White Paper

POST MERGER COMPETITION: Addressing the Competitive Loss of AT&T and MCI

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3. *In the Matter of SBC Communications Inc. Apparent Liability for Forfeiture*, Order on Review, File No. EB-00-IH-0326a, FCC 02-61 (Feb. 25, 2002).
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Executive Summary

This white paper addresses the proposed mergers of SBC/AT&T and Verizon/MCI – the combination of the nation's two largest incumbent local telephone companies with the two largest competitive carriers – and the likely impact of these proposed transactions on the competitive landscape for both new and emerging voice and data services.[1] This paper demonstrates that the unprecedented combination of these proposed mergers will significantly harm competition and undermine innovation, increase prices, disrupt services and otherwise imperil the evolving communications arena that consumers today enjoy. While merger proponents tout the mergers as the path to "ensure a strong and vibrant industry"[2] and the way to "strongly benefit all kinds of customers and thereby promote the public interest,"[3] the facts show that only by imposing specific, effective and enforceable conditions upon the grant of the merger approvals will the public interest be protected. Indeed, if the Federal Communications Commission ("FCC" or "Commission") is to make sure that these transactions really are a transition to a more robust, redundant and innovative communications landscape, it must act

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[1] *SBC Communications Inc. and AT&T Corp. Applications for Approval of Transfer of Control,* WC Dkt. 05-65, filed Feb. 21, 2005 (*"SBC/AT&T Merger Application")*; *Verizon Communications, Inc. and MCI, Inc. Applications for Approval of Transfer of Control*, WC Dkt. 05-75, filed Mar. 11, 2005 (*"Verizon/MCI Merger Application").*

[2] *SBC/AT&T Merger Application*, Description of the Transaction, Public Interest Showing, and Related Demonstrations, p. iii. *See id.* at 15 ("[The merger] will accelerate the transition to a true 'services over IP' environment in which customers will be offered the full range of voice, data, and video services over IP by a range of competing providers.").

[3] *Verizon/MCI Merger Application*, Exhibit 1, p. 1.

decisively to ensure consumers can enjoy the benefits of competitive offerings post-mergers.

For ease of reference, the paper is divided into four sections. Section I describes today's advanced services and broadband marketplace, including the available competitive alternatives for information service providers and others to bring retail consumers tomorrow's services. Whether VoIP, high-speed Internet access, data services, or IP video, these retail offerings rely upon the availability of broadband inputs at reasonable prices and terms. Today, EarthLink and others utilize DSL special access transmission as key inputs for retail broadband consumer offerings. In addition, EarthLink is developing advanced technologies that provide facilities-based alternatives for retail consumers premised upon UNE-L. Stand-alone DSL also offers an avenue for competitive retail delivery of new communications services. Currently, stand-alone DSL service is successfully offered by Qwest. Verizon also offers stand-alone DSL service, albeit with significant restrictions and uncertain implementation. SBC does not offer a stand-alone DSL service at all. Given the emphasis the FCC has placed upon contractual arrangements for procurement of the necessary broadband inputs such as DSL, it is especially vital that the Commission's action on these mergers recognizes the changes the mergers will cause to the arena in which broadband contractual negotiations will occur.

Section II details how the consummation of the proposed mergers will diminish competition for voice and data services, thereby harming the public interest. Relevant and longstanding legal precedent requires the FCC, in considering the impact upon the public interest of proposed transactions, to take into account both actual and likely future competition. In the case of both the SBC/AT&T and Verizon/MCI mergers individually, and especially in light of their combined impact, it is clear that there will occur a significant diminution of advanced services competition at the wholesale level. Not only will these mergers eliminate the most viable competitors in this area – entities which either offer today or are well-poised to offer wholesale advanced services – they will likely increase the ability of the merged entities to engage in practices in the context of contractual negotiations that are antithetical to a properly operating free market.

Section III further explains the impact the proposed mergers will have on the ability of the merged companies to act upon their incentives to engage in anticompetitive discrimination in their broadband and end-to-end services. Once the AT&T and MCI Internet backbone services are combined with the incumbents' local access facilities, the merged companies have both the increased ability and incentive to use existing Internet backbone priority mechanisms and practices already in place as a means of selectively degrading, and so discriminating against, the services of competing IP providers. Moreover, with the mergers' additional loss of competitive advanced services, the merged companies will have increased ability to interfere with the advanced services used by competing retail providers in the SBC and Verizon regions.

Finally, Section IV details suggested conditions that would help ameliorate the harmful public interest impact of these proposed transactions. In particular, the paper describes requirements that would:

- Condition the grant of the mergers upon the merged entities offering in-region stand-alone DSL services, including at wholesale, and with effective, appropriate OSS; and
- Require the merged companies to agree that they will not block, impair or interfere with the traffic traversing their networks, including the traffic of retail competitors who use the merged companies' advanced services as inputs for competitive retail services.

Part and parcel with these conditions, of course, is company compliance with and effective enforcement of them. Moreover, while the requirement of pre-set payments to the U.S. Treasury has been imposed in previous mergers involving SBC and Verizon to deter impermissible conduct (with debatable deterrent value), the potential harm clearly warrants a remedy that helps to set right the injuries caused by merger condition violations. As such, both SBC/AT&T and Verizon/MCI should:

- Have both a company compliance officer and an independent auditor submit publicly available compliance reports; and
- In the context of a swift and expedited enforcement process, competitors harmed as a result of merger violations will have the right to seek and obtain preset damages and/or discounts.

I. ADVANCED SERVICES TODAY: THE CHALLENGE OF A SUCCESSFUL TRANSITION

The wholesale broadband and advanced services market faces both marketplace and regulatory changes as a result of the decisions that will be made in the pending merger approval proceedings. Today, FCC data confirm that the provision of advanced services bandwidth to information service providers ("ISPs") and other service providers on a wholesale basis is confined to the wireline platform.[4] Unlike the market for retail Internet services, cable operators have chosen largely not to participate in the provision of wholesale bandwidth to retail providers.[5] Further, while they may offer promising futures, FCC data also show that neither satellite nor wireless technologies currently offer

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[4] "The record indicates that no third parties are effectively offering, on a wholesale basis, alternative local loops capable of providing narrowband or broadband transmission capabilities to the mass market." *In the Matter of Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers,* Report and Order, 18 FCC Rcd. 16978, ¶ 233 (2003), *partially vacated on other grounds,* USTA v. FCC, 359 F.3d 554 (D.C. Cir. 2004) ("*TRO*"). *See, also,* Appendix A, "Market Concentration and Broadband Access."

[5] For ease of reference, this white paper uses the terms "broadband," "bandwidth," and "advanced services" to refer generally to the services previously defined as "advanced services" in both the mergers of SBC/Ameritech and Bell Atlantic/GTE: "For purposes of these Conditions, the term "Advanced Services" means intrastate or interstate wireline telecommunications services, such as ADSL, IDSL, xDSL, Frame Relay, Cell Relay and VPOP-Dial Access Service (an SBC Frame Relay-based service) that rely on packetized technology and have the capability of supporting transmissions speeds of at least 56 kilobits per second in both directions. This definition of Advanced Services does not include (1) data services that are not primarily based on packetized technology, such as ISDN, (2) x.25-based and x.75-based packet technologies, or (3) circuit switched services (such as circuit switched voice grade service) regardless of the technology, protocols or speeds used for the transmission of such services." *In the Matter of Applications of Ameritech Corp. and SBC Communications Inc.,* Memorandum Opinion and Order, 14 FCC Rcd. 14712, Appendix C, ¶ 2 (1999) ("*SBC/Ameritech Merger Order*") *rev'd in part* ASCENT v. FCC, 235 F.3d 662 (D.C. Cir. 2001); *In the Matter of Application of GTE Corp. and Bell Atlantic Corp.,* Memorandum Opinion and Order, 15 FCC Rcd. 14032, ¶ 2 (2000) ("*Bell Atlantic/GTE Merger Order*").

an alternative to wholesale broadband provisioned today on the wireline network,[6] likely due to the high costs of satellite services and the technical and geographical deployment limitations of terrestrial wireless. Because these proposed mergers will re-shape the current and future wireline industry for years to come, and because the development of innovative, competitive and redundant IP-Enabled communications services is dependent upon the continued availability of robust advanced telecommunications services, it is critical for the merger decisions to take account of the advanced wireline services available today. Only in this way will the outcome of these proposed mergers reflect consumers' expectations for continuing broadband and new services competition in the future.

