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April 29, 2002

Via Hand Delivery

Marlene H. Dortch, Secretary
Federal Communications Commission
445 12th Street, S.W., Room TW-B204
Washington, D.C. 20554
c/o 236 Massachusetts Avenue, N.E.
Suite 110
Washington, D.C. 20002-4913

Re: *Applications for Consent to the Transfer of Control of Licenses from Comcast Corporation and AT&T Corporation to AT&T Comcast Corporation*, MB Docket No. 02-70

Dear Ms. Dortch:

Enclosed for filing in the above-captioned proceeding are the original and four (4) copies of the Comments of SBC Communications Inc.

Please call me at 202-326-7968 if you have any questions. Thank you for your assistance.

Sincerely,

Colin S. Stretch

Enclosures

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Before the
FEDERAL COMMUNICATIONS COMMISSION
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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

In the Matter of Applications for Consent to the Transfer of Control of Licenses COMCAST CORPORATION and AT&T CORP., Transferors, To AT&T COMCAST CORPORATION, Transferee.	)	MB Docket No. 02-70

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April 29, 2002

EXECUTIVE SUMMARY

Even viewed against the backdrop of unprecedented consolidation in the cable industry, the proposed merger of AT&T and Comcast is stunning. AT&T and Comcast (the "Applicants") are the first and third largest cable operators in the country. Together (setting to one side AT&T's 25-percent share of Time Warner), they already provide video programming to close to one-third of the nation's MVPD subscribers.

Standing alone, such broad coverage might not threaten the public interest. After all, the merger would eliminate little or no actual competition, since the Applicants – like the remainder of the cable industry – have historically refused to overbuild other cable territories, even though they have access to the content that could make such an effort worthwhile. But, critically, the Applicants' vast video bottleneck does not stand alone. AT&T and Comcast both have tentacles reaching far upstream into vertically related businesses, providing control over content that MVPD providers wishing to challenge cable's hegemony need to compete. And, make no mistake, each of the merging parties has a well-established history of abusing that control to disadvantage competitors. Thus, for example, Comcast has steadfastly refused to provide DBS providers with access to its regional sports programming in certain areas, instead performing an end-run around the Commission's program access rules and thereby limiting its competitors' growth to well below the national average. AT&T has likewise refused to provide its content aggregation service – known as "Headend in the Sky," or "HITS" – to competing MVPDs that so much as cross a right-of-way in its service area.

If approved as proposed, the merger would permit these companies to continue this anticompetitive conduct, but on a far larger stage. Indeed, the Commission has already acknowledged that, combined with its vertical content interests, the scale of AT&T's cable operations *alone* threatens "competition and diversity in the delivery of programming to consumers." It necessarily follows that uniting AT&T with Comcast's expansive properties and vertical interests poses a far more substantial threat to MVPD competition.

The threat to broadband Internet access is even more severe. The dominant cable incumbents already control close to 70 percent of broadband Internet access subscribers, and their lead is growing. The market is nascent, moreover, and – particularly in light of its network characteristics – it is highly susceptible to vertical foreclosure. This merger would make the significant cable broadband players both more powerful and less numerous, and thus raise the distinct possibility that the merged company – acting either alone or in concert with but a few cable brethren – will be able to tip the market irretrievably toward the cable platform.

This danger is particularly problematic because the cable platform's chief competitor – DSL-based access provided by incumbent LECs – continues to be shackled by one-sided, onerous regulatory requirements that severely distort the competitive process. Though ILECs as a group collectively provide service to less than a third of broadband subscribers, they remain subject not only to a vast array of access requirements – including, among others, unbundling spectrum, collocation, and loop conditioning – but also the continuing threat of additional obligations. What is more, the largest of the ILECs have been forced as a condition of recent mergers to carve out their advanced services operations into separate affiliates, purportedly to make these requirements more effective. The cable incumbents face none of these obligations, and neither AT&T nor Comcast has made a meaningful commitment to provide ISP access to its broadband networks – AT&T's confidential, eleventh-hour deals being all the more insufficient in light of its three-year-old pledge to provide nondiscriminatory access to multiple ISPs. AT&T and Comcast accordingly enjoy an artificial regulatory advantage that distorts the competitive process and renders DSL an insufficient competitive counterbalance to the market power the Applicants will obtain as a result of this merger.

To offset these undeniable harms, the Applicants once again trot out the familiar claim that the transaction will further the development of facilities-based voice competition in the residential market. But, for one thing, this claim runs counter to AT&T's claim in the *Triennial Review* proceeding that cable telephony is not viable, and that CLECs continue to require unbridled access to ILEC facilities to serve the residential market. Moreover, for years AT&T has been claiming that its expertise *as a phone company* would turn its cable properties into robust voice competitors. Now it claims that jettisoning that expertise – and uniting instead with a company that has steadfastly committed *not* to "touch[] circuit-switched telephony with a 10-foot pole" – is required to achieve that same result. In light of the Applicants' own characterizations of the prospects of cable telephony, it is difficult to take their claims seriously.

The Applicants have thus fallen well short of establishing, as they must, that the benefits of the proposed transaction outweigh its harms. The Commission may accordingly approve the transaction only if it imposes conditions that would mitigate the harms threatened, and encourage the benefits claimed.

In the video business, that means requiring AT&T to divest not only its interest in Time Warner Entertainment – as the Applicants concede they must do – but also its interest in HITS. In addition, the Commission must require the Applicants to license all content in a nondiscriminatory manner regardless of the medium used to deliver programming, and thereby prevent them from withholding valuable content from competing video providers.

In broadband, the Commission must commit – in the numerous rulemaking proceedings that are now underway – to deregulate ILECs and permit them to compete head-to-head with cable, without the disincentives and additional costs that flow as a direct consequence of the Commission's asymmetric rules. Unless ILECs are free to compete with cable on an equal regulatory footing, the Commission cannot rely on them to mitigate the competitive threat posed by the dominant cable incumbents.

It is not enough, however, for the Commission merely to *intend* to free ILECs from burdensome regulation. Each day that the regulatory imbalance remains in place, the cable incumbents can further cement their enormous lead in broadband Internet access. And they may further leverage that lead to strike deals with content providers and others that disfavor DSL and other competitors. SBC has always been and continues to be firmly committed to the principle that all broadband services should be governed by the marketplace and not by regulatory fiat. But the fact remains that this is not the situation in place today, and interim measures are necessary to ensure that cable does not transform its vast head-start into perpetual market dominance. To permit the Applicants to continue to exploit this imbalance – even for a period as short as a year – is potentially to stifle the development of competition in broadband permanently.

The Commission must accordingly hold the transaction in abeyance until it puts in place a coherent, uniform broadband regulatory framework that eliminates ILECs' disincentives to invest in broadband, and permits them to compete head-to-head with the Applicants. Until it does so – and removes the disincentives to investment that now plague ILECs' participation in the broadband market – the merger cannot be allowed to proceed.

If the Commission is unwilling to hold the merger in abeyance pending its articulation of a uniform broadband regulatory framework, at the very least it must impose conditions on the transaction to protect the public interest. That means imposing – in *this* docket – obligations on AT&T/Comcast that mirror the obligations that the Commission has imposed on ILECs. SBC continues to believe that any conditions attached to license transfer applications should be narrowly tailored to address precise, identifiable harms that are the direct result of the merger. The open access conditions proposed here amply satisfy that test. Indeed, to allow this merger to close without leveling the broadband regulatory and competitive field will only exacerbate the already substantial competitive and market share advantages held by cable modem providers.

In voice, the Commission must likewise take steps to encourage facilities-based competition. SBC does not here propose that the Commission continue its approach – applied in other mergers of comparable scale – of adopting particular investment or entry requirements. Instead, the Commission should simply put in place rules that would encourage the Applicants to live up to their pledge to deploy new telephony facilities. In particular, the Commission should forbid the merging parties from obtaining unbundled network elements – and particularly full platforms of such elements – in any geographic area where those companies provide cable service today or in the future. Such a condition will foster facilities-based competition by requiring a combined AT&T/Comcast to utilize its own facilities to compete with ILECs, the very pro-competitive advantage cited by the Applicants to support the merger.

