

Before the  
Federal Communications Commission  
Washington, D.C. 20554

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

REPLY COMMENTS OF  
AD HOC TELECOMMUNICATIONS USERS COMMITTEE

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## SUMMARY

As Ad Hoc has repeatedly informed the Commission, the greatest single threat to the emergence of robust competition in telecommunications markets is the ILECs' continuing stranglehold on the business broadband or "special access" market. Just like the SBC/AT&T and Verizon/MCI mergers of last summer, the merger at issue in this docket will exacerbate the competitively dysfunctional special access market by creating irresistible and destructive opportunities for the merged company to exploit special access customers. The merger therefore cannot be approved under the standard in Section 214 of the Communications Act unless and until competition emerges in AT&T's and BellSouth's special access markets or the merger is subject to conditions that protect consumers and competition from the merged entity's market power.

Because AdHoc admits no carriers as members and accepts no carrier funding, it has no commercial self-interest in imposing unnecessary regulatory constraints on the BOCs. In fact, AdHoc has been a long-standing and enthusiastic supporter of de-regulation for competitive telecom markets and forbearance authority for the FCC whenever a market becomes competitive. As high-volume purchasers of telecommunications services, AdHoc members have historically been among the first beneficiaries of the FCC's de-regulatory efforts.

And yet AdHoc has consistently opposed de-regulation of special access markets for the simple reason that special access markets, including AT&T's and BellSouth's, are not competitive. The Commission has heard this repeatedly, over the past several years, from AdHoc and a broad range of other special

access customers. In the face of these persistent complaints, and steady price increases that have produced mind-boggling profit levels for the BOCs, the Commission has done nothing. Indeed, the Commission's inaction drove AT&T itself (before its merger with SBC, of course) to file a mandamus petition with the D.C. Circuit<sup>1</sup> which finally prompted the Commission to take action.

Unfortunately, that action consisted of the initiation of the *Special Access Rulemaking*,<sup>2</sup> begun only last year to re-visit the Commission's failed experiment with special access de-regulation through "pricing flexibility" rules, which has been languishing ever since.

The lack of competition in business broadband markets creates a two-fold problem – it can be exploited by ILECs to impede competitive entry into telecommunications markets and it allows ILECs to charge unjust and unreasonable rates to customers. Thanks to rates of return that have hit triple digits for some carriers, the Commission's failure to fix its special access regulation cost enterprise customers over \$21.3 million dollars *per day* in excessive charges during 2005. Meanwhile, AT&T and BellSouth earned returns of 91.7% and 98.3%, respectively, on their special access services last year.

Both of these effects will be magnified by the merger – to the detriment of the public interest, convenience, and necessity – unless the applicants' authority to merge is conditioned by the Commission upon compliance with pro-competitive conditions. Many of the commenters in this proceeding have

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<sup>1</sup> *In re AT&T Corp., et al*, No. 03-1397 (D.C. Cir.), *dismissed as moot*, Feb. 4, 2005 ("AT&T Mandamus Petition"). The court's dismissal was based on the Commission's initiation of the *Special Access Rulemaking*, note 23, *infra*.

<sup>2</sup> *Special Access Rulemaking*, note 23, *infra*.

proposed pro-competitive conditions which Ad Hoc supports. In particular, Ad Hoc urges the Commission to

- Require the merged entity reinitialize its special access rates at the Commission's last-authorized 11.25% rate of return. This should be an interim measure pending re-determination based on current conditions.
- Permit unlimited downward pricing flexibility to respond to competition should it develop in the merged entity's operating region.
- Adjust special access rates annually by a price cap adjustment mechanism that includes a productivity adjustment and an earnings sharing component.
- Require divestiture of competitively sensitive facilities, particularly the broadband wireless spectrum licensed to either applicant and the duplicative wireline facilities of the applicants in either BellSouth's or AT&T's local operating territories;

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### Attachments

Attachment A, *Competition in Access Markets: Reality or Illusion. A Proposal for Regulating Uncertain Markets*, Economics and Technology, Inc. (August, 2004)

Attachment B, Reply Declaration of Susan M. Gately on behalf of AdHoc Telecommunications Users Committee, June 20, 2006

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The Ad Hoc Telecommunications Users Committee (the “Ad Hoc Committee”) submits these Reply Comments pursuant to the Commission’s April 19, 2006 Public Notice in the docket captioned above.<sup>3</sup>

**INTRODUCTION**

AT&T and BellSouth have supported their merger application with a declaration by Dennis W. Carlton and Hal S. Sider in which asserts that “[t]he proposed transaction raises no competitive concerns relating to...special access circuits”<sup>4</sup> and that “there is no basis to conclude that the proposed transaction would adversely affect competition” in the provision of special access services.”<sup>5</sup> Their conclusion is hardly surprising nor particularly remarkable: There is today so little actual competition for special access services that it is difficult to imagine

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<sup>3</sup> *AT&T Inc. and BellSouth Corporation, Applications for Approval of Transfer of Control*, WC Docket No. 06-74, Public Notice, DA No. 06-904 (rel. Apr. 19, 2006) (“*Merger Application*”).

<sup>4</sup> Application of BellSouth Corporation, Transferor, and AT&T, Inc., Transferee, for Consent to Transfer Control of Licenses and Authorizations, WC Docket No. 06-74 , filed Mar. 31, 2006 (“*Merger Application*”), Declaration of Dennis W. Carlton and Hal S. Sider, (“*Carlton/Sider Declaration*”).

<sup>5</sup> *Id.* at para. 118.

how there could be much less competition following AT&T's absorption of BellSouth. That is not the same, however, as claiming that the proposed acquisition raises no serious competitive concerns, which, of course, it does. As discussed below, the proposed merger exacerbates the anti-competitive market conditions that the Commission must address with appropriate regulatory safeguards in order to protect customers from unreasonable and exploitive rates and practices by the merged entity.

