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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

February 22, 2000

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Ms. Deborah Lathen
Chief
Cable Services Bureau
Federal Communications Commission
445 12th Street, SW
Washington, DC 20554

Re: In the Matter of Applications for Transfer of Control to AT&T Corp. ("AT&T") of Licenses and Authorizations Held by MediaOne Group, Inc. (MediaOne")

CSB Docket No. 99-251

Dear Ms. Lathen:

This letter summarizes and updates the information submitted by AT&T and MediaOne ("Applicants") documenting the substantial public interests benefits that will accrue from the merger of the two companies. For the convenience of you and your staff, we are attaching the various public comments, affidavits and documents already provided to the Commission in this regard. Separately, under the protective order, we are also submitting a set of the confidential materials that we have provided over the past several months detailing the public interest benefits of the merger.

As Applicants have explained, the proposed merger will create significant public efficiency benefits in two general areas.[1] First, combining the two companies'

[1] *See* Public Interest Statement, filed July 7, 1999 at 20-31; Reply Comments of AT&T Corp. and MediaOne Group, Inc., filed September 17, 1999, at 5-18, & Declaration of Janusz A. Ordover and Robert D. Willig (Ex. A), Declaration of Nancy McGee (Ex. B), and Declaration of Douglas D. Holmes (Ex. C); November 24, 1999 letter to To-Quyen Truong from Stephen C. Garavito and Sean C. Lindsay, at Response 12; *Ex Parte* Reply Comments of AT&T Corp. and MediaOne Group, Inc, at 8-12, 41-53

complementary assets will create the first large-scale competitive alternative to the local telephone monopolies in MediaOne's service areas. The AT&T brand and other complementary assets AT&T brings to the merger will significantly increase the success of MediaOne's telephony offer. Indeed, recent AT&T experience indicates that MediaOne can expect penetration rates *two to three times higher* by combining with AT&T. The enhanced competitiveness of MediaOne's telephony offering will bring immediate benefits to residential consumers in its serving areas, including lower prices, improved quality and increased innovation, regardless of whether they choose MediaOne as their local carrier or remain with the incumbent. The benefits to these consumers from lower prices alone has been estimated at $600 million per year. *See Ex Parte* Declaration of R. Glenn Hubbard and William H. Lehr, filed December 8, 1999, ¶¶ 9, 20. Likewise, access to MediaOne's upgraded cable network and its hard-won expertise in offering cable telephony will enable AT&T to accelerate its own local telephony deployment. In the longer run, the merger safeguards against the substantial risk that the incumbent telephone monopolists will leverage their existing monopolies into non-telephone services.

Second, the merger of AT&T and MediaOne will allow the combined entity to gain substantial economies of scale, scope and clustering. These economies would be unavailable to either party acting alone. Economies of scale will result from the expanded footprint and subscriber base of the post-merger cable network, and the ability of the combined firms to utilize their respective areas of expertise over the larger base. Economies of scope will result from offering telephone, data, and broadband services over MediaOne's cable platform at increased penetration levels. And economies of clustering will result from the ability to use common assets or activities to service adjacent or neighboring territories.

The remainder of this letter restates and updates the public interest benefits of the merger in more detail.

& Ex Parte Reply Declaration of Janusz A. Ordover and Robert D. Willig (Ex. 1), filed December 14, 1999.

INCREASED, EFFECTIVE FACILITIES-BASED COMPETITION

As with AT&T's merger with TCI, the principal benefit of the AT&T-MediaOne merger will be the creation of "an entity that has incentives to expand its operations and provide facilities-based competition in the local exchange and exchange access markets, and will be able to do so more quickly than either party alone."[2] No alternative means are likely to attain the same benefits. As Applicants have detailed, the incumbent LEC monopolies have been enormously resistant to competitive entry. The limited effectiveness since the 1996 Act of entry through the purchase of unbundled network elements or the resale of wholesale services demonstrates that broad-scale facilities-based entry is needed to inject effective competition into local exchange markets. The modest success of MediaOne in penetrating local telephone markets confirms that even well-managed cable companies lack the brand reputation and other assets needed to gain market share rapidly among consumers.

Combining the complementary assets of AT&T and MediaOne will create the first large-scale facilities-based competition to the large incumbent local telephone monopolists in MediaOne's service areas. As a result, consumers in those areas will see lower prices and greater choices than in the current monopoly environment, whether they choose AT&T local exchange service or choose to stay with the LEC at the new lower prices. The benefit of these merger-created lower prices has been estimated at $600 million per year. These benefits would not be available to customers in MediaOne's serving areas without the merger.

