presumption that AT&T's decision to acquire MediaOne *exclusively* supports the hypothesis that AT&T was motivated by the desire to achieve efficiency gains. Unfortunately, the same acquisition decision could support the alternative hypothesis that AT&T was motivated by the desire to earn monopoly rents. AT&T's decision to acquire MediaOne cannot, by itself, definitively rule out either hypothesis.

68. The fact that AT&T paid such an enormous premium for MediaOne does not help to distinguish between the two conflicting hypotheses. According to Professors Ordover and Willig, the large premium "reflects the earnings that AT&T hopes to gain through the synergies of offering telephony, Internet access and cable over the MediaOne and AT&T systems combined, and can be recovered only if the combination as a whole is successful."[112] A large premium, however, could also be associated with the expected exercise of market power, as AT&T would control a greater share of the total cable and broadband customer base to collect Internet rents.[113]

69. Professors Ordover and Willig essentially ask the Commission to grant AT&T the kind of deference to its private business decisions that one associates with the business judgment rule in corporate law. Delaware corporate law grants a "presumption that in making a business decision the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company."[114] Dean Robert Clark of Harvard Law School has explained that the business judgment rule provides "that the business judgment of the directors will not be challenged or overturned by courts or shareholders, and the

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112. *Id.* at ¶ 33.

113. Declaration of Jerry A. Hausman, on behalf of SBC Corp., Applications for Consent to the Transfer of Control of Licenses, MediaOne Group, Inc., Transferor, to AT&T Corp., Transferee, CS Dkt. No. 99-251, at 2 (filed Aug. 23, 1999).

directors will not be held liable for the consequences of their exercise of business judgment—even for judgments that appear to have been clear mistakes."[115] In this case, Professors Ordover and Willig in effect argue that, if AT&T's management acted on an informed basis, in good faith, and in the honest belief that the acquisition of MediaOne was in the best interests of the company because the transaction could be expected to produce efficiency gains, then the FCC should defer to AT&T's business judgment and not challenge, let alone overturn, the merger. Such deference to private business judgments in a regulated industry, however, cannot be reconciled with the existence of the public interest standard in the Communications Act. If the regulatory deference that Professors Ordover and Willig advocate were the law, there would be no need for the Commission to review transfer applications such as the one filed by AT&T and MediaOne. Moreover, the deference to private business judgments that Professors Ordover and Willig advocate cannot even be reconciled with the antitrust standard applicable to wholly *unregulated* firms, which places on the party proposing a merger the burden of proving that efficiency gains will offset the consumer harm from a facially anticompetitive combination.[116] In summary, what matters in this proceeding is the duty of AT&T's management to the *general public*—not merely its duty to AT&T's shareholders. The public interest standard governing the Commission requires a greater degree of independent scrutiny than that given by a court, in a

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114. Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984); *see also* Cede & Co. v. Technicolor, Inc., 634 A.2d 345, 361 (Del. 1993).

115. ROBERT C. CLARK, CORPORATE LAW 123-24 (Little Brown & Co. 1986).

116. *See, e.g.*, FTC v. University Health, Inc., 938 F.2d 1206, 1223 (11th Cir. 1991); *Merger Guidelines*, *supra* note 8, at § 4. That Professors Ordover and Willig would advocate that the government's competitive scrutiny of mergers defer to the private business judgments of the merging parties is especially puzzling in light of the fact that both were formerly chief economists of the Antitrust Division of the Department of Justice.

business judgment rule case, assessing the effect of a private business decision on the well-being of a corporation's shareholders.[117]

70. AT&T's experts go one step further by asking the Commission to trust the judgments of AT&T executives even if the academic, policy, and financial communities conclude that the alleged benefits are not genuine:

> But in fields as dynamic as communications, efforts at handicapping are almost certain to be futile. Rather, economics and experience teach that the best safeguard against perpetuation and extension of market power is to encourage—or at least not stand in the way of—efforts by new entrants to combine the assets that *they* believe are needed for a plausible challenge to the entrenched power of the incumbents. If AT&T's and MediaOne's cable-based strategy has a real prospect of greater success than other approaches—and, as we explain below, there is every reason to believe the near consensus that it does—then AT&T and MediaOne's claims that their merger will serve the public interest cannot seriously be questioned.[118]

We believe that it is unsound public policy to follow the devises and desires of any single economic agent. It is incumbent on the Commission to ground its policy prescriptions in principles that incorporate the welfare of *all* effected parties—not merely the interests of the acquiring firm.

71. Surely, Professors Ordover and Willig would not say that the FCC should defer to the judgment of SBC about its acquisition of Ameritech, as AT&T applauded the imposition of the numerous conditions on that merger.[119] Under what conditions, therefore, would Professors Ordover and Willig have the FCC defer to the business judgments of private companies? It is evident that they provide no unbiased decision rule. The expediency of their position forces

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117. It should be clear that we are not taking Professors Ordover and Willig out of context, for this is the publicly expressed view of AT&T's senior management as of October 25, 1999. According its CFO, protecting AT&T's private interests (and shareholder interests) does not "conflict with where the industry will ultimately end up." Cauley, *supra* note 94, at B1 (quoting Dan Somers).

