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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

September 12, 2002

Memorandum of Ex Parte Presentation

Marlene H. Dortch, Secretary
Federal Communications Commission
445 12th Street, SW
Washington, DC 20554

Re: CC Docket No. 01-338, Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers;
CC Docket No. 96-98, Implementation of the Local Competition Provisions in the Telecommunications Act of 1996; and
CC Docket No. 98-147, Deployment of Wireline Services Offering Advanced Telecommunications Capability

Dear Ms. Dortch:

On September 11, 2002, James C. Smith, Senior Vice President, Don Cain, Vice President –Federal Regulatory and Gary Phillips, General Attorney and Asst. General Counsel representing SBC Communications, Inc. (SBC), met with Deputy Chief Jeff Carlisle, Chief of Staff Rich Lerner and Legal Counsel Scott Bergmann of the Wireline Competition Bureau.

The purpose of the meeting was to discuss issues associated with the financial and investment impacts of the UNE Platform. The attached material was discussed during the course of the meeting.

Please contact the undersigned at (202) 326-8875 should you have any questions.

Sincerely,

Don Cain

Attachment

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List ABCDE

CC: Jeff Carlisle (w/o attachment)
Rich Lerner (w/o attachment)
Scott Bergmann (w/o attachment)

UNE-P: Impacts and Implications

Prepared for the
Federal Communications Commission

SBC Communications Inc.

Agenda

Overview — **Ed Whitacre**

Financial Review — **Randall Stephenson**

- Financial Trends
- UNE-P Impacts

Summary — **Bill Daley**

Overview

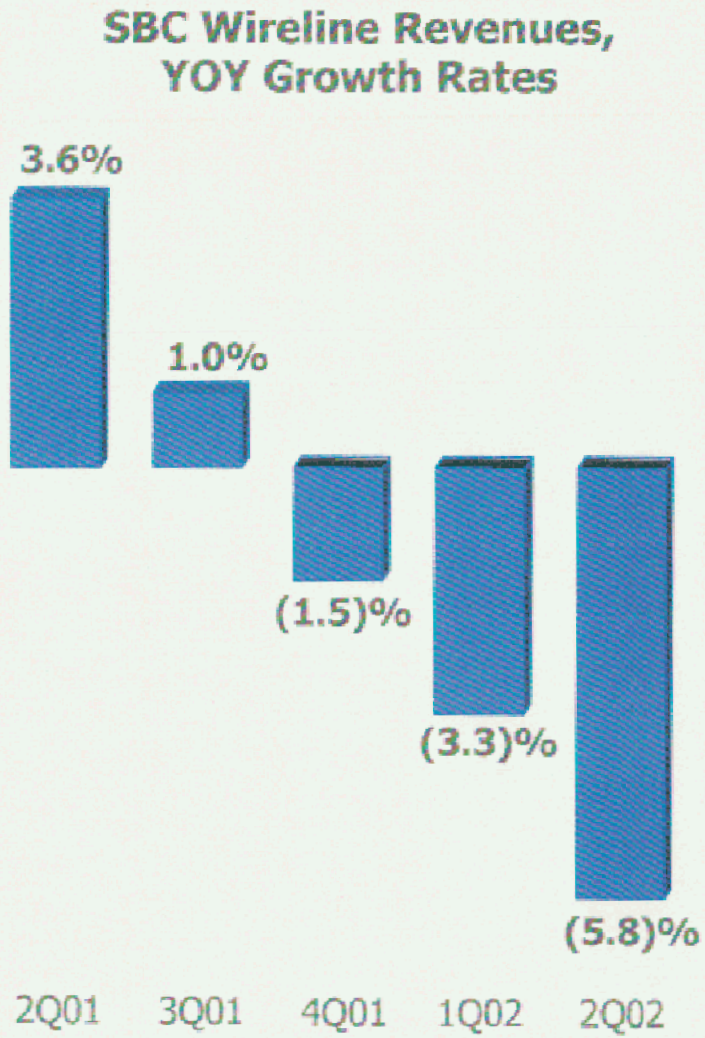
Ed Whitacre
Chairman and Chief Executive Officer
SBC Communications Inc.

Financial Review

- **Financial Trends**
- UNE-P Impacts

Randall Stephenson
Chief Financial Officer
SBC Communications Inc.

