cost as much as $610.[123] Two-way wireless broadband service requires customers to buy $400 to $800 in equipment and spend $150 for installation.[124] Likewise, DirecPC costs new subscribers between $300 and $800 for installation.[125] On top of these substantial cost barriers to entry, the installation process for complex services is plagued with "poor service, difficult appointments, computer problems, and tedious troubleshooting."[126] Given cable's substantial head start in the residential market, cable modem subscribers who have already incurred significant up-front costs and installation headaches are highly unlikely to switch to DSL or any other technology. This problem will only be compounded by AT&T/MediaOne's first-mover advantage and anticompetitive actions toward other broadband providers, as customers wanting to switch would only be able to move to broadband networks with anemic content, limited software offerings, and few opportunities for e-commerce.

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[123] *Fast Connections Compared*, PC MAGAZINE, Apr. 22, 1999 <www.zdnet.com/products/stories/reviews>; Veeneman & Williams Declaration ¶ 9 (noting that "it may cost a customer as much as $300 to switch from cable access to DSL").

[124] *See* Marc Liggio, *Wireless Internet -- No Threat to Cable*, MULTICHANNEL NEWS ONLINE, Oct. 26, 1998 <204.243.31.23/cgi-win/csearch.exe/vsrchtip>.

[125] *See Fast Connections Compared*, PC MAGAZINE, Apr. 22, 1999 <www.zdnet.com/products/stories/reviews>.

[126] Corey Grice, *The Pitfalls of High-Speed Installs*, CNET NEWS.COM, July 28, 1999 <www.news.com/SpecialFeatures>.

D. As the Dominant Provider of Broadband Internet Service, AT&T/MediaOne Will Stifle Consumer Choice, Exercise Market Power in Negotiations With Advertisers, Software Developers, and Content Providers, and Undermine Investment in Competing Broadband Technologies.

Market power on the Internet stems from two related sources. The first is a large customer base, and with roughly 80 percent of broadband customers connected to its network, a combined Excite@Home/Road Runner would have no rival. The second is a demonstrated ability to keep customers on one's network, rather than roaming the public Internet for other providers' content. The ability to keep customers from leaving is particularly important for ISPs seeking to wield market power against advertisers, content and software providers, and Internet merchants, because the more time customers spend on-net, the greater guarantees these vertically related firms have that their products will be seen, used, or purchased.

The closed network architecture employed by Excite@Home and Road Runner is perfectly designed to keep broadband customers from venturing outside "the walled garden." Strategis Group Report at 128. Excite@Home and Road Runner customers purchase a broadband connection that is hard-wired directly to the ISP.[127] Unlike DSL users, who can use their broadband connection to reach the ISP of their choice, Excite@Home and Road Runner customers purchase connections that terminate exclusively at the cable ISP's network.[128]

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[127] *See* Declaration of Albert Parisian, attached as Appendix D, at ¶ 9 (Parisian Declaration) ("Because the system is closed, when cable customers turn on their modem service, they have no choice but to enable a hard-wired connection to their cable provider's ISP.").

[128] *Compare* Veeneman & Williams Declaration ¶ 6 ("GTE's DSL network is an open access system that allows customers to choose from a variety of" ISPs) *with* Parisian Declaration ¶ 9 ("[T]here is no way to dial around the ISP or otherwise establish a direct connection to any other provider.").

Because cable modem customers have no opportunity to reach other ISPs apart from Excite@Home/Road Runner, all broadband cable users wishing to access the Internet must do so by passing through AT&T/MediaOne's gates. "Content from outside ISPs (like AOL), portals (like Yahoo!) and content providers (like Broadcast.com) . . . can only be reached by sending and receiving data through the affiliated ISP's backbone and over the public Internet connection maintained by that ISP." Parisian Declaration ¶ 9.

Customers logging on to a combined Excite@Home/Road Runner network would first be exposed to AT&T/MediaOne's own proprietary content. Customers need not venture onto the public Internet to reach this content; rather, it is stored in servers located as near as practicable to each customer's individual location.[129] One common method of pushing content closer to the user is to cache content originating in far-away servers by replicating it in nearby servers.[130] Excite@Home has indicated that it is planning to locate "proxy servers for caching at the local head end," meaning that on-net content will be delivered to customers from servers often located within their own neighborhoods.[131] Because this content does not have to pass through the numerous traffic bottlenecks on the public Internet, Excite@Home and Road Runner's network architecture provides an inherent advantage to their own proprietary content.

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[129] *See* Parisian Declaration ¶ 8 ("In closed systems, cable modem customers do not need to access the public Internet to reach content supplied directly by their cable provider's affiliated ISP.").

[130] *See id.* ("Within the ISP's point of presence linked to the regional router, the affiliated ISP is able to cache preferred content for the fastest possible delivery to customers (though this may be done elsewhere in the ISP's very-high-speed national backbone).").

