Consumer Federation of America

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THE END OF THE END OF COMPETITION FOR DIGITAL ACCESS SERVICE:

THE VERIZON-CABLE SPECTRUM SALE AND COLLABORATIVE AGREEMENTS MARK THE FINAL FAILURE OF THE 1996 TELECOMMUNICATIONS ACT TO PROVIDE CONSUMERS WITH EFFECTIVE COMPETITION IN LOCAL MARKETS

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I. INTRODUCTION

A. The Anticompetitive, Anti-consumer Nature of the Proposed Transaction

The Telecommunications Act of 1996 promised consumers that competition would replace regulation, delivering a wide range of competing choices. For local service, deregulation took place, competition did not follow. Each of the most important local communications markets, multichannel video, broadband data service and wireless service remains a highly concentrated market. In each of product markets, a series of mergers eliminated actual and potential competitors. In each market, a seminal, groundbreaking transaction unleashed a merger wave (two Baby Bells merge, a Baby bell acquires a long distance company, cable giants are allowed to merger, cellular companies are gobbled up by the dominant firms).

The proposal by Verizon to acquire virtually all of the wireless spectrum owned by cable companies and enter into collaborative agreements whereby the firms would cross-market each other's services and jointly develop shared technology, is another key moment in the sad history of the failure of competition in local service under the 1996 Act. The cable operators and Verizon are the overwhelming dominant incumbents in the vast areas where Verizon sells wireline service. Even outside of Verizon's wireline footprint, its massive spectrum holding place it among the top three providers of local digital connectivity. The local market has been reduced to two dominant wireline broadband service providers, one of whom also dominates local wireless service. Since broadband is the "fat pipe" that delivers digital data close to the consumer, the wireline duopoly dominates the local market.

Against the background of this very highly concentrated market, Verizon and the cable companies have proposed to declare a competitive cease fire between the two broadband wireline networks. Verizon will not extend it high capacity broadband network, rather it will market cable's network. Cable will not enter the wireless market or use smaller wireless carriers to build a bundle of wireless and wireline service, it will use Verizon's wireless service. Both parties give up the single best product they had to compete, taking a commission on the sale of the competitor's product. Both have an incentive to use their collaborative venture to undermine the competition from non-collaborators that they face in the local markets. This is the sense in which the proposed collaboration between Verizon and the major cable operators represents the end of the end of competition for local digital service.[1]

B. An End Run Around the Antitrust Laws and the Communications Act

If Verizon had proposed to merge with Comcast in its service territory, or spin off all of its wireless businesses to the dominant cable operators across the country, we believe that the antitrust authorities would have been in full throated opposition. In those service areas where Verizon and the acquiring cable companies overlap in wireline service, the antitrust authorities would have seen it as a merger of the number one and number two firms in a highly concentrated market for major services. In service territories where the wireline assets do not overlap, it would be seen as a merger of two of the top three firms.

The parties to the transaction will insist that it is just a joint venture, not a merger and therefore should not be evaluated within this perspective. We disagree. Both the antitrust laws and the Communications Act recognize that joint ventures can have many of the anticompetitive effects

[1] Craig Moffett, Quick Take – Verizon Buys Spectrum from Cable… The End of the World as We Know It, Bernstein Research, December 2, 1011.

of mergers. The analysis must take the nature of the collaborative agreement into account, but the fundamental premises and approach are the same. Because the markets affected are so highly concentrated and the services supplied so vital to the growth of the digital economy a collaborative agreement can alter the incentives to compete sufficiently to result in a significant increase in market power and harm to competition. Under these circumstances, a joint venture may be a clever way to get around the careful antitrust scrutiny and the obvious public policy implications that such scrutiny would arrive at. The antitrust agencies reject such a strategy as made explicit in the *Antitrust Guidelines for Collaboration Among Competitors*[2] – "In any case, labeling an arrangement a "joint venture" will not protect what is merely a device to raise price or restrict output; the nature of the conduct, not its designation, is determinative. [3]

Even viewed strictly as a joint venture, the proposed transactions fail the antitrust review. The *Collaborative agreement Guidelines* make reference to the *Horizontal Merger Guidelines,* note similarities and differences, but lay out an analytic framework that is essentially the same in terms of analysis of market structure and competitive impacts. The component that one must add to basic merger review is an assessment of how the joint venture filters or affects the ability and incentive to abuse the market power that may result from the transaction. It is our view, based on a review of the evidence that this joint venture violates the Guidelines. It possesses many of the characteristics that have led antitrust authorities to oppose major joint ventures in recent years and few of the characteristics that have led antitrust authorities to allow major joint ventures.

C. Outline

The paper is divided into two sections after this introduction. In Section II we describe the antitrust framework used to evaluate collaborative agreements and show that it has been applied in recent reviews of proposed collaborative agreements. We also examine the practice of the FCC with regard to collaborative agreements and joint ventures.

Section III presents the empirical evidence on market structure and the collaborative agreements. It starts with the assessment the market structure issues raised by the Verizon-SpectrumCo transaction. It reviews the development of the market structure since the Telecommunications Act of 1996 as the context for the discussion of both the current market structure and insights into how public policy has affected that market structure. It then reviews the potential for competition between the collaborators. Finally, it reviews the impact of the collaborative agreement on competition and consumers.

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[2] Federal Trade Commission and the U.S. Department of Justice, April 2000.
[3] Collaborations Guidelines, p. 9.

II. THE ANALYTIC FRAMEWORK

A. BASIC MARKET STRUCTURE ANALYSIS

In 28 pages of text, the *Guidelines for Collaboration Among Competitors* (Collaboration Guidelines) references the *Horizontal Merger Guidelines* as the framework for analysis 16 times. The underlying approach to the analysis is the same, but the *Guidelines for Collaboration Among Competitors* add additional criteria for assessing the unique characteristics of the collaborative agreement. The basic analysis is the same as the *Horizontal Merger Guidelines.*

> The Agencies typically define relevant markets and calculate market shares and concentration as an initial step in assessing whether the agreement may create or increase market power or facilitate its exercise. The Agencies examine the extent to which the participants and the collaboration have the ability and incentive to compete independently. The Agencies also evaluate other market circumstances, e.g. entry, that may foster or prevent anticompetitive harms. (4)
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> Rule of reason analysis focuses on the state of competition with, as compared to without, the relevant agreement. The central question is whether the relevant agreement likely harms competition by increasing the ability or incentive profitably to raise price above or reduce output, quality, service, or innovation below what likely would prevail in the absence of the relevant agreement…. (4)
>
> The Agencies also evaluate whether entry would be timely, likely, and sufficient to deter or counteract any anticompetitive harms. In addition, the Agencies assess any other market circumstances that may foster or impede anticompetitive harms. (11)
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> In examining the nature of the relevant agreement, the Agencies take into account inferences about business purposes for the agreement that can be drawn from objective facts. The Agencies also consider evidence of the subjective intent of the participants to the extent that it sheds light on competitive effects… Anticompetitive harm may be observed, for example, if a competitor collaboration successfully mandates new, anticompetitive conduct or successfully eliminates procompetitive pre-collaboration conduct, such as withholding services that were desired by consumers when offered in a competitive market… In some cases, however, a determination of anticompetitive harm may be informed by consideration of market power. (12)

Characterizing Market Structure

Under the joint Department of Justice/Federal Trade Commission *Merger Guidelines,* the consideration of proposed mergers begins with a straightforward analysis of market concentration.

> **Market Structure:** Markets affected by a competitor collaboration include all markets in which the economic integration of the participants' operations occurs or in which the collaboration operates or will operate, and may also include additional markets in which any participant is an actual or potential competitor…
>
> Market share and market concentration affect the likelihood that the relevant agreement will create or increase market power or facilitate its exercise. The creation, increase, or facilitation of market power will likely increase the ability and incentive profitably to raise price above or reduce output, quality, service, or innovation below what likely would prevail in the absence of the relevant agreement…In assessing whether an agreement may cause anticompetitive harm, the Agencies typically calculate the market shares of the participants and of the collaboration.
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> The Agencies assign a range of market shares to the collaboration. The high end of that range is the sum of the market shares of the collaboration and its participants. The low end is the share of the collaboration in isolation. In general, the Agencies approach the calculation of market share as set forth in Section 1.4 of the *Horizontal Merger Guidelines*. (16-17)

If a merger increases the concentration in the market by an amount that could result in a significant increase in the market power of the post-merger firm, then the merger demands scrutiny. Concentration is measured by the Hirschman-Herfindahl Index (HHI) because that index has a direct relationship to existence of market power.[4] The thresholds at which concern is felt about mergers were raised substantially in the recent revision of the *Guidelines*.