**I. THE PROPOSED MERGER'S EXPANSION OF AT&T'S MONOPOLY FOOTPRINT CREATES NEW INCENTIVES AND OPPORTUNITIES FOR ANTI-COMPETITIVE BEHAVIOR IN THE BUSINESS BROADBAND MARKET**

The Applicants go to considerable lengths to portray the proposed transaction as an RBOC-to-RBOC merger, not unlike prior RBOC-to-RBOC consolidations, such as SBC/Pacific Telesis, Bell Atlantic/NYNEX, SBC/Ameritech, and Bell Atlantic/GTE. To the extent that the merger combines what is now called AT&T Inc. (which itself includes what had been the 13-state SBC operating territory) with BellSouth – creating an ILEC footprint spanning 22 states and encompassing about half of all wireline access lines in the US – the proposed transaction certainly does have a great deal in common with prior RBOC/RBOC combinations. It is, however, considerably more than that.

First, the incorporation of BellSouth into AT&T Inc., like last year's consolidation of SBC and AT&T Corp., is also a *vertical* combination that will produce an even larger ILEC and the country's largest interexchange carrier – one that is considerably larger than the former AT&T Corp. had been at the time that it was acquired by SBC. The vertical integration that swallowed up SBC's

then-largest local and long distance competitor within its 13-state operating area will similarly sweep aside BellSouth's single largest local and long distance competitor across its nine-state region. The vertical integration that has already operated to frustrate competitive activity and entry within the 13-state SBC footprint will now be extended to embrace the nine additional states dominated by BellSouth.

Second, if the massive geographic scope of the proposed acquisition were not enough of a concern, this merger expands the extent of vertical integration into what the FCC regularly portrays as the single largest source of "intermodal" competition – wireless. AT&T's Senior Executive Vice President for Corporate Development, James S. Kahan advised the Commission in his March 29, 2006 Declaration that a key objective of the merger is the integration of Cingular's wireless operations into the 22-state AT&T/BellSouth ILEC network.<sup>6</sup> According to Mr. Kahan,

17. Today, wireless networks use a significant amount of wireline network services to connect their cell sites to their switches, wireless switches to each other, as well as to the larger public switched network. However, today's wireline and wireless networks have not been designed, engineered or operated on an integrated basis. But integration of wireline and wireless networks not only creates capital and operational efficiencies, but also allows for deployment of new integrated service offerings that will offer significant benefits to mass market and business customers alike. Such integration will thus be necessary for firms to remain competitive going forward.

18. The ability to achieve such wireline-wireless integration is one of the primary motivations for AT&T's acquisition of

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<sup>6</sup> *Merger Application*, Declaration of James S. Kahan, Senior Executive Vice President – Corporate Development, AT&T Inc., ("*Kahan BellSouth Declaration*").

BellSouth. ...<sup>7</sup>

As an example of a “benefit” of wireline/wireless integration, Mr. Kahan cited the following:

23. ... [AT&T, BellSouth and Cingular] have been working on development of a “dual-mode” phone that will seamlessly shift between wireless and broadband VoIP networks. For example, when a user is on a call outdoors and walks into his house, the handset would automatically transition the call from Cingular’s GSM wireless network to AT&T’s broadband Wi-Fi connection in the user’s home.<sup>8</sup>

Mr. Kahan does not, of course, explain why the proposed merger is necessary to achieve the kind of service integration that he describes, when the pre-merger AT&T, BellSouth and Cingular already “have been working on development of a ‘dual-mode’ phone” under their existing corporate structures. Indeed, the introduction of “equal access” interconnection and dialing parity two decades ago – and the more recent introduction of local number portability (including wireline/wireless portability) – demonstrates that seamless *service integration* can be achieved without corporate consolidation.

Vertical integration threatens to undo the progress towards economically efficient and pro-competitive market conditions that the industry has made in the wake of the 1984 break-up of AT&T. At that time, the FCC established its system of “access services” – switched and special – as a means of ensuring reasonable and non-discriminatory access for interexchange carriers (“IXCs”) and other non-ILEC entities to the ILEC network services that were essential

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<sup>7</sup> *Id.* at paras. 17-18.

<sup>8</sup> *Id.* at para. 23.

inputs to their operations. Wireless carriers – even those owned or controlled by ILECs – were initially required to operate as fully-separated subsidiaries, and so also purchased switched and special access services from ILECs – including their own affiliates – under tariff and on a nondiscriminatory basis.

During the period in which RBOCs were barred from long distance entry, they were entirely indifferent as to which IXC – and, for that matter, which fully-separated wireless carrier – purchased access services from them, particularly when the significantly above-cost access prices made those services quite profitable for the RBOC. And even though access rates were generally set well in excess of cost, the same excessive access prices confronted all of the then-competing IXCs and wireless carriers, affording no one of them a competitive advantage vis-à-vis the others. Indeed, the “equal charge per minute of use” principle applied by the FCC in the years following the 1984 break-up to price switched access, and similar principles applicable to special access, precluded then post-divestiture AT&T from gaining any undue advantage over its smaller interexchange service rivals as a result of its overall scale of operations and more extensive access connectivity.

But vertical integration changes all of that, eliminating the RBOCs’ “indifference” as to who purchases its access services or which IXC its local service customers select. Once they were allowed to compete with their access service customers for end-user long distance business, the RBOCs’ control of switched and special access charges was instantly transformed into a formidable competitive weapon.

This problem is magnified by the proposed merger. Mr. Kahan correctly notes the heightened dependence of today's wireless networks on wireline network services to connect their cell sites to switches, wireless switches to each other, and wireless traffic to the larger public switched network. For wireless carriers that are affiliated with their wireline carrier, such payments constitute intracorporate accounting transfers, *i.e.*, the movement of money from one pocket to another.