[131] Fred Dawson, *RealNetworks, @Home Team Up on Streaming*, Multichannel News Online, Jan 18, 1999 <204.243.31.23/cgi-win/csearch.exe/vsrchtip>.

In addition to advantaging on-net content, a combined Excite@Home/Road Runner would have numerous means at its disposal to disadvantage competitors and firms operating in vertically related markets. *First*, because its network would be closed and exclusive to cable modem customers, Excite@Home/Road Runner would have a strong incentive to establish proprietary network management and software protocols that render software and content written for its system incompatible with competing systems. This task would be easily accomplished given AT&T's relationship with Microsoft, Microsoft's well-known acumen at developing closed network standards, and Excite@Home's stated intention "to accelerate" its "content . . . discussions with Microsoft."[132] AT&T's own chairman has made plain that a combined AT&T/MediaOne would adopt such a strategy, arguing that the company cannot "offer a seamless set of services" unless it "control[s] . . . the interfaces and the specifications, the protocols, the standards, [and] the platforms."[133] Excite@Home's Chief Technical Officer, Milo Medin, recently echoed Mr. Armstrong's suggestion, explaining in a recent meeting at the Commission that "he was working with cable modem manufacturers to make proprietary changes to cable modems" and cable modem termination systems. Parisian Declaration ¶ 16.

"Once these proprietary protocols are established, software and content providers would have a strong incentive to write for AT&T's system first," because by doing so, they will be assured of reaching the largest number of customers. Rubinfeld & Sidak Declaration ¶ 51. This

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[132] Jim Hu, *AT&T Moves Good for Excite, Exec Says*, CNET NEWS.COM, May 12, 1999 <www.news.com>.

[133] C. Michael Armstrong, *Networking: The New Generation Comes of Age*, Speech Delivered at the ComNet '99 Conference, Jan 26, 1999 <www.att.com/speeches/99>.

would have the dual effect of enhancing the standing of Excite@Home/Road Runner's network -- making it the exclusive outlet for the newest and best broadband software and content -- and denying alternative broadband providers access to the inputs they need to compete. As a recent article in Wired Magazine explained, "by introducing an incompatible system," networks like the combined Excite@Home/Road Runner can precipitate a "VHS-vs.-Beta standards battle" that will be decided not on the relative efficiency of competing technologies, but on the size of the customer base the technologies serve.[134]

Industry analysts expect that "software and applications designed to exploit the high bandwidth market" will be developed in earnest once the total number of broadband customers surpasses one million customers.[135] Because this benchmark has just been surpassed, Excite@Home/Road Runner's early adoption of proprietary standards would have a tremendous impact on the foundation of broadband software and content development. Protocols adopted early on establish the foundation for all future application development. Once closed protocols catch on, it becomes almost impossible to undo the damage, much in the same way that Apple Computer has never overcome the disadvantage it faced because application developers wrote (and continue to write) first for PCs.

Ultimately, AT&T/MediaOne's adoption of proprietary protocols would give it a tremendous advantage over competitors. Not only would AT&T/MediaOne control the most popular broadband content and software, but it would also be able to stock customers' homes

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[134] Randall Rothenberg, *Rob Glaser, Moving Target*, WIRED, Aug. 1999, at 130.

[135] Carol Wilson, *Broadband: Get Ready for the Gale*, ZDNN, June 26, 1999 <www.zdnet.com/ zdnn/stories/news>.

with equipment (like set-top boxes) "incompatible with the services and equipment offered by competitors." Parisian Declaration ¶ 19. Because this equipment will soon control all of the video, Internet, and telephone services customers demand, competitors "unable to replace the full bundle of services offered by Excite@Home/Road Runner and its cable affiliates would therefore have little hope of offering consumers a valued product." *Id.* Thus, as Professor Gertner concludes, the adoption of proprietary protocols "would help preserve AT&T's current position as the leading provider of broadband Internet access and would raise the costs faced by providers of rival broadband access technologies, such as DSL, from offering access services that compete with AT&T's." Gertner Declaration ¶ 26.

Second, Excite@Home/Road Runner "could use the bargaining power generated by its large captive customer base to negotiate exclusive arrangements with leading software and content providers." Rubinfeld & Sidak Declaration ¶ 52. These providers would have an extraordinary incentive to conclude such agreements because, by doing so, they would ensure themselves of the same preferential treatment afforded to other on-net content. Such exclusive agreements are consistent with Excite@Home's stated plan to "monetize its start page" by offering preferential placement to partners willing to pay "fair value" in return.[136]

These agreements, moreover, would have a number of highly anticompetitive consequences. In many cases, they would leave competing broadband providers without access to a needed input. RealNetworks, for example, has developed the industry-standard video streaming player: 85 percent of streaming media broadcasts use its technology and numerous

[136] Dick Satran. *Excite@Home Denies Merger, But Sees Deals*, Reuters, Aug. 3, 1999.

