

October 20, 2005

**EX PARTE**

Marlene Dortch  
Secretary  
Federal Communications Commission  
445 12<sup>th</sup> Street, S.W.  
Washington, DC 20554

**Re: Applications for Consent to Transfer Control of Filed by Verizon Communications, Inc. and MCI, Inc., WC Docket No. 05-75**

Ms. Dortch:

In its recent filing in this proceeding, BT Americas Inc. (“BT”) asserts that the transaction will harm competition in the Internet backbone business.<sup>1/</sup> However, BT largely repeats arguments that others have made and that Verizon/MCI already have refuted. The record evidence demonstrates that, contrary to BT’s claim, the Internet backbone business will remain competitive after this transaction.

As we have shown, the transaction will not materially alter the status quo in terms of the backbone business, which will remain highly competitive. The combined company will carry less than 10% of North American Internet traffic, it will rank fourth among seven comparable or larger backbone operators, and operators other than those seven will carry approximately 35 percent of Internet traffic.<sup>2/</sup> BT in fact *concedes* (at 7) that “neither firm [i.e., Verizon/MCI or SBC/AT&T] will be large enough to profitably degrade quality alone” and that “neither of the merged entities could acquire dominance without coordination.” Accordingly, it is left to assert that Verizon/MCI and SBC/AT&T somehow would engage in a coordinated effort to obtain dominance over the Internet backbone business. However, this argument fails for at least two fundamental reasons.

*First*, Verizon/MCI and SBC/AT&T would not have near the market share to successfully implement a coordinated degradation strategy. The economic theory of anticompetitive harm on which BT relies (at 2-4) was premised on unilateral effects in a context where a single provider (WorldCom/Sprint) allegedly was going to achieve a traffic share approaching 50%. Here, however, even if the two merged companies had the incentive and

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<sup>1/</sup> See Letter from A. Sheba Chacko, BT Americas Inc., to Marlene Dortch, Secretary, FCC, WC Docket No. 05-75 & Attached White Paper by Economists Inc. (“White Paper”) (Oct. 7, 2005).

<sup>2/</sup> See Reply at 70-80; Kende Reply Decl. ¶ 8; see also Merger Procedure Article 6(1)(b) Decision, *Verizon/MCI Notification of 2 Sept. 2005*, Case No. COMP/M.3752, ¶¶ 27-29, 33 (Commission of the European Communities) (“EC Decision”).

ability to coordinate their strategy and effectively acted as one backbone (which, as discussed below, they would not), their combined traffic share would be approximately 28 percent — significantly less than the 40-50% shares that gave rise to concern in prior mergers and less than would be necessary under a tipping theory for even a single firm, let alone where two separate firms would need to coordinate. *See* Reply at 71-72 & n. 105, 74; Carlton et al. Reply Decl. ¶¶ 84-87; Kende Reply Decl. ¶ 8. The EC recently rejected BT’s theory on this very basis. *See* EC Decision ¶¶ 42-43. Moreover, Verizon/MCI would be ranked *fourth* by traffic share, and it makes no sense to suggest that the first- and fourth-ranked backbones would engage in a bilateral coordinated degradation strategy.

Indeed, the likely result of any such strategy would be to drive customers to the second- and third-ranked backbones, as well as the three other backbones of comparable stature and the numerous others that themselves carry 35% of North American Internet traffic today. *See* Reply at 71; Kende Reply Decl. ¶ 8 (noting that there would be seven backbones of comparable stature following the two transactions). Backbone customers with large numbers of end users would have both the ability and incentive to defeat any attempt to engage in a “mega-peering” strategy by switching providers, self-provisioning, and/or engaging in practices such as secondary peering. For example, as discussed below, cable companies are the market leaders in providing broadband service. As a result, a backbone provider that provided service to one or more cable companies would have a significant customer base, and the combined Verizon/MCI (as well as the combined SBC/AT&T) could not afford to degrade service to (or disconnect from) that backbone. *See, e.g.,* Carlton et al. Reply Decl. ¶ 85; Kende Reply Decl. ¶ 26. Although BT suggests (at 26-31) that cable companies and other customers would have an incentive to switch to Verizon/MCI or SBC/AT&T, its argument assumes that the two operators are already “dominant” and that therefore a customer would want to purchase service from one of those companies. But, as explained above, in fact the large majority of Internet traffic would *not* ride over either of these backbones.

