Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of
AT&T Corp
Petition for Rulemaking to Reform
Regulation of Incumbent Local Exchange
Carrier Rates for Interstate Special
Access Services

RM No. 10593

OPPOSITION OF SBC COMMUNICATIONS INC.

CHRISTOPHER M. HEIMANN
GARY L. PHILLIPS
PAUL K. MANCINI

SBC COMMUNICATIONS INC.
1401 Eye Street, NW
Suite 400
Washington, D.C. 20005
202-326-8909 – phone
202-408-8745 - facsimile

Its Attorneys

December 2, 2002
# Table of Contents

<table>
<thead>
<tr>
<th>Section</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>I. Introduction and Summary</strong></td>
<td>1</td>
</tr>
<tr>
<td><strong>II. Background</strong></td>
<td>4</td>
</tr>
<tr>
<td><strong>III. Competition for Special Access Services is Flourishing</strong></td>
<td>10</td>
</tr>
<tr>
<td><strong>IV. AT&amp;T's “Evidence” Does Not Establish That ILECs Have Market Power For Special Access Services, Much Less That Pricing Flexibility Has Enabled ILECs to Impose Excessive Special Access Rates</strong></td>
<td>15</td>
</tr>
<tr>
<td>A. AT&amp;T's “Evidence” Does Not Show That Pricing Flexibility Permits BOCs to Set Anti-Competitive Rates for Special Access Services</td>
<td>17</td>
</tr>
<tr>
<td>B. The BOCs Cannot Manipulate Special Access Rates to Impede Competition</td>
<td>25</td>
</tr>
<tr>
<td>C. There Are Competitive Alternatives to BOC Special Access Services</td>
<td>32</td>
</tr>
<tr>
<td><strong>V. Conclusion</strong></td>
<td>37</td>
</tr>
</tbody>
</table>
In the Matter of

AT&T Corp.

Petition for Rulemaking to Reform
Regulation of Incumbent Local Exchange
Carrier Rates for Interstate Special
Access Services

RM No. 10593

OPPOSITION OF SBC COMMUNICATIONS INC.

I. INTRODUCTION AND SUMMARY

More than fifteen years ago, a mere three years after the divestiture, AT&T asked the Commission to deregulate all of its long-distance services. Three years later, it asked again, and the Commission responded by subjecting AT&T’s business services to a regime that substantially resembles the Phase II pricing flexibility regime AT&T now derides. A few years later, AT&T sought and received a declaration that it was non-dominant in all of its services.

In each of these proceedings, AT&T argued forcefully that Commission regulation of its long-distance services not only was unnecessary but also counterproductive because it encouraged its competitors to fight their competitive battles in the regulatory arena instead of the marketplace. AT&T correctly convinced the Commission that, in competitive markets, market forces better protect consumers against unjust and unreasonable rates and practices than regulation, and therefore that decreased regulation should accompany increased competition.

AT&T now has become the champion of the very practices it used to condemn. In the local residential market, AT&T has based its business plan on “regulatory blackmail,”
demanding that state commissions dramatically lower the UNE-P rate notwithstanding what the forward looking costs should be based on the TELRIC methodology and filed cost studies (so that, consistent with its policy of "maximizing cash," AT&T can receive a 45% margin on virtually no investment), or AT&T will stay out of the market to the embarrassment of state regulators. At the same time, it is attempting to make it politically impossible for the Commission to eliminate the UNE-P in total disregard of Supreme Court and D.C. Circuit precedent, and so it orchestrates state resistance to any such action while pushing the legally unsustainable notion that states are free to override the Commission's impairment analysis.

In the long-distance arena, AT&T has been no less aggressive, attempting at every turn to morph the 1996 Act into something Congress never intended: a vehicle for re-pricing access services at TELRIC rates. As early as 1996, AT&T set its sights on switched access services, claiming that it should be able to purchase unbundled local switching in lieu of switched access even when it was not providing local service to the customer in question. The Commission rejected that argument but, undaunted, AT&T now wants its special access services -- services used exclusively to serve larger business customers and that have been subject to growing competition for almost twenty years -- re-priced at TELRIC. Indeed, that is what this petition is really about. AT&T has no illusions that the Commission is likely to re-regulate special access services, nor does AT&T even have much of a stake in that game. What it really wants is TELRIC-based special access pricing, and to that end it paints a selective, deceptive picture of the special access market.¹

¹ AT&T asserts that ILEC special rates are "simply obscene" because they exceed forward looking (i.e., TELRIC) costs. AT&T Petition at 4-5, 10-11.
According to AT&T, the Commission was "duped" into granting ILECs special access pricing flexibility.\(^2\) It argues that the Commission’s "predictive judgment" that special access competition in markets meeting the Commission’s pricing flexibility triggers was sufficient to justify special access rate "deregulation" has been proven wrong.\(^3\) Notwithstanding the hundreds of competitors that provide special access services in markets across the country, and the billions of dollars CLECs have invested in competitive transport facilities, AT&T maintains that the special access market is a natural monopoly. It argues further that pricing flexibility has enabled the Bell operating companies (BOCs) to exercise market power to impose "grossly excessive" rates and provide unacceptably poor service quality, even while increasing sales.

AT&T’s petition does not even come close to supporting these arguments. AT&T’s "evidence" regarding the BOCs’ special access revenues and regulatory accounting rates of return says nothing about the impact of pricing flexibility, much less supports its claim that the BOCs retain market power for special access services. To the contrary, the evidence, corroborated by AT&T’s own statements to investors, confirms that competition for special access services and the deployment of alternative transmission facilities not only is possible, it is happening — "every day" "building-by-building" and "address-by-address."\(^4\) AT&T therefore has provided the Commission no basis for turning its back on nearly twenty years of regulatory reform, and substituting regulation, and in particular TELRIC prices, for market forces as the

---

\(^2\) AT&T Petition at 2.

\(^3\) Id. at 2-3. As discussed below, far from "deregulating" special access rates, the Commission’s pricing flexibility regime granted ILECs relatively modest pricing relief, retaining the bulk of the Commission’s regulatory requirements for special access services.

\(^4\) David W. Dorman, President. AT&T, Presentation to Goldman Sachs Communicopia Conference, October 2, 2002 (Dorman Presentation).
primary means of setting prices and constraining anticompetitive behavior in competitive markets. The Commission therefore should reject AT&T's petition.

II. BACKGROUND

Since TCG, MFS and other competitive access providers (CAPs) first began laying competitive fiber networks in New York and other urban markets almost two decades ago, competition for special access services has rapidly grown and prospered. By 1990, CLECs had deployed 20 networks in 15 cities, and in 1991, the Commission found that fiber-based CAPs were providing access services to large customers "in the central business districts of many major cities." Four years later, following the introduction of expanded interconnection, which permitted CAPs to collocate fiber in LEC wire centers to interconnect with LEC networks, the Commission found that CAPs had "experienced incredible growth, nearly doubling in size each year for the [previous] five years." The Commission further concluded that, with the deployment of competitive fiber systems in the 20 largest MSAs, the seeds of local competition were widespread.

By 1995, 29 local competitors had deployed fiber optic networks in 104 cities, and competition was continuing to explode. Between 1995 and 1998 local competitors increased their fiber networks five-fold and were expanding those networks at a significantly faster clip

---


8 Id. at *6. The Commission noted that these initial fiber facilities, usually in the form of fiber rings or loops through central business districts, connected customers to hubs where traffic could be concentrated and handed over to interexchange carriers. Id. at *7.

than incumbent LECs. By the end of 1999, competitors had deployed more than 100,000 route miles of fiber in hundreds of cities.

In response to this growth in competition, the Commission gradually relaxed its regulation of special access services. Thus, in the early 1990's the Commission permitted a LEC to offer volume and term discounts and to deaverage rates for access services once it established operational expanded interconnection (i.e., collocation) offerings. In 1996, the Commission granted LECs greater flexibility by eliminating the lower service band indices, which prevented LECs from lowering access prices, and relaxed the procedures for introducing new switched access services.

In 1999, after examining abundant evidence of increasingly intense competition for special access services, the Commission determined that, while the foregoing measures had afforded LECs some pricing flexibility, LECs still were subject to significant regulatory constraints that were ill suited to the increasingly competitive marketplace. The Commission

---


12 Expanded Interconnection with Local Telephone Company Facilities, CC Docket No. 91-141, 7 FCC Rcd 7369, 7451 (1992) ("Excessive constraints on LEC pricing and rate structure flexibility will deprive customers of the benefits of competition and give new entrants false economic signals.") vacated in part and remanded, Bell Atlantic Tel. Cos. v. FCC, 24 F.3d 1441 (D.C. Cir. 1994).

13 Id. at 7454, 7463-64; Expanded Interconnection with Local Telephone Company Facilities, CC Docket No. 91-141, 8 FCC Rcd 7374, 7426 (1993), subsequent order, 9 FCC Rcd 5154 (1994).


found that, far from being necessary, these constraints were counterproductive and inefficient.\textsuperscript{16} It further determined that, in light of marketplace developments, some price cap requirements safely could be relaxed and that market forces, together with the regulatory requirements left in place, would be sufficient to ensure that rates offered to “sophisticated purchasers” of special access services would be just and reasonable.\textsuperscript{17} The Commission therefore established a framework for granting a price cap LEC modestly greater pricing flexibility when it demonstrates that, in a given area, certain competitive triggers based on sunk investments in competitive facilities have been met.\textsuperscript{18}

Contrary to AT&T’s hysterical claims, the Commission did not deregulate special access services. Rather, it adopted relatively modest pricing reforms, retaining the bulk of its regulatory regime for special access services, including tariff filing requirements. In particular, under Phase I pricing flexibility, a price cap LEC may offer volume and term discounts and contract tariffs.\textsuperscript{19} But a LEC obtaining Phase I relief still must make contract tariff services generally available to all similarly situated customers.\textsuperscript{20} In addition, it must continue to offer services pursuant to generally available, price-cap-constrained tariffs.\textsuperscript{21} And, the LEC remains subject to the Act’s enforcement regime.\textsuperscript{22} Under Phase II, in addition to the relief granted under Phase I, a price cap

\begin{itemize}
  \item \textsuperscript{16} \textit{Pricing Flexibility Order} at para. 19.
  \item \textsuperscript{17} \textit{id.} at para. 155.
  \item \textsuperscript{18} \textit{Pricing Flexibility Order} at para. 24. Under the pricing flexibility framework, relief generally is granted on an MSA basis, but also may be granted for the non-MSA sections of a study area. \textit{id.}
  \item \textsuperscript{19} \textit{id.} at para. 24.
  \item \textsuperscript{20} \textit{id.} at paras. 124, 130.
  \item \textsuperscript{21} \textit{id.} at para. 24.
  \item \textsuperscript{22} \textit{id.} at paras. 127, 131.
\end{itemize}
LEC may file, on one day’s notice, tariffs for subject services free from price cap regulation.\textsuperscript{23} But, as with Phase I, a LEC must file generally available tariffs, and remains subject to the enforcement provisions of the Act.

To obtain Phase I relief, a price cap LEC must show that unaffiliated competitors actually have made irreversible, sunk investments in the facilities needed to provide the services at issue, and thus that the LEC cannot “successfully pursu[e] exclusionary strategies.”\textsuperscript{24} For example, for mileage and entrance facilities, a price cap LEC must demonstrate that unaffiliated carriers have collocated in fifteen percent of the LEC’s wire centers in an MSA or collocated in wire centers accounting for 30 percent of the LEC’s revenues from such services in the MSA.\textsuperscript{25} For channel terminations, the LEC must meet a higher threshold and demonstrate that unaffiliated competitors have collocated in 50 percent of the wire centers in an MSA or in wire centers accounting for 65 percent of the LEC’s revenues from such service in the MSA.\textsuperscript{26} To satisfy these collocation triggers, the LEC must show with respect to each wire center with collocation that at least one of the competitors in the wire center uses transport provided by a provider other than the incumbent LEC.\textsuperscript{27}

For Phase II relief, a price cap LEC must show that competitors not only have made irreversible, sunk investments in facilities but also that competitors have established a significant

\textsuperscript{23} Id. at para. 25.
\textsuperscript{24} Id. at paras. 24, 69.
\textsuperscript{25} Id. at para. 24.
\textsuperscript{26} Id. For traffic-sensitive, common line, and the traffic-sensitive components of tandem-switched transport services, a LEC must show that competitors offer service over their own facilities to fifteen percent of the LEC’s customer locations. Id.
\textsuperscript{27} Id.
market presence in the provision of the services at issue, and thus that competition in the MSA is sufficient to preclude the incumbent from exploiting any market power over a sustained period. In particular, for dedicated transport services, a LEC must show that unaffiliated carriers have collocated in at least 50 percent of the wire centers in an MSA or in wire centers accounting for 65 percent of the LEC’s revenues from these services in the MSA. For channel terminations, a LEC must show that unaffiliated carriers have collocated in 65 percent of the LEC’s wire centers in an MSA or in wire centers accounting for 85 percent of the LEC’s revenues from this service in the MSA.

In establishing these competitive triggers, the Commission relied largely on collocation because it concluded that collocation provides a clear picture of competitive conditions in an MSA. In particular, it found that collocation provides an “easily verifiable” and “reliable indication of sunk investment by competitors” and, in particular, in “transmission facilities to compete with the incumbent.” The Commission reasoned that such investment, and the resulting potential for entry into the market, would prevent an ILEC from successfully pursuing anti-competitive and exclusionary pricing over a sustained period. In particular, it found that:

28 Id. at para. 25.
29 Id.
30 Id.
31 Id. at para. 78.
32 Id.
33 Id. at para. 81.
34 Id. at para. 82. The Commission acknowledged that some competitors collocate to provide DSL using ILEC transport facilities. To ensure that its triggers provide a clear picture of competitive conditions, the Commission therefore required an ILEC to show that at least one competitor at each wire center listed in the ILEC’s pricing flexibility petition as the site of an operational collocation arrangement relies on transport facilities provided by someone other than the ILEC. Id.
Once multiple rivals have entered the market and cannot be driven out, rules to prevent exclusionary pricing behavior are no longer necessary. Investment in facilities, particularly those that cannot be used for another purpose, is an important indicator of such irreversible entry. If a competitive LEC has made substantial sunk investment in equipment, that equipment remains available and capable of providing service in competition with the incumbent, even if the incumbent succeeds in driving the competitor from the market.35

The Commission noted that, if anything, collocation was a conservative measure of competition because it did not measure competition from competitors that by-pass LEC facilities altogether.36 But, because collocation “traditionally ha[d] served as the building block for competitive transport,” the Commission found it constituted a reasonable “measure of the degree to which competitors have invested in facilities to provide [such] services.”37

Thus, the Commission did not simply rely on predictions of where and when competition might develop. Rather, it limited pricing flexibility only to markets in which competitive alternatives actually are available, and competition is sufficient to prevent a LEC from successfully exercising market power over a sustained period.