A market that is considered moderately concentrated used to be defined as one that exhibited an HHI between 1,000 and 1,800 (see Table II-1). An HHI above 1,800 was considered a

TABLE II-1: DESCRIBING MARKET STRUCTURES

Department of Justice Merger Guidelines	Type of Market	HHI	Equivalents in Terms of Equal Sized Firms	4-Firm Share CR4
Highly Concentrated	Monopoly[a/]	10,000	1	100
	Duopoly[b/]	5,000	2	100
		2,500	4	100
Moderately Concentrated			5.5	72
	Tight Oligopoly			60
	Loose Oligopoly	1,000	10	40
	Monopolistic Competition			
Unconcentrated	Atomistic Competition	200	50	8

Sources and Notes a = Antitrust practice finds monopoly firms with market share in the 65% to 75% range. Thus, HHIs in "monopoly markets can be as low as 4200; b = Duopolies need not be a perfect 50/50 split. Duopolies with a 60/40 split would have a higher HHI. Sources: U.S. Department of Justice, *Horizontal Merger Guidelines*, revised August 2010, for a discussion of the HHI thresholds; William G. Shepherd, *The Economics of Industrial Organization* (Englewood Cliffs, NJ: Prentice Hall, 1985), for a discussion of four firm concentration ratios.

highly concentrated market. Translated into everyday terms, a market with ten equal-sized competitors would have an HHI of 1,000. A market with 6 equal-sized competitors would have an HHI of 1,667. In effect, a market with 10 or more equal-sized competitors was considered unconcentrated, and a market with fewer than roughly 5.5 was considered highly concentrated. In between, the market was considered to be moderately concentrated. Under the recently revised guidelines, the unconcentrated threshold was raised to 1,800, while the highly concentrated threshold was raised to 2,500, or the equivalent of 4-equal sized firms.

The revised guidelines are consistent with long-standing conceptualizations in the economic literature, as described in Table II-1. A moderately concentrated market would

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4 Viscusi, w. Kip, John M. Vernon and Joseph E. Harrington, Jr., *Economics of Regulation and Antitrust*, MIT Press: Cambridge,, 3rd Ed, 2001: 147-149, 212-213.

correspond to a tight oligopoly, which was defined as a market where the top four firms (the four firm concentration ratio, or CR4) had more than 60 percent of the market.[5]

Key Thresholds

Because the review of mergers and collaborative agreements involves forward looking analysis and it intended to be prophylactic, the analysis always involves projections about what the impact of the transaction. In the *Merger Guidelines* the antitrust agencies identify danger zones. They identify increases in the HHI that trigger concerns about the potential abuse of market power or presumptions that market power will be abused. During merger review, a merger is evaluated by examining the level of concentration of the post-merger market and the impact of the merger on the level of concentration in the market. The higher the level of post-merger concentration and the larger the increase in concentration, the greater the threat to competition and the more likely the antitrust authorities are to block a merger or demand remedies to mitigate the potential harms of increased market power.

> *Moderately Concentrated Markets:* Mergers resulting in moderately concentrated markets that involve an increase in the HHI of more than 100 points potentially raise significant competitive concerns and often warrant scrutiny.
>
> *Highly Concentrated Markets:* Mergers resulting in highly concentrated markets that involve an increase in the HHI of between 100 points and 200 points potentially raise significant competitive concerns and often warrant scrutiny. Mergers resulting in highly concentrated markets that involve an increase in the HHI of more than 200 points will be presumed to be likely to enhance market power. The presumption may be rebutted by persuasive evidence showing that the merger is unlikely to enhance market power. (DOJ/FTC, 2010: 19)

In the *Guidelines for Collaborations Among Competitors* the antirust agencies identify safety zones.

> **Safety Zones:** Absent extraordinary circumstances, the Agencies do not challenge a competitor collaboration when the market shares of the collaboration and its participants collectively account for no more than twenty percent of each relevant market in which competition may be affected….
>
> Absent extraordinary circumstances, the Agencies do not challenge a competitor collaboration on the basis of effects on competition in an innovation market where three or more independently controlled research efforts in addition to those of the collaboration possess the required specialized assets or characteristics and the incentive to engage in R&D that is a close substitute for the R&D activity of the collaboration. In determining whether independently controlled R&D efforts are close substitutes, the Agencies consider, among other things, the nature, scope, and magnitude of the R&D efforts; their access to financial support; their access to intellectual property, skilled personnel, or other specialized assets; their timing; and their ability, either acting alone or through others, to successfully commercialize innovations. The antitrust safety zone does not apply to agreements that are per se illegal, or that would be challenged without a detailed market analysis, or to competitor collaborations to which a merger analysis is applied. (22)

B. SPECIFIC ISSUES THAT BEAR ON COLLABORATIONS AMONG COMPETITORS

In the case of a merger, the interests and assets of the two parties become one. In the case of a collaborative agreement, their interests and assets are partially joined. As described in Table II-2, the antitrust authorities must evaluate the extent to which the interests and assets are joined. In the situation where the market structure analysis indicates that the collaborative agreement

[5] In the case of 5.5 equal-sized firms, the four firm concentration ratios would be 72%.

TABLE II-2: KEY CHARACTERISTICS OF COLLABORATIVE AGREEMENTS

Collaborators as Potential Competitors: most competitor collaborations preserve some form of competition among the participants. This remaining competition may reduce competitive concerns, but also may raise questions about whether participants have agreed to anticompetitive restraints on the remaining competition.

Mergers are designed to be permanent, while competitor collaborations are more typically of limited duration. Thus, participants in a collaboration typically remain potential competitors, even if they are not actual competitors for certain purposes (*e.g.*, R&D) during the collaboration. The potential for future competition between participants in a collaboration requires antitrust scrutiny different from that required for mergers.

Nonetheless, in some cases, competitor collaborations have competitive effects identical to those that would arise if the participants merged in whole or in part. The Agencies treat a competitor collaboration as a horizontal merger in a relevant market and analyze the collaboration pursuant to the *Horizontal Merger Guidelines* if appropriate, which ordinarily is when: (a) the participants are competitors in that relevant market; (b) the formation of the collaboration involves an efficiency-enhancing integration of economic activity in the relevant market; (c) the integration eliminates all competition among the participants in the relevant market; and (d) the collaboration does not terminate within a sufficiently limited period10 by its own specific and express terms. Effects of the collaboration on competition in other markets are analyzed as appropriate under these Guidelines or other applicable precedent. (5)

Assets Devoted to the venture: The Agencies ask whether the relevant agreement requires participants to contribute to the collaboration significant assets that previously have enabled or likely would enable participants to be effective independent competitors in markets affected by the collaboration. If such resources must be contributed to the collaboration and are specialized in that they cannot readily be replaced, the participants may have lost all or some of their ability to compete against each other and their collaboration, even if they retain the contractual right to do so. In general, the greater the contribution of specialized assets to the collaboration that is required, the less the participants may be relied upon to provide independent competition. (19)

The Agencies examine factors relevant to the extent to which the participants and the collaboration have the ability and incentive to compete independently, such as whether an agreement is exclusive or non-exclusive and its duration. (11)

Independent Decision Making: production collaborations may involve agreements on the level of output or the use of key assets, or on the price at which the product will be marketed by the collaboration, or on other competitively significant variables, such as quality, service, or promotional strategies, that can result in anticompetitive harm. Such agreements can create or increase market power or facilitate its exercise by limiting independent decision making or by combining in the collaboration, or in certain participants, the control over some or all production or key assets or decisions about key competitive variables that otherwise would be controlled independently. (13)

Marketing collaborations may involve agreements on price, output, or other competitively significant variables, or on the use of competitively significant assets, such as an extensive distribution network, that can result in anticompetitive harm. Such agreements can create or increase market power or facilitate its exercise by limiting independent decision making; by combining in the collaboration, or in certain participants, control over competitively significant assets or decisions about competitively significant variables that otherwise would be controlled independently; or by combining financial interests in ways that undermine incentives to compete independently.(14)

To the extent that the collaboration's decision making is subject to the participants' control, the Agencies consider whether that control could be exercised jointly. Joint control over the collaboration's price and output levels could create or increase market power and raise competitive concerns. Depending on the nature of the collaboration, competitive concern also

may arise due to joint control over other competitively significant decisions, such as the level and scope of R&D efforts and investment. (20-21)

Exclusivity: The Agencies inquire whether a collaboration is non-exclusive in fact as well as in name and consider any costs or other impediments to competing with the collaboration. (19)

Duration: In general, the shorter the duration, the more likely participants are to compete against each other and their collaboration. (21)

Collaborators as Colluders: Competitor collaborations also may facilitate explicit or tacit collusion through facilitating practices such as the exchange or disclosure of competitively sensitive information or through increased market concentration. Such collusion may involve the relevant market in which the collaboration operates or another market in which the participants in the collaboration are actual or potential competitors.

Source: *Antitrust Guidelines for Collaboration Among Competitors,* Federal Trade Commission and the U.S. Department of Justice, April 2000.

could be anticompetitive, the antitrust authorities must ascertain whether the terms of the collaborative agreement lessen competition or mitigate the potential harm from any lessening of competition. In the context of a threat to competition based on the market structure analysis, the issues underlying the concern in the *Collaborations Among Competitors Guidelines* are straightforward. Is there a loss of competition? Are competitively important assets devoted to the collaborative agreement and who controls them? How long is the agreement in duration? Does it control anticompetitive conditions or will it facilitate collusion? While these are broad, general questions, antitrust practice provides fairly clear guidance.

C. Antitrust Practice

The handling of two recent collaborative agreements – one opposed, one not opposed – provide a useful starting point for understanding how the antitrust authorities evaluate such agreements. The DOJ was prepared to go to court to block Google-Yahoo!, but did not oppose a nearly identical collaborative agreement of Microsoft-Yahoo!.

Google and Yahoo! Search Advertising Agreement[6]

Hours before the Justice Department was going to file suit to enjoin the cross-platform advertising agreement between Google and Yahoo! the parties abandoned the deal. Nonetheless, the DOJ released a public statement explaining its rationale:

Harm to markets: The DOJ found that the agreement "would likely harm competition in the markets for Internet search advertising and Internet search syndication."