118. *MediaOne Ordover-Willig Declaration*, *supra* note 1, at ¶ 31 (emphasis in original).

119. *See* Comments of AT&T Corp., Applications for Consent to the Transfer of Control of Licenses, Ameritech, Corp., Transferor, to SBC Communications Inc., Transferee, CS Dkt. No. 98-141 (filed July 19, 1999).

Professors Ordover and Willig to be inconsistent with respect to the mandatory unbundling of an ILEC's provision of DSL at TELRIC prices (which they consider essential)[120] and AT&T's tying of cable television service and Internet access (which they fail to find problematic).[121]

72. Finally, Professors Ordover and Willig do not attempt to demonstrate that, on balance, the merger will be procompetitive. Even if, *arguendo*, the alleged synergies lower the marginal costs of the combined firm, Professors Ordover and Willig fail to demonstrate that AT&T's incentive to lower prices (due to savings in marginal costs) outweigh its incentive to raise prices (due to decreased competition). A complete analysis would involve a detailed understanding of the relevant cross-price elasticities, the slope of the demand curve, and the extent of the marginal cost reduction.[122] Professors Ordover and Willig fail to carry the burden of providing such economic analysis.

### B. Professors Ordover and Willig Confuse the Procompetitive Benefits of a Cable Strategy with the Benefits of the Merger Itself

73. According to Professors Ordover and Willig, the putative procompetitive benefit of the AT&T-MediaOne merger is "large-scale facilities-based bypass of the bottleneck monopoly possessed by the incumbent telephone carriers in the local loop."[123] It is not persuasive, however, for AT&T's economic experts to attribute the benefits of increased local telephone competition to this merger. In particular, Professors Ordover and Willig confuse the benefits of cable-based telephony—the real driver of competition for local services—with the benefits of the merger itself. In several paragraphs, AT&T's experts use the term "cable-based

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120. Affidavit of R. Glenn Hubbard, William H. Lehr, Janusz A. Ordover & Robert D. Willig on behalf of AT&T Corp., at 7, Implementation of the Local Competition Provisions of the Telecommunications Act of 1996, Federal Communications Commission, CC Dkt. No. 96-98 (filed June 10, 1999) [hereinafter *Hubbard-Lehr-Ordover-Willig Affidavit*].

121. *MediaOne Declaration of Ordover and Willig*, *supra* note 1, at ¶ 12.

122. *See generally* Jerry A. Hausman & Gregory K. Leonard, *Efficiencies from the Consumer Viewpoint*, 7 GEO. MASON L. REV. 707 (1999).

strategy" when they presumably meant to say "merger." For example, they write that "cable telephony offers an important prospect of large-scale competitive entry into local telephony, even in the short run."[124] Hence, Professors Ordover and Willig incorrectly conclude that the merger should be approved. But that step is a non sequitur. If cable telephony already poses an important competitive alternative to the ILEC's wireline network, then Professors Ordover and Willig cannot count such competition as a benefit that would flow from AT&T's acquisition of MediaOne.

74. Professors Ordover and Willig pity the "modest success of MediaOne" in luring cable customers to adopt cable telephony, attributing MediaOne's difficulties to the lack of "an established telephone services reputation and brand, along with first-hand experience in providing and marketing telephone services."[125] For several reasons, Professors Ordover and Willig are incorrect to assume that AT&T's know-how will significantly increase the propensity of a MediaOne cable subscriber to embrace cable telephony.

75. First, Professors Ordover and Willig ignore the fact that MediaOne, the third-largest cable operator, already offers cable telephony service in Atlanta, Los Angeles, Boston, Richmond, Jacksonville, and Pompano, Florida.[126] According to a statement made in the summer of 1999 by MediaOne's own vice president for operations and business development, customer demand for cable telephony is stretching MediaOne's capacity: "We've got more business than we can handle."[127] That statement is inconsistent with the assertion of Professors Ordover and Willig that MediaOne needs assistance in luring cable telephony customers. Moreover,

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123. *MediaOne Ordover-Willig Declaration*, *supra* note 1, at ¶ 15.
124. *Id.* at ¶ 30.
125. *Id.* at ¶ 18.
126. *Beyond Excitement—Cable Telephony Today*, TELCORDIA NEWS RELEASE, at *1, downloaded from http://www.telcordia.com/newsroom/knowledgebase/exchange/winter1999/w99feature4.html on Sept. 29, 1999

MediaOne's sister company, TeleWest, has offered cable telephony since the early 1990s to U.K. residents over "Siamese" cable.[128] Although TeleWest's voice calls are not technically placed over the cable network,[129] the U.K. ventures nevertheless gave U S WEST (which, as MediaOne's former parent company, partnered with TCI to form TeleWest) a chance to gain useful experience in marketing cable and telephony services simultaneously in a market where the company was an entrant rather than the incumbent, and where there was already substantial competition from satellite dishes. Hence, not only is MediaOne more successful than AT&T in its current manifestation, but MediaOne has additionally accrued more know-how in cable telephony than its "experienced" partner. By contrast, AT&T has achieved a meager penetration rate of 0.5 percent in Fremont, California; only 1000 subscribers have signed up for cable telephony[130] from a base of 200,000 homes passed.[131]