Following the AT&T/BellSouth merger, however, when the AT&T, BellSouth, and Cingular wireline and wireless networks *can* be "designed, engineered or operated on an integrated basis," the merged entity will possess both the financial incentive and the opportunity to raise prices for the "wireline network services" (*i.e.*, business broadband or special access services) needed by Cingular and other wireless carriers to whatever level maximizes the merged entity's competitive advantage vis-à-vis rival wireless carriers and maximizes its profits overall. Once the merger transforms access payments into mere intracorporate accounting transfers, access price increases become painless competitive weapons.

Unfortunately for enterprise customers, it is precisely these same business broadband/special access services upon which they rely for their corporate network. Before the merger, AT&T and BellSouth already had a fiduciary responsibility to set prices for those services as high as possible so as to maximize earnings for their shareholders. The merger introduces an additional incentive for AT&T and BellSouth to increase business broadband prices in order

to increase their wireless competitors' costs, which exposes business broadband customers to the risk of even higher special access prices than the already excessive prices charged by AT&T and BellSouth pre-merger.

The prospect of massive BOC/IXC and BOC/Cingular integration means that the AT&T IXC and AT&T wireless entities are no longer "purchasers" of access services within the AT&T/BellSouth footprint and, in fact, are no longer even separate "entities" at all. Post-merger, the only "purchasers" of access services within those 22 states are the competitors of the AT&T IXC and AT&T wireless operations (with enterprise customers purchasing special access services directly or through these competitors). The pre-Sec. 271 "indifference" is thus turned on its head – AT&T will confront enormous business, financial and competitive incentives to set its switched and special access prices as high as possible. And so long as the Commission's "pricing flexibility" rules for special access remain in place, the post-merger entity will have the opportunity to do so without any consequential regulatory oversight or constraint. AT&T will thereby be enabled to (a) continue to capture a substantial profit even where one of its local wireline customers purchases IXC or wireless services from a rival provider; (b) maximize corporate profits overall; and (c) increase its rival IXC and wireless competitors' costs and entry barriers, undermining at a fundamental level their ability to compete in these segments.

The FCC itself has provided the means by which these anti-competitive market conditions, with their attendant risk of anti-consumer outcomes, are created. Under the current regulatory regime for special access, the Commission

has effectively de-regulated the vast majority of special access services in the most important metropolitan markets, and has effectively eliminated productivity-based price cap rate adjustments for the remaining special access and switched access services still (in principle) subject to price constraints.

As a result, special access prices continue to rise. And the BOCs' special access profits continue to soar. AdHoc's economic analysis continues to confirm the individual experiences reported by its members – access markets, and the special access market in particular, simply are not competitive. The BOCs' are continuing to increase prices and earn record-setting profits for special access, which demonstrates that they face little or no competition to protect consumers from exploitive rates and practices.

The BOCs' stunning prices and profits for their business broadband (special access) services are displayed and analyzed in attachments to these Reply Comments. Attachment A is a white paper released in August, 2004 by the Ad Hoc Committee's economic consultants, Economics and Technology, Inc. ("ETI"). The paper, *Competition in Access Markets: Reality or Illusion. A Proposal for Regulating Uncertain Markets ("ETI White Paper")*, demonstrates that competitive alternatives simply do not exist for the "last-mile" telecommunications services enterprise customers must have to conduct business.

Attachment B is a declaration by Susan M. Gately, Senior Vice President of ETI, containing updated data for the *ETI White Paper* where such data exist ("Gately Declaration"). Those data reveal that the BOCs' overpricing of business

broadband services cost American businesses \$21.3 million *per day* in 2005. At those prices, AT&T's and BellSouth's rates of return were a jaw-dropping 91.7% and 98.3%, respectively.

In theory, Sec. 272(e)(3) of the Communications Act<sup>9</sup> would discourage anti-competitive price increases for business broadband services because it would require AT&T to "impute" all access charges into its prices for wireless and wireline interexchange services. This imputation requirement would supposedly eliminate any competitive advantage that the post-merger entity might acquire by overpricing access services, since the entity would, in theory, be required to increase its own retail prices by a corresponding amount.

In practice, however, this requirement does not provide adequate protection against anti-competitive pricing. Imputation requirements can be policed as between separate corporate entities, such as the separate affiliates required by Section 272 of the Act. As long as the "separate affiliate" exists, it must "purchase" access services from the BOCs. But Sec. 272(f)(1) "sunsets" the separate affiliate requirements unless extended by the Commission, which the Commission has in every case declined to do. Once AT&T's long distance and wireless operations are fully integrated, no such "purchases" take place; the combined local/long distance/wireless networks can be operated as a single entity.

As AT&T itself recognized, before its merger with SBC, the imputation requirement proved to be difficult to monitor and enforce even while the separate

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<sup>9</sup> 47 U.S.C. § 272(e)(3).

affiliate requirement was in place, much less once full BOC/IXC/wireless integration is allowed.<sup>10</sup> The integration of Cingular's wireless operations across and into the 22-state AT&T/BellSouth footprint as contemplated and described by Mr. Kahan would exacerbate this condition, effectively eliminating Cingular as a "customer" of AT&T/BellSouth special access services, to be replaced by a fully integrated wireline/wireless network.

These concerns would, of course, be ameliorated if there were in fact any consequential amount of facilities-based competition for "last mile" special access type services. While the experience of most business broadband customers is that there is no material competition for "last mile" special access services, AT&T's position appears to have "evolved" over the past several years as its corporate interests have changed.

