

BEFORE THE
FEDERAL COMMUNICATIONS COMMISSION
WASHINGTON, D.C. 20554

In the Matter of)
)
Application Pursuant to Section 214 of the)
Communications Act of 1934 and)
Section 63.04 of the Commission's) WC Docket No. 06-74
Rules for Consent to the Transfer of) DA 06-904
Control of BellSouth Corporation to)
AT&T, Inc.)

COMMENTS

CBEYOND COMMUNICATIONS
GRANDE COMMUNICATIONS
NEW EDGE NETWORKS
NUVOX COMMUNICATIONS
SUPRA TELECOM
TALK AMERICA INC.
XO COMMUNICATIONS, INC., AND
XSPEDIUS COMMUNICATIONS

June 5, 2006

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COMMENTS

Pursuant to the Public Notice issued by the Federal Communications Commission ("FCC" or "Commission") in the above-captioned proceeding on April 19, 2006,¹ Cbeyond Communications, Grande Communications, New Edge Networks, NuVox Communications, Supra Telecom, Talk America Inc., XO Communications, and Xspedius Communications (hereinafter referred to as "Commenters"), by their attorneys, hereby file their comments on the application for consent to transfer of control filed by AT&T Inc. ("AT&T") and BellSouth Corporation ("BellSouth") (jointly, the "Applicants").

I. INTRODUCTION AND SUMMARY

Only six months ago, Commissioner Copps expressed a fear that the acquisitions of AT&T and MCI by SBC and Verizon, respectively, could write the "epitaph for . . . competition"

¹ *Commission Seeks Comment on Application for Consent to Transfer of Control Filed by AT&T, Inc. and BellSouth Corporation*, Public Notice, DA 06-904 (rel. Apr. 19, 2006). Specific file numbers related to the proposed transaction are hereby incorporated by reference.

in telecommunications.² There can be no debating his follow-on observation that “[t]hanks in part to [Commission] actions, the wireline market became increasingly the province of the few.”³ One can only wonder when the Commission will say that enough is enough, and stop the incessant effort of AT&T to reestablish a nationwide wireline monopoly by using monopoly profits to eliminate its primary actual and potential competitors, rather than by competing for customer loyalty through innovation and quality service. If the Commission is ever to draw the line, now is the time. Should the Commission permit AT&T to swallow BellSouth as proposed by the Applicants, the resulting enterprise would control approximately 50% of all switched access lines in the nation, and the largest wireless company as well. Unless the Commission takes strong action on this application, it seriously risks breaching a tipping point in which AT&T's market power is sufficiently enormous that it can effectively forestall any intramodal wireline competition and much intermodal competition in its enormous operating footprint.

The concern is not new or imaginary. The Commission has long been fearful of threats posed to competition by the merger of RBOCs. When the number of RBOCs was reduced from six to five by the merger of NYNEX and Bell Atlantic, the Commission observed that any further reduction in the number of RBOCs “would present serious public interest concerns”,⁴ and said that future applicants would bear an increased burden of establishing that their merger

² *SBC Communications Inc. and AT&T Corp. Applications for Approval of Transfer of Control*, 20 FCC Rcd 18290 (2005) (“*AT&T/SBC Merger Order*”) and *Verizon Communications, Inc. and MCI, Inc. Applications for Approval of Transfer of Control*, 20 FCC Rcd 18433 (2005) (“*Verizon/MCI Merger Order*”), Statement of Commissioner Michael J. Copps, Concurring.

³ *Id.*

⁴ *Applications of NYNEX Corp. and Bell Atlantic Corp. For Consent to Transfer Control of NYNEX Corporation and Its Subsidiaries*, 12 FCC Rcd 19985 (1997), ¶ 156 (“*NYNEX/Bell Atlantic Merger Order*”).

would be pro-competitive and serve the public interest. When SBC proposed two years later to further reduce the ranks of RBOCs from five to four by acquiring Ameritech, the Commission found that the applicants failed to carry their burden, and permitted the combination only after the applicants agreed to an extensive set of conditions designed to ameliorate the anticompetitive consequences of the transaction. It is clear that whether to approve the SBC/Ameritech merger under *any* circumstance was a close question for the Commission, and that it only agreed to the merger after the Applicants committed to an array of conditions that were simply too vast to ignore.

It is not surprising that permitting RBOC-to-RBOC mergers is unsettling to the Commission. As the Commission explained only last year, in considering whether a proposed transaction will reduce existing competition, it must consider “whether the merger will accelerate the decline of market power by dominant firms in relevant communications markets,” and the effect of the proposed transaction on future competition.⁵ At least in the absence of incredibly stringent pro-competitive conditions, it is hard to fathom how the merger of two RBOCs – each with market power sufficient to be deemed dominant in their own regions – could be said to facilitate a decline in market power and increase in future competition. Indeed in the most recent RBOC-to-RBOC merger proceeding, the Commission determined that mergers of RBOCs actually harm telecommunications consumers by: (1) denying them the benefit of probable future competition between the merging firms; (2) undermining the ability of regulators and

⁵ *Applications of Ameritech Corp., and SBC Communications Inc., For Consent to Transfer Control of Corporations Holding Commission Licenses and Lines Pursuant to Sections 214 and 310(d) of the Communications Act and Parts 5, 22, 24, 25, 63, 90, 95 and 101 of the Commission’s Rules*, 14 FCC Rcd 14712, ¶18 (1999) (“*SBC/Ameritech Merger Order*”).

competitors to implement the deregulatory framework of the 1996 Act; and (3) increasing the incentive of the merged entity to raise entry barriers and discriminate against competitors.⁶

The proposed merger of AT&T and BellSouth must be measured against the failings identified by the Commission in connection with the SBC/Ameritech merger and its progeny. Although it is tempting to believe that nothing has changed, fact is that the risk posed to competition by RBOC-to-RBOC mergers has increased over time. By eliminating three of the original seven RBOCs, the anticompetitive effects of eradicating *any* of the remaining RBOCs are accentuated substantially. The loss last year of the two primary non-incumbent LEC market participants – the pre-merger AT&T and MCI – has made the situation even more acute. The annual revenue of the largest competitive LEC, XO, is only approximately 1.6% of the revenue of a combined AT&T and BellSouth. Similarly, the annual revenue of the largest competitive LEC located in the BellSouth region, ITC^Deltacom, is less than .005% of the revenue of a combined AT&T and BellSouth. Indeed the AT&T-BellSouth combination would enjoy a 30% *nationwide* share of the customer segment primarily targeted by competitive LECs -- small and medium-sized businesses -- while its largest non-incumbent LEC competitor (XO) would have only 4%.⁷

When this enormous disparity of scale is combined with the market power enjoyed by RBOCs through their control of legacy bottleneck facilities, the barriers to both the entry and growth of competitive carriers become overwhelming. Hence, it should be no surprise that the number of UNE loops provided by incumbent LECs to competitive carriers has not increased appreciably since mid-2002, or that competitive LEC penetration of the small to medium-sized

⁶ *Id.* ¶ 3.

⁷ Yankee Group Report, “How do SMBs Fare in the competitive LEC Versus incumbent LEC Matchup?” (Apr. 2006) (“*Yankee Group Study*”), Exh. 1.

business market peaked in 2003⁸, even while such customers say they much prefer competitive LEC service quality.⁹ In any event, it is clear that each concern expressed by the Commission with respect to prior RBOC-to-RBOC mergers applies at least equally to the proposed acquisition of BellSouth by AT&T.

Eliminating Potential Competition. As geographically adjacent RBOCs, AT&T and BellSouth are the most significant potential competitors to one another. As was the case in the Commission's review of the SBC/Ameritech merger, both firms are the "most significant market participants in geographic areas adjacent to their own regions."¹⁰ The Commission has established that the relevant geographic markets are individual metropolitan areas.¹¹ In this instance, it is clear that due to simple proximity it would be relatively easy for BellSouth to expand its network as required to provide competitive telecommunications services in a number of SBC-dominated metropolitan areas just over the border from its existing operating territory – Houston, Galveston, Little Rock, St. Louis and Indianapolis are but a few prime examples.

The likelihood of AT&T competing in the existing BellSouth region is even more striking. Of course, it has the same opportunity to extend its existing local network to nearby metropolitan areas where BellSouth is dominant – examples include New Orleans, Shreveport, Memphis, Lexington and Nashville. In addition, however, AT&T operates substantial fiber networks in many other BellSouth cities that are not near the border of the traditional SBC operating territory. In major cities like Atlanta, Miami, Tampa, Jacksonville, Birmingham, Charlotte, and Raleigh, AT&T has extensive switching facilities and transmission networks in

⁸ *Id.* Exh. 4.

⁹ *Id.* 5.

¹⁰ *SBC/Ameritech Merger Order*, ¶ 66.

¹¹ *Id.* ¶ 69.

place that, when combined with AT&T's other assets, position it uniquely to provide telecommunications services in competition with BellSouth across virtually the entire region.

The ability of AT&T and BellSouth to compete with each other extends to virtually all telecommunications product markets as well. The Commission has previously determined that adjacent RBOCs possess the "capabilities and incentives" to make each firm the most significant market participant in each other's regions for *mass market* local exchange services.¹² Indeed the Commission has found that adjacent RBOCs have "certain advantages when expanding out-of-region that other potential local service market entrants lack."¹³ In fact, with the effective elimination of local switching as a UNE and the resultant withdrawal of the pre-merger AT&T and MCI from offering mass market local services, such adjacent RBOCs may now be the only realistic potential intramodal competitor for wireline local exchange services. While Applicants contend that wireless services will compete in the future for mass market dial tone, the unfortunate fact is that the proposed transaction will bring an end to the independent operation of Cingular, the nation's largest wireless company.

When considering the impact of the proposed merger on the *small-to-medium-sized business* and *enterprise* customer markets, one need not even analyze the potential for AT&T and BellSouth to compete with each other. AT&T already is, by its own claim, the foremost nationwide competitor for business customers, while there can be no denying that BellSouth is aggressively vying to prevent business customers in its region from slipping away. And the anticompetitive effect of losing AT&T as a potential competitor for the supply of *wholesale services* in adjacent RBOC territories is now a settled matter. In connection with the

¹² *Id.* ¶ 77.

¹³ *Id.*

AT&T/SBC merger only last year, the Commission found that the withdrawal of AT&T as a competitor to RBOC special access services was likely to have an anticompetitive effect on the market for Type I special access services.¹⁴ Indeed, the problem was sufficiently worrisome that the U.S. Department of Justice filed a lawsuit contending that the likely diminution of special access competition was violative of federal antitrust laws.

