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November 20, 2006

EX PARTE

Ms. Marlene H. Dortch
Secretary
Federal Communications Commission
Room TW-A325
445 12th Street, SW
Washington, DC 20554

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

Dear Ms. Dortch:

On November 17, 2006, the undersigned and Jonathan Lechter, met with Scott Deutchman, legal advisor to Commissioner Michael Copps, and Scott Bergmann, legal advisor to Commissioner Jonathan Adelstein. The enclosed document formed the basis of our discussion.

Pursuant to Section 1.1206(b) of the Commission's rules, 47 C.F.R. § 1.1206(b), one electronic copy of this notice is being filed the above referenced proceeding.

Sincerely,

/s/

Thomas Jones

WILLKIE FARR & GALLAGHER LLP
ATTORNEYS FOR TIME WARNER TELECOM INC.

cc: Scott Deutchman
Scott Bergmann

ILLUSTRATIONS OF THE MARKET POWER AND ANTI-COMPETITIVE CONDUCT THAT ARE THE FACTUAL PREDICATES FOR THE BIG FOOTPRINT AND BENCHMARKING PROBLEMS

**WC Docket No. 06-74
(Nov. 17, 2006)**

- I. **Elimination of AT&T and BellSouth as Actual and Potential Competitors.** 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. The merger also eliminates BellSouth as a potential competitor in this product market in AT&T's territory. The elimination of this actual and potential competition makes a bad situation worse.
- II. **Applicants' Enduring Market Power Over Local Transmission Facilities Needed to Service Enterprise Customers.**
 - A. Two years ago, AT&T and BellSouth stated that **CLECs have deployed fiber loops to only 32,000, or 1.1-4.6 percent of the nation's commercial office buildings.** See *UNE Fact Report* at III-4. This conclusion was adopted by the FCC in the *TRRO*. See *Triennial Review Remand Order* n.856. Verizon estimated that in 1996 24,000 buildings were served by CLEC fiber. See Verizon Comments, WC Dkt. No. 05-25, Attach. C, Declaration of William Taylor, at Table 10, (filed June 13, 2005). According to the ILECs, therefore, **in 10 years, CLECs have constructed loops to only 8,000 buildings,** underscoring the continuing difficulty of loop construction.
 - B. **"For the vast majority of commercial buildings in its territory, SBC is the only carrier that owns a last-mile connection to the building."** Department of Justice, *SBC/AT&T Merger Competitive Impact Statement* at 6.
 - C. "[I]n the vast majority of the commercial buildings to which TWTC cannot deploy and has not deployed loops in the BellSouth and AT&T ILEC territories, BellSouth and AT&T have respectively deployed their own loops. In fact **in TWTC's experience, BellSouth and AT&T own the only loops serving most of these commercial buildings in their respective territories.**" *Taylor Reply Dec.* ¶ 4.
 - D. The Applicants indicate that there are 219,000 locations that demand enterprise class services in BellSouth's territory. See *Carlton and Sider Dec.* ¶ 22. Yet, in the *TRRO*, BellSouth stated that CLEC fiber loops serve only approximately 2,200 buildings in all of BellSouth's territory. See BellSouth Ex Parte Letter, CC Dkt. No. 01-338 at 4 (filed Aug. 19, 2004). **Based on BellSouth's own numbers therefore CLECs have deployed loops to only one percent of the commercial buildings in BellSouth's region.**

- E. As demonstrated by the rate information set forth below, the Applicants also have substantial and persisting control over the “mileage” component of special access facilities because of the limited geographic scope of competitors’ networks.
- F. TWTC is one of the most prolific CLEC builders of fiber loop facilities and TWTC focuses its service offerings wherever possible on customers with at least some locations to which TWTC can deploy its own loops. Yet, as of May 2006 TWTC had built fiber to only 6,185 of its 16,865 customer locations, meaning that even **TWTC must rely on leased (almost always ILEC) facilities to serve 73.2 percent of its customer locations.**
- G. CLEC wholesale loops are not available in the vast majority of locations, but where they are, **[confidential begin]**
[confidential end]
1. Despite TWTC’s best attempts to lease CLEC wholesale facilities wherever possible, **TWTC has purchased or is in the process of purchasing access to non-ILEC Ethernet loops to [confidential begin] [confidential end] of the locations to which TWTC provides Ethernet service.**
 2. TWTC often cannot purchase local transmission from competitors even in the few locations in which they are available because **[confidential begin]**