A less effective competitor: After noting Google's market share ("more than 70 percent in both markets") and the concentration involved in their collaboration ("combined market shares of 90 percent and 95 percent in the search advertising and search syndication markets, respectively"), the DOJ emphasized that Yahoo! "provides an alternative to Google for many advertisers and syndication partners." Indeed, the DOJ observed that "Yahoo! is by far Google's most significant competitor in both markets" – the agreement would, for reasons described below, actually undermine Yahoo!'s competitiveness. Washington Attorney General Rob McKenna, who led a fifteen state investigation into the agreement, noted that the companies were "each other's closest competitors."[7]

Innovation: In its filing with the DOJ, the Association of National Advertisers (ANA) [8] argued that the search advertising marketplace was already marked by "substantial advances in technology" and thus needed no "artificial stimulation" from the agreement to "produce a high-quality, more-competitive environment for advertisers." Rather, innovation "has grown out of the combined technological investments that Google, Yahoo, Microsoft, AOL, Ask.com and many others have made over recent years."

Decreased Innovation/Investment: The DOJ notes that Yahoo! "recently had begun making significant investments in order to compete more effectively against Google, including the 2007 introduction of its Panama search advertising platform." The agreement would have the effect of diminishing Yahoo!'s innovation by relying heavily on Google.

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[6] http://www.justice.gov/opa/pr/2008/November/08-at-981.html):
[7] http://www.atg.wa.gov/pressrelease.aspx?id=21322
[8] http://www.ana.net/getfile/14754

Harm to consumers: The DOJ noted that the "arrangement likely would have denied consumers the benefits of competition – lower prices, better service and greater innovation."

Higher Prices: The ANA led the attack against the agreement from the commercial side: in filings with the DOJ it alleged that the agreement would likely increase the cost of search advertising.

Limited Choices: ANA also emphasized that by reducing competition between close competitors, the agreement would "leave advertisers with limited choices and alternatives to secure high-quality, affordable online advertising"

Collaborators vs. Competitors – the making of *less* effective competitors: The DOJ concluded that as a result of the agreement, Google and Yahoo! "would have become collaborators, rather than competitors, for a significant portion of their search advertising businesses, materially reducing important competitive rivalry between the two companies."

Misaligned Incentives: The DOJ noted that with the choice of outsourcing ads to Google rather than using its own ads "Yahoo! would have had significantly reduced incentives to invest in areas of its search advertising business where outsourcing ads to Google made financial sense to Yahoo!" Washington Attorney General Rob McKenna noted that "the agreement would have created conflicting incentives for Yahoo! to continue to invest in its own sponsored search business."[9]

Immediate effect on competition: The DOJ notes that with the agreement, "competition likely would have been blunted immediately." Statements by the lead counsel for the DOJ also help clarify the DOJ's analysis. In an interview with AmLawDaily, Sandy Litvack offered details about the averted lawsuit: The complaint would have charged that the agreement violated Sections 1 (agreements that restrain trade unreasonably) and 2 (making unlawful acts that monopolize, or attempt to monopolize, trade) of the Sherman Act. The suit would have depended on "alleging that Google had a monopoly and that [the advertising pact] would have furthered that monopoly."[10]

Growth over time: ANA echoed this statement, arguing that the agreement will create "a reasonable probability that Yahoo's connection to Google will grow over time…the Yahoo-Google partnership should be expected to increase.

Dependence: ANA also argued that the agreement created a "marketplace risk" that "all search engines rely on Google to 'help'" – thus allowing Google to act as "marketplace 'allocator' and manager" and putting Google "in defacto [sic] control of the marketplace."

No modifications could remedy the harm: The DOJ emphasized in its statement that the parties had submitted numerous modifications to the original agreement to address the antitrust concerns of the DOJ – the DOJ "determined that such modifications would not eliminate the competition concerns raised by the agreement."

Non-exclusivity no panacea: ANA noted that while non-exclusive, the deal still created misaligned incentives

[9] http://www.atg.wa.gov/pressrelease.aspx?id=21322
[10] http://amlawdaily.typepad.com/amlawdaily/2008/12/hogans-litvack.html

Advertising Agreement between Microsoft and Yahoo![11]

The Department of Justice in 2009/2010 investigated an agreement between Microsoft and Yahoo! that in essence replicated the paid search advertising agreement that Yahoo! was pursuing with Google until the DOJ announced it would sue to enjoin the Google/Yahoo! venture. The DOJ found that the transaction was "not likely to substantially lessen competition," emphasizing:

Increased Innovation as a result of the collaborative agreement: The agreement likely "will enable more rapid improvements in the performance of Microsoft's search and paid advertising technology than would occur if Microsoft and Yahoo! were to remain separate." The "larger data pool" created by the collaborative agreement could "enable more effective testing and thus more rapid innovation in potential new search-related products, changes in the presentation of search results and paid listings, other changes in the user interface, and changes in the search or paid search algorithms."

More effective competitors: The agreement "would be likely to increase competition by creating a more viable competitive alternative to Google, the firm that now dominates these markets."

Who they're actually competing against -- collaborative agreement between lesser market participants against a common competitor less problematic than collaborative agreement that includes the market leader: Crucially, the DOJ concluded that *both Microsoft and Yahoo! view Google as their competitive focus*, not each other. Google's overarching predominance in this market helped alleviate the concern of a collaborative agreement between lesser market participants.

Greater competitive pressure in the marketplace: All of the above indicated to the DOJ that the collaborative agreement could "exert correspondingly greater competitive pressure in the marketplace."

ANALYSIS OF COLLABORATIVE AGREEMENTS AT THE FCC: ATT/BT

The FCC has also examined collaborative agreements and objected to them. The FCC examination of the AT&T-British Telecom (BT) collaborative agreement might well give the greatest insight into the FCC's consideration of the Verizon/SpectrumCo collaborative agreement. AT&T and BT proposed a collaborative agreement that would offer international telecommunications services through a number of subsidiaries. While the DOJ appears to have signed off on the arrangement without any conditions, the FCC did go through an extensive review and – perhaps most importantly – did impose one significant condition relevant for our purposes. Of particular relevance to the Verizon/Spectrum transaction:

The FCC explicitly acknowledged that it applies that same analytical framework to assessing the competitive effects of collaborative agreement as it applies to outright mergers. The FCC directly cites the Collaborations Among Competitors Guidelines in its analysis.

The FCC analyzes a number of specific markets in which it is claimed that either through the collaborative agreement, or independently, the parties can exercise anticompetitive influence. The market that garners the most attention from the FCC is for "global seamless services." The FCC goes through an extensive analysis, examining market share, looking at

[11] (http://www.justice.gov/opa/pr/2010/February/10-at-163.html):

the market conditions, and considering whether the collaborative agreement will eliminate a significant provider of global seamless services by combining the international assets of two significant providers. A number of conclusions of the Commission are highly relevant for the purposes of considering Verizon/SpectrumCo. For one, the Commission found that the market for global seamless services was highly competitive and had no significant barriers to entry from new competitors (unlike many of the product markets affect by the Verizon-SpectrumCo collaboration). In analyzing different regional markets, the Commission concludes time and again that the collaborative agreement partners do not have the ability to act anti-competitively. For instance, the collaborative agreement does not impair the ability of the collaborative agreement competitors to obtain operating agreements from foreign carriers. Moreover, the customers in the global seamless services market are highly sophisticated – they're able to "aggressively seek out competing providers."

Mark Leaders are important: One notable harm alleged by competitors was that the collaborative agreement could anticompetitively monopolize the global seamless services market by establishing proprietary standards for a particular service – and by leveraging their dominance, lead to 'tipping' where an initial edge over incompatible rival systems allows a market participant to set the industry standard and achieve market dominance. The Commission found this anticompetitive use of proprietary standards unlikely for a number of reasons (all highly relevant in the context of Vz/SpectrumCo): 1) it was not persuaded by competitors' arguments that AT&T/BT had an initial advantage that would allow them to tip the market through proprietary standards because there "was no evidence in the record that they are the current leaders" (unlike Verizon/SpectrumCo, which clearly do have market advantage because they unequivocally *are* current leaders); (2) No evidence existed that the collaborative agreement would be able to successfully migrate customers to its proprietary platform; (3) in a number of standards-areas, AT&T/BT committed to developing open, public standards – and in fact the Commission found that they would have disincentives to offer proprietary standards because sophisticated customers would be concerned with being locked in.

Raising Rivals Costs: This anticompetitive harm received a great deal of attention from the Commission, specifically because of alleged abilities of the collaborative agreement to raise rivals costs along specific routes in which AT&T and BT were dominant (most obviously the US-UK Route). Competitors alleged that the collaborative agreement gave the partners the incentive to terminate all AT&T traffic with BT rather than with rivals (analogous to the claim of numerous commenters that the collaborative agreement might give the cable companies incentives to offer backhaul out-of-region only to Verizon and not to Verizon competitors, or in the case of Wi-Fi, to exempt Verizon traffic from cable hotspots and exempt cable customer device traffic at Verizon hotspots). The FCC concluded that market conditions made it unlikely that the collaborative agreement partners could successfully implement a strategy of raising rivals costs: the US-UK route is one of the most competitive in the world; many facilities-based alternatives to AT&T exist; and if the collaborative agreement tried to maintain prices above-cost its competitors could easily and quickly respond by undercutting AT&T's price for termination. (None of these are the case in Verizon/SpectrumCo: the relevant markets in which they do or would compete are *not* highly competitive; there are not many facilities-based alternatives; and customers *cannot* readily respond to parallel accommodating price increases by Verizon/SpectrumCo by undercutting them). With a high level of competition in the market, the FCC concluded that U.S. carriers would seek the lowest cost alternative for terminating traffic. In the case of Verizon/SpectrumCo, the relevant customers do not have these same alternatives.

