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

In the Matter of	)	
	)	
VERIZON COMMUNICATIONS, INC.	)	
	)	
and	)	WC Docket No. 05-75
	)	
MCI, INC.	)	
	)	
Application for Transfer of Control	)	

COMMENTS

OF

THE AMERICAN ANTITRUST INSTITUTE

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I Introduction

The American Antitrust Institute ("AAI") submits these Comments on the application for transfer of control filed by Verizon Communications, Inc. ("Verizon") and MCI, Inc. ("MCI," collectively, "Applicants")[1] in response to the Commission's *Public Notice* in the above-captioned proceeding.[2]

The AAI is an independent research, education, and advocacy organization that supports a leading role for competition, as enforced by our antitrust laws, within the national and international economy. Background on the AAI may be found at www.antitrustinstitute.org, including the AAI's participation in other matters involving competition policy related to mergers in general, to specific mergers that may fall within the prohibitions of Section 7 of the Clayton Act,[3] and to certain sectors of the telecommunications and media industries over which the Commission has assumed jurisdiction.[4]

The AAI's sole interest in this proceeding is to ensure that the Commission promotes the public interest, convenience and necessity by minimizing the potential for competitive distortions in the national telecommunications markets.[5] The AAI appreciates the opportunity

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[1]Verizon Communications, Inc. and MCI, Inc. Application for Transfer of Control, WC Docket No. 05-75 (filed March 11, 2005) (*Verizon-MCI Application*).

[2]*Verizon Communications, Inc. and MCI, Inc. Application for Transfer of Control*, WC Docket No. 05-75, Commission Seeks Comment on Application for Consent to Transfer of Control Filed by Verizon Communications, Inc. and MCI, Inc. (DA 05-762, rel. March 24, 2005).

[3]15 U.S.C. §18. Section 7 of the Clayton Act prohibits a corporation from acquiring "the whole or any part of the assets of another corporation engaged also in commerce, where in any line of commerce in any section of the country, the effect of such acquisition may be substantially to lessen competition, or to tend to create a monopoly."

[4]Funding comes to the AAI through contributions from a wide variety of sources. Nearly 90 separate sources each have contributed over $1,000, a full listing of which is available on request.

[5]In this proceeding, Verizon and MCI have objected to the disclosure of Confidential Information to the AAI (see Letter from Sherry A. Ingram to Marlene H. Dortch, Secretary, Federal Communications

to provide Comments on the captioned applications.

II The Transaction

The proposed acquisition of MCI by Verizon will combine the country's largest incumbent local exchange carrier and its second largest network-facilities company in a transaction that the Applicant's describe as so complementary that it is almost "a perfect fit."[6] Yet, the proposed transaction "will not adversely affect competition in any market."[7] Moreover, this unambiguous pro-competitive result is *invariant* to the chosen definition of the relevant product and geographic markets.[8]

Commission, WC Docket 05-75 (filed May 5, 2005)), pursuant to the procedures of ¶7 of the Protective Order entered in this proceeding (see *Verizon Communications Inc. and MCI, Inc. Applications for Approval of Transfer Of Control*, WC Docket No. 05-75, *Order Adopting Protective Order, Appendix A - Protective Order* (DA 05-647, rel. March 10, 2005)). While the merits (if any) of the Applicant's objections are the subject of a separate filing by AAI, we cannot let pass the statements in their letter that AAI has "coordinated with Qwest" and "may be acting merely as a surrogate for others."These accusations are simply untrue. The AAI adheres to a strict policy of independence; it does not slant its analysis or adopt positions based on the interests or desires of any private party. Donations are accepted into the organization's general treasury only, and donations earmarked for a particular purpose or conditioned on a particular position are not accepted.

[6]*Verizon-MCI Application, Exhibit 1, Public Interest Statement,* at 10 ("At the level of network assets, the two companies are an almost perfect fit, with MCI providing a global long-distance voice and data network and, even more important a top-of the-line internet backbone that will mesh with Verizon's dense, in-region local wireline network and best-in-class wireless network.")

[7]*Id.,* at 18. Not surprisingly, a similar claim is made by the SBC Communications, Inc. and AT&T Corp. with respect to their proposed merger, see Application of AT&T Corp., and SBC Communications, Inc., for Consent to the Transfer of Control, WC Docket No. 05-65, *Description of the Transaction, Public Interest Showing, and Related Demonstrations* (filed Feb. 21, 2005). References in the text to "these mergers" refer collectively to the application in the instant proceeding and the SBC-AT&T proposal.

[8]*Id.*, at 9-10 ("In analyzing the markets affected by proposed combinations, the Commission has recognized that it must take into account fundamental changes in the marketplace ... When it does so, it will find that some of the traditional market boundaries and definitions have shifted, while others have not. ... In any case, even if the Commission were to apply its traditional framework, the result would be the same – the transaction does not harm competition in any traditional market segment, and the combining companies are not 'among a small number of ... most significant market participants' *for any relevant service or for any relevant customer group.*"[emphasis supplied])

Contrary to these quite astounding claims, the Commission's actions on these applications will affect the competitive environment in the telecommunications industry for years to come. The analysis of the likely competitive effects of these proposed transactions will necessarily take the Commission beyond the typical market-by-market analysis that ordinarily characterizes the evaluation of such applications.

III FCC's Statutory Duties and the Standard of Review

The Commission is required to determine that the proposed transfer "serves the public interest, convenience, and necessity" before the application for the instant application may be approved.[9] The applicants bear the burden of proving by a preponderance of the evidence that the proposed transaction, on balance, serves the public interest.[10] The Commission has identified "four overriding questions" when applying the public interest test:

> (1) whether the transaction would result in a violation of the Communications Act or any other applicable statutory provision; (2) whether the transaction would result in a violation of Commission rules; (3) whether the transaction would substantially frustrate or impair the Commission's implementation or enforcement of the Communications Act, or would interfere with the objectives of that and other statutes; and (4) whether the merger promises to yield affirmative public interest benefits.[11]

The Commission's balance of public interest benefits and harms must include an analysis

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[9]47 U.S.C. §310(d)

[10]See, *e.g.*, Applications of AT&T Wireless Services, Inc. Transferor, and Cingular Wireless Corporation Transferee, For Consent to Transfer Control of Licenses and Authorizations, WT Docket No. 04-70, *Memorandum Opinion & Order*, 19 FCC Rcd 21522, ¶40 (2004) ("*AWE/Cingular Order*"), and the authorities cited therein.

[11]Applications of Ameritech Corp. Transferor, and SBC Communications Inc. Transferee, For Consent to Transfer Control of Corporations Holding Commission Licenses, CC Docket No. 98-141, *Memorandum Opinion and Order*, 14 FCC Rcd. 14712 ¶48 (1999)(subsequent history omitted) ("*Ameritech/SBC Order*").

of the potential competitive effects of the proposed transaction, as informed by traditional antitrust principles.[12] In evaluating a merger or acquisition, the Commission must consider the likely effect on future competition. In order to find that a merger is in the public interest, "the Commission must 'be convinced that it will enhance competition.'"[13]

Customarily, the Commission performs its competitive analysis by hewing closely to the approach set forth in the *DOJ/FTC Horizontal Merger Guidelines.*[14] The *Merger Guidelines* approach product market definition from the perspective of demand substitution factors, *i.e.*, possible consumer responses. Starting with the smallest possible group of competing products, the analysis asks whether a hypothetical monopolist could profitably impose a small but significant and non-transitory increase in price ("SSNIP").[15] Antitrust doctrine has come to regard 5% as a "small but significant" price increase.[16] Similarly, for the definition of the geographic antitrust market, if buyers would switch to substitute services outside of the geographic market as initially defined, the market boundaries should be expanded. Otherwise,

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[12]See *Ameritech/SBC Order*, at ¶49, note 121 (1999)("Although the Commission's analysis of competitive effects is informed by antitrust principles and judicial standards of evidence, it is not governed by them, which allows the Commission to arrive at a different assessment of likely competitive benefits or harms than antitrust agencies arrive at based on antitrust law").

[13]*Id*. at ¶49, quoting Applications of Nynex Corp. & Bell Atl. Corp., *Memorandum Opinion and Order*, 12 FCC Rcd. 19985, 19987, ¶ 2 (1997) ("*Nynex/BellAtlantic* Order"). Under the Communications Act, the Commission shares concurrent antitrust jurisdiction with the Department of Justice ("DOJ") under the Clayton Act to review mergers between common carriers, see 15 U.S.C. § 21(a); the Commission usually determines that its public interest authority is sufficient to address the competition issues, see, *e.g.*, *Ameritech/SBC Order*, at ¶53.

[14]*Horizontal Merger Guidelines*, U.S. Department of Justice and the Federal Trade Commission (April 2, 1992, as revised April 8, 1997) (hereinafter, "*Merger Guidelines*").

[15]*Id.*, at §1.11

[16]See *U.S. v. Sungard Data Sys., Inc.*, 172 F.Supp.2d 172, 182 (D. DC, 2001).

the subject market may constitute the relevant antitrust market.[17] Once the relevant markets are identified they are then analyzed for the likelihood of both unilateral and coordinated effects.[18]

In the present case, however, the proposed transaction affects not only a multitude of markets but also the *relationships* between these markets. The tools of merger analysis customarily relied on by the Commission, therefore, cannot resolve the numerous policy issues that these transactions force the Commission to confront, and it will fail to deliver a useful assessment of their likely competitive effects. To adequately evaluate the transaction under its public interest standard, the Commission will need a method of evaluating the *industry-level implications*, as well.

