Before the
Federal Communications Commission
Washington, D.C. 20554

In the Matter of	)	
	)	
SBC Communications Inc. and	)	
AT&T Corp. Applications for	)	WC Docket No. 05-65
Approval of Transfer of Control	)	
	)	

MEMORANDUM OPINION AND ORDER

Adopted: October 31, 2005 **Released:** November 17, 2005

By the Commission: Chairman Martin and Commissioner Abernathy issuing separate statements; Commissioners Copps and Adelstein concurring and issuing separate statements.

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I. INTRODUCTION

1. SBC Communications Inc. (SBC) and AT&T Corp. (AT&T) (collectively, "the Applicants") have filed a series of applications[1] pursuant to sections 214 and 310(d) of the Communications Act of 1934, as amended (Communications Act or Act)[2] and section 2 of the Cable Landing License Act[3] in connection with their proposed merger. This merger would combine one of the largest regional Bell Operating Companies (BOCs) with one of the largest providers of interexchange and competitive local service. This proposed merger occurs against the backdrop of ongoing change in the industry, including the pending merger of Verizon and MCI and the recent merger of Sprint and Nextel.[4] SBC and AT&T

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[1] *Commission Seeks Comment on Application For Consent to Transfer of Control Filed By SBC Communications Inc. and AT&T Corp.*, Public Notice, WC Docket No. 05-65, DA 05-656 (rel. Mar. 11, 2005), *corrected by* Erratum, WC Docket No. 05-65 (rel. Mar. 14, 2005) (*Public Notice*).

[2] 47 U.S.C. §§ 214, 310(d).

[3] *Id.* § 35; *see generally* An Act Relating to the Landing and Operation of Submarine Cables in the United States, 47 U.S.C. §§ 34-39 (Cable Landing License Act).

[4] This merger is one of three in little more than a year involving the former "Big 3" long distance carriers (AT&T, MCI, and Sprint), which faced rapidly declining revenues in some of their core retail markets in the past few years as a result of increasing competition from local carriers, wireless carriers, cable companies, and others. *See Verizon Communications Inc. and MCI, Inc. Applications for Approval of Transfer of Control,* WC Docket No. 05-75, Memorandum Opinion and Order, FCC 05-184 (rel. Nov. 17, 2005); *Applications of Nextel Communications, Inc. and Sprint Corporation for Consent to Transfer Control of Licenses and Authorizations*, WT Docket No. 05-63, File Nos. 0002031766, *et al.*, Memorandum Opinion and Order, FCC 05-148 (rel. Aug. 8, 2005) (*Sprint/Nextel Order*).

offer competing services in many communications markets, and each also supplies wholesale inputs relied upon by the other Applicant and other competitors in various retail markets. Thus, the proposed merger requires us to examine its effects on competition – which are both horizontal and vertical in nature – in a wide range of significant communications markets.

2. In accordance with the terms of sections 214(a) and 310(d), we must determine whether the Applicants have demonstrated that the proposed transfers would serve the public interest, convenience, and necessity.[5] Based on the record before us, and as discussed more fully below, we find that the transaction meets this standard. After analyzing the record, we conclude that significant public interest benefits are likely to result from this transaction. These benefits, which are likely to flow to consumers, relate to enhancements to national security and government services, efficiencies related to vertical integration, economies of scope and scale, and cost savings. We further conclude that, in light of the consent decree executed between the Department of Justice and the Applicants (DOJ Consent Decree),[6] the transaction is not likely to have anticompetitive effects in the relevant markets discussed below. Moreover, to the extent that the merger increases concentration in relevant markets, we find that the public interest benefits of the merger outweigh any potential public interest harms. Finally, we note that the Applicants have offered certain voluntary commitments.[7] Because we find these commitments will serve the public interest, we accept them and adopt them as conditions of our approval of the merger.

II. EXECUTIVE SUMMARY

3. As discussed below, our analysis of the competitive effects of the merger, which focuses on the following key services, finds that the merger is not likely to result in anticompetitive effects in relevant markets.

- **Special access competition.** The record indicates that, in a limited number of buildings where SBC and AT&T are the only carriers with direct connections, the merger is likely to have an anticompetitive effect on the market for Type I wholesale special access services. We find, however, that the DOJ Consent Decree adequately addresses these likely anticompetitive effects. With respect to Type II wholesale special access services, we find that other competitors with similar types of local facilities will remain post-merger to help mitigate the loss of AT&T.