Nonetheless, the FCC did find that the collaborative agreement had the potential to raise rivals costs in one key area: competitor access to BT's local exchange customers for interexchange and international calls. There it found that AT&T and BT's arguments were unpersuasive, concluding that as a result of the collaborative agreement, BT had the incentive to discriminate against the joint venture's competitors by denying them equal access in its local exchange market. As a condition of approval the FCC therefore *prohibited* the collaborative agreement subsidiaries from accepting BT traffic originated in the UK so long as BT failed to comply with proposed equal access requirements the British regulator had imposed as a condition of the collaborative agreement.

FCC review of a market it doesn't regulate: to counter the argument that the FCC cannot examine aspects of the agreements that touch upon areas it doesn't regulate, it is notable that in the AT&T/BT transaction the FCC *did* examine the effect of the transaction on the Transit Market – even though it acknowledged that it doesn't regulate that market. While the FCC declined to impose any conditions, finding that it lacked enough information to make a determination regarding the ability of the collaborative agreement to exercise market power in the Transit Market, it did examine the market, finding it highly competitive and cautioning that it would "continue to monitor the transit market to ensure that the joint venture, as well as other transit providers, are not acting in an anticompetitive manner."

Public Interest Analysis: Perhaps the most interest aspect of the collaborative agreement analysis involves the public interest analysis: the FCC found that the collaborative agreement was in the public interest because of the standard pro-competitive effects outlined in the guidelines (and that we see in DOJ statements not to sue to block joint ventures between competitors) – increased choices for consumers, more effective competitor in the global seamless services market, increased innovation in the market from the collaborative agreement's combined investment.

Other Collaborative Agreements that were Not Opposed

Review of mergers and collaborative agreements is fact-specific and there is an infinite variety of possible configurations of facts that one can imagine. However, the broad themes that we have noted in the two above cases appear repeatedly in the reviews of collaborative agreements. The key themes that are repeated in those transactions that are not opposed are that they involve weaker competitors in relatively competitive markets, do not have anticompetitive effects nor afford opportunities for collusion.

Orbitz Joint Venture:[12] The Department of Justice investigated the creation of Orbitz, a joint venture of United Airlines, Continental Airlines, Delta Airlines, Northwest Airlines, American Airlines and more than 40 foreign and domestic "charter associates" to create a travel website. Under the terms of the agreement and its "most favored nation" (MFN) provision the airlines would market through Orbitz any publicly available fares they offered through third party websites or their own proprietary websites. Despite a number of anticompetitive harms potentially posed by the joint venture, the DOJ found that the joint venture had "not reduced competition or harmed airline customers." Key aspects of the joint venture that concerned the DOJ included:

Agreement between major horizontal competitors: The DOJ stated that "any agreement among major horizontal competitors in a concentrated industry to collaborate and jointly market their products or services, particularly if they agree to restrict their individual marketing

[12] http://www.justice.gov/atr/public/press_releases/2003/201208.pdf

prerogatives, raises serious antitrust concerns." In the case of Verizon/SpectrumCo, the Applicants are direct horizontal competitors in several important markets (e.g. broadband access – particularly in which wireless can increasingly serve as a competitive substitute to wireline broadband; special access; WiFi hotpots).

Reduction in competition among collaborating competitors partners: The DOJ expressed concern that the MFN agreement potentially "undercuts the participating airlines' incentives to compete by offering discount airfares, because those fares must be offered on the Orbitz website where customers might instead buy from another carrier." Similarly, the agreement prevents the partners from "offering their best fares only on their individual websites" – their lowest cost distribution channel – since it requires them to publish those same fares on Orbitz.

Collusion between the partners: By providing a shared platform, the Orbitz joint venture could "provide a convenient means for the airlines to monitor each other's fares. By improving monitoring, Orbitz might facilitate collusion among the participating airlines and thereby curtail discounting." As a related harm, this improved monitoring could "also curtail discounting by allowing competitors to match a carrier's discounts more quickly. Rapid matching results in revenue dilution, thus reducing the sales bump or first move advantage of offering a lower web fare."

Incentive to harm third party competitors of the collaborators, thereby reducing market-wide innovation and investment: Created in response to preexisting travel websites Travelocity and Expedia, the Orbitz MFN agreement – and incentives stipulated in the agreement that rewarded partners for offering fares exclusively on Orbitz rather than Travelocity or Expedia – could "reduce competition in the online distribution market by making competing distributors less attractive to consumers, possibly forcing them to reduce their investment in technological development and innovation or even exit the online travel distribution business." As a result, "Orbitz could gain market power in online distribution, resulting in higher airline ticket distribution costs, lower quality distribution services, and ultimately higher airline ticket prices."

Ultimately, however, the DOJ found that none of these harms were realizable, utilizing extensive empirical and market analysis to reach its conclusion. In particular, the DOJ emphasized:

Industry-wide rate decreases: The DOJ relied heavily on empirical analysis showing that since the inception of Orbitz, "average airfares have decreased" because of a number of factors (September 11th, financial difficulties of the airlines, etc.). By contrast, since announcing their joint venture, Verizon and many of its cable partners have announced rate increases or restricted offerings.

No discontinuance in existing operations: The DOJ noted that "participating carriers continue to compete through their own websites," including by "improve[ing] their own sites to make them more user friendly" and continue to compete "by offering frequent flyer bonuses on their own sites." By contrast, the joint venture between Verizon/SpectrumCo involves the cable companies affirming that they will not compete with Verizon in wireless and Verizon's decision, after the announcement of the collaborative agreement, to end offering stand-alone DSL access that competed with the cable companies' broadband service.

Competitive Alternatives: The DOJ noted that low cost carriers – which "exert pressure on Orbitz owners and charter associates to offer more competitive fares" – had not joined the joint venture.

Collaborative partnership as an Effective Competitor, Not Market Dominator: The DOJ emphasized that rather than achieving a "dominant position, [Orbitz] remained the third largest online travel agency." Rival sites continued to grow and "compete aggressively against Orbitz."

Digital Music Joint Ventures:[13] The Department of Justice investigated two parallel joint ventures created by five of the nation's major record labels – pressplay (a joint venture between Sony Music and Universal Music Group) and MusicNet (a joint venture between Warner Music Group, EMI Entertainment, BMG Music and RealNetworks). As in the case of its Orbitz investigation, the Department of Justice found that the joint ventures were unlikely to harm competition because of countervailing market conditions. Nonetheless it emphasized:

Potential for Collusion: The DOJ expressed concern that "joint ventures might provide the major record labels an opportunity to collectively establish the terms on which they would license to third parties." Specifically, the joint ventures "might have permitted the exchange of competitively sensitive information relevant to each label's licensing conditions." This type of anticompetitive information harm is posed by Verizon/SpectrumCo in a number of contexts, including Retransmission Consent negotiations, backhaul contracts, and broadband pricing.

Safeguards to prevent: Ultimately the DOJ concluded that the terms of the licenses of the major labels varied significantly. Perhaps more importantly, the DOJ noted that "Safeguards adopted by both pressplay and MusicNet to prevent the sharing of confidential information among their participants also appear to have succeeded in preventing the inappropriate exchange of information among the major record labels through the medium of the joint ventures."

Harm to Third Party Competitors: Another concern of the DOJ was that the joint ventures might have "diminished competition among the major record labels in the terms on which they licensed their music to third-party music services that sought to compete with the joint ventures."

Harm to disruptive technology/innovation/alternative markets: One of the overarching concerns the DOJ had with the joint ventures concerned the potential for the joint ventures to "suppress the growth of the Internet as a means of promoting and distributing music, in order to protect their present positions in the distribution of music on physical media, such as CDs." Specifically, by "proceeding collectively" the major record labels could have controlled the "pace and direction" of Internet distribution of music. This ability to leverage control of one market as a means of effectively stifling an alternative and potentially disruptive market figures prominently in Verizon/SpectrumCo: by partnering with the nation's largest 4G LTE wireless provider (and indeed acting as resellers of the service), the cable companies can effectively shape the pace and direction of the wireless market as a potential competitive alternative to their cable high speed internet offerings.

As in the case of the Orbitz collaborative agreement, the Department of Justice was ultimately satisfied with the ability of third party services to acquire access to the music catalogs of the major labels at competitive rates. Market dynamics, including innovation by "a growing number of competing digital music suppliers, each of which offers songs from the music catalogs of all five of the major record labels" (for instance, Apple and Amazon.com), helped avert any competitive harm posed by the joint ventures.

[13] http://www.justice.gov/atr/public/press_releases/2003/201946.pdf

III. THE EVALUATION OF THE CABLE-VERIZON COLLABORATIVE AGREEMENT

A. THE VERIZON-SPECTRUM CO. TRANSACTION RAISES SEVERE COMPETITIVE CONCERNS UNDER THE ANTITRUST LAWS AND FAILS THE PUBLIC INTEREST TEST OF THE COMMUNICATIONS ACT

The analysis in this section shows that the proposed collaborative agreement between Verizon and the major cable operators raises concerns in each and every area that the *Collaborations Among Competitors Guidelines* and subsequent antitrust practice use to evaluate these collaborative agreements. As show in Table III-1, the *Collaborations Among Competitors Guidelines* combined with the *Horizontal Merger Guidelines* identify a dozen factors that are used to evaluate a proposed collaborative agreement, spread between general market factors and collaborative agreement details.