Moreover, merger analysis depends on reasonable prediction. If it is impossible to assess the competitive conditions in the post-merger markets (however defined) the merger analysis is invalid. This problem arises in the present case not only because of the pendency of the proposed SBC-AT&T transaction (which introduces substantial uncertainty into the post-merger scenario, commending consolidation of the two proceedings[19]), but also because the industry is currently in a state of regulatory, policy, and technological flux. As long as such conditions

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[17]*Id*, at §1.21.

[18]A merger challenge based on unilateral effects is usually based on a particular group or class of customers who are likely to be harmed as a consequence of the accretion of market power resulting from the merger, see *Merger Guidelines*, §2.21. The Merger Guidelines define "coordinated interaction" as "actions by a group of firms that are profitable for each of them only as a result of the accommodating reactions of the others." *Id.,* §2.1. That is, the post-merger market may be so concentrated that coordinated interaction would be facilitated by the merger.

[19]The AAI also urged consolidation in its Comments in the SBC-AT&T proceeding based on the reasoning in *FTC v. Cardinal Health, Inc., et al*., 12 F.Supp2d 34 (D.C.D.C, 1998)(finding the FTC entitled to enjoin two simultaneous mergers in the wholesale prescription drug industry in a consolidated proceeding and giving weight to the cumulative effect of the two proposed mergers), see Application of AT&T Corp., and SBC Communications, Inc., for Consent to the Transfer of Control, WC Docket No. 05-65, *Comments of the American Antitrust Institute* (filed April 25, 2005).

appertain, even if the relevant market definitions were crystal clear, the post-merger market would still elude reliable assessment.

The upshot of these circumstances is that the Commission first and foremost must solve a problem of process: How should this application and the proposed SBC-AT&T merger be evaluated? The AAI submits that in addition to the conventional market-level end-game, in which unilateral and collusive effects of a proposed merger are mitigated by blocking the transaction or conditioning it on certain pro-competitive remedies, an *industry-level* end-game is also a precondition to a meaningful competitive analysis.

IV The Industry-Level End-game

On the industry level, if the goal is to return to an atavistic natural monopoly approach and regulate the post-merger firm under traditional Title II strictures, it signals one outcome for the proposed transaction; if, on the other hand, the goal is an optimally competitive market with numerous competing platforms and wide user choice, it signals another. The industry-level paradigm involves a perspective on both regulation and on the competitive sector of the market.

A The Regulatory Sphere

In the regulatory sphere, the Commission in numerous proceedings is engaged in an evaluation of its regulatory approach in response to developments in the industry and the failure to successfully implement certain pro-competitive provisions in the Telecommunications Act of 1996. For example, in the *IP-Enabled Services* proceeding[20] the Commission is examining the appropriate regulatory policy towards "services and applications relying on the Internet Protocol

[20]See IP-Enabled Services, WC Docket No. 04-36, *Notice of Proposed Rulemaking*, 19 FCC Rcd.4836 (FCC 04-28, rel. March 10, 2004)("*IP-Enabled Svcs. NPRM*").

family."[21] Given that consumers, business, and telecommunications providers are *all* in the midst of migrating from legacy communications systems to IP-based networks and applications, the *IP-Enabled Services* proceeding involves no less than a policy debate about the future of telecommunications regulation.[22] Unfortunately, with the advent of the present mergers and the unrelenting march of technology, the future is now.

Among the specific topics addressed in the *IP-Enabled Svcs. NPRM* is the extent to which the Commission should rely on a "layered" approach to regulation.[23] Some observers have argued that the present categorical regulatory scheme, in which *ex ante* rules treat substitutable[24] services differently, should yield to a layered approach governed by *ex post* agency enforcement of antitrust-informed competition norms.[25] Whatever the ultimate result with regard to the Commission's plenary exercise of its jurisdiction, it seems clear that the layered approach imposes much-needed discipline on the analysis of the proposed ILEC-IXC transactions. Thus, an analysis which differentiates between a physical layer, a logical (protocol) layer, an applications layer and a content layer provides the tools necessary to evaluate many of the claims made by the Applicants.

Using the layered approach to evaluating these transactions not only dispenses with obviously nonsensical claims—for example that VoIP (an application) "competes with" copper

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[21]*IP-Enabled Svcs. NPRM*, at 2, note 1.

[22]See generally Jonathan E. Nuechterlein and Philip J. Weiser, *Digital Crossroads*: *American Telecommunications Policy in the Internet Age*, Cambridge: MIT Press (2005)("*Digital Crossroads*").

[23]*Id.,* at 26 ("Under a layered model, a provider's ownership of bottleneck facilities might warrant economic regulation of the facilities 'layer' but not of the applications that traverse those facilities.")