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In the Matter of Applications for Consent to the Transfer of Control of Licenses COMCAST CORPORATION and AT&T CORP., Transferors, To AT&T COMCAST CORPORATION, Transferee.	)))))))))))))))	MB Docket No. 02-70

SBC Communications Inc. ("SBC") respectfully submits these comments in response to the Commission's public notice in the above-referenced docket.

The proposed merger marks the culmination of a decade of unprecedented consolidation in the cable industry. AT&T is already the nation's largest cable operator, and it still maintains a substantial attributable interest in Time Warner Entertainment, which owns the nation's second largest cable operator. Comcast is the third largest. Even without Time Warner, the Applicants would be the largest "last mile" provider in the country – an enormous, vertically integrated media conglomerate with extensive interests not only in video and broadband distribution, but also in video programming and broadband content as well.

This unprecedented combination of content and distribution poses substantial threats to the video distribution and, by extension, broadband Internet access markets. Consumers are increasingly relying on bundled video and data service, and "[w]ith almost 70 percent of U.S. households having cable TV, the MSOs could easily convert these customers to cable modem subscribers."[1] To attempt to compete with cable for these customers, SBC has recently teamed with EchoStar to provide a video and broadband bundle.[2] Yet, if this merger is approved as proposed, the viability of that offering will be in serious jeopardy. A combined AT&T/Comcast would have the incentive and the ability to foreclose competition in both the video and Internet content markets, and thereby diminish the ability of other platforms to compete on an equal footing.

To offset these undeniable public interest harms, moreover, the Applicants rely upon a single, wholly unsubstantiated claim: that the merger will facilitate increased deployment of cable telephony. Yet, barely three weeks ago, AT&T filed approximately 1,000 pages of comments and supporting declarations dedicated in large part to the proposition that widespread facilities-based competition in the residential market is unlikely, and that competitors continue to require complete reliance on ILEC facilities.[3] In light of this obvious duplicity, the Commission can hardly credit these alleged benefits.

The Commission must accordingly take significant steps not only to mitigate the adverse effects of this merger in both multi-channel video programming distribution ("MVPD") and

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[1] Insight Research Corp., Market Research Reports Summary, *DSL vs. Cable Modems: The Future of High-Speed Internet Access 2000-2005*, *at* http://www.insight-corp.com.

[2] *See* Tiffany Kary, *Satellite, DSL Team Up Against Cable*, CNET News.com (Apr. 19, 2002), *at* http://story.news.yahoo.com/news?tmpl=story&cid=70&ncid=738&e=6&u=/cn/20020419/tc_cn/satellite__dsl_team_up_against_cable.

[3] *See, e.g.*, Comments of AT&T Corp. at 58, CC Docket No. 01-338, *et al.* (FCC filed Apr. 5, 2002) ("cable companies in general have been able only gradually to invest in and adopt the technology needed to offer telephony; and limitations on capital and operating experience make it questionable how quickly and comprehensively this particular form of competition will evolve"); *id.* at 12 ("CLECs are serving almost as many residential local telephone customers through UNE-P in New York alone than are served by all the nation's cable operators in the country as a whole.").

broadband Internet access, but also to ensure that the Applicants make good on their promise to rely on their own facilities, rather than ILEC UNEs, to provide local voice service.

Such steps are particularly important in light of the fact that the merger takes place against a backdrop of significant regulatory uncertainty. In video distribution, the Commission's horizontal ownership rules – which in past mergers have served to mitigate concern about foreclosure of video programming content – have been vacated, and the Commission has yet to promulgate new rules to take their place. In broadband, although the Commission is weighing a series of proposals that may eventually provide some coherence to the regulation of competing platforms, it remains the case that the Applicants' chief competition – ILEC-provided DSL – is mired in a web of costly, disparate regulation. Through participation in recent merger proceedings, SBC is familiar with the nature of this Commission's merger review process, and it continues to believe that the scope of that review is often overly expansive. Yet, if the Commission's practice of comprehensive merger review is determined to be appropriate in any case, it is clearly so here, where, in the absence of existing regulations, the merger review process is the critical – if not the only – forum in which to timely address the numerous competitive threats posed.

DISCUSSION

In the wake of the Telecommunications Act of 1996 ("1996 Act"), the Commission has set a high bar for communications companies hoping to merge. "In order to find that a merger is in the public interest," this Commission must "be *convinced* that it will enhance competition."[4]

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[4] Memorandum Opinion and Order, *Applications of NYNEX Corp. and Bell Atlantic Corp. For Consent to Transfer Control of NYNEX Corp. and Its Subsidiaries*, 12 FCC Rcd 19985, 19987, ¶ 2 (1997) ("*Bell Atlantic/NYNEX Order*") (emphasis added); *see also* Memorandum Opinion and Order, *Applications of Ameritech Corp. and SBC Communications Inc. For Consent to Transfer Control of Corporations Holding Commission Licenses and Lines Pursuant to Sections 214 and 310(d) of the Communications Act and Parts 5, 22, 24, 25, 63, 90, 95 and 101 of the Commission's Rules*, 14 FCC Rcd 14712, 14738, ¶ 49 (1999) ("*SBC/Ameritech*

A merger satisfies this standard only if "the harms to competition – *i.e.*, enhancing market power, [or] slowing the decline of market power . . . are outweighed by benefits that enhance competition. If applicants cannot carry this burden, the applications must be denied."[5] The Applicants have fallen well short of meeting that demanding standard.

I. THE MERGER WILL REDUCE COMPETITION IN THE MVPD MARKET.

In 1992, Congress expressly warned that increasing levels of concentration in the cable industry could create "barriers to entry for new programmers and a reduction in the number of media voices available to consumers."[6] In the ensuing ten years, the Commission has witnessed cable industry consolidation on an unprecedented scale. Yet none of those transactions posed as significant a threat to the statutory interests in programming diversity and competition as this latest – and by far the largest – transaction.

Horizontal Concentration and Vertical Foreclosure. The anticompetitive risks of vertical links between distribution and content have long been a concern of competition policy. Congress, the Department of Justice, and the Federal Trade Commission have all acknowledged this as a serious problem. Vertical leveraging was the motivating concern behind two federal Acts (the 1992 Cable Act and the Satellite Home Viewer Improvement Act of 1999) and several consent decrees.[7] Moreover, the D.C. Circuit has expressly endorsed the view that "increases in

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Order").

[5] *Bell Atlantic/NYNEX Order*, 12 FCC Rcd at 19987, ¶ 2.

[6] Cable Television Consumer Protection and Competition Act of 1992, Pub. L. No. 102-385, § 2(a)(4), 106 Stat. 1460 ("1992 Cable Act"); *see* Third Report and Order, *Implementation of Section 11(c) of the Cable Television Consumer Protection and Competition Act of 1992*, 14 FCC Rcd 19098, 19118-19, ¶ 51 (1999) ("*Horizontal Ownership Third Report and Order*").

