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September 28, 2006

VIA ELECTRONIC FILING

Ms. Marlene H. Dortch, Secretary
Federal Communications Commission
445 12th Street S.W.
Washington, D.C. 20554

Re: *WC Docket No. 06-74: In the Matter of the Application Pursuant to Section 214 of the Communications Act of 1934 and Section 63.04 of the Commission's Rules for Consent to Transfer Control of BellSouth Corporation to AT&T, Inc.*

Dear Ms. Dortch:

On September 8, 2006, Julia Strow of Cbeyond Communications ("Cbeyond"), Susan Berlin of NuVox Communications ("NuVox"), Lisa Youngers of XO Communications ("XO"), Jim Falvey of Xspedius Communications ("Xspedius"), and Brad Mutschelknaus and Tom Cohen of Kelley Drye & Warren LLP met with Scott Deutchman, Legal Advisor to Commission Copps, to discuss the proposed merger of AT&T, Inc. ("AT&T") and Bell South Corporation ("BellSouth"). At that meeting, Mr. Deutchman asked the attendees about the legal standards and precedents by which this proposed merger should be judged. The attendees responded that this proposed merger, because it involves both an RBOC acquiring another RBOC and the horizontal overlap of a CLEC and RBOC combining, should be considered under the dual Commission precedents of the BOC-BOC merger orders and BOC-CLEC(IXC) merger orders. To elaborate on this response, Cbeyond, NuVox, XO, Xspedius, along with New Edge Networks, Supra Telecom, and Talk America (collectively, the "CLEC parties") submit this *ex parte* letter.

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Commission Precedents: RBOC-RBOC Mergers

The Commission has long been fearful of threats posed to competition by the merger of RBOCs. When the number of RBOCs was reduced from six to five by the merger of NYNEX and Bell Atlantic, the Commission observed that any further reduction in the number of RBOCs “would present serious public interest concerns”,¹ and said that future applicants would bear an increased burden of establishing that their merger would be pro-competitive and serve the public interest. When SBC proposed two years later to further reduce the ranks of RBOCs from five to four by acquiring Ameritech, the Commission found that the applicants failed to carry their burden, and permitted the combination only after the applicants agreed to an extensive set of conditions designed to ameliorate the anticompetitive consequences of the transaction. As the Commission stated then, the Commission has approved merger transactions between BOC applicants only subject to “very substantial market-opening, benchmarking conditions to alleviate the grave harms th[e] merger poses to the regulatory processes and the operation of the 1996 Act’s interconnection requirements.”² It is clear that whether to approve the SBC/Ameritech merger under *any* circumstance was a close question for the Commission, and that it only agreed to the merger after the Applicants committed to an array of conditions that were simply too vast to ignore.

It is not surprising that permitting RBOC-to-RBOC mergers is unsettling to the Commission. As the Commission explained only last year, in considering whether a proposed transaction will reduce existing competition, it must consider “whether the merger will accelerate the decline of market power by dominant firms in relevant communications markets,” and the effect of the proposed transaction on future competition.³ At least in the absence of incredibly stringent pro-competitive conditions, it 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 and

¹ *Applications of NYNEX Corp. and Bell Atlantic Corp. For Consent to Transfer Control of NYNEX Corporation and Its Subsidiaries*, 12 FCC Rcd 19985 (1997), ¶ 156 (“NYNEX/Bell Atlantic Merger Order”).

² *Applications of Ameritech Corp., and SBC Communications 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*, 14 FCC Rcd 14712, ¶185 (1999) (“SBC/Ameritech Merger Order”).

³ *Id.* ¶ 18.

