Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Applications for Consent to the Transfer of Control of Licenses of	)	
	)	
MediaOne Group, Inc., Transferor	)	CS Docket No. 99-251
	)	
To	)	
	)	
AT&T Corp., Transferee	)	

PETITION OF SBC COMMUNICATIONS INC. TO DENY APPLICATION

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EXECUTIVE SUMMARY

AT&T asserts that its proposed merger with MediaOne is about bringing local telephone competition to consumers. Nothing could be further from the truth. In reality, the merger is about reinforcing market power in traditional cable, multichannel video programming distributor ("MVPD"), and video programming markets and extending that power into a host of emerging and vitally important broadband-dependent markets. Simply stated, the merger will impair competition, reduce service choices, and increase consumer costs.

Unprecedented reach and influence. If this merger is consummated, AT&T and its affiliates would have a dominant presence in the supply of a staggering number and diversity of services and products as reflected in the attached diagram (section I):

- AT&T would serve almost two-thirds of the homes passed by the entire cable industry.
- AT&T would control about 98 percent of cable Internet subscribers and almost 85 percent of the total broadband Internet market.
- AT&T would have interests in approximately 60 percent of the most popular cable programming.
- AT&T would have substantial equity relationships with General Instrument, Microsoft, and leading electronic programming guide services.
- AT&T would have interests in both of the two competing cellular providers in at least 37 markets across the country.

Indeed, the merger would create ownership interests and alliances between AT&T/TCI/MediaOne/Liberty Media and a veritable Who's Who of leading cable companies, programmers, broadband ISPs, software companies, and hardware providers. Consequently, it is not an overstatement to suggest that the merger's true goal is to assure that every customer for every cable- or broadband-related service must deal with a company that AT&T either owns or influences. AT&T fully intends to use the resulting market leverage to serve its own private interests to the detriment of the public (section II).

Serious rule violations. Not surprisingly, a merger conferring such a pervasive presence on a single company violates Commission cable ownership and cellular licensing rules designed to preserve competition and protect consumers (section III). While AT&T's public interest statement acknowledges these rules in passing, it presents no basis for assuring compliance. For example, AT&T downplays the phenomenal concentration that would result from the merger by using fanciful attribution principles that bear no resemblance to the attribution rules found in the Code of Federal Regulations. In fact, AT&T analyzes post-merger cable ownership using a standard – whether the combined company has the ability to control the purchasing or selection of programming – that the Commission has expressly rejected.

If the stay of the cable horizontal ownership cap is lifted, AT&T would be immediately and significantly out of compliance. AT&T has nonetheless failed both to disclose plans for divesting systems and to explain how the asserted public interest benefits would be achieved if it is compelled to scale back its empire. Similarly, AT&T has conceded that it will violate the Commission's cross-block cellular rule in 37 markets but has failed to identify these markets or to demonstrate how it will come into compliance.

Widespread competitive harms. The proposed merger, if allowed to proceed, would adversely affect a striking array of markets (section IV). The tremendous concentration resulting from the merger coupled with AT&T's closed network model would diminish consumer choice, foreclose competition, and impede innovation across both established and emerging communications markets:

- **Video Programming.** AT&T would wield monopsony power in the video programming market – effectively assuming control over the purchase of programming nationwide – enabling it to extract anticompetitive concessions from unaffiliated programmers. For example, AT&T could: (1) force unaffiliated programmers to accept lower subscriber fees; (2) demand exclusivity and thereby block rival transmission systems' access to popular programming; (3) effectively preclude the development of new, unaffiliated programming; and (4) place unaffiliated programming on less desirable tiers. Consumers would have fewer and lower-quality programming choices, and potential competitors would think twice before entering the market under these conditions.

- **MVPD Services.** The merger would immediately harm competition in a market where AT&T and MediaOne have already overbuilt. In addition, the vertically-integrated AT&T will have the power and incentive to thwart the development of rival MVPDs by denying them access to choice programming on fair terms and conditions. Moreover, AT&T would be able to continue to choke-off potential competition from Internet video streaming by limiting such streaming to 10 minutes when carried over its broadband Internet access networks.

- **Set-Top Boxes.** AT&T also will be able to leverage its indirect ownership stake in set-top box manufacturers and its massive purchasing power to influence technical standards in ways that benefit its services, impeding the development of open and competing industry standards, contrary to Section 629 of the Act. This danger is compounded by Microsoft's access to AT&T's cable systems, which will enable it to establish a *de facto* set-top box operating system standard.

- **EPGs.** AT&T would likely restrict the availability of competitive electronic programming guide ("EPG") services by discriminating in favor of its affiliated EPGs. For example, AT&T would have the incentive and ability to deny carriage to competitors and strip their signals out of the vertical blanking interval. The merged companies' influence over leading cable modem services – @Home and Road Runner – together with the equity relationship with Microsoft would also enable them to dominate future operations of EPGs, which will combine Internet access and cable programming through browser-based interfaces.

- **Broadband.** AT&T would be able to use its affiliations and exclusive tying arrangements with cable modem providers to harm vertical Internet markets. This danger is heightened by AT&T's apparent intent to convert the Internet into a closed system based on its technology and services.

Deleterious regulatory disparity. The consumer and competitive concerns triggered by this merger might be partially mitigated if SBC and other incumbent LECs could compete on the same basis as AT&T. In reality, though, AT&T enjoys almost absolute regulatory freedom even as it advocates ever more onerous burdens on incumbent LECs (section V). Most strikingly, whether operating as a competitive carrier, as a cable company, or as a broadband access provider, AT&T seeks to run a closed system while escaping effective regulatory control in virtually every aspect of its businesses.

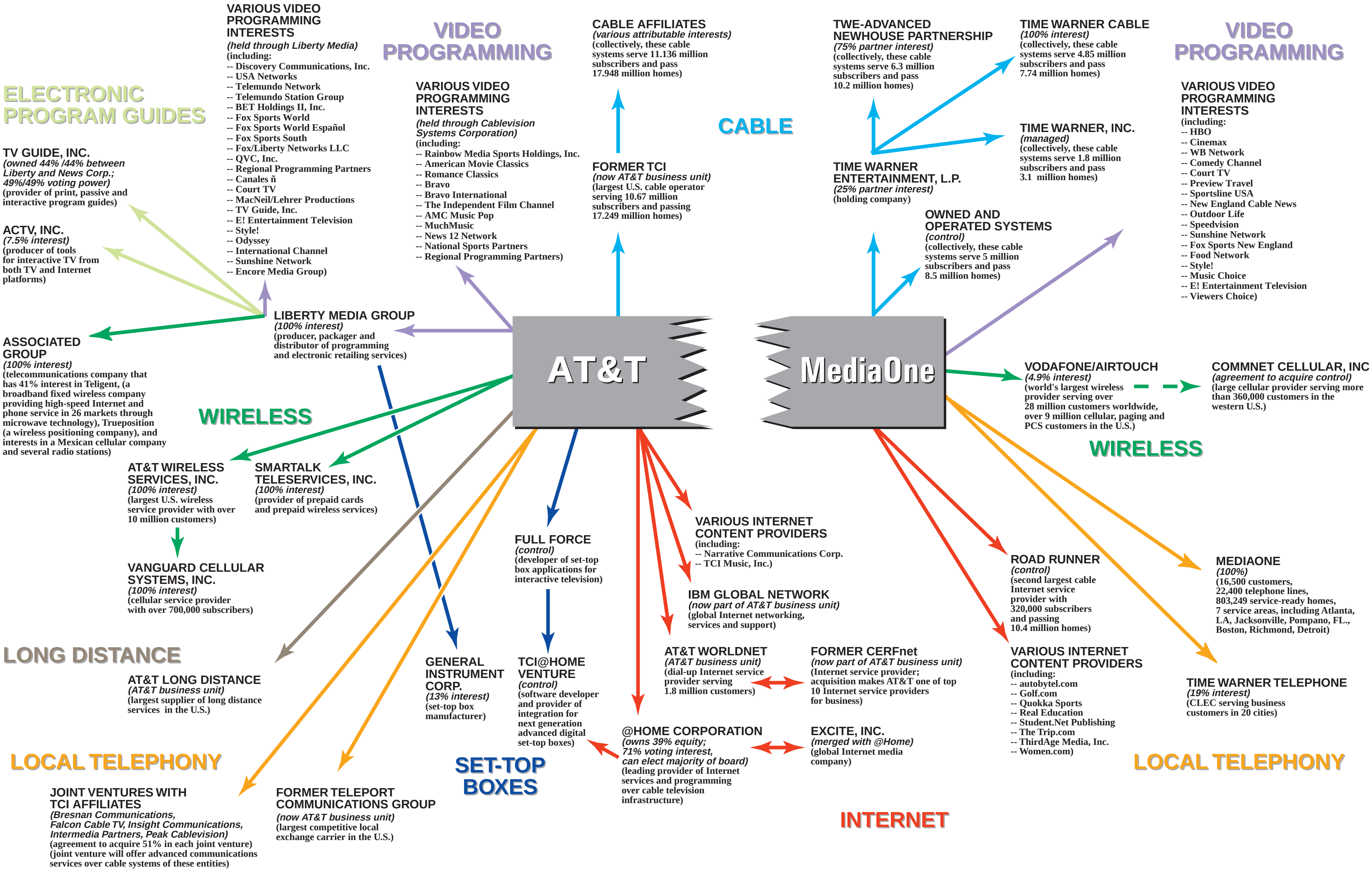
In contrast, AT&T has consistently urged the Commission to impose ever more burdensome regulations on comparable ILEC offerings, ostensibly to ensure the open telecommunications network necessary to promote consumer welfare. If the Commission continues to give effect to AT&T's hypocritical positions, ILECs that offer the same services as AT&T will remain in a regulatory briar patch that exacts an exorbitant price in dollars and delay before services are delivered to consumers. Such disparate regulatory treatment of similarly situated services and competitors will hinder the ability of telephone companies seeking to provide a viable competitive alternative to AT&T.

No demonstrated benefits. Notwithstanding these significant and tangible competitive harms that the merger would produce, AT&T's public interest statement abjectly fails to demonstrate that there are *any* benefits (let alone offsetting benefits) that are both "likely and verifiable" and "achievable only as a result of the merger," as required by the controlling *Bell Atlantic/NYNEX* standard (section VI). First, in marked contrast to the SBC/Ameritech merger, AT&T offers no firm service commitments and provides no affidavits detailing the merged entity's plans to compete in the local telephone or any other market. Even if it had made such commitments, AT&T's track record in fulfilling the claims made in the TCI merger is poor, as it has failed to live up to its commitment to open its broadband access system, leaving no basis to believe the touted benefits will occur.

Second, AT&T does not and cannot show that the merger would cause any of the claimed benefits to occur. Each company already is investing in upgrades needed to provide cable telephony. And AT&T's threat to abandon investment in digital cable upgrades if it cannot preserve its closed system is simply not credible.

* * *

Given the impenetrable web of cross-ownership interests the merger would create among AT&T, TCI, MediaOne, Time Warner, Liberty Media, Cablevision, Microsoft, Excite@Home, Road Runner, and the dozens of other companies in the AT&T family, it will be impossible to protect competition and consumers through conditions. The wide-ranging competitive harms stemming from the merger can be prevented only through denial of the Application.



ELECTRONIC PROGRAM GUIDES
TV GUIDE, INC.
(owned 44% /44% between Liberty and News Corp.; 49%/49% voting power)
(provider of print, passive and interactive program guides)
ACTV, INC.
(7.5% interest)
(producer of tools for interactive TV from both TV and Internet platforms)
VARIOUS VIDEO PROGRAMMING INTERESTS
(held through Liberty Media)
(including:
-- Discovery Communications, Inc.
-- USA Networks
-- Telemundo Network
-- Telemundo Station Group
-- BET Holdings II, Inc.
-- Fox Sports World
-- Fox Sports World Español
-- Fox Sports South
-- Fox/Liberty Networks LLC
-- QVC, Inc.
-- Regional Programming Partners
-- Canales ñ
-- Court TV
-- MacNeil/Lehrer Productions
-- TV Guide, Inc.
-- E! Entertainment Television
-- Style!
-- Odyssey
-- International Channel
-- Sunshine Network
-- Encore Media Group)
VIDEO PROGRAMMING
VARIOUS VIDEO PROGRAMMING INTERESTS
(held through Cablevision Systems Corporation)
(including:
-- Rainbow Media Sports Holdings, Inc.
-- American Movie Classics
-- Romance Classics
-- Bravo
-- Bravo International
-- The Independent Film Channel
-- AMC Music Pop
-- MuchMusic
-- News 12 Network
-- National Sports Partners
-- Regional Programming Partners)
CABLE AFFILIATES
(various attributable interests)
(collectively, these cable systems serve 11.136 million subscribers and pass 17.948 million homes)
FORMER TCI
(now AT&T business unit)
(largest U.S. cable operator serving 10.67 million subscribers and passing 17.249 million homes)
CABLE
TWE-ADVANCED NEWHOUSE PARTNERSHIP
(75% partner interest)
(collectively, these cable systems serve 6.3 million subscribers and pass 10.2 million homes)
TIME WARNER CABLE
(100% interest)
(collectively, these cable systems serve 4.85 million subscribers and pass 7.74 million homes)
TIME WARNER, INC.
(managed)
(collectively, these cable systems serve 1.8 million subscribers and pass 3.1 million homes)
TIME WARNER ENTERTAINMENT, L.P.
(25% partner interest)
(holding company)
OWNED AND OPERATED SYSTEMS
(control)
(collectively, these cable systems serve 5 million subscribers and pass 8.5 million homes)
VIDEO PROGRAMMING
VARIOUS VIDEO PROGRAMMING INTERESTS
(including:
-- HBO
-- Cinemax
-- WB Network
-- Comedy Channel
-- Court TV
-- Preview Travel
-- Sportsline USA
-- New England Cable News
-- Outdoor Life
-- Speedvision
-- Sunshine Network
-- Fox Sports New England
-- Food Network
-- Style!
-- Music Choice
-- E! Entertainment Television
-- Viewers Choice)
LIBERTY MEDIA GROUP
(100% interest)
(producer, packager and distributor of programming and electronic retailing services)
ASSOCIATED GROUP
(100% interest)
(telecommunications company that has 41% interest in Teligent, (a broadband fixed wireless company providing high-speed Internet and phone service in 26 markets through microwave technology), Trueposition (a wireless positioning company), and interests in a Mexican cellular company and several radio stations)
AT&T
MediaOne
WIRELESS
VODAFONE/AIRTOUCH
(4.9% interest)
(world's largest wireless provider serving over 28 million customers worldwide, over 9 million cellular, paging and PCS customers in the U.S.)
COMMNET CELLULAR, INC
(agreement to acquire control)
(large cellular provider serving more than 360,000 customers in the western U.S.)
WIRELESS
AT&T WIRELESS SERVICES, INC.
(100% interest)
(largest U.S. wireless service provider with over 10 million customers)
SMARTALK TELESERVICES, INC.
(100% interest)
(provider of prepaid cards and prepaid wireless services)
VANGUARD CELLULAR SYSTEMS, INC.
(100% interest)
(cellular service provider with over 700,000 subscribers)
FULL FORCE
(control)
(developer of set-top box applications for interactive television)
VARIOUS INTERNET CONTENT PROVIDERS
(including:
-- Narrative Communications Corp.
-- TCI Music, Inc.)
IBM GLOBAL NETWORK
(now part of AT&T business unit)
(global Internet networking, services and support)
ROAD RUNNER
(control)
(second largest cable Internet service provider with 320,000 subscribers and passing 10.4 million homes)
MEDIAONE
(100%)
(16,500 customers, 22,400 telephone lines, 803,249 service-ready homes, 7 service areas, including Atlanta, LA, Jacksonville, Pompano, FL., Boston, Richmond, Detroit)
LONG DISTANCE
AT&T LONG DISTANCE
(AT&T business unit)
(largest supplier of long distance services in the U.S.)
GENERAL INSTRUMENT CORP.
(13% interest)
(set-top box manufacturer)
TCI@HOME VENTURE
(control)
(software developer and provider of integration for next generation advanced digital set-top boxes)
AT&T WORLDNET
(AT&T business unit)
(dial-up Internet service provider serving 1.8 million customers)
FORMER CERFnet
(now part of AT&T business unit)
(Internet service provider; acquisition makes AT&T one of top 10 Internet service providers for business)
VARIOUS INTERNET CONTENT PROVIDERS
(including:
-- autobytel.com
-- Golf.com
-- Quokka Sports
-- Real Education
-- Student.Net Publishing
-- The Trip.com
-- ThirdAge Media, Inc.
-- Women.com)
TIME WARNER TELEPHONE
(19% interest)
(CLEC serving business customers in 20 cities)
LOCAL TELEPHONY
SET-TOP BOXES
@HOME CORPORATION
(owns 39% equity; 71% voting interest, can elect majority of board)
(leading provider of Internet services and programming over cable television infrastructure)
EXCITE, INC.
(merged with @Home)
(global Internet media company)
LOCAL TELEPHONY
JOINT VENTURES WITH TCI AFFILIATES
(Bresnan Communications, Falcon Cable TV, Insight Communications, Intermedia Partners, Peak Cablevision)
(agreement to acquire 51% in each joint venture)
(joint venture will offer advanced communications services over cable systems of these entities)
FORMER TELEPORT COMMUNICATIONS GROUP
(now AT&T business unit)
(largest competitive local exchange carrier in the U.S.)
INTERNET

8/12/99

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PETITION OF SBC COMMUNICATIONS INC. TO DENY APPLICATION

SBC Communications Inc. ("SBC"), by its attorneys, hereby submits its petition to deny the application of AT&T Corp. ("AT&T") and MediaOne Group, Inc. ("MediaOne") for authority to transfer control of MediaOne and its Commission licenses and authorizations to AT&T.[1] AT&T's acquisition of MediaOne would enable AT&T to dominate the cable industry and have unprecedented influence over related product markets. As shown herein and in the Declaration of Professor Jerry Hausman attached as Appendix A, the proposed transaction would give rise to widespread competitive harms in important new broadband markets, as well as serious violations of rules designed to preserve competition and protect the public. Consequently, consumers will

[1] *See AT&T Corp. and MediaOne Group, Inc. Seek FCC Consent For A Proposed Transfer Of Control*, CS Docket No. 99-251, DA 99-1447 (Public Notice) (July 23, 1999).

pay more for less and will lose many of the very substantial economic and social benefits of an open and fully competitive broadband marketplace.

