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August 22, 2006

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Federal Communications Commission
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BY HAND DELIVERY

Ms. Marlene H. Dortch
Secretary
Federal Communications Commission
445 12th Street, S.W.
Washington, D.C. 20554

Re: In the Matter of AT&T Inc. and BellSouth Corporation
Applications for Approval of Transfer of Control, WC Docket No. 06-74
REDACTED HIGHLY CONFIDENTIAL FILING

Dear Ms. Dortch:

Enclosed for filing in the above-referenced proceeding are two copies, in redacted format, of an *Ex Parte* letter containing Highly Confidential information. ("Redacted Highly Confidential Filing") A copy of the unredacted Highly Confidential Filing is also being submitted under separate cover.

Kindly date stamp the duplicate of this letter and return it to the courier.

Please contact the undersigned at (202) 342-8614 if you have any questions about this letter.

Respectfully submitted,

Denise N. Smith

Denise N. Smith

Enclosures

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HIGHLY CONFIDENTIAL INFORMATION SUBJECT TO SECOND PROTECTIVE ORDER IN WC DOCKET 06-74

Ms. Marlene H. Dortch
Secretary
Federal Communications Commission
445 Twelfth Street, N.W.
Washington, D.C. 20554

Re: *AT&T Inc. and BellSouth Corporation Applications for Approval of Transfer of Control, WC Docket No. 06-74*

Dear Ms. Dortch:

Cbeyond Communications, NuVox Communications, XO Communications, Inc. and Xspedius Communications (collectively the "Group Commenters") hereby respond to the July 31, 2006 *ex parte* letter filed by AT&T Inc. ("AT&T") and BellSouth Corporation ("BellSouth") (referred to combined as "Applicants").[1] In that submission, Applicants make inaccurate assertions regarding the effect of the proposed merger on wholesale and retail rates and competitors, as well as the degree to which AT&T is the primary competitor to BellSouth.[2] In fact, both the record and information produced by Applicants in response to Commission Information Requests show that they are incorrect and in fact that: (i) the SBC-AT&T merger eliminated the strongest local competitor to SBC, and enabled the merged entity to raise rates to

1 Letter from Gary L. Phillips, AT&T Inc. and Bennett L. Ross, BellSouth Corporation, to Marlene H. Dortch, Federal Communications Commission (July 31, 2006) ("Joint Ex Parte")

2 *Joint Ex Parte* at 1-3.

business customers; (ii) the proposed AT&T-BellSouth merger will eliminate the strongest local competitor to BellSouth and can be expected to cause similar price escalation in the BellSouth region; (iii) by eliminating AT&T's market presence in the BellSouth region, the AT&T-BellSouth merger will undermine the competitive pressure applied by the remaining competitive local exchange carriers ("CLECs") serving the BellSouth region; and (iv) the proposed AT&T-BellSouth merger will eliminate an important competitor to AT&T in its region.

As Predicted by Critics, the SBC-AT&T Merger Has Led to Significant Price Increases to Business Customers.

Price is fundamental to competition analysis. The Department of Justice ("DOJ") recognized the fundamental importance of price when it stated in its *Horizontal Merger Guidelines* that "mergers should not be permitted to create or enhance market power or to facilitate its exercise. Market power to a seller is the ability profitably to maintain prices above competitive levels for a significant amount of time."[3] The Commission also acknowledges the importance of price effects, noting in its *SBC Merger Order* that "we need to consider the potential vertical effects of the merger – specifically, *whether the merged entity will have an increased incentive or ability to injure competitors by raising the cost* of, or discriminating in the provision of, inputs sold to competitors."[4] While conditions imposed by the Commission in the recent AT&T-SBC and MCI-Verizon mergers were intended to limit the ability of the merged companies to exercise their market power by increasing rates,[5] it now is evident that they are insufficient to alleviate the loss of AT&T and MCI as local service competitors.

Last year, the Group Commenters submitted evidence in the Commission's proceeding to review the SBC-AT&T and Verizon-MCI mergers demonstrating that wholesale pricing for private line services was decreasing due largely to competition supplied by the pre-merger AT&T and MCI, and that the elimination of an independent AT&T and MCI through merger was likely to reverse this trend.[6] We now know that the price increases predicted by the Group Commenters have begun to occur, and truly devastating wholesale price increases have

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3 U.S. Department of Justice and the Federal Trade Commission, *Horizontal Merger Guidelines*, Sec. 0.1 ((April 1997) ("Merger Guidelines").