[7] *See United States v. Primestar Partners, L.P.*, 1994-1 Trade Cas. (CCH) ¶ 70,562 (S.D.N.Y. 1994); Proposed Final Judgment and Competitive Impact Statement, *United States v. Tele-Communications, Inc.*, 59 Fed. Reg. 24723, 24727 (May 12, 1994); Decision and Order, *Time Warner Inc., a Corporation; Turner Broadcasting System, Inc., a Corporation; Tele-Communications, Inc., a Corporation; and Liberty Media Corporation, a Corporation*, Docket

the concentration of cable operators threaten[] diversity and competition in the cable industry."[8] Thus, although the court vacated and remanded the Commission's horizontal ownership limits for lack of a sufficient evidentiary record, it left intact – and indeed reaffirmed – the Commission's mandate under section 613(f)(1) of the Communications Act to guard against undue concentration in the cable industry. That mandate requires the Commission to *ensure* that "no cable operator or group of cable operators can unfairly impede, either because of the size of any individual operator or because of joint actions by a group of operators of sufficient size, the flow of video programming from the video programmer to the consumer."[9]

There can be little doubt that, if the Commission allows this merger to proceed as proposed, it will have exactly that effect. As noted at the outset, standing alone, AT&T and Comcast are the first and third largest cable operators in the country.[10] According to their own Public Interest Statement, they will provide video programming to approximately 30 percent of all MVPD subscribers.[11] And that is only the half of it. As the Applicants appear to concede (*see* Public Interest Statement at 61), AT&T's 25-percent stake in Time Warner Entertainment renders the proposed merger a nonstarter under the governing rules and regulations. And while AOL Time Warner has recently professed interest in buying AT&T's interest in TWE, a mere intention to divest – without any enforceable commitment or condition – is hardly sufficient to permit approval of this unprecedented transaction.

No. C-3709 (FTC Feb. 3, 1997).

[8] *Time Warner Entm't Co. v. FCC*, 240 F.3d 1126, 1130 (D.C. Cir. 2001) (internal quotation marks omitted).

[9] 47 U.S.C. § 533(f)(2)(A).

[10] *See* Eighth Annual Report, *Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming*, 17 FCC Rcd 1244, 1341, Table C-3 (2002) ("*Eighth Annual Video Report*").

[11] Public Interest Statement at 50.

Yet even without Time Warner, the proposed transaction seriously threatens MVPD competition. As the Commission has previously acknowledged, a subscribership base on the order proposed by the Applicants can severely impact "competition and diversity in the delivery of video programming to consumers."[12] That is so because "[s]tart-up video programmers need to reach a critical level of subscribership quickly in order to achieve long-term financial viability." *AT&T/MediaOne Order*, 15 FCC Rcd at 9841, ¶ 51. If one particular cable operator – or more than one, acting in concert – controls access to a sufficient number of subscribers, it may be in a position "to deal a programmer a death blow," and thereby reduce competition for programming content. *Time Warner*, 240 F.3d at 1131; *see* Declaration of Robert H. Gertner ¶ 20 ("Gertner Decl.") (Attachment A hereto).

A combined AT&T/Comcast could have precisely that effect. Indeed, the Commission has already concluded that AT&T's subscriber base, standing alone, creates "significant bargaining power." *AT&T/MediaOne Order*, 15 FCC Rcd at 9841, ¶ 51. It did so, moreover, while of the view that 15 million MVPD subscribers "is the minimum number necessary to give a video programmer a reasonable chance of long-term success." *Id.* at 9842, ¶ 55 (citing *Horizontal Ownership Third Report and Order*, 14 FCC Rcd at 19117-18, ¶¶ 48-49). More recent evidence supports the view that, at least in some cases, the Commission significantly *under*estimated the number of subscribers necessary to support new programming, and that in fact 25 million subscribers is the minimum number necessary for long-term viability.[13] It

[12] Memorandum Opinion and Order, *Applications for Consent to the Transfer of Control of Licenses and Section 214 Authorizations from MediaOne Group, Inc. to AT&T Corp.*, 15 FCC Rcd 9816, 9840-41, ¶ 50 (2000) ("*AT&T/MediaOne Order*").

[13] *See AOL, NBA Need 25 Million Subscribers to Launch Channel*, Reuters (Apr. 12, 2002) ("The new cable channel AOL Time Warner Inc. and the National Basketball Association plan to launch later this year will only become a reality if it reaches 25 million subscribers from its first day, NBA Commissioner David Stern said."). Although the D.C. Circuit vacated the horizontal ownership limit, it did not question the Commission's view that 15 million subscribers were necessary to support new programming. *Time Warner*, 240 F.3d at 1131.

necessarily follows that vastly expanding AT&T's subscribership base by combining it with Comcast's creates a serious threat to competition and diversity in video programming.

As the Commission recognized in the *AT&T/MediaOne Order*, moreover, "recent consolidation in the MVPD industry" exacerbates these concerns. 15 FCC Rcd at 9843, ¶ 57. AT&T's cable operations were created by consolidations with MediaOne and TCI, which were themselves outgrowths of years of consolidation of at least 15 separate cable operators.[14] Comcast's current operations were similarly created over a number of years through the consolidation of at least eight separate cable operators, including Jones Intercable and Lenfest Communications.[15] The current Adelphia cable operations were created through the consolidation of at least 25 separate cable operators, including acquisitions of Century Communications, Harron Communications, and G.S. Communications.[16] Charter includes what

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[14] *See American Cablesystems Corporation and Continental Cable to Merge*, PR Newswire (Oct. 14, 1987); *Continental Cablevision Sets $1.4 Billion Deal*, United Press Int'l (Nov. 22, 1994); J. Estrella, *SouthCoast's First Wave of Cable Changes Hits Today*, SouthCoast Today (Aug. 7, 1997); B. Mattson, *Continental Rides to Top with Zeuli*, Minneapolis-St. Paul City Bus., sec. 1, at 15 (Dec. 22, 1995); New Paradigm Resources Group, Inc., *CLEC Report 1998*, MediaOne, at 3 (9th ed. 1997); M. Ricciutu, *AT&T, MediaOne Merger a Done Deal*, CNET News.com (June 15, 2000), *at* http://news.cnet.com/news/0-1004-200-2082335.html; T. Gauntt, *Dallas Radio Chain Makes Offer for Ailing KKSN*, Bus. J. – Portland (Apr. 25, 1988); K. Bulkley, *WTCI Takes New Direction, Moves into Cable Business*, Denver Bus. J., sec. 1, at 10 (Oct. 26, 1987); *Telecommunications Financial Results*, Bus. Wire (Mar. 29, 1988); F. Danzig, *Media's Fastest-Rising Star, Cable, Soars 23.9%*, Advertising Age, at S-14 (June 26, 1989); K. Oberlander, *UA Board Mulls Offer From TCI*, Electronic Media, at 3 (May 6, 1991); *TCI Announces Agreement on Merger with United Artists*, Associated Press (June 7, 1991); TCI, 1994 10-K (SEC filed Mar. 31, 1995); C. Moozakis, *AT&T, TCI Complete Merger*, Internet Week (Mar. 9, 1999), *at* http://www.internetwk.com/news0399/news030999-11.htm.

[15] Comcast, *About Us: Key Events*, *at* http://www.comcast.com/defaultframe.asp?section=about_us&SubSection=au-key_events.