[confidential end]

III. **CLECs’ Increased Dependence on ILEC Enterprise Loops.**

- A. Business customers increasingly demand that a single carrier serve all or most of the customer’s locations, the vast majority of which can only be reached by ILEC supplied loops. As explained by TWTC declarant Graham Taylor, “it is becoming increasingly important that TWTC serve a higher percentage of its Customer Locations than it has in the past. In the past, it was possible for TWTC to provide a service to a subset of a customer’s locations and the customer would then integrate the TWTC service with services offered by other carriers. **However, customers increasingly demand that carriers perform this network integration function and that carriers provide all of the services that a business customer needs to all of the customer’s locations...to reach all of a customer’s locations to provide services in this manner, TWTC is increasingly dependent on purchasing local transmission facilities to locations to which TWTC could not deploy its own loops**” Taylor Dec. ¶ 25.

B. The average TWTC customer has [confidential begin]

[confidential end] Therefore, to serve the remainder of its customers' locations, TWTC will in the future be forced to increasingly rely on ILECs.

IV. **The Applicants Are Acting On Their Incentives To Raise Rivals' Costs.**

A. AT&T's and BellSouth's local transmission service prices and margins have increased while the same transmission services offered in competitive markets have declined sharply:

1. Two former FCC economists investigated ILEC special access rates and determined that, in those regions where ILECs had been granted pricing flexibility, these rates increased substantially in nearly every region. They concluded that **"in a competitive market with the demand for special access service growing...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 their market power and that the market for special access service is not competitive."** Noel D. Uri and Paul R. Zimmerman, *Special Access Service and its Regulation in the United States*, 6 Journal Of Policy, Regulation, and Strategy for Telecommunications, 122, 157 (2004).
2. In contrast, "Consider the market for DS3 level transport from New York to Los Angeles, a distance of approximately 2,500 miles. In June 1999, such a circuit would be leased for \$55,000 per month. In February 2004, the price was \$3,500 per month. This represents **a decline of over 90 percent**." See Declaration of Simon Wilkie, ¶ 10, Attached to Opposition of Global Crossing, WC Dkt. No. 05-65 (filed Apr. 25, 2005).
3. The ILECs' assertion that prices per line equivalent have gone down is misleading and in no way shows that prices in real terms are declining.
 - a. As AT&T explained, "It is highly likely that the higher-capacity special access services, at the DS-3 and OCn levels, have experienced disproportionately greater growth than low-capacity DS-0 and DS-1 services. Since the effective price per DS-0 equivalent is lower in these higher capacity services, their likely disproportionate growth readily explains the apparent drop in DS-0 equivalent price levels (revenue per line)." Reply Declaration of Lee Selwyn ¶ 78, attached to Comments of AT&T, RM No. 10593 (filed Jan. 23, 2003).
 - b. As explained recently by former FCC Chief Economist Joseph Farrell, an analysis of "average special access revenue per DS1" is highly misleading and has little to do

with the actual price of DS1 or DS3 facilities: As the years go on, and the march of Moore's law continues, the average customer desires more and more bandwidth, so a customer that used to only demand 4 DS1s of capacity may now demand 7 DS1s of capacity. Suppose that a DS1 costs \$365 per month, while a DS3 (which has the capacity of 28 DS1s) costs \$2,290. These were SBC's 2004 tariffed rates. Since a DS3 costs slightly less than 7 individual DS1s, when the customer needs the seventh DS1 of capacity, he will buy a DS3 instead. As a result, when the customer converts from 6 DS1s to 1 DS3, the "average special access revenue per DS1" for that customer drops from \$365 to \$82 (*i.e.* \$2290/28). However, the *actual price* for DS1s and DS3s has not declined at all, and in fact, may have increased. *See* Declaration of Joseph Farrell ¶ 4, attached to Global Crossing *et al.*, Comments, WC Dkt. No. 05-25 (filed July 29, 2005).