4 *SBC Communications Inc. and AT&T Corp. Applications for Approval of Transfer of Control*, 20 FCC Rcd 18290, ¶20 (2005)(" SBC Merger Order")

5 *See SBC Merger Order*, ¶77 and *Verizon Communications, Inc. and MCI Inc. Applications for Approval of Transfer of Control*, 20 FCC Rcd 18433, ¶78 (2005) ("Verizon/MCI Merger Order").

6 *See*, for instance, Letter from Thomas W. Cohen on behalf of Conversent Communications, Eschelon Telecom, NuVox Communications, XO Communications, and Xspedius Communications to Marlene H. Dortch, Federal Communications Commission (WC Docket No. 05-65, October 3, 2005).

been avoided only because the Commission imposed temporary price caps as a condition of the prior mergers. As the Group Commenters noted in their Reply Comments, "since the AT&T-SBC merger closed on November 18, 2005, AT&T has raised prices for Local Private Line services from the legacy SBC nine times, or more than once a month"[7] and these price increases affected rates in six states.[8] AT&T also has increased prices for local private line services offered by the legacy AT&T.[9] These rate increases are especially significant because rates of the legacy AT&T historically were lower than those charged by incumbent local exchange carriers ("ILECs") for comparable services.

Applicants respond by arguing that the AT&T rate increases are immaterial because they apply only to intrastate retail services for business customers.[10] However, they ignore the fact that the rates paid by wholesalers are based on the resale discount taken off of retail rates,[11] and such an increase in retail rates consequently results in an increase in wholesale rates as well. Such an increase in rates paid by wholesalers is far from "unremarkable" or "irrelevant" to the issues at hand as contended by Applicants. However, what is most important is not the extent of the private line price increases, but the fact that AT&T raised private line prices wherever it was not barred from doing so by merger conditions. Thus, the price increases

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7 Group Commenters Reply Comments in WC 06-74 (filed June 20, 2006).

8 *See* AT&T Accessible Letters dated May 5, 2006 (RATE CHANGES DS1 Service – Missouri), April 25, 2006 (RATE CHANGES Fractional DS1 Service – IL, IN, OH, WI), April 24, 2006 (RATE CHANGES DS1 Service – IL, IN, OH, WI), April 24, 2006 (RATE CHANGES DS3 Service – IL, IN, OH, WI), January 6, 2006 (RATE CHANGES Ds3 MTM and Service Packs Rate Changes – Illinois, Michigan), January 10, 2006 (RATE CHANGES DS3 MTM and Service Packs Rate Changes Revision – Illinois, Michigan), December 21, 2005 (RATE CHANGES DS1 Service – Illinois, Michigan), February 20, 2006 (RATE CHANGES Megalink III (DS1) Service – Texas), February 17, 2006 (RATE CHANGES Megalink III (DS1) Service – Texas) at https://clec.att.com/clec/accletters/home.cfm.

9 *See* AT&T Business Service Guide, Private Line Change: "Effective April 20, 2006, rates will change for Single Channel IOCs, Single Channel and T1.5 Local Channels and select Frame and ATM port and PVC speeds…Single Channel (Voice Grade and ASDS) Rate Schedule A Domestic Private Line rates will increase 10%...Single Channel (Voice Grade, DDLA/DDLC, and GDA) and T1.5 Local channels rates will increase 10%."

10 *Joint Ex Parte* at 3.

11 The "Accessible Letters" in which AT&T provided notice of the rate increases each state that they are applicable to "Resale" services and, because the notices are sent to wholesalers (*i.e.*, CLECs), that the "appropriate Resale discounts will be applied to the Retail rates." *See* Footnote 17 *supra*. Further, the Accessible Letters are found on AT&T's "CLEC Online" website and the website contains a statement that the postings are "for the convenience of our wholesale customers." Statement Attached as Exhibit 1.

are indicative of AT&T's inclination to raise wholesale prices wherever competition declines due to its mergers.

