Policy Brief

Stanford Institute for Economic Policy Research

Humpty-Dumpty? Competitive Effects of the AT&T – BellSouth Merger

by Gregory Rosston

AT&T has made an offer to buy BellSouth. This is not the first large telecommunications merger and it is likely not to be the last. Of the proposed telecommunications mergers since the passage of the Telecommunications Act in 1996, only one, the proposed MCI-Sprint merger, was challenged and blocked on antitrust grounds – all of the other mergers have been approved, some with divestitures to ameliorate competitive concerns. This is also just one in a series of mergers that have partially reconstituted the original AT&T that was broken apart in 1984.

There will be a lot of talk in the press about the competitive concerns surrounding the re-creation of Ma Bell. This brief will outline some of the competition analysis the Department of Justice, the FCC and state regulatory agencies will undertake in evaluating the proposed merger. In addition to analysis of potential competitive effects resulting from the merger, much of the public debate is likely to focus on competitive issues unrelated to the merger because the review process gives parties a chance to bring their concerns to the forefront of the debate. While those may enter into the debate, they should not be a part of the competitive effects analysis and the DOJ is unlikely to address those concerns. The FCC has a broader mandate and has shown a tendency to address non-merger issues in the context of mergers, so its reaction may be different.

Background

AT&T is the combination of several former Regional Bell Operating Companies (RBOCs) that provide local landline telephone service in 13 states including California, Texas, the Midwest and the Southeast. In these regions, AT&T provides service to about 50 million landline telephones and 7 million DSL lines. AT&T operates long-distance service and provides enterprise solutions across the country. The only other company with comparable size on the telephone side is Verizon.

BellSouth is another RBOC. It has operations in 9 states in the Southeast. It has about 20 million lines in service. BellSouth provides long-distance service throughout its region and service to enterprise business in its region and throughout the country. If the merger goes through, Verizon and Qwest will be the other two remaining RBOCs.

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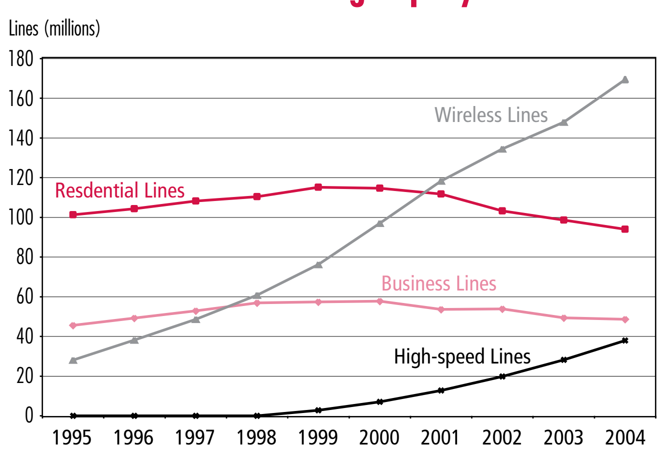
In addition to their landline operations, AT&T (60 percent) and BellSouth (40 percent) jointly own Cingular Wireless, which operates in all 50 states. Cingular has more than 54 million wireless subscribers in the United States. It is the result of a set of mergers among the wireless operations of SBC, BellSouth, Pacific Bell and, recently, AT&T Wireless (in a merger separate from the SBC-AT&T merger).

Figure 1 shows that subscriptions to wireless and high-speed access (cable and DSL primarily) have been rising rapidly while traditional wired residential and business lines subscriptions have been flat or decreasing. Data for Voice over Internet Protocol (VOIP) subscriptions would show a similar rapid growth pattern over the last couple of years, especially with cable companies beginning to push VOIP services along with their broadband service. The share of revenue has changed even more rapidly as lucrative long-distance calls have migrated from wireline to wireless and VOIP and prices have dropped dramatically. This figure highlights some of the reasons for the merger and, more importantly, where the focus of competition policy should be – ensuring that wireless and high-speed services are free to provide competition.

Figure 1.
Number of Wireless and High-speed Lines Are Growing Rapidly



Soure: Federal Communications Commission, CTIA.

Relevant Markets

Standard antitrust competitive effects analysis will begin with a determination of relevant markets. Based on experience, especially the recently completed SBC-AT&T merger, the antitrust authorities are likely to examine several candidate relevant markets and then assess the competitive concerns within those markets.

A relevant antitrust market is, according the DOJ Merger Guidelines, delineated by performing a hypothetical experiment whereby a small set of products or services at issue is examined. If a hypothetical monopolist controlled the supply of all the products and could then sustain a small, significant non-transitory increase in price (SSNIP), that set of products would constitute a relevant product market. If not, additional products are added to the set until such a price increase would be profitable. A similar exercise is performed in geographic space to settle on relevant geographic markets.