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competitors 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.⁴

The proposed merger of AT&T and BellSouth must be measured against the failings identified by the Commission in connection with the SBC/Ameritech merger and its progeny. Although it is tempting to believe that nothing has changed, the fact is that the risk posed to competition by RBOC-to-RBOC mergers has increased over time. By eliminating three of the original seven RBOCs, the anticompetitive effects of eradicating *any* of the remaining RBOCs are accentuated substantially. The loss last year of the two primary non-incumbent LEC market participants – the pre-merger AT&T and MCI – has made the situation even more acute. The annual revenue of one of the largest competitive LECs, XO, is only approximately 1.6% of the revenue of a combined AT&T and BellSouth. Similarly, the annual revenue of the largest competitive LEC located in the BellSouth region, ITC^Deltacom, is less than .005% of the revenue of a combined AT&T and BellSouth. Indeed the AT&T-BellSouth combination would enjoy a 30% *nationwide* share of the customer segment primarily targeted by competitive LECs - small and medium-sized businesses -- while its largest non-incumbent LEC competitor (XO) would have only 4%.⁵

When this enormous disparity of scale is combined with the market power enjoyed by RBOCs through their control of legacy bottleneck facilities, the barriers to both the entry and growth of competitive carriers become overwhelming. Hence, it should be no surprise that the number of UNE loops provided by incumbent LECs to competitive carriers has not increased appreciably since mid-2002, or that competitive LEC penetration of the small to medium-sized business market peaked in 2003⁶, even while such customers say they much prefer competitive LEC service quality.⁷ In any event, it is clear that each concern expressed by the Commission with respect to prior RBOC-to-RBOC mergers applies at least equally to the proposed acquisition of BellSouth by AT&T.

⁴ *Id.* ¶ 3.

⁵ Yankee Group Report, “How do SMBs Fare in the competitive LEC Versus incumbent LEC Matchup?” (Apr. 2006) (“*Yankee Group Study*”), Exh. 1.

⁶ *Id.* Exh. 4.

⁷ *Id.* 5.

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Eliminating Potential Competition. As geographically adjacent RBOCs, AT&T and BellSouth are the most significant potential competitors to one another. As was the case in the Commission's review of the SBC/Ameritech merger, both firms are the "most significant market participants in geographic areas adjacent to their own regions."⁸ The Commission has established that the relevant geographic markets are individual metropolitan areas.⁹ In this instance, it is clear that due to simple proximity it would be relatively easy for BellSouth to expand its network as required to provide competitive telecommunications services in a number of SBC-dominated metropolitan areas just over the border from its existing operating territory – Houston, Galveston, Little Rock, St. Louis and Indianapolis are but a few prime examples.

The likelihood of AT&T – with the combined resources of the legacy SBC and AT&T -- competing for mass market customers in the existing BellSouth region is even more striking. Of course, it has the same opportunity to extend its existing local network to nearby metropolitan areas where BellSouth is dominant – examples include New Orleans, Shreveport, Memphis, Lexington and Nashville. In addition, however, AT&T operates substantial fiber networks in many other BellSouth cities that are not near the border of the traditional SBC operating territory. In major cities like Atlanta, Miami, Tampa, Jacksonville, Birmingham, Charlotte, and Raleigh, AT&T has extensive switching facilities and transmission networks in place that, when combined with AT&T's other assets, position it uniquely to provide telecommunications services in competition with BellSouth across virtually the entire region.

When considering the impact of the proposed merger on the *small-to-medium-sized business* and *enterprise* customer markets, one need not even analyze the potential for AT&T and BellSouth to compete with each other.¹⁰ AT&T already is, by its own claim, the

⁸ *SBC/Ameritech Merger Order*, ¶ 66.

⁹ *Id.* ¶ 69.

¹⁰ While the FCC only believed that the loss of potential competition in the SBC-Ameritech merger would harm mass market customers, the rationale underpinning that finding was based on the conclusion that "incumbent LECs face increasing competition from numerous new facilities-based carriers in serving the larger business market" (paragraph 89, *SBC/Ameritech Order*) and that "a large number of other firms may have similar capabilities and incentives expanding out-of-region to serve larger business customers." (paragraph 91, *SBC/Ameritech Order*) The Commission then goes on to state in footnotes 200 and 201 of the *SBC/Ameritech Order* that the most prominent of these competitors are the legacy AT&T and MCI. But, neither of these carriers exists after last year's mergers, and the other carriers mentioned – NEXTLINK, e.spire, and WinStar – too are gone, entities that could not survive once the gold rush ended. Finally, and of significant import, the largest CLECs today, as noted in the text above, are dwarfed by the legacy AT&T and MCI. Thus, in revisiting the question of business competition today, the Commission would necessarily find that robust competition did not exist and was not about to develop.

