Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
AT&T CORP.	)	WC Docket No. 05-65
	)	
and	)	
	)	
SBC COMMUNICATIONS INC.	)	
	)	
Application Pursuant to Section 214 of the Communications Act of 1934 and Section 63.04 of the Commission's Rules for Consent to the Transfer of Control of AT&T Corp. to SBC Communications Inc.	)	

OPPOSITION OF BROADWING COMMMUNICATIONS, LLC, AND SAVVIS COMMUNICATIONS CORPORATION TO THE MERGER APPLICATION FILED BY SBC COMMUNICATIONS, INC., AND AT&T CORP.

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Broadwing Communications, LLC, and SAVVIS Communications Corporation respectfully submit these comments opposing the application of SBC Communications Inc., and AT&T Corp. (jointly "the applicants") for the approval of their proposed merger.

I. SUMMARY

The applicants contend that "[t]he 1984 divestiture of the Bell System," which "segregated the telecommunications industry along artificial local and long distance faults," must be reversed.[1] In their view, "the broadband future of our country critically

[1] *Merger of SBC Communications Inc. and AT&T Corp., Description of the Transaction, Public Interest Showing and Related Demonstrations,* WC Docket No. 05-65, at iii (*"Public Interest Showing"*).

depends on the ability of companies to assemble these separate networks."[2] The applicants' simply are recycling the same argument the Bell System advanced throughout the 1970s in attempting to avoid competition. The argument is wrong and clashes sharply with the applicants' claim that the merger will not harm competition. There would be little or no room for competition if only a regionally recombined Bell System were capable of providing quality service, yet that is the fundamental premise on which the applicants base their claim that the public will benefit from the merger. SBC and AT&T need to reconcile themselves to the longstanding conclusions of Congress and the Commission that the public will benefit from competition in telecommunications markets. As currently proposed, this merger does not provide adequate protections to preserve competition in two key markets – special access and Internet backbones – as described more fully below.

In order to receive Commission approval, the applicants must affirmatively establish that a proposed merger promises public interest benefits that outweigh any likely detrimental effects of the merger.[3] Here, the proposed merger is fundamentally anticompetitive in two significant ways: (1) the merger would further reduce the already limited competition in the special access market and increase prices to consumers; and

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2 *Id.*

3 *See Applications of Ameritech Corp., Transferor, and SBC Communications Inc., Transferee, for Consent to Transfer Control of Corporations Holding Commission Licenses and Lines Pursuant to Sections 214 and 310(d) of the Communications Act and Parts 5, 22, 24, 25, 63, 90, 95 and 101 of the Commission's Rules,* Memorandum Opinion and Order, 14 FCC Rcd 14712, 14737 (¶ 48) (1999) (*"SBC/Ameritech Merger Order"*).

(2) the merger (when viewed in conjunction with the proposed Verizon-MCI merger)[4] would likely result in the collapse of the current competitive market for Internet backbone services and replace it with a market dominated by two companies. For those reasons, the public will suffer serious harm if the transaction is consummated without adequate competitive protections.

Special Access. The merger will eliminate what little competition currently exists in the special access market. Before focusing on the merger-related future harm to this market, it is important to understand the problems afflicting *today's* market, where AT&T and MCI provide special access in competition with the more dominant Bell Operating Companies ("BOCs"). As AT&T itself previously told the Commission: "The marketplace reality is that, despite limited, targeted entry, price-constraining levels of competition in the provision of special access services simply . . . do not[] exist in any local market."[5] To the extent that there is competition, it is provided primarily by AT&T and MCI – the two companies that would be eliminated by the acquisitions being proposed to the Commission.

The BOCs are the *only* companies that own high capacity loops to the vast majority of commercial buildings. The BOCs use their dominance by structuring special access rates around region-wide volume discounts. By offering discounts off inflated

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[4] In addition to the SBC-AT&T application, Verizon and MCI have filed a merger application with the Commission. *Merger of Verizon Communications Inc. and MCI, Inc., Description of the Transaction, Public Interest Showing and Related Demonstrations,* WC Docket No. 05-75 (filed Mar. 11, 2005) ("*Verizon-MCI Public Interest Showing*"). That application remains pending even though Qwest continues to attempt to buy MCI.

[5] *AT&T Petition for Rulemaking To Reform Regulation of Incumbent Local Exchange Carrier Rates for Interstate Special Access Services,* Petition for Rulemaking, RM-10593 at 2 (filed Oct. 15, 2002) ("*AT&T Petition for Rulemaking*").

special access rates only when high volume commitments are met, the BOCs force carrier customers either to turn down competitive service where it is available or lose the volume discount region-wide. In this way, the BOCs use their monopoly access to many buildings to penalize companies like Broadwing and SAVVIS if they use a competitor to reach a building that is served by a competitive provider of special access service.

The result of the BOCs' largely undisciplined exercise of their monopoly power is entirely predictable. As AT&T set forth in its October 2002 filing, the BOCs' special access returns are too high to be consistent with the existence of a competitive market.[6]

Prior to the announcement of the proposed mergers, Broadwing and SAVVIS did not find the special access market fully competitive, but the special access debate was not a high business priority for either company. The announcement of the SBC-AT&T merger, followed by the announcement of the Verizon-MCI merger, has made special access a top business priority for both companies. As bad as things are in the special access market, *they can get worse, and consummation of this merger without adequate competitive protections would guarantee that they will*. Of the non-BOCs, AT&T and MCI are by far the largest providers of special access – indeed, as a practical matter, only the in-region BOC, AT&T, and MCI have sufficient scale to provision any significant percentage of the substantial special access needs of companies like Broadwing and SAVVIS. Accordingly, the proposed merger will reduce the number of special access competitors in many markets from three to two, removing vital competitive pressure and leaving the two remaining companies little incentive to compete on price. Moreover, the number of suppliers will effectively decrease to one if SBC and Verizon fail to compete

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6 *Id.* at 3-4.

with each other out-of-region – and as the Commission knows, they have avoided competition in the past.

SBC's acquisition of AT&T will cause Broadwing, SAVVIS, and other companies serving large enterprise and medium-sized businesses to be caught in a price squeeze resulting from the fact that their supplier for local access – which amounts to about one-half of all their costs of providing service – will also be their principal competitor for their services, with the incentive and ability to raise costs while reducing its own retail rates. As the applicants state, AT&T has been a far more active competitor in the enterprise market for Broadwing's and SAVVIS services than has SBC. The merger will result in SBC becoming a major player in a market where special access costs are about half the cost of providing service. Although it is not ideal for Broadwing and SAVVIS to currently be required to make special access payments to SBC that are far above SBC's cost of providing service, at least their major competitors in this market (AT&T and MCI) currently also make excessive special access payments to SBC, even with whatever discounts they enjoy as a function of their size. If SBC acquires AT&T and is allowed to integrate the local and long-distance businesses, the new entity's costs for special access – a significant input into services to large enterprise and medium-sized businesses – will be much lower than those it charges its competitors. In short, competitors will be caught in a classic price squeeze if the merger is approved. The combined SBC-AT&T (and the combined Verizon-MCI) will have special access costs that are much lower than those of their competitors, and they will be able to raise their rivals' costs without the constraints provided by the competition that currently exists.

Price is not the only area in which purchasers of special access – and, correspondingly, their customers – will suffer. SBC currently provides better performance and service support to its own customers than to non-affiliated wholesale customers, as AT&T documented in filings before the Commission.[7] If this merger is consummated, SBC will have an even greater incentive to discriminate since it will be a bigger player in the market for medium and large businesses. Enterprise companies served by SBC's competitors likely will suffer a degradation of service quality because SBC will provide relatively slower and poorer provisioning and repair of circuits supplied to its competitors, which, along with price, are critical benchmarks customers use to select suppliers.

Internet Backbone. While the detrimental effects that the merger would have on the special access market are perhaps the most readily apparent, they are by no means the only harms that consumers would experience as a result of the proposed merger. In particular, when viewed in conjunction with the proposed Verizon-MCI merger, the SBC-AT&T merger gravely threatens the current competitive market for Internet backbone services. If both mergers are consummated without protections, the current market of numerous comparably-sized "peers" will likely become a duopolistic market dominated by two "mega-peers."

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[7] *See Section 272(d) Biennial Audit of SBC Communications, Inc.,* Comments of AT&T on SBC's Second Section 272 Compliance Biennial Audit, EB Docket No. 03-199 at 7-10 (filed March 26, 2004); *see also Implementation of the Telecommunications Act of 1996; Accounting Safeguards Under the Telecommunications Act of 1996,* Comments of AT&T Corp., CC Docket No. 96-150 at 17-21 (Jan. 29, 2003).

Once again, it is important to understand critical aspects of *today's* backbone services market in order to grasp the merger-related harms. In particular, in addition to requiring a national, redundant network and the ability to meet at multiple peering points and to provide high-speed, high-quality service, many peering agreements today contain provisions relating to the ratio of outgoing to incoming traffic. Many backbone providers will not exchange traffic on a settlement-free basis with a network that originates more than twice as much traffic as it terminates. This ratio is enormously affected by the number of a network's end-users that are content-providing businesses (*e.g.*, CNN.com) compared to the number that are consumers or businesses that do not provide, but instead want access to, content – colloquially known as "eyeballs." Eyeballs typically use their Internet connections to, for example, send short queries for Web pages, while content providers send a large amount of data in response, such as the Web page itself. Accordingly, when an "eyeball-heavy" network exchanges traffic with a "content-heavy" network, the content-heavy network will have a high – normally far exceeding two to one – outgoing to incoming traffic ratio.

The eyeball/content distinction is important in the present context because SBC and Verizon, given their dominance in local consumer telephone markets, have disproportionately strong positions in the market for eyeballs. Indeed, because of their last-mile dominance in providing telecommunications services, the BOCs have extremely eyeball-heavy networks. SBC and Verizon, for example, serve a large number of DSL customers. MCI and AT&T have a strong position in the market for traditional business customers, few of which are content providers. Thus, applying a traffic ratio requirement such as that currently used by many Internet backbone providers, there is a very real

possibility that a merged SBC and AT&T (and a merged Verizon and MCI) could decline to peer with any of the other Internet backbone providers with which they currently peer. Absent evidence that traffic ratios reflect important cost factors – and applicants have provided no such evidence – such de-peering would be the result of the exercise of market dominance rather than the result of real cost considerations.

Such "de-peering" would both drive up rivals' costs and enable the dominant mega-peers to raise the price at which they will provide "transit" or "paid for peering" to competitors that have been "de-peered." This is not merely hypothetical – AT&T is currently (although just recently) attempting to de-peer competitors on the basis of traffic ratios. SBC does not currently list a ratio requirement in its published peering policies – but post-merger it may conclude that such a requirement provides a convenient excuse for de-peering competitors. Similarly, it may use its dominance over last-mile facilities to develop other requirements that most other Internet backbone providers cannot meet.