Much ink and economic research is sure to be spilled on the relevant market definitions. This step is generally the critical piece in determining whether a merger would cause competitive concern or not. In the AT&T-BellSouth merger, there will be several different relevant product and geographic markets. These are likely to be very similar to the markets that were examined in the SBC-AT&T merger since many of the competitive issues are identical.

However, since most of the wireline services the two companies provide are in different geographic areas and they do not directly compete with each other, this will not be a critical piece for assessing the impacts on most local residential and business customers. This means that residential service – voice and high-speed Internet access – are unlikely to play a key role in the competitive effects analysis.

After determining relevant markets, the agencies will assess the competitive conditions in each market and changes in conditions resulting from the proposed merger. There are at least two likely areas for substantial investigation: business, or "enterprise," service and long-distance service in the BellSouth region; and wireless competition with wireline service in both companies regions and the effect across the country. The answers to both of these questions turn on empirical evidence.

Enterprise and Long-Distance Service

AT&T provides service to customers in BellSouth territory. These include residential long-distance customers as well as many business customers who buy a suite of telecommunications services.

The regulatory agencies faced similar issues when they examined the merger of SBC and AT&T. AT&T provided the same types of services in SBC's territory. In that merger, the DOJ did not require any remedies for consumer services. The agency must have concluded that there were sufficient choices for long-distance service that the merger would not cause competitive concern, and the overlap for high-speed access was small enough that the merger did not change the competitive conditions.

For enterprise services, the DOJ found "local private lines" to be a relevant market. These are high-capacity lines connecting directly to business buildings. In most cases, only the incumbent local exchange provider has a physical connection from its network to a building. In some cases competitive service providers also connect to buildings. Because of the guaranteed high-capacity and dedicated nature of the facility, the DOJ determined that other services such as wireless or switched access lines would not be a good substitute.

To remedy the effects where AT&T and SBC were the only two competing providers of private line services, the DOJ required divestiture of some physical assets (lines) that connected those buildings so that a competitor would have physical access to the building. It is reasonable to expect a similar issue and remedy in this merger.

Wireless Competition

Because Cingular is already a joint venture between the two companies, at first blush it might not appear that there would be any competitive issues for wireless arising from the merger. The two companies are partners in the provision of wireless services and the merger will solidify the relationship, but not change the number of wireless providers anywhere. However, because of the extension of geographic territory for wireline service, this issue merits further examination.

Wired and wireless services could be in the same relevant market. The incentive for Cingular to get customers to "cut the cord" might be dampened by the acquisition of additional wireline customers who would then be cannibalized. Of course, the answer to this investigation relies on the competitiveness of the entire relevant market, which would at a minimum include several other wireless providers. In this analysis, the DOJ should consider that Verizon Wireless is also majority-owned and controlled by Verizon and how much the merger changes the incentives and abilities of all parties in the relevant market.

If the DOJ determines that the relevant geographic market for wired/wireless service is local, which is likely, then it will have to examine the nature of pricing. The DOJ is likely to examine detailed pricing records to determine the nature of price setting for wireless to see whether Cingular effectively sets different prices in different areas despite nationwide plans. If this shows up in the data, the DOJ would be more concerned about geographic extension and the impact on competition than if pricing is set on a national basis.

Other Concerns

It appears from the press that many parties will use the merger to bring up the question of network neutrality. (See Roger Noll's SIEPR Policy Brief, May 2002, for a discussion of this.) While this is sure to be an issue, and the FCC may impose conditions on the merger such as a requirement to sell "naked DSL" – DSL service independent of landline telephone service – the merger is likely to have no, or only a slight, impact on any incentives or ability to engage in discrimination that would cause network neutrality concerns. Because of the limited overlap for DSL service, the merger will not change the competitive conditions for high-speed access service in any area. Therefore, to conclude that the merger impacts the network neutrality debate, one would have to argue that the ability of a firm with a larger national presence would give it a better ability to engage in discrimination.

Related to the broadband discrimination concern is the concern that the companies may discriminate against VOIP providers in an attempt to preserve their voice service. This is more than a hypothetical concern as a small telephone company in North Carolina blocked VOIP access over its DSL lines, until the FCC weighed in and told it not to. It will be hard for the FCC to write rules preventing bad conduct in this regard, but it and the DOJ should be vigilant in ensuring that network providers do not use market power to extend to other markets. