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# *Reconcentration of Telecommunications Markets After the 1996 Act: Implications for Long-Term Market Performance (Second Edition)*

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## I. Prologue

Last year, I wrote an article entitled *Reconcentration of Telecommunications Markets After the 1996 Act: Implications for Long-Term Market Performance*.[1] In that paper, I attempted to analyze the underlying reasons for, and the likely economic effects of, the telecommunications industry's massive attempt to reconcentrate almost immediately after the Telecommunications Act of 1996 (the 1996 Act) was enacted. Among the various analytical tools I used was the little-known, yet highly-accurate "Reasonable Mother test" -- *i.e.*, "if you were one of the merging parties, would your mother be ashamed of your actions?" The reason I used this test at the time of the first edition of this article is because soon after the passage of the 1996 Act, my mother telephoned me and asked, given her observance of a demonstrable trend in telecommunications industry reconcentration (especially in the last month alone), whether or not she should be ashamed. After conducting my analysis using more conventional economic tools (*i.e.*, examining elasticities of supply and demand, the presence of barriers to entry, etc.), I informed her that while emerging market trends were, in fact, starting to give me good reason to worry, it was still just a bit too early to tell whether we should be ashamed or not.[2]

Well, hell hath no wrath like a Jewish mother who thinks she's been duped by her so-called maven son. Once again, my Mother recently

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* President, Phoenix Center for Advanced Legal and Economic Public Policy Studies. However, the views expressed herein are strictly exclusively those of the author alone, and do not reflect the views of the Phoenix Center or any of the Center's individual Adjunct Fellows or Editorial Board Members.

1 ANTITRUST REPORT (Matthew Bender May 1997) (Hereinafter "First Edition") at 17.

2 *Id.*

called me at my office and repeated her same question of one year ago (although modified slightly to account for my current employment status): "Son, you used to work for the Federal Communications Commission before they disbanded ignominiously the Competition Division,[3] so therefore you still should be a maven about telecommunications industry mergers. Not that I doubted the answer you gave to me last year, but -- *maybe it's just me* -- I still can't help noticing that since Congress passed that new telecommunications law two years ago, it *really* appears that they are trying *very* hard to reconstruct the old Bell system. Are you *sure* we shouldn't be ashamed?"

Because I remain a person who cannot lie to his own mother (and, one year wiser, a person who also remembers Bismarck's caveat that: "those who love both laws and sausages shall inquire how neither are made"), I once again attempted to reply honestly to her inquiry. The only difference is that this time I had to tell her regretfully that, given the remarkable events of the last year, the entire telecommunications industry (both the private and (*especially*) the public sectors alike) should be ashamed -- in fact *extremely ashamed* -- of the emerging structure of the telecommunications industry.

And so my story begins -- *again* . . . .

## II. Competitive Issues at Stake Raised by Industry (Especially Incumbent LEC) Reconcentration

When the 1996 Act was passed, politicians and pundits alike promised residential consumers that as the tectonic plates of industry and competition started to shift, they would soon enjoy the same type of competitive benefits for local (and bundled "one-stop-shopping") service

[3] *See In the Matter of Amendment of Part 0 of the Commission's Rules to Reflect the Elimination of the Competition Division*, FCC 98-136 (rel. June 29, 1998) at ¶ 1 ("[T]his action, and reassignment of the personnel involved, will make more effective and efficient use of the Commission's scarce resources."); see also David Molony, *FCC To Close Down Its Competition Division,* COMMUNICATIONS WEEK INTERNATIONAL (April 20, 1998) ("The Federal Communications Commission is to close its competition division within the next few weeks as part of an overhaul of the regulatory authority's administration." However, '[s]ome Washington DC analysts say that as a result the FCC will no longer be able to deal fully with mega-mergers or marketing tactics that might reduce user choice. In particular, the intellectual rigor of the FCC would be "diminished, because it will have no counsel to formulate a policy response on competition across the industry."); COMMUNICATIONS DAILY, *Telephony* (April 3, 1998) (FCC officials conveniently "weren't available" at deadline to explain why Competition Division was being eliminated.)

as they now enjoy for long-distance service. What they failed to tell residential consumers when they made this promise, however, is not only are the challenges faced today really quite unlike the challenges the Department of Justice (DOJ) and the Federal Communications Commission (FCC) faced at the time of the breakup of AT&T, but that they would also use a paradigm completely inapposite to the one used to promote successfully competition for long-distance service 15 years ago when the Commission first promulgated its *Competitive Carrier* paradigm.[4]

To wit, fifteen years ago, the Commission basically was attempting to accelerate entry into a single, homogeneous, and *nation-wide* long-distance market dominated by one firm (AT&T). At that time, while AT&T no longer controlled local bottleneck facilities (which were given to the RBOCs), AT&T still controlled the majority of interstate transportation facilities. However, because: (1) ILECs were forbidden by law to enter the long-distance market; and (2) AT&T, with its exclusive monopoly for over 50 years, was the only game in town, the only source for potential new entrants would have to come from "outside" of the traditional telecommunications industry.[5]

The Commission recognized this fact, and attempted to create sufficient incentives for rapid and accelerated facilities-based entry by new firms. How they did this was to use essentially a two-stage process: On one hand, the Commission continued to subject AT&T, as the "dominant" carrier, to all existing regulations (*i.e.*, rate of return and

4 *See Policy & Rules Concerning Rates for Competitive Common Carrier Services and Facilities Authorizations Therefor*, CC Docket No. 79-252 ("*Competitive Carrier*"), *First Report & Order*, 85 FCC 2d 1 (1980); *Second Report & Order*, 91 FCC 2d 59 (1982); *recon.* 93 FCC 2d 54 (1983); *Third Report & Order*, 48 Fed. Reg. 46,791 (1983); *Fourth Report & Order*, 95 FCC 2d 554 (1983), *vacated, AT&T v. FCC,* 978 F.2d 727 (1992), *cert. denied, MCI Telecommunications Corp. v. AT&T*, 113 S.Ct. 3020 (1993); *Fifth Report & Order*, 98 FCC 2d 1191 (1984); *Sixth Report & Order*, 99 FCC 2d 1020 (1985), *rev'd, MCI Telecommunications Corp. v. FCC,* 765 F.2d 1186 (D.C. Cir. 1985).

5 Indeed, when the whole *Competitive Carrier* process began, there essentially were no "CLECs," "CAPS," "Resellers" and, most certainly, no alternative facilities-based providers such as Sprint, WorldCom/LDDS. In fact, when MCI began to provide service, its initial entry strategy was the previously unthinkable idea of entering the long-distance market using both its existing *de minimis* facilities, coupled with resale of AT&T facilities, so that it could represent to consumers, with assistance from the Commission's *1980 MTS/WATS Resale Order, supra,* that it was, in fact, a nation-wide facilities-based carrier until its facilities were built-out.

then later price cap regulation, all new tariffs would continue to be suspended for 45 days before any new rate could go into effect, numerous reporting requirements, and the like). Not *more* regulation, not *less* regulation, just the *status quo.* On the other hand, however, in order to accelerate entry into the long-distance market (and therefore improve market performance to a level of sufficient rivalry such that regulation could eventually be removed altogether), the Commission basically removed all regulatory barriers to entry for new entrants. In addition, the Commission -- via its 1980 MTS/WATS resale decision, *see, e.g., Resale and Shared Use of Public Switched Network Services,* CC Docket No. 80-54, 83 FCC 2d 167 (1980) -- helped new entrants, *inter alia*, to "appear" to consumers that they had a nation-wide, facilities-based presence until their networks could be completed. Note, however, that this "appearance" was supposed to provide only a short-term mechanism to help nascent firms establish a market presence, and *not* to establish a perpetual resale model (which was specifically considered and rejected).

The success of this approach cannot be disputed. As a result of the *Competitive Carrier* paradigm, the long-distance market was transformed from a market characterized by a single dominant firm with a small competitive fringe, to a market characterized by, *inter alia*, high elasticities of both demand and supply, low barriers to entry, *de minimis* switching costs among competing carriers, vibrant *non-price* competition (phone cards, frequent flyer miles, *etc.*) and, most importantly, sustained and demonstrable trends of declining prices and new products and services.[6] Given these market conditions, the Commission eventually decided to remove the asymmetrical regulation previously imposed on AT&T (realizing that the economic harms created by asymmetrical dominant carrier regulation outweighed the public interest benefits the

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[6] Indeed, it seems a bit bizarre that some people actually believe it is still necessary to regulate a firm that is actually willing to pay people to be their customers.); *see also* Peter Elstrom, *Slugfests: Reach Out and Pay Someone,* BUSINESS WEEK (March 23, 1998) (Reporting that the "truce in the phone wars has broken down" as MCI Communications is accusing arch-rival AT&T of "flooding the market with checks to attract new customers" – estimated to be worth $368 million in January, up from $70 million a month in fourth-quarter '97 – despite AT&T's alleged assertions that it is curtailing the practice. According to MCI, "*AT&T continues to pay customers to switch carriers, even though it says publicly that the tactic is misguided.*" (emphasis supplied)); Scott Woolley, *Get Lost, Buster – Lots of Companies Face a Peculiar Problem: How to Get Rid of Customers,* FORBES (Feb. 23, 1998) at 90 ("What if cut-rate service drives off lower-paying customers? So be it. AT&T loses $500 million a year on its 15 million to 20 million 'occasional communicators,' who rarely make long-distance calls yet cost plenty to acquire, bill and service.")

dominant carrier regulation was originally intended to achieve[7]) and, in fact, imposes only *de minimis* regulation on this market today.[8]

In contrast to the long-distance experience, the Commission is now faced with the task of promoting competition for residential telephone service in *numerous* local markets -- all of which are dominated by a monopoly incumbent. Moreover, potential entry is no longer limited to a discrete set of firms. Rather, under the 1996 Act, new entry may come ostensibly from a wide variety of sources, such as long distance companies, cable companies, fixed and mobile wireless providers, utilities, and supposedly even other incumbent local exchange carriers ("ILECs"), especially the largest of the ILECs, the Regional Bell Operating Companies or "BOCs." In addition, new entry does not have to be on a facilities-basis. Rather, under Section 251 of the 1996 Act, ILECs must make facilities available to competitors on either a total resale or unbundled network element (UNE) basis on a significantly discounted basis. Once certain pre-conditions are met from the "Competitive Checklist" contained in Section 271 of the 1996 Act, then the BOCs will be permitted to enter the market for in-region long-distance and international service. In other words, a legislative *quid pro quo* -- if "local" markets are "open" for competition, then the "reintegration" of the U.S. telephone market (the inapposite goal of the MFJ and the FCC's Competitive Carrier paradigm) is perfectly acceptable.

Where the big economic rub comes into play is that the Competitive Checklist contained in Section 271 of the 1996 Act makes no reference to what level of market performance is necessary before BOC inter-LATA entry is in the public interest. Rather, the Checklist emphasizes only a minimum set of preconditions that can arguably be satisfied simply by *de minimis* entry via UNE and resale mentioned above.[9] What Congress did

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7 *See Motion of AT&T Corp. to be Reclassified as a Non-Dominant Carrier,* Docket No. 95-427, 11 FCC Rcd 3271 (1995).

8 *See* Lawrence Spiwak, *Reorienting Economic Analysis of Telecommunications Markets After the 1996 Act*, ANTITRUST MAGAZINE (American Bar Association, Spring 1997) (hereinafter, *Reorienting Economic Analysis*) at 32, 33.

9 This standard has been the subject of vicious legal battles between the FCC and the industry. On one hand, the FCC has attempted to use its Section 271 approval process to achieve indirectly what the 8th Circuit held it could not do indirectly under Section 251 of the 1996 Act. *See In the Matter of Application of Ameritech Michigan Pursuant to Section 271 of the Communications Act of 1934, as amended, To Provide In-Region, InterLATA Services In Michigan,* Memorandum Opinion And Order, CC Docket No. 97-137 (rel. Aug. 19, 1997). On

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not understand (or deliberately ignored), however, is the economic reality that (as explained in more detail *infra*), it is far more difficult to enter into the local distribution market than it is to enter the long distance market and, therefore, immediate and significant new entry is unlikely to occur.[10] Thus, if entry for residential local service is already "difficult" at best, it is important to ask whether the recent reconcentration trend (especially among incumbent LECs) has contributed positively or negatively towards facilitating (and, in particular, accelerating) new, facilities-based entry.

### A. *Vertical Re-Integration*

As a general economic matter, there is absolutely nothing wrong will vertical integration in and of itself. Vertical integration can allow a firm to realize many economies of scale and scope.[11] (Indeed, to the best of anyone's knowledge, the United States appears to be the only country that currently has an artificial distinction between "local" and "long-distance" markets.) The competitive problems arise whenever the economic costs of vertical integration outweigh the efficiencies gained from such integration. Accordingly, if the "re-integrated" structure of post-1996 Act telecommunications markets permit one or more firms to engage successfully in strategic, anticompetitive conduct against its rivals, then the consumers are unlikely to enjoy the purported benefits that politicians promised them prolifically they would receive.

First, it is very important to recognize that because entry is far easier into the long-distance market than it is into the local market, incumbents have a significant cost advantage over their rivals. In contrast to the local market, entry into the "long-distance" is far less expensive. That is to say,

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the other, the 8th Circuit, as it did not view kindly the FCC's attempt to circumvent its decision to overturn the FCC's interconnection rules, granted a writ of mandamus ordering the FCC to cease and desist. *Iowa Utilities Bd. v. FCC,* 135 F.3d 535 (8th Cir. 1998), *petition for cert. filed* March 13, 1998 (No. 97-1519).

[10] For a truly excellent and easy to understand article outlining the economics of local distribution market entry, see George S. Ford, *Opportunities for Local Exchange Competition are Greatly Exaggerated,* ELECTRIC LIGHT & POWER Vol. 76, No. 4 (April 1998) at 20.

[11] *See, e.g., In Re Applications of Capital Cities/ABC, Inc., (Transferor) and The Walt Disney Company, (Transferee),* Memorandum Opinion & Order, 11 F.C.C.R. 5841 (rel. Feb. 8, 1996); *See also* James Olson & Lawrence Spiwak, *Can Short-Term Limits on Strategic Vertical Restraints Improve Long-Term Cable Industry Market Performance?* 13 CARDOZO ARTS & ENT. L.J. 283 (1994).

the long distance network by design is a non-ubiquitous, facilities-concentrated, usage-based, mass-market network where high capital costs are spread among huge number of customers who in turn indirectly heavily subsidize the local loop. In contrast, the local loop by design is ubiquitous, more facilities-dispersed, generally fixed-cost, retail market where high cost rural areas a subsidized by urban and suburban areas and from long-distance access charges.[12]

Moreover, there is a huge differential in the capital cost involved in replicating the local loop verses the long-distance network. The local loop has roughly 6,200,000 km of all types of cable plant, while the long-distance industry has roughly 150,000 km of cable plant. This approximately amounts to a 41:1 kilometer differential. This differential magnifies if one considers the physical and regulatory costs of digging up America's cities. Indeed, the total value of the local plant is roughly $270 billion while the total value of the long-distance plant is roughly $40 billion. These widely disparate costs result in a valuation differential of approximately 7:1.[13] Finally, even if a new entrant can raise sufficient capital, readers must also understand that because local residential rates are so heavily-subsidized, entry (even on a total resale basis at a discounted rate) is often so unprofitable as to make entry unlikely.[14]

Given the above, it will be quite expensive for new entrants to enter the market at "two" (*i.e.*, "local" and "long-distance") levels. If an incumbent can use this structure to its strategic advantage, therefore, then an incumbent can further deter new entry.[15] For example, without

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12 *See* Scott Cleland, *Telecomplexity: navigating the New Telecom Law for Investment Advantage"* The Washington Research Group (March 25, 1996) *at* 13.

13 *Id.*

14 *AT&T's Armstrong Says Small Resale Discounts Delay Residential Competition*, TELECOMPETITION REPORT (Feb. 26., 1998) (Reporting that AT&T Chairman Michael Armstrong statement that because the current average discount rate of 22% offered for wholesale local service, coupled with the "lack of [an unbundled network element platform]" means that no one can afford to go into the local exchange business. . . ." As such, Armstrong stated that because AT&T was losing $3 a month on each customer, AT&T was "not going to spend money on this fool's errand, and that's what [total service resale] is today."*); MCI Halts Drive into Residential Market Using Resale, Joins AT&T in Shift,* COMMUNICATIONS DAILY (Jan. 23, 1998)

15 Indeed, a long-distance company seeking to transform itself into a provider of "bundled" services faces a difficult strategic decision: It can either pass on pursuing the local loop while its core business is invaded, or it can counterattack with a time-
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competitive alternatives for "local service," ILECs will still control essential bottleneck facilities which they may use to deter entry into the "bundled, vertically-integrated" market. Moreover, not only does the incumbent LEC have significant cost and access advantages (the economic "yin and yang" of bottleneck facilities), but it also has significant other "first mover" advantages over new entrants -- *i.e.*, ILECs currently have virtually 100% of the residential traffic "pre-reintegration," and, as such, they have brand loyalty and an established local presence that other new entrants may not possess. If other potential entrants conclude that the risks associated with attempting to provide both long distance and create nascent "local" competition is simply too great (*i.e.*, uneconomical), then entry may not occur.[16] If entry does not occur or is delayed, then it is highly probable that an ILEC will be able to grab immediately a substantial -- if not an outright majority -- share of the "bundled service" market before any of its rivals.[17] If this scenario comes to pass, however, then we may end up with the undesirable outcome of several regional markets (*i.e.*, the ILECs' original service territory) characterized by a "dominant firm/fringe" model for "bundled" products (been there, done that), rather than the preferred outcome of a national market characterized by multiple vertically-integrated, facilities-based carriers and a healthy competitive niche fringe which sustains a level of rivalry sufficient to make stringent regulation unnecessary.[18]

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consuming costly build-out of alternative facilities all over the country or it can resell the local loop wholesale break-even or at a loss. *See* Scott Cleland, *supra* n. 12 at 10.

16 *See, e.g.,* John Greenwald *et al.*, *Hung Up on Competition Cable Television, Utilities, Railroads – Everyone Was Going to Provide Local Phone Service. But Until AT&T and the Baby Bells are Cleared to Compete Head-On, Customers will Still Pay Monopoly Prices,* TIME MAGAZINE (July 21, 1997) at 50 ("[S]peed is key" to get a head-start in the race to sell customers a bundle of branded services).

17 *See, e.g., id.* reporting that because GTE – which has some 20 million local customers scattered across 29 states and sales that exceeded $21.3 billion in 1996 – was not required to open its local markets before it may provide in-region, inter-LATA service under Section 271, GTE aggressively signed-up more than 1.25 million long-distance subscribers (most from AT&T) within only one year of the enactment of the 1996 Act.

18 *See First Edition* at 22.

### B. *Horizontal Re-Concentration*

Just as with increased vertical integration, increased horizontal concentration is not necessarily reason for concern. Indeed, it is crucial to avoid resorting to the populist arguments that government intervention is appropriate merely because a particular company is too "big" or makes "too much money" because, under long-standing antitrust precedent, it is perfectly acceptable for a firm to gain market power by superior business acumen or even historical accident.[19] Market power, like all human endeavors, is really a question of *degree.* Accordingly, the appropriate inquiry should not focus on whether a particular firm *has* market power, but rather on whether the firm has the ability to *exercise* this market power successfully (*i.e.*, raise prices or restrict output) and affect adversely market performance (*i.e.*, consumer welfare).[20]

Accordingly, policy-makers should look to see if increased horizontal concentration will permit the merged firm to raise prices or restrict output and, in particular, erect or maintain barriers to new entry. In particular, while economies of scope can certainly have pro-competitive benefits, economies of scope can also create ability to engage in strategic anti-competitive conduct. That is to say, because of the significant costs of entry (especially for residential, local telephone competition), entry rarely occurs in "waves of competition" on a large scale basis. Rather, entry usually occurs in "pin point" attacks wherever the incumbent may be the most vulnerable. Yet, if the incumbent enjoys significant economies of scope, then it may attempt to allocate the defense costs of these attacks over a much wider customer base where competitive pressures may not be present -- *i.e.*, the more captive customers an incumbent may have, the more the per unit share of defense costs will decrease. If there are enough customers to make the per unit/customer share sufficiently *de minimis* -- such that neither captive consumers nor regulators notice (or care about) this *de minimis* increase in price -- then the incumbent has used successfully its economies of scope to both successfully deter entry and evade regulation.[21]

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19 *Eastman Kodak Co. v. Image Tech. Serv., Inc.*, 112 S.Ct. 2072, 2089 (1992); *United States v. Grinnell Corp.*, 384 U.S. 563, 570-71 (1966).

20 *See, e.g., City of Anaheim v. Southern California Edison Co.*, 955 F.2d 1373 (9th Cir. 1992) (Plaintiffs seeking to prove monopolization under Section 2 of the Sherman Act must demonstrate *both*: (1) specific anticompetitive intent; *and* (2) anticompetitive harm.)

21 Indeed, it is the potential to use strategically economies of scope successfully to deter new entry is significant reason why the 1996 Act (and the MFJ before that) (continued ...)

The ability to engage in such strategic conduct is also exacerbated by the number of states a firm provides service in. That is to say, as the number of independent regulatory bodies increases, then the easier it may be for the regulated firm to play one state PUC off of another -- in other words, regulatory evasion. When this occurs, those captive ratepayers who live in rural or high cost areas where competitive entry may not be, to put it politely, immediate, may inadvertently end up paying against their own interests.[22]

## III. Prognostications from the First Article

In the first edition of this article, I argued that because the *1996 Act's* naked goal is to create a vertically-integrated telecommunications market for bundled products and services, we probably should not spend an inordinate amount of time to analyze the current trend of reconcentration from a horizontal perspective. Why? Because from a strictly horizontal point of view, I then believed that if the *Act's* interconnection provisions successfully eliminated barriers to entry for the local market, it was probably unlikely that horizontal concentration among LECs would permit any one firm to successfully raise prices or restrict output. Moreover, based on what we knew to date, it appeared that most BOCs never even really had any immediate intention of entering each others' service territories.[23] Rather, the new competitive

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prohibited the BOCs from interLata entry but permitted other LECs such as SNET and Cincinnati Bell (with their relatively small footprint) or GTE (with its very diverse yet non-contiguous footprint) to enter the long-distance market immediately.

22 It is also equally important to recognize the converse of this rule: Legitimate concerns about regulatory evasion are similarly not be an excuse for increased government intervention to maximize "regulatory" – as opposed to "economic" – efficiency. *See infra* n. 58.

23 The article examined, for example, how the FCC adjudicated the merger between Pacific Telesis ("PacTel") and SBC Communications. *In re Applications of Pacific Telesis Group and SBC Communications, Inc. for Consent to Transfer Control of Pacific Telesis and its Subsidiaries*, FCC 97-28 (rel. Jan. 31, 1997). There, the Commission specifically held that because SBT and PacTel provide telecommunications services "in States that are separated by at least 500 miles" of desert, the proposed merger did not result in any reduction of existing competition. *Id.* at ¶ 15. Similarly, the Commission found that in light of the fact that – barring a re-appearance by Moses himself – neither entity was likely to cross the desert, the proposed merger would therefore not violate at least one element of the "potential competition" doctrine – *i.e.*, that SBC would enter or would have entered the markets in question but for the proposed transfer. The Commission stated that not only

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entry was expected to come from an increasingly vertically-integrated fringe -- CLECs, CAPs, cellular, PCS, maybe cable, maybe utilities, and hopefully the Internet.

Instead, I argued that the key area to watch would be the re-vertical integration of the industry. On one hand, I argued that even if "one-stop-shopping providers" dominated the market, I had little doubt that there would be a significant fringe of "single-service" providers at each level to serve niche markets. On the other hand, however, I posited that the real question to ask is how many fully-integrated, facilities-based providers consumers will actually be able to choose from in any given market? I argued that the answer to this question would depend on how competition actually develops -- regionally or nationally.

That is to say, I argued that if a true national market for telecommunications services actually developed, then -- assuming no additional consolidation among the large carriers -- consumers should be able to choose a "one-stop" telecommunications service provider from at least eight fully-integrated nationwide facilities-based providers -- *i.e.*, the former five BOC providers and the three or four former major "long-distance" providers -- plus be able to construct a package of "*ala carte*" products and services from various niche providers. So long as competitive conditions exist (*e.g.*, excess capacity, high own-price elasticity of demand, low barriers to entry, low switching costs), I believed that consumer welfare should probably be improved significantly.

Despite this rosy optimism, given the preliminary evidence available at the time of the first version of this paper, I nonetheless noticed uncomfortably that the current trend appeared to indicate that it was entirely possible that the telecommunications industry may eventually be characterized not by a single, national market, but instead by several distinct regional markets comprised of incumbent LECs' prior service territories. As mentioned above I believed that it was highly unlikely (but

was it unaware of any evidence that SBC was a likely entrant into local markets in California before the proposed transfer was announced, but that no party had submitted even informed speculation in the trade press or by experts to that effect. Moreover, the Commission found that no party had brought to its attention "any instance" in which SBC had "engaged in such entry against *any other RBOC, including those with which it shares a border – BellSouth, Ameritech and US West.*" *Id.* at ¶ 25.

not impossible) that most fully-integrated BOCs will try to compete head-to-head in the near-term with other BOCs. Rather, they would probably try to focus on defending their core territories from new entrants by offering a wide variety of vertically-integrated bundled services and products.[24] If this occurred, I argued that these regional markets would probably be characterized by a dominant firm / fringe model and, in such a case, the Federal Communications Commission may find itself revisiting its original *Competitive Carrier* regulatory paradigm.

## IV. Events of the Past Year

As mentioned above, the events of the last year (and, in particular, during the past two months) have been so remarkable that I am compelled to write a second edition of this paper far quicker than I ever expected. Indeed, despite the FCC's various attempts to write "pro-competitive rules" (the FCC refuses to acknowledge that because it is a regulatory body, it writes *regulations* that have both costs and benefits[25]) to further the interests of "competition, community and common sense,"[26] the empirical evidence unfortunately supports the conclusion that the FCC's efforts to date have been a dismal failure. For example (just to highlight a few), the center-piece of the 1996 Act -- the interconnection rules under Section 251 -- have been completely eviscerated by the 8th Circuit Court of Appeals. [27] Similarly, the safe-

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[24] Market Reconcentration at 22 & n. 17 (*citing* Mark Lander, *Year of Intense Activity Looms for Phone Industry, Experts Say*, NEW YORK TIMES (January 2, 1997) ("Yet in the domestic local phone business, where the most revolutionary changes were supposed to occur, the outlook for consumers is murky. The regional Bell Operating Companies are zealously defending their local franchises.")).

[25] *See* Lawrence Spiwak, *Antitrust, the "Public Interest" and Competition Policy: The Search for Meaningful Definitions in a Sea of Analytical Rhetoric*, ANTITRUST REPORT (Matthew Bender, December 1997) (hereinafter, *The Search for Meaning*) at 2, 7-9.

[26] *See Kennard Takes Helm of FCC, Sounds Pro-Consumer Themes,* TR WIRELESS NEWS (November 13, 1997) ("In his first public statements last week as chairman of the FCC, William E. Kennard set a pro-consumer tone, vowing to make 'competition, community, and common sense' his watchwords.") While this is certainly very nice, readers should note how the word "*consumers*" is conspicuously absent.

[27] *See Iowa Utilities Bd. v. FCC*, 120 F.3d 753, (8th Cir., Jul 18, 1997), *as amended on reh'g* (Oct 14, 1997), *cert. granted by AT&T Corp. v. Iowa Utilities Bd.*, 118 S.Ct. 879, 39 L.Ed.2d 867 (U.S., Jan 26, 1998) (NO. 97-826, 97-829, 97-830, 97-831, 97-1075, 97-1087, 97-1099, 7-1141). In my opinion, however, one other probable reason (among numerous others) not often discussed for this failure was, once again, the FCC's deliberate refusal to articulate as clear view of industry structure and performance post-1996 Act. Indeed, FCC officials publicly (continued …)

guards designed to mitigate an incumbent LEC's ability to engage successfully in strategic anticompetitive conduct required by Section 272 of the 1996 Act are proving not to be worth the paper they are written on.[28] And, of course, the ultimate FCC-sponsored barrier to entry -- the surreptitious imposition of hidden costs to pay for the Administration's pet political project of wiring the schools of America at the expense of overall consumer welfare.[29] Finally, in addition to the FCC's ill-fated attempts to write "pro-competitive" rules, the FCC's various case-specific adjudications also deserve particular criticism -- especially those adjudications reviewing major industry mergers and acquisitions. As explained more fully below, these include the FCC's gross mishandling of both the Bell Atlantic / NYNEX and BT / MCI mergers.

Give these developments, where does this leave us at the present moment? Certainly not in any condition that I would be bragging about. For example, because the growing amount of evidence indicates that the legal and economic merger analyses used, and the "voluntary merger commitments" obtained by, the FCC in Bell Atlantic / NYNEX are not

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stated that because of the difficult and contested nature associated with the Section 251 Docket, the FCC decided to simply to "draw a line straight down the middle." What these officials never understood, however, is that there is a major difference between approaching major issues like Mr. Lupner (remember, he was born without a spine) by attempting to improperly "split the baby" and approaching the problem with a firm policy objective and never deviating from achieving that end objective. Yet, I suppose upon reflection, that because the Clinton Administration's primary policy objective has been the reallocation (and redistribution) of wealth, rather than the maximization of consumer welfare (*see* discussion *passim*), then perhaps, in their own little way, Messrs. Hundt, *et al.* did in fact successfully "focus like a laser beam" on achieving their goal.

