October 14, 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 BT Americas Inc. Ex Parte Filed October 7, 2005

Dear Ms. Dortch:

On behalf of SBC Communications Inc. and AT&T Corp., (the "Applicants"), we are submitting this brief response to the ex parte submission of BT Americas Inc. and the accompanying paper prepared by Economists Incorporated ("EI") dated July 20, 2005.[1] BT attempts to have the Commission believe it filed "new" data by now submitting a report that is three months old. The EI paper, however, adds nothing new either to the framework for analyzing the effects of the transaction on the Internet backbone market or to the relevant facts. Moreover, EI ignores the detailed expert declarations by Dr. Marius Schwartz that fully addressed both the Department of Justice prior enforcement actions, as well as the theoretical analysis of Crèmer, Rey and Tirole.[2] Finally, EI's market share analysis both utilizes an overly broad definition of Internet backbone services, and is based on publicly available revenue data, a basis that has been directly rejected by the Department of Justice in prior actions. BT not only does not advise the FCC that this proposed measure of market share has been reviewed and rejected by the Department, it also wholly fails to discuss why the FCC should accept this measure in light of the Department's rejection of revenue data in favor of traffic data when analyzing Internet backbone merger effects.

Dr. Schwartz's initial Declaration reviewed, with far greater analytic rigor than does the EI paper, prior Department of Justice enforcement actions in *WorldCom-MCI*, *WorldCom-Sprint*

---

[1] Letter from A. Sheba Chacko to Marlene H. Dortch, October 7, 2005.

[2] The initial Declaration of Dr. Schwartz (February 21, 2005), and the Reply Declaration of Dr. Schwartz (May 10, 2005) were both filed over two months prior to the completion of the EI paper.

and *WorldCom-Intermedia*.[3] Using traffic data from RHK, Dr. Schwartz demonstrated that the Internet backbone market has become substantially less concentrated since 2000, to the point where the pre-merger HHI is now less than 800, and the post-merger HHI under 1000.[4] Verizon's expert, Dr. Kende, likewise utilized RHK traffic data in his Reply Declaration, and independently came to a similar conclusion that the Internet backbone market is unconcentrated.[5] While EI claims that there is no indication in the Kende Reply Declaration as to how RHK estimated the overall size of the market, and otherwise dismisses the RHK traffic study as implausible because of the very large loss in traffic share experienced by MCI,[6] EI overlooks that Appendix 2 to the initial Schwartz Declaration contains RHK's methodology.[7] Further, as will be shown below, the proper analysis of IDC's revenue data actually supports the RHK conclusions.

EI claims, without support, that "[r]evenue measures can be a good measure of the value and size of the customer base of an Internet backbone provider."[8] EI fails to acknowledge, however, that DOJ declined to rely on revenue measures in *WorldCom-Sprint* because, in the words of the Antitrust Division's Director of Operations, "there were questions about the accuracy" of the publicly available revenue data.[9] Given DOJ's reliance on traffic measures in *WorldCom-Sprint*, and the availability of reliable, third-party traffic measures from RHK, EI simply has not made the case for the FCC to consider revenue-based market share analysis, let

---

[3] Declaration of Marius Schwartz ¶¶ 4-18.

[4] *Id.* ¶¶ 22-23 and Table 2.

[5] Reply Declaration of Michael Kende in WC Docket 05-75, at ¶¶ 5-8.

[6] EI Paper at 11.

[7] EI also states that Kende relies on a "private traffic study" that RHK did "for Verizon/MCI". *Id.* RHK, however, has prepared traffic studies for several years by gathering data from top Internet backbone providers, and then estimating the total Internet backbone traffic. It provides this information to those companies who have provided it with data, but only identifies the providing company's data. If EI is implying that the RHK studies are unreliable because they were privately commissioned by Verizon/MCI, that implication is simply wrong. In any event, the RHK data on which Dr. Schwartz relied was not part of any private study for Verizon/MCI.

[8] EI Paper at 9.

[9] Address by Constance K. Robinson, Director of Operations and Merger Enforcement, Antitrust Division, U.S. Department of Justice, Before the Practicing Law Institute, San Francisco, California, August 23, 1999, "Network Effects in Telecommunications Mergers - MCI WorldCom Merger: Protecting the Future of the Internet" at 11, *available at* www.usdoj.gov/atr/public/speeches/3889.htm. Robinson also criticized WorldCom's efforts to measure the Internet using revenues because they "included revenue from sources other than their backbone services and double counted other revenue, such as revenues for ISPs who buy connectivity from others." *Id.* at 10, n.14. EI has not shown that its revenue data are free from these defects.

alone extrapolated revenues. Nor has EI made the case that the revenues on which it relies reflect Internet backbone functions, as opposed to ISP functions.