The Commission made both Phase I and Phase II relief available on an MSA basis because, it concluded, MSAs best reflect the scope of competitive entry and thus are the logical basis for measuring the extent of competition.38 The Commission found these geographic areas were defined “narrowly enough so that competitive conditions within each area [would be] reasonably similar, yet broadly enough to be administratively workable.”39 It acknowledged

35 Id. at para. 80.
36 Id. at 104.
37 Id. at para. 109.
38 Id. at para. 72.
39 Id. at para. 71.
that, because it did not require competitive facilities in every wire center in an MSA, it theoretically was possible that an ILEC could engage in predatory pricing to deter investment in areas where it did not yet face competition.\footnote{Id. at para. 83.} But, the Commission concluded that, because special access customers are “IXCs and large businesses” and “generate significant revenues for the incumbent,” they have sufficient “bargaining power” in dealing with the incumbent to ensure reasonable rates in areas that lack an existing competitive alternative.\footnote{Id. at para. 142.} It further found that, delaying relief until all customers in an MSA have a competitive alternative would invite competitors to “‘game the system,’” and “prevent an incumbent from obtaining pricing flexibility . . . simply by choosing not to enter certain parts of [an] MSA or to serve certain customers.”\footnote{Id. at para. 143.} And, the Commission reasoned, if an ILEC were to engage in anti-competitive pricing, parties still could pursue remedies before the Commission or under the antitrust laws.\footnote{Id. at para. 83.}

The D.C. Circuit found the Commission’s analysis and pricing flexibility framework was reasonable. It therefore upheld the Commission’s \textit{Pricing Flexibility Order}, and denied AT&T’s and others’ petitions for review.\footnote{WorldCom, Inc., \textit{et al.} \textit{v.} FCC, 238 F.3d 449 (D.C. Cir. 2001).}

\section*{III. \textbf{COMPETITION FOR SPECIAL ACCESS SERVICES IS FLOURISHING.}}

Since the Commission adopted the special access pricing flexibility framework in 1999, competition for special access services has continued to grow rapidly. The number of carriers

\footnote{\textit{Id.} at para. 83.}

\footnote{\textit{Id.} at para. 142.}

\footnote{\textit{Id.} at para. 143.}

\footnote{\textit{Id.} at para. 83.}

\footnote{\textit{WorldCom, Inc., \textit{et al.} \textit{v.} FCC, 238 F.3d 449 (D.C. Cir. 2001).}
reporting to the Commission that they provide competitive access services has grown to 532; these competitors now account for between 28 and 39 percent of all special access revenues. Moreover, special access customers are highly concentrated in a limited number of wire centers and a small number of buildings in those wire centers. For example, 80 percent of SBC’s special access revenues are derived from 25 percent of the wire centers in which it provides special access. And, it has been estimated that, in a typical Tier-One MSA, just 200 to 300 multi-tenant units, out of an average of 15,000 or more multi-tenant units in such MSAs, account for 80 percent of the data revenues generated in those MSAs. Consequently, through targeted investment, competitors cost-effectively could extend their existing fiber facilities to buildings housing customers accounting for 97 percent of all special access revenues, or virtually all of the customers that demand special access services.

At the same time, competitive service providers deployed a wealth of competitive high-capacity facilities, much of which is used to provide special access services. In the past three

---

45 FCC, Telecommunications Provider Locator at Table 1 (November 2001).


47 Id. at III-8.

48 Id. at IV-3, citing Lehman/McKinsey MAN Report at 8 (“enterprise traffic is currently very concentrated, as in a typical Tier One MSA, 200 to 300 MTUs (of more than 15,000) constitute 80% of data revenues”).


years, the number of CLEC fiber networks in the 150 largest MSAs, which contain 70 percent of the U.S. population, has increased from 1,100 to nearly 1,800 — an increase of nearly 60 percent.\textsuperscript{51} As a consequence, all but nine of the top 100 MSAs are served by at least three CLEC fiber networks, 77 of the top 100 are served by at least seven networks, and 59 are served by at least 10.\textsuperscript{52} One or more CLECs also have obtained fiber-based collocation in Bell company wire centers containing 54 percent of the business lines and 44 percent of all access lines; many of those wire centers are served by multiple CLECs.\textsuperscript{53}

Competitive carriers have deployed at least 184,000 route miles of fiber.\textsuperscript{54} ALTS claims the actual number is 339,501,\textsuperscript{55} which is comparable to the total route miles of fiber that AT&T has attributed to ILECs nationwide.\textsuperscript{56} Thus, according to their own trade association, CLECs have deployed almost as much competitive fiber as there is ILEC fiber. CLECs have connected this fiber to at least 30,000 unique office buildings, and likely many more.\textsuperscript{57} According to a coalition of which AT&T was a part, buildings accounting for “roughly one third of the 60

\textsuperscript{51} 2002 UNE Fact Report at III-7.

\textsuperscript{52} Id.

\textsuperscript{53} Id. at III-2.

\textsuperscript{54} Id. at III-6.

\textsuperscript{55} ALTS 2002 Local Competition Report at 17.

\textsuperscript{56} AT&T Comments in CC Docket No. 01-338, at 123 (estimating ILEC fiber transport networks at 362,000 miles) (AT&T Triennial Review Comments).

\textsuperscript{57} Joint Comments of Allegiance Telecom, Inc. and Focal Communications Corp. at 25, and Comments of WorldCom, Inc. at 7, both filed in CC Docket 96-98 (June 11, 2001). As discussed in the 2002 UNE Fact Report, Most CLECs do not report how many buildings their fiber networks serve. However, publicly available data for about 20 CLECs shows that they operate networks that serve approximately 330,000 buildings, which includes buildings served in part using facilities leased or resold from another carrier — including the ILEC. 2002 USTA Fact Report at IV-4.
million or so business lines in the country” are directly connected to competitive fiber. Indeed, Covad and MPower concede that sufficient competitive transport is available to serve as much as 50 percent of their needs.

Despite the downturn in the high-tech market, CLECs have continued to build out their competitive fiber networks. For example, in July, Cavalier announced that it had “added thousands of fiber route miles, tripled [its] Internet backbone capacity and doubled [its] long distance network,” and, in the second quarter of 2002, Level 3 added 5,000 fiber miles to its local network.

CLECs also have continued to receive funding to build out their networks. For example, since the beginning of 2002, Level 3 raised $500 million, Williams raised $150 million, DSL.net raised $35 million, Broadview Networks secured $40 million, Yipes raised $54 million, and IP Communications secured commitments for $30 million. Just last month, ALTS reported that “CLECs have collectively acquired over $1 billion in additional funding in the last nine months.”

Notwithstanding its claims about the lack of alternative facilities and the infeasibility of self-deployment, AT&T itself has deployed significant amounts of competitive fiber, and relies

---


59 See UNE Rebuttal Report 2002, CC Docket No. 01-338 at 40 (filed October 2002) (UNE Rebuttal Report 2002), citing Covad Comments in CC Docket 01-338 at 67-69; Mpower Reply Comments in CC Docket No. 01-338 at 12-15 (Mpower has alternative options for transport for over 50 percent of the routes it currently requires).

60 Id. at 23, quoting Cavalier Press Release, Cavalier Telephone Expands Capacity (July 9, 2002).

61 Id.

62 UNE Rebuttal Report 2002 at 22 (citations omitted).
on non-ILEC fiber to serve a substantial number of its customers. AT&T's own comments in the *Triennial Review* proceeding establish that it self-provides or obtains from third parties a large portion of its DS-1 transport and tails (i.e., loops), and that ILECs account for a mere fraction of its DS-3 tail facilities. In addition, just last month, AT&T's president, David Dorman, reported to investors that AT&T had "built 18,000 route miles of [local] fiber in 90 cities" and had "7,000 buildings on net and that's growing every day"—based on AT&T's figures, it added 1,000 route miles of fiber and 1,000 buildings to its network in the last six months alone. Mr. Dorman also reported that those 90 cities make up about 70 percent of the local business market, and that AT&T had "put [its] network where customers are and that's what [it's] focusing on, small to large." He further boasted that AT&T was "extending that fiber network — these metropolitan area networks — through a variety of means, not just optically, but also with radio and free-based optics — any way we can get customers on net." As a consequence, "over 20 percent now of [AT&T's] T-1-equivalent services are on net," and AT&T is "growing that every day with a real focus on grassroots, granular level, building-by-building, address-by-address." Finally, Mr. Dorman claimed that AT&T has been able to significantly lower its access costs by

---

63 *ALTS 2002 Progress Report* at 5.

64 AT&T Confidential Comments, CC Docket No. 01-338, at 150.

65 Dorman Presentation (October 2, 2002).

66 Compare *id.* (18,000 route miles of local fiber connecting to 7,000 buildings) with AT&T Comments at 150 (AT&T has 17,000 route miles of local fiber), 152 (AT&T has connected 6,000 buildings to its local network).

67 *Id.*

68 *Id.* (emphasis added).

69 *Id.*
integrating its 60,000-mile backbone network and 600 points of presence with its 18,000-mile local fiber network and concomitant “ability to reach more locations ourselves.”

Finally, a vibrant wholesale fiber market has developed, providing real alternatives to ILEC special access services. For example, Fiberloops, an on-line fiber clearinghouse, lists competitive fiber in 175 cities nationwide, with over 250,000 miles of long-haul fiber and 34,000 miles of local fiber. It also lists fiber hotels at which carriers can connect with competitive facilities and has developed a directory of companies with metropolitan area networks that identifies “2,000 local networks from 100+ companies.” And other wholesale providers, like American Fiber Systems, provide turnkey services, offering to design, build, lease and maintain high-capacity fiber networks for other carriers. In addition, utility companies, which control one-third of the nation’s fiber infrastructure and rights-of-way offer real alternatives to ILEC special access services.

IV. AT&T’s “EVIDENCE” DOES NOT ESTABLISH THAT ILECS HAVE MARKET POWER FOR SPECIAL ACCESS SERVICES, MUCH LESS THAT PRICING FLEXIBILITY HAS ENABLED ILECS TO IMPOSE EXCESSIVE SPECIAL ACCESS RATES.

Neither in its petition nor in any other proceeding (including the Triennial Review proceeding) has AT&T seriously challenged the foregoing evidence that competitors have entered the special access market in droves. Nor does it dispute that they have invested billions

70 Id.


of dollars to deploy hundreds of thousands of fiber route miles, thousands of collocation arrangements, and other competitive transmission facilities. Instead, it claims that, despite these investments, competitors cannot use these facilities to compete effectively in the market, and, as a consequence, pricing flexibility has enabled ILECs to exercise market power to establish "grossly excessive and unlawful" rates for special access services. In support, AT&T asserts that: (1) "new" quantitative evidence, including purportedly high and increasing revenues, regulated earnings and prices, show that pricing flexibility has permitted Bell Operating Companies (BOCs) to exploit market power in the special access market to adopt grossly excessive special access rates; (2) barriers to entry prevent competitors from responding to excessive ILEC special access rates; and (3) the BOCs' excessive special access rates are having anti-competitive effects in local and long distance markets. AT&T argues that the Commission therefore should impose a moratorium on further pricing flexibility petitions, initiate a rulemaking proceeding to revoke pricing flexibility, and reinitialize price caps to levels that would produce an 11.25 percent rate of return. AT&T's claims are meritless.

AT&T's purportedly "new" quantitative evidence is neither new nor does it show that pricing flexibility has caused market failure in the special access market. In the first place, BOCs only began to take advantage of pricing flexibility in 2001. Consequently, AT&T's "evidence" regarding BOC special access revenues and earnings since adoption of the pricing flexibility framework say nothing about the impact of pricing flexibility. More importantly, the data AT&T cites do not support its claims that the BOCs retain market power nor do they suggest that competition is insufficient to prevent the BOCs from pursuing anti-competitive or exclusionary pricing strategies over a sustained period of time.

74 UNE Fact Report 2002 at III-10 (citations omitted).
AT&T’s other claims fare no better. AT&T simply regurgitates here its claims in the
Triennial Review proceeding, the Special Access Performance Measurements proceeding, and
myriad other proceedings regarding the lack of competitive alternatives to ILEC special access
services and the existence of significant barriers to entry. But, as the evidence discussed above
establishes, competition for special access services is flourishing. Plainly, CLECs would not
continue to deploy competitive transmission facilities at the rate they have if they could not use
them to compete with ILECs or if there were significant barriers to entry. AT&T itself does not
even believe its own claims, as evidenced by David Dorman’s boasts to investors that AT&T
already has deployed “metropolitan area” fiber networks in markets reaching 70 percent of
business customers, and is extending that network “every day” “building-by-building” and
“address-by-address.” Furthermore, AT&T’s complaint that pricing flexibility permits BOCs to
engage in anti-competitive price squeezes and predatory pricing ignores: (1) the
nondiscrimination safeguards applicable to BOC long distance affiliates, and (2) the fact that
BOCs could never recoup losses sustained if they engaged in such anti-competitive pricing
behavior because they could not successfully drive competitive facilities from the market and
thus raise prices above the competitive level.

AT&T therefore has offered no justification for the Commission to abandon its policy of
relying on market forces as the primary means of setting prices for special access services.
Consequently, the Commission should reject AT&T’s petition.

A. AT&T’s “Evidence” Does Not Show That Pricing Flexibility Permits BOCs
to Set Anti-Competitive Rates for Special Access Services.

AT&T contends that new evidence, including purportedly high revenues, earnings and
prices, now establish conclusively that: the BOCs retain overwhelming market power in the
market for special access services; neither market forces nor the existing regulatory regime for
special access services constrains that market power; and, consequently, existing special access rates are “grossly” excessive and unlawful. In particular, it argues that the BOCs’ ARMIS reports to the Commission now establish that their special access rates of return, and thus their special access rates, are three to five times the 11.25 percent rate of return the Commission found just and reasonable in 1990, and rising rapidly. It claims these regulatorily-derived returns are “conclusive proof of the Bells’ overwhelming market power,” because, in competitive markets, market forces drive prices toward costs. AT&T also contends that, where they have obtained pricing flexibility, the BOCs have avoided X-Factor reductions, and either maintained existing rates or raised them further even while increasing sales, proving that the BOCs have market power. And it reiterates its oft-repeated claim that the BOCs have “abysmal performance in provisioning their special access services,” which AT&T claims confirms the BOCs’ continuing market power and the need for immediate rate regulation reform.

1. AT&T’s “new” quantitative evidence regarding special access revenues and earnings is not new nor does it show that pricing flexibility has led to market failure and grossly excessive prices in special access markets. In the first place, AT&T’s data that purportedly show “excessive” earnings, and therefore (according to AT&T) excessive rates, represent earnings and services that, for the most part, were subject to price caps. Although the Commission established

---

75 AT&T Petition at 4, 38 (“Years of data now confirm that the Commission’s predictive judgment” that competition would “provide sufficient safeguards to protect against the Bells’ exercise of monopoly power over special access customers” “was wrong.”).
76 Id. at 8.
77 Id. AT&T claims that the returns calculated from ARMIS data grossly understate the BOCs’ excessive profits because the BOCs’ “true” costs are much lower, forward-looking (i.e., TELRIC) costs. Id. at 10.
78 Id. at 11-12.
79 Id. at 15-16.
its pricing flexibility framework in 1999, none of the BOCs took advantage of pricing flexibility until just last year. BellSouth was first granted pricing flexibility in some MSAs on December 15, 2000, followed by Verizon and SBC on March 14, 2001, and Qwest on April 24, 2002. Even then, the BOCs did not implement pricing flexibility in the affected MSAs until several months later (for example, SBC’s tariffs implementing its first pricing flexibility petition did not go into effect until May 16, 2001). However, AT&T’s data relate only to the period 1996-2001 (i.e., largely before pricing flexibility could have had any impact on ILEC revenues and earnings). Thus, the data do not show that pricing flexibility had a significant impact on BOC special access earnings and revenues, nor, consequently, do the data show that pricing flexibility has enabled BOCs to exercise market power to establish excessive rates.

In fact, ARMIS data show that BOC regulatory accounting earnings and revenues from interstate special access have grown steadily since 1996 long before the Commission adopted its pricing flexibility framework. Thus, the levels and trends of the data proffered by AT&T, which were clear at the time the Pricing Flexibility Order was adopted, did not spike up following pricing flexibility. Indeed, the growth in SBC’s regulatory accounting rate of return for special access actually has slowed and, apparently has reversed since SBC implemented pricing flexibility. Consequently, AT&T’s evidence regarding BOCs’ regulatory accounting rates of return and earnings say nothing about the impact of pricing flexibility on the special access market.