- **Retail enterprise competition.** We find that the merger will not likely have anticompetitive effects for enterprise customers, even though we find that the Applicants currently compete against each other with respect to a range of enterprise customer classes and enterprise services. We find that competition for medium and large enterprise customers should remain strong after

[5] *Sprint/Nextel Order,* FCC 05-148 at para. 20; *Applications of NYNEX Corp., Transferor, and Bell Atlantic Corp., Transferee, For Consent to Transfer Control of NYNEX Corp. and Its Subsidiaries*, File No. NSD-L-96-10, Memorandum Opinion and Order, 12 FCC Rcd 19985, 19987 at para. 2 (1997) (*Bell Atlantic/NYNEX Order*); *Merger of MCI Communications Corp. and British Telecommunications PLC,* GN Docket No. 96-245, Memorandum Opinion and Order, 12 FCC Rcd 15351, 15353 at para. 2 (1997) (*BT/MCI Order*).

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

[7] *See generally* Letter from Thomas F. Hughes, Vice President-Federal Regulatory, SBC, to Marlene H. Dortch, Secretary, FCC, WC Docket No. 05-65, Attach. (filed Oct. 31, 2005) (SBC Oct. 31 *Ex Parte* Letter); *see also* Appendix F.

the merger because medium and large enterprise customers are sophisticated, high-volume purchasers of communications services that demand high-capacity communications services, and because there will remain a significant number of carriers competing in the market. With respect to small enterprise customers, we recognize that AT&T had announced its gradual withdrawal from that market, and we conclude after examining the record that it was not exerting significant competitive pressure with respect to those customers.

- **Mass market competition.** We conclude that the merger will not likely have anticompetitive effects in the mass market. While AT&T currently retains a significant share of mass market customers, we find, as with small business customers, that AT&T has ceased marketing mass market services and has been gradually withdrawing from that market. Consequently, we find that, immediately prior to the announcement of the merger, AT&T was not exerting significant competitive pressure on SBC within SBC's own region. Moreover, we note the rapid growth of intermodal competitors – particularly cable telephony providers (whether circuit-switched or voice over IP (VoIP)) – as an increasingly significant competitive force in this market, and we anticipate that such competitors likely will play an increasingly important role with respect to future mass market competition.

- **Internet backbone competition.** Based on the record, we are persuaded that the merger is not likely to result in anticompetitive effects in the Internet backbone market. We do not find that the Tier 1 backbone market is likely to tip to monopoly or duopoly, based either on market share or on other factors, such as changes in relative traffic volumes or through targeted de-peering or degraded interconnection. Rather, we expect a number of Tier 1 backbones to remain as competitive alternatives to the merged entity. We also are not persuaded that the merger will increase the Applicants' incentive and/or ability to raise rivals' costs. Given the level of competition we expect to remain in the Tier 1 backbone market, we are not persuaded that such actions would be viable.

- **Wholesale interexchange competition.** We find that the merger is not likely to result in anticompetitive effects for wholesale interexchange services. We conclude that the market will remain competitive post-merger, due primarily to the presence of numerous competitive nationwide fiber networks with excess capacity.

- **International competition.** We find that the merger is not likely to result in anticompetitive effects for international services provided to mass market, enterprise, or global telecommunications services customers. Additionally, we find that the merger is not likely to result in anticompetitive effects in the international transport, facilities-based IMTS, or international private line markets.

- **Applicants' commitments.** The Applicants offered certain voluntary commitments related to special access, stand-alone DSL, the Commission's Internet Policy Statement, and Internet backbone services. Because we find these commitments serve the public interest, we accept them and adopt them as express conditions of our merger approval.

4. Accordingly, based on the record, we find that the merger of SBC with AT&T is in the public interest and we grant the applications for transfer of control.

competition for long distance services, and because SBC's (and to some extent AT&T's) market shares in the long distance and bundled local and long distance markets vary significantly from state to state,[304] we find it appropriate to consider a narrower relevant geographic market.