A. DSL Services

Of wireline special access services, DSL is today perhaps the most central to broadband consumer retail services. Nonetheless, the merging companies almost completely neglect to describe the impact of the proposed mergers on competition for these special access services which, as shown, is significant. While DSL technology had

[6] According to FCC data, fixed wireless and satellite hold insufficient market share (just 1.8%) to be considered serious competition to the incumbent LEC or cable operator in any relevant market. High-Speed Services for Internet Access: Status as of December 31, 2004, Chart 2 – High-Speed Lines by Technology (Jul. 7, 2005); *see also*, *TRO*, ¶ 231 ("The record indicates that, at present, fixed wireless and satellite services remain nascent technologies, with limited availability, when used to provide broadband services to the mass market."); Pew Internet Project Data Memo, at 2 and 6 (April 2004), *found at* http://www.pewinternet.org/pdfs/PIP_Broadband04.DataMemo.pdf (fixed-satellite and wireless providers capture just 3% of the home broadband market).

been employed in the wireline network for many years,[7] in 1998, GTE initiated the first wholesale offering of ADSL service to third-party providers on a bulk basis.[8] At that time all the former Bell Operating Companies ("BOCs"), including SBC and Verizon (then Bell Atlantic), argued that DSL services should be regulated federally as interstate services and, more specifically, as part of the carrier's interstate special access service offerings.[9] Following GTE's lead, the BOCs amended their federal interstate special access tariffs to offer a number of wholesale ADSL services to third-parties, primarily ISPs, on a wholesale basis. Indeed, because the services were wholesale and not retail offerings, the FCC decided in 2000 that these interstate services were not subject to the retail discount provisions of Section 251(c)(4) of the Communications Act, a decision that, according to the Commission, furthered the broadband goals of Section 706 of the Telecommunications Act of 1996 because it facilitated low-cost broadband access to a variety of ISPs who, in turn, could offer affordable and diverse broadband-based services

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[7] *DSL strategic moves: ISPs get aggressive in provisioning high-speed access on their own* at http://telephonyonline.com/mag/telecom_dsl_strategic_moves/index.html (May 18, 1998); *US WEST changes the rules, derails competitor's DSL plans* at http://www.networkworld.com/news/1997/0609giant.html (Jun. 9, 1997) (describing ISPs use of clean copper pairs from alarm tariffs to offer DSL directly to businesses, competing with BOC T1 service).

[8] *In the Matter of GTE Telephone Operating Cos.; GTOC Tariff No. 1; GTOC Transmittal No. 1148*, Memorandum Opinion and Order, 13 FCC Rcd. 22466 (1998) ("*GTE DSL Order*").

[9] *GTE DSL Order*, CC Dkt. 98-79, Comments of Southwestern Bell at 1 (Sept. 18, 1998); Comments of Bell Atlantic at 2 (Sept. 18, 1998).

to consumers.[10] Notably, MCI also offers a competitively priced wholesale DSL service.[11]

The Commission has continued to treat BOC DSL as a special access service subject to increasingly deregulatory treatment. In 1999, the Commission introduced Phase I and Phase II special access deregulation for price-cap carriers.[12] Both Verizon and BellSouth have taken advantage of this price cap relief in their DSL offerings.[13] Finally, most recently, the Commission has deregulated BOC wholesale DSL arrangements almost entirely in its *Wireline Broadband* decision of August 2005. The decision was predicated on the ability of the ISPs and BOCs to move forward into an environment without regulations and where ISPs and BOCs negotiate commercial arrangements for wholesale broadband services, including DSL. If purchasing ISPs have viable broadband access alternatives so that negotiations are significantly more than "take

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[10] *In the Matter of Deployment of Wireline Services Offering Advanced Telecommunications Capability,* Second Report and Order, 14 FCC Rcd. 19237, ¶ 20 (1999).

[11] *See* http://global.mci.com/wholesale/us/internet/, viewed Sept. 19, 2005 (describing MCI's wholesale broadband Private Label DSL Internet service).

[12] *In the Matter of Access Charge Reform; Price Cap Performance Review for Local Exchange Carriers*, Fifth Report and Order and Further Notice of Proposed Rulemaking, 14 FCC Rcd. 14221, ¶ 4 (1999) ("In Phase I, we allow price cap LECs to offer contract tariffs and volume and term discounts for those services for which they make a specific competitive showing. In Phase II, we permit price cap LECs to offer dedicated transport and special access services free from our Part 69 rate structure and Part 61 price cap rules, provided that the LECs can demonstrate a significantly higher level of competition for those services.").

[13] *See In the Matter of Verizon Petition for Pricing Flexibility for Special Access and Dedicated Transport Services*, Memorandum Opinion and Order, 18 FCC Rcd. 6237 (2003); *In the Matter of BellSouth Petition for Pricing Flexibility for Special Access and Dedicated Transport Services*, Memorandum Opinion and Order, 17 FCC Rcd. 23726 (2002).

it or leave it," the FCC's new regulatory environment can be a workable framework that serves the public interest.

B. UNE-L and Broadband Services

UNE-L is another component in today's broadband marketplace. As the Commission has emphasized, UNE-L may hold the key for facilities-based competitors to offer a range of services to consumers, including voice, data, and video, via a single copper pair.[14] EarthLink and Covad, in fact, are currently realizing the potential of line-powered voice using a UNE-L connection to deliver a range of innovative retail services (including data, IP voice and other services) in a manner that is more robust and consumer-friendly than more standard VoIP offerings. Line-powered voice, for example, may permit competitors such as EarthLink and Covad to offer all of the enhancements of voice-over-Internet services without the customer installation of cumbersome CPE or the loss of service due to power outages. This is possible, in large part, due to technological advances of DSLAM equipment offering DSL 2+ capability, which both eliminates the need for traditional line-splitting and offers higher data speed capabilities.[15] While the

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[14] *TRO*, ¶ 258 (noting "the fact that there are a number of services that can be provided over the stand-alone loop, including voice, voice over xDSL (*i.e.*, VoDSL), data, and video services. In so doing, we conclude that the increased operational and economic costs of a stand-alone loop (including costs associated with the development of marketing, billing, and customer care infrastructure) are offset by the increased revenue opportunities afforded by the whole loop.")

[15] Covad currently deploys Samsung access gateway equipment. *Covad and Samsung Announce Upgrade to Covad Nationwide Network that Enables Local and Long Distance Service, Internet Access and Video over DSL*, News Release, Jun. 28, 2005 at http://www.covad.com/companyinfo/pressroom/pr_2005/062805_news.shtml?SrcID=111-0000201546. In addition, Zhone offers digital loop carrier equipment capable of

operational and commercial implementation of the technology is still far from mature, it offers a promising new capability for leveraging UNE-L capacity to provide consumer benefits such as alternative data and voice services, with price and service competition. Similarly, another participant in this proceeding, Telscape Communications, has described how it uses UNE-L to deliver voice services to low-income residences in California, stressing it is "fully dependent on SBC's wholesale provision of residential copper loops."[16]

Notably, UNE-L would also have provided AT&T and MCI with a viable wireline access platform upon which to compete in the broadband markets. While it is true that AT&T and MCI had placed significant emphasis on UNE-P entry, it is equally true that, had they continued in the competitive market, they would certainly have re-evaluated the efficacy of UNE-L competition in light of technological advancements.[17] Such a re-evaluation is not speculative; with the wireline network as their only access platform into the residential markets, these companies would have had to examine the increased potential of UNE-L, much as EarthLink and Covad have done.

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offering voice, data and video solutions via a single copper loop. http://www.zhone.com/products/malc/index.html.

[16] *Ex Parte* Letter from Danny E. Adams, Telscape Communications, Inc, to Chairman Martin, Federal Communications Commission, WC Dkt No. 05-65 at 2 (Jul.29, 2005).