Undermining Implementation of the 1996 Act. The Commission has found that a substantial anticompetitive harm flowing from RBOC-to-RBOC mergers is that the “resulting...overall loss of diversity at the operating company level” is likely to derail efforts by the Commission and competitors to identify the best practices among incumbent LECs, and then use the best practices as a benchmarking tool to root out anticompetitive practices by other incumbent LECs.¹⁵ The problem is that the “larger combined entity will have a greater incentive to unify the practices of its separate operating companies,” and the adoption of poor practices can be a sort of race to the bottom. Indeed, the Commission has found that mergers between RBOCs “directly increase the incentive and ability of remaining incumbent LECs to coordinate their behavior to resist market opening measures.”¹⁶ That concern is well-founded in the immediate proposed transaction. AT&T and BellSouth have dramatically different practices and policies on matters that materially affect the ability of new entrants to compete. In the areas of special access pricing, commercial agreements, performance metrics, line sharing and interconnection agreement terms and conditions, to name a few, the practices of one applicant are significantly more anticompetitive than the behavior of its proposed merger partner. BellSouth, for example,

¹⁴ *AT&T/SBC Merger Order*, ¶ 3.

¹⁵ *SBC/Ameritech Merger Order*, ¶ 59.

¹⁶ *Id.*

allows meaningful circuit portability in its special access volume and term deals, whereas AT&T does not. By contrast, AT&T is open to negotiating line sharing arrangements, whereas BellSouth is not.

On such occasions, the disparity in practices enables both regulators and competitors to identify unreasonable behavior that interferes with accomplishing the market-opening objectives of the 1996 Act, and take appropriate steps to rectify problem situations through negotiation or regulatory intervention. The Commission has concluded that its “ability to analyze a wide variety of approaches” among the major incumbent LECs is “especially crucial” for regulators and competitors to implement the 1996 Act, and that regulators “benefit greatly from observing diverse strategic decisions and experimentation among the incumbents.”¹⁷ However, the comparative practices analyses that the Commission has described as the “best means” available to stay abreast of problems,¹⁸ would be almost completely sacrificed by the proposed AT&T/BellSouth combination. While some ability to engage in benchmarking is lost with each successive merger of incumbent LECs, the proposed AT&T/BellSouth merger crosses the tipping point by reducing the number of RBOCs to only three – a number that is inadequate to permit the kind of experimentation and behavioral comparison heretofore relied upon so critically.

Increasing Incentive to Discriminate. As the Commission has found with respect to previous AT&T acquisitions of fellow RBOCs, such mergers increase both the incentive and ability of the “larger merged entity to discriminate against rivals in retail markets where [AT&T]

¹⁷ *Id.* ¶ 109.

¹⁸ *Id.*

will be the dominant LEC.”¹⁹ The sheer increase in the number of local areas controlled by AT&T as a result of the merger will increase substantially its incentive and ability to discriminate against carriers competing in retail markets that depend on access to AT&T’s inputs in order to provide services. The proposed transaction, for example, introduces the incentive and ability to reduce rivals’ ability to compete in Houston by discriminating against them in Atlanta, raising their overall costs in ways that hinder their ability to compete systemwide. Currently the ability of AT&T and BellSouth to engage in such behavior stops at the borders of their respective operating regions, whereas the proposed merger would expand the capability across nearly half the nation.

Two decades after the Bell System divestiture, and a decade after enactment of the 1996 Act, who would have thought that the telecommunications industry could be in this state? A behemoth telecommunications monopoly – again named AT&T – seeks permission to “put Humpty Dumpty back together again.” With the current AT&T senior executives in Texas playing the role of modern day Theodore Vails, AT&T once again seeks to establish a virtual stranglehold over critical telecommunications infrastructure covering most of the nation. This is the very situation that the Department of Justice sought to undo in 1984, that Judge Greene worked heroically to remedy throughout the 1980’s, and that Congress intended to prevent recurring by its action in 1996. Yet now AT&T asks this Commission to sacrifice two decades of effort by the executive branch, courts and Congress by enabling its grand design to effectively reassemble the old Bell System. Remarkably the Commission already has tolerated AT&T’s

¹⁹ *Id.* ¶ 60.

appetite for PacTel, Ameritech, SNET, AT&T and AT&T Wireless.²⁰ The time has come for the Commission to tell AT&T that it simply is not in the public interest for its acquisition binge to continue, and that it is time for it to grow through innovation and service rather than mergers that simply entrench and expand its market power.

The Commission should just say “no” to the proposed merger. Failing that, at a minimum, the Commission simply must impose a set of conditions that are tailored to offset – to the fullest extent reasonably possible – the enormous anticompetitive effects of the proposed transaction. The Commission has repeatedly imposed strict conditions on horizontal RBOC-to-RBOC mergers.²¹ A different set of conditions has historically been required on vertical RBOC-IXC mergers.²² The proposed AT&T/BellSouth transaction uniquely raises *both* sets of concerns, and requires, at a minimum, an updated version of both sets of conditions. How the Commission handles this application is a litmus test of who is in control of telecommunications policy at this point in history. The Applicants would like to believe that their arguments are all that matters, and they have grown to a point that no one can deny their ambitions. But the time has come for the Commission as the primary arbiter of the public interest to put on the brakes and establish strict limits. To do otherwise would be to sacrifice the model of an open market with a multiplicity of competitors in favor of a return to the failed supplier paradigm of yesteryear.

²⁰ The anticompetitive effects of this consolidation, of course, has been exacerbated by Verizon’s consolidation of the previous NYNEX, Bell Atlantic, GTE and MCI.

²¹ See *NYNEX/Bell Atlantic Merger Order*, ¶ 12; *GTE/Bell Atlantic Merger Order*, ¶¶ 3-4; *SBC/Ameritech Merger Order*, ¶¶ 55-62.

²² E.g. *AT&T/SBC Merger Order*, ¶ 24.

II. THE COMMISSION MAY APPROVE THIS TRANSACTION ONLY IF THE PROPOSED TRANSFER OF CONTROL OF LICENSES AND LINES FROM BELL SOUTH TO AT&T SERVES THE PUBLIC INTEREST, CONVENIENCE AND NECESSITY

Under sections 214(a) and 310(d) of the Act, the Commission must conclude that the proposed transfer of control of licenses and lines from BellSouth to AT&T “serves the public interest, convenience and necessity” before the proposed transaction may be approved.²³ In this proceeding, the Applicants bear the burden of proving, by a preponderance of the evidence, that the proposed transaction “will not violate or interfere with the objectives of the Act or the Commission’s rules,” and that “the predominant effect of the transfer will be to advance the public interest.”²⁴ In reviewing the Application, the Commission must “weigh the potential public interest harms of the proposed transaction against the potential public interest benefits to ensure that the Applicants have shown that, on balance, the merger serves the public interest, convenience and necessity.”²⁵ The Application may be granted only if the Commission is persuaded that the proposed transfer of control from BellSouth to AT&T would advance the public interest, convenience and necessity, and is fully consistent with the pro-competitive objectives of the Act and the Commission’s rules.

Consistent with its prior orders, the Commission must consider several overriding factors in making its public interest determination.²⁶ First, the Commission must conclude that the proposed transaction would not violate the Act.²⁷ Second, the Commission must conclude that

²³ *SBC/Ameritech Merger Order*, ¶47.

²⁴ *Id.* ¶ 48.

²⁵ *Id.* ¶ 47.

²⁶ *Id.* ¶ 48. *See also AT&T/SBC Merger Order*, ¶ 16.

²⁷ *SBC/Ameritech Merger Order*, ¶ 48.

the proposed transaction would not violate the Commission's rules.²⁸ Third, the Commission must conclude that the proposed transaction would not substantially frustrate or impair the Commission's implementation or enforcement of the Act, or interfere with the objectives of that and other statutes.²⁹ Fourth, the Commission must conclude that the proposed transaction "promises to yield affirmative public interest benefits."³⁰

The public interest analysis undertaken by the Commission must be informed by, but not limited to, traditional antitrust principles.³¹ Under the Act, the Commission is charged with making an "independent public interest determination" that necessarily includes evaluating the public interest benefits and harms of proposed transactions that likely will impact future competition.³² The Commission has concluded that telecommunications competition "is shaped not only by antitrust rules, but also by regulatory policies that govern the actions of industry players."³³ Thus, in reviewing proposed transactions among telecommunications carriers, the Commission must be guided by the broad aims of the Act, including but not limited to implementing the pro-competitive national policy framework envisioned by Congress to open all telecommunications markets to competition, preserving and advancing universal service, accelerating private sector deployment of advanced services, ensuring a diversity of license holders, and generally managing the spectrum in the public interest.³⁴ The Commission also may assess whether such transactions "will affect the quality of telecommunications services or will

²⁸ *Id.*

²⁹ *Id.*

³⁰ *Id.*

³¹ *AT&T/SBC Merger Order*, ¶ 18; *SBC/Ameritech Merger Order*, ¶ 49.

³² *SBC/Ameritech Merger Order*, ¶ 49.

³³ *AT&T/SBC Merger Order*, ¶ 18.

³⁴ *Id.* ¶ 17; *SBC/Ameritech Merger Order*, ¶ 50.

result in the provision of new or additional services to consumers.”³⁵ Such regulatory policy objectives must be considered in light of the nature, complexity and speed of technological and market changes and trends in the communications industry,³⁶ as well as factors that influenced Congress to enact specific provisions of the Act.³⁷

The public interest standard imposed by the Act also requires that the Commission evaluate the likely impact of proposed transactions on future conditions within local telecommunications markets.³⁸ In addition to considering whether a proposed transaction will reduce existing competition, the Commission also must consider “whether the merger will accelerate the decline of market power by dominant firms in the relevant communications markets,” and the effect of the proposed transaction on future competition.³⁹ Indeed, vibrant changes within the telecommunications industry suggest that a transaction “may have predictable yet dramatic consequences for competition over time even if the immediate effect is more modest.”⁴⁰ Thus, the Act directs the Commission “to rely on its specialized judgment and expertise to render informed predictions about future market conditions and the likelihood of success of individual market participants.”⁴¹

The Commission may conclude that the proposed transfer of control of licenses from BellSouth to AT&T would serve the public interest only if it is persuaded that the transaction

³⁵ *AT&T/SBC Merger Order*, ¶ 17; *SBC/Ameritech Merger Order*, ¶ 50.

³⁶ *AT&T/SBC Merger Order*, ¶ 17.

³⁷ *SBC/Ameritech Merger Order*, ¶ 50.

³⁸ *Id.* ¶ 51.

³⁹ *AT&T/SBC Merger Order*, ¶ 18.

⁴⁰ *SBC/Ameritech Merger Order*, ¶ 51.

⁴¹ *Id.*

would enhance competition.⁴² Consequently, the Applicants must demonstrate that the transfer of control of licenses and lines from BellSouth to AT&T would have the effect of “affirmatively advancing competition throughout the region.”⁴³ As the Commission has recognized, “the same consequences of a proposed merger that are beneficial in one sense may be harmful in another.”⁴⁴ Specifically, “combining assets may allow the merged entity to reduce transaction costs and offer products, but it also may create market power, create or enhance barriers to entry by potential competitors, and create opportunities to disadvantage rivals in anticompetitive ways.”⁴⁵ Thus, a mere showing by the Applicants that the proposed transaction is counterbalanced, in part, by nominal public interest benefits does not satisfy the public interest standard imposed by the Act, and therefore must be rejected by the Commission.