For these reasons, market share or revenues are inappropriate or at least incomplete measures of whether a particular Internet backbone provider has or will have the ability to de-peer existing peers. Equally if not more important is whether certain networks have a dominant position in the market for eyeballs. If this merger is approved, SBC will have such a position, and it will be able to leverage it into a dominant position in the market for Internet backbone services. If SBC-AT&T and Verizon-MCI make peering decisions based on eyeball count, they will be in the position to recognize only each other as peers. They would be able to impose transit or paid for peering charges on their other competitors, thus raising their rivals' costs and undermining competition.

In addition, while the applicants have touted their ability to provide Voice-over-Internet-Protocol ("VoIP") service post-merger, they have failed to recognize that if their VoIP projections are correct the merged entity will be in a position to de-peer competitors simply on the basis of traditional market shares. SBC and Verizon, of course, provide a substantial amount of voice traffic. If any significant portion of that traffic is converted to VoIP traffic, their share of the Internet market will increase dramatically. Again, they would be able to de-peer competitors, to the ultimate detriment of consumers.

II. THE MERGER WOULD HAVE A DIRECT AND SUBSTANTIAL NEGATIVE EFFECT ON CUSTOMERS OF BROADWING AND SAVVIS.

SAVVIS operates a nationwide fiber optic network and provides Internet backbone, hosting, internet access and other services. Broadwing uses its nationwide, all-optical network to provide local and long-distance telecommunications and Internet services. Both companies need to lease thousands of special access circuits (or "local loops") to connect their customers to their networks in order to provide them with service.

A. SAVVIS

SAVVIS is a global information technology services company with more than 5,000 customer endpoints in the financial services, media, retail, professional services, healthcare, manufacturing, government (including the federal government), and other sectors. SAVVIS provides its customers with a full range of information technology services, including: (1) Internet Protocol virtual private networks ("IP VPNs"); (2) hosting facilities, networks, servers, storage, and operations offered through 24 data centers located in the United States, Europe, and Asia; (3) infrastructure tied to workflow applications that enhance the creation, production, and efficient distribution of digital

content and streaming media, and (4) a broad range of network services to support voice, video, data, and web applications.

In addition to (and in conjunction with) providing and supporting sophisticated internal networks, SAVVIS offers businesses in the United States, Europe, and Asia IP voice and data services at speeds from fractional T-1 to full OC192. Unlike Internet Service Providers ("ISPs") that provide only the physical connection between end-users and the nearest network node connected to the public Internet, SAVVIS is a true Internet backbone provider, owning and operating a network of high-volume fiber "pipes" that physically connect Internet nodes throughout the United States as well as around the world. This network also includes approximately 50 MPLS switches, 200 backbone routers, 17,000 access devices at customer locations, and hundreds of Points of Presence ("POPs") in 47 countries. SAVVIS acquired this Internet backbone network from Cable and Wireless, which had previously acquired Internet backbone facilities divested as part of the WorldCom-MCI merger. A map showing SAVVIS' North American network is attached.[8]

To provide universal connectivity to its customers, SAVVIS (like other comparably sized Internet backbone providers) has formed "peering" agreements with 16 other Internet backbone providers that also have national and international geographic footprints and high data throughput. These agreements contain two basic provisions. *First*, they authorize SAVVIS to transfer, at specified handoff points, IP data packets originating on its network and addressed to a customer of the other network, and vice versa. *Second*, the peering agreements specify that the transfer is to be "settlement-free,"

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[8] *See* Exhibit A.

meaning that neither network incurs any cost so long as each terminates the other's traffic as per the agreement. Because SAVVIS exchanges traffic with other networks solely on a settlement-free basis, it is known as a "Tier 1 peer."

Notwithstanding its extensive global infrastructure, SAVVIS has to connect its customers to its network. To do this, SAVVIS purchases special access services. Neither SAVVIS nor any other competitive provider of information technology services can cost-effectively self-provision these connections, and the cost of leasing special access circuits accounts for nearly half of SAVVIS' cost of providing service. SAVVIS currently obtains the majority of its special access circuits from AT&T and MCI.

The increased concentration in the special access market threatened by the proposed merger will directly affect SAVVIS by driving up its costs for special access and threatening the quality of the service it obtains. Similarly, SAVVIS' Internet backbone operations will be directly affected both by de-peering and the resulting paid for peering and transit costs. Ultimately, of course, it is consumers, including current SAVVIS customers, who will bear these increased costs and suffer as a result of the deterioration of service quality.

B. Broadwing

Broadwing is a major national telecommunications carrier that provides voice communications, broadband transport, and data and Internet services to large enterprises, mid-market businesses, and other telecommunications carriers. Broadwing's fourth-quarter 2004 revenue, on an annualized basis, was $872 million. Broadwing owns and operates a nationwide, all-optical network that connects 137 cities nationwide and is capable of transmitting up to 800 Gbps per fiber. Broadwing also acquired the assets of

the former Focal Communications Corporation in 2004. These assets include a local fiber network in nine cities and a 4,000 enterprise and wholesale/carrier customer base.

Broadwing provides a full array of voice services – long distance, toll-free, calling-card, audio conferencing, and other enhanced services – to business customers. Broadwing provides Internet backbone service both on an unbundled basis and in combination with Virtual Private Network ("VPN") services. A map is attached showing Broadwing's network.[9]

Like SAVVIS, Broadwing is not able cost-effectively to self-provision "last-mile" infrastructure. Special access costs amount to more than one-half of Broadwing's cost of serving its enterprise customers. Unlike SAVVIS, Broadwing currently obtains most of its special access circuits from the BOCs – it purchases 20,000 circuits from SBC today. But the limited competition provided by AT&T and MCI helps Broadwing obtain better prices and service from the BOCs. Accordingly, the increased concentration in the special access market threatened by the proposed merger will directly affect Broadwing by driving up its costs for special access services.

To provide its Internet customers with high-quality service and universal connectivity, Broadwing has formed "peering arrangements" with approximately 50 other Internet backbone providers. A typical peering agreement provides that Broadwing will accept and terminate any traffic from a particular Internet backbone provider if the traffic is addressed to one of Broadwing's customers. In return, the Internet backbone provider agrees to accept and terminate any traffic that originates from a Broadwing customer and is addressed to any of that Internet backbone provider's customers. Most of Broadwing's

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[9] *See* Exhibit B.

agreements provide for "settlement-free" interconnection, meaning that Broadwing and the peer Internet backbone provider collect fees only from their own customers and charge nothing for termination to the other and the other's customers. Similarly, like SAVVIS, Broadwing expects that the merger will affect its Internet backbone operations by imposing increased costs via de-peering and higher transit or paid for peering charges. Broadwing's customers will therefore also pay a price for the merger.

III. THE HARMS TO BROADWING AND SAVVIS ARE MERGER-RELATED AND SHOULD BE ADDRESSED IN THIS PROCEEDING.

The applicants attempt to circumvent concerns about the effects of the merger on special access by asserting that "[t]he regulation of ILEC provision of special access services is an industry-wide issue," and as such, it is "not within the scope of merger proceedings."[10] Instead, according to SBC and AT&T, issues concerning special access "should be reserved for rulemakings of general applicability."[11] That is simply incorrect. The special access and Internet peering problems highlighted by Broadwing and SAVVIS will be caused by the merger, and should accordingly be addressed in this docket. As we have stated, Broadwing and SAVVIS were not active participants in the special access debate until the SBC-AT&T and Verizon-MCI mergers were announced, but are now participating because it is clear to both companies that the mergers threaten their ability to obtain special access at reasonable prices and on nondiscriminatory terms.

The basic special access concern is simple: the special access market is already highly concentrated, and the merger will reduce the number of competitors from three to two in many markets – or even three to one, since SBC and Verizon have never shown

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[10] *Public Interest Showing* at 103.

[11] *Id.* at 104.

any desire to compete with each other when given the opportunity in the past. As a direct result of the merger, Broadwing and SAVVIS will lose a major supplier of special access circuits. At the same time, the merged SBC-AT&T will likely provide better service at lower prices to itself than to its competitors. Hence, Broadwing and SAVVIS have significant concerns about special access that are *specific to the merger*, and it would be inappropriate for the Commission to defer resolution of these concerns to a broader rulemaking docket. In the rulemaking docket, the FCC cannot recreate the competition that will disappear if this merger is approved.

Similarly, the Internet backbone problems of de-peering and increased transit costs are also directly merger related. It is the combination of SBC's stranglehold over "last mile" in-region facilities with AT&T's large Internet backbone that would produce an enormous, eyeball-heavy "mega-peer" here. And the combination of Verizon and MCI would produce a second such entity, likely replacing the current competitive Internet backbone market with one in which there are only two peers. Accordingly, it is the mergers themselves that will create the opportunity for de-peering, increased transit or paid for peering costs, and collusion between the mega-peers.

IV. THE APPLICANTS HAVE FAILED TO DEMONSTRATE THAT THE MERGER WILL SERVE THE PUBLIC INTEREST.

The standard for reviewing this application is well established. In order to transfer the licenses at issue in this proceeding, the applicants must prove that the transaction serves the public interest.[12] Unlike the Department of Justice, the Commission does not conduct a public interest analysis to determine whether the merger

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[12] *See* 47 U.S.C. § 310(d).

will *harm* competition. Instead, in order to find that a merger is in the public interest, the Commission "must 'be convinced that it will *enhance* competition.'"[13] The merger of SBC and AT&T would not enhance competition. Instead, if the merger is approved as proposed by the applicants, it would harm the public interest and substantially frustrate the achievement of core objectives of the Communications Act.

A. The Commission Should Stop the 180-Day Clock Until the Applicants Supplement Their Application with Additional Information about the Impact of the Merger on Special Access Consumers and Internet Backbone Providers.

It appears from the Commission's data request of April 18 in this docket that the Commission recognizes how deficient the application is. Nevertheless, the Commission did not stop the 180-day time clock on the merger. It should do so. The fact that the Commission made a 12-page request asking for such basic information as how many special access circuits SBC and AT&T provide and what their peering policies are demonstrates that the application is seriously defective. Just as the Commission stopped the clock on the WorldCom-Sprint merger, it should do so here.[14]

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[13] *See SBC/Ameritech Merger Order*, 14 FCC Rcd at 14738 (¶ 49) (emphasis added) *citing Applications of NYNEX Corp., Transferor, and Bell Atlantic Corp., Transferee for Consent to Transfer Control of NYNEX Corp. and its Subsidiaries*, Memorandum Opinion and Order, 12 FCC Rcd 19985 (¶ 2) (1997) ("*Bell Atlantic/NYNEX Order*"). In applying the public interest test, the Commission's analysis focuses on "four overriding questions: (1) whether the transaction would result in a violation of the Communications Act or any other applicable statutory provision; (2) whether the transaction would result in a violation of the Commission's rules; (3) whether the transaction would substantially frustrate or impair the Commission's implementation or enforcement of the Communications Act, or would interfere with the objective of that and other statutes; and (4) whether the merger promises to yield affirmative public interest benefits." *Id.* at 14737-48 (¶ 48).