These benefits of the merger have been confirmed by the competitive responses of the incumbent carriers. The mere announcement of the proposed merger and AT&T's aggressive cable-based entry strategy have provoked a stampede of new offerings of telephony and broadband service offerings by the incumbent local suppliers, who had previously made little effort to deploy and market such services. It is no coincidence that SBC's initial offer of a bundle of wireless, local exchange and Internet access service occurred in Fremont, California, and Dallas, Texas, two cities where AT&T is offering market trials of its cable telephony service.[3] Since then, the threat that the combined

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[2] *AT&T-TCI Merger Order*, 14 FCC Rcd 3160, 3229-30 ¶ 147 (1999).

[3] SBC offered a package of telephone service, DIRECTV, wireless service, and dial-up or high-speed DSL Internet access at prices described as from 6 to 35 percent

entity poses to SBC's local monopoly has caused SBC to re-engineer its entire network through its $6 billion Project Pronto in order to be able to provide an alternative to the full range of services promised by the merged entity.

COMPLEMENTARY ASSETS

The complementary assets that permit successful competitive entry include: (1) MediaOne's existing cable network to millions of households, most of which has already been upgraded to provide high-speed two way service; (2) MediaOne's technical expertise in deploying circuit-switched local telephony services over cable; (3) AT&T's brand name and reputation as a reliable provider of telecommunications services; (4) AT&T's experience and resources in marketing and customer care; (5) AT&T's experience in obtaining interconnection and other facilities and services from incumbent LECs; (6) AT&T's existing switches and facilities in MediaOne's service areas that will complement MediaOne's existing cable facilities; and (7) AT&T's head start in developing and deploying IP telephony and digital cable.[4]

MediaOne's Cable Network. MediaOne's cable network, which reaches millions of households, is a facilities-based vehicle for entering local telephony that AT&T could not duplicate without prohibitive expense and great delay. Without the MediaOne merger, AT&T would face the far costlier, slower, more litigious and less certain prospect of entry through other means such as the purchase of unbundled network elements from incumbent LECs.

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lower than SBC's retail rates. *See* Jessica Hall, *SBC Launches Service Packages To Battle AT&T* (Reuters, Aug. 24, 1999) <dailynews.yahoo.com/h/nm/19990824/wr/telecoms_sbc_2.html>; *SBC Launches Telecom/Entertainment Offerings* (SBC Press Release, Aug. 24, 1999) <http://www.sbc.com/news/articles.html?query_type=article&query=19990824-01.>.

[4] *See* Public Interest Statement, filed July 7, 1999 at 21-27; Reply Comments of AT&T Corp. and MediaOne Group, Inc., filed September 17, 1999, at 16-18, & Declaration of Janusz A. Ordover and Robert D. Willig (Ex. A) ¶¶ 13-31, Declaration of Nancy McGee (Ex. B); November 24, 1999 letter to To-Quyen Truong from Stephen C. Garavito and Sean C. Lindsay, at Response 12.

MediaOne's Upgrades. MediaOne also contributes its recent and planned upgrades of the existing cable network and its technical experience in deploying circuit-switched local telephony services over that network. MediaOne is nearing the end of a massive seven-year program to upgrade its network to handle high-speed two-way voice and data service, along with a platform for digital video service. Last year the Commission recognized the profound competitive benefits of an AT&T branded and operated cable telephony service in approving AT&T's acquisition of TCI cable systems that required substantial upgrades before that service would even be possible. The very different state of MediaOne's cable plant guarantees that these same competitive benefits previously recognized by the Commission are both more certain and more imminent in the MediaOne service areas.

Benefits to AT&T Customers. MediaOne's experience and know-how in upgrading cable plant and deploying two-way service should bring benefits to customers in AT&T's cable service areas. In particular, Applicants expect that upgrade and deployment expertise gained from MediaOne personnel will enable AT&T to accelerate and improve the efficiency of its deployment of circuit-switched cable telephony on AT&T cable systems until IP-based cable telephony can be deployed on those systems. AT&T has identified two MediaOne telephony vice presidents who were in charge of MediaOne's telephony roll outs and ramp ups in Atlanta (the first cable telephony launch for MediaOne) and Boston (the area with the largest base of telephony customers) to aid in AT&T's roll out efforts. AT&T thus will gain the expertise of people who had day-to-day responsibility for launching MediaOne's telephony service. Similarly, AT&T intends to use the specific expertise of a third MediaOne vice president – who developed MediaOne's cable telephony product strategy and oversaw sales channels at both the regional and national levels – to enhance AT&T's telephony offering.