2. In any event, accounting rates of return cannot be used to measure market power as AT&T contends. Fisher and McGowan established almost twenty years ago that using accounting rates of return to draw conclusions about monopoly power and/or profits is totally

---

80 Id. at 11.
misleading because “only by the merest happenstance will the accounting rate of return . . . be equal to the economic rate of return,” which is “the only correct measure of the profit rate for purposes of economic analysis.” As Fisher explained:

The problem is as follows. The numerator of the accounting rate of return in question is current profits; those profits are the consequence of investment decisions made in the past. On the other hand, the denominator is total capitalization, but some of the firm’s capital will generally have been put in place relatively recently in the expectation of a profit stream much of which is still in the future. While the economic rate of return is the magnitude that properly relates a stream of profits to the investments that produce it, the accounting rate of return does not. By relating current profits to current capitalization, the accounting rate of return fatally scrambles up the timing.

Thus, relying on “accounting rates of return to make inferences about monopoly profits is a baseless procedure.”

Measures of profitability, like rates of return, are irrelevant as a measure of market power for another reason. Competition is a dynamic process in which firms strive to maximize revenues while, at the same time, improving their position relative to rivals. This process ultimately drives prices towards costs. But changes in demand or other factors (such as improvements in technology) can affect this process and temporarily produce high accounting profit margins as the market adjusts and new or more efficient sources of supply come on line. Even AT&T has acknowledged elsewhere that measures of profitability cannot be used to gauge market power. In its reply to oppositions to its non-dominance petition, AT&T dismissed as meaningless

---


82 Id. at 82.


84 Fisher & McGowan at 89.
evidence regarding its profitability as a measure of market power because, it maintained, “price/cost margins (i.e., profits) can indeed vary over time in a competitive market.” AT&T added that “in the real world in a competitive market if my firm can lower its costs faster than the market can, I can make money while adjustments take place.” Thus, even if rate of return data accurately reflected a firm’s profitability, such evidence cannot be used to infer the existence of market power or supra-competitive rates.

But here, the regulatory accounting rate of return data on which AT&T relies cannot be depended upon as an accurate measure even of profitability because of the arbitrary way in which costs are allocated. As Kahn and Taylor explain, the BOCs are multi-jurisdictional companies that use integrated networks and management structures, and the same physical and human resources to provide multiple, multi-jurisdictional services. Much of the BOCs’ network and other costs therefore cannot be assigned on a cost-causal basis to any particular service. The cost allocations required under the Commission’s cost allocation rules, and Part 36 separations in particular, therefore cannot be used to derive the true economic costs of

---


87 Indeed, AT&T has stated publicly that it will not enter any local market using the UNE-P unless it can earn a 45 percent margin. Betsy Bernard, AT&T Consumer Services President and CEO, Q2 2002 AT&T Earnings Conference Call (July 23, 2002). Because AT&T makes little, if any, investment in facilities when it enters a local market via the UNE-P its rate of return nears infinity. If AT&T’s hypothesis were correct (i.e., that high rates of return demonstrate market power), the Commission would have to conclude that AT&T has market power in local markets; a conclusion that AT&T presumably would dispute.

88 Attachment A, Declaration of Alfred E. Kahn and William E. Taylor On Behalf of BellSouth Corporation, Qwest Corporation, SBC Communications Inc., and Verizon, at 7-9 (Kahn and Taylor Declaration).

89 Id.
providing a particular service. And, as a consequence, the regulatory rates of return based on those allocations are economically meaningless.\textsuperscript{90}

Indeed, the same ARMIS reports on which AT&T relies to support its claim that SBC and the other BOCs have exorbitant rates of return, and thus excessive rates, for special access services show that SBC’s regulatory rate of return for switched access services is anemic and falling. In particular, those reports show that SBC’s regulatory rate of return for switched access fell from 30.45 percent in 1996 to 25.75 percent in 1997, 19.88 percent in 1998, 19.09 percent in 1999, 15.15 percent in 2000, 1.37 percent in 2001, and, for the 12 month period ending August 31, 2002, turned negative at –3 percent. Either the ARMIS data provide a distorted, and therefore meaningless, picture of the BOCs’ rates of return, or switched access rates are unreasonably low.

The Commission itself has recognized that regulatory cost allocations are imprecise, especially in a price cap regime, and therefore has required price-cap LECs to report rate-of-return information only on total interstate earnings, rather than based on individual baskets or service categories.\textsuperscript{91} The Commission further has observed that reducing “regulatory reliance on earnings calculations based on accounting data is essential to the transition to a competitive marketplace.”\textsuperscript{92} AT&T too has acknowledged that calculating rates of return for individual services is meaningless. In particular, in seeking elimination of rate-of-return regulation for

\textsuperscript{90} Id.

\textsuperscript{91} See Policy and Rules Concerning Rates for Dominant Carriers, CC Docket No. 87-313, Order on Reconsideration, 6 FCC Rcd 2637, 2677-80 (1991). See also Policy and Rules Concerning Rates for Dominant Carriers, CC Docket No. 87-313, Second Report and Order, 5 FCC Rcd 6786, 6833 (1990) (“the collection of rate of return data on an access category or rate element level is improper and unnecessary for price cap LECs”).

\textsuperscript{92} Price Cap Performance Review for Local Exchange Carriers, Fourth Report and Order, CC Docket No. 94-1, 12 FCC Rcd 16642, 16701 (1997).
intrastate services in Massachusetts, AT&T argued that “determining a cost basis for calculating an economically meaningful rate of return is impossible” because AT&T “used the same network, computers and other facilities” to provide multiple, multi-jurisdictional services. As a consequence, the Commission cannot use rates of return calculated based on regulatory cost assignments for specific services (such as BOC special access services) to assess market power, or to determine whether rates for those services are reasonable, as AT&T contends.

3. AT&T’s claims regarding BOC special access prices in areas where they have obtained pricing flexibility likewise do not support its contention that those prices are excessive. Between 1996 and 2001, demand for special access services exploded with the rapid increase in demand for data services. According to ARMIS data, during this period, BOC special access lines grew on average 30 percent per year. In these circumstances, as Kahn and Taylor explain, “an increase in prices, revenue and demand volumes does not necessarily evidence that a large firm possesses market power.” In fact, AT&T itself has repeatedly raised its basic schedule rates for long distance services, but SBC doubts that AT&T would concede it has market power for these services.

In any event, as Kahn and Taylor point out, the BOCs’ special access revenue per special access line has been essentially flat in nominal terms, and has fallen 3 percent per year in

---


94 Id. at 7.

95 Id. at 12.

96 Id. at 14.
constant dollars over the past several years.\textsuperscript{97} AT&T's contention that the BOCs have significantly raised their prices for special access services therefore is without merit.

4. Finally, AT&T claims that the BOCs' purportedly "abysmal" performance in provisioning special access services "confirms" the BOCs' continuing market power and the need for immediate rate regulation reform.\textsuperscript{98} The only problem is that BOC special access performance data tell a very different story. According to ARMIS data, on average, BOC trouble reports per line fell during the 1996-2001 period, and the percentage of installation order commitments met was high and increasing.\textsuperscript{99}

Moreover, in response to burgeoning competition for special access services, SBC has expended significant time and resources to improve special access service quality, and worked cooperatively with customers to monitor and resolve service quality problems when they arise. It has incorporated in its standard special access tariffs performance measures, standards and penalties for missing certain targets (including targets relating to service installation on-time performance and service interruption). SBC also has developed an alternative pricing plan (the MVP plan) that contains additional, premium performance standards and substantial liquidated damages for failing to meet commitments relating to on-time performance, failure frequency, and time to restore. These service performance targets progressively become more stringent over the life of the contract. SBC's MVP arrangements now are being utilized by carriers accounting for approximately one-third of SBC's special access revenues, and over 50 percent of its wholesale special access revenues. In addition, SBC meets regularly with any customer that chooses to do

\textsuperscript{97} Id. at 15.

\textsuperscript{98} AT&T Petition at 15.

\textsuperscript{99} Kahn and Taylor Declaration at 16.
so to identify any service quality concerns it may have, and to devise solutions, including service improvement plans that ensure that carriers’ service quality needs are met. SBC adopted each of these measures in response to competition and customer demands, not regulation. As such, there simply is nothing to AT&T’s claim that the BOCs’ “abysmal” special access service quality proves their continuing market power.

B. The BOCs Cannot Manipulate Special Access Rates to Impede Competition.

AT&T argues that the Commission must impose stringent pricing requirements for special access to prevent the BOCs from manipulating special access rates to raise rivals’ costs, foreclose the development of local competition, and impede long distance competition. First, it claims that purportedly excessive BOC special access rates impede competitors’ ability to deploy alternative facilities by raising their transport costs. In particular, it contends that CLEC access to BOC transmission facilities is a necessary “bridge” to facilities-based competition because competitive carriers cannot build transmission facilities unless they have “reasonable assurance that there is sufficient demand to support deployment of transmission facilities.” It asserts that the availability of UNEs could mitigate these concerns, but that use and commingling restrictions on UNE loop/transport combinations prevent conversion of special access services to UNEs. It concludes that, because “special access rates are typically twice . . . the TELRIC rates for comparable UNEs,” facilities-based competition is not possible under these conditions.

100 AT&T Petition at 16.

101 Id. at 16-17.

102 Id. at 17.

103 Id. at 17.
Next, AT&T contends that the BOCs’ ability to engage in contract tariffs permits them to price discriminate to drive competitors from the market or foreclose entry, and to use long term contracts to lock up customers and thus prevent entry. Specifically, it argues that the Commission’s conclusion that the pricing flexibility triggers measure the extent to which competitors have made irreversible investments in facilities used to compete with ILECs was wrong. It maintains that, as a result, the Commission was wrong when it concluded that a BOC meeting the pricing flexibility triggers could not successfully engage in predatory pricing. AT&T further claims that the BOCs' purportedly excessive special access rates are “having an increasingly anticompetitive effect in the long distance market, as the Bells win interLATA authority.”

1. AT&T’s contention that access to ILEC transmission facilities is a necessary bridge to deployment of alternative facilities simply regurgitates AT&T’s claim in the Triennial Review proceeding that CLECs do not know whether there will be sufficient demand to justify building transmission capacity until they actually need that capacity, and that CLECs therefore need unbundled access to ILEC transmission facilities to build market share. AT&T thus reveals its petition for what it is — nothing more than a flank attack in its effort to retain maximum unbundling requirements.

But AT&T’s suggestion that CLECs cannot build alternative facilities without assurance that there is sufficient demand to justify deployment of those facilities, and that CLECs need

---

104 Id. at 21-22.
105 Id. at 20.
106 Id. at 19.
107 Id. at 23.
ILEC transmission facilities at TELRIC rates to build market share, is specious. As Professor Shelanski explained in the *Triennial Review* proceeding, in many industries with high entry costs, “competitors build facilities and prepare to compete with established firms well before they have any assurance of attracting a single customer.”\(^{108}\) The mere fact that CLECs would prefer to build market share before investing in facilities “does not mean that absent such a risk-reducing option they would not invest in the capital necessary to compete against the ILECs.”\(^{109}\) Moreover, the fact that AT&T and others are successfully using special access services to provide local services to customers (and thus build market share),\(^{110}\) even as they build out their local networks,\(^{111}\) demonstrates that they do not need lower priced UNEs as a bridge to deployment of their own facilities. Indeed, requiring ILECs to unbundle transmission facilities at steep, TELRIC-based discounts would only undermine this process by discouraging CLECs from deploying their own facilities.

2. AT&T’s assertion that pricing flexibility permits the BOCs to engage in price discrimination to drive competitors from the market or foreclose entry fares no better. Indeed, this argument cannot even be taken seriously given that AT&T’s stated goal is for the Commission to *prescribe* below cost (*i.e.*, TELRIC) rates for special access services. AT&T’s disingenuousness aside, AT&T does not show, and could not show, that ILECs have engaged in predatory pricing in areas where they have received pricing flexibility. To the contrary, it argues


\(^{109}\) *Id.* at ¶ 4.

\(^{110}\) AT&T claims that over 98 percent of its facilities-based local service for business customers using high-capacity facilities is provided over ILEC special access services, not UNEs. AT&T Petition at 17.

\(^{111}\) *See supra* text accompanying notes 60-70.
that special access rates are too high, and, as it argued in defense of its own request for pricing
flexibility over a decade ago, predatory pricing is rarely tried and almost never successful. And the Commission itself agreed that predatory pricing is unlikely in granting that request.

In any event, ILECs cannot use their contract tariff authority to discriminate and offer lower prices only to those customers that could potentially be served by a new entrant, while keeping prices high for all other customers. The Commission’s rules specifically require that contract tariff services must be “made available to all similarly situated customers.” Thus, when an ILEC offers service pursuant to a contract tariff it must make that service available throughout the entire MSA and cannot lower prices only on one route but not others. Consequently, AT&T’s concerns about price discrimination are entirely misplaced.

Moreover, AT&T’s speculations regarding the risk of predatory pricing evaporate when one considers the conditions necessary for such a strategy to succeed. First, a LEC would have to reduce its special access rates below cost for a sufficient period to drive all of its competitors out of the market. Next, it would have to snap up all of its competitors’ fiber transmission facilities to keep them out of the hands of actual or potential competitors. Then it would have to raise prices sufficiently above competitive levels to recoup its losses. And it would have to achieve all of these steps without attracting any new entry, or the attention and intervention of the Commission or antitrust authorities. Plainly, such a sequence of events is inconceivable. Consequently, AT&T’s claim that the BOCs could successfully engage in such predatory behavior is absurd.


3. AT&T’s complaint regarding optional pricing plans and other volume and term discount plans is equally misguided. These plans do not permit the BOCs to “lock-up” customers in an anti-competitive manner. As Kahn and Taylor explain, every special access carrier offers customers volume and term discount plans with early termination penalties.115 While a customer purchasing services pursuant to such a plan is removed from the market for such services for the contract term, every carrier has an equal opportunity to sell the contract to the customer in the first place.116 And because demand for special access services is growing rapidly, new customer demand is coming on the market continuously, making room for new entrants.117

In addition, AT&T’s claim that the BOCs have “locked up the largest special access customers” ring hollow given that the largest special access customers are carriers, like AT&T and WorldCom. And these carriers now control vast fiber optic networks through their acquisition of Teleport, MFS, and Brooks Fiber. As a consequence, it is difficult to see how the BOCs lock up these carriers by “forcing” them to enter into optional pricing plans.118

Moreover, the BOCs have had authority to provide alternative pricing plans for special access (e.g., optional pricing plans (OPPs) and volume and term discounts) for well over a decade. In that time, competition for special access services has exploded. As discussed above, the number of carriers reporting to the Commission that they provide competitive access services

115 Kahn and Taylor Declaration at 33.
116 Id.
117 Id.
118 Id.
has grown to 532,\textsuperscript{119} and these competitors now account for between 28 and 39 percent of all special access revenues.\textsuperscript{120} Moreover, CLECs and alternative fiber providers, including AT&T, have continued to build out their networks at a rapid pace.\textsuperscript{121} Plainly, if OPPs and other volume and term discount plans were the threat to facilities-based competition AT&T claims it is, competition for special access services would have withered a long time ago, instead of continuing to flourish.