These dire consequences are made all the more pernicious by the regulatory disparity between the post-merger AT&T and incumbent local exchange carriers ("ILECs") with which it would compete. In almost every material respect, the rules are skewed to facilitate AT&T's goal of establishing a closed broadband pipe into the home that will permit it to create and sustain market power over the myriad of video, Internet, and other services to be delivered through that pipe. Yet, AT&T has utterly failed to demonstrate any likely and verifiable public benefits resulting from the merger that counterbalance the evident competitive risks and harms in order to justify a grant of transfer authority. Accordingly, the Application must be denied.

I. THE MERGER WOULD GIVE AT&T DOMINANCE OF THE ENTIRE CABLE INDUSTRY AND CONTROL OVER CONSUMER ACCESS TO SERVICES

In the Application, AT&T and MediaOne describe their assets as "complementary" in nature.[2] Complementary indeed, as the proposed transaction would enable AT&T to acquire such extensive audience reach and the levers to key industry assets so as to exercise market power in several communications market sectors. As detailed below, the proposed transaction would result in the combined company and its affiliates controlling the broadband pipe into almost two-thirds of the homes passed by cable in this country – more than double the number permitted by the cable horizontal ownership cap. In addition, the transaction would ensconce

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[2] *Transfer of Control of FCC Licenses MediaOne Group, Inc. to AT&T Corp.*, CC Docket No. 99-251, at 4 (filed July 7, 1999) ("Application").

AT&T at the center of a comprehensive web of ownership relationships (displayed graphically by the chart that follows the Executive Summary) and other affiliations involving numerous key companies in related sectors of the communications industry – giving it the opportunity to exert additional anti-competitive pressures on those product markets.

A. The Combined Company And Its Affiliated Systems Would Pass Almost Two-Thirds Of U.S. Homes Passed By Cable

In the Application, AT&T deliberately attempts to minimize the extensive reach of the combined entity in the cable market. It states that, after the transaction, AT&T would be involved in programming decisions for cable systems serving only 26.6 percent of all Multichannel Video Programming Distributor ("MVPD") subscribers nationwide.[3] AT&T further asserts that this equates to only 31 percent of U.S. cable homes passed.[4] Not only are these numbers unsubstantiated, but they grossly understate AT&T's actual holdings.[5]

Appropriate application of the cap and current attribution rules makes clear that, after the transaction, AT&T and its attributable affiliates would control almost two-thirds of cable homes passed nationwide. AT&T, through its acquisition of TCI, already has attributable interests in systems passing over 35 million homes.[6] The merger would appear to garner AT&T interests in cable systems serving at least 23.9 million more homes. Specifically, AT&T would acquire:

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3 *Id.* at 62.

4 *Id.* at 63.

5 *See, infra,* at I.B.

6 *See* Application at Appendix A. *See also* Letter to Magalie Roman Salas, Secretary, Federal Communications Commission, from Douglas G. Garrett, Senior Regulatory Counsel, AT&T (June 7, 1999) (specifying 35,197,000 cable homes passed).

- 100 percent of MediaOne, which serves roughly 5 million subscribers and passes 8.5 million homes; and

- MediaOne's partnership interest in Time Warner Entertainment L.P., which has:

    - 100 percent control over Time Warner Cable (4.85 million subscribers and 7.74 million homes passed);

    - a majority partner interest in TWE-Advanced Newhouse Partnership (6.3 million subscribers and 10.2 million homes passed);[7] and

    - although not mentioned in the application, management control of Time Warner, Inc.'s cable systems (1.8 million subscribers and 3.1 million homes passed).[8]

Thus, after the transaction, the combined entity would pass more than 62 million homes or 65 percent of the homes passed by cable nationwide.[9]

In addition, AT&T already has reached exclusive agreements to provide telephony services over various cable systems, including the systems controlled by Time Warner, Inc., Bresnan Communications, Insight Communications, Intermedia Partners, and Peak Communications.[10] AT&T has announced that, after the transaction, it expects to enter into a similar arrangement with Comcast, whose systems currently reach 4.5 million subscribers and may increase by as many as

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[7] Application at Appendix B.

[8] *MediaOne 1998 Investor Handbook*, at 30 <http://www.mediaonegroup.com/investorinfo/publicationsframe.html>.

[9] Even if the management interest in Time Warner, Inc. were not attributable, the combined entity would still pass 58,981,000 homes or 62 percent of the homes passed nationwide. These calculations reflect the deduction of 2,686,000 homes passed for systems in which AT&T and MediaOne (through Time Warner) both currently hold interests (and thus would otherwise be double counted). Application at 62 n.151.

[10] *AT&T and Time Warner Form Strategic Relationship to Offer Cable Telephony*, News Release (Feb. 1, 1999) <http://www.att.com/press/item/0,1193,330,00.html>; *AT&T Reaches Agreements to Form Commercial Joint Ventures with Five Cable Operators*, News Release (Jan. 8, 1999) <http://www.att.com/press/item/0,1193,275,00.html>.

2,000,000 as a result of this merger.[11] Although not currently attributable for purposes of the horizontal cap, such exclusive arrangements clearly extend AT&T's influence over more systems and thus over more U.S. consumers.

B. The Transaction Would Also Position AT&T At The Center Of An Extensive Web Of Relationships Reaching Into Virtually Every Related Sector Of The Communications Industry

Aside from extending AT&T's already substantial reach within the cable market sector, the transaction would ensconce AT&T at the center of a vast array of ownership relationships and other affiliations involving key companies in related sectors of the communications industry. Through an interlocking "web" of interests—graphically shown in the previous chart—encompassing AT&T/TCI, Liberty Media, MediaOne, Comcast, Excite@Home, Road Runner, Microsoft and other major players, AT&T's pervasive reach would give it the ability and incentive to exert additional anticompetitive pressures on those product markets, particularly markets for new broadband services.

The proposed transaction would position AT&T as an Internet gatekeeper – able to control or influence the two dominant providers of broadband Internet access whose services are tied to the purchase of cable-modem access. Through its acquisition of TCI earlier this year, AT&T acquired control of At Home Corporation, the leading provider of Internet services and programming over the cable television infrastructure, serving 620,000 customers and passing 17

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11 *AT&T and Comcast Agree to Swap Cable Systems*, News Release (May 4, 1999) <http://www.att.com/press/item/0,1193,467,00.html>.

million homes.[12] The acquisition of MediaOne would also give AT&T more than a one-third interest in Road Runner, which has 320,000 customers and passes 10.4 million homes.[13] Together, these companies serve approximately 98 percent of all cable-modem Internet subscribers and over 80 percent of all high-speed Internet access subscribers using any platform.[14]

The transaction would also expand AT&T's significant presence in related Internet businesses. In particular, the combined entity would have substantial interests in a major web portal[15] as well as a variety of Internet content providers.[16] Such vertical integration will only increase AT&T's market power over all Internet-related services.

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12 *Excite@Home Reports Second Quarter 1999 Results*, Press Release <http://www.home.net/news/pr_990720_01.html>. @Home recently merged with Excite, Inc., a major web portal, to create Excite@Home.

13 *Road Runner Continues Strong Growth*, Press Release <http://www.rr.com/rdrun/ company/press/july13299.html>. Additionally, AT&T is one of the top 10 Internet providers for businesses through its WorldNet unit and newly acquired CERFnet. It would take little effort for AT&T to convert these customers over to broadband.

14 *See generally The Battle for the Last Mile*, The Economist, May 1, 1999, at 59; *@Home Network Reports First Quarter Results*, Press Release (Apr. 13, 1999).

15 As indicated above, AT&T-controlled @Home recently acquired Excite. In addition, through Microsoft's $5 billion investment, AT&T would have an equity relationship with the Microsoft Network, the nation's second largest ISP, and a score of Microsoft-owned websites.

16 AT&T controls Narrative Communications Corp., which provides media advertising and direct marketing solutions for the World Wide Web, and TCI Music, Inc., a music entertainment company delivering audio and video music via TV and Internet. In addition to the Microsoft properties discussed in the preceding footnote, by acquiring MediaOne, AT&T would gain interests in numerous other content providers including autobytel.com (nationally branded Internet-based purchasing program for new and certified pre-owned vehicles), Golf.com (home to NBC's golf coverage and online editions of Golf Digest and Golf World), Quokka Sports (new form of entertainment that brings fans in-depth event coverage), Real Education (provider of turnkey Internet-based learning solutions for higher education institutions and corporations), Student.Net Publishing (website with online content targeting college students), TheTrip.com (online travel agency), ThirdAge Media, Inc. (leading network of content websites for adults 45

Additionally, the proposed transaction would significantly add to AT&T's already substantial stable of video programming assets, garnering it significant ownership interests in roughly 60 percent of the most popular cable programming in the U.S. AT&T already holds a 100 percent equity interest in Liberty Media Group, whose principal programming and related assets include numerous programming channels, program production and distribution companies, and electronic retailers.[17] AT&T also holds indirect interests in a variety of other programmers through its interest in Cablevision.[18] In acquiring MediaOne, AT&T would obtain interests in additional programming assets, including many popular cable channels and production companies.[19]

Further, the combined entity would have substantial interests in manufacturers of software and/or equipment used to access and manipulate such programming. AT&T currently participates in the creation and manufacturing of electronic program guides through its interests in TV Guide, Inc.[20] and ACTV, Inc.[21] AT&T also has a significant presence in the set-top box market through

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(Continued...)
and older), and Women.com (leading network of content websites for women). *MediaOne 1998 Investor Handbook* <http://www.mediaonegroup.com/investorinfo/publicationsframe.html>.

17 For a list of these assets, *see* Application at 9.

18 Cablevision has ownership stakes in Rainbow Media Sports Holdings, Inc. which owns numerous programming channels. For a list of these assets, *see* Application at 12.

19 For a list of these assets, *see* Application at 17 & n.43.

20 TV Guide, Inc. is a provider of print, passive, and interactive program guides.

21 ACTV, Inc. is a producer of tools for interactive TV from both TV and Internet platforms.

its control of the TCI/@Home venture[22] and Full Force,[23] as well as its investment in General Instrument Corp.[24] Microsoft's recent alliance with AT&T raises additional concerns about anticompetitive activity in these markets.[25]

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22 AT&T is engaged in a joint development effort with @Home to develop software and provide integration services for next generation advanced digital set-top boxes.

23 Through @Home, AT&T controls Full Force, a developer of set-top box applications for interactive television.

24 AT&T owns 13 percent of General Instrument through Liberty Media. Application at 12, n.31. General Instrument has announced that AT&T, through Liberty Media, has agreed to purchase an additional 10 million shares of General Instrument, raising AT&T's ownership stake to approximately 20 percent. Appendix A, Declaration of Professor Jerry A. Hausman, at 16 n.34 ("Appendix A, Hausman Declaration").

25 Through an existing agreement with TCI, Microsoft will install its proprietary Windows CE operating system in 5 million TCI cable set-top boxes. In addition, Microsoft's $5 billion investment in AT&T may put Windows CE in an additional 5 million AT&T next-generation cable set-top boxes. This compares to a market consisting of barely one million broadband set-top boxes today. And future generations of hardware for WebTV, the leading provider of Internet access via TV which is 100 percent owned by Microsoft, will also reportedly employ the Windows CE operating system. *See* John Markoff, *Microsoft Hunts Its Whale, The Digital Set-Top Box*, N.Y. Times (May 10, 1999) <http://www.nytimes.com/library/tech/99/05/biztech/articles/10box.html>.

AT&T's electronic program guide investments also may receive a boost from AT&T's recent alliance with Microsoft Corp. The companies have plans to create a "new, pay-one-bill service featuring interactive TV bundled with phone service, e-mail, and other Internet features—all through one, superfast cable," and to incorporate Microsoft's Windows CE operating system. *See* Noelle Knox, *Microsoft-AT&T Plan Combines TV, Telephone, E-mail*, The Arizona Republic, May 7, 1999 (AT&T currently plans to test this service in three cities, two of which will use the Microsoft operating system).

Microsoft is an increasingly common link between cable MSOs (both in the United States and abroad) and related broadband service companies and manufacturers. The software giant also owns 11 percent of Comcast and 10 percent of Road Runner. Moreover, Microsoft has invested a reported 5 million dollars as a "strategic partner" in @Home Solutions, which was formed in April 1999 to serve subscribers of small and midsize cable TV operators.

II. AT&T'S EXPLOITATION OF ITS DOMINANT POSITION IN MULTIPLE BROADBAND MARKETS WILL HARM CONSUMERS

AT&T has made clear that its acquisition strategy is premised on positioning itself for the day "when the cable device on the TV becomes a virtual communications center."[26] At that time, AT&T avowedly intends to assume a gatekeeper role, making sure that it controls access by consumers to broadband service providers and by such providers to consumers. As succinctly stated by TCI's chairman at the time of its merger with AT&T, they will "*have to go through us*."[27] Contemporaneous press reports explained that:

> Going 'through us' has been cable's game …. Now Malone foresees a *new gatekeeper role*, with the whole cable industry aligning with AT&T to form a single giant network … @Home and [Road Runner] are poised to become *the electronic gateway to the Internet*.[28]

The CEO of @Home has echoed these sentiments, asserting that "[w]e have access to the home. If [another ISP] wants to get there with broadband, *they will have to work through us.*"[29] He dismissed the notion that another ISP could reach potential broadband customers directly with one word: "ridiculous."

If achieved, the gatekeeper status sought by AT&T will confer on it an inordinate level of market power which AT&T fully intends to exploit in furtherance of its own private interests. For example, the head of AT&T's Internet businesses, Leo Hindery, could not have been more candid

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[26] Remarks of C. Michael Armstrong, *Cable Ready: Convergence and the Communications Revolution*, 1999 NCTA Convention (June 14, 1999).

[27] Ken Auletta, *The Talk of The Town*: *How the AT&T deal will help John Malone get into your house*, The New Yorker, July 13, 1998, at 25 (emphasis added).

[28] *Id.*

about AT&T's plans in connection with the 10-minute video streaming limitation it imposes on ISPs accessed through Excite @Home: It is a "restriction which we imposed on @Home so that we were the determiner of how streaming video worked in our world …."[30] The broad horizontal and vertical scope of AT&T's entanglements will give it both the incentive and ability to exert anticompetitive control over a host of other broadband offerings in which it has taken a financial interest or which merely must transit its closed last mile transmission pipe to consumers.

Just as in the case of cable-modem Internet access, where AT&T would have consumers pay twice to reach the ISP offering they want, the likely consequences of the merger will be to increase the costs of and reduce the choices available to consumers in each of the affected market segments. This will cause higher prices and fewer competitive alternatives for video programming services themselves, multichannel video programming distributors, cable set top boxes, electronic program guides, and broadband Internet access offerings. The public interest will not countenance such a result.

III. ON ITS FACE, THE MERGER VIOLATES COMMISSION RULES ENACTED TO PROMOTE COMPETITION AND PROTECT CONSUMERS

In order to protect against market domination and the damaging anticompetitive effects that follow, the Commission – often at the direction of Congress – has adopted ownership caps

(Continued...)

[29] Saul Hansell, *The Battle For Internet Supremacy is Shifting to the Companies That Sell the Connections to Users*, N.Y. Times, June 29, 1998, at D4 (emphasis added).

[30] En Banc Hearing on Telecom Mergers to Discuss Recent Consolidation Activities in the Telecommunications Industry, Focusing on Three of the Proposed Mergers Before the Federal Communications Commission, Transcript (Oct. 22, 1998) ("Unofficial Hearing Transcript").

and cross-ownership limitations in cable and other communications services. The proposed transaction would clearly and substantially violate at least two of these. Nevertheless, AT&T virtually ignores such restrictions. Indeed, the Application only briefly mentions these important competitive safeguards – and understates the extent to which the transaction would violate these rules.

A. The Merger Would Not Only Violate The Cable Horizontal Ownership Cap, But Shatter It

The FCC's cable horizontal ownership cap rules prohibit any cable operator from having an attributable interest in more than 30 percent of the homes passed by cable nationwide.[31] While these rules have been temporarily stayed pending judicial review of the underlying statutory provision,[32] the Commission has recognized the potential anticompetitive effects against which they guard and, thus, has continued to monitor large cable operators' audience reach. For example, the agency recently ordered that MSOs must notify the Commission before acquiring attributable interests in any additional cable systems that would result in a total ownership percentage of 20 percent or more of homes passed nationwide.[33]

AT&T, however, cavalierly ignores these ownership cap and notification requirements. Instead, it provides an incomplete description of the combined company's holdings that fails to disclose the full extent of its cable reach post-merger. Substituting its own self-serving analytical

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[31] 47 C.F.R. § 76.503.