Hence, Applicants' assertion that they will not increase prices[12] is belied by AT&T's own recent practice. Moreover, AT&T itself says that it will continue raising prices wherever it can. As AT&T CEO Ed Whitacre recently told Wall Street, "Prices [which had been declining] have stabilized in our judgment and even in some cases, believe it or not, there's some upside to pricing, which is a good thing."[13] This sentiment was echoed by Rick Lindner, AT&T's Senior EVP and CFO, in an earnings call only last month: AT&T's "wireline revenues showed considerable stability. In fact, sequentially they were up slightly."[14] He explained that AT&T's "pricing is at a point in terms of point-of-sale pricing where we are still seeing some declines, but at a much reduced level from where we were seeing even a few quarters ago."[15] The replacement of price declines with rate increases disturbingly bucks a long running trend in a declining cost industry.

Analysts have observed the proclivity of AT&T to raise prices for wholesale service wherever they are not legally barred from doing so, and are predicting that they will search for every opportunity to do so. One prominent analyst recently reported that Verizon told them that "while the company was somewhat hamstrung in raising special access rates due to the FCC conditions imposed as part of the Verizon-MCI merger, it was looking for other ways to extract higher prices for its services, including the recent FCC forbearance petition that could lead to better pricing on SONET and other inter-central office services." The analyst predicted that AT&T would do the same, writing that: *"Prices should continue to improve on the back of less intense competition resulting from M&A.* We believe that AT&T and Verizon, which dominate the current market for enterprise and wholesale services, will drive the market higher by raising the price cards for services inherited from *AT&T Corp. and MCI, and will find creative ways to get around FCC rate caps on special access prices*."[16] Currently, the merger

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12 *Joint Ex Parte* at 2-3.

13 Thompson Street Events: T-AT&T at Sanford Bernstein & Co. Strategic Decisions Conference at 9 (May 31, 2006) ("Bernstein Transcript").

14 Thompson Street Events: T-Q2 2006 AT&T Earnings Conference Call Final Transcript at 3 (July 25, 2006) ("Earnings Call Transcript").

15 *Earnings Call Transcript* at 11.

16 "Buckingham Research Group," Communications Services: Telecom Carriers Upbeat on Non-Consumer Trends," July 6, 2006, at p.2 (attached hereto as Exh. 1) (emphasis added).

conditions imposed by the FCC are the only impediment to AT&T raising prices across-the-board for special access and UNEs.[17]

However, those conditions are only temporary and, as evidenced by AT&T's numerous price increases, are even now insufficient. It should be noted that AT&T's CEO does not believe that the conditions imposed on the SBC-AT&T merger are meaningful. He recently stated that: "I don't think we'll have to give back one thing to gain approval of the BellSouth merger. And we really did not on the AT&T merger…I don't expect to give back anything."[18] Counsel for AT&T and BellSouth try mightily to rewrite the meaning of the AT&T's CEO's statement by adding bracketed – but unsaid – words to make it seem as not to disparage the efforts of the Commission.[19] Alas, they fail. Nothing can alter both the plain meaning of the quote and the arrogance that it displays.

Because AT&T has Substantial Local Market Presence in the BellSouth Region, Significant Price Increases for Business Customers There are Likely.

Contrary to Applicants' assertions,[20] AT&T is the single most important existing competitor to BellSouth. Information provided by BellSouth to the Commission[21] demonstrates that BellSouth itself views AT&T as its foremost competitor. In one telling BellSouth document, for example, [BEGIN HIGHLY CONFIDENTIAL] [END HIGHLY CONFIDENTIAL] Similarly, a [BEGIN CONFIDENTIAL] [END CONFIDENTIAL] Indeed, in a [BEGIN CONFIDENTIAL]

17 *SBC Merger Order*, ¶77 and *Verizon/MCI Merger Order*, ¶78.

18 *Bernstein Transcript* at 6.

19 *Joint Ex Parte*, fn. 17.

20 Applicants state that "the elimination of AT&T as an independent wholesale special access supplier cannot have a significant adverse impact on competition" because AT&T has only "limited local fiber facilities and miniscule wholesale special access sales in the BellSouth franchise areas." *Joint Ex Parte* at 1.

21 On July 11, 2006, BellSouth Corporation filed a response to the Wireline Competition Bureau Staff's Initial Information and Document Request of June 23, 2006. ("BellSouth Information Response").