In October 2004, SBC (AT&T's predecessor company) was a co-sponsor, along with BellSouth, Verizon, and Qwest, of a so-called "UNE Fact Report" submitted to the Commission in the *Triennial Review Remand* proceeding, WC Docket No. 04-313.<sup>11</sup> The "UNE Fact Report"<sup>12</sup> identified a total of 31,669 "Buildings Connected Directly to CLEC's Fiber Networks Using CLEC Fiber," of

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<sup>10</sup> See *Sunset of the BOC Separate Affiliate and Related Requirements*, WC Docket No. 02-112, CC Docket Nos. 00-175, 01-337, 02-33, *ex parte* filing of AT&T Corp., June 9, 2004, and attached *ex parte* declaration of Lee L. Selwyn, dated June 8, 2004.

<sup>11</sup> *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*, CC Docket Nos. 01-338, 96-98, 98-147, Report and Order and Order on Remand and Further Notice of Proposed Rulemaking, 18 FCC Rcd 16978 (2003) (subsequent history omitted) ("*TRRO Proceeding*").

<sup>12</sup> UNE Fact Report, prepared for and submitted by BellSouth, SBC, Qwest, and Verizon, filed Oct. 4, 2004 in *TRRO Proceeding* ("UNE Fact Report").

which 6,400 buildings – slightly over 20% -- were attributed to (pre-merger) AT&T's CLEC/CAP operations.<sup>13</sup> The "UNE Fact Report" advised that

AT&T told investors two years ago that AT&T was already providing "over 20 percent ... of our T1-equivalent services ... on net and we're growing that every day." One analyst more recently estimated that AT&T was now earning at least a quarter of its high-capacity revenues entirely over its network.<sup>14</sup>

While the competitive picture painted by the UNE Fact Report was bleak, SBC and AT&T painted an even bleaker competitive picture in order to support their merger application last year, dismissing AT&T's provision of local services as having no competitive consequence. As the Commission noted in the *SBC/AT&T Merger Order*,<sup>15</sup>

[i]n the 19 in-region MSAs where AT&T has local facilities, SBC identifies over 240,000 commercial buildings with more than 10 DS0 line equivalents...AT&T provides Type I service to only 1,691 buildings...using its own facilities – only 0.7%.<sup>16</sup>

Though the specifics (and spin) of AT&T's competitive claims in the *Triennial Review* and *SBC/AT&T Merger* proceedings conflict, they both nevertheless establish that the number of commercial buildings for which non-ILEC facilities are available is extremely small. Indeed, according to Verizon's filing in the *AT&T Special Access Petition Proceeding*, all CLECs combined served only

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<sup>13</sup> *Id.* at p. III-4, Table 1.

<sup>14</sup> *Id.* at p. III-4, footnote references omitted.

<sup>15</sup> *SBC Communications Inc. and AT&T Corp. Applications for Approval of Transfer of Control*, WC Docket No. 05-65, Memorandum Order and Opinion, 20 FCC Rcd 18290 (2005) ("*SBC/AT&T Merger Order*") at fn. 98.

<sup>16</sup> *Id.* at fn. 98.

30,000 commercial buildings with their own final mile facilities.<sup>17</sup> With approximately three million commercial buildings nationwide, Verizon's figure equates to about 1% of the total.

The post-merger environment contemplated by the AT&T/BellSouth application is no improvement on this competitive state of affairs. AT&T will control some 46% of all wireline access lines in the U.S. and some 27.7% of nationally-based CMRS carrier wireless phones.<sup>18</sup> Verizon, at that point, will control roughly 36.7% of all wireline access lines and some 27.2% of all wireless phones. Competition between AT&T and Verizon for mass market services outside of their respective ILEC footprints will be minimal to nonexistent – indeed, AT&T's James Kahan, testifying in support of last year's SBC/AT&T merger, emphasized the (then-to-be-merged) company's focus on the large enterprise customer segment, while at the same time recognizing that the AT&T that SBC was acquiring had "made an irreversible decision to cease actively competing for mass market customers and to scale back its operations to retain only the

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<sup>17</sup> *AT&T Corp. Petition for Rulemaking To Reform Regulation of Incumbent Local Exchange Carrier Rates For Interstate Special Access Services*, RM Docket No. 10593, *Opposition of Verizon*, filed December 2, 2002 ("*RM 10593 Opposition of Verizon*") at p. 13..

<sup>18</sup> There are approximately 136-million ILEC switched access lines. AT&T currently has 44-million switched access lines. BellSouth has 18.8-million switched access lines. Verizon has 48.6-million switched access lines. ARMIS Report 43-08, Operating Data Report: Table III, YE 2005, available at <http://www.fcc.gov/wcb/eafs> (accessed June 19, 2006). Following the merger, AT&T/BellSouth will control 46%, and Verizon will control 35.7%, of all ILEC lines. Cingular wireless has approximately 54-million customers. [http://www.cingular.com/about/company\\_overview](http://www.cingular.com/about/company_overview) (accessed June 19, 2006) ("Cingular website"). Verizon Wireless has approximately 53-million customers. <http://aboutus.vzw.com/atagance.html> (accessed June 19, 2006) ("Verizon Wireless Website"). Wireless carriers with a nationwide presence have approximately 195-million wireless subscribers. Verizon Wireless Website, Cingular Website, Sprint 1Q 2006 Investor Briefing (<http://www.sprint.com/investors/> accessed June 20, 2006) T-Mobile 1Q 2006 Investor Briefing ([http://www.t-mobile.com/Company/InvestorRelations.aspx?tp=Abt\\_Tab\\_InvestorRelations](http://www.t-mobile.com/Company/InvestorRelations.aspx?tp=Abt_Tab_InvestorRelations), accessed June 20, 2006), Alltel website <http://alltel.com/corporate/> (accessed June 19, 2006). Cingular thus controls a 27.7% market share, Verizon Wireless enjoys a 27.2% market share.

infrastructure necessary to continue serving its rapidly declining base of mass market customers.”<sup>19</sup> Verizon has shown no signs of a serious mass market out-of-region effort, and similarly portrayed its own acquisition of MCI as supporting its efforts in the enterprise market.<sup>20</sup>

These indicators do not bode well for the enterprise market insofar as serious competitive activity is concerned. Assuming that AT&T and Verizon compete for enterprise customers out-of-region, Verizon (including its wireless affiliate) will be AT&T’s single largest special access customer. Similarly, AT&T and its then-integrated wireless operations will be Verizon’s single largest special access customer. In both regions, there will not be even a close second. Each will confront a strong incentive to stay mainly within its own footprint, since any out-of-region activity will necessarily involve large out-of-pocket cash payments to the other for access services.

