Divestiture Requirement

Effect of Mergers on Competition:

1. *Existing Market Conditions. The market for local and intermediate distance transport services is highly concentrated.*[1] *Only a few companies own the physical local networks which are essential to connecting "long-haul" or "backbone" networks to customer buildings or traffic aggregation points such as carrier hotels and RBOC central offices. Further, the barriers to entry for new facilities-based transport providers are dauntingly high. Building networks in metropolitan and suburban areas is expensive and complicated due to costs of underground construction in densely-populated areas and the myriad of requirements imposed by various municipalities, local governmental entities (which in many instances impose franchise terms that discriminate against new entrants) and building owners. Further, given capital constraints, it seems unlikely that any entity will (in the near term) construct networks replicating those currently owned by AT&T and MCI, especially since no other entity has anywhere near the volume of traffic (both voice and data) that AT&T and MCI have. Because of their high volumes of traffic, AT&T and MCI have been able to justify capital expenditures on network builds that would not be justifiable for competing providers with much smaller volumes of traffic.*

2. *Existing Suppliers. Not surprisingly, ILECs like SBC and Verizon are the dominant suppliers of transport services within their regions. Level 3 spends well over a hundred million dollars each year for the purchase of transport services from SBC, Verizon, AT&T and MCI*[2]*. Both MCI and AT&T have developed or procured the physical network footprint, off-net supply contracts, scale and operations necessary to make them the largest and most capable alternative suppliers to SBC and Verizon for in-region transport services.*

3. *Effect of Mergers on Competition. The competitive harm caused by the mergers is readily apparent: eliminating MCI and AT&T from a market already characterized by lack of competitive alternatives and high prices will increase the risk of anti-competitive conduct and above market pricing by the remaining dominant supplier.*

4. *Coordinated Anti-Competitive Effects. SBC and Verizon have not competed meaningfully in each other's territory despite repeated pledges and despite being well-positioned in some key markets (CT/NY, Dallas, Los Angeles) to do so. The mergers significantly increase the risks of coordinated anti-competitive effects from the merged entities. After closing of the mergers, we do not expect MCI to continue as a significant competitor in SBC's territory (nor do we expect AT&T to be a significant competitor within Verizon's territory) for the provision of transport services on a wholesale basis. Thus, mergers could mean the effective loss of* ***both*** *of*

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[1] By "intermediate distance", we mean generally intrastate transport from major urban areas to surrounding suburban, ex-urban communities and smaller cities, where important business customers are increasingly migrating.
[2] SBC, Verizon, AT&T and MCI are the four largest Level 3 vendors in terms of annual payments.

the best-positioned alternative providers in the local transport market in SBC and Verizon territories.

Effective Remedies:

1. <u>*Divesting Transport Facilities*</u>*. In order to maintain competition in the transport marketplace at premerger levels, AT&T and MCI should be compelled to divest tangible and intangible transport assets. Requiring a divestiture at the transport facilities level of these networks allows users of transport services (whether they be other carriers, systems integrators or large end user customers) to have an alternative access option other than the incumbent RBOC and to ensure that redundant physical facilities -- built at great difficulty and expense -- remain owned by different companies for the offering of competitive services.*

2. <u>*Access Price Regulation*</u>*. While the divestiture of AT&T and MCI facilities is necessary to preserve access competition where it exists today, it is important to emphasize that for the vast majority of buildings in their respective regions (both traffic aggregation points such as central offices as well as end user buildings), no provider exists other than SBC and Verizon. As such, in addition to divestiture, it is critical that the FCC take aggressive steps to ensure that special access prices are reasonable and non-discriminatory for these monopoly destinations.*

Divestiture Specifics:

1. <u>*Divestiture Requirement*</u>*. Level 3 advocates a "Network Divestiture/Customer Retention" plan, where all of AT&T's and MCI's "In-Region Transport Assets" (defined below) should be divested within SBC's and Verizon's territories. "In-Region Transport Assets" means tangible assets such as fiber, transport equipment and collocation space and intangible assets such as AT&T's and MCI's off-net transport purchase agreements or rights within the territories of SBC and Verizon. In-Region Transport Assets would not include AT&T's and MCI's long-haul intercity backbone.*