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foremost nationwide competitor for business customers, while there can be no denying that BellSouth is aggressively vying to prevent business customers in its region from slipping away. And the anticompetitive effect of losing AT&T as a potential competitor for the supply of *wholesale services* in adjacent RBOC territories is now a settled matter. To support this potential for cross-territory entry into the business markets, some of the CLEC parties recently submitted evidence to the FCC demonstrating that BellSouth considered AT&T its most formidable competitor in its region, that competing against AT&T would have resulted in a “price war” benefiting customers, and that rather compete it would rather combine with AT&T, sacrificing these customer benefits. This submission also noted BellSouth’s efforts and plans to compete in AT&T’s region.¹¹

Undermining Implementation of the 1996 Act – the Loss of Benchmarks. The Commission has found that a substantial harm to competition flowing from RBOC-to-RBOC mergers is that the “resulting...overall loss of diversity at the operating company level” is likely to derail efforts by the Commission and competitors to identify the best practices among incumbent LECs, and then use the best practices as a benchmarking tool to root out anticompetitive practices by other incumbent LECs.¹² The problem is that the “larger combined entity will have a greater incentive to unify the practices of its separate operating companies,” and the adoption of poor practices can be a sort of race to the bottom. Indeed, the Commission has found that mergers between RBOCs “directly increase the incentive and ability of remaining incumbent LECs to coordinate their behavior to resist market opening measures.”¹³ That concern is well-founded in the immediate proposed transaction. AT&T and BellSouth have dramatically different practices and policies on matters that materially affect the ability of new entrants to compete. In the areas of special access pricing, commercial agreements, performance metrics, line sharing and interconnection agreement terms and conditions, to name a few, the practices of one applicant are significantly more anticompetitive than the behavior of its proposed merger partner. BellSouth, for example, allows meaningful circuit portability in its special access volume and term deals, whereas AT&T does not. By contrast, AT&T is open to negotiating line sharing arrangements, whereas BellSouth is not.

¹¹ See Letter from Denise Smith, Kelley Drye & Warren LLP, Counsel to Cbeyond, NuVox, XO and Xspedius to Marlene Dortch, Secretary, Federal Communications Commission (transmitting *ex parte* presentation in WC Docket No. 06-74) (August 22, 2006 at 7-8 (“Joint CLEC August 22, 2006 *Ex Parte*”).

¹² *SBC/Ameritech Merger Order*, ¶ 59. It is important to note that the Commission’s concern about potential entry in this previous RBOC-RBOC merger was limited to the mass market, but its concerns about benchmarking and discrimination were not so limited, extending to all markets.

¹³ *Id.*

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On such occasions, the disparity in practices enables both regulators and competitors to identify unreasonable behavior that interferes with accomplishing the market-opening objectives of the 1996 Act, and take appropriate steps to rectify problem situations through negotiation or regulatory intervention. The Commission has concluded that its “ability to analyze a wide variety of approaches” among the major incumbent LECs is “especially crucial” for regulators and competitors to implement the 1996 Act, and that regulators “benefit greatly from observing diverse strategic decisions and experimentation among the incumbents.”¹⁴ However, the comparative practices analyses that the Commission has described as the “best means” available to stay abreast of problems,¹⁵ would be almost completely sacrificed by the proposed AT&T/BellSouth combination. While some ability to engage in benchmarking is lost with each successive merger of incumbent LECs, the proposed AT&T/BellSouth merger crosses the tipping point by reducing the number of RBOCs to only three – a number that is inadequate to permit the kind of experimentation and behavioral comparison heretofore relied upon so critically. Indeed, the Commission has previously speculated that a merger reducing the number of major incumbent LECs from four to three “would so severely diminish the Commission’s ability to benchmark that it is difficult to imagine that any public interest benefit could outweigh such a harm.”¹⁶ Thus, as the Commission has previously observed, the resulting loss of oversight through comparative practice analyses “can only serve to further entrench the large incumbent LECs’ substantial market power,” to the detriment of the public interest.¹⁷