[16] Adelphia Communications, Inc., 2001 10-Q (SEC filed May 15, 2001); J. Maclain, *TV Delivery Contest Rages*, Ventura County Star, at D1 (July 22, 2001); Adelphia Communications, Inc., 10-Q (SEC filed Nov. 14, 2000); Adelphia Communications, Inc., 1998 10-KT (SEC filed May 25, 1999); Adelphia Communications, Inc., 10-Q (SEC filed Nov. 15, 1999); Adelphia Communications, Inc., 1997 10-K (SEC filed June 26, 1998); Adelphia Communications, Inc., 1996 10-K (SEC filed June 20, 1997); Adelphia Communications, Inc., 1996 10-Q (SEC filed

were formerly at least 20 separate cable operators.[17] The consolidation of at least 15 separate cable companies resulted in the current Time Warner cable operations.[18]

Feb. 14, 1997); Adelphia Communications, Inc., 1996 10-Q (SEC filed Nov. 14, 1996); Adelphia Communications, Inc., 1995 10-K (SEC filed June 28, 1996); Adelphia Communications, Inc., 1995 10-Q (SEC filed Feb. 14, 1996); Adelphia Communications, Inc., 1994 10-Q (SEC filed Feb. 14, 1995); Adelphia Communications, Inc., 1994 10-Q (SEC filed Nov. 14, 1994); Adelphia Communications, Inc., 1994 10-K (SEC filed June 29, 1995); J. Flint, *Cabler Consolidation Current Craze*, Variety, at 43 (June 19, 1994); Comm. Daily at 11 (Mar. 2, 1990); Comm. Daily at 5 (Sept. 6, 1989); *Adelphia Communications Acquires Cable Systems in Virginia*, PR Newswire (Apr. 3, 1989); *Adelphia Communications Acquires*, PR Newswire (Mar. 24, 1988); Comm. Daily at 5 (Apr. 4, 1984); *Book Banned*, Associated Press State & Local Wire (Apr. 14, 1999); Advertising Age at 81 (Nov. 3, 1986); *Pennsylvania Company Buys FrontierVision*, Associated Press State & Local Wire (Feb. 26, 1999); Comm. Daily, Mass Media (Dec. 7, 1999); Electronic Media at 34 (Sept. 26, 1988); *Century Buys 3 Cable Units*, N.Y. Times, at D16 (July 6, 1988); *Century Communications Corp. Has Acquired Cowlitz Cablevision Inc.*, Bus. Wire (Nov. 18, 1986).

[17] *See* Rifkin Acquisition Partners, 1996 10-K (SEC filed Apr. 1, 1997); Comm. Daily at 9 (Oct. 21, 1986); *Target: Cable TV Systems Operations (Toledo, OH); Fanch Communications Inc.*, Mergerstat M&A Database (updated Jan. 15, 1998); Comm. Daily at 6 (Aug. 29, 1995); *Target: Outer Banks Cablevision; Falcon Cable Systems Co.*, Mergerstat M&A Database (updated Oct. 12, 1992); Avalon Cable, LLC, 10-Q (SEC filed Aug. 16, 1999); M. Farrell, *Smaller System Deals Close, Too*, Multichannel News, at 88 (July 12, 1999); *Local and State Actions*, Warren's Cable Regulation Monitor (Sept. 21, 1998); *Cable Notes*, Warren's Cable Regulation Monitor (June 8, 1998); *Target: Cross Country Cable Inc.; Avalon Cable Television*, Mergerstat M&A Database (updated Jan. 15, 1999); Renaissance Media Group LLC, 2000 10-K405 (SEC filed Mar. 30, 2001); American Cable TV Investors 5 Ltd., 2000 10-K405 (SEC filed Mar. 30, 2001); *Helicon Cable Communications Selects General Instrument to Provide Digital Systems and Consumer Set-Top Terminals for Its Cable Systems*, PR Newswire (Feb. 16, 1999); Comm. Daily (Apr. 14, 1998).

[18] Time Warner Inc., 1995 10-K (SEC filed Mar. 22, 1996); J.L. Sullivan, *The Cable Shakeout: OC Loses One HQ But Attracts New Investment*, Orange County Bus. J., at 1 (May 15, 1995); K. Maddox, *Time Warner Merges ATC, Warner Cable*, Electronic Media, at 3 (Aug. 17, 1992); *A Summary of Developments in the News Industry for the Week of Feb. 3-10*, Associated Press (Feb. 10, 1992); W. Belcher, *Leach Stops by to Mark Cable Deal*, Tampa Trib., at 4 (Apr. 19, 1996); *Broadcast TV*, Electronic Media, at 38 (July 10, 1989); *American Television and Communications Reports Second Quarter 1987 Financial Results*, Bus. Wire (July 15, 1987); K. Bulkley, *Denver's Paragon to Manage Rogers U.S. Cable TV Systems*, Denver Bus. J., at 9 (Oct. 10, 1988); *Business Briefs*, United Press Int'l (May 5, 1983); *ATC to Acquire Chapel Hill, N.C. Cable System*, Bus. Wire (Dec. 3, 1991); PR Newswire (Dec. 4, 1980); *Warner Cable Announces Expansion, Becomes Time Warner Communications*, Bus. Wire (Mar. 25, 1997); L. Aguilar, *Council Hears Complaints About Paragon Cable*, L.A. Times, at 10 (June 8, 1989); *In Brief*, Star Trib., at 3D (Aug. 2, 1994).

The result of all of these transactions is to reduce the number of major distribution outlets for video programming, and thereby to increase the likelihood of coordinated action among the ones that remain. Three years ago, the Commission recognized that, "[b]ecause cable operators generally do not compete against each other in their respective franchise areas, they may incur no loss from carrying the same programming networks and have little economic disincentive for coordinated action."[19] And, although the D.C. Circuit vacated the Commission's horizontal ownership limit in part because the record did not reflect "a serious risk of collusion," it did not dispute the "economic commonplace" that "collusion is less likely when there are more firms." *Time Warner*, 240 F.3d at 1130, 1132. Simply put, because there are now only a handful of firms that programmers can rely upon to reach enough viewers to sustain operations, the Commission must be particularly vigilant to ensure that those firms do not amass sufficient scale to diminish competition in the development of video programming.

The anticompetitive impact of the merger would be further exacerbated by the combined AT&T/Comcast's increased incentive and ability to discriminate in preference of its own programming. This discrimination will limit the viability of competing distributors – which cannot get access to prized programming – while limiting the audience of competing programmers – which cannot get carriage on the nation's largest video distributor.[20]

And there is, moreover, quite a lot of programming for AT&T/Comcast to favor. Both of these companies are significant content providers in their own right. As noted above, AT&T still owns a 25-percent interest in Time Warner Entertainment, which owns substantially all of the

[19] *AT&T/MediaOne Order*, 15 FCC Rcd at 9843, ¶ 56.

[20] *See AT&T/MediaOne Order*, 15 FCC Rcd at 9844, ¶ 58 ("Not only will the merged entity have attributable interests in a vast number of programming networks, including many of the networks with the largest number of subscribers nationwide, but new networks will reduce their chances for long-term success if they do not meet the terms and preferences of the merged firm.").

assets of HBO, Warner Bros., Time Warner Cable Networks, Cinemax, Comedy Central, Court TV, as well as many other popular film and entertainment companies. AT&T also owns an attributable interest in E! Entertainment, style., and iN DEMAND, as well as regional services such as Fox Sports New England, New England Cable News, and Pittsburgh Cable News Channel.[21] In addition, AT&T has an indirect ownership interest in Rainbow Media Sports Holdings, which includes national programs such as American Movie Classics, Bravo, Independent Film Channel, and Women's Entertainment, and regional program services such as the Fox Sports Net services and MSG Network.[22]

For its part, Comcast owns a majority share of QVC (one of the top 20 programming services in the country), and significant shares of the Discovery Health Channel, E! Entertainment, The Golf Channel, and others.[23] Comcast is also a substantial provider of regional content to Pennsylvania, Delaware, New Jersey, Maryland, North Carolina, Alabama, Arkansas, Florida, Georgia, Kentucky, Louisiana, Mississippi, South Carolina, and Tennessee.[24]

This local programming – and especially the sports programming – is of great importance in the MVPD market. *See* Gertner Decl. ¶¶ 43, 45. According to RCN, "40-58% of cable subscribers would be less likely to subscribe to cable service if it lacked local sports programming, and . . . an additional 12% said they were not sure."[25] Without access to local sports programming, RCN assumes it would achieve a penetration rate of about 15 percent of the

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[21] Public Interest Statement at 25.

[22] *Id.* at 20 & n.27.

[23] *Id.* at 15.

[24] *Id.* at 14-15.

