.C.

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

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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.