Wireline Revenues



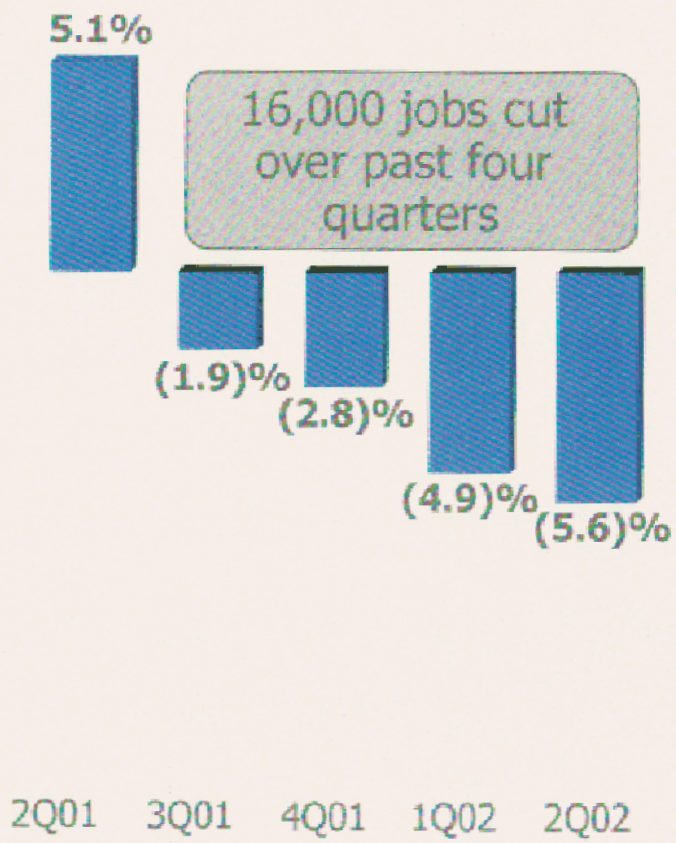
- Down more than $1 billion over the past three quarters.
- More than half of that loss came in the most recent quarter.
- Assuming annual revenue declines continue at current pace (5.8)% -- no further acceleration -- over the next four quarters, we will lose another $2.3 billion from our wireline revenue stream.