[17] *See also*, Petition to Deny, filed by Cbeyond, et al., WC Dkt. 05-65, Declaration of Simon Wilkie, ¶ 49 (Apr. 25, 2005) ("Wilkie Declaration") (Assertion that AT&T exited the market is problematic because "there is no assurance that, absent the [merger] transaction, AT&T would not re-enter the market." Moreover, assuming that the FCC's *TRO* decisions were correct, then AT&T and MCI "were not impaired without access to UNE switching and local transport. If this is correct, then by the FCC's definition of impairment, it must be that AT&T and MCI can profitably enter the residential market absent the UNEs, and so as rational firms, they will.").

C. Stand-Alone DSL and IP-Enabled Services

Stand-alone DSL offerings also significantly advance both voice competition and the deployment of innovative and competitive broadband services, including VoIP and other IP-enabled services. By affording consumers the ability to select their preferred suite of services without being required to purchase incumbent local voice service, choice is enhanced and the competitive market is allowed to function. As many parties have argued before the Commission[18] and as found by the staff of the New York Public Service Commission as well as the New York Attorney General,[19] stand-alone DSL has the potential to enhance consumers' voice and data service offerings. Currently, Qwest offers a stand-alone DSL service, and has done so since February 2004, demonstrating that there are no technical feasibility barriers to offering stand-alone DSL.[20] Verizon

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[18] *In the Matter of BellSouth Telecommunications, Inc. Request for Declaratory Ruling that State Commissions May Not Regulate Broadband Internet Access Services by Requiring BellSouth to Provide Wholesale or Retail Broadband Services to Competitive LEC UNE Voice Customers*, WC Dkt. 03-251, Comments of Louisiana PSC at 14-17 (Jan. 30, 2004)(contending that state decisions promote competition and encourage deployment of new technologies); Comments of Vonage at i, 1-2 (Jan. 30, 2004)(stating that allowing customers to choose their preferred voice and broadband service provider will spur development of traditional service alternatives); Comments of MCI at 19 (Jan. 30, 2004)(contending that state policies remove impediments to voice competition); Comments of Z-Tel at 11-13 (Jan. 30, 2004)(arguing that requiring a traditional telephone line in addition to broadband access limits VoIP development as a possible replacement for traditional telephone service).

[19] The New York Public Service Commission staff report demonstrated that both the voice and the data markets were highly concentrated and noncompetitive in the New York Verizon region, and that the merger would only add to the troubling market conditions. For those reasons, the PSC staff recommended a stand-alone DSL requirement as part of merger approval to enhance the ability of VoIP services to make competitive inroads. Department of Public Service Staff White Paper, State of New York Public Service Commission, 05-C-0237 and 05-C-0242 (Jul. 6, 2005).

[20] Qwest Corporation, Tariff F.C.C. No. 1, § 8.4.1.A.

offers stand-alone DSL subject to certain restrictions. SBC has never offered a stand-alone DSL service.

Verizon in April 2005 announced a type of stand-alone DSL. The offering is restrictive and confusing in its terms and conditions. And, even when the stated restrictions do not apply, consumers have also reported substantial difficulties in actually ordering the service. Among the most confusing conditions, consumers that may take local phone services from some CLECs in the former Bell Atlantic regions are able to order the service only if their CLEC provides Verizon line-sharing for free.[21] Similarly, Verizon's stand-alone service is not available if a truck roll (*i.e.*, "dispatch of Company personnel") is required in connection with the discontinuance of Verizon local telephone service.[22] Such restrictions unnecessarily complicate the process for consumers seeking to obtain stand-alone DSL and restrict a potentially vital venue for consumer-based market decisions. Moreover, anecdotal evidence indicates that even this somewhat limited stand-alone DSL service is not, in fact, available because consumer requests are often denied, evidencing clear implementation problems that require attention.[23]

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[21] Verizon Telephone Companies, Tariff F.C.C. No. 20, § 5.1.2.D (3); Verizon Transmittal No. 614 (effective Sept. 10, 2005).

[22] Verizon Telephone Companies, Tariff F.C.C. No. 20, § 5.1.2.D (1); Verizon Transmittal No. 614 (effective Sept. 10, 2005). *See also* restrictions on service in former GTE areas.

[23] *Naked DSL: no shoes, no shirt, no service*, May 2, 2005, CNET, at http://reviews.cnet.com/4520-6028_7-6215358-1.html. ("So I thought I'd stick with Verizon, and after failing to sign up at its Web site, I called the company up. But I got the same story there, where I used the word *unbundled* instead of *naked* to describe the DSL service it supposedly was offering. The Verizon service rep told me that naked DSL wouldn't happen for another few months . . ."); *Verizon: We Sell Naked DSL*, May 30, 2005, Multichannel News (Despite Verizon's claims that its allegedly "naked" DSL was

D. Contract Negotiations and Broadband Competition

Even before the FCC's recent *Wireline Broadband* decision,[24] EarthLink's preferred option and its regular business practice has been to obtain necessary broadband inputs through contractual negotiated arrangements with willing vendors in the context of a competitive supply market. Contractual negotiations permit EarthLink to formulate specific vendor requirements and services that best serve the retail consumers of EarthLink's services, such as service level agreements, specific OSS interfaces, particular build-out schedules and product development requirements, all of which help EarthLink to deliver new and innovative services to retail consumers in the marketplace. While tariffs have offered some regulatory backstop, unnecessary terms and conditions of service that are suboptimal to the relationship between EarthLink and its vendors, such as are found in many tariffs, are less advantageous. Indeed, tariffs traditionally favor the tariffing carrier since it is the carrier that unilaterally sets the terms of service and it is the carrier that is protected by the filed rate doctrine and other regulatory processes. In fact, it has been the case, in EarthLink's experience, that reliance upon regulators to mitigate incumbent carriers' ability to dictate unilaterally tariff terms is not practical and that contracts can well serve effective and successful relationships.

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generally available, "[a] spot check by a reporter who takes Verizon local phone and DSL services in the D.C. market turned up contrary evidence. A Verizon customer-service representative last Wednesday told the reporter that dropping the company's telephone service would require dropping DSL. A Verizon spokesman said naked DSL is an option when switching voice providers not when seeking to drop just Verizon voice service.").

[24] *FCC Eliminates Mandated Sharing Requirement on Incumbents' Wireline Broadband Internet Access Services*, FCC News Release, CC Dkt. 02-33 (Aug. 5, 2005).

EarthLink recognizes that both SBC and Verizon have committed to the Commission in the USIIA Memorandum of Understanding to offer broadband access to ISPs on a wholesale basis through a fair and balanced contractual negotiation.[25] EarthLink accepts and even looks forward to such negotiations to allow it to provide both DSL and fiber-based retail communications services to consumers. As long as negotiating leverage and bargaining power is not skewed in the incumbent carriers' favor, contractual negotiations can be the optimal vehicle for securing wholesale advanced services inputs.

The merger approval process, however, will seriously affect the success of this approach – either hurt or help – as the parties undertake the negotiation process because, as shown below, the mergers as proposed will certainly reduce the competitive options available to EarthLink and others, significantly skewing the bargaining posture of the negotiations. It is not too strong a statement to underscore that the success of the Commission's actions in the broadband regulatory arena will be measured by how well contractual negotiations and, ultimately, service to the public was improved by the elimination of a regulatory aspect of the relationship between the BOCs and the ISPs. Effectively, the decisions made in connection with the proposed mergers will either hinder or buttress the Commission's broadband goals.

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[25] *See Memorandum of Understanding SBC and USIIA*, May 2, 2002, at www.usiia.org/news/SBCMOU.pdf and *Memorandum of Understanding Verizon and USIIA*, Jun. 25, 2002, at www.usiia.org/news/VerizonMOU.pdf.

II. THE PROPOSED MERGERS WILL DIMINISH COMPETITION AND HARM THE PUBLIC INTEREST

The dramatic impact of the SBC/AT&T and Verizon/MCI mergers on the competitive landscape is central to the Commission's review of the proposed transactions. A query into previous FCC merger reviews and orders demonstrates the FCC's consistent recognition and consideration of the impact on actual and future competition resulting from a proposed merger. The FCC also recognizes that while in some instances a merger may result in cost and other efficiencies, these same efficiencies might cause harm as well and thus, the FCC makes detailed inquiries into and analysis of whether a proposed merger will serve the broader public interest. The mergers of AT&T and MCI with SBC and Verizon, respectively, will result in the loss of the largest actual and potential competitors in the wholesale broadband market in both the SBC and Verizon regions, which in turn will adversely impact the public interest in numerous ways.

A. FCC Must Review Mergers' Effects on Actual and Potential Competition

Sections 214(a) and 310(d) of the Communications Act require the FCC to approve a merger only where the applicants have shown that the proposed merger will serve the public interest, convenience, and necessity.[26] The FCC's evaluation must "encompass[] the 'broad aims of the Communications Act,' which include. . . a deeply rooted preference for preserving and enhancing competition in relevant markets [and]

[26] 47 U.S.C. §§ 214(a), 310(d).

accelerating private sector deployment of advanced services. . . ."[27] Thus, the FCC is mandated to inquire and analyze actual competition as well as future competition in the marketplace in determining the mergers' impact on the public interest.[28]

Both the U.S. Department of Justice ("DOJ") and the FCC recognize that the elimination of an actual or a potential entrant as a result of a merger can cause harm to the public interest. Under the *Horizontal Merger Guidelines*, the DOJ will perform an "entry analysis" in its inquiry into the competitive effects of a merger in order to determine whether a certain market can be easily entered by potential entrants, telling of the importance of such issue.[29] DOJ also recognizes that "by eliminating the possibility of entry by the acquiring firm in a more procompetitive manner, the merger could result in a lost opportunity for improvement in market performance resulting from the addition

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[27] *In the Matter of Applications of Nextel Communications, Inc. and Sprint Corporation*, Memorandum Opinion and Order, FCC 05-148, ¶ 21 (rel. Aug. 8, 2005) ("*Sprint/Nextel Merger Order*").

[28] *See, e.g., Sprint/Nextel Merger Order*, ¶ 22 ("In addition to considering whether the merger will reduce existing competition, therefore, we also must focus on. . . the merger's effect on future competition."), *Bell Atlantic/GTE Merger Order*, ¶ 23 ("The Commission must make an independent public interest determination that includes an evaluation of the merger's likely effect on future competition."). *See also, In the Matter of AT&T Corp., British Telecommunications, plc, VLT Co. L.L.C., Violet License Co. LLC, and TNV [Bahamas] Limited Applications*, Memorandum Opinion and Order, 14 FCC Rcd. 19140, ¶ 15 (1999); *In the Matter of Applications for Consent to the Transfer of Control of Licenses from Comcast Corporation and AT&T Corp., Transferors, to AT&T Comcast Corporation, Transferee*, Memorandum Opinion and Order, 17 FCC Rcd. 23246, ¶ 28 (2002) ("*AT&T/Comcast Merger Order*").

[29] United States Dept. of Justice and Federal Trade Com'n Horizontal Merger Guidelines (1992), Section 3 at http://www.usdoj.gov/atr/public/guidelines/hmg.htm. The Entry Analysis presupposes that easy entry into a market will likely deter any anticompetitive effect from the merger.

of a significant competitor."[30] Likewise, while the FCC is not limited to the consideration of traditional antitrust principles in determining the competitive effects of a merger,[31] the Commission's analysis is informed by these same principles.[32]

Indeed, the Communications Act requires the Commission to make an independent public interest determination, including an evaluation of a merger's public interest benefits or harms and likely effect on future competition, while an antitrust

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[30] U.S. Dept of Justice Merger Guidelines (1984), Section 4 at http://www.usdoj.gov/atr/public/guidelines/2614.htm. This section was specifically not superseded by 1992 revisions.

[31] "In determining the competitive effects of the merger, our analysis is informed by, but not limited to antitrust principles." *Sprint/Nextel Merger Order*, ¶ 22. *See also, In the matter of Applications of AT&T Wireless Services, Inc. and Cingular Wireless Corporation*, Memorandum Opinion and Order, 19 FCC Rcd. 21522, ¶ 42 (2004); *In the Matter of General Motors Corporation and Hughes Electronics Corporation, Transferors And The News Corporation Limited, Transferee, For Authority to Transfer Control*, Memorandum Opinion and Order, 19 FCC Rcd 473, ¶ 17 (2003); *In the Matter of Application of EchoStar Communications Corporation, General Motors Corporation, and Hughes Electronics Corporation (Transferors) and EchoStar Communications Corporation (Transferee)*, Hearing Designation Order, 17 FCC Rcd. 20559, ¶ 27 (2002)("*Echostar/Hughes Hearing Designation Order*"); *Bell Atlantic/GTE Merger Order*, ¶ 23; *AT&T/Comcast Merger Order*, ¶ 28; *In the Matter of Applications for Consent to the Transfer of Control of Licenses and Section 214 Authorizations from Tele-Communications, Inc., Transferor To AT&T Corp., Transferee*, 14 FCC Rcd. 3160, ¶ 14 (1999); *In the Matter of Application of WorldCom, Inc. and MCI Communications Corporation for Transfer of Control of MCI Communications Corporation to WorldCom, Inc.*, Memorandum Opinion and Order, 13 FCC Rcd. 18025, ¶ 13 (1998)("*WorldCom/MCI Merger Order*"). *See also In the Matter of Satellite Business Systems*, Memorandum Opinion, Order, Authorization and Certification, 62 F.C.C.2d 997,¶ 268 (1977), aff'd sub nom United States v. FCC, 652 F.2d 72 (D.C. Cir. 1980) (en banc); Northern Utilities Service Co. v. FERC, 993 F.2d 937, 947-48 (1st Cir. 1993) (public interest standard does not require agencies "to analyze proposed mergers under the same standards that the Department of Justice . . . must apply").

[32] For instance, in analyzing a transaction, the FCC looks to the DOJ's Horizontal Merger Guidelines to define and assess "market power:" "A horizontal transaction is unlikely to create or enhance market power or facilitate its exercise unless it significantly increases concentration and results in a concentrated market, properly defined and measured." *Sprint/Nextel Merger Order*, ¶¶ 30-31.

analysis focuses solely on whether the effect of a proposed merger "may be substantially to lessen competition." [33] In order to find that a merger is in the public interest, therefore, the Commission must "be convinced that it will enhance competition."[34]

Further, in its review, the FCC must consider the anticompetitive impact resulting from loss of potential entrants as a result of a merger, especially when, as here, the markets at issue are already highly concentrated pre-merger.[35] Recognizing the importance of competition in communications markets, the FCC has repeatedly found that a merger resulting in the loss of a potential entrant into the market raises crucial competitive concerns and warrants investigation into the effect on the public interest. Most recently, in the Sprint/Nextel merger, the FCC held that "[w]hen a merged firm would hold a large, post-transaction market share, it is necessary to evaluate the number of competitors and potential entrants who are close substitutes for the merging parties in order to determine the likelihood of competitive harm."[36] Further, in the SBC/Ameritech merger, the FCC spelled out its concerns that the merger would result in loss of a "significant potential competitor" in portions of each other's region and resulting in "potential public interest harm" that required certain divestures and other conditions for approval of the merger.[37] Thus, in these merger proceedings, the FCC is obligated to

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[33] Section 7 of the Clayton Act, 15 U.S.C. § 18; *WorldCom/MCI Merger Order*, ¶12 ("Pursuant to our authority under the Communications Act, we are required to make and independent determination whether a proposed merger will serve the public interest.").

[34] *In the Applications of NYNEX Corporation Transferor, and Bell Atlantic Corporation Transferee*, Memorandum Opinion and Order, 12 FCC Rcd. 19985, ¶ 2 (1997).

[35] *See* Appendix A.

[36] *Sprint/Nextel Merger Order*, ¶ 92.

[37] *SBC/Ameritech Merger Order*, ¶ 99.

investigate AT&T and MCI as actual *and* potential entrants into SBC and Verizon's regions and address the anticompetitive effects resulting from elimination of such entry.

B. The Mergers Will Remove the Two Largest Actual and Potential Wireline Competitors for SBC and Verizon

The records in these proceedings demonstrate convincingly that MCI and AT&T are the two last and best-positioned nationwide competitive LECs in each of the SBC and Verizon regions.

For example, the FCC's former Chief Economist has presented testimony that the effect of the SBC/AT&T merger would be to:

> consolidate the first and second largest providers of long distance telecommunications services in approximately 40 percent of the nation, combine the first and second largest providers of retail local exchange services in the same region, and merge the owner of the largest holder of local network facilities in SBC region with the owner of one of the two largest sets of CLEC local networks in that region. When considered in the broader context of the proposed Verizon-MCI merger, the situation is even more complicated as that transaction would result in the loss of the third largest competitor in the region as well, with no other competitive service providers of sufficient size and scale available to replace them in the marketplace.[38]

Similarly, Professor Bernheim has noted that "AT&T has been a leader among competitive local exchange carriers (CLECs)" both in terms of wholesale provisioning, the number of deployed voice and data switches, as well as its facilities, including "21,000 route miles of local fiber" and that "AT&T-owned facilities connected about 6,400 buildings in 2004."[39] Further, Professor Bernheim presented evidence that "in

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[38] Wilkie Declaration at ¶5.

[39] Petition to Deny, filed by Qwest, WC Dkt. 05-65, (Jun. 25, 2005), Declaration of B. Douglas Bernheim, ¶ 41 ("Bernheim Declaration").

terms of voice switches, MCI is number two," and seventh in terms of data switches.[40] In terms of access lines, "MCI is number two**,** with *six* million. The next closest competitor in terms of access is McLeod with one million-far less than either MCI or AT&T. MCI is also the second largest CLEC in terms of revenue."[41]

This expert testimony also makes notable and relevant observations of fact on the wholesale markets impacted by the merger of SBC and AT&T: "AT&T's wholesale offerings compete directly with SBC's special access products. By removing the competitor with one of the two largest sets of CLEC local networks in the SBC region, the merger would likely lead to significant increases in these prices."[42] In the special access markets, AT&T and MCI have exerted unique constraints on BOC pricing behavior by obtaining substantial discounts on BOC services from the BOCs "due . . . to AT&T's and MCI's scale and scope and extensive local facilities, which appear to give them much more bargaining power and a more credible threat to deploy their own facilities."[43]

While each of the mergers alone impede competition and heighten monopoly concerns in the wholesale local access market, as Professor Wilkie has shown, the combined effect of the two mergers is even more threatening to the public interest: "the combination of SBC controlling AT&T and Verizon controlling MCI creates a 'perfect

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[40] *Id.* at ¶ 42.

[41] *Id.*

[42] Wilkie Declaration at ¶ 6.

[43] *Id.* at ¶ 11.

storm' for tacit collusion with the resulting coordinated effects harming consumers."[44] As Professor Wilkie also shows, SBC and Verizon retail DSL pricing in the Los Angeles market already exhibits collusive traits, with both companies declining to compete against one another;[45] common sense dictates that one would expect no better, more competitive post-merger behavior. Similarly, the preeminent economist Professor Bernheim has testified in the record that the combined mergers are likely to create a market of "mutual forbearance" between SBC and Verizon, in which both choose to avoid competition with the other.[46]

C. The Mergers Will Substantially Harm the Market for Wholesale Broadband Access

One of the most striking aspect of the records to date in these proceedings is that – given the statutory importance placed on the deployment of broadband by Congress in Section 706 of the Telecommunications Act of 1996, as well as the Commission's own focus and decision-making to spur the growth of more competitive, low-cost broadband services to the American public – there is little, if any, serious examination given to the effects of the mergers on broadband services.[47] The Commission's review of these mergers, however, must recognize that Congress has solely vested the Commission with

[44] *Id.* at ¶ 28.

[45] *Id.* at ¶ 38.

[46] Bernheim Declaration at ¶10.

[47] Notably, in Verizon's lengthy white paper responding to concerns regarding its position in the special access market, it fails even to mention broadband, despite the fact that these are special access services. Special Access White Paper, filed by Verizon, WC Dkt. 05-75, filed Aug. 25, 2005. *See also SBC/AT&T Merger Application*, Description of the Transaction, Public Interest Showing, and Related Demonstrations, *supra* n. 2.

the responsibility to ensure that its actions, including merger approvals, will not hamper or dampen, but will likely further, the deployment and proliferation of broadband services. As it recently explained, "[t]he Commission . . . is charged with determining whether the transfer of licenses serves the broader public interest. In the communications industry, competition is shaped not only by antitrust rules, but also by the regulatory policies that govern the interactions of industry players."[48]

The Commission's merger review must, therefore, take account of the facts that the proposed mergers will eliminate MCI and AT&T as significant actual and potential entrants in the wholesale broadband access market. In MCI's case, it currently offers a wholesale DSL service, Private Label DSL Internet, which is used by EarthLink and other ISPs.[49] MCI markets that this is service available to large enterprise customers and Internet Service Providers, and it allows customers to "brand" their own Internet service either for their own internal use or for use as a retail broadband service to the public.[50] MCI is no small entrant into this market. Indeed, in 2001, WorldCom (now MCI)

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[48] "DOJ reviews mergers pursuant to section 7 of the Clayton Act, which prohibits mergers that are likely to lessen competition substantially in any line of commerce. The Commission, on the other hand, is charged with determining whether the transfer of licenses serves the broader public interest. In the communications industry, competition is shaped not only by antitrust rules, but also by the regulatory policies that govern the interactions of industry players. In addition to considering whether the merger will reduce existing competition, therefore, we also must focus on whether the merger will accelerate the decline of market power by dominant firms in the relevant communications markets and the merger's effect on future competition." *In the Matter of Applications of Western Wireless Corporation and ALLTEL Corporation For Consent to Transfer Control of Licenses and Authorizations*, Memorandum Opinion and Order, FCC 05-138, ¶ 20 (2005) (internal citations omitted).

[49] http://global.mci.com/wholesale/us/internet/, viewed Sept. 19, 2005.

[50] *Id.*

acquired Rhythms Net Connections,[51] one of the country's major independent wholesale DSL providers, which positioned WorldCom as a "facilities-based provider of DSL service." As WorldCom explained it, "[w]ith the recent acquisition of Rhythms DSL assets, WorldCom is now a facilities-based provider of DSL service in over 700 central offices covering 31 markets across the United States. WorldCom provides DSL service in these circumstances using its own electronics, *i.e.* DSLAMs, and the BOCs' unbundled loops. With the Rhythms DSL assets, WorldCom is able to deliver DSL service to wholesale and retail customers who can access WorldCom's complete suite of data and Internet services."[52] EarthLink's current wholesale DSL agreement with MCI, amended as recently as 2004, contemplates MCI's wholesale DSL access service to EarthLink in over 25 major U.S. metropolitan markets,[53] with pricing and terms of service competitive with that of Verizon's and SBC's wholesale DSL services. Moreover, the continuing wholesale DSL service MCI provides to EarthLink demonstrates that MCI has acquired the necessary commercial line-sharing arrangements and that it has local facilities (*i.e.*, collocations, cross-connects, etc.), DSLAMs, management and staff, and upstream

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[51] *In the Matter of Rhythms Links Inc. Section 63.71 Application to Discontinue Domestic Telecommunications Services*, Order, 16 FCC Rcd 17024, ¶ 14 (CCB 2001) (Approving Rhythms' Section 214 discontinuance application, and noting with favor WorldCom's bid for Rhythms' xDSL assets and customer commitments to offer service.).

[52] *In the Matter of Request for Comments Deployment of Broadband Networks and Advanced Telecommunications*, NTIA Dkt. No. 011109273-1273-01, Comments of WorldCom, Inc. at Sec. I (Dec. 19, 2001).

[53] Due to contractual confidentiality restrictions, EarthLink is not able to disclose the material terms of its wholesale DSL arrangement with MCI.

network services capable of making such a nationwide wholesale DSL offering.[54] Post-merger, however, it is wholly unreasonable to expect that Verizon will support the continuation of this competitive wholesale broadband access service.

As a potential entrant, the pre-merger AT&T also exerts a significant effect on the market for wholesale broadband access services.[55] Similar to MCI's acquisition of Rhythms, AT&T acquired NorthPoint Communications, a competitive data provider, in 2001 for $135 million, acquiring numerous assets to provide a wider array of data services to its customers, including DSL.[56] An AT&T press release at the time declared that "acquiring NorthPoint's DSL assets . . . will help us in our efforts to move aggressively to bring the full benefits of DSL to consumers and businesses," and articles quote AT&T representatives who announced, "DSL is going to be a key focus for us."[57]

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[54] It is also significant to note that MCI is unique among potential entrants because it had a significant cash reserve of $5.6 billion at the time of the merger announcement with Verizon by which MCI could have further supported and expanded its entry into the wholesale broadband access service. *Verizon to Acquire MCI for $6.8B*, Feb. 14, 2005, Forbes.com.