Under the Act, the Commission may impose and enforce certain types of conditions on a transaction that “tip the balance and result in a merger yielding overall positive public interest benefits.”⁴⁶ In approving a merger, the Act permits the Commission to impose any condition that “the public convenience and necessity may require.”⁴⁷ Importantly, the Commission has attached conditions to numerous similar mergers, concluding that such conditions were necessary to remedy the unlawful, anticompetitive effects likely to result from the transaction.⁴⁸

⁴² *Id.* ¶ 49.

⁴³ *NYNEX/Bell Atlantic Merger Order*, ¶ 11.

⁴⁴ *AT&T/SBC Merger Order*, ¶ 18.

⁴⁵ *Id.*

⁴⁶ *SBC/Ameritech Merger Order*, ¶ 52.

⁴⁷ *Id.*

⁴⁸ *NYNEX/Bell Atlantic Merger Order*, ¶ 12; *SBC/Ameritech Merger Order*, ¶¶ 55-62; *GTE/Bell Atlantic Merger Order*, ¶¶ 354-362.

III. THE PROPOSED MERGER DOES NOT SERVE THE PUBLIC INTEREST

A. The Proposed Merger Would Significantly Decrease Telecommunications Competition in All Relevant Markets

As explained in Section II above, the Commission's task is to determine whether the public interest would be served by the transfer of BellSouth's numerous licenses and lines to AT&T. Public interest harms must be weighed against potential public interest benefits and a merger may be permitted only if the Commission concludes "that, on balance, the merger serves the public interest, convenience and necessity."⁴⁹ In applying this public interest test, the Commission must carefully consider the merger's likely effect on future competition.⁵⁰ In order to find that a merger is in the public interest, the Commission must be convinced that it will actively promote the development of competition, not merely prevent the lessening of competition, which is the policy objective of antitrust laws.⁵¹

In the last ten years, the Commission has conducted a careful review of every proposed merger involving an RBOC and repeatedly has concluded that the proposed transaction could not go forward absent the parties' agreement to significant substantive conditions tailored to address the public interest harms the merger would create. Beginning with the Bell Atlantic/NYNEX merger in August 1997, the Commission has insisted on a variety of conditions to both mitigate the potential public interest harms of the applicants' transaction and to enhance competition.⁵² In

⁴⁹ *Ameritech/SBC Merger Order*, ¶ 46.

⁵⁰ *Id.* ¶ 49.

⁵¹ *Id.* ¶ 63; *see also AT&T/SBC Merger Order*, ¶ 18.

⁵² *See NYNEX/Bell Atlantic Merger Order*, ¶ 12; *see also GTE/Bell Atlantic Merger Order*, ¶¶ 3-4; *SBC/Ameritech Merger Order*, ¶¶ 55-62; *AT&T/SBC Merger Order*, ¶ 24; *Verizon/MCI Merger Order*, Appendix G, Conditions.

the SBC/Ameritech combination – the most recent merger involving two RBOCs or an RBOC and a major independent incumbent LEC – the Commission found:

[T]he proposed merger of these RBOCs threatens to harm consumers of telecommunications services by: (a) denying them the benefits of future probable competition between the merging firms; (b) undermining the ability of regulators and competitors to implement the pro-competitive, deregulatory framework for local telecommunications that was adopted by Congress in the Telecommunications Act of 1996; and (c) increasing the merged entity's incentives and ability to raise entry barriers to, and otherwise discriminate against, entrants into the local markets of these RBOCs.⁵³

The applicants' ongoing compliance with the conditions adopted in the order was a mandatory requirement for Commission merger approval. The Commission concluded that "[t]hese conditions are sufficient to tip the scales, so that, on balance, the application to transfer licenses and lines should be approved."⁵⁴

The threats to competition that caused the Commission to find in the SBC/Ameritech case – and in numerous other merger cases involving RBOCs – that the proposed merger would not be in the public interest absent the implementation of a variety of "significant and enforceable conditions"⁵⁵ are present to an even greater degree here.

1. ***The Proposed Merger Poses a Significantly Greater Risk to Competition than Any Past Merger Given the Current Competitive Landscape***

a. The Competitive Landscape in 1999

The appropriate starting point for the Commission's required public interest inquiry – which necessarily includes an analysis of competitive effects of the proposed merger⁵⁶ – is the

⁵³ *Ameritech/SBC Merger Order*, ¶ 3 (footnote omitted).

⁵⁴ *Id.* ¶ 5.

⁵⁵ *Id.* ¶ 2.

⁵⁶ *Id.* ¶¶ 48-49.

last RBOC-to-RBOC merger proceeding (in which the Commission found that public interest harms far outweighed public interest benefits in the absence of conditions).⁵⁷ At that time, competition was expanding in all product markets and was expected to continue to grow rapidly. In the second half of 1999, when the SBC/Ameritech merger was under consideration by the Commission, competitive LECs were making steady progress in their efforts to compete with incumbent LECs. According to the Commission's August 2000 *Local Telephone Competition Report*, the number of lines that incumbent LECs provided as UNEs more than doubled during the six months from June through December 1999 – from about 700,000 to nearly 1.5 million.⁵⁸ In the same period, lines provided under resale arrangements grew from 3.6 million to 4.6 million, making the total lines provided by incumbent LECs to other carriers about 5.7 million at the end of 1999.⁵⁹ Importantly, competitive LECs' local service revenues nearly doubled from 1998 to 1999 – rising from \$2.4 billion to \$4.5 billion and the share of local service revenues claimed by carriers competing with the incumbent LECs rose from 3.5% in 1998 to 5.8% in 1999.⁶⁰ In short, competitive LECs' prospects in late 1999 were bright.

⁵⁷ *Id.* ¶ 2. While it is appropriate for the Commission to begin its inquiry by focusing on the potential harms and benefits that arose from that RBOC-to-RBOC combination, the Commission also must take into account that an AT&T/BellSouth merger represents a potential quadruple threat; *i.e.* an RBOC-RBOC combination, an RBOC-IXC combination, an RBOC-Wireless combination and an RBOC-competitive LEC merger. In each instance, the merger partner is the largest provider (or among the largest providers) in the market. In its review and analysis, the Commission must consider the potential threat to competition in all four market sectors.

⁵⁸ *Local Competition at the New Millennium*, Industry Analysis Division, Common Carrier Bureau, FCC (August 2000), at 2 (“August 2000 Local Competition Report”).

⁵⁹ *Id.* Incumbent LECs acquired about 400,000 lines from other carriers on a resale basis during this period.

⁶⁰ *Id.* 3.

The three largest interexchange carriers – AT&T, MCI and Sprint – were viewed as the most significant non-incumbent LEC market participants, particularly in the mass market. The Commission found “that [those] three firms each have the capabilities, incentives, and stated intentions to serve the mass market for local exchange services” and to acquire a critical mass of customers in the relevant markets relatively rapidly.⁶¹ Further, the Commission concluded that other firms were entering the larger business market successfully, citing NEXTLINK, e.spire, and WinStar as companies that, in addition to AT&T, MCI and Sprint, were, or could soon become, significant market participants for larger business customers.⁶²

In addition, head-to-head competition among the RBOCs was expected. With respect to SBC and Ameritech, the Commission found that pre-merger, each firm “had plans to enter other incumbent LECs’ regions, including each other’s.”⁶³ The Commission cited Ameritech’s Project Gateway and found that, “but for the merger, Ameritech would have implemented Project Gateway and entered the St. Louis residential market.” The Commission viewed Project Gateway as a “testbed” in which Ameritech could learn about competing against incumbent LECs, concluding that “had it not been cancelled by Ameritech so that it could merge with SBC, [it] would have given Ameritech insights and experience for later use about how to enter additional out-of-region markets.”⁶⁴ Similarly, the record indicated that SBC had plans to enter the mass market in Chicago, building off of its cellular base in that city, and that Ameritech

⁶¹ *SBC/Ameritech Merger Order*, ¶ 87; *see also NYNEX/Bell Atlantic Merger Order*, ¶ 82.

⁶² *SBC/Ameritech Merger Order*, ¶ 91, n. 201.

⁶³ *Id.* ¶ 77.

⁶⁴ *Id.* ¶ 86.

perceived SBC's potential entry into Chicago as a competitive threat.⁶⁵ The combination of operational capabilities, requisite access to necessary facilities, "know-how," special expertise in the interconnection negotiation and arbitration process, and brand recognition enjoyed by incumbent LECs has resulted in a general finding by the Commission in numerous merger orders that incumbent LECs are significant potential competitors in out-of-region markets.⁶⁶

The general conclusion that competition had taken root and would continue to grow resulted in the grant by the Commission of RBOC in-region interLATA entry applications for thirty-five (35) states in the three-year period between September 1999 and September 2002.⁶⁷ Indeed, the first application – for New York – was granted a mere seven (7) days prior to adoption of the order granting the SBC/Ameritech merger application.⁶⁸ In each case, the Commission was convinced that the competitive landscape was significantly robust to support entry by the RBOC.⁶⁹

⁶⁵ *Id.* ¶¶ 82-83. Similarly, in the earlier *NYNEX/Bell Atlantic Merger Order*, the Commission found Bell Atlantic to be among the most significant market participants in the market for local exchange, exchange access, or bundled local exchange, exchange access and long distance services to the mass market in NYNEX's LATA 132 and the New York metropolitan area. *NYNEX/ Bell Atlantic Merger Order*, ¶ 73 ("The basis for this conclusion is that Bell Atlantic was actively seeking to enter those markets using wireline technology and has the capabilities necessary to have an effect on those markets."). See also *GTE/Bell Atlantic Merger Order*, ¶ 106 ("GTE has had the incentive and intention to enter portions of Bell Atlantic's region . . .").

⁶⁶ *SBC/Ameritech Merger Order*, ¶¶ 84-87; see also, *NYNEX/Bell Atlantic Merger Order*, ¶ 73; *GTE/ Bell Atlantic Merger Order*, ¶¶ 100, 106-117.

⁶⁷ See RBOC Applications to Provide In-region, InterLATA Services Under §271 at http://www.fcc.gov/Bureaus/Common_Carrier/in-region-applications/

⁶⁸ *Application by Bell Atlantic New York for Authorization Under Section 271 of the Communications Act to Provide In-Region InterLATA Service in the State of New York*, 15 FCC Rcd 3953 (1999) ("Bell Atlantic New York InterLATA Entry Order").

⁶⁹ See, e.g., *Bell Atlantic New York InterLATA Entry Order*, ¶ 6 ("It is also noteworthy that New York State has some of the most intensely competitive local exchange and exchange access markets in the nation."). See also *Application by SBC Communications, Inc.*,

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b. The Competitive Landscape Since 2001

The competitive gains cited by the Commission in late 1999 continued at a significant pace for the next year but in late 2000 the competitive telecommunications industry entered into a substantial economic downturn. At the end of 2000, there were 300 competitive LECs in business; by 2001 experts estimate that the number had dropped to 150,⁷⁰ and only 70 competitive LECs were in business by early 2002.⁷¹ Numerous companies filed for bankruptcy protection as a result of the slowing of the general economy and the major reduction in competitors' access to capital.⁷² Venture capital investment for the competitive

Southwestern Bell Telephone Company, And Southwestern Bell Communications Services, Inc. d/b/a Southwestern Bell Long Distance Pursuant to Section 271 of the Telecommunications Act of 1996 to Provide In-Region InterLATA Services in Texas, 15 FCC Rcd 18354 (2000), ¶ 3 (“SBC Texas InterLATA Entry Order”) (“As a result of the Texas Commission’s efforts, competition has taken root, and is expanding in local telecommunications markets, which ultimately benefits consumers.”); *Joint Application by BellSouth Corporation, BellSouth Telecommunications, Inc., And BellSouth Long Distance, Inc. for Provision of In-Region, InterLATA Services in Georgia and Louisiana*, 17 FCC Rcd 9018 (2002), ¶ 3 (“BellSouth Georgia/Louisiana InterLATA Entry Order”).