[32] *Daniels Cablevision, Inc. v. U.S.*, 835 F. Supp. 1 (1993).

[33] *Implementation of Section 11(c) of the Cable Television Consumer Protection and Competition Act of 1992*, 13 FCC Rcd 14462, 14492 (1998).

framework that minimizes the calculated scope of its post-merger operations, AT&T disregards the rules' defined attribution criteria and reference market.

AT&T unilaterally calculates its attributable post-transaction cable systems based upon those systems for which it "would be involved in programming decisions or purchase programming,"[34] rather than those in which it would have an attributable interest or ability to influence as defined under the rules. As a result, AT&T excludes from its calculation its interest in Cablevision and two existing ventures with Time Warner, as well as the interest in Time Warner Entertainment, L.P. that it will acquire when the MediaOne transaction is completed.[35] Yet, the Commission has specifically rejected arguments that the attribution criteria in this context should focus exclusively on control, observing that its rules "have long recognized that parties that have less than a majority equity interest in a media property can influence management and programming decisions."[36]

AT&T also resists using the homes passed standard in discussing its interests. Instead, AT&T bases its analysis on its subscribers (using its own limited attribution definition described above) as a percentage of all MVPD subscribers. Such an approach both understates AT&T's actual market power within the cable industry and ignores the pertinent market definition

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34 Application at 62.

35 *Id.* at 62 n.151. Through this self-serving redefinition of the attribution rules, AT&T manages to delete 14,299,000 subscribers and 23,066,000 homes passed from its total number of attributable cable systems.

36 *Implementation of Sections 11 and 13 of the Cable Television Consumer Protection and Competition Act of 1992*, 8 FCC Rcd 6828, 6852 (1993). Accordingly, the Commission's ownership caps and cross-ownership rules in other communications services also deem minority interests attributable. *See, e.g.,* 47 C.F.R. §§ 20.6, 73.3555, 101.1003.

prescribed by the Commission. Where AT&T does mention in passing the percentage of cable homes passed by the combined entity, even that number is distorted. AT&T calculates that percentage using an unsubstantiated and inflated estimate of the total homes passed nationwide (100 million),[37] rather than the number endorsed by the Commission and generally used for such calculations (95.1 million).[38]

In fact, as discussed above, were AT&T correctly to apply the cable horizontal ownership cap and attribution rules, post-merger AT&T would have attributable interests in cable systems that pass almost two-thirds of the homes passed by cable nationwide.[39] Such extensive audience reach would not simply violate the cap, but completely eviscerate it.

It comes as no surprise, therefore, that AT&T offers no commitments to a plan for how it would divest systems or explanations for how the merger would benefit the public in the event the stay of the ownership cap were lifted. AT&T's failure to address how it would comply with the law is a grave omission.

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37 Application at 63 n.153.

38 *Annual Assessment of the Status of Competition in Markets for the Delivery of Video Programming*, 13 FCC Rcd 24284, 24294 (1998) ("*Fifth Annual Video Competition Report*"). Interestingly, AT&T indicates that a study supporting the 100 million homes passed number was submitted to the Commission in October 1997. Application at 63 n.153. Yet, when the *Fifth Annual Video Competition Report* was released in December 1998, the Commission did not endorse this number, relying instead on more recent Kagan studies showing homes passed at 95.1 million in 1998. *Fifth Annual Video Competition Report,* at 13 FCC Rcd at 24294, Appendix B, Table B-1.

39 *See*, *supra*, at I.A. This total would also include the 3.1 million homes passed by Time Warner, Inc.'s cable systems, over which MediaOne apparently has management control. Although not mentioned in the Application, MediaOne indicates such an attributable, management relationship in its 1998 Investor Handbook. *MediaOne 1998 Investor Handbook*, at 30 <http://www.mediaonegroup.com/investorinfo/publicationsframe.html>.

B. The Merger Would Violate The Cellular Cross-Ownership Rule

In a similar effort to prevent anticompetitive activity in the mobile telephone market, the Commission has adopted several rules designed to limit the ability of one company to monopolize spectrum or own competing providers in the same geographic area. One of these is the cellular cross-ownership restriction, which prohibits any entity from having a direct or indirect interest in overlapping cellular systems in the same geographic area, unless the interests pose no threat to competition.[40] The rule underscores that an entity that actually controls a cellular licensee may not have *any* interest in an overlapping cellular licensee.[41]

In the proposed transaction, AT&T, the largest provider of wireless services (including cellular) in the U.S., would acquire MediaOne's interest in Vodafone Airtouch Plc, which provides cellular and other wireless services to over 9 million U.S. customers. Once again, AT&T acknowledges only in passing that this merger of interests would result in a number of violations of the cellular cross-ownership restriction – 37 to be exact.[42] Vodafone's announced agreement to buy CommNet Cellular raises the prospect of even more prohibited overlaps.[43] Nevertheless, AT&T fails to provide any analysis to explain or justify such overlapping interests. It seems to assume instead that the cross-block rule will simply be eliminated by the time the merger closes, will somehow not apply to its overlaps, or will be automatically waived.

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40 47 C.F.R. § 22.942.

41 *Id.*

42 Application at 40-41 n.91.

43 CommNet provides cellular service to approximately 360,000 customers located in the western United States.

Amazingly, AT&T even fails to identify which markets will contain overlaps, what the combined entity's interest would be in each licensee, or the number of actual competitors to the combined entity in each of these markets. Indeed, AT&T provides absolutely no basis upon which the Commission can conclude that the merged entity's ownership of these interests would pose no threat to competition under the rule[44] or upon which to justify an outright waiver. Absent such a showing, these overlaps are clearly inconsistent with the Commission's regulations and cannot be permitted.

For its part, AT&T merely notes that the merged entity's cross-block interests would not violate the CMRS spectrum cap.[45] However, the cross-block rule and the spectrum cap are designed to provide different types of protections. The Commission has recently underscored that "compliance with the spectrum cap does not preclude further analysis of the possible anticompetitive effects of a transaction or imposition of appropriate conditions to remedy those effects."[46] In this case, holding interests in both cellular carriers in 37 markets nationwide clearly presents a risk to competition and consumers from coordinated conduct (such as tacit price coordination) and diminished incentives for price competition, service expansion, and innovation. Yet, AT&T has offered nothing to negate such an analysis – nothing to overcome the presumption

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[44] AT&T does note that MediaOne has "monetized" most of its holdings in Vodafone, thus reducing its real interest. Application at 40. However, monetization has not been recognized by the Commission as a method of reducing attributable interests for purposes of the cellular cross-block rule.

[45] 47 C.F.R. § 20.6.

[46] *Vanguard Cellular Systems Inc., Transferor, and Winston, Inc., Tranferee*, DA 99-481, ¶ 20 (Mar. 11, 1999).

of potential anticompetitive activity embodied in 37 separate violations of the cellular cross-block rule.

IV. IN VIEW OF THESE *PRIMA FACIE* COMPETITIVE CONCERNS, AT&T'S FAILURE TO PROVIDE CRITICAL INFORMATION ADDRESSING ITS RESULTING MARKET POWER AND ABILITY TO IMPAIR COMPETITION IN NUMEROUS PRODUCT MARKETS IS STRIKING AND TROUBLING

As discussed above, the Commission should deny AT&T's acquisition of MediaOne because it would result in a *prima facie* violation of the Commission's pro-competitive rules governing the horizontal ownership of cable as well as the agency's cellular cross-ownership restrictions. In addition, the Application clearly warrants denial because it fails to demonstrate that the transaction serves the public interest, as required by *Bell Atlantic/NYNEX* and the Commission's other recent merger precedent. Rather than advancing the public interest, the merger would foreclose competition, impede innovation, and diminish consumer choice across a variety of communications service and product markets.

A. AT&T Has Failed To Satisfy Its Burden Of Proof Under *Bell Atlantic/NYNEX* To Demonstrate That This Merger Is In The Public Interest

In the *BellAtlantic/NYNEX Order*, the FCC established a detailed analytical framework for evaluating the anticompetitive harms and public interest benefits of mergers, pursuant to Sections 214(a) and 310(d) of the Act.[47] This framework, which has been refined in and applied to all

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[47] *Application of WorldCom, Inc. and MCI Communications Corporation for Transfer of Control of MCI Communications to WorldCom, Inc.*, 13 FCC Rcd 18025, 18030-31 (1998) ("*WorldCom/MCI Order*"). ("The public interest standard of sections 214(a) and 310(d) is a flexible one that encompasses the 'broad aims of the Communications Act.' These broad aims

significant subsequent mergers since *Bell Atlantic/NYNEX*[48] – including AT&T's acquisition of TCI – fundamentally requires applicants to "demonstrat[e] . . . that the proposed transaction is in the public interest."[49] In assessing the merger, the Commission will consider "whether a proposed license transfer is consistent with the policies of the Communications Act, including, among other things, the transfer's effect on Commission policies encouraging competition and the benefits that would flow from the transfer."[50] "If applicants cannot carry [their] . . . burden" of establishing

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include, among other things, the implementation of Congress' 'pro-competitive, de-regulatory national policy framework designed to . . . open[] all telecommunications markets to competition,' 'preserving and advancing' universal service, and 'accelerat[ing] rapidly private sector deployment of advanced telecommunications and information technologies and services.'").

48 The Commission's criteria evolved from its consideration of three significant mergers in 1997. *See NYNEX Corporation, Transferor, and Bell Atlantic Corporation, Transferee*, 12 FCC Rcd 19985 (1997) ("*Bell Atlantic/NYNEX Order*"); *Pacific Telesis Group Transferor, and SBC Communications, Inc. Transferee*, 12 FCC Rcd 2624 (1997) ("*SBC/PacTel Order*"); and *MCI Communications Corporation and British Telecommunications plc*, 12 FCC Rcd 1535 (1997) ("*BT/MCI II Order*"). The Commission has applied this framework to all significant subsequent mergers including *WorldCom/MCI*, *AT&T/TCI*, *GTE/Bell Atlantic*, and *SBC/Ameritech*. Moreover, the Commission has applied the *Bell Atlantic/NYNEX* framework to mergers involving both horizontal and vertical anticompetitive effects. *Teleport Communications Group, Inc., Transferor and AT&T Corp., Transferee*, 13 FCC Rcd 15236, 15246 (1998) ("We must evaluate the likely competitive effects of the proposed merger in each of the relevant markets. In the instant case, this requires us to examine both the likely competitive effects due to the 'horizontal' aspects of the merger and the likely competitive effects due to the 'vertical' aspects of the merger.").

49 *Bell Atlantic/NYNEX Order*, 12 FCC Rcd at 20000-01 ("Under both Title II and Title III, applicants bear the burden of demonstrating that the transaction is in the public interest"). *See also Tele-Communications, Inc., Transferor, and AT&T Corp., Transferee*, 14 FCC Rcd 3160, 3169 (1999) ("The Applicants bear the burden of proving that the transaction serves the public interest.") ("*AT&T/TCI Order*").

50 *Bell Atlantic/NYNEX Order*, 12 FCC Rcd at 20003; *AT&T/TCI Order*, 14 FCC Rcd at 3169 ("To apply our public interest test, then, we must determine whether the merger violates our rules, or would otherwise frustrate our implementation or enforcement of the Communications Act and federal communications policy. That policy is, of course, shaped by Congress and deeply rooted in a preference for competitive processes and outcomes.").

that any harms to competition are outweighed by public interest benefits, "the applications must be denied."[51] Alternatively, where the requisite public interest showing cannot be demonstrated on the basis of the transaction as initially proposed, "the Commission may attach conditions to the approval of a transfer of licenses."[52]

AT&T would have the Commission wholly omit such a public interest review of this merger, despite the serious anticompetitive concerns raised by the proposed combination, and thereby simply excuse AT&T's failure to meet its burden of proof under *Bell Atlantic/NYNEX*.[53] However, the incentives and opportunities created by this transaction for AT&T to engage in anticompetitive conduct with severely adverse consequences for consumers are too evident to ignore.

Under the *Bell Atlantic/NYNEX* standard, AT&T is required first to define the relevant product and geographic markets affected by the transaction.[54] Second, it must identify significant actual or potential competitors in each relevant market.[55] Third, it must identify whether the merger is likely to result in unilateral or coordinated effects that enhance or maintain the market

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[51] *Bell Atlantic/NYNEX Order*, 12 FCC Rcd at 19987.

[52] *WorldCom/MCI Order*, 13 FCC Rcd at 18032.

[53] Application at 18-19 n.46 (AT&T claims ". . . it is [not] necessary for the Commission, in determining whether this Merger is in the public interest, to conduct the searching competitive effects inquiry that the Commission first employed in *Bell Atlantic-NYNEX*. . . .").

[54] *Bell Atlantic/NYNEX Order*, 12 FCC Rcd at 20014 (". . . [T]he burden is on the Applicants to establish the relevant markets.").

[55] *WorldCom/MCI Order*, 13 FCC Rcd at 18037. ("Under . . . the *Bell Atlantic/NYNEX Order*, the Commission seeks to determine whether either or both of the merging parties are among a small number of 'most significant market participants' that could most quickly foster competition in the relevant market.").

power of the merging parties and whether entry by other competitors would be likely, prompt, and effective enough to counteract the merging parties' ability to exercise market power.[56] More specifically, AT&T is required to show "that the proposed merger would not eliminate potentially significant sources of competition. . . ."[57] and would not "substantially . . . lessen competition . . . or . . . create a monopoly[,]"[58] but instead "will enhance competition."[59]

Finally, ". . . applicants cannot carry their burden if their efficiency claims are vague or speculative, . . . cannot be verified by reasonable means[,]" or are not achievable only by the merger.[60] Thus, the *Bell Atlantic* decision requires AT&T concretely to "prove that, on balance, the merger will enhance and promote, rather than eliminate or retard" other sources of the competition.[61]

AT&T has wholly failed to satisfy this burden. It has not and, indeed, cannot demonstrate that the proposed merger is in the public interest. As detailed below, AT&T has ignored the

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56 *Bell Atlantic/NYNEX Order*, 12 FCC Rcd at 20008-09.

57 *Bell Atlantic/NYNEX Order*, 12 FCC Rcd at 19988; *see also id.* at 20039 ("With respect to other market participants, a merger that eliminates a market participant can also increase these other firms' incentives to behave less competitively.").

58 *Id.* at 20005 (citing 15 U.S.C. §§ 18, 21(a) (1997)).

59 *Id.* at 19987.

60 *Id.* at 20064. In the *Bell Atlantic/NYNEX Order*, the Commission concluded that it would not take into account Bell Atlantic/NYNEX's claimed "efficiencies" because "Applicants have not demonstrated in a specific and verifiable manner that these efficiencies could not be achieved in the absence of the merger." *Id.* at 20068; *see also id.* at 20063 (". . . [P]ro-competitive benefits include any efficiencies arising from the transaction if such efficiencies are achievable only as a result of the merger, are sufficiently likely and verifiable, and are not the result of anticompetitive reductions in output or increases in price.").

61 *Id.* at 19988.

anticompetitive effects that this merger will have in the video programming, MVPD, EPG and set-top box, Internet access, and CMRS markets – and has not demonstrated that the anticompetitive effects would be outweighed by public interest benefits.

B. The Merger Will Give Rise To Serious Anticompetitive Consequences In The MVPD And Video Programming Markets

In its Application, AT&T baldly asserts, based on wholly inadequate and misleading showings, that this merger will have no negative impacts on the MVPD or video programming markets or for consumers.[62] Not only is AT&T's cursory treatment of these issues insufficient under *Bell Atlantic/NYNEX*, but its conclusions fly in the face of the available data.

Although MVPDs and video programming exist in separate markets for antitrust purposes, their markets overlap. Because MVPDs are purchasers of video programming, anticompetitive developments in the MVPD market may affect competition and consumers in the video programming market, and vice versa. For example, as shown below, monopsony power in the video programming market will not only lead to fewer choices and higher prices for consumers of that product, it will permit AT&T to disadvantage rival MVPDs whose programming options will be similarly limited. It therefore is useful to analyze the competitive impact of the merger on these markets jointly.

[62] Application at 41 ("AT&T's acquisition of MediaOne will not eliminate or reduce competition in the MVPD marketplace."); *see also id.* at 43 (The merger will have "no anti-competitive effects in the thriving video programming marketplace.").

The MVPD market consists of cable systems and, arguably, other distributors such as satellite and wireless cable providers.[63] AT&T's cable systems are typically monopolies on the wireline side. Few overbuild situations exist, and Professor Hausman demonstrates that the presence of non-cable MVPDs does not constrain the exercise of cable's market power, as reflected in the pricing of their respective offerings.[64]

According to Professor Hausman, after the merger, AT&T will have "control"[65] over approximately 29 percent of MVPD customers which, in the national market for the purchase of

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63 The Act defines a "multichannel video programming distributor" as "a person such as, but not limited to, a cable operator, a multichannel multipoint distribution service, a direct broadcast satellite service, or a television receive-only satellite program distributor, who makes available for purchase, by subscribers or customers, multiple channels of video programming." 47 U.S.C. § 522(13). Under the Act, a "cable operator" (or cable MSO) is defined as "any person or group of persons (A) who provides cable service over a cable system and directly or through one or more affiliates owns a significant interest in such cable system, or (B) who otherwise controls or is responsible for, through any arrangement, the management and operators of such a cable system." 47 U.S.C. § 522(5).

