Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C.

In the Matter of GTE Corporation, Transferor,	))	
	)	
and	)	CC Docket No. 98-184
	)	
Bell Atlantic Corporation, Transferee	))	

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FEDERAL COMMUNICATIONS COMMISSION
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REPLY COMMENTS

OF THE

COMPETITION POLICY INSTITUTE

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SUMMARY OF THE REPLY COMMENTS OF THE COMPETITION POLICY INSTITUTE ON THE PROPOSED MERGER OFGTE AND BELL ATLANTIC CC DOCKET NO. 98-184

The proposed merger poses significant threats to the achievement of the goal of Congress to promote competition for local exchange telephone service and raises other public interest concerns. The commenters have identified at least four reasons why this merger will directly harm the growth of competition for local telephone service. *First*, the merger removes a strong and experienced potential and, in some cases, an actual competitor. *Second*, the merger increases both the company's ability and incentives to engage in anticompetitive activity. *Third*, the merger results in one fewer company that can be used to "benchmark" or compare the practices of one ILEC with another. *Fourth*, the merged company would have an increased ability to leverage its monopoly power over local telephone service into related markets.

Furthermore, the alleged benefits of the RBOC mergers in terms of cost savings are speculative, and in any case, may not be reflected in lower rates to consumers. If the merger results in any cost efficiencies, it is unlikely that these efficiencies will be passed on to consumers. The applicant's proposed strategy to launch attacks on other RBOCs' regions is highly suspect.

It appears as if the applicants have not opened their markets to competition. If the applicants had complied with these requirements, then the Commission could have some reason to predict that competitive forces would develop in sufficient strength to ameliorate many of the potential risks to competition posed by this merger. In part because of the applicants' inability or unwillingness to comply with the requirements set forth by Congress, the FCC and the courts to open their local networks to competitors, these companies continue to hold a near-monopoly over local telephone service. The FCC cannot be certain at this time that local telephone competition will grow to sufficient levels to create a competitive check on the practices of these companies.

Most important, the Commission must consider the consequences of its decision in this case on the future of the telecommunications industry. If the Commission approves the pending merger, it is likely to encounter proposals to merge all the large ILECs into one carrier in the near future. Such a result could be devastating to the nation's telecommunications and political landscape.

For all these reasons, the proposed merger should be denied.

REPLY COMMENTS OF THE
COMPETITION POLICY INSTITUTE
ON THE PROPOSED GTE-BELL ATLANTIC MERGER

I. INTRODUCTION

Should the United States have a single dominant national telephone company? This is the essential policy question the Federal Communications Commission must answer when it considers the proposed merger of two very large local exchange carriers, GTE and Bell Atlantic.

The same logic that the applicants employ to justify this merger can also be used to justify the merger of the remaining large incumbent LECs into a single national telephone company. Economic and operational efficiencies, the need to bulk up in order to compete, and homage to the natural forces of the marketplace can all be cited to support the combination of the remaining large local exchange companies into a single national company. The Competition Policy Institute (CPI) urges the Commission to consider the consequences of taking the applicants' reasoning to its logical conclusion *in this case*. The Commission should not agree to cross this bridge later.

To be clear, the logic used to support of this merger is *no different* than the logic that will be used to justify the merger of all the remaining RBOCs and GTE into a single company. **If the Commission accepts these arguments now, it will be pressured to accept them later in the context of an even larger ILEC merger. If the Commission plans to reject this logic later, then the Commission should reject it now.**

If this merger and the proposed merger of SBC and Ameritech are approved, the number of large incumbent local exchange carriers (ILECs) will have fallen from eight to four in just

three years. Approval of these mergers will signal that any future mergers are acceptable, and the Commission is likely to face applications to merge all the remaining large ILECs in the future.

Such a colossus, with over $100 billion in annual revenues, would be one of the world's largest companies. It would exercise a sobering degree of influence over the nation's communications system, its political system and consumers' daily lives. A single national telecommunications company could effectively decide which telecommunications services are deployed and on what schedule, the level of prices charged (within the limited regulatory restraints that currently exist), which telecommunications standards should be established, the pay scales and working conditions for hundreds of thousands of employees, which manufacturers' products are acceptable, which information services would receive favorable access to the telephone network, the uses of customers' proprietary network information, which international services are supported, etc. In addition, the national telephone company could have far-reaching influence over non-telecommunications aspects of our lives. This single firm would have a dominant influence in social and political spheres through its support of charitable organizations and contributions to political candidates.

If the FCC approves the pending mergers, the Commission must face the possibility that this vision will become reality. Obviously, this vision stands in sharp contrast to a competitive local exchange market where all of these influences are much more diffused and, most importantly, are controlled by the forces of competition.