Faced with these problems, BT attempts to brush aside the traffic share data and instead to focus on extrapolations of *revenue* data for the two combined firms to suggest they would have higher shares. *See* BT at 9-12. But as Dr. Kende has previously explained, currently available traffic data is a more reliable measure of share than available revenue data. Kende Reply Decl. ¶ 4. BT’s only substantive criticism of the RHK traffic data is to suggest (at 11) that it is “not plausible” that MCI’s traffic share dropped to just over 8 percent from the 37 percent that DOJ attributed to it in 2000. But, as we previously noted, RHK’s numbers are confirmed by MCI’s (and Verizon’s) own internal traffic studies, which show similar volumes of traffic. *See* Kende Reply Decl. ¶ 8. Given that MCI has had financial difficulties and the backbone business has become increasingly competitive in the years since the DOJ estimate, it is hardly surprising that MCI’s traffic share would have declined substantially. In addition, the two share numbers are not directly comparable: as BT itself notes (at 11), the DOJ share number was only for the top 15 Internet backbones in the U.S., while the RHK data is for all backbones. That difference is particularly significant given the increased use of secondary peering, whose direct result is to increase traffic that rides over smaller backbones without passing through a transit connection to a larger backbone. BT’s other criticism of the traffic data — its suggestion (at 11) that the data

was the result of a study conducted specifically for Verizon/MCI — is simply not true. RHK has conducted Internet traffic studies for several years, and Verizon/MCI purchased a copy of a study that RHK already had completed because it is viewed as the most reliable and valid measurement of Internet traffic. *See* Kende Reply Decl. ¶ 7.

By contrast, as we have explained, the IDC revenue numbers to which BT points do not accurately reflect the relevant market shares. *See, e.g.*, Letter from Dee May, Verizon and Curtis Groves, MCI to Marlene Dortch, Secretary, FCC, WC Docket No. 05-75, at 1-2 (Sept. 12, 2005) (“Vz/MCI Sept. 12 Ex Parte”). In particular, the revenue data for Verizon (and other ILECs) appear to include revenue from dedicated business lines that connect Internet service provider customers to Verizon’s points of presence; because non-ILEC backbone operators do not typically offer these dedicated lines, the revenue figures are not for comparable services. *See* Kende Reply Decl. ¶¶ 12-13.

*Second*, even if the two combined firms did have higher shares, the economic theory of anticompetitive harm on which BT relies is premised on *unilateral* effects. Here, by contrast, BT asserts (at 4-8) that Verizon/MCI and SBC/AT&T will “coordinate their actions by only peering with each other.” But there is no basis for that suggestion or BT’s alternative claim that the two merged entities would coordinate a degradation strategy. *See, e.g.*, Reply at 73-74; Carlton et al. Reply Decl. ¶¶ 82, 85. To the contrary, there is every reason to believe that an attempt to coordinate by two backbones A and B would fail. For example, if Backbone A were to degrade interconnection with a smaller peer C, not only would Backbone A risk losing its own customers (since they too would suffer from the degradation), but the customers of the target C might well decide to move to Backbone B or some other backbone operator (and not Backbone A given the animosity that inevitably would result from the degradation). Thus, it would be much better for one backbone to let the other take the risk of degradation, while being in a position to reap the benefits. Similarly, if Backbone A de-peered Backbone C, and C had to use transit as a result, C likely would turn to another backbone provider such as B rather than the one that had targeted it. Consequently, Backbone A’s strategy would potentially make its rival larger. As a result, once again, each backbone operator would have the incentive to wait for the other to engage in a de-peering strategy, and thus it is highly unlikely two backbone operators would ever elect to implement a “coordination” strategy of the kind BT posits. The coordination strategy would be even more difficult if the backbones were not of equal size: if Backbone A were smaller than Backbone B to begin with, Backbone A would have to worry about being disproportionately affected by the degradation, and be less likely to initiate this strategy, but then backbone B also would be unwilling to be the only one engaging in this strategy.

BT ultimately falls back to the position that Verizon/MCI will be able to gain an increased share of Internet backbone customers because it will be able to use its alleged “bottleneck control over local connectivity to businesses” through special access and its “large customer bases of residential users and small businesses” to route Internet traffic to its backbone.<sup>3/</sup> *See* BT at 7-8, 13-23. But this claim is wrong on both counts. With respect to

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<sup>3/</sup> BT’s suggestion (at 13) that Michael Kende, Verizon/MCI’s expert in this proceeding, has previously “sounded the alarm about how ILEC local bottleneck monopoly control could be used to obtain

special access, BT's premise that the combined company's special access services will give it a "bottleneck" over business connectivity is simply wrong. The evidence in the record — which BT does not bother to address, let alone refute — demonstrates, among other things, that there are numerous alternative facilities-based providers of local connectivity to businesses in the areas where MCI currently provides service and that the transaction will not lessen competition for such connectivity. *See, e.g.*, Reply at 13-28; Letter from Dee May, Verizon and Curtis Groves, MCI to Marlene Dortch, Secretary, FCC, WC Docket No. 05-75, Special Access White Paper (Aug 25, 2005).