64 As Professor Hausman notes, DBS and other non-cable MVPDs are not constraining the price of cable in local markets and, therefore, AT&T's post-merger market power may be best analyzed in the cable operator product market. *See* Appendix A, Hausman Declaration, ¶ 9. The Commission has found that cable operators still control 85.3 percent of the MVPD market. *Fifth Annual Video Competition Report*, 13 FCC Rcd at 24374.

65 AT&T materially understates its combined market power in the MVPD market by focusing its analysis only on cable systems in which AT&T or MediaOne have a 50 percent or greater ownership interest, rather than on those in which they have an attributable interest, under the Commission's cable attribution rules. Application at 41 ("The analysis in [the MVPD] . . . section focuses on cable systems in which AT&T or MediaOne have a 50 percent or greater ownership interest."). This approach contradicts the Commission's "attributable interest" standard, which assigns an attributable interest, and thus a measure of market power, to a cable operator if it owns five percent or greater of outstanding voting stock or any non-insulated limited partnership interest in a cable system. *See* 47 C.F.R. § 76.501. As Professor Hausman explains, direct control is not the proper method to evaluate the market power of the merged company:

> Given that the economic interests of cable MSOs coincide on many economic issues, such as achieving low programming costs from third party providers, direct

video programming, correlates to a change in HHI of approximately 296. This is far above the safe harbor level set by the Department of Justice and Federal Trade Commission Merger Guidelines.[66] Including MediaOne's interest in TWE and AT&T's other attributable interests, the concentration effect is even more dramatic. With respect to cable homes passed, AT&T post-merger would have 62-65 percent of the market, a change in HHI of 1851.[67] Using the MVPD market definition, the combined entity's total market share would be 48-50 percent – correlating to a change in HHI of 1092.

The video programming product market involves both buyers and sellers and is an input market to the MVPD market.[68] The market is largely national and includes major participants such as TCI's Liberty Media, Time Warner, and Viacom, as well as numerous smaller programmers. As detailed in section I, the Applicants hold significant interests in many of the most popular video programmers, including USA Networks, TV Guide, HBO, Cinemax, and the

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> control is not required for cable MSOs to decide jointly to bargain together, or at least to take similar negotiating positions when bargaining with outside suppliers. Thus, affiliated cable MSOs should be considered in the competitive analysis of the merger, rather than limiting the analysis only to cable MSOs that are directly controlled by the merged company. Economic analysis demonstrates that given the commonality of interests, affiliated companies will act in a co-ordinated manner with the merged company in many of the economic decisions.

See Appendix A, Hausman Declaration, ¶ 12 (footnotes omitted).

66 *See id*. ¶ 11; *cf.* Application at 55.

67 Appendix A, Hausman Declaration, ¶ 12.

68 The market is national in scope, although there are some regional sports networks and local cable news networks.

WB Network. Further, the merger will result in consolidation in the ownership of E! Entertainment and Sunshine Network, in which AT&T and MediaOne each currently hold stakes.[69]

The concentration of cable system subscribers and video programming assets resulting from the merger will enable AT&T to harm competition in the MVPD and video programming markets. Most significantly, the monopsony power that AT&T will enjoy will lead it to disadvantage non-affiliated video programmers, rival MVPDs, and consumers.[70] The potential for AT&T to refuse to sell programming to rival MVPDs and to impede the growth of video streaming will further harm competition and consumers. Thus, the merger will result in the very same harms that Congress[71] and the FCC have repeatedly identified and attempted to prevent through passage of the Cable Act of 1992 and the subsequent Commission Rules.[72]

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69 Post-merger, AT&T will hold 100 percent of Liberty Media Group, which holds significant programming interests. In addition, Liberty Media holds approximately nine percent of Time Warner, Inc., which has significant programming interests. Further, Time Warner, Inc. holds 74.49 percent of Time Warner Entertainment, which maintains programming interests. AT&T, through TCI, also owns a 33 percent equity interest in Cablevision Systems Corp., which has programming interests. Application at 9-10, 12. In addition, MediaOne holds programming interests in various channels individually and through its 25.51 stake in Time Warner Entertainment. Application at 17 n.43.

70 "[S]trategic vertical restraints (achieved by exclusive distribution contracts or monopsonistic pressure) can also deter entry and competition in the video marketplace and can limit the diversity of cable programming, reducing the number of voices available to the public." *Fifth Annual Video Competition Report*, 13 FCC Rcd at 24376.

71 Indeed, the Senate Report on the 1992 Cable Act, which imposed restrictions of horizontal and vertical misconduct, observed that "concerns raised regarding increased vertical and horizontal integration in the cable industry are serious and substantial." S. Rep. No. 102-92, at 200 (1992).

72 In evaluating the anticompetitive effects of a merger, the FCC will consider "whether a proposed license transfer is consistent with the policies of the Communications Act, including, among other things, the transfer's effect on Commission policies encouraging competition. . . ." *Bell Atlantic/NYNEX Order*, 12 FCC Rcd at 20003; *see also AT&T/TCI Order*, 14 FCC Rcd at 3169 ("To apply our public interest test, then, we must determine whether the merger violates our

1. AT&T Will Possess Monopsony Power, Leading To Anticompetitive Harms For Non-Affiliated Video Programmers, Rival MVPDs, And Consumers

AT&T would have the FCC believe that even though it will be, by far, the largest MVPD and purchaser of video programming in the United States, it will not possess monopsony power in the video programming market.[73] However, economic and Commission data lead to the conclusion that, given its MVPD subscriber reach, AT&T will possess *per se* monopsony power in the video programming market, which will give rise to a myriad of attendant anticompetitive harms for non-affiliated video programmers, competitive MVPDs, and consumers.

As Professor Hausman notes in Appendix A, "[m]onopsony power is the ability of a buyer to require sellers of inputs to accept prices below the competitive price. Monopsony power typically occurs because sufficient alternative buyers do not exist for the seller's product if the monopsonist refuses to buy the product."[74] Professor Hausman makes clear AT&T's fallacy in suggesting that monopsony power cannot exist in the absence of a greater than 35 percent market share.[75] The merger undeniably will increase the ability of AT&T to exercise monopsony power through the combination of AT&T's and MediaOne's cable subscribers. Moreover, AT&T will have continued incentives to harm competing video programmers because, given its increased

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rules, or would otherwise frustrate our implementation or enforcement of the Communications Act and federal communications policy.").

73 Application at 43 (The merger will not "create a video programming *buyer*. . . large enough to exercise monopsony power or to engage in vertical foreclosure.").

74 *See* Appendix A, Hausman Declaration, ¶ 14 (footnotes omitted).

75 *See* Application at 57; Appendix A, Hausman Declaration, ¶ 12 n.19.

monopsony power, it will be able to extract favorable concessions from non-affiliated programmers. Indeed, given that the vertically-integrated AT&T also will increasingly compete against non-affiliated programming entities as a primary *seller* of video programming, the merger creates a stronger incentive to discriminate against non-affiliated video programming sources.[76]

The Commission has found that video programmers must have access to approximately 15-20 million subscribers to be viable and that "programmers have an incentive to minimize transaction costs of securing access to [these subscribers]," thus giving large MSOs bargaining power against programming networks.[77] For example, the Commission has found that "new programmers almost invariably need to negotiate for carriage with multiple cable operators."[78] Accordingly, even before AT&T's merger with MediaOne, the agency concluded that "TCI [now AT&T], with 17.8 million subscribers, . . . [was already] the only MSO large enough to provide th[e] . . . number of subscribers [needed for viability] on its own."[79]

With the acquisition of MediaOne, AT&T's over 36 million subscriber reach will enable it to single-handedly wield monopsony power great enough to affect non-affiliated video programmers. It will be able to extract substantial concessions [80] in the form of lower subscriber

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76 AT&T could harm non-affiliated video programmers by placing their programming on less widely-distributed programming tiers, thus dampening the programmer's exposure and ability to attract advertiser support. These concessions will result in lower quality cable offerings and diversity of programmers, ultimately harming consumers.

77 *Fifth Annual Video Competition Report*, 13 FCC Rcd at 24374-75.

78 *Id.* at 24374.

79 *Id.*

80 Professor Hausman notes:

fees, exclusive agreements, or a percentage share in the programmer itself (or a "monopsony tax" on successful offerings).[81] Simply put, no other MVPD exists that could offer a video programmer such subscriber access and instant viability, or credibly threaten to deny the same. It would be economically infeasible for video programmers who are dissatisfied with AT&T's demands to shop their products to a number of other MVPDs to obtain the needed subscriber reach.

These actions will cause non-affiliated programmers to receive lower revenues and, thereby, enjoy fewer economic incentives and abilities to increase the quality of their products and create new content.[82] This could significantly reduce their viability in the long run. Moreover, as a result of the merger, AT&T would have the ability to foreclose vertically the entry of new

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> . . . most advertisers will pay increasing amounts for additional increments of customers. . . . If a large cable MSO can credibly threaten to deny access for a given cable channel to a significant proportion of customers by either not carrying the channel or putting it on a less widely-viewed (higher price) programming tier, the cable channel will realize that its ability to earn revenue from advertisers will be affected significantly. The cable channel will then heed to choose to either forgo the additional advertising revenues or accept a lower price from the cable MSO. This 'leverage' allows the exercise of monopsony power by a cable MSO, if the cable MSO is of sufficient size to significantly affect the advertising revenues of the cable channel.

See Appendix A, Hausman Declaration, ¶ 16.

AT&T claims that "[s]uch conduct is already largely foreclosed by existing regulations . . . which already prohibit discrimination and require the carriage of programming from diverse sources." Application at 59. However, as the Commission knows, these existing rules – such as the Carriage Agreement rules – are insufficient to protect rival market participants, because these participants are reluctant to bring complaints, fearing retribution from the MVPDs and video programmers on which they rely.

81 Appendix A, Hausman Declaration, ¶¶ 20-22.

82 *See id.* ¶ 17.

programmers. Professor Hausman questions the Commission's conclusion in the *1998 Annual Competition Report* that no single cable operator or pair of cable operators is large enough to block entry by a new programmer because:

> . . . cable channels in deciding on their content will need to decide whether a marginal increase in expenditure on content will be worthwhile. If their economic return is lower than the competitive level because the subscription rates are depressed below competitive levels or they have fewer potential viewers that advertisers want to reach, they will produce lower quality programming. If the effect is large enough, a marginal entrant may decide to forgo entry altogether.[83]

Indeed, this is precisely the concern that led to the *Time Warner Consent Decree*, which was imposed, in part, to prevent TCI from engaging in such vertical foreclosure.[84]

In addition to video programmers, rival MVPDs will likewise be harmed.[85] As Professor Hausman explains:

> The exercise of monopsony power by a vertically integrated cable MSO can allow . . . [it] to charge higher subscription fees for its own programming to non-affiliated cable MSOs because of reduced programming competition. Thus, the vertically integrated company pays a lower price for programming it buys from third parties and is able to charge a higher price for its [affiliated] programming because of the lower quality of the competing programming."[86]

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83 *See id.* ¶ 19.

84 *See Statement of FTC Chairman Pitofsky and Commissioners Steiger and Varney*, *In the Matter of Time Warner Inc.)* Docket No. C-3709 (Feb. 7, 1997) <http://www.ftc.gov/os/1997/9702/ c3709d%26o.htm> (finding that given their access to 44 percent of all cable subscribers, Time Warner and TCI could foreclose unaffiliated programming from their cable systems).

85 *Fifth Annual Video Competition Report*, 13 FCC Rcd at 24362 ("If incumbent MVPDs can successfully limit new entry into their markets, there may be a tendency for prices to rise above competitive levels and for product quality, innovation, and service to fall below competitive levels in both household and MDU markets").

86 *See* Appendix A, Hausman Declaration, ¶ 23.

Furthermore, "the vertically integrated company can charge higher fees to advertisers, because advertisers will have fewer competing programs (with viewers) to choose from."[87]

It follows that consumers will ultimately pay the price of this merger by having access to lower quality programming and fewer actual programmers. As rival MVPDs are harmed, AT&T will be able to charge higher prices to consumers for subscription. Thus, the anticompetitive effects that will result from the monopsony power created by this merger will be significant and substantial.

2. AT&T's Concentration Of MVPD And Programming Assets Will Deter Alternative Providers

Aside from anticompetitive effects arising from AT&T's monopsony power, the combination of AT&T's and MediaOne's cable and programming interests will give rise to other unacceptable market problems, including the removal or foreclosure of actual and potential competitors among cable overbuilders and ISPs offering video streaming as well as anticompetitive refusals to deal on the part of AT&T's affiliated programmers.

a) Loss of Cable Competition

As AT&T concedes, the merger will result in an actual *loss* of competition in the MVPD market in Atlanta, Georgia MSA where AT&T and MediaOne have overbuilt, and in seven territories in which AT&T and MediaOne hold competing franchises.[88] Without such facilities-

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87 *See id.*

88 Application at 41, n.93. Indeed, in the *AT&T/TCI Order*, the Commission approved the merger in part because it found that there were no anticompetitive effects in the MVPD market given that there would not be a precluded competitor in the MVPD marketplace. *AT&T/TCI Order*, 14 FCC Rcd at 3173 ("AT&T is unlikely to become a significant competitor in the distribution of multichannel video programming absent the merger. . . . Accordingly, the merger is

based competition, consumers will suffer. AT&T will be able to continue to charge supracompetitive prices, and its monopolistic rents will only continue to increase. MSOs are already able to charge subscriber fees that are increasing at rates far-exceeding the CPI index.[89] In addition, without competition for the delivery of video programming and other services, consumers will be left with fewer choices in providers and programming.

b) Foreclosure of Video Streaming Opportunities

The merger will also give AT&T an increased incentive and ability to harm a potential new entrant into the MVPD market – ISPs offering Internet-based "video streaming." As capacity and technology on the Internet continue to grow, ISPs may become a viable competitor to MVPDs and, therefore, may stand as a significant potential rival to cable operators in the traditional market.[90] Indeed, ISPs may even offer a superior product because their services may finally achieve the "video on demand" goal.

AT&T has apparently recognized the potential competitive threat that video streaming represents. Through Excite@Home it is engaging in anticompetitive behavior to thwart the development of ISPs as competitors to its own MVPD services by limiting video streaming to 10-minute increments. While AT&T has at times claimed that technical constraints are the reason for this limitation, it has elsewhere conceded that its real goal is control over the development of video

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unlikely to result in the loss of a significant source of current or future competition in MVPD services.").

[89] *Report on Cable Industry Prices*, 15 Comm. Reg. (P&F) 965, ¶ 6 (May 7, 1999).

[90] *Fifth Annual Video Competition Report*, 13 FCC Rcd at 24349.

streaming in the cable market.[91] Moreover, there are a number of ISPs that have begun to offer video streaming services without problems.

Broadband Internet streaming holds out the potential to become a significant competitor to cable operators. By dominating broadband transport and tying its ISP, AT&T will be in a position to continue its 10-minute limitation on video streaming. If the Commission allows the merger to proceed, by missing the chance to decrease the exercise of market power by cable MSOs and by hindering the development of new types of broadband Internet cable offerings, consumer welfare will be most adversely affected.

c) Refusals to Deal for Programming

Congress and the Commission have long-recognized the anticompetitive harms that can result from vertically integrated cable operators' refusal to sell affiliated programming to competing MVPDs.[92] Given AT&T's and MediaOne's significant cable system and video programming interests, including interests in some of the most popular video programming, AT&T post-merger will have the increased power, and incentive, to thwart the development of rival MVPDs by denying them access to AT&T's cache of affiliated programming on fair terms and conditions. This will be possible because AT&T will receive sufficient advertising revenues and subscriber fees for its programming from its own systems. Simply put, without reasonable

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91 *See infra*, n.30 and accompanying text.

92 *See* 47 U.S.C. § 548; *Implementation of Sections 12 and 19 of the Cable Television Consumer Protection and Competition Act of 1992*, 8 FCC Rcd 3359, 3362 (1993) ("In enacting the program access provisions of the 1992 Cable Act, Congress expressed its concern that potential competitors to incumbent cable operators often face unfair hurdles when attempting to gain access to the programming they need in order to provide a viable and competitive multichannel alternative to the American public.") (subsequent history omitted).

and fair access to AT&T's programming, competing MVPDs cannot be competitive in the marketplace, leading to fewer MVPDs and leaving consumers with fewer choices and higher prices.[93]

C. The Merger Would Have Anticompetitive Effects In The Navigation Devices Markets

Section 629(a) of the Communications Act, enacted as part of the Telecommunications Act of 1996, imposes on the Commission the duty:

> to assure the commercial availability, to consumers of multichannel video programming and other services offered over multichannel video programming systems, of converter boxes, interactive communications equipment, and other equipment used by consumers to access multichannel video programming and other services offered over multichannel video programming systems from manufacturers, retailers, and other vendors not affiliated with a multichannel video programming distributor.[94]

These devices, known as "navigation devices," which include not only converter boxes but also EPGs, are as necessary to cable systems as modems, portals, and browsers are to the Internet. The Congressional policy embodied in Section 629 is intended to benefit consumers by encouraging competition in the provision of such devices, and by giving consumers, and MVPDs, the choice of which devices to use.

