August 15, 2005

Via ECFS

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

Re: SBC Communications Inc. and AT&T Corp. Applications for Consent to Transfer of Control, WC Docket No. 05-65; Response to Cox Communications, Inc. Ex Parte Filed July 28, 2005

Dear Ms. Dortch:

On behalf of SBC Communications Inc. and AT&T Corp., ("Applicants"), we are submitting this brief response to the ex parte submission by Cox Communications, Inc. ("Cox") and the accompanying paper prepared by Dr. Gerald W. Brock. Dr. Brock's paper is premised on hypotheticals that are quite far removed from present day or expected future reality, raises issues that are not merger-specific, and ignores the existence of any form of effective regulation. Dr. Brock's analysis of his hypotheticals, therefore, does not support the "remedies" he proposes. Moreover, his basic premise – that "telecommunications policy has been based on a [specific] industry structure" consisting of historical market, service and provider segmentation, including specifically separate local and long distance markets – has not been U.S. policy since at least 1996. Indeed, he fundamentally misses two points on which his own client, Cox, has premised its business plans and which it is successfully demonstrating:[1] (1) there is increasing facilities-based competition for last-mile connections to business and residential customers to provide a full suite of communications services, and (2) competition from cable TV companies, telephone companies, broadband providers, systems integrators, wireless firms and others cuts across any

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[1] Press Release, Cox Communications, Cox Communications Announces Fourth Quarter and Full-Year Financial Results for 2004 (Mar. 16, 2005) (quoting Cox's President and CEO as saying, "Our bundled customer penetration signals that Cox customers are embracing multiple communications and entertainment services from a single provider they trust. In fact, we expect the number of advanced revenue generating units will soon surpass the number of basic cable customers we serve, illustrating that we've truly arrived as a full service broadband communications company."); Cox Communications, 2004 Form 10-K, at 2 ("Bundling is a fundamental business strategy for Cox. . . . In 2004, the number of bundled customers grew by 23% to 2.8 million, and 44% of Cox's basic video customers now subscribe to more than one service.").

historical market segmentation and provides a vibrant, effectively operating competitive marketplace. Hence, as we have demonstrated repeatedly, the SBC/AT&T merger poses no threat of competitive harm, and there is no basis for the Commission to impose any conditions on its approval.

Vertical integration issues, whether involving traditional circuit-switched voice, Internet, or so-called "hybrid" services, have been thoroughly addressed in Applicants' submissions to date. Although Dr. Brock purports to raise such issues, until he reaches the "Application" section of his paper, on page 8, he does nothing more than restate the general proposition that a firm with a large enough share of an installed base of customers may have an incentive to impair interconnection with rivals.[2] But the fundamental question is how, if at all, do the vertical aspects of *this* transaction enhance *these* Applicants' ability or incentive to engage in anticompetitive conduct? A quick review of Dr. Brock's three specific applications shows that there is no merger effect to be remedied.

As an initial matter, Dr. Brock repeatedly refers to the "two-level" industry structure of the current market as providing adequate safeguards, including, in particular, the opportunity for "indirect" interconnection.[3] His "two-level" structure, however, in which neither level is integrated into the other, is a theoretical construct based on plainly counterfactual assumptions, which does nothing to advance real-world policy considerations. In analyzing how vertical integration might harm local access competition, Dr. Brock raises two theoretical concerns, both of which hinge on the elimination of independent "long haul" backbone providers post-integration: (a) access competitors (ISPs) would be denied a bypass connection, and (b) backbone transmission is a necessary complement to local access, and a denial of interconnection, or an increase in the price of backbone services, could disadvantage access competition. As to both issues, however, Applicants have shown that the fragmented nature of the Internet constrains any credible threats of de-peering or denial of interconnection – for all of the reasons discussed in Dr. Schwartz's Reply Declaration.[4] Thus, as will be seen in the three

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[2] This proposition has been widely discussed in the economics literature, and has also been the premise of past enforcement actions, such as DOJ's complaint against the *MCI-WorldCom/Sprint* transaction five years ago. As such, it adds nothing new to the Commission's consideration of the current application.

[3] Dr. Brock refers to this structure at page 7 in Case 3 (referring to long distance as an alternative to direct local interconnection), on page 8 in Case 4, and again on page 13 in his conclusion. For ease of discussion, Applicants have considered this theoretical construct in terms of the Internet, which seems to have been Dr. Brock's starting premise (Brock Paper, at 4). As shown in Section A, below, however, the two-level construct likewise has no application to the real world of common carrier voice communications.

[4] As Applicants have explained, a single transit agreement will provide complete connectivity, even to customers on a backbone that has denied the ISP any direct interconnection. *See* Joint Opposition of SBC Communications Inc. and AT&T Corp. to

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specific cases discussed by Dr. Brock, and analyzed below, the "two-level" construct is an inappropriate framework for analyzing the specific effects of this merger on competition.