28 *See, e.g.,* Linda Woody, *CLECs and Incumbents Collide Over Service Issues,* X-CHANGE MAGAZINE (June 1987) at 26; Peter Elstrom, *Why SBC Shouldn't be the First Bell in Long Distance,* BUSINESS WEEK (July 21, 1997) at 33.

29 *See, e.g.,* Mike Mills, *AT&T Imposing Fee on Residential Users,* WASHINGTON POST (May 6, 1998) (Reporting that AT&T has begin to impose a fee on residential customers to pay for FCC's universal service program. In a bald-faced lie, however, FCC officials complained that AT&T and other carriers should be absorbing the charges themselves, and were never ordered by the FCC to pass them on to consumers. "This is not a federal charge. This is a charge that AT&T is creating on its own," said the FCC's Chief of Staff, John Nakahata. Such a claim is really quite incredulous, given the fact that former FCC Chairman Reed Hundt tried actively to "keep the fees from appearing as new line items on consumers' bills. Long-distance companies declined that request, but in a deal with [Hundt,] AT&T said it would refrain temporarily from charging the fees to consumers who pay undiscounted rates for long-distance service.")

worth the paper they are written on,[30] coupled with the FCC's almost complete "capture" by ILECs (which is an open secret around Washington),[31] incumbent LECs now apparently have no fear (or, perhaps more accurately, the chutzpah) of asking regulators to approve a proposed merger between SBC and Ameritech -- a merger that, if approved, would give one company control over one third of the nation's aggregate phone lines and near monopoly control over the residential local service for eleven states (including Texas, California and Illinois).[32]

Similarly, just as this paper is going to press, Bell Atlantic announced that it was now going to attempt to acquire GTE. This merger, if approved, would give create an ILEC that would control over 63 million access lines, have direct access to 33 million households in 38 states (along with 10.6 million wireless customers) and have revenues that will probably exceed easily $53 billion.[33]

To counter balance this increasing trend in mega-ILEC re-concentration, AT&T also announced just as this paper is going to press

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30 *See* COMMUNICATIONS DAILY (March 24, 1998) (Reporting that MCI filed formal complaint with FCC alleging that Bell Atlantic is violating the terms of its $21-billion merger agreement with FCC); *AT&T Accuses Bell Atlantic of Ignoring Promises Made to Win Merger Approval*, COMMUNICATIONS DAILY (Nov. 6, 1997); COMMUNICATIONS DAILY (Oct. 24, 1997) (MCI accuses Bell Atlantic of trying to "thwart" merger conditions).

31 *See* Steve Lohr, *Giving Old Ma Bell New Lease on Life, More New Math: Promoting Competition by Addition, Not Division*, NY TIMES (May 12, 1998) at D1, D10 (Mr. Kennard has "forged a reputation of being . . . conciliatory towards the Bells. . . ."); *Kennard Challenges Long Distance Companies to Prove they Reduced Rates*, Communications Daily (Feb. 27, 1998) (Reporting that FCC Chairman Bill Kennard sent letter to "Big 3" long-distance companies questioning why they have been adding mandatory universal service contributions as a line-item in consumers bills rather than reducing rates, citing as "evidence" letter from USTA President Roy Neel.)

32 *Id.* My comments herein should not be construed by anyone as a comment (pro or against) about the reasonableness of business judgment by any executive from the various companies mentioned herein. Firms are profit maximizers, and, accordingly, will act to further this end. In fact, some of these executives can represent the very epitome of hoe corporate America can contribute positively to community welfare. *See* COMMUNICATIONS DAILY (June 2, 1998) (Edward Whitacre, SBC Communications Chairman & CEO, named national president, Boy Scouts of America).

33 *See, e.g.*, Margaret Kane, *Telco Merger Mania*, ZD NET NEWS (July 28, 1998; 4:53 am PT); Seth Schiesel, *Telephone Mergers: A Heated Game of Musical Chairs*, NY TIMES (July 28, 1998).

that it is acquiring TCI, the largest cable MSO in the United States.[34] While everyone is heralding this potential merger as the "Great White Hope" that will finally bring consumers real competition for local telecommunications service and fulfil the promise of the 1996 Act, several points should be highlighted before we all get a bit too excited. As an initial matter, everybody needs to understand that despite the potential merger's promises, scientists have yet to develop technology that allows firms to provide voice-over-coax cable (a) at the same cost and (b) with the same quality as the existing copper twisted pair (*i.e.*, voice-over coax costs more and gives you less).[35] Moreover, even assuming *arguendo* that voice-over-coax is really a close substitute for the traditional twisted pair loop, there are several economic structural characteristics regarding both the telecommunications and cable markets that also may place a frost on the proposed merger's bloom.

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[34] What is particularly humorous to note about this proposed transaction (among other things), is that given the substantial amount of effort exerted by AT&T to shed finally fifteen years of asymmetrical dominant carrier regulation by the FCC's Common Carrier and International Bureaus, AT&T is now voluntarily throwing itself back onto the mercy of the most regulatory, burdensome (and considered by many to be the most poorly run due to wholly-inexperienced staff) Bureau of the Commission – the FCC's infamous Cable Bureau. *See New Cable Bureau Chief Has Little Experience But Right "Skill Set"*, COMMUNICATIONS DAILY (Reporting that Deborah Lathen, a twenty-year friend of FCC Chairman Bill Kennard, was taking over the helm of the FCC Cable Bureau despite admitting having absolutely no experience in the industry or issues. In fact, although she stated that she "followed the debates" on telecom policy, when pressed on the issue, she could not "say what needs to be done to spur cable competition." Such an appointment should not come as any real suppress, however, as Lathan replaces Meredith Jones, "who also had no cable experience when hired." Yet, when reached for comment, an unnamed senior cable industry official added that while the industry was dismayed over selection, "we look forward to helping her understand the subtleties of our business.")

[35] *See* Peter Elstrom, *John & Mike's Big Adventure*, BUSINESS WEEK (March 9, 1998) at 34 (Because "cable telephony is far from a sure bet" AT&T could end up with "poor-quality service that could hurt its reputation." Moreover, the "Internet technology that AT&T and TCI plan to use has proved problematic and what's more, cable networks are so far not as reliable as phone systems."); Vanessa Clark, *Network Costs may Undermine AT&T's TCI Merger*, COMMUNICATIONS WEEK INTERNATIONAL (June 26, 1998); Margaret Kane and Erica Schroeder, *AT&T, TCI Officials Shed More Light on Merger Details*, ZDNET ONLINE (June 26, 1998 2:59 PM PT) ("The costs to complete the upgrade once the merger is finalized will be between $700 million to $900 million, officials said. TCI has already spent between $4 million and $5 million on the upgrade; the total overall cost of the upgrade is $1.8 billion." Moreover, "AT&T officials estimate it will cost the company between $400 and $500 to convert each individual customer home to support new services such as IP telephony.")

To wit, TCI (like all major cable MSOs) does not have a nation-wide contiguous footprint. Rather, its footprint is made up of multiple franchises in which it is the dominant (if not outright monopoly) provider. Second, given this status, TCI (again, just like the cable industry as a whole) has a less-than-stellar reputation for consumer satisfaction.[36] Third, given the ease of rent extraction from existing captive customers, the record is quite clear that cable MSOs have very little desire to overbuild into other dominant MSO providers' service territory (gee, just like the BOCs).[37] Thus, if you live in a non-TCI franchise area, don't hold your breath waiting for this new AT&T low-cost broad-band access to the home; and, conversely, if you do live in a TCI franchise service area, don't hold your breath waiting for any competition for multichannel video programming to come from AT&T.[38]

## IV. The Political Response: The FCC's "Effectively Precluded" Merger Analysis.

This is not to say, however, that the FCC has not attempted to develop some kind of pseudo-analytical cover to convince both naïve consumers and naïve politicians on Capitol Hill that they are firmly out to protect and promote the public interest from increased industry reconcentration. In a speech narcissistically entitled *Thinking About Why Some Communications Mergers are Unthinkable* delivered at the Brookings Institution, former FCC Chairman Reed Hundt proudly announced his vision (or, more accurately, the revision) of how the FCC should analyze telecommunications industry mergers post-1996 Act -- *i.e.*, the "effectively precluded competitor" framework.[39] Yet, because, as Mr.

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[36] *See generally*, John Higgins, *Viacom Hits Malone With Antitrust Suit,* MULTICHANNEL NEWS (Sept. 27, 1993).

[37] *See In the Matter of Annual Assessment of the Status of Competition in Markets for the Delivery of Video Programming, Fourth Annual Report,* FCC 97-423 (Rel. Jan. 13, 1998) at ¶¶ 11, 141 ("Competitive overbuilding by franchised cable systems remains minimal" and, in those "recent instances where overbuilding has occurred or is planned, the overbuilders . . . have not been the operators of existing adjacent cable systems.") In fact, when TCI acquired Telecable, it eliminated one of the few successful overbuilds in the country, much to the dismay of the FCC and the Federal Trade Commission. *See In re Tele-Communications, Inc. and Telecable Corporation*, 10 FCC Rcd 2147 (1995).

[38] Indeed, given the FCC's own data provided *id.*, any attempt by the FCC to consider either TCI or AT&T to be a "significantly precluded competitor" (discussed *infra*) would be laughable.

[39] *See*, Reed Hundt, *Thinking About Why Some Communications Mergers are Unthinkable*, Delivered to the Brookings Institution, Washington D.C. (June 19, 1997). As I have argued (continued ...)

Hundt's title clearly implies, the *EPC* framework was designed, at bottom, to provide nothing more than political cover for the Commission's then-anticipated (and pre-determined) dispositions of *BT-MCI III* ("thinkable" if "neo-mercantile" trade objectives are achieved),[40] Bell Atlantic / NYNEX ("thinkable" if enough voluntary commitments are obtained), this "framework" -- by its very purpose -- was forced to abandon any firm legal or economic analytical foundation when precedent or first principles conflicted with the pre-determined outcome. In doing so, the Commission unnecessarily subjected itself to claims of arbitrary and capricious decision-making -- especially when the Commission's policy objectives could have been achieved equally using a more "analytically honest" approach.[41]

What is even more disturbing, however, is the fact that the FCC has used successfully its *EPC* framework as political / analytical cover to extract sufficient "voluntary" concessions or "involuntary" conditions to "buy off" opposing parties from contesting the case. I'm sorry, but "regulatory shakedowns" should not be the centerpiece of the Commission's litigation-avoidance strategy. At the end of the day, the

previously, however, this type of arrogant subjectiveness is more accurately described as the "Potter Stewart I Know It When I See It" test of anticompetitive conduct or market power, because merely "thinking" about the competitive effects of a merger on long-term market performance is not the intellectual equivalent of conducting a thorough legal and economic analysis. *See The Search for Meaning* at 4 & n. 15 (citing Jacobellis v. Ohio, 378 U.S. 184, 197 (1964) (Stewart, J., concurring) (while it is impossible to define "obscenity," "*I know it when I see it.*" (emphasis supplied))). Thus, as a argued before, if government continues to intervene in the market without providing any legal or economic analysis to justify its actions, then the terms "market power," "dominant," or "anticompetitive" will essentially boil down to nothing more than the intellectual equivalent of "I don't like you." *See TV Communications Network, Inc. v. Turner Network Television, Inc.*, 964 F.2d 1022, 1026 (10th Cir.), *cert. denied*, 113 S. Ct. 601 (1992); *see also Hawaiian Telephone v. FCC*, 498 F.2d 771, 776-77 (D.C. Cir. 1974) (FCC "cannot merely assert the benefits of competition in an abstract, sterile way").

[40] *See The Search for Meaning* at 15-23; Lawrence Spiwak, *From International Competitive Carrier to the WTO: A Survey of the FCC's International Telecommunications Policy Initiatives 1985-1997*, 51 FED. COMM. L. J. (forthcoming December 1998).

[41] Tragically, the Commission's subjective, arbitrary approach to merger review continues to this day. *See* June 24, 1998 Statement From FCC Chairman William E. Kennard On AT&T And TCI Proposed Merger **("**If AT&T and TCI make a strong commitment to bring residential consumers more choice in local telephone and high speed Internet access services, then this proposed merger is eminently thinkable.")

Commission simply cannot use "voluntary" commitments to make either economically (*i.e.,* when the FCC's own competitive analysis concludes that the merger should not be permitted to move forward) or politically (*i.e.*, where trade concerns outweigh the economic evidence) "unthinkable" mergers "thinkable" at the expense of consumer welfare.

Accordingly, so long as the political hyperbole remains the centerpiece of the FCC's merger analyses, therefore, then whenever the Commission does conduct an accurate economic analysis regarding the potential pro- and anticompetitive effects on industry re-concentration post-1996 Act, these important conclusions will simply be lost in the morass. This loss is quite sad, given the fact that the Commission truly had an opportunity to advance the analytical debate about the form of industry structure post-1996 Act. Moreover, as stated above, the Commission could have achieved its policy objectives just as easily and effectively -- and garnered the respect and admiration of the professional and academic communities in the process as well -- had the Commission adopted a more straight-forward analytical approach. This vacuum in analysis and leadership is even more acute today, given the plethora of recent impediments that have deterred the implementation of the goals of the 1996 Act -- *i.e.,* substantial industry reconcentration, overturned interconnection rules, and a preliminary ruling that the salient pro-competitive provisions of the 1996 Act are unconstitutional. Accordingly, if the Commission is going to continue to apply its *EPC* framework on a generic industry-wide basis, then several key "elements" of the *EPC* framework need to be refined and re-considered substantially to make the framework more legally and economically supportable in the future.[42]

### A. *While the Commission's "Public Interest" Review is Certainly Broader than the Review Required Under the Antitrust Laws, the Commission's Competitive Analysis May Not, However, "Extend Beyond" Well-Accepted Economic First Principles*

Under well-accepted precedent, because of the FCC's unique and difficult responsibility to regulate the dynamic industries under its jurisdiction, courts generally hold that the Commission's powers are significantly *broader* than those of the antitrust enforcement agencies, because they are "entrusted with the responsibility to determine when

[42] As such, unless relevant to my central analysis, I will not critique the specific successes and failures of the FCC's individual applications of the *EPC* "framework" in either *Bell Atlantic/NYNEX* or *BT/MCI*.

and to what extent the public interest would be served by competition in the industry."[43] Thus, for example, if an antitrust enforcement agency found that a joint venture might result in the loss of present static economic efficiencies, then this agency would probably be bound to attempt to enjoin the venture. In contrast, because of the Commission's broader scope of review, the FCC may find it appropriate (and entirely lawful) to risk the potential for short-term static economic efficiencies in the hope of achieving much greater dynamic economic efficiencies in the long-run.[44] The ability to enjoy a broader perspective, however, does not mean that the FCC can ignore basic economic first principles.