4. In what appears to be a throw-away claim, AT&T asserts that BOC special access rates are “having an increasingly anti-competitive effect in the long distance market, as the Bells win interLATA authority.”\textsuperscript{122} In particular, AT&T claims that, because access is a necessary input for long-distance service, the BOCs have “the opportunity to undertake a classic strategy of raising rivals’ costs” through a price squeeze.\textsuperscript{123} AT&T made a similar argument in the context of the BOCs’ switched access services, and the Commission rightly rejected it. In particular, it found:

At least four interexchange carriers — AT&T, MCI, Sprint, and LDDS WorldCom — have nationwide, or near-nationwide, network facilities that cover every BOC region. These are large well-established companies with millions of customers throughout the nation. It is unlikely, therefore, that a BOC interLATA affiliate, whose customers are likely to be concentrated in the BOC’s local service region, could drive one or more of these national companies from the market. Even if it could do so, it is doubtful that the BOC interLATA affiliate would be able to raise prices in order to recoup lost revenues. As Professor Spulber has

\textsuperscript{119} FCC, Telecommunications Provider Locator at Table 1 (November 2001).


\textsuperscript{121} See supra text accompanying notes 50-70.

\textsuperscript{122} AT&T Petition at 23.

\textsuperscript{123} Id. at 23-24.
observed, ‘[e]ven in the unlikely event that [a BOC interLATA affiliate] could
drive one of the three large interexchange carriers into bankruptcy, the fiber-optic
transmission capacity of that carrier would remain intact, ready for another firm to
buy the capacity at distress sale and immediately undercut the [affiliate’s]
noncompetitive prices.’

AT&T’s argument is even more implausible in the context of special access services,
where there are alternative facilities and numerous competitive offerings available. As Kahn and
Taylor explain, a BOC cannot successfully create a price squeeze by charging interexchange
carriers a higher margin for access services than the BOC’s long distance affiliate earns on its
retail service. First, a BOC affiliate could not implement such a strategy unless it priced its long
distance service below its incremental cost because the affiliate must operate independently from
the BOC and buy access services on the same terms and conditions as unaffiliated interexchange
carriers. Such a strategy, though theoretically possible, is highly unlikely because the BOC
affiliate would have to sacrifice long distance profits for some period of time with no reasonable
possibility of driving its long distance competitors out of the market, and raising prices without
attracting entry and recovering its lost profits. Second, when the BOC receives from an
interexchange carrier a greater margin for access services than it receives from supplying retail
long distance service, the BOC’s profit is reduced, not increased, for every minute of retail
service supplied. Thus, AT&T’s claim that the BOCs can use high access charges to effect a
price squeeze are implausible.

---

124 Regulatory Treatment of LEC Provision of Interexchange Services Originating in the LEC’s Local
Exchange Area, and Policy and Rules Concerning the Interstate, Interexchange Marketplace, CC Docket
Nos. 96-149, 96-61, Second Report and Order in CC Docket No. 96-149 and Third Report and Order in

125 Kahn and Taylor Declaration at 34.

126 Id. at 35.

127 Id.
C. There Are Competitive Alternatives to BOC Special Access Services.

Disregarding overwhelming evidence of special access competition and alternative transport, AT&T sings its old refrain that market forces cannot constrain BOC special access prices because, according to AT&T, except in limited circumstances IXCs and CLECs have no alternatives to BOC special access services.\(^{128}\) AT&T asserts that, despite investing billions of dollars, it has replicated only a fraction of the BOCs’ high-capacity network and therefore can serve only a limited number of customers using its own facilities.\(^{129}\) It claims generally that it cannot use other CLECs’ facilities because CLECs have few buildings on-net, CLECs may go bankrupt, and “capacity on CLECs’ networks is also often expensive, because CLECs typically provide only a modest discount off . . . the Bells’ special access [prices],” and using that capacity poses logistical problems.\(^{130}\)

AT&T next claims that further deployment of alternative facilities is infeasible for several reasons. First, it contends that competitors cannot match the BOCs’ “enormous” economies of scale because: (1) most of the cost of transmission facilities is in supporting structures (not the wires or fibers), and the costs of such structures are insensitive to the number of wires deployed, and (2) the BOCs have dark fiber connecting virtually all their LSOs and can increase capacity on most routes simply by adding electronics.\(^{131}\) Second, it claims that, because transmission facilities are characterized by large sunk costs and declining average costs, entrants may not enter because of the threat of predatory pricing. Third, it claims that BOCs enjoy a first

---

\(^{128}\) AT&T Petition at 25.

\(^{129}\) *Id.* at 26.

\(^{130}\) *Id.* at 27.

\(^{131}\) *Id.* at 29.
mover advantage because competitors cannot rely on existing facilities, rights of way, or conduit.132 AT&T maintains that, as a consequence, the Commission cannot rely on new entry to constrain special access rates.133

1. AT&T grossly overstates the extent to which it must rely on BOC special access services and the purported barriers to new entry. Marketplace evidence before the Commission in multiple proceedings thoroughly refutes AT&T's claims, and establishes that robust competition for special access services already is widespread and growing. SBC has summarized that evidence above, and will not repeat it here. Suffice it to say, competitors already account for at least one-third, and possibly as much as forty percent, of special access revenues, and are continuing to receive funding and build out their networks despite the downturn in the economy, and the telecommunications sector in particular.134 AT&T itself has deployed a significant amount of alternative transmission facilities in metropolitan area networks reaching thousands of buildings in 90 cities accounting for 70 of the local business market, and recently boasted that it is continuing to extend those networks building-by-building and address-by-address.135

AT&T’s complaint that competitors have not yet deployed alternative facilities in every town or to every building is entirely beside the point because competitors do not need to deploy such facilities everywhere to compete effectively in the special access market. As the Commission itself acknowledged in the Pricing Flexibility Order, special access customers

132 Id. at 31.

133 Id. at 32.

134 See supra text accompanying notes 45-63.

135 See supra text accompanying note 65-67.
typically are “IXCs and large businesses” that “generate significant revenues,” which “are not without bargaining power.” In addition, special access customers are geographically concentrated in a limited number of wire centers and a small number of buildings in those wire centers. This high degree of concentration generates significant economies of density, reducing the cost of extending facilities to reach new customers. Consequently, through targeted investment, competitors cost-effectively could extend their existing networks to reach buildings housing customers accounting for 97 percent of all special access revenues, or virtually all of the customers demanding such services. Indeed, that is precisely what AT&T has told the investment community it is doing.

It is no answer to claim that some competitive special access providers are in financial distress or have gone bankrupt. As discussed in the *UNE Rebuttal Report 2002*, those wholesalers that have sought bankruptcy protection are still operating their networks, and are beginning to emerge from bankruptcy. In any event, even if some firms exit the market, their facilities will not. Because such facilities are “irreversible investment,” they will continue to be available, and at fire sale prices.

Nor is there anything to AT&T’s claims that it cannot use CLEC fiber capacity because it is “expensive” and poses logistical/practical problems. In the first place, the fact that CLECs’ provide “only a modest discount off” the BOCs’ prices does not establish that CLEC services are

---

136 *Pricing Flexibility Order*, at para. 142.
137 See *supra* text accompanying notes 47-49.
138 *Crandall Declaration* at 5.
139 *Id.* at 7.
140 *UNE Rebuttal Report 2002* at 42-43.
“too expensive.” If anything, given the plethora of competitive special access service providers, that fact suggests that, rather than being grossly excessive, BOC prices are competitive. In any event, AT&T’s claims regarding CLEC special access rates ring especially hollow since AT&T, through TCG, is a major provider of competitive access services.

Moreover, the fact that CLECs routinely are deploying or seeking out competitive suppliers of fiber, as AT&T itself does, puts to rest the notion that logistical or other practical problems prevent AT&T and others from using CLEC fiber. Plainly, if logistical or “practical problems” prevented AT&T and others from using alternative sources of fiber, there would not be 532 providers of competitive access services, nor would CLECs and wholesale suppliers have deployed alternative fiber at the rate they have, nor, for that matter, would AT&T be building out its fiber network “building-by-building” and “address-by-address.”

2. AT&T’s claims regarding the purported “infeasibility” of deploying alternative facilities likewise does not withstand scrutiny. In the first place, AT&T’s complaint that CLECs cannot match ILEC economies of scale is irrelevant.\(^{141}\) CLECs need not do so. As Kahn and Taylor point out, special access facilities are “point-to-point, not switched, and a ubiquitous network is not necessary to participate successfully as a competitive supplier” of dedicated circuits.\(^{142}\) Rather, such facilities are efficiently deployed (whether by a CLEC or an ILEC) where there is sufficient traffic between the relevant points. Consequently, the fact that an ILEC

\(^{141}\) AT&T asserts that most of the cost of deploying loops is in the supporting structures, rights of way, and access to buildings, and that, because such costs are largely insensitive to the number of wires deployed, BOCs enjoy substantial scale economies. AT&T Petition at 29. However, the Act specifically requires LECs to afford access to poles, ducts, conduits, and rights of way to competitors. As a consequence, the BOCs must share any economies they have in such rights of way, etc., with their competitors.

\(^{142}\) Kahn and Taylor Declaration at 25.
has deployed facilities on another point-to-point route has no bearing on whether deployment is viable on the route in question.

Moreover, AT&T offers no evidence that the existence of a large network enables an ILEC to provide dedicated services to a new customer or to a new location more quickly than CLECs. Indeed, CLECs, with smaller, more nimble organizations, often are able to win contracts because of their ability to initiate service quickly. In any event, the fact that CLECs and other competitive access providers (including AT&T) have deployed as much fiber as they have, and are continuing to expand their networks, utterly refutes AT&T’s claims that they must match the BOCs’ scale to deploy competitive fiber.

AT&T’s speculation that “the threat that the incumbent would respond [to competitive entry] with rock-bottom prices may deter all but targeted, limited entry” fares no better. As discussed above, predatory pricing, which is highly unlikely in any industry, is especially so in the telecommunications industry because, even if facilities-based carriers were to leave the market, they would leave their facilities behind to be purchased by others at fire sale prices. Any ILEC that drove its existing facilities-based competitors from the market thus would face a new crop of competitors with dramatically lower cost structures. And, even then, the ILEC could not be certain that regulators would permit it to raise its prices to recoup its losses. In any event, CLECs, including AT&T, apparently do not believe the ILECs pose a credible threat of predatory pricing, otherwise they would not have deployed (and continued to deploy) alternative transmission facilities at the rate they have.

---

143 For example, earlier this year, Time Warner announced to investors that it won the New York state Unified Court System as a customer because of its “ability to construct [its] own fiber facilities into their seven location [sic] in four cities within 30 days.” Larissa Herda, President and CEO, Time Warner Telecom, Conference Call Announcing Fourth Quarter Results (Feb. 5, 2002).

144 AT&T Petition at 30 (emphasis added).
Finally, AT&T’s claims regarding the ILECs’ purported first-mover advantage (because competitors “cannot rely on existing facilities, rights-of-way, or conduits”\(^{145}\)) are vastly overstated. ILECs are obligated to share their poles, ducts, conduit, and rights-of-way with competitors, mitigating any theoretical advantage ILECs may have. And, to the extent rights-of-way and building access present problems, they equally affect ILECs, which also must negotiate new rights-of-way for new facilities. In any event, if rights-of-way were the entry barrier AT&T claims it is, CLECs would not have deployed alternative facilities at the rate they have.

V. CONCLUSION

For the foregoing reasons, the Commission should reject AT&T’s request that the Commission institute a rulemaking proceeding to revoke pricing flexibility, and reinitialize price caps to levels that would produce an 11.25 percent rate of return.

Respectfully Submitted,

Christopher M. Heimann
Gary L. Phillips
Paul K. Mancini
SBC Communications Inc.
1401 Eye Street, NW, Suite 400
Washington, D.C. 20005
202-326-8909 – phone
202-408-8745 – facsimile

Its Attorneys

December 2, 2002

\(^{145}\) AT&T Petition at 31.
Attachment A

Declaration of
Alfred E. Kahn and William E. Taylor
on behalf of
BellSouth Corporation, Qwest Corporation,
SBC Communications Inc., and
Verizon
Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of
AT&T Corp. RM No. 10593
Petition for Rulemaking to Reform
Regulation of Incumbent Local Exchange
Carrier Rates for Interstate Special
Access Services

Declaration of
Alfred E. Kahn and William E. Taylor
On Behalf of
BellSouth Corporation, Qwest Corporation, SBC Communications, Inc., and Verizon

SUMMARY

Competition in the special access market is vigorous and growing. Even in an environment in which RBOC local service volumes are declining and market valuations of telecommunications firms have collapsed, local exchange competition and competition for special access services continue to expand. Retraction of pricing flexibility for RBOC special access services as AT&T demands is not only unnecessary; it would weaken competition.

In contrast to AT&T’s litany of familiar complaints about the prematurity of pricing flexibility and its dependence on RBOC facilities and services, we observe that the competitive supply of special access services has steadily increased with no observable slowdown from the implementation of limited special access pricing flexibility in 2001 and 2002. Competitive fiber route miles roughly doubled each year between 1990 and 1995, increasing from about 500 route miles to about 21,000, and current estimates put CLEC fiber networks at approximately 100,000 route miles in 1999 and 184,000 in 2002. Geographic coverage increased correspondingly; there are now
nearly 2,000 CAP networks in the largest 150 MSAs, and the top 25 MSAs average over
32 CLEC networks in each. Several independent estimates put the current CLEC share
of special access revenues—not including the very large extent to which such CLECs as
WorldCom and AT&T supply their own needs—at approximately 30 percent, and that
share has continued to increase since the RBOCs were permitted flexibility in pricing of
these special access services. On the retail side, the three largest IXCs still dominate the
market for large business customers (the “enterprise business market”), which is the
largest retail market that uses special access as an input. That fact demonstrates that
IXCs can successfully compete in one of the most competitive retail markets, relying on
some combination of self-supply, competitive supply and RBOC supply of the requisite
special access facilities.

The principal putative facts that AT&T cites in support of its complaint center
around the level and growth of RBOC special access rates of return and price-cost
margins. Rates of return for individual services based on fully distributed costs are,
however, notoriously meaningless as measures of anything, a fact upon which we and
AT&T’s economists have, until now, been in complete agreement. Similarly, price-cost
margins measured using TELRIC are not evidence of market power: blank-slate TELRIC
does not approximate RBOC forward-looking incremental costs and even properly-
calculated price-cost margins need not be small in competitive markets where fixed and
common costs are important, as they undoubtedly are in the telecommunications market.
Indeed, evidence from AT&T’s pricing of long distance service three years after it was
granted full pricing flexibility shows margins as large or larger than those of which it
complains here. Finally, the facts contradict AT&T’s theories. The RBOCs’ average
revenue per line between 1996 and 2001 decreased by more than 1 percent per year in
nominal terms and by more than 3 percent per year in constant dollars. Over the same
period, trouble reports per access line fell, and the percentage of installation order
commitments met remained consistently high. Nothing in the data remotely suggests the
exercise of market power, whether by increasing prices or allowing service quality to
deteriorate.

This is no evidence on which to reverse the Commission’s long-standing policy of
adapting regulatory constraints to the degree of competition in the market. Reducing the
RBOCs’ ability to price services flexibly in markets where competitors have already constructed facilities and incurred sunk costs would only hamstring one of the larger participants in the market and deny customers—wholesale and retail—the benefits of vigorous competition.
Declaration of
Alfred E. Kahn and William E. Taylor
On Behalf of
BellSouth Corporation, Qwest Corporation, SBC Communications, Inc., and
Verizon

I. Qualifications

My name is Alfred E. Kahn. My business address is 308 N. Cayuga Street,
Ithaca, NY 14850. I am the Robert Julius Thorne Professor of Political Economy,
Emeritus, Cornell University and Special Consultant with National Economic Research
Associates, Inc. (NERA). I received my A.B. degree summa cum laude from New York
University and my Ph.D. from Yale University, in 1942. I came to Cornell University in
1947 and have served successively as Chairman of the Department of Economics and
Dean of the College of Arts and Sciences. I have been Chairman of the New York State
Public Service Commission and of the (U.S.) Civil Aeronautics Board; and in my
capacity as Advisor to President Carter on Inflation, I participated actively in the
successful efforts of his Administration to deregulate the trucking industry.