76. Second, AT&T has not presented any marketing evidence that would suggest that MediaOne's non-voice customers would have a *greater propensity* to embrace cable telephony if AT&T offered that service. Much of the evidence presented by Nancy McGee, the vice president of digital telephone services marketing at MediaOne—such as the fact that AT&T is considered "more of a leader in the market for telephone services"—is irrelevant for purposes of understanding whether AT&T will accelerate cable telephony penetration in MediaOne's

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[hereinafter TELCORDIA STUDY].

127. *Id.* (quoting Bill Sumner).

128. TELEWEST COMMUNICATIONS PLC., 1999 SEC FORM 10-K, at 2 (1999).

129. Affidavit of Oliver E. Williamson on behalf of the Regional Bell Operating Companies, at 12, United States of America v. Western Electric Company, Inc. and American Telephone and Telegraph Company, No. 82-0192 (D.D.C. Apr. 1994). Under the "Siamese" method, new cabling was laid with both a twisted pair and a coaxial cable going down the same conduit. However, the cable network was not used to carry voice telephony calls.

130. *Cable Carrier News, AT&T Expands Phone Service to Pleasanton*, downloaded from http://www.catv.org/ccn/ on Oct. 7, 1999.

131. STRATEGIS GROUP, CABLE TRENDS 1999, 11 (1999).

regions.[132] Although Ms. McGee references some "internal research that disclosed that a significant percentage of customers would purchase telephony services from AT&T who would not do so from MediaOne as a standalone provider," she does not explain how the survey was conducted, how many people were polled, how the level of significance was determined, or how the common sources of survey bias were treated.[133] Given the fact that *all* of the procompetitive benefits claimed by Professors Ordover and Willig rest on the existence and credibility of such evidence, it is difficult to understand why that survey was referenced so casually in the filings of AT&T and its witnesses. Moreover, Ms. McGee's contention that MediaOne "projects only a modest local telephony penetration rate in the coming years"[134] is directly contradicted by the head of MediaOne's telephony division.[135] In short, there is no factual basis in Ms. McGee's testimony on which to judge whether AT&T will truly accelerate MediaOne's cable telephony deployment.

77. Professors Ordover and Willig mistakenly rely on Ms. McGee's affidavit to inform their beliefs of a cable customer's propensity to choose cable telephony conditional on the identity of the cable provider. It appears that they are unwilling, however, to accept completely the marketing executive's conclusions: "MediaOne believes (and has *apparently* heard from customers themselves) that this slow of rate of penetration stems, in large part, from the unwillingness of consumers to buy a service as basic and essential as local telephone service from a firm without an established reputation for reliable, high quality service."[136] If such apprehension were rampant, as Professors Ordover and Willig claim, what would explain a

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132. Declaration of Nancy McGee, on behalf of AT&T Corp., Application for Consent to the Transfer of Licenses of MediaOne Group, Inc., Transferor to AT&T Corp., Transferee, at ¶ 8 (filed Sept. 15, 1999).

133. *Id.*

134. *Id.* at ¶ 10.

135. TELCORDIA STUDY, *supra* note 46, at *1.

consumer's willingness to buy wireless service—a form of local telephone service that is even used in emergencies—from startups such as Omnipoint and Nextel, or from cellular resellers who substitute their own brand for that of the actual licensee? More recent consumer research by J.D. Power and Associates reveals that a cable subscriber's willingness to embrace cable telephony is most closely correlated with her satisfaction with the incumbent local exchange carrier—not the identity of the cable provider.[137] Moreover, all customers of competitive local exchange carriers (CLECs) have overcome the same apprehensions to buy local telephone services from an unknown provider.

78. Third, if the AT&T brand name were essential for local voice penetration, what would explain the success of other cable providers such as Cox Communications? Cox is the fourth-largest cable operator in the United States and, as of September 1999, had deployed residential telephone services in five of its nine major cluster markets nationwide: Orange County and San Diego, California; Omaha, Nebraska; Meriden, Connecticut; and Phoenix, Arizona.[138] As of June 30, 1999, Cox claimed more than 59,000 telephony customers, representing roughly 6.9 percent of "telephony ready" homes.[139] According to one equipment vendor, Cablevision Systems, Cox and MediaOne are earning returns on cable telephony that are "absolutely blowing away all the spreadsheet assumptions."[140]

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136. *MediaOne Ordover-Willig Declaration*, *supra* note 1, at ¶ 40 (emphasis added).

137. *J.D. Power Finds Satisfied Cable Telephony Subs*, downloaded from web site at www.jdpower.com on Sept. 29, 1999. J.D. Power reported that the typical cable telephony subscriber (who also subscribed to cable television services) tended to be "younger, less likely to have a college education, have smaller household incomes and have larger families and reside in more rural locations than the general population."

138. TELCORDIA STUDY, *supra* note 46, at *1.

139. COX COMMUNICATIONS INC., SEC FORM 10-Q, at __ (filed Aug. 16, 1999). Cox Communications Inc., Press Release, *Cox Communications Announces Second Quarter Financial Results for 1999*, July 29, 1999. Can be downloaded from http://www.cox.com/Press/Default.asp?c=NewsReleases.asp.

140. Vince Vittore, *The rebirth of cable telephony: New business cases, technologies make it work*, TELEPHONY, July 6, 1998, at *1.

79. Fourth, if the AT&T brand name were truly helpful in luring customers, MediaOne could follow Comcast's proposed strategy of entering into an agreement to market its services under the AT&T name.[141] Because that same benefit could be achieved through a marketing agreement, that benefit should not be attributed to the merger. Such an arrangement would not require large contract-specific investments or complicated contingencies. Hence, according to their own decision rule for when businesses should use contracts over vertical integration (which we examine in greater detail later in this declaration), Professors Ordover and Willig would approve of something short of a merger to achieve this dubious benefit.

### C. AT&T's Announced Purchase of MediaOne Did Not Spur Digital Subscriber Line Growth

80. Professors Willig and Ordover claim that the mere *announcement* of the AT&T-MediaOne merger has "triggered nothing less than a competitive avalanche" in broadband deployment.[142] They write:

> The stampede of anticipatory competitive offerings in the wake of the merger *proposal* refutes any possible claim that the competitive benefits of the proposed merger will be nonexistent or trivial. The competitive benefits of the merger are no longer a matter of speculation. They have already begun to occur.[143]

When viewed in the proper competitive context, the stampedes and avalanches that Professors Ordover and Willig perceive are illusory on both empirical and theoretical grounds.[144]

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141. Paul Farhi, *Fears Rise of a 'Digital Divide'; TV-Phone-Internet 'Convergence' Leaves Many Out, Groups Say*, WASH. POST, May 25, 1999, at E1.

142. *MediaOne Ordover-Willig Declaration*, *supra* note 1, at ¶ 51.

143. *Id.* at ¶ 52 (emphasis in original).

144. The FCC also mistakenly claims "the ILECs' aggressive deployment of DSL can be attributed in large part to the deployment of cable modem service." CABLE BUREAU BROADBAND REPORT, *supra* note 7, at 27. The *only* evidence the Bureau provides in support of that conjecture is a price comparison of T-1 and DSL services, which does not speak to the relationship between cable modems and DSL deployment. We strongly urge the Commission to engage in empirical analysis of AT&T's procompetitive assertions rather than taking those assertions at face value.

81. An empirical investigation reveals that Professors Ordover and Willig are misinformed about the causal factors driving DSL deployment across U.S. markets. Before the announcement of the AT&T-MediaOne merger on April 22, 1999, many U.S. consumers already had high-speed access to the Internet available through DSL connections. Table 2 shows the date of the first major deployment of DSL and the number of homes passed before the announcement of the AT&T-MediaOne merger.

**TABLE 2: DATE AND LOCATION OF DSL DEPLOYMENT, BY ILEC**

| ILEC | Date of First Major DSL Deployment* | Number of Cities Covered by First Major Deployment |
|---|---|---|
| SBC[1] | September 1998 | 15 |
| BellSouth[2] | September 1998 | 7 |
| GTE[3] | June 1998 | 30 |
| Bell Atlantic[4] | September 1998 | 5 |
| U S WEST[5] | May 1998 | 20 |
| **TOTAL** | | **77** |

*Sources*: (1) Email from Michael Coe, SBC media contact, on Oct. 6, 1999. (2) *BellSouth Update on Technology Deployment*, downloaded from http://www.bellsouthcorp.com/proactive/documents/render/18442.html on Oct. 6, 1999. (3) *Chuck Lee Remarks: November 17, 1998*, downloaded from http://www.gte.com/aboutgte/newscenter/executive/warburg.html on Oct. 6, 1999. (4) *Bell Atlantic's New ISP Partnership Program Will Bring Customer Choice to the High-Speed Internet Access Market*, News Release by Bell Atlantic, Sept. 30, 1998. (5) U S WEST to Turns on Nation's First Mass-market, Multi-city Deployment of Ultra-fast DSL Internet Service—Boise Area Leads First Wave of 20 Cities to Get Lightning-Fast, Affordable Digital Service by May, downloaded from http://www.uswest.com/news/050498.html on October 6, 1999.

As Table 2 shows, the first multi-market deployments of DSL occurred in 1998 and reached over 77 metropolitan areas. Hence this "procompetitive effect" cannot be attributed to the announcement of the AT&T-MediaOne merger the following year.