TABLE III-1: A DOZEN REASONS WHY ANTITRUST AND COMMUNICATIONS LAW REQUIRE THE DOJ AND THE FCC TO OPPOSE THE VERIZON-CABLE TV SPECTRUM SALE & COLLABORATIVE AGREEMENTS

	General conditions that favor allowing	Characteristics of the Verizon-SpectrumCo agreements that dictate opposition
Market Factors		
1. Market Structure	Unconcentrated	Highly concentrated (wireless), Very highly concentrated (Cable, Broadband)
2. Collaborator Market Shares	Small	Very large
3. Thresholds: Safety Zone	Safe Harbors: Market :20% combined share Research: 3 or more not in collaborative	Far outside safe harbor Cable 75%, Broadband 90%, Voice 90%, Wireless 35% Lack of competitors
4. Entry	Easy	Extremely difficult, compounded by sale of spectrum
Collaborative Agreement Details		
5. Actual/potential competition between collaborators	Little	Substantial head-to-head competition (video, broadband, WiFi, private line)
6. Impact on competition	Procompetitive Strengthens weak competitors	Replaces existing 3rd party competition Strengthens dominant firms, concentrates spectrum holdings
7. Assets devoted to venture	Insignificant	Cross marketing crown Jewels (wireless, video)
8. Control of assets	Independent	Most Favored Nation clauses Exclusives, Sharing crown jewel assets
9. Duration	Short	Very Long
10. Incentives	Neutral	Reduced competitive intensity Mutual Retail Price Maintenance diminishes price competition Cross marketing of highly profitable Products Other restrictive conditions Strategic assets favor, collaborators, disadvantages 3rd parties Back haul, private line, special access, data roaming
11. Facilitation of Collusion	No	Sharing super sensitive information
Potential Mitigating Factors		
12. Efficiency gains	Procompetitive, Cognizable Unique (transaction specific) Variable cost	Anticompetitive, Doubtful Less harmful alternatives available Fixed Cost

Sources: The market structural conditions are discussed in the attached white paper at pp. 18-19; The collaborative Agreement details are documented in comments filed In the Matter of Applications of Cellco Partnership c/b/a Verizon Wireless and SpectrumCo LLC For Consent to Assign Licenses; Application of Cellco Partnership d/b/a Verizon Wireless and Cox TMI Wireless, LLC for consent to Assign Licenses, WT Docket No.12-4, by the Communications Workers of America, the American Antitrust Institute, Spring, and the Computer and Communications Industry Association.

Collaborative agreements are unlikely to raise competitive concerns when:

- the markets into which the fruits of the collaboration are sold are unconcentrated; the collaborators are small; entry is easy; and the collaboration introduces a new competitor or strengthens weak competitors;
- the agreements are short; preserve independent control of assets and are structured in a way to not diminish the incentive to compete;
- or, when they do raise competitive concerns, these might be offset by procompetitive, unique cognizable efficiency gains based on variable cost savings.

The Verizon-SpectrumCo. collaborative agreement possesses none of these characteristics. In our review of the product markets involved we find aspects of the market context and the collaborative agreement in every category of factor that strongly support opposition to the transaction. Given the clear guidance from the antitrust authorities and the past practices of the Department of Justice, we believe this is a case it could easily win if it went to court to block the collaborative agreement.

Collaborative agreements are unlikely to raise competitive concerns when:

- the markets into which the fruits of the collaboration are sold are unconcentrated; the collaborators are small; entry is easy; and the collaboration introduces a new competitor or strengthens weak competitors;
- the agreements are short; preserve independent control of assets and are structured in a way to not diminish the incentive to compete;
- or, when they do raise competitive concerns, these might be offset by procompetitive, unique cognizable efficiency gains based on variable cost savings.

In every way, the Verizon collaborative agreement possesses characteristics that raise serious concerns about harm to competition.

- The markets into which the fruits of the collaboration are sold are highly or very highly concentrated and the collaborators are large.
- The market shares of the collaborators are way beyond the safe harbors defined by the *Collaboration Guidelines* – two to four times higher.
- Entry is extremely difficult in each of these markets.

Collaboration between dominant firms in highly concentrated markets where entry is extremely difficult sets off the antitrust alarm bells, particularly where the collaborators are were actual and potential competitors. Any lessening of competition in such a market is a major competitive concern.

B. The Current State of Competition in Local Digital Connectivity Markets

Critical Product and Geographic Markets: Local, Digital Connectivity is Highly Concentrated

The market analysis starts with the definition of the products affected by the transaction and the geographic areas in which they are sold. Here the critical products are access services used to obtain broadband access, multichannel video, and wireline and wireless voice. The present and future of communications is digital. In important ways, all communications starts as local communications. In order to communicate with a neighbor or reach a national network, a consumer must have a local means of connecting to the larger network. The services most deeply affected would be communications connectivity services, like connectivity for video, voice, broadband and wireless including "first mile" and "middle mile" connectivity. We refer to this as local digital connectivity.

Entry into the market for local connectivity is extremely difficult and the incumbent cable and telecommunications companies who provide that service have maintained their dominant positions, in spite of the hope that the Telecommunications Act of 1996 would introduce competition into these markets.

In a large part of the U.S., Verizon and the collaborating cable companies are the number one and number two dominant providers of local digital connectivity. In areas where their franchise service territories overlap, their combined market share is above 75% (see Table III-2). Even at the national level, the collaborators' market shares are well beyond the safety zone. Even where they do not overlap, Verizon (through its wireless service) and the cable companies are likely to both be in the top three local connectivity suppliers.

TABLE III-2: MARKET SHARES OF COLLABORATING ENTITIES LOCAL DIGITAL CONNECTIVITY PROVIDERS

	Cable	Verizon*	Transaction Shares	Zone of Safety
National				
Video	41	6	47	20
Broadband	32	9	41	20
Wireless	* *	34	34**	
In Region				
Video	55	20	75	20
Broadband	50	40	90	20
Wireless	0*	35	35+	20

Sources and Notes: Author estimates based on national trends in Federal Communications Commission reports on, High Speed Internet and Wireless applied to local market shares data in International Strategy and Investment Group, *Media and Cable,* October 24, 2011, Yankee Group, ATT-T-Mobile Merger: More Market Concentration, Less choice, Higher Prices, August 2011.
*** Verizon market shares of video and broadband are higher in FIOS areas and lower in non-FIOS areas, but the cable shares would be the obverse, suggesting that the market shares impacted by the transaction shares would be about the same.**
*** *To the extent cable has joint marketing agreement with non-Verizon wireless providers it can be considered to have some market share. The likely termination of those agreement and/or neglect of marketing those agreement that would likely result from the collaboration constitutes competitive harm of the collaborative agreement.**

The high level of concentration in the markets for local digital connectivity makes any transaction between these parties a source of great concern. The fact that they have been actual competitors in video and broadband connectivity and could be in wireless is a major competitive losses associated with the transaction. The collaborative agreement between actual and potential competitors magnifies that concern because the parties are contracting to become the marketing agents for the competitive crown jewel products on which they have built their dominant market positions. By doing so, each of the parties gives up the best source of leverage that it possesses in their rivalry with one of the biggest competitors. Verizon could combine its market leading broadband network with its market leading wireless network to wind customers from cables market dominant video offering and wireline broadband network. Instead, they have signed a peace treaty.

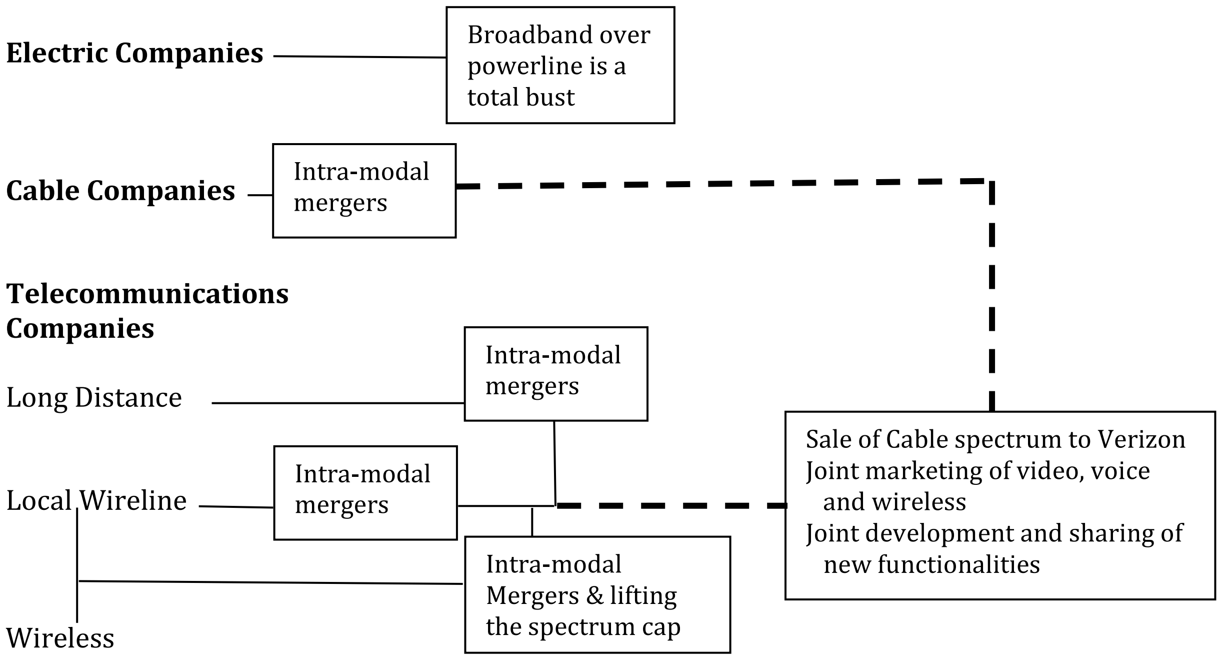
C. LESSONS FROM THE FAILURE OF COMPETITION TO LIVE UP TO THE PROMISE OF THE TELECOMMUNICATIONS ACT OF 1996

The fact that we have come to a situation in which each of these markets is at best highly concentrated, at worst a duopoly, is disheartening for consumers. Understanding how we got into this mess is important for decision makers confronted with a dramatic transaction that will alter the competitive landscape significantly. The failure of competition to live up to the promise of the Telecommunications Act of 1996 is not ancient history. It is the directly relevant experience and teaches a great deal about the current situation and what regulators should do to promote competition and protect consumers from the abuse of market power.