I am the co-author of Fair Competition, The Law and Economics of Antitrust
Policy, author of the two-volume The Economics of Regulation, reprinted in 1988 by
MIT Press, Letting Go: Deregulating the Process of Deregulation, published in 1998 by
Michigan State University Institute of Public Utilities, Whom the Gods Would Destroy or
How Not to Deregulate, published last year by the AEI-Brookings Joint Center for
Regulatory Studies, and have published and testified extensively over the last twenty
years in the area of direct economic regulation and deregulation, and on the requisites of
efficient competition in regulated and previously regulated industries. I served as
Associate Economist with the Antitrust Division of the U.S. Department of Justice in
1941-42; as a member of AT&T’s Economic Advisory Board in 1968-74; was a member
of the Attorney General’s National Committee to Study the Antitrust Laws and the
National Commission on Antitrust Laws and Procedures in the Eisenhower and Carter
Administrations, respectively; I have served as consultant with both the Antitrust
Division of the Department of Justice and the Federal Trade Commission; I was recently
a member of the National Research Council – Transportation Research Board committee
charged with reporting to Congress on the state of competition in the airline industry.

   My name is William E. Taylor. I am Senior Vice President of National Economic
Research Associates, Inc., head of its Communications Practice, and head of its
Cambridge office located at One Main Street, Cambridge, Massachusetts 02142.

   I have been an economist for over twenty-five years. I earned a Bachelor of Arts
degree from Harvard College in 1968, a Master of Arts degree in Statistics from the
University of California at Berkeley in 1970, and a Ph.D. from Berkeley in 1974,
specializing in Industrial Organization and Econometrics. For the past twenty-five years,
I have taught and published research in the areas of microeconomics, theoretical and
applied econometrics and telecommunications policy at academic and research
institutions including the Economics Departments of Cornell University, the Catholic
University of Louvain in Belgium, and the Massachusetts Institute of Technology. I have
also conducted research at Bell Laboratories and Bell Communications Research, Inc. I
have appeared before state and federal legislatures, testified in state and federal courts,
and participated in telecommunications regulatory proceedings before state public utility
commissions, as well as the Canadian Radio-television Telecommunications
Commission, the Mexican Federal Telecommunications Commission and the New
Zealand Commerce Commission. I have also filed studies before the Federal
Communications Commission on numerous occasions. Of particular relevance to the
present docket were a series of five filings with Professor Richard Schmalensee between
1994 and 1998 in CC Docket Nos. 94-1 and 96-262 on the use of observable triggers to
determine when markets were sufficiently competitive to warrant pricing flexibility and
the application of those triggers to special access markets.

II. The Special Access Market Remains Vigorously Competitive.

   Special access services are private line services, i.e., services or facilities
dedicated to a single customer. Special access channel terminations are sold to long
distance carriers ("IXCs") to originate or terminate interstate networks generally built for
large business customers, and special access transport to connect the IXCs' or CLECs'
points of presence ("POPs") with the local exchange carrier's central offices. Special
access services are also sold directly to large business customers, typically as part of private networks.

A. Competition in the special access market is well-developed.

Competition for special access services is as old as the RBOCs. Taking advantage of the regulatorily-imposed markups above marginal or book costs incorporated in RBOC interstate and intrastate carrier access charges, as a contribution to recovery of fixed and common costs, including the deliberate subsidization of basic residential charges, Teleport (TCG) began providing bypass services to IXCs and business customers in lower Manhattan in 1984, shortly after the divestiture of the Bell System. Additional entry and expansion followed rapidly, as Institutional Communications Company (ICC) entered the Washington, DC market in 1986 and Chicago Fiber Optic followed shortly with an optical fiber network in Chicago. Between 1984 and 1992, competitive access providers ("CAPs") proliferated, constructing fiber rings in the business districts of large and medium-sized cities, primarily providing dedicated connections between large business customers and their IXCs in order to avoid the regulated carrier access charges. In 1992, incumbent LECs were required to provide collocation in their central offices to CAPs, and CAP networks responded by building facilities between IXC POPS and collocation facilities in LEC central offices, opening the market for transport to competition.¹

Demand for CAP services grew rapidly. CAP fiber route miles roughly doubled each year between 1990 and 1995, increasing from about 500 route miles to about 21,000, and current estimates of CLEC fiber networks total approximately 100,000 route miles in 1999 and 184,000 in 2002. Geographic coverage increased correspondingly; there are now nearly 1,800 CAP networks in the largest 150 MSAs, and the top 25 MSAs average over 32 CLEC networks in each.² Independent sources put the current CLEC share of special access revenues at more than 30 percent, and that share has continued to

¹ See “Competition For Special Access Services” filed as Attachment B to Opposition of Verizon in this proceeding on December 2, 2002 ("2002 Special Access Fact Report") at 7.
increase since the RBOCs were permitted flexibility in pricing of these special access services.\(^3\)

On the retail side, the three largest IXCs still dominate the market for large business customers (the “enterprise business market”), which is the largest retail market that uses special access as an input. That fact demonstrates that IXCs can successfully compete in one of the most competitive retail markets, relying on some combination of their own special access facilities and those of the other competitive suppliers and the RBOCs.

**B. The FCC’s triggers for pricing flexibility are reasonable and have been successful in application.**

Against this background of established and proliferating facilities-based competition, the FCC embarked on a measured transition path towards pricing freedom for special access services as competition developed. Upon divestiture, LECs were permitted limited pricing flexibility in the form of optional volume discounts for private line and special access services, in recognition of the growing competition for those services.\(^4\) In transitioning to price cap regulation in 1990, the FCC authorized additional flexibility in the form of relaxed pricing rules in the special access basket, and those rules were gradually loosened over the next five years, permitting more extensive term and volume discounts and prices deaveraged by density zone.\(^5\) After the Telecommunications Act of 1996 opened the local and long distance markets to additional competition, the FCC reassessed the special access pricing rules, and in August 1999 adopted the Fifth Report and Order in CC Docket No. 96-262, which outlined circumstances under which suppliers of price-cap-regulated access services would be permitted additional pricing flexibility. The intention of the Order was to allow[] competition rather than regulation, to determine prices for interstate access services, thus providing customers more choices among services, carriers, and rates. The Order gives the nation’s largest telephone companies progressively greater flexibility in setting interstate

rates as competition develops, gradually replacing regulation with competition as the primary means of setting prices.⁶

Among other reforms, the Order established a two-phased framework for granting specific forms of pricing flexibility, along with objective triggers that measured the degree to which competition had developed in specific geographic markets. In general, if competitors have collocated and use competitive transport in a target percentage of a price cap LEC’s wire centers (or wire centers accounting for a target percentage of the LEC’s revenue) in an MSA, the LEC’s special access services are entitled to either Phase I or Phase II relief, depending on the trigger attained.

Phase I relief permitted the LEC to offer contract tariffs and volume and term discounts on one day’s notice; Phase II relief removed the price caps entirely. More stringent triggers were set for obtaining Phase II relief than for Phase I and for relief applying to channel terminations than to transport. Beginning in the Fall of 2000, the LECs applied for such flexibility, and the first petitions were granted in December.⁷ Additional petitions followed in 2001 and 2002.

These rules represent a reasoned and measured transition from a regime in which regulation constrains prices towards one in which prices are constrained only by competitive forces. Properly, they tailor the degree of pricing flexibility to the geographic differences in the rate at which CAPs, IXCs and CLECs invest and build their own competitive facilities—specifically, to the proportion of wire centers in an MSA in which competitors have made sunk investments in their own facilities.⁸ The presence of such investments indicates the need for pricing flexibility because it shows that—in the wire center in question—the market is open and entry barriers are sufficiently low that some firms are actually investing in sunk assets. Such committed entry is also a powerful deterrent to anticompetitive pricing by incumbent LECs because, once installed, the facilities would remain even if the original owner could be driven from the market.

⁷ BellSouth Petition for Pricing Flexibility for Special Access and Dedicated Transport Services, CCB/CPD No. 00-20, Memorandum Opinion and Order, 15 FCC Rcd 24588, (Dec. 15, 2000).
⁸ In fact, the FCC’s triggers underestimate the amount of sunk competitive investment in each wire center because they focus on collocation and ignore investment and competition that makes no use of RBOC facilities at all!
The Commission explicitly expounded the economic logic in its decision. Competitors who collocated in a wire center almost always constructed transmission facilities that terminated in the collocation cage. Once competitors had made such irreversible investments, there was no need for protection against possible ILEC anticompetitive pricing because it was unlikely to succeed. Entry in one wire center in an MSA was an effective trigger for competition throughout the MSA because carriers enter the market on an MSA basis and special access customers are large, sophisticated businesses with bargaining power sufficient to prevent the exercise of ILEC market power in parts of the MSA in which competitive facilities are absent. Moreover, the effect of using collocation as the trigger mechanism was likely to be conservative because it ignored the presence of competitors that completely bypassed the ILECs’ facilities.

III. AT&T Offers No Valid Evidence of Excessive ILEC Market Power or Insufficiently Effective Competition.

AT&T provides no valid economic evidence that RBOCs retain significant market power in special access markets. Its use of accounting profit rates as we will proceed to explain, based on fully distributed costs to demonstrate that individual services are

---

9. "the presence of an operational collocation arrangement in a wire center almost always implied that a competitor has installed transmission facilities to compete with the incumbent," Fifth Report And Order And Further Notice Of Proposed Rulemaking, CC Docket Nos. 96-262, 94-1, 98-63 and 98-157, released: August 27, 1999 ("Fifth Report and Order") at ¶82.

10. "Phase I of our pricing flexibility framework provides incumbent LECs with regulatory relief when competitors have made irreversible investments in facilities within a given MSA. At that point, we no longer need to protect competition from exclusionary pricing behavior by incumbent LECs, because efforts to exclude competitors are unlikely to succeed" Fifth Report and Order at ¶77.

11. "...regulatory relief is warranted ... even though such relief might lead to higher rates for access to some parts of an MSA that lack a competitive alternative, for several reasons. First, the customers for the services we address in this section are IXCs and large businesses, not residential or small business end users. These large and sophisticated customers generate significant revenues for the incumbent and are not without bargaining power with respect to the incumbent. Second, delaying Phase II regulatory relief until access customers have a competitive alternative for access to each and every end user might give competitors the ability to "game the system." In other words, competitors might be able to prevent an incumbent from obtaining pricing flexibility in an MSA simply by choosing not to enter certain parts of that MSA or to serve certain customers. We will not distort the operation of the market in this manner. Finally, because regulation is not an exact science, we cannot time the grant of regulatory relief to coincide precisely with the advent of competitive alternatives for access to each individual end user. We conclude that the costs of delaying regulatory relief outweigh the potential costs of granting it before IXCs have a competitive alternative for each and every end user." Fifth Report and Order at ¶¶142-144.

12. "evidence of collocation may underestimate the extent of competitive facilities within a wire center, because it fails to account for the presence of competitors that do not use collocation and have wholly bypassed incumbent LEC facilities" Fifth Report and Order at ¶95.
overpriced is economic nonsense. Similarly, inferring the presence of market power from price-cost margins—particularly where the cost measure employed is TELRIC—has no valid economic basis. Finally, AT&T’s claim that increases in special access prices and revenues imply the absence of competitive alternatives for customers is incorrect as a matter of both fact and principle.

A. Earnings derived from measures of fully allocated costs cannot be used to justify a reduction in pricing flexibility.

AT&T says that high accounting rates of return for RBOC interstate special access services “represent conclusive proof of the Bells’ overwhelming market power.”

This is a truly outrageous claim, relying as it does on measures of fully allocated book costs of services whose production in common with others entails a very high proportion of fixed and common costs and significant economies of scope—all the more so coming from a company and specific witnesses who have consistently and correctly decried the basis for such claims in economic terms for many decades. Yet, in this case, Drs. Ordover and Willig surprisingly, without comment, equate ARMIS regulated rates of return for special access with economic profits (at ¶24), even adjusting them upward on the ground that “the RBOCs’ true costs of providing services over their local networks are their much lower forward-looking economic costs” (at ¶26) and by so doing enjoying the best of both possible worlds—regulatory allocations of costs themselves lower than regulatory costs, as typically measured.

High or increasing rates of return calculated using regulatory cost assignments for interstate special access services do not in themselves indicate excessive economic earnings reflecting the exercise of market power. Indeed, regulatory rates of return for geographic subsets of single services in multi-product, multi-geographic firms bear no relationship with economic profits and thus can serve no useful purpose in determining whether pricing flexibility has or has not been excessively permissive. ILECs are integrated multi-regional firms and rely on an integrated regional management structure employing the regional physical and human resources to provide a multiplicity of services. The cost allocations required render such a calculation meaningless.

---

13 AT&T Corp., Petition for Rulemaking To reform Regulation of Incumbent Local Exchange Carrier Rates For Interstate Special Access Services, RM 10593, October 15, 2002 (“Petition”), at 8.
Indeed, AT&T presented this very argument to regulators in Massachusetts when requesting to be relieved of rate of return regulation for intrastate services:

AT&T is an integrated, multijurisdictional company providing telecommunications services worldwide using an integrated national management structure and employing the same physical and human resources to provide international, interstate and intrastate services. Because AT&T's services used the same network, computers and other facilities whatever the jurisdiction, determining a cost basis for calculating an economically meaningful rate of return is impossible. Rationally determining the cost basis for purposes of pricing individual state subsets of those services is also an economically impossible task. Yet, Massachusetts ROR regulation requires that a fully-allocated cost basis be established and that the prices for AT&T's intrastate services be modified to reflect such cost allocations. Allocating AT&T's multistate costs to determine AT&T's Massachusetts costs, further allocating those costs between interstate and intrastate services, and yet further allocating the intrastate costs among numerous intrastate services is economically irrational as a basis for setting prices. There is no rational basis for believing that rates based on fully allocated costs are either fair or economically justified.\footnote{Initial Brief of AT&T Communications of New England, Inc., dated April 23, 1992, in the Commonwealth of Massachusetts Department of Public Utilities proceeding DPU 91-79, at 42-43. Citations omitted.}

The same considerations that led AT&T to contend that rates of return based on allocated accounting costs are “economically irrational” as a basis for pricing apply equally to RBOC interstate special access. The allocations of RBOC accounting costs between regulated and unregulated intrastate and interstate services are, of necessity, not based on cost-causation. Among interstate services, the allocation of costs to special access services requires additional, similarly arbitrary assumptions. The sources of these difficulties are obvious. Fixed and common costs permeate—indeed dominate—a telephone company’s cost structure: to offer a single example, Executive and Planning plus General and Administrative Expenses represents more than 11 percent of Total Operating Expenses for the RBOCs.\footnote{In the 2001 RBOC ARMIS 43-02 report, the relevant expenses accounts are Executive and Planning (6710), General & Administrative (6720) and Total Operating Expenses (720).} Even more important, each RBOC’s network provides interstate and intrastate services, carrier services (special and switched access) and retail services (local and toll): a large fraction of these network costs cannot be assigned on a cost-causal basis to individual services.
The regulatory expedient of assigning fixed costs among categories (e.g., between regulated and unregulated or between interstate and intrastate jurisdictions), in proportion to variable costs or demand volumes, though “reasonable,” is not cost-causative, and the resulting costs are not economic costs. It might be equally reasonable to allocate railroad overhead costs to services by volume, weight or value, but shippers of feathers, coal and diamonds would undoubtedly disagree about the results. In Dr. Willig’s prophetic words some 15 years ago,

Fully allocated cost figures and the corresponding rate of return numbers simply have zero economic content. They cannot pretend to constitute approximations to anything. The “reasonableness” of the basis of allocation selected makes absolutely no difference except to the success of the advocates of the figures in deluding others (and perhaps themselves) about the defensibility of the numbers. There just can be no excuse for continued use of such an essentially random, or, rather, fully manipulable calculation process as a basis for vital economic decisions by regulators.16

B. Margins between price and incremental cost are not a measure of market power for telecommunications services.

AT&T asserts (Petition at 10) that the markup above incremental costs for special access services is unreasonable and much higher than markups in competitive markets.17

Special access services are provided over the same facilities and are functionally equivalent to high capacity loop and transport network elements. Yet, the Bell’s month-to-month special access rates are generally double…their comparable UNE rates.18

Both the comparison and the inference drawn from it are absurd.