B. Today, Applicants' local transmission prices are exorbitant by any measure.

1. Pricing charts recently filed by Global Crossing in the merger docket indicate that **BellSouth's in-region DS1 and DS3 prices are, in some cases, more than 100 percent higher than competitive rates, including the rates charged by AT&T's CLEC subsidiary.** Discounts of up to 21 percent (available only with substantial volume and term commitments) do not come close to closing the ILEC/CLEC price delta. *See* Letter of Paul Kouroupas, counsel, Global Crossing, to Marlene H. Dortch, Secretary, FCC, WC Dkt. No. 06-74 at 2 (filed Oct. 27, 2006).
2. As of the year end 2005, rates of return for RBOC special access had reached stratospheric levels: **AT&T-91.7 percent and BellSouth-98.3 percent.** *See* Reply Declaration of Susan Gately, ¶ 7 attached to Reply Comments of Ad Hoc Telecommunications Users' Committee, WC Dkt. No. 06-74 (June 20, 2006).
3. AT&T's prices under pricing flexibility are higher than price caps, especially for channel mileage:
 - a. Legacy SBC **DS1 channel termination charges were up to 19 percent higher under price flex than under price caps. DS3 channel terminations were up to 35 percent higher.** *See* Declaration of Janet Fischer at Table 1, attached to Comments of Global Crossing, WC Dkt. No. 05-25 (filed June 13, 2005);
 - b. Legacy SBC **DS1 channel mileage charges were up to 32 percent higher under price flex than under price caps. DS3 channel mileage charges were up to 44 percent higher.** *See*

Declaration of Janet Fischer at Table 1, attached to Comments of Global Crossing, WC Dkt. No. 05-25 (filed June 13, 2005);

4. According BellSouth's own data, special access rates are much higher than either competitor or UNE rates.
 - a. BellSouth's average special access price for a DS1 is \$240, compared to a competitor's average of \$140 and a UNE DS1 average of \$141. *See* Reply Comments of CompTel *et al.*, WC Dkt. No. 05-25 at 20 (filed July 29, 2005) (citing Declaration of Stephanie Boyles ¶¶ 6-8, attached to BellSouth Comments, WC Dkt. No. 05-25 (filed June 13, 2005)).
 - b. BellSouth's average special access price for a DS3 is \$1,356 while competitors charge on average \$700 and a UNE DS3 costs on average \$628. *See* Reply Comments of CompTel *et al.*, WC Dkt. No. 05-25 at 20 (filed July 29, 2005) (citing Declaration of Stephanie Boyles ¶¶ 6-8, attached to BellSouth Comments, WC Dkt. No. 05-25 (filed June 13, 2005)).
 - c. **DS1 mileage charges are between 13 to 71 percent higher in BellSouth price flex MSAs than under price caps.** Comments of CompTel *et al.*, WC Dkt. No. 05-25 at 7 (filed June 13, 2005).
 5. The average ILEC DS1 UNE per mile charge is \$1.52 per mile versus \$13.72 for special access. ILEC DS3 UNE mileage was \$23.35 per mile versus \$57.84 for special access. Comments of CompTel *et al.*, WC Dkt. No. 05-25 at 10 (filed June 13, 2005).
- C. In order to obtain lower (but still monopoly-level) rates for special access services from AT&T, carriers must agree to provisions such as a MARC, forgoing the right to UNEs and purchasing circuits from other wholesale carriers and agreeing to unreasonable tying arrangements.
1. **"[W]hen a monopoly offers proportional or relative discounts off its undiscounted prices in order to induce customers to agree to exclusionary provisions, it has an incentive to set the undiscounted price above even the monopoly level (because rather than simply deterring demand, an increase above the monopoly level steers customers into the discount plans and also brings the discount prices closer to the monopoly level)."** Declaration of Joseph Farrell ¶ 4, attached to Global Crossing *et al.*, Comments, WC Dkt. No. 05-25 (filed July 29, 2005).
 2. TWTC signed its 2005 special access volume/term contract with AT&T [confidential begin]

[confidential end] simply **“[b]ecause of the absence of alternatives to AT&T’s ubiquitous network.”** *Taylor Reply Dec.* ¶ 29. TWTC would have been unable to provide service to most of its customers in its region without the discounts provided by AT&T’s contract. Even under that contract, however, TWTC faces substantial limitations in terms of the *types of customers it can serve.*

3. The FCC has repeatedly found in the context of interconnection and pole attachment agreements that inequality in bargaining power would likely force the weaker party (the CLEC or attacher) to agree to unreasonable terms and conditions from the stronger party (the ILEC or utility).