[25] Initial Comments of RCN Telecom Services, Inc. at 18, CS Docket No. 01-290 (FCC filed Dec. 3, 2001).

homes it passes in each market it builds out, assuming a loss, on average, of 49 percent of homes passed due to absence of local sports, and a 30-percent penetration rate of the remaining 51 percent.[26] According to RCN, this rate is "so low that no entrepreneur would be willing to risk the hundreds of millions of dollars required to overbuild an urban area with modern fiber optic plant."[27]

Significantly, Comcast has already shown an unwillingness to make this regional sports programming available to competing MVPDs. For example, in the Philadelphia area, Comcast has refused to license its regional sports network to competing DBS providers. *See* Gertner Decl. ¶ 43. And DBS subscription rates there are well below the national average. *Id.* ¶ 45. Thus, Comcast not only has the ability and incentive to disadvantage its competitors by restricting access to content, it has a demonstrated track record of doing so.

The merger will only make this situation worse, as the combined company will be able to leverage a far larger array of regional content over an expanded service area, reducing competition for one-third of the country. Indeed, the potential anticompetitive havoc that can be caused has not escaped the merging parties' senior management. AT&T CEO C. Michael Armstrong has stated that the merging parties intend to "develop new and 'leverage' existing programming content." He pointed specifically to, among other things, Comcast's regional sports networks.[28]

Raising Rivals' Costs. Against all of this, the Applicants point mainly to the existence of alternative video platforms – primarily DBS – as providing sufficient competition to keep them

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[26] *Id.* at 18 & n.43.

[27] *Id.* at 18.

[28] C. Michael Armstrong, Chairman and CEO, AT&T, Presentation to Salomon Smith Barney Conference (Jan. 7, 2002).

from abusing their market power.[29] But, even as things stand today, DBS is plainly insufficient to check the dominant cable operators. For the past six years, cable prices have been rising at three times the rate of inflation.[30] Those operators most likely to face head-to-head competition from satellite "charge higher, not lower prices."[31]

More fundamentally, the merger will makes things *worse*, by diminishing the already strained ability of DBS and other platforms to compete. AT&T/Comcast's increased bargaining leverage stemming from the merger would not only diminish the amount and diversity of video programming, it also would increase the costs of rival distribution networks, both in- and out-of-region. As the attached declaration of Dr. Robert Gertner explains, the combined company's leverage will allow it to drive down the prices it pays for programming. *See* Gertner Decl. ¶¶ 24, 39-41. This is, in fact, what several studies have found: large MVPDs obtain significant discounts from cable networks.[32] And AT&T and Comcast themselves predict that they will achieve annual programming cost savings of $250 to $450 million.[33]

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[29] *See* Public Interest Statement at 66-67.

[30] *See* Mark Cooper, Consumer Federation of America, *The Failure of "Intermodal" Competition in Cable Markets* at 15 (Apr. 23, 2002) ("*CFA Study*"), *at* http://www.consumerfed.org/Intercomp.20020423.pdf; *see also* Report on Cable Industry Prices, *Implementation of Section 3 of the Cable Television Consumer Protection and Competition Act of 1992; Statistical Report on Average Rates for Basic Service, Cable Programming Service, and Equipment*, MM Docket No. 92-266, FCC 02-107, ¶ 22 (rel. Apr. 4, 2002) ("The cable [consumer price index ("CPI")] increased by 3.9% over the 12 months ending July 2001," outpacing the overall CPI's 2.7% increase.); *Comcast's Roberts Says AT&T Merger Will Benefit Consumers*, Comm. Daily, at 3 (Apr. 24, 2002) (noting that a "skeptical" Senator Kohl told Comcast President Brian Roberts that he was "doing an outstanding job in representing [his] company's best interest," but that "whether that is in the best interest of the consumers of America is open to debate").

[31] *CFA Study* at ii.

[32] *See* Gertner Decl. ¶ 39 (collecting sources).

[33] Pick Decl. ¶ 21 (Public Interest Statement App. 9).

Putting aside the question of whether a combined AT&T/Comcast would pass these discounts through to consumers, the fact remains that content providers – particularly those operating at a thin margin – will need to recoup the revenue elsewhere. To do so, they will seek greater revenues from other MVPD providers. Higher programming prices paid by other MVPDs may, in turn, reduce their incentives to upgrade their equipment. This could reduce the number of channels offered by other MVPDs. Higher programming costs may also imperil competing platforms – such as DBS – because they will be hard-pressed to gain any ground on the cable giants when the cable giants enjoy lower programming costs. *See* Gertner Decl. ¶¶ 23-26.

A combined AT&T/Comcast's ability to raise its rivals costs would be buttressed by the company's ownership of Headend in the Sky ("HITS"). HITS is a wholly owned subsidiary of AT&T Broadband that aggregates programming for MVPDs. HITS aggregates 150 digital programming channels from a variety of different satellites and delivers them in a single transmission path and in digitized format. This service allows MVPDs to reduce significantly their investment in head-end equipment; indeed, HITS can reduce a cable system operator's investment from $500,000 to about $30,000. Thus, HITS is a valuable service to overbuilders and others who want to provide video services.

Because AT&T/Comcast would own HITS, the combined company could refuse to offer its video programming services to any cable overbuilder that would compete with AT&T/Comcast anywhere in its vast geographic footprint. Indeed, based on HITS' past behavior, it appears that AT&T/Comcast would do exactly that. SBC recently inquired about obtaining video programming from WSNet, a firm that lists HITS as a strategic partner. WSNet "distribut[es] both digital and analog satellite television programming to the private cable and wireless cable industries serving the multiple dwelling unit (MDU) real estate sector" and serves "small and rural cable companies, and alternative access providers seeking a private label digital programming solution."[34] The bulk of WSNet's programming comes from HITS (although it contracts directly for some additional programming). SBC recently engaged in discussions with WSNet to see if WSNet could serve as a possible supplier for a Broadband Passive Optical Network ("BPON") application. But WSNet has informed SBC that HITS will not permit WSNet to sell HITS services to overbuilders – apparently defined as video distributors that cross a public right-of-way, and including the SBC BPON application in question – that compete with AT&T cable systems.

This conduct is transparently anticompetitive. And, with AT&T practically doubling the size of its geographic footprint, more of the same can be expected – but across a much wider territory. HITS programming would become unavailable to overbuilders not merely in the AT&T cable service areas, but in Comcast's as well.[35]

It is imperative that the Commission use the merger review process carefully to consider these potential harms. As noted at the outset, unlike in previous mergers,[36] the Commission does not have the luxury of simply asking whether the transaction would violate its existing horizontal ownership rule. Instead, it must carefully examine the likelihood that the merged company could foreclose access to programming, and take any steps necessary to ensure "the flow of video programming from the video programmer to the consumer."[37]

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[34] WSNet, *Frequently Asked Questions*, *at* www.wsnet.tv/FAQ/faq.asp#1.

[35] Comcast, too, has already demonstrated its desire to eliminate overbuilders. WideOpenWest, Comcast's only cable competitor in Michigan, recently alleged that "Comcast is trying to eliminate cable TV competition by giving customers who try to leave *unpublished* lower rates." *See* Brenda Rios, *Competitor Says Comcast Unfair*, Detroit Free Press (Apr. 2, 2002) (emphasis added).

[36] *See AT&T/MediaOne Order*, 15 FCC Rcd at 9844, ¶ 59.

[37] 47 U.S.C. § 533(f)(2)(A).

