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 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.

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[46] *Vanguard Cellular Systems Inc., Transferor, and Winston, Inc., Tranferee*, DA 99-481,

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 significant subsequent mergers since *Bell Atlantic/NYNEX*[48] – including AT&T's acquisition of TCI – fundamentally requires applicants to "demonstrat[e] . . . that the proposed

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(Continued...)
¶ 20 (Mar. 11, 1999).

[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 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.").

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 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

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[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.").

[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*. . . .").

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 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

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[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.").

[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.

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 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.

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[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.

[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.").

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.

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]

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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.

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 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

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[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 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.

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 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

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

[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

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]

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

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(Continued...)
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 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.").

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 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

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

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

[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.

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

78 *Id.* at 24374.

79 *Id.*

80 Professor Hausman notes:

> . . . 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

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 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]

(Continued...)
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.

83 *See id.* ¶ 19.

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]

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.

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[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.

[87] *See id.*

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-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.

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[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 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).

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 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.

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

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

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 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

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[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).

[93] Appendix A, Hausman Declaration, ¶ 26.

> 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 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

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

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.

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

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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)).

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 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

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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.

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

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 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.

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[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.

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

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

[104] *See supra* at 6.

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

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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>.

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.

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,

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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).

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 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

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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).

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

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(Continued...)
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.