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[43] *FCC v. RCA*, 346 U.S. 86, 93-95 (1953); *Northeast Utilities Service Co. v. FERC*, 993 F.2d 937, 947-48 (1st Cir. 1993) (public interest standard does not require agencies "to analyze proposed mergers under the same standards that the [DOJ] ... must apply" because administrative agency is not required to "serve as an enforcer of antitrust policy in conjunction" with the DOJ or FTC; thus, while agency "must include antitrust considerations in its public interest calculations . . . it is not bound to use antitrust principles when they may be inconsistent with the [agency's] regulatory goals"). *See also National Broadcasting Co. v. United States*, 319 U.S. 190, 219 (1943) (Congress, through the Communications Act, "gave the Commission not niggardly but expansive powers."); *Craig O. McCaw*, Memorandum Opinion & Order, 9 FCC Rcd 5836 (1994) at ¶ 7, *aff'd, SBC v. FCC*, 56 F.3d 1484 (D.C. Cir. 1995) (FCC's "jurisdiction under the Communications Act gives us much more flexibility and more precise enforcement tools that the typical court has. . . .")

[44] The Commission's entire Program Access policy is predicated exactly on this type of approach. That is to say, Program Access seeks to promote long-term market performance for delivered video programming by vigorously promoting entry into the local distribution market by multiple rivals. This is accomplished by ensuring non-discriminatory access to satellite cable programming owed by vertically-integrated cable systems. Thus, the Program Access policy expressly contemplates the potential sacrifice of static economic efficiencies (*i.e.*, the benefits of exclusivity such as minimized risk) in the hope of improving long-term market performance with rivalrous competition from multiple distribution technologies – *i.e.*, dynamic economic efficiency. *See* Olson & Spiwak, *supra* n. 11. Similarly, in *United States v. FCC*, 652 F.2d 72 (D.C. Cir. 1980), the Commission, over the strenuous objections of the DOJ, permitted a joint venture between the largest manufacturer of computers (IBM) and the largest supplier of satellite facilities (Comsat) in order to spur immediate entry into a market previously occupied by a single firm. In conducting a dynamic economic analysis, the Commission balanced the possible anticompetitive effects of the joint venture in the domestic land-line market against the potential pro-competitive effects of bringing competition to a highly concentrated, monopolistic market with poor performance. The net result of this decision is now a vibrant, competitive market for private satellite services.

Yet, the Commission departed radically from this analysis when it reviewed the *BT/MCI* transaction, where the FCC rationalized the imposition of significant "voluntary" trade-related commitments – unrelated to any market power concerns – by reasoning that

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As (now) Justice Stephen Breyer explained, despite the fact that economic regulation and antitrust approach analyze market performance from different perspectives -- *i.e.*, economic regulation seeks to promote competitive rivalry directly "through rules and regulations" while antitrust enforcement by the DOJ and FTC seeks to foster competitive rivalry "indirectly by promoting and preserving a process that tends to bring them about"[45] -- both regimes should fulfill *identical* public-policy goals. These goals, according to Justice Breyer, are "low and economically efficient prices, innovation, and efficient production methods. . . ."[46]

As such, those who argue that there is no relationship between antitrust and economic regulation completely miss the point.[47] Congress clearly intended this "direct/indirect" dual regime approach, because there are often situations where certain market conditions or an individual firm's conduct may not satisfy the requisite legal criteria to violate the antitrust laws, but nonetheless have a direct negative impact on market performance. These conditions are sometimes referred to as "policy-relevant" barriers to entry -- *i.e.*, those situations where government intervention may be warranted, because the economic costs of imposing remedial regulation will not exceed the existing economic

while the proposed merger might substantially lessen competition on the U.S./UK route for IMTS service (even though competitive conditions dramatically *improved* since *BT/MCI I*), the merger would nonetheless "enhance" competition in the market for "global seamless service" – an ethereal market which, at best, is directed towards the largest and most sophisticated business customers around the world (a class of customers that clearly does not need any regulatory protection).

45 *Town of Concord v. Boston Edison Co.*, 915 F.2d 17, 22 (1st Cir. 1990), *cert. denied*, 499 U.S. 931 (J. Breyer).

46 *Id.*; *accord, United States v. FCC, supra* n. 3, 652 F.2d at 88 ("basic goal of direct governmental regulation through administrative bodies and the goal of indirect governmental regulation in the form of antitrust law is the same – to achieve the most efficient allocation of resources possible. . . .")

47 *See U.S. v. AT&T*, 498 F. Supp. 353, 364 (D.D.C. 1980) (Green, J.) (it is "not appropriate to distinguish between Communications Act standards and antitrust standards" because "both the FCC, in its enforcement of the Communications Act, and the courts, in their application of the antitrust laws, guard against unfair competition and attempt to protect the public interest.")

costs created by the barrier if no government intervention occurs.[48] If a "policy-relevant" barrier to entry is present, then regulatory intervention may be appropriate.[49] What Congress did not intend by this dual merger review process is wasteful redundancy of government and taxpayer resources.[50]

### B. *The EPC Framework Tries to Perpetuate the Flawed Notion that the Commission May Use Regulatory Proceedings to "Level the Playing Field" Among Competitors."*

Under its *EPC* merger framework, the FCC now holds that "although the public interest includes consideration of the competition policies underlying the Sherman and Clayton Acts, the public interest standard necessarily subsumes *and extends beyond* the traditional parameters of review under the antitrust laws." No longer will the Commission merely require applicants to demonstrate that their proposed merger would not

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[48] *See Reorienting Economic, supra* n. 8 at 35 & n. 32 & citations therein; *see also The Search for Meaning* at n. 29. That is to say, from a public policy perspective, not all impediments to entry are necessarily barriers to entry that require some type of government intervention or remediation. Thus, when analyzing whether a particular structural characteristic is a "policy-relevant" barrier to entry, policy makers will have to engage in a cost-benefit analysis that identifies, *inter alia*: (1) all possible economic efficiencies, if any, that might result from the presence of the barrier to entry; (2) all offsetting economic efficiencies that might be attributable to the barrier to entry, if any; (3) all relevant positive and negative network externalities; and (4) the estimated economic cost of eliminating the barrier to entry or minimizing its effects.

[49] For example, while ESPN, CNN, HBO or Showtime appropriately should not be considered to be an "essential facility" under the antitrust laws, without these popular channels, new entrants will find it extremely difficult to establish a viable, rival distribution system for delivered multichannel video programming. As such, Congress, in the 1992 Cable Act required, *inter alia*, parties to an exclusive programming distribution contract to demonstrate that such contract is in the public interest. *See* 47 U.S.C. § 548. When undertaking this review – just like under antitrust precedent – the Commission must weigh the pro-competitive benefits of an exclusive distribution contract against its likely anticompetitive harms. Evidence has borne out that this short-term regime has contributed significantly to the deconcentration of the MVPD market. *See* Olson & Spiwak, *supra* n. 11.

[50] Again, as now-Justice Breyer once wrote, an "antitrust rule that seeks to promote competition but nonetheless interferes with regulatory controls could undercut the very objectives the antitrust laws are designed to serve." As such, where regulatory and antitrust regimes coexist, "antitrust analyses must sensitively 'recognize and reflect the distinctive economic and legal setting' of the regulated industry to which it applies." *Town of Concord, supra* n. 45, 915 F.2d at 22.

"substantially . . . lessen competition . . . [or] . . . tend to create a monopoly" -- *i.e.*, maintain the competitive status quo. Now, the Commission requires applicants to demonstrate specifically that their proposed merger actually *"will enhance competition."* In the Commission's view,

> A merger will be pro-competitive if the harms to competition -- *i.e.*, enhancing market power, slowing the decline of market power, or impairing this Commission's ability properly to establish and enforce those rules necessary to establish and maintain the competition that will be a prerequisite to deregulation -- are outweighed by benefits that enhance competition.[51]

The Commission therefore held that under its new *EPC* approach,

> consistent with the 1996 Act's focus on competition and deregulation, it is incumbent upon applicants to prove that, on balance, the merger will enhance and promote, rather than eliminate or retard, competition. The competition and deregulation Congress sought to foster extends not just to traditional local telephone service, but to related interstate access services, to Commercial Mobile Radio Services ("CMRS"), and to interstate long distance services.[52]

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51 *See In re Applications of NYNEX and Bell Atlantic Corp. For Consent to Transfer Control,* Memorandum Opinion & Order, 12 FCC Rcd 19,985, FCC 97-286 (rel. Aug. 14, 1997) (hereinafter "*Bell Atlantic/NYNEX Order*") at ¶ 2.

52 *Id.* at ¶ 3. *But cf., FCC v. RCA Communications, Inc., supra* n. 3, 346 U.S. at 93-95, wherein Mr. Justice Frankfurter, in reversing a Commission order, wrote that:

> it is improper for the Commission to suppose that the standard it has adopted is to be derived without more from a national policy defined by legislation and by the courts. * * * There can be no doubt that competition is a relevant factor in weighing the public interest. Our difficulty arises from the fact that while the Commission recites that competition may have beneficial effects, it does so in an abstract, sterile way. Its opinion relies in this case not on its independent conclusion, from the impact upon it of the trends and needs of this industry, [or] that competition is desirable but primarily on its reading of national policy, a reading too loose and too much calculated to mislead in the exercise of the discretion entrusted to it.

The problem with this approach, however, is that it is black-letter law that an administrative agency may not subvert the public interest to leveling the playing field -- *up or down* -- among competitors.[53]

Hard to believe, but the Ninth Circuit recognized this basic principle nearly *sixty* years ago in *Pacific Power & Light Co. v. FPC*, 111 F.2d 1014, 1016 (9th Cir. 1940). There, the Ninth Circuit specifically rejected the Federal Power Commission's (FERC's predecessor) argument that an applicant's burden to show that a particular proposal is consistent with the public interest "requires something more than a showing of convenience to the applicant, and can reasonably be interpreted as indicating that the Congress intended that there be a showing that benefit to the public will result from the proposed merger of facilities before it should receive Commission approval." In particular, the court rejected the FPC's argument that it may deny a merger application if the parties cannot show that "the consuming public will be benefited thereby." According to the court, the "phrase 'consistent with the public interest' does not connote a public benefit to be derived or suggest the idea of a promotion of the public interest. The thought conveyed is merely one of compatibility." As such, the court concluded that it is "enough if the applicants show that the proposed merger is compatible with the public interest. The Commission, as a condition of its approval, may not impose a more burdensome requirement in the way of proof than that prescribed by law."[54]

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53 *See, e.g., Hawaiian Telephone v. FCC*, 498 F.2d 771, 775-76 (D.C. Cir. 1974) (According to the court, a legal and economic analysis of competitive issues under the public interest standard must be more than an inquiry into "whether the balance of equities and opportunities among competing carriers suggests a change." As such, the court reversed and remanded the Commission's decision, finding that it was "all too embarrassingly apparent that the Commission has been thinking about competition, not in terms primarily as to its benefit to the public, but specifically equalizing competition among competitors."); *SBC v. FCC*, 56 F.3d 1484, 1491 (D.C. Cir. 1995) (*citing Hawaiian Telephone, supra; W.U. Telephone Co. v. FCC*, 665 F.2d 1112, 1122 (D.C.Cir.1981) ("equalization of competition is not itself a sufficient basis for Commission action")) (when the Commission deliberates whether a proposed merger serves the public interest, the "Commission is not at liberty ... to subordinate the public interest to the interest of 'equalizing competition among competitors.'"); *accord Brunswick Corp. v. Pueblo Bowl-O-Mat, Inc.*, 429 U.S. 477, 488, 97 S.Ct. 690, 697, 50 L.Ed.2d 701 (1977) (*quoting, Brown Shoe Co. v. United States*, 370 U.S. 294, 320, 82 S.Ct. 1502, 1521, 8 L.Ed.2d 510 (1962)).

54 *Id.* To place the scope of the FCC's improper expansion of an applicant's burden into context, consider the hypothetical ramifications if the Commission had required AT&T, as a pre-condition of a determination of non-dominance, to demonstrate not only

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### C. *The EPC Framework Simply Provides the FCC with Another Opportunity to Engage in "Regulatory Shakedowns" and/or "Regulatory Greenmail" to Expand its Powers Improperly and "Tax by Regulation."*

In its effort to "enhance competition," the FCC apparently has little shame in not so quietly hinting that, as a significant component of its *EPC* framework, it is

> also possible, in certain circumstances, for prospective merger partners to make pro-competitive commitments, whose likely effect in enhancing competition in some or all relevant markets outweighs the likely harmful effects that are expected to occur by reason of the merger. In such a case, we might find it in the public interest, convenience and necessity to approve the merger.[55]

Of course, the Commission was quick to point out that it did "not intend to suggest, however, that applicants, by offering pro-competitive commitments, will always be able to carry their burden of demonstrating that a proposed transaction is in the public interest." To the contrary, the FCC explained that for

> some potential mergers, the harm to competition may be so significant that it cannot be offset sufficiently by pro-competitive commitments or efficiencies. In such cases, we would not anticipate the applicants could carry their burden to show the transaction, even with commitments, is pro-competitive and therefore in the public interest.[56]

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that it lacked market power, but that re-classification would "enhance competition" as well. (However, as AT&T had to provide numerous "voluntary commitments" to protect its rivals (both resale and facilities based), as well as numerous "low volume" and "low income" commitments (so as to avoid "rate shock") as a pre-condition of non-dominance – plus a large, "unrelated" multi-million dollar promise to wire the schools of America (*see infra* n. 59) – perhaps I spoke to soon.)

55 *See In re Merger of MCI Communications Corp. and British Telecommunications, plc,* Memorandum Opinion & Order, FCC 97-302, 12 FCC Rcd 15,351 (re. Sept. 24, 1998) (hereinafter "*BT/MCI*" ) at ¶ 10.

56 *See Bell Atlantic/NYNEX* at ¶ 15; *BT/MCI* at ¶ 11.

Unfortunately, these statements simply provide the public and industry with the improper yet distinct impression that a serious economic analysis is the last thing on the FCC's agenda. This message -- express or implied -- is completely unacceptable. Because economic regulation has both costs and benefits, any condition imposed must have a *direct nexus* to a specific anticompetitive harm and, moreover, must be narrowly tailored to mitigate only that specific anticompetitive harm. In the FCC's apparent view, however, the dicta cited above indicates that a nexus is irrelevant; rather, such language sends a clear message to the industry and public that the FCC will only entertain seriously a merger application unless the applicants are also prepared to accompany this application with a "political" deal for the benefit of their competitors,[57] and reporting requirements designed to perpetuate the Commission's regulatory oversight over the industry.[58] Moreover, this the impression of

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57 Indeed, as Judge Frank Easterbrook observed well over ten years ago,

> Often an agency with the power to deny an application (say, a request to commence service) or to delay the grant of the application will grant approval only if the regulated firm agrees to conditions. The agency may use this power to obtain adherence to rules that it could not require by invoking statutory authority. The conditioning power is limited, of course, by private responses to the ultimatums – firms will not agree to conditions more onerous than the losses they would suffer from the agency's pursuit of the options expressly granted by the statute. The firm will accept the options expressly granted by the statute. The firm will accept the conditions only when they make both it and the agency (representing the public or some other constituency) better off. *Still, though, the agency's options often are potent, and the grant of an application on condition may greatly increase the span of the agency's control.*

Frank Easterbrook, *The Court and the Economic System*, 98 HARV. L. REV. 4, 39 (1984) (emphasis supplied).