[55] United States v. Penn-Olin Chemical Co., 378 U.S. 158, 174 (1964) ("The existence of an aggressive, well equipped and well financed corporation engaged in the same or related lines of commerce waiting anxiously to enter an oligopolistic market would be a substantial incentive to competition which cannot be underestimated.").

[56] *AT&T Acquires Assets of NorthPoint Communications*, News Release, Mar. 22, 2001 at http://www.att.com/news/2001/03/22-3726; *In the Matter of Request for Comments Deployment of Broadband Networks and Advanced Telecommunications*, NTIA Dkt. No 011109273-1273-01, Comments of AT&T at Sec. A (Dec. 19, 2001). As early as 1999, AT&T had announced its intention of offering wholesale DSL services to ISPs. AT&T News Release, "AT&T rolls out DSL Internet access for businesses and ISPs" (April 27, 1999), *found at*, http://www.att.com/news/1999/04/27-667.

[57] *AT&T Acquires Assets of NorthPoint Communications*, News Release, Mar. 22, 2001 at http://www.att.com/news/2001/03/22-3726; *AT&T Buys NorthPoint*, May 2001, http://www.phoneplusmag.com/articles/151bnew2.html; *AT&T buys NorthPoint assets*, Mar. 22, 2001 at http://news.com.com/ATT+buys+NorthPoint+assets/2100-1033_3-254629.html.

Specifically, under the acquisition AT&T acquired: collocations in 1,920 locations, 3,000 DSLAMs and other DSL networking equipment, 153 ATM switches, and the associated systems (hardware and software) to support the provisioning, engineering, testing and maintenance functions.[58]

Thus, there can be no denying that AT&T intended to move aggressively into the broadband space: "[w]e've been saying for a long time that DSL is a key part of our consumer strategy" and the NorthPoint purchase "gives us a great infrastructure in areas where there are lots of consumers."[59] Indeed, AT&T promised regulators as much, with the California Public Utilities Commission approving the NorthPoint acquisition in reliance on AT&T's asserted "commitment to fully utilize the collocations sites and DSL equipment in California that it has agreed to purchase from NorthPoint."[60] Finally, AT&T is currently a provider of retail DSL-based services: "AT&T has about 1.2 million customers for its WorldNet and DSL services."[61]

Both AT&T and MCI represent powerful potential entrants, individually and in combination, and, as such, they currently exert an important market influence over the current BOC wholesale broadband access services. As the Commission has explained in

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[58] Statement of C. Michael Armstrong (Chairman/CEO, AT&T Corp.) to the Senate Committee on Commerce, Science and Transportation, at 5 (Jun. 16, 2001); *In the Matter of Request for Comments Deployment of Broadband Networks and Advanced Telecommunications,* NTIA Dkt. No 011109273-1273-01, Comments of AT&T at Sec. A (Dec. 19, 2001).

[59] *AT&T buys NorthPoint assets*, Mar. 22, 2001 at http://news.com.com/ATT+buys+NorthPoint+assets/2100-1033_3-254629.html

[60] *In the Matter of NorthPoint Communications, Inc. Request for Transfer of Useful Assets to AT&T Corporation Pursuant to the Requirements of Section 851 of the Public Utilities Code*, Resolution, CPUC T-16530 at 6 (May 14, 2001).

[61] *SBC/AT&T Merger Application,* Declaration of John Polumbo, AT&T, at ¶ 12.

the *SBC/Ameritech Merger Order*, a "significant potential entrant" is a telecommunications company with "operational capabilities necessary" to enter the market, "access to the necessary facilities, 'know how,' and operational infrastructure such as customer care, billing, and related systems . . . ."[62]

Moreover, the Commission has emphasized the likelihood of potential entry greatly increases where the company has interconnection expertise, facilities and network in place to expand into the new service or market, as well as good brand recognition. AT&T and MCI currently have all of these attributes for significant entry into the wholesale broadband access market. As discussed above, they both have significant market presence in the major U.S. markets, they both have unparalleled network capabilities, "know how" and management skills, existing customer care and billing structures, as well as advanced skills and knowledge of interconnection and resale agreements. Equally important, both companies have the brand recognition that is quite unique in the telecommunications industry; indeed, some publicly speculate that SBC will change its name to AT&T after the merger to take advantage of the superior brand.

Indeed, even if one *arguendo* discounts the competitive entry plans of MCI and AT&T into the wholesale broadband access market, the anticompetitive effects on the market cannot be denied because, each of AT&T and MCI is, as the Supreme Court has explained, "a potential competitor in the sense that it was so positioned on the edge of the market that it exerted beneficial influence on competitive conditions in that market."[63] As the Supreme Court has also explained, the merger of an actual and potential

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[62] *SBC/Ameritech Merger Order*, ¶¶ 83-84.

[63] U.S. v. Falstaff Brewing Corp., 410 U.S. 526, 532-33 (1973).

competitor raises serious competitive concerns under antitrust law because a potential competitor "at the edge of the industry exert[s] considerable influence on the market" especially where (1) the industry is "influenced by each firm's predictions of the market behavior of its competitors, actual and potential," (2) "the barriers to entry by [the potential competitor of its] size and with its advantages were not significant," (3) "the number of potential entrants was not so large that the elimination of one would be insignificant, and (4) the potential entrant is "the most likely entrant."[64] Surely, AT&T and MCI possess all of these qualities of potential entrants into the wholesale broadband access market.

In short, all relevant factors indicate that the Commission should evaluate the effect of the merger on the wholesale advanced services market by treating AT&T as a significant potential entrant in that market and treating MCI as a significant actual and potential entrant in that market.[65] Notably, when faced with a merger of potential entrants in the broadband market, the Commission's *Echostar/Hughes* decision recognized the "harm to competition that will result from combining" the assets "of the two strongest existing potential entrants" where "serious questions remain as to whether the proposed transaction would do significant and irreversible damage to competition in

[64] Federal Trade Commission v. Proctor & Gamble Co., 386 U.S. 568, 581 (1967).

[65] Nor is the significance of the loss of AT&T and MCI as *potential* entrants diminished by the fact that neither company has yet achieved significant *actual* competition with a critical mass of DSL customers. As the FCC has explained in the *SBC/Ameritech Merger Order*, "[t]he harm is significant because both firms are among a very few that are poised on the edge of an entrenched monopolist, with genuine abilities to challenge that monopolist." *Id.* at ¶ 99.

several markets without sufficient offsetting and cognizable public interest benefits."[66] The same, if not greater, harm to the broadband access market is presented in the two pending mergers which propose to combine the top two significant potential competitors with the two dominant providers of wholesale broadband access.

D. The Mergers As Proposed Will Harm Consumer Welfare

As discussed above, the effect of the merger approvals would be to take away not just one competitive entrant, each with the ability to offer actual competition and a presence as a potential competitor to constrain BOC pricing. These mergers, however, deliver the telecommunications services marketplace a one-two punch – both of the top two actual competitors and potential entrants in SBC and Verizon regions, along with their combined competitive facilities and unique assets, will be eliminated entirely. And, what will be left after the mergers are a set of much more diminutive competitive LECs, already hobbled by limited size and financial ability, that are unlikely collectively to pose an actual or potential threat to either SBC or Verizon.[67] Effectively, what is left post-merger is the re-assembly of the pre-1984 divestiture AT&T, strengthened by the end-to-end Internet facilities of AT&T and MCI.

EarthLink need not belabor the economic consequences for consumers should the Commission decide to approve two mergers that restrict competition and eliminate two significant competitive entrants. EarthLink's own experience, however, is telling of the

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[66] *Echostar/Hughes Hearing Designation Order*, ¶¶ 286-287.