AT&T's Brand Name, Reputation, and Experience. Among the most important complementary assets that AT&T brings to the merger are its brand name, reputation and experience as a reliable provider of two way communications services. Third party surveys have confirmed that AT&T remains the leading brand name in telephony.[5]

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[5] *See* International Data Corp. Press Release, October 12, 1999 ("IDC's survey revealed the brand game is AT&T's to lose. The company ranked as the best known, best trusted, and most powerful brand"); International Data Corp. Press Release, August 17, 1999 (AT&T has the greatest awareness of all telecommunications brands); Interbrand

Although MediaOne is among the most respected providers of traditional video services, MediaOne's brand enjoys far less strength among consumers for local telephone service. For example, in a brand study that measured other local telephone service brands against an AT&T standard of "100," MediaOne registered a mere "5."[6] The enormous advantage enjoyed by the incumbent LECs over *all* cable companies – but not AT&T – is both stark and undeniable. AT&T's telephony brand and reputation will allow the combined entity to challenge the incumbent LECs' bottleneck monopolies in ways and on a scale that a stand-alone cable company simply could not hope to accomplish.

AT&T's Experience in Marketing and Customer Care. AT&T also brings to the merger its valuable and unequalled experience and resources in marketing and customer care. AT&T's experience in vigorously competitive markets includes two decades of experience marketing long distance services in competition with MCI, Sprint, and hundreds of other aggressive rivals, as well as significant experience in the mass market Internet business. AT&T's resources in marketing and customer care include its large and well-established organizations devoted to customer segmentation, customer service, and billing.

On the local front, through its efforts to enter the local exchange market on a resale, unbundled network element, and facilities basis, AT&T has expended substantial time and money developing mechanized back office systems to interface with the operations support systems of incumbent LECs. Post-merger, MediaOne will gain the ability to use these mechanized systems – rather than its existing manual processes – to

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Group Press Release, June 22, 1999 (ranking AT&T ninth overall in Interbrand's World's Most Valuable Brands survey) (Bates Nos. AT&T 000772 through AT&T 000781, all attached to November 24, 1999 letter to To-Quyen Truong from Stephen C. Garavito and Sean C. Lindsay).

[6] The full results of the survey are set forth in AT&T's November 24th response to Question 12 (p. 8). AT&T provided the study itself (Bates No. AT&T 000915) under the protective order as part of its response to Question 7. MediaOne's brand research was provided to the Commission under the protective order on November 24, 1999 (Bates Nos. AT&T 000782-840), as was a Yankee Group survey (Bates No. AT&T 000210). On January 12, 2000, in response to the Commission's supplemental request, AT&T provided under the protective order an additional survey identified by its consumer organization (Bates Nos. AT&T 002476-543).

obtain necessary facilities and services from incumbent LECs. AT&T's provisioning experience and resources will greatly enhance the ability to fill customers' orders for telephony and other new services in the MediaOne service areas.[7]

AT&T's Experience in Dealing with Incumbent LECs. A related AT&T asset is its costly, but invaluable, experience negotiating the hurdles of obtaining interconnection and unbundled network elements from incumbent LECs, which includes more than three years of litigating and negotiating interconnection agreements with incumbent LECs in literally hundreds of hotly contested proceedings in virtually every state. As a telephony provider, MediaOne is vitally dependent on incumbent LECs for number portability and interconnection trunks. Yet, MediaOne has struggled to obtain these critical facilities and services from the incumbents. In Massachusetts, for example, MediaOne has spent 13 months trying to get Bell Atlantic to comply with its contractual commitments to provide necessary number portability and interconnection trunks. Bell Atlantic's failure to comply with these commitments has caused customer outages and has limited MediaOne's ability to grow its telephony service. Through the merger, MediaOne will obtain critical bargaining leverage in its dealings with incumbent LECs, including Bell Atlantic, which should increase its ability to provide a quality product to existing and potential customers. Moreover, AT&T's experience in integrating TCG's and TCI's requirements into its current interconnection negotiations and other dealings with incumbent LECs confirms that the merger will aid MediaOne in expediting the process of gaining just and reasonable interconnection to the incumbents' networks.