With respect to traffic from Verizon/MCI's mass market customers, BT's argument appears to be that the amount of traffic on Verizon/MCI's backbone sometime *in the future* will increase due to the growth of broadband traffic from services such as DSL and wireless. *See* BT at 15-23. But, as we have explained elsewhere, there is no basis to conclude that Verizon/MCI's relative *share* of Internet backbone traffic will increase. *See, e.g.*, Vz/MCI Sept. 12 Ex Parte at 2-4. While more IP traffic is likely to originate from (and terminate to) the combined company's retail broadband customers, other broadband access providers will also see increases in such traffic, and there is no reason why that increase would somehow be disproportionately greater for Verizon/MCI. Indeed, cable modem, not DSL, is the clear market leader for broadband, and Time Warner, Comcast, and other cable companies obviously also will benefit from increases in broadband Internet traffic. *See* Letter from Dee May, Verizon and Curtis Groves, MCI to Marlene Dortch, Secretary, FCC, WC Docket No. 05-75, at 7-8 (Aug. 8, 2005); Reply at 83-84; Hassett et al. Decl. ¶ 58; Hassett et al. Reply Decl. ¶¶ 38-40. And, while BT suggests (at 19-21) that Verizon/MCI's introduction of video services through its FTTP deployment will give it a competitive "advantage" by offering a "sticky bundle," cable companies today already have that advantage because they offer the so-called triple play bundle of phone, video, and broadband access.

Moreover, while BT suggests (at 17-19) that DSL's share is starting to grow relative to cable modem, as the Commission itself has recognized, alternative forms of broadband, including 3G wireless, satellite technologies, fixed wireless, Wi-Max, and broadband over power lines, are poised to grow rapidly. *See, e.g.*, Report and Order, *Appropriate Framework for Broadband Access to the Internet over Wireline Facilities*, CC Docket No. 02-33 et al. ¶¶ 33, 56-61 (rel. Sept. 23, 2005). That will likely *reduce* the proportion of broadband access traffic carried over DSL because customers can turn to these additional alternative technologies. Although, as BT notes (at 21-23), Verizon Wireless will benefit to some degree from the growth of wireless broadband access, so will the various other significant wireless players. For example, Sprint is in the midst of rolling out an EV-DO network that provides high-speed connectivity,

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dominance over the Internet backbone" is incorrect. Rather, Dr. Kende simply said, at the end of the very passage that BT quotes, that such an issue "is best left to an analysis of the market for last-mile access." Michael Kende, *The Digital Handshake: Connecting Internet Backbones*, FCC OPP Working Paper No. 32 (2000). And, as we discuss below, such an analysis demonstrates that cable companies are the market leaders for broadband and that the broadband access business is not the subject of an "ILEC local bottleneck monopoly."

and Cingular is following suit with a GSM equivalent.<sup>4/</sup> Similarly, T-Mobile has also upgraded its data capabilities.<sup>5/</sup> The end result of these developments will be an increasingly fragmented broadband access market. As a result, although the overall amount of broadband IP traffic may well increase, there is no reason to believe that the relative share carried over Verizon/MCI's backbone will increase.

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In sum, as the EC recently concluded in rejecting the same claims BT makes here, the evidence demonstrates that this transaction will not have harmful effects on competition for Internet services.

Sincerely,



Dee May  
Verizon



Curtis Groves  
MCI

cc: Michelle Carey  
Julie Veach  
William Dever  
Ian Dillner  
Gail Cohen  
Tom Navin  
Don Stockdale  
Gary Remondino

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<sup>4/</sup> See, e.g., S. Ellison, IDC, *US Wireless Consumer 2004-2008 Forecast Update: November 2004*, at 3 (Nov. 2004) (“Other carriers like Sprint PCS, Nextel, and Cingular are expected to follow suit with their 3G deployment in late 2005, throughout 2006, and beyond.”); UBS Investment Research, *Sprint Corporation: Improved outlook based on strong selling wireline performance*, at 7 (July 27, 2005) (“[W]e believe that Sprint PCS will likely see meaningful contributions from highspeed wireless data, which has commanded higher price points.”); Friedman Billings Ramsey, *Capital Expenditures Forecast 2005-2006: Wireless Strength Partially Offset by Consolidation Synergies*, at 3 (Apr. 13, 2005) (“Cingular plans to deploy UMTS in 15 to 20 markets by 4Q05 and in the remainder of its markets by the close of 2006.”); J. Halpern, et al., Bernstein Research, *US Wireless: Accelerated growth Driven by Youth and Business Markets; Outlook Positive for Large Carriers* (May 12, 2005); Bill Draper, *Sprint Rolls Out Wireless Internet Plan*, Associated Press, July 8, 2005.

<sup>5/</sup> See, e.g., T-Mobile USA Technology Overview (visited Sept. 9, 2005)  
<http://www.tmobile.com/company/about/technology.asp>.