Web sites are dedicated exclusively to showcasing RealNetworks-based content.[137] If Excite@Home/Road Runner were to negotiate an exclusive agreement with RealNetworks to control the next version of its application, competing broadband providers would be unable to develop content to play on the upgrade. Excite@Home/Road Runner, on the other hand, would have no difficulty getting new content developed for its system due to the size of its captive audience. The competitive injury caused by such exclusive agreements would correlate directly to how new (and therefore desirable to customers) the service is. If Excite@Home/Road Runner is able to secure exclusive control over the next "killer app," broadband competitors will suffer an extreme disadvantage. In Professor Gertner's words, "these rivals may be forced to operate at an inefficient scale or may be driven from the market." Gertner Declaration ¶ 22.

Excite@Home/Road Runner's exercise of monopsony power in these negotiations also presents a significant threat to competition. Just as cable providers did in the 1980s, a combined Excite@Home/Road Runner will be able to demand steep payments -- including possible equity positions -- from software and content providers in exchange for preferential placement on its system.[138] Moreover, software and content providers that compete with anointed Excite@Home/Road Runner partners will be foreclosed from reaching roughly 80 percent of the broadband marketplace. As Professor Gertner concludes, "[s]uppliers that do not establish preferential relationships with AT&T may face significant difficulties in distributing their

[137] Randall Rothenberg, *Rob Glaser, Moving Target*, WIRED, Aug. 1999, at 129, 131.

[138] *See* Parisian Declaration ¶ 19 ("[O]nce these protocols are established and incorporated into equipment throughout the network, Excite@Home/Road Runner would be able to demand equity interests or revenue sharing from broadband content providers wishing to operate on its system.").

services. In the absence of alternative channels of broadband distribution, disfavored providers of broadband services may be driven from the market or may fail to achieve the scale required to provide services efficiently." Gertner Declaration ¶ 21. Excite@Home/Road Runner will therefore have complete control over which application developers live and die; whether developers' services appear on the first screen or are squirreled away behind five mouse clicks; and the exact extent to which application developers are allowed to prosper.

Third, Excite@Home/Road Runner could affirmatively discriminate against content available on the public Internet, preventing "customers from accessing web sites outside of Excite@Home and thereby control[ling] how broadband content is presented to customers." Rubinfeld & Sidak Declaration ¶ 50. Because the IP protocol allows ISPs to see the source of every data packet, and because routers can be configured to block any packets the network administrator wishes to keep out, it would be a simple matter for Excite@Home/Road Runner to block content coming from targeted Internet sites.[139] If, for example, Excite@Home/Road Runner was attempting to advantage its own exclusive broadband music library, it could selectively degrade the quality of its customers' access to MP3.com, the leading music library on the public Internet.

AT&T and MediaOne claim in their Public Interest Statement that "@Home and Road Runner have no incentive to engage in such behavior" because engaging in discrimination

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[139] Parisian Declaration ¶ 15 ("This blocking capability is already marketed to closed data system providers by router manufacturers (like Cisco), enabled in part by the openness of the IP Protocol, which places a signature on each data packet identifying its point of origin. It is a simple matter to configure router filters to block packets coming from particular portals (like Yahoo! or Lycos) or particular content providers (like Broadcast.com or ESPN.com).").

"would cause subscribers to switch to other ISPs." AT&T/MediaOne at 84. But the incentive to engage in discrimination is strong when doing so prompts customers to look for on-net substitutes.[140] Moreover, AT&T/MediaOne's assertion ignores the fact that, over the next few years, the great majority of U.S. households will not have access to an alternative broadband connection. And even for those fortunate few who do have a choice, the critical question is the *relative* value of the broadband ISP service offered by alternative providers. Once Excite@Home/Road Runner has established its first-mover advantage, negotiated exclusive deals with leading software and content providers, and established proprietary protocols that effectively limit the software available to users of competing broadband technologies, customers would not be willing to switch. Indeed, reasonable customers would never abandon Excite@Home/Road Runner because they were barred from reaching a few select sites on the Internet when switching would mean losing access to far more Excite@Home/Road Runner proprietary content.

Finally, to the extent that competitive threats to its hegemony do crop up in certain markets, AT&T/MediaOne could readily drive these competitors from the market through predatory pricing. Predatory pricing schemes typically cannot succeed because firms that price their services below cost are unable to later raise prices enough "to compensate for the amounts expended on the predation."[141] But because cable providers are subject to a preferential

[140] Parisian Declaration ¶ 14 ("Such a strategy would encourage customers to rely more extensively on the cable provider's own content and spend more time on its network, which in turn would increase the premium the provider could charge to advertisers, portals, and content providers for preferred placement on its system.").

[141] *Brooke Group, Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209, 225 (1993).

regulatory regime that allows them to tie broadband access and ISP services, AT&T/MediaOne would have no difficulty recovering losses incurred from predatory pricing. By operating a closed system, AT&T/MediaOne would be assured that any new broadband customers would take its ISP service to the exclusion of any other.[142] Customers therefore could not avoid AT&T/MediaOne's super-competitive price increase by selecting an different ISP.

