

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

In the Matter of)	
)	
SBC Communications, Inc. and AT&T Corp.)	WC Docket No. 05-65
)	
Applications for Approval of Transfer of Control)	
)	

REPLY COMMENTS OF BT AMERICAS INC. AND BT INFONET USA

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BT Americas Inc. (“BTA”) and BT Infonet USA (“BT-IUSA”), wholly-owned indirect subsidiaries of BT Group plc, submit these reply comments in the above-referenced proceeding pursuant to the Commission’s Public Notice, DA 05-656 (released Mar. 11, 2005).

INTRODUCTION AND SUMMARY

BTA is an active participant in the US market, authorized by the Commission to provide international telecommunications service in the United States since 1994. Its sister company in the US, BT-IUSA, has provided managed international information and communications services to customers in the US since 1988. BTA, BT-IUSA, and their parent, BT Group plc (collectively referred to as “BT”), bring a unique perspective to this proceeding. BT is the incumbent local exchange and long distance service provider in the UK and a competitive interexchange carrier here. In the UK, BT provides local and long distance communications services to residential, small/medium enterprise, and large enterprise customers, and essential local connectivity and long haul services to our competitors subject to stringent Ofcom regulations. In the United States and globally, BTA, BT IIUSA, and other BT affiliates compete with AT&T to provide global telecommunications services to large enterprise customers. Both BTA and BT-IUSA depend on wholesale purchases of various services and

facilities indirectly from SBC within its 13-state region (primarily by virtue of a wholesale contract with AT&T), and from AT&T across the country.

BT agrees with many of the points raised in the initial comments filed by other parties in opposition to the proposed merger. We confine our reply comments to the areas on which BT has a unique perspective as a global enterprise competitor and as an affiliate of an ILEC in the UK – the horizontal and vertical effects of the proposed merger on (1) global services provided to enterprise customers, which we refer to as “global telecommunications services” (“GTS”), and (2) Internet backbone services.

The proposed SBC/AT&T merger presents almost unprecedented risks to competition and consumers, and gravely threatens the public interest that the Commission is charged with safeguarding. If allowed to proceed without extensive divestitures and conditions, the merger could have devastating impacts on US consumers – in particular, large and medium-size businesses that intensely use telecommunications services – by making on-the-merits competition in the enterprise marketplace virtually impossible whenever connectivity in SBC territory is a significant feature.

First, the *horizontal* nature of the merger will eliminate a large part of what little competition for local connectivity (*i.e.*, special access) exists today.

Second, the *vertical* anti-competitive effects of the merger enterprise customers will be devastating to competition, which means that customers will have fewer choices, pay higher rates and receive poorer service as a direct consequence of the merger. The merger would give the merged firm the greatly heightened incentive and ability to abuse its dominance over wholesale local connectivity by using discrimination and price-squeeze strategies against

competing providers of GTS. The only way to mitigate these impacts, short of denying the proposed merger application, would be to require SBC, at a minimum, to:

- comprehensively divest overlapping facilities, operations, and customer contracts;
- provide special access services to all at non-discriminatory prices and terms, with prices based on forward-looking incremental costs (*note* that price cap regulation alone would not address the merger-related harm);
- comply with stringently non-discriminatory performance standards and reporting requirements with regard to special access offerings;
- continue to abide by the Section 272 structural and non-structural separation requirements, notwithstanding the statutory “sunset.”

Third, the merger would harm both business consumers and mass market customer that use Internet services, because if permitted to merge, SBC/AT&T would have the ability and strong incentives to use their concentration over Internet backbone services to raise their competitors’ costs and tip the market to the merged companies. ^{1/}

I. THE MERGER WOULD HARM COMPETITION FOR GLOBAL TELECOMMUNICATIONS SERVICES, TO THE DETRIMENT OF BUSINESS CONSUMERS

GTS includes the provision of international and domestic 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. Over the past decade, the Commission has recognized the existence of a distinct market for “global seamless services” and defined such services as “a combination of voice, data, video, and other telecommunications services that are offered by a

^{1/} BT notes that, as a general matter, vertical integration that enables a traditional telephone company to offer facilities-based all-distance voice along with broadband Internet access and video (the so-called triple-play) in competition with facilities-based triple-play offerings by cable companies promotes consumer welfare and the public interest. In the case of the proposed merger between SBC and AT&T, however, any such pro-competitive public interest benefits are more than offset by the profound damage to competition, in the absence of appropriate conditions discussed herein.

single source or multiple sources over an integrated global or regional international network of owned or leased facilities, and that have equivalent (though not identical) quality, characteristics, features and capabilities wherever they are provided.” ^{2/} Similarly, the US Department of Justice (“DOJ”) ^{3/} and the European Commission (“EC”) have defined the provision of GTS as a distinct relevant product market. ^{4/} AT&T and MCI are the two largest providers of GTS worldwide, with market shares of 30-40 percent (for AT&T), as the European Commission recently found. ^{5/}

A merger of AT&T and SBC would reduce competition in the GTS market, as well as the market for national telecommunications services provided to large enterprise customers, and harm the US businesses that depend on such services, for several reasons. First,

^{2/} *AT&T Corp., British Telecommunications plc, et al., Modification of Authorizations and Assignment of Licenses in Connection with the Proposed Joint Venture of AT&T Corp. and British Telecommunications, plc*, 14 FCC Rcd 14140, ¶ 28 (1999) (“*AT&T/BT Joint Venture*”); see also *Sprint Corp., Declaratory Ruling and Order*, 11 FCC Rcd 1850, 1864 (1996). The AT&T/BT joint venture for international telecommunications services was dissolved in 2002.

^{3/} Complaint, *United States v. Sprint Corp. and Joint Venture Co.*, Civil Action No. 95-1304, ¶ 18 (D.D.C., filed July 13, 1995) (available at <http://www.justice.gov/atr/cases/f0200/0277.htm>) (defining a market of “seamless international telecommunications services . . . used by multinational corporations and other users of international telecommunications services in the US to exchange voice, data, and video messages with corporate offices, vendors, operations, and persons in . . . other countries[,]” and recognizing that “other types of international telecommunications and enhanced telecommunications services provided through the correspondent system will not be substitutes for seamless international telecommunications services as they emerge, as existing services often lack standardization of advanced features between countries that customers prefer.”). Essentially the same definition was used in Complaint, *United States v. MCI Corp. and BT Forty-Eight Co.*, Civil Action No. 94-1317 (D.D.C., filed June 15, 1994) ¶ 23 (“*MCI/BT Forty-Eight Complaint*”) (available at <http://www.justice.gov/atr/cases/f0000/0071.htm>).

^{4/} *MCI WorldCom/Sprint*, Case No. COMP/M.1741 (Commission of the European Communities, June 28, 2000) (available at http://europa.eu.int/comm/competition/mergers/cases/decisions/m1741_en.pdf) (defining a market consisting of “telecommunications services linking a number of different customer locations, generally in at least two different continents and across a larger number of different countries . . . which are generally purchased by MNCs [multinational corporate customers] with presence in many countries and a number of continents . . . [and which] are enhanced services – going beyond the provision of simple services such as basic voice and fax – to provide customers with package solutions including virtual private networks for both voice and data services and advance functionalities.”).

^{5/} *BT/Infonet*, Case No. COMP/M.3641, at ¶ 13 (Commission of the European Communities, Jan. 25, 2005), available at http://europa.eu.int/comm/competition/mergers/cases/decisions/m3640_en.pdf (“*BT/Infonet (EC)*”). Other GTS providers include Deutsche Telekom (and its T-Systems subsidiary), BT (including Infonet), Cable & Wireless, France Télécom (Equant), Global Crossing, Colt, and Vanco. *Id.*

the merger would eliminate SBC as a separate, powerful potential entrant into these markets. ^{6/} Second, and more significantly, SBC has near-monopoly control over special access services, a critical upstream input service needed by all providers of GTS and other enterprise services, in the 35-40% of the US in which SBC is the dominant ILEC. SBC's acquisition of AT&T would increase SBC's market power over special access services and give SBC the ability and incentive to discriminate against its competitors, such as by imposing "price squeezes" and poorer service quality. ^{7/} Third, when the SBC/AT&T merger is considered in the context of other comparable consolidation in the industry, the effect would be to exacerbate these competitive harms. ^{8/} We discuss each of these points at greater length below.

A. The Merger Would Increase Concentration in the GTS Market Because it Would Eliminate SBC as a Potentially Powerful New Entrant in the GTS Market

AT&T is the leading provider of GTS in the US and worldwide. ^{9/} In 1999, the Commission accepted estimates of AT&T's market share of approximately 16-17%. ^{10/} Since then, AT&T's share of the GTS market has increased substantially. As noted above, according to the latest measures considered by the EC (for 2003), AT&T has a share of the worldwide GTS

^{6/} BT generally concurs with the points made in support of this proposition by other commenting parties. *See, e.g.,* CompTel/ALTS at 23-26; *accord*, ACN Communications, *et al.*, at 26-31; Qwest at 23-32 & Declaration of Dr. B. Douglas Bernheim at 22-29 (¶¶ 57-83)

^{7/} Other commenting parties presented strong economic and legal support for this point in their initial comments. *See, e.g.,* ACN Communications, *et al.*, at 34-41; Broadwing/SAVVIS at 21-35 & Declarations of Mark Pietro and Gary Zimmerman; Cbeyond Communications, *et al.*, at 19-30; CompTel/ALTS at 11-23, 27-30, 50-52; Cox Communications at 5-13; Global Crossing at 6-22 & Statement of Dr. Joseph Farrell; Qwest at 24-25 & Declaration of Dr. B. Douglas Bernheim at 17-21, 30-32 (¶¶ 40-56, 84-92).

^{8/} *Accord*, Cbeyond Communications, *et al.*, at 41-59.; Consumer Federation of America, *et al.*, at 12-14, 23-27; Qwest at 2-7, 39-45 & Declaration of Dr. B. Douglas Bernheim at 12-15 (¶¶ 29-37).

^{9/} SBC/AT&T Public Interest Statement at 97-98 and Appendix A at A-1; Carlton/Sider Declaration at 32 (¶ 61) & 45 (¶ 101); Kahan Declaration at 7 (¶ 19).

^{10/} *AT&T/BT Joint Venture*, at ¶ 42. The Commission also concluded that BT was not a significant competitor in the market for GTS in the United States. *Id.*, ¶ 45.

market somewhere between 30 and 40 percent. [11/](#) Moreover, 50% of GTS customers are headquartered in the US, with an estimated 30-40% of US customers' locations in the SBC region. [12/](#)

SBC admits that it “has sought since the late 1990s to become a significant provider to enterprise customers at the national level” and since 1999 has made “substantial investments to expand its geographic reach and the scope of its products and services to appeal to large national enterprise customers.” [13/](#) It strains credibility to argue, as SBC does, that the second largest telecommunications company in the country, with 45 million subscribers and a total market capitalization of \$77 Billion (almost 2 ½ times the size of BT), serving most of California, Texas, Illinois, and 10 other states, an area in which 220 of the Fortune 500 companies are headquartered, nevertheless lacks the scale and scope to compete effectively for enterprise customers on a national or global basis. Indeed, SBC claimed that a benefit of its 1999 acquisition of Ameritech would be to facilitate a “National-Local” strategy in which it would enter into at least 30 out-of-region markets; and the company accepted a merger condition requiring it to live up to that commitment or face a penalty of up to \$1.2 Billion. [14/](#) The fact that SBC has chosen not to compete vigorously out-of-region certainly does not mean that it is incapable of doing so.

As a result of SBC’s “throwing in the towel” on trying to compete and instead purchasing AT&T, the merger effectively would eliminate potential competition in the GTS

[11/](#) *BT/Infonet (EC)*, ¶ 13.

[12/](#) *MCI/BT Forty-Eight Complaint* at ¶ 23. *See also infra* note 19.

[13/](#) Kahan Declaration at 9 (¶ 23).

[14/](#) *Applications of Ameritech Corp. and SBC Communications, Inc. for Consent to Transfer Control*, 14 FCC Rcd 14712 (1999). SBC claimed that it satisfied this condition, *see* SBC Merger Compliance Report, CC Docket No. 98-141, at 26-27 (filed Mar. 14, 2003), but as a practical matter, SBC’s presence outside its region remains negligible, as the company admits. Kahan Declaration at 10 (¶ 25).

market, and leave consumers with few choices besides AT&T/SBC. The Utility Rate Network (“TURN”), a consumer organization in California, calculated based on data provided by SBC and AT&T that the HHI for telecommunications services for large business customers in California is currently 4,852 – indicating a very high degree of concentration – and would increase by 966 points to 5,818 as a result of the merger. ^{15/} (A market with an HHI above 1800 is considered highly concentrated, and any merger that raises concentration more than 50 points in a market with an HHI above 1800 is suspect.) ^{16/}

B. The Merger Would Harm GTS Competition By Increasing SBC’s Monopoly Market Power Over Local Special Access Connections For Enterprise Networks, A Critical Wholesale Input to GTS

1. GTS Consumers And Providers Are Highly Dependent on SBC’s Special Access Service for Local Connectivity

The provision of GTS as a global service is highly dependent on local connectivity. Given GTS’ trans-border and multi-country nature, and given that local networks historically were constructed by companies (often monopolies) native to the country or region involved, no GTS provider today is in a position to provide its end-to-end network GTS services solely over its own infrastructure. In order to respond to their customers’ requirements, a GTS provider typically contracts with third parties to supply the necessary connectivity in areas where it lacks its own local network. Then, the customers are able to obtain a total service package, including those local connectivity elements, on a one-stop-shop, single-supplier basis.

^{15/} See Protest of The Utility Reform Network (“TURN”), *et al.*, *Joint Application of SBC and AT&T for Authorization to Transfer Control*, Application 05-02-027 (filed Apr. 15, 2005, Calif. PUC), Redacted Exhibit 2 at 2; *see also* Statement of Gene Kimmelman on behalf of Consumers Union and Consumer Federation of America on the SBC-AT&T and Verizon-MCI Mergers, Senate Judiciary Committee (Apr. 19, 2005), at 7, available at http://www.consumersunion.org/pub/0419_gk_testimony_final.pdf. Given that the underlying data were provided on a confidential basis in response to an interrogatory in the California proceeding, it is not clear whether TURN’s calculations group together local and long-distance services; but even if they do, such an approach may be appropriate in the context discussed here, given that GTS comprise both voice and data services provided in an “all-distance” marketplace environment (local as well as long-distance services).

^{16/} DOJ/FTC, *Horizontal Merger Guidelines*, at § 1.51.

Customers require US local connectivity on cost-based, non-discriminatory terms.

In BT's experience, local connectivity can be as much as 40-60% of the total package price for a GTS contract. ^{17/} This experience is validated industry-wide by a report recently cited in an AT&T filing, which also demonstrates that the problem is growing worse:

In many instances, the special access circuits required to connect the end user to the IXC network represents the majority of the total cost of the circuit. That is, more than 50% of the total cost of a frame relay drop or private line circuit is represented by the cost of the last mile that the IXCs must pay to the ILECs. . . . The price of these corporate data services is falling at a faster rate than the price of special access, suggesting that, over time, access is becoming a larger portion of the overall spend and that the Bells' cost advantage versus the IXCs will continue to increase. ^{18/}

Moreover, a substantial proportion of sites to be served in any given GTS customer contract put out for bid are likely to be located in the US – and in SBC's ILEC region – simply because so many of the world's largest corporations have major operations, if not also headquarters facilities, in those states. ^{19/} Even in instances where the SBC region-specific sites are not in the majority, the price and quality of connectivity to the SBC region sites are fundamental to the effectiveness of the overall GTS network and the businesses that rely upon it.

When large enterprise customers with sites in the SBC region – or GTS providers, such as BT, that serve such customers – need high-capacity local connectivity to access global

^{17/} *Accord Broadwing/SAVVIS* at 29.

^{18/} UBS Investment Research, "Q-Series™: Paying to Play?" (April 2, 2004) ("*UBS Access Report*"), at 22, cited in *Unbundled Access to Network Elements*, WC Docket No. 04-313, AT&T Reply Comments, Reply Declaration of Lee L. Selwyn on behalf of AT&T Corp. (filed Oct. 19, 2004) ("*AT&T Triennial Remand – Selwyn Reply Declaration*"), at 40.

^{19/} *MCI/BT Forty-Eight Complaint* at ¶ 23 ("Almost half of the potential customers of seamless global telecommunications services are based in the US, and many others are headquartered in the UK; in addition, most other potential customers want to include locations in the US and the UK in their networks. Thus, to ensure a competitive market for these services, providers must have nondiscriminatory access to the US and the UK.").

SBC is one of the two largest ILECs, and its local exchange business encompasses about 40 percent of the locations in the United States where large enterprise customers maintain offices and sites needing GTS network connectivity BT estimates that it incurs about 35%-40% of its total US access expenditures in SBC's ILEC territories.

services, their choice is almost invariably limited to special access services provided over wireline facilities owned by SBC (or, in extremely limited circumstances, by an alternative wireline provider). ^{20/} Mobile wireless services do not offer sufficient capacity for GTS applications, and fixed wireless services and broadband powerline services have not been deployed significantly across the country and are not likely to be available ubiquitously for several years in the future. In sum, at present there are no realistic intermodal alternatives in the US to wireline special access service for GTS providers and their large business customers.

2. SBC Already Has Enormous Market Power Over Special Access and Other Local Wholesale Services in Its Region

Despite statutory and regulatory policies intended to promote facilities-based competition in all sectors of the telecommunications marketplace – particularly the markets for wholesale local wireline facilities – there is virtually no competition today in the market for special access in most parts of SBC’s region – as evidenced by the supra-competitive 76.2% rate of return that SBC is enjoying on special access services. ^{21/} This is actually a conservative estimate, since it is based on comparing SBC’s revenues against its embedded costs, rather than against the company’s forward-looking economic costs. ^{22/} Clearly, if SBC faced any serious competitive threat for this service, it would not be earning such a substantial rate of return. These substantial returns are paid for by enterprise customers and, ultimately, by their customers – and represent sizable, unproductive expenditures.

^{20/} The focus here is on the absence of *intermodal* alternatives to wireline fiber; the following section discusses the scarcity of competitive *intramodal* wireline alternatives to SBC’s special access services.

^{21/} This figure is based on year-end 2004 data that SBC filed in ARMIS 43.01, Table 1. SBC has enjoyed a steadily increasing rate of return on special access services over the past few years – from 51.3% in 2002, 63.2% in 2003, and 76.2% in 2004. See also *Special Access Rates for Price Cap Local Exchange Carriers*, Order and Notice of Proposed Rulemaking, 20 FCC Rcd 1994, ¶ 27 (2005) (“*Special Access Rulemaking*”).

^{22/} *AT&T Corp. Petition for Rulemaking To Reform Incumbent Local Exchange Carrier Rates for Interstate Special Access Services*, RM No. 10593, Joint Declaration of Professors Janusz A. Ordovery and Robert D. Willig on Behalf of AT&T, Tab B, ¶ 27 (filed Oct. 15, 2002).

AT&T recently filed data showing a steadily widening gap between SBC's revenues per voice grade equivalent ("VGE") and costs per VGE. This widening revenue-cost gap explains SBC's dramatically increasing rate of return. According to AT&T,

SBC's "[a]verage revenue per VGE [voice grade equivalent] remained almost unchanged over the [1996-2003] period, with a 2003 index value of 97.8. However, SBC's costs plummeted. In 2003, SBC's average special access net investment per VGE had dropped by almost two-thirds, to an index value of 34.6. SBC's special access operating expenses per VGE had been cut by more than half, to an index value of 46.7. And SBC's special access total plant in service had been almost halved, to an index value for 2003 of 54.9." 23/

AT&T submitted the following graph, which vividly illustrates SBC's anomalous special access pricing:

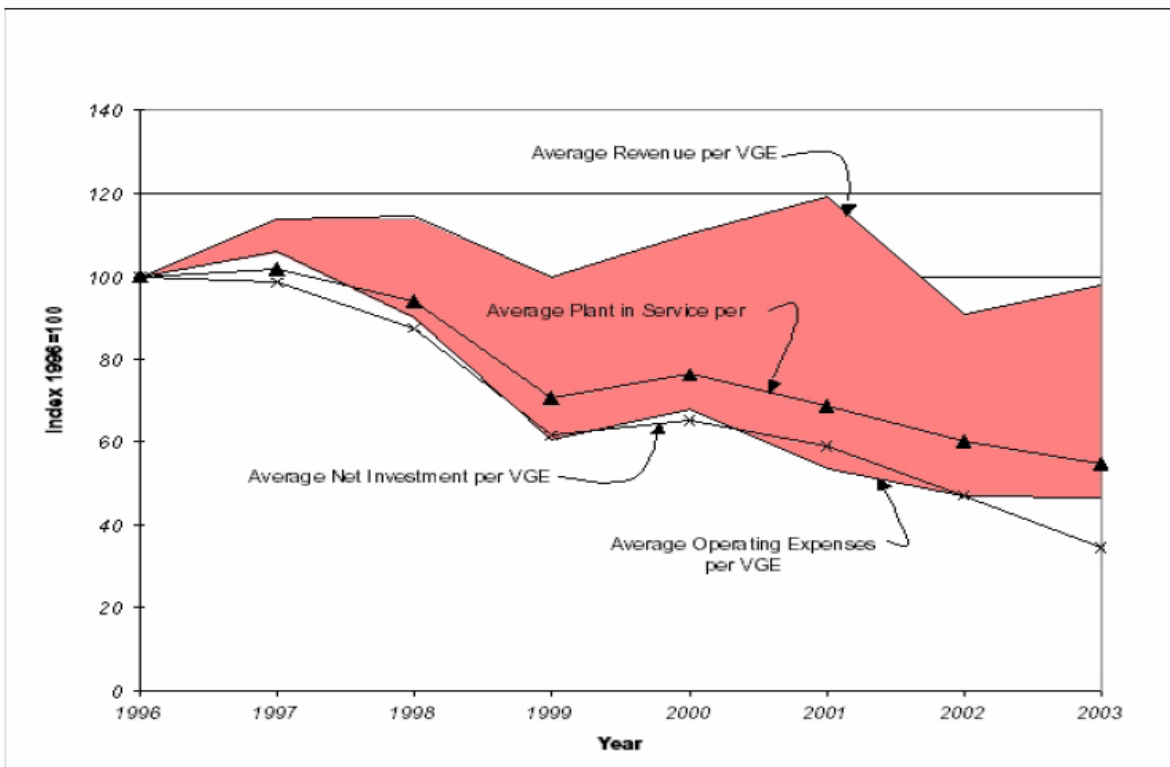


Figure 4. The Widening Special Access Price/Cost Gap – SBC. (See Attachment 1 for data sources and data.)

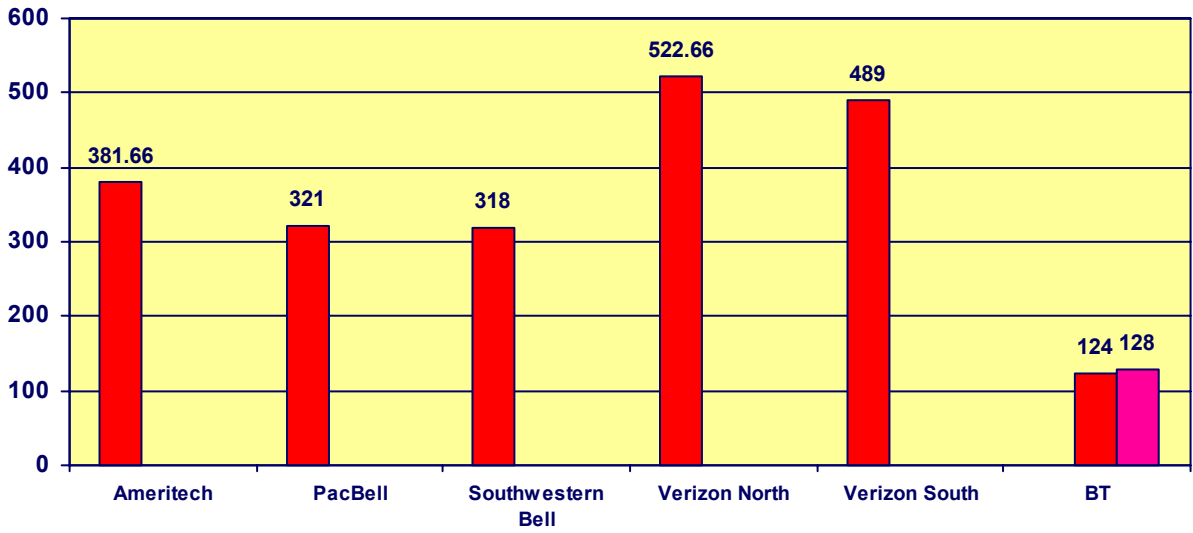
23/ AT&T Triennial Remand – Selwyn Reply Declaration at 67, 73. The graph is taken from *id.* at 70.

A pricing comparison of SBC's special access rates with BT's rates for equivalent offerings in the UK further demonstrates the problem in the US. BT conducted its own price comparison between SBC's long term special access prices and the prices charged by BT for the UK equivalent of special access lines (partial private circuits or "PPCs"). BT's prices are substantially lower than the prices charged by SBC in the US, and BT's prices have been steadily declining rather than increasing as in the US. BT's PPC prices are decreasing on average by 5-7 percent each year. BT's PPC rate of return was 13.5 percent in 2003 and is slightly less than that in 2005. There are several important regulatory reasons for the significant difference between SBC's special access pricing in the US and BT's PPC pricing in the UK, each of which is directly relevant to the proposed merger. In particular, BT's rates are required to be set based on Long-Run Incremental Cost ("LRIC") using a bottom-up cost estimation; BT's wholesale and retail activities are subject to strict accounting separation rules and accounting transparency; nondiscrimination rules prevent BT's Wholesale division from favoring BT's UK Retail or Global Services arms; and BT is obligated to file extensive reports on its provisioning performance.

The charts below show that consumers purchasing special access services from SBC (and Verizon) pay 2.5 to 4.1 times more for DS1 circuits than consumers pay BT in the UK for a product with 30% higher bandwidth, and 2.4 to 3.8 times more for DS3 circuits than consumers pay BT in the UK for a product with 5% higher bandwidth. This price comparison indicates that SBC's special access rates are grossly in excess of forward-looking costs, which, if unchecked, would permit them to engage in price squeezes devastating to competition if the proposed mergers are permitted. [24/](#)

[24/](#) Source: BT research, Sept. 2004. Both comparisons are based on standard tariffed five-year term rates, and adjust UK prices to US dollars using the OECD May 2004 Purchasing Power Parities Rate.

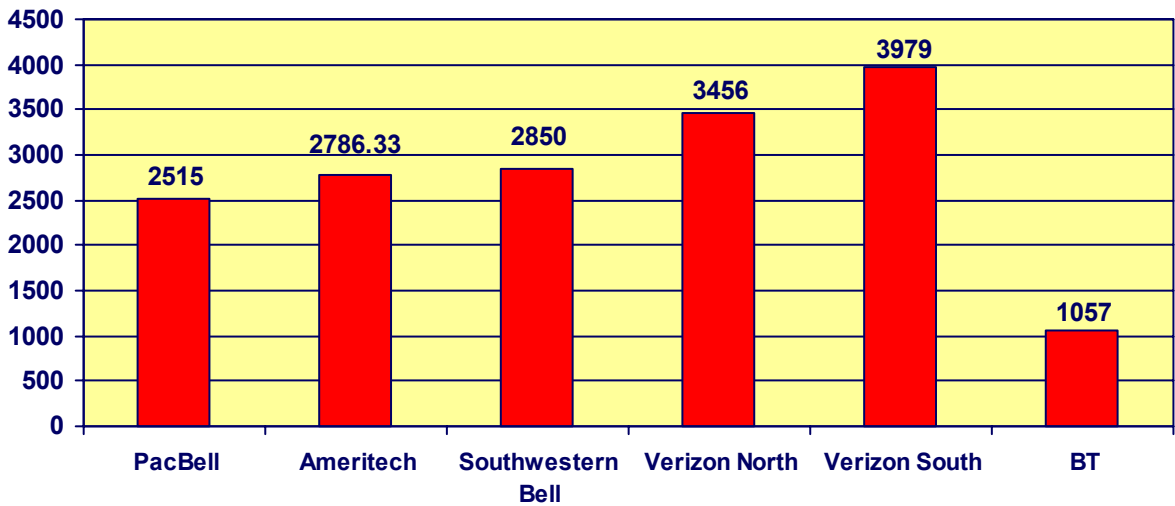
**2004 5 Year Term SBC and Verizon Averaged DS-1 Rates
Compared to BT's 5 Year Term 1 Mbps and 2 Mbps Rates**



(UK PPC Rates Converted to US Dollars Using May 2004 OECD Purchasing Power Parities Rate)



**2004 5 Year Term SBC and Verizon Averaged DS-3 Rates
Compared to BT's 5 Year Term 45 Mbps UK Rates**



(UK PPC Rates Converted to US Dollars Using May 2004 OECD Purchasing Power Parities Rate)



SBC and AT&T argue that potential problems regarding regulation of SBC's special access services are "an industry-wide issue, and the Commission has consistently held that industry-wide issues are not within the scope of merger proceedings." ^{25/} But as discussed in the following two sections of these comments, the harms caused by the proposed merger must be addressed in part by requiring that SBC offer special access priced at forward-looking incremental cost, because the proposed merger would (1) eliminate AT&T as an existing special access competitor in some parts of SBC's territory, as a potential competitive entrant elsewhere, and as the largest consumer of SBC's special access services, and (2) give SBC tremendous incentives to abuse its special access market power, to the detriment of enterprise consumers as well as competing GTS providers.

The Commission is thus *compelled* to consider, in the context of the proposed merger, the competitive and public interest issues raised by SBC's special access dominance, notwithstanding the pendency of the *Special Access Rulemaking* proceeding. Accordingly, this case is not comparable to the tangential matters subject to generic rulemakings that opposing parties raised during other merger proceedings, as cited by SBC and AT&T. ^{26/} Rather, the relationship between the *Special Access Rulemaking* and the proposed SBC/AT&T merger is more comparable to the relationship between state PUC proceedings on UNE pricing and the Section 271 applications. SBC and other RBOCs were compelled to address and resolve UNE pricing matters in proceedings before state commissions *prior to* FCC approval of their Section 271 applications, because of the critical relevance of UNE pricing to the openness of local

^{25/} SBC/AT&T Public Interest Statement at 103.

^{26/} SBC/AT&T Public Interest Statement at 103-04 n. 345.

markets – the central issue in the Section 271 dockets. [27/](#) Similarly here, the problems with SBC’s special access pricing, while raised generically in the *Special Access Rulemaking*, must be fully resolved – and the resolution implemented in effective tariffs – before the Commission can even consider allowing the instant proposed merger to proceed.

3. The Merger Would Strengthen SBC’s Special Access Monopoly By Eliminating One of the Few Remaining Serious Special Access Competitors and the Largest Special Access Consumer

The proposed SBC/AT&T merger would further entrench SBC’s monopoly over special access and other wholesale wireline services, by eliminating the largest CLEC in the SBC region – AT&T itself – as a separate company. To the limited extent competitive wireline wholesale facilities have been deployed in the SBC region, AT&T itself is responsible for the largest number of these. [28/](#) AT&T is the largest and most financially stable of the CLECs, with the most extensive local network in place in many of the major metropolitan areas in SBC’s region. Clearly, if the merger were allowed to proceed, SBC would not overbuild itself.

Even if AT&T’s local network assets and service contracts were divested to a competitive carrier capable of carrying on AT&T’s CLEC business, the merger would still substantially reduce potential competition since AT&T, as the largest purchaser of access services, would remain the most significant *potential* competitor due to its bypass threat. Even if AT&T had no local facilities, the credible threat that it could build or acquire them provides at least some check on SBC’s ability to abuse its market power.

[27/](#) See, e.g., *Joint Application of SBC Communications, Inc., et al., for Provision of In-Region, InterLATA Services in Kansas and Oklahoma*, 16 FCC Rcd 6237, ¶¶ 52-53, 72-73 (2001) (SBC proposed to reduce UNE rates, state commissions approved rate reductions, and *then* the FCC found that the new rates satisfied the requirements of Section 271); *remanded sub nom. Sprint Communications Co. v. FCC*, 274 F.3d 549 (D.C. Cir. 2001); *on remand*, 18 FCC Rcd 24474 (2003).

[28/](#) See Broadwing/SAVVIS Opposition at 21-25.

AT&T is the largest purchaser of special access services from SBC. Using its buying power, AT&T may have the ability to impose at least some degree of discipline on SBC's special access pricing and provisioning, both through contract negotiations and through advocacy in the regulatory process. Other parties have a limited opportunity, under Section 202 and the FCC's rules, to "opt in" to whatever special access rates AT&T may be able to obtain from SBC, based on its clout in negotiations and/or regulatory advocacy. ^{29/} Post-merger, however, any leverage AT&T may have been able to wield would disappear entirely, and other competitors would lose whatever opportunity they may now have to piggy-back on AT&T's deals with SBC. Thus the vertical integration of SBC and its largest retail customer would eliminate even the limited discipline that AT&T, as a large and powerful purchaser, may currently impose on SBC's special access pricing.

Moreover, elimination of AT&T as a stand-alone purchaser of special access services would take away a very significant source of demand for special access facilities provided by CLECs and others. Thus, the merger would effectively prevent other competitors from having any chance of reaching the necessary scale economies to overbuild SBC. ^{30/}

In sum, the merger would give SBC an even more incontestable monopoly over special access services in its region.

4. The Merger Would Severely Undermine GTS Competition By Heightening The Merged Company's Ability And Incentive To Impose Anti-Competitive Harms On Other GTS Service Providers

The combination of AT&T's enormous network reach and experience serving GTS customers with SBC's local wholesale monopoly would make the merged company the

^{29/} Of course, the value of that discipline may be undermined somewhat by contract tariffs, which could enable SBC to offer AT&T special access pricing benefits that, as a practical matter, might be unavailable to competing carriers.

^{30/} Cf. Broadwing/SAVVIS Opposition at 24, 27.

only company able to provide end-to-end facilities-based service to enterprise customers in the 13 states of the SBC region, which account for over 42% of the nation's gross national product.^{31/} The combination of SBC's local wholesale monopoly with AT&T's power in the retail GTS marketplace would give the combined company the ability and incentive to impose price squeezes and engage in other forms of discrimination against their retail competitors, including BT. Ultimately it is consumers who would be harmed if such an anti-competitive merger were allowed to proceed.

SBC may already have the *ability* to discriminate among retail long-distance providers, given (i) its near-monopoly over special access, (ii) the over-broad pricing flexibility, including contract tariffs, that it has obtained in most parts of its region pursuant to the FCC's deregulatory special access pricing flexibility policy, and (iii) the impending sunset of Section 272's strict non-discrimination requirements.^{32/} But to date SBC's *incentive* to do so may have been limited by the fact that it is not yet a major player in the retail enterprise marketplace.^{33/} Following a merger with AT&T, however, SBC will have a much more powerful incentive to favor its affiliate over rivals in the GTS market.

^{31/} US Bureau of Economic Analysis, 2003 gross state product data.

^{32/} SBC's ability to discriminate in favor of its own affiliate might have been controlled to some degree by the requirements of Section 272 of the Communications Act, which imposes a separate subsidiary requirement and strict rules regarding public disclosure, arm's length, and non-discrimination in transactions between an RBOC's ILEC operating companies and affiliated long-distance entities. However, Section 272 "sunsets" automatically within 3 years after an RBOC has received long-distance authority in each state under Section 271, unless the FCC acts to continue the application of those requirements – and the FCC has thus far refused to do so. In SBC's case, Section 272 has already sunset in 5 states (Texas, Kansas, Oklahoma, Arkansas, and Missouri); it never applied in Connecticut; and it is scheduled to sunset in California by Dec. 2005, and in the remainder of SBC's territory by Oct. 2006.

^{33/} *But see AT&T Corp. v. BellSouth Telecommunications, Inc.*, 19 FCC Rcd 23898 (2004) (holding that a particular tariffed special access discount plan discriminated against AT&T and in favor of BellSouth's relatively small, but rapidly growing, long distance affiliate, in violation of Section 272), *recon. denied*, FCC 05-82 (released Apr. 11, 2005).

Following an SBC/AT&T merger, SBC could discriminate in favor of its own retail GTS affiliate (AT&T) and against rivals in a number of ways, most of which would be relatively difficult to detect or prevent. *First*, SBC could offer itself higher quality of service than it provides to competitors. For example, by providing higher quality of service to AT&T – e.g., more prompt installation of new circuits; more effective maintenance and repair of existing service – the merged company could give itself benefits that would be very difficult to monitor or detect, but that could seriously harm rival providers’ ability to compete effectively. As with pricing of special access, the FCC has talked about addressing the deteriorating quality of special access provisioning and maintenance by SBC and other ILECs. [34/](#) However, the proceeding initiated in 2001 has gone into a long stall and has yet to be revived four years later. [35/](#) Larger carriers like AT&T that were able to negotiate better Service Level Agreements (“SLAs”) with the ILECs were contractually silenced and prevented from disclosing well-documented prior deficiencies in ILEC provision of special access. [36/](#)

Second, SBC could impose discriminatory “price squeezes” upon its rivals for GTS and other long-distance services, by simultaneously reducing retail rates and raising the prices of the indispensable wholesale input service, special access. [37/](#) The impact of such anti-competitive pricing strategies in the GTS market would be clear. Having grossly abused its special access pricing power even before it had a GTS affiliate to favor, SBC would have even

[34/](#) Even as competing carriers’ dependence on SBC and other ILECs’ special access services has increased, the quality of special access services provided to competing carriers and their customers has declined significantly. See *Performance Measurements and Standards for Interstate Special Access Services*, Notice of Proposed Rulemaking, 16 FCC Rcd 20896 (2001).

[35/](#) The recently initiated *Special Access Rulemaking* only addresses pricing issues, not service quality.

[36/](#) See Comments of AT&T, CC Docket No. 01-321 (filed January 21, 2002). See also data filed in that docket by VoiceStream Wireless.

[37/](#) See generally *FPC v. Conway*, 426 U.S. 271 (1976); *City of Batavia v. FERC*, 672 F.2d 69 (D.C. Circuit 1982); *Bethany v. FERC*, 670 F.2d 187 (D.C. Cir. 1981); *United States v. Aluminum Co. of America*, 138 F.2d 416, 436-38 (2d Cir. 1945).

stronger incentives to use that power to distort the GTS market to the benefit of its merged affiliate. Pre-merger, SBC has the ability and ample opportunity to overcharge AT&T and everyone else for special access – and AT&T has been in the forefront complaining about that to regulators, courts, and legislators. But because SBC was not yet substantially involved in GTS, SBC had no reason to favor any one GTS provider over others. They were all charged supra-competitive prices. The acquisition of AT&T, the largest supplier in the global GTS market with a share between 30% and 40%, gives SBC an enormous incentive to exploit its bottleneck monopoly power over special access to anti-competitively assist the merged firm in the worldwide GTS business.

SBC effectively could impose a price squeeze, for example, by increasing all of its GTS competitors' access costs, even if SBC were to charge all retail enterprise long-distance providers nominally identical special access rates. In effect SBC's affiliate AT&T would have a major advantage, since the charges imposed upon AT&T would be a wash for the merged company; that is, they would not have any material impact on the merged SBC/AT&T as a whole – out one pocket and back in the other. The “true” marginal cost of special access to AT&T will be SBC's marginal cost of supply no matter what transfer price SBC may charge AT&T for special access. The marginal cost of special access to AT&T's competitors will be the supra-competitive price that SBC actually charges those competitors. SBC can charge downstream affiliate AT&T the same supra-competitive price that it charges AT&T's GTS competitors and AT&T can include that supra-competitive price as a line item on any competitive bids that it makes to prospective GTS customers. From all outward appearances, there would be no obvious price discrimination for special access in favor of AT&T. However, it would be economically rational and profit-maximizing for AT&T to adjust downward its

prices on the non-special access elements of the GTS package to reflect the true “marginal cost” of special access to AT&T. For a complex, multi-faceted, customer-specific GTS package, such discrimination in favor of AT&T would be almost impossible to detect by outside observers. The price discrimination would enable AT&T to steadily expand its market share at the expense of its GTS competitors, which would reduce innovation, competition, and investment. [38/](#) Ultimately, consumers will face higher prices and poorer service.

Third, to whatever extent the merged company’s GTS operation (*i.e.*, AT&T) is able to acquire special access services (or the equivalent) from its ILEC affiliates at volume-based or other discounted rates, it would no longer have the incentive to offer excess capacity on a wholesale basis to other CLECs or to rivals in the GTS business. So, enterprise customers and the carriers (other than the merged company) that serve them would no longer be able to rely upon AT&T to buy SBC special access at volume-based or other discounted rates and pass a portion of that benefit along to competitive carriers and their customers.

[38/](#) In some past decisions, the FCC has rejected price squeeze allegations, relying principally on the effectiveness of its price cap regulatory framework to preclude excessive switched access rates. *See, e.g., Applications of Ameritech Corp. and SBC Communications, Inc. For Consent to Transfer Control*, 14 FCC Rcd 14712, ¶¶ 232-33 (1999) (acknowledging that SBC and Ameritech would have “increased incentive to discriminate against the termination of calls through a price squeeze that neither individual company would have absent the merger,” but concluding that “given the existing regulatory safeguards, they do not have a significant ability to act on this incentive”). Here, however, the upstream (input) rates at issue are the virtually deregulated rates for *special access* – and as noted above, the Commission’s special access regulatory regime is dysfunctional and has allowed SBC and other ILECs to impose grossly supra-competitive rates. *See supra* Section I.B.2.

Moreover, in certain past decisions the Commission has been skeptical of price squeeze claims where the retail rates at issue were subject to regulation by state commissions, which often set residential rates at low levels in pursuit of universal service policy goals. *See, e.g., Joint Application of SBC Communications, Inc., et al., for Provision of In-Region, InterLATA Services in Kansas and Oklahoma*, 16 FCC Rcd 6237 (2001); *remanded sub nom. Sprint Communications Co. v. FCC*, 274 F.3d 549 (D.C. Cir. 2001) (FCC could not ignore argument that SBC was engaged in a price squeeze – charging prices for UNE inputs that were so high by comparison to retail rates as to preclude competition by firms relying on those inputs); *on remand*, 18 FCC Rcd 24474 (2003). By contrast, the downstream (retail) rates at issue here are unregulated GTS prices charged to large enterprise customers.

In all events, price cap regulation cannot address the potential for price squeezes unless special access rates are first re-initialized based on forward-looking incremental costs.

In sum, the merger will reduce competition between GTS providers because in the SBC region, local access to GTS customers will be controlled in the vast majority of cases by a bottleneck monopolist with the incentive and ability to discriminate in favor of its downstream affiliate provider of GTS services and against the downstream affiliate's GTS competitors. Moreover, this is not a situation without a track record or history of the extraction of monopoly rents; the preexisting situation of abuse will be exacerbated by the merger. The exclusionary or discriminatory behavior will mean the foreclosure of GTS competitors and meaningful competition for GTS customers located in those two territories. Post-merger, SBC's local services and AT&T's anti-competitively favored GTS services can be conveniently bundled together distorting GTS competition and further entrenching SBC's dominance over local services.

C. The Anti-Competitive Impact of the SBC-AT&T Merger Must Be Considered In the Context of Other Industry Concentrations

The anti-competitive impact of an SBC/AT&T merger upon the GTS market would be compounded if a Verizon/MCI merger were to proceed at the same time without appropriate conditions. First, not only AT&T, but probably also MCI, would be eliminated as potential and actual competitors for provision of special access on a wholesale basis in the SBC local regions. (Similarly, not only MCI, but probably also AT&T, would be eliminated as potential and actual competitors for provision of special access to GTS service providers in the Verizon local regions.) To date, SBC and Verizon do not appear to have competed aggressively in one another's home regions, despite the ability to do so – and despite commitments to do so in the FCC's *SBC/Ameritech* and *Bell Atlantic/GTE* merger decisions. ^{39/} The incentives for

^{39/} *Applications of Ameritech Corp., Transferor, and SBC Communications, Inc., Transferee, for Consent to Transfer Control*, 14 FCC Rcd 14712 (1999), *subsequent history omitted*; *Application of GTE Corporation*,

avoiding head-to-head competition would be stronger if both the proposed SBC/AT&T merger and the Verizon/MCI merger are permitted to proceed without conditions, given that the SBC and Verizon regions are large and symmetrical, and both companies enjoy highly profitable special access businesses. Post-merger, the two companies would have incentives not to undercut each other's special access prices – enforced via a mutual threat ability.

Second, SBC/AT&T and such the other merged entity would have overwhelming 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.

Third, because the two acquiring ILECs come from exclusive geographic centers of power and apparently have been reluctant to engage in head-to-head competition against each other, the likelihood that AT&T might continue as a true facilities-based CLEC alternative in Verizon's territory and MCI might continue as a true facilities-based CLEC alternative in SBC's territory is quite low.

Thus, the coordinated effect of the SBC-AT&T and Verizon-MCI mergers would likely 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.

Transferor, and Bell Atlantic Corporation, Transferee; For Consent to Transfer Control, 15 FCC Rcd 14032 (2000).

II. THE MERGER WOULD HARM COMPETITION FOR INTERNET BACKBONE SERVICES

A. AT&T is One of a Handful of Tier 1 Internet Backbone Providers That Willingly Exchange Interconnected Traffic With One Another Without Imposing Connection or Transmission Charges

The Commission has previously found that Tier 1 Internet backbone provider (“IBP”) connectivity constitutes a relevant nationwide (or worldwide) product market, for which there are no close substitutes. ^{40/} IBPs transport Internet traffic that originates or terminates with or through their customers, including enterprises and government agencies that need direct connections to the Internet for the conduct of their own businesses, as well as Internet service providers (“ISPs”) and other IBPs that provide Internet connectivity to their own customers. IBPs charge fees for dedicated Internet access and for Internet transit services.

Pairs of IBPs also exchange traffic between their respective networks’ customers. IBPs that are relatively equal with respect to size, capacity, and geographic reach generally do not charge each other for such “peering” arrangements. However, where IBPs possess differing levels of capacity and bargaining power, the larger IBP often can compel the other IBP to pay for the privilege of interconnecting with it. A small group of the largest IBPs across the world – including AT&T and MCI, as well as Sprint, Level 3, and possibly SAVVIS and/or Global Crossing – never pay for peering and never need to purchase transit from other IBPs, and are thus considered “Tier 1” IBPs. “Tier 2” or “Tier 3” IBPs may peer for free with some other IBPs but they must buy transit or enter into paid interconnection arrangements with the Tier 1

^{40/} *Application of WorldCom, Inc. and MCI Communications Corp. for Transfer of Control*, 13 FCC Red 18025, ¶ 148 (1998); *see generally id.*, ¶¶ 142-156.

IBPs. By refusing to peer for free with another IBP and requiring that the other IBP pay for its connection and transit, a Tier 1 IBP helps to perpetuate its hierarchical status. [41/](#)

For all lower-tier IBPs, direct or indirect connectivity to Tier 1 IBPs is an essential input in their own provision of downstream wholesale Internet transit services and Internet access services to end-users, markets in which they compete with the Tier 1 IBPs. Because lower-tier IBPs must purchase a significant amount of connectivity from other IBPs, they are forced to operate at substantial cost disadvantages compared to Tier 1 IBPs. Tier 1 IBPs can provide direct connections to their own large number of ISPs and to other Tier 1 IBPs and thus to those IBPs' customers. Its Tier 1 status gives the Tier 1 IBP significant competitive advantages over other IBPs, enabling the Tier 1 IBP to provide its customers the most direct routing with the fewest number of cross-network connections, "hops" that could cause data to be lost or delayed and quality of service to suffer. Regardless of the high quality and efficiency of their own networks, lower tier IBPs remain disadvantaged from cost and quality of service perspectives in their pursuit of customers, often the same prospective transit and access customers sought by the Tier 1 IBPs.

Five years ago, the European Commission and the Department of Justice concluded that Tier 1 IBP connectivity was a dangerously concentrated market with "already high" barriers to entry. [42/](#) Not only was the WorldCom/Sprint consolidation forbidden by the Department and the EC, but consolidation of Tier 1 IBP WorldCom (now MCI) with a Tier 2 or

[41/](#) See Michael Kende, *The Digital Handshake: Connecting Internet Backbones*, OPP Working Paper No. 32, at 16-22 (FCC Office of Plans & Policy, Sept. 2000).

[42/](#) *United States v. WorldCom, Inc. and Sprint Corp.*, Complaint, ¶¶ 32, 47 (D.D.C, filed June 27, 2000) (available at <http://www.justice.gov/atr/cases/f5000/5051.htm>) ("*US v. WorldCom/Sprint Complaint*"); see also *Application of WorldCom, Inc. and MCI Communications Corp. for Transfer of Control*, 13 FCC Rcd 18025, ¶¶ 142-150 (analyzing competitive impacts on Internet backbone market) (1998).

Tier 3 IBP (Intermedia) was prevented by the Commission and DOJ. ^{43/} Indisputably, the number of Tier 1 IBPs remains small today despite the Internet's enormous growth. Entry, except by major acquisition within the US, appears effectively blocked.

B. The Merger Would Lead to Even Further Concentration in the Dangerously Concentrated Internet Backbone Market

In forecasting the probable impact of the instant transactions on the IBP business, it is critical not to engage in a static or backward-oriented analysis. ^{44/} However market shares of Tier 1 IBPs should be measured, the present shares of AT&T and MCI understate the future competitive significance of both companies' respective IBP businesses post-merger. Each firm's IBP business will be greatly strengthened by the combinations in a variety of ways. ^{45/}

First, the SBC/AT&T merger (as well as a Verizon/MCI merger) would eliminate potential horizontal competition. If one views the marketplace in a dynamic rather than static way, the two mergers are likely to lead to significantly increased horizontal concentration by combining the shares of the two top Tier 1 IBP firms (AT&T and MCI) with the likely future shares of the extremely fast-growing new IBP entrants (SBC and Verizon) – both of which have experienced tremendous growth, in many ways paralleling the spiraling growth they experienced in long distance voice since achieving Section 271 inter-LATA entry. Based on data supplied to the FCC by SBC/AT&T's economist Marius Schwartz, SBC and Verizon were among the highest absolute and percentage gainers in Internet backbone related revenue in the 2002-03

^{43/} *United States v. WorldCom, Inc. and Intermedia Communications, Inc.*, Proposed Final Judgment, Civ. Action No. 002789 (D.D.C., filed Nov. 17, 2000), available at <http://www.justice.gov/atr/cases/f7000/7042.htm>.

^{44/} DOJ/FTC Horizontal Merger Guidelines §1.521. See *United States v. General Dynamics Corp.*, 415 U.S. 486, 498-511 (1974) and progeny.

^{45/} Other parties presented cogent reasoning in support of these points. See, e.g., ACN Communications, *et al.*, at 31-34, 41-43; Broadwing/SAVVIS at 35-56 & Declarations of Dr. Mathew P. Dovens and Dr. Michael Bortz; CompTel/ALTS at 30-40; Cox Communications at 13-15; Earthlink at 3-14; Vonage at 9-13, 16-18.

period -- while many of the Tier 1 IBP firms slumped considerably. [46/](#) Moreover, the vast majority of the relatively few companies that SBC/AT&T claim may be in the Tier 1 group along with AT&T, MCI, and Sprint are financially challenged and weak in terms of current and prospective underlying customer base (e.g., Level 3, Global Crossing, and SAVVIS) and are likely to continue losing traffic because their customers are switching to more financially stable firms.

Second, the mergers would eliminate for AT&T and MCI the constraining effect of the two ILECs as actual and potential backbone providers. SBC was enough of a threat that, prior to the AT&T merger announcement, it “expect[ed] to obtain settlement-free peering fairly soon with several of the other Tier 1 IBPs.” [47/](#) Moreover, the mergers would enable AT&T and MCI to extend their existing Tier 1 backbones far deeper and more ubiquitously within MSAs than any other Tier 1 IBP, penetrating deep into the most populous areas of the United States, including most of the country’s regional high-tech centers that depend on the Internet and nearly all of the county’s commercial and industrial centers. Moreover, the mergers would give the two largest IBPs vastly increased and more dependably stable economic resources to finance expansion of their IBP activities – in sharp contrast to several other companies in the exclusive Tier 1 club that are severely handicapped financially, as noted above.

Third, SBC and Verizon will control special access within their regions to the main customer types of Internet backbones: ISPs, content providers and businesses requiring dedicated Internet access. SBC and Verizon will have the incentive and ability to favor their downstream affiliates as they compete with other Internet backbones for customers. Thus

[46/](#) Schwartz declaration, Table 3 and Appendix 3.

[47/](#) Schwartz declaration, ¶ 20.

advantaged, AT&T's and MCI's customer bases and Internet traffic will grow at the expense of other Internet backbone providers.

Fourth, the two vertical mergers would permit SBC to favor AT&T, (and potentially also permit Verizon to favor MCI), by directing their extensive base of retail customers' Internet traffic ("eyeballs") onto their respective merger partner's Internet backbone. This would greatly enhance the two Tier 1 IBPs' current and future power, giving them unmatched scale and scope, and enhancing their respective incentives and abilities to exploit those advantages, further increasing the dominance of the two merged companies over the remaining firms in the IBP connectivity business. The addition to the AT&T backbone of the "eyeballs" controlled by SBC (and similar actions by other merging parties) – given SBC's and Verizon's leading positions today in offering DSL-based Internet services, as well as their increasing deployment of technologies such as Fiber-to-the-Home and IP-based video – would substantially expand and entrench the two Tier 1 IBPs' market shares. Moreover, the presence of those "eyeballs" on the SBC/AT&T and Verizon/MCI Internet backbones, combined with those two companies' monopoly bottleneck control over the local connectivity on which enterprise customers (*e.g.*, Internet content providers) depend, would increase the likelihood that Internet content, as well as "eyeballs," would increasingly migrate to the two merged companies' Tier 1 backbones. Additionally, the two firms will have the incentive and ability to develop proprietary technology that makes use of their services seemingly more efficient or more attractive to end-users. Similarly, as third generation (3G) wireless services develop and exponentially increase Internet usage in that way, SBC will have the incentive and ability to direct its majority-owned Cingular's wireless Internet traffic to AT&T, while Verizon will have the incentive and ability to direct majority-owned Verizon Wireless's 3G Internet traffic to

MCI's backbone. ^{48/} The mergers would foreclose competing backbone providers from the opportunity to serve that traffic. Thus, the mergers would greatly enhance the two Tier 1 IBPs' current and future power, giving them unmatched scale and scope, and enhancing their respective incentives and abilities to exploit those advantages.

C. The Two Mergers Could Tip the Internet Backbone Market to Duopoly

The dramatically increased concentration brought about by the two mergers could well cause the entire IBP marketplace to "tip" to a duopoly. ^{49/} These two simultaneous proposed mergers present a high risk that the duopoly theory postulated by eminent economists in connection with the WorldCom/MCI merger in 1998 could come to pass. ^{50/} Consistent with that theory, once a firm (or two firms) reach a size considerably greater than all the rest, competitive interaction among the firms in the presence of the substantial network effects or externalities that characterize the IBP sector will lead inexorably to domination by the largest firm (or, in the present case, the two largest firms).

In the first place, the mergers would give both SBC/AT&T and Verizon/MCI the ability and incentive to cease to peer with other IBPs and to raise the costs faced by all other Internet backbone competitors. For example, some Tier 2 or Tier 3 IBPs may currently have a free peering arrangement with SBC, but once the proposed merger is consummated and SBC's

^{48/} Given that Cingular and Verizon Wireless have the largest wireless subscriberships by a considerable margin, other Tier 1 IBPs would not have that opportunity, and certainly not on the same scale and dimensions.

^{49/} Cf. *US v. WorldCom/Sprint Complaint*, ¶ 42 ("Whereas in a competitive environment Tier 1 IBPs have incentives to charge reasonable prices for transit, the merged entity threatens to become so large relative to other IBPs that its interest in providing reasonable prices or terms for transit service will diminish. Ultimately, there is a significant risk that, as a result of the merger, the combined entity will be able to 'tip' the Internet backbone services market and raise prices for all dedicated access services.").

^{50/} The theory, which BT believes was the primary basis for the US and European antitrust authorities' rejection of the proposed Internet backbone consolidation at issue in the three proposed WorldCom mergers (with MCI, Intermedia, and Sprint), was subsequently published in J. Cremer, P. Rey, J. Tirole, "Connectivity in the Commercial Internet," 48 *Journal of Industrial Economics* pp. 433-72 (December 2000).

backbone business is merged into that of AT&T, presumably the pre-existing AT&T policy of refusing to freely peer with such Tier 2 or Tier 3 providers would prevail over SBC's pre-merger policy, and those IBPs would be terminated as free peers of SBC. Moreover, by removing two prominent independent threats to the stability of the Tier 1 group – SBC and Verizon – the mergers would enable the leading Tier 1 IBPs to work even more closely in parallel to maintain the group's hegemony and avoid any “maverick” behavior. [51/](#)

More troubling, the parallel mergers would give both companies the ability and incentive to favor each other in peering arrangements and potentially to engage in free peering only with one another and not with smaller, weaker providers, in light of the greatly increased size and scope of both leading IBPs due to the mergers. The widening market share gap will give the merged firms an ever-increasing incentive to degrade connections with and to stop peering with other IBPs and to impose discriminatory and above-cost transit fees and to engage in other practices that will lead eventually to shared dominance of the Tier 1 IBP business by SBC/AT&T and Verizon/MCI. Express collusion between SBC/AT&T and Verizon/MCI is not required for this result. Each firm is likely to recognize that the other has a shared interest in a common outcome, and they would be able to signal each other through effectively bilateral contractual dealings and leaks about their treatment of third parties to achieve their common objectives.

Thus, the simultaneous proposed mergers raise a grave risk that the merged parties would be content ultimately to establish a duopoly – *i.e.*, a shared monopoly – of the Internet backbone. The two merged firms would peer with each other exclusively and require transit payments from everyone else (including former Tier 1 firms), and use that position to

[51/](#) DOJ/FTC *Horizontal Merger Guidelines*, § 2.12.

continue to garner “eyeballs” and content subscribers in their respective territories and beyond. Given the network externalities involved here, the prospect of ever reversing that trend will grow dim and eventually disappear.

CONCLUSION

For the reasons discussed above, BT respectfully submits that the Commission must very carefully scrutinize the proposed merger in light of the substantial anti-competitive impacts it would likely cause to consumers, competitors, and the wider competitiveness of the US economy.

Respectfully submitted,

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