Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
AT&T Inc. and BellSouth Corporation	)	WC Docket No. 06-74
Applications for Approval of	)	
Transfer of Control	)	

DECLARATION OF

SUSAN M. BALDWIN

and

SARAH M. BOSLEY

on behalf of the

New Jersey Division of the Ratepayer Advocate

June 5, 2006

TABLE OF CONTENTS

Tables and Figures

Appendices

I. INTRODUCTION

Introduction and qualifications

1. My name is Susan M. Baldwin. I am a consultant, and my business address is 17 Arlington Street, Newburyport, Massachusetts, 01950. I provide consulting services to public sector agencies on telecommunications economics, regulation, and public policy. My statement of qualifications is included as Attachment A.

2. My name is Sarah M. Bosley. I am a consultant, and my business address is 107 Oxpens Road, Cary, NC 27513. I provide consulting services to public sector agencies on telecommunications economics, regulation, and public policy. My statement of qualifications is included as Attachment B.

3. We assisted the New Jersey Division of the Ratepayer Advocate ("Ratepayer Advocate") in the preparation of initial and reply comments in WC Docket No. 05-65, the investigation by the Federal Communications Commission ("FCC" or "Commission") of the proposed merger of SBC Communications Inc. ("SBC") and AT&T Corp. ("AT&T").[1] We also co-sponsored a declaration on behalf of the Ratepayer Advocate in WC Docket No. 05-75, on behalf of the Ratepayer Advocate, regarding the proposed

[1]/ *In the Matter of Transfer of Control Filed by SBC Communications Inc. and AT&T Corp.*, FCC WC Docket No. 05-65, Comments on behalf of the New Jersey Division of the Ratepayer Advocate, April 25, 2005 and May 10, 2005. Ms. Baldwin also submitted testimony before the New Jersey Board of Public Utilities ("New Jersey Board" or "Board") in its review of the proposed SBC/AT&T merger. *Joint Petition of SBC Communications Inc. and AT&T Corp., Together with its Certificated Subsidiaries for Approval of Merger*, New Jersey Board of Public Utilities Docket No. TM05020168, on behalf of the New Jersey Division of the Ratepayer Advocate, May 4, 2005, and June 1, 2005.

merger of Verizon Communications Inc. ("Verizon") and MCI, Inc. ("MCI") and assisted with the preparation of initial and reply comments in that proceeding.[2]

4. As evidenced by our statements of qualifications, we have analyzed numerous other mergers between telecommunications carriers on behalf of consumer advocates. Ms. Baldwin has filed testimony on behalf of the Nevada Bureau of Consumer Protection on the proposed merger of Sprint Corporation ("Sprint")and MCI WorldCom Inc. ("WorldCom"); the California Office of Ratepayer Advocate and Washington Office of Attorney General in their respective state public utility commissions' review of the merger of Bell Atlantic Corporation ("Bell Atlantic") and GTE Corporation ("GTE"); the Ohio Consumers' Counsel and the Indiana Office of Utility Consumer Counselor with respect to the SBC Communications, Inc.'s ("SBC") acquisition of Ameritech Corporation ("Ameritech"); the Connecticut Office of Consumer Counsel regarding SBC's acquisition of Southern New England Telecommunications Corporation ("SNET") and filed Affidavits with the Commission in its review of the SBC/Ameritech and Bell Atlantic/GTE mergers on behalf of consumer coalitions. Ms. Baldwin also provided assistance to the Hawaii Division of Consumer Advocacy in its analysis of the Bell Atlantic/GTE merger and the California Office of the Ratepayer Advocate's review of the SBC's acquisition of Pacific Telesis Group. Ms. Bosley contributed to the investigations of the Bell Atlantic/GTE merger on behalf of the California Office of Ratepayer

[2]/ *In the Matter of Verizon Communications Inc. and MCI, Inc., Applications for Approval of Transfer of Control*, WC Docket No. 05-75, May 9, 2005. The Ratepayer Advocate submitted initial and reply comments on May 9, 2005, and May 24, 2005, respectively. Ms. Baldwin also submitted direct and rebuttal testimony before the New Jersey Board on behalf of the Ratepayer Advocate regarding the proposed Verizon/MCI merger. *Joint Verified Petition of Verizon Communications Inc. and MCI, Inc. For Approval of Agreement and Plan of Merger*, New Jersey Board of Public Utilities Docket No. TM05030189, on behalf of the Ratepayer Advocate, July 8, 2005 and August 19, 2005.

Advocate, the Washington Attorney General and Hawaii Division of Consumer Advocacy, and the SBC/Ameritech merger on behalf of the Indiana Office of Utility Consumer Counselor.

5. Ms. Baldwin and Ms. Bosley have substantial experience evaluating the status of local competition; incumbent local exchange carriers' ("ILECs") proposals for deregulation; and the consumer impact of changes in telecommunications markets.

6. Ms. Baldwin has been actively involved in public policy for twenty-eight years, twenty-two of which have been in telecommunications policy and regulation. Ms. Baldwin received her Master of Economics from Boston University, her Master of Public Policy from Harvard University's John F. Kennedy School of Government, and her Bachelor of Arts degree in Mathematics and English from Wellesley College. Ms. Baldwin has extensive experience both in government and in the private sector. Ms. Baldwin has testified before sixteen state public utility commissions and submitted numerous affidavits and comments to the Federal Communications Commission on behalf of consumer advocates, the National Association of State Utility Consumer Advocates ("NASUCA"), users, and competitive local exchange carriers ("CLEC"). Ms. Baldwin also served four years as the Director of the Telecommunications Division for the Massachusetts Department of Public Utilities (now the Department of Telecommunications and Energy).

7. Sarah M. Bosley has six years of experience in telecommunications economics, regulation, and public policy. Ms. Bosley earned her Master of Science in Agricultural and Applied Economics from Virginia Tech, her Master of Arts in International Affairs from American University, and her Bachelor of Arts in Political Science from McGill

University. She has contributed to and co-authored reports for state commissions and comments filed in Federal Communications Commission proceedings.

8. Our statements of qualification provide further detail. It is with these backgrounds and experience that our declaration analyzes whether the proposed merger between AT&T Inc. ("AT&T") and BellSouth Corporation ("BellSouth") is in the public interest.

Purposes of Declaration

9. The Ratepayer Advocate asked us to prepare this Declaration to supplement and to provide further factual support for its comments in the instant proceeding regarding the application of AT&T and BellSouth (collectively, the "Applicants") for approval of transfer of control.[3] We address the impact of the proposed transaction on the overall structure of the national telecommunications industry with a particular focus on the mass market. Although neither AT&T's nor BellSouth's home regions include New Jersey,[4] the proposed transaction would alter the national telecommunications industry significantly and irrevocably. Therefore, the Commission's deliberations in this

[3]/ *In the Matter of BellSouth Corporation and AT&T Inc. Application Pursuant to Section 214 of the Communications Act of 1934 and Section 63.04 of the Commission's Rules for Consent to the Transfer of Control of Bellsouth Corporation to AT&T Inc*, WC Docket No. 06-74, Application for Consent of Transfer of Control, filed March 31, 2006 ("Application"). Attachment 1 to the Application, "Description of Transaction, Public Interest Showing and Related Demonstration," ("Public Interest Statement") includes: declarations in support of the merger submitted by James S. Kahan (Senior Executive Vice President – Corporate Development, AT&T), Christopher Rice (Executive Vice President, Network Planning and Engineering, AT&T), William Smith, Barry L. Boniface (Chief Strategy & Development Officer for BellSouth), Robert W. Bickerstaff (Vice President, Data Product Management, BellSouth), and Dennis W. Carlton and Hal S. Sider. Carlton and Sider submitted a joint declaration. Attachment 1 also includes Appendix A, "Description of the Applicants", and Appendix B, "Description of Selected Competitors." *See*, www.fcc.gov/transaction/att-bellsouth.html.

[4]/ AT&T Labs is located in New Jersey.

proceeding directly affect the choices, prices, and quality of telecommunications services for residential and business consumers throughout the nation.

10. The Applicants have not yet submitted market-specific data, nor relevant business plans, marketing plans, or strategic documents. Therefore, we anticipate that we will supplement our analyses based on our review of forthcoming information.

11. As this Declaration demonstrates, the Commission should assess the merits of the proposed AT&T/BellSouth merger, not in a vacuum, but rather within the context of the present stagnation in, indeed retreat from, local and bundled services competition. The Commission's analysis should be anchored in a detailed evaluation of data about relevant markets, and based on empirical data about consumers' actual demand rather than speculations about possible future demand.[5]

The proposed merger would continue a troubling trend toward a Bell-controlled oligopoly at best and market re-monopolization at worst.

12. The sequence of recent events, involving Bell operating companies ("BOCs" or "Bells") is troubling. Legacy SBC's back-to-back acquisitions of its archrival, AT&T, and now of a fellow regional Bell operating company ("RBOC") greatly diminish the prospect of mass market competition. Furthermore, the total synergies from these two

[5]/ We are hopeful that the Commission will issue a request for detailed information from AT&T and BellSouth, similar to that which the Commission issued to SBC and AT&T, in WC Docket No. 05-65. Letter to Applicants from Michelle M. Carey, Deputy Chief, Wireline Competition Bureau, April 18, 2005, Initial Information and Document Request.

mergers, estimated at approximately $36 billion,[6] seemingly will benefit shareholders and executives[7] and certainly render obsolete the need for such subsidies as the non-rural high cost fund. The implications for consumers, however, are bleak. It is essential for the FCC and state public utility commissions to re-assert regulatory oversight to protect mass market consumers, particularly those who are most vulnerable to monopoly practices, *e.g.*, those in rural areas, those who do not seek "bells and whistles," those who do not want bundled services, and those with low and moderate incomes.

13. The merger, as it is presently structured, exposes consumers to potential adverse effects (service quality deterioration, excessive rates, tiered access to the Internet, aggressive sales practices, and the loss of competitive choice) and yet fails to provide residential and small business consumers with the likelihood of offsetting benefits. Absent significant conditions, the merger is not in the public interest.

14. The major theme that emerges with this proposed merger and last year's two major mergers is that consumers will have the worst of both worlds – a pretext of competition that justified the unleashing of regulation, major CLECs either fleeing the

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[6]/ Public Interest Statement, at iv (estimates total efficiencies of $18 billion for AT&T/BellSouth merger); SBC/AT&T Public Interest Statement, at 44 (estimated total synergies from SBC/AT&T merger of $15 billion); AT&T now expects merger synergies resulting from merger of SBC and AT&T to exceed the predicted synergies. *See*, Kahan (AT&T), at 19, citing AT&T Analyst Meeting Presentation, January 31, 2006, at 51; AT&T Investor Update: 1Q06 Earnings Conference Call, April 25, 2006 (revised synergy estimates accruing from SBC/AT&T merger from $15 to $18 billion).

[7]/ The estimated cash value of severance packages to which BellSouth executives would be entitled upon termination of employment within two years of the merger: F. Duane Ackerman (Chairman and CEO), $9,213,750; Mark L. Feidler (President and COO), $5,197,500; W. Patrick Shannon (CFO), $3,150,000, for example. Form S-4: Preliminary Proxy Statement and Prospectus of AT&T Inc. and Preliminary Proxy Statement of BellSouth Corporation ("Preliminary Joint Proxy Statement"), March 31, 2006, at 55. At a January 2006 AT&T Analyst Conference the company projected "double-digit adjusted EPS [Earnings per Share] growth over each of the next three years." AT&T Analyst Meeting Slide Presentation, January 31, 2006, New York, NY, at 143, available at http://library.corporate-ir.net/library/11/113/113088/items/181348/analyst06_b.pdf (accessed June 1, 2006). EPS estimates were reaffirmed by Mr. Whitacre (AT&T Chairman and CEO) at Sanford C. Bernstein & Co. Strategic Decisions Conference, May 31, 2006, presentation slideshow available at: http://att.sbc.com/gen/landing-pages?pid=5718.

local market or merging with their rivals, and ILECs merging rather than competing. Since apparently neither AT&T nor MCI could make a go of it on its own, and now AT&T and BellSouth cannot or will not compete in each other's territory, the outlook is poor for mass market consumers, particularly those that do not seek bundled offerings.[8] It is time to rethink the regulation of Bells, particularly for the services they offer mass market consumers.

15. Bell operating companies started the trend of acquisition rather than competition in the l990s. As Ms. Baldwin observed in 1998, regarding SBC's acquisition of Ameritech:

> Not only would a larger SBC tend to precipitate interest in mergers by other large telecommunications companies, this latest of SBC's merger proposals is by no means assured to be the last. All of the rationale that SBC offers in support of its proposed merger with Ameritech would also support further aggrandizement of SBC through subsequent mergers. If merging with Ameritech provides the size that SBC claims is necessary for it to enter 30 out-of-region markets, would acquiring BellSouth supply the means for SBC to set up shop in 20 additional markets (while as the same time alleviating SBC from the bother of competing out-of-region in the BellSouth region)? Would SBC need another takeover target any time a telecommunications provider anywhere in the world got larger? Simply put, there is no obvious logical ending point to the SBC acquisition strategy."[9]

As was the case eight years ago, buying out the competition continues to be SBC's strategy. Although this tactic might serve shareholders' interests and executives' pension

[8]/ As of January 2006, 32 percent of U.S. households do not have access to the Internet and an additional 27% of households still use dial-up, according to the American Consumer Institute. American Consumer Institute ("ACI"), *Who Uses Information Technology Services? A Demographic Analysis of American Consumers*, March 14, 2006. ACI also reports that about 91 percent of U.S. households with incomes of more than $75,000 have Internet access, but the share is 49.8 percent for those with household incomes under $25,000.

[9]/ *Applications of Ameritech Corp., Transferor, and SBC Communications, Inc., Transferee, For Consent to Transfer Control*, Federal Communications Commission CC Docket No. 98-141, Affidavit of Susan M. Baldwin and Helen E. Golding, on behalf of Indiana Utility Consumer Counselor, Michigan Attorney General, Missouri Public Counsel, Ohio Consumers' Counsel, Texas Public Utility Counsel and Utility Reform Network, filed on October 13, 1998, at para. 31.

plans, the Applicants have not demonstrated how "further aggrandizement" will help residential and small business consumers.

The proposed merger is not in the public interest.

16. The proposed merger should be considered within the context of today's telecommunications industry and market structure. In his statement accompanying the Commission's decision regarding legacy SBC's most recent acquisition of an actual and potential competitor,[10] Commissioner Copps aptly stated:

> The mergers before us are about more than the union of this country's largest telecommunications carriers. They are about consumers' phone bills, the availability of competitive broadband options and the future of the Internet. But in a sense, these mergers can also be seen as an epitaph for the competition that many of us thought we would enjoy as a result of the Telecommunications Act of 1996. That legislation, I am convinced, envisioned a vastly different communications landscape than the one we find ourselves living in today.[11]

[10]/ Legacy SBC (re-named to AT&T) acquired Pacific Telesis in 1997, Southern New England Telephone Company in 1998, Ameritech in 1999, and legacy AT&T in 2005. *Applications of Pacific Telesis Group, Transferor, and SBC Communications, Inc., Transferee, for Consent to Transfer Control of Pacific Telesis Group and its Subsidiaries*, Report No. LB-96-32, *Memorandum Opinion and Order*, 12 FCC Rcd 2624 (1997) ("SBC/PacTel Merger Order"); *Applications for Consent to the Transfer of Control of Licenses and Section 214 Authorizations from Southern New England Telecommunications Corporation, Transferor To SBC Communications, Inc., Transferee*, CC Docket No. 98-25, *Memorandum Opinion and Order*, 13 FCC Rcd 21292 (1998) ("SBC/SNET Merger Order"); *Applications of Ameritech Corp., Transferor, and SBC Communications, Inc., Transferee, For Consent to Transfer of Control*, CC Docket No. 98-141, *Memorandum Opinion and Order*, 14 FCC Rcd 14712 (1999) ("SBC/Ameritech Merger Order"); *In the Matter of SBC Communications Inc. and AT&T Corp. Applications for Approval of Transfer of Control*, WC Docket No. 05-65, *Memorandum Opinion and Order*, released November 17, 2005 ("SBC/AT&T Merger Order").

[11]/ *SBC/AT&T Merger Order*, Statement of Commissioner Michael J. Copps, Concurring ("Copps Statement"), at 137.

17. The Applicants have failed to demonstrate that the proposed merger is in the public interest.[12] The risks to consumers of further and irrevocable market concentration, which would thwart the goal of competition set forth in the Telecommunications Act of 1996,[13] outweigh the speculative benefits that the Applicants describe. Although the achievement of the predicted merger synergies seems probable, the savings will flow to shareholders and managers, and not to consumers. Moreover, the Applicants fail to address declining telephone subscribership and deteriorating basic service quality.

18. The exit of legacy AT&T and MCI from the mass market, the Bells' refusal to compete out-of-region, and consumers' continuing reliance on the Bells' local service expose the mass market to the risk of price increases, service quality decline, and cross-subsidization of the Applicants' entry into new lines of business. The lure of IPTV and other speculative benefits does not offset the irrevocable harm that would ensue as a result of the proposed increase in market concentration. Our declaration demonstrates that the Commission should reject the proposed merger as it is presently structured.

[12]/ The Commission stated in its order approving SBC's acquisition of AT&T: "If the proposed transaction would not violate a statute or rule, the Commission considers whether it could result in public interest harms by substantially frustrating or impairing the objectives or implementation of the Communications Act or related statutes. The Commission then employs a balancing test weighing any potential public interest harms of the proposed transaction against the potential public interest benefits. The Applicants bear the burden of proving, by a preponderance of the evidence, that the proposed transaction, on balance, serves the public interest." *SBC/AT&T Merger Order,* para. 16, note omitted.

[13]/ Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 ("1996 Act"). The 1996 Act amended the Communications Act of 1934. Hereinafter, the Communications Act of 1934, as amended by the 1996 Act, will be referred to as "the 1996 Act," or "the Act," and all citations to the 1996 Act will be to the 1996 Act as it is codified in the United States Code.

II. OVERVIEW OF MERGER.

The proposed merger would create a 117 billion dollar competitor.[14]

19. AT&T and BellSouth announced an Agreement and Plan of Merger on March 5, 2006.[15] The Boards of Directors of BellSouth and AT&T have approved the merger, and stockholders of the two companies must also approve the merger.[16] The Applicants submitted an application, public interest statement, and six declarations in support of their proposed transaction with the FCC on March 31, 2006.[17]

20. Under the proposed merger, a wholly owned subsidiary of AT&T, ABC Consolidation Corporation, will be merged with and into BellSouth. Thus, BellSouth will become a wholly owned subsidiary of AT&T. Each share of BellSouth common stock will be converted to 1.325 shares of AT&T common stock. BellSouth will continue to hold the stock of its subsidiaries and there will be no assignment of licenses or transfer of direct control of FCC authorizations.[18] AT&T's price for BellSouth represents a 17.9 percent premium over BellSouth's closing stock price on March 3, 2006. The total equity

14/ According to the Preliminary Joint Proxy Statement, the total operating revenues for the Combined Pro Forma AT&T Inc. are estimated to be $117.5 billion. Preliminary Joint Proxy Statement, at 94. Total Assets are estimated to be $276 billion. Preliminary Joint Proxy Statement, at 95.

15/ "A Reborn AT&T to Buy BellSouth," *Wall Street Journal*, March 6, 2006, A1.

16/ http://www.sbc.com/Common/files/doc/Merger_Fact_Sheet.doc.

17/ *See*, www.fcc.gov/transaction/att-bellsouth.html. The following submitted declarations in support of the merger: James S. Kahan (Senior Executive Vice President – Corporate Development, AT&T), Christopher Rice (Executive Vice President, Network Planning and Engineering, AT&T), William Smith, Barry L. Boniface (Chief Strategy & Development Officer for BellSouth), Robert W. Bickerstaff (Vice President, Data Product Management, BellSouth), Dennis W. Carlton and Hal S. Sider. Carlton and Sider submitted a joint declaration.

18/ Public Interest Statement, at 3.

is valued at approximately $67 billion, which is $10 billion more than BellSouth's equity market value at the close of trading on March 3, 2006.[19]

21. AT&T is a telecommunications company operating in domestic and international voice, data, and Internet services markets. AT&T provides services to residence, business and government customers. For the mass market, AT&T provides wireline and Internet-protocol ("IP")-based voice, wireless, video, and Internet access service. AT&T offers IP and "traditional" voice and data networking services as well as consulting and management services. AT&T operates a research and development organization, AT&T Laboratories, which it bills as "an industry leader in the development of DSL and other broadband Internet transport and delivery systems, wireless data networks, and new technologies and applications for networking and enterprise business needs."[20] AT&T serves 49.4 million access lines with either local or long-distance voice services mostly within its 13-state incumbent operating territory and serves 7 million digital subscriber lines ("DSL").[21] AT&T has a 60 percent financial interest in Cingular Wireless.[22]

22. BellSouth provides service in nine Southeastern states. The Communications Group, a wholly owned subsidiary of BellSouth, provides wireline service (local, access, IntraLATA long distance, and Internet access) to its customers. BellSouth Long Distance, Inc. provides long distance services to residential and business customers in its home operating territory, long distance to enterprise customers headquartered in

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[19]/ "Investor Briefing," No. 251, March 6, 2006, http://www.sbc.com/Common/files/pdf/bls_ib.pdf, at 2.

[20]/ Public Interest Statement, Appendix A, at A-1.

[21]/ *Id.*

[22]/ *Id.*, at A-4.

BellSouth's region, and wholesale long distance "primarily" to Cingular Wireless. BellSouth serves approximately 20 million access lines and 2.9 million DSL customers (both retail and wholesale) as of year-end 2005.[23] Bell South's Wireless and Advertising & Publishing group owns a 40 percent interest in Cingular Wireless and "is one of the leading publisher of telephone directories in the United States."[24]

23. Cingular Wireless provides wireless service to 54.1 million customers in the United States. AT&T and BellSouth holds a 60 percent and 40 percent economic interest in Cingular Wireless, respectively and each have a 50 percent voting interest.[25]

24. AT&T reports pro forma operating revenues (*i.e.,* reflecting combined revenues of AT&T Corp. and SBC Communications Inc. as if they were merged for the entire year of 2005) of $66.2 billion for 2005.[26] BellSouth reported $20.5 billion in operating revenues (excluding its proportional interest in Cingular) for 2004.[27] Cingular reported total operating revenues of $34.4 billion in 2005.[28] According to the Preliminary Joint Proxy Statement, Form S-4, filed with the Securities and Exchange Commission ("SEC") on March 31, 2006, the total operating revenues for the Combined Pro Forma AT&T Inc. are estimated to be $117.5 billion.[29] Before any staff reductions, the merged entity would employ approximately 317,000 people.[30]

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[23]/ *Id.*, at A-2.

[24]/ *Id.*, at A-3.

[25]/ *Id.*, at A-4.

[26]/ *Id.*, at A-2.

[27]/ *Id.*, at A-3.

[28]/ *Id.*, at A-4.

[29]/ Preliminary Joint Proxy Statement, at 94. Total Assets are estimated to be $276 billion. Preliminary Joint Proxy Statement, at 95.

25. According to the two companies, the new company "will be more innovative, nimble, and efficient, providing benefits to customers by combining the Cingular, BellSouth and AT&T networks into a single fully integrated wireless and wireline Internet Protocol network offering a full range of services."[31] The companies also assert that the merger will benefit consumers "seeking a real alternative to cable monopolies" and that businesses will "stand to benefit from the expertise and innovation of AT&T Labs, as well as the combination of AT&T's state-of-the-art national and international networks and advanced service with BellSouth's local exchange and broadband distribution platforms and expertise."[32]

26. The merger of AT&T, BellSouth and Cingular would create a behemoth organization which would even overshadow the telecommunications giants created by the SBC/AT&T and Verizon/MCI mergers in 2005.[33] The newly enlarged AT&T would serve 22 states. Legacy SBC's expansion through acquisition has vastly increased its territory from the five southwestern states that the original SBC (Southwestern Bell) served, to a scale likely not contemplated by Congress when it opened local markets with the 1996 Act. Table 1 below summarizes the access lines, operating revenue, and net income of the four remaining Bells.

30/ *Id.*, at 12.

31/ http://www.sbc.com/Common/files/doc/Merger_Fact_Sheet.doc.

32/ *Id.*

33/ The merger between SBC and AT&T closed on November 18, 2005. AT&T Form S-4, filed March 31, 2006, at 1. The merger between Verizon and MCI closed on January 6, 2006. *See* Verizon Press Release, "Verizon and MCI Close Merger, Creating a Stronger Competitor for Advanced Communications Services," January 6, 2006.

Table 1[34]

RBOC Relative Size Indicators
First Quarter 2006

	Total Switched Access Lines (thousands)	Operating Revenue (millions)	Net Income (millions)
AT&T	48,768	$15,835	$1,445
BellSouth	19,799	$8,684	$983
Qwest	14,546	$3,476	$88
Verizon	47,966	$22,743	$1,632

Note: BellSouth operating revenue and net income are "normalized" to account for several one-time charges.

AT&T's depiction of the telecommunications industry is incomplete and misleading.

27. According to Mr. Kahan, the senior executive vice president for corporate development of AT&T, [35] until as recently as 1999, the telecommunications industry was "voice-centric" and since then has become "data-centric," with "an evolution toward IPTV [Internet Protocol TV] services to provide video over IP networks."[36] He also describes an "explosive increase in wireless telephone usage" and refers to increasing "cord cutting."[37] Mr. Kahan does not, however, provide any data regarding customers who have migrated entirely from local wireline to the exclusive use of wireless service.

[34]/ Sources: AT&T Investor Briefing, April 25, 2006; BellSouth 1q06x.xls (accessed at http://phx.corporate-ir.net/phoenix.zhtml?c=95539&p=irol-IRHome);Qwest Q12006EarningsReleaseAttachments.xls (accessed at http://phx.corporate-ir.net/phoenix.zhtml?c=119535&p=irol-reportsAnnual); Verizon Investor Quarterly, May 2, 2006.

[35]/ Mr. Kahan supported SBC's acquisitions of Pacific Telesis Group, Southern New England Telecommunications Corporation, Ameritech Corporation, AT&T, and now, BellSouth. Kahan (AT&T), at para. 2. Ms. Baldwin and/or Ms. Bosley reviewed Mr. Kahan's declarations, submitted to the Commission, and his testimony, submitted in many different state jurisdictions, for each of these SBC acquisitions.

[36]/ Kahan (AT&T), at para. 6.

[37]/ *Id.*, at para. 7.

As Section V demonstrates, customers' demand for wireless typically supplements but does not replace demand for a basic primary landline.

28. Mr. Kahan estimates that there are 42 million broadband Internet connections provided primarily through cable modem, DSL, and fiber to the premises.[38] AT&T fails, however to provided stratified data, based on income and geography, which indicate deployment data and demand data. Absent such information, the Commission cannot assess whether AT&T's (and other carriers') deployment of new technology is even-handed, nor can the Commission assess diverse customers' willingness to pay for such technology. Appendix C demonstrates that the deployment of and demand for broadband is far from ubiquitous, and Sections VI and VII demonstrate that a cable-telco duopoly controls consumers' access to the Internet. AT&T's proposed acquisition of BellSouth would further entrench AT&T's market power in this evolving and critically important market segment.

29. Mr. Kahan refers to a "trend in VoIP adoption" and, among other things, refers to Vonage's rapid expansion.[39] However, recent media coverage of Vonage suggests that the provision of "over-the-top" voice over Internet protocol ("VoIP") services may not be a sustainable business model.[40] Furthermore, the "over-the-top" VoIP services of the top Vonage provides, relies on broadband access, which, as Section VI discusses in more

[38]/ *Id.*, at para. 9, citing UBS Investment Research, *Wireline Postgame Analysis 13.0* (March 2006), at 61.

[39]/ *Id.*, citing Press Release, Vonage, Vonage Crosses 1.5 Million Line Mark, March 1, 2006.