82. Table 3 shows DSL deployment inside and outside MediaOne territories both before and after the announcement of the AT&T-MediaOne merger.[145] DSL deployment is defined as the decision to *commence* commercial DSL connections to residences in a major

145. We consider any metropolitan areas with at least one city where MediaOne offers cable television services to be a MediaOne territory. Information downloaded from company web site on Oct. 20, 1999 (http://www.mediaone.com/avail/default.htm).

metropolitan area. We consider any DSL deployments after May 1, 1999 to be part of the "post-announcement" sample.[146]

**TABLE 3: DSL DEPLOYMENT BEFORE AND AFTER THE AT&T-MEDIAONE MERGER ANNOUNCEMENT**

| | MediaOne Territory | Non-MediaOne Territory | Total |
|---|---|---|---|
| **PRE-ANNOUNCEMENT** | | | |
| DSL Deployment | 14 | 66 | 80 |
| Total Unpopulated MAs | 33 | 240 | 273 |
| Frequency of DSL Deployment | 42.4% | 27.5% | 29.3% |
| **POST-ANNOUNCEMENT** | | | |
| DSL Deployment | 6 | 30 | 36 |
| Total Unpopulated MAs | 19(A) | 174 (B) | 193(C) |
| Frequency of DSL Deployment | 31.6% | 17.2% | 18.7% |

Notes: (A) Equals 33 – 14. (B) Equals 240 – 66. (C) Equals 273 – 80.

As Table 3 shows, ILECs deployed DSL services in 14 of 33 (42.4%) metropolitan areas where MediaOne *offers* cable television services before the announcement of the merger. After the announcement of the merger, ILECs deployed DSL services in 6 (31.6%) of the remaining metropolitan areas where MediaOne *offers* cable television services and where DSL was not deployed in the pre-announcement period. Without controlling for other factors that influence the DSL deployment decision, it appears that the announcement of the AT&T-MediaOne merger did not increase DSL deployment in MediaOne territories. One could argue that the *difference* in the duration of the pre- and post-announcement periods is driving the decline in DSL deployments within MediaOne territories. In the pre-announcement period, DSL deployments in MediaOne territories accounted for 17.5 percent of the pre-announcement total, whereas the corresponding number was 16.7 percent in the post-announcement period. Hence, even when accounting for differences across time periods, it does not appear that the announcement spurred DSL deployment in MediaOne territories.

146. Because the time between the decision to deploy DSL and the deployment itself is typically between 90 and 180 days, one could argue that the post-announcement period should not include *any* commercial DSL deployments that occurred within several months of the announcement of the AT&T-MediaOne merger. Information

83. Formal econometric analysis that controls for such factors confirms this commonsense conclusion. Using a binary logit model, we separately estimate the probability that an ILEC deploys DSL service in a given metropolitan area before *and* after the announcement of the AT&T-MediaOne merger.[147] Included in the data set are demographic and DSL service information on 273 metropolitan areas (MAs) consisting of 245 metropolitan statistical areas (MSAs), 17 consolidated MSAs (CMSAs), and 11 New England County Metropolitan Areas (NECMAs). If the presence of MediaOne does not have a positive and statistically significant effect on the probability of deployment *after* the announcement of the merger, then the announcement cannot be credited with producing the procompetitive benefits that Professors Ordover and Willig claim. Alongside a dummy variable for the presence of a MediaOne service area,[148] we include as explanatory variables the mean per capita income, population density, and the percentages of the MSA population between the ages of 35 and 54, and over 65.[149] The results of the binary logit model are presented in Table 4.

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based on an interview with a network engineer at Pacific Bell on Nov. 1, 1999. To be conservative, we assume that the time between the decision to deploy DSL and the deployment itself is less than two weeks.

147. A logit model is used to estimate relationships when the dependent variable takes only values of 0 or 1. *See, e.g.*, DANIEL L. RUBINFELD & ROBERT S. PINDYCK, ECONOMETRIC MODELS AND ECONOMIC FORECASTS 10 (McGraw Hill 3d ed. 1991). For the "pre-announcement" period, we include all Metropolitan Areas based on 1990 census data, which consist of 278 MSA, CMSAs, and New England Metropolitan Areas. In the logit regression for the "post-announcement" period, we eliminate from the sample the markets in which DSL was deployed before the announcement of the merger.

148. The MediaOne dummy is assigned the value of one in Metropolitan Area (consisting of MSAs and CMSAs) where MediaOne currently offers television cable service to a city or a county contained in the MSA or CMSA based on information downloaded from http://www.mediaonegroup.com/whoweare/index.html on October 6, 1999. This definition of MediaOne presence is the most conservative definition of "market presence" given that MediaOne would be able to upgrade its television offerings in these markets to offer voice telephony. Location data was taken from the MediaOne web-site http://www.mediaone.com/avail/default.html on October 8,1999.

149. All demographic data is taken from the Current Population Survey and is available on the census web-site at http://www.census.gov. The years of the relevant estimates include: mean per capita income (1994), population density (1990), and the percentage of the MSA population in various age cohorts (1994).