99. We recognize that the competitive choices customers face may vary within a state (*e.g.*, in some areas of a state, cable companies may provide cable VoIP, while in other areas they may not). This suggests that we should define the relevant geographic market to be an area smaller than the state. The data in the record is not sufficiently detailed, however, for us to perform a structural analysis at a more disaggregated level than that of the state. Accordingly, in performing our structural analysis, we calculate market shares and changes in market share at the state level. While we recognize that, in theory, using a state-level analysis may mask some variations in smaller geographic areas, we find it a reasonable approach to our analysis, particularly given that SBC's pricing for local, long distance, and bundled local and long distance services is generally advertised on a statewide basis.[305] Accordingly, we analyze mass market local, long distance, and bundled local and long distance services in SBC's franchise area within each state.

c. Market Participants

100. As the foregoing indicates, SBC faces competition from a variety of providers of retail mass market services. These competitors include not only wireline competitive LECs and long distance service providers but also, to at least some extent, facilities-based and over-the-top VoIP providers, and wireless carriers.

2. Competitive Analysis

a. Horizontal Effects

101. *Unilateral Effects.* As discussed below, we find that SBC's acquisition of AT&T is not likely to result in anticompetitive effects for mass market services due to AT&T's actions to cease marketing and gradually withdraw from providing local service, long distance service and bundled local and long distance service to the mass market. We also conclude that competition from intermodal competitors is growing quickly, and we expect it to become increasingly significant in the years to come.[306]

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[304] The variation in market share from state to state for long distance and bundled local and long distance services is due in large part to the fact that SBC obtained section 271 authority in a particular state to provide such services at different times and therefore has been competing in those markets for varying periods of time.

[305] *See, e.g.*, *SBC – Residential Products and Services* (visited Sept. 9, 2005) *available at* http://www.sbc.com/gen/general?pid=1080&cdvn=localize&prod-snip=res_long_distance; *SBC Selector* (visited Sept. 9, 2005) *available at* http://configurator.sbc.com/acct_cfg/SBCSelector/AppUI/BMSFrontAppUI/content/residential/splash_files/splash.jsp.

[306] Although the Applicants allude to regulatory safeguards, which they claim would constrain the post-merger firm's prices, we are not persuaded that this would adequately address competitive concerns. SBC Application at 45. For example, local services are subject to only limited price regulation in some states (*e.g.*, Oklahoma, Arkansas, and Ohio). Currently there is limited regulatory oversight for SBC's retail service offerings provided through its section 272 separate affiliate. In many states, SBC's bundled offerings either have no price regulation (*e.g.*, Arkansas, Missouri, Michigan) or they can be priced no lower than a price floor (*e.g.*, Texas, California, Nevada). SBC Info. Req. at 134-169.

102. Following Commission precedent, we begin our analysis by examining SBC's and AT&T's market share, and supply and demand factors. In general, the market share calculations indicate a high level of concentration in most franchise areas in SBC's states for all relevant services.[307] Within SBC's franchise areas, its median market share for local services increases from **[REDACTED]** percent to **[REDACTED]** percent,[308] with a post-merger market share range of **[REDACTED]** percent to **[REDACTED]** percent. Similarly, within SBC's franchise areas, its median market share of long distance services will increase from **[REDACTED]** percent to **[REDACTED]** percent, with a post-acquisition market share range from **[REDACTED]** percent to **[REDACTED]** percent.[309] Finally, within SBC's franchise areas, its median market share for bundled local and long distance services will increase from **[REDACTED]** percent to **[REDACTED]** percent, with a post-acquisition market share range of **[REDACTED]** percent to **[REDACTED]** percent.[310] Because these market shares suggest potentially problematic levels of concentration, we must next evaluate other aspects of the market.

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[307] We discuss the Applicants' market shares before and after the merger instead of HHIs for each geographic market because we do not have sufficient market share information for all of the significant competitors in these markets. Market share calculations for each of SBC's franchise areas are provided in Confidential Appendix D. Our analysis of concentration in the mass market relies upon data for residential customers because of the administrative difficulty of distinguishing small business data from data for other classes of businesses. The Commission has previously found that residential and very small businesses have similar patterns of demand, are served primarily through mass marketing techniques, purchase similar volumes and communications services, and would likely face the same competitive alternatives within a geographic market. Thus, we conclude that an analysis of market share of residential consumers is likely to accurately represent SBC's position in the mass market. *Cf. Bell Atlantic/NYNEX Order*, 12 FCC Rcd at 20016, para. 53 (discussing similarities between residential and small business customers); *Implementation of the Local Competition Provisions of the Telecommunications Act of 1996*, Third Report and Order and Fourth Further Notice of Proposed Rulemaking, 15 FCC Rcd 3696, 3829, para. 293 (1999) (discussing similarities between residential and small business customers in the context of unbundling rules); *SBC/Ameritech Order*, 14 FCC Rcd at 14746, para. 68 (including residential and small business customers in the same market).