In its evaluation, the Commission must determine whether this merger satisfies the public interest. In the past, the Commission has employed an extensive discussion of the economic benefits and costs of telecommunications mergers. But the Commission should not make the

mistake of limiting its public interest evaluation to a mechanical or formulaic comparison of such dollar figures. The telecommunications policy landscape has changed and the Commission's analysis must reflect the policy shift that culminated in the Telecommunications Act of 1996 (the 1996 Act). Since passage of that Act, the public interest is inextricably tied to the development of competition in the telecommunications industry. Similarly, the Commission should not use its public interest authority simply to replicate the antitrust analysis performed by the Department of Justice and other antitrust authorities. The public interest test is an inherently broader inquiry than a strict antitrust analysis. The public interest test "leaves wide discretion and calls for imaginative interpretation."[1] As the Commission stated in its Order approving, with conditions, the Bell Atlantic-NYNEX merger:

> Commission analysis of the effect of the transfer on competition is informed by antitrust principles, but not limited by the antitrust laws. The public interest standard, and the competitive analysis conducted thereunder, are necessarily broader than the standard applied to ascertain violations of the antitrust laws. Under the public interest standard, the burden of proof is on the applicant, not the Commission. In addition, under the public interest standard, the Commission may consider the *trends* within and *needs* of the industry, the *factors* that influenced Congress to enact specific provisions for a particular industry, and the *complexity and rapidity* of change in the industry. [emphasis added; footnotes omitted][2]

Consistent with this statement in the ***Bell Atlantic Merger Order***, CPI urges the FCC to reject the GTE-Bell Atlantic merger. First, the Commission must recognize the *trend* of large ILECs to merge and must put an end to further consolidation. Second, the Commission must recognize the

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[1] *Federal Communications Commission v. RCA Communications, Inc.*, 346 U.S. 86, 90 (1953).

[2] *In the Matter of Application of NYNEX Corp. and Bell Atlantic Corp. For Consent to Transfer Control of NYNEX Corp. and its Subsidiaries*, 12 FCC Rcd 19985, Memorandum Opinion and Order (1997)(hereinafter "***Bell Atlantic Merger Order***"), para. 32.

industry's *need* to become more competitive, not more consolidated. Third, the Commission must recognize Congress's desire to promote greater competition in the local exchange market, not to promote large ILEC mergers. Fourth, the *complexity and rapid change* in the competitive side of the industry requires that the ILECs devote significant attention to making their networks open and compatible with the competitors' networks, rather than becoming distracted by merger-related activities.

The balance of these comments illustrate, through the initial comments filed in this case, why the proposed merger would be contrary to the public interest. We also demonstrate why the FCC should deny this and future mergers of large ILECs unless and until the companies follow through on Congress's requirements to open their local telephone networks to competition.

II. THE COMMENTS DEMONSTRATE THAT THE MERGER FAILS TO MEET THE PUBLIC INTEREST TEST BECAUSE THE POTENTIAL HARMS OF THE PROPOSED MERGER OUTWEIGH THE POTENTIAL BENEFITS.

As described in the ***Bell Atlantic Merger Order,*** the Commission employs a balancing test to determine whether the public interest test is met with respect to a merger application. In conducting this balancing test, the Commission places the burden on the applicants to show that the merger is in the public interest.

In the initial comments in this case, parties identified several significant potential harms that will come about because of the merger. In addition, the purported benefits set forth by the applicants and their supporters are far too speculative to merit our reliance on them.

Before reviewing the evidence specific to this merger, we stress that the Commission should recognize that these mergers occur against the backdrop of significant Congressional

legislation. While Congress did not specifically indicate that mergers such as the pending ILEC mergers were contrary to its intent, it is clear that the pending mergers upset the careful balance Congress fashioned in passing the Act. In particular, Congress acted under the assumption that the RBOCs would remain independent competitors of each other.[3]

Unfortunately, the mergers of several key industry players has upset this balance to the detriment of competition and consumers. Since passage of the 1996 Act, the concentration of ownership in the communications industry has developed much faster than the growth of local exchange competition. If this industry consolidation continues unchecked, the pro-competitive goals that Congress endorsed in the 1996 Act may be impossible to achieve, with the result that consumers may end up paying higher rates for lower quality service.

For this reason alone, the Commission should arrest the mergers of large ILECs until competitors have had an opportunity to obtain a significant foothold in the marketplace. We recognize that the Commission cannot "unring the bell" by undoing its prior merger approvals. It can, however, avoid a further loss of balance by denying the pending application until such time as these large incumbent local exchange companies make significant progress in opening their networks to competitors.