II. THE MERGER THREATENS COMPETITION IN THE MASS MARKET FOR BROADBAND SERVICES.

The impact of the merger on the broadband market would be equally severe. The facts regarding the cable industry's domination of the mass market for broadband Internet access are by now familiar. Cable has 69 percent of the broadband mass market,[38] and is adding new subscribers at a faster rate than competing high-speed technologies.[39] Indeed, not only are cable operators signing up new customers at a faster clip than incumbent LECs, they are *increasing* their already dominant market share.[40] And cable's existing dominance of broadband services appears likely to perpetuate. Analysts expect that cable will maintain a substantial lead over DSL at least through 2005.[41]

This merger threatens to cement the dominance of the cable platform over competing platforms. Even putting aside AT&T's interest in Time Warner, a combined AT&T/Comcast would control more than 23 percent of all residential broadband subscribers in the country and almost 34 percent of all cable modem customers.[42] After the merger, the top two cable

[38] R.A. Bilotti, *et al.*, Morgan Stanley, Dean Witter, *Cable Modem and xDSL Conference Call* Exh. 3 (Jan. 18, 2002) (cable modem subscribers); xDSL.com, *TeleChoice 4Q01 DSL Deployment Summary* (DSL subscribers) *at* http://www.xdsl.com/content/resources/deployment_info.asp.

[39] *See, e.g.*, *UNE Fact Report 2002* at IV-19 to IV-20 & Figure 7 (Apr. 2002) (prepared for and submitted by BellSouth, SBC, Qwest, and Verizon in CC Docket No. 01-338, *et al.*).

[40] *See* R. Waters, *Baby Bells Hit By a Series of Wrong Numbers*, FT.com, at 2 (Apr. 16, 2002) ("[T]he Bells continue to lag behind the cable companies in the development of broadband services. . . . [T]heir high-speed DSL services have lost market share to cable modems."), *at* http://gloabalarchive.ft.com/globalarchive/article.html?id=020416000836.

[41] *See, e.g.*, N. Gupta, *et al.*, Salomon Smith Barney, *The Battle for the High-Speed Data Subscriber: Cable vs. DSL*, at 1 (Aug. 20, 2001) (cable will account for 59 percent of subscribers and DSL will account for 34 percent in 2005).

[42] R.A. Bilotti, *et al.*, Morgan Stanley, Dean Witter, *Cable Modem and xDSL Conference Call* Exh. 3 (Jan. 18, 2002); xDSL.com, *TeleChoice 4Q01 DSL Deployment Summary*, *at* http://www.xdsl.com/content/resources/deployment_info.aspl; J. Morris, *Satellite Internet*

companies – AT&T/Comcast and Time Warner – would control nearly 40 percent of residential broadband customers and almost 58 percent of all cable modem customers. The merger thus makes the major cable players both more important and less numerous, while minimizing the competitive significance of smaller players in the purchase of programming and content. And, as in the video market, size is not all. Because a combined AT&T/Comcast would have substantial interests in Internet content – and the ISPs and portals they use to access it – the merger substantially increases the parties' incentive and ability to discriminate in favor of affiliated content. As one analyst put it, "[t]o the benefit of its shareholders – but to the detriment of . . . vendors in the cable and communications industries – AT&T Comcast would be a powerful gatekeeper on a scale unrealized since the late 1980s."[43]

Horizontal Concentration and Vertical Foreclosure. The merger thus poses threats to the broadband mass market similar to those in the MVPD market, and perhaps even more so. The broadband market is nascent, and crucial new products and technologies are being developed quickly. Accordingly, as the Commission has previously recognized, any harm to this market at this critical stage will have long-lasting effects on consumer welfare.[44]

Indeed, as Dr. Gertner explains, compared to video programming, the broadband market is undeveloped, with far fewer total subscribers available to purchase content. Programmers may therefore have more difficulty securing the distribution and promotion necessary to justify

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Providers Facing Road Against Cable, DSL Competitors, Aerospace Daily, at 1 (June 13, 2001).

[43] George Mannes, *Telephone Temptress Reels in Comcast*, TheStreet.com, *at* http://www.thestreet.com/_ cnet/tech/georgemannes/10005703.html.

[44] Memorandum Opinion and Order, *Applications for Consent to the Transfer of Control of Licenses and Section 214 Authorizations by Time Warner Inc. and America Online, Inc. to AOL Time Warner Inc.*, 16 FCC Rcd 6547, 6599, ¶ 121 (2001) ("*AOL/Time Warner Order*") (acknowledging as a "public interest harm" the possibility that AOLTime Warner might "withdraw support from DSL – even if it were limited to Time Warner cable service areas, and even if its ultimate effect were only to *slow* DSL's continued growth") (emphasis added).

developing content, and may accordingly be more beholden to AT&T/Comcast's increased bargaining leverage. *See* Gertner Decl. ¶¶ 15, 17. As a consequence of this leverage, content providers may be forced either to reduce the quality or quantity of their content (because they lack funds sufficient to develop higher-quality or more programming) or to obtain greater revenues from cable modem competitors, such as DSL. In the first case, output is restricted and consumers and the public interest suffer. In the second case, the costs of rival distribution platforms are raised in an anticompetitive manner, with the same end result.

Coupled with their demonstrated proclivity to discriminate in favor of their own Internet content, moreover, the Applicants' presence in the ISP/portal market creates further cause for concern. "[U]nlike high-speed access offered over the telephone network where the customer can select the Internet Service Provider ("ISP") of his own choice, the cable ISP is selected by the cable provider and offered to customers in that cable operator's individual regions."[45] As the Commission has recognized, notwithstanding a smattering of recent transactions, cable operators typically offer only one ISP to customers.[46] As a general matter, that ISP is usually either owned by or affiliated with the cable operator. Thus, for example, Excite@Home previously had a contractual arrangement to be the exclusive portal on both AT&T's and Comcast's cable Internet service. Now Comcast has "transferred all of its high-speed Internet customers to a network that is owned and managed by Comcast."[47] AT&T has likewise provisioned a replacement network to provide Internet service to its customers.[48]

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[45] *Eighth Annual Video Report*, 17 FCC Rcd at 1266-67, ¶ 46.

[46] *Id.* at 1267, ¶ 46.

[47] Public Interest Statement at 12.

[48] *Id.* at 23.

The Commission thus need not speculate about whether a combined AT&T/Comcast might favor its own affiliated content to the exclusion of competing content. Both companies have a demonstrated history of doing so. Moreover, the merger would substantially aggregate interests in vertical markets, thus increasing the merging companies' ability and incentive to favor their affiliated content as well as that tailored to the cable platform. The result, of course, would be to disadvantage unaffiliated content providers – as well as competing platforms that rely on those unaffiliated content providers – to the detriment of consumers. And, as we now discuss, with the leading competitors hobbled by onerous regulation, the competitive pressure brought to bear on a combined AT&T/Comcast would likely be insufficient to force it to change its practices. *See* Gertner Decl. ¶¶ 17, 62.

Regulatory Obstacles to Competition. In the face of these potential harms, the Applicants contend that competition from competing broadband platforms – in particular, from DSL – will keep them in check.[49] To be sure, it was precisely the existence of such competition that mitigated the Commission's broadband-related concerns in AT&T's last major cable transaction.[50] But, whatever the merits of that view three years ago, in today's unbalanced regulatory environment, it cannot justify this transaction.

Indeed, this unbalanced environment is a major reason for cable's market dominance in the first place. SBC fully supports the Commission's recent steps toward a rational and balanced broadband regulatory framework. But those steps have yet to provide any actual regulatory

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[49] Public Interest Statement at 92.

