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May 6, 2005

EX PARTE – VIA ELECTRONIC FILING

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

Re: WC Docket. No. 05-65
WC Docket No. 05-75

Dear Ms. Dortch:

On May 5, 2005, Kristen Verderame and Jill Cocayne from BT, met with FCC staff to discuss BT's concerns regarding the proposed merger of SBC and AT&T. FCC staff included Commissioner Adelstein, Barry Ohlson, and Scott Bergmann. The BT representatives discussed the adverse impacts of the merger on the global telecommunications services and internet backbone markets, and the compounding adverse effect of Verizon's proposed merger with MCI. BT's presentation to FCC staff is attached as Exhibit A.

Pursuant to Sec. 1.1206(b)(2) of the Commission's rules, this letter is being filed electronically with the Office of the Secretary. If you have any questions, please contact the undersigned.

Respectfully submitted,

Kristen Verderame

Enclosure

In the Matter of

SBC Communications, Inc. and AT&T Corp. Applications for Approval of Transfer of Control

WC Docket No. 05-65

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Introduction

- BT is very concerned about the serious anti-competitive effects of the proposed concentration between SBC/AT&T followed by Verizon/MCI

- Said concentrations will significantly impede effective competition resulting in higher prices, lower quality and reduced innovation for business customers.

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Affected Markets about which BT can Offer Unique Insights

- *Global Telecommunications Services*

  Allowing SBC and AT&T to merge would give the merged firm the incentive and ability to abuse its dominance over wholesale local connectivity to discriminate against competing providers of global telecommunications services ("GTS") and to price squeeze other GTS providers on access. The damage to competition would be compounded by a concurrent Verizon/MCI merger.

- *Internet Backbone Market*

  If permitted to merge, SBC/AT&T and Verizon/MCI would use their concentration over Internet backbone services to raise their competitors costs and tip the market to the merged companies.

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GTS market

- GTS entails the provision of international communications services to multi-sited multinational companies across a number of countries. The services include end-to-end managed networks, communications solutions, information technology applications, and out-sourcing services.
- Two biggest players are AT&T and MCI with respective GTS market shares of 30-40% and 15-25% -- i.e. a combined market share of as much as 65% (EC Commission decision in BT Infonet).
- Some of other GTS providers include T-Systems (DT), BT (including BT Infonet), C&W, Equant, Global Crossing, Colt and Vanco.

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GTS market

- 50% of GTS customers are headquartered in the US.
- An estimated 70% of GTS customer locations are in SBC and Verizon regions.
- SBC and Verizon are estimated to have the only facilities in place to 98% of commercial buildings in their regions.

How The AT&T/SBC Merger Will Harm GTS Competition

Horizontal effects

- Eliminate SBC as a potentially powerful new entrant in the GTS market (and as an existing competitor for medium size businesses in-region).
- Eliminate AT&T as a competitive provider of local connectivity in SBC region, and, in its role as a large purchaser, as a force to discipline SBC's special access rates through bypass threat.
- Because of its large volumes and consequent limited by-pass threat to SBC, AT&T – as the largest purchaser of special access – provides some market discipline on SBC's special access rates even when it does not directly compete.
  - With the elimination of AT&T as a separate company, even that limited check on special access prices would be eliminated.

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How The AT&T/SBC Merger Will Harm GTS Competition

Vertical effects

- SBC has the ability to harm other GTS service providers through anti-competitive price squeezes, discriminatory provisioning, and other means.
  - Even today SBC has supra-competitive special access profits of 76.2% (up to 4 times over TELRIC) which demonstrates the ability of SBC to disadvantage its competitors for this essential input.
  - BT's UK rates for equivalent services are 60 to 66% lower than SBC's for DS-1 equivalents and BT s UK return for such services is 13.5% because BT's rates are based on LRIC.
- Incentivize the merged SBC/AT&T to price squeeze GTS competitors like BT in providing local connectivity
- Incentivize the merged company to delay and degrade service to competitors.

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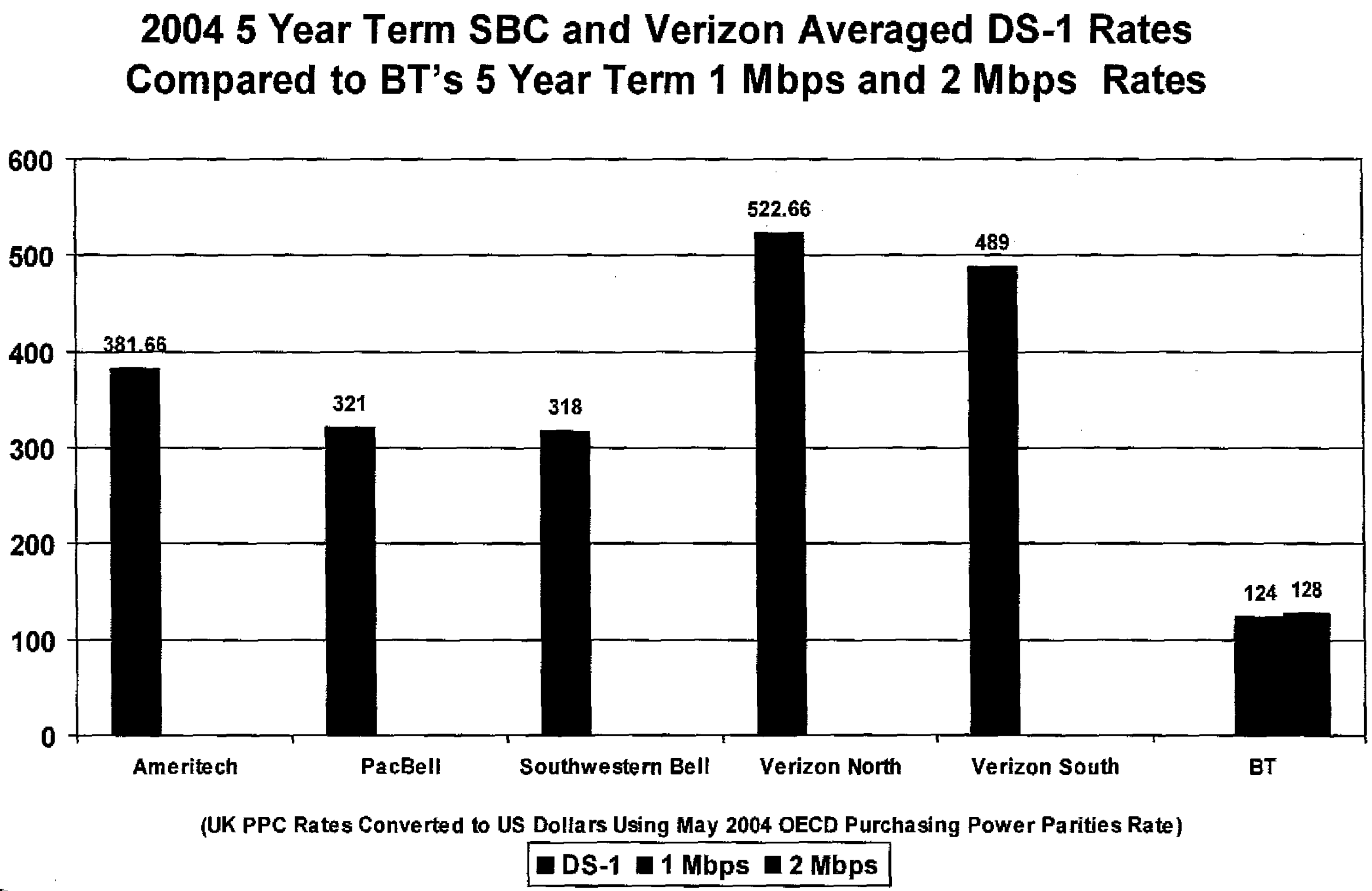
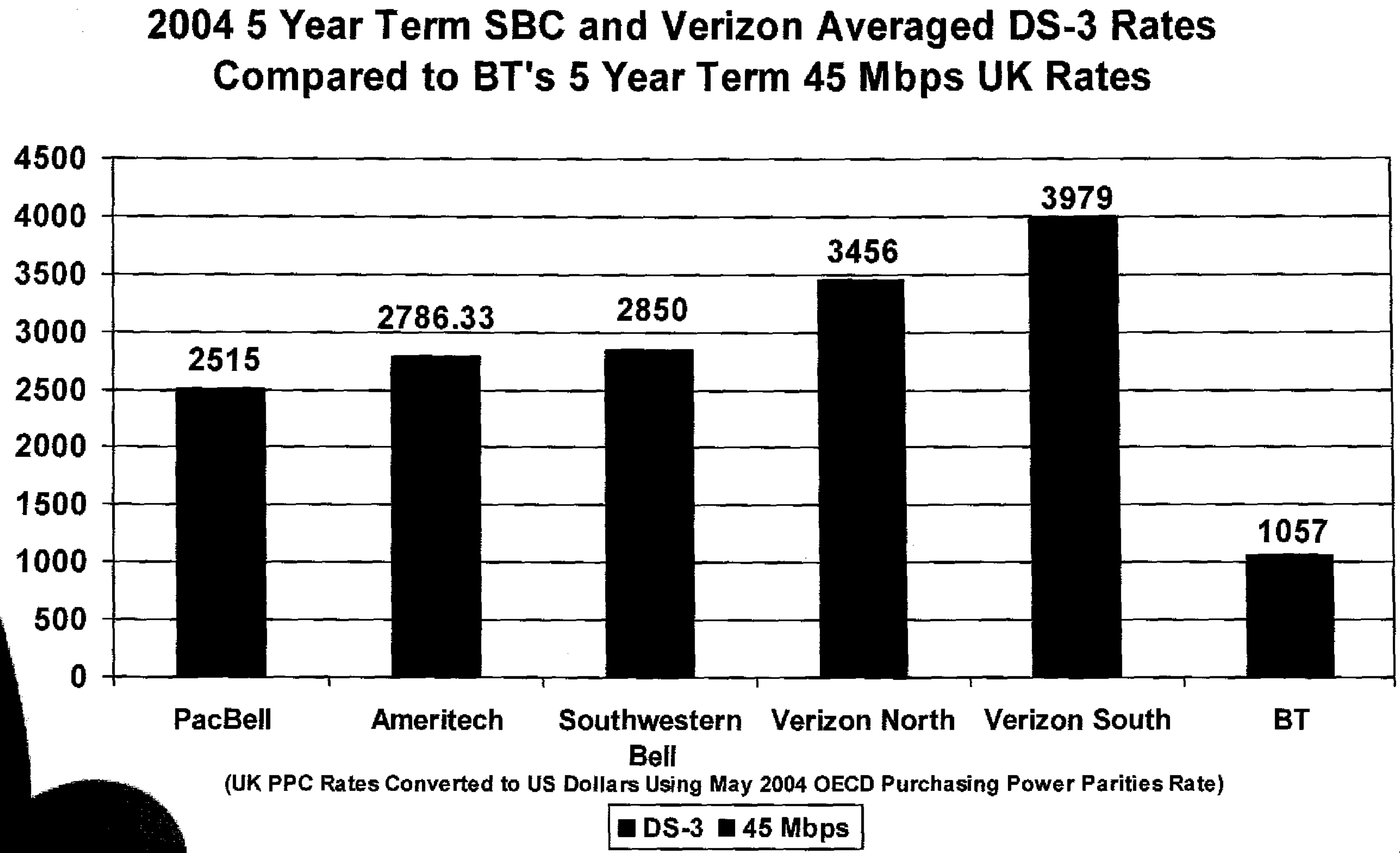
The Vertical Competitive Threat to GTS – Block the Merger or Adopt LRIC Pricing Condition

- The best way to counter the vertical threat would be to block the merger
- Otherwise, the only means to counter the vertical threat are:
  - Pricing of special access at forward-looking cost – *price caps would not address the harm*
  - Extension of section 272 separate affiliate requirements
  - Provisioning standards and reporting requirements

Comparison of SBC and Verizon DS-1 Rates with BT's 1 and 2 Mbps Rates in UK



Comparison of SBC and Verizon DS-3 Rates with BT in UK



The SBC/AT&T and Verizon/MCI Mergers Will Create a Classic Duopoly

➔ *Coordinated effects of two mergers (mutual forbearance)*

- SBC and Verizon regions large and symmetric with highly profitable special access business.
- Post mergers in mutual interest not to undercut each other's special access prices.
- Post mergers AT&T will not undercut Verizon's special access prices and MCI will not undercut SBC's special access prices.
- Mutual threat ability will enforce tacit collusion.

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The SBC/AT&T and Verizon/MCI Mergers Will Create a Classic Duopoly

- The anti-competitive impact of the SBC-AT&T merger would be highly exacerbated by the simultaneous Verizon-MCI merger.

Discrimination

- SBC/AT&T and Verizon/MCI would have irresistible incentives to offer one another much more favorable special access/wholesale arrangements than they would offer to third party competitors.
- Such discrimination would occur under the cover of FCC rules permitting volume discounts – since no other carriers would have nearly the same traffic volumes.

Tacit Market Division

- Historically SBC and Verizon have not competed actively despite *commitments* to do so in the FCC's SBC/Ameritech and Bell Atlantic/GTE merger decisions. The same phenomenon is likely with respect to the merged companies in the special access wholesale market.

