

October 21, 2005

BY ECFS

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

Re: WC Docket No. 05-65

Dear Ms. Dortch:

Applicants SBC and AT&T respectfully submit this response to the *ex parte* presentation that was jointly filed by Qwest, four other carriers and the Ad Hoc Telecommunications Users Committee on October 14, 2005 (“the Qwest group”).¹ The Qwest group proposes a series of extraordinary conditions that purportedly would “ameliorate” “anticompetitive effects” of the proposed merger in the provision of special access services.² These conditions include requiring SBC to halve its tariffed special access rates region-wide, barring SBC from providing volume discounts, authorizing wholesale abrogation of customers’ existing contracts with SBC and AT&T, and the adoption of vague “anti-discrimination” requirements that either duplicate or are inconsistent with the Communications Act and established Commission policy.

These proposals bear absolutely no relationship to any potential anticompetitive effects of the merger in the provision of special access services, and they are thus patently unlawful. The only way the Qwest group can now contend otherwise is by offering empty rhetoric and repeating the same unsubstantiated and baseless allegations that Applicants have repeatedly shown to be contrary to the actual marketplace facts.

The actual facts are undisputed and indisputable. AT&T provides only small amounts of dedicated local access services in the SBC region.³ Whereas there are some 400,000 commercial buildings with special access demand in SBC’s region, AT&T has local facilities only in a limited number of dense commercial areas, and it has direct (“Type I”) connections to only a tiny fraction of the commercial buildings even in those areas. Unlike many other CLECs, AT&T’s focus is on serving its retail commercial customers, and it serves the large majority of its “on-net” buildings using equipment deployed in its customers’ premises that cannot be used to serve other tenants even in the same buildings. Contrary to the Qwest group’s rhetoric, the record establishes that AT&T provides truly *de minimis* volumes of wholesale dedicated access services

¹ See October 17, 2005 Ex Parte Letter from Melissa Newman, Qwest Communications International, Inc. to Marlene H. Dortch, FCC (“Qwest Group Ex Parte”).

² Qwest Group Ex Parte at 1.

³ 8/1/05 SBC-AT&T Ex Parte, App. B at 1-2; SBC-AT&T Joint Opposition, Fea *et al.* Decl. ¶¶ 19, 43 (May 9, 2005); *see also id.*, Carlton-Sider Decl. ¶¶ 32-35 (providing building data on MSA-specific basis); AT&T Response to FCC Information Request Nos. 5, 6 (May 10, 2005).

to other carriers. And even AT&T's discounted wholesale access rates are routinely higher than those charged by other CLECs.⁴ This is true of AT&T's Type I wholesale dedicated access services as well as its truly trivial provision of so-called partial "Type II" wholesale dedicated access services partially provided over facilities leased from SBC.⁵

Moreover, the services that AT&T provides would be readily replaced by other CLECs if the merged company attempted to raise prices. Many other CLECs have competing local networks in each of the dense commercial areas that AT&T serves, and individual CLECs have more on-net buildings, have more deployed fiber, and collectively serve many times more buildings than does AT&T. In addition to having the same (or greater) ability to reach buildings by connecting special access circuits (or UNEs) to their metropolitan fiber,⁶ these CLECs have already established direct connections to many of the same buildings that are served by AT&T and readily could establish direct connections to all or virtually all the remaining buildings.⁷ Thus, even if Applicants' overwhelming showing that the merger will not lessen competition in the provision of dedicated local access to *any* building in the SBC region were not credited, there could be, at most, a few hundred buildings scattered throughout the SBC region where it could even be argued that the merger could lead to a material reduction in competition.

It is quite plain under any objective view of the record in this proceeding that the only legitimate focus of the Commission's merger review is *these* claimed anticompetitive effects, and any conditions that are imposed on the merger must be limited to those required to maintain competitive options in this relative handful of buildings. That, in turn, means that merger opponents could, at most, request no more than the imposition of narrowly tailored conditions designed to allow competitive carriers to obtain the interests necessary to connect their networks to customers in this tiny subset of buildings over the existing AT&T facilities. Applicants believe that even conditions limited in this manner are unnecessary, for contrary to the Qwest group's *ipse dixit* assertion that customers are "nearly unanimous" in opposing the merger,⁸ numerous customers, ranging from worldwide companies like General Motors to regional banks to single location customers have publicly stated their full and unambiguous support for the merger without *any* conditions.⁹

⁴ 8/1/05 SBC-AT&T Ex Parte, App. B at 4; *see also* 8/24/05 SBC-AT&T Ex Parte at 3.