[24]By which is meant services that demonstrably exhibit positive cross-elasticity of demand.

[25]See, *e.g.*, Philip J. Weiser, "Toward a Next Generation Regulatory Strategy," 35 *Loy.U.Chi.L.J.* 41 (2003-2004).

loop telephony (physical infrastructure capable of supporting broadband transmission)—but it also focuses the analysis on the key competition issue, preventing the owner of the physical layer from leveraging its control of last-mile facilities to discriminate against unaffiliated providers of higher level services, applications and content.[26] Many believe that the incentive to leverage the market power that accompanies control of bottleneck physical facilities is too great to be checked by *ex post* antitrust-type agency intervention. Thus, Richard S. Whitt of MCI has warned that "the failure to appropriately regulate last-mile broadband facilities will allow those providers to extend their market power into the higher layers."[27] Absent such regulations, "innovation clashes with legacy revenue streams, and the latter wins out if the underlying platform provider is allowed to control what the customer can and cannot do."[28]

Under either regulatory scenario, an *ex ante* proscriptive approach to control of the physical layer or an *ex post* enforcement approach to deter discrimination and denial of provisioning, the Commission should focus on the extent of post-merger control over bottleneck physical transmission facilities and impose conditions and remedies that minimize the need for governmental intervention by minimizing such control. Where such control is unavoidable, antitrust-informed procedures that remedy anticompetitive denial of neutral access to "essential facilities" should be established.

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[26]See Jonathan E. Nuechterlein and Philip J. Weiser, "First Principles for an Effective Rewrite of the Telecommunications Act of 1996", *AEI-Brookings Joint Center for Regulatory Studies, Working Paper 05-03* (March 2005), at 16.

[27]Richard S. Whitt, "A Horizontal Leap Forward: Formulating a New Communications Public Policy Framework Based on the Network Layers Model," 56 *Fed.Comm.L.J.* 587, 658 (2003-2004) ("*Horizontal Leap*"). Mr. Whitt is Vice President of Federal Law and Policy, MCI, Inc., and signatory of the *Verizon-MCI Application* on behalf of MCI. In a world rushing toward IP-centric, packet-switched networks, the modifier "broadband" is unnecessary; all facilities will be "broadband."

[28]*Id.,* at 659.

B The Competitive Sphere

The industry-level end game also requires a policy toward the competitive outcome. Despite the Applicant's exaggerated claims of inter-modal competition, multiple, competing IP platforms are not yet a reality.[29] However, promoting multiple competing platforms should also determine the conditions under which the ILEC-IXC transactions may be approved. The goal of the merger conditions, therefore, would be not only minimization of anticompetitive harm, but maximizing the competitive strength of other, competing third-party networks and platforms.

Operationally, the Commission should not only engage in a market-by-market analysis to identify where overlapping facilities will lead to the elimination of a competitor in a well-defined product and geographical market,[30] but should also consider potential competition in the from other platforms and carriers. Competitors that operate potentially competing platforms should be permitted to identify "holes" in their networks, and the divestiture conditions imposed on this and the SBC-AT&T transaction should serve to strengthen third-party networks by filling-in the gaps in their physical access layer.

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[29]See *Horizontal Leap*, at 658, note 272 ("'Physics gets in the way of the supposed competition' in providing broadband transmission services. As a result, '[a]t best, the residential market is a duopoly—and in the worst case, consumers have only one choice or, in poorly served areas, no choice at all'") quoting Letter from Vinton G. Cerf, Senior Vice-President, WorldCom, Inc., to Donald Evans, Secretary, U.S. Department of Commerce and Michael Powell, Chairman, Federal Communications Commission (May 20, 2002).

[30]In particular, this transaction is likely to lead to an anticompetitive combination of special access facilities required by larger users and competitive telecommunications companies, see Special Access Rates for Price Cap Local Exchange Carriers, WC Docket 05-25, *Notice of Proposed Rulemaking* (rel. April 13, 2005). However, several of the issues raised in the pricing flexibility NPRM concern the appropriate geographic market definition. These issues should be settled first, based on well-accepted economic principles, before the competitive effects of the proposed transaction—or the Applicant's claims—can be evaluated.

V Conclusion

Ordinarily, a merger proceeding is not the appropriate vehicle for the determination of wider issues of regulatory policy. In this case, however, the Commission should not let the private interests of these Applicants dictate the future course of regulation. The Commissions continuing struggle with incumbent LEC market power and the appropriate treatment of innovative services dictate that these issues must be settled before this application can be addressed. Failing that, the Commission must evaluate this transaction with a coherent industry-level end-game in mind.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I, Jonathan L. Rubin, do hereby certify that on this 9th day of May, 2005, I caused copies of the Comments of the American Antitrust Institute to be electronically served upon the following:

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