A. Common Carrier Voice

This hypothetical is premised entirely on the assumed abuse of terminating access charges to disadvantage non-affiliated long distance carriers, which provide long distance service to CLECs so that the CLECs can provide their customers bundles of local and long distance services. There are at least two responses to this rather far-fetched hypothetical: (1) neither the ability nor the incentive to impose the hypothesized abusive access charges is altered by the merger, and (2) as to the BOCs, Section 272(e)(3) of the Communications Act[5] provides adequate regulation of interconnection charges to prevent such hypothesized abuse (Dr. Brock explicitly assumes away any regulatory constraint). Moreover, as Dr. Brock notes, the issue traces to the percentage of U.S. telephones to which the merging companies provide terminating access – but the "merging companies" are SBC and AT&T (not SBC and Verizon).[6] Combining SBC with AT&T adds nothing to the calculus.

B. Internet

Applicants' previous submissions, and in particular the Declaration and Reply Declaration of Dr. Marius Schwartz (collectively, the "Schwartz Declarations"), and Applicants' July 6 and July 26, 2005, Responses to comments filed by EarthLink, Inc. (collectively, "Applicants' EarthLink Rebuttal Comments"), have thoroughly rebutted claims that vertical integration might lead to competitive harms in the Internet market segment. Applicants have demonstrated time and again that SBC/AT&T's share of Internet traffic will simply be too small for any denial or degrading of traffic interconnection to occur. Even if the effects of the SBC/AT&T and Verizon/MCI transactions are combined as if they were a single transaction, the

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Petitions to Deny and Reply to Comments, May 10, 2005, at 69; Schwartz Reply Declaration, ¶ 30.

[5] 47 U.S.C. § 273(e)(3).

[6] As Applicants have shown previously, Commission precedent dictates separate consideration of the effects of the SBC/AT&T and Verizon/MCI mergers. The Commission has consistently held that license transfer applications are ordinarily treated as "mutually exclusive" and are subject to "simultaneous consideration" only where "the grant of one application would *require* the denial of the other." *Applications for Consent to Transfer Control from MediaOne Group, Inc. to AT&T Corp.*, 15 FCC Rcd. 9816, ¶ 181 (2000). Thus, for example, the Commission flatly rejected requests that the AT&T/MediaOne merger proceeding be "consolidated" with the AOL/Time Warner merger proceeding on the theory that the "AT&T-MediaOne merger would fundamentally change the nature of the relevant markets of the applicants in the AOL-Time Warner merger." *Id.* ¶ 179. Similarly, the Commission considered the SBC/Ameritech merger independently of the contemporaneous Bell Atlantic/GTE merger.

result does not change – the combined companies do not control a sufficient share of Internet traffic to engage in global, near-global or even targeted degradation or de-peering.

Dr. Brock's "high quality" network example is just a variant on the same spurious arguments offered by EarthLink, and is not credible for the all the reasons set forth in the Schwartz Declarations and in Applicants' EarthLink Rebuttal Comments.[7] To recap, since customers will insist on universal connectivity for VoIP and video conferencing, a refusal by SBC/AT&T to interconnect at the appropriate quality with Internet Backbone Providers ("IBPs") other than Verizon/MCI would undermine the value of SBC's own VoIP services. Since competing IBPs would be free to develop, and interconnect among themselves, their own high quality network, SBC's (and Verizon's) VoIP and video-conferencing offerings would suffer relative to the offerings of other providers, whose VoIP customers collectively would reach more than twice the Internet at the assumed high quality level as could be reached by the VoIP customers of SBC/AT&T and Verizon/MCI. Moreover, even the static post-merger traffic shares overstate the anticipated market power of the merging companies because of the significant amount of traffic controlled by broadband ISPs other than SBC and Verizon, notably the cable companies. These broadband ISPs are large enough that they can rapidly alter the shares of traffic across IBPs without any coordination at all. Therefore, Dr. Brock's statement that "[t]he effectiveness of that response [to degradation by the post-merger companies] would depend upon relative shares of the Internet access market and the ability of the non-ILEC access providers to coordinate their efforts"[8] simply is incorrect – unilateral action will suffice to defeat any attempt by SBC (or Verizon) to degrade the transmission of its competitors' traffic.

C. Hybrid Services

Lastly, Dr. Brock suggests that, because of regulatory uncertainty, hybrid services may be "more easily" affected than common carrier voice (where regulation constrains strategic conduct)[9] and Internet services (where competition constrains strategic conduct). The specific example offered by Dr. Brock is with terminating access for VoIP and related services such as 911. But Dr. Brock does not explain how SBC's incentives and abilities to affect VoIP interconnection with the PSTN are altered by the merger, nor could he because such concerns are not merger-specific. Indeed, the one VoIP complaint, involving blocking of Vonage calls by Madison River, shows that such conduct is unrelated to mergers in general, and this merger in particular. To the contrary, that incident confirmed that such discrimination is an "edge" issue, as to which the Commission has demonstrated that it can and will take swift and strong action to remedy.

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[7] Applicants limit their comments here to the pure Internet aspects of the VoIP hypothetical, since the hybrid aspects are dealt with in Section C.

[8] Brock Paper, at 10.

[9] Applicants note that it is Dr. Brock who asserts that regulation constrains strategic conduct in the common carrier voice segment, notwithstanding that his hypotheticals are premised on the absence of such regulation. Brock Paper, at 11.

Conclusion

Dr. Brock and Cox reargue and restate economic principles and facts that already have been fully and conclusively addressed by Applicants in multiple submissions. As there is (still) no identifiable increase in Applicants' ability or incentive to engage in anticompetitive behavior flowing from the merger, there is no basis for the remedies suggested by Dr. Brock.

Sincerely,

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