[14] *See* Letter from Michelle Carey, Chief, Policy and Program Planning Division, Common Carrier Bureau, Federal Communications Commission, to Magalie Roman

The Special Access Market. Despite the applicants' assertions about the high degree of competition in the special access market, the reality is that the merger will eliminate much of the limited competition existing in the special access market today. Indeed, the merger will lead to even greater concentration in a market that currently enjoys only limited competition. The net effect will be poorer service quality and higher rates for special access circuits. The merger also will enhance opportunities for collusion between SBC and Verizon over the rates they pay for special access outside of their respective regions.

SBC and AT&T presented no evidence and virtually no discussion of special access in their application. This is in contrast to Verizon and MCI, which presented inadequate evidence, but at least devoted several pages of their application and two declarations to special access issues. Indeed, while the SBC-AT&T application contains some qualitative information regarding the applicants' view of the special access market today, the application largely relies on a summary of the Commission's existing regulatory framework for special access. In essence, the applicants try to assure the Commission that the special access market is vibrantly competitive based on the fact that the Commission has granted SBC pricing flexibility for interstate special access services in several areas. Notably missing from the application, however, is any quantitative data concerning the actual level of competition in the special access market today, and how that competition will be diminished when AT&T – a carrier that SBC has previously

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Salas, Secretary, Federal Communications Commission, CC Docket 99-333 (Apr. 19, 2000).

portrayed as one of its most significant competitors in the special access market – is acquired by SBC.

The Internet Backbone Market. To alleviate concerns about concentration in the Internet backbone market, the applicants' public interest statement asserts that the combined entity's market share would not be as large as the WorldCom market share that prompted concerns by the U.S. Department of Justice and the FCC in the proposed WorldCom-Sprint merger.[15] But the data that the applicants have submitted is incomplete or inappropriate for at least four reasons.[16]

First, the data – which were compiled in 2003 – are outdated. Indeed, AT&T may be the largest Internet backbone provider in the market today.[17] And SBC has grown rapidly since 2003.

Second, the applicants provided data that shows only a single point in time. The data does not provide any information about dynamic trends. SBC has been authorized to offer in-region, long distance service for only a few years. Even the 2003 data show that SBC went from nothing to being a serious player in only two years after getting Section 271 approval in all of its in-region states. The development of SBC into a Tier-1 peer in that short period of time shows the power of its position as a local provider in negotiating peering arrangements with existing Internet backbone providers, and suggests that it will continue to grow quickly.

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[15] *See Public Interest Statement* at 107-108.

[16] *See* Declaration of Dr. Mathew P. Dovens at ¶ 25 ("Dovens Declaration").

[17] *See id.* at ¶ 26.

Third, the applicants have not projected their growth into the future, taking into account the growth in VoIP traffic they intend to provide. Such data could show that the merged entity will quickly exceed the size criteria that previously have been applied to stop mergers.

Fourth, the applicants' data fail to capture the distinction between eyeball-heavy and content-heavy networks. The applicants have not focused on the one criterion – traffic ratios – on which AT&T is currently seeking to de-peer competitors, even though the merged entity could seize on that criterion to dominate the Internet backbone market along with Verizon-MCI. Thus, applicants' reliance on pure market share data is significantly incomplete.

The Commission should make clear to the applicants that, in responding to the recent data request, a description of the "type" of customers the applicants serve will not be adequate if they fail to distinguish between eyeball and content customers. In addition, the Commission should require the applicants to provide the data the Commission has requested for 2004 by quarter (and to provide quarterly updates while the merger is pending) so that dynamic trends can be evaluated. And the applicants' discussion of their peering policies should include a description of the steps they have taken or plan to take to de-peer competitors.

B. The Commission Should Be Skeptical of the Applicants' Claim that the Merger Will Enhance Competition.

The applicants claim the merger will benefit the public by making SBC a robust competitor that can compete on a national and global basis.[18] As an initial matter, if SBC

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[18] *See Public Interest Statement* at v.

and AT&T alone are not capable of providing competitive telecommunications services without combining, it is not clear who – if anyone – can. Clearly, under their view – in which AT&T is not capable of providing competitive local service without SBC and SBC is not capable of providing competitive service to medium and large businesses without AT&T – there is no basis on which to think that any other company (save, perhaps, the merged Verizon-MCI) could provide competitive service. Indeed, the applicants hardly disguise their view that the current goal of vibrant competition in all telecommunications markets should be replaced with a system of regional monopolies, with limited competition in residential markets provided by cable operators.

In any event, the Commission should be very skeptical of SBC's claims that it must acquire its competitors in order to compete outside its footprint. SBC previously justified its acquisition of Pacific Telesis,[19] Southern New England Telephone,[20] and Ameritech[21] – mergers that gave SBC approximately one-third of the nation's access lines – on the grounds that it had to purchase additional facilities to be able to compete out-of-region. SBC, for example, defended its acquisition of Ameritech on the basis that the merger was necessary to promote SBC's entry into new markets. Yet five years after that transaction was consummated, and despite merger conditions that required SBC to

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[19] *See Applications of Pacific Telesis Group, Transferor, and SBC Communications, Inc., Transferee, For Consent to Transfer Control of Pacific Telesis Group and Its Subsidiaries*, Memorandum Opinion and Order, 12 FCC Rcd 2624, 2638 (¶ 27) (1997)

[20] *Applications for Consent to the Transfer of Control of Licenses and Section 214 Authorizations from Southern New England Telephone, Transferor, to SBC Communications Inc., Transferee*, 13 FCC Rcd 21292, 21301 (¶¶ 18-19) (1998).

[21] *See SBC/Ameritech Merger Order*, 14 FCC Rcd at 14839-40 (¶ 295).

enter out-of-region markets, SBC has done little to compete against its sister companies. Instead, as a former CEO of AT&T explained in response to the SBC-Ameritech merger,

> When it comes to mergers between the Bells, we've heard it all before. We heard SBC promise increased competition when it bought Pacific Telesis. It didn't happen. SBC promised more market opening competition when it announced its purchase of Southern New England Telephone. It didn't happen. We heard Ameritech say that it would compete with SBC in St. Louis. Now, SBC wants to buy Ameritech – instead of expanding competition, these two companies have found a way to expand their monopoly reach and control.[22]

Based on its track record, there is simply no reason to think that SBC will change its past behavior and compete vigorously out-of-region after it acquires AT&T. Thus, the Commission should take applicants' assertion that "the merger will *enhance* competition outside of SBC's region" with a grain of salt. The real purpose of this merger is to re-establish SBC's local monopoly within its 13-state footprint, and extend its reach to new markets, including the long distance and enterprise business market within its region and the Internet backbone market.

Moreover, as the Commission has found, "[m]arket performance can also be adversely affected if a merger increases the potential for coordinated interaction by firms remaining in the post-merger market."[23] Coordinated interaction occurs when a group of firms engages in conduct that is profitable to each firm because of the accommodating reactions of all the others.[24] The two mega-mergers currently proposed are likely to significantly increase the likelihood of coordinated interaction between SBC and

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[22] News Release, AT&T, "AT&T Chairman says Bell mergers should be rejected" (Sept. 29, 1998), *available at* http://att.com/news/0998/980929.cha.html.

[23] *Bell Atlantic/NYNEX Order*, 12 FCC Rcd at 20046 (¶ 121).

[24] *See id* at 20047 (¶ 121).

Verizon. For instance, after the merger, SBC-AT&T likely will focus on serving large business customers headquartered or with large presences in its region, and Verizon-MCI likely will focus on serving large business customers headquartered or with large presences in its region. For those legacy AT&T customers that are located in Verizon's region, Verizon could provide SBC with preferential special access rates and performance, if SBC returned the favor for the legacy MCI customers located within SBC's region. Both firms would clearly be better off if they tacitly agree to provide each with superior special access and not compete in one another's region than if they engage in vigorous competition. The net result is that the merger will make it much easier and more likely that SBC and Verizon will continue to avoid competing with each other, to the ultimate detriment of consumers.

In short, the applicants cannot demonstrate, as they must to obtain approval, that the merger will yield affirmative public interest benefits. To the contrary, as further discussed below, the merger is likely substantially to frustrate or impair the Commission's implementation of the Communications Act by increasing prices and decreasing service levels in the special access market and by permitting the merged entity to de-peer competing Internet backbone providers. Accordingly, the Commission should not approve the merger as proposed.

V. THE MERGER WILL HARM THE SPECIAL ACCESS MARKET.

A. AT&T Exerts a Disciplining Effect on SBC's Special Access Pricing.

Broadwing and SAVVIS need special access services to connect their end-user customers to their network points of presence. As a practical matter, Broadwing and SAVVIS always purchase these services from a third-party provider. Broadwing and SAVVIS cannot self-provision their own loop facilities because, as AT&T previously

explained to the Commission, "building alternative loop and transport facilities is, in most instances, fundamentally uneconomic."[25] Due to the tremendous capital investment required, the Commission itself expressly acknowledged that there are large sunk costs and economies of scale associated with the deployment of loop facilities which, along with other operational barriers, prevent competitive carriers from entering the special access market to compete with the BOCs except in a few locations.[26]

AT&T and MCI are the BOCs' primary, and in many cases only, competitors. Although special access facilities that AT&T and MCI own reach only a fraction of the buildings served by the BOCs, they reach many more buildings than any other company and normally reach the larger buildings in an area. For example, as shown by the data below, there are approximately 429 connections to enterprise buildings by providers other than SBC within the Chicago MSA.[27] Of the total number of connections provided by competitors, AT&T and MCI serve more than one-half. By contrast, the next largest provider – XO – only serves 72 buildings, or about 17 percent. The same trend is evident with regard to "lit" LEC serving wire centers. Of the 53 LEC wire centers that are served by competitive carriers, AT&T serves an astounding 92 percent, and MCI serves more than one-half. These figures overshadow XO, the next largest provider with only 14 "lit" serving wire centers.

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[25] *AT&T Petition for Rulemaking* at 25.

[26] *See Unbundled Access to Network Elements; Review of Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers*, Order on Remand, WC Docket No. 04-313 (¶¶ 150, 151) (rel. Feb. 4, 2005) ("*Triennial Review Remand Order*").

[27] *See* Declaration of Mark Pietro at ¶ 10 ("Pietro Declaration").