As shown in Figure III-1, local digital connectivity has experienced a modest decrease in multichannel video concentration, an alarming increase in broadband access concentration and an initial decline and recent increase in wireless concentration. The figures for multichannel video include intermodal competition from all technologies. The broadband wireline technologies include cable teclo intermodal competition, although the telco copper-based broadband service has substantially less capacity than cable hybrid fiber coaxial networks of full fiber networks. Wireless is based on total market shares for wireless technologies (the broadband wireless share is certainly higher). Wireless is dominated by the two largest wireline telcos and the ability of wireless to substitute for wireline in the broadband space is somewhat limited. Based on market shares, it is fair to say that local digital communications connectivity is a duopoly and the proposed transaction seeks to marry the interests of the most important (cable) duopolist with a leading competitor in all markets.

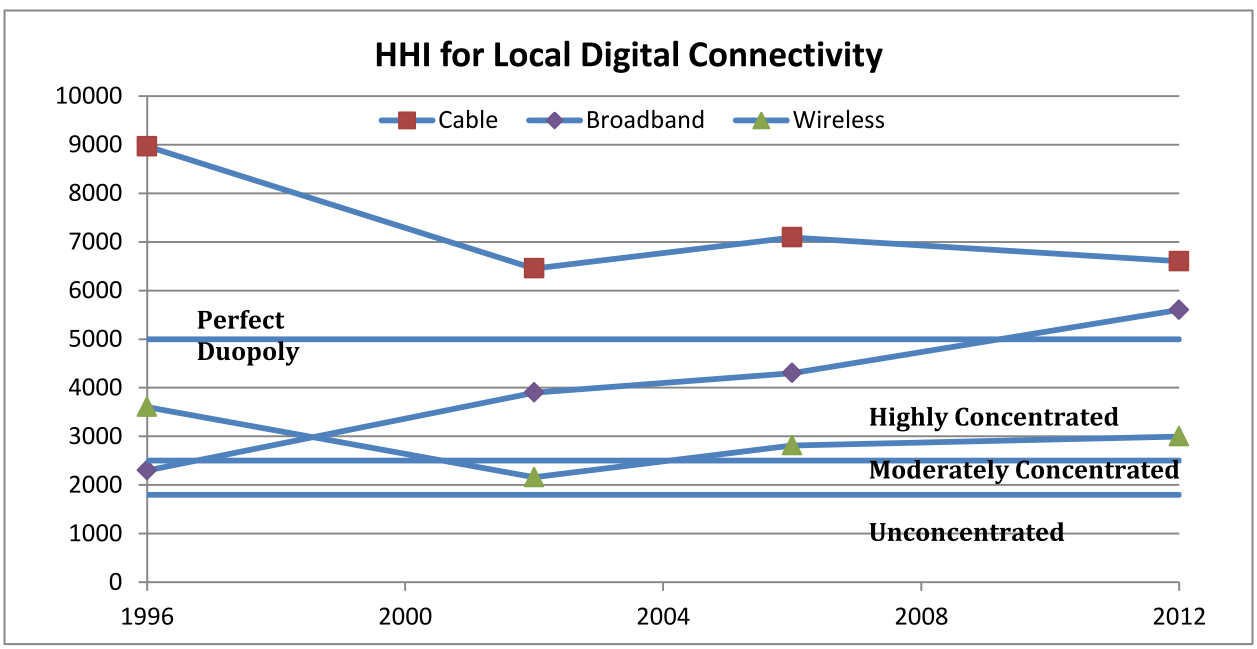
FIGURE III-1: THE PATH TO A COZY DUOPOLY FOR LOCAL DIGITAL CONNECTIVITY

Mergers and Policy Patterns



Major Mergers

Telco	**BA-Nynex , SBC-Pactell, SBC-Ameritech, BA-GTE, Qwest-US West**	**SBC-ATT**	**ATT/BS**
Long D.	**WorldCom-MCI**	**BA-MCI, SBC-ATT**	
Wireless		**ATT-Cingular Sprint-Nextel, VZ-RC,Alltel, Sprint-Nextel/Cleaerwire**	
Cable	**ATT-TCI, ATT-Media, AOL-Time Warner, Comcast-ATT, Comcast-TW-Adelphia**		



Source: Eli Noam, *Media Ownership and Concentration in America,* 2009, for pre-2008; see sources in Table III-2 for post 2008.

One of the central premises and goals of the 1996 Act was to replace regulation with competition. The Committee Report on the Act passed by the Senate Commerce Committee described the competitive landscape of the mid-90s: "Telephone companies are seeking the right to provide cable service in competition with the cable companies. Similarly, cable companies are seeking the right to provide telephone services."[14] While prior state and federal legislation had held back robust, intermodal competition between these industries, the Act, the Committee noted, "reforms the regulatory process to allow competition for local telephone service by cable, wireless, long distance, and satellite companies, and electric utilities, as well as other entities."[15] Under intense lobbying from a wide array of telecommunications industries – "including the broadcast, computer, long distance, cable and satellite, telephony and wireless industries"[16] – Congress struck an historic compromise and unleashed competition between cable and telephone companies.

To foster competition between telecommunications providers, the Act "permits telephone companies to enter cable and cable to offer telephone services immediately upon enactment."[17] Congress envisioned that the results of this robust competition between telecommunications providers would accrue to the benefit of consumers. As Representative Barton observed, the Act would "provide more competition for more industries for more consumers around this country. It will allow local telephone companies to get in long distance service. It will allow long distance telephone companies to get into local service. It will allow cable television providers to get into long distance and local service and vice versa. We will not have telephone companies, cable companies. We will have communications providers. The consumers will be the ultimate driver. They will have more choice."[18] Rather than the "selective, cherry-picking competition" that previous telecommunications markets were susceptible to, the Act sought to "open the entire telecommunications industry to full competition."[19]

The failure of competition is the result of the difficult economics facing new entrants, strategic choices by the dominant incumbents to avoid competition, and bad policy decisions by regulators enforcing the antitrust laws and the Communications Act. Time-after-time, there was a novel, and crucial trend setting decision that challenged the regulator to take a stand in favor of competition and the regulators got it wrong (a merger of two Baby Bells, major cable companies, large wireless carriers). These decisions opened the door to a flood of anticompetitive transactions that could not be stopped, once the initial mistake had been made. The Verizon-Cable collaborative agreement has all the markings of just such a disastrous transaction.

Telephone companies failed to compete for or failed in competing in key product markets.

- Local companies, who were widely seen as the most likely competitors for local telephone service failed to enter the service territories of their sister companies in any significant way.
- Long distance companies failed to successfully enter into local telephone service.
- Entry into the video business was slow to get started and produced mediocre results at best.

[14] S. Rep. No. 104-23, at 3 (1995).
[15] *Id.* at 5.
[16] 141 Cong. Rec. H4520-21 (May 3, 1995) (statement of Rep. Jack Fields).
[17] *Id., supra* note 2, at 6.
[18] 141 Cong. Rec. H8281-87 (August 2, 1995) (statement of Rep. Joe Barton).
[19] 141 Cong. Rec. S7881-82, 7885 (June 7, 1995) (statement of Sen. Trent Lott).

Cable companies failed to compete for or failed in competing in key product markets.

- Cable failed to enter into the service territories of their sister cable companies.
- Few cable companies entered the wireless business, even though they purchased spectrum.
- Cable was generally unsuccessful in entering the local phone business.

Broadband over wireline was an abject failure.

Although wireless has remained less concentrated than other digital connectivity product markets, it remains highly concentrated.

- Recent trends and spectrum acquisitions suggest greater concentration is a threat to current and future competition.
- Although wireless service eroded long distance and local revenues, the vast majority of this shift of business was from the incumbent local bell telephone companies to the wireless subsidiaries of the same corporate parents.

Each failure of competition was used to justify a permanent reduction of potential competition. Whenever a company failed to try to compete, or failed to compete effectively after trying, it sold itself to the competitor it had failed to successfully challenge. Since it had been unwilling or unable to compete, the argument put forward, was that the merger did not harm competition. While the micro-logic applied to each transaction might have seemed reasonable, the macro consequences were catastrophic for competition. Each individual merger did weaken the prospects for competition by removing a potential competitor and strengthening the position of the dominant incumbent.