Ultimately, a combination of Excite@Home and Road Runner risks grave competitive injury to all participants in the broadband marketplace. Consumers would see severe limitations imposed on their ability to choose between broadband providers; advertisers and Internet merchants would be forced to pay monopoly prices for access to broadband customers -- charges that would ultimately be passed on to consumers; software and content providers would be forced to accept the monopsonist's terms or risk being foreclosed from the great majority of the broadband market.

The express purpose of AT&T/MediaOne's strategy is to discourage competing broadband providers from investing in alternative technologies. Thus, AT&T and MediaOne miss the mark when they assert that "investment in broadband facilities by cable operators" has spurred ILEC investment in "competing facilities." AT&T/MediaOne at 29. AT&T and MediaOne have not offered any explanation for how their merger will accelerate "investment in broadband facilities by cable operators." Both AT&T and MediaOne are well underway in upgrading their systems and have demonstrated the ability to do so without need for a merger. What the AT&T/MediaOne merger will achieve, however, is the creation of a monolithic

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[142] *See* Parisian Declaration ¶ 20.

broadband ISP that DSL providers -- because they are subject to unequal regulatory requirements -- will be powerless to combat. Once the Excite@Home/Road Runner network takes its place as an entrenched first-mover -- fueled by proprietary protocols and exclusive agreements that create a permanent competitive imbalance -- investment in competing broadband technologies will diminish.

E. The Commission Can Eliminate This Threatened Harm to Broadband Competition By Requiring, as a Condition of Merger Approval, That AT&T/MediaOne and Other Cable Providers Contractually Affiliated with Excite@Home and Road Runner Open Their Cable Networks.

Although the Commission has articulated a policy of "carefully monitor[ing] the situation" in the broadband marketplace, this policy will fail to protect broadband competition if it permits consummation of the AT&T/MediaOne merger. The regulatory cost and complexity associated with eliminating monopoly power by post-hoc regulation is confirmed by the numerous highly complex issues -- including the unbundling and pricing of network elements -- associated with the Commission's implementation of the 1996 Act. Likewise, the antitrust laws are not an effective or easily administrable remedy once a network monopolist becomes entrenched, as proven by the extreme cost and complexity of DOJ's suit against Microsoft.

As an alternative to blocking the merger outright, the Commission could require, as a condition of merger approval, that AT&T/MediaOne and the other cable providers contractually affiliated with Excite@Home and Road Runner afford competing ISPs open and nondiscriminatory access to their cable modem networks. There can no longer be any debate about the technical feasibility of this solution. As explained Albert Parisian, Director of Business Development for Broadband Data Services for GTE's cable arm, GTE "recently demonstrated open cable access on its own Clearwater, Florida cable system." Parisian Declaration ¶ 23. Likewise, Canadian regulators have required Canada's cable providers to afford competing ISPs open access -- a requirement that Canadian MSOs are currently implementing.[143] Indeed, Canadian MSOs have embraced the idea of open access, concluding that it provides a significant "business opportunity" to get independent ISPs on their networks "rather than pushing them onto the networks of . . . competitors."[144] This optimism is confirmed by GTE's own experience in Clearwater, where GTE was inundated with requests from ISPs hoping to offer Internet service over its cable infrastructure. *Id.* ¶ 30. Based on this extraordinary demonstration of demand, GTE is currently in the process of developing a business plan that implements open access on all of its cable systems. *Id.*

Although AT&T has publicly asserted that an open access requirement would impose substantial regulatory burdens on cable providers, the U.S. Code and Code of Federal Regulations are replete with examples of unbundling and nondiscrimination obligations imposed on cable operators. The 1992 Cable Act, for example, barred cable providers from imposing discriminatory terms and conditions on unaffiliated video programmers in exchange for carriage. *See* 47 U.S.C. § 616. Similarly, the Cable Act and implementing Commission regulations preclude cable operators from engaging in "unfair methods of competition or unfair or deceptive acts or practices" that would hinder "any multichannel video programming distributor from providing satellite cable programming." 47 C.F.R. § 76.1001; *see also* 47 U.S.C. § 528(c)(2).

open access precedent

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[143] Kinetic Strategies, *Canadian Cable Ops Prepare for Open Access*, CABLE DATACOM NEWS, August 1999, at 8 <www.CableDatacomNews.com>.

[144] *Id.*

Included in this prohibition is a requirement that no "satellite cable programming vendor in which a cable operator has an attributable interest . . . discriminate in the prices, terms, and conditions of sale for delivery of satellite cable programming." 47 C.F.R. § 76.1001(d).