58 To wit, the imposition of "voluntary" commitments designed to maximize *regulatory efficiency* (*i.e.*, conditions which make it easier for the Commission to regulate) – rather than commitments designed to protect market performance by guarding against *regulatory evasion* – is similarly unacceptable. *See, e.g., Bell Atlantic/NYNEX Order* at ¶ 16 (Because Commission was "concerned about the impact of the declining number of large incumbent LECs, on this Commission's ability to carry out properly its responsibilities to ensure just and reasonable rates, to constrain market power in the absence of competition, and to ensure the fair development of competition that can lead to deregulation" it was critical for FCC during "the transition to competition" to "be able effectively to establish and enforce its pro-competitive rules and policies." However, noted the Commission, as "diversity among carriers declines, both this Commission and state commissions may lose the ability to compare performance between similar carriers that have made different management or strategic choices" because, for example, it often relies "on cross-carrier comparisons as strong evidence as to technical feasibility or reasonableness." Thus,
(continued ...)

a regulatory "shake down" is exacerbated by the fact that the FCC has yet to find any "merger-related" efficiencies resulting from any of the mergers the FCC reviewed under its *EPC* framework.[59]

The SBC / Ameritech merger provides unfortunately the FCC with yet another opportunity to achieve indirectly what it cannot do directly at the expense of consumer welfare. To wit, readers should understand that prior to the announcement of the proposed SBC / Ameritech merger, SBC was one of the most vociferous -- and successful -- antagonists of the 1996 Act and the FCC's attempts to implement this Act. It was one of the primary parties behind the effort to have the FCC's interconnection rules overturned by the 8th Circuit, and (if that wasn't enough) hired hot-shot Harvard law professor Lawrence Tribe to argue (also successfully, at least as of the time of this writing) that the 1996 Act was unconstitutional to boot. Now, numerous industry observers are arguing rationally that the proposed SBC / Ameritech merger would be pro-competitive because the merger application "gives the FCC the leverage to push hard on SBC to

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reasoned the Commission, it would only approve the merger as conditioned, because the "Bell Companies, being of similar size, history, and regional concentration have, to date, been useful benchmarks for assessing each other's performance. Reducing the number of Bell Companies makes it easier to coordinate actions among them, and increases the relative weight of each company's actions on average performance.")

59 Unfortunately, the Hundt Administration has been notorious for extracting "voluntary" commitments (*a.k.a.* regulatory shakedowns) from regulated entities – wholly-unrelated to mitigating any conceivable anticompetitive harm relating to the transaction under consideration – to advance their pet political agendas in a wide variety of situations. See, e.g., Sept. 20, 1995 Statement of Reed Hundt on FCC's approval of Westinghouse / CBS merger ("Westinghouse's assurance that it will deliver three hours of children's educational TV on CBS underscores the tremendous importance of teaching our kids, instead of harming them, with broadcast TV." In the words of President Clinton, American children must not "lose 'countless opportunities to learn' from quality educational TV delivered by commercial networks for free to every home in the country.") (Note: The FCC tried to pull these same shenanigans when Disney sought to acquire ABC / Cap Cities. Considering Disney's well-documented record with creating children's programming, however, Mr. Hundt could only argue that "it remain[ed] to be seen" whether Disney could still do something more to help America's children.); *see also* Oct. 31, 1995 Statement by Reed Hundt in Response to AT&T's Pledge of $150 million to Help Put the Nation's Schools on the Information Superhighway ("We at the FCC hope that AT&T's gift [mysteriously made concurrent with the FCC's decision to declare AT&T as a non-dominant carrier for domestic service] of free internet access and voice-mail to all the children of America will catalyze a nationwide public / private partnership to network all classrooms as the President and Vice President have challenged.")

open its markets" and, if a deal can be reached, would be a "major accomplishment for [current FCC Chairman Bill] Kennard" and the "de-regulation of local services could move into high gear."[60] Please. "Regulatory Green-Mail" (*i.e.*, we'll let you reconcentrate if you promise to go away") is no substitute for sound legal and economic analysis and should not -- *under any circumstance* -- be tolerated by the American public.[61]

### D. *"Protecting Competition by Protecting Competitors" does not Contribute Positively to Consumer Welfare.*

In general, "leveling the playing field" (*a.k.a.* a naked "by protecting competitors, we protect competition" approach) -- especially by policies (and, more specifically, by "voluntary" merger commitments) that rely heavily on promoting local residential competition through "resale" -- does nothing to maximize consumer welfare, because any alleged competitive benefits consumers might perceive will be created neither by the addition of new capacity nor from competitive efficiencies as firms are forced to lower costs or innovate, but essentially from below-cost pricing and "state" subsidies (*i.e.*, artificially imposed costs ) -- especially as local residential rates are already subsidized heavily by other services. All that is accomplished, therefore, is a redistribution of wealth from one firm to another because, in the long-term, this policy provides neither any real incentives for new firms to enter on a true facilities basis nor any real incentives for incumbents to upgrade their networks.[62]

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60 *See* Gary McWilliams *et. al., A Break in the Logjam? SBC-Ameritech may Push the Feds into Rewriting the Telecom Rules,* BUSINESS WEEK (May 25, 1998) at 36-38.

61 *And compare,* Jared Sandberg and Steven Lipin, *Bell Atlantic and GTE Boards Approve Plans for a Merger,* WALL STREET JOURNAL (July 28, 1998) (According to former FCC Chairman Reed Hundt, the "question isn't so much whether regulators will nix any Bell Atlantic-GTE pact, but whether rivals such as SBC will be forced to play by the same rules to which Bell Atlantic must currently adhere.")

62 This flawed logic is precisely what Justice Frankfurter instructed specifically the FCC *not* to adopt nearly forty-five years ago – *i.e.,* view term "competition" in an "abstract, sterile way." *See, FCC v. RCA, supra* n. 3, 346 U.S. at 93-95. In ignoring Frankfurter's caveat, the *EPC* has recasted the end-goal of "competition" (which, through rivalry, attempts to maximize consumer welfare by producing dynamic and static economic efficiencies) to something more akin to "fair, competition-like outcomes accompanied by the benevolent use of 'market-friendly' regulation." In other words, competition is a zero-sum game. *See The Search for Meaning* at 2 & n. 2 (*citing,* Thomas W. Hazlett and George S. Ford, *The Fallacy of Regulatory Symmetry: an Economic Analysis of the "Level Playing Field" in Cable TV Franchising Statutes* (1997) (unpublished manuscript) (*citing*

(continued …)

Moreover, the economic costs of maintaining this kind of "artificial" competition are particularly expensive when the FCC uses heavily "voluntary" commitments -- rather than serious legal and economic analysis -- to justify why a merger may be in the public interest, yet these commitments, either for exogenous or endogenous reasons, nonetheless fail to achieve their objectives. Because it is highly unlikely that any increase in ILEC concentration will contribute positively to the creation of a competitive local exchange market, consumers should not be the ones to pay for regulatory failure.[63] When this regulatory failure occurs, consumers, once again, get the short-end of the stick, and merely reinforces their notion that regulatory proceedings are politics first, based on economics last.[64]

Finally, the *ad homonym* defense of such policies that "those who oppose 'leveling the playing field' must *a fortiori* be against competition" is specious at best. Let us be quite clear here: the naked "protection of competitors" is *not* the analytical equivalent of attempting to promote tangible new entry (*i.e.*, expanding capacity) into a market currently dominated by a monopoly incumbent by reducing barriers to entry, exogenous costs, *etc.* As the FCC's former chief economist recently remarked:

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Harold Demsetz, *Information and Efficiency: Another Viewpoint*, J.L. & ECON., Apr. 1969 at 1-22) (notion of "fair, competition-like outcomes" is ridiculous because regulators will never "choose 'efficient' prices, outputs, and quality costlessly and with perfect information."); Paul McNulty, *Economic Theory and the Meaning of Competition*, 82 Q.J. ECON. 639-656 (1968)).

63 *See supra* n. 30 noting the FCC's recent experience with enforcing the "voluntary" commitments in *Bell Atlantic/NYNEX*.

64 *See The Search for Meaning* at n. 110 and citations therein; *see also* John Berresford, *Future of the FCC: Promote Competition, Then Turn Out the Lights?* 21-22 (Economic Strategy Institute, May 1997). Berresford states that the "playing field is never 'even' to begin with, and bringing in a lot of regulatory landscape architects and earth-moving equipment will, in most cases, only postpone the emerging competition and the benefits it would bring to consumers." Thus, once regulators start to level the playing field to be "fair" to one competitor, "all the other competitors will find something unfair to them and will want their valleys to be filled and their mountains and hills to be brought low. The process can become an endless one and, if carried to its logical conclusion, makes the regulator into a cartel manager. This guarantees jobs for the regulators, lawyers and lobbyists, and oligopoly for the so-called competitors, but it will do little for consumers."

> Like most economists, I am uncomfortable with rules that forbid a firm from exploiting efficiencies just because its rivals cannot do likewise. Such handicapping, or leveling without regard for up or down, may make for a good game, but the game is only a metaphor. When firms are hamstrung, even in order to equalize them with other firms, consumers are liable to lose out.[65]

Indeed, there is a substantial analytical difference between the *EPC* framework's attempt to "enhance competition" (*i.e.*, promote "artificial entry" by "voluntary" commitments) and what the Commission attempted to do over 15 years ago in its *Competitive Carrier* paradigm discussed supra. As stated above, while the FCC took great pains to remove regulatory barriers to entry and implemented policies designed to help new entrants, *inter alia*, to appear to consumers that they had a nation-wide, facilities-based presence until their networks could be completed, it is extremely important to realize that this "appearance" was supposed to provide only a short-term mechanism to help nascent firms establish a market presence and *not* to establish a perpetual resale model (which was specifically considered and rejected).

### E. *The EPC Framework Improperly Relies on "Ephemeral Possibilities," Not Real Probabilities.*

The core of the FCC's *EPC* merger framework is its near exclusive reliance on the identification of the firms that, in the FCC opinion and prognostication, are likely to be the "most significant market participants based on an analysis of capabilities and incentives to compete effectively in each relevant market from the universe of actual and precluded competitors" -- in particular, those market participants that, in the Commission's exclusive opinion, are likely to be at least as significant a competitive force as either of the merging parties. After the Commission has identified these significantly precluded firms, then the Commission attempts to "forecast the probable future (absent the merger) as a base case by which to evaluate the merger" -- *i.e.*, calculate HHIs based on the number of "significantly precluded competitors" pre- and post-merger. There are two fundamental analytical problems with this approach, however.

The first analytical problem with such a framework is not that the FCC is attempting to forecast what the market may look like in the future

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[65] Joseph Farrell, *Creating Local Competition*, 49 FED. COMM. L.J. 201, 212 (1996).

with or without the merger. Indeed, it is wholly-appropriate — indeed crucial — for *both* antitrust enforcement agencies and administrative agencies (including the FCC) to view the market from both a static and a dynamic perspective.[66] Such an analysis cannot be undertaken in a vacuum, however; public policy officials must also have some policy goal of long-term market structure to make this dynamic approach worthwhile.[67] The problem with the FCC's *EPC* framework is that the Commission's prognostication focuses improperly more on "ephemeral possibilities" rather than true probabilities.[68] Indeed, there is a substantial analytical difference between improperly finding that future market conditions will adequately protect future consumers and properly analyzing the effect of imminent future competition on current market conditions.[69]

Specifically, rather than attempting to use the number of current and likely entrants to calculate supply and demand elasticities, the FCC, in its discretion, simply identifies the particular firms that, in its opinion, will be the most "significant" competitors. Yet, by apparently relying on a firm's brand name or professional reputation rather than its actual abilities, the FCC is essentially opining on which firms it believes will be successful, and which firms that it believes will not. (Indeed, assuming that you were the president of a start-up venture, one shudders to think how your investors and creditors would react when they hear that the FCC, out of nowhere, opines that you are not a "significant" enough competitor.) The dangers of such a flimsy analysis can be found in the events immediately following the FCC's disposition of the Bell Atlantic/NYNEX merger, where two of the FCC's most significantly precluded competitors (AT&T & MCI) announced that they were

[66] *See, e.g., Reorienting Economic Analysis passim*; *The Search for Meaning* at 4-9.

[67] *Id.*

[68] *SBC v. FCC, supra* n. 13, 56 F.3d at 1494 (agency's responsibility in public interest merger analysis is to deal with "probabilities," not "ephemeral possibilities") (citations omitted).

[69] *See Connecticut Department of Public Utility Control v. FCC,* 78 F.3d 842, 850-51 (2d Cir. 1996) ("It is entirely appropriate for the Commission to take into account the present-day impact of future market entry in evaluating whether current market conditions are inadequate to protect consumers.")

delaying short-term entry into local residential because resale was not economically viable.[70]

Thus, the *EPC* framework simply turns the potential competition doctrine on its head.[71] Indeed, it is extremely difficult to discern exactly what specific competitive effects the FCC is actually looking for in its prognostication of future market structure, conduct and performance. For example, under the doctrine of "actual potential competition," it may be appropriate to enjoin a merger when one of the merging parties was *actually* about to enter the market, but for the merger. If this market is already highly concentrated and no other immediate and significant entry is likely, then the merger may be anticompetitive. When an economic analysis comes down to nothing more than cockroach-race betting, however, consumers are the ones to suffer.[72]

Yet, because the *EPC* framework focuses so heavily on subjective prognostication, it does not address squarely whether a "significantly precluded competitor" designation automatically means that a firm has the ability to exert pressure on incumbents to innovate and lower price. Under the doctrine of "perceived" potential competition (or, in non-merger situation, under contestable market theory), it is the contestable effect created by one or more new entrants "waiting in the wings" that exerts downward pressure on incumbent firms to *sua sponte* lower prices or increase services in anticipation of the forthcoming competition. This type of downward pressure was a primary reason behind the FCC's

[70] *See supra* n. 14. While "brand name" recognition is a very important component of a firm's ability to provide "residential" telephone service (*i.e.*, because "residential" service requires potential and existing firms to possess, in addition to a distribution mechanism, the resources and ability to mass market their product), a well-recognized brand-name alone does not a successful business case make.

[71] It would be just as equally arbitrary and capricious if the Commission decided to adopt and apply on a generic basis a bastardized version of the "essential facilities doctrine" or "failing company" defense. Yet, because the *EPC* is more political than substantive, the Commission would probably have been better off it decided to "move beyond" the *Noerr-Pennington* and *Parker v. Brown* doctrines instead.