A. The Potential Harms from the Proposed Merger are Real and Significant.

In these comments, CPI will focus in on the particular damage to competition and

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[3] See, for example, section 273(a)("A Bell operating company may manufacture and provide telecommunications equipment, . . . except that neither a Bell operating company nor any of its affiliates may engage in such manufacturing in conjunction with a Bell operating company not so affiliated or any of its affiliates.")

consumers that will attend these mergers.[4] Of course, it is difficult to predict with certainty the exact effects that will flow from any merger. But there are several strong reasons to believe that this merger is likely to harm the public interest. These include:

1. The proposed merger will eliminate a significant potential competitor in each of the existing GTE and Bell Atlantic regions.

2. The proposed merger would strengthen the incumbents' incentive and ability to thwart the growth of local competition.

3. The proposed merger will reduce the number of companies whose performance can be used to "benchmark" or compare one company against another.

4. The proposed merger will increase the opportunity for the merged company to leverage its market power into other markets.

For these reasons, the FCC should find that the proposed merger of GTE and Bell Atlantic is contrary to the public interest.

1. The proposed merger will eliminate a significant potential competitor and an actual competitor in each of the existing Bell Atlantic and GTE regions.

This merger eliminates a significant potential competitor in the market for local telephone service. No companies are better financed and equipped to provide competitive local telephone service than the very large companies who already provide local telephone service in their own regions. The merger eliminates such a competitor in the regions of Bell Atlantic and GTE and removes a competitor that would likely enter regions outside its own. As Sprint points out in its

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[4] Several commenters give examples of actions by GTE and Bell Atlantic to forestall competition. To be sure, these anticompetitive practices (and the incentives that motivate them) will likely persist whether or not the merger is permitted. But these examples are nevertheless relevant to the FCC's public interest inquiry in evaluating this merger: first, they demonstrate that the possible harm that may result from the merger is not mere speculation, but is grounded in fact; second, they illustrate the types of problems that will persist even longer and worsen if the merger is permitted.

comments,

> [GTE and Bell Atlantic] have advantages in entering local markets that are unavailable to virtually all other potential entrants. These advantages include experience in providing local services, particularly expertise in established complex systems to handle administrative capabilities (billing, order taking, customer care, etc.) not enjoyed by other possible entrants such as cable companies or CAPs.[5]

The existing ILECs already have the marketing skills, the access to capital, the technological know-how, the management and employees to be significant competitors outside of their regions. Indeed, all of the efficiencies that the merger applicants allege would result from the merger are equally valid reasons to believe these companies would be effective competitors outside their home markets.[6]

Furthermore, Sprint points out that GTE and Bell Atlantic had each made plans to compete in the other's territory.[7] GTE had received CLEC certification in New Hampshire, Rhode Island, Connecticut and Maryland. GTE had applied as well in Virginia but withdrew its CLEC application after the merger was announced. GTE had also entered interconnection

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[5] Sprint Petition to Deny, p. 11.

[6] The FCC should consider GTE and Bell Atlantic to be significant potential competitors even if the companies have not drawn up detailed business plans to enter every one of the other's markets. The parties are already competing with each other in mobile services and in a variety of overseas services, and they are planning to compete with each other in long distance services once Bell Atlantic receives approval under section 271. Indeed, the applicants' stated desire to become a full-service provider to customers with locations spread across the country demonstrates their incentives to provide competitive local telephone service outside of their own regions. It is thus reasonable for the Commission to predict that market forces will drive the companies to compete with each other for local telephone service even if they do not have explicit plans to do so today. The Commission has authority under the public interest to make such predictive judgments.

[7] See Sprint Petition to Deny, pp. 14-25.

agreements to compete with Bell Atlantic in Virginia and Pennsylvania. Sprint also notes Bell Atlantic pursued competitive opportunities to compete with GTE for business at Dulles International Airport and Virginia Beach.

There is one more reason to believe that Bell Atlantic and GTE would have competed with one another absent the merger. Both companies have engaged in nationwide and regionwide advertising campaigns. Each company inevitably would find it profitable to provide service in neighboring regions served by the other carrier in order to take maximum advantage of its marketing strategies. Just as cable companies find it economically valuable to assemble large "clusters" of cable systems in neighboring regions, these large telephone companies would have found it valuable to provide telephone service over a large "footprint".

In short, marketplace realities would likely have driven these companies to compete with one another if they had not decided to merge. The loss of an actual and potential competitor would be a significant blow to the prospects of vibrant local exchange competition.

2. The proposed merger would strengthen the applicants' incentive and ability to thwart the growth of local competition.

. The comments show that the proposed merger would increase *both the incentive and the ability* of the carriers to thwart competitive entry.

a. Increased incentives to discriminate.