Similar nondiscrimination requirements have been imposed on the pricing of cable services. Commission regulations provide, for example, that certain cable operators "may not discriminate between subscribers to the basic service tier and other subscribers with regard to the rates charged for video programming." *Id.* § 76.921(b). Likewise, cable operators are required to "unbundle" the sale of customer premises equipment and cable service, establishing "rates for remote control units, converter boxes, and other customer equipment . . . separate from rates for basic tier service." *Id.* § 76.923(b). Cable operators can sell this equipment at discounted promotional prices, but only if those offerings are "not unreasonably discriminatory." These restrictions are premised on the notion that the market for customer premises equipment is competitive, while the market for cable television service is not, making this case directly analogous to the market for broadband access (not competitive) and the market for broadband ISP service (competitive in an open access world). The Commission's rationale for adopting the equipment unbundling requirement is therefore directly applicable here:

> We have found, in the common carrier service and equipment markets, that unbundling of service rates from equipment rates has been essential to creating the vigorous competition that now exists in the customer premises equipment market. On the other hand, we have found bundling can eliminate virtually all competition for certain services, "because bundling forces . . . subscribers to pay . . . for services even when the subscribers obtain them from other sources." We believe that these findings are equally pertinent to cable equipment and installation markets.

> Section 2(b)(5) of the Cable Act of 1992 states that one of the policies the Act is designed to promote is "ensur[ing] that cable operators do not have undue market power vis-a-vis . . . consumers." Bundling of equipment and services is one industry practice that Congress has identified as contributing to the market power of cable operators. We believe that by requiring the unbundling of all cable service rates from equipment and installation, as well as the unbundling of equipment and installation rates from each other, we promote this legislative goal.[145]

In the very same way, precluding cable providers like AT&T and MediaOne from tying broadband access service with ISP service is "essential to creating the vigorous competition" that prevails in other Internet markets. Such an open access obligation will be easy to administer, requiring the Commission to impose only three simple conditions on the AT&T/MediaOne merger.

First, the Commission should adopt a condition requiring AT&T/MediaOne and the other cable providers contractually associated with Excite@Home and Road Runner to allow ISPs to interconnect with their cable modem networks on terms and conditions that are nondiscriminatory. Likewise, these cable operators should be required to allow ISPs to interconnect on terms and conditions that are equivalent to those offered to affiliated ISPs like Excite@Home and Road Runner. No further detail is required to implement the interconnection prong of the proposed merger conditions.

As explained in the Parisian Declaration, interconnection with open cable systems can take place at a device called an "ISP Subscriber Manager." Parisian Declaration ¶ 23. This

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[145] *In re Implementation of Section of the Cable Television Consumer Protection and Competition Act of 1992*, MM Docket 92-266, Report and Order and Further Notice of Proposed Rulemaking, 8 FCC Rcd 5631, ¶¶ 410-11 (1993).

device is functionally indistinguishable from a traditional Internet router and is manufactured by numerous firms, including Cisco Systems and RedBack. *Id.* ¶ 25. The subscriber manager is connected to an MSO's regional switch or router, which itself acts as a traffic aggregation point for smaller groups of cable modem termination systems. *Id.* ¶ 23. Because the ISP Subscriber Manager is no different than a traditional Internet router, interconnection with open cable networks does not differ from the millions of other Internet interconnections taking place between Internet backbones at public and private peering points, between smaller ISPs that directly exchange traffic, and between large Internet customers like Web hosting services and their backbone providers. *Id.* ¶ 24.

The standards for such interconnection are well-known and need not be detailed in regulations to be implemented in a nondiscriminatory manner. Typical off-the-shelf Subscriber Managers, like those manufactured by Cisco Systems, can accommodate more than 400 ISPs -- more than could possibly want to interconnect in a given market. *Id.* ¶ 25. Moreover, Subscriber Managers are stackable, eliminating any upper limit on the number of ISPs that can interconnect with an open cable system. *Id.* Interconnection with the Subscriber Manager also involves nothing more than plugging the ISP's fiber into a router port, eliminating any need for collocation of ISP equipment in the cable operator's space. *Id.* ¶ 24. Thus, none of the difficulties associated with interconnection of telephone networks are present here.[146]

[146] There is likewise no need to regulate the number or location of Subscriber Managers that cable providers make available to competing ISPs. Cable operators must themselves connect their own affiliated ISP through the same Subscriber Managers, giving them every incentive not to locate them in places that create network inefficiencies or create needless bottlenecks choking the throughput of Internet traffic. *See* Parisian Declaration ¶ 26.

Second, the Commission should ensure that AT&T/MediaOne and other cable providers contractually affiliated with Excite@Home and Road Runner do not charge unaffiliated ISPs discriminatory prices for broadband access. There is no question that cable providers should be compensated for the access portion of broadband service, and GTE is not suggesting that the Commission regulate the price of cable Internet access. But to ensure that competing ISPs are not disadvantaged by being charged a higher price for access *than ISPs affiliated with cable operators*, the Commission should prohibit cable operators from discriminating in their access pricing between Excite@Home, Road Runner, and unaffiliated ISPs. This regulation constitutes no intrusion into cable providers' competitive pricing flexibility; the only justification for charging discriminatory prices to unaffiliated ISPs is an anticompetitive one.