⁵ 8/1/05 SBC-AT&T Ex Parte at 2, 6; SBC-AT&T Joint Opposition, Fea *et al.* Decl. ¶ 43.

⁶ 8/1/05 SBC-AT&T Ex Parte, App. B at 1-4 & App. C at 1-3; 6/24/05 SBC-AT&T Ex Parte at 2-7; SBC-AT&T Joint Opposition, Carlton-Sider Reply Decl. ¶¶ 31-51.

⁷ 9/6/05 SBC-AT&T Ex Parte; 8/1/05 SBC-AT&T Ex Parte, App. B at 1-2 & n.6; SBC-AT&T Joint Opposition, Carlton-Sider Reply Decl. ¶¶ 37-43 & Fea *et al.* Decl. ¶ 30; AT&T Response to FCC Information Request No. 6(a).

⁸ Qwest Group Ex Parte at 2.

⁹ Among the companies publicly supporting the merger, are: ASUSTek Computer; Baldor Electric; Burlington Northern Santa Fe Corporation; Call SolutionsCom Inc. (Novo1); CBC Companies, Inc.; CenterPoint Energy, Inc.; Cresleigh Bank Corp. (Oak Street Mortgage); Dairy Farmers of America; DR Partners; First Midwest Bancorp (Del.); Fremont Bank; Granite
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In any event, however, adherence to the Commission's merger precedents requires flat rejection of each and every one of the conditions that the Qwest group has proposed. Not one of the proposed conditions is a "narrowly tailored" response to a "transaction specific" harm.¹⁰ As detailed below, the proposed conditions are illegitimate in myriad specific respects, but they all share one fatal defect: in each case, the Qwest group is asking the Commission to confer enormous windfalls on its members by "singl[ing] Applicants out for special treatment unwarranted by any likely adverse consequences of the transaction."¹¹

"Pricing" Conditions. This is perhaps most evident in the Qwest group's demand that SBC halve its DS1 and DS3 special access rates regionwide and then allow the Qwest group and other customers simply to walk away from any contracts entered into *prior* to the merger that might inconvenience them in their attempts to make off with these illegitimate spoils.¹² Such flash-cut rate reductions of literally *billions* of dollars would be met with cries of confiscation and government fiat in *any* context. As a proposed "response" to truly insignificant competitive overlaps in, at most, a few hundred buildings scattered across more than a dozen of the most competitive areas in the country, the proposal is nothing short of absurd.¹³

The Qwest group suggests that the rate reductions that they seek are necessary to replicate the pre-merger presence of AT&T. That is manifestly false. By definition, AT&T's pre-merger competitive presence is already reflected in SBC's *pre-merger* prices. Nor can it plausibly be argued that a *regionwide* 50% rate reduction for services offered in some 400,000 buildings is a narrowly tailored response to the "loss" of AT&T's special access services in a tiny fraction of those buildings, all or virtually all of which already are, or economically could be, served by other competitive carriers. In all events, the 50% figure that has been plucked from the air is entirely arbitrary. The Qwest group does not point to a shred of record evidence

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Construction; General Motors Corporation; Gregg Appliances Inc.; Journal Communications, Inc.; KCG Inc.; LaQuinta Motor Inns; Magna International, Inc.; Mazzios Corporation; Meijer Companies Ltd.; Mission Federal; National University; NIBCO Inc.; Nix Check Cashing 62; Orco Construction Supply; Pulte Corporation; The ServiceMaster Company; U.S. Bancorp; Woodard Tech & Investments LLC; World Wide Technology; Yellow Freight; Young's Market; Your Vitamins Inc. /dba Pro-Cap Laboratories.

¹⁰ *Rainbow-EchoStar Order*, 2005 WL 2559682, ¶ 13 (Oct. 12, 2005) ("Our public interest authority also enables us to impose and enforce narrowly tailored, transaction-specific conditions that ensure that the public interest is served by the transaction."); *Nextel-Sprint Order*, 2005 WL 1876367, ¶ 23 (Aug. 08, 2005); *Western Wireless-AllTel Order*, 2005 WL 1693557, ¶ 21 (July 19, 2005); *AT&T Wireless-Cingular Order*, 19 FCC Rcd. 21522, ¶43 (2004).