[40]/ Vonage Holding Corp.'s recent IPO was by all accounts lackluster, as the stock price dropped 12.6% in its first day of trading. Vonage has yet to be profitable and customers continue to complain about poor quality of service. Shawn Young and Lynn Cowan, "Vonage Lacks Voltage in Its IPO, With Weakest Debut in 2 Years," *The Wall Street Journal*, page C4, May 25, 2006. See our more detailed discussion of "over-the-top" VoIP in Section V below.

detail, is controlled by a cable-telco duopoly, and which is also jeopardized by ILECs' threat to net neutrality (see Section VII).

30. AT&T indicates that it is losing "thousands of access lines every day to alternative competitors."[41] Mr. Kahan fails, however, to indicate the percentage of this loss that is attributable to migration from AT&T's *additional* lines to other suppliers. Mr. Kahan also fails to indicate the percentage of this loss that has migrated to AT&T's wholesale services (resale, unbundled network element platform ("UNE-P"), UNE loop ("UNE-L")), to AT&T's DSL, and to AT&T-controlled Cingular service. As Section III shows, AT&T and BellSouth indisputably dominate local markets in their home regions.

AT&T's "re-invention" through acquisitions.

31. Mr. Kahan contends that the "rapid pace of change in the telecommunications industry has required AT&T to continually reinvent itself."[42] AT&T's method of "re-inventing itself" has been to gradually re-monopolize the market through a series of acquisitions of its potential and actual rivals.

32. AT&T's other road to "re-invention" is its substantial investment in IPTV so that it can compete with cable companies. This sidetracking further away from the more mundane, but nonetheless essential provision of basic telephone service at just and reasonable rates, offered at reasonable levels of service quality may benefit AT&T's shareholders. It is less evident that AT&T's forays into these video services will benefit the basic consumer of regulated services.

41/ Kahan (AT&T), at para. 11.

42/ *Id.*, at para. 12.

BellSouth's depiction of the market is similarly misleading, and similarly lacks empirical analyses.

33. Mr. Boniface, on behalf of BellSouth, describes what he depicts as the "dynamic state of competition for business and residential customers" in BellSouth's region.[43] According to him, BellSouth does not have a national network to serve customers outside of its region and "has no plans to build such a network."[44] Mr. Boniface indicates that BellSouth's regional focus and its limited products make it difficult for BellSouth to compete for large business customers.[45]

34. BellSouth contends that even for those customers with demands for service only within its territory, BellSouth faces "a host of capable and aggressive competitors including national interexchange and data/IP carriers, national and regional competitive local exchange carriers and cable companies, as well as system integrators, equipment vendors and foreign carriers."[46]

35. Mr. Boniface asserts that it "faces substantial competition for residential customers in [its] region, particularly from wireless, cable and VoIP competitors" and further states that "AT&T is no longer a significant competitor for mass market customers in our region."[47] As we demonstrate in Section V, these intermodal alternatives do not constrain BellSouth's dominance in the local market.

[43]/ Boniface (BellSouth), at para. 4.

[44]/ *Id.*, at para. 5.

[45]/ *Id.*, at para. 8. *See also,* paras. 11-22.

[46]/ *Id.*, at para. 9.

[47]/ *Id.*, at para. 10.

36. BellSouth asserts also that competition for regionally focused medium-to-large customers, such as regional banks and state governments, and for smaller business customers "is intense" and that BellSouth "face[s] a host of aggressive competitors at all levels of the market in which [it] compete[s]."[48] BellSouth also identifies "cable competitors as a key emerging threat to our business."[49]

37. BellSouth fails, however, to provide data in support of its assertion. The mere presence of alternative providers does not demonstrate that the purported competitors have made sufficient inroads in the local market as to discipline the prices and quality of BellSouth's local services. Furthermore, a cable-telco duopoly does not constitute effective competition.

38. BellSouth contends that it "faces intense competition for residential customers in its region," and states that as a result of such factors as wireless and VoIP growth that demand for wireline services "continues to decline."[50] According to BellSouth, it lost more than 1.3 million access lines, including 4.8 percent of its retail residential access lines, between 2004 and 2005.[51] BellSouth also identifies the markets in its region that cable operators serve using either circuit switched or IP telephony.[52] BellSouth also estimates that at the end of 2005, VoIP providers served approximately 5 percent of the residential market, which, it contends, had been 3 percent in 2004.[53]

[48]/ *Id.*, at para. 23.

[49]/ *Id.*, at para. 27.

[50]/ *Id.*, at para. 32.

[51]/ *Id.*

[52]/ *Id.*, at para. 33.

[53]/ *Id.*, at para. 34.

39. We demonstrate later in this declaration that BellSouth's minor line loss does not diminish its monopoly power. BellSouth does not provide any cites or other support for its VoIP demand estimates. Furthermore, its demand estimate likely includes households where customers rely on wireline *as well as* VoIP. Finally, as we demonstrate below, a cable-telco duopoly does not protect mass market consumers from ILECs' exercise of their market power.

40. A dominant carrier is one that can unilaterally raise and sustain prices above competitive levels and that can exercise market power by restricting its output or by its control of an essential input such as access to bottleneck facilities.[54] AT&T and BellSouth are both dominant carriers, and the proposed transaction would further entrench their monopoly position, while diverting their resources away from the provision of basic telephone service and toward new unregulated lines of business.

41. The elimination of prices based on total element long run incremental costs ("TELRIC") for UNE-P three months ago, and AT&T's and MCI's exits from the mass market have cast grave doubt on the sustainability of intramodal local competition. In its order approving the SBC/AT&T merger, the Commission stated:

> AT&T's decision to shut down its mass market operations indicates it was not a potential purchaser of third party UNE-P substitute products, as some commenters claim. The elimination of UNE-P was a significant factor in AT&T's decision, but we reject commenters' suggestion that this implies other wireline competitive LECs would also find it unprofitable to serve this market. … While certain commenters express concern about

[54]/ *In the Matter of Regulatory Treatment of LEC Provision of lnterexchange Services Originating in the LEC'S Local Exchange Area and Policy and Rules Concerning the Interstate Interexchange Marketplace*, *Second Report and Order in CC Docket No. 96-149 and Third Report and Order in CC Docket No. 96-61*, 12 FCC Rcd 15756,at 15802-15803.

> their ability to offering competing service based on current TELRIC rates for unbundled DS0 loops, such concerns are not merger specific.[55]

42. We respectfully disagree with the Commission's determination that concerns about the impact of the elimination of UNE-P on competition are not merger-specific. The impact of the UNE-P elimination goes specifically to the issue of whether carriers *other than* the entrenched Bells and cable companies can compete in local markets. This is a question that fundamentally affects the merits of the proposed transaction and the need for conditions.

The Commission should examine critically the purported benefits flowing from the faster-paced and more widespread deployment of IPTV that the Applicants contend would occur as a result of the merger.

43. One of the benefits that the Applicants repeatedly describe is television over an IP network ("IPTV"), which will, "[b]y using a highly-interactive, two-way switched network that delivers only the programming requested by the subscriber…enable AT&T to offer consumers a broad menu of programming choices and controls."[56] AT&T plans to spend more than $4 billion to deploy its Lightspeed service to approximately 18 million households in its 13-state region, but fails to provide any market studies that demonstrate consumer demand that justifies the enormous expense.[57] The planned suite of voice, data, and video services, available over a single network, although technologically impressive, does not appear to be based on a business case foundation.

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[55]/ *SBC/AT&T Merger Order,* note 318, citing Telscape Comments at 5-6; Letter from Ross A. Buntrock, Counsel for Fones4All, to Marlene H. Dortch, Secretary, FCC, WC Docket No. 05-65 at 2-3 (filed Sept. 7, 2005); Letter from Richard M. Rindler, Counsel for TDS.

[56]/ Kahan (AT&T), at para. 13.

[57]/ *Id.*, at paras. 14-15.

Mr. Kahan discusses cost and numbers of households that will be passed by this state-of-the-art network, but entirely neglects to discuss any marketing studies or business case evaluations that would justify the expenditures.

44. If new technology, such as fiber to the premises, or IPTV, becomes an essential link for households, it is critically important that all households have the ability to avail themselves of such technology. If, by contrast, the Commission determines that some new services such as IPTV are non-essential, it becomes all that much more important to ensure that POTS customers are not cross-subsidizing AT&T's forays into these new unregulated areas and that AT&T is not neglecting POTS customers in its pursuit of new revenues.

45. Similarly, the Commission should be skeptical of AT&T's assertion that its deployment of IPTV is a consumer benefit. If anticipated revenues (based, in turn on *prices* that might reflect estimates of consumers' willingness to pay and the price of competitive alternatives and based on anticipated consumer demand, or *quantity*), are greater than anticipated costs, it makes good business sense for AT&T to deploy IPTV, and, presumably, it will do so. If, however, even with the proposed merger, the anticipated costs exceed the anticipated revenues, the purported benefit is instead a risk because AT&T's pursuit of new lines of business exposes mass market customers to

likely cross-subsidization[58] and also because AT&T's new ventures distract AT&T from its core mission of providing basic service at adequate levels of service quality.[59]

46. Among the various benefits that Mr. Kahan describes are:

- Wireline-wireless integration, facilitated by a single set of decision-makers for Cingular.
- Convergence to an IP Multimedia Subsystem ("IMS").
- Deployment of a "dual-mode" telephone that will shift between wireless and broadband VoIP networks.
- Larger base of customers, which increases the scale and scope efficiencies of investments in new features.
- Integrating wireless devices with office applications, including one-stop shopping for business customers.
- Improved end-to-end security for classified communications, including more alternative routing.
- More rapid deployment of IPTV to the BellSouth region than would otherwise occur.
- Lower cost deployment of IPTV.

[58]/ AT&T recently announced that it intends to invest $247 million in Kansas as part of the first phase of fiber network upgrades that will ultimately support high-speed Internet access, IP-based video, and VoIP services. AT&T indicates that the investment, which is part of a planned investment of $4.6 billion throughout its territory, is a consequence of state legislation that allows new video entrants to seek state-issued franchises rather than being required to negotiate individual agreements with local governments. "AT&T Plans $247M Upgrade in Kansas," *TR Daily*, May 30, 2006. This *quid pro quo* (investment in states where it benefits from favorable legislation) underscore's AT&T's market power.

[59]/ In Section VII, below, we demonstrate that AT&T's service quality has been declining in Kansas.

- BellSouth's ability to avoid lengthy programming negotiation (by using AT&T's IP video product).
- Increased competition (against the cable companies and DBS), diversity, and flexibility (in programming selections) in the programming marketplace.[60]

47. These benefits are speculative, general, and do not flow necessarily to customers of basic telephone services. Furthermore, AT&T and BellSouth would likely pursue these new lines of business, regardless of whether the merger occurs.[61] The vague speculation that these products will come to market sooner than they would absent the merger does not justify the substantial harm caused by further irrevocable market concentration.[62]

48. According to Mr. Kahan, AT&T's acquisition of BellSouth "will speed up [its] ability to deliver the integrated wireline-wireless devices and services that consumers

60/ Kahan (AT&T), at paras. 17-39.

61/ BellSouth plans to invest $2.2 billion over a five-year period to increase the bandwidth of its current network from a maximum speed of 6 Mbps to speeds of 24 Mbps. BellSouth intends to provide the increased bandwidth to approximately half its households by the end of 2007, and to approximately three-quarters of its households by the end of 2009. Smith (BellSouth), at para. 8. On May 31, 2006, BellSouth submitted a "Supplemental Declaration" of Mr. Smith. Letter from Bennett L. Ross, General Counsel – D.C., BellSouth, to Ms. Marlene H. Dortch, Secretary, Federal Communications Commission, May 31, 2006. The supplemental declaration indicates that BellSouth is "unlikely to offer IPTV service in any community before 2007." Smith Supplemental (BellSouth), at para. 2. Mr. Smith also reiterates his assertion that BellSouth will be able "to deploy IPTV more quickly and at lower cost than BellSouth could do so on its own." *Id.*. Mr. Smith's Supplemental Declaration provides other details about the status of BellSouth's negotiations with content providers and trials. *Id.*, at paras. 1-5.

62/ BellSouth asserts that without the merger BellSouth might not have offered an IPTV service at all. *Id.*, at para. 21. BellSouth's lukewarm commitment to this service underscores the possibility that the costs of deploying IPTV could well outweigh the benefits.

want."[63] Although Mr. Kahan refers repeatedly to what consumers "want" he fails to provide evidence of their demand, particularly as it relates to potential price points. Consumers "want" many different products and services, but the more relevant question is their estimated demand for diverse products at prices that allow a supplier to recover its costs and earn a reasonable return on investment. The Applicants fail to provide this critically important information. It is clear that the Applicants *want* to compete with cable companies and to enter the triple-play arena aggressively. It is not clear, however, that their ambitious plans benefit mass market consumers.

49. The Applicants have failed to substantiate a key merger rationale, that is, that consumers *want* another TV provider. Their filing lacks evidence that they have assessed customers' willingness to pay for these new products. Absent more compelling empirical data, the purported benefit should be viewed as a risk of harm to consumers.

50. Furthermore, the Commission should first ensure that the Applicants provide basic telephone service at reasonable prices and at acceptable quality. The Applicants' ambitious plans to migrate beyond the world of dial tone to the world of entertainment represents a risk, not a benefit because in the Applicants' foray into new lines of business, they will lack an incentive to complete the mundane task of providing basic service. Furthermore, in the absence of effective local competition, the Applicants will be able to cross-subsidize their entry into risky areas with the near-monopoly source of

[63]/ Kahan (AT&T), at para. 25 (emphasis added). *See also*, para. 26, in which Mr. Kahan states that what customers "want is *integrated* services, not a bundle of separate services" (emphasis in original).

revenues from basic services. The Commission's recent extension of the separations freeze facilitates this cross-subsidization.[64]

51. Mr. Rice describes benefits that he contends will result from the merger:

- Combining AT&T's, BellSouth's, and Cingular's three IP networks into a single fully integrated network will allow the delivery of more features and functionality at a lower cost.
- The proposed merger will enhance AT&T's ability to increase research and development of new products and services, based on the experience of AT&T Labs.
- The merger will establish network resources that are better equipped for disaster response and national security.
- The benefits of the merged regional ILEC (legacy SBC) network with the legacy AT&T national and national network will be extended to the BellSouth states.[65]

52. Among other things, Mr. Rice contends that the merger of SBC and AT&T enabled it to "push products and services that were formerly available only to the largest enterprise customers down to smaller business customers."[66] Mr. Rice describes multiple business services, but does not provide any data demonstrating consumer demand for these products.

64/ *In the Matter of Jurisdictional Separations and Referral to the Federal-State Joint Board*, CC Docket No. 80-286, *Order and Further Notice of Proposed Rulemaking*, released May 16, 2006.

65/ Rice (AT&T), at para. 3. The SBC/AT&T merger occurred on November 18, 2005. *Id.*, at para. 4.

66/ *Id.*, at para. 11.

53. Mr. Rice also indicates that in "the consumer space" financial resources are being used to increase the capacity of the AT&T CallVantage platform.[67] Among other purported benefits described by Mr. Rice is the anticipated streamlined decision-making for Cingular's operations.[68]

54. Similarly, Mr. Smith describes the following anticipated post-merger benefits:

- Improved ability to provide IPTV.
- Improved disaster recovery capabilities.
- Improvements in network efficiency and service quality.
- Deployment of new services to new markets.
- Additional innovation and market investment.[69]

55. The rationale of purported benefits of enhanced emergency preparedness and national security which the Applicants describe[70] could be applied equally to future mergers. If, by merging with their potential competitors, ILECs are better prepared to handle recoveries from disasters such as Hurricane Katrina and to address national security goals, then the Commission should encourage AT&T, BellSouth, Qwest, and Verizon to merge into a single entity. According to the Applicants' logic, the Commission should encourage the creation of a single, gargantuan RBOC.

[67]/ *Id.*, at para. 14.

[68]/ *Id.*, at para. 28.

[69]/ Smith (BellSouth), at para. 3.

[70]/ Rice (AT&T), at paras. 35-43.

BellSouth's prediction that its customers "will be pleased" by the merger is entirely speculative, and does not address the disturbing level of market concentration that the proposed transaction would yield.

56. Mr. Boniface speculates that "BellSouth's customers will be pleased by [its] combination with AT&T, and will be excited about the increased capabilities [it] will be able to provide after the merger by having AT&T, BellSouth, and Cingular under one roof."[71] Furthermore, he asserts that customers will be able to rely on "dozens of other aggressive and well-qualified competitors to fill any competitive needs in the event they prefer not to work with the combined company after the transaction."[72]

57. BellSouth's prediction about customers' "pleasure" is entirely speculative. Customers could be instead alarmed about the increasing market concentration and the dwindling number of suppliers.

58. Carlton and Sider suggest that mass market customers will benefit from greater availability of bundles of services: wireless, wireline, Internet and (eventually) video services. According to Carlton and Sider, such a bundle would even include "a single bucket of minutes and a flat monthly charge covering multiple access devices, such as a wireless handset and a landline."[73]

59. In summary, the Applicants describe general purported benefits but fail to demonstrate consumer demand for these new services and fail to demonstrate that the benefits could not occur absent the merger. The speculative benefits do not outweigh the risks to consumers of neglected basic telephone service, a more concentrated market, a dominant provider with yet more resources to control consumers' access to the Internet,

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[71]/ Boniface (BellSouth), at para. 31.

[72]/ *Id*

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[73]/ Carlton and Sider, at para. 52.

and a heightened incentive to cross-subsidize AT&T's entry into unregulated lines of business with revenues from an embedded customer base of unrivalled size and scope.

III. STATUS OF COMPETITION

The FCC's resolution of this proceeding will affect consumers' choices in the short-term and long-term.

60. As the Commission recognized in its order approving the merger between Bell Atlantic and NYNEX Corporation:

> Even upon hypothetical full implementation of the Telecommunications Act of 1996, significant barriers to entry into the local telecommunications market will remain. Entrants must still be able to attract capital, as well as to amass and retain the technical, operational, financial and marketing skills necessary to operate as a telecommunications provider in the local market. For mass market services, entrants will have to invest in establishing the brand name recognition and, even more importantly, the mass market reputation for providing high quality telecommunications services. These consumer "goodwill" assets take significant amounts of time and resources to acquire. An unknown entrant's attempts to build "goodwill" by providing reliable, high quality service relies heavily on the cooperation of the incumbent LEC that provides interconnection, unbundled elements, resold services or transport and termination, and can be frustrated by the incumbent LEC if that carrier engages in discriminatory conduct affecting service quality, reliability or timeliness. For all these reasons, we cannot at this time simply assume that implementation of the Telecommunications Act of 1996 and the potential for development of competition will eliminate any concerns about potential competitive effects of mergers, particularly the effects on the pace of the development of competition.[74]

61. Despite the efforts of state and federal regulators to eliminate market barriers, successful entry to ILEC-dominated markets has not been easy during the ten years since the enactment of the 1996 Act. As a result of regulatory and industry developments, entry into local markets has become vastly more difficult. CLECs must overcome (1) customer inertia, (2) economic and operational impediments, and (3) more than a century

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[74]/ *Applications of NYNEX Corporation, Transferor, and Bell Atlantic Corporation, Transferee, For Consent to Transfer Control of NYNEX Corporation and Its Subsidiaries*, File No. NSD-L-96-10, *Memorandum Opinion and Order*, 12 FCC Rcd 19988 (1997), at para 42, emphasis added.

of the RBOCs' dominance in local markets. Based on the FCC's most recently available statistics, AT&T and BellSouth dominate the vast majority of the local market either directly through their own retail services or indirectly by leasing wholesale facilities to their competitors (*i.e.*, the non-facilities-based competition that occurs through resale, unbundled network element platform ("UNE-P"), and UNE loop).[75] The incumbent local exchange carriers as a whole own or control approximately 94% of the end-user switched access lines nationwide as of June 30, 2005.[76]

62. Even if viewed solely on a retail basis (which would be misleading because it would mask CLECs' reliance on the incumbent carriers' facilities), incumbent carriers dominate over 80 percent of the nation's local markets.[77] Furthermore, as we discuss in more detail below, CLECs' demand for UNE-P has peaked and is now declining in the wake of the UNE-P expiration.[78] The RBOCs' retail market share will likely climb as demand for UNE-P declines. As the FCC has stated, a "high market share does not necessarily confer market power, but it is generally a condition precedent to a finding of

[75]/ CLECs owned fewer than 129,187 (or 2%) of the total 6.2-million end-user switched access lines in service in New Jersey as of June 30, 2005. Federal Communications Commission, Wireline Competition Bureau, Industry Analysis and Technology Division, *Local Telephone Competition: Status as of June 30, 2005*, (April 2006), at Table 11.

[76]/ *Id.*, at Table 7 and 11. CLECs own 9,071,598 end-user switched access lines nationally, while the incumbents own 144,065,156 as of June 30, 2005.

[77]/ *Id.*, at Table 7. CLECs provided 34,114,396 end-user access lines nationally, the vast majority (19,188,870) provided through the use of UNEs. CLECs also relied on resold lines (5,853,928) and provided just 9,071,598 facilities-based lines. *Id.*, at Table 11. Approximately 50% of the facilities-based lines were provided by CLECs over coaxial cable connections. *Id.*, at 2.

[78]/ The FCC reports that the number of UNE loops with switching (*e.g.* UNE-P) fell 12% between December 2004 and June 2005. *Id.*

market power."[79] ILECs continue to control the "last mile" to customers, and, as a result, dominate local markets and adjacent markets for related telecommunications products.

63. The FCC, in its order approving the SBC/Ameritech merger, stated:

> Following passage of the 1996 Act, local telecommunications markets have been undergoing a transition to competitive markets, so a transaction may have predictable yet dramatic consequences for competition over time even if the immediate effect is more modest. Therefore, when a transaction is likely to affect local telecommunications markets, our statutory obligation requires us to assess future market conditions. In doing so, the Commission may rely upon its specialized judgment and expertise to render informed predictions about future market conditions and the likelihood of success of individual market participants.[80]

When the FCC approved the SBC/Ameritech merger, there was a glimmer of hope for local competition. As the FCC applies its "specialized judgment and expertise" to the pending AT&T/BellSouth merger, it should take stock of the waning local competition in today's market, and the chilling impact of the pending transaction (combined with the impact of the just-completed mergers between SBC and AT&T and Verizon and MCI) on future markets.

AT&T's acquisition of BellSouth would further concentrate the market and entrench the evolving cable-telco duopoly.

64. The prospect of competitive choice among suppliers of basic local telecommunications services for mass market consumers has already suffered serious setbacks. The FCC's approvals of legacy SBC's entry into the long distance market in

[79] / In the Matter of Special Access Rates for Price Cap Local Exchange Carriers; AT&T Corp. Petition for Rulemaking to Reform Regulation of Incumbent Local Exchange Carrier Rates for Interstate Special Access Services, FCC WC Docket No. 05-25; RM-10593, Order and Notice of Proposed Rulemaking, Released January 31, 2005 ("Special Access NPRM"), at para. 103, citing U.S. Department of Justice and the Federal Trade Commission, Horizontal Merger Guidelines, issued April 2, 1992, revised April 8, 1997 ("Horizontal Merger Guidelines"), § 1.11.

[80]/ *SBC/Ameritech Merger Order*, at para. 51, note omitted.

twelve jurisdictions and BellSouth's long distance entry in nine jurisdictions[81] has enabled these Bells to leverage their unique position in the local market to enter new markets by bundling local and long distance services for consumers. Furthermore, the FCC decided to forbear from regulating regional Bell operating companies' broadband deployment.[82] Without detailed accounting, which is subject to regulatory audit, it is difficult to detect and to prevent cross-subsidization of Bells' entry into broadband and IPTV markets with revenues from non-competitive services.

65. Bells are continuing to press for regulatory forbearance. On December 6, 2005, BellSouth filed a petition for forbearance pursuant to section 10 of the Communications Act of 1934, as amended from the Commission's cost allocation rules.[83] The Ratepayer Advocate submitted initial and reply comments opposing the petition on January 23, 2006 and February 10, 2006, respectively. Among other things, the Ratepayer Advocate stated (in response to BellSouth's observation that it is subject to price cap regulation in all of its nine states and by the Commission for its interstate services):[84]

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[81]/ Section 271 long distance approvals were granted for 21 of the BellSouth and legacy SBC states between 2000 and 2003. SNET did not require long distance authority because it was not one of the Bells. http://www.fcc.gov/Bureaus/Common_Carrier/in-region_applications/.

[82]/ In the Matters of Appropriate Framework for Broadband Access to the Internet over Wireline Facilities, CC Docket No. 02-33; Universal Service Obligations of Broadband Providers, Review of Regulatory Requirements for Incumbent LEC Broadband Telecommunications Services, CC Docket No. 01-337; Computer III Further Remand Proceedings: Bell Operating Company Provision of Enhanced Services; 1998 Biennial Regulatory Review –Review of Computer III and ONA Safeguards and Requirement, CC Docket Nos. 95-20, 98-10; Conditional Petition of the Verizon Telephone Companies for Forbearance Under 47 U.S.C. § 160(c) with Regard to Broadband Services Provided Via Fiber to the Premises; Petition of the Verizon Telephone Companies for Declaratory Ruling or, Alternatively, for Interim Waiver with Regard to Broadband Services Provided Via Fiber to the Premises, WC Docket No. 04-242; Consumer Protection in the Broadband Era, WC Docket No. 05-271, Report and Order and Notice of Proposed Rulemaking, rel. September 23, 2005 ("Broadband Sharing Order").

[83]/ Petition of BellSouth Telecommunications, Inc. for Forbearance Under 47 U.S.C. § 160 From Enforcement of Certain of the Commission's Cost Assignment Rules ("BellSouth Petition").

[84]/ Ratepayer Advocate Initial Comments re BellSouth Petition, at 22.

> With the numerous and major changes in the market (such as the granting of Section 271 authority, the classification of digital subscriber line ("DSL") and cable modem as informational services, the classification of VoIP as an interstate service, pending proposals to revise intercarrier compensation, and proposed universal service reform), rate caps need to be re-initialized at both the state and federal levels. The availability of the cost data necessary for the re-initialization of rate caps depends upon the cost allocation rules that BellSouth seeks to abandon. To jettison these rules would be contrary to the public interest.[85]

66. Legacy SBC's acquisition of legacy AT&T and Verizon's acquisition of MCI have enabled these Bells, and Qwest and BellSouth to dominate the long distance market. Although ILECs may tout VoIP as gaining consumer appeal, as we discuss in Section V, this technology does not yet represent an economic substitute for basic local exchange service. The FCC's *TRRO* decision eliminated the major mode of entry for CLECs seeking to serve the mass market.[86]

The recent disappearance of UNE-P will likely eliminate the minimal mass market competition that has evolved, but AT&T and BellSouth have already been granted significant regulatory relief, premised in large part on the existence of that ephemeral UNE-P-based competition.

67. UNE-P, priced at TELRIC-based rates, expired March 2006, relegating this mode of entry to the history books,[87] and replacing it with commercially "negotiated" prices. AT&T's acquisition of BellSouth would further tip the balance at the negotiating table between the ILEC and the CLEC, thwarting prospects for local competition.

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[85]/ *Id.,* at 10.

[86]/ *Unbundled Access to Network Elements; Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers*, FCC WC Docket No. 04-313; CC Docket No. 01-338, *Order on Remand*, rel. February 4, 2005 ("Triennial Review Remand Order" or "TRRO").

[87]/ *Id.*, at para. 227.

68. The end of the UNE-P era essentially closes the door on competition in the mass market. Furthermore, the short-lived availability of UNE-P provided a pretext for relaxing regulatory oversight of the Bells. Legacy AT&T witnesses aptly observed in a New Jersey proceeding regarding Verizon's request to classify business local exchange service offered to customers with two to four lines as competitive:

> The continued availability of UNE-P arrangements at reasonable rates was a critical assumption in this Board's recommendation (and the FCC's decision) to grant Verizon entry into New Jersey's interLATA market under Section 271 of the Federal Telecommunications Act of 1996. It was also a factor in the Board's prior Decision and Order in the instant proceeding.[88]

The legacy AT&T witnesses continued:

> The Board stated on page 149 of its 2002 Decision and Order that "The NJ UNE Remand Order substantially modified the Board's prior December 2, 1997 UNE decision…and, we believe, has effectively removed any concern that UNE prices, terms or conditions continue to constitute a barrier to local exchange entry in New Jersey." The recent FCC ruling effectively reverses much of the Board's UNE Remand Order and therefore calls into question the fundamental basis for the Board's 2002 Decision and Order in this matter.[89]

The foundation for state regulators' earlier decisions to relax oversight of Bells has crumbled, yet the Bells continue to enjoy regulatory freedoms.