Company	Lit Buildings	Lit LEC SWCs
MCI	253	29
AT&T	239	49
XO	72	14
LGN	24	6
On-Fiber	16	
FiberNet	8	
Time Warner	4	2
ICG	1	
Total:	429	53

In addition to the circuits they own, known as "Type 1" circuits, AT&T and MCI also lease many special access circuits from the BOCs and resell these "Type 2" circuits. In fact, it appears that approximately 75% of the special access circuits AT&T and MCI sell to third parties are Type 2 circuits.

While imperfect, the competition provided by AT&T and MCI has had some disciplining effect on the special access rates charged by the BOCs. The BOCs typically establish rates for special access circuits based on a carrier's "buy" rate throughout the BOC's region.[28] In other words, the BOCs provide a sliding scale discount off their tariffed rates if the buyer commits to purchasing a set monetary amount of special access services each month, usually for a term of one, three, or five years. A large IXC such as AT&T buys many more special access circuits per month *from each BOC* than companies like SAVVIS and Broadwing. As the largest customer of SBC for special access, AT&T should be able to command the best available discount on special access. Moreover, AT&T has a large amount of internal capacity in its network due its

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[28] *See* Gary Zimmerman Declaration at ¶ 11 ("Zimmerman Declaration"); *see also Triennial Review Remand Order*, (¶ 56) (finding that "incumbent LECs generally offer incentive plans [for special access] that offer greater discounts to competitive LECs willing to commit to maintaining a given quantity of tariffed offerings.").

acquisition of TCG, a competitive access provider with significant metro fiber facilities. Thus, unlike most other companies, AT&T sometimes has a choice between using or extending its own special access circuits or purchasing circuits from the BOC.

AT&T's volume of demand, combined with the implicit threat that AT&T could deploy more circuits of its own, exerts some discipline on SBC's access rates in general. Moreover, it allows a company such as SAVVIS, which does not have the volume of demand for a similar discount, to leverage AT&T's buy rate to receive a lower price for special access than if it bought directly from the BOC.[29]

Rather than purchase resold circuits from AT&T or MCI, Broadwing purchases large quantities of circuits from the BOCs in order to obtain the best volume discount possible from them. That choice comes at a price, however. First and foremost, to receive a discount off the normal tariffed rate for special access, the BOCs require purchasers to maintain a fixed level of spending with the BOC pursuant to a long-term contract (again, generally for a term of one, three, or five years) for all of their special access circuits within the BOC's region.[30] If Broadwing attempts to purchase special access from competitive carriers on routes where the BOC faces competition, and its overall spend falls below the level required by the contract, Broadwing will be required to make up the shortfall under the contract's "take or pay" provision.[31] The natural

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[29] *See* Zimmerman Declaration at ¶ 12.

[30] Indeed, while Broadwing and SAVVIS define the market for special access on a route-by-route basis, the BOCs have effectively redefined the market for special access as the BOCs' entire region. This is because the BOCs, which are the only supplier that can satisfy a carrier's entire demand, only provide a discount off the tariffed rate if a carrier purchases special access on a regional, rather than a route-by-route, basis.

[31] *See* Pietro Declaration at ¶ 9.

consequence – and the consequence intended by the BOCs – is that it is difficult for Broadwing to procure special access circuits from a competitive provider, even in locations where competitive providers have deployed facilities.

Second, BOCs frequently offer discounts on special access along routes where no competitive facilities are available on the condition that purchasers buy special access services along routes where competitive alternatives do exist.[32] In other words, the only way to receive a discount on the non-competitive route is to buy from the BOC along the competitive route. Finally, BOCs sometimes offer discounts on special access if a purchaser transfers business from a CLEC to the BOC. For instance, in Broadwing's prior contract with SBC, Broadwing had to commit to moving four percent of its special access circuits from competitors to SBC in order to qualify for a discount off the normal tariffed rate for special access.[33] It is clear that the underlying purpose of such requirements is to eliminate demand for alternatives to BOC special access. In short, the BOCs have manipulated their pricing structures to penalize carriers such as Broadwing if they attempt to purchase special access from a competitive carrier.

B. The Merger Will Reduce the Supply of Special Access Circuits.

Broadwing recently explored the possibility of moving some of its circuits to competitors. Broadwing currently obtains most of its special access circuits in Verizon territory from the incumbent – approximately 10,000 of the 10,500 circuits it uses in Verizon territory – pursuant to a contract that provides Broadwing with a discount off the

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[32] *See, e.g., AT&T Corp. Petition for Rulemaking to Reform Regulation of Incumbent Local Exchange Carrier Rates for Interstate Special Access Services,* Reply Comments of WorldCom, RM No. 10593, Declaration of Michael D. Pelcovits at 12-13 (filed Jan. 23, 2003).

[33] *See* Pietro Declaration at ¶ 9.

tariffed rate. Broadwing issued a request for proposals in December 2004 to determine if it could use other carriers on some of those routes, and it sent the RFP to about a dozen carriers. The only responses that were at all useful were from MCI and AT&T. Yet MCI could serve less than 20 percent of the routes from Broadwing's POPs to Verizon central offices. AT&T provided a substantial list of buildings that it reached with its own network facilities – although its list was far shorter than the total number of buildings served by Verizon. No other carrier could serve more than a tiny percentage (usually one or two percent) of Broadwing's special access needs.[34] This RFP experience confirms that AT&T and MCI are the primary competitors to the BOCs in the special access market.

Broadwing's experience is not unique to the Verizon region, however. Today, throughout SBC's 13-state region, there are only two primary providers of special access circuits, in addition to SBC: AT&T and MCI. Sprint is a distant third. SBC itself has acknowledged that AT&T and MCI are its two largest competitors.[35] The merger will therefore reduce competitive provision of special access facilities in the SBC region from three potential suppliers to two.[36] The courts have generally condemned mergers that

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[34] *See* Pietro Declaration at ¶¶ 11-16.

[35] *See, e.g., AT&T Corp. Petition for Rulemaking to Reform Regulation of Incumbent Local Exchange Carrier Rates for Interstate Special Access Services,* Opposition of SBC Communications, Inc., RM No. 10593, at 13-14 (filed Dec. 2, 2002); *see also Ex Parte* Presentation by SBC Communications, Inc., RM No. 10593, CC Docket No. 01-338 and WC Docket No. 04-313, at 4 (filed Dec. 3, 2004).

[36] Even though Sprint is a large IXC, it has far fewer self-provisioned special access circuits than the large IXCs. This is because Sprint never purchased a competitive access provider, unlike AT&T (which acquired TCG) and MCI (which acquired MFS). Thus, Sprint is not a major competitor to the BOC in the special access market.

result in such a duopoly.[37] And as the Commission has previously found, when the number of competitors in a market declines from three to two, "[s]uch a drastic reduction in the number of competitors and concomitant increase in concentration create a strong presumption of significant anti-competitive effects."[38]

Indeed, if the SBC-AT&T merger is consummated, AT&T will no longer be able to exert any discipline over SBC's rates. Moreover, companies such as SAVVIS likely will no longer be able to leverage AT&T's volume discount into better rates and terms for special access, because AT&T might no longer resell Type 2 special access circuits. The net effect is that the vast majority of customers for special access will see prices increase within the SBC region. This is particularly true because, as the Commission has recognized, the large sunk costs and economies of scale associated with the deployment of loop and transport facilities make it unlikely that competitive carriers will enter the market to replace AT&T.[39]

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[37] *See, e.g., FTC v. H.J. Heinz*, 246 F.3d 708 (D.C. Cir. 2001) (rejecting the district court's finding that that a merger between the second and third largest firms in the baby food market would increase the ability of the merged firm to compete with the number one firm); *FTC v. Staples*, 970 F.Supp. 1066, 1081 (D.D.C. 1997) (enjoining the merger of two competing office supply superstores where the merger would have left only one superstore competitor in 15 metropolitan areas and only two competing superstores in 27 other areas); *FTC v. Swedish Match*, 131 F.Supp.2d 151 (D.D.C. 2000) (enjoining proposed merger of the first and third largest producers of loose-leaf tobacco).

[38] *Application of EchoStar Communications Corporation (a Nevada Corporation), General Motors Corporation, and Hughes Electronics Corporation (Delaware Corporations) (Transferors) and EchoStar Communications Corporation (a Delaware Corporation), Transferee*, Hearing Designation Order, 17 FCC Rcd 20559, 20604 (¶ 99) (2002) ("*DirecTV-EchoStar Merger Order*").

[39] *See Triennial Review Remand Order*, ¶¶ 72, 150.

More troubling still, the number of suppliers might actually decrease to one (the incumbent) if SBC and Verizon fail to compete with one another out-of-region after their respective mergers. This should be a significant concern to the Commission. As explained earlier, in both the SBC-Ameritech and Bell Atlantic-GTE mergers, the BOCs argued that the transactions were in the public interest because they would serve as a catalyst for out-of-region competition. More than five years after the mergers, however, significant out-of-region competition has failed to materialize. The Commission imposed conditions on those mergers because, by "reducing the number of major incumbent LECs, the merger[s] also increase[] the risk that the remaining firms will collude, either explicitly or tacitly."[40] And as the Commission recognized, "collusion is more likely to occur where only a few participants comprise a market and entry is relatively difficult."[41]

We could not have said it any better and it is precisely the case here. Upon consummation of the merger, the number of special access providers will immediately drop from three to two within most portions of SBC's 13-state region, and the same will be true in Verizon's territory. Thus, consistent with their past behavior, there is a strong likelihood that Verizon will tacitly agree to quit providing special access facilities to third parties within SBC's footprint if SBC tacitly agrees to quit providing special access facilities to third parties in Verizon's footprint. And as the sole remaining provider of

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[40] *SBC/Ameritech Merger Order*, 14 FCC Rcd. at 14762 (¶ 104).

[41] *Id.* at 14768-69 (¶ 121); *see also id.* at 14785 (¶ 156) ("The proposed merger, by reducing to five the number of major incumbent LECs, also would increase the incentive and ability of the remaining incumbents to coordinate their behavior, either explicitly or implicitly, to impede benchmarking and resist market-opening measures."); *see id.* at 14785-86 (¶ 158)

special access circuits throughout its entire region, SBC will able to reduce service quality and raise rates to its retail competitors.

The Commission previously found that the "existing antitrust doctrine suggests that a merger to duopoly or monopoly faces a strong presumption of illegality."[42] Where, as here, "a proposed merger would result in a significant increase in concentration in an already concentrated market, parties advocating the merger will be required to demonstrate that claimed efficiencies are particularly large, cognizable, and non-speculative."[43] The applicants have failed to make such a showing.

C. The Merger Will Result in a Price Squeeze.

Within its 13-state region, SBC will have every incentive and the ability to engineer a price squeeze that benefits the newly integrated AT&T operations. Special access is a key input into telecommunications and Internet services provided by Broadwing. Special access also is an essential input into the IP VPN and Internet access services provided by SAVVIS. In fact, for both companies special access is between 40 percent and 60 percent of the cost of serving their enterprise customers.