Increasing Incentives to Discriminate. As the Commission has found with respect to previous AT&T acquisitions of fellow RBOCs, such mergers increase both the incentive and ability of the “larger merged entity to discriminate against rivals in retail markets where [AT&T] will be the dominant LEC.”¹⁸ The sheer increase in the number of local areas controlled by AT&T as a result of the merger will increase substantially its incentive and ability to discriminate against carriers competing in retail markets that depend on access to AT&T’s inputs in order to provide services. The proposed transaction, for example, introduces the incentive and ability to reduce rivals’ ability to compete in Houston by discriminating against them in Atlanta, raising their overall costs in ways that hinder their ability to compete system-wide. Currently the ability of AT&T and BellSouth to engage in such behavior stops at the

¹⁴ *Id.* ¶ 109.

¹⁵ *Id.*

¹⁶ *Application of GTE Corp. and Bell Atlantic Corp. for Consent to Transfer Control of Domestic and International Section 214 and 410 Authorization*, Memorandum Opinion and Order, 15 FCC Rcd 14032, at 1170 (2000) (“*Bell Atlantic/GTE Merger Order*”).

¹⁷ *Id.* ¶ 104.

¹⁸ *Id.* ¶ 60.

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borders of their respective operating regions, whereas the proposed merger would expand the capability across nearly half the nation.

The previous RBOC-RBOC orders thus provide the bases upon which to judge the pending proposed merger. The Commission, being bound by its precedents, needs to follow the standards in these orders and develop conditions along the lines of those adopted in the previous orders to remedy these harms.

Commission Precedents: RBOC-CLEC Mergers

Analysis of the RBOC-RBOC merger orders, however, does not end the Commission's review in the context of the proposed merger of AT&T and BellSouth. Because AT&T is the dominant local competitor in the BellSouth region, there are additional Commission orders – most notably those deciding the RBOC-CLEC mergers – that establish further precedents that it is obligated to follow in the pending merger review.

In connection with the AT&T/SBC merger only last year, the Commission found that the withdrawal of AT&T as a competitor to RBOC special access services was likely to have an anticompetitive effect on the market for Type I special access services.¹⁹ Indeed, the problem was sufficiently worrisome that the U.S. Department of Justice filed a lawsuit contending that the likely diminution of special access competition was violative of federal antitrust laws. In the proposed AT&T-BellSouth merger, any analysis of local private line competition in the BellSouth markets will result in findings of even greater harm. Some of the CLEC parties have submitted evidence to the Commission that AT&T's local market presence in the BellSouth region is much more expansive than just this Type I service. Not only does AT&T have networks throughout the region, but it throws its competitive weight around by being the largest user of other CLEC facilities. It also is the most recognized competitive brand in the region.²⁰ This evidence provides the bases for the Commission to adopt and enhance the conditions adopted in last year's merger.

¹⁹ *AT&T/SBC Merger Order*, ¶ 3.

²⁰ *Joint CLEC August 27, 2006 Ex Parte*.

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Conclusion

If approved, the transfer of control of BellSouth to AT&T will reduce the number of RBOCs from four to three, eliminate AT&T as the most dominant local competitor to BellSouth in its region, and eliminate BellSouth as an actual and potential competitor to AT&T in its region, and thereby result in undue concentration of the telecommunications industry and consequent harm to customers. As set forth in this letter, the Commission has an obligation to review this merger under both its RBOC-RBOC merger precedents and its RBOC-CLEC merger precedents. The Joint CLECs maintain that by following the standards established in these order, the Commission has no choice but to find the combination would result in substantial public interest harms, which cannot be mitigated by the nominal public interest benefits, if any, claimed by the parties' Application. However, in the event that the Commission grants approval of the Application, once again following these precedents, such approval must be subject to stringent conditions, as is necessary to protect the public interest, convenience and necessity.

Respectfully submitted,



Brad E. Mutschelknaus

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