Third, because AT&T/MediaOne will have an additional measure of market power stemming from its control over Excite@Home and Road Runner, the Commission should adopt a third merger condition that would preclude AT&T/MediaOne from engaging in a different form of price discrimination. Instead of charging competing ISPs more for access service, a cable operator with monopoly power in the broadband ISP market could disadvantage competitors by charging *both* its affiliated ISP and unaffiliated ISPs an inflated charge for access. The affiliate could then give away the ISP segment of the service or charge a nominal fee, leaving the cable operator *as a whole* profitable while curtailing the ability of unaffiliated ISPs to compete. For example, assume that the cost of providing a broadband ISP service is $10 per customer, and that a cable provider offers broadband service to its customers for $40 per month. If the cable provider, through internal transfer pricing, charges its own ISP $39 for access, its total margin as a company will remain unaffected. Competing ISPs, on the other hand, will be unable to offer service for less than $49 even though it has been charged a nondiscriminatory price for access.

Again, this problem is easily solved without placing any significant restrictions on AT&T/MediaOne's ability to price its Internet access service. One simple solution is to require as a condition of merger approval, that AT&T/MediaOne continue to operate Excite@Home and Road Runner, whether operated independently or merged into one entity, as separate subsidiaries. Because these ISPs have separate boards of directors, separate accounting from their affiliated cable providers, separate creditors, and, in the case of Excite@Home, separate shareholders, they cannot be operated at a permanent loss without escaping detection. The Commission has repeatedly relied on separate subsidiary requirements to solve cost-allocation and price squeeze problems, and the imposition of such a remedy here will have no significant costs because it does nothing more than maintain the status quo.[147]

AT&T and MediaOne may object that Excite@Home and Road Runner own and operate a significant amount of the network infrastructure required to provide broadband Internet service to cable customers. In some markets, Excite@Home owns and operates the cable modem termination systems required to collect IP traffic coming from customer homes. (These systems are the functional equivalent of a DSLAM in a DSL environment. *See* Parisian Declaration ¶ 6.)

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[147] *See, e.g., Establishment of Competitive Service Safeguards for LEC Provision of CMRS*, WT Docket No. 96-162, Report and Order, 12 FCC Rcd 15668 (1997) ("[A] separate affiliate requirement is a very effective way to afford the requisite degree of 'transparency' to enable competitors and the Commission to detect discrimination.").

Likewise, Excite@Home sometimes owns and operates the regional routers that aggregate local traffic and interconnect with the larger Excite@Home network. In an open access world, competing ISPs will be afforded access to these Excite@Home facilities; without them, competing ISPs could not reach end users unless forced needlessly to duplicate these network components.

Nevertheless, this problem should not pose any difficulty for the Commission's implementation of the proposed merger conditions. In effect, Excite@Home is providing two services, network buildout and management -- an essential component of the cable provider's broadband access service -- and ISP service offered to end users. Excite@Home is currently compensated for its network management service by receiving a larger share of per-customer revenue than it otherwise would if cable providers operated their own cable modem networks. In an open access environment, Excite@Home would simply revise its agreements with cable providers to secure more direct compensation for performing network management functions.

Nor should the Commission give any weight to AT&T and MediaOne's assertion that the imposition of an open access requirement would reduce their incentive to invest in broadband access. AT&T/MediaOne at 90. GTE's own experience as a cable provider confirms that "the decision to upgrade cable networks to provide data services is usually an easy one. Most of the plant changes needed to support the service are by-products of plant upgrades already made to increase channel capacity, add digital tiers, add pay-per-view, use intelligent set top boxes, introduce interactive television services, and offer on-set program information guides." Parisian Declaration ¶ 29. The returns available on the sale of broadband access alone make it "the cable provider's most remunerative use of channel capacity," not including the returns the cable provider's affiliated ISP -- even in an open access world -- stands to earn from advertising and e-commerce. *Id.*

GTE's experience is confirmed by a detailed examination, conducted by Rubinfeld and Sidak, of AT&T's relative cost of capital and returns just on broadband Internet access. "A basic decision rule in investment theory is that a firm will invest in a project if and only if the 'project's return,' defined as the ratio of expected annual income to investment, exceeds the firm's weighted-average costs of capital." Rubinfeld & Sidak Declaration ¶ 66. Currently, AT&T's weighted cost of capital is 12 percent, while its margin on broadband access is 18.1 percent, giving AT&T a "*strong* incentive to undertake the necessary upgrades to provide voice and Internet service to its cable customers, because its project return vastly exceeds its weighted-average costs of capital." *Id.* ¶ 67. Thus, even "under an extreme assumption that broadband prices were to fall by 20 percent, the new margin of 12.1 percent would encourage AT&T to continue upgrading its cable system." *Id.* These results are consistent with AT&T's own long-held position that DSL providers do not need to avail themselves of a closed access regime to recover their investment in providing broadband access service. The costs of providing DSL service are not lower than those associated with offering cable modem service, so what's good for the goose must also be good for the gander. At bottom, AT&T and MediaOne's claim is that they need to recover monopoly rents in the ISP market to justify investments in broadband access. This position amounts to nothing less than a confirmation of AT&T/MediaOne's anticompetitive plans.