Meanwhile, both AT&T and Verizon will have powerful incentives to maintain their currently excessive special access rate levels in order to impose excessive costs of doing business upon their would-be rivals for enterprise customers (companies such as Sprint, Qwest, XO, Level3, and others) and constrain their rivals’ activities within the combined AT&T and Verizon footprints. As long as AT&T and Verizon are allowed to set special access prices without limit or constraint, they will be able to block or seriously retard entry by other

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<sup>19</sup> See generally, Declaration of James S. Kahan, Exhibit 2 to the SBC/AT&T Merger Application, at paras. 20-26.

<sup>20</sup> See, e.g., *Verizon Communications Inc. and MCI, Inc. Applications for Approval of Transfer of Control*, WC Docket No. 05-75, Memorandum Opinion and Order, FCC 05-184, rel. Nov. 17, 2005, at paras. 3 and 11.

companies into their respective (and growing) regions. While there can be no assurance that requiring cost-based special access rates will make the enterprise market competitive, there can be no question but that, with special access rate levels continuing at their present excessive levels, there is no realistic possibility that competition for enterprise customers will develop or be sustained.

## II. COMPETITION HAS YET TO EMERGE IN THE BUSINESS BROADBAND MARKET

Ad Hoc has repeatedly urged the Commission to examine the marketplace facts regarding business broadband services and take steps to protect enterprise customers from the ILECs' exercise of market power with respect to those services.<sup>21</sup> The Commission's failure to update its special access rules to reflect

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<sup>21</sup> See, e.g., Comments of AdHoc Telecommunications Users Committee (Jan. 22, 2002) at 2-3, filed in *Performance Measurements and Standards for Interstate Special Access Services*, CC Docket Nos. 01-321, 00-51, 98-147, 96-98, 98-141, 96-149, 00-229, Notice of Proposed Rulemaking, 16 FCC Rcd 20896 (2001) ("*Performance Standards rulemaking*"); Comments of AdHoc Telecommunications Users Committee (Mar. 1, 2002) at 14-17, filed in *Review of Regulatory Requirements for Incumbent LEC Broadband Services; SBC Petition for Expedited Ruling That It Is Non-Dominant in its Provision of Advanced Services and for Forbearance From Dominant Carrier Regulation of These Services*, CC Docket No. 01-337, Notice of Proposed Rulemaking, 16 FCC Rcd 22745 (2001) ("*Broadband Regulation Rulemaking*"); Reply Comments of AdHoc Telecommunications Users Committee (Jul. 1, 2002) at i, filed in *Appropriate Framework for Broadband Access to the Internet Over Wireline Facilities*, CC Docket Nos. 02-33, 95-20, and 98-10, Notice of Proposed Rulemaking, 17 FCC Rcd 3019 (2002) ("*Wireline Broadband Internet Access Rulemaking*"); Comments of AdHoc Telecommunications Users Committee (Dec. 2, 2002) at 5, filed in *AT&T Petition for Rulemaking to Reform Regulation of Incumbent Local Exchange Carrier Rates for Interstate Special Access Services*, RM No. 10593 ("*AT&T Special Access Rulemaking Petition*"); Comments of AdHoc Telecommunications Users Committee (Jun. 30, 2003) at 6, filed in *Section 272(f)(1) Sunset of the BOC Separate Affiliate and Related Requirements, WC Docket No. 02-112, and 2000 Biennial Regulatory Review Separate Affiliate Requirements of Section 64.1903 of the Commission's Rules*, CC Docket No. 00-175, Further Notice of Proposed Rulemaking, 18 FCC Rcd 10914 (2003) ("*ILEC Separate Affiliate Dominant/Non-Dominant Rulemaking*"); Reply Comments of AdHoc Telecommunications Users Committee (September 23, 2004) at 3-14, filed in *Petition of Qwest Corporation for Forbearance Pursuant to 47 U.S.C. § 160(c) in the Omaha Metropolitan Statistical Area*, WC Docket No. 04-223, Memorandum Opinion and Order, FCC 05-170 (rel. Dec. 2, 2005) ("*Qwest Omaha Forbearance Petition*"); Reply Comments of Ad Hoc Telecommunications Users Committee (May 10, 2005), filed in *SBC/AT&T Merger Proceeding*; Reply Comments of AdHoc Telecommunications Users Committee (May 24, 2005) at pp. 8-23, filed in *Verizon Communications Inc. and MCI, Inc. Applications for Approval of Transfer of Control*, WC Docket

the ILECs' virtual monopoly over special access services has resulted in historically unprecedented prices and profit levels for nearly eight years. Indeed, the Commission's inaction with respect to special access has become a significant obstacle to the development of robust competition in telecommunications markets because of the critical role that special access plays as a bottleneck facility for both local and interstate traffic. In order to accurately evaluate the instant merger application, the Commission must be willing to accurately assess the state of competition in the special access market.

**A. The Commission cannot simply reiterate the findings in its SBC-AT&T Merger Order regarding special access competition**

Throughout their Public Interest Statement in support of the merger application,<sup>22</sup> AT&T and BellSouth frequently cite to passages from the Commission's Order approving the SBC/AT&T merger.<sup>23</sup> In fact, they cite to the *SBC/AT&T Merger Order* over ninety times. But their attempt to rely on the discussion in that order is problematic for several reasons.