69. End-user lines provided by CLECs through UNEs are declining. As Figure 1 shows, the number of UNE-P lines provisioned by AT&T and BellSouth peaked in June 2004. AT&T's UNE-P lines plummeted 20% in one year, from 6,886,338 in June 2004

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[88]/ *In the Matter of the Application of Verizon New Jersey, Inc. for Approval (I) of a New Plan for an Alternative Form of Regulation and (II) to Reclassify Multi-Line Rate Regulated Business Services as Competitive Services, and Compliance Filing*, New Jersey Board of Public Utilities Docket No. TO01020095, Supplemental Joint Testimony of Ola Oyefusi and E. Christopher Nurse on behalf of AT&T Communications of N.J., L.P., January 10, 2005, at 11.

[89]/ *Id*., at footnote 9.

to 5,499,890 in June 2005. BellSouth's UNE-P lines declined 17%, from 2,949,388 in June 2004 to 2,454,335 in June 2005.[90]

Figure 1

Sources: Industry Analysis and Technology Division, Wireline Competition Bureau, *Selected RBOC Local Telephone Data*, (June 2003 through June 2005 versions).

[90] / FCC, Wireline Competition Bureau, Industry Analysis and Technology Division, Selected RBOC Local Telephone Data, (June 2003 through June 2005 versions).

AT&T's and BellSouth's phenomenal success in selling bundled services already raises significant regulatory concerns, which the merger would exacerbate.

70. One of the key regulatory freedoms that AT&T and BellSouth obtained in recent years was long distance authority. Section 271 approvals provided AT&T's and BellSouth's gateway to re-monopolizing telecommunications markets. Furthermore, legacy SBC's acquisition of legacy AT&T, and Verizon's acquisition of MCI have eliminated major rivals to the remaining Bells.

71. AT&T and BellSouth's entry into the long distance market has been, and continues to be, enormously successful. According to their recent quarterly financial reports:

- In the first quarter of 2006, BellSouth served over 7.4 million long distance lines, a 60% increase from the first quarter of 2004;[91]
- AT&T's base of long distance lines grew from approximately 14.4 million at the end of 2003 to 23.5 million at the end of 2005, an increase of 63%.[92]
- Forty-five percent of BellSouth's primary residential lines subscribe to the "BellSouth Answers" bundle;[93]
- Sixty-eight percent of AT&T's retail customers subscribe to a bundle.[94]

72. The Bells have been far more successful in entering new markets than have CLECs. Considering that the Bells received their most recent approvals to offer long distance service less than three years ago (and their first approvals about six years ago),

[91]/ *BLS Investors News*, April 20, 2006.

[92]/ *AT&T 2005 Annual Report*, May 5, 2006, at page 25.

[93] / *BLS Investor News*, April 20, 2006, page 8.

[94] / *Investor Briefing*, 4Q 2005, January 26, 2006, page 5,

this success is enormous compared to the minimal inroads that CLECs have made in the local markets that the Bell serve. The 1996 Act was enacted more than a decade ago, and yet CLECs collectively have garnered, at most, a 20 percent market share in the local market.[95] In approximately half the time, the Bells have has made twice the inroads into the long distance market than all the CLECs have made over ten years. In other words, collectively the CLECs have been less than half as successful as the Bells have been, and have taken about twice as long as the Bells to achieve that tenuous success.

73. The Bells' long distance authority makes it vastly harder for CLECs to compete in local markets. The Bells' substantial and unique advantage in the race to offer consumers bundled packages is directly tied to their century-long relationship with consumers, as the primary link to the public switched telephone network. This large and growing segment of Bells' business is occurring precisely at a time when the door has been shut in the face of CLECs who had sought to enter the local market. Mass market consumers, through many years of predictable demand for the Bells' essential local telephone services, enabled the Bells' to establish a formidable position in the telecommunications marketplace. The combination of its entrenched position in the local market with its deployment of substantial resources to attract consumers to numerous packages is helping the Bells lock in its market power.

74. By buying out its actual and potential competitors, AT&T is acquiring invaluable access to an embedded base of customers. As AT&T and the other Bells move into new competitive markets, including broadband markets, it is essential to ensure that basic non-

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[95]/ According to Commission-reported data, as of June 30, 2005, CLECs account for only 19.1% of end-user switched access lines. Federal Communications Commission, *Local Telephone Competition Status as of June 30, 2005*, released April 2006, at Table 1.

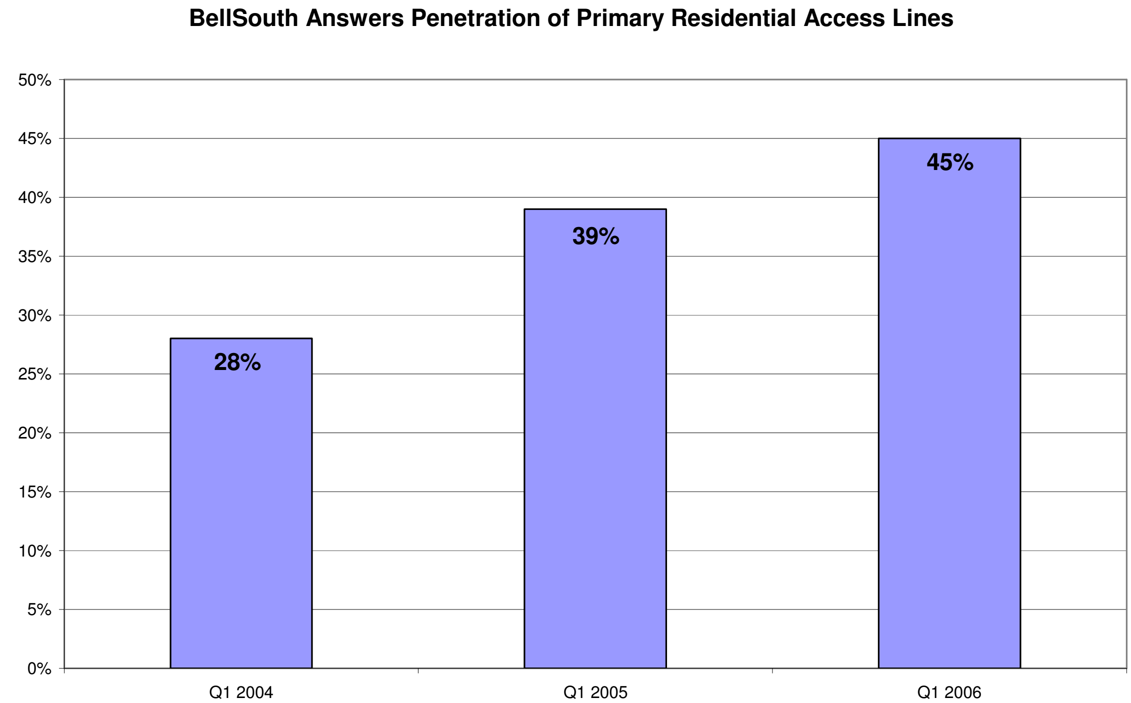
competitive services are not cross-subsidizing these new services. It is also essential to ensure that the Bells do not neglect the more "mundane" responsibilities of installing and repairing basic telephone service in a timely manner.

AT&T's and BellSouth's packages lock in customers.

75. BellSouth and AT&T have successfully marketed packages to customers as a result of leveraging their long distance authority. BellSouth introduced the BellSouth Answers package in 2002. Subscribership to this bundle has grown each year since then, as has the percentage of "Answers" customers including long distance in their package. As of the end of the first quarter of 2006, over 5 million customers subscribe to BellSouth Answers. BellSouth also serves 3.1 million DSL customers, and 628,000 DIRECTV subscribers.

76. Figure 2 below shows the significant growth in demand for BellSouth's "Answers" package from 28 percent penetration in the first quarter of 2004 to 45 percent penetration in the first quarter of 2006. The percentages of "Answers" customers that also subscribe to BellSouth's long distance customers was 75 percent in 2003, 84 percent in 2004, and 86 percent in 2005. Table 2 shows the change in the number of local access lines served by BellSouth and the quantity of long distance customers from first quarter 2004 to first quarter 2006.

Figure 2[96]



Note: BellSouth reports that the percentage of BellSouth Answers customers with BellSouth long distance service was 75%, 84%, and 86% in 2003, 2004, and 2005, respectively.

Table 2[97]

BellSouth Change in Subscriber Portfolio
(lines in thousands)

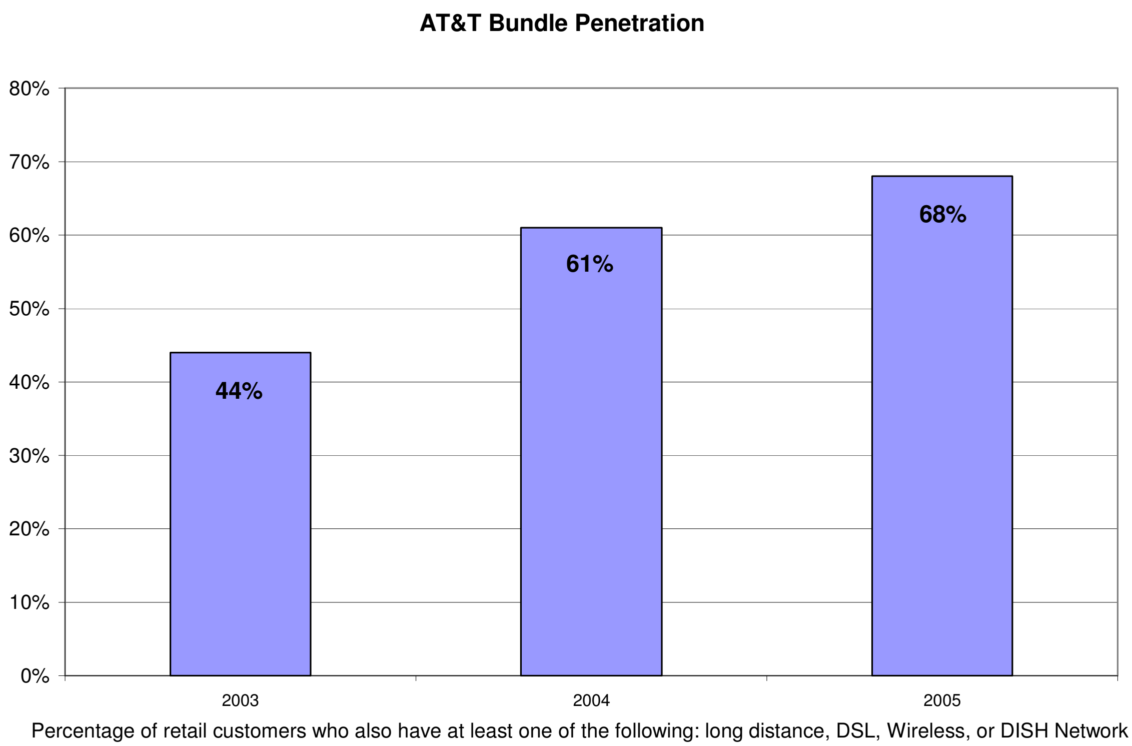
	Q1-2004	Q1-2005	Q1-2006
Total Access Lines	22,087	21,219	19,799
Primary Residential Retail Lines	12,198	11,751	11,231
Total Business Lines	6,135	6,048	5,956
Long Distance Customers	4,596	6,470	7,358

96/ Sources: *BLS Investor News*, April 21, 2005, page 5; *BLS Investor News*, April 20, 2006, page 8.

97/ Source: BellSouth Corporation "statementsbyquarter_0406rev.xls" (accessed May 30, 2006 at http://phx.corporate-ir.net/phoenix.zhtml?c=95539&p=irol-IRHome).

77. Figure 3 illustrates the increasing demand for AT&T bundles. As of year-end 2005, sixty-eight percent of AT&T local wireline customers subscribed to at least one other service (long distance, DSL, wireless, or video).

Figure 3[98]



78. As shown in Table 3 below, although the total number of access lines AT&T serves has declined in recent years, its subscriber base for DSL and Video services has increased by 33% and 25%, respectively, over the past year, and its penetration rate for bundled services continues to rise.

[98]/ Sources: SBC 2004 Annual Report, page 5; *Investor Briefing*, 4Q 2005, January 26, 2006, page 5, *Access Line Information as of 12/31/2005* (available at http://www.sbc.com/gen/investor-relations?pid=1129)

Table 3[99]

AT&T Change in Subscriber Portfolio (lines in thousands)

	Q1-2004	Q1-2005	Q1-2006
Total Access Lines	54,256	51,868	48,768
Primary Residential Lines	23,792	23,222	22,630
DSL Customers	3,962	5,608	7,432
Video Subscribers	NA	394	491

79. There is not anything, *per se*, that is anticompetitive about a firm offering packages, particularly if the firm that is supplying the packages is operating in an effectively competitive market. Price discrimination can benefit consumers by allowing consumers to select the service that maximizes the "utility" they derive from their expenditures. One example is Amtrak offering off-peak consumers lower rates for travel than peak consumers. Those consumers who are indifferent to traveling during off-peak time (or who may actually prefer to do so) benefit from Amtrak's price discrimination. Similarly, Amtrak prices first class options differently from business class.

80. By contrast, although Bells' one-stop shopping for its calling packages may offer customers the predictability and simplicity they seek, the Commission should be concerned because the Bells' packages include a blend of competitive services (long distance) and non-competitive services (unlimited local calling). This combination of competitive and non-competitive products raises significant issues about potential anticompetitive pricing behavior. Furthermore, the Bells' packages blend interstate services with intrastate services, which further complicates regulation.

[99]/ Sources: *SBC Investor Briefing, Q1 2005*, April 25, 2005, page 16; *AT&T Investor Briefing, Q1 2006*, April 25, 2006, page 15.

81. Of course, in the short term, consumer choice increases consumer welfare because consumers can select the package that yields the greatest benefit within their budget constraints. However, in the long term, the critical question is whether adequate safeguards prevent cross-subsidization of competitive services by non-competitive ones. In the short term, this impressive array of options may benefit consumers, but if, in the long term, the Bells squeezes out their competitors, consumers are harmed by diminishing competitive choice.

82. By way of illustration, assume that tomatoes are a monopoly product. If the sole tomato supplier also owns a pizza chain, which sells pizzas in direct competition with its tomato customers, the tomato supplier will have the ability to offer lower-priced pizzas by charging more for its wholesale tomatoes than it imputes to its own pizza operations. The pizza chain customers would seem to benefit from low-priced pizza, but, in the long run, the departure of other pizza vendors from the market would harm consumers.

83. The Bells' bundled offerings also raise concerns about possibly anticompetitive tying arrangements. The FCC has previously investigated complaints about tying arrangements, such as when it concluded that the pay phone commissions offered by AT&T on its "0+" services were "an added inducement, when coupled with [AT&T's] dominance in the "0+" market, which AT&T [was] using as leverage in the "1+" market." The FCC's Common Carrier Bureau concluded that "AT&T's conduct ha[d] significant enough anticompetitive consequences to find an unreasonable practice." In its explanation of its finding, the FCC stated, among other things, the "unbundling policy also prevents a carrier from configuring the basic service elements in a way which would

be anticompetitive."[100] In a subsequent order the FCC explained the Bureau's order as finding "that AT&T's tying of its "0+" service to its "1+" service violates the underlying policy goals of the antitrust laws, and is, therefore, unreasonable under Section 201(b),"[101] concluded that AT&T's bundling practices "constitute[d] an unreasonable practice in violation of Section 201(b) of the Communications Act,"[102] and declined to vacate the Bureau's order.[103] The Bells' bundling practices merit further regulatory scrutiny, similar to that afforded more than ten years ago to AT&T's pay phone practices.

84. Among other things, regardless of the outcome of the proposed AT&T/BellSouth merger, the FCC should analyze the following:

- Are the Bells compensating their state operations adequately for the use of their local network and brand recognition?
- Are basic local exchange services customers who do not subscribe to packages receiving the same quality of service as customers of bundles receive?
- Are those business consumers of packages with unlimited usage being cross-subsidized by those businesses which do not opt for package?

Without data about consumers' actual average usage and information about the way in which Bells compensate state operations for use of the local network, one cannot assess whether cross-subsidization occurs.

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100 / In the Matter of AT&T's Private Payphone Commission Plan, File No. ENF-87-19, Memorandum Opinion and Order, October 3, 1998, 3 Rcd (1988), at paras. 26-27.

101 / In the Matter of AT&T's Private Payphone Commission Plan, File No. ENF-87-19, Memorandum Opinion and Order, October 3, 1998, 7 Rcd (1992), at para. 11.

102 / *Id.*, at para. 16.

103 / *Id.*, para. 17.

85. The Bells' packages are clearly intended to attract customers who seek the convenience of flat rate calling and a single bill for multiple telecommunications services. For example, AT&T's website includes the following: "A World of Savings. Delivered Online. Get the mix of products and services that work best for you - on one money-saving bill. Build your bundles today!"[104] The Bells' aggressive foray into the bundled services market makes it that much harder for CLECs to make headway in local markets.

86. Individual consumers cannot be expected to consider the long-term public policy impact of the Bells' packages on the local market structure. As consumers, they maximize their utility by seeking the products they prefer at the least cost. By contrast, the regulators' responsibility is to ensure that, in the long term, effective local competition evolves, and, if it does not, and where it does not, to provide adequate regulatory oversight. If the Bells return to their Ma Bell days enabling consumers to benefit from the simplicity of a single supplier of diverse packages, then FCC and state public utility commissions ("PUCs") should regulate the Bells where they have market power. Alternatively, if regulators continue to seek to encourage the development of local competition, they confront the challenge of ensuring that the Bells do not cross-subsidize competitive pursuits with non-competitive revenues or engage in discriminatory tying arrangements. This will likely require audits of inter-affiliate transactions and cost studies for the relevant products.

[104]/ Available at: https://swot.sbc.com/swot/bundleCatalog.do, accessed June 3, 2006.

87. Also, bundled customers may ultimately become vulnerable to Bell pricing and service quality whims. The transaction cost of migrating *from* a bundle is high, thus deterring customer churn.

88. In summary, the Bells' ability to offer local and long distance services to their home-region consumers makes them formidable telecommunications competitors because they can readily meet the demand of those customers that seek a single supplier of multiple telecommunications services. The Bells are the first point of contact for many customers, a position they enjoy as a result of many years as the incumbent carriers.

AT&T's presence in the telecommunications market is already formidable, and its dominant position in the market would be further fortified by its acquisition of yet another rival RBOC.

89. AT&T is uniquely positioned to offer comprehensive packages of telecommunications services to residential and small business customers. Its position is unique because (1) it is the most widely recognized provider of service; (2) it dominates the local market; (3) it has a pre-existing and long-term relationship with its customers; and (4) it has unique access to a vast customer base. AT&T can provide customers with bundled plans that lock them into AT&T as a provider of multiple services, including local telecommunications services.

90. One definition of lock-in that captures consumers' decision-making process is as follows:

> Lock-in is defined as consumers' decreased propensity to search and switch after an initial investment. Lock-in is driven by a preference to minimize immediate costs and an underweighting of the impact of future switching costs. Consumers tend to focus on short-term considerations and

> select the more easily accessible option at the time of the transaction, even at the cost of forgoing future benefits. Consumers also fail to anticipate the impact of future switching costs, and when the future arrives, these switching costs dominate these later decisions in ways that consumers do not anticipate when making the initial decision.[105]

91. At this juncture, there is inadequate information to assess whether the Bells' "packages" are anticompetitive. However, we urge the Commission to address this important question, regardless of its decisions in this merger proceeding. In one paper exploring the use of bundling as a way to leverage monopoly, the author explains:

> Imagine that the monopoly price of good A is m, and the competitive price of good B is c. The monopolist offers its customers the following deal: I'll sell you A at a discount, say m-ε, in return for which you agree to buy all of your good B from me at a premium, say c+δ. Or, you can still buy good A from me at m.[106]

92. The Bells offer various bundles of services, including several that include unlimited local usage and toll usage. Without access to comprehensive data about consumers' usage patterns (*e.g.*, local and toll usage), and interaffiliate transactions between the parent companies and the state operations, (e.g., cost and revenue information), one cannot assess whether an antitrust concern exists.[107]

93. The Bells' long distance offerings raise regulatory concerns that merit investigation before the Commission considers approving pending mergers. Regarding BellSouth, the Commission stated:

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[105]/ Gal Zauberman, "The Intertemporal Dynamics of Consumer Lock-In," Journal of Consumer Research (December 2003, 30(3), 405-419), at 3.

[106]/ Barry Nalebuff, "Bundling As a Way to Leverage Monopoly," Yale School of Management, Working Paper #36, at 3. Also see page 2, where the author states "[w]hile there are some special cases in which leverage does not lead to higher profits, in the general case, a monopolist can earn higher profits by leveraging its power into a competitive market."

[107]/ In our declaration in WC Docket No. 05-75, we included exhibits regarding long distance market share, based on confidential information. (Confidential Exhibit SMB-2a through 2d, attached to our declaration, illustrated Verizon's enormous success in capturing long distance market share, even before its acquisition of MCI. Similar data for AT&T and BellSouth have not yet been provided in this proceeding.

> As an example of the type of discriminatory tariffs about which we are concerned, the Commission recently found that BellSouth's Transport Savings Plan (TSP) discriminates in favor of BellSouth's interexchange affiliate in violation of section 272. See AT&T Corp. v. BellSouth Telecommunications, Inc., FCC 04-278, Memorandum Opinion and Order (rel. Dec. 9, 2004) (holding that the TSP's volume discounts violate section 272 by favoring low-volume and rapidly growing long distance companies, like BellSouth Long Distance, and disfavoring BellSouth Long Distance's larger competitors, and further holding that the 90% volume commitment requirement contained in BellSouth's TSP tariff violates section 272).[108]

94. When one considers what is at stake, namely the rates, terms and conditions for non-competitive telecommunications services and the development of fair and effective competition, the costs and effort of an audit are justified.

The Applicants' assertion that a reduction in the absolute number of access lines they serve is evidence of declining market power should be dismissed.

95. AT&T indicates that it is losing "thousands of access lines every day to alternative competitors."[109] Mr. Kahan fails, however, to indicate the percentage of this loss that is attributable to migration from AT&T's *additional* lines to services provided by competitors. AT&T's *Investor Briefing* of April 25, 2006, however, states that "retail access lines declined by 267,000 [in the quarter]. Additional lines, which reflect migration to DSL, accounted for nearly 40 percent of the total decline."[110] Mr. Kahan also fails to indicate the percentage of this loss that has migrated to AT&T's wholesale services (resale, UNE-P, UNE-L) or to AT&T-controlled Cingular service.

108/ *TRRO*, footnote 163.

109/ Kahan (AT&T), at para. 11. *See*, also, Carlton and Sider (AT&T/BellSouth), at para. 31.

110/ AT&T *Investor Briefing,* April 25, 2006, at page 5.

96. BellSouth contends that it "faces intense competition for residential customers in its region," and states that as a result of such factors as wireless and VoIP growth that demand for wireline services "continues to decline."[111] According to BellSouth, it lost more than 1.3 million access lines, including 4.8 percent of its retail residential access lines, between 2004 and 2005.[112] BellSouth also estimates that at the end of 2005, VoIP providers served approximately 5 percent of the residential market, which, it contends, had been 3 percent in 2004.[113] As the Pew Internet & American Life Project recently reported, however, over half of all VoIP users maintain traditional wireline service.[114]

97. According to FCC data, between June 2003 and June 2005, AT&T lost 4,162,242 retail access lines.[115] According to AT&T documents, DSL connections *increased* by approximately 3,421,000 in the same period.[116] BellSouth lost 2,208,178 retail access lines between June 2003 and June 2005 according to FCC data.[117] During the same period BellSouth *increased* its DSL connections by approximately 1.4 million. Many of the DSL additions likely represent a migration of consumers from additional lines that were formerly used for dial-up Internet access. For the sake of illustration, if one assumed that all new DSL connections fit this description, then the new DSL connections

111/ Boniface (BellSouth), at para. 32.

112/ *Id.*, at para. 32.

113/ *Id.*, at para. 34.

114/ Pew Internet & American Life Project, *Home Broadband Adoption 2006*, May 28, 2006, at page 15.

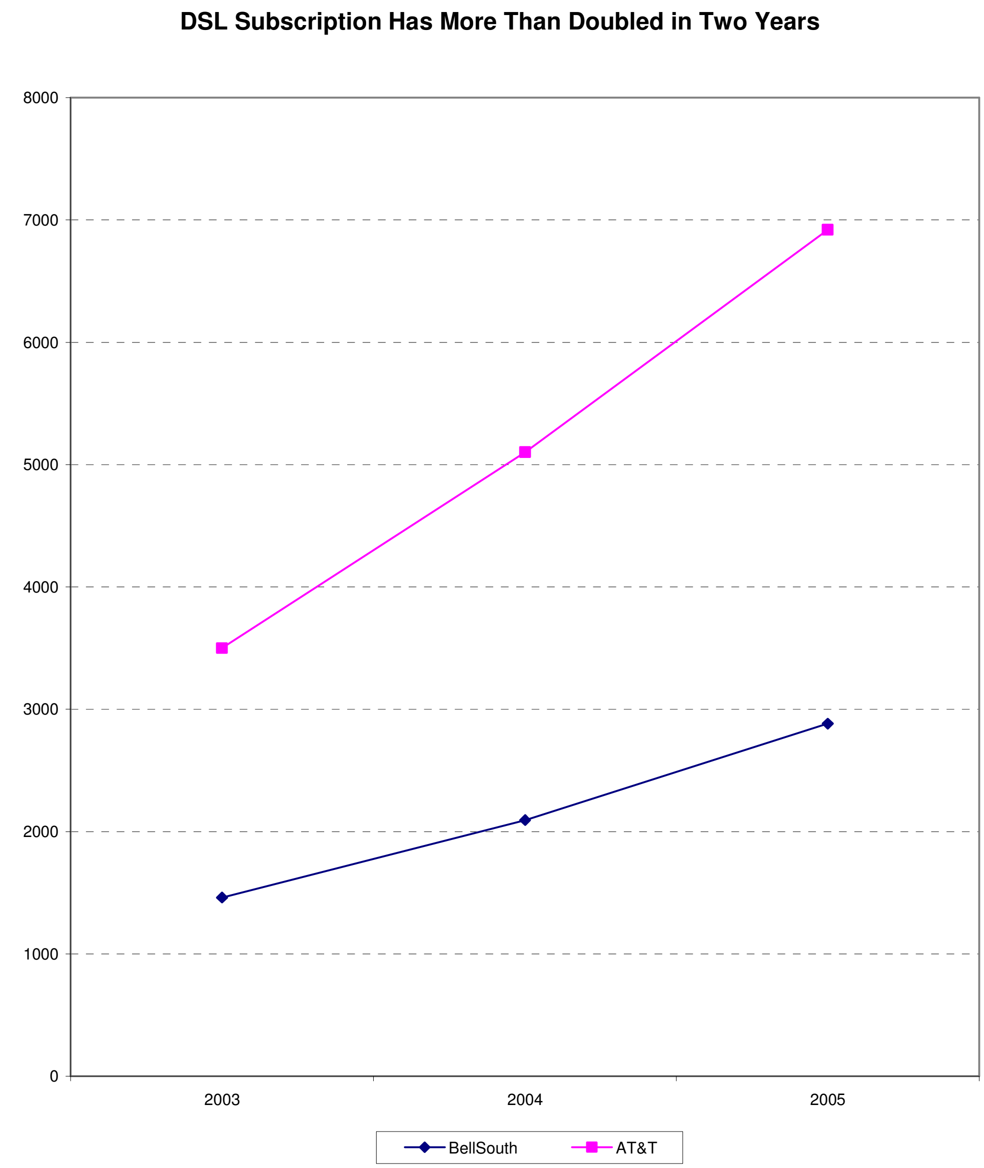
115 / Industry Analysis and Technology Division, Wireline Competition Bureau, Selected RBOC Local Telephone Data, (June 2003 through June 2005 versions).