Today, these devices provide a convenient means for consumers to access and select cable programming services, and the merger raises serious competition issues for their market segment which the Commission must address. Perhaps even more importantly, however, are the

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93 Appendix A, Hausman Declaration, ¶ 26.

94 47 U.S.C. § 549(a). The Commission's implementing regulations appear at 47 C.F.R. § 76.1200-76.1210.

implications of the merger on future navigation equipment and services. The Commission has recognized that digital set-top boxes and EPGs (functioning much like Internet browsers) could become the critical gateway into the home for a broad array of converging bitstreams carrying video, data, voice, and home automation services. This is especially true in view of the rapid digitization of video and its convergence with the already-digital Internet. As Commissioner Ness has observed:

> Digital set top devices are likely to be the gateway between digital bitstreams and new applications that may reside in the intelligent appliances of the future. These devices not only will control television service, but are likely to be the customer's gateway to the Internet and the world of electronic commerce."[95]

In the same vein, Professor Hausman notes that "EPGs could become a critical competitive element as the interface between consumers and MVPDs for both video programming and Internet services. EPGs could function similarly to a browser for a set-top box 'computer' that uses the television set as a monitor."[96] The Commission's decisions today will have a profound effect on whether competition is allowed to develop in this converged market as well.

Preserving competition in both the set-top box and EPG markets is an important governmental interest, as it promotes "the widespread dissemination of information from a multiplicity of sources."[97] The proposed merger, however, would consolidate AT&T's market power over cable navigation devices and enable AT&T to forestall competition in these markets.

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95 *Commercial Availability of Navigation Devices*, 15 Comm. Reg. (P&F) 817 (May 14, 1999) (Order on Reconsideration) (Separate Statement of Commissioner Susan Ness).

96 Appendix A, Hausman Declaration, ¶ 28.

97 *Turner Broadcasting v. FCC*, 520 U.S. 180, 189 (1997) (quoting *Turner Broadcasting System, Inc. v. FCC*, 512 U.S. 622, 624 (1994)).

After this merger, AT&T will be able to dictate technical standards through its monopsony power in the set-top box market, its power over vertical programming services, and its dominance over broadband Internet access services. This ability will arise from its combination of extensive cable system holdings, its web of interests in programming services, and its stakes in cable modem services. In addition, Microsoft's $5 billion investment in the post-merger company gives AT&T a powerful incentive to favor Microsoft software in set-top box and related navigation equipment and services. This, in turn, will likely forestall competition in the operating and browser software for digital devices that can provide both traditional "cable" and Internet services. The result will be to reduce the options available to consumers and reduce competition, contrary to the purpose of Section 629 and the public interest.

1. The Merger Would Impede Competition In The Cable Set-Top Box Market.

Both Congress, in Section 629, and the Commission, in its *Navigation Devices Order,*[98] have recognized that set-top boxes constitute a discrete market. It is, therefore, surprising that AT&T's list of seven "product markets possibly relevant" to the merger[99] completely ignores navigational devices. This failure to address the implications of the proposed merger for

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98 *See, e.g., Commercial Availability of Navigation Devices*, 13 FCC Rcd 14775, 14776 (1998) (Report and Order) ("*Navigation Devices Order*") (subsequent history omitted). The Commission defines "navigation devices" to include "converter boxes, interactive equipment, and other equipment used by consumes within their premises to receive multichannel video programming and other services offered over multichannel video programming systems." *Id.* at 14776 n.1.

99 Application at 33.

navigational devices, including cable set-top boxes and broadband EPGs, under the proper standard alone renders the Application fatally defective.

Application of the *Bell Atlantic/NYNEX* analysis to this market demonstrates that the proposed merger would jeopardize the open competition for navigation equipment that Section 629(a) seeks to foster. The market for set-top boxes is a national market.[100] It is uniquely vulnerable at this time because it is undergoing a transition from a market characterized by leased, analog equipment to a retail-oriented, digital marketplace.[101]

Although significant market participants include cable operators and manufacturers, their roles are changing. Currently, cable operators (including AT&T/TCI, MediaOne, and Time Warner) purchase boxes from manufacturers for leasing to customers. The manufacturers include companies such as General Instrument. Although such companies traditionally have sold only to cable systems, today they are transitioning to a retail market based on the Commission's Open Cable Initiative, which has as its purpose the goal of achieving open standards for set-top boxes.

Consistent with Section 629(a), the FCC has affirmed that "competition in the navigation equipment market is central toward encouraging innovation in equipment and services, and toward bringing more choice to a broader range of consumers at better prices."[102] Thus, the Commission

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100 *See* Appendix A, Hausman Declaration, ¶ 31 ("Set-top boxes form a relevant product market, which is national in geographic scope.").

101 *Navigation Devices Order*, 13 FCC Rcd at 14776 ("Competition in the markets involved is in an early stage of development and the enormous technological change resulting from the movement from analog to digital communications is underway."). *See also Carriage of the Transmissions of Digital Television Broadcast Stations*, CS Docket No. 98-120, FCC 98-153, ¶¶ 18, 25-30 (July 10, 1998) (Notice of Proposed Rulemaking); *Fifth Annual Video Competition Report*, 13 FCC Rcd at 24385.

102 *Navigation Devices Order*, 13 FCC Rcd at 14776.

must consider whether the post-merger AT&T would have the ability and the incentive to dominate the set-top box navigational devices market in ways that would harm consumers. The answer is clearly yes, as the proposed merger threatens harm to consumers and competition in several ways.

First, after the merger AT&T would serve at least 62 percent of the homes passed by cable, constituting a dominant share of the conventional set-top box market.[103] In addition, through @Home and Road Runner, AT&T would also control access to approximately 98 percent of cable broadband Internet access subscribers – almost 85 percent of total broadband – giving it dominance over broadband set-top boxes as well.[104] This imposing market share in these two important sectors of the set-top box market would allow AT&T essentially to dictate set-top box architecture, for few manufacturers would risk alienating a potential customer of such large size. This inevitably will lead to fewer choices for consumers, as equipment manufacturers will adjust to AT&T's preferred design and reduce innovation and consumer choices.

Second, in exchange for Microsoft Corporation's investment of $5 billion in AT&T, AT&T has committed to purchase Microsoft's Windows CE technology for 2.5 million to 5 million set-top boxes. Coupled with AT&T's pre-existing commitment (through TCI) to purchase Microsoft's Windows CE for another 5 million boxes, Microsoft has ensured that AT&T will purchase between 7,500,000 and 10,000,000 copies of Windows CE software for its set-top boxes. The proposed merger will aggravate this situation by (1) eliminating MediaOne as a potential independent buyer of set-top box software and (2) expanding the number of cable

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103 Appendix A, Hausman Declaration, ¶ 12, n.15.

104 *See supra* at 6.

systems potentially subject to this contract. All of which serves to take away from consumers the choices that Section 629 meant to ensure.

The deal with AT&T gives Microsoft a clear headstart toward establishing its software as the *de facto* industry standard for digital set-top boxes.[105] This itself poses another danger in light of Microsoft's demonstrated preference for use of its closed proprietary software – operating systems as well as browsers – over competing non-proprietary programs such as Linux. Although the policy established by Section 629 and the Open Cable initiative requires open set-top box standards, these are still being developed. Allowing Microsoft to obtain a greater role in the set-top box market before open standards are firmly established would be contrary to the public interest. Surely Section 629 would not be satisfied if Microsoft software were to dominate the next generation of set-top boxes in a manner comparable to the dominance of Windows in personal computers.

2. The Merger Would Impede Competition In Electronic Programming Guide Technology, Equipment, And Services

The merger would also harm competition in the closely-related market for electronic programming guides ("EPGs"). The merger creates greater power to discriminate against unaffiliated cable EPG services. As digital cable EPGs and Internet browsers converge, the post-merger AT&T will, through its interests in @Home and Road Runner, have the ability and

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[105] The Chief Financial Officer of General Instruments has stated that AT&T has selected Microsoft Windows as the operating system "for most of their systems" and claims that General Instruments currently has an 80-90 percent share of the two-way interactive digital market. *The Motley Fool Interview With General Instrument Corp. CFO Eric Pillmore* (July 27, 1999) <http://www.fool.com/foolaudio/transcripts/1999/stocktalk990727_General_Instrument.htm>.

incentive to favor its affiliated services and discriminate against both unaffiliated EPG services and upstream content providers.

In the *Navigation Devices Order,* the Commission stated that EPGs constitute a distinct market.[106] As in the case of set-top boxes, the EPG market is national.[107] Significant market participants include EPG services affiliated with MVPDs such as AT&T/TCI's affiliated EPG, TV Guide,[108] and various independent EPGs not affiliated with MVPDs.

The Commission further concluded that equipment used to access EPGs is subject to the requirements of Section 629,[109] that it must promote the competitive availability of EPG equipment, and that it would monitor competition for EPG services.[110] The time has now come to replace monitoring with action. The Commission must prevent AT&T from acquiring such dominance of the cable market that it could impede competition for EPG equipment, including software and services.

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106 "Based on the plain language of Section 629, it appears clear that the equipment used to access such electronic program guides is 'equipment used by consumers to access . . . services offered over multichannel video programming systems' and hence falls within the requirements of Section 629." *Navigation Devices Order*, 13 FCC Rcd at 14820.

107 Appendix A, Hausman Declaration, ¶ 27 ("EPGs are a relevant product market that is national in geographic scope").

108 AT&T owns 44 percent of TV Guide. Appendix A, Hausman Declaration, ¶ 27.

109 *Navigation Devices Order*, 13 FCC Rcd at 14820-21.

110 Chairman Kennard wrote separately to emphasize his concern "that a variety of electronic programming guides be made available to the consumer," reiterating his intention to monitor closely developments in this market. *Commercial Availability of Navigation Devices*, 13 FCC Rcd at 14843 (1998) (Separate Statement of Chairman William Kennard).

First, the merger would increase AT&T's incentives and ability to restrict competition in EPG services by discriminating (or continuing to discriminate) in favor of its affiliated EPGs, such as the TV Guide for video programming and Excite@Home for cable broadband services, and against competing EPG providers. It would likely deny cable carriage to competitors and strip competitors' signals out of the vertical blanking interval of broadcast signals. Given AT&T's dominance of the cable market, such actions alone would so reduce the market opportunities of unaffiliated EPG services as to damage their viability. This would result directly in fewer choices and higher prices for consumers.

Second, by consolidating its control over EPGs, AT&T would acquire an additional means of exercising market power to discriminate against unaffiliated cable content providers. For example, AT&T would be able to favor its extensive lineup of affiliated video programming services in access to or placement on EPGs, steering customers to its affiliated providers instead of competing services. As Professor Hausman points out, this behavior closely resembles the practice of airlines that, in the 1980s, were accused of using screen-based reservation systems to steer customers towards their own flights, but is likely to have greater anticompetitive impact.[111]

Third, the merger would position AT&T to exercise market power in the market for EPGs designed to serve the converging digital video/Internet market. As Commissioner Ness anticipated in the *Navigation Devices* proceeding, EPGs are likely to become the critical interface between the consumer and MVPDs for both video programming and Internet services.[112] For example, EPGs

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[111] Appendix A, Hausman Declaration, ¶ 29.

[112] *Commercial Availability of Navigation Devices*, 15 Comm. Reg. (P&F) 817 (May 14, 1999) (Order on Reconsideration) (Separate Statement of Commissioner Susan Ness).

could function in effect as a browser for a set-top box "computer" that uses the television set as a monitor. The recent report that the AT&T-controlled Excite@Home plans to introduce a browser branded with its own name illustrates the possibilities. The Excite@Home browser would consist of Microsoft's Internet Explorer's search engine, coupled with Excite@Home software.[113] AT&T and its allies should not be permitted to dominate this emerging market as well.

Finally, the merged AT&T would have market power over the design and operation of digital EPG services themselves. As noted above, the $5 billion investment by Microsoft provides AT&T with a strong incentive to provide Microsoft's operating and EPG software favorable access to AT&T's digital set-top boxes. Indeed, AT&T is already contractually committed to purchase from 7.5 to 10 million copies of Windows CE software for digital cable set-top boxes. This figure dwarfs the current size of the entire broadband access market – about 1,000,000 customers – and appears to reflect an intent on the part of Microsoft to "lock up" the software for so many digital devices as to dominate the next generation of set-top box software. The extension of Microsoft's dominant position in personal computer operating systems to EPG services in the digital video and Internet markets cannot help consumers or advance the public interest.

D. The Merger Would Harm Competition In Internet Broadband Offerings

The merged entity would possess market power over broadband Internet access services. This power would arise from two sources (1) AT&T's control of the first and third largest cable MSOs in the nation and (2) AT&T's stakes in two cable broadband ISPs – Excite@Home and

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113 *See* Bloomberg News, *Browsing with Excite@Home?* (July 27, 1999) <http://www.news.com/News/Item/0,4,39806,00.html> (Special to CNET News.com).

Road Runner – which collectively provide almost 85 percent of broadband Internet access services in the nation today.[114]

After the merger, AT&T would be well-positioned to extract financial concessions from broadband content providers and discriminate in favor of affiliated or otherwise preferred content providers. Cable systems currently provide about 85 percent of broadband transport for Internet access, and for many consumers, who currently lack access to Digital Subscriber Line, wireless cable, or satellite, there is no alternative provider of broadband capacity.

AT&T would thus be able to leverage its existing market share position to harm unaffiliated vertical providers and favor its affiliated offerings. One obvious example of this practice is AT&T's tying of broadband transport to Excite@Home, its affiliated Internet access provider and portal.[115] MediaOne engages in a similar practice in bundling Road Runner to its cable modem service. These tying arrangements deprive customers of even the option of purchasing cable broadband transport without having to purchase the affiliated ISP service[116] and, thus, harm consumers and competition.

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[114] It is important to note that the reach of the AT&T post-merger would extend even beyond the cable systems that it owns. By virtue of these affiliated ISPs' exclusive contracts with other MSOs, AT&T would control or influence the broadband transport and access to a substantial percentage of additional homes.

[115] Under current antitrust law, tying arrangements are evaluated under a five-part test established by the Supreme Court in *Tri-Jefferson Parish District No. 2 v. Hyde,* 466 U.S. 2 (1984). To prevail on a tying claim, a plaintiff must establish that: (1) two separate products are involved; (2) conditioning of purchase of one product (cable broadband transport) on the other (Internet access/content service); (3) market power in the tying product; (4) a "not insubstantial" amount of commerce in the tied product; and (5) an anticompetitive effect in the market for the tied product. These criteria are easily satisfied here.

[116] AT&T asserts that customers would be free to select their own ISP after logging on the Internet through Excite@Home. While in a theoretical sense this may be true, the notion that

Importantly, the extent of potential harm to other vertical Internet markets from AT&T's self-dealing and self-favoritism is literally as broad as the Internet itself. It ranges from portals (Excite@Home and MSN stand to gain); to search engines (such as Microsoft's Internet Explorer);[117] to information/entertainment sites; to e-commerce sites;[118] and to the many markets that include providers of products and services to these entities. The inevitable result will be higher prices and fewer choices for consumers and/or providers at all levels.

These harms could arise from a variety of means. For example, AT&T could impose a "broadband Internet tax" – comparable to the monopsony tax that AT&T could assess with respect to cable content – that would, in effect, convert smaller websites to the economic equivalent of leased access customers.[119] Also, AT&T would possess an imposing array of technical tools by which it could discriminate against unaffiliated Internet providers by slowing their downloading speeds or establishing proprietary technical protocols for the @Home and Road Runner services.

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many consumers, once on the Internet, would seek to enter it again through another ISP, thereby incurring additional charges, is self-evidently ludicrous.

117 Excite@Home is reportedly developing a branded web browser based on Microsoft's Internet Explorer browser, effectively shutting out rival browsers. *See* Bloomberg News, *Browsing with Excite@Home?* (July 27, 1999) <http://www.news.com/News/Item/0,4,39806,00.html> (Special to CNET News.com).

118 AT&T's extensive video interests are summarized *supra* at 5-8. Its shareholder, Microsoft, has an extensive lineup of Internet content properties. All of these interests stand to benefit from their corporate affiliation with AT&T.

119 In cable systems, leased access typically is available to content providers of such relatively low popularity that they must pay, rather than receive payment from, the cable system for carriage. AT&T could refuse to allow its Excite@Home subscribers to access unaffiliated websites that had not paid a fee for the ability to be reached. This cannot occur in open access systems.

In sum, as the "first mover" in the Internet broadband marketplace, AT&T possesses an advantage that has proven highly valuable. If AT&T is allowed to build on this "first mover" advantage, a significant risk exists that its closed access model could change the fundamental nature of the Internet from an open, peering model to a closed model far more closely akin to traditional cable. This conversion of the open Internet to a closed model, with AT&T as the gatekeeper, would be plainly contrary to the interests of competition, unaffiliated providers, and consumers.