Once SBC acquires AT&T, it will compete with non-affiliated providers, such as Broadwing and SAVVIS, that also ultimately depend on SBC for interstate special access circuits. As is not unusual, Broadwing and SAVVIS are both customers of AT&T for special access circuits but also competitors in the IP VPN and interexchange services markets, respectively. The acquisition of AT&T thus provides SBC with the opportunity and incentive to weaken its new competitors' competitive position by overcharging them

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[42] *DirecTV-EchoStar Merger Order*, 17 FCC Rcd at 20605 (¶ 103)

[43] *Id.*

for special access. An increase in price for special access circuits (or indeed the same price that AT&T currently charges for which SBC is receiving a profit) will provide AT&T with a strategic cost advantage that is not related to efficiency, but rather preferential treatment by its parent. As a result of this discriminatory behavior, SBC-AT&T will be able to make the services of non-affiliated carriers, such as Broadwing and SAVVIS, non-competitive with its product offerings.

Indeed, according to data submitted by AT&T in its petition to reform the regulation of BOC special access rates, SBC will not need to raise prices, but may merely maintain its current prices, in order to squeeze competitors. AT&T concluded, based on an analysis of ARMIS data, that the BOCs' returns on interstate special access have nearly tripled since 1996, resulting in a rate of return of more than 50 percent for SBC.[44] Even though the BOCs special access circuits are currently subject to price cap regulation, and not rate-of-return regulation, for 2001, the BOCs' returns on special access exceeded the Commission-established 11.25 percent rate of return by almost $5 billion.[45] More troubling still, the BOCs have *raised* special access rates in every MSA in which they have received "Phase II" pricing flexibility from the Commission.[46] As AT&T concluded, it appears that the BOCs are charging far more than their cost of providing special access plus a reasonable profit.[47]

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[44] *See AT&T Petition for Rulemaking* at 3-4.

[45] *See id.* at 8.

[46] *See id.* at 12.

[47] The Commission declined to conclude, on the basis of AT&T's data, that "every special access rate" charged by BOCs with pricing flexibility "violates section 201," noting that AT&T relied on only one year's data. *Special Access Rates for Price Cap Local Exchange Carriers; AT&T Corp. Petition for Rulemaking to Reform*

The real cost of special access to a competitor that must rely on SBC is the cost SBC charges it. The real cost of special access provisioned by SBC to itself, however, is its forward-looking economic cost. If SBC's rates exceed those costs – and there is good reason to think they already do – competitors will be squeezed.

The SBC-AT&T and Verizon-MCI mergers also could result in anti-competitive agreements for special access pricing outside of each BOC's respective region. The mergers, if consummated, would create two players with huge volumes of special access circuits. Based on their enormous buy rates, each BOC could offer the other deeply discounted special access services out-of-region. But no other carrier would be able to qualify for these sweetheart deals because they will never have the same volume of traffic as the BOCs. Hence, non-affiliated entities like Broadwing and SAVVIS would not be able to compete on price because SBC-AT&T and Verizon-MCI would have lower input costs even outside their regions.[48]

D. Special Access Performance Will Deteriorate as a Result of the Merger.

In the short term, the acquisition of AT&T by SBC will likely degrade special access service quality for non-affiliated entities.[49] After AT&T acquired TCG, it flooded TCG with orders for special access circuits as it tried to move its customers on-net to the TCG network. As a result, the amount of time it took for customers to obtain delivery of

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Regulation of Incumbent Local Exchange Carrier Rules for Interstate Special Access Services, Order and Notice of Proposed Rulemaking, 20 FCC Rcd. 1994, ¶¶ 129, 130 (rel. Jan. 31, 2005). But the Commission acknowledged that the "further development of evidence" might justify "interim relief" and "broad reforms." *Id*. at ¶ 130. SBC and AT&T should be required to supplement the data AT&T supplied in October 2002.

[48] *See* Zimmerman Declaration at ¶ 18.

[49] *See id.* at ¶ 17.

new circuits from TCG increased dramatically. If SBC uses the same strategy, the net result likely will be that service to non-affiliated entities will decline. Companies such as Broadwing and SAVVIS will be rendered non-competitive if they are not be able to provide service to their end user customers within the same timeframe, and at the same level of service quality, as SBC.

Special access performance for non-affiliated companies is also likely to worsen in the long term. Just as SBC has an incentive to raise its rivals' costs by increasing the rates for special access circuits, it also has an incentive to degrade its rivals' performance by providing inferior quality special access circuits. The BOCs already provide inferior quality special access services to non-affiliated entities, as shown by the Section 272 audits that have been conducted. While seriously flawed in SBC's favor, SBC's first Section 272 audit report nevertheless showed that SBC regularly provided its own long distance affiliate with superior performance for three of the special access performance measurements that the auditor tested, in all three states that were examined. First, SBC provisioned special access circuits by the customer's desired due date for itself and its long distance affiliate more frequently than it met the desired due date for non-affiliated entities.[50] Second, SBC returned Firm Order Confirmations ("FOCs") for DS1 and DS3 circuits more quickly to its long distance affiliate and itself than to non-affiliated entities.[51] And third, when a trouble report was received on a special access circuit, SBC

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[50] *See* Exhibit C, Attachment A-7 (Performance Measurement 1).

[51] *See id.*, (Performance Measurement 3).

restored service more quickly to itself and its long distance affiliate than to non-affiliated entities.[52]

The same troubling trends continued through SBC's second Section 272 audit, which covered several additional states, including California. Once again, on behalf of itself and its affiliates, SBC regularly met customer desired due dates more frequently, returned FOCs more quickly, and responded to trouble reports in a shorter timeframe than it did for non-affiliated companies.[53] Upon acquiring AT&T and its major presence in the interexchange and IP VPN markets, SBC will have the incentive and the ability to discriminate against its rivals. Indeed, there was less danger that SBC would degrade its wholesale customers' performance when SBC was just entering the long distance market with a small market share. For SBC to engage in this behavior after acquiring the largest long distance provider poses even greater harm to the future of competition.

E. The Commission Should Not Approve the Merger Without Strict Conditions to Protect Consumers of Special Access Services.

The merger between SBC and AT&T will result in greater concentration in the special access market within SBC's 13-state region, reducing the number of suppliers of special access services from three to two, or perhaps even from three to one if SBC and Verizon tacitly agree not to compete with one another outside their respective regions. Greater concentration in the special access market will result in higher rates and poorer service quality for special access. Moreover, SBC will have an even greater incentive to discriminate against non-affiliated companies – both in terms of price and performance – after the merger.

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[52] *See id.* (Performance Measurements 4 and 5).

[53] *See* Exhibit D, Attachment A-7, (Performance Measurements 1, 3 and 5).

Special access is a key input into local, long distance, and data services because it provides the essential connection between the customer's premises to their service provider's network. Thus, SBC will be able to create a competitive advantage for its new affiliate, AT&T, by both charging non-affiliated companies higher rates and providing them with inferior service for special access.[54] For these reasons, the merger will not serve the public interest and should not be approved without adequate conditions to protect competition.

For example, the Commission should require divestiture or impose other conditions to preserve and enhance competition in the special access market. SBC has attempted to dodge possible concerns about the effects of the merger on the special access market by asserting that "[t]he regulation of ILEC provision of special access services is an industry-wide issue," and as such, it is "not within the scope of merger proceedings."[55] Instead, according to SBC, issues concerning special access "should be reserved for rulemakings of general applicability."[56] That is not so. As the result of the merger, Broadwing and SAVVIS will immediately lose one major supplier of special access circuits whose presence disciplines SBC's rates. That will allow SBC, as the largest remaining supplier of special access services within its footprint, to raise rates and degrade service, to the advantage of itself and its new affiliate, AT&T. Hence, Broadwing and SAVVIS have concerns about special access that are *specific to the*

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[54] Moreover, to the extent that AT&T merely pays a rate for special access that is based on SBC's costs to provide special access, it will have a significant competitive advantage over non-affiliated carriers that do not enjoy cost-based rates.

[55] *SBC Public Interest Showing* at 103.

[56] *Id.* at 104.

merger. As such, it would be inappropriate for the Commission to defer resolution of merger-specific concerns to a broader rulemaking docket. Broadwing and SAVVIS will suffer substantial harm if they were forced to wait for the Commission to resolve its rulemakings on special access pricing and performance measures, the latter of which has been pending since 2001.

If the Commission approves the merger, it will be necessary to: (1) impose conditions ensuring that competitors will be able to obtain special access at the same rates and on the same terms that the merged entity provides special access to itself; and (2) order divestitures that ensure the survival of a viable entity providing the special access alternatives that AT&T provides today. To fully analyze these alternatives, Broadwing and SAVVIS need the data the Commission recently ordered the applicants to provide.

VI. THE SBC-AT&T MERGER WILL HARM COMPETITION IN THE MARKET FOR INTERNET BACKBONE SERVICES.

The proposed SBC-AT&T merger (along with the proposed Verizon-MCI merger) gravely threatens the currently competitive market for Internet backbone services. Broadwing and SAVVIS believe that if these mergers are consummated without conditions, the current market of numerous similarly-sized "peers" will become a duopoly dominated by two "mega-peers." These newly-created mega-peers will be able to exploit two forms of market power. *First*, they will have power over their rivals, such as Broadwing and SAVVIS, who will be forced to purchase transit or paid for peering at inflated, anti-competitive prices. *Second*, they will have power over their customers, the content-providers and ISPs that must purchase backbone services in order to access the Internet. The ultimate losers, of course, will be the millions of American consumers and businesses that have come to expect and rely upon low-cost Internet connectivity.

Moreover, SBC and AT&T's limited efforts to address the public interest implications of their proposed merger sidestep the real issues. The companies' public interest statements and declarations rely on incomplete and outdated data and an analytical framework that may have been applicable to the Internet backbone market *circa* 1998-2001, but that fundamentally misunderstands today's marketplace.

A. Backbone Services are a Separate Relevant Product Market That is Essential to the Functioning of the Internet.

Broadwing and SAVVIS own and/or operate high-speed fiber networks that span the entire United States, as well as parts of Europe and Asia in the case of SAVVIS. Using these networks, both companies are substantial providers of Internet backbone services. The Commission has explained that Internet backbone service providers constitute one of the "three classes of participants" in the physical transmission of information across the Internet.[57] The first class consists of end users, who originate and receive traffic in the form of IP packets. The second class consists of ISPs that transport packets the short distance between end users and the nearest Internet network node. The third class is composed of Internet backbone providers, companies like Broadwing and SAVVIS whose high-capacity "pipes" pick up packets from ISPs and carry them across the country or even the globe to deliver them to other ISPs for last mile delivery to the recipient end user. The Commission has recognized that "Internet backbone services . . . constitute[] a separate relevant product market" for merger evaluation purposes.[58] Indeed, because backbone transmission service is "essential" to the functioning of the

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[57] *Application of WorldCom, Inc. and MCI Communications Corp. for Transfer of Control of MCI Communications Corp. to WorldCom, Inc.*, Memorandum Opinion and Order, 13 FCC Rcd 18025, 18104 (¶¶ 143-44) (1998) ("*MCI/WorldCom Order*").