¹¹ *General Motors-News Corp. Order*, 19 FCC Rcd. 473, ¶ 131 (2004).

¹² Qwest Group Ex Parte, Att. at 1.

¹³ The Qwest group further compounds the confiscatory nature of its proposal by suggesting that the Commission as a "backsliding protection" repeal pricing flexibility for SBC by prohibiting it from adjusting any of its halved rates "for the later of five years or until the FCC determines that the ceilings are not necessary to protect competition." Qwest Group Ex Parte, Att. at 1.

showing that the prices AT&T charges for dedicated access in the few buildings that both companies serve are half of even SBC's "rack" rates, much less that AT&T's prices are half of the discounted prices that SBC's customers actually pay.¹⁴ In short, the nationwide special access rate reduction proposal has nothing to do with maintenance of the competitive *status quo* and everything to do with abuse of the merger process in pursuit of competitive advantage and naked wealth transfer.

The same is true of the Qwest group's unprecedented proposal that the Commission sweep away entire categories of commercially negotiated contracts that Qwest and other sophisticated customers agreed to under *pre-merger* conditions. With regard to SBC's pre-merger special access contracts, the Qwest group asks the Commission to allow customers to keep the terms they like – such as the steep discounts off of tariffed month-to-month rates (which, under their proposal, would be subject to an *additional* 50% discount) – and discard the terms they do not like – such as the volume and other commitments that justified those discounts. Incredibly, the Qwest group does not stop there. Once the contractual *quid pro quo* is distilled to its *quid* alone, the Qwest group asks for the right to extend the one-sided contract for *an additional five years*. Perhaps government agencies in North Korea engage in such "regulation" of competitive activity; government agencies in the United States do not.

The Qwest group's proposals for AT&T's pre-merger contracts are no less offensive. With regard to their wholesale special access contracts with AT&T, they ask the Commission to allow them to pay lower "Type I" rates for circuits for which they agreed to pay higher "Type II" rates where AT&T leases the circuit tail today from SBC. In other words, in the guise of protecting the pre-merger *status quo*, they claim they are entitled to *better* rates than they would have obtained in the absence of the merger. It goes without saying that the Commission's merger precedents (and the most basic economic and antitrust principles) require that the competitive constraint imposed by AT&T pre-merger be assessed on the basis of AT&T's *actual* pre-merger prices, not on the prices parties claim it could potentially charge only by virtue of the merger. As Applicants' public interest showing vividly confirms, the combination of SBC's and AT&T's complementary assets and capabilities promises substantial efficiency benefits that will flow through to customers. But, there is no conceivable transaction-specific justification for relieving these carrier customers of pre-merger obligations that fully reflect the pre-merger competitive dynamics.

¹⁴ To the extent that the Qwest group means to suggest that the Commission should accept their claims about other CLECs' special access prices as evidence of the relationship between AT&T's and SBC's prices, the unchallenged record evidence demonstrates that AT&T's dedicated access prices are typically *higher* than those charged by other CLECs. 8/1/05 SBC-AT&T Ex Parte, App. B at 4; *see also* 8/24/05 SBC-AT&T Ex Parte at 3. In this regard, it is notable that merger opponents have previously claimed only that CLECs offer rates 15% to 35% below SBC's prices. 8/9/05 ACN *et al.* Ex Parte, Att. at 2. Even ignoring Applicants' rebuttal of this evidence (8/24/05 SBC-AT&T Ex Parte at 3), the Qwest group's arbitrary demands go well beyond the levels implied by this price difference.

The Qwest group next proposes that AT&T's *retail* enterprise customers be allowed to walk away from their pre-merger commitments, regardless of any term condition or early termination liability that they agreed to under the competitive conditions that existed before the merger was even proposed.¹⁵ This "fresh look" opportunity is obviously attractive to Qwest and other individual *competitors* – whose zeal only confirms that customers will have ample supply alternatives when their contracts expire in due course – but it is completely untethered from the competition and other public interest concerns that the Commission has held must animate its merger analysis. That is why the Commission has only imposed the "extraordinary remedy" of fresh look to allow customers who were locked into long term contracts entered into in a *non-competitive* marketplace to have the immediate benefit of contract negotiations in a *competitive* environment.¹⁶ That is obviously not the situation at hand here – no AT&T retail customer was denied choice in retail services. AT&T has no market power now, and it had none at the time it entered into the retail relationships with its customers. Each of AT&T's retail customers entered into its present AT&T retail relationship as a result of negotiations (directly or through bidding) in a highly competitive marketplace, in which any provider seeking to serve the customer had the same opportunity as AT&T to build or lease its own facilities to connect with that customer.