The affidavit of Drs. Michael Katz and Steven Salop, attached to the comments of Sprint, demonstrate that the merged ILEC has greater reason to discriminate against the competitors that

provide nationwide service than if the companies do not merge.[8] This is because the effects of discrimination in one region of the country will have "spillover effects" on the competitor's operations in other regions of the country as well. Katz and Salop give the following examples:

i. Long distance competitors.

An IXC providing traffic among regions requires an interconnection at both ends of the call. If the ILEC providing terminating access to the IXC denies or degrades that access, then an ILEC competing with the IXC to offer long distance service at the originating end also will benefit. Thus, in the interexchange market, an exclusionary access policy by one ILEC towards IXCs will spill over and benefit other ILECs in other regions.[9]

ii. Competing local exchange carriers.

Exclusionary access policy by one ILEC directed toward multi-market CLECs can also benefit other ILECs. . . . if a CLEC suffers lower quality or higher costs, reduced market share, and lower profitability in one region, those factors will reduce the likelihood that it enters other regions as well. . . . In deciding whether to enter the business at all, a potential carrier will evaluate its overall expected profits for entry. . . . If the market-specific profits sum to less than the required return on their capital and common costs, then entry will be unattractive. Thus, an ILEC's actions that reduce the profitability of entry in one region can lower the likelihood of entry in all regions.[10]

There also may be economies of scope associated with offering service in multiple local markets that affect variable costs (e.g., reduced costs of obtaining certain pieces of equipment whose use varies with the number of subscribers or calling volume). In this case, exclusion that reduces the entrant's volume in one market increases the entrant's

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[8] Declaration of Dr. Michael L. Katz and Dr. Steven C. Salop, "Using a Big Footprint to Step on Competition: Exclusionary Behavior and the SBC-Ameritech Merger," October 14, 1998, Attachment B to Sprint's Petition to Deny (Katz and Salop Declaration). Although the initial Declaration of Drs. Katz and Salop analyzed the proposed SBC-Ameritech merger, they attach an addendum to their declaration along with Sprint's Petition to Deny the Bell Atlantic-GTE merger which states that "the economic analysis set forth in the attached declaration applies to the proposed merger of Bell Atlantic and GTE, CC Docket No. 98-184." November 23, 1998.

[9] Katz and Salop Declaration, p. 41.

[10] Katz and Salop Declaration, pp. 42-43.

variable costs in the other markets in which it is competing.[11]

iii. Combined services

> A CSC [combined services carrier] may be offering advanced services that are subject to service-specific network effects (i.e., each service derives value from the fact that it is offered in a lot of places and allows many end users to communicate with one another). Exclusionary tactics in one region can weaken a CSC's ability to sell its entire suite of combined services in other regions by reducing customers' perceived quality of the advanced services that are included in that suite.[12]

According to Katz and Salop, in each of these cases the ILEC's actions in its own region affect the ability of the another market participant to compete in other regions. Before a merger, the ILEC may not account for these "spillover" effects since they accrue to the benefit of an unrelated ILEC. A merged company, however, will be able to capture some of these "spillover effects" in the newly merged region. The possibility of enhanced rewards will give the carrier greater incentives to act in anticompetitive ways. Katz and Salop explained this effect in their analysis of the SBC-Ameritech merger (included with their statement in this case as well):

> For example, when SBC raises the cost of access to the IXCs, CLECs or CSCs in its region, SBC's foreclosure action may weaken the rivals' ability to offer service in Ameritech's region as well. If so, Ameritech derives an anticompetitive benefit from SBC's exclusionary conduct. Of course, before the merger, SBC would not take this spillover benefit to Ameritech into account. However, after the merger, SBC will take this spillover benefit accruing to Ameritech into account. As a result of internalizing these spillovers, SBC's incentives to raise rivals' costs would be increased. Similarly, the merger would raise the merged entity's incentives to engage in exclusionary behavior in Ameritech's region.[13]

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[11] Katz and Salop Declaration, p. 44.

[12] Katz and Salop Declaration, pp. 44-45

[13] Katz and Salop, p. 38. See also, the example contained in the Declaration of Stanley Besen, Padmanabhan Srinagesh, and John R. Woodbury, attached to the Sprint Petition to Deny, p. 18-19 ("As one example, the higher costs or degraded service quality imposed on a

The significance of this analysis must not be underestimated. Katz and Salop have identified a *qualitative* change in the incentives of the merged firm to discriminate. It is not simply that the combined companies have the combined incentives of the old companies. Instead, a new, larger incentive is created; the whole is larger than the sum of the parts.

b. Increased ability to discriminate.