Local Voice Driving Revenue Decline

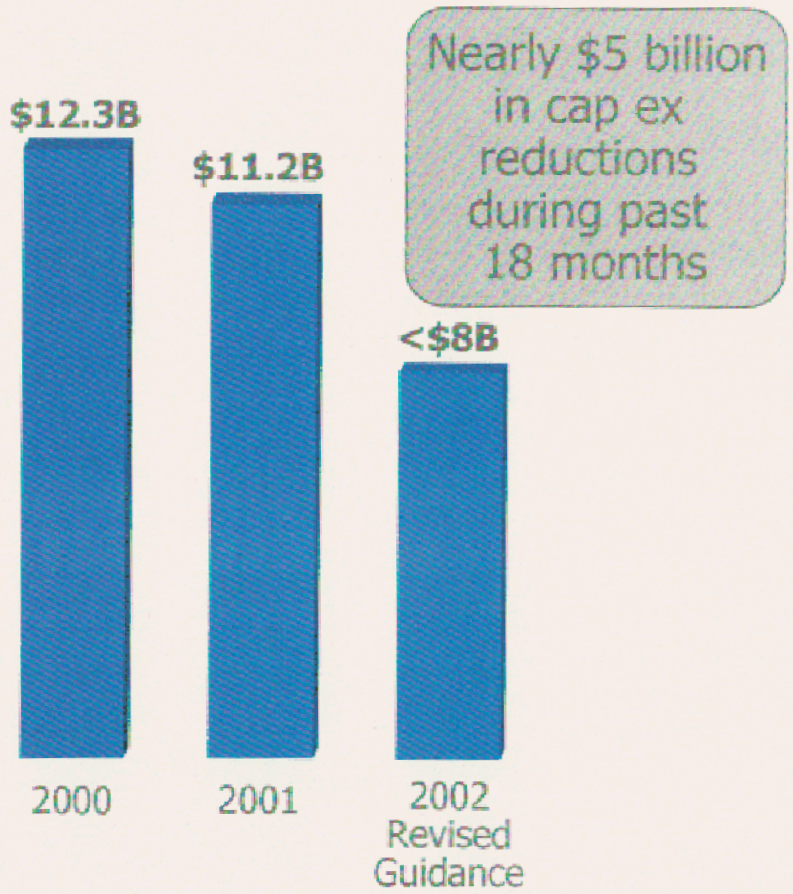
2Q02/2Q01 Changes By Product Group

Cutbacks in Jobs and Investment

SBC Wireline Cash Operating Expenses, YOY Growth Rates



SBC Annual Capital Investment



A Shrinking Business

SBC Wireline Results

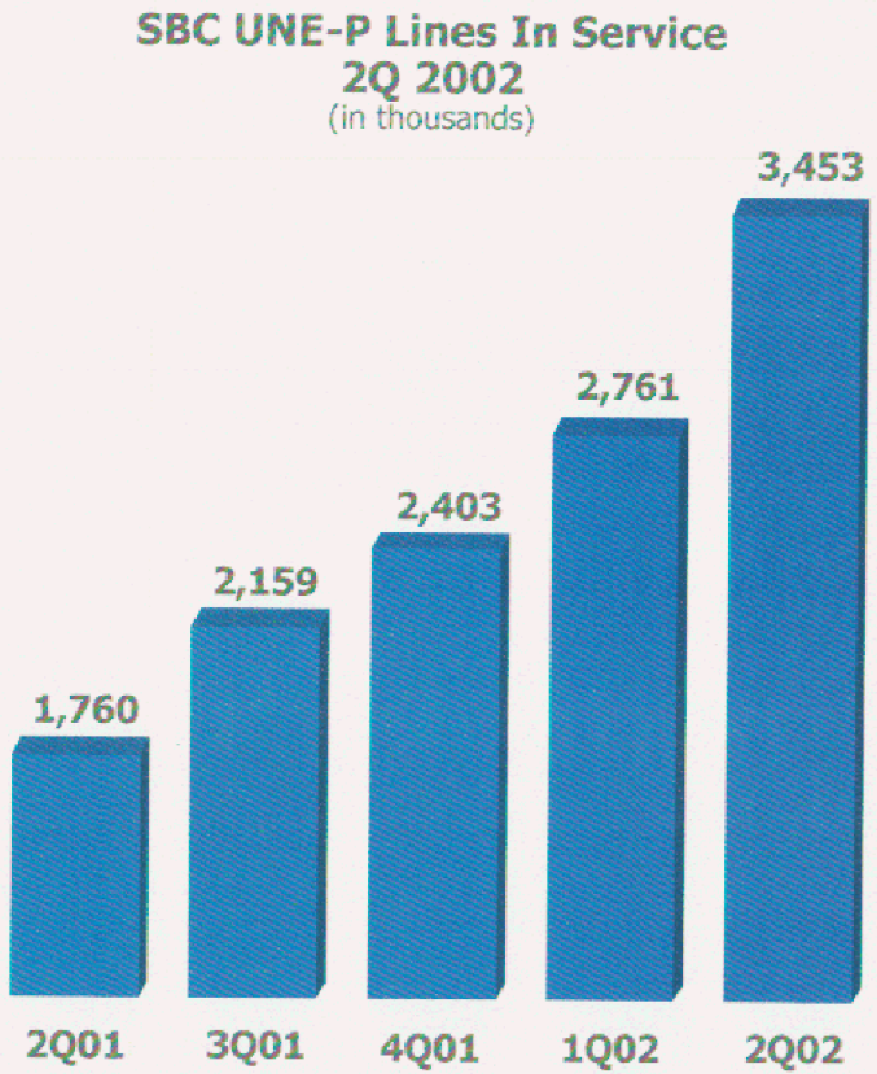
	2Q02/2Q01
Revenues	(5.8)%
Cash Operating Expenses	(5.6)%
Depreciation & Amortization	1.2%
Operating Income	(12.6)%
Capital Investment	(41)%

Financial Review

- Financial Trends
- **UNE-P Impacts**

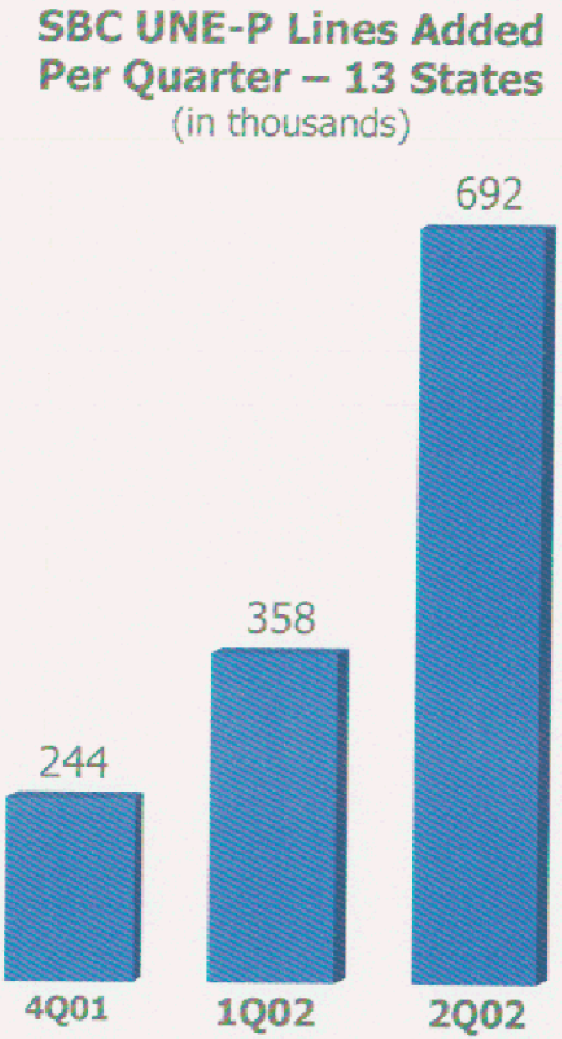
Randall Stephenson
Chief Financial Officer
SBC Communications Inc.