First, each merger presents a set of unique facts regarding the service

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No. 05-75 ("*Verizon/MCI Merger Proceeding*"); Comments and Reply Comments of AdHoc Telecommunications Users Committee (June 13, 2005 and July 29, 2005), *filed in Special Access Rates for Price Cap Local Exchange Carriers; AT&T Corp. Petition for Rulemaking to Reform Regulation of Incumbent Local Exchange Carrier Rates for Interstate Special Access Services*, WC Docket No. 05-25, RM-10593, Order and Notice of Proposed Rulemaking, 20 FCC Rcd 1994 (2005) ("*Special Access Rulemaking*"); Comments of AdHoc Telecommunications Users Committee (February 22, 2006), *filed in Petition of Qwest Communications International Inc. for Forbearance from Enforcement of the Commission's Dominant Carrier Rules as They Apply After Section 272 Sunset Pursuant To 47 U.S.C. § 160*, WC Docket No. 05-333 ("*Qwest § 272 Forbearance Petition*"), Letter from Colleen Boothby, Counsel for Ad Hoc Telecommunications Users Committee, to Marlene Dortch, Secretary, FCC, WC Docket No. 04-440 (filed Mar. 16, 2006).

<sup>22</sup> *Merger Application, Description of Transaction, Public Interest Showing, and Related Demonstration ("Public Interest Statement")*.

<sup>23</sup> *SBC/AT&T Merger Order, supra*, note 13.

providers and geographic markets at issue. In particular, each successive ILEC merger brings the industry to a higher level of concentration.<sup>24</sup> As several parties observed in their Comments in the instant proceeding, the Commission has previously identified the heightened incentives and opportunities for competitive harm that result when two Bell Operating Companies merge.<sup>25</sup>

Second, many key conclusions in the *SBC/AT&T Merger Order* regarding special access competition are supported by inconsistent or irrelevant evidence or are based on rosy predictions of a competitive future that simply ignores conflicting record evidence. The present merger applicants are quick to capitalize on these findings and adopt them as the anchor for their own claims, saying “The Commission thoroughly reviewed detailed records in the SBC/AT&T and Verizon/MCI merger proceedings with respect to these and other special access allegations and properly rejected each of them based on *findings that apply with equal force here.*”<sup>26</sup> Often, the Applicants recitation of these findings

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<sup>24</sup> See generally discussion in Section I, *supra*.

<sup>25</sup> Comments of Sprint Nextel, filed June 5, 2006 (“*Sprint Nextel Comments*”) at 5 (“[A]s the Commission found in the SBC/Ameritech merger the expanded service territory of the merged company will increase its incentive and opportunities to engage in anticompetitive practices destined to harm national competitors.”). See also Comments of Cbeyond, filed June 5, 2006 (“*Cbeyond Comments*”) at 3 (*citing* SBC/Ameritech Merger Order at para. 18) (“[I]t is hard to fathom how the merger of two RBOCs – each with market power sufficient to be deemed dominant in their own regions – could be said to facilitate a decline in market power and increase in future competition. Indeed, in the most recent RBOC-to-RBOC merger proceeding, the Commission determined that mergers of RBOCs actually harm telecommunications consumers by: (1) denying them the benefit of probable future competition between the merging firms, (2) undermining the ability of regulators to implement the deregulatory framework of the 1996 Act; and (3) increasing the incentive of the merged entity to raise entry barriers and discriminate against competitors.”). These concerns are particularly acute with respect to the ILEC-dominated special access market.

<sup>26</sup> *Public Interest Statement* at 55.

(which also are referenced in the supporting declarations)<sup>27</sup> constitutes the only “proof” they feel compelled to provide – as though an actual evidentiary record for this application were superfluous.

Ad Hoc urges the Commission to examine – rather than clone – its earlier findings in light of the evidence in this proceeding. Any findings with respect to special access competition that were not supported by the record in the *SBC/AT&T Merger Order* should not be improperly repeated with respect to the current application. The Commission cannot assume the validity of these erroneous and unsupported conclusions when it finally turns to the comprehensive evaluation of special access competition and pricing rules in the context of the long-pending *Special Access Rulemaking*.<sup>28</sup>

The particularly egregious examples of conclusions in the *SBC/AT&T Merger Order* that were either not supported or contradicted record evidence include:

- The Commission improperly assessed the importance of different transmission speeds in analyzing and applying its definition of the relevant product market for special access.<sup>29</sup> Initially, and consistent with prior findings, the Commission acknowledged that carriers purchase specific

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<sup>27</sup> The *Merger Application* includes two declarations that directly address special access competition – the declaration of Robert Bickerstaff and the *Carlton/Sider Declaration*. Mr. Bickerstaff’s brief (4 page) affidavit is conclusory and lacking in data. Carlton and Sider also present conclusions about special access competition, tailored to the analytical framework of the SBC/AT&T merger analysis and thus with little insight into the realities of how the highly ILEC-dominated wholesale special access market will be altered by the elimination of its largest non-ILEC participant. Like the *Public Interest Statement*, their declaration relies heavily on the conclusions articulated in the SBC/AT&T Merger Order.

<sup>28</sup> *Special Access Rates for Price Cap Local Exchange Carriers; AT&T Corp. Petition for Rulemaking to Reform Regulation of Incumbent Local Exchange Carrier Rates for Interstate Special Access Services*, WC Docket No. 05-25, RM-10593, Order and Notice of Proposed Rulemaking, 20 FCC Rcd 1994 (2005) (“*Special Access Rulemaking*”).