In addition to increased incentives to discriminate, the merged company will have a greater *ability* to discriminate. First, it would have a greater revenue base that can be used to support predatory pricing. The merged company may be more willing to endure losses by pricing services below cost in markets that new entrants have targeted if the merged company has a larger source of revenue from other services and markets.[14]

Second, the size and scope of the merged companies' operations will make it even more

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CLEC in Bell Atlantic's territory will result in the CLEC obtaining fewer customers in Bell Atlantic's territory than it would otherwise attract. As a result, the CLEC may engage in less national advertising or invest less in upgrading its service quality than otherwise, and will be a less aggressive competitor in other geographic areas, which would likely include the GTE territory. GTE will then experience less competition and greater profits. . . . A merger between Bell Atlantic and GTE would internalize this anticompetitive spillover and increase the incentives for exclusionary behavior.")

[14] The fact that so many states have adopted price cap regulatory regimes may make it even easier for carriers to engage in predatory pricing. Many states allow carriers to lower prices with little or no regulatory review. Other regulatory regimes, including the FCC's price cap plan, allow the carriers to lower prices of targeted services within a basket as long as the overall level of prices within the basket remains within a certain range. As a result of these pricing plans, it has become difficult or impossible to establish that carriers have engaged in anticompetitive price manipulation. This does not mean that regulators should abandon flexible regulatory regimes; it simply means that the increased size of the carriers, combined with their market power and ability to use pricing flexibility, poses a risk to competition and to consumers that is very difficult to detect and prove. CPI suggests that the main weapon to combat this behavior is to insist that competition develops before mergers proceed.

difficult for state and federal regulators to protect against unlawful pricing behavior. In this proceeding, the applicants claim that any potential for discriminatory action can be monitored and prevented by regulation. The Commission has dealt with this argument before. Parallel arguments were raised in the context of the Commission proceeding on the limit on subscribers served by cable operators. In deciding that no cable operator should serve more than 30% of the nation's cable subscribers, the Commission found that

> [t]he 30% limit is a structural complement to the program access provisions. . . . structural regulation generally is more easily enforced and detected than conduct regulation. . . . structural regulation imposes far fewer economic costs on the market than regulatory models that use primarily price or case-specific conduct regulation as a way to mitigate strategic, anticompetitive behavior.[15]

The Commission should recognize here, as it did in the cable context, that regulators have a limited ability to protect against anticompetitive behavior through regulation of behavior. Regulators are correct to rely on structural regulation to enforce the public interest. Denying the proposed merger between GTE and Bell Atlantic would thus be fully consistent with the Commission's adoption of a 30% limitation on subscribers by cable MSOs.

In addition, AT&T correctly notes that the merged companies would have the potential to share their "best practices" used to combat competitive inroads. (AT&T Petition to Deny, pp.14-19) In other words, the sharing of these "best practices" may actually allow the merged companies to share their "worst tendencies" — their most successful means of keeping competitors out of the market.

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[15] *In the Matter of Implementation of Section 11(c) of the Cable Television Consumer Protection and Competition Act of 1992, Horizontal Ownership Limits*, MM Docket No. 92-264, Memorandum Opinion and Order on Reconsideration and Further Notice of Proposed Rulemaking, June 26, 1998, para. 42.

3. The proposed merger will result in the loss of a participant in the local telephone market that policy-makers can use to compare or "benchmark" one ILEC against another.

AT&T and Sprint accurately note that a diminution in the number of large ILECs will make it more difficult for regulators to compare, or "benchmark", the practices of one ILEC against others. In particular, the Declaration of Joseph Farrell and Bridger M. Mitchell, attached to Sprint's Petition, argues that "interconnection arrangements for rivals may be particularly suited to "best-practice" benchmarking. Farrell and Mitchell continue:

> By probing the practices of individual ILECs, the Commission endeavors to assess whether ILECs' claims about technical feasibility are warranted, and to monitor the quality of interconnection. It can then establish as a standard for all ILECs a benchmark based on the best observed (or offered) practice.[16]

Farrell and Mitchell go on to describe the example of Location Routing Number (LRN) technology. More than a year ago, six RBOCs, GTE, and USTA petitioned the FCC to use a lower-quality version of local number portability, called Query on Request or QOR. Only one large ILEC (Ameritech) planned to deploy a superior method, called LRN. On the basis of Ameritech's experience, the Commission was able to conclude that it was feasible for all large ILECs to implement the LRN method.[17]

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[16] Farrell and Mitchell Declaration, p. 14. Farrell and Mitchell originally submitted their Declaration in the proceeding to consider the proposer merger of SBC and Ameritech. Farrell and Mitchell included in this proceeding an Addendum to their original declaration "to affirm that the economic analysis set forth in the [earlier] declaration applies to the proposed merger of Bell Atlantic and GTE, CC Docket No. 98-184."