116 / SBC *Investor Briefing*, January 26, 2005; AT&T *Investor Briefing*, January 26, 2006.

117 Industry Analysis and Technology Division, Wireline Competition Bureau, Selected RBOC Local Telephone Data, (June 2003 through June 2005 versions).

would account for approximately 82% of AT&T's line losses and 64% of BellSouth's alleged line losses.[118] Figure 4 illustrates the rapid growth in DSL demand over a two-year period.

Figure 4



Sources: BellSouth *Investor News*, January 25, 2006; SBC *Investor Briefing*, January 26, 2005; AT&T *Investor Briefing*, January 26, 2006.

[118] / BellSouth *Investor News*, January 25, 2006.

98. Finally, with respect to the Applicants' assertions with respect to line loss, the decline in competition via UNE-P may lead to leveling off or reversal of that trend. The dramatic decline in UNE-P lines discussed above must be appreciated in the context of UNE-P's former importance as a mode of entry for competitive suppliers. Furthermore, the position of CLECs negotiating access to UNE-P facilities is now seriously weakened, due the expiration of regulated UNE-P access in March 2006. ILECs are enjoying significant success winning back customers that they lost to CLECs (often through the provision of UNE-P). Therefore, much of the Applicants' line loss can be seen as transitory, and easily reversed.

IV. MARKET DEFINITION

It is essential that the FCC correctly define the relevant markets before it analyzes the proposed merger.

99. In order to assess the impact of the proposed merger on competition and on consumers, it is critical to define the relevant markets. Economists generally agree that defining the market properly is an essential first step to assessing market structure. As stated by some:

> The first step in any analysis of competition in a market is to properly define the product and geographic dimensions of the relevant market. If a market is defined either too broadly or too narrowly, spurious conclusions may arise.[119]

In considering substitution possibilities, further economic discussion of the complexities of defining relevant products is as follows:

> The ideal definition of a market must take into account substitution possibilities in both consumption and production. On the demand side, firms are competitors or rivals if the products they offer are good substitutes for one another in the eyes of buyers. But how, exactly, does one draw the line between 'good' and 'not good enough' substitutes.[120]

100. For example, to a Bostonian, a ticket to a Yankees game might not be a good enough substitute for a ticket to a Red Sox game. Yet, to a resident of Seattle, tickets to see the Yankees or the Red Sox could be interchangeable. AT&T and BellSouth fail to justify their reliance on intermodal service as a "good enough" substitute for land-line service.

[119]/ David L. Kaserman and John W. Mayo, "Competition in the Long-Distance Market," Handbook of Telecommunications Economics, Vol.1, Martin E. Cave, Sumit K. Majumdar, and Ingo Vogelsang, eds., (Elsevier: Amsterdam, 2002), at 512.

[120]/ *Industrial Market Structure and Economic Performance*, F. M. Scherer (Chicago: Rand McNally & Company, 1970), at 53.

101. Consumers are in a far better position than the Applicants to decide whether wireless, VoIP, or cable represent "good" substitutes for basic telecommunications service. The most valuable and unbiased evidence about consumers' preferences are consumers' actual purchasing decisions.[121]

102. Consumers attribute high "utility"[122] to the ability to reach medical, safety, and emergency assistance in a reliable, timely manner, whether to meet the needs of young children, the elderly, or other household members and business employees. Society's investment in substantial resources to deploy state-of-the-art emergency response systems and public safety officials' widespread efforts to geocode consumers' addresses to enable prompt public safety response are compelling evidence of the utility (or value) that consumers ascribe to E911. That a tiny percentage of the population may choose to abandon wireline entirely does not alter the fact that the vast majority of households and small businesses place a high value on the public safety characteristics of wireline telephone service. The preferences of a minority certainly do not constitute evidence that intermodal technology offers an economic substitute for the majority of consumers who continue to rely on traditional wireline service.

103. In its *Notice of Proposed Rulemaking* ("NPRM") of August 2004 in the Triennial Review proceeding, the FCC appropriately sought comment on "how best to define relevant markets (e.g., product markets, geographic markets, customer classes) to develop

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[121]/ Consumers, through their purchasing decisions, seek to maximize their utility, and in so doing show their "preferences." See generally, Mas-Colell, Andreu, Michael D. Whinston and Jerry R. Green, *Microeconomic Theory* (New York: Oxford University Press, 1995).

[122]/ As defined in one textbook, "it is possible to show formally that people are able to rank in order all possible situations from the least desirable to the most. Following the terminology introduced by the nineteenth-century political theorist Jeremy Bentham, economists call this ranking utility. We will also follow Bentham by saying that more desirable situations offer more utility than do less desirable ones." Walter Nicholson, *Microeconomic Theory: Basic Principles and Extensions*, seventh edition, (The Dryden Press, 1998), at 70 (footnotes omitted; emphasis in original).

rules that account for market variability and to conduct the service-specific inquiries to which USTA II refers."[123] The *Triennial Review NPRM*, incorporated by the FCC into the August 2004 NPRM, also sought comment on how best to define markets.[124] Defining markets accurately is equally important in the FCC's investigations of mergers.

104. In its August 2004 *TRRO NPRM*, the FCC states that the *USTA II* decision requires that it "must account for specific characteristics of the market in which a particular requesting carrier operates" when undertaking its impairment analysis.[125] The D.C. Circuit Court of Appeals found in *USTA II* that "the FCC is obligated to establish unbundling criteria that are at least aimed at tracking relevant market characteristics and capturing significant variation."[126] This follows the Court's objection expressed in *USTA I*, to the FCC's issuance of "broad" unbundling rules that apply across all geographic markets and customer classes "without regard to the state of competitive impairment in any particular market."[127]

105. Unfortunately, in its order, the FCC abandoned its earlier, apparent intention to analyze specific markets in detail.[128] Nonetheless, the proper definition of relevant markets is essential for analyzing the impact of proposed mergers on the development of

123/ *In the Matter of Unbundled Access to Network Elements, Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers*, WC Docket No. 04-313, CC Docket No. 01-338, *Order and Notice of Proposed Rulemaking*, released August 20, 2004 ("TRRO NPRM"), at para. 9.

124/ *Id.*, at para. 11, footnote 39; *Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers, Implementation of the Local Competition Provisions of the Telecommunications Act of 1996, Deployment of Wireline Services Offering Advanced Telecommunications Capability*, CC Docket Nos. 01-338, 96-98, 98-147, Notice of Proposed Rulemaking, 16 FCC Rcd 22781 (2001) ("Triennial Review NPRM"), at paras. 39, 43, 57-58.

125/ *TRRO NPRM*, at para. 9, footnote 35.

126/ USTA II, 359 F.3d 554 (D.C. Cir. 2004), at 9.

127/ *USTA II*, at 9, citing *USTA I*, 290 F. 3d, at 422.

128/ *See, e.g.*, *TRRO*, at paras. 43, 199.

competition. Relevant markets include product markets (*i.e.*, mass market vs. enterprise market), geographic market (*i.e*., the physical boundaries), and customer class (*i.e*., residential vs. business).

106. Economic theory relies, in part, on the presence of price discrimination to define markets.[129] In their *Horizontal Merger Guidelines*, the U.S. Department of Justice ("DOJ") and the Federal Trade Commission ("FTC") define a market "as a product or group of products and a geographic area in which it is produced or sold such that a hypothetical profit-maximizing firm, not subject to price regulation, that was the only present and future producer or seller of those products in that area likely would impose at least a 'small but significant and nontransitory' increase in price, assuming the terms of sale of all other products are held constant." The DOJ and FTC explain further that a "relevant market is a group of products and a geographic area that is no bigger than necessary to satisfy this test."[130] An excessively broad market masks important structural differences within the area.

107. The Commission has previously stated:

> Based on the record in this proceeding, we identify three relevant product markets for our mass market analysis: (1) local service; (2) long distance service; and (3) bundled local and long distance service. In previous wireline mergers, the Commission focused on local and long distance services. Based on recent market and technological developments, including increased subscription to mobile wireless service and VoIP services that provide a bundle of local and long distance services, we find it appropriate to refine our market analysis, including defining a separate relevant product market for bundled local and long distance service.
>
> The Commission defines product markets from the perspective of customer demand. We thus begin our analysis by recognizing two types

129/ Horizontal Merger Guidelines, Department of Justice and the Federal Trade Commission, issued April 2, 1992, revised April 7, 1997 ("Horizontal Merger Guidelines"), § 1.12.

130/ Horizontal Merger Guidelines, §1.0.

> of consumer demand for communications services: (1) demand for "access" and (2) demand for "usage." The consumer demands "access" from a provider so as to be able to connect to a communications network. Depending upon the type of access chosen by the consumer, the consumer will be able to connect to a wireline telephone network, a mobile wireless network, or the Internet.[131]

The Commission should define geographic markets more narrowly than the entire state.

108. In its recent order approving SBC's acquisition of AT&T, the Commission stated:

> We recognize that the competitive choices customers face may vary within a state (*e.g.*, in some areas of a state, cable companies may provide cable VoIP, while in other areas they may not). This suggests that we should define the relevant geographic market to be an area smaller than the state. The data in the record is not sufficiently detailed, however, for us to perform a structural analysis at a more disaggregated level than that of the state. Accordingly, in performing our structural analysis, we calculate market shares and changes in market share at the state level. While we recognize that, in theory, using a state-level analysis may mask some variations in smaller geographic areas, we find it a reasonable approach to our analysis, particularly given that SBC's pricing for local, long distance, and bundled local and long distance services is generally advertised on a statewide basis. Accordingly, we analyze mass market local, long distance, and bundled local and long distance services in SBC's franchise area within each state.[132]

109. The FCC "punted" on an important matter. By conducting its structural analysis at a state level, the FCC glosses over important market differences between rural and urban areas. In considering whether consumers have meaningful competitive alternatives (and also in assessing the degree to which the nation has succeeded in deploying broadband service), the Commission, in collaboration with state public utility commissions, should examine regions within states.

[131]/ *SBC/AT&T Merger Order,* at paras. 82-83, notes omitted.

[132]/ *Id.*, at para. 99, note omitted.

V. INTERMODAL SERVICES

Intermodal alternatives do not yet provide economic substitutes for consumers of wireline services across all market segments.

110. The Applicants claim that the proposed merger will not adversely affect competition for mass-market customers, and that "local markets are irreversibly open to competition and VoIP, cable, and wireless companies now provide vigorous intermodal competition across all services and market segments."[133] The Applicants' declarants assert: "BellSouth will continue to face increasing mass market competition from a variety of sources including cable based voice-over-Internet-protocol (VoIP) services, 'over-the-top' VoIP services and wireless services."[134]

111. However, the competition that the Applicants describe is irrelevant to competition in the mass market for basic local exchange service. The Commission should afford little weight to the ability of intermodal competition to discipline the actions of AT&T in the wake of its merger with BellSouth. The Applicants' references to intermodal alternatives shed no light on the impact of the merger on the market for plain old telephone service ("POTS") offered to residential and small business customers. The Applicants contend that intermodal services are substitutes for POTS lines.[135] However, as we demonstrate in this section of our Declaration, wireless, facilities-based VoIP, and "over-the-top" VoIP services do not constrain ILECs' prices and service quality for basic voice grade service.

133/ Application, Exhibit 1, at 9.

134/ Carlton and Sider, at para. 12.

135/ *See*, *id.*, at paras. 12, 27-31.

112. Residential consumers' increasing reliance on DSL and intermodal substitutes for *additional* lines does not provide evidence of facilities-based competition in the provision of mass market consumers' primary lines. Intermodal competition that disciplines dominant carriers' prices, service quality, and service innovation is still in the future. The Applicants reliance upon analyst predictions about future competition should be disregarded.[136] Rather than rely on predictions of future, uncertain competition, the Commission should base its review of the merger on the local market structure as it exists today. This is consistent with the Commission's decision in its *Cingular/AT&T Wireless Merger Order* to base its findings on the current state of intermodal competition instead of estimates of potential future competition.[137]

VoIP services are not substitutes to wireline basic exchange services due to differences in consumer needs and to variances among VoIP offerings.

113. The FCC stated in the *SBC/AT&T Merger Order* that "the record indicates that mass market consumers view facilities based [*i.e.,* cable] VoIP services as sufficiently close substitutes for local service to include them in the relevant product market."[138] The FCC elaborated that "[w]hile we recognize that facilities based VoIP services may not be available ubiquitously in SBC's territory, our product market analysis does not require

[136]/ *Id.*, at para. 30.

[137]/ *Applications of AT&T Wireless Services, Inc. and Cingular Wireless Corporation for Consent to Transfer of Control of Licenses and Authorizations, File Nos. 0001656065, et al.; Applications of Subsidiaries of T-Mobile USA, Inc. and Subsidiaries of Cingular Wireless Corporation for Consent to Assignment and Long-Term De Facto Lease of Licenses, File Nos. 0001771442, 0001757186, and 0001757204; Applications of Triton PCS License Company, LLC, AT&T Wireless PCS, LLC, and LaFayette Communications Company, LLC For Consent to Assignment of Licenses, File Nos. 0001808915, 0001810164, 0001810683, and 50013CWAA04*; FCC WT Docket Nos. 04-70; 04-254; 04-323, *Memorandum Opinion and Order*, rel. October 26, 2004 ("Cingular/AT&T Wireless Merger Order"), at para. 242.

[138]/ *SBC/AT&T Merger Order*, at para. 86.

that all mass market consumers would be willing or able to substitute VoIP service for wireline local service, or even that it be widely available for it to be included in the relevant product market. Rather, our product market definition analysis only requires evidence of sufficient demand substitutability in those geographic markets where facilities based VoIP service is available."[139]

114. The Commission should use caution when considering facilities-based VoIP services as substitutes to wireline services for residential consumers for at least two reasons. First, cable telephony does not work during power failures.[140] Second, the competitive threat faced by the telephone companies is in the provisions of bundles of services (often referred to as the "triple play", i.e. phone, video, and Internet access). Such services are usually more expensive than a single, local wireline connection that low-income or elderly consumers may require. For example, the Time Warner Cable website includes the following language in its FAQ section:

> Q: Do I have to subscribe to other services from Time Warner Cable to get Digital Phone Service?
>
> A: No, customers who are only interested in subscribing to Digital Phone Service from Time Warner Cable can receive the service for one low rate of $49.95 per month. If you subscribe to video or high-speed Internet service from Time Warner Cable you'll pay just $44.95 per month for Digital Phone Service. If you subscribe to video and high-speed Internet services from Time Warner Cable,

139/ *Id.*, at para. 87 (note omitted).

140/ Time Warner Cable provides the following FAQ on its website: "Q: Can I call 911 using Digital Phone? A: Yes, absolutely. Safety is an important consideration and enhanced 911 service is provided. *Please note that Digital Phone Service does not include back-up power and, as is the case with a cordless phone, should there be a power outage, Digital Phone Service, including the ability to access 911 services, will not be available until the power is restored*." (emphasis added) Available at: http://www.timewarnercable.com/nc/products/digitalphone/faq.html. Accessed June 1, 2006. Comcast makes the following statement on its website: Comcast Digital Voice "(including 911/emergency services) may not function during an extended power outage, network congestion, network/equipment failure, or another technical problem." http://www.comcast.com/Support/Corp1/FAQ/FaqDetail_2790.html, accessed June 1, 2006.

> you'll receive a discount of $10.00 per month and pay just $39.95 per month for Digital Phone Service.[141]

Similarly, Comcast, as of June 1, 2006, was advertising bundle discounts on its website. A customer subscribing to Comcast Digital Voice faces a price of $54.95 per month. Subscribing to either cable or high-speed Internet access reduces the phone rate to $44.95. A customer subscribing to cable and high-speed Internet access can receive phone service for $39.95 a month.[142] In order to qualify for a rate that is more comparable to a typical wireline rate, cable telephony customers typically must also subscribe to an entire bundle of services they may not need or desire.[143] In a recent survey of VoIP customers, eighty percent of cable VoIP customers indicated that they subscribed to VoIP and high-speed Internet access as a bundle.[144]

115. Cable telephony is not a substitute for basic local service for most small businesses. As the FCC concluded in its Triennial Review proceeding:

> Some incumbent LECs, nevertheless, argue that the Commission should reach similar conclusions about the state of competition in local exchange markets, particularly based on competition from cable companies. As discussed more fully below, we consider such evidence of competition from cable providers as part of our impairment analysis. Our review shows that cable companies predominantly compete in the mass market

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141/ *See*, http://www.timewarnercable.com/nc/products/digitalphone/faq.html. Accessed June 1, 2006.

142/ *See*, www.comcast.com/Benefits/Voice_CMPage.ashx?CTMID=2204&SlotNumber=3, accessed June 1, 2006.

143/ The Commission notes at footnote 267 of its *SBC/AT&T Merger Order* that the average monthly household expenditure for billed wireline local telephone service is $37. Of course, rates vary widely among states for a plethora of reasons and many households subscribe to discretionary services. A basic exchange line that provides access to the network, but no bells and whistles will be substantially less. Thus the cable telephony option will not be price-competitive for the consumer seeking a bare-bones service that provides access to the public switched telephone network.

144/ Brian Santo, "Survey: Cable VoIP subs more satisfied than pure-play VoIP customers," *CED,* May 25, 2006, available at http://www.cedmagazine.com/index.asp?layout=articlePrint&articleID=CA6338178.

> for broadband services throughout the country. To the extent that they compete in other product markets, like the enterprise services market, such competition is evolving more slowly and in more limited geographic areas.[145]

116. In its *SBC/AT&T Merger Order*, the Commission excluded over-the-top VoIP services from the relevant product market.[146] In so doing, the Commission noted that the various over-the-top services:

> . . . differ significantly in their service characteristics, including quality of services and price. The extent to which consumers view these services as substitutes for traditional wireline local service may vary based on these differences. In addition, the requirement that a customer have broadband access to be able to use certain over-the-top VoIP services affects the substitutability of those services with wireline local services.[147]

Regarding the issue of broadband access, the Commission noted that such a requirement made substitution "uneconomical" and further concluded that even those consumers who already subscribed to broadband services may still not be willing to view over-the-top services as substitutes depending on "the attributes of the service and the consumer's willingness to trade off service characteristics for lower prices."[148] The Commission should similarly exclude over-the-top VoIP services from the relevant product market in its investigation of the proposed merger in this proceeding and, more specifically, should continue to reject the Applicants' position that all VoIP services should be included in the Commission's analysis.[149]

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145 / *TRRO*, at para. 39.

146/ *SBC/AT&T Merger Order*, at para. 88.

147/ *Id.* (cite omitted).

148/ *Id.*.

149/ *Id.*, at para. 86. The Commission specifically cites the Declaration of Carlton and Sider and rejects their assertion that all VoIP offerings should be included in the market analysis. *Id.*, at footnote 252, citing SBC/AT&T Carlton/Sider Decl. at paras. 26-29.

117. Carlton and Sider assert that "the credibility" of "over-the-top" VoIP services has been supported by the market's valuation of VoIP providers.[150] The recent Vonage IPO would suggest that the market has re-evaluated VoIP provider prospects. Vonage was apparently in need of capital and attempted to find a buyer at a price similar to the October 2005 buyout of Skype by eBay ($2.5 billion). Unable to find a buyer, Vonage instead raised $531 million in an IPO. Vonage Holding Corp.'s recent IPO was by all accounts lackluster, as the stock price dropped 12.6% in its first day of trading and, as of June 2nd, was down 30% overall from its initial sale on May 24th.[151] Vonage has yet to be profitable, has not yet fully met FCC requirements with respect to E-911 capabilities, and customers continue to complain about poor quality of service.[152] One recent report notes that Vonage has "acknowledged that it may never be profitable" and cites analyst projections that as broadband access becomes more widespread Vonage "may have a harder time ahead as cable and telecom companies' bundled services take hold."[153] A recent survey of VoIP subscribers indicated that the customers of cable VoIP providers

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150 / Carlton and Sider cite the September 2005 purchase of Skype for $2.5 billion. See Carlton and Sider (SBC/AT&T), at para. 30.

151/ Shawn Young, "Web Calling Firms Vonage and Skype Are Focus of Suits," *The Wall Street Journal*, page B8, June 5, 2006; Shawn Young and Lynn Cowan, "Vonage Lacks Voltage in Its IPO, With Weakest Debut in 2 Years," *The Wall Street Journal*, page C4, May 25, 2006.

152/ Shawn Young and Lynn Cowan, "Vonage Lacks Voltage in Its IPO, With Weakest Debut in 2 Years," *The Wall Street Journal*, page C4, May 25, 2006. *See*, also, Reuters, "Update 1 – Vonage sells $531 million in IPO share," May 23, 2006. *See also*, Matt Richtel, "Is Vonage Sinking or Coming Up for Air? Stock's Dive at Debut Is Among the Deepest Seen in Recent Years," *The New York Times,* June 3, 2006, B-1.

153 / Reuters, "Update 1 – Vonage sells $531 million in IPO share," May 23, 2006.

were twice as likely to be satisfied with their service as compared to "over-the-top" VoIP subscribers.[154]

Wireless service is not an economic substitute for basic wireline service.

118. While wireless telecommunications services are prevalent, with approximately 191 million U.S. consumers subscribing to wireless services,[155] ILEC reports that subscribers are abandoning wireline in favor of wireless do not provide support that wireline and wireless phones are truly economic substitutes. The *UNE Fact Report*, sponsored, in part, by SBC (now AT&T) submitted in 2004 in the FCC's Triennial Review proceeding, claims that "[a]n increasing share of wireless subscribers are abandoning their wireline phone . . . Since the Triennial Review, the percentage of wireless users that have given up wireline service has grown from 3-5 percent to 7-8 percent."[156] ILECs also contend that approximately 14 percent of consumers "now use their wireless phone as their primary phone."[157] Apparently, the first statistic that the

[154]/ Brian Santo, "Survey: Cable VoIP subs more satisfied than pure-play VoIP customers," *CED*, May 25, 2006, available at http://www.cedmagazine.com/index.asp?layout=articlePrint&articleID=CA6338178. Despite the apparent relative satisfaction, roughly 40% of cable VoIP subscribers did not express satisfaction with their service. Thirty-four percent of cable subscribers had a technician to the home within 90 days of installation due to problems and sixteen percent had a technician visit multiple times. *Id.*

[155]/ Industry Analysis and Technology Division, Wireline Competition Bureau, FCC, *Local Telephone Competition: Status as of June 30, 2005*, April 2006, at Table 14. Facilities-based wireless carriers with under 10,000 mobile telephony subscribers in a state were not required to report data to the FCC until June 2005. Consequently, it is difficult to determine how much growth in subscribership from June 2004 to June 2005, for instance, is due to additional carriers reporting and how much is due to actual growth in the number of subscribers. *See*, *e.g.*, *Id.*, at footnote 1 to Table 14.

[156]/ *In the Matter of Unbundled Access to Network Elements, Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers*, WC Docket No. 04-313, CC Docket No. 01-338, *UNE Fact Report 2004*, prepared for and submitted by BellSouth, SBC, Qwest, and Verizon, October 2004 ("UNE Fact Report"), II-28, footnote omitted.

[157]/ *UNE Fact Report*, at II-30.

ILECs estimate refers to users who do not have wireline service at all, and the second statistic includes two categories of users – those who keep their wireline service but primarily use their wireless phone and those users who have disconnected their wireline service. The second statistic is less relevant because, until consumers actually disconnect their wireline service, their demand for wireless is not truly an economic substitute for a wireline connection to the public switched telephone network.

119. There are little data supporting the Applicants' assertion that line losses are wholly attributable to intermodal technologies, such as wireless phones. The FCC's most recent commercial mobile radio service ("CMRS") competition report indicates that 5.5 percent of adults were living in households with only wireless phones at the end of 2004.[158] Data provided in the *Tenth Annual CMRS Competition Report* further corroborates the view that mobile wireless and wireline services are complements. The wireless penetration rate is estimated to be 62% and the FCC notes that one study found two-thirds of US households have at least one cellphone, while may have more than one.[159] One might conclude then that very few consumers, even among those already subscribing to wireless services, view the services as perfect substitutes for wireline services. Indeed, one would expect wireless-only rates to be much higher at least among those that already subscribe if the services were viewed as substitutes.

120. In its order approving the merger of SBC and AT&T, the Commission similarly found that approximately six percent of households rely on wireless services for all of

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[158]/ *In the Matter of Implementation of Section 6002(b) of the Omnibus Budget Reconciliation Act of 1993*, FCC WT Docket No. 05-71; *Annual Report and Analysis of Competitive Market Conditions With Respect to Commercial Mobile Services*, Tenth Report, Rel. September 30, 2005 ("Tenth Annual CMRS Competition Report"), at para. 196.

[159]/ *Id.*, at para. 195.

their telecommunications needs (*i.e.* six percent have "cut the cord").[160] The Commission concluded that "the record does not present credible evidence that mobile wireless services have a price constraining effect on all consumers' demand for primary line wireline services."[161] In addition, the Commission observed that the "average cost for mobile wireless services appears to be higher than for wireline local service"[162] which "may make it not price competitive for consumers."[163]

121. Despite those findings, the Commission made the following conclusion:

> . . . our expectation is that intermodal competition between mobile wireless and wireline service will likely increase in the near term. Even if most segments of the mass market are unlikely to rely upon mobile wireless services in lieu of wireline local services today, as discussed above, our product market analysis only requires that there be evidence of sufficient substitution for significant segments of the mass market to consider it in our analysis. Based on the factors discussed in this section, we conclude that mobile wireless services should be included within the product market for local services *to the extent that customers rely on mobile wireless service as a complete substitute for, rather than complement to, wireline service*.[164]

Consumer preference is the best indicator of substitutability. However, we respectfully disagree with the Commission's reliance on an "expectation" of substitutability. The most reliable measure of consumer preference is today's market demand.

122. The Applicants own filing suggests that even the carriers themselves view wireline and wireless services as complements, rather than perfect substitutes. Carlton and Sider state that one of the benefits of the merger will be the simplified governance of

160/ *SBC/AT&T Merger Order*, at para. 90.

161/ *Id.*, at fn 277.

162/ *Id.*, at para. 89.

163/ *Id.*, at fn 267.

164/ *Id.*, at para. 90 (notes omitted, emphasis added).

Cingular and the facilitation of "the merged firm's ability to *jointly market wireline and wireless services to mass market and business customers*."[165]

123. The Applicants have also recognized that wireless does not constitute a substitute for traditional wireline voice service in various regulatory proceedings and in statements to the investor community. Indeed, SBC/BellSouth-owned Cingular and AT&T Wireless, in their merger application, made clear that they believe wireless and wireline networks are not substitutes. The filing argued that wireless service constitutes its own relevant product market for the purposes of antitrust analysis and that "[a]lthough there is some competition between wireless and wireline service, it is not currently sufficient to conclude that a wireless-only product market is too small for antitrust analysis . . . wireline service is sufficiently differentiated from wireless service to exclude wireline from the relevant product market."[166]

124. The Commission should continue to rely on its recent findings in the *Cingular/AT&T Wireless Merger Order* that consumers use wireless and wireline telecommunications services "in a complementary manner," that the services are "distinct because of differences in functionality," and that substitution between wireline and wireless services remains "limited."[167] As the Commission noted: "It would be

[165]/ Carlton and Sider, at para. 10 (emphasis added). *See*, also, *Id.*, at para. 52, stating "The proposed transaction eliminates impediments to developing innovating marketing strategies involving wireless services. Such bundles enable customers to have a single point of contact for a broader range of services."

[166]/ *AT&T Wireless Corporation and Cingular Wireless Corporation Joint Application for Transfer of Control of Licenses and Authorizations*, FCC WT Docket No. 04-70, Declaration of Richard J. Gilbert, March 18, 2004, at para. 44. Dr. Gilbert further stated: "Customer substitution from wireless to wireline would not be sufficient to make unprofitable a small but significant non-transitory price increase by a hypothetical monopoly supplier of mobile wireless voice services." *Id*.

[167]/ *Cingular/AT&T Wireless Merger Order*, at paras. 239, 242.

premature to consider the existence of a separate relevant market in which wireline and wireless services compete for mass market consumers."[168]

The reduction in access lines served by incumbent local exchange carriers over the past several years results from various factors and the Applicants have failed to show a one-to-one relationship between line losses and intermodal competition.