UNE-P Adoption



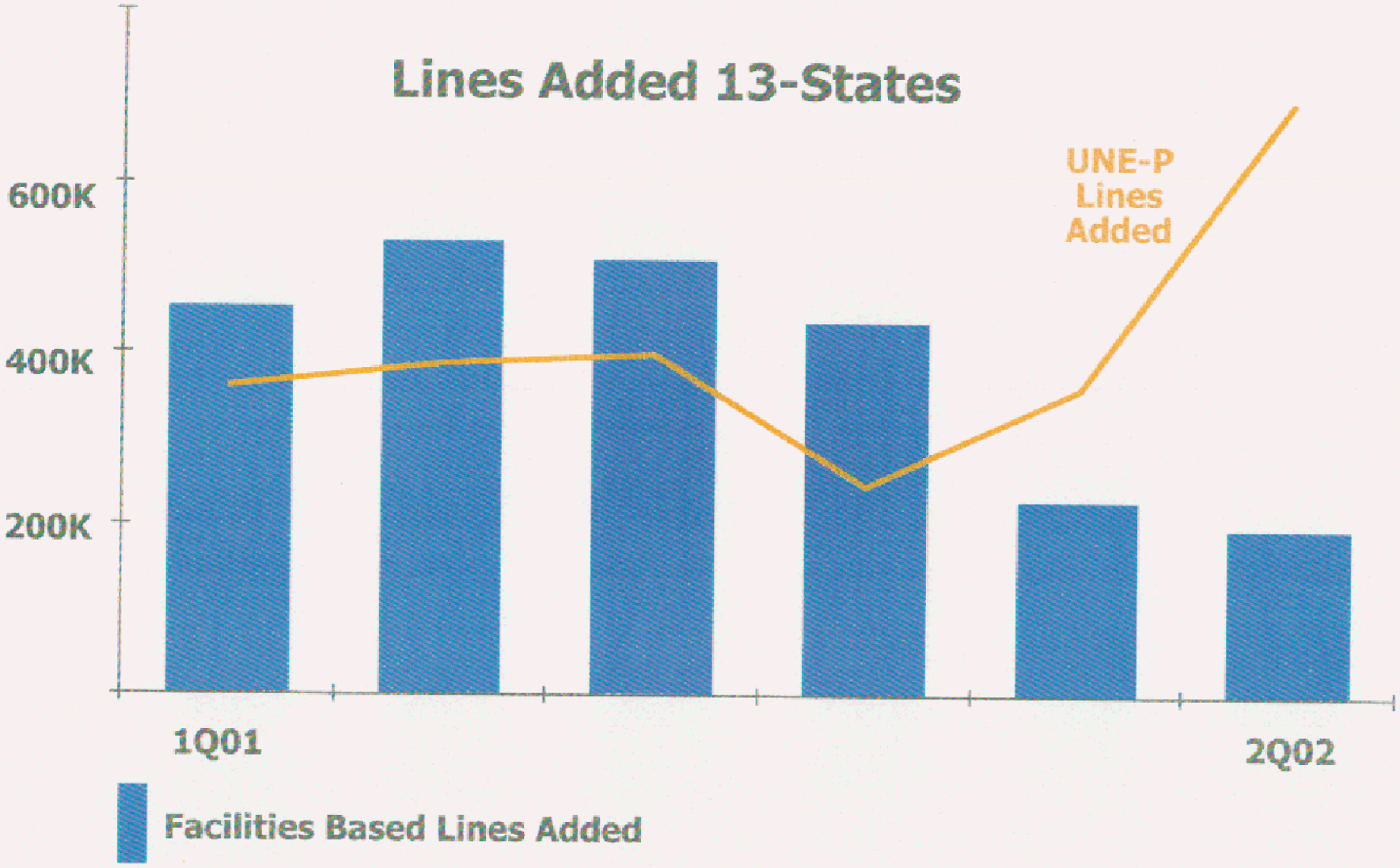
- Over the past year, UNE-P lines in service have doubled.
- We have lost 3.5 million lines... nearly equivalent to losing the state of Ohio.
- SBC still has 1 million resale lines likely to be converted to UNE-P.
- SBC's market share is currently 85%. Projected to be 66% by end of 2003.