[72] *Cf.* Separate Statement of Commissioner Harold W. Furchtgott-Roth, *In The Matter of Consent to Transfer Control of Teleport Communications Group, Inc. to AT&T Corp.*, FCC 98-169 (rel. July 23, 1998) (Asking the Majority whether "[u]nder the precluded competitor framework, is [the Commission's] analysis of potential competitors too speculative – especially since we do not seem to require the same type of evidence as the Department of Justice's merger guidelines would require of intent to enter the market by other means?")

recent decisions to pre-empt state regulation of cellular rates, *even though the cellular duopoly was still clearly very much in force*.

In those cases, the FCC reasoned that pre-emption of intra-state cellular rates was warranted because the FCC found that, *inter alia*, although new PCS entrants had yet to roll-out service, their entry was likely and substantial in the short term because they had already committed the substantial sums necessary to win the FCC's spectrum auction and, more significantly, that cellular incumbents were already taking steps (*i.e.*, lowering prices and adopting new technologies) to respond to this imminent PCS competition.[73] As no party produced any specific evidence in either *Bell Atlantic/NYNEX* or *BT/MCI* that indicated whether the incumbent actually *perceived* that because entry by one or more "significantly precluded competitors" would be significant and immediate (regardless of actual ability) that it should preemptively respond by lowering prices or introducing more services, however, the Commission apparently relied improperly more on "ephemeral possibilities" rather than true probabilities in these situations.

The preceding discussion brings us to my second concern: the "pavlovian" return to, and heavy reliance upon, the calculation of HHIs as either the primary indicator of current, or the primary prognosticator of future, market performance. It is very well accepted, both in antitrust jurisprudence and Commission precedent, that market shares are not, in and of themselves, an absolute indication that a market is performing poorly -- rather, a much broader inquiry must be conducted to examine demand and supply elasticities and, in particular, the presence (or lack) of barriers to entry.[74] Exclusive reliance on market shares is even more capricious, however: (a) where the predominant market share was the result of regulation[75]; and especially (2), *where the market boundaries (i.e., LATAs) were never intended to be definitive or (permanent) economic boundaries for purposes of measuring market power*.[76] By arbitrarily constructing, and then heavily relying upon, the pool of significantly

[73] *See, e.g., California Petition to Retain Regulatory Authority Over Intrastate Cellular Service Rates*, FCC 95-195, 10 FCC Rcd 7486 (1995); *Connecticut Department of Public Utility Control v. FCC, supra* n. 25.

[74] *See Reorienting Economic Analysis* at 34 & n. 14 and citations therein.

[75] *Id.*

[76] *Id.* at 33.

precluded competitors to calculate HHIs, the conclusions derived by the Commission are meaningless and, as such, may constitute arbitrary and capricious decision-making.[77]

### F. *Gerrymandering Geographic Market Definitions is an Unacceptable Substitute for Thorough Economic Analysis.*

As a general proposition, while it is crucial to identify first the correct product market when conducting a competitive analysis, defining the relevant "geographic market" is not. By placing inappropriately too much priority on identifying initially the relevant geographic markets, gerrymandering geographic market definitions has now become nothing more than an intellectually lazy way to ensure that pre-determined outcomes can be achieved with a minimum amount of analytical effort.[78] For this reason, when the FCC promulgated its original *Competitive Carrier* paradigm, it refused specifically to first define the relevant markets or consider whether these markets were competitive and regulate them accordingly. Rather, the FCC examined certain characteristics of the participants in these markets and established two distinct sets of rules to regulate the firms which, based on the FCC's assessment of these characteristics, had or lacked the ability and incentive to impede competition.[79] This analytical caveat is even more important to day.

Shortly after the 1996 Act was enacted, I warned that it is extremely important to avoid the use of overly narrow or broad market definitions when analyzing the structure of telecommunications markets, because the convergence of technologies makes "traditional" telecommunications

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77 *Cf., U.S. v. Baker Hughes, Inc.*, 908 F.2d 981 (D.C. Cir. 1990) (Thomas, J.), where the D.C. Circuit rejected an almost identical HHI-based analysis used by the DOJ to enjoin a merger. Moreover, given the fact that the FCC relied on "confidential data" to calculate its HHIs, the FCC's analysis also opens the Commission to a strong charge that it failed to show the "why's and wherefores" of its conclusions. *See, e.g., City of Holyoke Gas & Electric Dept. v. FERC,* 954 F.2d 740, 743 (D.C. Cir. 1992) ("Since it is already doing the relevant calculation, it is a small matter to abide by the injunction of the arithmetic teacher: Show your work! For the Commission to do less deprives the [consumer] of a rational explanation of its decision.").

78 *See generally*, Franklin M. Fisher, *et al.*, FOLDED, SPINDLED AND MUTILATED: ECONOMIC ANALYSIS AND U.S. V. IBM (MIT Press 1983).

79 See Scott M. Schoenwald, *Regulating Competition in the Interexchange Market Telecommunications Market: The Dominant/Non-Dominant Carrier Approach and the Evolution of Forbearance*, 49 F. COM. L.J. 367, 375-77 (1997).

market definitions increasingly irrelevant. For example, it makes no sense to discuss a single "cable" or similar technology market, when cable actually competes with broadcast television, direct broadcast satellite systems, MMDS systems, and the like.[80] Indeed, to argue that a telephone company has a monopoly over an "open video system" ("OVS") or a cable company has a monopoly over "cable" programming in a relevant market, is like saying that Hostess has a monopoly over Wonder-Bread -- despite the fact that consumers view a variety of breads as acceptable substitutes.[81]

Similarly, as alluded to above, it is becoming increasingly questionable to define a homogeneous "long-distance" or "local" telephone market. Indeed, it makes little sense to consider separate "long-distance" or "local" markets with the imminent re-integration of the long-distance and local business as permitted by the new *1996 Act*. *See* 47 U.S.C. § 271. This distinction becomes even more obtuse now that companies are beginning to bundle additional telecommunications or information products and services into a single package, such as wireless service, paging, Internet access, video or even alarm monitoring.[82]

Accordingly, with this increasing convergence of telecommunications services and products into a variety of bundled offerings, the boundaries created by the MFJ increasingly reflect a dated economic picture of the market. When the MFJ was implemented, the various parties agreed to create "local access and transport areas" or "LATAs." Although these lines were completely arbitrary, the LATAs were a convenient way to delineate the respective service areas of the BOCs. The creation of these boundaries under the MFJ therefore argued for three distinct economic markets: (1) local; (2) intra-LATA toll; and (3) inter-LATA or "long-distance" service. However, while these boundaries may have made sense at the actual time of divestiture, it is important to realize that *the LATA boundaries were never intended to be definitive (or permanent) economic boundaries for purposes of measuring market power.* Accordingly, given the radical changes set in motion by the *1996 Act,* continuing to use the MFJ

80. *See Time Warner, Turner Seek Peace with FTC While Girding for War*, WALL STREET JOURNAL, June 27, 1976, (reporting that parties object to narrow "cable" market definitions).

81 *Reorienting Economic Analysis* at 33 and citations therein.

82 *Id*.

approach will not be able to reflect accurately a market where firms offer "one-stop shopping" for a variety of telecommunications services.[83]

For example, most consumers appear to take a more simplistic approach towards telephone service. To them, there is the local (fixed-charge) call (near) and the more expensive (per minutes of usage) long-distance toll call (far). In their minds, there is no significant difference between an *intra*-LATA toll call and an *inter*-LATA toll call -- they are *both* toll calls. Accordingly, the fact that consumers tend to view both toll calls as one product, rather than distinct services, argues against the automatic use of LATA boundaries as appropriate market definitions for antitrust or regulatory purposes. Similarly, the increasing use of wireless service also argues against the use of LATAs as appropriate market definitions. Wireless service, by definition, can extend beyond artificial LATA boundaries. Thus, if wireless service eventually replaces, or at minimum is viewed as a close substitute for, wired local service, then LATA lines again will not accurately reflect the actual economic boundaries of the market.[84]

Notwithstanding the above, the FCC decided to use LATAs as relevant economic geographic boundaries for purposes of analysis in its disposition of the Bell Atlantic/NYNEX merger. What is particularly incredulous, however, is that the FCC rationally believed that it could analyze a merger that would create a single firm with dominant control over the entire East Coast of America from Maine to Virginia (a footprint that -- according to Bell Atlantic Chairman Ray Smith's own admission -- is worth "$20 billion" alone[85]) by defining exclusively the geographic market as LATA 132 -- *i.e.*, the New York Metropolitan Area.[86] Accordingly, as a life-time resident of Washington, D.C., let me take this brief opportunity to thank personally the FCC for assuming that me and my neighbors -- along with the other good citizens of Washington, Boston and Philadelphia -- for looking out for our interests as well.[87]

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83 *Id.*

84. *Id.* at 33-34.

85 *See* CNN Moneyline With Lou Dobbs (Oct. 7, 1997, Tues. 18:00 EST).

86 *See BA/NYNEX* at ¶¶ 55-57.

87 Funny, I though that the law is pretty clear on this point: The "public interest" may not be used to benefit a particular individual or group; rather, an agency's actions (continued ...)

Similarly, the fact that the FCC held that the relative market was limited to LATA 132 cannot substitute for its failure to examine -- much less even mention in a footnote -- the proposed merger's effect on international IMTS traffic, especially as the merged entity would control five of the largest origination and termination markets for U.S. IMTS traffic (Boston, New York, Philadelphia, Baltimore and Washington).[88] Again, it was most disconcerting to see Ray Smith, smiling like the cat who just ate the canary, proclaim proudly on CNN the very night the FCC approved the merger that the merged company "*accounts for 50 percent of all the European international traffic*" originating and terminating in the U.S.[89] Considering the sheer size of this number alone it would seem, therefore, that it would have been quite appropriate -- and indeed very important -- for the Commission to have considered these issues as part of its analysis.[90]

### G. *Merger Review Should Focus on Whether a Transaction Will Permit the Merged Entity to Raise Prices or Restrict Output -- Not to Advance Improperly "Neo-Mercantilist" Agendas.*

As I explained in earlier writings, with the growing influence of the "neo-competition" school, trade considerations are now increasingly becoming legitimate concerns in both antitrust and public interest

must be consistent with the interest of "the public" *as a whole*. *See, e.g., Northeast Utilities Service Co. v. FERC,* 993 F.2d 937, 951 (1st Cir. 1993).

88 *See* the *First Edition* at 22-23 for an explanation of how increased concentration could affect adversely the performance of the market for international telecommunications products and services.

89 *See* CNN Moneyline With Lou Dobbs (Oct. 7, 1997, Tues. 18:00 EST).

90 Given SBC's and (especially) Ameritech's substantial international investments, we can only hope that the FCC does not make the same mistake twice. *See Enlarging Already Big Holdings in Europe,* NY TIMES (May 12, 1998) at D11 ("*Ameritech has taken big stakes in European state-run monopoly or dominant telecommunications companies as they are sold to the public*. It has a $3.1 billion, or 42 percent share of Tele Danmark; a $865 million or 17.5 percent stake in Belgacom; 29 percent of Matav in Hungary; a 20 percent stake in Netcom, a Norwegian mobile phone company . . . and has a recent agreement with France Telecom that permits the two companies to handle each other's long-distance traffic." SBC has a 15 percent stake in FT's "main competitor, Cegetel", and "holds a stake in Diax in Switzerland and a 10 percent stake in Telewest Communications of Britain." (Emphasis supplied.)

economic analysis.[91] The problem with this approach, however, is that Adam Smith demonstrated powerfully over 200 years ago in his classic treatise *The Wealth of Nations* that whenever government attempts to coordinate the efforts of entrepreneurs, such policies almost invariably discourage economic growth and reduce economic well-being.[92] Because Smith called this system "mercantilism,"[93] I figured it was appropriate to describe current policies as "neo-mercantilism."[94] Indeed, after providing several examples of how trade concerns increasingly became an acceptable factor in antitrust and public interest lexicon, I questioned why not one proponent of the "neo-competition" school had bothered to demonstrate what economic conditions have actually changed since Smith was alive that would merit a departure from his work.[95]

The FCC's approach to foreign investment into U.S. telecommunications markets is no exception to this rule.[96] Indeed, contrast the FCC's disposition of Bell Atlantic / NYNEX (*i.e.*, attempting to

[91] *See* Catherine Yang, *Commentary: When Protectionalism Wears Camouflage,* Business Week, June 2, 1997, at 60.

[92] *See* Paul Magnusson, *Getting a Grip on Trade Sanctions,* Business Week, Nov. 17, 1997, at 115. Magnusson reports that in the past four years, President Clinton has signed 62 laws and executive actions targeting 35 countries. These numbers account "for more than *half* the sanctions imposed [by the U.S.] *in the past 80 years.*" Moreover, Magnusson reported that the direct cost to U.S. exporters in lost sales in 1995 alone was as high as $20 billion, an estimated 250,000 U.S. jobs disappeared and "*no one can measure the damage to relations with angry allies.*" (Emphasis supplied.)

[93] *See* James C. Miller et al., *Industrial Policy: Reindustrialization Through Competition or Coordinated Action?* 2 Yale J. on Reg. 1, 5 (1984). According to Adam Smith, mercantilism "retards, instead of accelerating, the progress of the society towards real wealth and greatness; and diminishes, instead of increasing, the real value of the annual produce of its land and labour" because of two basic reasons: a tendency of special interests to turn government programs to their own narrow advantages, and a tendency of joint business efforts to result in collusion to reduce output and raise prices, especially when government willingly permits such collusion. As such, although "the law cannot hinder people of the same trade from sometimes assembling together, it ought to do nothing to facilitate such assemblies; much less to render them necessary." (Citations omitted.) It would seem, therefore, that "FCC" should not stand for "Facilitating Cartels and Collusion."

[94] *Id.* (doctrine of "neo-mercantilism" can be characterized as the principle that "in a world of monopolies, the nation with the biggest and strongest industries and firms can reign supreme and recoup for the mother country the supra-competitive profits earned from abroad").

[95] *See The Search for Meaning* at 15-16.

[96] *See From International Competitive Carrier to the WTO, supra* n.

make the uneconomically justifiable merger "thinkable") with the Commission's disposition of the proposed (and subsequently aborted) merger between BT and MCI (*i.e.*, attempting to make the politically unthinkable merger "thinkable"). In that case, even though the record clearly revealed that the competitive conditions had improved dramatically since the time of BT's original investment in MCI (including, among other things, the adoption of the February 1997 WTO Accord and the fact that the UK enjoyed effective competition for local loop facilities[97]), the FCC decided to impose *more* regulation than it did in *BT/MCI I* in order to advance naked mercantile trade concerns.[98] Moreover, and certainly not least on the FCC's collective mind, because the 8th Circuit Court of Appeals struck-down viscously the FCC's much-hyped interconnection rules,[99] the FCC was under substantial political pressure to make it look like they were doing something to "enhance competition."