⁷⁰ *Big Business: Why the Sudden Rise in the Urge to Merge and Form Oligopolies*, WALL ST. J., Feb. 25, 2002.

⁷¹ *Review of the Section 251 Unbundling Obligations of Local Exchange Carriers; Implementation of Local Competition Provisions of the Telecommunications Act of 1996; Deployment of Wireline Services Offering Advanced Telecommunications Capability*, 18 FCC Rcd 16978 ¶ 37 (2003) (“Triennial Review Order” or “TRO”), citing ALTS, THE STATE OF LOCAL COMPETITION 2002, Annual Report at 5 (April 2002).

⁷² *Wrong Numbers: Telecom Debt Debacle Could Lead to Historic Proportions – Upstarts Borrowed Like Mad; Now Their Assets Fetch Pennies on the Dollar – A Yard Sale in Cyberspace*, WALL ST. J., May 11, 2001. Indeed, NEXTLINK, e.spire, and WinStar, the companies cited by the Commission in the *SBC/Ameritech Merger Order* as significant competitors in the larger business market each filed for bankruptcy protection and subsequently ceased to operate.

telecommunications industry dried up, declining over 50 percent from Spring 2000 to April 2001.⁷³

The competitive telecommunications industry has slowly rebuilt from the 2001-2002 “Telecom Bust” but that recovery has been sluggish and uneven.⁷⁴ This is attributable to several factors. For instance, investors have not been eager to resume financing upstart competitors. The ready availability of capital for competitive telecom ventures that helped define the late 1990s has been slow in returning.⁷⁵ In addition, competitive carriers’ business plans (including, importantly, their ability to expand) have been hampered by the actions of the Commission in proceedings involving competitive LECs’ continued rights to use incumbent LEC facilities and services. The Commission’s decisions in the *Triennial Review Order* and the *Triennial Review Remand Order*⁷⁶ to significantly narrow incumbent LECs’ UNE obligations and its decisions to grant forbearance from enforcement of section 251 and/or section 271 unbundling obligations in

⁷³ Bill Scanlon, *Newsfront: Carrier Retreat Bashes Gear Vendors*, INTERACTIVE WEEK, Apr. 9, 2001 at 12.

⁷⁴ In their February 2005 filing with the Commission in support of their proposed merger, SBC and AT&T represented that since 2000, telecommunications service providers and equipment manufacturers have lost over 700,000 jobs and over \$2 trillion in market capitalization. *SBC Communications, Inc. and AT&T Corp. Applications for Approval of Transfer of Control*, Description of the Transaction, Public Interest Showing and Related Demonstrations, WC Docket No. 05-65, at ii (filed Feb. 21, 2005) (“*SBC/AT&T Public Interest Filing*”).

⁷⁵ A number of Competitive LECs have announced successful new rounds of financing this year; notable examples include Covad, NuVox, Eschelon and Cbeyond. However, carriers report that the funding is less and has more strings attached than in the past. As importantly, they say that the investor community has made clear that regulatory stability will be a precondition to additional funding.

⁷⁶ *Unbundled Access to Network Elements; Review of Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers*, 20 FCC Rcd 2533 (2005) (“*Triennial Review Remand Order*” or “*TRRO*”).

the *Qwest Omaha Order*⁷⁷ and other forbearance dockets,⁷⁸ have – at a minimum – created uncertainty in the competitive LEC industry. More importantly, those decisions have foreclosed access to incumbent LEC facilities and services that are critical to competitive LECs’ ability to service existing operations or to expand. Indeed, the negative impact of the loss of access to the incumbent LECs’ networks is just beginning to be felt in the marketplace as the industry struggles to implement these recent deregulatory decisions.

Competitive LEC market shares have not increased significantly since the competitive telecommunications downturn as the industry has struggled to regain momentum. Indeed, a review of the data collected by the Commission from the incumbent LECs and compiled in twice-yearly Local Competition Reports is helpful in illustrating the recent history of the competitive industry. In December 1999, incumbent LECs provided 1,004,000 UNE loops without switching to competitive carriers.⁷⁹ For each six month period from December 1999 to June 2002, the number of UNE loops without switching provided by incumbent LECs to competitors increased an average of slightly more than 610,000 every six months.⁸⁰ From June 2002 to June 2005, however, the average increase in the number of UNE loops without switching provided by incumbent LECs to competitors each six month period was less than 40,000.⁸¹

⁷⁷ Petition of Qwest Corporation for Forbearance Pursuant to 47 USC §160(c) in the Omaha Metropolitan Statistical Area, 20 FCC Rcd 19415 (2005).

⁷⁸ See *Petition of Verizon Telephone Companies for Forbearance Under 47 U.S.C. § 160(c) From Title II and Computer Inquiry Rules With Respect To Their Broadband Services*, WC Docket No. 04-440, effective March 19, 2006.

⁷⁹ *Local Telephone Competition: Status as of June 30, 2005*, Industry Analysis and Technology Division, Wireline Competition Bureau, FCC, Table 4, April 2006 (“*June 30, 2005 Local Competition Report*”).

⁸⁰ *Id.*

⁸¹ *Id.* Indeed, 73,000 less UNE loops without switching were provided by incumbent LECs to competitors in June 2003 than in December 2002 and 105,000 less UNE loops without

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Disturbingly, in December 2002, incumbent LECs were providing 4,300,000 UNE loops without switching to competitive carriers and three years later, in June 2005 (the most recent period for which data is available), the number of UNE loops without switching being provided to competitors by incumbent LECs also was 4,300,000.⁸²

In its most recent Form 10-K annual filing with the Securities and Exchange Commission, BellSouth stated that in the one year period from December 31, 2004 to December 31, 2005, the number of resale and UNE lines it provisioned to competitors decreased 25 percent.⁸³ Total wholesale residential lines⁸⁴ decreased from 2,089,000 as of December 31, 2004 to 1,488,000 as of December 31, 2005. Total wholesale business lines decreased from 881,000 as of December 31, 2004 to 668,000 as of December 31, 2005. Interestingly, in the same filing, BellSouth lists its most significant local service competitors as AT&T and MCI.⁸⁵

c. RBOC Consolidation Since 1999

Competitive carriers' efforts to compete in recent years have not been furthered by the consolidation that has taken place among the RBOCs and major independent incumbent LECs. Today, competitive telecommunications providers must compete against four – and potentially three – RBOC behemoths. In 2005, AT&T's pro forma operating revenues were \$66.2 billion and BellSouth's revenues (excluding its proportional interest in Cingular) were \$20.5 billion.⁸⁶

switching were provided by incumbent LECs to competitors in December 2004 than in June 2004.

⁸² *Id.*

⁸³ SEC Form 10-K, BellSouth Corporation, at 15 (2006) (“2005 BellSouth 10-K”).

⁸⁴ BellSouth defines wholesale lines, both for business and residential purposes, as lines provisioned via resale, the unbundled network element platform (UNE-P), or commercial agreement.

⁸⁵ SEC Form 10-K, BellSouth Corporation at 15.

⁸⁶ AT&T/BellSouth Public Interest Filing, at A-2, A-3.

In comparison, in 2005, two of the nation's largest competitive LECs, XO and Time Warner Telecom, reported revenues of \$1.4 billion and \$708 million, respectively.⁸⁷ ITC^DeltaCom, the largest facilities-based competitive LEC in the BellSouth local exchange operating territory, reported revenues of \$415 million in 2005.⁸⁸

AT&T and BellSouth serve 49.4 million and 20 million switched access lines, respectively.⁸⁹ In combination, they would control nearly 70 million switched access lines, or slightly less than 50% of the 144.1 million switched access lines reported in the Commission's most recent Local Competition Report.⁹⁰ In comparison, at the time of their merger, SBC and Ameritech reportedly served 55.5 million switched access lines, or 31.9% of the nation's total switched access lines.⁹¹ The increasing concentration of the nation's access lines brought about by past RBOC mergers has caused the Commission great concern, and was one of the fundamental reasons underlying the Commission's conclusions that the NYNEX/Bell Atlantic merger and the SBC/Ameritech merger would not be in the public interest absent numerous conditions.

In considering the proposed NYNEX/Bell Atlantic merger – which would result in a decrease in the number of RBOCs from six to five – the Commission said that any further reduction in the number of RBOCs “would present serious public interest concerns.”⁹² The Commission stated:

⁸⁷ SEC Form 10-K, XO Holdings, Inc., at 40 (2006); SEC Form 10-K, Time Warner Telecom Inc., at 30 (2006).

⁸⁸ SEC Form 10-K, ITC^DeltaCom, Inc., at 35 (2006).

⁸⁹ *Id.*

⁹⁰ *June 2005 Local Competition Report* at 2.

⁹¹ *SBC/Ameritech Merger Order*, ¶ 31.

⁹² *NYNEX/Bell Atlantic Merger Order*, ¶ 156.

Further reductions, however, 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. We therefore reject suggestions in the record that there would be no issues raised by the consolidation of all Bell Companies into a single company.⁹³

In the SBC/Ameritech merger proceeding two years later (which reduced the number of RBOCs from five to four), two years later, the Commission registered its grave apprehension at the additional decrease in the number of RBOCs. Citing its prior statements in the NYNEX/Bell Atlantic merger proceeding that future applicants bear an increased burden of establishing that their merger would be pro-competitive and serve the public interest, the Commission found that SBC and Ameritech "have not overcome that burden."⁹⁴ The applicants' agreement to conditions to address the anticompetitive consequences that would otherwise occur was the prerequisite to winning merger approval from the Commission. Now the Commission is being asked to approve a proposed merger that would reduce the ranks of the RBOCs even more, further concentrating market power in both wholesale and retail residential and business telecommunications markets, and further constraining competitive LECs' ability to effectively compete.

d. RBOC Competition in Non-Incumbent Markets

One of the oft-stated reasons RBOCs have given for their "urge to merge" is the alleged need to increase size and scope to be able to effectively compete outside of their incumbent local operating territories. For instance, in the documents filed in support of their proposed merger, SBC and Ameritech articulated their "National-Local Strategy," the "essentially-simultaneous, facilities-based entry of the combined company into each of the Top 30 major U.S. markets

⁹³ *Id.* (citation omitted).