2. <u>*Divesting Customer Contracts*</u>*. Requiring divestiture of AT&T's and MCI's customer agreements, while preferable from the standpoint of reducing the retail market concentration of the merged entities, is not feasible because:*

   a. *Division of customer contracts would be exceedingly difficult. Most of the customer contracts are "Master Service Agreements" or "MSAs" pursuant to which customers buy a wide variety of multiple services (e.g., voice, internet, virtual private networks, transport, systems integration) from AT&T and MCI in a number of locations throughout the U.S. and other countries. These single contracts would need to be divided into multiple agreements, with pricing allocated potentially to each separate service and even each separate circuit. Customers will find this compelled transfer of their agreements to be unattractive.*

b. *If customer contracts were split and conveyed, the new owner of the In-Region Transport Assets would have to heavily rely on billing systems, provisioning systems, Network Operations Center (NOC) support and other Operational Support Systems (OSS)/Business Support Systems (BSS) that would have to be retained by AT&T and MCI (so as to permit them to continue to provide services under the "unassigned" portions of the MSAs). The extent of required cooperation between the new owner and the merging entities would be significant and long term, and could hamstring the new owner's abilities to effectively compete with the incumbent upon which it relies.*

c. *It is likely that many of the more sophisticated enterprise customers receive proprietary services or service level agreements from AT&T and MCI that would be difficult for a competitor to quickly replicate.*

d. *Given that customers would be "involuntarily" conveyed to the new owner, the risk of losing that customer base seems great, even if AT&T and MCI are contractually limited from actively marketing services to those end users (divestiture of MCI's customers to Cable & Wireles was an example of the difficulties involved with such customer divestitures).*

3. *Maintenance of Traffic on Divested Assets. Currently, the costs of maintaining AT&T's and MCI's In-Region Transport Assets is amortized over large volumes of traffic – both their own traffic (voice and data) over shared circuits as well as circuits dedicated to particular customers. For the purchaser of the In-Region Transport Assets to be able to compete as effectively going forward as AT&T and MCI do today, it is important that the purchaser obtain the scale benefits that such traffic volumes create. Traditional antitrust remedies would replicate the premerger competitive environment by compelling divestiture of customer agreements along with the assets. As noted above, we believe the divestiture of all of AT&T's and MCI's customer relationships is infeasible.[3] If the merged entities desire to retain customers, they should be required to keep existing traffic on the divested In-Region Transport Assets for some minimum period of time (with payment to the buyer for continuing to carry such traffic). As a practical matter, the merged entities will take considerable time to migrate the traffic off of the divested In-Region Transport Assets, so such a condition will not be onerous to the sellers. This purchase commitment would also allow the purchaser sufficient time to build a customer base – both wholesale and retail – on the In-Region Transport Assets so that it could compete with the incumbent even after expiration of the purchase commitment.[4]*

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[3] It may be feasible, however, to require divestiture of some subset of AT&T's and MCI's existing customer agreements, such customer agreements where wholesale customers purchase basic transport services from AT&T or MCI.

[4] It should also be noted that restrictions on the *number* of purchasers of In-Region Transport Assets may also be required in order to assure that the purchasers have the incentive to restore premerger levels of competition. If AT&T's In Region Transport Assets were sold to different purchasers in each separate market, those separate purchasers would be less likely to have the scale and operations necessary to restore the competitive landscape.

4. *__Network Divestiture/Customer Retention__. We believe that the best structure to preserve premerger levels of competition would require conveyance of the In-Region Transport Assets, a purchase commitment from the sellers to continue to use those assets for a stated period, and retention of customer agreements by AT&T and MCI. Such a structure has the following advantages:*

   a. *It restores the premerger competitive landscape, in that the new owner would be able to quote pricing, terms and conditions for wholesale services that were offered by AT&T and MCI prior to the merger and to use the facilities to provide services directly to end user retail customers.*

   b. *It permits AT&T and MCI customers to continue their direct contractual relationships, so that there would be no interruption (except as might otherwise result from the merger itself) in the customer's support, billing and contractual terms.*

   c. *The interfaces between the new owner and AT&T and MCI are the straightforward transport interfaces that the companies use currently when they buy off-net circuits from LEC's and other network providers. No support from or interfaces with the sellers would be necessary for more complex services.*

   d. *It delivers benefits to SBC and Verizon that they have publicly claimed as reasons for the merger, including serving the largest business customers with a full range of products and services.*

   e. *It requires divestiture of only the assets that are essential to restoring premerger competition. While narrowly tailored, however, it places into the hands of the purchaser all of the transport assets necessary for the purchaser to be an effective, long-term competitor for the provision of local and intermediate distance transport services.*

   f. *It is easily enforceable, and does not require significant, intrusive regulation of the conduct of the merger parties or the purchaser of the divested assets.*