Throughout this period, regulators made another critical error, allowing the merging parties to take different positions in the proceedings where they propose anticompetitive transactions than they took in the proceedings where they were seeking to deregulate their services. As the number of intramodal competitors shrank, the spotlight shifted to intermodal competition, which is the target of the collaborative agreements.

D. The Collaborators are Actual and Potential Competitors for the Products they Propose to Cross-Sell

Before deciding to discontinue its FiOS expansion, Verizon frequently provided the only competition in many markets outside of cable, with studies demonstrating that "its entry into an area leads to lower cable prices."[20] While Verizon claims that it discontinued construction of its FiOS service because of high costs and low margins, its most recent quarterly filing before announcing deals with its cable competitors noted that wireless data and FiOS represented the company's two greatest engines for growth and increased revenue per customer.[21]

Similarly, the cable companies at one time represented a serious interest in providing facilities-based wireless services. Eager to offer a 'quadruple' play, the cable companies

[20] Peter Svensson, "Verizon winds down expensive FiOS expansion," USA Today, March 26, 2010, *available at* http://www.usatoday.com/tech/news/2010-03-26-verizon-fios_N.htm

[21] Verizon Communications, Quarterly Report (Form 10-Q), at 22 (Oct. 25, 2011), *available at* *http://www.sec.gov/Archives/edgar/data/1166691/000119312507039301/d10k.htm* http://www.sec.gov/Archives/edgar/data/732712/000119312511280401/d233490d10q.htm

accumulated significant spectrum assets, with SpectrumCo spending $2.4 billion for AWS-1 licenses covering approximately 91% of the population in 2006 (Comcast's share alone stood at $1.3 billion).[22] Separately, Cox spent $305 million for 700 MHz licenses in 2008. And Comcast had earlier acquired WCS licenses in 1997, not long after passage of the Act. Comcast's 2006 Annual Report, following the purchase of AWS licenses, describes how the company has "begun to explore various ways to offer wireless services…We have not yet built any networks using our spectrum, but we are exploring various strategies to utilize this spectrum to enhance our service offerings and offer new services."[23] Cox, another party to the pending transactions, even began offering wireless service, deploying its 700 MHz spectrum in Connecticut, Ohio, Rhode Island, Virginia, Nebraska, southern California, and Oklahoma -- with a goal of expanding wireless service to "more than 50 percent of the Cox footprint" by the end of 2011.[24]

In some sense, the aspiration of the '96 Act to rely on competition suffered the smallest setback from the point of view of intramodal competition in the wireless space and the greatest hope for intermodal competition with 4G technologies offering a mobile broadband service that could challenge cable with the attractiveness of mobility that compensated for its lower capacity. As recently as 2010, Comcast identified "wireless phone companies and other providers of wireless Internet service" as competitors in the provision of "High Speed Internet services" (in particular singling out "4G wireless high-speed data networks" as offering services "similar to ours").[25] Similarly, Verizon stated in its 2010 Annual Report that "cable operators are significant competitors," in particular because "several major cable operators offer bundles with wireless services through strategic relationships."[26] In its 2007 Annual Report, filed not long after its cable competitors had acquired their AWS licenses, Verizon noted that "some cable companies have partnered with wireless carriers, acquired wireless spectrum and are now introducing wireless offerings to their customers."[27] The ability for cable companies to offer bundled services – including wireline and wireless telephony – prompted Verizon in its subsequent Annual Report to claim that "cable operators represent the largest overall threat to our wireline business. Cable operators have increased the size and digital capacity of their networks so that they can offer more digital products and services."[28]

These very recent affirmations of the importance and possibility of cable telco competition by the parties that now propose to collaborate highlights another extremely troubling aspect of the post-Telecom Act world – hypocrisy. Verizon insists that the recent roaming order will resolve concerns about the anticompetitive behavior, while it is challenging the legality of the order in court. It points to the special access proceeding to correct any market power issues, but steadfastly resists any commission action in that proceeding. It is leading the charge against the network neutrality order, claiming competition restricts any incentive communications providers would

[22] Comcast Corp., Annual Report (Form 10-K), at 2 (Feb. 26, 2007), *available at* http://www.sec.gov/Archives/edgar/data/1166691/000119312507039301/d10k.htm

[23] Comcast Corp., Annual Report (Form 10-K), at 6 (Feb. 26, 2007), *available at* *http://www.sec.gov/Archives/edgar/data/1166691/000119312507039301/d10k.htm*

[24] Press Release, "Cox Launches Wireless in Rhode Island, Connecticut, Cleveland," Cox Communications, May 17, 2011, *available at* http://cox.mediaroom.com/index.php?s=43&item=543

[25] Comcast Corporation, Annual Report (Form 10-K), at 7 (Feb. 25, 2011), *available at* http://www.sec.gov/Archives/edgar/data/1166691/000119312511047243/d10k.htm

[26] Verizon Communications, Annual Report (Form 10-K), at 14 (Feb. 28, 2011), *available at*: http://www.sec.gov/Archives/edgar/data/732712/000119312511049476/d10k.htm

[27] Verizon Communications, Annual Report (Form 10-K), at 4 (March 1, 2007) *available at* http://www.sec.gov/Archives/edgar/data/732712/000119312507044126/d10k.htm

[28] Verizon Communications, Annual Report (Form 10-K), at 4 (Feb. 28, 2008), *available at* http://www.sec.gov/Archives/edgar/data/732712/000119312508042027/d10k.htm

have to give their own services preference, while seeking a collaborative agreement that would give its services clear advantages.

Unfortunately for consumers, the agreements between Verizon and the cable companies amount to a competitive cease-fire. Through numerous forms of accommodating behavior, Verizon has signaled that it won't challenge the cable companies in their core business and in turn the cable companies will never act as genuine, facilities-based competitors to Verizon's highly profitable wireless business (so profitable, in fact, that it accounts for 63% of Verizon Communications' aggregate revenues[29]). By selling their nearly nationwide AWS footprint (and Cox shuttering its 700 MHz network), the cable companies have made clear that they have no intention of challenging Verizon in wireless. Even as outright wholesale purchasers of wireless service under the joint marketing and resale agreements the cable companies will never act as genuine competitors to Verizon. As Verizon itself has acknowledged, "a fundamental goal of the 1996 Act was to encourage competing carriers to deploy their own facilities in order fully to unleash the incentives of incumbents and competitors alike to develop innovative service and pricing options to the benefit of customers."[30] As MVNOs, the cable companies will not be able to competitively distinguish themselves from Verizon based on service quality, since, as Verizon explained in the case of TracFone, a reseller "can only represent that its service is of the same quality and reliability as that of its underlying vendors."[31]

In return for staying on the sidelines of the wireless industry, Verizon has effectively signaled it will refrain from challenging the cable companies in high speed broadband and video programming. Though the company had announced a cessation to FiOS build-out prior to the transactions, that decision is hardly irrevocable.

Indeed, given the tremendous growth FiOS has provided Verizon, it would have made sense for Verizon to continue building-out the network. Instead, Verizon has signaled in myriad ways that it has no intention of offering alternatives to core cable products of its former competitors. Calculations suggest that that the percentage of SpectrumCo cable customers within Verizon's legacy wireline footprint stands at over 70% -- precisely the consumers that Verizon could lure away with competitive high-speed Internet offerings. Instead, Verizon has selectively cherry-picked its FiOS deployments, building in areas not served by its SpectrumCo allies.

Verizon's decision to end offering stand-alone DSL provides an illustrative example of its accommodating behavior – particularly in light of DIRECTV's recent disclosure that it had been working with Verizon to develop a "next-generation fixed wireless broadband product" to be marketed jointly between the two companies and "compete directly with cable operators." That is, until Verizon abandoned the efforts "almost immediately after entering into the Commercial Agreements" with the cable companies.[32]

Intermodal competition served to encourage competing communications providers to develop innovative and *new* services to differentiate their products. These competitive efforts

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[29] Verizon Communications, Annual Report (Form 10-K), at 2 (Feb. 24, 2012), *available at* http://www.sec.gov/Archives/edgar/data/732712/000119312512077846/d257450d10k.htm

[30] Response of Verizon to Petitions for Reconsideration, *Review of Section 251 Unbundling Obligations for Incumbent Local Exchange Carriers*, CC Docket No. 01-338, at 52 (Nov. 6, 2003), *available at* http://apps.fcc.gov/ecfs/comment/view?id=5510441603

[31] Comments of Verizon, *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, at 13 (July 26, 2004), *available at* http://apps.fcc.gov/ecfs/comment/view?id=5511437941

[32] Letter from William M. Wiltshire, Counsel for DIRECT, LLC, to Marlene H. Dortch, Secretary, FCC, WT Docket No. 12-4 (May 16, 2012), *available at* http://apps.fcc.gov/ecfs/comment/view?id=6017035690

would, in turn, act as engines for the nation's economic development.[33] By contrast, the joint operating agreement between the erstwhile competitors Verizon and Big Cable envisions a pooling of research and development and a sharing of intellectual property, patents and innovations.[34]

The extent to which the next generation of wireless broadband service being rolled out (4G LTE) would be a full or partial competitor to the cable broadband network is hotly debated. There is no doubt that it would provide some competition and the proposed transaction reduces that competitive threat to cable, by marrying the interests of Verizon to the cable operators out of its footprint. Cable now has one of the crown jewels that would have driven competition in its pocket. The obverse holds within the Verizon footprint. To the extent that Verizon is losing customers to cable (particularly where it has not deployed FIOS), it has the cable crown jewel in its pocket, since it now has a much greater opportunity to secure the wireless part of the quad play bundle. The exchange of the competitive crown jewels between dominance firms cannot be good for competition.