⁹⁴ *SBC/Ameritech Merger Order*, ¶ 102.

outside of the area in which it would be the incumbent carrier.”⁹⁵ In recognition of the benefits to be had from the combined entity’s competitive entry into out-of-region markets, and in order to help ensure that such entry actually would occur, the Commission adopted a condition that SBC/Ameritech, within thirty (30) months of the merger closing date, enter at least thirty (30) major markets outside their incumbent service area as a facilities-based provider of local telecommunications services to business and residential customers.⁹⁶

Rather than faithfully implementing this National-Local strategy once their merger was approved, the combined company (*i.e.* SBC) instead chose to continue its efforts to dominate wholesale and retail telecommunications markets through further acquisitions. In early 2005, SBC announced its agreement to acquire AT&T, claiming that “neither SBC nor AT&T standing alone has the assets and expertise necessary to assemble a true nationwide end-to-end broadband network.”⁹⁷ In approving that merger (with conditions), the Commission noted that SBC was spending billions of dollars to buy AT&T’s nationwide network and, in light of that investment, it was reasonable to expect SBC to have strong incentives to utilize fully those assets.⁹⁸ Now, in lieu of following through on its representations and using those AT&T assets (and the assets it acquired through multiple past mergers) to actually compete in the provision of telecommunications services, post-merger AT&T has embarked on yet another buying spree. Yet again, it has asked for merger approval on the ground that the proposed acquisition would

⁹⁵ *In re Applications of Ameritech Corp. and SBC Communications Inc. for Consent to Transfer Control of Corporations Holding Commission Licenses and Lines Pursuant to Sections 214 and 301(d) of the Communications Act and Parts 5, 22, 24, 25, 63, 90, 95, and 101 of the Commission’s Rules*, Description of Transaction, Public Interest Showing, and Related Demonstrations, CC Docket No. 98-141, Exhibit 1, p. 5.

⁹⁶ *SBC/Ameritech Merger Order*, ¶ 398.

⁹⁷ *SBC/AT&T Public Interest Filing*, p. iii.

⁹⁸ *AT&T/SBC Merger Order*, ¶ 54.

strengthen its ability to compete.⁹⁹ The Commission must see this for what it actually is: a convenient, politically-acceptable cover story to mask the true reason for acquiring one of the three other remaining RBOCs, *i.e.* to dominate the nation's wholesale and retail telecommunications markets.¹⁰⁰

2. The Proposed Merger Must be Reviewed Using Appropriate Definitions of the Geographic and Product Markets

a. Tests for Relevant Market Determination

In reviewing the competitive aspects of the merger, it is first necessary to identify the relevant markets, that is the area of trade within which merging parties may create or enhance market power or facilitate its exercise. The relevant market has two dimensions: product(s) and geography. In determining the relevant product markets, the emphasis has been on two factors: “the reasonable interchangeability of use [by consumers]” and, (2) “the cross-elasticity of demand between the product itself and substitutes for it.”¹⁰¹ In determining the relevant

⁹⁹ *AT&T/BellSouth Public Interest Filing*, at vii, 114. There already is evidence that the instant merger – if permitted to occur – will have the opposite effect. Since announcement of the merger, AT&T has in effect put its CallVantage service (which is marketed nationwide, including in the BellSouth territory) on hold. *See* Rich Tehrani, *Analyzing the AT&T BellSouth Merger*, TMCnet, Mar. 6, 2006, at 5.

¹⁰⁰ The former SBC is not unique in its “urge to merge” rather than compete. In its June 2000 order granting Bell Atlantic and GTE the authority to merge with conditions, the Commission found that “GTE’s extensive entry plans [for the Bell Atlantic region] were ultimately cancelled because [GTE] preferred to merge with Bell Atlantic rather than compete on its own in the mass market for local exchange and exchange access services.” *GTE/Bell Atlantic Merger Order*, ¶ 115 (footnote omitted).

¹⁰¹ *Brown Shoe Co. v. U.S.*, 370 U.S. 294, 325 (1962), 82 S.Ct. 1502. The Horizontal Merger Guidelines phrase the product market test as follows: “[A]ssuming that buyers likely would respond to an increase in price for a tentatively identified product group only by shifting to other products, what would happen? If the alternatives were, in the aggregate, sufficiently attractive at their existing terms of sale, an attempt to raise prices would result in a reduction of sales large enough that the price increase would not prove profitable, and the tentatively identified product group would prove to be too narrow.” U.S. Department of Justice and Federal Trade Commission, Horizontal Merger

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geographic market, the key question is “where does a potential buyer look for potential suppliers of the service - what is the geographical area in which the buyer has, or, in the absence of monopoly, would have, a real choice as to price and alternative services?”¹⁰² In both instances, the definition of a market focuses only on demand substitution factors and not only changes in supply.

b. Relevant Product Markets for Purposes of Evaluating the Proposed Merger

Following these tests for determining relevant markets, the Commission in last year’s SBC/AT&T and Verizon/MCI mergers identified several relevant product markets that bear on analysis of the commenters: telecommunications services to mass market customers (including residential and small business customers); telecommunications services to enterprise customers (medium and large business customers); and telecommunications services to wholesale customers. Within each overall product market, the Commission identified specific submarkets. For the mass market, the Commission found there were three products: local service, long distance service, and bundled local and long distance service.¹⁰³ The Commission further concluded that facilities-based VoIP service and mobile wireless service should be included

Guidelines at 6 (Issued April 3, 1992, Revised April 8, 1997) (“*Horizontal Merger Guidelines*”).

¹⁰² *United States v. Grinnell Corp.*, 384 U.S. 563, 588-89, 86 S.Ct. 1698, 1713 (1966). The *Horizontal Merger Guidelines*’ geographic market test is: “[A]ssuming that buyers likely would respond to a price increase on products produced within the tentatively identified region only by shifting to products produced at locations of production outside the region, what would happen? If those locations of production outside the region were, in the aggregate, sufficiently attractive at their existing terms of sale, an attempt to raise price would result in a reduction in sales large enough that the price increase would not prove profitable, and the tentatively identified geographic market would be too narrow.” *Horizontal Merger Guidelines* at 8.

¹⁰³ *SBC/AT&T Merger Order*, ¶ 82.

within these mass market products.¹⁰⁴ For the enterprise market, the distinct products were: local voice service, long distance voice service, and data services.¹⁰⁵ For the wholesale market, there were two products: on-net (or Type I) and off-net (or Type II, which also may be a combination of on-net and off-net circuits).¹⁰⁶

The commenters generally agree with the Commission's definitions of the relevant product markets. However, the grouping of both residential and small business customers into the mass market is not consistent with market evidence. Small business customers¹⁰⁷ are a prime target of the commenters, and their experience of the past several years is that these customers, because of their greater use of computers and telecommuting, are increasing their demands for more bandwidth and sophisticated and integrated voice and high-speed symmetrical data products. For these reasons, the sales and marketing teams of the Commenters treat small business customers as a unique class and target them with particular products and programs. In contrast, residential customers tend to purchase only voice-grade lines and ADSL (one-way) data service. Accordingly, the Commission should place small business customers in a separate product market.

c. Relevant Geographic Markets for Purposes of Evaluating the Merger

In the SBC/AT&T and Verizon/MCI mergers, the Commission concluded that the relevant geographic market was the customer's location, reasoning that it would be prohibitively expensive for any of these customers to move their locations to avoid a "small but significant and

¹⁰⁴ *Id.* ¶¶ 87, 90.

¹⁰⁵ *Id.* ¶ 58

¹⁰⁶ *Id.* ¶ 26.

¹⁰⁷ The Commenters categorize firms with fewer than 20 employees as small businesses.

nontransitory”¹⁰⁸ increase in the price.¹⁰⁹ It then decided “for reasons of administrative practicality” to aggregate customers facing “similar competitive choices” in differing ways depending on the product market. For mass market and single-location enterprise customers, the Commission decided to analyze products at the state level.¹¹⁰ For multi-location enterprise customers, the market chosen was multi-state or regional – or even nationally, if the enterprise had locations throughout the U.S.¹¹¹ For wholesale customers, the relevant geographic market selected was the metropolitan statistical area (“MSA”).¹¹²

The commenters generally agree with the Commission’s identification of relevant geographic markets as customer locations but disagrees with some decisions to aggregate customers in larger markets for reasons of administrative practicality. This misidentification can result in the failure to recognize anticompetitive harms. Following on the discussion in the section on product markets, small business customers form their own product market, and the relevant geographic market should be the metropolitan area. These customers generally have between 1-2 locations and it would be improper to judge substitutability on a statewide level. That is largely irrelevant to them. Instead, the relevant geographic market is the MSA. By the same logic, larger enterprises with only 1-2 locations too fall into this market.

3. *The Commission Must Examine Existing and Potential Competition by the Applicants and Other Significant Market Participants*

Once the Commission has defined the relevant geographic and product markets, it must identify those companies in each relevant market that are the most significant market

¹⁰⁸ *Horizontal Merger Guidelines* at p. 5

¹⁰⁹ *SBC/AT&T Merger Order*, ¶¶ 28, 62, 97.

¹¹⁰ *Id.* ¶¶ 62, 97

¹¹¹ *Id.* ¶ 63.

¹¹² *Id.* ¶ 29

participants.¹¹³ Of particular importance are those companies “that are likely to be as significant a competitive force as either of the merging parties.”¹¹⁴ At the outset, the Commission must identify “actual competitors” as market participants. Actual competitors are companies that are now offering the relevant products in the relevant geographic market.¹¹⁵ In addition, the Commission must analyze each possible competitor to see whether that possible competitor has the capabilities and incentives such that it would be reasonably likely to enter the relevant market and exert pressure on competitors in the absence of regulation to lower prices, innovate or upgrade services.¹¹⁶

Potential competition is to be measured against the Significant Market Participant standard. As articulated in the *NYNEX/Bell Atlantic Merger Order*, the Commission must identify the most significant market participants from the universe of actual and potential competitors based on the companies’ capabilities and incentives to compete effectively in the relevant market.¹¹⁷ Of particular interest are those market participants that are likely to be at least as significant a competitive force as either of the merging parties.¹¹⁸ In determining the most significant market participants, the Commission must identify the companies that “have, or are most likely to gain speedily, the greatest capabilities and incentives to compete most effectively and quickly in the relevant market.”¹¹⁹ Importantly, as explained by the Commission,

¹¹³ *NYNEX/Bell Atlantic Merger Order*, ¶ 58.

¹¹⁴ *Id.*

¹¹⁵ *Id.* ¶ 59.

¹¹⁶ *Id.* ¶ 61; see also *SBC/Ameritech Merger Order*, ¶ 72.

¹¹⁷ *NYNEX/Bell Atlantic Merger Order*, ¶ 58.

¹¹⁸ *Id.* ¶ 62.

