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October 19, 2005

**VIA ECFS**

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

Dear Ms. Dortch:

**Re:** Applications for Consent to the Transfer of Control of Licenses and Section 214 Authorizations from AT&T Corp., Transferor, to SBC Communications Inc., Transferee, WC Docket No. 05-65.

Applications for Consent to Transfer Control of Filed by Verizon Communications, Inc. and MCI, Inc., WC Docket No. 05-75.

This responds to the August 24, 2005 letter from SBC Communications, Inc. ("SBC") and AT&T Corp. ("AT&T") in WC Docket No. 05-65 and the September 7, 2005 letter from Verizon Communications, Inc. and MCI, Inc. in WC Docket No. 05-75.[1] Those letters responded to our notices of *ex parte* presentations of August 10 and August 23, 2005.[2]

Contrary to Applicants' contentions, the harms that that would be caused by the proposed mergers are not *de minimis*. The record establishes that MCI and Verizon have overlapping facilities in 39 "areas."[3] AT&T admits that it has local fiber facilities in 19 MSAs in

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1 Letter to Marlene H. Dortch from Gary Phillips, SBC Communications, Inc., and Lawrence J. Lafaro, AT&T Corp., WC Docket No. 05-65, August 24, 2005 ("SBC/AT&T Letter"); Letter to Marlene H. Dortch from Dee May, Verizon Communications, Inc., and Curtis Groves, MCI, Inc., WC Docket No. WC 05-75, September 7, 2005 ("Verizon/MCI Letter").

2 Letters to Marlene H. Dortch from Patrick J. Donovan, WC Docket Nos. 05-65, 05-75, August 10 and 23, 2005, Counsel for ATX Communications Inc., et al.

3 Verizon/MCI Letter at 1.

the SBC region.[4] AT&T operates the largest independent network facilities in the SBC region.[5] Both IXCs constrain special access prices by forcing ILECs to meet their competitive bids.[6] Therefore, acquisition of AT&T's and MCI's very substantial local networks by ILECs would very significantly undermine retail and wholesale competition.

Applicants' letters deliberately ignore the concern that they could establish a price squeeze by raising special access prices, including for their long distance affiliates. Applicants instead address only a price squeeze that could be established by reducing prices for the affiliate, permitting it to undercut prices of competitors. Contrary to Applicants' claim that a price squeeze established by price reductions would be too costly because of lost revenues, raising prices on a nondiscriminatory basis would not harm the ILEC or its affiliate because this would merely result in a transfer of funds from the long distance affiliate to the ILEC in the form of higher special access prices. On the other hand, this could seriously harm competitors that use special access. This is a serious and substantial risk because ILECs are currently raising special access prices. SBC recently substantially raised prices for DS1 interstate special access,[7] and others have been doing so under pricing flexibility. BOCs offer lower prices only if customers agree to a host of anticompetitive terms and conditions.[8]

The safeguards cited by Applicants would be completely ineffectual in identifying or preventing price increases that could establish a price squeeze. Price cap regulation does not protect against a price squeeze because price caps do not apply in MSAs where Phase II pricing flexibility has been granted. The requirement that ILECs may not offer a contract tariff to an affiliate until an unaffiliated provider takes under the tariff would not prevent ILECs raising prices for all competitors and charging its affiliate the same price.[9] Similarly, the requirement that ILECs impute access charges to their own offering of long distance service is fully compatible with establishing higher special access charges across the board which the ILEC can

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4 SBC/AT&T Letter at 2.

5 Letter to Marlene H. Dortch from Robert L. Connelly, Jr., Qwest, WC Docket No. 06-65, September 21, 2005, n. 1.

6 *Id.*

7 SBC raised prices for DS1 and DS3 special access for which there is little or no competition and offset these by decreases for OCn level services which are more subject to competitive supply. ("Increases to High Capacity rate elements will be offset with decreases being made to BCS rate elements.") Pacific Bell Telephone Company, Transmittal No. 223, Transmittal Letter, April 29, 2005.