As such, the FCC in essence decided not to attack the potential anticompetitive harms resulting from the merger, but rather to attack the British government's refusal to adopt a regulatory regime identical to one adopted in the United States, rather than any particular harm specifically created by the merger. To wit, even though the FCC conceded that BT faced increasing competition in this market[100] and that U.K. originating access services were subject to many of same regulatory constraints as those described for terminating access services (*e.g.*, price caps and various license conditions regarding non-discriminatory behavior),

> Other U.K. regulatory policies, however, undermine these constraints and allow BT to leverage its market power over

[97] Indeed, just three months after the FCC issued its order in *BT/MCI III*, the European Commission issued a public report finding that "effective local loop competition currently only takes place in three Member States" – one of which is the United Kingdom. *See Commission Communication Concerning the Review Under Competition Rules of the Joint Provision of Telecommunications and Cable TV Networks by a Single Operator and the Abolition of Restrictions on the Provision of Cable TV Capacity over Telecommunications Networks* (European Commission, Brussels 1998); *see also* Guatam Naik, *UK Telecom Deregulation Delivers Nice Surprise: Jobs,* New York Times (March 5, 1998).

[98] *See First Edition passim.*

[99] *See Iowa Utilities Bd., supra* n. 27.

[100] *BT/MCI* at ¶ 181.

> originating access market [*sic*] into the markets for end-user services that depend on originating access (*e.g.*, U.K. domestic and international services). [T]hese policies include the decision not to require BT to provide equal access to other long distance carriers, to provide unbundled local network elements to other carriers, and to resell local service at wholesale prices. Alternatives to BT's local network may grow in time and eventually constrain BT's control of originating access services, but they do not significantly do so at this time. *In fact, the absence of equal access, unbundled local exchange network elements, and resale in the United Kingdom appears to create the conditions by which BT's market power over U.K. domestic and international services will be perpetuated.*[101]

Not to stop there, however, the FCC was equally as dismayed with the UK's choice not to require incumbent LECs to provide unbundled local exchange network elements and resale as US ILECs are required to do under the Telecommunications Act of 1996. Once again, the UK Government disagreed that "line-side" unbundling was necessary or appropriate in the United Kingdom because, in its view, the cost advantages of line-side unbundling would be small in the United Kingdom because prices are in line with costs, interconnection charges are to be based on long-run incremental costs, and access deficit charges have been abolished. The U.K. Government also claimed that making BT unbundle its local exchange network elements would be unlikely to promote local competition but would instead jeopardize the development of facilities-based local competition now underway.[102]

Accordingly, even though the WTO Agreement was signed over seven months prior to this order, because the FCC had yet to adopt final rules that implemented the WTO Basic Telecom Agreement, it stated that it was obligated to examine BT's entry as a foreign carrier into the U.S. market under its *ECO* test. Because the Commission had previously found that BT did possess market power in its home market, but that the UK market nonetheless provided US carriers with effective competitive

[101] *Id.* at ¶ 182 (emphasis supplied).

[102] *Id.* at ¶¶ 192-94.

opportunities, the FCC decided to regulate the merged entity as a dominant carrier.[103]

Despite this fiery neo-mercantilist rhetoric, the FCC, after blasting another sovereign government, in the end decided to waive *sua sponte* the application of its then-current dominant carrier requirements to MCI pending the effective date of any new rules it might adopt in the *Foreign Participation* proceeding.[104] In the FCC's opinion, not only would it be unduly burdensome (and therefore not in the public interest) but denying the merger could harm competition in the "market for global seamless service." Yet, even though this "market" might have a very impressive-sounding name, it is extremely important for readers to understand exactly the characteristics of this so-called market the FCC is referring to. Basically, the purported "market" for global seamless service is essentially nothing more than a sophisticated marketing ploy by large carriers of IMTS traffic to attract and retain the 2,000 largest users of IMTS products and services. As such, one must therefore ask why exactly is the FCC suddenly so concerned about protecting the largest business customers (who the FCC already found on numerous occasions to be quite capable of fending for themselves (*see, e.g., Bell Atlantic/Nynex Merger Order*), instead of the all other consumers?[105] Perhaps a good place for the FCC to start would be for it to fulfill the letter and spirit of the US's own WTO regulatory commitments, rather than accuse other sovereign countries of

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[103] *In re BT North America, Inc.*, 13 FCC Rcd 5992, DA 97-2071 (IB rel. Sept. 25, 1997).

[104] *BT/MCI* at ¶¶ 286-89. In a small gesture of international comity, however, the Commission recognized "OFTEL's active role in the United Kingdom in protecting against abuse of market power by BT." This gesture completed, the FCC went on to state that it did not believe that OFTEL's regulation of BT alone was sufficient to justify regulating MCI as non-dominant on the U.S.-U.K. route. In the FCC's view, "[u]naffiliated U.S. competitors of BT/MCI who must rely on BT in order to terminate traffic in the United Kingdom should be able to rely on our enforcement process to address complaints of discrimination." *Id.* at 288

[105] Tragically, in the end, all of this effort – both public and private sector – that was put into resolving this case, all came for naught. After MCI announced that it lost over $ 800 million in its efforts to enter the U.S. local market, coupled with all of the events chronicled above, BT was looking for an excuse to get out of the deal. As fate would have it, Bernie Ebbers of WorldCom gave BT that excuse by counter-offering $ 34.5 billion (and, not uncoincidentally, providing BT with a $1.2 billion profit on their original investment made in *BT/MCI I*). *See* Peter Elstrom *et al.*, *The New World Order*, BUSINESS WEEK (Oct. 13, 1997) at 26-33.

regulatory failure when they have actually achieved tangible facilities-based competition.

The final epitaph to this regulatory passion play came just this week, when AT&T announced that it plans to enter a $10 billion joint venture with British Telecom that will, of course, "enable BT and AT&T to deliver in a unique and powerful way the seamless global services [its] customers need and want."[106] Given the record developed in the BT/MCI proceeding, this deal should go through for the same reasons the BT/MCI deal should have (but unfortunately did not) go through — *i.e.*, the U.S. firm is a non-dominant carrier (indeed, AT&T controls neither any bottleneck facilities (domestic or abroad) and has even sold its submarine cable repair division); there is effective and tangible local loop competition in the UK (a point that even the EC has stated this publicly); new under sea capacity continues to come on line (e.g. FLAG); and, of course, the near international commitment to adopt the WTO Regulatory Reference paper. What is particularly interesting/humorous about this proposed Joint Venture with BT, however, is that AT&T was one of the most vociferous opponents of the proposed BT/MCI deal, and was the primary motivating force behind the FCC's decision to insert that fiery, neo-mercantilist rhetoric in the BT/MCI Order referenced above. Accordingly, while this merger does not appear to raise any competitive concerns and market conditions clearly have not changed dramatically over the past year, my only question to AT&T is: "were you lying then, or are you lying now?"

### H. *By Focusing on "Press Release Hyperbole," the Commission Fails to Ask the Real Questions At Hand Regarding of How a Proposed Merger will Affect Long-Term Market Structure.*

As stated above, what is perhaps the most disappointing about the FCC's laudable attempts to bring increased vigor to its merger reviews is that any analytical improvements are simply lost in the morass of political, economic-type rhetoric. Indeed, while the purported rational for the construction of the *EPC* "framework" was a need to create an analysis to help provide the Commission with a mechanism to manage the "transition" from monopoly to competitive markets, the FCC consistently refuses to articulate specifically what exactly the underlying *structure* of this competitive market should be, even when Congress (in

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106 *See* Associated Press, *British Telecom, AT&T Form Alliance*, (July 27, 1998 filed 10:07 am EDT).

the domestic context), and the WTO (in the IMTS context), provided clear guidelines as to what kind of long-term market structure they wished to create. By failing to articulate a clear vision of long-term industry structure and performance (aside from apparently satisfying consumers' alleged desire for "one-stop-shopping" from a few dominant, vertically-integrated firms and the wiring of the schools of America), therefore, this so-called "transition period" to competition may be a very long time to endure.[107] If, however, the FCC had adopted a more analytically honest and straight-forward merger analysis, then the Commission's underlying rationales -- and its policy concerns and objectives -- would have been far more persuasive.

To wit, the Commission stated that under the *EPC* doctrine:

> In demonstrating that the merger will enhance competition, applicants carry the burden of showing that the proposed merger would not eliminate potentially significant sources of the competition that the Communications Act, particularly as amended by the Telecommunications Act of 1996, sought to create. When facing a changing regulatory environment that reduces barriers to entry, firms that would otherwise compete directly may, as one possible strategic response, seek to cooperate through merger.[108]

This is an excellent point. The problem is that the FCC has never followed through with it.

Take for example the facts of *Bell Atlantic/NYNEX*. Low and behold, the Commission actually found documents showing that, among other things, Bell Atlantic ceased its planning to enter NYNEX territories during the pendency of merger discussions. Presented with such evidence, the Commission was then able to conclude that: (a) yes, Bell Atlantic did in fact plan to enter LATA 132 and other NYNEX territories; and therefore, (b) that Bell Atlantic would have been a competitor to NYNEX but for the proposed merger; and therefore (c) the proposed merger would *a fortiori* eliminate Bell Atlantic as a likely significant independent competitor in the market to provide local exchange and exchange access services, and bundled local exchange, exchange access and long distance services, to residential and smaller business customers particularly in, but certainly not limited to, LATA 132 and the New York

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107 *The Search for Meaning* at 4.

108 *Bell Atlantic/NYNEX* at ¶ 3.

metropolitan area (including northern New Jersey).[109] As this situation is a classic case of where the "actual potential competition" doctrine would argue for disapproving a merger (*e.g.*, very concentrated market, high barriers to entry, no other significant entry likely in short-term), there was nothing else for the Commission to say. The Commission, therefore, had no business attempting to prognosticate arbitrarily about the likelihood of success or failure of other market participants' business plans.

## V. Conclusion

The preceding analysis is not meant to suggest in any way that the Commission should not review major telecommunications industry transactions, or that when it does, it lacks a persuasive story to tell about how and why it should approach mergers post-1996 Act. Quite to the contrary, given its broad and important responsibilities, there are actually numerous legitimate reasons very the FCC should play a significant role. Where the problem arises is that the FCC is guilty of simple regulatory failure. Indeed, not only has the FCC failed to articulate, or convey, clearly this story to date, but that it has failed altogether to fulfill its public interest mandate under the Communications Act to protect and maximize overall consumer welfare.[110]

It is well-accepted (and indeed by now hopefully obvious) that telecommunications markets are characterized by rapid change and innovation and, as such, policy initiatives must undertake both a static and a dynamic analysis of current and likely market structure and performance.[111] Logically, therefore, in these situations, as any attempt of prognostication will be tricky at best, it would stand to reason that the most effective analytical approach would not be to "guestimate" about future market conditions that are impossible to foresee accurately, but to focus specifically on those easily identifiable current structural conditions that will impact directly and substantially on future market structure, conduct and performance.

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109 *Id.* at ¶ 8.

110 *See The Search for Meaning passim*.

111 Walter G. Bolter *et al.*, TELECOMMUNICATIONS POLICY FOR THE 1980'S: THE TRANSITION TO COMPETITION 360 (Prentice Hall 1984); *Reorienting Economic Analysis* at 32.

Like it or not, Congress (in the domestic context), and the WTO (in the IMTS context) each have provided clear guidelines as to what kind of long-term market structure the world wants to create; whether or not these structural parameters are actually capable of producing rivalrous competition, unfortunately, is a completely other matter and, moreover, is moot question at this point.[112] It is the FCC's job, therefore, to attempt to promote the best market performance possible under these instructions -- no matter how economically or legally difficult this task may turn out to be. The problem, however, is that while the purported rationale for the construction of the *EPC* "framework" was a need to create an analysis to help provide the Commission with a mechanism to manage the "transition" from monopoly to competitive markets, the FCC consistently refuses to articulate specifically what the long-term *structure* of this "competitive" market should be -- even when Congress (in the domestic context), and the WTO (in the IMTS context) provided clear guidelines as to what kind of long-term market structure they wished to create.

What I take from this experience is the growing belief that most people simply do not understand that "competition" is just a form of conduct (in fact, the dictionary defines "competition" as the "act of competing"). Any evaluation of "competition" is worthless, however, without an analysis of *structure*, because structure will determine *conduct* (*i.e.*, whether firms can engage successfully in strategic, anticompetitive unilateral or coordinated conduct).[113] If this competition is rivalrous, then the market will produce good performance. When this performance is achieved, regulators are supposed to go home. Stated another way, different market structures induce different types of rivalrous conduct. As such, unless the Commission articulates an explicit model of long-term industry organization within these parameters, it will be extremely difficult for the Commission to evaluate the success of its efforts to "promote competition." Only by spelling out specifically such a view can the Commission know when market performance is satisfactory enough to justify the eventual elimination of its regulatory intervention.

Accordingly, if we are truly serious about "de-regulation," then, using the 1996 Act's and WTO's instructional guideposts, the Commission needs to formulate, articulate and implement policy paradigms designed to establish, to the extent practicable, a market

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[112] *First Edition passim*.

[113] *Id.* at 20-23; *The Search for Meaning* at 8.

structure with a foundation conducive to competitive rivalry, under which firms will be unable to engage in strategic anticompetitive conduct -- even if they tried.[114] The FCC will preferably achieve this goal by developing and implementing pro-competitive policies; if it cannot, then it is required to approximate such performance by imposing price, conduct and structural regulation. Under any circumstance, however, what the Commission may not do is create, and perpetually rely upon, a hybrid of "managed competition" -- *i.e.*, regulation that "mimics" competition. This is because

> economic regulation is supposed to be a *substitute for*, and *not a complement of*, competitive rivalry. It is not, contrary to popular belief, "*because we can*." In other words, economic regulation is only appropriate where one or more firms are capable of successfully exercising market power (charging monopoly prices or restricting output) for a sustained period of time, and additional entry is unlikely.[115]

Yet, because the Commission relies so heavily on "voluntary" commitments that benefit competitors in its *EPC* framework, it appears that the *EPC* framework is deliberately designed to create improperly such a hybrid market structure. In doing so, consumer welfare is not

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[114] *See generally*, *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209, *reh'g denied*, 509 U.S. 940 (1993); *A.A. Poultry Farms, Inc. v. Rose Acre Farms, Inc.*, 881 F.2d 1396, 1401 (7th Cir. 1989) ("Market structure offers a way to cut the inquiry [of potential, anticompetitive strategic vertical conduct] off at the pass . . . ."); *see also* F.M. Scherer and David Ross, INDUSTRIAL MARKET STRUCTURE AND ECONOMIC PERFORMANCE (3rd Ed. 1990) at 5 (Despite antitrust's focus on structural measures such as the HHI, economic concentration is only one aspect of market structure. Other relevant features of market structure include product differentiation, barriers to entry, cost structures, vertical integration, and diversification.) To illustrate this point, take, for example, the restaurant market in New York City. This market is performing well. It is characterized by high elasticities of supply and demand, ease of entry, stable prices and a variety of choices (*i.e.*, product differentiation). Thus, if a restaurant operates inefficiently (*i.e.*, it charges high prices for bad food and poor service), then it will not be able to sustain itself in the market. Conversely, if this same restaurant instead attempts to price below cost to gain market share under this structure, then this firm will be forced to subsidize this pricing from its finite profits or cash reserves. Moreover, even if this single restaurant could drive out some of its rivals, new entry would occur if prices increased. Once again, it is therefore highly unlikely that this firm will be able to sufficiently sustain this practice and drive its rivals' out before it runs out of cash reserves. To the contrary, it should be this inefficient firm – and not its rivals – which should be forced to exit the market. *See The Search for Meaning* at n. 35.