125. As noted in Section III above, the Applicants repeatedly cite the declining number of local exchange wirelines served by AT&T and BellSouth as evidence of robust competition. For example, Carlton and Sider note that BellSouth "lost" 735,000 lines between year-end 2003 and year-end 2004 and "lost" another 1.2 million lines between year-end 2004 and year-end 2005.[169] Carlton and Sider attribute this loss to consumer substitution of wireline services with wireless and VoIP services.[170] As discussed in Section III above, our analysis indicates that intermodal alternatives are, in large part, substitutes for *additional* lines, not primary lines. The apparent reduction in household subscription to additional lines in no way diminishes the market power that AT&T and BellSouth possess in their respective operating territories with respect to basic primary residential lines.

126. During the same time period that BellSouth and AT&T "lost" lines, demand for DSL increased dramatically. Customers are choosing DSL service in lieu of additional lines they had previously used for dial-up access to the Internet. In fact, a portion of AT&T's and BellSouth's customer requests to drop an additional line are

[168]/ *Id.*, at para. 239.

[169]/ Carlton and Sider, at para. 79. *See*, also, Application, at 5; Kahan (AT&T), at para. 11.

[170]/ Carlton and Sider, at para. 79.

counterbalanced by a DSL service request. As incumbents, BellSouth and AT&T have an advantage in the broadband market by virtue of their long-term and ubiquitous provision of basic local exchange service, and so the purported "loss" in one category frequently represents a gain in the DSL category. As noted in Figure 4, AT&T and BellSouth have more than doubled the number of subscribers to their DSL services from year-end 2003 to year-end 2005.

127. Customers' preference for wireless, broadband, and/or VoIP in lieu of a traditional second phone line does not provide evidence that intermodal alternatives are economic substitutes for the primary line. Bells' entry into the long distance market and aggressive use of bundled services appear to be a success story for them. In contrast to the "gloom and doom" story the ILECs have been telling regulators with respect to wireline losses, AT&T has been touting its results in the consumer market to analysts and investors this year.[171] The evidence suggests, in fact, that while AT&T has "lost" a percentage of the basic exchange lines it once served, it has more than made up the difference in DSL additions, video subscriptions, and continued growth in the revenue derived from each line. For example, AT&T recently reported:

- 33 million consumer connections (tradition lines, DSL and video), up one million over the past year;
- revenue connections increased year over year for the 6th straight quarter;
- "deepened penetration of key services"

[171]/ AT&T Analyst Meeting Slide Presentation, January 31, 2006, New York, NY, available at http://library.corporate-ir.net/library/11/113/113088/items/181348/analyst06_b.pdf (accessed June 1, 2006).

- Average Revenue Per User (ARPU) increased for the 7th straight quarter (ARPU increased 7.3% in 2005);
- Penetration rate of 25% for consumer DSL lines.[172]

128. These results show that AT&T's success is derived from its legacy, monopoly connection to the user through the basic local exchange line. Certainly, the acquisition of BellSouth's basic local exchange lines provides AT&T the opportunity to grow its mass market business through increasing the services that each customer buys in association with that basic wireline. At a minimum, such results suggest that to the extent the RBOCs are "losing" lines to intermodal alternatives, many consumers are buying those alternatives from the RBOCs themselves. Any analysis of market concentration should certainly take account of the fact that AT&T controls a significant portion of the intermodal market through Cingular wireless, DSL, and its CallVantage VoIP service offering.

129. While some consumers are giving up additional lines in favor of wireless phones and broadband options, the majority of mass market consumers continue to view a basic wireline as essential.[173] The major power outage that occurred in large portions of the Midwest and Northeast in the summer of 2003 underscores one of several significant differences between wireline and wireless telephones. As reported by one major newspaper the day after the power outage began, "The regular public telephone network

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172/ AT&T Analyst Meeting Slide Presentation, January 31, 2006, New York, NY, available at http://library.corporate-ir.net/library/11/113/113088/items/181348/analyst06_b.pdf (accessed June 1, 2006).

173/ As noted previously, the Pew Internet & American Life Project estimates that over half of all VoIP subscribers continue to maintain a traditional wireline. Pew Internet & American Life Project, *Home Broadband Adoption 2006*, May 28, 2006, at page 15.

generally kept working after the power went out in parts of six states yesterday afternoon, but the cellular systems in affected areas were often unable to cope."[174] Customers with cable telephony also would be unable to make telephone calls (emergency of otherwise) during such a power outage.

130. At a minimum, the degree of cross-elasticity of demand among telecommunications services must be assessed separately for primary versus secondary lines. Lack of access to E911 capabilities or for service when there is a power outage may be tolerable on a second line but unacceptable for a family's or an elderly person's primary line. The fact that a household may substitute a wireless service for a second line for a teenager is irrelevant to the preference that the same household may exhibit for the primary line that connects the household members' to the well-established public switched telephone network, emergency services and the ability to function during a power outage.

131. The Commission should continue to bear in mind that different demographic groups exhibit different preferences and needs, and as such, differing views with regard to the utility of wireless service as a substitute for wireline service. The Commission repeatedly found that there is "significant variation" in the number of consumers "cutting the cord" across both metropolitan areas and across demographic groups.[175]

[174] / Matt Richtel and Simon Romero, "When Wireless Phones Failed, Callers Turned to Land Lines," New York Times, August 15, 2003, page 18.

[175] / *Cingular/AT&T Wireless Merger Order*, at para. 241. *See*, also, *SBC/AT&T Merger Order*, at para. 90.

The Commission should disregard predictions about future competition in assessing the proposed merger's impact on the local exchange market.

132. The Applicants' predictions about the future role of intermodal alternatives is irrelevant to an assessment of the market forces that might constrain AT&T's prices today. For example, Carlton and Sider assert that "recent comments from analysts highlight the dramatic and continuing increase in competition faced by ILECs" and proceed to cite three predictions by analysts regarding the future of telecommunications services.[176] However, the Commission should disregard musings regarding the future of the telecommunications market. Instead, the Commission should give substantial weight to the lack of affordable substitutes in the local exchange market today.

Evidence suggests that intermodal alternatives, even where they are viewed by consumers as substitutes by wireline consumers, make up a very small share of the market; the Applicants have failed to show that such a small share adequately constrains the incumbent's behavior in the market.

133. The Applicants would have the Commission rely on consumer "outliers" to conclude that intermodal alternatives are economic substitutes for basic, unbundled voice grade service. Examining the consumer "outliers" is irrelevant to the mainstream consumers' clear preference to maintain a wireline link to the switched network. The Applicants and other ILECs exaggerate the relevance of intermodal services, and, furthermore, fail to demonstrate that there is sufficient cross-elasticity of demand with households' and small businesses' primary lines to justify considering intermodal services as acceptable substitutes for wireline service. In sum, the Applicants' assertions that intermodal alternatives represent true economic substitutes are unpersuasive.

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[176]/ *See*, *e.g.*, Carlton and Sider, at para. 30.

134. It should be noted that the Commission's market concentration calculations in the *SBC/AT&T Merger Order* include intermodal alternatives only in those instances where evidence suggests that consumers actually use wireless and VoIP as complete substitutes for wireline services. The *SBC/AT&T Merger Order* contains the following explanation of the FCC's methodology:

> We estimate total residential local access lines in each relevant geographic market by summing the number of wireline local access lines (i.e., residential resold lines, residential UNE P lines, non-SBC residential E 911listings, SBC's residential access lines) and an estimate of the number of residential wireless only lines. We estimate residential wireless only lines in two steps. First, we assume that the total number of all local access lines is the number of landline residential lines in SBC's franchise areas divided by 94% (100% minus that 6% of residential customers that rely solely on wireless). Second, we estimate the number of wireless only lines by taking the difference between the estimate of the total number of local access lines and the total number of wireline local access lines. We estimate SBC's share of the residential wireless only lines by multiplying the estimate of residential wireless only lines by an estimate of Cingular's share of mobile wireless based upon mobile wireless lines in the NRUF database. Facilities based VoIP lines will be captured in the E 911 listings. We note that, although we do not intend to include over-the-top VoIP subscribers in our market share calculations (because we are unable to determine which services fall within our relevant product market), subscribers to some of these services may be included in the E 911 listings, and thus included in our market share calculations. [177]

135. The New Jersey Board undertook its own analysis of the state of competition in New Jersey as part of its investigation of the proposed merger Verizon/MCI merger. In its Order approving the merger,[178] the Board found that intermodal technologies does not currently serve as an economic substitute for wireline services in New Jersey's local

[177]/ *SBC/AT&T Merger Order*, at footnote 308.

[178]/ *In the Matter of the Joint Petition of Verizon Communications Inc. and MCI, Inc. for Approval of Merger*, New Jersey Board of Public Utilities Docket No. TM05030189, *Order of Approval*, April 12, 2006 ("NJ BPU Verizon/MCI Merger Order").

market for either enterprise or mass market customers.[179] The Board acknowledged the Petitioners' position that price constraining competition takes place at the margins, and thus intermodal competition need not reach all consumers, but the Board faulted the Petitioners for failing to "actually opine as to how large a percentage of 'early adopters' is required for pricing discipline to occur."[180] In reviewing the evidence, the Board made the following conclusions with respect to the mass market:

> In the case of the aforementioned technologies except wireless, market penetration rates are very low. Thus, we are not willing to accept on this record that intermodal technologies such as VoIP, WiFi, WiMAX and cable telephony currently constrain Verizon's wireline pricing to a meaningful degree.[181]

136. The Board also found the rate at which consumers were "cutting the cord" was insufficient to constrain Verizon's wireline pricing. Though wireless penetration is certainly larger than the penetration of other technologies mentioned above, the Board agreed with the Ratepayer Advocate in finding that "wireless service is currently viewed by the majority of its users as a supplement to wireline service rather than a substitute."[182]

137. With respect to the small businesses, the Board found that none of the intermodal technologies put forth by the Petitioners as substitutes for enterprise wireline services sufficiently disciplined Verizon NJ's behavior in the market. The Board concluded that the various technologies identified by Verizon and MCI are either not true economic

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179/ *Id.*, at 33-35, 36.

180/ *Id.*, at 36.

181/ *Id.*

182/ *Id.*

substitutes (*e.g.,* wireless and VoIP) or have not been adopted by enough subscribers to provide price constraining competition (*e.g.,* cable, WiFi).[183] The Board stated:

> . . . acknowledging the increasing presence of such technologies is not the same as concluding that they sufficiently mitigate competitive harms created by the merger by constraining ILEC wireline pricing. In fact, we conclude that in New Jersey such alternative technologies have not yet had this effect in the business market.[184]

138. In summary, for the reasons discussed in this section, intermodal alternatives do not yet constrain AT&T's and BellSouth's market power. The Commission should rely on actual market demand data and should reject the Applicants' speculations about consumers' future patterns of demand. Mass market consumers are particularly vulnerable to neglect, service quality deterioration, price increases, and discriminatory access to the Internet as a result of the proposed merger. Intermodal alternatives will not protect them from the harm that the merger poses.

[183]/ *NJ BPU Verizon/MCI Merger Order*, at 33-35.

[184]/ *NJ BPU Verizon/MCI Merger Order*, at 35.

VI. IMPACT OF MERGER ON RELEVANT MARKETS

A duopoly will not protect mass market consumers from AT&T's near-monopoly position in the local market.

139. As we discuss above, intermodal alternatives do not constrain the Bells' market power. As we also demonstrated, CLECs' inroads into the local market are minimal and precarious, and, therefore, do not discipline the prices and quality of basic local telephone service. Furthermore, with legacy AT&T's and MCI's exits from the mass market, and the recent end of TELRIC-based prices for UNE-P, prospects for residential basic local telephone service competition have largely evaporated.

140. Some point to the cable industry as evidence of competition. Indeed, the cable industry represents the major potential threat to AT&T's, BellSouth's, Verizon's and Qwest's dominance in telecommunications markets.[185] Companies that traditionally offered cable services are now entering telecommunications markets. Companies that traditionally offered telecommunications services are now offering video services. However, this emerging rivalry between companies which seek to offer customers bundles of video, data, and voice, represents at best a duopoly. A duopoly is not an effective form of competition.

[185]/ AT&T's assessment of cable competition seems to differ by audience, however. While citing analyst predictions regarding the growth of access lines provided by cable companies in this proceeding (*see, e.g*. Carlton and Sider (SBC/AT&T), at 13), AT&T recently made the following prediction: "While cable telephony will be widely deployed by 2009, we expect only 6% of revenue to be at risk. This risk will be offset by ARPU growth from video and broadband penetration." AT&T Analyst Meeting Slide Presentation, January 31, 2006, New York, NY, available at http://library.corporate-ir.net/library/11/113/113088/items/181348/analyst06_b.pdf (accessed June 1, 2006).

141. Cable companies do not discipline the prices, quality, and terms of conditions of basic telecommunications services offered to customers that do not seek bundles.[186] Furthermore, even those customers who are willing and able to pay for bundled packages of voice, data, and/or video services confront high transaction costs to migrate from one supplier to another. Transaction costs include the time and financial outlay for service installation, equipment, and an e-mail address change.

142. Moreover, telecommunications service providers use various tactics to lock-in customers. Although some of these tactics may offer short-term consumer benefits, they also impose transaction costs if customers later wish to change service providers. Some of the tactics that deter migration include:

- offering discounts for one-year contracts, instead of month-to-month agreements,
- bundling necessary equipment with a long-term commitment,
- imposing early termination fees, and
- non-portability of features.

The Ratepayer Advocate calculated a yearly cost of $264 for customers who seek to avoid being "locked in" to their service ("Lock-in Avoidance Premium") for AT&T recently in reply comments filed in the Commission's *Consumer Protection in a Broadband Era* proceeding.[187]

143. Indeed, in addition to the business goal of seeking to attract customers in the high revenue segment of the market, the desire to lower customer churn is one of the

[186]/ See our earlier discussion of rates for cable telephony with and without the purchase of bundles.

[187]/ *In the Matter of Consumer Protection in a Broadband Era*, FCC WC Docket No. 05-271, Reply Comments of the New Jersey Division of the Ratepayer Advocate, at 7-10.

industry's key motivating reasons for marketing bundled offerings to customers. The Commission stated:

> SBC's documents reveal that its research and development, marketing, and corporate strategies focus upon service offerings designed to encourage consumers to subscribe to a local and long distance service bundle. SBC's incentive is to drive consumers to purchase all telephone services from SBC to reduce its marketing costs and churn, as well as to increase its average revenue per user[188]

144. In discussing its analytical framework for its review of the SBC/AT&T merger, the Commission cited its reasoning in the *EchoStar/DirectTV Order*:

> Unilateral effects arise when the merging firm finds it profitable to alter its behavior following the merger. Examples of unilateral effects include a merging firm's raising its price or reducing the quantity it supplies. Coordinated effects, in contrast, arise when competing firms, recognizing their interdependence, take actions "that are profitable for each of them only as a result of the accommodating reactions of others." Because coordinated effects generally are more likely the smaller the number of firms in a market, mergers may significantly increase the likelihood of coordinated effects by reducing the number of firms. Examples include explicit collusion, tacit collusion, and price leadership.[189]

188/ *SBC/AT&T Merger Order,* at note 297, citing SBC/AT&T Reply at 89-91; SBC Investor Briefing, April 21, 2004 at 5; SBC Investor Update, SBC 2004 First Quarter Earnings Conference Call, Apr. 21, 2004 at 6, 16, 18; SBC Info. Req., SBC24705-22. The Commission also stated, "[m]oreover, these strategies are revealed by the marketing of its bundled service offerings, as well as its policy of requiring consumers to subscribe to its local service as a prerequisite to subscribing to its long distance service." *Id.*, citing, SBC Residential Solutions (visited Aug. 19, 2005) available at http://www02.sbc.com/Products_Services/Residential/Catalog/1,,13--1-3-13,00.html; see also, e.g., SBC Info. Req., SBC57075 at 57089; SBC218651 at 218693; SBC121379 at 121381, 121388; SBC39089 at 39098, 39140-41.

189/ *SBC/AT&T Merger Order*, at fn 85, citing *EchoStar/DirecTV Order*, 17 FCC Rcd at 20609, para. 152.

The Commission also noted in its *SBC/AT&T Merger Order*:

> It is generally recognized that the likelihood of coordinated effects depends on a number of factors, including the ease with which firms can reach tacit agreement, the incentive of firms to cheat, and the ability of the remaining firms to detect and punish such cheating.[190]

145. A landmark Commission decision in 2005, which determined that wireline broadband Internet access services are information services, and which eliminated ILECs' requirement to share their DSL lines, further reinforced the emerging cable/telco duopoly.[191] The Commission should not rely on this duopoly to protect consumers from AT&T's exercise of its monopoly power. The Commission should deny the merger because it would significantly increase the likelihood of coordinated effects among the major carriers.

146. A duopoly, which is an extreme form of an oligopoly, is only one step away from a monopoly. In an oligopoly, a number of firms compete in a market, and the firms' behavior, cost functions, and strategic interaction as well as consumers' demand functions affect the market structure. One textbook describes the behavior of firms in an oligopoly as follows:

> Any realistic theory of oligopoly must take as a point of departure the fact that when market concentration is high, the pricing decisions of sellers are interdependent, and the firms involved can scarcely avoid recognizing their mutual interdependence. If they are at all perceptive, the managers of oligopolistic firms will recognize too that profits will be higher when cooperative policies are pursued than when each firm looks only after its own narrow self-interest. As a result, we should expect oligopolistic

[190]/ *Id.*, at para. 52, citing Jean Tirole, *The Theory of Industrial Organization* 239 (1988); George Stigler, "A Theory of Oligopoly," in *The Organization of Industry* 39 (1968); Alexis Jacquemin and Margaret E. Slade, "Cartels, Collusion, and Horizontal Merger," in *The Handbook of Industrial Organization* 415 (1989).

[191]/ *Broadband Sharing Order.*

> industries to exhibit a tendency toward the maximization of collective profits, approximating the pricing behavior associated with pure monopoly.[192]

147. In its order approving SBC's merger with AT&T, the Commission determined that the transaction would not increase the probability of coordinated interaction among suppliers of telecommunications services:

> We also find that SBC's acquisition of AT&T is unlikely to result in anticompetitive effects through coordinated interaction among remaining competitors. Given our finding that AT&T is not a significant market participant, we find no indication that the proposed acquisition increases the likelihood of coordinated interaction for the relevant products. Moreover, the increasing trend toward bundled service offerings likely decreases the possibility of coordinated interaction. Because of the complexity and variety of the bundled local and long distance service offers, competitors will find it difficult to coordinate on prices.[193]

The Commission's optimism in the market should not extend to this merger. Instead, the Commission should reject the proposed transaction because, by eliminating an actual and potential competitor, the Commission would facilitate the coordinated interaction among the remaining suppliers. Indeed, at a recent analyst conference, AT&T Chairman and CEO Ed Whiteacre suggested that there would not be a "price war" between cable and telephone companies, stating "We're not going to chase that down." Instead, Whiteacre suggested that the companies would compete on the basis of who offers more services in their packages.[194]

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[192]/ F. M. Scherer, Industrial Market Structure and Economic Performance, Rand McNally & Company, (1970), at 157; *see also* discussion at 131 through 157. *Also see* Mas-Colell, Andreu, Michael D. Whinston and Jerry R. Green, Microeconomic Theory (New York: Oxford University Press, 1995), at 387 through 427.

[193]/ *SBC/AT&T Merger Order*, at para. 106, notes omitted.

[194]/ Roger Chang, "AT&T CEO Backs View of Double-Digit Adjusted EPS Growth," *The Wall Street Journal Online*, May 31, 2006.

SBC's acquisition of BellSouth would eliminate an actual and potential competitor in the mass market.

148. The Applicants suggest that because "legacy" AT&T had already retreated from the mass market, the merger would not impose any harm on mass market competition. Carlton and Sider acknowledge that the FCC concluded in the SBC/Ameritech and Verizon/GTE Orders that mergers among ILECs can raise competitive concerns.[195] They conclude that none of the FCC's previous concerns is applicable to this transaction.[196]

149. Carlton and Sider claim that BellSouth is not a potential entrant in legacy SBC's region. They contend further that legacy AT&T was already withdrawing from the mass market thus there is not elimination of a potential entrant.[197] Finally, Carlton and Sider argue that "the experience of recent years indicates that an ILEC has no special advantage relative to other CLECs in providing mass market services outside of its service territory."[198] Carlton and Sider provide no evidence, however, for this assertion. They note that BellSouth has no "significant" customer base outside its home territory and no "significant" network and that they are "unaware" of any case where an ILEC has successfully competed out-of-region.[199] Carlton and Sider fail to address legacy SBC in this discussion except to note that AT&T has continued to "harvest" its mass market customers since completion of the SBC/AT&T merger.[200]

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[195]/ Carlton and Sider, at para. 119.

[196]/ *Id.*, at para. 121.

[197]/ *Id.*, at para. 142.

[198]/ *Id.*, at para. 143

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[199]/ *Id.*

[200]/ *Id.*, at para. 144.

150. The Commission has previously determined that a merger among Bells "would increase the incentives and ability of the larger merged entity to discriminate against rivals."[201] The Commission also determined that if one ILEC discriminates in one region against a CLEC, the CLEC is less likely to enter other regions, and, therefore, the marginal benefit of discrimination increases as ILECs merge.[202]

151. Carlton and Sider acknowledge that the Commission, in its analysis in the *SBC/Ameritech Merger Order*, rejected Carlton and Sider's analysis that purportedly contradicted the theory of ILECs' increased incentives to discriminate against CLECs. Carlton and Sider state, however, that "a number of other researchers" have conducted additional empirical analyses finding results similar to their original study.[203] The studies they cite, however, are based on the telecommunications industry of 1999, which bears little resemblance to today's significantly more concentrated market, which, among others, legacy AT&T and MCI have abandoned.[204]

152. Carlton and Sider contend that industry changes reduce the possibility for discrimination, and rely on a purported increase in CLEC activity, growth in facilities-based competitors, CLECs' ability to use another carrier's network as opposed to the ILEC's fiber network, regulators' increased experience with the provisioning of UNEs

[201]/ *SBC/Ameritech Merger Order*, at para. 60.

[202]/ *Id.*, at paras. 192-193.

[203]/ Carlton and Sider, at para. 125.

[204]/ *Id.*, at fn. 144.

and interconnection arrangements, and the existence of performance metrics designed to detect discriminatory provisioning.[205]

153. We disagree with their optimistic view about the purportedly improved climate for CLECs. The Applicants have failed to demonstrate that the incentives and opportunities for Bell discrimination against CLECs have diminished since 1999. The concerns that the Commission described in the context of SBC's acquisition of Ameritech are germane to AT&T's acquisition of BellSouth. The further reduction in the number of ILECs will further increase the benefit which the remaining ILECs gain from CLEC discrimination.

The merger would diminish opportunities for out-of-region competition among the Bells.

154. Carlton and Sider argue that the merger "raises no significant concerns regarding harm to mass market competition," in part due to the fact that it does not "eliminate competition in the provision of mass market services."[206] AT&T refers to legacy AT&T's decision in June 2004 to cease actively marketing its traditional services to mass market customers, to AT&T's originally planned "harvesting" strategy, and to the new AT&T's continued harvesting strategy for mass market wireline customers outside its

[205]/ *Id.*, at paras. 126-131.

[206]/ *Id.*, at para. 12. *See also,* Kahan (AT&T), at paras. 46-52, contending that the merger will not adversely affect mass market competition. Yet, at a January 2006 analyst conference, AT&T indicated that it was "maximizing the legacy AT&T customer base," continuing to serve customers out-of-region, and in the long term would "consider offering bundles with AT&T CallVantage, DISH Network, Cingular and broadband in strategic markets." AT&T Analyst Meeting Slide Presentation, January 31, 2006, New York, NY, available at http://library.corporate-ir.net/library/11/113/113088/items/181348/analyst06_b.pdf (accessed June 1, 2006).

ILEC footprint.[207] Carlton and Sider also assert that "[t]he minor roles played by both AT&T and BellSouth as over-the-top VoIP providers provide no basis to conclude that the proposed transaction creates any potential competitive harm."[208]

155. It is premature to deduce that AT&T and BellSouth, absent the merger, could not have competed in each other's territory. The merger would irrevocably eliminate actual and potential competitors.

156. According to AT&T, in the BellSouth footprint, as of February 2006, AT&T served approximately 285,000 "all-distance" customers.[209] By acquiring BellSouth, AT&T would eliminate this competition in the BellSouth region. We understand that the legacy AT&T was allowing its mass market base to erode, but, as a result of the legacy AT&T's merger with SBC, the new, enlarged ILEC could conceivably muster the resources to engage in head-to-head competition with BellSouth.

157. Also, as of February 2006, AT&T served fewer than two million stand-alone distance customers in BellSouth's region.[210] Similarly, AT&T, with its new IXC/ILEC identity, could have parlayed these two million customers into bundled customers. Instead, Mr. Kahan estimates that AT&T continues to lose customers at a rate of approximately 3 percent each month.[211] AT&T's inability to leverage its substantial resources into rivalry with BellSouth seriously undermines any pretense that local

[207]/ Kahan (AT&T), at paras. 46-47.

[208]/ Carlton and Sider, at para. 86.

[209]/ Kahan (AT&T), at para. 48.

[210]/ *Id.*.

[211]/ *Id.*

competition can evolve. If the recently merged AT&T/SBC cannot compete with BellSouth, who can?

158. AT&T indicates that, *in its ILEC region,* it is actively marketing "to some of the legacy AT&T's mass market customers to respond to aggressive competition from cable and other providers," actively pursu[ing] AT&T customers to try to sell them a bundle of services, including local and long-distance voice, DSL, wireless and video, at competitive prices."[212]

159. AT&T markets its CallVantage (its over-the-top VoIP service) through its website and retailers such as Best Buy.[213] AT&T asserts that it "does not have an active sales channel for AT&T CallVantage."[214] AT&T has fewer than 14,000 AT&T CallVantage customers in BellSouth's nine states, and fewer than 80,000 customers nationwide.[215] Mr. Kahan's statement that the rate of increase in AT&T's CallVantage subscribers "has been well under 50% in the past year,"[216] and his statement that AT&T has "not made any other decisions about expanding [its] AT&T CallVantage marketing efforts, either in-region or out-of-region," simply underscores the fact that AT&T's acquisition strategy, is its mode rather than competition. The ability to increase one's business by 50% in a year, without even exerting an effort, is compelling evidence that AT&T has a substantial

[212]/ *Id.*, at para. 49.

[213]/ *Id.*, at para. 51.

[214]/ *Id.*

[215]/ *Id.*

[216]/ *Id.*, at para. 51.

advantage as the incumbent. Although Vonage is an example of a potential rival with more than a million customers, its growth has depleted its financial resources.[217]

160. BellSouth does not operate a national network outside its nine-state region, and according to Mr. Boniface "had no plans to build such a network absent the pending transaction."[218] Furthermore, BellSouth indicates that it competes to serve-out-of-region services for large customers "only in cases where the customers' operations are predominantly located within our region."[219] Carlton and Sider assert that "BellSouth has no plans to provide mass market services outside its home region" and state that "AT&T has no plans to deploy additional facilities to serve mass market customers in BellSouth's region and, as discussed later, has only a limited customer base for its over-the-top VoIP service."[220]

161. Mr. Boniface asserts that BellSouth and AT&T "are not significant competitors in the mass market" and that BellSouth has no plans to sell wireline telephone services outside of its nine-state region.[221] He further states that BellSouth has a limited arrangement with "8 x 8" to resell its VoIP service within the BellSouth footprint, but that BellSouth "currently has no plans to develop its own VoIP offering for the mass market."[222]

217 / *See* our more detailed discussion in Section V of VoIP limitations.

218/ Boniface (BellSouth), at para. 17.

219/ *Id.*, at para. 22.

220/ Carlton and Sider, at para. 17.

221/ Boniface (BellSouth), at para. 35.