8 Reply Comments of Wiltel Communications, LLC, WC Docket No. 05-25, July 29, 2005, p. 27 ("The ILECs' plans typically contain regional demand commitments, mandated bundling of competitive and non-competitive routes, high penalties and non recurring costs for termination of service.")

9 47 C.F.R. Section 69.727(a)(iii).

impute to its own service, because, as noted, such an imputation results only in a transfer of funds between the ILEC and its affiliate.[10]

Applicants' claim that the Commission has already determined in connection with the U.S. West/Qwest merger that acquisition of an IXC by a BOC does not materially increase the risk of a price squeeze is incorrect.[11] In that the decision, the Commission specifically stated that "[w]e agree ... that, by combining US West incumbent LEC business and Qwest's competitive interexchange businesses, the merged entity will have an increased incentive to discriminate against competitive LECs currently competing or entering the US West region and against competing interexchange carriers."[12] Moreover, at that time, U.S. West was not operating in an environment in which major markets were subject to pricing flexibility, substantially increasing the ability of the ILEC to engage in a price squeeze, unlike the present SBC and Verizon. Moreover, when the ILEC owns the IXC, rather than making payments to a third party IXC for wholesale carriage, the ILEC has a greater scope of financial opportunity to raise prices to its affiliate. Payments to the third party wholesale IXC include the wholesalers profit which the ILEC must pay as part of the costs of purchasing wholesale access, whereas the ILEC may choose to forego its affiliates' profit. Therefore, when the ILEC owns the IXC, it may increase special access charges to a higher level without causing the affiliate's incremental or other costs to exceed its prices, which is a key measure of anticompetitive pricing.

Although price increases are a serious concern, it is also possible that the SBC and Verizon could engage in price discrimination in favor of their affiliates. SBC and Verizon could target individual companies and decline to enter into contract tariffs with them, making them pay the increasing and inflated standard tariffed prices, even if it chooses to enter into contract tariffs with others, including its affiliate. It is no answer that in theory contract tariffs are available to similarly situated customers. This is largely a fiction. Contract tariffs are usually sufficiently tailored to individual customers that others cannot practically take advantage of them. Moreover, they are only available for a short purchase period.[13] Nor is it relevant, if correct, that AT&T and MCI do not <u>now</u> obtain greater discounts for special access prices than do CLECs, since they might in future obtain such discounts that only they could qualify for.[14] The Commission's rule that the ILEC must offer a contract tariff to an unaffiliated provider would be

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[10] 47 U.S.C. Section 272(e).

[11] *Qwest Communications Int'l Inc. and US West, Inc.*, 15 FCC Rcd 5376, 5398 (2000) ("*Qwest/US West Order*"); *Applications of PacTel and SBC Communications Inc.*, 12 FCC Rcd 2624, 2469 (1997).

[12] *Qwest/US West Order*, para. 42.

[13] *See e.g.*, Verizon Telephone Companies, FCC Tariff No. 1, Contract Tariff Option 9, Section 21.10 (subscription period of 30 days); Pacific Bell Telephone Company, FCC Tariff No. 1, Contract Tariff No. 5, Section 33.5.2(A) (purchase period of 11 weeks).

[14] Verizon/MCI Letter at 2.

satisfied if both AT&T and MCI subscribe to a contract tariff offered by SBC or Verizon even if only they could qualify for the volume and term discounts made available in it.

Applicants criticisms of Herfindahl-Hirschman Index ("HHI") estimates on the record are apparently premised on the view that the Commission should take into account the Applicants' speculation that intermodal competition eliminates any possible negative impacts of the merger. However, this is merely an admission that the proposed transactions measured on current market conditions are a large step in the wrong direction. Applicants' failure to submit their own HHI calculations affirms that the mergers would fail under the Horizontal Merger Guidelines.[15] Moreover, there is no substantial reason to believe that intermodal competition will ameliorate the impacts of the merger for all the reasons that have been placed on the record.[16] Applicants grossly exaggerate the extent of probable VoIP growth. Less than 1% of total voice revenue comes from VoIP and less than 3% of U.S. households have converted to VoIP.[17] While growth among "early adopters" has been rapid, industry experts have substantially revised estimates downward because "[i]nterest in VoIP hasn't grown."[18] In any event, VoIP is largely irrelevant to an analysis of the harm to competition that would be caused by the mergers because in virtually all markets the ILECs are the only providers of wholesale access.