**TABLE 4: LOGIT MODEL FOR THE ILEC'S DSL DEPLOYMENT DECISION**

| Variables in Logit Model | Coefficients | Standard Errors | First Derivatives of Likelihood Function at Mean of Data |
|---|---|---|---|
| **Dependent Variable: DSL Deployment in Pre-Announcement Period {0,1}** | | | |
| Intercept | -0.4608 | 1.9828 | -0.0910 |
| MediaOne Dummy | 0.1520 | 0.4305 | 0.0300 |
| Income Per Capita, 1994 | 0.0002 | 6.3E-05 | 3.6E-05 |
| Population Density | 0.0021 | 0.0008 | 0.0004 |
| Percentage of Population 35-54 years old | -0.1074 | 0.0818 | -0.0212 |
| Percentage of Population Over 65 years old | -0.1351 | 0.0467 | -0.0267 |
| **Dependent Variable: DSL Deployment in Post-Announcement Period {0,1}** | | | |
| Intercept | -0.0957 | 2.6442 | -0.0136 |
| MediaOne Dummy | 0.8677 | 0.0529 | 0.1233 |
| Income Per Capita, 1994 | 6.3E-05 | 8.4E-05 | 9.0E-06 |
| Population Density | 0.0006 | 0.0012 | 8.6E-05 |
| Percentage of Population 35-54 years old | -0.0319 | 0.1178 | -0.0045 |
| Percentage of Population Over 65 years old | -0.1561 | 0.0664 | -0.0221 |

As Table 4 shows, the coefficient on the MediaOne dummy variable is statistically insignificant at the ten percent level in the "post-announcement" period.[150] The results are not supportive of what Professors Ordover and Willig claim to be empirical truth. Hence, we conclude that the announcement of the AT&T-MediaOne merger did not stimulate DSL deployment by ILECs as Professors Ordover and Willig assert.

84. Similarly, the assertion by Professors Ordover and Willig that an ILEC would delay the deployment of a new technology *given that the design is ready* is difficult to justify in theory.[151] Professors Ordover and Willig speak of the ILECs' "long-standing reluctance to

150. The *p*-value is 12.3.

151. Traditional investment theory instructs a firm to invest in a project so long as the net present value of project is positive and hence would not support the claim of Professors Ordover and Willig. A recent development in the investment literature suggests that firms should value the option of postponing investment, especially if new information is forthcoming. *See, e.g.*, AVINASH K. DIXIT & ROBERT S. PINDYCK, INVESTMENT UNDER UNCERTAINTY (Princeton 1994). As applied to the question of DSL deployment, however, the value of waiting for additional information would not outweigh the cost of losing potential customers to cable.

market DSL and broadband services" as if that strategy were in an ILEC's best interest.[152] Conceivably, the ILECs may have been concerned that their introduction of DSL for business customers would divert demand away from T-1 connections. But that cannibalization story does not apply to residential customers, because T-1 connections never represented a viable option for residential customers.[153] It would be counterproductive for an ILEC to deprive customers of a service with large unmet demand (broadband Internet services) if a viable alternative (cable modems) was already developing on the horizon. Moreover, the suggestion by Professors Ordover and Willig that the ILECs withheld innovation[154] ignores the regulatory climate in which the ILECs formulate their business strategies. The Commission's decision to include the necessary inputs to provide T-1 connections on its list of network elements subject to mandatory unbundling at regulated prices would have lowered the (protected) margins on business customers sufficiently to deter any delay strategy.[155] Stated another way, if an ILEC were balancing the potential of lost margins on business customers (switching to DSL from T-1 connections) against the new margins created for residential customers (embracing DSL), the FCC's regulations on mandatory unbundling of ILEC network elements would have tipped the scale in favor of rapid DSL deployment.[156]

85. A more likely explanation of the recent growth in DSL use is the increase in demand for broadband services. According to GartnerGroup Dataquest, a telecommunications consultancy, a different factor (unrelated to cable modems) is driving DSL growth: "a growing

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152. *MediaOne Ordover-Willig Declaration, supra* note 1, at ¶ 51.
153. Enzo Signore, *DSL Does Data and Other Services, Too*, TELEPHONY, at *1 (Jan. 26, 1998).
154. *MediaOne Ordover-Willig Declaration, supra* note 1, at ¶ 51.
155. *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, ¶ 108 (1998) [hereinafter *Advanced Services NPRM*].

need to access information in the Internet and remote intranets, and an increasing tendency to use the Internet not only for e-mail, but also for more bandwidth demanding tasks such as research and education and news and information access."[157] Hence, Professor Ordover and Willig are ignoring an alternative source—namely, demand for broadband access—that is really behind the increase in DSL deployment.