<sup>29</sup> In keeping with this approach, the present merger applicants do not separately analyze competitive impacts for DS1/DS3 as opposed to OCn capacity special access circuits.

special access capacities – not a generic capacity.<sup>30</sup> But the Commission ignored this product characteristic because a competing carrier’s Type I “facilities can be ‘channelized’ to provide service at all capacity levels.” For Type II service, competing carriers “can purchase the required capacity ... from the incumbent or from any competitive access provider.”<sup>31</sup> This conclusion is inconsistent with the service offerings actually available in the marketplace. Variable capacities of service, and especially lower speed service, is widely available from ILECs but not from competitive providers.<sup>32</sup> If, for example, a prospective customer needs DS-1 circuits or a even a couple of DS-3s at a building not already served by a CLEC, the customer cannot induce a CLEC to make new investment just for that service level, whereas an ILEC like BellSouth will typically have facilities already available.<sup>33</sup> By *de facto* merging different speeds of service, the Commission’s analysis erroneously assumed that alternative suppliers compete with the ILECs equally across all speeds of service.

- The *SBC/AT&T Merger Order*, at para. 33, concludes that AT&T doesn’t offer a significant amount of Type II services, so its elimination as an independent supplier is not consequential for competition. The *Order* can cite no specific evidence in support of this finding<sup>34</sup> and acknowledges that the record is inconclusive with respect to the extent of competitive special access services. The Commission cannot determine that prices will not increase once AT&T is eliminated as a competitor without information regarding the relative amounts of service sold by AT&T and the remaining CLECs.<sup>35</sup>

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<sup>30</sup> *SBC/AT&T Merger Order* at para. 27.

<sup>31</sup> *Id.* at fn. 90.

<sup>32</sup> Sprint Nextel discloses that it “has no alternative to BellSouth or AT&T for more than 99 percent of Sprint Nextel’s PCS cell sites in the BellSouth and AT&T regions, which are serviced through special access service, primarily DS-1 service.” Sprint Nextel Comments at 9.

<sup>33</sup> This is consistent with the Commission’s finding in the TRRO that CLECs are impaired without access to enterprise loops for capacities less than 3 DS-3s.

<sup>34</sup> In fact, it likely that the Commission has underestimated AT&T’s market share. At footnote 86 of the *SBC/AT&T Merger Order*, the Commission mistakenly defines “special access” as including “all services provided by any carrier that involves such dedicated links.” This definition would include retail private line service, of which special access is a component, but commingling the retail and wholesale services in this manner distorts the assessment of the relevant product market. Assessing AT&T’s special access as a percentage of a “pie” that also includes retail private line service would inappropriately diminish its size.

<sup>35</sup> When, as here, elimination of the *largest* competitor of special access services in BellSouth territory will make no appreciable difference in the working of the market because the overall level of competition is so low to begin with, then regulation of access markets and, at a minimum, the kinds of “voluntary conditions” included as part of the SBC/AT&T merger, are all that much more relevant. See discussion that follows in section III.

- The Commission’s faith that other competitors will fill any gap left by AT&T’s departure as a special access competitor<sup>36</sup> conflicts with the Commission’s subsequent concession that there is little potential for competitive entry in the short term.<sup>37</sup> Similarly, the Commission’s professed confidence in the “threat of competitive entry through collocation” relies on predictions regarding an uncertain future, unsupported by record evidence. As Ad Hoc and others have documented repeatedly, special access customers have paid millions of dollars in inflated special access prices over the past several years because of the Commission’s willingness to base its pricing flexibility rules on “predictive judgments” regarding the imminent emergence of sufficient special access competition to discipline the BOCs’ prices.
- The Commission relies on CLEC access to ILEC-provided UNEs as a source of cost-based loops for special access.<sup>38</sup> But UNE loops can only be used for local services, not the kinds of interstate services for which enterprise customers use special access.<sup>39</sup> CLEC providers cannot use UNEs where special access is required. The price of UNEs cannot therefore constrain special access prices for these services.
- Finally, the Commission states that CLECs other than AT&T have “invested heavily” and have “deployed substantial fiber facilities” in a number of MSAs where AT&T also has facilities – although it cannot specify the amounts of these CLEC deployments. As Ad Hoc has demonstrated previously, competitive presence at customer locations cannot be assessed simply with fiber route miles because access to customers depends on final mile connections. From a customer’s perspective, a CLEC either has facilities serving a particular building or it does not, regardless of the fiber capacity passing the building by.

As was discussed in detail in Ad Hoc’s reply comments in the *SBC/AT&T*

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<sup>36</sup> *SBC/AT&T Merger Order* at para. 34.

<sup>37</sup> *SBC/AT&T Merger Order* at para. 39.

<sup>38</sup> *SBC/AT&T Merger Order* at para. 41.

<sup>39</sup> The Commission plainly recognized this distinction in the *TRRO Proceeding* when it observed that, “[a]s an initial matter, we note that the incumbent LECs’ argument rests on the flawed assumption that any carrier using special access is competing successfully in the local exchange markets. This is not so. First, as stated above, the majority of special access arrangements are used to provide service in the mobile wireless and long distance markets. These arrangements clearly are not pertinent to the state of the local exchange market, and, in any event, we have above foreclosed UNE access for the exclusive provision of mobile wireless and long distance services.” *TRRO Proceeding* at para. 64.

*Merger Proceeding*,<sup>40</sup> the heightened ability and incentive for a post-merger AT&T to engage in anti-competitive price squeezes is among the foremost threats to competition. For many years before its acquisition by SBC, AT&T was an active and vocal advocate for FCC intervention against both the potential and actual price squeezes imposed by the RBOCs by virtue of their dominance over access services.<sup>41</sup> Although AT&T's silence regarding this issue has been deafening since its acquisition by SBC, these concerns have only increased for the remaining competitors as a result of SBC's vertical integration with its former rival AT&T and then, in short order, its proposed expansion to the BellSouth region.