V. COMPETITIVE CONCERNS ARE PARTICULARLY ACUTE GIVEN THE MARKET-DISTORTING EFFECTS OF THE DISPARATE REGULATORY TREATMENT OF AT&T AND ILEC SERVICES

SBC supports the rollout of advanced services in a manner that ensures deployment to all consumers.[120] However, this goal will be successfully achieved only if the market for advanced services is competitive and robust. The disparate regulatory treatment of AT&T's and ILECs' broadband services is unwarranted and will only serve to exacerbate and perpetuate the competitive harms described above and, thereby, severely undermine consumer welfare. Rather than create asymmetric schemes that will ultimately limit consumers' choice of service providers and increase the prices they pay for advanced telecommunications services, the Commission must act swiftly to level the playing field – either by denying the merger or, at a minimum, conditioning the merger's approval upon AT&T's agreement to open its broadband "pipes" to competitors.

AT&T seeks to run a closed system while escaping effective regulatory control in virtually every aspect of its businesses. In contrast, ILECs who offer the same services – be they local or

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120 *See* 47 U.S.C. § 706.

long distance voice services or high-speed data capabilities – will continue to be forced into a regulatory briar patch, one that exacts an exorbitant price in dollars and delay before services are delivered to consumers. For example, while ILECs are required to provide interconnection to their networks at any technically feasible point,[121] AT&T post-merger will be free of these costly and cumbersome obligations. Similarly, while ILECs must unbundle the elements of their networks for competitors,[122] offer services for resale at wholesale rates,[123] provide equal access to their networks[124] and offer collocation of competitor equipment,[125] it appears that none of these requirements will apply to AT&T after the merger. Nor will AT&T be bound by the provisions of Sections 271 and 272 of the Act, or the rules governing open network architecture and CEI.

The stated rationale for the costly regulatory burdens imposed on ILECs is that they are necessary to provide an opportunity for competitors to penetrate the local telephone and advanced data services markets. AT&T itself has long supported the "market opening" provisions of the Act, as well as other measures that have been touted as providing competitors a lever to open access to ILEC networks.[126] It has taken advantage of every opportunity to caution the

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[121] 47 U.S.C. § 251(b)(2)(B).

[122] 47 U.S.C. § 251(c)(3).

[123] 47 U.S.C. § 251(c)(4).

[124] 47 U.S.C. § 251(b)(4).

[125] 47 U.S.C. § 251(c)(6).

[126] *See Statement of James W. Cicconi, Senior Vice President for Government Affairs and Federal Policy, "AT&T Reaction to Supreme Court Ruling Upholding FCC Authority on Establishing Guidelines for Competition,"* (Jan. 26, 1999) <http://techlawjournal.com/courts/attviowa/19990126.html> ("AT&T is delighted the Court has confirmed that the Telecom Act established a national policy in support of local competition. It's

Commission regarding the likely harmful effects of creating "bottleneck[s] . . . with respect to providing advanced services, which are provided over [the] same loops" as telephony and other services.[127] And as recently as last month, AT&T opposed even the sweeping market-opening conditions that accompanied the merger of SBC and Ameritech because, in its estimation, the conditions do not go nearly far enough to ensure open access to the SBC and Ameritech networks.[128]

Yet, as AT&T hopes to complete a merger that will deliver it bottleneck control over a broadband pipe into the home, its perspective has changed dramatically. Regulation that would guarantee open access to *its* loop architecture is inherently bad, AT&T hypocritically claims – wholly ignoring the fact that it will occupy comparable incumbent status as a cable monopolist and its service territories and associated interests will be broader in scope than any existing ILEC enterprise. Notwithstanding the time and effort AT&T has expended seeking to subject SBC and

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especially good news the Court upheld the FCC's rules prohibiting local monopolies from misusing their control of network elements to inhibit competitors from entering the local market.").

[127] Comments of AT&T Corp., CC Docket No. 98-26, at 9 (April 6, 1998); "[T]he high-speed access connection to the home . . . at issue here is entirely capable of carrying *all* of a customer's traffic, including voice. Once a home . . . purchases such access connections, there is no need for it to maintain a separate POTS line . . . . Consequently, the local carrier who wins the customer's 'Internet' business will also win its local voice business. Thus, it will effectively preclude the development of local competition . . . .". *Id.* at 6.

[128] *See* Comments of AT&T Corp. on the Proposed SBC-Ameritech Merger Conditions, CC Docket 98-141, at 1 (July 19, 1999) ("[The proposed conditions] do not address in any meaningful fashion the serious competitive concerns which demonstrated that the merger as originally proposed would be anticompetitive and would fail the statutory public interest test. Nor do the Conditions mitigate those concerns by making Applicants' markets more open in any other, independent respect.").

other ILECs to ever more stringent open network requirements, claiming time and again that such efforts were necessary to protect the interests of competitors and consumers,[129] there is no basis for the distinctions that AT&T seeks to create, and the public interest will suffer if they are maintained.

SBC has consistently encouraged the Commission to take an even-handed approach to regulation in the deployment of advanced services rather than select "winners" and "losers" in what amounts to little more than government-sponsored industrial planning.[130] The obligations imposed solely on ILECs are by themselves a substantial impediment to deployment of advanced services, and that impediment is exacerbated by the asymmetrical treatment of their already advantaged largest competitor, AT&T.

The Commission itself has recognized that regulation has the potential to create disincentives to investment in the advanced services market.[131] This is even more true of disparate regulation of competing technologies. In particular, by artificially raising the costs of one technology, such regulatory handicapping creates the potential for an inefficient rival technology to best its competition in the market without regard to individual merit. At no time has AT&T explained how the benefits of a competitive market for advanced services can be realized in the absence of parity in regulatory treatment. While AT&T claims that its merger will bring benefits to consumers by spurring competition from ILECs in the advanced services market, it is at the very

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129 *See id.* at 54-70.

130 *See generally* Comments of SBC Communications Inc., CC Docket 98-146 (Sept. 14, 1998).

131 *See Deployment of Advanced Telecommunications Capability*, 13 FCC Rcd 24011, 24043-45, 24047-50 (1998).

same time seeking to hamstring ILECs through the imposition of regulations that will raise ILEC costs and inhibit ILEC entry. The paradox is irresolvable, and AT&T can not defend such conflicting positions.

To the extent existing legal requirements limit the Commission's ability to deregulate all providers consistently, the public interest demands as a minimum that they be accorded symmetrical obligations. By permitting one incumbent provider of advanced services to operate free of virtually any regulatory constraints, much less the excessive burdens placed on the ILECs, the Commission will effectively prevent consumers from reaping the benefits of full and fair competition, including a broader array of services and lower prices. The reasons are clear: laboring under the costs associated with regulatory compliance and the disabilities tied to providing competitors cheap access to their services, the ILECs will be less effective competitors in the marketplace.

It cannot be the case that the public interest countenances, much less demands, such disparate treatment of comparably situated entities. The adverse impact on consumers caused by these regulatory disparities will increase both the risk of anticompetitive market power and the harm to the public from its exercise in each of the markets addressed above. The Commission may not, in the public interest, perpetuate such a situation, much less aggravate it as sought by AT&T here.

VI. AT&T HAS FAILED TO DEMONSTRATE THAT ANY SIGNIFICANT PUBLIC INTEREST BENEFITS WILL ARISE FROM THE MERGER

Contrary to the impression left by the Application, this transaction is not about local telephone service, but rather about exploiting dominion over a broadband pipeline into homes in order to exert market power over video, Internet, and related offerings. Accordingly, the merger should be denied on that ground alone. But, even if the Commission were to seek to examine AT&T's claimed local telephone competition benefits, it would find those claims to be neither substantial nor credible. As such, they may not be considered in the Commission's public interest analysis.

Under *Bell Atlantic/NYNEX*, claimed benefits must be shown to be "likely and verifiable." Moreover, "[a]s the harms to the public interest becomes greater and more certain, the degree and certainty of the public interest benefits must also increase commensurately in order for [the Commission] to find that the transaction on balance serves the public interest, convenience and necessity."[132] As shown below, AT&T has not even come close to meeting these standards.

AT&T's primary assertion of public interest benefits is predicated upon purported gains in the local telephony market.[133] But, AT&T has provided no evidence or other reliable indications that this benefit will be realized. There are no service commitments contained in the application, no implementation schedules, and no investment plans. Absent such a showing, the Commission and the public can have no assurance that AT&T's claims have any substance.

Just as in its acquisition of TCI, AT&T apparently believes it may proceed on a "trust us" basis – wholly disregarding the incongruity of such a perception in light of the staff's recent negotiation of detailed performance requirements with SBC/Ameritech notwithstanding already

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132 *Bell Atlantic/NYNEX Order*, 12 FCC Rcd at 20063; *MCI/WorldCom Order*, 13 FCC Rcd at 18137.

133 Application at 20-28.

existing substantiation in the record of that merger's enormous public benefits.[134] In fact, there is no reason to "trust" AT&T, as it has yet to fulfill even its prior promise regarding establishment of an open broadband system. To obtain approval of its merger with TCI, AT&T explained to the FCC that its customers "do not have to 'go through' @Home or view any @Home-provided content or screens."[135] In approving that merger, the FCC explicitly relied upon this commitment to openness, stating that: "We take this representation seriously [and] will monitor broadband deployment closely."[136] AT&T has not, of course, lived up to this commitment. It follows that, given AT&T's slippery rhetoric and the lack of any independently verifiable benefits, AT&T's claimed efficiencies should be discounted as vague and speculative and, therefore, not creditable.

The speculative and illusory nature of the claimed benefits is highlighted by the fact that both AT&T and MediaOne – without the merger – were committed to deployment of local telephony service throughout their respective systems.[137] MediaOne already boasts approximately 26,000 subscribers,[138] and typical penetration rates of 7-8 percent,[139] with some as high as 24

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134 *See Pleading Cycle Established For Comments on Conditions Proposed by SBC Communications Inc. and Ameritech Corporation For Their Pending Applications to Transfer Control*, DA 99-1305, CC Docket No. 98-141 (July 1, 1999).

135 *Applications for Consent to the Transfer of Control of Licenses and Section 214 Authorizations from Tele-Communications, Inc., Transferor, to AT&T Corp., Transferee,* 14 FCC Rcd 3160, 3206 (1999).

136 *Id.* at 3207.

137 *See Comments of AT&T Corp*., CS Docket No. 99-230, at 22-24 (Aug. 4, 1999); *Comments of MediaOne Group, Inc.*, CS Docket No. 99-230, at 15-16 (Aug. 6, 1999).

138 *See* Application at 23.

139 Mike Farrell, *Boston Hot for Telco Competition,* Multichannel Online News (March 8, 1999) < http://www.multichannel.com/digest.shtml>.

percent in its earlier trials.[140] In addition, MediaOne previously allocated $4.1 billion for network system upgrades,[141] which are due to be completed by the end of 2000.[142] AT&T cannot claim that these "benefits" are attributable to the proposed transaction.[143]

In apparent recognition of the insufficiency of its local telephony showing, AT&T attempts to augment its public interest statement with sparse and unsupported claims of benefits in other markets.[144] For example, AT&T asserts that the roll out of cable telephony will speed the deployment of Internet services and, thereby, spur competitors to invest in their networks. But, as set out above, there is no evidence or commitment from AT&T that the merger would increase deployment of cable telephony over what AT&T and MediaOne already have planned. It follows that any corresponding Internet deployment efforts would be similarly untethered to this transaction.[145]

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[140] *MediaOne Investor Handbook,* at 18 <http://www.mediaonegroup.com/investorinfo/publicationsframe.html>. Undoubtedly, this success can be attributed to MediaOne's IP telephony experience internationally, where it has enjoyed penetration rates of 32 percent in the UK. *Id.*

[141] Application at 23.

[142] *Id.* at 23, n.60.

[143] AT&T's attempt to belittle MediaOne's accomplishments by touting the advantages of IP telephony over circuit-switched offerings fails in view of AT&T's own deployment of the latter and the absence of any showing that either AT&T's or MediaOne's conversion to digital technology will be accelerated in any appreciable and certain way by the merger. *See* Application at 25.

[144] AT&T only devotes a total of two and a half pages to these other markets. *See* Application at 28-31.

[145] MediaOne concedes that one digital upgrade covers all services:

> It costs approximately $400 per home passed to upgrade the network to 750 MHz. This basic upgrade makes the network ready to carry two-way services, including

AT&T's threat not to invest in local telephone competition is simply not credible.[146] AT&T has already paid a $40 billion premium for TCI. To earn the revenues that would justify that premium, AT&T *must* invest in local telephone competition. If AT&T were to announce that it was abandoning its plan, its stock price assuredly would decrease substantially almost immediately. In other words, AT&T must press forward with its investment in local telephone competition or else receive a severe punishment at the hands of the stock market, which would cost AT&T's shareholders the premium that they have already paid for TCI.

AT&T's claim to generating pro-competitive incentives for other broadband providers is similarly baseless. In fact, AT&T is actively working through the regulatory process to promote requirements such as below cost TELRIC pricing that will discourage investment and handicap the potential ILEC competitors it claims to be spurring.[147] Thus, AT&T has shown no material benefits to the Internet marketplace, only harms.

VII. CONCLUSION

In view of the foregoing, the record shows that the proposed AT&T/MediaOne merger would impede competition in numerous product markets with no countervailing benefits. The

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(Continued...)

advanced video, high-speed data and telephone services. Once the network has been upgraded, most of the other costs associated with new products are revenue-led. In other words, you don't need to install customer premises equipment (CPE) until the customer signs up for the service and starts generating revenue.

1998 MediaOne Investor Handbook, at 11 <http://www.mediaonegroup.com/investorinfo/publicationsframe.html>.

[146] Appendix A, Hausman Declaration, ¶ 36.

[147] Appendix A, Hausman Declaration, ¶ 37.

public would not only suffer higher costs and be denied choices in the selection of alternative providers, but also face the prospect of irreversible damage to the open framework of the Internet. Accordingly, the merger applications must be denied.

Respectfully submitted,

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APPENDIX A

Declaration of Professor Jerry A. Hausman

Declaration of Professor Jerry A. Hausman

1. My name is Jerry A. Hausman. I am MacDonald Professor of Economics at the Massachusetts Institute of Technology in Cambridge, Massachusetts, 02139.

2. I received an A.B. degree from Brown University and a B.Phil. and D. Phil. (Ph.D.) in Economics from Oxford University where I was a Marshall Scholar. My academic and research specialties are econometrics, the use of statistical models and techniques on economic data, and microeconomics, the study of consumer behavior and the behavior of firms. I teach a course in "Competition in Telecommunications" to graduate students in economics and business at MIT each year. Internet competition, service provision by cable providers, the effect of competition to cable providers, and competition among ILECs and CLECs are a few of the primary topics covered in the course. In December 1985, I received the John Bates Clark Award of the American Economic Association for the most "significant contributions to economics" by an economist under forty years of age. I have received numerous other academic and economic society awards. My curriculum vitae is included as Exhibit 1.

3. I have done significant amounts of research in the telecommunications industry. I have published numerous papers in academic journals and books about telecommunications. I have also edited two books on telecommunications, Future Competition in Telecommunications (Harvard Business School Press, 1989) and Globalization, Technology and Competition in Telecommunications (Harvard Business School Press, 1993). Two of my recent papers in telecommunications are: "Valuation and the Effect of Regulation on New Services in Telecommunications," Brookings Papers on Economic Activity: Microeconomics, 1997 and J. Hausman and H. Shelanski, Economic Welfare and Telecommunications Welfare: The E-Rate Policy for Universal Service Subsidies," Yale Journal on Regulation , 1999.

4. I am familiar with the cable industry and direct broadcast satellite (DBS) industry. I first did research on DBS in the early 1980's when I served as a consultant to Sears and Comsat on the commercial viability of DBS. I have continued to follow the DBS industry since that time. I have also studied DBS and cable competition in the United Kingdom and DBS in Australia. I have previously submitted Declarations to the Commission on behalf of DirecTV regarding the competitive impacts of policies affecting DBS. I have also made presentations to the DOJ regarding competition in the cable industry in the U.S.

I. Summary and Conclusions

5. Cable MSOs have significant market (monopoly) power. Since cable MSOs are largely unregulated, they charge consumers prices above competitive levels. The merger of AT&T/TCI (AT&T) with Media One will unite two of the top three cable companies. Direct Broadcast Satellite (DBS) places only a small constraining factor on cable.

6. The merger will increase the probability that the combined company will harm consumers in new ways in addition to the current pattern of charging supra-competitive prices. By exercising monopsony power, the combined company can create decreased programming choices for consumers, decreased quality of programming for consumers, and higher costs and prices for competing services such as DBS. The combined company will also be more likely to use its market power to affect competition adversely in the market for set top boxes and programming guides.

7. The ability of the Internet to provide future competition to cable is especially important given AT&T's repeated attempts to cause the Commission to adopt regulations that decrease the economic incentives and make it more difficult for ILECs to invest in broadband capacity. AT&T's attempted anti-competitive use of regulation to hamper

future competition demonstrates that AT&T will expend significant resources to maintain its largely unregulated ability to exercise market power in cable.[1]

II. Cables MSOs Have and Exercise Significant Market Power

8. Market power is defined as the ability to price above competitive levels for a significant amount of time.[2] Most economists who have considered the issue, the DOJ, the FCC, and the GAO have concluded that cable MSOs have significant market power.[3] When a new entrant comes into a local cable market by overbuilding, prices typically decrease by 10%-20%, which provides significant evidence of the exercise of market power. Thus, regardless of the market definition one uses, cable MSOs are charging prices above competitive prices because when wireline cable competition appears, prices of the incumbent cable provider decline significantly. Indeed, the latest data from the Commission demonstrates the price gap between cable systems that face head-to-head overbuild competition compared to cable systems that do not face "effective competition" has increased over the period July 1, 1997 to July 1, 1998.[4] Price increases during this period were also higher for the "noncompetitive group" of cable operators.