222/ *Id.*

162. BellSouth's apparent lack of plans to compete out-of-region, and lack of plans to develop its own VoIP service simply underscore the difficulty of challenging incumbent local exchange carriers. Furthermore, Mr. Boniface's explanation that although AT&T provides some mass market services within AT&T's region, it not a "price constraining force" because AT&T "is no longer competing actively in that market,"[223] is tautological. The rationale simply is that because AT&T has chosen not to compete in BellSouth territory, it is not a competitor. However, neither AT&T nor BellSouth address the more important question of *why* the new and larger AT&T is uninterested and/or unable to compete with BellSouth.

163. Carlton and Sider characterize the merger as combining a "regional ILEC (BellSouth) with a major national carrier (AT&T) that operates both inside and outside the ILEC's territory" and state further, "[t]hus, the transaction is subject to the same competitive analysis that the FCC applied in the AT&T/SBC and Verizon/MCI transactions."[224] Carlton and Sider rely on the FCC's analysis of the SBC/AT&T and Verizon/MCI mergers,[225] with respect to the proposed merger's impact on mass market consumers, but these mergers differ fundamentally from the merger of two ILECs. Unlike the two recent mergers, the transaction in this proceeding would concentrate market power by eliminating yet one more Bell. The Commission previously stated: "In addition, the record indicates that SBC has invested over $1 billion in improvements to its out-of-region network which can be used to serve out-of-region customers; it has at least [REDACTED] out-of-region customers; and it provides enterprise service to 30 out-

223/ *Id.*

224/ Carlton and Sider, at para. 24.

225/ *Id.*, at paras. 27-31.

of-region MSAs, with collocation facilities in at least 10 central offices in each MSA."[226] By acquiring BellSouth, AT&T could avoid competing. If the FCC decides to approve this merger, it would be conceding implicitly that mass market competition is no longer feasible.

The Commission should analyze AT&T's pricing and service quality since the SBC/AT&T merger occurred.

164. In AT&T's previous merger application to the Commission, its declarants stated: "[i]n addition, our analysis to date indicates that the transaction is unlikely to create significant competitive problems due to a variety of characteristics of the industry and Parties, including: (i) the largely complementary nature of AT&T's and SBC's networks, services and target customers; (ii) the rapid on-going pace of developments in telecommunications technology; (iii) AT&T's prior decision to cease marketing its services to residential and small business customers; (iv) the growth of facilities-based competition for both businesses and residential consumers; and (v) the sophistication and purchasing practices of business customers as well as the importance of non-price dimensions of telecommunications services."[227]

165. In its previous merging filing, AT&T's declarants stated that "residential customers that would have remained with [the legacy] AT&T in the absence of the transaction are likely to benefit from the merger because SBC, which has no plans to exit,

[226] / *SBC/AT&T Merger Order,* at note 237, citing SBC/AT&T Reply at 136-38; SBC Info. Req., SBC255592-621 at 255598.

[227] / Carlton/Sider (SBC/AT&T), at para. 5.

does not face the same incentives as [the legacy] AT&T to raise prices to this group."[228] The Commission should direct AT&T to submit information about any pricing changes to residential customers that were served by the legacy AT&T and that are now served by the new AT&T.

The FCC should consider why the RBOCs merge rather than compete with each other.

166. There is negligible evidence of Bells seeking to compete head-on as rivals with other Bells, particularly for mass market consumers. The Applicants have not provided persuasive evidence (either through SBC's historic actions or the Application) that they will compete for mass market consumers.

167. Almost seven years ago, SBC and Ameritech filed an application with the FCC for approval of their merger, and promised, if the merger were approved, that SBC would enter 30 out-of-region markets throughout the country.[229] When SBC sought regulatory approval to merge with Ameritech, it touted the benefit of its "National Local Strategy" which would purportedly bring competition to markets throughout the country as the merged entity entered rival BOC local markets. Among other things, SBC predicted that:

> SBC will begin offering service to residential customers within one year of the closing with Ameritech, and plans to offer service to a majority of the households in the 30 out-of-region markets within four years of closing. We anticipate that we will achieve an overall penetration rate of 4 percent of the residential customers in all of these 30 markets. … We anticipate achieving similar results in the small business segment.[230]

228/ *Id.*, at para. 6.

229/ *In re: Applications of Ameritech Corp., Transferor, and SBC Communications, Inc., Transferee, for Consent to Transfer Control*, FCC CC Docket No. 98-141, *Application*, filed July 27, 1998, § II.A.1.

230/ SBC/Ameritech Merger, Description of the Transaction, Affidavit of James S. Kahan, CC Docket No. 98-141, July 20, 1998, at para. 63.

168. Skepticism about SBC's planned entry into out-of-region market was expressed at the time of its proposed merger with Ameritech: "SBC's fiduciary responsibilities lie with its stockholders, not its customers, and if top management subsequently determines that out-of-region markets are not likely to become profitable within a reasonable period of time, SBC may well abort or scale back its National/Local strategy."[231] Furthermore, one of SBC's own managers recognized that local entry might not be profitable. As was observed at the time the application was pending regulatory approval, "Mr. Kahan specifically states that the business plan for the National/Local Strategy contemplates a 'negative cash flow for nearly ten years'"[232] and the "Applicants' claims with respect to the benefits for residential and small business market are particularly unpersuasive. In fact, the Applications are openly disparaging of the residential and small business market."[233]

169. The FCC transformed the carrier's promises into regulatory conditions.[234] The fact that SBC's entry into out-of-region local markets was among the conditions of the FCC's approval of the merger simply underscores the regulatory concern that, absent such an explicit requirement, SBC, despite its substantial size, resources, and expertise

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[231]/ *In re Applications of Ameritech Corp., Transferor, and SBC Communications, Inc., Transferee, For Consent to Transfer Control*, Federal Communications Commission CC Docket No. 98-141, Affidavit of Susan M. Baldwin and Helen E. Golding, on behalf of Indiana Utility Consumer Counselor, Michigan Attorney General, Missouri Public Counsel, Ohio Consumers' Counsel, Texas Public Utility Counsel and Utility Reform Network, filed on October 13, 1998, at para. 41.

[232]/ *Id*., at footnote 65, citing James S. Kahan (SBC), at para. 80.

[233]/ *Id*., at para. 87.

[234]/ *In re: Applications of Ameritech Corp., Transferor, and SBC Communications Inc., Transferee, for Consent to Transfer Control*, FCC CC Docket No. 98-141, *Memorandum Opinion and Order*, released October 8, 1999 ("SBC/Ameritech Merger Order"), at paras. 398-399, Appendix E. The FCC's conditions required SBC to enter 30 of 50 potential out-of-region markets.

serving the local market, might have decided not to enter out-of-region markets, once it had obtained the requisite regulatory approval to merge.

SBC's apparent compliance with the bare bones out-of-region entry conditions the FCC imposed on its merger with Ameritech does not provide compelling evidence of likely concerted future out-of-region efforts.

170. The FCC established minimum market entry conditions when it approved the SBC/Ameritech merger in 1999. The "verifiable entry requirements" set by the merger order were:

- installing or obtaining switching capability;
- providing facilities-based service to each of three business or residential customers;
- collocating in each of ten wire centers;
- offering facilities-based service to all business and all residential customers served by each of those ten wire centers; and
- offering service, whether by resale, unbundled elements of facilities to all business and all residential customers with the entire service area of the incumbent RBOC of Tier 1 incumbent LEC in the market.[235]

171. Four years ago, SBC reported to the FCC that Condition 21 (i.e., the Out-of-territory competitive entry condition) had been met.[236] On March 5, 2002 (a month shy of the April 8, 2002 deadline) SBC provided notice to the FCC that it had satisfied all remaining entry requirements. SBC had installed switching capacity and was providing facilities-based local exchange service to at least three unaffiliated customers in Charlotte, Jacksonville, Las Vegas, Louisville, Memphis, Nashville, Norfolk, Portland, Raleigh and Tucson.[237] Also on March 5, 2002, SBC claimed to have collocated

[235]/ *SBC/Ameritech Merger Order*, at para. 399.

[236]/ SBC Communications, Inc., *SBC/Ameritech Merger Conditions 2002 Compliance Report to the FCC*, March 15, 2003.

[237]/ *Id.*, at 26.

facilities in at least 10 wire centers in the market "that could be used to provide facilities-based service to customers served by those wire centers"; was offering facilities-based local exchange service all residential and business customers served by the 10 wire centers; was offering local exchange service to all business and residential customers throughout the areas within RBOC service territories in the following markets: New York, Atlanta, Ft. Lauderdale, Phoenix, Denver, Salt Lake City, Washington DC, Minneapolis, Orlando, Baltimore, Philadelphia, Tampa, and West Palm Beach. In August of 2002, SBC reported to the FCC that it had met all of the entry requirements for each of the 30 out-of-territory markets.[238] However, although SBC may have fulfilled the "letter" of the FCC's requirements, there is no evidence that SBC has fulfilled the "spirit" of the FCC's condition approving its merger with Ameritech.[239]

172. SBC's foot-dragging compliance with prior merger conditions underscores two concerns that are relevant to this proceeding. First, based on legacy SBC's merger history, once having obtained the requisite regulatory approvals, the Applicants are likely to comply at a bare minimum level with any conditions that the Commission imposes. Therefore, unless there is a preponderance of evidence that the merger is in the public interest, the Commission should deny the transaction. If, however, the Commission does approve the merger, conditioned upon specific commitments, the Commission should

[238]/ *Id.*, at 27. The FCC required SBC to enter Boston, Miami, and Seattle within twelve months after the merger closing, an additional twelve markets within 18 months of the merger closing, and all 30 markets by the later of 30 months after the merger closing date or 60 days following SBC's authorization to provide in-region interLATA services in states representing at least 60 percent of all access lines that the merged entity served. *SBC/Ameritech Merger Order*, at para. 399.

[239]/ See, *e.g.*, "Bells Are Failing to Compete As They Promised," David Rohde, *Network World*, March 5, 2001.

design the conditions carefully with strong incentives for compliance and clear standards for enforcement.

If the past is a guide, the likelihood of benefits flowing to mass market consumers is negligible.

173. Although the proposed combined AT&T/BellSouth entity may have greater resources with which to compete with Verizon and Qwest, based on SBC's track record, it is not evident that, as the merger is presently structured, mass market consumers would actually benefit from more vigorous local competition. In 1998, Affiant James S. Kahan, on behalf of SBC and Ameritech stated that the merged company planned to "offer service to a majority of households in the 30 out-of-region markets within four years of closing."[240] As part of the FCC's approval of the SBC/Ameritech merger in 1999, the following conditions regarding competition in out-of-region markets (termed SBC's National-Local Strategy):

> SBC and Ameritech will select the 30 out-of-territory markets from the list of 50 major markets that they included in their proposal. As part of the combined firm's entry into each of these new markets, SBC and Ameritech will either meet certain verifiable entry requirements in each market (i.e., installing or obtaining switching capability; providing facilities-based service to each of three business or residential customers; collocating in each of ten wire centers; offering facilities-based service to all business and all residential customers served by each of those ten wire centers; and offering service, whether by resale, unbundled elements or facilities, to all business and all residential customers within the entire service area of the incumbent RBOC or Tier 1 incumbent LEC in the market), or make voluntary incentive payments to a state-designated fund (or as governed by state law) in the amount of $110,000 per day for each missed entry requirement, for a total of $1.1 million per entry requirement per market . . . The Applicants' implementation schedule requires the combined firm to enter Boston, Miami and Seattle within 12 months after the merger

[240]/ SBC/Ameritech Merger, Description of the Transaction, Affidavit of James S. Kahan, CC Docket No. 998-141, July 20, 1998, at para. 63.

> closing, an additional 12 markets within 18 months of closing, and all 30 markets by the later of 30 months after the merger closing date or 60 days following the company's authorization to provide in-region, interLATA services in states representing at least 60 percent of all access lines served by the combined firm's incumbent LECs.[241]

174. Even at the time of the merger approval, the FCC found that there was no evidence that SBC/Ameritech's National-Local Strategy would benefit residential and small business consumers. In fact, the FCC found that the companies' plan was to target the top quartile of the residential market in terms of telecommunications expenditures.[242] SBC's Senior Executive Vice President of Corporate Development, James S. Kahan admitted as much in his declaration submitted a year ago in support of SBC's proposed acquisition of AT&T, stating:

> SBC has sought since the late 1990s to become a significant provider to enterprise customers at the national level . . . Despite the commitment of significant resources and investment to execute the "National-Local" strategy we envisioned at the time of the Ameritech acquisition, the results so far have fallen short of our expectations. We have come to realize that acquisition of a firm that has the strengths and resources we lack is far more prudent than incurring the massive investment and time that, without a substantial likelihood of return in a reasonable period of time, would be required to develop them independently.[243]

175. Mr. Kahan also suggests that the National-Local strategy was always geared towards acquiring the large business customers, describing the strategy as "our organic attempt to achieve in a reasonable time frame the critical mass of customers needed to achieve the scale and scope economies required to compete successfully in the large business segment. It involved the expansion to 30 out-of-region cities with an interconnecting backbone network. We have so far spent in excess of $1 billion over five

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[241]/ *SBC/Ameritech Merger Order*, at para. 399.

[242]/ *Id.*, at paras. 313-314.

[243]/ Kahan (SBC/AT&T), at para. 23.

years . . . Still, we find it very difficult to win a prime supplier role for large enterprise customers . . . "[244]

The dwindling number of Bells is concentrating market power among a few.

176. Many years have passed since Mr. Kahan promised that SBC would compete out of its home region in direct competition with other Bells. As we discussed above, not only did SBC barely fulfill its commitment to do so, but it has clearly abandoned any pretext of competing with fellow Bells. The lack of Bell entry into other Bell territory, whether a result of tacit collusion or the result of each Bell independently deciding such a business strategy would be imprudent, casts serious doubt over the probability of other carriers being able to enter and succeed in Bell-dominated markets. If legacy AT&T, legacy MCI, legacy SBC, Verizon, Qwest, and BellSouth were and are unable to compete profitably in local markets, how can effective competition possibly evolve in local markets? The cable-telco rivalry, as we demonstrate earlier, is at best an oligopoly, and at worst a duopoly. Economic literature clearly conclude that neither represents effective competition.

177. Nonetheless, assuming that, contrary to the RBOCs' avowed plans to avoid competing in each other's territory, the RBOCs engaged in inter-BOC rivalry, one could analyze the impact of the proposed merger on market concentration. An Herfindahl Hirschman Index ("HHI") analysis illustrates the excessive market concentration that this merger would cause.

[244]/ *Id.*, at para. 24.

178. The HHI is a well-known measure of market share concentration,[245] and is computed as the sum of the squares of each firm's market share. If a single firm serves a market, the HHI is 10,000 (the highest possible HHI), and if two firms each equally serve a market the HHI of that market is 5000. The larger the HHI, the greater the concentration. Markets with HHI below 1000 are considered to be unconcentrated; those with an HHI between 1000 and 1800 to be moderately concentrated, and those with an HHI above 1800 to be highly concentrated.[246] Table 4 shows that, if AT&T acquires BellSouth, the HHI would increase from 3,075 to 4,199,[247] an increase that vastly exceeds the 100-point threshold of concern set forth in the Merger Guidelines.

[245]/ U.S. Department of Justice and the Federal Trade Commission, *Horizontal Merger Guidelines*, issued April 2, 1992, revised April 8, 1997 ("Horizontal Merger Guidelines"), § 1.5; F.M. Scherer, *Industrial Market Structure and Economic Performance*, Rand McNally & Company, Chicago, 1970, 50-52.

[246]/ *Horizontal Merger Guidelines,* § 1.51.

[247]/ The analysis does not include CLECs' minimal market shares. Including small market shares would not significantly alter the analysis.

Table 4[248]

The Merger of AT&T and BellSouth Further Concentrates an Already Concentrated Industry

Pre-Merger HHI

	Total Switched Access Lines (thousands)	Market Share	HHI Component
AT&T	48,768	37%	1,384
BellSouth	19,799	15%	228
Qwest	14,546	11%	123
Verizon	47,966	37%	1,339
RBOC Total	131,079		
	Pre-Merger HHI		**3,075**

Post-Merger HHI

	Total Switched Access Lines (thousands)	Market Share	HHI Component
AT&T-BellSouth	68,567	52%	2,736
Qwest	14,546	11%	123
Verizon	47,966	37%	1,339
RBOC Total	131,079		
	Post-Merger HHI		**4,199**

179. The implication of this market concentration and re-monopolization by RBOCs is that the merger would further entrench AT&T's market power and thus its ability to raise prices without consumer flight (*i.e.*, consumers will not have other options if AT&T raises prices or provides poor service quality).

248/ Sources: AT&T Investor Briefing, April 25, 2006; BellSouth 1q06x.xls (accessed at http://phx.corporate-ir.net/phoenix.zhtml?c=95539&p=irol-IRHome); Qwest Q12006EarningsReleaseAttachments.xls (accessed at http://phx.corporate-ir.net/phoenix.zhtml?c=119535&p=irol-reportsAnnual); Verizon Investor Quarterly, May 2, 2006.

180. Section 1.5.1 of the Merger Guidelines state, *inter alia,*

> In evaluating horizontal mergers, the Agency will consider both the post-merger market concentration and the increase in concentration resulting from the merger. Market concentration is a useful indicator of the likely potential competitive effect of a merger. The general standards for horizontal mergers are as follows:
>
> ...
>
> Post-Merger HHI Above 1800. The Agency regards markets in this region to be highly concentrated. Mergers producing an increase in the HHI of less than 50 points, even in highly concentrated markets post-merger, are unlikely to have adverse competitive consequences and ordinarily require no further analysis. Mergers producing an increase in the HHI of more than 50 points in highly concentrated markets post-merger potentially raise significant competitive concerns, depending on the factors set forth in Sections 2-5 of the Guidelines. *Where the post-merger HHI exceeds 1800, it will be presumed that mergers producing an increase in the HHI of more than 100 points are likely to create or enhance market power or facilitate its exercise.* The presumption may be overcome by a showing that factors set forth in Sections 2-5 of the Guidelines make it unlikely that the merger will create or enhance market power or facilitate its exercise, in light of market concentration and market shares.[249]

181. The Applicants have failed to demonstrate "that factors set forth in Sections 2-5 of the Guidelines make it unlikely that the merger will create or enhance market power or facilitate its exercise, in light of market concentration and market shares."[250]

182. The Commission has referred to its "deeply rooted preference for preserving and enhancing competition in relevant markets."[251] The AT&T/BellSouth merger would jeopardize competition in relevant markets and therefore would thwart the Commission's achievement of its goals.

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[249] / Horizontal Merger Guidelines (emphasis added)

[250] / Horizontal Merger Guidelines.

[251] / *SBC/AT&T Merger Order*, para. 17.

Absent enforceable regulatory conditions, it is unlikely that AT&T will pursue residential and small business consumers.

183. In assessing the purported benefits of the proposed transaction, the Commission should consider whether any of the benefits that SBC anticipated would occur as a result of its acquisition of AT&T have come to pass. A year ago, the Ratepayer Advocate stated in it initial comments:

> The documents filed with regulators and the investor community demonstrate that the motivation for the merger is to gain access to the enterprise customer. The purported advantage to residential customers is that in its aggressive push to acquire enterprise customers, SBC will "trickle down" some of AT&T's innovations to residential and small business customers. The Applicants contend that "[b]ecause of SBC's strong focus on residential and smaller business consumers, the merged firm will have the incentive to bring those customers innovative services and features originally developed for higher-end customers, and it will have the expertise, financial strength and incentives to do so." According to the Applicants, "[t]he proposed transaction will promote competition by creating a more efficient firm which will achieve significant cost savings and will be better positioned to develop and deploy new products and services for business and residential customers."[252]

184. The Commission should direct AT&T to identify all new products and services that it has deployed as a result of its merger with SBC, including information about its marketing, education, and demand for stand-alone DSL. The Commission should also direct AT&T to provide detailed information about any complaints received about its provision of stand-alone DSL.

185. The Commission should seek and analyze detailed market and pricing data from the Applicants regarding demand for and deployment of its DSL, long distance, video,

[252]/ Initial Comments of the Ratepayer Advocate, April 25, 2005, at 20-21, citing and excerpting: Kahan (SBC/AT&T), at para. 32; Declaration of Hossein Eslambochi (AT&T) (discussing the prediction that the combination of the companies will allow AT&T Lab innovations to eventually reach residential and small business customers. Among the potential innovations, according to Declarant Eslambochi, are IP-based video, speech/text technologies, fraud reduction, service provisioning, and repair); Eslambochi (AT&T), at paras. 7, 10-14; Kahan (SBC/AT&T), at para. 36; Carlton/Sider (SBC/AT&T), at para. 5.

and bundled services. The Commission should also seek and analyze data for each state that the Applicants serve about its position in local markets such as quantities of residential customers and quantities of business customers separately by mode of entry (UNE-P, UNE-L; other).

186. The Commission should also seek and analyze comprehensive service quality data including performance data as well as information about complaints from AT&T's and BellSouth's retail and wholesale customers.

VII. OTHER POTENTIAL HARMS TO CONSUMERS

If the FCC approves the proposed transaction, it should increase the X factor in its price cap regulation to recognize the $36 billion in synergies resulting from SBC's back-to-back acquisitions of AT&T and BellSouth.

187. When they sought the Commission's approval to merge, AT&T and SBC estimated annual synergies of $2 billion by 2008, or a net present value of approximately $15 billion.[253] AT&T indicates that it expects 20 percent greater synergies from the AT&T/SBC merger than it had originally forecast,[254] which, based on the original forecast of $15 billion would translate into approximately $18 billion from the AT&T/SBC merger.

188. The Applicants also anticipate substantial merger synergies from this merger. AT&T anticipates a net present value of the synergies resulting from its acquisition of BellSouth of approximately $18 billion, with annual cost savings exceeding $2 billion by 2008, and increasing to more than $3 billion in 2010.[255]

189. Cost reductions are anticipated to comprise more than 90 percent of the total synergies.[256] AT&T, BellSouth, and Cingular presently spend approximately $2.5 billion annually on advertising. As a result of adopting a common brand, the Applicants anticipate savings of approximately $400 to $500 million per year.[257] Other cost savings

[253]/ SBC/AT&T proceeding, Public Interest Statement, at 44; Kahan (SBC/AT&T), at para. 37.

[254]/ Kahan (AT&T), at para. 40, citing AT&T Analyst Meeting Presentation (January 31, 2006, at 51, and para. 42.

[255] / *Id.,* at para. 42.

[256]/ *Id.*

[257]/ *Id.*, at para. 43.

are anticipated based on the elimination of duplicate facilities and overlapping staff;[258] consolidation of operations. AT&T also anticipates reductions in procurement, network and IT expenses to be approximately $700 to $800 million per year by 2009; reduced capital expenditures of approximately $400 to $500 million annually, and savings from organizational consolidation of approximately $1.0 to $1.1 billion by 2009.[259]

190. SBC's back-to-back acquisitions of AT&T and BellSouth would yield $36 billion in synergies. Absent regulatory invention, these synergies will flow to shareholders and not to consumers. Competitive pressures are insufficient to cause AT&T to flow through synergies to consumers of basic services and other monopoly services (such as special access) through rate reductions, service innovation, or enhanced service quality. The FCC should recognize this market failure in its decisions in the Special Access, Intercarrier Compensation, and non-rural high cost proceedings to prevent AT&T from earning supracompetitive profits from its non-competitive services.

191. Mr. Bickerstaff contends that BellSouth "faces aggressive competition for [its] special access services.[260] Mr. Bickerstaff's analysis, however, consists of generalities (such as statements that BellSouth's share of wholesale special access services has declined whole those of its competitors has grown). BellSouth's analysis lacks data about quantities lost to competitors or about competitors' market share. Mr. Bickerstaff's conclusion that "the merger will have no noticeable effect on the vigorous competition

[258]/ AT&T anticipates that through hiring freezes and attrition, they can "minimize the impact on job losses." *Id.*, at para. 44.

[259]/ *Id.*, at paras. 44-45.

[260]/ Bickerstaff (BellSouth), at paras. 3-9.

BellSouth faces for wholesale customers"[261] lacks any meaningful analytic support or empirical data.

192. The FCC released its *Special Access NPRM* (Order and Notice of Proposed Rulemaking) in WC Docket No. 05-25 on January 31, 2005, which addresses issues directly related to the proposed AT&T/BellSouth merger.[262] The *Special Access NPRM* commenced a "broad examination of the regulatory framework to apply to price cap local exchange carriers' (LECs) interstate special access services"[263] given the expiration of the CALLS plan on June 30, 2005. The FCC sought comments regarding both traditional price cap issues and its current pricing flexibility rules for special access services.[264] The FCC has recognized that special access is a key input for competitive LECs, CMRS providers, business customers, and interexchange carriers (IXCs). Special access revenues have grown from 12.8 percent of BOC interstate operating revenues in 1991 to 45.4 percent of interstate operating revenues in 2003.[265] Among the issues that the FCC is considering is the need for, and appropriate magnitude of, a productivity factor and the merits of earnings sharing.[266]

193. The *Special Access NPRM* also addresses a legacy AT&T petition for rulemaking asking the FCC to revoke pricing flexibility and re-examine the CALLS Plan claiming

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[261]/ *Id.*, at para. 13.

[262]/ *In the Matter of Special Access Rates for Price Cap Local Exchange Carriers*; *AT&T Corp. Petition for Rulemaking to Reform Regulation of Incumbent Local Exchange Carrier Rates for Interstate Special Access Services*, FCC WC Docket No. 05-25; RM-10593, *Order and Notice of Proposed Rulemaking*, Released January 31, 2005 ("Special Access NPRM").

[263]/ *Id.*, at para. 1

[264]/ *Id.*, at paras. 1 and 4.

[265]/ *Id.*, at para. 3.

[266]/ *Id.,* at paras. 35-36.

that predicted competitive entry in the special access market has not materialized and that BOC special access rates have increased or remained flat in every market where pricing flexibility has been granted.[267] Indeed, the FCC notes in the *Special Access NPRM* that the BOCs have "earned special access accounting rates of return substantially in excess of the prescribed 11.25 rate of return that applies to rate of return LECs."[268]

194. The loss of legacy AT&T as an independent regulatory voice in the special access rulemaking means that the Commission's regulatory oversight is greater than ever. If the FCC approves the proposed merger between AT&T and BellSouth, the FCC should indicate its intentions:

- To require AT&T to share the substantial synergies that the Applicants anticipate in the Special Access rulemaking with special access customers through measures such as the productivity factor and an earnings sharing mechanism.
- In assessing Bell operating companies' pricing flexibility, to consider the impact of the multiple mergers on the competitiveness of relevant markets.
- In assessing the potential benefits and harms from the proposed transaction, the FCC should examine AT&T's and BellSouth's home-region behavior.

195. The Commission also should determine in the non-rural high cost fund that high cost support is no longer needed for AT&T and BellSouth. In reply comments submitted regarding the Commission's non-rural high cost fund, the Ratepayer Advocate stated:

267/ *Id.*, at para. 19.

268/ *Id.*, at para. 35.

> The cost of providing basic local exchange service should be considered within the larger context of many significant factors that offset the relatively higher costs of serving rural areas within non-rural carriers' territories, most of which Congress likely did not anticipate when it established its universal service mandates ten years ago. These factors include: the substantial stream of revenues that ILECs generate as a direct result of consumers' near-monopoly reliance on ILECs for a basic link to the public switched network (*e.g.*, revenues from switched access, toll, vertical features, bundled offerings, etc.); billions of dollars of synergies resulting from multiple major mergers in the telecommunications industry; ILECs' supra-competitive earnings from special access services; and the virtual absence of local competition. Together these factors provide compelling evidence that the erosion of non-rural ILECs' implicit support has not occurred, and, therefore, the original rationale for explicit non-rural high cost support does not apply to today's telecommunications market. Accordingly, the Ratepayer Advocate urges the Commission to establish a near-term sunset date for the non-rural high cost fund.[269]

AT&T's pursuit of operating efficiencies and enhanced revenues exposes consumers to service quality deterioration and aggressive sales practices.

196. The proposed merger exposes consumers to two possible ill effects related to the Applicants' achievement of the predicted merger synergies:

- The Applicants' efforts to reducing operating expenses could jeopardize service quality.
- The Applicants' efforts to enhance revenues could lead to aggressive sales practices.