"Anti-Leveraging" Conditions. The Qwest group proposes a second set of conditions purportedly designed to prevent SBC from "restricting" carriers from purchasing alternatives to SBC's special access services.¹⁷ In fact, the proposed conditions are intended to "remedy" existing SBC practices that are "unrelated to this transaction."¹⁸ Again, by definition, there is no link between such conduct and the "loss" of AT&T as an independent competitor. Whatever the merit of such challenges to existing incumbent LEC special access practices that are designed to gain business certainty in return for additional rate discounts, those claims must be pressed in other proceedings, because the merger does nothing to alter those practices. Indeed, these and related complaints are already the subject of *ongoing* industrywide rulemaking proceedings. SBC strongly believes that the records in those proceedings will establish that these claims have no merit,¹⁹ but, if any rule changes are deemed necessary, they will apply to the merged company and must apply equally to Qwest and other carriers.²⁰

¹⁵ Qwest Group Ex Parte, Att. at 1. Of course, this is a one-way ratchet: SBC-AT&T would be bound by the terms of the agreements for customers that decide to meet their pre-merger commitments. *Id.*

¹⁶ *Intelsat System Order*, 14 FCC Rcd 15703, ¶¶ 118, 124 (1999).

¹⁷ Qwest Group Ex Parte, Att. at 2.

¹⁸ *General Motors-News Corp. Order*, 19 FCC Rcd. 473, ¶ 131 (2004).

¹⁹ 9/27/05 SBC Ex Parte at 1-5. As noted therein, there is no public policy reason why SBC should be forced to ignore the rates customers actually pay for the complete basket of high capacity facilities they obtain from SBC when negotiating contract tariffs for those facilities. To the contrary, one of the central purposes of any contract negotiation is business certainty, and limiting the certainty that SBC can derive from its contract negotiations only limits its ability to offer customers the best possible terms. By the same token, carriers should be able to negotiate limits on costly and resource-intensive activities as conditions for their steepest discounts. To
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Anti-Discrimination Conditions. The Qwest group also advocates conditions that purport to forbid SBC from “discriminating” in favor of itself.²¹ Of course, SBC is already prohibited by the Communications Act from unreasonably discriminating in favor of itself – or any other customer for that matter – and a combined SBC-AT&T will continue to be subject to the those same existing protections. Moreover, the discrimination incentives that the Qwest group posits are not remotely merger-specific given SBC is already a vertically integrated competitor.²² The proposed “anti-discrimination” conditions must be rejected on that ground alone.²³

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deny them that ability would deny them the ability to consider *costs* in the rates they charge.

²⁰ The Qwest group also lumps under the “anti-leveraging” label a proposal to require SBC to *violate* the Commission’s nondiscrimination policy by allowing special access customers to continue to obtain volume discounts for which they do not qualify. In particular, the Qwest group contends that the Commission should abrogate existing volume discount contracts and allow customers that obtained those contracts on the basis of their volume commitments to continue to receive those discounts without regard to the volumes they purchase. Qwest Group Ex Parte, Att. at 2. But the Commission has approved special access discounts for customers that make term and volume commitments *because* it generally costs less to serve a long term/high volume customer. See *Access Charge Reform Order*, 11 FCC Rcd. 21354, ¶ 187 (1996); see also *Pricing Flexibility Order*, 14 FCC Rcd. 14221, ¶ 126 (1999); *Volume Discount Order*, 97 F.C.C. 2d 923, ¶¶ 68-69 (1984). And the Commission has ruled that some discount structures that lack proportionality between the volumes committed and the discounts offered violate section 272 of the Act. *BellSouth Tariff Complaint Order*, 19 FCC Rcd. 23898, ¶ 22 (2004).

²¹ Qwest Group Ex Parte, Att. at 2.

²² Indeed, Qwest itself was instrumental in convincing the Commission that this is so. In the Qwest-US WEST merger proceeding, opponents of the merger argued that the merged company’s *ownership* of both local access and inter-exchange facilities would increase its incentive to “discriminate against long-distance rivals and give[] it the ability to degrade the quality of access provided for calls by [its] competitors that terminate in [its local] service territory.” *Qwest-US WEST Order*, 15 FCC Rcd. 5376, ¶ 40 (2000). The Commission, consistent with Qwest’s own argument in that merger proceeding, dismissed this contention, reasoning that “[a]n incumbent LEC . . . would have the same incentive to degrade the quality of . . . access it provides to competing interexchange carriers whether the incumbent LEC is providing . . . [interexchange] service over facilities it constructed or that it purchased from another carrier.” *Id.* at ¶ 42.