9. The Commission has typically analyzed competition within a market defined as the multichannel video programming distributors (MVPD) market. Using this market definition, cable still accounts for approximately 85% or the market despite the presence of

[1] FCC rate regulation of cable ended on March 31, 1999.
[2] See DOJ and FTC Horizontal Merger Guidelines (MG), 1992. Similar definitions are used in economics textbooks, e.g. D.W. Carlton and J.M. Perloff, Modern Industrial Organization, Scott, Foresman, 1990, p. 8 and in legal articles, e.g. W. Landes and R. Posner, "Market Power in Antitrust Cases", Harvard Law Review, 94, 1981, p. 937. Economists (and many legal decisions) tend to use the terms monopoly power and market power interchangeably with the above definition. I will use the two terms in this way.
[3] The recent GAO Report: "The Changing Status of Competition to Cable Television", July 1999, concludes "The cable industry maintains a high share of the subscription television market nationally and is currently not very competitive." (p. 1, also p. 9). The Commission determined in June 1998 that cable operators did not face "effective competition". See "Implementation of Section 304 of the Telecommunications Act of 1996: Commercial Availability of Navigation Devices", 12 CR 531, 63 FR 38089, 1998, ¶ 88.
[4] FCC, Report on Cable Industry Prices (FCC Survey), MM Docket No. 92-266, May 5, 1999, ¶ 4.

DBS and other forms of wireless MVPD offerings that have existed for a number of years.[5] Furthermore, MVPD markets are local geographic markets because MVPD (cable) operators will not divert their supply of programming to an adjacent geographic market in response to a price increase by the incumbent MVPD supplier. Additionally, significant barriers to entry exist for MVPD markets because of the substantial costs involved in market entry.[6] Moreover, market data demonstrate that DBS and other potential multichannel substitutes to cable are not effectively constraining the price of cable in local markets.

(1) The price of DBS decreased significantly in 1998 (Report ¶ 73) but the price of cable increased significantly (Report ¶ 47).[7] The recently released FCC Survey (¶¶ 5-6) and the CPI for cable both demonstrate significant price increases for cable.

(2) Overbuilding by new cable entrants leads to a significant decrease in price as I discussed above. Since DBS providers are national in scope, these price decreases demonstrates the lack of an effective price constraint by DBS.[8] Indeed, the "overbuild gap" has increased over the past year according to the FCC Survey.

(3) DBS is hampered by a lack of local stations and high upfront costs (in some situations). These factors are discussed in my academic research and in the Report, ¶ 11, ¶ 63.[9] Contrary to AT&T's claim in its

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[5] See FCC "Fifth Annual Report on Cable", December 17, 1998 (Report), ¶ 154.

[6] For a discussion of the importance of sunk costs in creating barriers to entry, see MG Section 3.

[7] The Report ascribes much of the price increase in cable to increases in programming costs, especially sports programming. However, the Report fails to note that DBS providers face similar increases in programming costs since they also carry ESPN and similar programming. The Report gives no explanation for this disparity in price movements given a large proportion of common input costs from programming. The GAO Report also finds decreasing (real) prices. (p. 14)

[8] See also the "Price Survey Report", Report, p. F-3, fn. 18 where the FCC reports that prices are 12.5% higher where no wireline MVPD competition exists compared to competitive areas.

[9] See J. Hausman, Individual Discount Rates and the Purchase and Utilization of Energy Using Durables," Bell Journal of Economics, Spring 1979, for a discussion of why high upfront costs tend to discourage

Applications that the lack of local stations for DBS will cease to be a problem, today DBS not only does not televise local stations, but also DBS is not allowed to carry popular network shows. While Congress may act to alleviate the problem it is unlikely that DBS will have the capacity to carry sufficient local stations to compete closely with cable along this dimension.

(4) The Commission Report discusses that for most consumers, DBS is not a close substitute to cable, Report ¶ 63. It does not appear that sufficient marginal customers exist for DBS to constrain cable prices, since the price of cable decreases significantly when a new wireline MVPD provider enters.[10]

Thus, using the DOJ and FTC Merger Guidelines (MG) (1992) market definition approach that the Commission has used in prior decisions, suppose that two cable providers (one being an overbuilder) are providing cable service at competitive prices. Using the MG approach, a hypothetical unregulated monopolist cable provider who controlled the prices of both of the two cable providers could increase prices by 5% since the data demonstrate that the presence of overbuilt wireline cable networks lead to lower prices of 12-20%. The price data which demonstrates that the presence of a wireline overbuilder leads to decreased prices of 12%-20% introduce significant doubts whether the MVPD market definition is appropriate. However, within the MVPD market definition the price data demonstrate that DBS and other wireless services are not constraining the price of cable to competitive levels.

10. The market power of cable MSOs in local markets is unregulated in most important respects. The Commission has many years of experience in regulating telephone companies, most of which are highly regulated with respect to their prices and non-

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consumer purchases.

[10] The recent GAO Report, op. cit., notes that DBS has enjoyed much greater penetration in more rural states. (p. 11) Since cable subscription prices are set on a local basis, this finding means than more urban cable systems face less competition and can exercise a greater degree of market power.

discrimination rules. To the contrary, cable MSOs have no price regulation and they have consistently increased their prices to well above competitive levels.[11] Furthermore, cable companies actively discriminate, e.g. in their refusal to allow non-affiliated ISPs to access their broadband capacity. The proposed merger will likely allow the extension of this unregulated market power to additional markets. Consumers will be further injured by the merger as they currently are by the exercise of market power by cable companies. As I have stated in my academic research and in previous submissions to the Commission, consumer welfare should be the foundation of the public interest test used by the Commission.[12]

11. The combination of TCI/AT&T (AT&T) and Media One will give AT&T direct control over approximately 29% of all multi-channel video programming (MVPD) customer subscribers according to the recent Commission Report.[13] Thus, the number one cable MSO would be merging with the number 3 cable MSO with a change in the HHI of approximate 296 (2*22.8*6.5). This number far exceeds allowable Merger Guidelines safe harbors, so a "competitive effects" analysis would be required as called for in Section II of the MG .[14] Even with reasonable changes in the shares, the resulting change in the HHI will continue to far exceed MG safe harbors.

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[11] My understanding is that cable rate regulation has expired on March 31, 1999. When the regulation was in place, cable MSOs regularly increased their prices at 3-4 times the rate of inflation as discussed in the Report (Dec. 1998 Report and prior Reports).

[12] See e.g. J. Hausman, Taxation By Telecommunications Regulation," Tax Policy and the Economy, 12, 1998 and J. Hausman and H. Shelanski, Economic Welfare and Telecommunications Welfare: The E-Rate Policy for Universal Service Subsidies," Yale Journal on Regulation , 1999.

[13] The FCC Report specifies a total MVPD market of 76.6 M subscribers. AT&T has direct control over 17.3 M subscribers (AT&T's total attributable subscribers (21.8 M) minus subscribers of Cablevision systems (3.1 M) and two AT&T-Time Warner cable joint ventures (1.4 M)) or 17.3/76.6 MVPD subscribers = 0.228. MediaOne has direct control over 4.97 M subscribers or 4.97/76.6 MVPD subscribers = 0.065. Thus, the total is a 0.293 share.

[14] The share calculation and HHI calculation are likely to be too low because, as I demonstrated above, DBS does not provide an effective competitive constraint on cable. A method to adjust the HHI calculations which takes account of the non-homogeneous product nature of cable and DBS using cross-price elasticities is J. Hausman, G. Leonard, and J.D. Zona, "A Proposed Method for Analyzing Competition Among Differentiated Products," Antitrust Law Journal, 60, 1992

12. Direct control is likely not the proper concept for considering the competitive effects of the proposed merger. In terms of cable homes passed, including Media One's partnership interest in Time Warner Entertainment, and AT&T's other attributable interests, the combined company would have a share of approximately 62%-65%.[15] The change in the HHI is approximately 1851, again far beyond MG safe harbors. Using the MVPD market definition, the total market share is approximately 48%-50%.[16] Using the MVPD market definition, the change in the HHI is approximately 1092, again far beyond MG safe harbors. Given that the economic interests of cable MSOs coincide on many economic issues, such as achieving low programming costs from third party providers, direct control is not required for cable MSOs to decide jointly to bargain together, or at least to take similar negotiating positions when bargaining with outside suppliers.[17] Thus, affiliated cable MSOs should be considered in the competitive analysis of the merger, rather than limiting the analysis only to cable MSOs that are directly controlled by the merged company.[18] Economic analysis demonstrates that given the commonality of

[15] The FCC Report reports total cable homes passed as 95.1 MM. The Application specifies that AT&T has attributable interests in systems passing 35.2 MM homes. The Application details that MediaOne has attributable interests in systems passing 26.5 MM homes. Excluding 2.7 MM double-counted homes, AT&T post-merger would pass approximately 59 MM homes or 62% of homes passed nationwide. The estimate would increase to 62 MM homes or 65% of homes passed nationwide if I include 3.1 million homes passed by Time Warner Inc.'s systems apparently managed by Time Warner Entertainment. Additional affiliations (which I do not use in my share calculations) will arise from further agreements with Bresnan Communications, Falcon Cable TV, Insight Communications, Intermedia Partners, Peak Communications and a proposed joint venture with Comcast.

[16] The Application specifies AT&T's total attributable subscribers as 21.8 M or 21.8/76.6 = 0.285. The Application details MediaOne's total attributable subscribers as 16.1 M or 16.1/76.6 = 0.21. Elimination of possible double counting reduces the combined share from 49% to 48%. MediaOne's attributable interest in Time Warner Inc.'s cable systems would increase the combined entity's share of the MVPD market to 50%.

[17] The analysis of factors that limit coordinated interaction in Section 2 of the MG does not apply here because cable MSOs do not compete with each other in purchasing programming from unaffiliated third party providers. Thus, the usual economic incentive exists to cheat on agreements is largely absent. Rather an economic incentive exists to bargain in a coordinated manner.

[18] AT&T claims that the merged companies will provide service to only 31% of cable homes passed or 26.6% of MVPD subscribers. See "Applications and Public Interest Statement", July 7, 1999 (Applications), p. 55. AT&T provides no economic basis for changing the attribution rules used by the Commission nor does it substantiate its larger estimate of homes passed by cable nationwide, compared to usual statistics used by the industry. (Applications, p. 63, fn. 153)

interests, affiliated companies will act in a coordinated manner with the merged company in many of the economic decisions they make.[19]

III. Likely Anticompetitive Effects from the Merger

13. I first consider the effect of the merger in the market for video programming. Video programming forms a separate product market that has a national geographic scope. Video programmers earn revenues from two sources: subscription fees paid by cable MSOs and advertising revenue. Possible anti-competitive effects in this market will lead to lower quality programming for consumers, reduced choice of programming to consumers, and possible higher MVPD prices to consumers. I consider each separate effect on consumers.

A. Exercise of Monopsony Power

14. Monopsony power is the ability of a buyer to require sellers of inputs to accept prices below the competitive price.[20] Monopsony power typically occurs because sufficient alternative buyers do not exist for the seller's product if the monopsonist refuses to buy the product. The proposed merger will likely lead to the exercise of monopsony power in the purchase of programming. This outcome can harm consumers by reducing programming quality and raising prices.

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[19] AT&T claims that a 35% share is required for monopsony power. This claim is misplaced. The MG state that, "In order to assess potential monopsony concerns, the Agency will apply an analytical framework analogous to the framework of these Guidelines." MG ¶ 0.1. The MG use a 35% share in assessing the lessening of competition through unilateral effects, ¶ 2.211, but the MG also consider the lessening of competition including the exercise of monopsony power by "a coordinating group of buyers" (MG ¶ 0.1), and no particular market share is required for the lessening of competition through coordinated interaction. Indeed, as I discuss below, one or two large cable companies can exert market power, especially when they act in a coordinated manner.

For example, the Federal Trade Commission recently found that ToysRUs, which sells about 20% of the toys sold in the U.S., had market power as a purchaser of toys. *In the Matter of Toys 'R' US, Inc., a corporation*, Docket No. 9278 (FTC Order) (Oct. 12, 1998).

[20] Thus, monopsony power is similar in concept to monopoly power, except the effect is in terms of the input prices, rather than output prices. Economic textbooks discuss monopsony power. See e.g. Carlton and Perloff, op. cit., pp. 114-117.

15. The vast majority of cable channels are national in scope.[21] Existing cable channels, and especially new cable channels, must have sufficient subscribers to attract advertising revenue to help pay for content generation. Advertising is an important source of revenue for cable channels since 60% of revenues come from advertising (Report ¶ 188). Cable subscribers have very little choice regarding their available programming because the MSO determines what channels to carry, which programming tiers to place channels on, and almost no a la carte choices are available (apart from premium channels, which typically do not have advertising). The only alternative for a cable subscriber is to change to DBS, but as the analysis above demonstrates, this alternative does not place a significant restraint on cable MSO behavior.

16. Furthermore, most advertisers will pay increasing amounts for additional increments of customers. This non-linear relationship of advertising to "share of available viewers" has existed for many years in both over the air and cable programming. If a large cable MSO can credibly threaten to deny access for a given cable channel to a significant proportion of customers by either not carrying the channel or putting it on a less widely-viewed (higher price) programming tier, the cable channel will realize that its ability to earn revenue from advertisers will be affected significantly. The cable channel will then need to choose to either forgo the additional advertising revenues or accept a lower price from the cable MSO. This "leverage" allows the exercise of monoposy power by a cable MSO, if the cable MSO is of sufficient size to significantly affect the advertising revenues of the cable channel.

17. If a cable channel receives below the competitive price for its programming or receives lower advertising revenues, it will have an economic incentive to decrease the quality of its product and spend less on content creation.[22] This result follows from the

[21] The primary exception are cable news channels and regional sport networks.
[22] AT&T in its Applications focuses on possible vertical foreclosure of cable channels. (e.g. Applications, p. 56, pp. 59-60) However, it does not discuss the outcome of lower quality programming because of decreased revenues to the cable channel. Lower quality causes loss of consumer welfare since it is similar to a higher price (holding quality constant) for a product.

lower economic return a cable channel would receive from the marginal expenditure to increase its program quality. These same considerations can affect entry decisions by marginal cable channel entrants, but these effects are not as potentially important given the discrete nature of cable channel entry. Decreased quality of programming or decreased choice leads to lower consumer welfare. Thus, exercise of monoposony power by the merged company is anti-competitive and leads to consumer harm.

18. The Commission has recognized the potential problem of monopsony behavior, Report ¶¶ 152ff.[23] The Report states that buyer concentration can have anticompetitive effects on the supply of programming to MVPDs. The Commission also states that monopsony power can reduce the diversity of content available to consumers. However, the Commission states in the Report that no single MSO or pair of MSOs control a large enough share of cable subscribers to be able to block entry by a new programmer.

19. I disagree with this conclusion. The FCC Report fails to recognize that most economic decisions are made at the margin. Thus cable channels in deciding on their content will need to decide whether a marginal increase in expenditure on content will be worthwhile. If their economic return is lower than the competitive level because the subscription rates are depressed below competitive levels or they have fewer potential viewers that advertisers want to reach, they will produce lower quality programming. If the effect is large enough, a marginal entrant may decide to forgo entry altogether. But even if entry were not affected, program quality decisions are affected by these marginal considerations, which the Commission Report does not fully recognize. Both results, lower quality programming or decreased choices for consumers, lead to harm to consumers from

[23] The Commission has previous recognized that even low market concentration in cable can lead to the exercise of monopsony power: "Congress concluded that the degree of concentration, though low relative to other industries, may enable some MSOs to exercise excessive market power, or monopsony power, in the program acquisition market". (FCC 1993 Cable Ownership Order, ¶ 10). This finding was made when TCI was independent, before the proposed transaction with the third largest cable MSO.

the decrease in consumer welfare.[24] Furthermore, the 1999 GAO Report also disagrees with the FCC Report's conclusion. The GAO Report states that a "subscription network needs its product to be carried by at least one of the two largest cable companies to be economically viable—thus creating a dependence on the large cable companies and giving them significant influence over the subscription network." (p. 22)[25]

B. Holdup Effects from Possible Exclusion or Foreclosure

20. An additional anticompetitive effect can occur. A large MSO, through its power of exclusion, can demand an ex post share (holdup) in successful cable packages. This share can be considered similar to a tax on successful programming where the right hand tail of the distribution of returns is truncated. Since programming has a high proportion of sunk costs, where assets cannot be shifted to other uses economically, the tax will lead to a reduction in investment and lower quality cable offerings.[26] This lower quality outcome is anti-competitive and harms consumers.

21. Furthermore, the incidence of the "monopsony tax" will be on the programmers who will be unable to shift it forward to some other group. That is, a proportion of the potential revenue to the successful programmer will be captured as a tax by the cable MSO. Indeed, I am aware that TCI exercised this type of monopsony power in the early 1990s against Viacom and other cable programmers. Viacom brought suit against TCI partly on these grounds and alleged that TCI had used its power against the Discovery/Learning Channels to demand a stake in their successful products.[27] Nor does a cable MSO necessarily need to be as large (contrary to the Report) as the combination of AT&T and Media One to use its market power. Certain "strategic MSOs" can exercise

[24] Indeed, similar potential anticompetitive effects were present that led to the Time Warner Consent Decree when Time Warner purchased Turner Broadcasting System in 1997. The FTC Complaint (Docket No. C-3709, p. 9) stated that Time Warner had direct financial incentives "not to carry other Cable Television Programming Services that directly compete with the Turner Cable Television Programming Services." A similar claim was made with respect to TCI.