First, where margins between price and incremental cost are used to measure anything, the incremental cost in question is emphatically never TELRIC. For example, the familiar Lerner index (the percentage markup of price above incremental cost) is sometimes calculated for a firm, but the incremental cost in question is the forward-looking economic cost of the firm itself, not the hypothetical cost of a perfectly efficient

17 Also see the Declaration of Janusz A. Ordover and Robert D. Willig on Behalf of AT&T Corp. filed as Tab B to the Petition. (“O-W Declaration”) at 12.
firm serving the entire market as a wholesale provider using a fully-modern network optimally deployed around the incumbent firm’s existing switch locations. Second and more fundamentally, price markups above incremental cost are necessary in an industry like telecommunications that is characterized by a large proportion of shared and common costs, fixed and variable. It is well-understood in the industry that it is not possible to price each telecommunications service at incremental costs and still have a viable firm that can expect to recover all of its forward-looking costs.

Experience from other segments of the industry clearly demonstrates that in the face of significant fixed and common costs, prices systematically exceed marginal costs. For example, the domestic residential long-distance telecommunications market has often been considered to be reasonably competitive, and AT&T was declared to be nondominant in that market by the FCC in 1995. Three years later, margins in that market were, however, as large or larger than those cited as “obscene” by AT&T (Petition at 3) for RBOC special access margins today—three years after they were accorded more limited flexibility.

For July 1998, using a public database of telephone bills of a random sample of U.S. residential households, we measured the average rate per minute actually paid by AT&T’s customers for interstate domestic direct-dial phone calls, including a per-minute assignment of service charges, promotional credits, fixed monthly PICC flow-through charges, and a fixed monthly universal service fund assessment. From this sample, the average rate paid by AT&T residential customers was about 20 cents per conversation minute. Switched interstate access charges were about 2.8 cents per conversation minute in July 1998. We have estimated that, at that time, federal universal service fund assessments and the Primary Interexchange Carrier Charge (“PICC”) paid by AT&T to

---

18 Petition at 10 and O-W Declaration at 12. It is unclear whether to attribute this opinion to AT&T or to its independent economic experts, because—except for a typographic error in the AT&T Petition—they appear identically and without attribution in both the Petition and the O-W Declaration.


serve its residential customers, when added to access charges, came to about 6 cents per conversation minute.\footnote{In July 1998, the residential PICC was \$0.95 for the first line and \$1.77 for each additional line. \textit{See id.}, Table 7.14. The universal service fund ("USF") assessment was 3.93 percent. \textit{See Federal Communications Commission, Public Notice, Proposed Third Quarter 1999 Universal Service Contribution Factors}, CC Docket No. 96-45, DA 99-1091, June 4, 1999. We have calculated AT&T's average cost of the PICC and USF per minute of serving its residential customers using a sample of residential bills from Market Facts, Inc. and PNR and Associates, Inc., \textit{MarketShare Monitor™} (September 9, 1998).} Estimates of long distance network marginal cost vary between 1 and 2 cents per conversation minute and total about 5 cents per minute if one includes marketing expenses.\footnote{Estimates of toll and access incremental costs are presented in Robert W. Crandall, \textit{After the Breakup: U.S. Telecommunications in a More Competitive Era} (Washington D.C.: The Brookings Institution, 1991), at 138-141; Lewis J. Perl and Jonathan Falk, "The Use of Econometric Analysis in Estimating Marginal Cost," Presented at Bellcore and Bell Canada Industry Forum, San Diego, California (April 6, 1989), Table 2; Robert W. Crandall and Leonard Waverman, \textit{Talk is Cheap: The Promise of Regulatory Reform in North American Telecommunications} (Washington D.C.: The Brookings Institution, 1996); and Paul W. MacAvoy, \textit{The Failure of Antitrust and Regulation to Establish Competition in Long-Distance Telephone Services} (Cambridge, Massachusetts: The MIT Press and Washington D.C.: The AEI Press, 1996). The costs are obviously averages and vary a great deal across jurisdictions, times of day and technologies.} Combining these estimates, AT&T's marginal costs of serving residential customers totaled 7 to 11 cents per conversation minute, depending on whether one includes marketing expenses. Thus, AT&T's margin from residential customers was at least 9 cents per minute, even if one includes marketing expenses \((20 - 11 = 9)\), and uses the upper range of estimated network costs. Thus three years after receiving considerably more pricing flexibility than the RBOCs received three years ago, AT&T, in the residential long-distance market that is frequently asserted to be competitive, appears to have imposed a minimum markup of almost 82 percent \((9\) relative to 11 cents) or a markup of more than 185 percent if marketing costs are not treated as incremental.

The point of this example is that in industries, such as telecommunications, characterized by high fixed costs and economies of scale and scope, it is neither uncommon nor in itself incompatible with effective (but sustainable) competition to find high percentage mark-ups of price above incremental cost for individual services. The case made by Drs. Baumol, Panzar and Willig for the importance of contestability as a measure of the effectiveness of competition rests precisely on the inapplicability of the pure or perfect competition model, in which alone there can be no such markups.\footnote{W.J. Baumol, J.C. Panzar and R.D. Willig, \textit{Contestable Markets and the Theory of Industry Structure}, San Diego: Harcourt Brace Jovanovich, 1982.}
Thus, such markups in the special access market three years after limited pricing flexibility began are not in themselves evidence of excessive prices or of the presence of market power.

**C. AT&T misinterprets demand, price and revenue changes in the special access market.**

In both its Petition (at 11) and O-W Declaration (at ¶33), AT&T infers that RBOCs possess market power for special access services from its claim that the special access price increases (cited in Mr. Stith’s Declaration) have led to higher revenues. While RBOC special access revenues have indeed increased, the reason is not inelasticity of demand but simply rapid growth in the demand for such circuits. The same ARMIS data sources that Mr. Friedlander uses readily show that special access volumes, measured by the sum of analog and digital access lines, have increased rapidly throughout the late 1990s, while RBOC special access revenue per circuit has declined, not increased.

These data clearly show a rapid and accelerating growth of RBOC special access lines, averaging 30 percent per year over the 1996-2001 period, which is consistent with the conventional industry wisdom that data services have been growing much faster than voice services in recent years.\textsuperscript{24} Other sources show comparable growth rates for both ILECs and CLECs in the special access market: revenues grew at an annual rate of approximately 36 percent for both between year-end 1999 and year-end 2000,\textsuperscript{25} CLEC fiber network route miles increased by about 84 percent between 1999 and 2002\textsuperscript{26} and comparable expansion was experienced in the number of CLEC networks serving the largest 150 MSAs.\textsuperscript{27}

\begin{itemize}
  \item \textsuperscript{24} Qwest reported ARMIS special access line count data for 1996 through 1999 included channel terminations to the POP. Data for that period reported in this, and subsequent charts dependent on line counts, has been adjusted by the company to remove channel terminations to the POP based on the percentage of channel terminations to the POP in 2000 and 2001.
  \item \textsuperscript{25} 2002 Special Access Fact Report at 27.
  \item \textsuperscript{26} 2002 Special Access Fact Report at 12.
  \item \textsuperscript{27} 2002 Special Access Fact Report at 12-13.
\end{itemize}
In economic theory, growth in demand unrelated to reductions in price is modeled as an outward shift in the market demand curve. In the example below, demand shifts outward and the market-clearing price as well as the volume of sales increases. The market price will increase provided the industry supply curve is not horizontal, and, at least in the short run, there is no reason to believe that the market is willing and able to supply unlimited special access circuits at current prices.
Thus, an increase in prices, revenue and demand volumes is not necessarily evidence that a large firm possesses market power, as AT&T clearly implies. Supply and demand are normally equilibrated in unregulated markets as demand expands by increases in prices and revenue until additional capacity can be brought on line, in reaction to the increased prices.

An additional source of revenue and earnings growth in interstate special access markets has been the recent growth in demand for Digital Subscriber Line (DSL)—an interstate service. DSL technology exploits unused frequencies on existing copper telephone lines to transmit high-speed data traffic — i.e., voice and high-speed data are simultaneously transmitted over the same telephone line — so that its incremental loop cost is small. As a result, increasing demand for DSL service generally increases interstate revenues with little corresponding increase in interstate regulatory costs.

The DSL revenues booked by the RBOCs to their regulated interstate accounts are large and grew rapidly during this period.\(^{28}\) In 2001, BellSouth added more than 600,000

\(^{28}\) SBC provides DSL service through a separate affiliate and does not book DSL revenue to its interstate special access accounts.
subscribers and booked $264 million of DSL revenue.\textsuperscript{29} Similarly, in spite of a decline in overall company earnings, third-quarter 2001 results show Qwest DSL revenue grew 80 percent, as the company logged 90 percent growth in the number of subscribers.\textsuperscript{30} As the first quarter 2001 ended, Verizon had about 720,000 DSL lines — nearly five times more than it operated in the same period the preceding year.\textsuperscript{31} Setting aside the question of whether the level of ILEC charges for their DSL services was adequately constrained by competition—primarily of cable broadband, the market share of which was twice that of the telephone companies—these dramatic increases in revenues and earnings attributable to these services can obviously not logically be attributed to any exploitation of their market power over IXCs and CLECs, as AT&T alleges. RBOC DSL revenue for Verizon, Qwest and BellSouth through September 2002 exceeded $650 million, and, annualized, represents a 112 percent increase over total 2001 revenues of $410 million.

Once we recognize that demand for special access services is growing rapidly, some other anomalies that AT&T points to in its Petition and the O-W Declaration can be explained. In particular, AT&T complains that special access prices—especially those subject to permissive flexibility—have increased or failed to decrease [Petition at 11-12, O-W Declaration at ¶¶28-30]. At the same time, it expresses dissatisfaction with optional pricing plans (“OPPs”) and term and volume discounts that it is either offered (as an IXC) or required to compete against (as a facilities-based self-supplier). As a matter of fact, using RBOC ARMIS 43-08 data, we find that the growth in special access lines fully explains the growth in revenue and that the RBOCs’ average revenue per line between 1996 and 2001 decreased by more than 1 percent per year in nominal terms and by more than 3 percent per year in constant dollars.\textsuperscript{32}

\textsuperscript{29} See Revenues Rise at BellSouth, Broadband Week Direct, January 22, 2002
\textsuperscript{30} CNN Money, Qwest Posts 3Q Loss, October 31, 2001.
\textsuperscript{32} Even these decreases are somewhat understated insofar as special access revenue includes DSL revenue but special access lines do not include DSL lines.
Thus, the pricing flexibility exercised by some RBOCs during 2001 had no noticeable effect on their special access revenues per line, and AT&T's dire complaints of massive price increases likewise appear to be belied by the data.

Finally, AT&T infers the exercise of RBOC market power from its claim that the quality of the special access services it buys, particularly provisioning, is poor and deteriorating [Petition at 15, O-W Declaration at ¶31]. Again, the ARMIS data, measured per access line or per provisioning order, tell a very different story. On average, trouble reports per access line fell in half during the 1996-2001 period, and the percentage of installation order commitments met has remained consistently high throughout the period. Nothing in the picture remotely suggests the exercise of market power by allowing service quality to deteriorate.
In short, the basic ARMIS data show that on a per-occurrence basis, there has been an improvement, not a deterioration, in the quality of the RBOCs' special access service over this period, let alone any deterioration associated with or attributable to their having been accorded pricing flexibility in 2001 and 2002.

**IV. AT&T’s Proffered Evidence Has Nothing to do with Pricing Flexibility.**

In its Petition and O-W Declaration, AT&T presents quantitative evidence which it claims shows that the pricing flexibility granted by the Commission has been injurious to both competitors and customers. In this section, we show that whatever the merits of these claims, they cannot be attributed to the introduction of pricing flexibility.

AT&T cites RBOC data on the level and growth of special access earnings and revenues for the period 1996-2001 as evidence that special access pricing flexibility has enabled the RBOCs to increase prices profitably.\(^{33}\) The obvious problem with this

\(^{33}\) The data is derived in the Declaration of Stephen Friedlander, Exhibits 1 and 2. The Petition graphs both earnings and revenue data for the years 1996 through 2001, and the O-W Declaration repeats the graph of earnings and cites the revenue results. Both the Petition and the O-W Declaration argue that the level and growth of earnings are evidence of market power [Petition at 8, O-W Declaration at 12], and the Petition infers the presence of RBOC market power from the fact that revenue increased despite price increases [Petition at 14].
inference is that special access pricing flexibility began only in 2001 and was implemented transitionally over the 2001-2002 period. According to AT&T,

> [a]s of the 2002 tariff filings, approximately 59 percent of the Bells’ special access revenues (excluding GTE) are no longer subject to price cap regulation [Petition at 11, no citation of source]

If AT&T is correct, a large fraction of RBOC special access service remains under price cap controls today. Moreover, where pricing flexibility has been granted at all, it has been authorized and implemented quite recently. According to the schedule shown below, the first grant of pricing flexibility was for BellSouth on December 15, 2000, followed by Verizon and SBC (on March 14, 2001). Qwest first received its authorization in April 2002. In interpreting the Table, observe that (i) the date on which pricing flexibility was actually implemented was frequently some two months after the RBOC’s petition was approved by the Commission and (ii) as the table makes clear, whatever the merits of AT&T’s criticisms about the level and growth of RBOC earnings and revenues—merits that we criticized above—they have nothing to do with their authorization to price special access flexibly. RBOC accounting earnings and revenues for interstate special access services grew steadily from 1996 to 2000—before pricing flexibility was permitted. Again, according to AT&T, earnings for most RBOCs exceeded 11.25 percent, but that, once again, was before special access pricing flexibility was implemented. Qwest’s experience, of course, has no bearing at all on the issue, since it had no such authorization during the period covered by AT&T’s data.

---

34 For example, SBC's first petition for flexibility was approved on March 14, 2001 and implemented in tariffs filed on May 16, 2001. Its second petition was approved on April 11, 2002 and implemented on June 18, 2002.
But what about the AT&T argument that high and increasing earnings and revenues imply that RBOCs have had and retain significant market power—that IXCs have no competitive alternatives—so that granting pricing flexibility could have anticonsumer and possibly anticompetitive effects? There are three responses, in addition to the fallacy of using regulatory earnings to measure economic profit, which we will discuss in the next section. First, the levels and trends of the data offered by AT&T were clear to all industry participants in the pricing flexibility docket. Moreover, AT&T and its economists do not claim that the data show a change in those patterns after pricing flexibility was permitted, and, indeed, the data show no such change. Hence, AT&T offers no useful new information—let alone “years of data”—that the Commission could use to determine if pricing flexibility has had undesirable effects.
Second, the trend and level of prices, revenue and earnings for special access in the data offered by AT&T are almost entirely the effect of price cap regulation, including the recent modification approved by the Commission in its CALLS agreement, to which AT&T was a willing signatory. Effects of the reduction in the productivity factor for the special access basket in 2000 are included in the data presented by AT&T, but presumably it and the other signatories to the CALLS agreement received other considerations for that adjustment and ought not to be asking for relief from those effects in this proceeding. Finally, timing aside, the information provided about earnings and revenues has no bearing on the presence or absence of RBOC market power in the special access markets.