UNE-P Acceleration

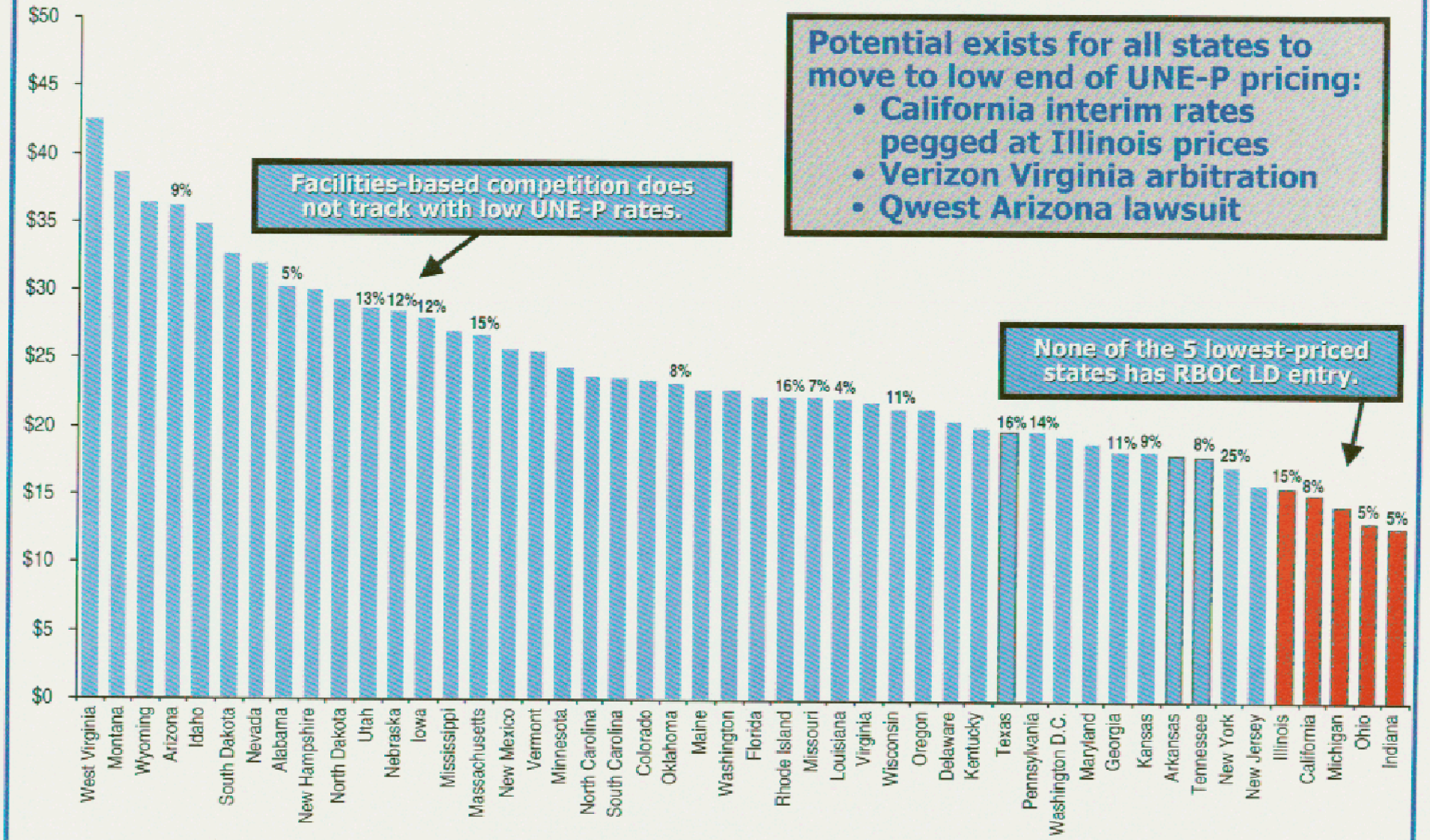


- SBC loses 12,000 lines per day to UNE-P. Projected to be 29,000 per day by end of 2003.
- UNE-P lines added in 2Q02 were more than 70% greater than any previous quarter.
- As states have dropped prices, facilities-based competition has lagged and UNE-P has become the dominant means to compete with SBC.