[25] The 1999 GAO Report went on to find "that program suppliers that are not vertically integrated (such as MTV, A&E Network, and the Weather Channel) may be very dependent on large cable companies." (p. 22)

[26] I have discussed this truncation effect on investment in telecommunications where a significant proportion of investment costs are sunk in J. Hausman, "Valuation and the Effect of Regulation on New Services in Telecommunications," Brookings Papers on Economic Activity: Microeconomics, 1997.

market power in their local markets. An example of this was the exclusion by Time Warner of Fox News in New York City in 1997 until Fox agreed to certain demands made by Time Warner.

22. The merged company will be more than large enough to exercise this type of monopsony power. In terms of direct control, approximately 29% of MVPD consumers will subscribe to the merged entity's cable MSOs. In terms of associated ownership interests, the shares are between 48%-65%. This amount of potential control over buying decisions for cable programming content would allow significant anticompetitive actions to succeed. This potential outcome particularly warrants Commission attention because TCI has exercised monopsony power in the past to distort competition.

C. Monopsony Power Used in Conjunction with Vertical Integration

23. A large cable MSO has an additional economic incentive and ability to exercise monopsony power when it is vertically integrated into programming. The addition of vertical integration into programming increases the economic return to the exercise of monopsony power so that the cable MSO will tend to exercise monopsony power beyond the point of a nonintegrated cable MSO. The exercise of monopsony power by a vertically integrated cable MSO can allow the vertically integrated company to charge higher subscription fees for its own programming to non-affiliated cable MSOs because of reduced programming competition.[28] Thus, the vertically integrated company pays a lower price for programming it buys from third parties and is able to charge a higher price for its programming because of the lower quality of the competing programming. Also, the vertically integrated company can charge higher fees to advertisers, because advertisers will have fewer competing programs (with viewers) to choose from. Thus, the distortion to

[27] The suit subsequently settled with a non-public agreement.
[28] The FTC used this potential anticompetitive effect as the one of the bases for their complaint in the Time Warner Purchase of Turner Broadcasting System in 1997. See the FTC Complaint (Docket No. C-3709, p. 9) and the discussion above in fn. 22.

competition can be significantly greater in the presence of vertical integration by cable MSOs that have basically unregulated market power.[29]

24. AT&T holds a 100% equity interest in Liberty Media Group, a very large producer of and distributor of video programming. AT&T/TCI has a significant financial interest in 15 of the top 50 cable channels by subscribership (Report, Table D6). AT&T also has an ownership interest in 28% (67 of 242) of all national programming services. This percentage has increased from 23% over the past few years (Report ¶ 163). Thus, AT&T has an economic incentive to decrease competition from other cable channels because they compete for subscribers and advertising dollars. Advertising is very important since 60% of revenues come from advertising (Report ¶ 188). The "monopsony tax" discussed above decreases competition, and the size of the monoposony tax levied by a cable MSO will increase with vertical integration.

25. The increase in monopsony power that would result if AT&T were allowed to acquire Media One would allow AT&T to increase the monopsony tax. Media One also has additional programming assets, which would increase the return to AT&T from the exercise of monopsony power. These programming assets include The Food Network, Style!, Preview Travel, Sportsline USA, Speed Vision, Outdoor Life, and regional networks. Media One also owns a 25% interest in TW/Turner programming (Report ¶ 165), which further increases the economic incentive to harm other channels. Thus, the merger will increase AT&T's ability to exercise monopsony power by increasing the number of its cable subscribers, and increase AT&T's incentives to harm competing cable programming because of Media One's programming interests.

26. By AT&T and Media One not carrying a channel (in some locations) or by placing the channel on a more expensive and less-watched programming tier, the channel will have less incentive to spend money on better content and will be less competitive to

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[29] Since market power can be exercised on both the output side (to residential customers) and on the input side (to programmers), the "one monopoly" theory does not apply.

AT&T channels overall on other companies' MSOs and on AT&T MSOs where the channels are carried. A similar outcome will result if AT&T and Media One pay below competitive subscription fees to a given cable network channel. The result will be reduced competition among cable channels, lower quality of content for viewers, and potentially increased advertising costs. Another result will be the ability of AT&T to charge higher fees to other MSOs for cable programs because of reduced competition. Prices to these MSO subscribers will subsequently be higher because economic analysis demonstrates that when costs increase to a firm with market power, the firm will increase its prices to consumers. Thus, consumer harm will arise from lower quality programming, reduced choice, and higher monthly cable fees to non-affiliated cable MSO customers because of the higher subscription fees that the vertically integrated company can charge for its own programming.

D. Exercise of Monopsony and Monopoly Power in Electronic Programming Guides

27. Electronic programming guides (EPGs) are a relevant product market that is national in geographic scope. Current significant market participants include the AT&T-affiliated EPG, TV Guide, and various independent EPGs, not affiliated with MVPDs. AT&T owns 44% (co-equal with News Corp.) of TV Guide, which provides an EPG.[30] The incentive and ability to exercise monopsony power with respect to EPGs or to weaken and to exclude competition for non-affiliated MSOs is similar to the situation for programming that I discussed above. Because of its vertical integration into EPGs, AT&T will have an increased economic incentive and the ability to weaken competing EPGs so that it can exercise market power in the market for EPGs. Given its market position, AT&T will be able to restrict the availability of competitive EPG services by discriminating in favor of its affiliated EPG and against competing EPG providers by denying carriage to those competitors and stripping the competitors' signals out of the

[30] Source: TV Guide 10Q filed with the SEC for the quarter ending March 31, 1999. AT&T and News Corp. control 98% of the voting power of the common stock of TV Guide.

vertical blanking interval (VBI).   The effect of these strategies will increase with the acquisition of Media One so that competition will be reduced by the merger.

28. While the future is difficult to forecast here, EPGs could become a critical competitive element as the interface between consumers and MVPDs for both video programming and Internet services. EPGs could function similarly to a browser for a set-top box "computer" that uses the television set as a monitor. Given its ownership stake in Excite @Home and Road Runner and its extensive cable holdings, the merged company would have the incentive and ability to steer customers to its affiliated video programming and Internet services. AT&T's EPG also would be similar to a portal for the TV and Internet combined, similar to Yahoo today, that aggregates and organizes content. AT&T, by controlling the EPG, can exercise monopoly and monoposony power against other cable TV content providers. AT&T will have the economic incentive to exercise this power, which will increase if the merger is allowed, given its large economic interest in Liberty Media and other cable TV content providers.

29. This "bias" in the use of EPGs would be somewhat similar to complaints brought in the 1980s by the DOJ against airlines that used their screen-based reservation systems to steer customers toward their own flights. However, the effect could be significantly greater here because travel agents had the economic incentive and the expertise to choose the best flight for their customers or their customers would switch to competing travel agents. Here many viewers would lack the necessary expertise to counteract program bias contained in EPGs. Furthermore, effective competition does not exist between cable MSOs and DBS, as I discussed above.

30. Thus, AT&T can exercise monopsony power in EPGs, and it may also be able to exercise monopoly power in EPGs. The exercise of this market power is likely to also spill over to the programming market. Consumers will be harmed because they will receive lower quality and less choice of EPGs, higher prices for EPGs, and similar effects in terms of MVPD programming.

E. Exercise of Monopsony and Monopoly Power in Set-top Boxes

31. Set-top boxes form a relevant product market, which is national in geographical scope. Major set-top manufacturers include General Instrument (GI) and Scientific Atlanta. GI is the largest manufacturer of digital set-top boxes with an estimated market share of 65%, or over two times larger than Scientific Atlanta.[31] Cable MSOs are the major purchasers and vendors of set-top boxes.[32] The Commission has previously stated that cable set-top boxes could be the critical gateway for a broad array of video, data, voice, and home automation services.

32. AT&T will have potential monopsony power given its large share of all cable households, either through direct or indirect control. The merged company will be able to exercise monopsony power to affect competition in the set-top box market. Furthermore, AT&T currently owns, through Liberty Media, 21.4 million shares or approximately 12.2% of General Instruments.[33] General Instrument has announced that Liberty Media (AT&T) has agreed to purchase an addition 10 million General Instrument shares, which will raise its ownership share to approximately 20% of GI.[34] Liberty Media will be, by far, the largest shareholder in GI after the purchase is completed. This large ownership stake in General Instrument creates a further incentive for the merged company to distort competition because of the vertical integration of AT&T into set-top boxes. AT&T may well be able to translate its monopsony power in set-top boxes to monopoly power in set-top boxes by this distortion of competition.

33. Also, the merged company may well be able to distort standards and impede the development of open and competing industry standards, which would allow the exercise of monopoly power. A non-open standard that favors AT&T and its affiliates

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[31] Source: http:/ /www.forbes.com/forbes/99/0503/6309214a.htm, May 3, 1999 and http:/ /www.forbes.com/forbes/99/0208/6303053a.htm, Feb. 8, 1999.

[32] Under recently adopted Commission regulations, consumers will not begin to purchase set-top boxes for at least 2-3 years. See “Implementation of Section 304 of the Telecommunications Act of 1996: Commercial Availability of Navigation Devices”, 12 CR 531, 63 FR 38089, 1998.

[33] Source: General Instrument, Form 10Q filed with the SEC for the quarter ending March 31, 1999. The AT&T Applications lists the market share as 13%, fn. 31, p. 12.

could well lead to problems that existed with pre-divestiture AT&T's relationship with its manufacturing arm, Western Electric.[35] The potential importance of open standards and competition in set-top boxes is emphasized by General Instrument's description of its set-top boxes as "providing the user a gateway to interactive services such as VOD (video on demand), Internet Access, Email, Home Shopping, and more."[36] The combination of the largest cable MSO with the largest manufacturer of set-top boxes in a situation where technology is rapidly changing permits the anticompetitive use of standards to distort competition and to harm consumers.

34. Consumer harm would result because of decreased choice and higher prices for set-top boxes. Distortion of standards could lead to distortion of competition in Internet Access, home shopping, and other markets. To the extent that set-top boxes become the critical "gateway" to these interactive services as General Instrument predicts, AT&T control could lead to significant consumer harm in these downstream markets.

IV. Consumer Welfare vs. Competitor Welfare: The Public Interest Test

35. The Commission has the ability to increase consumer welfare, which I consider to be the public interest test.[37] Consumer welfare is well-defined in economics, and measurement of consumer welfare (consumer surplus) uses agreed upon techniques that I (and many others) have long used in previous academic research.[38] If the proposed transaction is allowed to proceed, consumers will pay higher prices, have less choice of cable content, receive lower quality cable content, and continue to suffer from the exercise

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[34] Source: http:/ /www.gi.com/PRESS/CURRENTNEWS/repurchase 040599.html, April 5, 1999.
[35] This possibility has already received comment within the industry. In a recent analysis the effect of AT&T was described, "In the cable industry, at least, AT&T's choice of hardware and software could become a de-facto standard….Where AT&T goes, other cable operators are sure to follow, say industry insiders." (Jim Davis, "Rivalries, technologies confuse set-top market", June 17, 1999, available on http://www.news.com/News/Item/0,4,37973,00.html)
[36] Source: http://gicout60.gic.gi.com:81/GIHomepa.nsf/?Open
[37] See e.g. J. Hausman, Taxation By Telecommunications Regulation," Tax Policy and the Economy, 12, 1998 and J. Hausman and H. Shelanski, Economic Welfare and Telecommunications Welfare: The E-Rate Policy for Universal Service Subsidies," Yale Journal on Regulation , 1999
[38] Indeed, Commissioner Furchtgott-Roth has also used these techniques in his research. See R.W. Crandall and H. Furchtgott-Roth, Cable TV, Brookings Institution, 1996, Appendix B.

of unregulated cable monopoly power for the foreseeable future. All of these outcomes decrease consumer welfare.

36. AT&T claims it will not invest in its cable networks to provide local telephone competition unless the Commission protects AT&T from competition. I do not find AT&T's threat not to invest to be credible from an economic standpoint. AT&T has paid approximately a $40 billion premium to purchase TCI and Media One. Future monopoly cable profits and, to a large extent, future broadband Internet profits were already built into the pre-acquisition prices of these companies by stock market valuation. Thus, to earn the revenues associated with this $40 billion premium, AT&T must invest in local telephone competition. Otherwise, AT&T shareholders (the "widows and orphans" of stock market lore) will lose their $40 billion premium payment. If AT&T were to announce that it had decided not to proceed with its local telephone competition investment plan, AT&T stock would decrease almost immediately by about 25%. Thus, AT&T will be required by the stock market to compete in local telephone markets.[39] Otherwise, AT&T's shareholders lose the acquisition premium it paid, as well as a significant amount of its residential long distance revenue when the Commission allows the RBOCs to provide long distance competition.[40]

37. AT&T claims in its application that the merger will lead to a more rapid competitive response by the ILECs, which will create public interest benefits. (Application, p. 29) This claim is laughable given AT&T's continuing efforts with this Commission (successful to date) to decrease the incentives and the ability of ILECs to invest in upgraded networks. The Commission has recognized that the ILECs do not have market power in these advanced network features so that regulatory action is unnecessary and

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[39] Furthermore, Media One has stated that only a single digital upgrade is required to cover all services: "It costs approximately $400 per home passed to upgrade the network to 750 MHz. This basic upgrade makes the network ready to carry two-way services, including advanced video, high-speed data and telephone services." (1998 Media One Investor Handbook, p. 11) Thus, it would be economically irrational for AT&T not to proceed with upgrading its cable networks.

[40] AT&T is reported to have about 60% of residential long distance traffic. See e.g. WSJ, Aug. 9, 1999.

retards ILEC investment .[41] Yet, in the remand of the recent unbundling proceedings, AT&T claimed through its affiants that it should have access at TELRIC determined prices to all ILEC investment in advanced network facilities. As I have demonstrated numerous times, mandated access at below cost regulated prices discourages investment by ILECs.[42] AT&T is correct in one sense—unregulated monopoly profits do tend to create investment by hopeful competitors in unregulated markets. However, to the extent that AT&T continues to succeed in decreasing ILEC competition through this Commission's regulatory actions, normal market forces will continue to be frustrated. Consumer harm through the exercise of monopoly power by AT&T will continue, all against the public interest.

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[41] *See* Deployment of Wireline Services Offering Advanced Telecommunications Capability, Memorandum Opinion and Order and Notice of Proposed Rulemaking, CC Dkt. Nos. 98 147, 98-11, 98-26, 98-32, 98-15, 98-78, 98-91, 13 F.C.C. Rcd. 24,011, 24,055-59, ¶¶ 95-100 (1998)

[42] See e.g. J. Hausman, Valuation and the Effect of Regulation on New Services in Telecommunications," Brookings Papers on Economic Activity: Microeconomics, 1997; J Hausman, The Effect of Sunk Costs in Telecommunication Regulation," presented at Columbia University Conference, Oct. 1998, forthcoming in J. Alleman and E. Noam, ed., 1999, and J. Hausman and J.G. Sidak, "Affidavit in response to Second Further Notice of Proposed Rulemaking", CC Docket No. 96-98. I find it interesting that Professor William Baumol, a long time consultant and affiant for AT&T, has recognized in his paper, "Option Value Analysis and Telephone Access Charges", Oct. 1998, forthcoming in J. Alleman and E. Noam, ed., 1999, that the use of TELRIC omits a cost component in the investment decision so that the regulated prices based on total costs of such decisions are too low. Thus, TELRIC is inappropriate to use and will decrease the level of investment by ILECs. Nevertheless, AT&T continues to urge the Commission to use TELRIC to disadvantage its competitors.

I declare under penalty of perjury that the foregoing is true and correct.

Executed on Aug 23, 1999

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John Bates Clark Award of the American Economic Association, 1985
Jacob Marschak Lecture for the Econometric Society, 1988
American Academy of Arts and Sciences, 1991.
Fellow, Journal of Econometrics, 1998.

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1992-	John and Jennie S. MacDonald Professor
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Associate Editor, Bell Journal of Economics, 1974-1983
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Associate Editor, Econometrica, 1978-1987
Reviewer, Mathematical Reviews, 1978-1980
American Editor, Review of Economic Studies, 1979-82
Associate Editor, Journal of Public Economics, 1982-
Associate Editor, Journal of Applied Econometrics, 1985-1993
Member of MIT Center for Energy and Environmental Policy Research, 1973-
Research Associate, National Bureau of Economic Research, 1979-
Member, American Statistical Association Committee on Energy Statistics, 1981-1984
Special Witness (Master) for the Honorable John R. Bartels, U.S. District Court for the Eastern District of New York in Carter vs. Newsday, Inc., 1981-82
Member of Governor's Advisory Council (Massachusetts) for Revenue and Taxation, 1984-1992
Member, Committee on National Statistics, 1985-1990
Member, National Academy of Social Insurance, 1990-
Member, Committee to Revise U.S. Trade Statistics 1990-1992
Director, MIT Telecommunications Economics Research Program, 1988-
Board of Directors, Theseus Institute, France Telecom University, 1988-1995
Member, Conference on Income and Wealth, National Bureau of Economic Research, 1992-

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