[58] *Id.* at 18106-07 (¶ 148).

Internet, the Commission has recognized on two occasions (and the Department of Justice has recognized on three occasions) that concentration in this market could seriously harm consumers and is contrary to the public interest.[59]

Broadwing and SAVVIS provide Internet backbone services to two distinct types of customers. The first type transmits and receives what is colloquially known as "eyeball" traffic.[60] The hallmark of such traffic is that incoming quantities are much larger than outgoing quantities. This traffic pattern is due to end users who use their Internet connections, in significant part, to (1) send relatively small Web queries (of a few bytes) to content providers such as CNN.com or Amazon.com and (2) receive, in return, data-heavy Web pages.[61] Typical eyeball customers served by Broadwing and SAVVIS include (1) ISPs that purchase wholesale backbone services in order to provide dial-up and/or cable modem service to consumer and small business end users and (2) large businesses whose employees need Internet connections in order to surf the Web, send external email, and so forth.[62]

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[59] *See id.* at 18105 (¶ 144); *see also Intermedia Communications, Inc., Transferor, and WorldCom, Inc., Transferee, for Consent to Transfer Control of Corporations Holding Commission Licenses and Authorizations Pursuant to Sections 214 and 310(d) of the Communications Act and Parts 21, 63, 90, and 101*, Memorandum Opinion and Order, 16 FCC Rcd 1017 (2001) (*"Intermedia Order"*); *United States v. WorldCom Inc. and Intermedia Communications, Inc.*, Complaint (filed D.D.C., Nov. 17, 2000) (*"Intermedia Complaint"*), *available at* www.usdoj.gov/atr/cases/f7000/7043.htm; *United States v. WorldCom, Inc. and Sprint Corporation*, Complaint (filed D.D.C., June 26, 2000) (*"Sprint Complaint"*), *available at* www.usdoj.gov/atr/cases/f5000/5051.htm.

[60] *See* Dovens Declaration at ¶ 21; Declaration of Dr. Michael Bortz at ¶ 16 ("Bortz Declaration").

[61] *See id.*

[62] *See* Dovens Declaration at ¶¶ 4, 6; Bortz Declaration at ¶ 6. For enterprise customers, Broadwing and SAVVIS typically deliver Internet access directly to customers'

The second type of customer that Broadwing and SAVVIS serve is the content provider, one whose business involves providing text, graphics, and video – usually but not always in the form of a Web page – to end users. Content provider customers exhibit the opposite traffic pattern of eyeball customers – high outgoing flows and low incoming flows. The reason is that content providers receive only small queries from "eyeball" end-users and reply by sending large Web pages or sizeable quantities of data. Both Broadwing and SAVVIS provide Web-hosting services to a wide variety of content providers.[63]

B. The Current Backbone Market Is Composed of Similarly-Sized Entities that Form Pro-Consumer "Peering" Agreements.

Broadwing's and SAVVIS' customers naturally demand the ability to access Internet end users served by other backbone providers. This demand is driven by market expectations and, more fundamentally, by what economists call "direct network effects," meaning that the value of the network increases with each additional user who joins it.[64] For content providers, the larger network means that more people can view their content. And for "eyeballs," the larger network means more content to view and more end users

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workplaces. Formally speaking, this constitutes a bundled service combining both ISP (last mile) and Internet backbone (intra- and inter-national transport) services. *Id.*; *see also MCI/WorldCom Order*, 13 FCC Rcd at 18105 (¶143) ¶ 143 (noting that "[m]any [Internet backbone providers] are vertically integrated and thus are also ISPs").

63 *See* Dovens Declaration at ¶ 4; Bortz Declaration at ¶ 6.

64 *See Sprint Complaint* at ¶ 36; *see generally* Jacques Cremer et al., *Connectivity in the Commercial Internet*, 48 J. Ind. Econ. 433, 458-60 (2000); Nicholas Economides, *The Economics of Networks*, Int'l J. of Ind. Org., Vol 14, No. 2 (1996); Michael L. Katz and Carl Shapiro, *Systems Competition and Network Effects*, J. of Econ. Perspec., Vol. 8, No.2 (1994).

with whom to exchange email and files.[65]

In order to provide their customers with the universal connectivity that they demand, Broadwing and SAVVIS form "peering" arrangements with other backbone providers. Peering is the mechanism that makes the global Internet a single coherent entity, a "network of networks," as encouraged and envisioned by the National Science Foundation in 1989.[66] These peering agreements typically contain three basic provisions.[67] *First*, they allow exchange of traffic only between the backbone provider that serves the originating end user and the backbone provider that serves the terminating end user. These agreements therefore do *not* allow peers to use one backbone provider's network as an intermediate, or "transit," step in reaching an end user served by a different backbone provider. *Second*, they often provide for exchange of traffic on a settlement-free basis, meaning that no money exchanges hands so long as each party honors its specific obligations to terminate the other party's IP traffic. *Third*, they specify "hot potato routing," which means that the networks hand off originating traffic at the first available point of interconnection (nearest the physical origin of the traffic). Under this convention, traffic that originates on one backbone provider's network is carried for most of its journey on the terminating backbone provider's network.

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[65] In addition, Broadwing's and SAVVIS' customers demand high-quality connections, and both companies guarantee certain limits on latency, jitter, and other performance measures through Service Level Agreements ("SLAs") that provide for credits if these guarantees are not met. *See* Dovens Declaration at ¶ 24; Bortz Declaration at ¶ 17.

[66] *See MCI/WorldCom Order*, 13 FCC Rcd at 18105 (¶ 144).

[67] *See* Dovens Declaration at ¶ 9; Bortz Declaration at ¶¶ 8-9.

Broadwing and SAVVIS will peer with any backbone provider network that meets certain specified criteria.[68] Both companies publish their peering criteria on their public Web sites.[69] Though the two companies' criteria vary slightly, the basic requirements are: (1) a national, redundant network operating at OC12 or higher (OC192 in the case of SAVVIS); (2) deployed in eight or nine geographical regions; (3) providing a specified traffic volume; and (4) and with a ratio of outgoing to incoming traffic of no more than 2:1 (2.5:1 in the case of Broadwing).

Companies that are able to connect with the entire Internet through settlement-free peering agreements are known as Tier-1 peers.[70] Whether a particular company is a Tier-1 peer is not a matter of public record, and peering agreements are generally covered by non-disclosure agreements among the contracting parties.[71] Nor are individual companies required to publish their peering policies, though companies such as MCI, Qwest, Teleglobe, Level 3, AOL Transit Data Network, and SBC have elected to do so.[72]

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[68] *See* Dovens Declaration at ¶ 10; Bortz Declaration at ¶ 10.

[69] *See* http://www.broadwing.com/peering/InterconnectPolicy_2004_.doc & http://www.savvis.net/peering/peering_usa.doc.

[70] *See* Dovens Declaration at ¶ 11; *Sprint Complaint* at ¶ 27.

[71] *See Sprint Complaint* at ¶ 27.

[72] *See Verizon-MCI Public Interest Showing*, Kende Declaration Annex D: Publicly available peering policies; *see also* global.mci.com/uunet/peering/; http://www.qwest.com/legal/peering_int.html; http://www.teleglobe.ca/fr/our_network/peering_policy_for_as6453.pdf; http://www.level3.com/press/1890.html; http://www.atdn.net/settlement_free_int.shtml; http://www.sbcbackbone.net/peering/#public

MCI and AT&T's experts agree that their networks are among the existing Tier-1 peers.[73] And while SBC's expert asserts that its network is not a Tier-1 peer because it lacks settlement-free peering agreements with "some" existing Tier-1 peers, he concedes in the same breath that "I do not wish to overstate the significance of SBC's not being a 'Tier 1' [Internet backbone provider]."[74] In fact, SBC meets the published criteria of Broadwing and SAVVIS' peering policies and is thought of as a Tier-1 peer by knowledgeable industry observers.[75] Finally, although Verizon's regional network carries enough traffic to earn it the fourth largest revenue share in the country from Internet backbone services, Verizon is not currently viewed as a Tier-1 peer because its network is not sufficiently built out on a nationwide basis.[76]

A company that does not meet a particular backbone provider's peering policy may enter into a paid peering agreement or a transit agreement with a Tier-1 backbone provider, which entails paying a per-volume fee for originating and terminating traffic.[77] Transit customers need only sign one transit agreement in order to reach the entire

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[73] *See Public Interest Showing,* Schwartz Declaration at ¶ 20; *Verizon-MCI Public Interest Showing,* Kende Declaration at ¶ 2.

[74] Schwartz Declaration at ¶ 30.

[75] *See* Dovens Declaration at ¶ 11.

[76] *See Public Interest Showing,* Schwartz Declaration at Table 3; *Public Interest Showing,* Lack/Pilgrim Declaration at ¶ 17; Dovens Declaration at ¶ 11.

[77] *See generally Sprint Complaint* at ¶¶ 28-30. Less commonly, companies that fail to meet a particular backbone provider's peering policy may also reach a so-called paid-peering agreement, which gives it all the same rights as in an ordinary peering agreement but with a per-volume fee. *See* Dovens Declaration ¶ 12. Importantly, a company that forms paid-peering agreements must do so with *each* backbone provider that it needs to connect to, because the no-transit rule will prevent it from using a peering relationship with one backbone provider to reach the customers of a different backbone provider. *See id.* at ¶13.

Internet (though companies typically sign several in order to achieve redundancy). Backbone providers that are transit customers of a Tier-1 backbone provider thus can be said to "piggyback" on the Tier-1 provider's peering arrangements.

As the Department of Justice recognized when it blocked WorldCom's proposed acquisition of Sprint and of Intermedia's Internet backbone businesses based on concerns over concentration in the backbone market, transit backbone providers "that must purchase a significant amount of connectivity from other [Internet backbone providers] operate at substantial cost disadvantages compared to Tier 1 [Internet backbone providers]."[78] These concerns continue to apply today.[79] Indeed, the most common obstacle to a service provider becoming a Tier 1 Internet backbone provider is the enormous initial investment required to build out a high-capacity nationwide network. Notably, SBC – aided by cash flows from its consumer business – has not been hindered by the costs of attaining national scale. It quickly developed a nationwide network after receiving Section 271 approval, even though doing so required it to lease facilities outside of its existing geographic footprint.[80]

C. A Backbone Market of Similarly-Sized "Peers" Is Efficient and Competitive; A Market with One or Two "Mega-Peers" Is Not.