¹¹⁹ *SBC/Ameritech Merger Order*, ¶ 72.

if a company “is among a small number of ‘most significant market participants,’ then its absorption by the merger will, in most cases, create a competitive harm.”¹²⁰

The Commission has articulated the various factors to be considered in identifying the most significant market participants.¹²¹ As described in the *SBC/Ameritech Merger Order*, those factors include:

Whether the firm: (1) has the operational ability to provide local telephone service (i.e. know how, and operational infrastructure, including sales, marketing, customer service, billing and network management); (2) could quickly acquire a critical mass of customers; (3) has brand name recognition, a reputation for providing high quality and reliable service, an existing customer base, or the financial resources to get these assets; and (4) possesses some significant unique advantages, such as a cellular presence in the relevant market.¹²²

A company’s plans or attempts to enter a relevant market provide probative evidence of its perception that it possesses the capabilities and incentives necessary to be a significant participant in the market, and failed attempts and/or the lack of concrete entry plans do not eliminate a company from being considered a significant market participant. The Commission, however, must consider whether the company “has the capabilities, and is likely to have the incentive, to become a significant market participant soon.”¹²³ In assessing a company’s

¹²⁰ *MCI/WorldCom Merger Order*, ¶ 19.

¹²¹ *See NYNEX/Bell Atlantic Merger Order*, ¶¶ 58-64; *SBC/Ameritech Merger Order*, ¶ 72; *GTE/Bell Atlantic Merger Order*, n. 257.

¹²² *SBC/Ameritech Merger Order*, ¶ 73 (footnote omitted).

¹²³ *Id.* ¶ 75. *See also NYNEX/Bell Atlantic Merger Order*, ¶ 75 (“The more authoritative and reasonable case law . . . requires only a showing that a company was reasonably likely to enter, not that entry be certain as shown by vote of the Board of Directors or by the commitment of resources.”); *MCI/WorldCom Merger Order*, ¶ 19 (“Furthermore, depending on circumstances, firms may be included as significant competitors even though they may have yet to manifest a firm intention to enter or to invest substantially in preparation for entry.”); *GTE/Bell Atlantic Merger Order*, ¶ 106 (“While recognizing that a failed attempt could suggest that a firm is not a significant market participant, we would

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capabilities, relevant factors to be considered by the Commission include whether the company has the requisite access to the necessary facilities, its “know how,” and its operational infrastructure (e.g. billing and related systems).¹²⁴ Any special expertise that a company possesses, including the special expertise that incumbent LECs bring to the interconnection negotiation and arbitration process when entering out-of-region markets, also must be taken into account.¹²⁵

Moreover, the incumbent LECs’ “advantage of adjacency” must be considered.¹²⁶ Incumbent LECs have an array of switches and switching locations that have the capacity (or can be readily upgraded) to provide switching to out-of-region markets. Thus, incumbent LECs can lease or build transport from these existing switches to a newly entered market more readily than any other potential service provider.¹²⁷ The Commission has recognized that this advantage is particularly acute when considering adjacent territories. In the Bell Atlantic/GTE merger proceeding, the Commission found that the parties’ contiguous service areas afforded them a “unique advantage for out-of-region entry.”¹²⁸ A company’s brand recognition and reputation is an additional critical factor in assessing its capabilities to become a significant market participant.¹²⁹ Finally, while a company (particularly a smaller firm) may have access to facilities, knowledge, and an operational infrastructure, it may not have the requisite financial

also consider all relevant circumstances, including changed market conditions, that might facilitate successful subsequent entry . . .”).

¹²⁴ See, e.g., *SBC/Ameritech Merger Order*, ¶ 84; *NYNEX/Bell Atlantic Merger Order*, ¶ 70.

¹²⁵ See, e.g., *SBC/Ameritech Merger Order*, ¶ 84; *NYNEX/Bell Atlantic Merger Order*, ¶ 107.

¹²⁶ *SBC/Ameritech Merger Order*, ¶ 85.

¹²⁷ *Id.*

¹²⁸ *GTE/Bell Atlantic Merger Order*, ¶ 108.

¹²⁹ *NYNEX/Bell Atlantic Merger Order*, ¶ 84.

ability to be considered a significant market participant.¹³⁰ The Commission always has considered an RBOC (or other major incumbent LEC) the most significant market participant in its own incumbent operating territory.¹³¹ Further, the Commission repeatedly has concluded that the RBOCs and other major incumbent LECs are significant market participants in the operating territories of their fellow incumbent LECs.¹³²

The Commission has declined to set a bright line test for when – through a proposed merger – competition would be limited or retarded by the elimination of a significant market participant in the relevant market. Under the potential competition framework, however, a proposed merger between an existing significant market participant and a firm that is not currently a market participant, but that would have entered the market but for the merger, would harm competition in violation of the Act if the market is concentrated and entry by the non-participant would have resulted in some pro-competitive effects.¹³³

For example, the Commission held in the 1997 NYNEX/Bell Atlantic merger review proceeding that by removing one of the five most significant market participants in LATA 132 and the New York metropolitan area, the proposed merger was “likely to . . . adversely affect the dynamic development of competition in both local and bundled markets in LATA 132” and that “[t]he presence of other, less significant market participants [was] not likely to constrain such

¹³⁰ *SBC/Ameritech Merger Order*, ¶ 83.

¹³¹ *Id.* ¶ 87 (“[T]he dominance of each incumbent LEC in its own region makes it a most significant competitor in its own region.”); *GTE/Bell Atlantic Merger Order*, ¶ 104 (“We first note that Bell Atlantic and GTE remain dominant within their traditional service areas and therefore are included in the list of most significant market participants within their respective traditional markets.”).

¹³² *See, e.g., SBC/Ameritech Merger Order*, ¶ 86; *NYNEX/Bell Atlantic Merger Order*, ¶ 44; *GTE/Bell Atlantic Merger Order*, ¶ 100.

¹³³ *GTE/Bell Atlantic Merger Order*, ¶ 98.

behavior.”¹³⁴ Similarly, in the SBC/Ameritech merger review proceeding two years later, the Commission concluded that the proposed merger would “remove one of the most significant potential participants in local telecommunications mass markets both within and outside of each company’s region.”¹³⁵ And, less than a year after completion of the SBC/Ameritech merger review, the Commission held that the proposed merger of GTE and Bell Atlantic was “likely to result in a public interest harm by eliminating GTE as among the most significant potential participants in the mass market . . . in Bell Atlantic’s operating areas.”¹³⁶

a. The Merger Would Eliminate One of the Few Significant Participants in the Mass Market in the BellSouth Operating Territory

Upon application of the Significant Market Participant standard, the conclusion is inescapable that the merger of AT&T and BellSouth would eliminate existing and/or potential competition throughout the BellSouth incumbent local operating territory by one of the very few remaining and most significant market participants in the highly-concentrated mass market for local voice services. Consequently, the proposed merger would harm competition in violation of the Act.

(i) Mass Market Characteristics

Mass market customers – also known as Plain Old Telephone Service (“POTS”) customers – are, by definition, low revenue, geographically dispersed, and higher cost to serve than enterprise customers. Mass market customers typically are residential subscribers and small businesses such as beauty parlors, gas stations, and dry cleaners. They are not located in large office buildings or highly-concentrated business districts; they tend to be scattered throughout a

¹³⁴ *NYNEX/Bell Atlantic Merger Order*, ¶ 100.

¹³⁵ *SBC/Ameritech Merger Order*, ¶ 5.

¹³⁶ *GTE/Bell Atlantic Merger Order*, ¶ 100.

wide geographic area. They generally have very modest needs for telecommunications services and, consequently, the revenues they produce for service providers are small. They usually take service on a month-to-month basis (rather than via contract) and, as a result, the churn rate for mass market customers is higher than for enterprise customers. By definition, mass market customers are served via analog loops.

Except in unusual circumstances, a competitive carrier must incur the costs of digitizing,¹³⁷ aggregating, and transporting to its switch the loops that serve mass market customers.¹³⁸ This results in a higher cost to serve mass market customers than enterprise (*i.e.* digital) customers.¹³⁹ Because of the unique characteristics (and costs) of mass market customers, it generally is not operationally or economically feasible for a new entrant to serve them except through use of a combination of loops, transport and switching purchased from the incumbent LEC. The combination of DS0 loops, shared transport and local circuit switching used to serve mass market customers is commonly referred to as the Unbundled Network Element Platform (“UNE-P”). The use of non-incumbent LEC switching is cost-justified only when a carrier has achieved a threshold density in a particular wire center. It has been estimated that this threshold is met when an entrant has achieved approximately 1,500 lines in a wire center – the line concentration needed to support use of an OC-3 facility.¹⁴⁰

¹³⁷ Analog loops must be digitized to prevent the signal degradation inherent in analog loops.

¹³⁸ *Triennial Review Order*, ¶ 480.

¹³⁹ *Id.* ¶ 484.

¹⁴⁰ *Unbundled Access to Network Elements*, WC Docket No. 04-313, CC Docket No. 01-338, Comments of the PACE Coalition, et al. (Oct. 4, 2004), at 83.

(ii) Status of Mass Market Competition

Two years ago, the status of local voice competition in the mass market and its prospects for further growth were dramatically different than today. In its August 2003 *Triennial Review Order*, the Commission adopted network element unbundling rules in response to the D.C. Circuit's directive in *USTA I*¹⁴¹ that confirmed competitive LECs' rights to obtain from incumbent LECs each of the network elements necessary to serve mass market customers at TELRIC rates.¹⁴² A year earlier, the Commission's TELRIC methodology had been confirmed by the Supreme Court in *Verizon*,¹⁴³ and the states had established TELRIC-based network element rates at levels that allowed carriers to compete. In addition, the incumbent LECs had lost their battle to keep competitive LECs from being able to practically serve mass market customers via incumbent LEC facilities through the imposition of restrictions on the provision of the loop, transport and local switching network elements in combination.¹⁴⁴

By mid 2004, mass market competition had gained a toehold and had begun to grow at a significant pace. The Commission's June 2004 *Local Competition Report* noted that the incumbent LECs were providing approximately 22.2 million switched access lines to unaffiliated

¹⁴¹ *USTA v. FCC*, 290 F.3d 415 (D.C. Cir. 2002), *cert. denied*, 538 U.S. 940 (2003) ("*USTA I*").

¹⁴² In the *Triennial Review Order* the Commission required the incumbent LECs to provide nationwide access to DS0 (*i.e.* analog) loops, shared transport, and local circuit switching – the three UNEs needed by mass market service providers at TELRIC rates. *Triennial Review Order*, ¶ 7. At the same time, the Commission delegated to each state commission the authority to determine whether the nationwide rule should apply in the particular geographic markets in its state. *Id.*

¹⁴³ *Verizon Communications Inc. v. FCC*, 535 U.S. 467 (2002) ("*Verizon*").