### E. The Rationale Used to Justify the AT&T-TCI Merger Cannot Be Imported to Defend the AT&T-MediaOne Merger

86. AT&T asks the FCC to approve AT&T's acquisition of MediaOne on the same grounds that supported the Commission's approval of AT&T-TCI merger: "As the Commission found in its order approving the AT&T-TCI merger, the combination of the 'second wire' into the home provided by cable companies with AT&T's brand name, telephony experience and resources creates a competitor for local residential services that will be far more effective than either would be alone . . . These conclusions apply with equal force to the AT&T-MediaOne Merger."[158] But that reasoning is flawed in a fundamental way. Because the synergies between the assets of AT&T (a long-distance and wireless company) and TCI (a cable company) *differ* from the synergies between the assets of TCI and MediaOne (two cable companies), the AT&T-MediaOne merger should not be approved under the same rationale as that used in the AT&T-TCI merger. Also, it is easier for AT&T to resort to internal growth now by using TCI's expertise to expand into new territories. More importantly, because returns on assets are generally decreasing in identical inputs, the marginal gains from adding a *second* cable firm to

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156. The FCC has since removed DSLAMs from the list of unbundled network elements. But that recent fact could not have had any bearing on an ILEC's decision to deploy DSL in early 1999. *See, e.g. An Internet Boost for the Bells*, BUS. WK., Sept. 29, 1999, at *1.

157. *GartnerGroup's Dataquest Says Need for Higher Bandwidth Connections Spurs xDSL Equipment Growth*, downloaded from company web site at www.dataquest.com on Sept. 28, 1999.

AT&T's portfolio are much smaller than the gains from adding the first. AT&T overlooks those differences, however, by asking the Commission's to apply its previous rationale to the present case.

### F. Any Savings to Consumers from MediaOne's Ability to Avoid ILEC Access Charges Can Be Achieved Through Contracts Between AT&T and MediaOne

87. Of the six major complementarities listed by AT&T,[159] the only genuine synergy between AT&T and MediaOne is the ability to bypass an ILEC's facilities to complete telephone calls.[160] Professors Ordover and Willig argue that, unless AT&T and MediaOne formally merge, MediaOne will be forced to interconnect only to the ILEC's network:

> In contrast [to AT&T], MediaOne has few transport assets. It normally must interconnect to incumbent networks through tandem switches for both local exchange and exchange access calls. By combining MediaOne's cable facilities with AT&T's existing (albeit limited) large business local telephone infrastructure, the merger should allow some cost reductions in the provision of local and long distance service to some MediaOne customers.[161]

Professors Ordover and Willig fail to consider the use of contracts as a solution short of a formal merger. In this case, a simple interconnection agreement between AT&T and MediaOne could capture the synergies that Professors Ordover and Willig assert will flow only from the formal merger of AT&T and MediaOne.

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158. *See* Reply Comments of AT&T Corp. and MediaOne Group, Inc., Applications for Consent to the Transfer of Control of Licenses, MediaOne Group, Inc., Transferor, to AT&T Corp., Transferee, CS Dkt. No. 99-251, at 16 (filed Sept. 17, 1999) [hereinafter *AT&T-MediaOne Reply Comments*].

159. The six alleged merger synergies are (1) MediaOne's cable network could not be duplicated by AT&T (as if AT&T would try to do so), (2) MediaOne could bypass the ILEC's access charges by using TCG's networks (a genuine synergy that does not, however, require a merger), (3) AT&T's brand name would increase MediaOne's cable telephony penetration (AT&T's brand name has resulted in cable telephony penetration of only 0.5 percent in Fremont), (4) AT&T's marketing experience would increase MediaOne's cable telephony penetration (MediaOne and its corporate predecessor have been marketing cable telephony since the early 1990s), (5) AT&T's packet-switching experience would increase MediaOne's cable telephony penetration in the long run (the technology is too new for AT&T to have any lead), and (6) MediaOne's circuit-switching experience would increase AT&T's cable telephony penetration in the short run (MediaOne's cable telephony penetration is one-third of Cox's rate). *Id.* at 16-17.

160. *Id.* at 17-18.

161. *MediaOne Ordover-Willig Declaration*, *supra* note 1, at ¶ 38.

88. Professors Ordover and Willig reason that contracts can substitute for a formal merger whenever (1) the amount of contract-specific investment is small and (2) the parties can negotiate a "complete" contract.[162] Professors Ordover and Willig provide, as examples of contract-specific investment, "the expenses of promoting or marketing a trade name controlled by the other party, training personnel in the use of a product or process that is proprietary to the other party, or acquiring equipment or supplies that are useable only with the other parties' goods or services."[163] A simple interconnection agreement (contract) with AT&T to use AT&T's transport facilities would not necessitate the marketing of a trade name, training personnel, or acquiring new equipment; hence the first prong of the decision rule in favor of contracting is satisfied. With respect to negotiating a "complete" contract, a simple interconnection price that was a function of the total traffic terminated would incorporate all possible variation in outcomes. In short, a simple interconnection agreement would suffice to bring about the only genuine synergy between AT&T and MediaOne.