Ultimately, the Commission faces the choice of regulating a little now or a lot later. History is replete with examples underscoring the difficulty of undoing network monopolies once they have become entrenched. It bears noting, however, that if AT&T and MediaOne establish that the administration of the proposed merger conditions is too complex to justify the benefits, that conclusion does not justify approval of their merger. To the contrary, if these conditions prove unadministrable, the only conclusion available to the Commission is that no set of conditions will make the AT&T/MediaOne merger serve the public interest. If a regulatory compromise cannot be achieved, the Communications Act requires that AT&T and MediaOne's application be denied.

III. THE PROCOMPETITIVE BENEFITS AT&T/MEDIAONE ASSERT ARE SPECULATIVE AND, EVEN IF PROVEN, FULLY ACHIEVABLE WITHOUT THE MERGER.

In an effort to satisfy its burden under the Commission's *Bell Atlantic/NYNEX Order* -- which requires applicants "to prove that, on balance, the merger will enhance and promote, rather than eliminate or retard competition"[148] -- AT&T and MediaOne posit procompetitive gains in the markets for local telephone service, Internet access, and video services. AT&T/MediaOne at 30. AT&T and MediaOne support these asserted benefits with nothing more than lawyers' arguments, offering no detailed market analysis to demonstrate that these gains are meaningful, no supporting economic evidence to quantify the asserted gains, nor any sworn testimony from company employees attesting that the merger will bring the companies

[148] *Applications of NYNEX Corp. and Bell Atlantic Corp. for Consent to Transfer Control*, Memorandum Opinion and Order, 12 FCC Rcd 19985, at ¶ 3 (1997) (*Bell Atlantic/NYNEX Order*).

prove that they cannot be achieved without the merger. In the *Bell Atlantic/NYNEX Order*, the Commission stated that "[p]ro-competitive efficiencies include only those efficiencies that are merger specific, *i.e.*, that would not be available but for the proposed merger." *Id.* ¶ 158. AT&T/MediaOne's public interest statement fails to carry this burden because it does not explain why the same efficiencies cannot be achieved through contracts. Although AT&T and MediaOne assert that "[c]ontractual relationships . . . are much less efficient than full integration," AT&T/MediaOne at 31, this conclusory assertion cannot be squared with AT&T and MediaOne's own behavior in the marketplace.

Earlier this year, AT&T announced agreements with both Time Warner and Comcast to be the exclusive provider of telephone service over their cable lines. These agreements would have allowed AT&T to market local service to Time Warner's 20.6 million homes passed and Comcast's 7.3 million homes passed.[150] Because MediaOne itself passes 8.4 million homes,[151] these deals confirm that AT&T believes telephony ventures work when AT&T partners contractually with MSOs much larger than MediaOne. And because AT&T agreed to be Time Warner's exclusive telephone service provider *for 20 years*, the venture's duration confirms that AT&T believes telephony contracts will work over the long haul, even as new technologies like IP telephony come on-line.[152]

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[150] *See* Warren Publishing, CABLE & STATION COVERAGE ATLAS, Index 170 (1999).

[151] *Id.*

[152] *See* Leslie Cauley & Rebecca Blumenstein, *AT&T Moves Closer to Local Service*, WALL ST. J., Feb. 2, 1999, at A3.

Indeed, when the AT&T/Time Warner agreement was announced, AT&T Chairman C. Michael Armstrong predicted, in what he termed a conservative estimate, that the venture would sign up 25 percent of Time Warner's 20.6 million homes passed within four years.[153] Likewise, AT&T President John D. Zeglis stated that AT&T "plan[s] to give consumers in Time Warner's cable territories more than a choice in local service . . . . We're going to combine the information carrying capacity of cable with our own networking expertise to give families an easy-to-use suite of 'any distance' communications services."[154] Time Warner's President, Richard D. Parsons, further explained how the agreement would allow AT&T to bring Time Warner's customers the most advanced broadband services:

> On every level, cable customers are the winners in this combination. In addition to our existing cable systems' capacity to provide high-speed Internet delivery, cable programming and digital services, this venture will provide customers with telephony services through the same architecture. Going forward, the working partnership of Time Warner and AT&T in developing and deploying broadband communications also ensures that our customers will be among the first to enjoy new digital services, such as video telephony.[155]

At the time AT&T's deal with Time Warner was announced, the *Wall Street Journal* reported AT&T's intention "to use the landmark Time Warner pact as a model for forming alliances with other cable companies."[156] Among the companies reportedly negotiating such

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[153] *See id.*; Bruce Mohl, *AT&T, Time Warner Team Up Via Cable*, BOSTON GLOBE, Feb. 2, 1999, at A1.