Switching and Transport Synergies. AT&T and MediaOne will also gain synergies from their existing switching and transport facilities. In most markets where MediaOne operates, AT&T Local Services (ALS) already has a switch. Where spare capacity is available, AT&T and MediaOne will share switches and spare capacity, often avoiding (or delaying) the need for incremental switch investments. Such sharing also will ensure that the combined AT&T-MediaOne switches will be utilized more

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[7] *See* Bates Nos. AT&T 000943-1000, AT&T 002000-18, produced under the protective order on December 2, 1999; Bates Nos. AT&T 002019-45, produced on December 2, 1999; Bates Nos. AT&T 002399-401, produced under the protective order on December 10, 1999; and Bates Nos. AT&T 002463-75, produced under the protective order on January 12, 2000.

efficiently. In similar fashion, MediaOne will use AT&T's transport facilities where they are available, and AT&T will use under-utilized MediaOne transport facilities.

Network Operations and Provisioning Synergies. Combined and standardized network operations centers, customer service centers, and disaster recovery teams will permit efficiencies of scale that will help lower cable telephony rollout costs and permit AT&T to meet or exceed its own cable telephony deployment schedules. For example, AT&T and MediaOne both have network operations centers in Denver. Applicants plan to consolidate these centers shortly after closing the merger, and expect that MediaOne's five regional operations centers throughout the country will be consolidated thereafter. Similarly, Applicants expect that MediaOne's five regional provisioning centers nationwide will be efficiently consolidated with AT&T's existing provisioning center after closing. Such consolidation will enable the combined entity to provide service more efficiently, with greater quality control.

AT&T's Experience in IP Telephony. The combined entity will also benefit from AT&T's expertise in packet-switched IP telephony. AT&T Laboratories includes a large staff of professional researchers working on IP telephony, including professionals devoted specifically to the development of IP telephony over cable. With expertise in both telephony and cable, these researchers are at the forefront of developing open cable IP telephony standards.[8]

Accelerated Penetration of Local Telephone Service. As part of their November 24th response to Question 13, AT&T and MediaOne provided under the protective order

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[8] AT&T has also been a leader in the deployment of digital cable technology, and AT&T expects that its experienced personnel as well as the processes it has developed to handle high volumes of digital cable orders will accelerate MediaOne's deployment of digital cable technology. In this manner, customers in MediaOne's service areas will more quickly realize the benefits that the increase in cable system capacity caused by digital cable technology permits -- *e.g.*, the delivery of more services to consumers, including local and regional programs, niche channels that may be of interest to a small segment of the audience, minority programming, and other diverse services. Accelerated deployment of digital cable technology will also benefit video programmers by creating new opportunities for the distribution of their product.

their schedules for the upgrades of their systems and deployment of cable telephony (Bates Nos. AT&T 000919-921, produced on November 24, 1999, and Bates No. AT&T 000942, produced on November 29, 1999). In addition, on January 12, 2000, MediaOne provided under the protective order maps showing 1999 and 2000 deployment.[9] After the merger, MediaOne will continue to upgrade its systems and deploy cable telephony in accordance with that schedule. However, the merger is expected to increase significantly both consumer acceptance of MediaOne's telephony offers and the volume of customer orders that can be provisioned in a given period. This will require additional investment in customer care and marketing capabilities so that the merged entity will be "market ready" as well as "network ready" to provide local telephone service. Once this investment is complete, AT&T and MediaOne will be able to achieve *faster* and *deeper* penetration in each market, thereby providing the only prospect of a real, near-term competitive threat to incumbent providers sufficient to provoke meaningful competitive responses. As the Commission recognized in the TCI proceeding, it is this merger-specific product of the parties' complementary assets and the increased penetration it will bring—and not the mere *availability* of cable-delivered telephone service—that is the principal merger benefit.

Recent experience confirms the existence and enormity of this benefit. As illustrated in the chart below, comparing AT&T's per month penetration where it has rolled out cable telephony (a conservative figure of 1 percent/month -- AT&T has actually experienced penetration rates in excess of this amount) to MediaOne's actual and projected penetration rates demonstrates that MediaOne can expect penetration rates *two to three time higher* in combining with AT&T – 30 percent penetration with the merger, as compared to only 10 percent without it.[10] In other words, every day that the closing of this merger is delayed many consumers in MediaOne's territories miss out on the benefits of effective local exchange competition.