The current Internet market is competitive and economically efficient without government regulation. As the Commission and Department of Justice have recognized, so long as there is a "rough equality" among Internet backbone providers, each has an incentive to peer with the others to provide the universal connectivity that customers

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[78] *Intermedia Complaint* at ¶ 23; *Sprint Complaint* at ¶ 28.

[79] *See* Dovens Declaration at ¶ 14.

[80] *See Public Interest Showing,* Schwartz Declaration at ¶ 20 & n.14.

demand at low cost.[81] That incentive would change, however, if one or two backbone providers were to become significantly larger than the others, or to develop greater negotiating power.[82] These "mega-peers" would "be able to 'tip' the Internet backbone services market and raise prices for all dedicated access services."[83] As the Department explained in its complaint challenging the WorldCom-Sprint merger:

> Once the market begins to 'tip,' connecting to the dominant network becomes even more important to competitors. This, in turn, enables the dominant network to further raise its rivals' costs, thereby accelerating the tipping effect. As a result of an increase in their costs, rivals may not be able to compete on a long-term basis and may exit the market. If rivals decide to pass on these costs, users of connectivity will respond by selecting the dominant network as their provider. Ultimately, once rivals have been eliminated or reduced to 'customer status,' the dominant network can raise prices to users of its own network beyond competitive levels. Once this occurs, restoring the market to a competitive state often requires extraordinary means, including some form of government regulation.[84]

A market of "peer" backbone providers operates differently than a market with one or two "mega-peers" because of the opposing incentives to peer that backbone providers face. The Commission has explained this tension as follows: On one hand, "[Internet backbone providers] compete with one another [in the downstream market] for

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[81] Address by Constance K. Robinson, Director of Operations and Merger Enforcement, Antitrust Division: U.S. Dep't of Justice, *Network Effects in Telecommunications Mergers: MCI WorldCom Merger: Protecting the Future of the Internet*, at 12 (Aug. 23, 1999) (*"Robinson Speech"*), *available at* www.usdoj.gov/atr/public/speeches/3889.pdf; *see also MCI/WorldCom Order*, 13 FCC Rcd at 18105-07 (¶¶ 144, 148); *Sprint Complaint* at ¶¶ 37-40*; Intermedia Complaint* at ¶¶ 31-34.

[82] *MCI/WorldCom Order*, 13 FCC Rcd at 18107-08 (¶ 149); *Robinson Speech* at 12-13; *Sprint Complaint* at ¶¶ 41-46; *Intermedia Complaint* at ¶¶ 32-33, 37-38.

[83] *Sprint Complaint* ¶ 43.

[84] *Id.* at ¶ 41.

ISP customers" and thus would benefit from eliminating other backbone providers as rivals.[85] On the other hand, backbone providers "must also cooperate with one another, by interconnecting, to offer their end users access to the full range of content and to other end users that are connected to the Internet."[86] Each backbone provider, in short, is a competitor of the other backbone providers, but also has control over an input of crucial importance to its rivals, namely terminating access to its customers.

In a market where each backbone provider derives roughly equal benefit from settlement-free access to other backbone providers' customers, the incentive to cooperate will predominate and the market participants will peer with each other. But if an end to settlement-free peering would hurt one or two backbone providers less than the others, these backbone providers could credibly demand payment instead.[87] The result for customers and other backbone providers would be the vicious cycle the Department of Justice described in its *Sprint Complaint*.

In particular, the Department of Justice has noted that the mega-peer's discrimination against its smaller, defenseless rivals could take two forms. The first and most obvious would be an outright refusal to accept terminating traffic or a demand for economically ruinous paid for peering or transit payments.[88] The mega-peers could apply the technique "on an individual peer-by-peer basis (by picking off the smaller rivals first)."[89] That is, even if the mega-peer were actually forced to stop exchanging traffic

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85 *MCI/WorldCom Order*, 13 FCC Rcd at 18105 (¶ 144).

86 *Id.*

87 *See Robinson Speech* at 12.

88 *See Sprint Complaint* at ¶ 44; *Robinson Speech* at 12-13.

89 *Robinson Speech* at 12-13.

with the victim backbone provider (in order to show the credibility of that threat), its customers would experience only an inability to access a relatively small portion of the Internet.[90] The victimized backbone provider's customers, in contrast, would experience an inability to reach a relatively large portion of the Internet.[91]

If the victimized backbone provider were unwilling or unable to pay the mega peer for peering or for transit, universal connectivity would end and the smaller backbone provider would become isolated – creating what is known as a "black hole" in the Internet.[92] The customers of the victimized backbone provider would experience the unacceptable result of being unable to exchange traffic with any destination on the mega peer's network. Both eyeball users and content providers would leave the victimized provider and migrate to the mega peer, giving that entity a monopoly over both types of customer. This process, if writ large, would balkanize the Internet into isolated islands unable to communicate with each other. In that environment, customers would be compelled to purchase service from the mega-peers, who would continue to exchange traffic with one another.[93] And, as the Department noted, the victimized backbone providers might not even have the ability to bring these tactics to enforcement agencies' attention, since "the nature or existence of . . . interconnection agreements" and "the prices charged" are governed by "strict nondisclosure agreements."[94]

The second technique would not even require the mega-peer to threaten de-

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[90] *See* Dovens Declaration at ¶ 18.

[91] *See id.*

[92] *See id.*

[93] *See id.*

[94] *Sprint Complaint* at ¶ 45.

peering or to demand transit payments. Instead, the mega-peer could merely "fail[] to augment (*e.g.*, by denying, withholding, or 'slow-rolling' requested upgrades) or otherwise degrad[e] the quality of interconnection capacity between peers."[95] As with the direct threat of denying traffic exchange, this technique would have a greater effect on the victimized backbone provider's customers, since they would experience slow transfer speeds when accessing a far greater portion of the Internet. In the short term, this would impose direct costs on the victimized backbone provider because, as discussed above, providers give their customers credits for failure to meet specified service quality levels. And in the long-term, it would lead customers to leave the victimized backbone provider for the higher quality service offered (through artificial means, of course) by the mega-peer.

In three earlier cases – involving MCI, Intermedia, and Sprint – the Department of Justice and the Commission acted to prevent WorldCom from "tipping" the backbone provider market by acquiring Internet backbone assets through mergers.[96] In those cases, brought from 1998-2001, the Department and the Commission focused on overall market share of backbone traffic. They found that, at a minimum, an entity with 37 percent of the market (as measured by Internet traffic carried) cannot be allowed even to

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[95] *Id.* at ¶ 44; *see also MCI/WorldCom Order*, 13 FCC Rcd at 18110 (¶ 149); *Robinson Speech* at 12-13.

[96] *See MCI/WorldCom Order*, 13 FCC Rcd at 18110 (¶ 151) (noting and approving of Department of Justice and the European Commission's 1998 requirement that MCI divest itself of its Internet backbone assets before merger with WorldCom); *Intermedia Order*, 16 FCC Rcd at 1018-20 (¶¶ 3, 6-7) (noting and approving of Department of Justice's 2000 requirements that Intermedia divest itself of its Internet backbone assets before merger with WorldCom). The Sprint-WorldCom merger was never consummated, due to opposition from the Department of Justice and European Commission based on concerns over concentration in the Internet backbone services market. *See generally Sprint Complaint.*

"meaningfully increase[]" its market share through merger.[97] In other words, an entity of that size (or presumably two entities working in concert) could tip the market. Needless to say, this 37 percent figure represents only an upper bound – the Department and the Commission were *not* called upon to decide whether an entity acquiring a lesser share of the market via merger could also seek to tip the market.

By this measure, the mergers contemplated here probably do not pass the public interest test. As noted above, the burden here is on the merging parties to provide data that justifies the merger. SBC and AT&T, however, have not even provided traffic shares for the four relevant entities (SBC, AT&T, Verizon, and MCI) that have the potential to become collusive mega peers. The combined market share figure is essential because BOCs have a history of cooperation and false promises to compete with each other. That is in fact one of the key – though of course officially unacknowledged – business rationales for these mergers.

Once the applicants provide the data the Commission has recently ordered them to provide, it may be possible to assess the merger under prior standards. But even more important – as the next section explains – the marketplace has changed since 1998-2001 so that pure market share is no longer the proper measure of whether backbone providers will peer with each other on a settlement-free basis or will instead hold out for paid for peering or transit arrangements. Therefore, the Commission must be sure to require SBC

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[97] *Intermedia Complaint* at ¶¶ 28-29 (noting WorldCom's 37 percent market share and that "Intermedia is much smaller than WorldCom" and concluding that the proposed merger would tip the Internet backbone services market because it would "meaningfully increase[]" WorldCom's market share).

and AT&T to submit data that addresses the Internet *circa* 2005, not the Internet *circa* 1998-2001 when the WorldCom case law was developed.

D. In Today's Marketplace, a Combined AT&T-SBC (and Verizon-MCI) Would Be a "Mega-Peer" By Monopolizing Eyeballs and Eventually Content, Not Just Overall Traffic.

As discussed above, one of the many requirements of a typical peering policy is that traffic flow between the two networks be in balance to some degree, usually in a band up to about a 2:1 ratio. Though it is not clear that this requirement has a cost basis in the Internet backbone context, it could be used as a pretext for a mega peer or peers to de-peer exiting Tier 1 backbone providers. The reason is that, as also discussed above, traffic balance is greatly influenced by the proportion of eyeball to content provider customers that the backbone provider serves. Broadwing and SAVVIS serve an evenly balanced group of customers, with a proportion of eyeball and content customers that is typical for the industry.[98] The merged SBC-AT&T and Verizon-MCI entities, in contrast, will be extremely "eyeball-heavy" networks, able to exploit that position in the marketplace.

Indeed, as our experts have attested, AT&T is already eyeball-heavy.[99] Combined with AT&T's strength in the enterprise business market and its strong position in the special access market, this gives AT&T an already formidable number of eyeballs. SBC is similar. It has an increasingly dominant position in its geographic footprint in the DSL market.[100] This means even more eyeballs, and very little content. Combining AT&T

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[98] *See* Dovens Declaration at ¶ 23; Bortz Declaration at ¶ 6.

[99] *See* Dovens Declaration at ¶ 22; Bortz Declaration at ¶¶ 17-19.

[100] *See id.*

and SBC will thus not only create an enormous network in terms of overall traffic, but also a massive network serving mostly "eyeballs."

The same is true of MCI and Verizon.[101] MCI already is already eyeball-heavy because of its strengths in the enterprise and special access markets. And Verizon, like SBC, is increasingly dominant in the DSL market within its geographic footprint. Accordingly, the net result of the proposed combinations will be *two* eyeball behemoths. That will lead to anti-competitive concentration in the Internet backbone provider for two distinct reasons.