197. In their zeal to achieve anticipated merger synergies, the Applicants would likely seek ways to reduce operating expenses. Federal and state regulators should monitor carefully the quality of basic local service to ensure that those consumers most vulnerable to cost-cutting measures (i.e., those in rural areas and those that do not purchase bundled

[269]/ *In the Matter of Federal-State Joint Board on Universal Service*, CC Docket no. 96-45, *High-Cost Universal Service Support*, WC Docket No. 05-337, Reply Comments of the New Jersey Division of the Ratepayer Advocate, May 26, 2006, at 3.

services) do not receive inferior service quality as a result of the Applicants' simultaneous pursuit of revenues from competitive services and implementation of operating efficiency measures. Similarly, regulators should monitor the Applicants' sales practices for its discretionary and bundled services to ensure that consumers are sufficiently well-informed to be able to make efficient purchasing decisions. Finally, regulators should heed comments from the remaining CLECs so that they can prevent AT&T from squeezing out those competitors that are still attempting to compete in the many markets that the merged entity would dominate.

198. As we stated in our analysis of the Verizon and MCI merger:

> Federal and state regulators should monitor carefully the quality of basic local service to ensure that those consumers most vulnerable to cost-cutting measures (i.e., those in rural areas and those that do not purchase bundled services) do not receive inferior service quality as a result of the Applicants' simultaneous pursuit of revenues from competitive services and implementation of operating efficiency measures. Similarly, regulators should monitor the Applicants' sales practices for its discretionary and bundled services to ensure that consumers are sufficiently well-informed to be able to make efficient purchasing decisions. Finally, regulators should heed comments from the remaining CLECs so that they can prevent Verizon from squeezing out those competitors that are still attempting to compete in the many markets that the merged entity would dominate.[270]

The loss of BellSouth as an ILEC stakeholder in various telecommunications proceedings would be significant as evidenced by recent differences among stakeholders.

199. As the number of major carriers in the telecommunications markets dwindles, the Commission loses important perspectives that could otherwise inform policy making and regulation. Mr. Kahan asserts that "the merger of AT&T and BellSouth will not have an

[270]/ *In the Matter of Verizon Communications Inc. and MCI, Inc., Applications for Approval of Transfer of Control*, WC Docket No. 05-75, Declaration of Susan M. Baldwin and Sarah M. Bosley on behalf of the New Jersey Division of the Ratepayer Advocate, May 9, 2005, at para. 99.

adverse impact on the ability of regulators to monitor ILEC performance due to concerns over the loss of regulatory benchmarks."[271] However, Mr. Kahan's support for this assertion is minimal. He relies on, among other things, the fact that various performance metrics exist, and that AT&T reports 2.3 million performance measures on a monthly basis.[272]

200. The point of benchmarking is to be able to compare carriers' *differing* levels of performance. By eliminating BellSouth as a competitor, AT&T eliminates the potential for BellSouth to "outperform" AT&T on carrier-to-carrier benchmarks.

201. Carlton and Sider state:

> While the FCC also expressed concerns in earlier mergers that ILEC mergers would reduce regulators' ability to evaluate the ILECs' performance, changes in industry conditions have greatly mitigated any such concerns. As a result of the Section 271 approval process, regulators have developed and implemented a variety of measures of ILEC performance for monitoring issues that were the subject of the FCC's prior concerns. Finally, the increased competition faced by ILECs reduces the economic importance of regulatory benchmarks.[273]

Carlton and Sider argue that because of "fundamental changes in the telecommunications industry" that have occurred since the FCC approved the SBC/Ameritech merger, there are no benchmarking concerns.[274] Carlton and Sider suggest that competition has grown since the 1999 approval of SBC's acquisition of AT&T, and that competition now plays "an increasingly important role in constraining ILEC performance in providing wholesale

[271]/ Kahan (AT&T), at para. 53.

[272]/ *Id.*, at para. 54.

[273]/ Carlton and Sider, at para. 17.

[274]/ *Id.*, at para. 133.

services and unbundled network elements to CLEC and others."[275] However, as our Declaration demonstrates, the competition that the Applicants describe is myth, not reality, and, therefore, contrary to Carlton and Sider's assertion, benchmarks continue to have economic importance.

202. According to Carlton and Sider, since many of the goals of the 1996 Act have been fulfilled, the FCC no longer needs to engage in benchmarking to enforce the provision of the Act, as evidenced by the grant of Section 271 authority.[276] Carlton and Sider also argue that "the failure of UNE-P as a mass market entry strategy lessens the importance of benchmarks in promoting this form of entry."[277] Carlton and Sider posit that at the time of the SBC/Ameritech merger, the FCC and the states were "struggling" to determine a system of evaluating ILEC performance regarding unbundling and resale.[278] According to them, given that regulators have developed performance metrics with respect to interconnection, there is no concern with respect to benchmarking.[279]

203. Carlton and Sider's arguments are not persuasive. The concerns that the Commission expressed in 1997, when it examined the merger between Bell Atlantic and NYNEX, apply to the proposed SBC/AT&T merger:

> Further reductions … become more and more problematic as the potential for coordinated behavior increases and the impact of individual company actions on our aggregate measures of the industry's performance grows …

275/ *Id.*, at para. 134.

276/ *Id.*, at para. 135.

277/ *Id.*

278/ *Id.*, at para. 136.

279/ *Id.*, at para. 136. Carlton and Sider point to the CPUC performance incentive plan adopted in 2002 and notes that there are 44 metrics analyzed by the CPUC in monitoring ILEC-CLEC interconnection. *Id.*, at para. 139.

> [thus] further reductions in the number of Bell Companies or comparable incumbent LECs would present serious public interest concerns.[280]

204. The Applicants fail to demonstrate that the further reduction in the number of Bells is in the public interest. By focusing solely on performance metrics (and ignoring the value of comparing Bells' individual levels of performance and comparing Bells' differing policy positions), Carlton and Sider gloss over the complexities of benchmarking.

205. The Commission also found that "the ability to compare actions of a large number of carriers improves [the Commission's] ability to identify and constrain market power."[281] Among other reasons that the Commission has found benchmarking important are the following:

> [I]n establishing the productivity adjustment factor for price cap LECs, we rely on calculations of industry-wide productivity. The smaller the base on which this number is calculated, the more likely it is to include distortions and create unwanted incentives for cost misallocation by regulated companies that price caps were intended to mitigate.[282]

The Applicants fail to demonstrate that the Commission's earlier concerns no longer apply.

206. Legacy AT&T raised apt points about the merits of benchmarking in comments that it filed opposing SBC's acquisition of Ameritech:

> The multiplicity of RBOCs was considered a significant element in the restructuring of the AT&T divestiture and necessary to curb anticompetitive conduct by the RBOCs. Specifically, the Department of Justice believed it

[280]/ *Applications of NYNEX Corp., Transferor, and Bell Atlantic Corp., Transferee, For Consent to Transfer Control of NYNEX Corp. and Its Subsidiaries*, File No. NSD-L-96-10, Memorandum Opinion and Order, 12 FCC Rcd 19985 (1997) ("Bell Atlantic/NYNEX Merger Order"), at para. 156.

[281]/ *Id.*, at para. 147.

[282]/ *Id.*

desirable to dilute the monopoly power that the RBOCs otherwise possessed as buyers of equipment and services. Similarly, the existence of independent RBOC decisionmakers created "benchmarks" that were then repeatedly used by "federal and state regulators . . . in evaluating compliance with equal access requirements . . and in comparing installation and maintenance practices for customer premises equipment." [283]

207. AT&T also stated the following in rebuttal to SBC's and Ameritech's claim that the number of RBOCs is unimportant:

> Applicants' claim that there is "no regulatory significance" to the number of RBOCs, is thus astonishing. That claim is particularly egregious in light of the fact that the Applicants have themselves repeatedly emphasized the importance of benchmarking when it has suited their purposes. For example, Ameritech has stated that "[n]o amount of sophistry can suppress the importance of benchmarks," and that "division of the local exchange networks among seven independent companies has greatly enhanced the detectability of any monopoly abuses and the effectiveness of regulation." Likewise, SBC opined that seven benchmarks provided "an effective deterrent against even subtle attempts to abuse any advantage which might arise from ownership of local exchange communications facilities." Now, of course, SBC seeks to reduce this number to four. [284]

AT&T elaborated further on the value of benchmarking:

> Not only will the reduction of the number of RBOCs from seven to four make benchmarking much more difficult, it will also make the direct regulation of the remaining RBOCs -- especially the two super-RBOCs -- almost impossible. As the Commission recognized in the *BA-NYNEX Merger Order*, the RBOCs' "collective interest" is often best served when "they all cooperate[] minimally with regulators and competitors during the process of opening their local markets." *BA-NYNEX Merger Order.* The greater the number of RBOCs, and the greater the regional diversity of the RBOCs, the more likely it is that on a particular issue a RBOC will "break ranks" thereby allowing regulators to "speed[] the pro-competitive process." Id. The Ameritech/SBC merger, however, reduces the number of RBOCs as well as the regional diversity of the RBOCs,

[283] / Petition of AT&T Corp. To Deny Applications, *Applications of Ameritech Corp., Transferor, and SBC Communications, Inc., Transferee, For Consent to Transfer of Control*, CC Docket No. 98-141, October 15, 1998, at 28.

[284] / Petition of AT&T Corp. To Deny Applications, *Applications of Ameritech Corp., Transferor, and SBC Communications, Inc., Transferee, For Consent to Transfer of Control*, CC Docket No. 98-141, October 15, 1998, at 28-29.

thereby giving the remaining RBOCs even greater incentive to continue their strategy of non-cooperation with the regulatory process. [285]

208. As the Commission assesses the impact of the merger on benchmarking, it should heed the concerns that legacy AT&T raised eight years ago and that continue to apply to today's industry.

209. Moreover, the presence of multiple suppliers also provides differing regulatory perspectives. For example, in the pending non-rural high cost proceeding, AT&T and BellSouth express different views on the nation's non-rural high cost mechanism. For example, AT&T suggests that "universal service support has languished rather than advanced" in the ten years since the 1996 Act was passed,[286] and further asserts that the high-cost program "provides insufficient support to most rural areas."[287] By contrast, BellSouth suggests that the high-cost fund is successful and stable and that the Commission "should avoid undoing praiseworthy results in a quest for doctrinaire perfection that the courts have not demanded."[288] BellSouth further observes regarding the non-rural high cost program and the United States Court of Appeals for the Tenth Circuit's (Tenth Circuit or Court) decision in *Qwest Corp. vs. FCC* ("Qwest II"): "the core components of the high-cost funding architecture have withstood challenge."[289]

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[285] / Petition of AT&T Corp. To Deny Applications, *Applications of Ameritech Corp., Transferor, and SBC Communications, Inc., Transferee, For Consent to Transfer of Control*, CC Docket No. 98-141, October 15, 1998, at 30-31.

[286] / *In the Matter of Federal-State Joint Board on Universal* Service, CC Docket No. 96-45; *High-Cost Universal Service Support*, WC Docket No. 05-337, Comments of AT&T, March 27, 2006, at 6.

[287] / *Id.*

[288] / *Id.,* Comments of BellSouth, at 4.

[289]/ *Id.,* at 9, citing *Qwest Corp. v. FCC*, 398 F 3d. 1222 (10^{th} Cir. 2005) ("Qwest II").

210. Last year, AT&T's change in identity from CLEC to ILEC created a significant regulatory vacuum and diminished the breadth and depth of state and federal proceedings. Since divestiture in 1984, and since the enactment of the Telecommunications Act of 1996, AT&T had been an active, vocal participant, shaping state and federal telecommunications policy. The transformation of this well-heeled regulatory activist into an incumbent's partner irrevocably altered state and federal investigations of telecommunications policy, ultimately harming consumers.

211. The Commission should stop this trend of market consolidation. The "if-you-can't-beat-them-join-them" mentality that has overtaken the telecommunications industry reduces consumers' prospects for meaningful competition and underscores the necessity of federal and state regulators to exercise oversight of the local mass market. With each successive phase of market concentration, the need for regulatory oversight of the re-monopolized telecommunications market becomes more critical.

212. In order to mitigate the harm of the diminished benchmarking opportunities, the Commission should assert greater regulatory oversight over AT&T's and other ILECs' rates, service quality, and terms and conditions for its retail and wholesale services.

Mass market consumers are the most vulnerable to anticompetitive pricing practices.

213. BellSouth serves approximately 12.4 million retail residential lines and approximately 5.3 million retail business lines.[290] AT&T serves approximately 22.6 million primary lines, approximately 3.8 million additional lines (a total of 26.4 million

[290]/ BellSouth 1q06x.xls (accessed at http://phx.corporate-ir.net/phoenix.zhtml?c=95539&p=irol-IRHome)

residential lines) and approximately 17.4 million retail business lines.[291] The consumers who are most vulnerable to AT&T's anticompetitive behavior are those with low telecommunications usage, who cannot afford alternatives such as broadband-based VoIP, and those in rural areas. The Applicants have failed to demonstrate that their merger is in the public interest, and have failed to demonstrate that rates would be just and reasonable if their merger were approved.

The proposed merger jeopardizes net neutrality, and, therefore, the Commission should condition any approval of the proposed transaction on a commitment to net neutrality, without a sunset provision.

214. The Commission should reject the Applicants' attempt to silence discussion about the impact of the merger on net neutrality. Among other things, the Applicants state:

> Undoubtedly, some opponents of the merger will urge the Commission to impose a new "net neutrality" condition on the merger. There is no justification for doing so.[292]
>
> Because the merger will not create or enhance market power in either the Internet backbone or Internet access markets, there is no merger-specific concern that could justify special "neutrality" requirements that would apply only to the merged company. Indeed, the proponents of more regulation have made clear in other contexts that they seek "neutrality" requirements of general applicability, for reasons that have nothing to do with this merger.[293]

215. The Commission should reject the Applicants' argument that net neutrality is irrelevant to this proceeding. The transaction bears directly on large carriers' ability to restrict open, nondiscriminatory access to the Internet. The proposed merger would further concentrate market power in a dwindling number of providers, which control

[291]/ AT&T *Investor Briefing*, April 25, 2006, at 15.

[292]/ Public Interest Statement, at 109.

[293]/ Public Interest Statement, at 110.

households' and businesses' access to the Internet. This disturbing monopoly over transmission *and* potentially content would jeopardize the free market evolution of the Internet and the diverse and innovative applications that have developed.

216. In an earlier merger Order, Commission Copps appropriately observed:

> The more powerful and concentrated our facilities providers grow, the more they have the ability, and perhaps even the incentive, to close off Internet lanes and block IP byways. I'm not saying this is part of their business plans today; I am saying we create the power to inflict such harms only at great risk to consumers, innovation and our nation's competitive posture. Because, in practice, such stratagems can mean filtering technologies that restrict use of Internet-calling services or that make it difficult to watch videos or listen to music over the web. The conditions we adopt today speak directly to this issue—before increased concentration of last mile facilities and the Internet backbone make it intractable. This is why stand-alone DSL, enforceable net neutrality principles, and peering in the Internet backbone are so vital.[294]

217. Post-merger, AT&T would control approximately half the nation's telephone lines.[295] Absent enforceable commitments to net neutrality, this market concentration would stifle innovation, thwart the development of Internet applications, and unreasonably limit consumer choice. Allowing a single company to gain unfettered control over an essential input to the nation's information infrastructure would irrevocably harm consumers.

218. Consumers should be able to choose their Internet content, their Internet providers, and their network devices (provided they do not harm the network). As is explained in one article:

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[294]/ *SBC/AT&T Order,* Copps Statement, at 139

[295]/ Based on access lines data as of the end of first quarter 2006. *See* Table 1. AT&T Investor Briefing, April 25, 2006; BellSouth 1q06x.xls (accessed at http://phx.corporate-ir.net/phoenix.zhtml?c=95539&p=irol-IRHome);Qwest Q12006EarningsReleaseAttachments.xls (accessed at http://phx.corporate-ir.net/phoenix.zhtml?c=119535&p=irol-reportsAnnual); Verizon Investor Quarterly, May 2, 2006.

> Until recently, companies that provided Internet access followed a de-facto common carriage rule, usually called "network neutrality," which meant that all Web sites got equal treatment. Network neutrality was considered so fundamental to the success of the Net that Michael Powell, when he was chairman of the F.C.C., described it as one of the basic rules of "Internet freedom." In the past few months, though, companies like A.T.&T. and BellSouth have been trying to scuttle it. In the future, Web sites that pay extra to providers could receive what BellSouth recently called "special treatment," and those that don't could end up in the slow lane. One day, BellSouth customers may find, say, NBC.com loads a lot fater than YouTube.com, and that the sites BellSouth favors just seem to run more smoothly. Tiered access will turn the providers into Internet gatekeepers.
>
> …
>
> Decisions that once were made collectively by hundreds of millions of Internet users would now be shaped in large part by a handful of telecom executives.[296]

219. The Commission should prevent this scenario wherein a few powerful telephone companies control the nation's access to information. Furthermore, carriers should not be allowed to give preferential treatment to their own affiliates and/or discriminate against unaffiliated carriers. We oppose a "tiered" Internet where large carriers could act as gatekeepers to the flow of information. Under such a scenario, the economy and society risk being captive to the whims of the telco-cable duopoly, which has a compelling incentive to control consumers' access to information and entertainment, and to extract monopoly profits from such access. Discrimination would create inefficient barriers, unduly limit consumers' choices, and likely raise consumers' prices.

220. Another definition of network neutrality is the following:

> Although there is no consensus on precisely what "Network Neutrality" means—and thus no consensus on what rules are required to achieve it—the principle is usually couched in terms of preserving the "openness" of the Internet so that consumers can freely access third-party applications over broadband networks without the fear that the broadband network provider will deteriorate or degrade the transmission to these third-party

[296] / James Surowiecki, "Net Losses," *The New Yorker*, March 20, 2006, at 74.

> applications and services in favor of their own applications and services. In practice, the goal of Network Neutrality is to prevent anticompetitive conduct by placing various regulatory constraints on the behavior of broadband service providers.[297]

221. Consumers and not carriers should determine the flow of information over the Internet. As Columbia Law School Professor Tim Wu explains, the importance of net neutrality corresponds with the "Darwinian evolution" of advanced communications services. Wu argues that the development of the Internet has thus far proceeded in an evolutionary fashion, with a "survival of the fittest" mechanism, with consumer demand - determining what applications and services survive, and which fail.[298] Wu further explains:

> A communications network like the Internet can be seen as a platform for a competition among application developers. Email, the web, and streaming applications are in a battle for the attention and interest of end-users. It is therefore important that the platform be neutral to ensure the competition remains meritocratic. [299]

222. BusinessWeek pushed the issue of net neutrality into the spotlight in December 2005, when it reported AT&T CEO Edward Whitacre's now-famous "pipes" quip: "What [Google, Vonage, and others] would like to do is to use my pipes free. But I ain't going to let them do that."[300] The article explains that network providers are no longer content simply to provide the infrastructure. They now:

[297]/ Ford, George S., Thomas M. Koutsky and Lawrence J. Spiwak, *Phoenix Center Policy Paper No. 24 - Net Neutrality and Industry Structure*, Phoenix Center for Advanced Legal & Economic Public Policy Studies, 2006 at 2.

[298]/ Wu, Tim, "Network Neutrality, Broadband Discrimination," *Journal of Telecommunications and High Technology Law*, Vol. 2, 2005, at 145-147.

[299]/ "Network Neutrality, Broadband Discrimination," at 146.

[300]/ Catherine Yang, Roger O. Crockett, and Moon Ihlwan, "At Stake: The Net as We Know It," *BusinessWeek Online*, December 26, 2005.

> . . . also want to peddle more lucrative products, such as Internet-delivered TV programs, movies, and phone calls… But selling those extras puts the phone and cable companies in competition with Web services big and small. The network operators could block consumers from popular sites such as Google, Amazon, or Yahoo! in favor of their own. Or they could degrade delivery of Web pages whose providers don't pay extra. Google's home page, for instance, might load at a creep, while a search engine backed by the network company would zip along. "This new view of the world will break apart the Internet and turn it into small fiefdoms" divided between the network providers' friends and foes, says Vonage Chief Executive Jeffrey A. Citron.[301]

223. Wu also appropriately compares the Internet infrastructure to traditional applications of the common carriage concept. "What we're ultimately asking is a question that Adam Smith struggled with. Is there something special about 'carriers' and infrastructure -- roads, canals, electric grids, trains, the Internet -- that mandates special treatment? Since about the 17th century, there's been a strong sense that basic transport networks should serve the public interest without discrimination. This might be because so much depends on them: they catalyze entire industries, meaning that gratuitous discrimination can have ripple effects across the nation."[302]

224. Wu uses a simple example to illustrate one discouraging implication of Internet discrimination – that application providers will be forced to turn their efforts to courting the infrastructure providers rather than focusing on developing innovative products:

> Now, let's think about the nation's highways. How would you feel if I-95 announced an exclusive deal with General Motors to provide a special "rush-hour" lane for GM cars only? That seems intuitively wrong… And if highways really did choose favorite brands, you might buy a Pontiac instead of a Toyota to get the rush-hour lane, not because the Pontiac is actually a good car. As a result, the nature of competition among car-

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[301]/ "At Stake: The Net as We Know It."

[302]/ Wu, Tim, "Why You Should Care About Net Neutrality," *Slate*, May 1, 2006 (accessed at www.slate.com/id/2140850).

> makers would change. Rather than try to make the best product, they would battle to make deals with highways.[303]

225. A duopoly should not be able to extract rent from consumers and competitors nor be able to inhibit the flow of information. Our concern about the mega-Bell's control over consumers' access to the Internet has been expressed by many. One editorial states:

> But this merger also raises important questions about the future of the Internet itself, and about how much giant companies like AT&T will be allowed to control access to it.
> …
> The new combined company would wield tremendous clout. The least we could require of it is that it uphold the basic tenets of the Internet.[304]

226. The concerns that many raise are not simply hypothetical.[305] In November 2004, a customer of Madison River Communications, LLC ("Madison"), a broadband access provider, found that he could no longer access his Vonage VoIP account. When he complained to Madison, he was told that the company had begun blocking calls through Internet phone companies such as Vonage. After an investigation by the FCC, Madison agreed to pay a $15,000 fine and to refrain from blocking Internet telephone activity.[306]

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[303]/ "Why You Should Care About Net Neutrality"

[304]/ "The Call of the Wild Web," *The New York Times*, March 26, 2006, at A26. *See also,* "Keeping a Democratic Web," *New York Times*, May 2, 2006, which states, among other things: "One of the Internet's great strengths is that a single blogger or a small political group can inexpensively create a Web page that is just as accessible to the world as Microsoft's home page. But this democratic Internet would be in danger if the companies that deliver Internet service changed the rules so that Web sites that pay them money would be easily accessible, while little-guy sites would be harder to access, and slower to navigate. Providers could also block access to sites they do not like."

[305]/ *In The Matter of Madison River Communications, LLC and affiliated companies*, File No. EB-05-IH-0110, *Consent Decree*, Rel. March 3, 2005.

[306] / "At Stake: The Net as We Know It."

The arguments opposing net neutrality are not persuasive.

227. One problem with net neutrality, according to network access providers, is that certain applications and services require a great deal of bandwidth to operate correctly. According to this line of reasoning, the applications and companies that use more bandwidth should pay extra. However, consumers are already paying for Internet access, so forcing the companies behind the most useful Internet applications to pay a premium for their programs to be useful amounts to paying the network provider twice for providing one service – delivery of content. Also, when consumers pay for Internet access, they expect the *whole* Internet, not a degraded and predefined subset of the Internet. Consumers want to choose for themselves what applications and services meet their needs the best.

228. Another argument against net neutrality – apparently Edward Whitacre's view - involves the issue of property rights. According to this view, AT&T and other carriers own the network infrastructure. Contrary to that view, however, it is the general public that has financed the nation's telecommunications infrastructure through government subsidies and a near-monopoly flow of revenues from largely captive customers, over the past one hundred years.

229. We disagree that private investment has replaced that "public" network.[307] The Bells' ubiquitous infrastructure has evolved directly as a result of revenues derived directly and indirectly from the Bells' near-monopoly relationship with consumers. Consumers, which have funded the Bells' infrastructure deployment, should have unfettered access to the Internet, and not be subject to double-recovery of network costs.

[307]/ Gattuso, James, and Norbert Michel, "Are U.S. Telecom Networks Public Property?" *The Heritage Foundation Backgrounder #1745*, April 8, 2004.

230. A third criticism of net neutrality stems from what the Phoenix Center fears will be the "commoditization" of broadband access if net neutrality comes to pass. According to this idea, regulations preventing access providers from differentiating their service offerings will "deter facilities-based competition, reduce the expansion and deployment of advanced communications networks, and increase prices."[308] However, the Phoenix Center's analysis has been called into question.[309] In particular, one critics note that the Ford *et al*. paper fails to consider the economies of scale present in last-mile broadband networks, exaggerates the ability of regulators to fully eliminate product differentiation in broadband access, develops an excessively narrow view of "social welfare" (a view that ignores the impact of abandonment of network neutrality on the production and consumption of Internet content), and assumes that the sunk costs associated with last-mile deployment are negligible.

The Commission should impose net neutrality condition on any approval of the merger.

231. We recognize that federal legislation is pending that would address net neutrality.[310] Nonetheless, we urge the Commission to address net neutrality explicitly as a condition of any approval it grants of this merger (or any other telco or cable merger).

232. We also recognize that while Congress continues to work out the details of various bills, industry groups and consumer-rights groups are making appeals for net

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[308]/ Ford, Koutsky, and Spiwak, at 2.

[309]/ Roycroft, Trevor, "Network Neutrality, Product Differentiation, and Social Welfare A Response to Phoenix Center Policy Paper No. 24," Roycroft Consulting, May 3, 2006. Roycroft concludes that the Ford et al. model is fatally flawed, and provides no support for the conclusion that network neutrality will deter facilities-based entry.

[310]/ Among the various bills are the "Internet Freedom and Nondiscrimination Act of 1996," the "Internet Nondiscrimination Act of 2006," the "Communications Opportunity, Promotion, and Enhancement Act of 2006" ("COPE"), "Communications, Consumers's Choice, and Broadband Deployment Act of 2006," and various amendments.

neutrality.[311] We echo their request that the Net remain consumer-friendly, and open to all. Network owners should be prohibited from impairing Internet content transmitted over networks, and, furthermore should not be allowed to charge premium rates for faster transmission.

233. In its order approving SBC's acquisition of AT&T, the Commission stated, "[i]n addition, we find insufficient evidence in the record to conclude that the merged firm will engage in packet discrimination or degradation against rivals' VoIP, video over IP, and other IP-enabled services."[312] Nonetheless, as one of the conditions of the SBC/AT&T merger, the two merging companies agreed to conduct business in a way compatible with the Commission's September 23, 2005 Internet Policy Statement (FCC 05-151),[313] for a period of two years after the merger closing,[314] *i.e.,* until November 2007.[315]

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[311]/ As a New York Times editorialist wrote, Sir Tim Berners Lee, the inventor of the World Wide Web, has joined the debate. "Sir Tim argues that service providers may be hurting themselves by pushing for tiered pricing. The Internet's extraordinary growth has been fueled by the limitless vistas the Web offers surfers, bloggers and downloaders. Customers who are used to the robust, democratic Web may not pay for one that is restricted to wealthy corporate content providers. 'That's not what we call Internet at all,' says Sir Tim. 'That's what we call cable TV.'" Cohen, Adam, "Why the Democratic Ethic of the World Wide Web May Be About to End," *New York Times*, May 28, 2006. *See also,* Ben Scott, Free Press; Mark Cooper, Consumer Federation of America; Jeannine Kenney, Consumers Union, "Why Consumers Demand Internet Freedom, Network Neutrality: Fact vs. Fiction," May 2006.

[312]/ *SBC/AT&T Merger Order,* at para. 108.

[313]/ In the Policy Statement, the Commission adopts the following consumer protection principles: "Consumers are entitled to access the lawful Internet content of their choice; to run applications and use services of their choice, subject to the needs of law enforcement; to connect their choice of legal devices that do not harm the network; and to competition among network providers, application and service providers, and content providers." See *Appropriate Framework for Broadband Access to the Internet over Wireline Facilities*, Policy Statement, FCC No. 05-151 (rel. Sept. 23, 2005), at 3.

