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EX PARTE – VIA ELECTRONIC FILING

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

Re: WC Docket Nos. 05-65 and 05-75

Dear Ms. Dortch:

BT Americas Inc. (“BT”) is hereby submitting Economist Incorporated’s response to SBC Communications and AT&T Corp. ex-parte dated October 14, 2005 (“SBC/AT&T Letter”). BT believes that the 2002 data regarding the AOL contracts mentioned at Page 3 of the SBC/AT&T Letter may be dated and that AOL Internet Backbone traffic patterns may have changed. *See also* Declaration of Michael Kende ¶¶ 2, 11 and n. 5.

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

Respectfully submitted,

A. Sheba Chacko

cc: Jessica Rosenworcel
Scott Bergmann
Best Copy



**Reply to the SBC/AT&T Response to Economists
Incorporated's Internet Backbone Analysis**

**John H. Preston
October 19, 2005**

A. Introduction

1. In a submission dated October 14, 2005, SBC Communications, Inc. and AT&T Corp. (“SBC/AT&T”) responded (“SBC/AT&T response”) to a paper titled “An Economic Analysis of the Competitive Effects of the SBC/AT&T and Verizon/MCI Mergers on the Internet Backbone Market.” The economic analysis was prepared by Economists Incorporated (“EI”) and submitted by BT Americas, Inc. on October 7, 2005 (“EI’s IB paper”).¹ This submission is a reply to the claims made by SBC/AT&T in its response.
2. As a general comment, almost all of the SBC/AT&T response is devoted to a critique of EI’s market share measurement analysis. This analysis is covered in four pages of EI’s 38 page analysis.² The SBC/AT&T response ignores virtually all of the remainder of EI’s analysis, *i.e.*, (a) EI’s discussion of the underlying economic theory in Sections II-IV including the application of the same basic theory utilized by DOJ in prior merger investigations of IB mergers, (b) EI’s analysis of the impact of SBC’s and Verizon’s bottleneck monopoly control over special access on the IB market (Section VI); (c) EI’s analysis of the unique ability of SBC and Verizon to generate additional “eyeballs” for the AT&T and MCI Internet backbones, respectively (Section VII); (d) EI’s analysis of the competitive significance of the financial difficulties of other IB providers (Section VIII); and (e) EI’s analysis of how the two telecom mergers threaten Internet expansion and economic growth (Section X).
3. SBC/AT&T claim that “EI’s paper is otherwise filled with errors of fact and analysis which undermine its credibility.”³ They go on to cite only three

¹ EI’s IB paper is dated July 20, 2005

² See EI’s IB paper, Section V, pp. 9-12.

³ See SBC/AT&T response, p. 3.

supposed examples of “errors of facts and analysis”.⁴ As discussed below, the SBC/AT&T discussion of these three examples offers only unsupported and unresponsive assertions.

B. Market Share Measurement and Analysis

1. In Section V, EI’s IB report concluded that “[r]elying on the same IDC revenue data that Kende used to show MCI/WorldCom’s decline in Internet backbone revenue share, we have calculated that the combined Internet backbone shares of SBC/AT&T and Verizon/MCI reached 44.5% in 2003. Using the same extrapolation technique employed by Kende and referenced above, we project that the combined shares of the two merging firms reached 49.3% in 2004 and will reach 54.0% in 2005.”⁵ [footnotes omitted]
2. The SBC/AT&T response implies that it was inappropriate for EI to rely on publicly available revenue data for its market share measurement analysis.⁶ In fact, as the SBC/AT&T response eventually acknowledges, SBC/AT&T’s own Internet backbone economic expert, Marius Schwartz, relied upon these same publicly available revenue data in his first declaration for the purpose of estimating market shares.⁷ In addition, Verizon/MCI’s Internet backbone economic expert, Michael Kende, also relied upon the same publicly available revenue data for market share estimation in his first declaration.⁸ Furthermore, Kende, as discussed in more detail below, used these same publicly available revenue data in his second declaration for the purpose of showing that MCI’s share of Internet backbone revenues had declined over the period 2000-2004.

⁴ See SBC/AT&T response, p. 4.

⁵ See EI’s IB report, p. 9.

⁶ See SBC/AT&T response, pp. 1-3.

⁷ Marius Schwartz provided two declarations on behalf of SBC/AT&T on Internet backbone issues. The first declaration was dated February 18, 2005 and the second was dated May 7, 2005.

⁸ Michael Kende provided two declarations on behalf of Verizon/MCI on Internet backbone issues. The first declaration was dated March 9, 2005 and the second was dated May 23, 2005.