D. Unreasonably high (and ever-rising) special access rates restrict the scope of the customers and services that competitors can offer. As AT&T itself explained, prior to its merger with SBC, **it “largely discontinued providing local private line services where it relies upon leased access for the ‘last mile’ special access at both end[s] of the circuit.... [W]herever it must use special access at both ends of the private line, there is simply no way for it to profitably offer this service.** Thus, AT&T offers local private line service [in] those situations where it is able to provision the service primarily using its own network facilities. **As a result, AT&T’s offer is limited either to those customers with the high level of demand needed to justify deployment of facilities, or the relatively small number of potential customers in locations that AT&T already serves at least one end.”** Declaration of Alan Benway, attached to AT&T Comments, WC Dkt. No. 04-313, ¶ 101 (filed Oct. 4, 2004).

V. **Case Study of AT&T Anticompetitive Conduct: Ethernet Service.**

A. **AT&T’s Ethernet federal tariffed rates are set far above the level that would be charged in a competitive market.**

1. **AT&T’s federal tariff rates are [confidential begin]**
[confidential end] than TWTC’s retail prices in many cases.
For this reason, TWTC has not purchased a single Ethernet circuit from AT&T under tariff. [confidential begin]

[confidential end]

2. AT&T’s internal documents indicate that, **[highly confidential begin]**

[highly confidential end] ATT-FCC-00342879.

- B. AT&T has used its volume/term contract negotiations for Ethernet as a means of slow rolling TWTC's roll out of Ethernet and of dramatically restricting the scope of the services and customers TWTC can serve. During the course of [confidential begin]

1.

[confidential end] *Taylor Reply Dec.* ¶ 13. Given the limited reach of TWTC's network and customers' demand that carriers serve a larger percentage of their locations, the scope of TWTC's Ethernet offer would be extremely limited.

2. Place TWTC in a price squeeze by setting AT&T finished Ethernet loop prices in some cases at levels that are more than [confidential begin] [confidential end] than TWTC's retail rates; indeed, there is every reason to believe that AT&T exploits opportunities for price squeezes to its maximum advantage:

a. [confidential begin]

[confidential end] ATT-FCC-00344411.

- b. There is "substantial anecdotal evidence that AT&T is able to undercut TWTC's Ethernet rates ... because it sometimes offers its retail customers the intrastate rate for Ethernet services." *Taylor Reply Dec.* ¶ 34. In many states, AT&T is under no obligation to offer these intrastate rates to its wholesale carrier customers.

3. Require that TWTC [**confidential begin**]

4.

5.

[**confidential end**]

C. By contrast, when TWTC offers wholesale Ethernet, it does so in competition with Applicants and TWTC almost never controls the only local transmission facility. TWTC provides wholesale Ethernet services to AT&T and others:
[**confidential begin**]

1.

2.

3.

4.

[**confidential end**]

D. As a result of AT&T's high prices "TWTC can only serve a small subset of the market when relying on TDM transmission inputs than it could otherwise serve if it could obtain finished Ethernet loops on reasonable terms and conditions." *Taylor Reply Dec.* ¶ 25. This is so for several reasons:

1. Ethernet over TDM requires the purchase of additional electronics for each circuit to translate the signal from TDM to Ethernet and back again;

2. Ethernet over TDM "introduces additional points of potential failure into the circuit," (*Taylor Reply Dec.* ¶ 24) which substantially increases the cost of maintenance and troubleshooting, especially for circuits that are distant from urban centers;

3. Substantial mileage charges for TDM special access make it economically infeasible to use TDM special access if the prospective customer location is [**confidential begin**] [b] [**confidential end**]
(*Taylor Reply Dec.* ¶ 19) from TWTC's point of interconnection with AT&T in a particular market; and

4. The differences in bandwidth increments between Ethernet and special access, as well as the bandwidth degradation that occurs when TDM signals are converted to Ethernet, "increases TWTC's costs because TWTC must purchase much more TDM capacity than it needs to provide the Ethernet service." *Taylor Reply Dec.* ¶ 20.

E. **Pre-SBC merger AT&T experienced the same problems TWTC has experienced:** "AT&T has also had to apply similar limitations on its local Ethernet products...where [AT&T] must rely on the RBOCs for high priced special access as a product component, there was simply no way that it could profitably sustain a competitive offer. As a result, AT&T now primarily offers these services only in circumstances where it can self-provision the access. -- i.e., to the limited subset of customers whose locations are already on AT&T's network." Declaration of Alan Benway, attached to AT&T Comments, WC Dkt. No. 04-313, ¶ 103 (filed Oct. 4, 2004).