First, content-heavy or even balanced backbone providers like Broadwing and SAVVIS will generally have very high outgoing to incoming traffic flows with eyeball-dominant networks and will therefore suddenly fail to qualify for peering under traditional criteria. While no network has de-peered SAVVIS or Broadwing on this basis because the other networks do not want to create "black holes" for their customers, it is quite possible that AT&T and/or MCI could seize upon this imbalance to de-peer, or threaten to de-peer, SAVVIS and Broadwing for anti-competitive purposes. Indeed, it appears that AT&T has already initiated such a program. Accordingly, in the post-merger world, there is a real danger that most of the peering arrangements that currently provide for efficient settlement-free traffic exchanges will dissolve. The two eyeball-heavy merged entities will simply peer with each other and charge everyone else transit or demand paid for peering.

De-peering alone would harm consumers because it would drive up competitors' costs since even today's transit prices are high when compared to peering. But the harm

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[101] *See id.*

would be even greater since the behemoths would have little incentive to compete with each other on price, and transit prices accordingly would become even higher than they are now. In other words, unlike in today's competitive marketplace, a market reduced to *two* providers of transit will not price transit efficiently.[102] Rather, the prevailing transit rate will become an inefficient duopolistic rate.[103] Thus, even if history had not taught us to expect anti-competitive cooperation between two BOCs, the economics of a duopoly market provide an independent reason to expect such behavior.

Or, as also noted above, the two BOC entities may instead choose to build their market share by degrading the speed and quality of traffic exchange they offer to peers. The result will be the same – a duopoly with control over the overwhelming majority of consumer and business eyeballs.

The mega-companies might argue that it would be appropriate to de-peer smaller networks with uneven traffic flows because such imbalances impose undue costs on the network carrying more traffic. But AT&T and SBC have not even *attempted* to make such a showing. In any event, in a settlement-free world, if certain kinds of customers cause uneven traffic flows, the backbone provider could adjust its rates to recover from those customers any costs relating to the imbalance. In other words, if eyeball customers lead to higher incoming traffic flows than outgoing that impose undue costs (and SBC-AT&T have made no showing of such costs), the efficient solution is for the backbone provider to charge those eyeball customers the additional costs of delivering their traffic.

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[102] *See* Bortz Declaration at ¶ 14.

[103] *See* United States Department of Justice/Federal Trade Commission, *Horizontal Merger Guidelines*, Section 2 (rev. April 8, 1997), *available at* http://www.usdoj.gov/atr/public/guidelines/horiz_book/hmg1.html.

Second, the eyeball-heavy networks already have a negotiating advantage in the existing marketplace that goes beyond even the issue of traffic flow and reflects significant market power. Because of what economists and antitrust lawyers call the "one monopoly profit" rule, a monopoly (or duopoly) over eyeball backbone traffic is economically equivalent to a monopoly (or duopoly) over all Internet backbone traffic.[104] A simple example is that a company with a monopoly over manufacturing cameras would get no additional advantage from a monopoly over film, since it could already extract the full value of the combined camera *and* film from camera-buyers. Similarly, here, an Internet connection is worth nothing to a content provider if there are no eyeballs to view the provided content. Thus, even if there is robust competition for hosting content providers' traffic, a monopoly over eyeball traffic will still produce all the ills of a broader monopoly.

By concentrating eyeball traffic in two entities with (1) a long history of collusion, and (2) the ordinary duopolistic economic incentives not to compete, the proposed mergers will exacerbate this problem. That is, the proposed mergers combine BOC "last mile" dominance over end-user customers with massive Internet backbone networks. This will essentially allow the BOCs and IXCs to combine their strong presences in the eyeball markets in order to drive out competition in the Internet backbone market as a whole.

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[104] *See, e.g., Town of Concord, Mass. v. Boston Edison Co.*, 915 F.2d 17, 23 & Appendix A (1st Cir. 1990) (Breyer, C.J.) ("'[T]here is but one maximum monopoly profit to be gained from the sale of an end-product.'") (quoting P. Areeda & D. Turner, 3 *Antitrust Law* ¶ 725b at 199); *see also* R. Bork, *The Antitrust Paradox* 229 (1978) ("Vertically related monopolies can take only one monopoly profit"); R. Posner & F. Easterbrook, *Antitrust* 870 (2d ed. 1989) ("There is only one monopoly profit to be made in a chain of production.").

E. A Combined SBC-AT&T's Stranglehold Over the Special Access and Voice Markets Would Cement Its "Mega-Peer" Status in the IP Backbone Market.

As noted above, a combined SBC-AT&T entity (like a combined Verizon-MCI entity) would have a virtual stranglehold over the special access market in its 13-state geographic footprint. SBC-AT&T (and Verizon-MCI) would also serve virtually all of the consumer and business circuit-switched voice consumers in that region. This dominance over special access and circuit-switched voice service – rooted in the BOCs' former status as franchise monopolists with control over local bottleneck facilities – could easily be brought to bear to monopolize the upstream Internet backbone services market. Indeed, as discussed below, the applicants *frankly concede that extending their monopoly to the backbone market is one of the business justifications for the merger*. Because the promised benefits to the applicants' shareholders will come at the expense of consumers and the public interest, however, these considerations provide an additional reason for the Commission to block the proposed mergers or to impose significant conditions on them.

Special Access. The applicants' dominance over the special access market means that the overwhelming majority of business customers wishing to connect to the public Internet within the two BOCs' geographic footprint must do so over facilities owned by the combined SBC-AT&T or Verizon-MCI. This is vertical integration of the most worrisome kind: two backbone providers will have control over the bottleneck facilities needed by their rivals to serve virtually *any* business customer.

Such a situation would be ripe for abuse. To begin with, as discussed in greater detail above, no rival backbone provider could expect reasonable prices or comparable service to what the merged entities would provide themselves. Instead, backbone

providers wishing to provide access service to businesses would find themselves discriminated against at every turn, and eventually they would be forced to cede this market sector to the BOC entities. Even more worrisome, the BOCs could achieve the same result without resorting to anti-competitive discrimination of the sort that would attract the Commission's attention. Instead, they could revise their peering policies to require the ability to send and receive some amount of traffic at central offices – an amount that only SBC and Verizon could satisfy on account of their ownership of in-region bottleneck facilities and the out-of-region special access facilities acquired through merging with AT&T and MCI. The practical result would be de-peering of all but the two resulting mega-peers and for all the reasons discussed above, the ultimate losers would be consumers.

Circuit-Switched Voice Service. The applicants report in their public interest statement that one goal of the merger is to combine the two entities' packet-switched and circuit-switched networks into a "unified, advanced telecommunications network capable of delivering the full range of voice, data, and video services to an ever-expanding array of personal and business devices."[105] As they candidly explain, the chief advantage of doing so is that

> Network integration will result in more traffic being carried entirely on the combined company's network, thus avoiding the latency and reliability issues associated with traversing multiple networks. Network integration, as noted above, will avoid traffic hand-offs at fixed peering points, resulting in an efficiency increase of up to 25 or even 50% over current traffic handling on the SBC network. Decreased latency, improved reliability, and increased 'on-net' routing efficiencies translate not only

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[105] *See Public Interest Showing* at 35.

> into providing customers with better levels of service, but being able to *guarantee* that higher level of service.[106]

Of course, a different way to put the same point is that SBC and AT&T intend to leverage their dominance in the voice market to dominate the IP backbone market as circuit-switched technologies yield to packet-switched technologies. The impact of this transformation on the backbone market is almost impossible to overstate. For example, by the applicants' own expert's reckoning, the combined revenue of all Internet backbone providers was $1.5 billion in 2003.[107] By way of comparison, SBC earned over $24.5 billion of revenue from wireline voice services in 2003[108] and AT&T earned over $22 billion.[109] Obviously, if the applicants transfer even a meaningful *portion* of their voice traffic to their IP network – and their avowed intent is in fact to transfer *all* of it – then they will immediately become a mega peer nonpareil. Indeed, the only entity with a credible chance at matching the applicants' IP traffic volume would be Verizon-MCI. For this reason, the Commission should treat current voice revenue as future IP revenue when calculating the future market shares of the combined entities.

As the applicants' public interest statement correctly suggests, a mega peer with control over such a huge share of IP traffic could easily choose to keep its traffic on-net and deal with any other backbone providers as transit customers rather than Tier-1 peers. And the possibility that Verizon-MCI might be able to roughly match the applicants' traffic volume would be little comfort to consumers. As discussed above, a duopoly of

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[106] *Id.* at 41.

[107] *Public Interest Showing*, Schwartz Declaration, Table 3.

[108] *See SBC Communications 2004 Annual Report* at 10.

[109] *See AT&T Corp. 2003 Annual Report* at 19, 21.

entities with minimal geographic overlap and a history of collusion will inevitably translate into a bad deal for consumers and a price squeeze for rival backbone providers. Indeed, the applicants' claims of faster and better quality Internet service if "more traffic [is] carried entirely on the combined company's network" are speculative at best. Indeed, the far clearer benefit – from the applicants' point of view, but not consumers' – of keeping traffic "on-net" would be to permit the applicants to convert current Tier-1 peers into paid for peering or transit customers.

F. Unless SBC and AT&T Propose Conditions to Ensure that the Internet Backbone Market Remains Competitive, the Commission Should Not Approve the Merger.

As set forth above, the proposed merger threatens to destroy the existing competitive market for Internet backbone services. A market dominated by one or two mega-peers will degrade service and increase prices, first for competitors' customers, but ultimately for all of the millions of consumers and businesses that rely on Internet connectivity. Accordingly, the merger will not serve the public interest and should not be approved.

Should the Commission decide to approve the merger, however, it must prescribe conditions to ameliorate the harms discussed herein. At this point, however, the information provided by the applicants is so deficient that it is premature to discuss in detail what conditions might suffice. But it is possible to outline the purposes that conditions would be designed to serve. Again, the basic problem is the danger than a merged SBC-AT&T would use its power, and particularly the power based on its strength in the eyeball market, to de-peer other Internet backbone providers – perhaps all except a merged Verizon-MCI. Accordingly, conditions must be designed to ensure that a substantial number of competitive backbone providers are able to peer with the merged

company. That may require the Commission to forbid the company from relying on traffic ratios to de-peer competitors, and it may require the Commission to take other steps to ensure that the backbone provider market remains vibrantly competitive.

Once the applicants provide the data the Commission has requested, it will be possible to flesh out the conditions that would be necessary. But, of course, it will not be necessary for the Commission to enter that thicket if it concludes that the applicants have failed to demonstrate that the merger will serve the public interest – and they have failed to carry to carry their burden.

VII. CONCLUSION

For the foregoing reasons, the Commission should not approve the SBC-AT&T merger as proposed.

Respectfully submitted,

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