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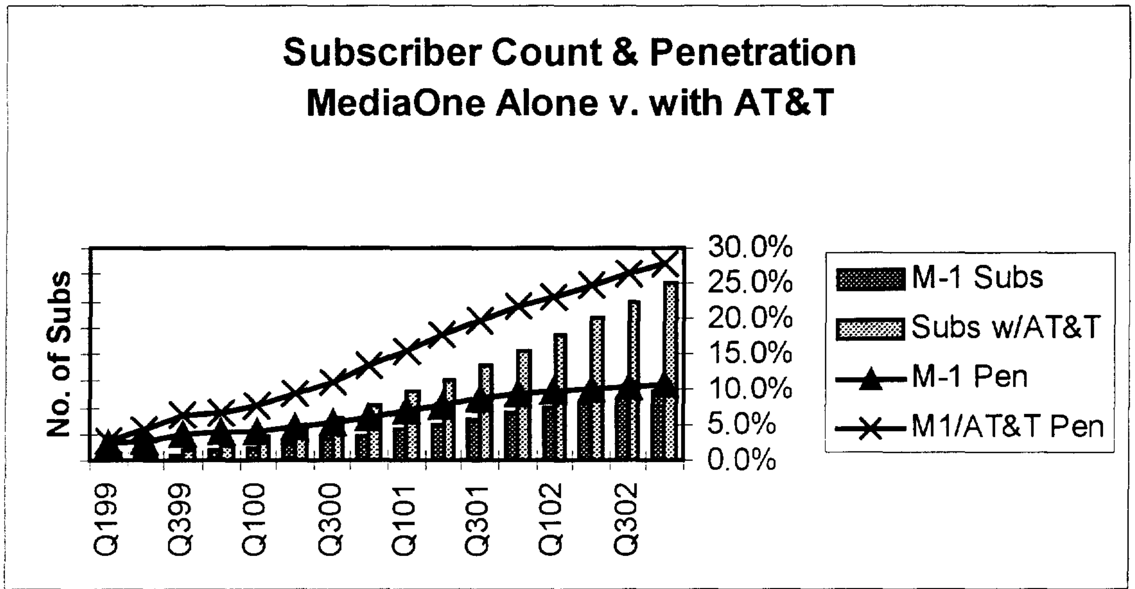
[9] *See* Bates Nos. AT&T 002410-11, AT&T 002414-15, AT&T 002419-22, AT&T 002426-27, AT&T 002435-40, AT&T 002443-44, AT&T 002447-48, AT&T 002451-52, AT&T 002454-55, AT&T 002457-58, AT&T 002460-61.

[10] AT&T is producing a more detailed version of the chart to the Commission under confidential seal pursuant to the Protective Order (*see* Bates No. AT&T 002555).



Joint Planning Discussions. AT&T and MediaOne have had increasing discussions to plan how service will be offered over the MediaOne and AT&T cable systems post-merger. These discussions have ranged from how people and organizations will be integrated after the merger to what integrated systems and processes will be used in the future. AT&T and MediaOne produced under the protective order on January 12, 2000 recent documents that reflect such discussions and planning (Bates Nos. AT&T 002462-75). These documents further demonstrate that the cable telephony efforts of both companies will benefit from the merger as the combined entity integrates the best processes, systems, and assets of each party to enhance the ability to provide competitive local telephone services.

SCALE ECONOMIES

Expanded Footprint Will Reduce Unit Cost of Service. The merger will achieve economies of scale by expanding the footprint and subscriber base of the post-merger cable network, thereby reducing the unit cost of service. Inputs that have increasing returns to scale include: switching, signaling and databases, network operations and technology services, disaster recovery and backup redundancy (backup generators, switches, and smaller equipment), back-office systems, customer care, and sales, general and administrative expenses.

Increased scale will enable MediaOne to lower the *unit cost* of many inputs. With greater scale, MediaOne will be able to obtain lower prices from vendors by buying in greater bulk. For example, manufacturers have notified AT&T that if, post-closing, it makes bulk purchases (for AT&T and MediaOne) of network interface units – the equipment which accounts for more than half of telephony-specific capital costs – it may obtain prices that are as much as 65 percent lower, on a per line basis, than the prices MediaOne is currently paying. Applicants also estimate that already available volume discounts would enable MediaOne, as part of the combined entity, to reduce the unit prices paid for SONET and switches, HFC telephony equipment, and fiber by five to ten percent or more.[11]

Scale Economies Will Increase Quality of Inputs. Another likely scale benefit from the merger is an increase in the *quality* of inputs offered to AT&T cable systems. The TCI and MediaOne transactions represent a $100 billion vote of confidence in cable telephony by AT&T. The demonstration effect of these transactions, and the rollout of cable telephony over the former TCI and MediaOne systems, provide a powerful incentive for major equipment vendors such as Lucent and Motorola to accelerate their development of more powerful, advanced and economical equipment for this market.