[17] Farrell and Mitchell Declaration, pp. 14-15. As another example of a type of benchmarking, Sprint points out that a reduction in the number of large ILECs regulated under price cap regulation could introduce unintended incentives to operate inefficiently. Under the FCC's price cap plan, the FCC requires prices to reflect a productivity offset (the so-called "X-factor") in the inflation-adjusted price ceiling. The Commission derives the "X-factor" by

CPI suggests that the Commission should consider other examples as well. In the course of the Commission's 1997 access charge proceeding, Bell Atlantic reached an agreement with AT&T that contemplated substantial reductions in interstate access charges. Although this proposal was not ultimately adopted, it provided the Commission with both the political and economic justification for making significant prescriptive reductions in access charges for the entire industry. The likelihood that an incumbent LEC would "break ranks" over an issue like access charge reductions is obviously diminished when the number of incumbent LECs dwindles.

In fact, the applicants themselves lend support to this concern when they argue that the merger will allow the companies to share their "best practices."[18] It may be true that the sharing of information between the companies about their "best practices" will benefit consumers and the companies. But the benefits of comparing "best practices" could be achieved without the merger, simply by sharing the information in industry fora. On the other hand, if the companies are allowed to merge, the combined company is unlikely to develop multiple responses to customer needs, or to experiment to solve problems in different ways. Regulators, consumers and competitors will have no idea whether the practices developed by the merged company are truly

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averaging the productivity gains of all the large ILECs. When there are several large ILECs, the actions of one large ILEC will have a small effect on the average productivity of the carriers. The fewer the number of large ILECs, however, the greater the effect of the actions of a single ILEC on the productivity average. The merged Bell Atlantic-GTE may be less likely to reduce its costs (thereby increasing the "X-factor"), if it finds it can lower the size of the X-factor that will be used in future years. Thus, the fewer the number of large ILECs, the less aggressive they will be in reducing their own costs and operating more efficiently. Sprint Petition to Deny, pp. 44-45; Farrell and Mitchell Declaration, pp. 10-13.

[18] Public Interest Statement of Bell Atlantic and GTE, p.22.

the "best practices", because there will be fewer ILECs with which to compare these practices. By acknowledging that each company, pre-merger, has different practices, the applicants essentially acknowledge that there is diversity in the manner in which these companies market and provision services, deploy new technologies, etc. In this sense, the value that lies in this diversity of approaches to solving problems will be lost if the companies are allowed to merge.

4. The proposed merger will increase the opportunity for the merged company to leverage its market power into other markets.

The comments of Consumers Union and the Consumer Federation of America raise the issue of whether the merged company will gain unprecedented power over products and services in downstream markets. This concern is especially appropriate given that the GTE-Bell Atlantic merger would create a company serving well over 30% of the nation's access lines. The substantial increase in horizontal concentration that this merger will produce raises significant concerns about the merged company's ability to leverage its near-monopoly over local telephone service into other vertical markets.

Mark Cooper, Director of Research at the Consumer Federation of America, presented the following analysis of the merger:

> The low elasticity of demand for basic network access can also be leveraged to attack other markets. Distribution has become so highly concentrated at the regional and national scale that a successful launch of new services may come to require the implicit consent and support of the major national players. Bundling and packaging of services can be used to foreclose demand. An independent content provider cannot get in front of enough eyeballs or talk to enough computers to make a go of it without access to the dominant systems.
>
> The increasingly large regional telephone monopolies have begun to show how they will leverage this market power. They have begun to try to control the success of upstream entities b[y] leveraging their monopoly at the point of sale and favoring integrated firms. They have tried to do this in their joint marketing arrangement for long distance service

> in which they give an advantage of one supplier over others. Similarly, in seeking to have their high-speed networks declared not to be common carriage networks, they hope to gain an ability to choose the Internet service providers who will have access to their huge base of subscribers.[19]

This is not a new concern for the Commission. As discussed earlier, for instance, the FCC adopted an order limiting any single cable television operator to serving no more than 30% of the nation's cable customers. In that decision, the FCC found that a 30% limit would "prevent the nation's largest MSOs from gaining enhanced leverage from increased horizontal concentration".[20] The logic of this approach was recently confirmed when the Commission found that

> [t]he legislative history of Section 613 indicates Congress' concern that excessive horizontal concentration had the potential to facilitate the anticompetitive exercise of monopsony power and adversely impact the diversity of programming.[21]

There are several service and product markets that could be harmed by the aggregation of the applicants' local telephone businesses:

a. The equipment market.

By centralizing purchasing decisions, the merged ILECs may have the incentive and ability to skew the manufacturing market by consolidating their purchase of certain equipment in

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[19] Comments of Consumers Union and the Consumer Federation of America, Appendix A, The Impact of Telephone Company Megamergers on the Prospects for Competition in Local Markets, p.18.

[20] *Second Report and Order* in MM Docket No. 92-264 ("*Second Report and Order*"), para. 25.