V. There are Competitive Alternatives to RBOC Special Access Services.

AT&T says that it continues to rely on the RBOCs’ high-capacity networks for interoffice facilities and for customer-premises channel terminations because CLEC services are unavailable or too expensive and self-supply is uneconomic because of its insufficient scale economies and difficulties in obtaining rights-of-way [Petition at 26-32].

Broadly speaking, these claims suffer from one timing problem and two errors of economic logic. As to the former, AT&T makes no attempt whatever to relate this asserted experience to the introduction of pricing flexibility for special access services. Instead, it merely repeats its general contentions about its difficulties in purchasing and supplying dedicated transport and channel termination services that have been thoroughly discussed in previous dockets. As for the erroneous economics, first, AT&T resolutely continues to ignore its ability to provide its own special access facilities; witness its meaningless claim that the “lion’s share of AT&T’s access dollars go to the Bells” [O-W Declaration at §35]. As we will proceed to demonstrate, the total “access dollars” to which it refers are only its payments to other suppliers, not its total outlays for such services—a difference that produces an enormous difference in results. What matters for CLECs and IXCs is that they have economically realistic alternatives to RBOC special access facilities available to them, not that they necessarily purchase them with “access dollars” from third parties. And, second, AT&T’s generic claims about economies of
scale and sunk costs are belied by the technology and by the rapid growth of non-RBOC networks that have competed successfully against the RBOCs in those markets since shortly after divestiture.

A. AT&T ignores its ability to supply its own special access facilities.

AT&T complains of difficulties in purchasing special access facilities and services from non-RBOC suppliers. Since AT&T purchased TCG, one of the largest independent suppliers of competitive access services and by so doing took its network in-house, this complaint amounts to a blatant application of the orphan defense—in which a child murders his parents and then begs the Court for mercy on grounds that he is an orphan.

During the years in which the Commission examined alternatives to the RBOCs, the participating parties regularly documented the breadth, depth, reach and growth of networks supplied by Competitive Access Providers ("CAPs") on a wholesale basis to IXC and CLEC and on a retail basis to large corporate customers. The business plan for a typical large CAP (in this case one that has since been acquired by WorldCom) was simple enough:

The Company sells its services primarily to IXC, ISP, wireless carrier and business, government and institutional customers who are high volume users of telecommunications services. ... Through the deployment of state-of-the-art fiber optic networks and switches, the Company is able to provide the IXC served by its networks with high quality, reliable services at prices less than those the regulated ILECs currently charge. The Company can expand its capabilities to offer these services beyond the locations served by its networks by interconnecting its facilities with the facilities of the ILECs, IXC and other providers of telecommunications services....

...As an early entrant in selected second and third tier cities, the Company believes it can attain a leadership position by securing needed franchises and rights-of-way, installing robust state-of-the-art CLEC networks and facilities and establishing customer relationships with IXC, ISP, wireless carrier and business, government and institutional end users that will enable it to take advantage of the attractive potential growth rates for local exchange service revenues in those markets. The Company is also pursuing opportunities in selected first tier markets (those with populations over two million) utilizing the Company's existing operational capabilities in conjunction
with operating agreements with the Company's major IXC customers.

The Company's networks are generally designed to access at least 70% to 80% of the identified business, government and institutional end user revenue base and the IXC facilities...and substantially all of the central offices of the ILECs within their markets.\(^35\)

Comparing the highlighted passages above with AT&T's litany of difficulties raises obvious questions. If Brooks Fiber could compete successfully against existing ILEC prices by installing "state-of-the-art fiber optic networks and switches" to serve IXCs, what are we to make of AT&T's sweeping assertion that economies of scale and the risk of sunk costs make special access circuits a "natural monopoly?" [O-W Declaration at ¶43]. If Brooks Fiber, as an "early entrant" into second and third tier city markets, can obtain "needed franchises and rights-of-way," how "enormous" is the RBOC first-mover advantage of which AT&T complains? [O-W Declaration at ¶¶44-45]. If Brooks Fiber can access 70 to 80 percent of its business, government and institutional revenue base and IXC POPs and all of the RBOC central offices, why is AT&T able to reach only 5 percent?

Of course, the claims of one such competitor—a competitor, moreover then acquired by the country's second-largest IXC—just as AT&T itself acquired Teleport—might logically be subject to some discount, particularly in light of the subsequent financial history of its acquirer. The fact is, however, that the CAP industry grew rapidly following this and similar business plans throughout the early 1990s. According to FCC statistics,\(^36\) CAP route miles and fiber miles grew at annual rates of 59 and 67 percent respectively from 1990 through 1998. Tables 14 and 15 from the FCC's "Fiber Deployment Update for Year End 1998" show the state of the CAP industry roughly at the time the Commission was considering special access pricing flexibility and consolidation in that CAP industry took place.

While consolidation, reorganization and bankruptcies have affected much of the industry since 1990, and devastated it financially in the last year or two, they have not fundamentally affected the physical facilities. The corporate names attached to the circuits in the attached tables may have changed as the growth in fiber capacity caught up

\(^35\) Brooks Fiber 10-K Report, fiscal year ending December 1996, emphasis supplied.

\(^36\) FCC, "Fiber Deployment Update for Year End 1998."
with and exceeded the growth in demand, but the capacity itself remains in place, as the
basis for a great potential elasticity of competitive supply, which continues to protect
customers from unjustified RBOC price increases.

<table>
<thead>
<tr>
<th>Company Name</th>
<th>Route Miles</th>
<th>Thousands of Fiber Miles</th>
</tr>
</thead>
<tbody>
<tr>
<td>Brooks Fiber</td>
<td>109</td>
<td>141</td>
</tr>
<tr>
<td>Electric Lightwave</td>
<td>6</td>
<td>104</td>
</tr>
<tr>
<td>e.spire (ACSI)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>GST Telecom</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Hyperion</td>
<td></td>
<td></td>
</tr>
<tr>
<td>ICG</td>
<td>105</td>
<td>132</td>
</tr>
<tr>
<td>Intermedia (ICI)</td>
<td>159</td>
<td>165</td>
</tr>
<tr>
<td>Kansas City Fib. Net</td>
<td>91</td>
<td>94</td>
</tr>
<tr>
<td>MCImetro</td>
<td></td>
<td></td>
</tr>
<tr>
<td>McLeod USA</td>
<td>65</td>
<td>75</td>
</tr>
<tr>
<td>Metromedia</td>
<td></td>
<td></td>
</tr>
<tr>
<td>MFS (WorldCom)</td>
<td>309</td>
<td>546</td>
</tr>
<tr>
<td>MHLightnet</td>
<td></td>
<td></td>
</tr>
<tr>
<td>NEXTLINK</td>
<td></td>
<td></td>
</tr>
<tr>
<td>RCN</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Teleport (TCG)</td>
<td>468</td>
<td>647</td>
</tr>
<tr>
<td>Time Warner Telecom</td>
<td>59</td>
<td>86</td>
</tr>
<tr>
<td>Total Reported</td>
<td>1,259</td>
<td>1,865</td>
</tr>
</tbody>
</table>

Table 14: Competitive Access Fiber Systems -- 1990 to 1998

Thousands of Fiber Miles
Towards the end of the 1990s, consolidation in the telecommunications industry sharply reduced the number of these competitors, and between 1996 and 1998, the three largest consolidated CAPs were further acquired by AT&T and WorldCom, as we already observed: AT&T acquired Teleport in January, 1998, and WorldCom bought MFS in August 1996 and Brooks Fiber in October, 1997. As a result, the capacity (and growth prospects) for competitive wholesale local exchange facilities was taken off the open market and brought in-house by the two largest IXCs (and two of the largest CLECs). Consequently, there are indeed fewer independent CAPs available to AT&T and WorldCom today when they seek alternatives to RBOC special access circuits; but, of course, the capacity of AT&T and WorldCom to supply these facilities themselves increased by the same amount. One cannot simultaneously acquire the major wholesale providers of special access circuits and then, invoking the orphan defense, complain about a shortage of independent supplies or suppliers on the open market!

The bottom line, as AT&T pursues its strategy of moving access services in-house, is of course that the fraction of its “access dollars” that “goes to the Bells”
becomes increasingly irrelevant as a measure of the competitive alternatives to RBOC special access circuits available to it and the other IXCs and CLECs.

**B. Special access markets are competitive in theory as well as in fact.**

AT&T [Petition at 29, O-W Declaration at ¶¶39-40] describes the technology of loop and dedicated transport services as characterized by either “enormous” or “substantial” economies of scale and sunk costs. From this observation, it concludes that special access services are a natural monopoly and (presumably) that competition is or will be insufficient to justify conferring pricing flexibility on the ILECs. To put it another way, AT&T seems to believe that the extensive competition that exists in practice is not possible in theory. Again, AT&T has made this claim before, and nothing in its Petition or Declarations suggests that experience under pricing flexibility has vindicated its claims. The best economic evidence that special access services are competitive is the long and continuing history of entry and expansion of competitors and the steady decline in RBOC market share that has occurred.

Experience, even taking into account the financial meltdown of telecommunications firms, provides in itself sufficient refutation of AT&T’s claims. It is worth, however, pointing to weaknesses in its supporting argument. First, it complains [O-W Declaration at ¶35] that it and other CLECs “have been able to replicate only a small fraction of the Bells’ [entire] high-capacity network.” It has chosen the wrong denominator in calculating that “small fraction”: special access dedicated transport and channel terminations are point-to-point, not switched services, and a ubiquitous network is not necessary to participate successfully as a competitive supplier.

Second, the main driver of scale economies for local exchange service is customer density—serving dense areas permits use of larger cable, larger switches and shorter loop lengths. That source of scale economies is less important for dedicated transport or other point-to-point circuits, which do not use switches and for which individual customer

---

37 AT&T used the former characterization [Petition at 29], its economists the latter [O-W Declaration at ¶¶39-40].

38 Of course, with interconnection, switched competition need not be ubiquitous to succeed either as many niche competitors have shown.
locations provide a high volume of usage. Moreover, insufficient demand on particular routes or inadequate assurance of demand sufficiently enduring to justify incurring the necessary heavy sunk costs [O-W Declaration at ¶49-52] may possibly explain why a small CLEC might find it uneconomic to undertake such investment, but they do not explain why a CAP, a group of CLECs or a wholesale fiber supplier could not. Indeed, the experience of the CAP industry has shown a willingness to invest in fiber in such markets. Wholesale local fiber suppliers such as Metromedia Fiber Networks, American Fiber Systems, Yipes and NEON have put fiber in the ground, and even though the current glut of fiber on the market has led to acquisitions, reorganizations and bankruptcies among these firms, the capacity they have installed remains. The fact that the incremental cost of operating that capacity is extremely low means that it can be brought into service quickly in response to a market price increase.

Third, AT&T claims that marketing expense is greater for entrants than for RBOCs because CLECs must “develop a brand” and incur large promotional expenditures to attract customers. As these costs are sunk, AT&T says, they constitute a barrier to entry, so that new entry cannot be relied upon to constrain the RBOCs' special access rates [O-W Declaration at ¶45]. While these contentions are relevant to the feasibility of retail competition, they are of drastically reduced significance in the special access market, whose services—special access channel terminations and dedicated transport—are sold mainly to IXCs and large businesses. Marketing and promotional expenditures and brand identity for services provided to a small number of long distance companies are much less important than for retail sales to the public at large. Similarly, retail customers of these services are large businesses which purchase them as part of networks supplied generally by the large IXCs. Marketing and branding costs are more of a problem for the RBOCs (which are essentially the new entrants into this market segment) than for AT&T, by far the largest incumbent provider. Irrespective of who the customer is, the claim that CLECs must incur higher costs than RBOCs to establish a brand may apply to some of them but surely not to AT&T and WorldCom, which already have business relationships with nearly every customer and who have long-established

39 That is, customers whose demand volumes warrant DS-1 or higher service can be served efficiently by direct connections from an IXC point of presence without requiring intermediate aggregation.
brands and name recognition, particularly in the market segments for which special access is purchased.

VI. There are no Anticompetitive Effects in Adjacent Markets.

AT&T claims that excessive special access prices impede competition in both local exchange and long distance markets [Petition Section II, O-W Declaration Section V]. The Company has made this argument regularly in the past but has proffered no evidence from the recent experience with special access pricing flexibility to support or justify its relitigation here.

A. Pricing flexibility fosters efficient competition in retail local exchange markets.

AT&T's quarrel here is with the use and commingling restrictions on the availability of unbundled network elements, not with flexibility in the pricing of special access. Its claim is that because of those restrictions, CLECs cannot afford to avail themselves of the opportunity to lease the circuits they need to interconnect their own switches or transport facilities at the favorable TELRIC-based UNE rates, but must instead pay the much higher special access charges of the ILECs. Ignoring for the moment the rationale of those use and commingling restrictions, the argument is on its face peculiar from an economist's perspective. AT&T and its economists are attempting to assure the Commission that if these restrictions are lifted (or special access prices reduced), IXCs and CLECs will be more rather than less inclined to invest in their own facilities rather than use those of the RBOCs. Considering that special access facilities and services are a factor of production for CLECs and IXCs, AT&T is in effect claiming that its demand curve (and those of other CLECs and IXCs) for RBOC special access facilities and services is, perversely, upward-sloping in relation to price. A more likely explanation of AT&T's preference is that its factor demand curve is indeed downward sloping, and it recognizes the economic axiom that, all else equal, a reduction in a factor price leads to its more intensive use. The result might well be more entry, but it would

---

40 AT&T argues that high special access prices indirectly impede CLEC investment in switches (O-W Declaration at ¶49) and transmission facilities (O-W Declaration at ¶51) because RBOC facilities are necessary to link CLEC facilities into a network. But at the same time, high special access prices directly encourage CLEC investment in their own transmission facilities. AT&T is effectively saying that RBOC
surely be less facilities-based and more based on use of RBOC circuits and services. Thus, it is difficult to understand how the assertedly excessive special access prices charged AT&T by the RBOCs could constitute “a major barrier to entry by potential facilities-based competitors into retail markets for local telephony.” [O-W Declaration at ¶48]

In addition, the use and commingling restrictions serve an important economic function: namely to prevent arbitrage between two sets of regulated prices, set intentionally by application of different ratemaking principles. On the one hand, carrier access charges were established at divestiture and set intentionally above incremental cost in order to continue the flow of contribution from long distance services to local exchange services. On the other hand, TELRIC-based UNE charges were set (in principle) at incremental cost (plus a small margin) in order to encourage entry into local exchange telephony. Obviously, applications of these differing ratemaking principles can give rise to different prices for similar services, and the purpose of the use and commingling restrictions is simply to reduce the amount of arbitrage artificially generated by those differences that would undermine the Commission’s regulated carrier access charges.

Finally, it is worth observing that despite AT&T’s concern for the viability of local exchange competition, retail local competition is extremely healthy. In the teeth of a dramatic downturn in the economy and in the telecommunications sector, CLECs continue to invest and CLEC market shares continue to grow. Although UNE-P is probably the fastest-growing method of entry, in most states, substantial facilities-based entry has taken place.41 While parties can disagree whether the competitive glass is half-empty or half-full, it is certainly the case that CLECs have been able to overcome the potential entry barriers listed by AT&T and compete successfully against the ILECs in the local exchange market.

---

special access facilities generally behave as complements to CLEC facility investment rather than as substitutes.