22 [BEGIN HIGHLY CONFIDENTIAL] [END HIGHLY CONFIDENTIAL]

23 [BEGIN CONFIDENTIAL]

[END CONFIDENTIAL]

Importantly, BellSouth's documents also show that it has felt a need to respond to the competitive pressure applied by AT&T. **[BEGIN HIGHLY CONFIDENTIAL]**

[END HIGHLY CONFIDENTIAL] BellSouth documents further show that BellSouth is aware that the powerful "AT&T" brand name positions AT&T uniquely to compete against it. **[BEGIN HIGHLY CONFIDENTIAL]**

[END HIGHLY

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27 **[END CONFIDENTIAL]**

28 **[BEGIN HIGHLY CONFIDENTIAL]**

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30 **[END HIGHLY CONFIDENTIAL]**

CONFIDENTIAL] Thus, in stark contravention to Applicants' claim that they do not compete directly with each other, BellSouth's own documents show that BellSouth currently regards AT&T as its primary competitor.

Finally, notwithstanding Applicants' assertion that the proposed merger will not harm competition,[31] the fact is that the proposed merger will deal a double blow to competitors in the BellSouth region. As discussed above, the competitive pricing of AT&T wholesale services will be lost. The harm stemming from the loss of AT&T as a wholesale competitor is compounded greatly by the fact that AT&T is likely to stop purchasing services from remaining CLECs in the BellSouth region who depend on AT&T as an anchor customer of their own wholesale service offerings. Thus, the removal of AT&T from the market both eliminates a critical source of competitive facilities directly through the absorption of AT&T metro fiber facilities and indirectly by undermining the wholesale offerings of other competitive carriers that have counted on AT&T as a critical customer.

BellSouth's documents make clear that its decision to combine with AT&T was motivated in substantial part by a desire to undermine such CLEC competition in its region. [BEGIN HIGHLY CONFIDENTIAL]

31 *Joint Ex Parte* at 4.

[END HIGHLY CONFIDENTIAL]

Indeed, the BellSouth documents further show [BEGIN HIGHLY CONFIDENTIAL]

[END HIGHLY CONFIDENTIAL] Clearly, via the proposed merger, BellSouth hopes to forestall both competitive facilities deployment by AT&T, and frustrate CLEC facility deployment by migrating AT&T traffic to the BellSouth network. This is precisely the danger forewarned by the Group Commenters, and steadfastly denied by the Applicants in their public submissions.

Put simply, Applicants' claim that AT&T is not a material in region competitor to BellSouth is impeached by BellSouth's own documents, which show without question that BellSouth regards AT&T as its most important competitor, and is motivated to merge with AT&T in major part out of a desire to reduce competition in its region.

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32 [BEGIN HIGHLY CONFIDENTIAL]

[END HIGHLY CONFIDENTIAL]

33 [BEGIN HIGHLY CONFIDENTIAL]

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[END HIGHLY CONFIDENTIAL]

The Loss of BellSouth as a Competitor in the AT&T Region also is Likely to Increase Prices for Business Customers in the AT&T Operating Territory.

The negative effects of the proposed merger are not limited to the BellSouth operating region. The ill effects will extend to the AT&T operating territory as well. Documents provided by BellSouth show that [BEGIN HIGHLY CONFIDENTIAL]

[END HIGHLY CONFIDENTIAL] BellSouth began to act on this plan later in 2005 when it entered into an internetworking agreement with Sprint Nextel Corp. that would give BellSouth a "nationwide data solution."[37] Jeff Kagan, an Atlanta-based telecom industry analyst, was quoted in the BellSouth news release, stating, "This new nationwide MPLS data service will immediately increase BellSouth's addressable customer base and will strategically position them to more effectively attract and retain large business customers." The proposed merger undoubtedly will put an end to these plans, and eliminate a potentially important in region competitor to AT&T for the enterprise market.

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35 [BEGIN HIGHLY CONFIDENTIAL]

[END HIGHLY CONFIDENTIAL]

36 [BEGIN HIGHLY CONFIDENTIAL]

[END HIGHLY CONFIDENTIAL]

37 BellSouth News Release, "BellSouth to Launch Nationwide Business Data Service," October 10, 2005. http://bellsouth.mediaroom.com/index.php?s=press_releases&item=1445

Thus, the Applicants' unsubstantiated claims that they do not compete with each other, and their merger will not lead to price hikes, are completely at odds with both their own recent behavior and documents taken from their own files. The evidence is clear that the proposed merger will materially reduce competition and lead to sizeable rate increases to customers of enterprise and wholesale services. Consequently, the public interest requires that the Application be denied.

Respectfully submitted,

CBEYOND COMMUNICATIONS
NUVOX COMMUNICATIONS
XO COMMUNICATIONS, INC., AND
XSPEDIUS COMMUNICATIONS

By: ______________________

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