[67] As Professor Wilkie points out, the combined effect of the mergers is to eliminate the two largest BOC competitors "with no other competitive service providers of sufficient size and scale available to replace them in the marketplace." Wilkie Declaration at ¶ 5.

effects that are sure to be felt by consumers. The loss of price competition, of course, for wholesale DSL access both emboldens the merged companies to raise wholesale prices for broadband access, as has been well documented in the special access markets, and it restricts the vendors to whom EarthLink can choose to contract with. The higher input prices and lack of choice have direct negative consequences for consumers. Consumers will not experience price competition from EarthLink, since the merger companies will function both as a retail competitor and virtually the only wholesale supplier, and thus can control EarthLink's costs of providing services. Further, consumers will face a market that is bereft of alternative or redundant data networks by which consumers can communicate when the BOC network should fail, particularly in light of the natural disaster and terrorist security concerns of recent years.

III. THE PROPOSED MERGERS WILL INCREASE THE POTENTIAL FOR ANTICOMPETITIVE ABUSES

Both SBC/AT&T and Verizon/MCI have told the Commission that the purpose of these mergers is to combine SBC and Verizon's assets with AT&T and MCI's assets to create two unified, end-to-end networks capable of providing IP connectivity for VoIP and other IP-based services. The vertical integration of two companies with substantial market power in the last mile markets (Verizon and SBC) with two companies with global, unregulated Internet backbones (MCI and AT&T) will, however, allow the two combined companies to discriminate against their in-region retail competitors through targeted service degradation. Indeed, given IP traffic growth, it is reasonable to assume that the vast majority of in-region traffic that either originates from or is destined for the SBC/AT&T or Verizon/MCI network will travel over the merged companies' unregulated Internet backbones, and each of the merged companies will have an incentive and the ability to degrade selectively the transmissions of their retail competitors while avoiding detection and regulation. Moreover, for competitive service providers in the SBC and Verizon regions, the anticompetitive effects of the mergers on potential and actual entry in the advanced services market, as discussed above, will make such discriminatory conduct virtually impossible to avoid.

Thus, the merged companies' backbones are able to program the routers on their networks to identify incoming traffic using any number of different criteria,[68] including by source (*i.e.*, provider) or destination (*i.e.*, receiver). Thus, the merged companies

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[68] *See Ex Parte* Letter from John W. Butler, EarthLink, to Marlene Dortch, Secretary, Federal Communications Commission (Aug. 26, 2005), Declaration of Greg Collins at ¶ 5 ("Collins Declaration").

would be able to identify the source of the Internet traffic using existing network components, without any need to install additional hardware and software after the mergers since all major networks today are capable of identifying incoming Internet traffic in this way. This is evidenced by the fact that every Internet backbone provider ("IBP") has its own internal eligibility requirement for peering with other IBPs, such as minimum connection speed and traffic ratios. No peering arrangement could be implemented unless the amount, nature, and source of all incoming traffic were readily identifiable.[69] Thus, the identification of a competitor's Internet traffic is entirely possible without any technical impediments to the Applicants.

Once the incoming traffic is identified, the merged companies could prioritize the traffic crossing its backbone by creating "queues," or rules governing the transmission priority that different classes of traffic would receive. Today, queuing is generally used to assign priority for certain types of traffic that require a greater level of quality. Some Internet-based services, like VoIP, are extremely sensitive to even minor degradations of speed or service quality. This traffic would ordinarily get queuing priority over other traffic, like Internet access services. After the mergers, however, the merged companies could also use the queuing technique already in commercial practice to degrade selectively the transmissions of their retail competitors.[70] Having identified the IP traffic of a retail competitor, the merged companies could configure the network to have this traffic moved to the last queue, which would cause serious degradation to the

[69] *Id.* at ¶ 8.

[70] *Id.* at ¶ 6.

competitor's service quality. In addition, the merged companies would also have the ability to discriminate in the same way against a competitor's Internet access service.[71]

Equally significant, but somewhat less invidious, is the tacit discrimination these merged companies can engage in when controlling the end-user's bandwidth usage among multiple services. For example, end-user customers that use broadband access for VoIP, high-speed Internet access, and video may exceed the bandwidth capabilities of their access arrangement, requiring the incumbent LEC to make prioritizations of traffic. It stands to reason that, given the opportunity, the incumbent will prefer its own services over those of a competing provider by using service degradation and bandwidth limitations as an anticompetitive tool.

Not only would the merged companies be able to use selective degradation to harm the Internet-based services of their retail competitors (*i.e.,* VoIP, Internet access, etc.), but they would be able to do so without degrading their own service at all. A customer whose service *never* works in-region (*i.e.,* a customer of the degraded provider) is likely to blame his own carrier for the problem. The customer of the merged company, however, would notice a loss of service quality *only* when a customer of the degraded company initiated the communication. Under these circumstances, the customer of the merged company is likely to assume that the problem is not with his or her own provider, but with the other's person's provider. Thus, the relative degradation of service would be close to 100% for customers of the targeted retail competitor, but very infrequent for

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[71] *See Ex Parte* Letter from John W. Butler, EarthLink, to Marlene Dortch, Secretary, Federal Communications Commission (Aug. 26, 2005) at 9 ("EarthLink Letter, Aug. 26").

customers of the merged company.[72] As a result, the merged company's customer is not likely to switch service providers, and the dissatisfied customers of degraded service would naturally turn to the merged incumbent companies for alternative service.

Finally, addressing this issue in the context of the merger approvals is critical because it is quite unlikely for the Commission to move effectively on such a matter on a case-by-case *ad hoc* basis.[73] First, given the uncertain regulatory status of VoIP, the Commission's authority to prevent such tactics in any portion of the network is unclear. Second, to the extent the discrimination occurs in the backbones, the fact is they have never been regulated by the Commission. Thus, targeted service degradation is not simply a last mile issue that the Commission is capable of monitoring, but instead a problem throughout the networks of the merger companies.

[72] Collins Declaration at ¶ 5.

[73] EarthLink Letter, Aug. 26 at ¶¶ 8-9.

IV. THE COMMISSION SHOULD REMEDY THE PUBLIC INTEREST HARMS BY CONDITIONING THE MERGERS

The proposed mergers present substantial public interest concerns that must be addressed if the grant of approval is to be found in the public interest. In particular, to redress the diminution of competition for wholesale advanced services and the increased ability and opportunity to engage in anticompetitive conduct with respect to advanced services traffic, remedies are suggested that would require: stand-alone DSL; non-interference with traffic traversing the merged companies' networks; and effective compliance and enforcement measures to help ensure the conditions serve their intended purpose.[74]

[74] EarthLink also strongly supports the remedies proposed by numerous parties to this merger regarding other special access services, including the need for special access performance metrics, promotional discounts, non-discrimination, and a fresh look for current customers of Verizon and SBC with the opportunity to reduce purchase commitments without termination penalties or the loss of discount eligibility. *See, e.g., Ex Parte* Letter from Melissa E. Newman, Qwest, to Marlene Dortch, Secretary, Federal Communications Commission, WC Dkt Nos. 05-65, 05-75, Attachment at 5-8 (Sept. 1, 2005); *Ex Parte* Letter from John T. Nakahata, Level 3, to Marlene Dortch, Secretary, Federal Communications Commission, WC Dkt Nos. 05-65, 05-75, Attachment at 2 (Jun. 17, 2005). Moreover, EarthLink believes that regardless of what other conditions are imposed, the FCC must make exceedingly clear that the merging parties must honor all existing AT&T and MCI contracts. As a customer of special access services (and as a customer of other vendors who purchase directly from the parties to these proposed mergers), EarthLink is certainly concerned about the mergers' impact on these services. This white paper, however, focuses primarily on the conditions impacting the availability and terms of advanced services as discussed above.

A. Stand-Alone DSL

Given the importance of assuring that consumers can avail themselves of retail broadband-based service options, and the significant competitive harm these proposed transactions will have on the competitive landscape, the FCC should require, at a minimum, that the merged companies offer a true stand-alone DSL product whereby consumers are not required to meet any service prerequisites (other than technical feasibility of service to that consumer) to acquire DSL service. In this way, consumers' retail service preferences can be satisfied and they will be empowered to choose any combination of voice and data services as meets their preference and needs. Notably, as referenced above, stand-alone DSL will also afford additional redundancy, as consumers avail themselves of VoIP services in the event traditional services are unable to function properly.