Applicants contend that virtually all of the conditions proposed in this proceeding are not "merger specific." Even if this were the case, it would be necessary for the Commission to impose the conditions that Applicants claim are not "merger specific" in order to reach a conclusion that the mergers are in the public interest. This is because there are no substantial public interest benefits that could balance even *de minimis* harms. As already pointed out in the record, the Applicants offer no more than vague, unsupported allegations of benefits that even if accurate would redound at best to the benefit of the Applicants and not to the public interest.[19] Therefore, as with other BOC mergers, they are contrary to the public interest, and conditions are necessary if the Commission is plausibly to conclude that they would serve the public interest.[20] The potential harms specific to the acquisition of major IXCs could not be appropriately addressed in the *Special Access Proceeding* because, there, the Commission must adopt rules of general applicability, which are not suitable to addressing the unique harms caused by the mergers.

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15 U.S. Department of Justice and Federal Trade Commission, "Horizontal Merger Guidelines" (revised 1997) ("Horizontal Merger Guidelines").

16 Comments of ACN Communications Services, Inc. et al, WC Docket No. 05-75, May 9 2005, pp. 8-20.

17 Telephony Online, *Level 3: Mass Market Not Ready for VoIP*, Ed Gubbins, September 22, 2005, 11:16 AM.

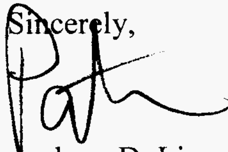
18 *Id.*

19 Comments of ACN Communications Services, Inc. et al, WC Docket No. 05-65, April 25, 2005, pp. 45-68; Comments of ACN Communications Services, Inc. et al, WC Docket No. 05-75, May 9 2005, pp. 42-50.

20 *GTE/Bell Atlantic Merger Order*, 15 FCC Rcd 14032 (2000); *SBC/Ameritech Merger Order*, 14 FCC Rcd 14712 (1999); *NYNEX/Bell Atlantic Merger Order*, 12 FCC Rcd 19985 (1997).

The conditions that the merger applicants object to are merger specific and tailored to the harms that would be caused by the mergers. The risk of a price squeeze is merger specific because, as explained, the acquisition of a major IXC will enhance the ability of the ILECs to engage in a price squeeze. A condition that imposes a cap on special access prices for a period of time is merger specific because it is tailored to the risk of a price squeeze. A condition that SBC and Verizon recalculate *TRRO* UNE triggers counting AT&T and MCI as affiliated fiber-based collocators is merger specific. The possibility that the Applicants could establish discounts that only MCI and AT&T could qualify for is merger specific because, taken together, the mergers present the unique circumstance that the two largest IXCs could both subscribe to contract tariffs of SBC and Verizon (evading the rule that an ILEC can offer a contract tariff to an affiliate only if an unaffiliated company purchases from it also) that contain volume discounts that only they could qualify for. Therefore, a condition that SBC and Verizon offer to others the same pricing made available to their IXC affiliates without volume and terms commitments is merger specific. A condition that caps UNE prices is merger specific because a unique consequence of the mergers is the termination of competitive advocacy by AT&T and MCI in state UNE pricing proceedings. The proposed cap on UNE prices for five years is appropriate to prevent SBC and Verizon from relitigating UNE prices which would be unduly burdensome for CLECs without AT&T's and MCI's participation. A condition that the merger partners must interconnect with other providers of IP-enabled services on reasonable terms and conditions would be merger specific because SBC has apparently admitted that it will de-peer some backbone providers after its merger with AT&T.[21]

Sincerely,



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Granite Telecommunications, LLC.

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21 SBC states that "[a]t least *initially*, all peers of the SBC backbone will continue in their current arrangement" and that after the merger "there may be Tier 2 IBPs and ISPs that reach current SBC customers for free, but who will have to pay for that access in the future because those companies do not, today, meet AT&T's criteria for settlement-free peering." Rice Reply Declaration at 10.

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