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

[309] Our calculations for the long distance market include only those consumers with a wireline long distance presubscribed carrier. We have no information to estimate the extent to which consumers may be able to migrate long distance minutes to their mobile wireless service or prepaid calling cards. Thus, we recognize that these market shares are likely to overstate SBC's share of the long distance market.

[310] With respect to bundled local and long distance market shares, we follow a methodology similar to that employed in calculating SBC's share of local services, described above. *See supra* note 308. In this case, however, we exclude consumers who do not have a PIC or who subscribe to an interexchange carrier other than their local service provider. Post-merger, we assume SBC's local customers who have AT&T as their presubscribed
(continued….)

103. Although we agree with commenters that the Applicants' post-merger market shares for the relevant products are high,[311] we nonetheless find, for the reasons given below, that these numbers significantly overstate the likely competitive impact of the merger. Regardless of what role AT&T played in the past, we conclude that AT&T's actions to cease marketing and gradually withdraw from the mass market mean it is no longer a significant provider (or potential provider) of local service, long distance service, or bundled local and long distance service to mass market consumers.[312] We base this conclusion on AT&T's cessation of marketing, its reductions in consumer operations, its retirement of infrastructure used to support mass market marketing and consumer care for mass market services, and its decision to "harvest" its mass market business by raising prices, resulting in a declining mass market customer base.[313] The record indicates that AT&T's decision was the result of its own internal deliberations after determining that it would be uneconomical for it to continue to offer mass market services.[314] We reject as speculative and unrealistic commenters' suggestion that AT&T could readily and easily reverse its decision.[315] The record demonstrates that once AT&T determined that mass market services were no longer a viable business opportunity, it implemented steps to close down its mass market operations in an orderly fashion, and there is no indication that, absent the merger, AT&T would reverse this decision.[316]

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interexchange carrier will migrate to SBC. Thus, our estimate overstates SBC's relative position post-acquisition to the extent that SBC local/AT&T long distance consumers switch to an alternative interexchange carrier or AT&T's local customers switch to a competitive provider.

[311] *See, e.g.*, Cbeyond *et al.* Petition at 34-35; Consumer Federation *et al.* Petition at 19-22; Nevada DOJ Comments at 5-6; Texas OPC Comments at 4.

[312] AT&T states that it found it difficult to compete for mass market local exchange customers for a variety of reasons, including competition from facilities-based intermodal providers, such as cable companies and wireless carriers; competition from other VoIP providers; competition from other wireline carriers; and the D.C. Circuit's vacatur of the unbundling rules set forth in the *Triennial Review Order*, to which the Commission responded by phasing out competitive LEC access to UNE-P at TELRIC prices. *See, e.g.*, SBC/AT&T Application at 50-52; Polumbo Declaration at paras. 6-10; SBC/AT&T Application, Declaration of Thomas Horton (SBC/AT&T Horton Decl.) at para. 7.

[313] *See* SBC/AT&T Application, Declaration of John Polumbo (SBC/AT&T Polumbo Decl.) at paras. 3-40; AT&T Info. Req., Exhs. 16(b)-I, 16(b)-IV; *see also* AT&T Info. Req., ATT551002844-51, ATT5600000524-90. "Harvesting" refers to AT&T's increasing prices to encourage customers to discontinue service. "Harvesting" refers to AT&T's steps to manage the decline in its mass market business. *See, e.g.*, *Q4 2004 AT&T Earnings Conference Call on Jan. 20, 2005* at 9 (Jan. 20, 2005) *available at* http://www.att.com/ir/pdf/4q04_transcript.pdf ("in our consumer business the revenue decline will accelerate from '04 as we've moved to harvest that business as a result of the regulatory changes effective middle of last year").

[314] *See* SBC/AT&T Polumbo Decl. at paras. 3-9; *see also* AT&T Info. Req., ATT551002844-51, ATT5600000524-90. The record does not indicate whether AT&T was continuing to offer mass market prepaid calling cards. Because we find that prepaid calling cards are of diminishing importance for domestic long distance services, we conclude that, even if AT&T continued to have a role in that market, it is of limited significance. AT&T's significance is diminished further by the ability of other competitors to provide such services, given continued competition and excess capacity for wholesale interexchange services. *See infra* Part V.F (Wholesale Interexchange Competition). In addition, we note that the record indicates that IDT is a leading provider of prepaid calling card services, and that other carriers and resellers operate in this market. SBC/AT&T Application at 65 n.212.