In delineating the parameters of a stand-alone DSL condition, the Commission should require that the service be offered on both a retail and wholesale basis within the service regions of the merged companies. Thus, existing wholesale DSL customers should be afforded bulk stand-alone DSL services with adequate OSS (electronic pre-ordering and ordering components, including loop information, and maintenance and repair) as well as volume and term discounts reflective of their wholesale nature and the efficiencies implicated. This requirement is clearly technically feasible, as illustrated by the Qwest offering. Verizon as well offers stand-alone DSL today, albeit with significant (non-technical) restrictions. As such, imposing such a condition is easily attainable and would go a long way to mitigate the public interest harms caused by the mergers.

In addition, with respect to retail stand-alone DSL services, the Commission should make clear that any retail offering can be ordered by any retail customer or their authorized agents and that the merged companies are not permitted to refuse a valid letter of authorization for such services. Moreover, the FCC should also clarify that such retail services shall be subject to resale pursuant to Section 251(c)(4) at a discounted rate equal to the greater of the relevant state discount resale rate or twenty percent (20%). While the law would seem to be clear in this regard requiring resale as available and valued means for competitors to bring broadband-based retail services to consumers, experience has shown that absent exceedingly clear FCC directives, incumbents operate best when any potential confusion is eliminated at the outset.

Critical to the success of such stand-alone services are assurances that they are offered at a sustainable price. As such, while EarthLink would not suggest detailed price regulation, the FCC should make clear that services must be offered at just and reasonable rates and terms and moreover, that the merged carriers shall impute to their retail service offerings the same charges as are charged for the stand-alone DSL service. While not a perfect remedy to potential anticompetitive pricing concerns (such as price squeeze), the imputation requirement is a solid step to protect consumers.

B. Non-interference

In August 2005, the FCC adopted a Policy Statement designed to preserve and promote the open and interconnected nature of the public Internet and outlined four principles to attain that goal.[75] There, the Commission committed to incorporating its principles into its ongoing policymaking activities. In light of the articulated concerns the proposed mergers present, the FCC should here also condition the mergers upon commitments from the merging companies that they shall not engage in any activity that would have a discriminatory and anticompetitive impact as a result of traffic degradation or interference. More specifically, the FCC should require that the merging parties agree that they will not block, impair or interfere with the traffic traversing their networks, including the traffic of retail competitors who use the merged companies' advanced services as inputs for competitive retail services, such that retail consumers shall have unimpeded access to the lawful content, applications and services provided.

Moreover, while it is impossible to describe specifically the various mechanisms that could be used for the merged companies to act upon their incentive to engage in anticompetitive conduct, the FCC can and should additionally require a commitment that the merged companies shall not install any features, functions or capabilities that will have the effect of degrading or interfering with the services provided by retail competitors and that traverse the merged companies' networks. Finally, the Commission should also require a commitment that the merged companies shall permit customers, whether wholesale or retail, to connect and use devices of their own choosing in connection with services provided over advanced service capabilities. By giving these "net neutrality" conditions the force of law, the FCC will be able to help ensure that the

[75] *FCC Adopts Policy Statement New Principles Preserve and Promote the Open and Interconnected Nature of Public Interest*, FCC News Release (Aug. 5, 2005).

mergers do not effectively sanction increased opportunities for anticompetitive discrimination but rather serve the public interest.

Significantly, the non-interference condition is quite analogous to the Commission's merger condition approved in the *AOL/Time Warner Merger Order* regarding Instant Messenger ("IM") interoperability.[76] In that merger, the Commission recognized the issue of "network effects" as a potential harm arising from the merger that would be remedied by an interoperability condition. As the Commission noted, where a dominant firm – in this case, SBC and Verizon – also retains certain intrinsic control over the operation of the network, it lacks incentive to reach cooperative results with competing providers, but will tend to make strategic use of its network control to impede other competitors to the detriment of competition and consumers. As the Commission described in relation to IM interoperability, "[t]he largest provider's refusal to interoperate will lead to user switching to it from the smaller providers, which will further swell the dominant provider's NPD and shrink the smaller ones.'"[77] The same network control issue and resulting threat to competition presents itself with the ability of SBC and Verizon to selectively degrade service after the mergers, and so it is entirely consistent with the precedent of *AOL/Time Warner Merger Order* for the Commission to condition merger approval with a remedy that will address the matter.

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[76] *In the Matter of Applications for Consent to Transfer Control of Licenses and Section 214 Authorizations by Time Warner Inc. and America OnLine Inc.*, Memorandum Opinion and Order, 16 FCC Rcd. 6547 (2001) ("*AOL/Time Warner Merger Order*").

[77] *Id*. at ¶ 155.

C. Compliance and Enforcement

Any conditions are only as efficacious as the corresponding compliance by the affected companies and the ability to engage in swift and effective enforcement. Unfortunately, both SBC and Verizon have a long history of merger condition violations, apparently viewing penalties as a cost of doing business rather than a disincentive to non-compliance.[78] Indeed, to date, it is hardly questioned that companies such as the large incumbent carriers here involved have far more to gain through violating any applicable conditions – especially when the violation serves to provide an immediate and lasting competitive boost in a rapidly developing market such as exists here for advanced services – than they have to lose if required to incur penalties or risk the possibility of being sued. For this reason, it is especially vital that the FCC impose compliance and enforcement obligations that will genuinely aid in ensuring the conditions are effective and the public interest is safeguarded (or redressed in the event of violation).

Towards this end, the FCC should require the merged companies: to appoint a senior corporate officer to oversee the implementation of, and compliance with, the conditions; to provide periodic reports regarding compliance; and to consult with the FCC and other appropriate individuals as the Commission may deem necessary on an ongoing basis regarding compliance. At a minimum, the companies shall be required to submit an annual compliance report for five years, detailing compliance and any issues that have arisen regarding non-compliance, including complaints, enforcement actions and the resolution or status thereof. Further, the corporate compliance officer shall be

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[78] See Appendix B, Tab 1-9.

obligated to provide to an independent auditor copies of all notices provided to the Commission or any relevant governmental body that may affect compliance with the conditions and shall be required to consult with the independent auditor regarding progress in meeting the conditions. The Commission should additionally require that the audit committee of the companies' Board of Directors shall oversee the corporate compliance officer's fulfillment of these responsibilities.

To help assist in compliance and to allow the FCC and interested parties to monitor compliance, the merged companies shall also be required to retain, at their own expense, an independent auditor to conduct an examination engagement resulting in a positive opinion (with exceptions noted) regarding compliance and the sufficiency of the internal controls designed to ensure compliance. The required independent auditor shall have access to books, records, and operations that are necessary to fulfill the audit requirements. The report of the independent auditor, as well as the compliance reports of the merged companies, shall be publicly available and accessible so as to help assist in detection and redress of violations.

With respect to enforcement, a swift and effective process is vital. Thus, while the FCC currently has an accelerated docket process, given the unprecedented nature of the proposed mergers and the likelihood that the communications arena will undergo permanent changes as a result of their consummation, the FCC should adopt a process specifically for redress of merger violation complaints. Not only should such a process provide an expedited decision making process, it should afford "injunctive"-type relief so that the harm to aggrieved parties (and ultimately to consumers who will be harmed by the ongoing anticompetitive conduct) is not exacerbated during the enforcement process.

Indeed, as many aggrieved litigants well know, SBC and Verizon are especially adept at utilizing the FCC's enforcement processes to their competitive advantage, including through delaying and obfuscation, while the competitive harms are compounded. By affording immediate redress (subject to a "true-up" according to the outcome of the alleged complaint), the Commission would take a much needed step to redressing the public interest harms caused by the merger condition violations.

In the same vein, the Commission should also condition the mergers on pre-established penalties to be paid to aggrieved parties for merger condition violations. Such payments would be in addition to monies paid to the U.S. Treasury. While those penalties may have some deterrent value (which is debatable given the frequency with which they are incurred), the fact is they do nothing to set right the competitive harm. Thus, for example, if a competitor is denied effective OSS, the harm can be most swiftly and effectively redressed by requiring immediate provision of the OSS and payment of a pre-established penalty (effectively liquidated damages) to the harmed party to compensate it for costs incurred because of the violation. Far from being rigid, the conditions could specify that such payments may be through credits, true-ups, or other billing mechanisms. In this way, the FCC's enforcement process can serve not only to deter proscribed conduct but also remedy the competitive harm to the public interest.