[314]/ *SBC/AT&T Merger Order*, Appendix F.

[315]/ On November 18, 2005, SBC acquired the legacy AT&T to create the current AT&T. S-4, March 31, 2006, at 1.

234. At a minimum, AT&T should extend this abbreviated time frame indefinitely so that it does not sunset unless and until the Commission considers it in the public interest to do so.

Service quality is declining in AT&T's and BellSouth's regions, and the proposed merger would likely divert resources away from basic telephone service toward new unregulated ventures.

235. Consumers of the Applicants' local telecommunications services are experiencing declining service quality. For example, in Florida, BellSouth's average installation interval for residential customers in its non-MSA areas increased from 1.2 days in each of the four years 2000 through 2003, to 1.5 in 2004, and to 1.7 in 2005.[316]

236. More urban areas in Florida have relatively better service quality than more rural areas, but also are experiencing a decline in the quality of basic service. In the MSAs, the average residential installation interval fluctuated between 1.1 and 1.2 between 2000 and 2004, and then increased to 1.3 in 2005.[317] Measured on a statewide basis, this metric deteriorated in Florida from 1.2 in 2000 to 1.5 in 2005.

237. In areas of Kansas, a state recently selected by AT&T for a roll-out of an IPTV trial,[318] service quality has declined in recent years, as illustrated by average installation

[316]/ FCC ARMIS Report 43-05, The ARMIS Service Quality Report, Table II, Installation and Repair Intervals (Local Service), Row 134, Data Run Date: 6/2/2006.

[317]/ In 2000 – 1.2, 2001 – 1.1, 2002 – 1.2, 2003 – 1.1., 2004 – 1.2, 2005 – 1.3. FCC ARMIS Report 43-05, The ARMIS Service Quality Report, Table II, Installation and Repair Intervals (Local Service), Row 134, Data Run Date: 6/2/2006.

[318]/ "AT&T Plans $247M Upgrade in Kansas," *TR Daily*, May 30, 2006

intervals and out-of-service repair intervals.[319] In the MSAs of Kansas, the average installation interval increased from 0.7 days in 2000 to 2.5 days in 2005. In non-MSA areas, the metric increased similarly, from 0.7 days in 2000 to 2.1 days in 2005.[320] Repair intervals increased between 2000 and 2005, as well. In MSAs, the average initial repair interval increased from 16 hours in 2000 to over 29 hours in 2004 and 2005. In non-MSA areas the repair interval increased from 13.7 hours to 24.6 hours.[321]

238. Our analysis of service quality is intended to be illustrative. We provide these examples to illustrate the type of analysis that Applicants should undertake for each of the metrics that it reports to the Commission. The analysis should be conducted for all relevant metrics, separately for residential and business customers, and separately for rural and urban areas.

239. Furthermore, the Applicants' promises of state-of-the-art IPTV and other new services do not justify the deterioration of basic telephone service quality. The Applicants have failed to demonstrate that the merger will not jeopardize service quality. Absent enforceable commitments, mass market customers will be at risk for long waits for the installation or repair of a basic dial tone line.

240. The Commission should direct the Applicants to provide detailed and comprehensive data for the years 2000 through 2005, separately for each of the states

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[319]/ ARMIS instructions define *Out-of-Service Average Repair Interval* as "the total time from receipt of the customer trouble to clearing the trouble. Clearing represents the final disposition of the report, either repairing the problem or closing the report to another category, such as a no trouble found category." http://www.fcc.gov/wcb/armis/instructions/2005/definitions05.htm

[320]/ FCC ARMIS Report 43-05, The ARMIS Service Quality Report, Table II, Installation and Repair Intervals (Local Service), Row 134, Data Run Date: 6/2/2006.

[321]/ FCC ARMIS Report 43-05, The ARMIS Service Quality Report, Table II, Installation and Repair Intervals (Local Service), Row 145, Data Run Date: 6/2/2006.

they serve, as well as for their region totals for key measures such as the percentage of installation appointments met, the average repair interval, trouble reports, etc. These data and analyses should be submitted *before* the Commission completes its investigation of the benefits and harms of the proposed merger.

241. The Commission should require the Applicants to commit to measurable improvement in service quality with sanctions for failure to comply with standards that are developed jointly by the relevant state public utility commissions.

The Applicants should commit to increasing basic telephone penetration.

242. In its decision approving SBC's acquisition of AT&T, Commissioner Copps raised concerns about various consumer issues, including, among other things, the declining household penetration rate:

> Looking beyond the transaction before us, it is obvious that the whole telecommunications landscape continues to change dramatically. But despite all of the advances in technology and efficiency over the last decade, local phone rates have failed to decline. Household phone penetration is at the lowest rate in 17 years. Surely being 16th in the world in broadband penetration is nothing to crow to about. And, yes, we still have enormous digital gaps from the inner city to the rural village, and there is a real threat that current policies may widen rather than close those gaps. So there are already ample warning signs something is not right. And it is long past time for the Commission to pay heed.[322]

243. The most recent FCC Subscribership Report indicates that the percentage of households subscribing to telephone service was 92.9%, down 1.1% from July 2005.[323] An essential part of making things "right" entails retaining the long-standing regulatory

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[322]/ *SBC/AT&T Merger Order*, Copps Statement, at 139.

[323]/ Federal Communications Commission, Wireline Competition Bureau, Industry Analysis and Technology Division, *Telephone Subscribership in the United States*, data through November 2005, Released May 2006, at 3. The decrease is statistically significant.

commitment to achieving universal service and to just and reasonable rates. In this proceeding, the Commission should require the Applicants to provide detailed data about telephone penetration within their home regions, and to describe fully their plans for improving subscribership.

244. In other proceedings, ideas have been raised for increasing subscribership. For example, in the "non-rural high cost proceeding," WC Docket No. 05-337, state agencies in Vermont and Maine described measures for improving telephone penetration and affordability, such as increasing Lifeline discounts, exempting Lifeline customers from universal service contributions, and analyzing state policies that improve penetration (such as requirements regarding advance notice of disconnection, ability to retain local service despite non-payment of toll bills, etc.).[324]

245. As Fones4All explains, the "80,000 low-income households served by Fones4All, most of whom had never before received basic wireline local telephone service until Fones4All made them aware of the existence of the state Universal Service program through grassroots efforts, are less concerned with someday gaining access to the latest 'IP enabled video services' that AT&T is promising and more concerned with keeping their existing basic telephone service."[325]

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[324]/ *In the Matter of Federal-State Joint Board on Universal Service*, CC Docket No. 96-45; *High-Cost Universal Service Support*, WC Docket No. 05-337, Comments of Vermont Public Service Board, Vermont Department of Public Service, and Maine Public Utilities Commission, March 27, 2006, at 11-12.

[325]/ WC Docket 06-74, *ex parte* letter from Ross A. Buntrock to Marlene Dortch, Secretary, Federal Communications Commission, May 9, 2006. The mission of fones4all is to "serve a vital need by providing essential telecommunications to undeserved households while emphasizing quality customer care and a friendly environment" and [f]urther, to evolve by developing affordable services aimed at bridging the "digital divide" in these communities." http://www.fones4all.com/fones4all_us/aboutus.html

VIII. CONDITIONS

Summary of conditions in SBC/AT&T and Verizon/MCI mergers.

246. The Commission has previously determined that conditions were necessary in order to find proposed mergers in the public interest. The Commission approved the mergers of SBC and AT&T, and MCI and Verizon on October 31, 2005.[326] The Commission conditioned its approval for the mergers on commitments offered by the applicants in each case and also incorporated into its approvals the divestiture arrangements adopted through the Department of Justice ("DOJ") reviews.[327]

247. The commitments in each proceeding are nearly identical, addressing rate freezes for unbundled network elements ("UNEs") and special access services, service quality reporting requirements, Internet backbone peering requirements, provision of "naked DSL," acceptance of net neutrality as per the FCC policy statement of September 23, 2005, and annual certification of conformance with these conditions.

248. Carlton and Sider assert that "the FCC's analysis of the public interest benefits from integration of an ILEC with a national carrier also applies to the merger of AT&T and BellSouth."[328] We certainly agree with Carlton and Sider that one facet of this merger is the integration an ILEC with an IXC (or "national carrier"). However, the transaction also involves the merger of an ILEC with another ILEC. AT&T is expanding

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[326]/ *SBC/AT&T Merger Order; In the Matter of Verizon Communications Inc. and MCI Inc. Applications for Approval of Transfer of Control*, WC Docket No. 05-75, Memorandum Order and Opinion, FCC 05-184 (rel. November 17, 2005) ("*Verizon/MCI Order*").

[327]/ *United States v. SBC Communications, Inc.*, Civil Action No. 1:05CV02102, Final Judgment (D.D.C. filed Oct. 27, 2005) ("*DOJ-SBC/AT&T Consent Decree"*); *United States v. Verizon Communications Inc.*, Civil Action No. 1:05CV02103, Final Judgment (D.D.C. filed Oct. 27, 2005) ("*DOJ-Verizon/MCI Consent Decree"*).

[328]/ Carlton and Sider, at para. 39.

its footprint, and as such, the consumer protection concerns may be more similar to those the Commission expressed in earlier mergers between, for example, SBC and Ameritech. There is nothing fundamentally different about BellSouth's local customers as compared to AT&T's local customers, in terms of the incentives for AT&T to undertake research and development initiatives. However, the merger does represent an opportunity for AT&T to acquire more local wireline customers to which it can market its highly profitable bundles of services.

249. Carlton and Sider claim that the FCC did not impose any conditions on mass market services in its recent merger orders.[329] However, conditions related to the provision of "naked DSL" and commitments to forgo increases in state-approved rates for unbundled network elements and to maintain settlement free Internet peering arrangements directly affect the availability of competitive services, and thus the price and service quality of the incumbent's mass market services.

250. The conditions imposed by the Department of Justice ("DOJ") involve divestiture of assets in buildings where only the Applicants have direct connection. The DOJ Consent Decrees list the specific building where the applicants must divest assets, and outlines the process and timeframe for doing so.

[329]/ *Id.*, at para. 29.

Conditions Imposed by the Commission in SBC/AT&T and Verizon/MCI mergers.[330]

Unbundled Network Elements

251. The Applicants agree that they will not seek to raise state-approved rates for unbundled network elements for a period of two years, other than for those rates that are currently subject to appeals.

252. The Applicants will re-evaluate wire centers for impairment of dedicated transport and high-capacity loops pursuant to the triggers established in the Triennial Review Remand Order, excluding from the analysis fiber-based collocation arrangements by AT&T in SBC territory, and by MCI in Verizon territory.

Special Access

253. The Applicants commit to implementing a "Service Quality Measurement Plan" for interstate special access services. Reporting is due on a quarterly basis for a period of 10 quarters.

254. The Applicants agree not to raise rates for current in-region customers of DS1 and DS3 special access services for a period of 30 months.

255. For a period of 30 months the Applicants will not provide special access offerings to themselves or their affiliates if those offerings are not available to other special access customers at similar terms and conditions.

256. The Applicants commit, for a period of 30 months, to certify to the Commission that they provide service pursuant to new or modified contract tariffed services to unaffiliated companies before offering them to its own affiliates.

330/ *SBC/AT&T Merger Order*, at Appendix F; *Verizon/MCI Merger Order*, at Appendix G.

257. The Applicants agree, for a period of 30 months, not to raise rates in their interstate tariffs for special access services that they provide in their in-region territory.

Internet Backbone

258. For a period of three years, the Applicants agree to maintain settlement-free peering arrangements with at least as many Internet backbone service providers as they do at the time of the merger closing.

259. The Applicants agree, for a period of two years, to post their peering policies, as well as any modifications to these policies, on publicly-available websites.

ADSL Service

260. The Applicants agree to provide, within 12 months of the merger closing, DSL service to in-region customers without requiring purchase of circuit-switched voice telephone service ("naked DSL"). The Applicants must maintain this offering for at least 24 months. The Applicants agree for a period of two years to conduct business in a way compatible with the Commission's September 23, 2005 Internet Policy Statement (FCC 05-151). [331]

Alaska (Alascom)

261. SBC/AT&T acknowledges: 1) that the merger does not change its status as carrier of last resort for interexchange services provided by Alascom in the State of Alaska; 2) that the merger does not alter statutory and regulatory geographic rate averaging and rate integration rules that apply to Alascom at the merger closing; and 3) that it will operate

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[331]/ In the Policy Statement, the Commission adopts the following consumer protection principles: "Consumers are entitled to access the lawful Internet content of their choice; to run applications and use services of their choice, subject to the needs of law enforcement; to connect their choice of legal devices that do not harm the network; and to competition among network providers, application and service providers, and content providers." See *Appropriate Framework for Broadband Access to the Internet over Wireline Facilities*, Policy Statement, FCC No. 05-151 (rel. Sept. 23, 2005), at 3.

Alascom as a distinct, but not structurally separate, corporate entity for at least two years after the merger close.

262. The Applicants agree to file annual certifications of compliance with these conditions.

Conditions imposed by the Department of Justice in SBC/AT&T and Verizon/MCI mergers.

263. The Department of Justice ("DOJ") found that, following the SBC/AT&T and Verizon/MCI mergers, certain buildings would have direct connections provided by only one company, and thus, competition would be harmed. To remedy this situation, the DOJ required that the Applicants (in both proceedings) divest certain assets. More specifically, the Applicants were ordered to make available lateral connections, and any transport facilities necessary for the acquirer to use these connections, in the form of indefeasible rights to use ("IRUs"). These long-term leases must be for a period of at least ten years. In the case of SBC/AT&T, the list of affected locations covers approximately 380 buildings in 9 states. For Verizon/MCI, the divestiture requirements cover approximately 350 buildings in 11 states and District of Columbia.[332]

If the Commission approves AT&T's acquisition of BellSouth, it should do so contingent upon enforceable conditions that mitigate risks for consumers.

264. Based on SBC's dubious track record, if the FCC approves the proposed AT&T/BellSouth merger, it should only do so contingent upon explicit conditions that would (1) mitigate and/or prevent harms that the merger would likely cause and (2)

[332]/ *DOJ-SBC/AT&T Consent Decree*, at Appendix A; *DOJ-Verizon/MCI Consent Decree*, at Appendix A.

enhance and/or increase the likelihood of merger benefits. Furthermore, these conditions should be designed so that:

- The FCC, state public utility commissions, competitors, and consumers can readily monitor the Applicants' compliance and the FCC can enforce them (i.e., the financial incentives for compliance are sufficient, and the Applicants' compliance can be assessed).
- The conditions do not sunset, but rather only terminate based upon an affirmative finding by the FCC that they are longer necessary. The Applicants should bear the burden of proving that the conditions are not longer necessary.

265. In this section of our Declaration we (1) identify potential harms of the merger and describe possible conditions to mitigate and/or prevent consumer harm and (2) describe conditions that would increase the potential for consumers to benefit from the proposed merger.

266. The conditions that the Commission set forth in its order approving SBC's acquisition of AT&T, while instructive, should be considered a floor, not a ceiling. The Commission should adopt, at a minimum, the conditions that it adopted in approving SBC's acquisition of AT&T. Given the substantial synergies expected, the demise of UNE-P, the RBOCs' increased bundle penetration, and the fact that the transaction would merge two ILECs, thereby greatly expanding AT&T's local footprint, the Commission should adopt the conditions below. The FCC should impose conditions to enhance and/or increase the likelihood of benefits for consumers. Absent regulatory requirements,

consumers of non-competitive services will not benefit from the anticipated merger synergies

267. Based on our review of documents and data that the Applicants provide in response to an information and data request that the Commission may issue, and based on our review of conditions that others recommend in comments submitted in this proceeding, we may modify or supplement the conditions that we propose.

The Applicants should commit to the deployment of affordable broadband throughout their region.

268. Several factors justify the widespread deployment of affordable broadband service. With its back-to-back mergers (SBC/AT&T and AT&T/BellSouth), AT&T anticipates a net present value of $36 million in synergies. AT&T's acquisition of BellSouth would concentrate the telecommunications market further and expose consumers to the risk of anticompetitive pricing.

269. More than 200,000 BellSouth households lack access to broadband.[333] BellSouth implies that the merger would allow it to deploy wireless broadband "across a wider swath of customers, than BellSouth could by itself."[334] However, although BellSouth acknowledges that broadband deployment to rural households (which comprise approximately 15 percent of its region)[335] is inadequate, and discusses its expanded capability to deploy broadband post-merger, the Applicants fail to make any tangible commitments to do so. Appendix C to our declaration summarizes the present status of

[333]/ Smith (BellSouth), at para. 57.

[334]/ *Id.*

[335]/ *Id.*

broadband deployment and penetration, based on national data and data specific to New Jersey.

270. The Commission should direct the Applicants to provide geographically disaggregated data about their deployment of, consumers' demand for, and the Applicants' prices for broadband access as part of any information and data request it may issue in this proceeding.

271. Furthermore, a better societal use of the substantial synergies derived from the merger than the deployment of IPTV likely would be to fund broadband deployment at affordable rates throughout the merged company's footprint. Ratepayers have financed the development of network infrastructure through government subsidies and a near-monopoly flow of revenues from largely captive customers, over the past one hundred years. Consumers, having funded the Bells' infrastructure deployment, should have access to widespread, affordable broadband services.

The market concentration among relatively few carriers means that net neutrality conditions are essential to protect consumers and competitors from undue control of access to the Internet.

272. The Applicants should commit to net neutrality until such time as the Commission affirmatively determines that such consumer protection is no longer needed for the reasons discussed in Section VII.

The Applicants should commit to unbundled DSL until such time as AT&T demonstrates to the Commission that the market has evolved to a point where the commitment is no longer necessary.

273. The Commission should examine AT&T's commitments regarding standalone DSL.

> In addition, as noted above, the Applicants have made a voluntary commitment to offer standalone DSL. In order to ensure that this commitment benefits consumers, we will monitor all consumer related problems concerning this service, including reviewing consumer complaints and other information. We expect that the terms and conditions for these services will reflect the underlying competitiveness of the market. The Commission retains its historical discretion to monitor the market and take corrective action if necessary in the public interest.[336]

274. Furthermore, if the Commission approves the proposed AT&T acquisition of BellSouth, the condition should include AT&T's enlarged serving area and the Commission should decline to adopt an expiration date. Instead, AT&T should bear the burden of proof in demonstrating at a future date that the condition is no longer appropriate. Furthermore, the Applicants should be required to provide evidence that consumers are aware of this option.

The Applicants should offer UNE-P at TELRIC rates until local markets are sufficiently competitive.

275. The merger would enhance AT&T's already formidable market power, making it that much more difficult for CLECs to "negotiate" reasonable rates for UNE-P. Therefore, the Applicants should commit to offer UNE-P at TELRIC rates for at least three years after the merger's closing. Absent detailed data about the rates and demand for commercially negotiated UNE-P, we cannot assess the status of CLEC activity. A

[336]/ *SBC/AT&T Merger Order*, at para. 207.

continuing decline in UNE-P seems likely. Therefore, the Commission should consider requiring AT&T to offer UNE-P with TELRIC-based prices for a minimum of three years, and preferably until AT&T demonstrates that the local markets it now dominates are sufficiently competitive.

The Commission should require an audit of AT&T's interaffiliate transactions and sales practices.

276. As stated previously, the Applicants anticipate more aggressive entry into IPTV and other unregulated lines of business. Also, the pursuit of enhanced revenues from bundled offerings creates incentives for (1) overly aggressive sales practices, (2) cross-subsidization of competitive services with revenues from monopoly services; and (3) anticompetitive tying arrangements. Therefore, the FCC should require an independent audit of AT&T's sales practices, an independent audit of AT&T's interaffiliate transactions, and comprehensive customer education.

The Commission should require AT&T and BellSouth to submit service quality data and adopt sanctions for reductions in service quality.

277. As we demonstrate earlier, AT&T's and BellSouth's service quality for basic telephone service has been steadily declining. The Applicants' efforts to lower operating expenses would further jeopardize the quality of basic services offered to mass market consumers, for which there is no effective competition. Service quality data that AT&T and BellSouth submit that is reported based on district-averages masks inferior performance in "pocket" problem areas (e.g., rural exchanges). The FCC should coordinate with state public utility commissions to impose sanctions if service quality for

non-competitive telecommunications services declines below benchmark levels (1) as measured at geographically disaggregated levels and (2) with comparative statistics for consumers that purchase only basic voice grade service and consumers that purchase bundled packages. These comparative statistics are essential to detect any discrimination against consumers who do not choose to purchase bundles. The Commission should also condition any merger approval on the Applicants' commitments to improve and maintain service quality for basic service at established standards.

AT&T should relinquish competitive classification of basic local exchange service unless and until concerted out-of-region entry and effective competition materializes.

278. In its approval of SBC's acquisition of AT&T, the Commission stated:

> In addition, we will continue to monitor the markets within which the Applicants compete. If the Commission determines that out-of-region competition is failing to develop, then it will revisit the merger conditions on its own motion or pursuant to a petition of a party. Similarly, if the Commission determines that the Applicants are acting to exclude competitors, it will revisit the merger conditions on its own motion or pursuant to a petition of a party.[337]

279. BOCs' attempts to compete out-of-region have been lackluster. The Applicants should commit to out-of-region entry to offer basic local exchange service to residential and small business consumers in more than a "bare bones" fashion or alternatively state that such out-of-region entry is not profitable and that they have no intention of pursuing mass market "unbundled" customers beyond their home turf.

280. Until RBOCs, such as AT&T (a 117 billion dollar telecommunications carrier post-merger with unique capabilities), are able to enter other local markets and

337/ *SBC/AT&T Merger Order*, at para. 206.

profitability compete for mass market customers,[338] the FCC and state PUCs should assume that these markets are non-competitive and should regulate them accordingly. AT&T should relinquish any competitive classification that it has acquired for providing basic voice-grade service to the mass market.

The FCC should impose conditions to ensure consumers benefit from merger synergies and should establish an adequate X-factor, consider rate regulation and take account of estimated merger synergies in its forthcoming decisions in ongoing proceedings.

281. In a competitive market place, suppliers would lower prices, increase service quality and/or offer new, innovative products as a result of generating merger synergies. However, in many of the telecommunications markets that the Applicants serve, there is inadequate competitive pressure to ensure that consumers of non-competitive services would benefit from the merger synergies. The Applicants should flow through merger synergies by reducing rates for non-competitive interstate and intrastate services and by deploying broadband widely to residential mass market customers.

The Commission should eliminate the non-rural high cost fund for the Applicants.

282. The non-rural high cost fund, which is presently under Commission investigation, should not be available to BellSouth and AT&T. There is no evidence that local competition has eroded the implicit support that BellSouth and AT&T receive from bundled services and their near-monopoly position in the local market.

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[338]/ The FCC previously determined that "as out-of-region competitors we consider SBC and Ameritech to be unusually qualified." *SBC/Ameritech Merger Order*, at para. 273. Despite this vote of confidence by the FCC, mass market consumers have yet to benefit from SBC's "unusually qualified" ability to compete beyond their home turf.

The Commission should ensure that legacy AT&T customers in BellSouth's territory are not harmed.

283. The Commission should monitor the treatment of legacy AT&T customers in BellSouth's territory and ensure proper customer notice to extent that these customers are migrated to BellSouth's network. In addition, these customers should receive proper information with respect to their options.

The Commission should ensure that the Applicants make firm commitments to increase telephone subscribership.

284. As we discuss earlier, telephone subscribership is declining nationally. The Applicants should make firm, measurable commitments to increase telephone subscribership throughout their merged region.

Competitive reporting and information are more essential than ever.

285. Timely comprehensive assessment of market structures is essential, particularly, during the ongoing retreat from competition. This assessment is critical to inform the FCC and state public utility commissions about market imperfections, and which customers are most vulnerable to Bells' exercise of market power. Data about consumer demand and about the quality and prices of services supplied contributes to informed public policy making. In order to monitor the impact of the *TRRO* and any merger approvals on local, DSL, long distance, and integrated telecommunications markets, ILECs should submit quarterly reports that provide, on a geographically disaggregated basis (i.e.. wire center basis) quantities of total retail lines; UNE-P lines; UNE-L lines; resale lines; demand for each of the bundled services they offer; demand for DSL;

demand for unbundled DSL; and price changes. Data such as these will enable informed oversight so federal and state regulators can identify and address market imperfections.

IX. CONCLUSION

286. In last year's merger proceeding regarding the proposed merger of Verizon and MCI, MCI described a local market that had become unattractive to serve:

> Once it became likely that UNE-P would no longer be available, the limited UNE-L buildout strategy no longer made sense. This is true even in those wire centers where MCI has a relatively high concentration of existing UNE-P customers, because the potential profits from any UNE-L plans or proposals reviewed by MCI were subject to great uncertainty and depended upon certain assumptions, including reductions in the nonrecurring charge for hot cuts, that were not realized. Therefore, MCI decided not to pursue this UNE-L strategy any more.[339]

One article characterized AT&T's decision to merge with SBC in this manner:

> AT&T's move is a potential windfall for the Bells . . . which have been increasingly successful in selling packages of local and long distance. Mr. Dorman said AT&T's decision to withdraw was clinched by a recent regulatory setback that will make it more expensive for AT&T and others to rent the Bells' lines to sell similar packages. MCI Inc. and Sprint Corp. also have throttled back on advertising and marketing.[340]

If the CLEC business was not profitable for the legacy AT&T or MCI, it is likely that being a CLEC out-of-region is not attractive to the new AT&T (perhaps evidenced by the apparent disregard for previous statements and plans regarding out-of-region entry) and is certainly dubious for small competitors. Therefore, regulators should assume that until actual head-to-head competition exists, local mass markets are non-competitive. Also, the absence of out-of-region BOC competition is evidence of the fallacy of the FCC's misplaced optimism in the *TRRO* about opportunities for local competition.

287. The pending merger further heightens concerns about the absence of sibling rivalry among the Bells and the growing potential for tacit collusion. As one economist

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[339]/ Verizon/MCI Public Interest Statement, Declaration of Wayne Huyard (Verizon/MCI), at para. 15.

[340]/ "AT&T Posts 80% Drop in Net, Confirms Consumer Retreat," The Wall Street Journal, July 23, 2004, page A11.

observed, "[t]he variety of collusive pricing arrangements in industry is limited only by the bounds of human ingenuity."[341] The pending merger facilitate collusion because they shrink the number of "players" in the industry, which has anticompetitive consequences. The following excerpts from an economics textbook discuss the beneficial impact of increasing the number of players:

> First, as the number of sellers increases and the share of industry output supplied by a representative firm decreases, individual producers are increasingly apt to ignore the effect of their price and output decisions on rival actions and the overall level of prices.
>
> . . .
>
> Second, as the number of sellers increases, so also does the probability that at least one will be a maverick, pursuing an independent, aggressive pricing policy.
>
> . . .
>
> Finally, different sellers are likely to have at least slightly divergent notions about the most advantageous price. ... The coordination problem clearly increases with the number of firms.[342]

If the FCC approves AT&T's acquisition of BellSouth, the FCC and state public utility commissions will need to devote substantially greater resources for regulatory scrutiny and oversight.

288. We intend to supplement our analysis of the proposed merger's impact on consumers after the Applicants make available relevant proprietary data and to respond, as necessary, to additional Applicant filings in this proceeding.

289. For the all of the foregoing reasons, the FCC should deny the proposed merger. If, contrary to our recommendation, the Commission approves the proposed transaction,

341/ F. M. Scherer, *Industrial Market Structure and Economic Performance*, Rand McNally & Company, (1970), at 158.

342/ *Id.*, at 183.

it should only do so contingent upon enforceable conditions that protect residential and small business consumers from harm and that increase the likelihood of consumer benefits from the transaction.

FCC CC Docket No. 06-74
DECLARATION OF SUSAN M. BALDWIN AND SARAH M. BOSLEY

I declare under penalty of perjury under the laws of the United States of America that the foregoing is true and correct.

Executed on June 5, 2006

Susan M. Baldwin

Susan M. Baldwin

I declare under penalty of perjury under the laws of the United States of America that the foregoing is true and correct.

Executed on June 5, 2006

Sarah M. Bosley