**B. The Commission should not permit the already inadequate level of competition for special access services to be further reduced**

With the exception of parties that focused exclusively on mass market impacts, virtually every commenting party focused on the lack of special access competition and the inevitable reduction in competition should the BellSouth-AT&T merger be approved. In their comments, these parties point out that the merger is likely to reduce competition in both the wholesale special access market and in the retail enterprise market, where special access is a critical input.<sup>42</sup>

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<sup>40</sup> Reply Comments of Ad Hoc Telecommunications Users Committee (May 10, 2005) at 21-22.

<sup>41</sup> See also Comments of Global Crossing at 4-5; Comments of Cbeyond at 88-92 ("Consumers are indirectly harmed when an incumbent LEC's discriminatory practices increase its competitor's general costs and negatively affect the competitor's ability to provide service to its consumers in other regions."); Comments of Comptel at 11.

<sup>42</sup> See, e.g., Comments of Cbeyond at 51-56, 61; Comments of Sprint Nextel at 11-12; Comments of Comptel at 7-8; Comments of Global Crossing at 3-5.

The merger applicants take the position that AT&T's Type I special access facilities in the BellSouth operating territory are much sparser than in the SBC region and, for all intents and purposes, inconsequential. But losing AT&T is hardly inconsequential as a competitive matter. Each of the CLECs and wireless carriers that filed initial comments emphasized that, for wholesale special access, AT&T has been the leading non-ILEC supplier.<sup>43</sup> While the applicants seek to minimize the significance of losing AT&T as a competitor, AT&T stands out as having, by a wide margin, the most broadly deployed alternative special access capabilities, both nationwide and in the BellSouth region.<sup>44</sup> According to BellSouth's filing in the *Special Access Rulemaking*, the largest of the remaining competitive providers had less than one-quarter the number of lit buildings as AT&T and a much sparser geographic coverage within the BellSouth region.<sup>45</sup> BellSouth's evidence also suggests that the merger applicants have underrepresented AT&T's presence in the BellSouth region. In a filing it made less than a year ago in the Special Access Proceeding; BellSouth identifies AT&T as having lit fiber installed in nearly twice as many MSAs as those the

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<sup>43</sup> As noted above, at note 32, CMRS provider Sprint Nextel indicates that has no choice but BellSouth or AT&T for 99% of its special access lines to cell sites located in their respective ILEC regions.

<sup>44</sup> Comments of Comptel at 7; Comments of Cbeyond at 63, Comments of Global Crossing at 3 ("estimates that [post merger] 38% of its national annual special access purchases would be direct to a combined AT&T/BellSouth."). Global Crossing also asks the Commission to take administrative notice of the extensive evidence it produced in the SBC/AT&T and Verizon/MCI merger dockets with regard to the substantial harm to competition in the special access services market(s). Comments of Global Crossing at 5. Ad Hoc also urges the Commission to take the appropriate measures to preserve the evidence from these two major dockets for reference in other relevant proceedings (such as the *Special Access Rulemaking*).

<sup>45</sup> Comments of Cbeyond at 63-64.

applicants claim today.<sup>46</sup> Ad Hoc shares the concerns of the many parties who have challenged the merger applicants' attempt to dismiss the significance of the competitive harm that would result from losing the strongest actual competitor in this market.

Ad Hoc also agrees with Cbeyond that AT&T's market presence in BellSouth's territory cannot be assessed merely by reference to the metrics of fiber miles or lit buildings. As Cbeyond points out, AT&T's "competitive success" "is determined by a variety of factors, including its network facilities in other cities and nationally as well as its unrivaled ability to negotiate discounts...for transmission services due to its size and scope."<sup>47</sup> The Commission cannot assume that AT&T had exhausted its opportunities for growth as a supplier of local transmission facilities. More likely, it would have continued to be the strongest candidate to expand its presence in competition with the ILEC.

### **III. THE COMMISSION MUST IMPOSE MERGER CONDITIONS TO ADDRESS THE LACK OF COMPETITION IN SPECIAL ACCESS MARKETS**

Ad Hoc agrees with those commenters who urge the Commission to impose conditions upon any grant of the merger application. Specifically, the Commission should require the applicants to comply with conditions that will prevent the merged entity from exploiting its virtual monopoly over the provision of business broadband (*i.e.*, special access) services. The conditions must not only protect competitors who are dependent on the applicants' broadband

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<sup>46</sup> Comments of Cbeyond at 63, *citing* Reply Declaration of Stephanie Boyles, attached to BellSouth Reply Comments, WC Docket No. 05-25, filed July 29, 2005.

<sup>47</sup> Comments of Cbeyond at 65.

service from anti-competitive practices, such as discriminatory pricing, provisioning, and service quality, but must also protect enterprise customers from exploitive prices and profits and ensure that the merged entity does not impede or restrict the development of competition in the special access market.

Consistent with these objectives, Ad Hoc supports many of the merger conditions proposed by a number of commenting parties. In particular, however, Ad Hoc urges the Commission to:

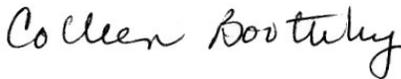
- Require the merged entity reinitialize its special access rates at the Commission's last-authorized 11.25% rate of return. This should be an interim measure pending re-determination based on current conditions.
- Permit unlimited downward pricing flexibility to respond to competition should it develop in the merged entity's operating region.
- Adjust special access rates annually by a price cap adjustment mechanism that includes a productivity adjustment and an earnings sharing component.
- Require divestiture of competitively sensitive facilities, particularly the broadband wireless spectrum licensed to either applicant and the duplicative wireline facilities of the applicants in either BellSouth's or AT&T's local operating territories;

## CONCLUSION

For the foregoing reasons, the Commission should require the applicants to comply with the requirements identified above as a condition of merger approval.

Respectfully submitted,

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### Certificate of Service

I, Michaeleen Terrana, hereby certify that true and correct copies of the preceding Reply Comments of Ad Hoc Telecommunications Users Committee were filed this 20<sup>th</sup> day of June, 2006 via the FCC's ECFS system,



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