Competition Trends



The Five Lowest-Priced UNE-P States Are All SBC Markets

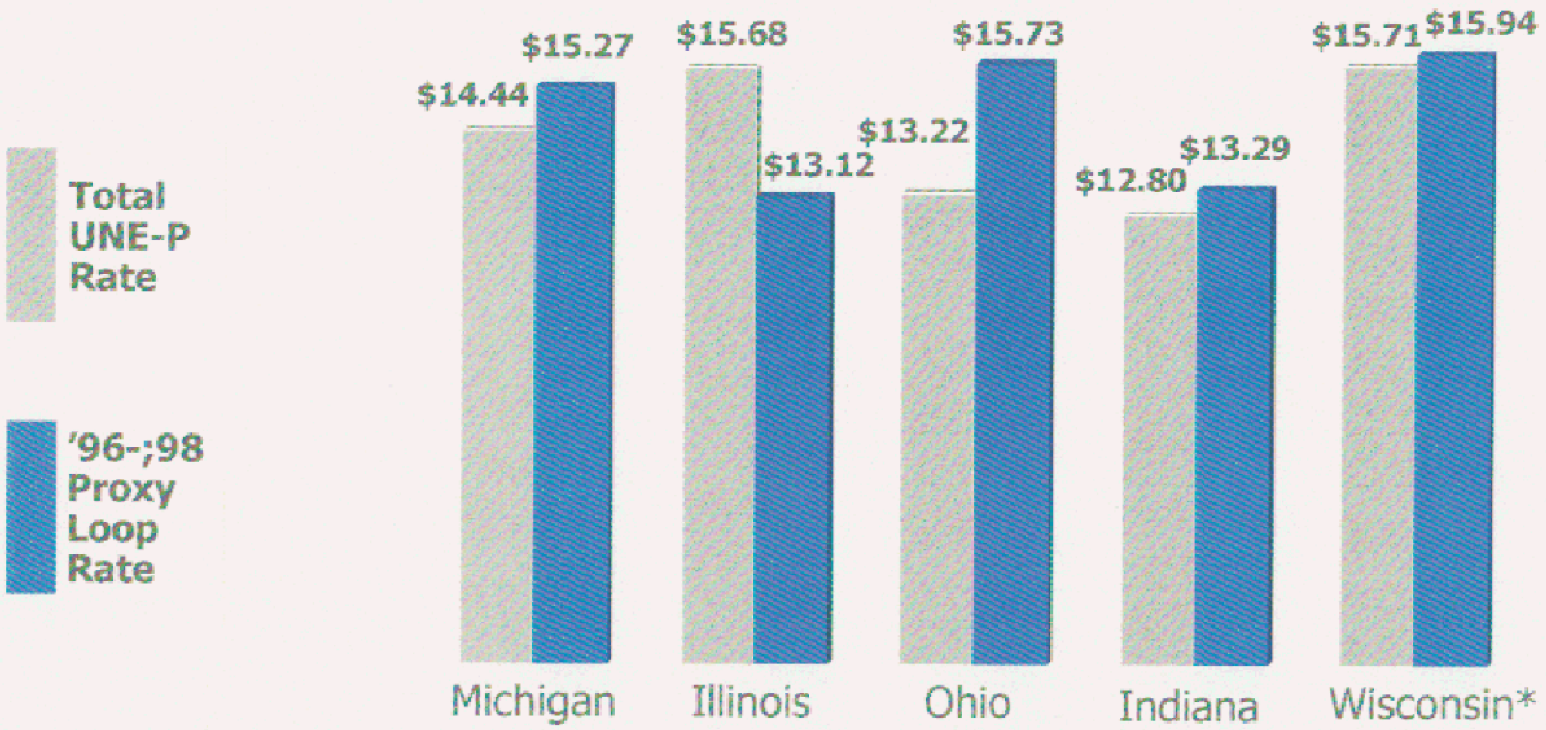


Potential exists for all states to move to low end of UNE-P pricing:

- California interim rates pegged at Illinois prices
- Verizon Virginia arbitration
- Qwest Arizona lawsuit

Percentage of end-user switched access line served by reporting competitive local exchange carriers source: FCC Industry Analysis Division Common Carrier Bureau, "Local Telephone Competition: Status as of December 31, 2001"

UNE-P Rates vs FCC Proxy Loop Rates



* Estimated impact of pending order.

IXCs Exploit Very Large UNE-P Discounts

	Total Recurring UNE-P Rate*	Discount From Retail Residential	Below Non-SBC National Ave
Illinois	$15.68	55%	39%
Michigan	$14.44	63%	44%
Ohio	$13.22	57%	48%
Indiana	$12.80	62%	50%
California	$15.24	47%	40%
Wisconsin**	$15.71	48%	39%

All have recently ordered lower prices

* Per Anna Marie Kovacs of Commerce Capital Markets, Inc. May report on UNE-P adjusted to reflect only recurring rates and recent rate changes.