[21] *In the Matter of Implementation of Section 11(c) of the Cable Television Consumer Protection and Competition Act of 1992, Horizontal Ownership Limits*, MM Docket No. 92-264, Memorandum Opinion and Order on Reconsideration and Further Notice of Proposed Rulemaking, June 26, 1998, para. 37.

an anticompetitive manner. (Concentration of ownership on the demand side can create an *oligopsony*, parallel to the concept of an oligopoly on the supply side.) This concern will become exacerbated once the RBOCs are allowed into the manufacturing market themselves.

b. The long distance market.

Several commenters point out that about one-half of the long distance calls originating in the GTE-Bell Atlantic region would also terminate in that region.[22] This will give the merged company an opportunity, unseen since divestiture, to skew the long distance marketplace by manipulating access charges paid by long distance companies and by other pricing methodologies. Again, this concern becomes even stronger once the RBOCs themselves are allowed to provide interLATA service.

c. Information services

The RBOCs are already permitted to provide information services. These companies are currently required to provide nondiscriminatory access to all information services providers under the Commission's open network architecture and comparably efficient interconnection rules. These rules have been extremely difficult to implement, however, and the risk of discrimination remains high. If the merged company is able to give favorable interconnection or pricing terms to its own subsidiary or a favored information services provider, the effects of that discrimination could be felt throughout the entire country. As noted earlier, if the merged company raises the costs of interconnection to its network, the effects of that cost increase could

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[22] AT&T estimates that approximately 50 percent of long distance calls that originate in the merged entity's regions will also terminate in those regions. (Petition of AT&T to Deny Application, p.32.)

make it harder for the disfavored companies to compete everywhere; conversely, if the merged company gives favored treatment to a particular information services provider, it will make it easier for that provider to compete nationwide. The larger the scope of the merged company's territory, the greater the potential effect that that discrimination could have on the information services market.

B. The Potential Benefits of this Merger are Speculative and Unlikely to be Realized by Consumers.

1. Efficiency gains from the merger are not likely to be passed on to consumers.

The applicants claim that the merger will result in substantial cost reductions.[23] Even if we assume that this claim is true, the important question for policy makers is not whether the mergers will benefit the companies, *but whether the mergers will benefit consumers*. In CPI's view, it is doubtful that these efficiency gains will be passed through to consumers under current marketplace conditions. The applicants face very limited competition today; they have little marketplace incentive to reduce rates, improve service quality, or otherwise flow the rewards of their merger to consumers. For the most part, these companies are regulated under price cap, price freeze, or other similar regulatory schemes that will not require them to reduce rates as a result of their lower costs. Thus, the applicants may keep these efficiency gains completely for themselves.

The applicants argue that the mergers will put them in a stronger financial position as they face increasing competition. But this is actually little comfort to consumers and, in some

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[23] GTE-Bell Atlantic Public Interest Statement, p.21.

sense, validates the concerns about the effect of these mergers on the development of competition. Even if this effect is counted as a benefit of the merger, CPI does not believe that this benefit alone can compensate for the risks of harm to competition detailed above.

2. The Commission should be highly skeptical of the applicants' stated intentions to compete with other large ILECs.

Several commenters raised doubts about the applicants' promise to use the GTE regions as the "enablers" that will allow the merged company to launch attacks on the territories of other large ILECs. CPI agrees with much of this scepticism, including the following:

a. If the applicants believe entry into out-of-region local markets is a good business strategy post-merger, then it should be a good business strategy for Bell Atlantic to enter as a competitor in GTE's service territories, and vice versa.

b. If the applicants believe it to be unprofitable to enter out-of-region local markets prior to the merger, there is little reason to believe that they will find the strategy profitable after the merger.

c. The applicants each have tremendous capital, marketing, management and other resources available to them today. There is little reason to believe the applicants need to merge to acquire the resources needed to compete outside their regions.

III. MANY OF THE PROBLEMS ASSOCIATED WITH THE MERGER COULD BE SIGNIFICANTLY AMELIORATED IF THE APPLICANTS COMPLIED WITH THE 1996 ACT'S REQUIREMENTS TO OPEN THEIR NETWORKS TO COMPETITION.

Although the applicants maintain that they face significant competition in their home

markets, competition for local telephone services has not yet developed anywhere near the levels that can serve as a competitive restraint on the dominance of the incumbent local exchange carriers. According to one analyst, the competitive local exchange carriers (CLECs) have captured only about 4% of the local telephone revenues and between 2% and 3% of the nation's access lines.

Competition has a long way to go. CPI estimates that **CLECs will need to win 42,000 new customer lines from ILECs every business day for the next five years simply to win just 30% of the nation's access lines.** According to Merrill Lynch, CLECs gained an estimated 670,000 lines in the third quarter of 1998, which translates into only about 10,300 lines per business day. The CLECs are thus far behind the pace needed to secure just 30% of the local market in five years.