[315] *See, e.g.*, ACN *et al.* Petition at 25; Cbeyond *et al.* Petition at 31; Qwest Bernheim Decl. at para. 77; EarthLink White Paper at 10.

[316] *See* SBC/AT&T Horton Decl. at paras. 2-7; SBC/AT&T Polumbo Decl. at paras. 3-40; AT&T Info. Req., ATT551002844-51, ATT5600000524-90.

Thus, we agree with the Applicants that AT&T ceased being a significant participant in this market.[317] We note that the record evidence further indicates that SBC's current and future pricing incentives are based more on likely competition from intermodal competitors and the remaining competitive LECs.[318]

104. Finally, we reject commenters' arguments that consumers will be worse off after the merger. Qwest argues that AT&T's customers would be better off if SBC had to compete for their business. [319] First, as stated above, AT&T ceased to act as a significant competitive presence in the market a year ago when it began to implement its strategy to harvest its customer base. Second, AT&T's customers will not necessarily be worse off after the merger because SBC (or other incumbent LECs outside of SBC's region) and the remaining competitive providers will continue to compete for customers (AT&T's former customers as well as each other's customers).[320] Third, AT&T's customers are free to seek service from whichever providers are present in the market.[321] As noted, we find that intermodal competitors, including facilities-based VoIP and mobile wireless providers, are likely to capture an increasing share of mass market local and long distance services. In addition, we take further comfort from the Applicants' voluntary commitment to offer stand-alone DSL[322]

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[317] For the same reasons, we conclude that AT&T has ceased to operate as a significant competitor for mass market broadband services. AT&T Info. Req. at 52-53. Further, the record indicates that AT&T has only a limited consumer DSL customer base, with **[REDACTED]** customers nationwide. AT&T June 17 *Ex Parte* Letter, Suppl. Exh. 1; *see also* EarthLink White Paper at 27 n.65 (stating that AT&T "has not yet achieved significant *actual* competition with a critical mass of DSL customers"). We also note that AT&T provides its DSL service "by leasing wholesale services from unaffiliated DSL providers" such as Covad, New Edge, and MegaPath. AT&T Info. Req. at 54. Given that AT&T offers DSL through such wholesale arrangements, we conclude that other competitors will be equally able to do so post-merger. Thus, as with mass market voice services, we find that the merger is not likely to result in anticompetitive effects for mass market broadband services through either unilateral or coordinated effects. *See, e.g.*, Consumer Federation *et al.* Petition at 3-9 (expressing concern about competitive effects with respect to broadband services).

[318] AT&T's decision to shut down its mass market operations indicates it was not a potential purchaser of third party UNE-P substitute products, as some commenters claim. The elimination of UNE-P was a significant factor in AT&T's decision, but we reject commenters' suggestion that this implies other wireline competitive LECs would also find it unprofitable to serve this market. *See, e.g.*, Qwest Petition at 34. While certain commenters express concern about their ability to offering competing service based on current TELRIC rates for unbundled DS0 loops, such concerns are not merger specific. Telscape Comments at 5-6; Letter from Ross A. Buntrock, Counsel for Fones4All, to Marlene H. Dortch, Secretary, FCC, WC Docket No. 05-65 at 2-3 (filed Sept. 7, 2005); Letter from Richard M. Rindler, Counsel for TDS Metrocom, to Marlene H. Dortch, Secretary, FCC, WC Docket No. 05-65 at 1-2 (filed Sept. 30, 2005).

[319] Qwest Bernheim Decl. at paras. 76-77.

[320] *See, e.g.*, SBC/AT&T Reply at 104. We note that Cbeyond *et al.*'s claims of a likely price increase for residential long distance and bundled services are flawed because their analysis does not consider competition from intermodal competitors. Moreover, this analysis incorrectly assumes AT&T is a competitive force in the market because of its legacy market share and thus overstates AT&T's significance in the market by failing to account for the fact that AT&T no longer is a significant market participant. Cbeyond *et al.* Wilkie Decl. at paras. 41-48.

[321] SBC/AT&T Reply at 102.

[322] Because we find this commitment will serve the public interest, we accept it and adopt it as a condition of our approval of the merger, as discussed below. *See infra* Part VII (Process and Enforcement).