[115] *See id.* at 7-8.

enhanced, only harmed. Rather, all the Commission achieves in reality with such a neo-competitive framework is giving those "less-significantly precluded competitors" that are lower in the entrance queue an opportunity to "butt-in" via enhanced resale commitments by the incumbents before they are really ready to enter on a facilities basis. As noted above, however, not only is it very expensive and wasteful to maintain such "artificial" entry for a significant period of time, but that such artificial entry cannot, in the long-run, be sustained at all.

This is not to say that I have a *per se* hatred against resale, for I do not. What I do believe is that resale has its proper place, but using improperly resale as the permanent cornerstone for restructuring a major industrial sectors of our economy simply is not this place. For example, resale, when placed in proper context, is often a sign of a market with robust performance -- e.g., it prevents otherwise unused resources from going wasted, it places competitive pressure on facilities-based competitors from the fringe, and can provide consumer with non-price product differentiation as well. On the other hand, however, because a number of economic factors make a strict resale model simply unsustainable over a significant period of time, it is therefore highly doubtful that such an approach could contribute anything positive to overall consumer welfare.[116] To wit, from a public-policy point of view, so long as demand continues to increase, then there is really no such thing (just as being "too rich" or "too thin") as having enough excess (*i.e.*, elastic) capacity. This is because if capacity is in short supply (*i.e.*, constrained), then the owner of the constrained facility will likely have the incentive to engage in some kind of strategic, anticompetitive conduct against other potential new entrants in order to protect its sunk investment. On the other hand, if supply is elastic (*i.e.*, it is very easy to obtain capacity from other sources), then the owner of the facility will

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116 Once again to help neophytes conceptualize the consequences of a strict "resale" approach, pretend that you are about to throw a party, and you need quite of bit of ice for your guests. For some reason, the only available source for ice is your freezer. In this freezer, you have one of those old metal ice trays, with what looks like an extended tic-tack-toe game or grid with a handle attached to it to help form individual cubes. The problem, however, is that regardless of whether you decide to use the tray with or without the separator, under the laws of physics (and, *a fortiori*, the laws of economics,) the total volume of the tray will still only produce a certain amount of ice for your guests – even though more people show up to the party than originally expected and the liquor store only had warm beer for sale. Moreover, by violently cracking the ice, one often ends up with useless small shards of ice on the counter-top that melt before they can be used successfully – in other words, a dead-weight efficiency loss.

instead have the incentive to *compete* in order to ensure full utilization of its facilities.[117]

Accordingly, as I have argued elsewhere, because consumers consider, *inter alia*, cheap and reliable telephone and video service as an American birthright, if consumers perceive a sufficient diminution in quality or increase and price, then they will demand swift and demonstrable action. When the cacophony of consumer outrage becomes sufficiently loud (and it always does), then there is a distinct and strong possibility that Congress will instantaneously blame, and pressure heavily, the Commission.[118] Yet, because of the large sunk costs required for new entry, additional new capacity cannot come on line to relieve constrained facilities whenever politicians want them. These projects are both very time and capital intensive. Thus, without forward-looking policies designed to promote and encourage tangible, facilities-based entry, as demand expands and supply stays constant (or, in some cases, shifts in as outdated facilities go off line and are not replaced), consumers may very well experience an increase in price and a diminution in choices or quality of services, rather than the opposite result which they were originally promised and fully expect to realize. When this happens, the lives of everyone involved with the process -- politicians, industry, and especially consumers -- become just a little bit more miserable.[119]

Yet, incredulous as it may seem, the uninitiated often still have a difficult time believing -- especially given the huge amount of "pro-competitive" rhetorical promises made by politicians about their allegedly "pro-consumer" policies -- that "neo-competition" is actually the end goal. Well, believe it. The FCC has had two years to develop paradigms designed to promote and accelerate facilities-based entry and carry out their mandate to maximize consumer welfare.[120] Rather than focus

117 *See Reorienting Economic Analysis* at 35.

118 To paraphrase Bill Cosby, "politicians aren't interested in justice, politicians are interested in *silence*" – *i.e.*, happy and content constituents. Indeed, this maxim is one of the most compelling proofs of why the "reasonable mother" test really works.

119 *The Search For Meaning* at 22-23.

120 As with all things political, two years is often the extent of the honeymoon or "grace period" a regulatory agency may have to produce tangible "pro-competitive" results – even from poorly-crafted legislation. If this honeymoon is squandered, legislators become quite upset (mainly because they had to put off their "paying" constituents to look good before their "voting" constituents). Indeed, look at the case of the Cable Television Consumer Protection Act of 1992 – one of the most poorly drafted

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appropriately on this task, however, the empirical evidence demonstrates that the FCC has been more interested -- not in maximizing overall consumer welfare -- in obtaining only the "appearance" of competition (i.e., a "trophy") to divert public attention from their real goal -- implementing the Clinton / Gore Administration's pet political agenda of wiring the schools of America via improper taxation by telecommunications regulation.[121] In my opinion, the fact that American

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statutes in recent memory. Because the FCC failed to achieve the purported goals of that statute (*i.e.*, lower cable rates) – mainly because, among other things, former FCC Chairman Reed Hundt appointed staff (*i.e.*, political cronies) who had absolutely no telecom experience (cable or otherwise) and promulgated rules that produced economic costs that far exceeded any conceivable public interest benefit – Congress decided to eviscerate, in substantial part, the rate provisions contained in the 1992 Cable Act in the 1996 Telecommunications Act. *See* 47 U.S.C. § 623 (c)(4).

In the context of the 1996 Telecommunications Act, Congress expected competition to flourish through a seemingly simple process – the BOCs would be permitted into the long-distance market in exchange for opening up their local monopolies. As explained *supra*, however, because the FCC has opted to promote "trophy" competition and children instead of encouraging or facilitating tangible, facilities-based entry for the past two years, it is unclear how much longer politicians can keep their "paying" constituents (i.e., the ILECs) at bay before the 271 "levy" breaks – regardless of whether there is sufficient rivalry to mitigate the likely competitive harms from "pre-mature" vertical re-integration.

[121] Indeed, in a clever bit of political "chutzpah," when asked about the possible competitive implications of the proposed SBC / Ameritech merger, former FCC Chairman Reed Hundt remarked simply that the merging parties are "asking the Government the following question: How many telephone companies is the smallest number you can accept." *Telephone Giant: Putting Back the Bell System*, NY TIMES (May 12, 1998) at A1, D10. Given Mr. Hundt's, his boyhood best-friend's (Al Gore), and his hand-picked successor's (Bill Kennard) less-than-stellar pro-consumer policy track record for telecoms and related services, however, it appears that so long as Messrs. Hundt, Gore (see 12 June 1998 Statement of Vice President Gore (I will fight vigorously "efforts by those who *would turn out the lights on our children* by pulling the plug on the E-rate . . . My commitment *to preparing our children for the 21st century* will not end until *every child* in every classroom and library in America can tap into the Internet. . . . *We will fight to protect our children's future* and oppose any effort by congress to eliminate or delay the goal of *expanding the educational horizons of our children*." (emphasis supplied)) and Kennard (*see, e.g.*, 5 June 1998 Statement of FCC Chairman William E. Kennard ("America's children, especially low income and rural children, need access to today's technology if they are to compete in tomorrow's workforce. . . . ending this effort is not in the best interest of the American public.") and Co. can ensure that all of the Children of the World (and, in particular, every American child) can sing together in the spirit of harmony and peace, the answer evidently is just "one." After the Bell Atlantic / GTE merger was announced, however, Mr. Hundt quickly changed his answer to "three," now arguing that it is actually possible to (continued ...)

consumers should pay for monopoly rents and decreased innovation with the sweat of their brows so that only the children of America can cross-over the bridge to the 21st Century -- adults may not cross this bridge because, like the initial group of the Children of Israel set free by Pharaoh from Egypt-land, they are not fully true believers in the master plan -- is obscene.[122]

If you think I am kidding about this "neo-competition" approach, I am not. Take for example a recent "regulatory Freudian-slip" uttered accidentally by the FCC's new Chairman, Bill Kennard. This "slip" was uttered recently while Mr. Kennard was speaking before a wireless industry trade association, where he was attempting to convey the point that competition and innovation can better the lives of people around the world. According to Mr. Kennard,

> I want to start by telling you about somebody from the tiny village of Bora in Bangladesh. Her name is Noa Jahan Begum. And if you walked up to her house now, you'd see twenty or thirty -- or fifty -- people. They're her customers. Some sit in her house, on chairs if they get there early enough. Others sit on the floor. The rest are lined up outside. And this goes on every day. Why? What's happened to transform a woman who had no work nine months ago into an entrepreneurial success story? She got a loan from Gramin Bank -- and bought a cell phone. Noa Begum lives only 20 miles from Daka, the capital of Bangladesh. Still, most of her neighbors have never

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have *more* competition with *fewer* players in the market. *See* Sandberg and Lipin, *supra* n. 61 (According to Mr. Hundt, the spate of recent consolidations (in particular, AT&T/TCI; Ameritech/SBC and Bell Atlantic/GTE) "would mean a triumvirate of telecom giants is likely to emerge, *resulting in more competition.*") (Emphasis supplied.)

122 On a similar note, consumer welfare should also not be sacrificed to pander to union/organized labor interests. *See, e.g.*, Aron Bernstein, *More Telecom Mergers, More Union Cards*, BUSINESS WEEK (May 25, 1998) at 38 (Reporting that the Communications Workers of America thinks it can use mega-telecom industry mergers "to its benefit – because companies now need labor support and labor peace to complete deals."); *but cf.*, NAACP v. FPC, 425 U.S. 662, 669-70 & n. 7 (1976) (employee job concerns do not fall within the scope of an agency's "public interest" inquiry to ensure "just and reasonable rates", because "the use of the words 'public interest' in a regulatory statute is not a broad license to promote the general public welfare." Only when the statute provides specific language ordering the administrative agency (*e.g.*, the FCC's "obligation under the Communications Act of 1934, 48 Stat. 1064, as amended, 47 U.S.C. s 151 *et seq.*, to ensure that its licensees' programming fairly reflects the tastes and viewpoints of minority groups") may an agency lawfully do so.)

> even seen a phone -- or a light bulb for that matter. To get a message to relatives in Daka they would walk. To call a relative, say, in New York City, they'd go to the city -- then wait days for a pay phone. Because to the rural poor, your technology has become a sure way to a better life. These new wireless phones give isolated people a link to the rest of the world. They help them in the most urgent ways.[123]

On its face, this is a very moving anecdote. While the concept that competition and innovation can better the lives of people around the world is certainly true, a close look at the preceding quote reveals that promoting competition and choice is not actually the true message that Mr. Kennard actually conveyed. Indeed, a careful look at the hypothetical reveals that Ms. Begum is clearly the exclusive monopolist for telephone service in the tiny village of Bora and, therefore, she clearly has the ability to charge consumers whatever she likes (as demonstrated by the throngs of people loitering around her house all day, hoping for a free chair). Ms. Begum gets rich, but the rest of the village continues to live in squalor. Of course, if Bangladesh had the current U.S. universal service system in place, then Ms. Begum would be able to both continue to receive monopoly rents and provide service at below-cost prices because she would receive substantial subsidies (*i.e.*, expropriated) from consumers in Daka and from anyone who terminates an international call in Bangladesh originated from anywhere else in the world.[124]

Accordingly, rather than dedicating its efforts to achieving the "appearance" of competition, the appropriate focus of the Commission's efforts should be on both: (a) accelerating the decline of the entry-barrier slope over time -- *i.e.*, reducing regulatory costs, effective enforcement,

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[123] Remarks by William E. Kennard, Chairman, Federal Communications Commission to WIRELESS 98, Atlanta, Ga. (February 23, 1998).

[124] *See* David Molony, *EC and U.S. to Clash Over Universal Service Funds*, COMMUNICATIONS WEEK INTERNATIONAL (April 6, 1998) (Reporting that Diane Cornell, chief of the telecoms division of the FCC's international bureau, argued that foreign carriers should pay their fair share to use U.S. local networks because an "international carrier benefits from being able to terminate a call to rural areas or low-income subscribers" in the U.S. The article further reported, however, that the international telecoms community found this official U.S. response to be specious at best. Quoting, among other anonymous sources, a leading Washington, D.C. telecoms analyst, the article questioned why, given the scale and scope of the U.S. domestic telecommunications network, "[e]very call from the poorest African nation is paying for an ISDN link to Ted Turner's ranch.")

*tangible things* [125]; and (b) ensuring that any increase in horizontal or vertical concentration does not delay or impede this process. The use of the word "preclusion" means nothing without this broader context. Indeed, under the Commission's current definition of "preclusion" -- *i.e.*, those firms that would have entered but for regulatory and other legal barriers -- *anyone* can be a precluded competitor. The key issue, therefore, is to turn the inquiry away from the *who*, and onto the *how*. If the Commission does everything in its power to reduce entry barriers, then the *when* will take of itself. So long as the FCC uses improperly the its merger review process to extract concessions to assuage political agendas, however, given the recent announcement of a possible merger between SBC and Ameritech, it tragically appears that the FCC's standard of merger analysis is now tragically just reduced to nothing more than "the bar is open."[126]

**Epilogue:**

So, unlike last time, I do not have very good news to tell my mother. While I argued one year ago that even though many of the ingredients to the giant telecommunications omelet were already pre-determined, it was not too late to help influence positively the final recipe before the eggs finally set-up permanently. Indeed, I argued specifically in that article and elsewhere that that because market structure is they key to achieving sustained competitive rivalry, public policy officials needed to take careful and deliberate steps to ensure that the final omelet did not turn out to be so unappetizing that consumers only had dry toast and water on the menu. Tragically, given the huge amount of successful incumbent reconcentration and regulatory capture over the past year, all I have left to say to my mother now is just "*please pass the jelly*."

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125 While it may be hard politically for the Commission to admit that its rules are currently in shambles, only an honest approach will enable the Commission to move the process of promoting local competition forward.

126 See David Molony, *Baby Bells Primed for Power Struggle*, COMMUNICATIONS WEEK INTERNATIONAL (June 1, 1998) at 6.