[154] *Local Competition: AT&T and Time Warner Form Strategic Relationship to Offer Cable Telephony*, EDGE, Feb. 8, 1999.

[155] *Id.*

[156] Leslie Cauley & Rebecca Blumenstein, *AT&T Moves Closer to Local Service*, WALL ST. J., Feb. 2, 1999, at A3.

agreements with AT&T were MediaOne and Cox Communications.[157] When AT&T announced its merger with MediaOne, it put the deals with Time Warner and Comcast on hold, and cut off its negotiations with Cox. Thus, not only has AT&T publicly recognized that agreements with other cable providers will provide *precisely the same benefits it claims here*, but the proposed merger has already proven to be *anticompetitive*. Had AT&T proceeded with its telephony joint venture strategy, it could already be rolling out local telephone service to the 41 million homes passed by Time Warner, Cox, Comcast, and MediaOne.[158] There can be no question, therefore, that AT&T's merger with MediaOne is not about providing local telephone service, but instead, is directed at achieving dominance in the broadband marketplace. This fact is further confirmed by the recent admission of AT&T executives that "the entire TCI acquisition came about because AT&T wanted to get its hands on At Home."[159]

AT&T/MediaOne also claimss that the merger will "provide economies of scale and scope" that will "expedite AT&T's ability to provide content-enriched high-speed Internet service." AT&T/MediaOne at 29. The only reason the applicants offer to support this assertion is that "the upgrades that are required to provide local telephone service over cable plant are also necessary to provide cable Internet services over these facilities." *Id.* But MediaOne has already upgraded over 70 percent of its cable systems and will be close to completing its upgrades by the end of 1999 -- well before AT&T can hope to secure regulatory approval for the merger.

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157 *Id.*

158 *See* Warren Publishing, CABLE & STATION COVERAGE ATLAS, Index 170 (1999).

159 Rebecca Blumenstein, *Inside the Tangles of AT&T's Wed Strategy*, WALL ST. J., Aug. 13, 1999, at B4.

Strategis Group Report at 140. Because the Public Interest Statement offers no explanation -- nor is one possible -- for why AT&T needs additional "scale and scope" to upgrade its own cable systems, the Commission should not give any weight to the merger's asserted Internet benefits. Indeed, as explained in detail above, the merger will visit substantial anticompetitive harm on fledgling markets for broadband Internet services.

Finally, AT&T and MediaOne assert that the merger will increase competition in the market for video services by providing "additional motivation for ILECs and others to step up their efforts to provide video programming." AT&T/MediaOne at 30. But they offer no economic support -- or even common sense explanation -- for why ILECs and others need an additional incentive, over and above the monopoly rents currently earned by cable providers, to enter the video market. Indeed, AT&T's asserted benefit proves, if anything, that the merger will make the market for video services *less competitive*, given that new entrants have a greater incentive to enter a market only if the incumbent's collection of greater monopoly rates makes entry more attractive.[160]

In the end, the *Bell Atlantic/NYNEX Order* spells out the Commission's rule of decision here: "Efficiencies are most likely to make a difference in our public interest review of a merger when the likely adverse competitive effects, absent the efficiencies, are not great. However, efficiencies almost never justify a merger to monopoly or near-monopoly." *Id.* ¶ 158. The pro-competitive benefits that AT&T and MediaOne assert will flow from their merger are

[160] *See, e.g.*, Richard A. Posner, Antitrust Law 9 (1976) ("the higher price" charged by a monopolist is what gives "firms in other markets an incentive to enter").

speculative, unsupported by any economic analysis or common-sense thinking, and, to the extent they do exist, can readily be achieved without the merger. These insignificant benefits are no counterweight to the extraordinary competitive injury the AT&T/MediaOne merger will inflict on the market for video programming or the nascent market for broadband Internet services. As such, AT&T and MediaOne have offered the Commission no reason to permit the "merger to monopoly" that will be occasioned by combining Excite@Home and Road Runner.

CONCLUSION

For the foregoing reasons, GTE respectfully requests that the Commission deny AT&T and MediaOne's application for transfer of control. Alternatively, the Commission can address the merger's anticompetitive impacts on the market for broadband Internet service by imposing the following three conditions:

(1) AT&T/MediaOne and any other cable provider contractually affiliated with Excite@Home or Road runner must allow any Internet Service Provider to interconnect with their networks on terms and conditions that are nondiscriminatory. This obligation includes, but is not limited to, a requirement that these cable operators allow any Internet Service Provider to interconnect on terms and conditions that are equivalent to the terms and conditions offered to Excite@Home or Road Runner. These cable operators must interconnect with unaffiliated Internet Service Providers through the same routers or ISP Subscriber Managers through which they interconnect with their own affiliated ISPs.

(2) AT&T/MediaOne and any other cable provider contractually affiliated with Excite@Home or Road Runner may not charge unaffiliated Internet Service Providers