[50] *See AT&T/MediaOne Order*, 15 FCC Rcd at 9867, ¶ 117 ("there is evidence that ILECs, CLECs, and other competitive providers are aggressively rolling out alternative broadband technologies, notwithstanding cable's early lead in the nascent broadband area"); *id.* at 9867-68, ¶ 117 (premising approval in part on understanding that "DSL sales [we]re . . . growing at a more rapid rate than cable modem sales," and speculating that the recently promulgated line-sharing rules would "further spur the deployment of DSL broadband services").

relief, and the fact remains that DSL provided by incumbent LECs remains mired in comprehensive, burdensome, and costly regulation that is not imposed on cable operators. The upshot of this regulatory imbalance is to create a playing field that is severely tilted toward the dominant cable providers. Thus, telephone companies have to invest hundreds of millions of dollars to "unbundle" the wireline spectrum that they use for broadband, for example, and make it available to all comers at regulated prices. Cable companies, by contrast, do not bear these obligations or costs. Telephone companies must invest additional hundreds of millions of dollars to permit their competitors to "collocate" equipment in telephone company premises to make it easier to use that "unbundled" spectrum. Again, cable companies do not bear these obligations or costs. Telephone companies are almost completely locked out of the multi-billion dollar (and rapidly expanding) Internet backbone service. Cable companies are not. Telephone companies must offer their retail broadband transmission services to competitors at a federally mandated discount. Cable companies do not. Telephone companies have to contribute to universal service when they provide broadband access, bearing what is, in effect, a 7-percent tax on their service. Cable companies do not. Telephone companies have been forced to carve-out their broadband transmission services into a separate affiliate as a condition to gaining regulatory approval of recent mergers. Cable companies have not. And, perhaps most critically, telephone companies labor under the constant threat of additional regulations imposed by state commissions, which, in the absence of rules promulgated by this Commission, have turned their sights on ILEC broadband facilities. Cable companies, particularly now that the Commission has inoculated them from state regulation by classifying them solely under Title I,[51] face no such threat.

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[51] *See* Declaratory Ruling and Notice of Proposed Rulemaking, *Inquiry Concerning High-Speed Access to the Internet Over Cable and Other Facilities*, GN Docket No. 00-185 & CS Docket No. 02-52, FCC 02-77 (rel. Mar. 15, 2002) ("*Cable Classification Order*").

Any one of these impediments is enough to hinder the development of DSL. In the aggregate, their impact is staggering. And it is for precisely this reason that DSL has failed to emerge as a counterbalance to the dominant cable providers. To be sure, there are other disadvantages that telephone companies face vis-à-vis cable operators. In particular, whereas all cable plant is upgradeable, a significant portion of telephone plant is not. DSL service can be provided at high speeds only on loops that are 18,000 feet or shorter,[52] which means that "only about two-thirds of U.S. homes are easily addressable for xDSL."[53] Even when it is possible to upgrade the telco plant for DSL, cable still has an edge because cable has significantly lower upgrade costs than DSL.[54] As a result of these advantages, cable modem service is currently available to significantly more homes than DSL: cable modem service is already available to between 66 and 77 percent of U.S. households,[55] compared to only about 45 percent for DSL.[56]

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[52] *See, e.g.*, A. Gilroy & L. Kruger, *Broadband Internet Access: Background and Issues*, Congressional Research Service – Policy Papers (May 18, 2001); D. Sweeney, *Ultra Long-Reach DSL: A Whole New Crop of Companies Aims To Boost DSL Performance*, America's Network (Sept. 15, 2001).

[53] McKinsey & Co. and JP Morgan H&Q, *Broadband 2001* at 40 (Apr. 2, 2001) ("*Broadband 2001*").

[54] *See, e.g.*, *id.* at 69 ("xDSL starts life at a much higher cost point (close to $800) than cable modem (about $470) primarily because cable makes use of shared head-end terminating equipment, whereas DSL requires dedicated line cards for each subscriber.").

[55] *See* M. Goodman, Yankee Group, *Residential Broadband: Cable Modems and DSL Reach Critical Mass*, Media & Entertainment Strategies, Vol. 5, No. 3, Exh. 4 (Mar. 2001) ("*Yankee Group Critical Mass Report*"); *Broadband 2001* Tables 1 & 6. *See also* NCTA, *Industry Overview; Industry Statistics* (as of November 2001, 70 million households were passed by cable modem service), *at* http://www.ncta.com/industry_overview/indStat.cfm?ind OverviewID=2. The cable industry association estimates that, by year-end 2002, approximately 95 million U.S. homes (or nearly 90 percent of homes passed by cable) will have access to cable modem service. *See* NCTA, *Cable & Telecommunications Industry Overview 2001* Chart 2 (2001) (citing Morgan Stanley Dean Witter, *Broadband Cable Second-Quarter Review* at 9 (Aug. 29, 2001)).

[56] *See, e.g.*, *Yankee Group Critical Mass Report* Exh. 4 (estimating that DSL will be available to 45% of all households by year-end 2001); *See* J. Bazinet & D. Pinsker, JP Morgan

But, standing alone, these technical limitations would likely not have derailed DSL's efforts to compete with cable. In fact, to counter them, SBC announced Project Pronto, a $6 billion initiative designed to overcome these limitations and bring DSL to 20 million consumers that otherwise were out of reach.[57] No sooner had SBC announced this initiative, however, than CLECs began to clamor for access to the new facilities. And, after reviewing those requests for nine months, the Commission granted many of them, and then issued an NPRM proposing a raft of new sharing obligations.[58] With that NPRM pending, the CLECs took their arguments to the states, which – with no jurisdiction over cable modem service, and therefore little ability to compel intermodal competition – opened a series of proceedings to further burden the deployment of DSL service. The economic case for the initiative – already tenuous in light of ample existing facilities-based competition – became more so. And, as a result, SBC was compelled to drastically scale back the deployment of Project Pronto facilities, and is rethinking the deployment of potential successor technologies – such as BPON – for fear that they too will be swept up in a mandatory sharing regime. As SBC Chairman and CEO Edward E. Whitacre, Jr. has explained: "Today's regulatory rules and uncertainty artificially increase costs, affect how we invest capital and how we market our products and services. . . . No responsible company could justify fully deploying broadband capabilities and investing in new advanced networks in the face of this uncertain environment."[59]

H&Q, *The Cable Industry* Figures 12 & 36 (Nov. 2, 2001) ("*JP Morgan Cable Industry Report*") (DSL available to 43% of U.S. homes as of 1Q2001); P. Roche, *DSL Will Win Where It Matters*, McKinsey Quarterly 2001, No. 1 (2001) ("40 percent of all phone lines are ready for DSL").

[57] Second Memorandum Opinion and Order, *Ameritech Corp. and SBC Communications Inc.*, 15 FCC Rcd 17521 (2000).

[58] Third Further Notice of Proposed Rulemaking in CC Docket No. 98-147, Sixth Further Notice of Proposed Rulemaking in CC Docket No. 96-98, *Deployment of Wireline Services Offering Advanced Telecommunications Capability*, 16 FCC Rcd 2101 (2001).

[59] *See SBC Reports Third-Quarter Results*, Investor Briefing, at 1 (Oct. 22, 2001), *at*

It is accordingly clear that, in today's uncertain regulatory environment, incumbent LECs face tremendous disincentives to deploy broadband facilities. Thus, unlike in AT&T's last major cable transaction, the Commission can have no confidence that DSL will emerge as a sufficiently strong counterbalance to offset the broadband market power that the Applicants would accrue as a result of this merger – at least not unless (and until) the Commission removes the regulatory obstacles to DSL deployment.

Standards and the Role of Microsoft. Another significant threat to competition and the public interest is the threat that a combined AT&T/Comcast could use its might to tilt standards away from competing broadband platforms such as DSL. *See* Gertner Decl. ¶¶ 59-60. Analysts recognize that the combined company will have "the dominant seat at the table in influencing technology standards."[60] The merged company will be able to use this seat to dictate standards and software for set-top boxes, which are critical to the development of interactive television. A combined AT&T/Comcast could also influence the development of sophisticated hardware and software needed to make caching work and to manage caching services. Caching is a key aspect of broadband service, as it improves the accessibility and delivery of popular, on-demand media clips and mitigates the large traffic spikes caused when many users access a particular source at one time (for example, to receive information on a breaking news event or to get a first look at popular new content). Absent adequate safeguards, the standards surrounding these services may favor the cable modem platform, and thereby further tilt the market away from DSL.

In this regard, it is no coincidence that Microsoft is involved in this transaction. Microsoft has spent many years (and billions of dollars) attempting to achieve a lasting presence

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http://www.sbc.com/Investor/Financial/Earning_Info/docs/3Q01_IB_Final.pdf.