## CONCLUSION

89. Since the late 1970s, cable companies have dominated the *delivery* of multi-channel video programming to residential customers in the United States. To use their dominance to create market power in the *production* of video programming, cable firms have repeatedly attempted to consolidate the delivery of video programming—either by combining cable operations across localities or by controlling new mediums of video programming delivery. If a single cable firm (or a coalition of cable firms) could control (1) a large share of video programming customers and (2) the development of any alternative method of delivery, then that

162. *Id.* at ¶ 55.

firm or group of firms could extract better terms from programming providers. The improved terms would range from exclusive rights (the content provider would agree not to sell its content to other mediums of delivery) to outright ownership in the content provider.[164] The pattern of behavior in the industry is undeniable.

90. In the late 1980s, regional cable firms began to combine cable operations across localities. Recognizing the threat to unaffiliated content providers and hence consumers of video programming, the FCC intervened and instituted a set of ownership rules that prevented a single cable firm from controlling the delivery of video programming to more than 30 percent of U.S. homes.[165] Next, when satellite technology appeared to threaten cable's grip on the delivery of multichannel video programming in the early 1990s, a coalition of cable firms attempted to purchase large blocs of satellite licenses. Recognizing the conflicting incentives that cable providers would face while controlling the only two viable methods of multichannel video delivery, the Department of Justice again intervened and ensured that the licenses were awarded to non-cable interests.[166] Now, at the close of the 1990s, as broadband access to the Internet emerges as a new medium for the delivery of multichannel video programming, cable firms are once again trying to extend their market power into video programming by controlling the development of broadband. Placed within this historical context, AT&T's attempt to control the next medium of video delivery should be recognized as the same anticompetitive strategy, and it should elicit a similar response from government officials charged with protecting consumer welfare and the public interest.

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163. *Id.*

164. *See generally* DAVID WATERMAN & ANDREW A. WEISS, VERTICAL INTEGRATION IN CABLE TELEVISION (MIT Press & AEI Press 1997).

165. *Implementation of Section 11(c) of the Cable Television Consumer Protection and Competition Act of 1992: Horizontal Limits, Second Report and Order*, MM Dkt. No. 92-264, 8 F.C.C. Rcd. 8565 (1993).

166. *See* United States v. Primestar, Inc., et. al, Complaint, Civil No. 1:98CV01193 (JLG), May 12, 1998.

## APPENDIX: ALTERNATIVE SPECIFICATIONS OF REGRESSION OF BROADBAND ACCESS PRICES ON NARROWBAND ACCESS PRICES

***Specification 2***

Left hand side variable: Log of Excite @Home access price plus amortized monthly cost of installation

| Variable | Est. Coefficient | Est. Std. Error | Est. t-statistic |
|---|---|---|---|
| Intercept | 3.98 | .107 | 37.2 |
| Log Price of Narrowband Access* | 0 .012 | .031 | 0.382 |
| Number of observations | 43 | | |
| Standard error of regression | .002 | | |
| $R^2$ | .004 | | |

* *Note*: Narrowband access price is the log of the price of a second telephone line plus second-line fees plus amortization of the installation cost.

***Specification 3***

Left hand side variable: Log of cable broadband access price plus amortized monthly cost of installation

| Variable | Est. Coefficient | Est. Std. Error | Est. t-statistic |
|---|---|---|---|
| Intercept | 4.86 | 0.564 | 8.62 |
| Log Price of Narrowband Access* | -0.029 | 0.033 | -0.877 |
| Log Population Density | 0.001 | 0.010 | 0.057 |
| Log Median Household Income | -0.028 | 0.064 | -0.433 |
| % Population Age 65 and Older | -0.006 | 0.006 | -1.16 |
| % Population Age 35 to 54 | -0.009 | 0.009 | -0.979 |
| % Population Under Age 5 | -0.016 | 0.022 | -0.757 |
| Road Runner Indicator | -0.114 | 0.014 | -8.07 |
| Number of observations | 59 | | |
| Standard error of regression | 0.002 | | |
| $R^2$ | 0.600 | | |

***Specification 4***

Left hand side variable: Log of Excite@Home access price plus amortized monthly cost of installation

| Variable | Est. Coefficient | Est. Std. Error | Est. t-statistic |
|---|---|---|---|
| Intercept | 4.81 | 0.653 | 7.36 |
| Log Price of Narrowband Access* | -0.0003 | 0.041 | -0.007 |
| Log Population Density | 0.006 | 0.012 | 0.506 |
| Log Median Household Income | -0.077 | 0.083 | -0.929 |
| % Population Age 65 and Older | -0.001 | 0.007 | -0.157 |
| % Population Age 35 to 54 | -0.001 | 0.011 | -0.112 |
| % Population Under Age 5 | 0.002 | 0.028 | 0.110 |
| Number of observations | 43 | | |
| Standard error of regression | 0.002 | | |
| $R^2$ | 0.056 | | |

I declare under the penalties of perjury under the laws of the United States that the foregoing is true and correct to the best of my knowledge.

Oct 29, 1999

Jerry A. Hausman

I declare under the penalties of perjury under the laws of the United States that the foregoing is true and correct to the best of my knowledge.

J. Gregory Sidak 11/1/99