For these reasons, CPI suggests that the FCC say "no" to the proposed merger unless and until GTE and Bell Atlantic have complied fully with the requirements of the 1996 Act to open their networks to competition. Over two and a half years ago, Congress directed all large incumbent local exchange carriers to provide interconnection on a nondiscriminatory basis to other competing LECs. To CPI's knowledge, neither Bell Atlantic nor GTE has successfully complied with these requirements in a single state. Under these circumstances, CPI respectfully recommends that the Commission decline to approve the merger with "post-approval" conditions attached. Instead, the Commission should deny the merger with clear language setting out the terms under which merger approval might be considered: i.e., after all necessary market-opening steps have been taken.

There are two reasons why the FCC should link the proposed merger with companies'

compliance with these market-opening requirements. First, the proposed merger diminishes the prospects for vibrant local telephone competition. The merger will strengthen companies with significant market power over local exchange service, enhancing their ability to compete unfairly against new entrants in the local telephone market. Requiring the companies to open their networks before allowing them to merge will make it less likely that the merged company could engage in discriminatory and anticompetitive behavior against new entrants. These market-opening requirements are essential to the prospects that new entrants will become viable local competitors. Once these companies become a fixture in the competitive landscape, their presence in the marketplace can go a long way towards mitigating the potential economic and political power of a merged company.

Second, denial of the proposed merger will give the companies a greater *incentive* to open their markets to competition. The theory of the 1996 Act was that interLATA relief would be the "carrot" that would induce the RBOCs to open their markets to competition. After two and a half years in which the RBOCs have made little progress toward this goal, it now appears that the prospect of long distance entry may not be a strong enough motive for the RBOCs to open their markets. If withholding long distance entry is not enough to induce them to open their networks, perhaps withholding approval of their merger will be.

In denying this application, the Commission does not have to decide whether or not GTE and Bell Atlantic are acting in bad faith. Indeed, it appears as if Bell Atlantic is making a good faith effort to implement nondiscriminatory OSS, particularly in New York. Yet competitors continue to raise questions about whether Bell Atlantic's OSS is capable of handling requests for interconnection on a sufficient scale to allow competition to develop fairly.

CPI understands that opening the local network to competitors is simply not easy and demonstrably takes a lot of time. But the complexity of this task is exactly why the FCC should keep the pressure on the ILECs to comply with the Act's requirements. Policy makers can be certain that the RBOCs will reduce their level of commitment to this task as soon as they receive the regulatory relief that they are seeking. We are also convinced that the merger will increase the incentives and abilities of the merged companies to resist the process of opening markets.

IV. CONCLUSION

The proposed merger poses significant threats to the achievement of the goal of Congress to promote competition for local exchange telephone service and raises other public interest concerns. The commenters have identified at least four reasons why this merger will directly harm the growth of competition for local telephone service. *First*, the merger removes a strong and experienced potential and, in some cases, an actual competitor. *Second*, the merger increases both the company's ability and incentives to engage in anticompetitive activity. *Third*, the merger results in one fewer company that can be used to "benchmark" or compare the practices of one ILEC with another. *Fourth*, the merged company would have an increased ability to leverage its monopoly power over local telephone service into related markets.

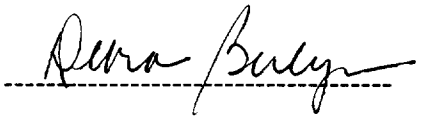
Furthermore, the alleged benefits of the RBOC mergers in terms of cost savings are speculative, and in any case, may not be reflected in lower rates to consumers. If the merger results in any cost efficiencies, it is unlikely that these efficiencies will be passed on to consumers. The applicant's proposed strategy to launch attacks on other RBOCs' regions is highly suspect.

It appears as if the applicants have not opened their markets to competition. If the applicants had complied with these requirements, then the Commission could have some reason to predict that competitive forces would develop in sufficient strength to ameliorate many of the potential risks to competition posed by this merger. In part because of the applicants' inability or unwillingness to comply with the requirements set forth by Congress, the FCC and the courts to open their local networks to competitors, these companies continue to hold a near-monopoly over local telephone service. The FCC cannot be certain at this time that local telephone competition will grow to sufficient levels to create a competitive check on the practices of these companies.

Most important, the Commission must consider the consequences of its decision in this case on the future of the telecommunications industry. If the Commission approves the pending merger, it is likely to encounter proposals to merge all the large ILECs into one carrier in the near future. Such a result could be devastating to the nation's telecommunications and political landscape.

For all these reasons, the proposed merger should be denied.

Respectfully Submitted,



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