¹⁴⁴ *See AT&T v. Iowa Utils. Bd.*, 525 U.S. 366, 395 (1998).

carriers via UNE-P (17.1 million) or resale (5.1 million) as of June 2004.¹⁴⁵ These figures were up from a total of approximately 17.9 million as of June 2003 and 11.9 million as of June 2002.¹⁴⁶ Further, mass market competition was occurring across the full range of markets, in urban states, in rural states, and in states in between. In mid 2004, the ten (10) states with the greatest penetration of mass market competition included Michigan, New York, and Texas as well as Wyoming, Indiana, and Kansas.¹⁴⁷ Moreover, many new entrants were serving the mass market. The largest traditional long distance companies – AT&T and MCI – were the single largest participants in the mass market; however, other smaller carriers accounted, in the aggregate, for approximately 42% of the total number of UNE-P lines as of July 2003.¹⁴⁸

The competitive landscape for mass market local voice services began to change markedly in the latter half of 2004 however. The changes that began to be manifested in late 2004/early 2005 were predominantly the result of shifts in federal regulatory policy. In the summer of 2004, the federal government declined to seek Supreme Court review of the D.C. Circuit's decision in *USTA II*¹⁴⁹ vacating the Commission's sub-delegation of authority to state commissions to engage in granular impairment analyses and vacating and remanding to the Commission its nationwide impairment findings for mass market switching and dedicated transport. The subsequent remand proceeding resulted in the *Triennial Review Remand Order*,

¹⁴⁵ *Local Telephone Competition: Status as of June 30, 2004*, Industry Analysis and Technology Division, Wireline Competition Bureau, FCC (Dec. 2004), at Tables 3, 4.

¹⁴⁶ *Id.*

¹⁴⁷ *State Report Card Shows UNE-P Benefiting the Mass Market Throughout Nation*, PACE Coalition (Jul. 2004), at 1.

¹⁴⁸ *See The UNE-P Fact Report: July 2003*, PACE Coalition (Jul. 2003), at 3.

¹⁴⁹ *United States Telecom Ass'n v. FCC*, 359 F.3d 554 (D.C. Cir. 2004) ("*USTA II*") *cert. denied*, 125 S.Ct. 313, 316, 345 (2004).

in which the Commission eliminated access to circuit switching used to serve mass market customers on a nationwide basis at TELRIC rates.¹⁵⁰

With the elimination of their ability to obtain TELRIC-based local switching from the incumbent LECs, competitive carriers were left with few viable alternative means to serve mass market customers. Those few carriers that could economically justify the deployment of a competitive switch to serve mass market subscribers in particular locations – or to acquire another service provider with an existing switch – began to do so.¹⁵¹ Carriers without the financial means to self-provide switching (whether through purchase or acquisition), or the customer line density necessary for self-provided switching to be economically viable, stopped marketing their services to potential mass market customers. Many began to implement plans to exit the mass market or to confine their operations to certain narrow geographic areas. In June 2005, the most recent date for which the Commission has made data available, the number of mass market customer lines being served via incumbent LEC loops plus switching (*i.e.* UNE-P) was 14.5 million.¹⁵² This represented a decrease of over 2.5 million lines from a year earlier.¹⁵³ Today, there are only a handful of competitive LECs actively marketing traditional voice services to mass market customers and many of the mass market customers who are still being

¹⁵⁰ *Triennial Review Remand Order*, ¶ 199. The Commission adopted a 12-month transition period during which carriers could continue to purchase unbundled mass market switching at TELRIC rates plus \$1 per line/mo. to serve their existing base of mass market customers. *Id.* The transition plan expired in March 2006.

¹⁵¹ *See, e.g.*, SEC Form 10-K, Talk America Holdings, Inc., at 5 (2006).

¹⁵² *June 2005 Local Competition Report* at Table 4.

¹⁵³ *Id.*

served by a competitive LEC are part of a legacy customer base that is not being replaced as it churns away.¹⁵⁴

A competitive LEC does have the opportunity to continue to serve mass market customers by entering into a commercial agreement with an incumbent LEC under which the incumbent LEC provides a wholesale service which includes local switching functionality. Indeed, the Commission has actively encouraged competitive carriers to enter into commercial agreements as a means to continue to serve the mass market.¹⁵⁵ Although numerous commercial agreements between incumbent LECs and mass market service providers do exist, by and large commercial agreements have not provided competitive LECs with an economically-rational opportunity to continue to provide mass market local voice services.¹⁵⁶

(iii) Application of the Significant Market Participant Standard

In reviewing the competitive landscape during the most recent RBOC-to-RBOC merger – the SBC/Ameritech merger proceeding – the Commission found SBC and Ameritech to be the overwhelmingly dominant market participants in their respective territories.¹⁵⁷ The Commission characterized SBC and Ameritech as “among a very few that are poised on the edge of an

¹⁵⁴ Resale of incumbent LEC retail services at wholesale rates under section 251(c)(4) of the Act remains an alternative with little economic viability. This is evidenced by the fact that the percentage of incumbent LEC switched access lines being served via resale has steadily declined since December 1999. *See June 30, 2005 Local Competition Report* at Table 3.

¹⁵⁵ *See, e.g., Unbundled Access to Network Elements; Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers*, 19 FCC Rcd 16783 (2004), Statement of Commissioner Kathleen Q. Abernathy, at 1-2.

¹⁵⁶ *See, e.g., Momentum Telecom, Inc. v. BellSouth Communications*, File No. EB-05-MD-029, Complaint, filed Nov. 14, 2005.

¹⁵⁷ *SBC/Ameritech Merger Order*, ¶ 71.

entrenched monopolist, with genuine abilities to challenge that monopolist.”¹⁵⁸ The conclusion was inescapable that they were significant market participants in each other’s service territory and that their merger would result in potential public interest harm.¹⁵⁹ The only other firms found by the Commission to have sufficient “capabilities, incentives, and stated intentions to serve the mass market” to be categorized as significant market participants were the three largest interexchange carriers – AT&T, MCI, and Sprint.¹⁶⁰ All three companies had a substantial customer base of residential customers of their long distance services and established brand names that they could capitalize on in offering mass market local voice services.¹⁶¹ Notwithstanding the fact that they had begun to serve the mass market, the Commission concluded that competitive LECs did not have the existing customer base and brand name to enable them to be characterized as significant market participants.¹⁶²

In the highly-compromised competitive environment for mass market services in which the Commission must now make its public interest determinations regarding the merger of AT&T and BellSouth, AT&T and BellSouth clearly remain the overwhelmingly dominant market participants in their respective service territories. Further, AT&T unquestionably is the most significant market participant among the small handful of significant market participants in BellSouth’s service territory. Because the merger will eliminate one of a very limited number of significant market participants in the mass market for local voice services throughout the BellSouth territory, the merger will result in public interest harm.

¹⁵⁸ *Id.* ¶ 99.

¹⁵⁹ *Id.*

¹⁶⁰ *Id.* ¶ 86.

¹⁶¹ *Id.* ¶ 95.

¹⁶² *Id.* ¶ 88.

Notwithstanding its July 2004 announcement (pre-merger with SBC) that it planned to shift its focus away from traditional consumer services,¹⁶³ AT&T remains a dominant player in the local voice services market nationwide, including throughout the BellSouth territory. AT&T itself reports that at the end of 2005 it continued to provide unbundled mass market (including local voice) services to over 3 million subscribers.¹⁶⁴ And today, AT&T remains the alternative carrier of choice for hundreds of thousands of residential and small business subscribers throughout the BellSouth operating territory.¹⁶⁵

More importantly, however, AT&T is *the most significant potential market participant* in the mass market throughout the BellSouth operating region. Applying the factors the Commission considers critical to identifying firms with the capabilities to be a significant competitive force,¹⁶⁶ AT&T has the operational ability to provide mass market services, AT&T could quickly acquire a critical mass of customers; AT&T has brand name recognition, a reputation for providing high quality service, an existing customer base, and the financial

¹⁶³ See News Release, *AT&T Announces Second-Quarter 2004 Earnings, Company to Stop Investing in Traditional Consumer Services, Concentrate Efforts on Business Markets*, Jul. 22, 2004, www.att.com/news/2004/07/22-13163. AT&T's 2004 decision to cease actively marketing switched-based mass market services is noted by the merger candidates in their Public Interest Filing. AT&T/SBC Public Interest Filing at v, 84.

¹⁶⁴ See Declaration of James S. Kahan, Senior Vice President – Corporate Development, AT&T Inc., Mar. 29, 2006, ¶ 81.

¹⁶⁵ AT&T is able to continue to effectively provide voice service to mass market customers within the BellSouth territory despite the elimination of UNE-P in part because it has executed a long-term commercial agreement with BellSouth for a wholesale local voice platform service. News Release, *BellSouth and AT and T Sign Commercial Agreement*, March 23, 2005, http://bellsouth.mediaroom.com/index.php?s=press_releases&item=1597. The precise terms of this agreement have not been made public by BellSouth or AT&T; however, there is reason to believe that the agreement contains substantial volume and term discounts such that the resulting wholesale service rates afford AT&T a reasonable opportunity to compete.

¹⁶⁶ See *SBC/Ameritech Merger Order*, ¶ 73.

resources to obtain additional assets; and AT&T possesses the significant unique advantages of a cellular presence in the BellSouth territory and a contiguous market.

More specifically, AT&T unquestionably has the operational ability to provide local voice services to mass market subscribers. SBC, the incumbent LEC side of AT&T, has been a dominant provider of mass market services for well over a hundred years. It is impossible to imagine a carrier with more operational expertise in the mass market. And AT&T's operational capabilities provide the platform necessary to support the rapid acquisition of a significant base of customers. Further, AT&T's brand name recognition and its reputation as a provider of reliable, high-quality services is well documented. Indeed, upon consummation of its merger with AT&T, SBC – the larger of the two firms – adopted the AT&T name.¹⁶⁷ According to Chairman and CEO Whitacre “[t]he AT&T brand reflects what customers are looking for in a provider . . . They want the latest technology and services, but they also want reliability, quality and trustworthiness. Only the AT&T brand offers this ideal combination of traits.”¹⁶⁸

AT&T doubtless also has the financial resources to acquire and deploy any additional facilities and other physical assets required to compete effectively in the mass market throughout the BellSouth region. As noted above, AT&T already is providing service to a substantial number of mass market customers in the BellSouth territory. In light of the fact that AT&T's operating revenues are over \$60 billion a year,¹⁶⁹ any additional assets it may require to ramp-up

¹⁶⁷ Press Release, *SBC Communications to Adopt AT&T Name*, Oct. 27, 2005, <http://att.sbc.com/gen/press-room?pid=4800&cdvn=news&newsarticleid=21850>.

¹⁶⁸ *Id.* 1. AT&T also enjoys brand recognition in the BellSouth territory because of its extensive advertising in media markets that cross the two regions. *See SBC/Ameritech Merger Order*, ¶ 85.

¹⁶⁹ *AT&T/SBC Public Interest Filing* at A-2.

its marketing efforts to serve additional mass market customers in the BellSouth region surely could be purchased and deployed.

Moreover, AT&T has a very significant “advantage of adjacency” that must be taken into account. As an incumbent LEC, AT&T has an array of switches and switching locations that have the capacity (or can readily be upgraded) to provide switching to out-of-region markets. These switches can be utilized to provide local voice services to mass market customers in particular wire centers within the BellSouth operating territory until AT&T obtains the threshold customer line density in those locations to cost-justify use of a non-incumbent LEC switch to provide service. This advantage is particularly acute considering that AT&T’s current incumbent service territory abuts four of BellSouth’s nine operating territory states.¹⁷⁰ Finally, the assets that AT&T possesses in the BellSouth region through its 60% ownership interest in Cingular provide it with a unique advantage for further competitive entry into the local voice services market. Cingular provides wireless service to over 54 million customers.¹⁷¹ As noted by the Commission, “a cellular presence provides a ready customer base for expanding into wireline local telephony.”¹⁷²

In its last RBOC-to-RBOC merger review, the Commission concluded that the only significant participants in the mass market other than the two merger partners were AT&T, MCI and Sprint, the three largest interexchange carriers.¹⁷³ This conclusion was predicated on the Commission’s assessment that those were the only firms with the “ability to capitalize on their

¹⁷⁰ The BellSouth states of Arkansas, Louisiana, Tennessee and Kentucky each share a border with at least one state within the incumbent operating territory of AT&T.