** Estimated impact of pending order.

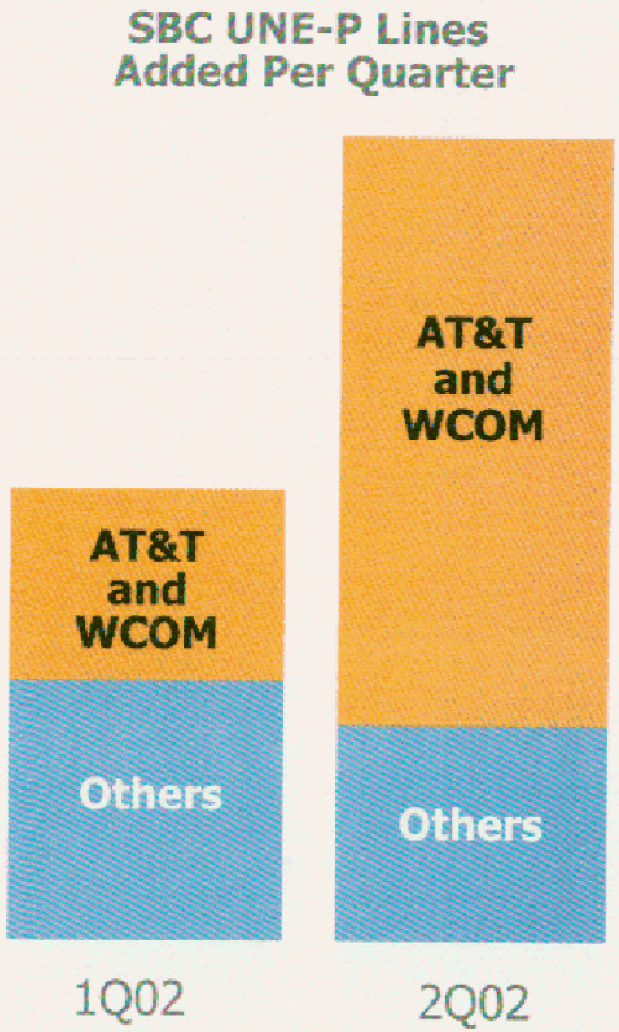
Simple Margin Transfer With No Investment

	Ameritech Consumer 5-State Averages		
	SBC Retail	SBC UNE-P	IXC Using SBC UNE-P
Revenue	$36	$15	$41
Expenses	*$26	*$26	**$23
Operating Margin	$10	$(11)	$18
Capital Investment	$1,100	$1,100	$0
Capital Investment	✓	✓	☐
Service Quality Regulated	✓	✓	☐
Universal Service Provider	✓	✓	☐

* Excludes cost associated with data services.

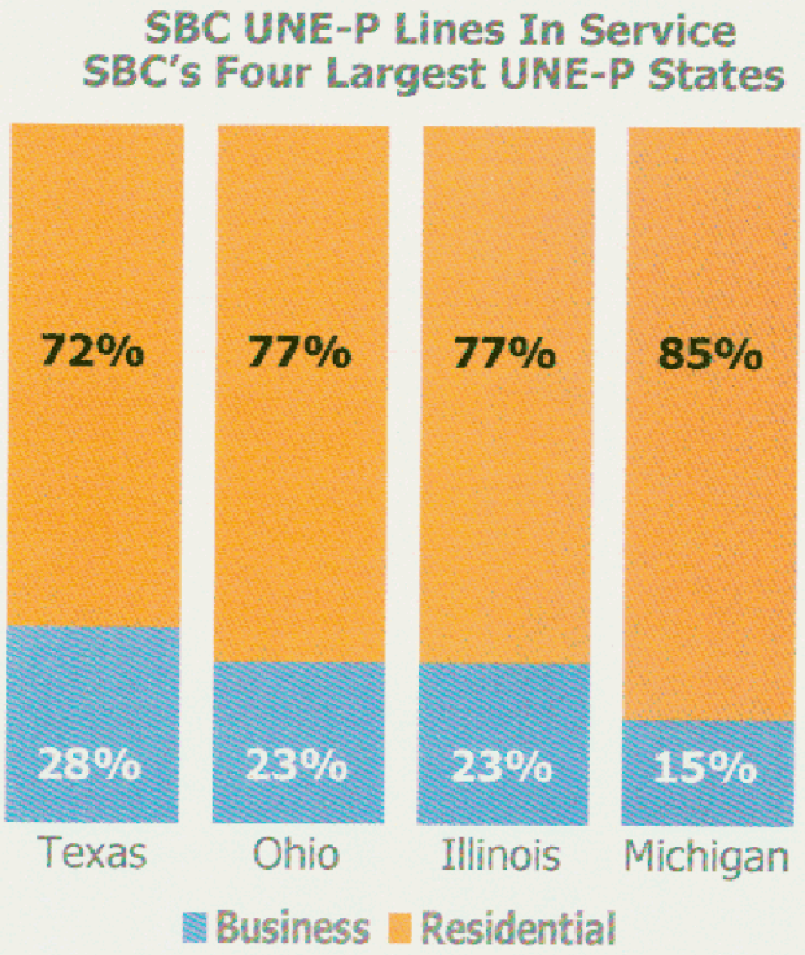
** UNE-P plus 20% SG&A.