3. The source for the Internet backbone revenue data relied upon by Schwartz and Kende for market share estimation is IDC, an information technology consulting firm. Schwartz attached two IDC reports to his first declaration showing Internet backbone revenues by provider in 2002.⁹ In Exhibits 2 and 5 of his second declaration, Kende provides Internet backbone revenues by provider for the period 2000-2003. The source of Kende's revenue data is also IDC. EI's market share estimation in Section V of its IB paper is based upon the IDC revenue data that are reproduced in Kende's second declaration in Exhibits 2 and 5.
4. Schwartz relied on three types of data for market share estimation in his first declaration: (1) RHK traffic data; (2) IDC revenue data; and (3) Telegeography AS connection data. He does not argue that one type of data is to be preferred over the others. He presents the market share measurements based on the three types of data as three alternative estimations.
5. Schwartz utilized two of four categories of the IDC revenue data in his analysis. He does not say that it would be inappropriate to use the two excluded categories. Rather, he says the two categories he did use "appear to reflect most closely Internet backbone functions," but he does not provide further analysis to support this weak assertion. He states that focusing on these two categories "tends to overstate the positions of the parties," which suggests that inclusion of the other two categories would be appropriate. If the two excluded categories were also used, he states that their inclusion would raise the MCI share and lower the shares of AT&T and SBC. He does not provide market share calculations based on this broader market definition.¹⁰
6. In his first declaration, Kende, provided a market share estimation analysis virtually identical to the analysis provided by Schwartz in his first declaration. Kende relied upon the three same sources of data, including revenue data from IDC.

⁹ See Schwartz's first declaration, Appendix 3. In his market share estimation shown in Table 3 of his first declaration, Schwartz, however, relied upon "unpublished" IDC revenue data for 2003.

¹⁰ See Schwartz's first declaration, pp. 11-12.

7. In his second declaration for Verizon/MCI, Kende analyzes MCI's market share based on all four IDC categories over four years (2000-2003) with a projection to 2004. He argues that these data show MCI's decline in market share over the 2000-2004 period. He goes on to argue, however, that using these same data to calculate market shares for all of the IB providers (including the merged entities) would be inappropriate. EI's IB paper directly addresses this aspect (as well as other aspects) of Kende's argument, concluding that this aspect of Kende's argument does not withstand scrutiny.¹¹
8. EI's market share estimation is a straightforward application of the IDC revenue data and methodology utilized by Kende in his second declaration and Schwartz's IDC revenue data and methodology utilized in his first declaration (except, as noted above, that Schwartz used only two of the four IDC revenue categories).
9. The RHK traffic data reports relied upon by both Schwartz and Kende were not submitted for public inspection, making third party evaluation of their methodology, data and analysis impossible. While the SBC/AT&T response claims that Appendix 2 of the first Schwartz declaration shows how RHK estimated the overall size of the market,¹² it does not. It is merely a very general description of broad categories of activities used to estimate overall Internet traffic. There is no way to determine if RHK's market size measurement was reasonable or not based on the information contained in Appendix 2 of the first Schwartz declaration.
10. The SBC/AT&T response cites a speech by Constance K. Robinson, the DOJ Director of Operations and Merger Enforcement, given in August 1999.¹³ This speech reviewed the approach of DOJ in analyzing the Internet backbone issues raised by the proposed WorldCom/MCI merger in 1998. While Ms. Robinson did state that "there were questions about the accuracy" of two publicly available sources of data, she also stated that DOJ did examine "market shares using other

¹¹ See EI's IB paper, footnote 12 on p. 9.

¹² See SBC/AT&T response, p. 2.

¹³ See SBC/AT&T response, p. 2 and footnote 9 for details about the speech ("Robinson speech").

methods as well.” Among the other methods used by DOJ was “a revised revenue share that attempted to eliminate the double counting and irrelevant revenues.”¹⁴

11. Marius Schwartz, in his first declaration, states that DOJ “considered a number of measures” in its review of the WorldCom/MCI merger. These measures included “Total Internet revenue for ISPs connected to the IBP, with and without eliminating double counting and irrelevant revenue.”¹⁵
12. Neither BT nor any other telecommunications provider is in a position to conduct a traffic study of the type employed by DOJ in WorldCom/Sprint. Such a study relied upon DOJ’s ability to obtain traffic data through compulsory process.

C. Other “Errors” Claimed by the SBC/AT&T Response

1. In response to the first bullet point on page 4 of the SBC/AT&T response, EI’s argument is a straightforward application of the underlying economic theory discussed in Sections II-IV of EI’s IB paper. As noted above, this underlying theory was relied upon by DOJ in prior IB merger investigations. It should also be noted that the market share analysis contained in Section V of EI’s IB paper provides estimated market shares consistent with this theory.
2. In the second bullet point on page 4 of its response, SBC/AT&T assert that EI’s argument that the merging parties will have an incentive to tacitly collude to achieve joint dominance is “bad economics.” They provide no analysis to support this assertion. In fact, EI’s IB paper explains in theoretical and factual detail the strong incentives that the merging parties will face to tacitly collude to achieve joint dominance.¹⁶
3. In the third bullet point on page 4 of its response, SBC/AT&T simply ignore the detailed analysis in EI’s IB paper explaining why customers (including Comcast

¹⁴ See Robinson speech, p. 11.

¹⁵ See Schwartz’s first declaration, p. 6 and footnote 7.

¹⁶ See EI’s IB paper, especially pp. 6-8

and Time Warner) will not be able to prevent anticompetitive behavior by the jointly dominant Internet backbones following the two mergers.¹⁷

¹⁷

See EI's IB paper, pp. 26-31.