²³ See, e.g., *AT&T-TCG Order*, 13 FCC Rcd. 15236, ¶ 46 (1998) (“we also reject Sprint’s argument that the Commission should only approve the merger subject to the conditions that: (1) Teleport is maintained as a separate entity, and (2) Teleport is subject to nondiscriminatory access requirements. We note in this regard that the merged entity will remain subject to Sections 201 and 202 of the Communications Act, and any party that believes itself aggrieved by alleged discriminatory behavior can seek recourse from the Commission under Section 208 of (continued . . .)

To the extent that the Qwest group asks the Commission to enforce “nondiscrimination” through “informational postings,” “audits” and “penalties,” it is simply advocating proposals for industry-wide reform that have already been advanced, and are most appropriately addressed, in the Commission’s ongoing special access performance measures proceeding.²⁴ Beyond that, the Qwest group’s intentionally vague anti-discrimination proposals would only provide a vehicle for gamesmanship that would embroil the Commission in constant and needless disputes without the benefit of established complaint proceeding procedures.

The Qwest group’s more specific anti-discrimination proposals only confirm that they are interested in special, not equal, treatment. For example, the Qwest group urges the Commission to insist that the merged company make available to other carriers the lowest special access rate at which it provides service to its own affiliates or to other BOCs, *regardless of volume or term*. The Qwest group does not even purport to explain how this patently self-serving proposal to require discrimination in favor of its members by entitling them to discounts for which they do not qualify – *e.g.*, by giving a customer that purchases a single circuit for a single month rates that can only be justified by the lower unit costs of serving a customer that commits to purchase large volumes for years – could be reconciled with the prohibition against unreasonable discrimination. Nor does the Qwest group bother to acknowledge that the nondiscrimination and complaint provisions of the Act and the Commission’s rules already provide full protection against any attempt by SBC (or any other carrier) to grant an affiliate discounts that are unreasonably advantageous and are not justified by volume and term commitments. Indeed, the Commission’s existing pricing flexibility rules require price cap LECs to certify, before making a pricing flexibility contract available to an affiliate, that they already provide service pursuant to that contract to an unaffiliated customer.²⁵

Similarly, the Qwest group would have the Commission require SBC to sell special access services in-region at the same prices that SBC purchases from other carriers outside its region. Qwest Group Ex Parte, Att. at 2. But even if it were possible to make apples-to-apples comparisons between the disparate terms and conditions of the myriad special access arrangements offered by independent special access providers, the price that one carrier may pay for special access outside of its region bears no necessary relationship to the costs that it may incur in providing special access in-region. Moreover, any such condition would create remarkably perverse incentives for a large special access purchaser such as Qwest that also sells special access and might find it advantageous to give away special access in Montana, for example, where it earns relatively little special access revenue, so that it could claim entitlement to free special access service from SBC in Chicago, Los Angeles and other areas where its purchases of special access are most heavily concentrated. And, of course, there is no way that this irresponsible proposal to require mirroring of other carriers’ rates without regard to relevant

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the Act.”).

²⁴ *Special Access Performance Measures NPRM*, 16 FCC Rcd. 20896 (2001); *see also Section 272(f)(1) Sunset NPRM*, 18 FCC Rcd. 10914 (2003).

²⁵ 47 C.F.R. § 69.727(a)(iii).

cost or other differences could be reconciled with the Communications Act or the Commission's established ratemaking policies.

In sum, the recent frenzy of merger condition proposals by the Qwest group and others should be seen for what they plainly are – illegitimate attempts to game the Commission's merger review process to gain unwarranted windfalls and competitive advantages that are entirely unrelated to the impact of this manifestly pro-competitive merger. The extensive record in this proceeding establishes that the merger will have no significant adverse effects on competition in any market, and there is thus no basis for the wish list of conditions proposed by the Qwest group and others. Applicants respectfully request that the Commission expeditiously approve the proposed license transfers without conditions.

Sincerely,

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AT&T Corp.

/s/ Gary L. Phillips

/s/ Lawrence J. Lafaro

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