SCOPE ECONOMIES

The merger will also generate substantial economies of scope. By achieving greater penetration of local telephone services than MediaOne would alone, the merged entity can offer new services over the existing MediaOne cable platform at a substantially lower incremental cost than the cost of providing the same services to the same customers on separate platforms.

Shared Facilities. Scope economies arise in a number of ways. Cable video services and new services can share the same cable, conduit, trenches, and other support structure for outside plant. Because the provision of additional services generally imposes no additional burden on the right-of-way, additional easements and franchise certification costs are unnecessary. Similarly, cable video and new services can share the

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[11] *See* November 24, 1999 letter to To-Quyen Truong from Stephen C. Garavito and Sean Lindsay, at p. 10.

support of combined and standardized marketing, network operation centers, customer service centers, sales, marketing, billing, bill processing, provisioning, disaster recovery systems, training facilities and staff, and central administrative staff. Further, AT&T can use the local telephone facilities that it obtained through its acquisition of TCG to interconnect the MediaOne network to incumbent networks at end offices rather than tandem switches, thereby avoiding the incumbent LECs' charges for needless tandem switching and shared transport.

Clustering. The merger will also generate substantial economies by allowing the combined entity to concentrate its cable footprint in denser clusters. In particular, the following MediaOne service areas are adjacent or close to AT&T/TCI service areas:

MediaOne	AT&T/TCI
New England	North Central Connecticut
Atlanta	Central and Northern Alabama
Pompano, FL	Dade County, FL
Jacksonville	North Central Florida
Sacramento Area	Sacramento/San Francisco Area

The geographic proximity of clustered service areas enables the sharing of switches, customer care and equipment service operations, and marketing (particularly when the two or more service areas are in the same newspaper or television markets).

EXPECTED MAGNITUDE OF BENEFITS

The forward-looking nature of these anticipated efficiency gains obviously precludes their precise quantification. As Applicants have previously demonstrated, however, neither the existence nor the great magnitude of these benefits can seriously be questioned. There is widespread recognition among industry and market analysts and the local monopolies themselves that this Merger promises a paradigm shift in the competitive environment in MediaOne's service areas. The incumbents' monopoly battlements remain unscaled nearly four years after Congress directed them to open the gates to competition. The threat of facilities-based competition by AT&T is the first -- and only -- entry strategy that has provoked any real competitive response.[12]

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[12] *See* Ordover-Willig MediaOne Declaration ¶¶ 20, 50-52 (Sept. 17, 1999);

Consumer Savings of Hundreds of Millions of Dollars Annually. The monopoly prices that incumbent monopoly providers currently impose on their customers, and which can finally be competed away if AT&T and MediaOne are allowed to break the monopoly bottlenecks and create a new competitive environment in MediaOne's service areas, are enormous. As explained in the *ex parte* declaration of economists R. Glenn Hubbard and William H. Lehr, the benefits to consumers in MediaOne serving areas resulting from greater competition in local telephone markets in the wake of the proposed merger are likely to exceed $600 million per year.[13] The benefits associated with preventing these monopolists from extending their bottlenecks to new services, although not susceptible of precise quantification, are likely to be as great. And, although forward-looking estimates of merger economies are also necessarily imprecise, the transaction price paid by AT&T reflects its judgment that the economies are likely to be large. Analyses by AT&T, MediaOne and investment bankers that support this conclusion have been provided to the Commission.[14]

In sum, the public interest benefits of this transaction are both certain and great, and Applicants respectfully urge the Commission promptly to approve the proposed transfer of licenses from MediaOne to AT&T.

Respectfully submitted,

Stephen C. Garavito

Stephen C. Garavito
AT&T Corp.

AT&T-MediaOne Reply Comments at 9-14 (Sept. 17, 1999); Ex Parte Reply Declaration of Ordover and Willig ¶¶ 107-126 (Dec. 14, 1999).

[13] Ex Parte Declaration of Hubbard and Lehr (Dec. 8, 1999).

[14] *See* Bates Nos. AT&T 000943-1000, AT&T 002000-18, produced under the protective order on December 2, 1999; Bates Nos. AT&T 002019-45, produced on December 2, 1999; Bates Nos. AT&T 002399-401, produced under the protective order on December 10, 1999.

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