VI. **The Merger Will Lead to Harms from an Increased Footprint and the Loss of a Benchmarking Firm.**

A. As the Commission found in the SBC/Ameritech and Bell Atlantic/GTE mergers, the extension of an ILECs' 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 such conduct.

1. TWTC's extensive facilities in both the AT&T and BellSouth regions will create an incentive to discriminate post-merger because the merged company can internalize the effects of its discrimination that would otherwise harm TWTC outside of the Applicants' regions.
2. TWTC customers have [confidential begin] [confidential end] locations respectively in markets in the AT&T ILEC and BellSouth territories outside of markets where TWTC has facilities. Of the total TWTC customer locations, [confidential begin] [confidential end] are located in AT&T's territory and [confidential begin] [confidential end] are located in BellSouth's territory. **Customers with locations that TWTC serves in both the BellSouth and AT&T regions already account for [confidential begin] [confidential end] of TWTC's billed revenues. This percentage will increase as TWTC must serve more of its customers' locations.**

B. The merger will eliminate BellSouth as a benchmark against which to judge and regulate the conduct of other large ILECs.

1. The need to benchmark ILEC behavior is so critical that the FCC 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 public interest benefit could outweigh such a harm. *Bell Atlantic/GTE Merger Order* ¶ 170.

2. For many years states and the Federal government have employed "best practice" "worst practice" and "average practice" benchmarking.
 - a. Interconnection arbitrations have often involved "best practice" benchmarking for such issues as traffic management and DSL deployment practices.
 - b. "Worst practice" benchmarking has often been used to detect and punish ILEC behavior that clearly falls below the standard that other ILECs can and do offer.
 - c. The states and FCC have often employed "average practice" benchmarking to set both price cap and TELRIC rates.
 - d. The FCC continues to use benchmarking. For example, in its most recent NPRM on special access pricing, the FCC requested data on average RBOC productivity in order to be in a position to set a new x-factor if it so chose. This is a classic example of "average practice" benchmarking.
3. The harm from the loss of a benchmarking firm stems from three main sources (1) fewer RBOCs provide fewer "data-points" for a regulator to analyze in its benchmarking analysis, increasing the likelihood of an error; (2) fewer RBOCs make it less likely that there is a model RBOC against which a best practice can be established; and (3) fewer RBOCs increase the likelihood that the remaining firms will take into their own behavior when the "average" benchmarks are set.
4. The need for benchmarking will only increase with the roll-out of new, advanced services about which the FCC has little experience.
5. Despite the Applicants' allegations, regulations based on "parity" comparisons (the ILEC provides the same level of service to competitors that it provides to itself) cannot serve as a replacement for regulations based on ILEC benchmarks. This is because, in many cases, RBOCs do not self-provide the services demanded by competitors. For example, ILECs need not provide **[confidential begin]**

[confidential end] to themselves or their own customers. Therefore, parity regulation will not prevent ILECs from discriminating against CLECs with respect to these services and facilities.

REDACTED FOR PUBLIC INSPECTION

Attachment

In the Matter of

AT&T Inc. and BellSouth Corporation
Applications for Approval of
Transfer Of Control.

WC Docket No. 06-74

Reply Declaration

of

SUSAN M. GATELY

on behalf of

Ad Hoc Telecommunications Users Committee

June 20, 2006

	AT&T Inc.	BellSouth
1996	12.6%	16.2%
1997	16.0%	17.4%
1998	24.5%	31.3%
1999	39.6%	32.4%
2000	41.4%	36.8%
2001	61.3%	49.3%
2002	51.3%	56.6%
2003	63.2%	69.1%
2004	73.2%	81.9%
2005	91.7%	98.4%

New Table 3.4: Historic AT&T and BellSouth Special Access Rates of Return

1

2 14. Chapter 3 of *Reality or Illusion* also documented that total interstate access return levels
3 were generally substantially above the FCC's last authorized rate. Table 3.1 documented
4 interstate access rates of return for the total interstate category that were, on average, more the
5 50% above the last authorized return level⁸. Inclusion of 2005 return levels on *Updated* Table
6 3.1 below demonstrates that, like special access, the overall earnings of the RBOCs have
7 continued to climb, with the *average* interstate rate of return for the RBOCs increasing by almost
8 37%, from 17.1% to 23.4%. (The new range is between 18.9% earned by Verizon, and 32.7%
9 earned by Qwest.)

10

⁸Id., at 32. These same return levels were also discussed in the initial report at vi and 7.