UNE-P Predominantly Used by the Two Largest IXCs



- More than 70% of SBC's UNE-P lines added in 2Q02 were for the two largest IXCs.
- From 1Q02 to 2Q02, UNE-P lines added for AT&T and WorldCom/MCI tripled while UNE-Ps added for others actually declined.
- WorldCom receivables to SBC and its affiliates have grown to more than $400 million.

Dominant Use of UNE-P: To Target Residential Customers



- Across SBC's 13 states, more than 70% of all UNE-P lines are residential.
- In SBC's four largest UNE-P states, which have been targeted most aggressively by the large IXCs, residential customers represent an even higher percentage of total UNE-Ps.

IXC Lead Offers
(Ameritech states)

AT&T

- **Pricing: $52.57 ***
- **Local Service**
  - Access line
  - Calling features (3)
- **Long Distance**
  - Unlimited to other AT&T residential consumers

MCI/WCOM

- **Pricing: $49.99 ***
- **Local Service**
  - Access line
  - Calling features (5)
- **Long Distance**
  - Unlimited long distance calling

* Pricing includes interLATA long distance but excludes Subscriber Line Charge and other miscellaneous taxes and fees.

Source: Company's website
- MCI's offer is their lead offering "Neighborhood Complete" at $49.99
- AT&T's offer includes their lead local "Call Plan Unlimited with 3 Feature Package Enhanced" at $29.95-34.95 and their long distance offer "Unlimited Plan" at $19.95. Offered in Il, OH and MI.

SBC Provides Residential Universal Service While IXCs "Cherry Pick" Profits

IXC offers target premium customers rather than universal service.

Ameritech Residential Customer Spending

		Ave Rev per Line	% of Total SBC Revenue	% of Total SBC Profit
IXCs	Quartile 1	$43-$54	36%	72%
IXCs	Quartile 2	$36-$43	29%	41%
SBC	Quartile 3	$24-$36	21%	9%
SBC	Quartile 4	$0-$24	14%	(22)%

SBC's resulting customer base will be unprofitable, with no funds for investment.

Clear IXC Strategy

No Capital Investment

"... gives AT&T Consumer unmatched leverage to create offers ... without making economic sacrifices."

Betsy Bernard,
President, AT&T Consumer

"We're profitable everywhere we sell because we limit ... where we sell based on cost.... [W]e're deploying very little capital to make it work."

Wayne Huyard
COO, MCI

"We do not expect that the growth of our business will require the levels of capital investment in fiber optics and switches that existed in historical telecommunications facilities-based models."

10-Q Filing
Z-Tel

High Margins, Low Risk

"Our principle of maximizing cash requires that we only enter states that meet our gross margin requirements."

"We are not going into states where we don't have a gross margin of 45% on the local ...."

Betsy Bernard,
President, AT&T Consumer

Capital Market Reaction

Stock Prices

	Before UBS Warburg Report (08/19/02)	After UBS Warburg Report (08/23/02)	Percent Change
SBC	$29.87	$26.30	(12.0)%
AT&T	$10.76	$12.22	13.6%

"We believe SBC has the most attractive region for UNE-P providers. SBC takes the hardest hit for each retail line lost to UNE-P competitors ... SBC has lost more retail lines to UNE-P than any other Bell, at 3.45 million... [and we] expect SBC to lose 1 million retail lines to UNE-P in the third quarter of 2002."

- UBS Warburg

Summary

Bill Daley
President
SBC Communications Inc.

Impacts

- Reduced Service Quality
- Reduced Ability to Provide Service to all Customers
- No Incentive To Invest in Networks
- Eliminated Jobs
- Slower Deployment of New Services
- Increased Cost of Capital
- Weakened Equipment Suppliers

Next Steps

- Current regulatory regime regarding UNE-P and pricing is unsustainable
- Turmoil in industry calls for quick and decisive action
- As long as we have carrier of last resort obligations, prices must be set to recover our costs
- There are many ways to solve this problem, but time is extremely short. Whatever direction the FCC moves, it must be effective in a very short period of time