EI uses aggregate data from IDC on Wholesale IP Backbone Revenues and Business IP Backbone Revenues. For each of these broad categories, however, IDC reported more refined revenue break-outs. Wholesale IP was divided between Dial IP (managed modem services) and Upstream Transit.[10] Of MCI's $1,389.3 million in Wholesale IP Backbone Revenues in 2002, $1,180.9 million, or 85% of the total revenue, was from wholesale Dial IP. IDC notes that the market shares in Dial IP are driven by the contracts with AOL and that, by virtue of these contracts, "AOL creates the leaders in the wholesale IP segment."[11] Moreover, Dial IP (managed modem services) is not a core backbone service, which is why Dr. Schwartz concluded that within the Wholesale segment, Upstream Transit revenue provided a more appropriate measure of Internet backbone functionality, and he therefore excluded the Dial IP revenue from his market share analysis.[12]

Similarly, IDC divides Business IP Backbone Revenues into Dedicated Internet Access (DIA) and Remote Access. IDC noted in its report that "MCI's revenue is concentrated more than most in the remote access space . . . ."[13] Of MCI's $1,453.8 million in 2002 Business IP revenue, $703.6 million comes from remote access. However, remote access is more in the nature of ISP functionality, which is why Dr. Schwartz concluded that DIA was a better measure than Business IP as a whole of backbone functionality.[14]

The results of Dr. Schwartz's analysis are reflected in Table 3 of his Declaration, and show that the Internet backbone market as measured by revenues that approximate Internet backbone functionality is unconcentrated, and would remain that way after the SBC/AT&T transaction. The consistency of the RHK traffic and IDC revenue measures used by Dr. Schwartz demonstrate that these are credible reflections of the current Internet backbone reality. The EI paper does nothing to refute these conclusions.

EI's paper is otherwise filled with errors of fact and analysis which undermine its credibility. For example:

---

[10] *See* Schwartz Declaration, Appendix 3-2 at Tables 2 and 3.

[11] *Id.,* Appendix 3-2, at 5.

[12] *Id.* ¶ 25.

[13] *Id.*, Appendix 3-1, at 3.

[14] *Id.* ¶ 25. As Dr. Schwartz also noted, the revenue streams selected were conservative, as they resulted in higher shares for SBC and AT&T than would have occurred had the MCI Dial IP revenue been included. As noted in footnote 2, all of Dr. Schwartz's analysis was on the FCC record for a number of months before EI prepared its paper, yet EI totally ignored all of this evidence.

- EI's assertion that SBC/AT&T and Verizon/MCI "will end up with roughly comparable market shares that considerably exceed the shares of any remaining rival" (EI Paper at 5) totally ignores the facts, which show that SBC/AT&T will be only marginally larger than its principal rivals, and that Verizon/MCI will rank fourth,[15] hardly the stuff of "two mega-peers."

- EI's assertion that SBC/AT&T or Verizon/MCI would have nothing to gain from breaking any supposed collusive agreement between them (EI Paper at 7) is simply bad economics. Further, the error is critical to EI's conclusion, since EI admits as a given that SBC/AT&T and Verizon/MCI will not "be large enough profitably to degrade quality alone" and therefore "neither of the merged entities could acquire dominance without coordination." *Id.* As the Applicants have repeatedly demonstrated, claims of such coordination are baseless.[16]

- EI's contention that Internet backbone customers would be powerless to prevent dominance of one network (or two colluding "mega peers") by shifting to other networks – thus eroding the customer base of the would-be dominant firm – ignores the growth in buyer power over the past five years. Cable giants such as Comcast and Time Warner are very large broadband ISPs, that between them control a larger share of residential Internet end users than do SBC and Verizon combined (about 33% versus 28%).[17] As retail competitors to the merging firms, they have every incentive – as well the ability – to prevent the former from acquiring market power over an input that all use, Internet backbone services. EI's submission contains barely a reference to the central role played by the cable companies, a role that has expanded dramatically since the past Internet mergers.

---

[15] Kende Reply Declaration, ¶ 8.

[16] *See, e.g.,* Letter from Gary L. Phillips and Lawrence J. Lafaro to Marlene H. Dortch ("Response to Joint CLECs"), September 15, 2005, at 9-10 and submissions cited in n.34 thereof.

[17] Schwartz Reply Declaration, Table 4.

Conclusion

The EI paper filed by BT Americas is replete with errors, and ignores the detailed factual record and economic analysis provided by the Applicants, all of which conclusively demonstrate that the transaction will have no adverse competitive effects in the Internet backbone market, or with respect to Internet connectivity issues generally.

Sincerely,

SBC Communications Inc.

/s/ Gary L. Phillips
Gary L. Phillips
SBC Communications Inc.
1401 I Street, N.W.
Suite 400
Washington, D.C. 20005
Tel: (202) 326-8910

AT&T Corp.

/s/ Lawrence J. Lafaro
Lawrence J. Lafaro
AT&T Corp.
Room 3A 214
One AT&T Way
Bedminster, NJ 07921
Tel: (908) 532-1850