¹⁷¹ *AT&T/SBC Public Interest Filing* at A-4.

¹⁷² *SBC/Ameritech Merger Order*, ¶ 85.

¹⁷³ *Id.* ¶ 87. This finding affirmed the Commission’s earlier finding in the NYNEX/Bell Atlantic merger review proceeding. *NYNEX/Bell Atlantic Merger Order*, ¶ 82.

brand name and existing customer base.”¹⁷⁴ The Commission further concluded that the presence of AT&T, MCI, and Sprint as significant market participants was insufficient to overcome the public interest harm that would ensue from the elimination of Ameritech as a significant market participant.¹⁷⁵

Today, there is an even more limited universe of significant market participants. Neither AT&T, MCI nor Sprint continues to operate as an independent firm. AT&T and MCI¹⁷⁶ each have been acquired by incumbent LECs and Sprint has merged with Nextel.¹⁷⁷ Neither MCI nor Sprint Nextel currently is marketing wireline local voice services to mass market customers in the BellSouth incumbent operating territory.¹⁷⁸ While both MCI and Embarq (the local telephone spin-off from Sprint Nextel) are potential significant market participants on the basis of their financial resources and operational expertise, their potential entry is not sufficient to ensure that no public interest harm will come from the elimination of the only other significant market participant in the BellSouth region – AT&T.

In the SBC/Ameritech merger review, the Commission found that competitive LECs lacked the existing customer base and brand name to become most significant participants in the

¹⁷⁴ *Id.* ¶ 95.

¹⁷⁵ *Id.*

¹⁷⁶ News Release: *Verizon and MCI Close Merger, Creating a Stronger Competitor for Advanced Communications Services*, Jan. 6, 2006
<http://newscenter.verizon.com/proactive/newsroom/release.vtml?id=93131>.

¹⁷⁷ Press Release: *Sprint Nextel Completes Merger*, Aug. 12, 2005,
http://www2.sprint.com/mr/news_dtl.do?id=7760.

¹⁷⁸ On May 18, 2006, Sprint Nextel completed the spin-off of its local telephone operations, which will operate as Embarq Corp. Sprint Nextel will focus its marketing and sales efforts in the mobile services market. See News Release: *Sprint Nextel Completes Spin-off of Local Telephone Business to Focus on Mobility Products and Services*, May 18, 2006, http://www2.sprint.com/mr/news_dtl.do?id=12060.

mass market.¹⁷⁹ The same conclusion is justified here. Indeed, there is even greater evidence today that competitive LECs do not qualify as significant market participants. As discussed in Section 111.A.1, at the time of the SBC/Ameritech merger, competition was expanding in all product markets and was expected to continue to grow rapidly. Competitive LECs were making steady progress in their efforts to compete with incumbent LECs in the mass market. In comparison, today most competitive LECs do not have an economically or operationally viable means to provide local voice services to mass market customers. The local switching competitive LECs had purchased from the incumbent LECs and used to provide service to mass market customers is no longer available at cost-based rates. Most competitive LECs cannot economically justify the deployment of a competitive switch to serve mass market customers, nor do they have the line density necessary serve mass market customers via switches that they already have deployed and are using to serve enterprise customers. Commercial agreements and resale of incumbent LEC retail services likewise do not represent a viable competitive option. The lack of an economically and operationally rational opportunity for competitive LECs to provide mass market services is clearly illustrated by the most recent Commission data on the status of local telephone competition. In the one year from June 2004 to June 2005, the number of mass market customer lines being served by competitors via incumbent LEC loops plus switching decreased by over 2.5 million.¹⁸⁰

Not surprisingly given today's competitive landscape, the Applicants do not argue that their combination should be permitted because there is sufficient competition in the mass market from wireline competitive service providers such that the public interest will not be adversely

¹⁷⁹ *SBC/Ameritech Merger Order*, ¶ 88.

¹⁸⁰ *June 30, 2005 Local Competition Report* at Table 4.

affected. Indeed, they make only passing reference to the “many wireline carriers that use unbundled network elements or commercially negotiated substitutes therefor.”¹⁸¹ Instead, they point out that BellSouth competes today with a multitude of . . . local service providers of various types”¹⁸² to support their contention that the merger will not harm the public interest and they highlight the existence of “vigorous competition among the national wireless carriers, including Verizon Wireless, Sprint Nextel and T-Mobile as well as numerous regional carriers.”¹⁸³ As further support for their contention that mobile wireless services should be considered in assessing the public interest with respect to mass market services, AT&T and BellSouth point to the Commission’s order in the SBC/AT&T merger review proceeding, suggesting that the Commission in that proceeding embraced mobile wireless carriers as significant participants in the mass market in the SBC operating territory.¹⁸⁴

Yet the Commission in the AT&T/SBC Merger Order did not ground its conclusions regarding the mass market on competition from mobile wireless services. The Commission merely noted that mobile wireless providers “are likely to capture an increasing share of mass market local and long distance services,”¹⁸⁵ it did not conduct a significant market participant analysis of the mobile wireless market – as it must do here – and its conclusions regarding the likely effect of the SBC/AT&T merger on the mass market did not rest on the status of competition for mobile wireless services.¹⁸⁶ The Commission’s reasons for refraining from

¹⁸¹ *AT&T/SBC Public Interest Filing* at 92.

¹⁸² *Id.* 91 (footnote omitted).

¹⁸³ *Id.*

¹⁸⁴ *Id.*

¹⁸⁵ *AT&T/SBC Merger Order*, ¶ 104.

¹⁸⁶ *Id.*

treating mobile wireless services as equivalent to wireline services for purposes of assessing competition for mass market services remained unstated. There are sound reasons, however, for not viewing wireless services as interchangeable with traditional wireline services. According to the Commission, only about 6 percent of households have chosen to rely on wireless services for all of their communications needs.¹⁸⁷ While intermodal competition between wireline and mobile wireless services likely will increase in the coming years, wireless services do not yet enjoy the ubiquity or the service quality¹⁸⁸ to qualify as a suitable substitute for wireline service offerings.

Regardless, application of the significant market participant test to mobile wireless services competition in the BellSouth region would not disrupt the conclusion that elimination of AT&T as a mass market participant in the BellSouth territory will harm the public interest. BellSouth's absorption into AT&T will result in the elimination of Cingular as an independent participant in the mobile wireless services market within the BellSouth region. Cingular is the largest of the few nationwide mobile wireless carriers in terms of subscribers and revenues¹⁸⁹ and the competitive landscape is not sufficiently robust to withstand the elimination of Cingular as an independent operating entity.

The merger candidates also point to "over-the-top" VoIP providers¹⁹⁰ operating in the BellSouth territory to support their contention that there are "numerous and powerful competitors

¹⁸⁷ *AT&T/SBC Merger Order*, ¶ 90.

¹⁸⁸ *See, e.g., Triennial Review Order*, ¶ 445.

¹⁸⁹ *Wireline Postgame Analysis 14.0 - Recap of First Quarter 2006 Results*, UBS Investment Research, May 18, 2006, at 59-60.

¹⁹⁰ The Commission has defined over-the-top VoIP providers as providers that require the end user to obtain broadband transmission from a third party provider. *See AT&T/SBC Merger Order*, ¶ 86.

[other than AT&T] that actively compete with BellSouth today for bundled local and long distance service customers.”¹⁹¹ AT&T and BellSouth argue that their merger would not adversely affect competition regardless whether the over-the-top VoIP market is considered a separate product market or part of the market for BellSouth’s local voice mass market services.¹⁹² As the Commission acknowledged in the SBC/AT&T merger review proceeding, however, there are certain fundamental characteristics of over-the-top VoIP services that distinguish them from traditional local voice services and make their inclusion in the local services market questionable. The Commission said:

The varieties of over-the-top VoIP differ significantly in their service characteristics, including quality of service 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 service.¹⁹³

The Commission was correct in its assessment of the differences between over-the-top VoIP services and traditional wireline local services and the dubious substitutability of the two types of services. More specifically, the fact that consumers of over-the-top VoIP services are required to purchase a broadband connection and to purchase and/or install additional software or equipment places VoIP services in a different class from traditional local voice offerings.¹⁹⁴

¹⁹¹ *AT&T/SBC Public Interest Statement* at 87.

¹⁹² *Id.* 96-97.

¹⁹³ *AT&T/SBC Merger Order*, ¶ 88 (footnotes omitted).

¹⁹⁴ Some over-the-top VoIP services require a consumer to have a computer and to install software on his/her computer; others require the purchase of specialized telephone handsets; and some require specialized equipment such as terminal adapters. *See, e.g., Vonage Holdings Corporation Petition for Declaratory Ruling Concerning an Order of the Minnesota Public Utilities Commission*, 19 FCC Rcd 22404, 22407-08, ¶¶ 8-9 (2004).

Even today, many POTS customers do not have the economic resources required to take advantage of over-the-top voice VoIP services. Other consumers are unwilling or unable to install specialized equipment or software. In addition, over-the-top VoIP services do not offer the same reliability and service quality as traditional POTS service.¹⁹⁵

Even if the Commission were to consider over-the-top VoIP services part of the local services mass market when conducting its public interest analysis (which it should not), the existence of some over-the-top VoIP competition in the BellSouth region should not affect the outcome of the Commission's analysis. Over-the-top VoIP providers today do not have the brand name recognition, reputation for providing high quality and reliable service, existing customer base or the financial resources to quickly acquire a critical mass of customers that are required in order to be considered significant market participants. Indeed, shares of over-the-top VoIP provider Vonage Holdings Corp. tumbled 12.6% in its market debut on May 24, amid serious concerns by investors that the company would never turn a profit.¹⁹⁶ Vonage's initial public offering marked the worst stock debut in nearly two years.¹⁹⁷

Finally, while facilities-based VoIP services provided by cable companies¹⁹⁸ may fall within the mass market for local voice services, AT&T and BellSouth have not presented any evidence that any particular cable company satisfies the significant market participant standard anywhere within the BellSouth territory. The only "support" by the Applicants for the contention that cable-based competition should be factored into the Commission's competition

¹⁹⁵ See, e.g., *AT&T/SBC Merger Order*, ¶ 88.

¹⁹⁶ See *Vonage Lacks Voltage in its IPO, With Weakest Debut in 2 Years*, Wall Street Journal, C4, May 24, 2006.

¹⁹⁷ *Id.*

¹⁹⁸ The Commission has defined facilities-based VoIP service providers as providers that own or control the last mile facility. *AT&T/SBC Merger Order*, ¶ 86.