41 See the UNE FACT REPORT 2002, Prepared for and Submitted by BellSouth, SBC, Qwest and Verizon in CC Docket Nos. 01-338, 96-98 and 98-147.
B. Targeted pricing and Volume/Term contracts are procompetitive.

After airing its claims that RBOC special access prices are too high, AT&T then contends that they are, at least in some circumstances, also too low. The O-W Declaration asserts that Phase I and II pricing flexibility would permit the RBOCs to engage in targeted price reductions to discourage entry along particular routes and so prevent competitors from serving IXC, CLEC and end-user customers. The Petition complains about downward pricing flexibility, customer foreclosure through multiperiod contracts and “severely anticompetitive” OPPs that would commit AT&T to minimum annual purchases over multiple years to obtain a discount.

It is important to point out at the outset that these allegations of strategic anticompetitive behavior are entirely theoretical. AT&T has presented no evidence to suggest it has in fact occurred, let alone as a result of the ILECs’ recent receipt of limited special access pricing flexibility. Nonetheless, in assessing these complaints, three relevant economic points must be borne in mind.

1. Downward pricing flexibility is in itself procompetitive.

In general, regulators should always look upon proposals to restrict price reductions with a jaundiced eye. Price reductions are painful to competitors, but they are the essence of the competitive process. Restricting the incumbent’s ability to lower prices denies consumers the benefit of those reductions immediately and reduces future consumer welfare by weakening competition and allowing inefficient competitors to remain in the market. As three well-known economic advisors to pre-divestiture AT&T observed,

These dangers remain even when regulatory commissions purport to prevent only discriminatory price competition. When an industry is subject to decreasing costs, the only way a supplier can cover his total costs while at the same time taking fullest possible advantage of scale economies is in fact to engage in price discrimination—specifically, to reduce prices selectively down toward incremental costs in markets where demand is relatively elastic. By prohibiting such suppliers from engaging
in selective price reductions in order to protect smaller rivals from the resultant competition, regulatory cartelization fosters inefficiency.\textsuperscript{42}

The offer of special deals to attract or retain customers, whether justified by differences in cost or actually discriminatory in the technical sense, is an essential way in which price competition takes place in the real world. That they may discommode or injure competitors is an inherent consequence; but one of the most fundamental distinctions in economics generally, and antitrust law specifically, is between the inflicting of harm on competitors, with a resulting net increase in consumer welfare, from weakening or impairment of the competitive process, resulting in an ultimate or net decrease in consumer welfare. The distinction is of course extremely difficult to make in practice, but it is absolutely fundamental. The fact that one of us has consistently over the decades emphasized the danger that such selected, discriminatory reductions can be predatory in intent or effect must not be permitted to obscure his consistent recognition of that crucial distinction, in principle. Any general restrictions on the ability of RBOCs to respond to Requests for Proposals or offer optional discount packages would restrict active competitive behavior and harm consumers by denying them both the direct economic benefit of any such offerings and of responses by competitors that they tend to compel, reducing the vigor of competition in the market. Term and volume discounts expand consumer choice and ultimately expand demand, increasing consumer welfare directly. Reasonable termination penalties are an inherent part of the bargain and make such plans possible by reducing opportunities for cheating; without such penalties, the plans could not be offered and the increase in consumer welfare, both direct and indirect, would be lost. Finally, distinguishing among differently-situated customers with optional discount packages can expand sales and increase consumer welfare, so that removing the option of downward pricing flexibility would be anticompetitive. And in all of the above cases, the fact that only the RBOCs would be precluded from using them would distort the process of competition and sacrifice its benefits to special access customers.

None of the foregoing arguments conflicts in any way, in principle, with the repeated emphasis by one of us on the dangers of predation—in particular, typically

manifested in the offer of deep price reductions highly selectively, to combat a typically much smaller competitor, followed by the quick restoration of previously prevailing prices once the competitive threat has been eliminated. But never have his warnings been unaccompanied by an explicit recognition that it would be injurious to competition and the welfare of consumers generally to prohibit the mere offering of special deals and discounts, and by a reminder that such blanket prohibitions would in practice entail a prohibition of competition itself.

The Commission effectuated its concern that selective price reductions might be used to thwart competition in its Pricing Flexibility Order by requiring the presence of competitors using their facilities before pricing flexibility by incumbents would be permitted. AT&T [Petition at 18-21] claims “[e]xperience now shows” that the Commission was mistaken: the only “experience” it cites, however, is the RBOCs’ offerings of OPPs.\textsuperscript{43} In fact, CAPs and CLECs have already invested heavily in facilities in major markets; those facilities are not going to go away and can be employed competitively at very low incremental costs. Any anticompetitive strategies aimed at frustrating new entry would be too late to be effective. Moreover, the customers for RBOC special access services are largely CLECs and IXCs, and the largest of them, AT&T and WorldCom, are also the largest owners of CAPs. While AT&T expresses concern that selective price reductions by the RBOCs might make competition difficult for independent suppliers of special access facilities and services, even selective price reductions would have no anticompetitive effect on the decisions of AT&T and WorldCom to supply their own needs, at low incremental cost. Finally, as AT&T has argued on its own behalf for decades—-from the time of Telpak to its more recent Tariff 12 offerings—customers are better off when incumbents, in addition to other suppliers, are able to respond to contract proposals from large business customers.

2. **OPPs with term and volume commitments fill an important market need.**

Any carrier precluded from offering optional pricing plans with term and volume discounts would be placed at a significant competitive disadvantage in the special access

\textsuperscript{43} AT&T makes the oxymoronic assertion that the RBOCs use market power to force carriers to use their optional pricing plans (Petition at 21).
market. Long-term contracts are used to minimize risk exposure and stabilize production requirements and costs over time. In addition, when the buyer or seller incurs heavy sunk costs as part of the transaction, both parties are better off under effective long-term contracts. Common examples of such costs in special access markets include network design of customer-specific facilities and the purchase of transaction-specific equipment and facilities. Under such contracts, the buyer and seller are both assured that (i) their sunk costs will eventually be recovered from the transaction for which the costs were incurred and (ii) up-front sunk costs can be amortized and recovered over the life of the transaction, better aligning costs with revenues. Long-term contracts thus have salutary effects in the form of risk and cost reduction for both suppliers and customers.

AT&T complains [Petition at 22-23, O-W Declaration at ¶61-62] that the RBOCs have forced it into signing long-term contracts and OPPs that oblige it to “commit to certain levels of annual purchases to obtain the discounts.” It also complains that those contracts come with “sizable penalties for early termination” and that the RBOCs have “insisted on specific penalties for migrating traffic to competitors.” These complaints are without merit. First, the plans are optional, not just nominally but in reality: AT&T is not in fact obliged to choose them. As always, and as it does on a large scale, it can supply its own special access services, purchase them from other competitive suppliers or continue to buy them from the RBOCs at the ordinary tariffed rate.

Second, AT&T admits [Petition at 22, O-W Declaration at ¶62] that the savings it realizes by taking special access service under long-term contract from the RBOCs “dwarf whatever savings AT&T could achieve by using competitive alternatives”: obviously this can mean only that the OPP offers it additional benefits that outweigh the additional restrictions. Having the choice, irrespective of which choice it actually makes, clearly makes AT&T better off. Third, AT&T wants to have its cake and eat it: it values the savings from RBOC OPPs but complains about the penalties that apply for early termination. Such penalties are a standard practice in the offering of long-term contracts because without them, the discounts could not be offered. Obviously, if a customer could sign a long-term contract, obtain a discounted price on the seller’s expectation that it will be fulfilled and then breach it without penalty when a better offer came along, such
contracts, with the benefits they offer both parties, would be simply infeasible in the first place and end user customers would, ultimately, be the losers.

3. **RBOC OPPs cannot “lock up” the largest special access customers.**

Term commitments in multi-year contracts do not “lock up” customers in an anticompetitive manner, any more than General Motors locks up a customer when it sells or leases a Buick that the customer will drive for the next five years. Every special access carrier offers its customers multi-year contracts with early termination penalties, and while each customer that signs such a contract is in principle removed from the market for the services for which it has contracted, every carrier has a fair shot at securing the customer in the first place. The total demand for data services is growing at double-digit annual rates, and new customers and demands come into the market continuously. There is no reason why competition for multi-year contracts for large customers must be any less vigorous—any less beneficial for customers—than competition confined to month-to-month service arrangements.

Moreover, while AT&T claims that the RBOCs “have locked up the largest special access customers” [Petition at 23], those customers are, of course, the largest IXCs and CLECs—AT&T and WorldCom. As both of them possess extensive local exchange networks from their absorptions of Teleport, MFS and Brooks Fiber, it is difficult to understand how their having the option of entering into term contracts with an RBOC could lock them up involuntarily or subject them to monopolistic exploitation.

**C. Long Distance Markets**

As in many other dockets since 1984, AT&T [Petition at 23-24, O-W Declaration at ¶¶64-69] asserts that setting access charges above incremental cost has anticompetitive effects in the long distance market, where RBOCs both supply carrier access services and compete for retail customers. The RBOCs, AT&T alleges, can use their “market power in the provision of special access” to sell that service to IXCs at prices above cost, while incurring only the underlying costs themselves in their own use of special access to offer competing long distance services. Such a strategy, AT&T claims, raises rivals’ (i.e., IXCs’) costs, and, in the limit, subjects them to anticompetitive price squeezes. It cites
two post-1999 examples as purported evidence that this theory has some relevance to the current proceeding, but in fact neither example demonstrates anything about the effect of special access pricing flexibility on long distance competition.

The flaws in AT&T’s reasoning are well-recognized. First, pricing special access services above cost can not impair competition in the long distance market because the RBOC long distance affiliates buy special access under the same tariffs and OPPs as AT&T. Therefore, pricing special access above cost can not generate a differential advantage for the RBOC’s own long distance service or impose an anticompetitive price squeeze on an IXC.

But, AT&T complains, the cost that the RBOC actually incurs in providing access to itself (or its affiliate) is less than the cost its rivals incur when they buy access from it. How could such access prices not be anticompetitive, it asks?

The answer is simple. True, when AT&T wins the retail customer, it may purchase special access from an RBOC, in which event the cost it incurs is the price the RBOC charges, whereas when the RBOC wins the retail customer, it incurs only the incremental cost of providing the equivalent of special access. In the latter case, however, the RBOC also gives up the contribution (price less incremental cost) from special access that it would have received if AT&T had served that retail customer. Special access charge revenue (when AT&T supplies the retail service) is revenue that the RBOC foregoes when it supplies the retail customer itself. The higher that access revenue, the higher the retail price the RBOC long distance affiliate would have to charge to make long distance service profitable for the RBOC as a whole, as well as to make long distance service profitable on the books of its long distance affiliate. Thus AT&T is simply wrong [O-W Declaration at 1681 when it claims that the RBOC can charge long distance prices “that do not reflect all of the artificially elevated access prices,” and “divert substantial business from the IXCs to itself.” The RBOC affiliate’s retail price reflects to the penny what IXCs pay for access, as is required by both the law and by economic self-interest.

44 In particular, Section 272(e)(3) of the Act requires BOCs to purchase carrier access out of the same tariffs as their competitors and to impute those carrier access charges into their long distance prices, so that all competitors effectively pay the same price for the same carrier access services.
Finally, AT&T is wrong again [O-W Declaration at ¶66] in supposing the RBOC can impose a price squeeze, earning a higher margin on its sale of access services to IXC competitors than its affiliate earns on its retail service. First, such pricing cannot occur unless the RBOC affiliate prices its long-distance service below its incremental cost, since the affiliate buys access out of the same tariff as the IXC. Such predatory pricing is possible, of course, but is an unlikely strategy because it entails the affiliate sacrificing profits for some period of time with no reasonable hope of being able to drive its IXC competitors out of the market, and then raise toll prices without attracting entry and recoup lost profits, greatly facilitated by the ability of entrants to use facilities already in place, at very low incremental costs. Second, if one ignores the affiliate’s balance of costs and revenues and looks only at the RBOC’s, the same analysis holds. When the RBOC receives from the IXC a greater margin above cost for a minute of access than it receives from selling a minute of retail toll service, it loses money on every minute of those retail sales. For example, assume toll competitors must buy the RBOC’s switched access service for 5 cents per minute and the RBOC’s incremental cost of supplying access is 1 cent per minute—yielding it a margin or contribution of 4 cents. Suppose, in addition, that the RBOC affiliate’s incremental cost for supplying toll is 2 cents per minute. If the RBOC’s affiliate prices toll below 6 cents per minute, it would be more profitable to sell access to AT&T than to sell toll at retail.45

Hence, AT&T’s conclusion that “[t]his strategy may be profitable to the RBOCs” is certainly incorrect in the short run, and only possible in the long run under circumstances in which predatory pricing in the toll market is likely to be a profitable strategy and that, we have pointed out is highly unlikely in a situation of excess capacity.

AT&T offers two examples of recent (post-1999) anticompetitive effects of access charges in long distance markets. The first is an example that apparently pertains to SBC intrastate switched access charges and toll prices in Texas. The relevance of that example to interstate special access pricing flexibility is somewhat murky, and from the details given, one cannot conclude that SBC’s affiliate is pricing its toll service below the sum of its toll incremental cost and the contribution (price less incremental cost) from

45 A minute of access generates 4 cents of contribution in this hypothetical example. A minute of toll service sold for 5 cents per minute generates 3 cents of contribution.
switched access. The second example has nothing to do with a price squeeze: it merely observes that BellSouth has offered an optional package that combines Fast Packet Access Service and Frame Relay Service at an attractive price. While AT&T complains that it cannot get discounted Fast Packet Access Service without buying Frame Relay Service, it does not explain why that option is anticompetitive. As long as the package is priced so that BellSouth covers its incremental costs as well as the contribution from any access service an IXC must buy from it, the offering is procompetitive, as well as optional. AT&T’s complaint amounts to a demand to buy the second item only in a “buy one, get one free” promotion.

VII. Conclusion.

Competitive activity in the special access market continues and continues to grow. RBOC average revenues per line continue to fall; service quality remains high and increases. AT&T’s complaints of high RBOC rates of return are based on fully distributed costs and have no bearing whatever on its claims that the RBOCs retain market power. Similarly, AT&T’s claims of high or increasing RBOC price-cost margins, especially calculated on the basis of TELRIC, are not evidence of the presence of market power when fixed costs are an important characteristic of the technology. AT&T’s own price-cost margins three years after the Commission granted it pricing flexibility equal or exceed the margins of which AT&T complains here.

AT&T’s submission offers neither factual nor theoretical ground on which to reverse the Commission’s long standing policy of adapting regulation to the degree and character of competition in the market.
We declare under penalty of perjury under the laws of the United States of America that the foregoing is true and correct.

Executed on Nov. 27, 2002

Alfred E. Kahn

William E. Taylor
CERTIFICATE OF SERVICE

I, Anisa A. Latif, do hereby certify that a copy of **Opposition of SBC Communications Inc.** has been served on the parties below via first class mail – postage prepaid on this 2\textsuperscript{nd} day of December 2002.

David W. Carpenter  
Sidley Austin Brown & Wood  
Attorneys for AT&T Corp.  
Bank One Plaza  
10 South Dearborn Street  
Chicago, Illinois 60603

David L. Lawson  
James P. Young  
C. Frederick Beckner III  
Christopher T. Shenk  
Sidley Austin Brown & Wood LLP  
Attorneys for AT&T Corp.  
1501 K Street, NW  
Washington, D.C. 20005

Mark C. Roseblum  
Lawrence J. Lafaro  
Judy Sello  
AT&T Corp.  
Room 3A229  
900 Route 202/206 North  
Bedminster, New Jersey 07921

By: Anisa A. Latif