Instead of the intermodal "communications providers" the Act's drafters envisioned, the nation will still be left with telephone companies and cable companies, with "selective, cherry-picked competition" in a few markets and collusive agreements not to compete in the vast majority. The '96 Act gave birth to these telecommunications giants, releasing them from state and federal regulations that had curbed their monopolistic and anticompetitive instincts in the hope that deregulation would encourage them to genuinely compete with one another. With a series of anticompetitive agreements, Verizon and Cable have signaled the death knell of the 1996 Telecom Act and quite possibly the end of a competitive wireless industry that consumer have enjoyed for the last fourteen years.

THE COLLABORATIVE AGREEMENT HAS NUMEROUS ANTICOMPETITIVE ASPECTS

Although the specific details of the collaborative agreements are shrouded in secrecy, the details that are available are most troubling for consumers and competition. The companies have structured the transaction in a way that dramatically reduces their incentive and ability to compete and jointly marketing each other's crown jewel asset is only the most obvious of these problems. Each of the parties controls the pricing of its crown jewels sold by the other parties, so there is no ability or incentive to discount. Since these are very high margin services, the post transaction price is likely to be maintained or increased with the relaxation of competitive pressures that results from cross-marketing of services. There appear to be some exclusive and most favored nation arrangements that in essence transfer control of strategic assets to the collaborators. The collaborators certainly have an incentive to favor the co-branded products of their partners over service from independent third parties, since they gain a commission on the sale of co-branded products.

Anti-Competitive Effects

The assessment of the collaborative agreement starts from markets that are highly concentrated and extremely difficult to enter. The dominant players are proposing to collaborate. Given the severe concerns from the market structural level, the nature of the collaborative agreement would have to be strong in controlling potential abuses of market power that would

[33] S. Rep. No. 104-23, at 16 (1995).
[34] Description of the Transaction and Public Interest Statement, WT Docket No. 12-4, at fn. 71 (Dec. 21, 2011).

result from the transaction. That is not the case. On the contrary, the collaborative agreement does exactly the opposite.

The fact that the collaborating parties are among the dominant firms on both sides of what had been a clearly competitive line in the market is particularly troubling. Any reduction of the intensity of the rivalry between these firms must be counted as a severe competitive loss. In a very real sense, the competition had boiled down to cable versus telephone companies. By entering into this collaborative agreement that rivalry is reduced and the nature of competition in the communications market is transformed for the worse. To put the vulnerability of these markets into perspective, in markets where the dominant firm has a 50% to 60% market share, a merger that increases its market share by a mere 2% increases the HHI index sufficiently to trigger the highest level of concern – the presumption that the merger will increase market power.

The agreements are immediately and directly anticompetitive. They pull into a collaborative relationship firms that currently compete head-to-head in a number of services that hey provision with their own facilities including video, voice, broadband and WiFi.

Existing arrangements that promote competition against dominant incumbents for specific products have been or are likely to be eliminated. These anticompetitive effects include: cable-agreements with non-dominant wireless firms to compete against dominant telecommunications firms; telephone company agreements with non-dominant video service providers to compete against dominant cable companies; weak telephone company arrangements with strong wireless firms, to compete against dominant cable companies.

Because the collaborators now have a vested interest in the success of their partners, the agreements call into question the willingness of collaborators to make essential inputs available to non-collaborating firms including services like backhaul, private line, and WiFi access

Collaborative Agreement Details

Given the very long term of the collaborative agreement, it is likely to substantially change incentives. The agreement reduces the incentive for Verizon to continue to build out its fiber broadband network to compete with cable's broadband network since it gets to market its high margin product (wireless) in areas that have not been upgraded, in a bundle with cable broadband, thereby reducing its capital expenditures.

The agreements appear to include retail price maintenance, exclusivity provision and most favored nation clauses that restrict the independence of action and reduce competitive rival. Sales quotas or quantitative targets would be particularly damaging to competition. The retail price maintenance provision gives the firms the incentive to keep prices high and precludes discounting. Given that they are the dominant firms and the collaborative agreement strengthens their market position, this will lead to higher prices.

The tools that the dominant firms will have available to wield against independent competitors are important. Cable's middle mile connectivity facilities will not be a competitive factor in the market, because Verizon is guaranteed the lowest price. Verizon's position in the wireless market out of its wireline footprint will be strengthened. Competition in the wireless market, which is the most competitive of the local connectivity product markets, albeit still highly concentrated, will be weakened. This will accelerate the movement toward a wireless duopoly. The leveraging of middle mile assets could undermine competition in another way. Cable has built an extensive WiFi network, which is used to provide first mile connectivity. The major cellular service providers have turned to WiFi as a means to alleviate congestion on their networks. Cable will have the incentive to allow Verizon to use the cable WiFi networks, but deny -- or hamper -- other cellular providers access.

The acquisition by Verizon of additional spectrum that is ideally suited to wireless broadband service cannot be seen as procompetitive. Verizon is already endowed with the largest amount of spectrum of any wireless company. Its spectrum has also been the least utilized. Unlike its competitors, it declared that it had sufficient spectrum for several years of development. Removing this spectrum from the market, and permanently eliminating the threat of cable going into the wireless business, is a severe blow to wireless competition.

Any sales quotas or targets will certainly diminish the incentive to sell its own product, build out its own network, or improve the product that competes against the sales-targeted product.

Efficiencies

Even a transaction that harms competition can be saved, if it can claim large, demonstrable efficiency gains that will be passed through to consumers, efficiency gains that will flow from the anticompetitive transaction and could not be achieved by less harmful means.

> **Efficiency Analysis:** The participants must substantiate efficiency claims so that the Agencies can verify by reasonable means the likelihood and magnitude of each asserted efficiency; how and when each would be achieved; any costs of doing so; how each would enhance the collaboration's or its participants' ability and incentive to compete; and why the relevant agreement is reasonably necessary to achieve the claimed efficiencies
>
> Efficiency claims are not considered if they are vague or speculative or otherwise cannot be verified by reasonable means.
>
> Moreover, cognizable efficiencies must be potentially procompetitive.
>
> The Agencies consider only those efficiencies for which the relevant agreement is reasonably necessary. An agreement may be "reasonably necessary" without being essential. However, if the participants could have achieved or could achieve similar efficiencies by practical, significantly less restrictive means, then the Agencies conclude that the relevant agreement is not reasonably necessary to their achievement.[35]

The efficiency gains from the collaboration, do not meet those tests. In the words of one of the defenders of the transaction, the gains "do not knock your socks off." They are not of the type (variable cost savings) that is most readily transmitted to consumers. Verizon had been independently working on the most important of the claimed gains – integration of wireless and wireline – and claimed to have already made great progress.

Conclusion

Rewarding failure and hypocritical double speak by the communications companies over a fifteen year period has led us from bold promises about vigorous intramodal and intermodal competition among large numbers of companies, to the stark reality of a cozy duopoly of a local cable company and a local telecommunications company that dominate communications

[35] Collaboration Guidelines

connectivity. To be sure, some competition is better than none, but a cozy duopoly is not enough competition to prevent the abuse of market power or to impose competitive discipline that drives innovation and a collaborative agreement will make matters worse.

Given the stature of the collaborators, each advantage gained as a result of the agreement, should be seen as a loss for competition, since it will reduce the incentive of dominant firms to compete while diminishing the prospects of the firms that are most likely to compete. Volume discounts may flow to the collaborators. Bigger bundles will reduce the churn to weaker competitors.

If one asks what the primary value the collaborators receive from this transaction, one must conclude that it is a respite from competition. Verizon gets a substantial leg up on its wireless competitors out of region. Cable gets relief from the threat of competition in the Verizon footprint, a threat that was growing substantially as FIOS matured. Each party gets a financial reward as a sales agent of the cross-marketed product, one of which is a high margin stream of revenue. Each party can count on more sales of the crown jewel it has allowed to be cross-marketed.

The proposed sale of Comcast spectrum to Verizon and the collaborative agreement between Verizon and the major cable companies mark the end of the competitive promise of the 1996 Act. The last two competitors standing, cable companies and telecommunications service providers, with any hope of building a serious competitive challenge by offering a bundle of services anchored in a product in which it has a clear advantage, have decided to collaborate, rather than compete.

After a decade and a half of failing to prevent the demise of competition by narrowly focusing on the individual impact of each merger and allowing the failure of competition to be an excuse for allowing mergers, it is difficult for those with antitrust and Communications Act responsibility to admit that competition policy has failed and to take the action necessary to address the problem. We believe that this case provides an ideal opportunity to do so for several reasons

- It represents the first time that dominant, cable and telecom companies who have been involved in head-to-head competition have proposed to collaborate and exchange assets.
- The claim that jointly marketing each other's marquee service and jointly developing and sharing new functionalities or services will not diminish the competitive intensity of these markets is absurd. The advantage that the joint efforts will confer on the dominant incumbents will certainly place the remaining independent competitors at a disadvantage.
- The harm to competition is most severe in those areas that the joint venturers both call home, but the impact of the joint venture will be felt everywhere because essential assets that are necessary for competition have been removed from the marketplace.

Creating a joint venture wireless-cable bundle excuses cable from entering wireless and creates an advantage for both cable and Verizon that is difficult if not impossible to match for firms that are not party to the joint venture.