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EX PARTE

November 17, 2003

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

Re: *In the Matter of Section 272(f)(1) Sunset of the BOC Separate Affiliate and Related Requirements*, WC Docket No. 02-112; *2000 Biennial Regulatory Review Separate Affiliate Requirements of Section 64.1903 of the Commission's Rules*, CC Docket No. 00-175

Dear Ms. Dortch:

At our meeting with Commission staff on October 28, 2003 to discuss Qwest's position on issues arising in the Section 272 Sunset proceeding, staff asked us to respond to IXCs' arguments that if BOCs were allowed to provide both interLATA long distance and local exchange services from a single regulated entity (*i.e.*, the BOC) the BOCs would subject interLATA competitors to an unlawful predatory price squeeze. At the time, Qwest stated that BOCs, such as Qwest, had neither the incentive nor the ability to engage in an unlawful predatory price squeeze. The purpose of this letter is to elaborate on Qwest's verbal comments and to reiterate the findings of Drs. Carlton, Sider and Shampine which were contained in declarations incorporated in Qwest's written comments (*see* Attachments).

AT&T Corp. ("AT&T") and WorldCom, Inc., d/b/a MCI, contend that BOCs are subjecting their interLATA long distance competitors to an illegal predatory price squeeze by increasing wholesale rates (*i.e.*, switched and special access rates) while decreasing retail rates (*i.e.*, interLATA long distance). Thus, they are claiming that BOCs are sacrificing long distance revenue today in order to drive competitors out of the market with a goal of recouping lost profits (or losses) through higher retail long distance prices in the future. AT&T and MCI's allegation is not supported by either the facts or economic theory.

Drs. Carlton, *et al.*, point out that even if the BOCs were able to raise access prices it is unlikely that they could successfully engage in a predatory price squeeze in the long distance market because: 1) BOCs face numerous well-established wireline and wireless long distance providers; 2) communications assets are largely fixed and will remain available to new entrants at low prices even if existing competitors are driven from the market; 3) any attempt by the BOCs to raise prices in such an environment would invite new entry; and 4) if BOCs were successful in eliminating long distance competition through predatory pricing they, inevitably, would be subject to re-regulation. Drs. Carlton, *et al.,* conclude that it is highly unlikely that a BOC could recoup its investment in predatory pricing and highly unlikely that such a strategy would be pursued by a BOC.[1]

Drs. Carlton, *et al.,* reject AT&T's and MCI's specific allegation that above-cost access charges provide BOCs with both the incentive and the ability to engage in a price squeeze. They point out that not only do higher access charges result in higher costs to all long distance carriers, higher access charges also represent higher opportunity costs for BOCs when the BOCs win long distance business from other IXCs. "That is, when ILECs [BOCs] provide long-distance service they gain retail revenue but lose access revenue paid by a subscriber's prior long-distance carrier. The loss in access revenue is a real cost of providing retail long-distance service faced by ILECs which must be considered in any evaluation of the prices charged by ILECs as long-distance carriers."[2] Drs. Carlton, *et al.,* go on to provide a numerical example demonstrating that BOCs "have no incentive to lower long-distance prices below the long-run competitive level (i.e., the level at which revenues cover relevant costs) and drive more efficient rivals from the industry in order to provide long-distance themselves."[3] Thus, contrary to the claims of AT&T and MCI, above-cost access charges -- even if they were true -- do not facilitate predation.

Kahn and Taylor came to similar conclusions in dismissing AT&T's special access price squeeze arguments that were contained in AT&T's petition seeking repeal of the Commission's *Pricing Flexibility Order*.

> 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 [as required by Section 272(e)(3)]. 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. … Special access charge revenue (when AT&T supplies the retail service) is revenue that the RBOC forgoes when it supplies the retail customer itself. The higher the 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. …The RBOC affiliate's retail price

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[1] The Court of Appeals recognized this in affirming the Pricing Flexibility Order, "there is a consensus among commentators that predatory pricing schemes are rarely tried and even more rarely successful." *WorldCom, Inc. v. FCC*, 238 F.3d 449, 463 (D.C. Cir. 2001).

[2] Reply Declaration of Dennis W. Carlton, Hal Sider and Allan Shampine, WC Docket No. 02-112 and CC Docket No. 00-175, filed July 28, 2003 at 4.

[3] *Id.* at 6.

> reflects to the penny what IXCs pay for access, as is required by both the law and by economic self-interest."[4]

In adopting the *LEC Classification Order*, the Commission rejected similar claims finding that the BOCs and their affiliates would not be able "to engage in a price squeeze to such an extent that the BOC interLATA affiliates will have the ability, upon entry or soon thereafter, to raise price by restricting their own output."[5] The Commission also found that even if the BOCs could subject IXCs to a price squeeze -- which they cannot -- imposing dominant carrier regulation on BOC long distance affiliates would not be an efficient means of preventing BOCs from engaging in a predatory price squeeze.[6] The same reasoning holds true with the sunset of Section 272.

In summary, AT&T and MCI's price squeeze arguments are illusory. They find no support in either economic theory or reality and should be dismissed by the Commission.

Respectfully,

/s/ Melissa E. Newman

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Attachments

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[4] *See* attached Declaration of Alfred E. Kahn and William E. Taylor, *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, Qwest Opposition, Kahn and Taylor Declaration at 34, filed December 2, 2002.

[5] *In the Matter of 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, Second Report and Order in CC Docket No. 96-149 and Third Report and Order in CC Docket No. 96-61*, 12 FCC Rcd. 15756, at 15832 ¶ 129 (1997).

[6] *Id.* at 15831-32 ¶ 128.