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The Classic Duopoly

- Post-merger, AT&T and MCI will no longer be wholesalers of special access at favorable rates in their parents' regions due to changed incentives created by the mergers and tacit market division

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The Classic Duopoly

- Left unchecked, the coordinated effect of the mergers would be to create a powerful duopoly that would have extraordinary market power – not just in their own regions, but nationwide and internationally – that would be difficult or impossible for any other competitor to overcome.
- Only means to constrain the incentives of the merged parties and prevent the duopoly are:
    - Forward-looking pricing at incremental cost of special access;
    - Separate subsidiary requirements; and
    - Provisioning standards and reporting.

How The AT&T/SBC Merger Will Harm Internet Backbone Competition

ILEC IP Traffic to Merged Firms' Backbones

- Permit SBC to favor AT&T, and Verizon to favor MCI, in each case with their extensive DSL, (and coming) FTTH, 3G originated traffic.
- SBC could over time use its eyeballs to grow into an Internet Backbone Provider ("IBP") rivaling the size and competitive position of today's largest Tier 1s, AT&T and MCI.
- Foreclose competing backbone providers from opportunity to serve that traffic
- All apply to Verizon / MCI as well

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How The AT&T/SBC Merger Will Harm Internet Backbone Competition

"Peering" Discrimination and Ultimately "Tipping"

- Give both SBC/AT&T and Verizon/MCI the ability and incentive to favor each other in peering arrangements, de-peer other Tier 1 providers, and raise costs faced by all other Internet backbone competitors.
- Peering (connection to the customers of a directly interconnected IBP) is "free" (sender keep all) where traffic exchanged is roughly in balance.

How The AT&T/SBC Merger Will Harm Internet Backbone Competition

- Where one IBP has greater bargaining power than other (e.g., because it has far more eyeballs requesting content from the other IBP than the other has eyeballs requesting content from it), the eyeball-rich IBP may demand a fee for peering.
  - Even today, IBPs who pay for peering or transit (indirect connection via an IBP to the customers of another IBP) are disadvantaged relative to IBPs who obtain free peering with Tier 1 IBPs.
  - Post-merger, the market power of the merged entities would increase substantially, so that the merged IPBs would be positioned to raise the costs of interconnection to rival IBPs, and diminish the quality of interconnections, driving away the rivals' eyeball and content subscribers.
  - For these reasons, EC blocked WorldCom from acquiring the IBP operations of MCI (forcing divestiture when approving the companies' merger), Sprint (refusing to permit the merger to proceed), and Intermedia (forcing divestiture when approving the companies' merger).
- Result: Over time the Internet backbone market will "tip" to the two merged companies.

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The Mergers Will Create a Dominant Tier 1 Backbone Duopoly

- As the DOJ has stated:

[redacted]

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The Mergers Will Create a Dominant Tier 1 Backbone Duopoly

- Express collusion between SBC/AT&T and Verizon/MCI is not required for this result. Each firm will recognize that the other has a shared interest in a common outcome, and they can effectively signal each other through bilateral contractual dealings and leaks about their treatment of third parties to achieve their common objectives.
- Given that SBC and Verizon have a long history of avoiding significant competition with each other, the two merged firms are likely to be content ultimately to share a monopoly of the Internet backbone and to use that position to continue to garner eyeballs and content subscribers in their respective territories and beyond.

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The vertical aspects of these mergers increases the threat

- Verizon/MCI's Internet backbone expert Michael Kende wrote a paper several years ago for the FCC observing:

  "While consolidation is the most obvious means for a backbone to become dominant, . . . there are other means by which a backbone could grow to become dominant. For example, one way is for a provider to leverage market power over last-mile access to end-users to market power in the backbone market."

--Kende, "The Digital Handshake: Connecting Internet Backbones," FCC, Office of Plans & Policy, Working Paper No. 32 (September 2000) at 26

Likely Outcome of Mergers

BT

Likely Outcome of Mergers

Likely Outcome of Mergers

[redacted]

Likely Outcome of Mergers

"If the mergers are approved, the new companies would dwarf their nearest competitors and control 79% of the business/government segment - one of the most lucrative in our industry. The reality is that this scale, pricing power and overall market clout make it extremely unlikely that any other player can grow market share. Odds are these behemoths would not compete head-to-head in most local markets but would instead flex their muscles to squeeze out smaller competitors, emptying the playing field [...] *less choice, less competition, massively increased pricing power* [...] *reduce*[d] *competition and innovation and diversity"*

"Don't create a duopoly", The Wall Street Journal,

28 February 2005

BT

Thank you

Offices worldwide