[60] N. Gupta, Salomon Smith Barney, Equity Research: United States, Comcast Corporation, at 3 (Jan. 4, 2002).

in set-top boxes. As set-top boxes have been equipped with digital technology, they have hard drive and operating system capabilities.[61] Set-top boxes are therefore a key gateway into people's homes, for TV, broadband Web access, and Internet telephony. By the middle of 2000, more than 50 million set-top boxes were deployed in homes across North America, and there were perhaps twice that worldwide.[62]

Microsoft recognizes that "[t]he mainstream receiver platform for TVs is, without a doubt, the set-top box."[63] And it has sought to dominate the software market for set-top boxes just as it attempted to corner the browser market: "If everything goes as we hope, the majority of those set-top boxes will be running Microsoft TV instead of some competing piece of software."[64] Thus, Microsoft will control a "leading future challenger to the Windows monopoly."[65]

The pillar of Microsoft's strategy is to invest in cable companies, with the intention of selling them Microsoft set-top box software and establishing the industry standard. Between 1996 and 1999, Microsoft invested in 15 to 20 cable television companies.[66] It invested $212 million in Time Warner, and $1 billion in Comcast. And, in May 1999, Microsoft made an

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[61] *Gates' Grand Internet Plan*, Bus. Rev. Weekly (Australia) (Sept. 15, 2000).

[62] Dominic Gates, *Gates and Malone Explore Cable Hookups*, Industry Standard (July 31, 2000).

[63] Jim Barthold, *Microsoft Whistling the Same Old Tune*, Cable World, at 60 (Sept. 11, 2000) (quoting Ed Graczyk, then-Director of Marketing Communications for the Microsoft TV Platform Group).

[64] *Id.*

[65] Amy Harmon, *Executive Fearful of Microsoft in Interactive TV Software*, N.Y. Times, at C2 (Apr. 3, 2002).

[66] Patrick Seitz, *Who Benefits, Who Loses Out in the Big Split – Proposed Microsoft Breakup Could Help Sun Microsystems, IBM, Oracle, But U.S. Firms May Pay More for Software*, Investor's Bus. Daily, at A4 (June 9, 2000).

investment five times larger than any direct U.S. cable company investment it had made previously: it staked $5 billion on AT&T Broadband.[67]

Microsoft plainly intends these investments in the leading cable companies to enable it to control set-top box software. In an internal email, Microsoft Chairman and CEO Bill Gates pointedly explained his understanding that Microsoft

> had convinced Comcast, AT&T and others to make it clear that all Cablelabs should do is OS [operating system] interop. I was very involved in this and I am stunned if this is going the other way without my hearing about it. This would be a total disaster for us in terms of our TV Platform efforts. We have to get the basics right and not allowing standards to destroy our position has got to be part of that.[68]

This merger makes it that much more likely that Microsoft would "get the basics right." It would give Microsoft a concentrated investment in the combined AT&T/Comcast that assuredly would enable it to "convinc[e]" the merged company – if any more convincing is necessary – to ensure that standards favor Microsoft's interests. And, because the merger greatly increases concentration in the cable industry, it makes it that much easier for Microsoft – with its hefty investments in AT&T/Comcast and number two Time Warner – to dictate the terms on which set-top boxes will operate.

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[67] *See* Jay Greene, *et al.*, *For Microsoft, It's "Inactive TV,"* Bus. Week, at 46 (Sept. 4, 2000). Microsoft's worldwide cable holdings are similarly vast. It invested $400 million in Canada's Rogers Communications. In Europe, Microsoft's stake in Britain's Telewest cost $3 billion, and it put more than $400 million into Netherlands-based UPC. It also invested $500 million in Telewest rival NTL, which afterward bought the cable division of Cable & Wireless to become the U.K.'s largest cable operation. In Latin America, Microsoft paid $126 million for 11 percent of Globo Cabo, a Brazilian cable company; and it invested $40 million in TV Cabo of Portugal. Dominic Gates, *Gates and Malone Explore Cable Hookups*, Industry Standard (July 31, 2000). Microsoft also owns 60 percent of the Japanese cable company Titus, now owned and merged with Japanese cable company Jupiter. Post-merger, the two U.S. companies thus jointly control the largest cable operator in Japan, offering broadband services in one of the most technologically advanced markets. *Id.*

[68] Plaintiffs' Exh. 334, *United States v. Microsoft Corp.*, Nos. 98-1232 & 98-1233 (D.D.C.) (E-mail from Bill Gates to Jon DeVaan and Craig Mundie (Aug. 18, 2000)).

Critically, the cable consortium – with AT&T/Comcast and Time Warner leading the way – can collaborate with Microsoft to use set-top box operating software to advantage cable operators at the expense of DSL. In exchange for exclusive contracts with cable companies to distribute its own set-top box software, Microsoft could put into its software triggers to activate certain features and functions that could only be used with cable-provided content, and therefore would be unavailable to DSL users. Thus, interactive links to information about video programming and other interactive television devices could be made available only with cable-provided content. With the popularity of interactive television on the rise, this would give cable a substantial advantage over DSL.

A merged AT&T/Comcast and Microsoft could collaborate in other ways to disadvantage competition. For instance, Microsoft could leverage its dominance of PC software and operating systems to steer new PC purchasers or set-top box users to cable modem, as opposed to DSL service. For example, Microsoft could insert a screen during the installation process for a new computer or set-top box that could ask consumers if they wish to obtain broadband service via their cable system and even to subscribe to MSN or the cable system's "home brand" ISP/portal service. Microsoft may also seek to leverage its operating software monopoly and ISP/portal position into other services, such as a comprehensive messaging service or a combined email and voicemail access service in order to obtain a return on its billions of dollars invested in AT&T/Comcast.

Or, to take another example, Microsoft and cable operators could work together to cache Microsoft and other favored content at major cable head-ends, which would improve the experience a cable modem customer receives when interacting with that content. *See* Gertner Decl. ¶ 59. Absent appropriate safeguards – in particular, open specifications facilitating the manufacture and sale of set-top boxes that have access to all of the same AT&T/Comcast

broadcast programming options, but are able to present their own electronic program guides, interactive programming links, and electronic commerce and content offerings – the companies might also seek to create a "walled garden" product that drives all content and electronic commerce requests to Microsoft.

Cable companies and Microsoft might also work with set-top box hardware makers to limit DSL's ability to use set-top boxes at all. Cable modem service has an inherent advantage over DSL in that the integration of video and broadband services is readily done over the cable network. One way DSL can minimize this disadvantage is to offer DSL service through an integrated set-top box that allows the provision of both DSL and video service. But those boxes are less likely to get developed if the cable companies persuade the leading manufacturers not to produce DSL-compatible boxes, in exchange for the cable companies' business. This is easily accomplished given the links between set-top box hardware makers and the cable companies. AT&T is a leading purchaser of Motorola set-top boxes, and AOL Time Warner is aligned with Scientific-Atlanta. If a combined AT&T/Comcast commits to discriminating against competing broadband platforms in the same manner as it has against competing video platforms, *see infra* pp. 11-14, there can be little doubt that, absent Commission intervention, it will seek to make set-top boxes incompatible with DSL.

III. VAGUE PROMISES OF VOICE COMPETITION CANNOT OFFSET THE PUBLIC INTEREST HARMS CREATED BY THE MERGER.

Commission precedent firmly establishes that the merger may be approved only if AT&T and Comcast demonstrate that the transaction will result in public-interest benefits that outweigh the competitive harms. These benefits must be "achievable only as a result of the merger," "sufficiently likely and verifiable," and "not deemed the result of anti-competitive reductions in output or increases in price."[69] Moreover, in view of the extensive competitive threat that the

[69] *SBC/Ameritech Order*, 14 FCC Rcd at 14825, ¶ 255.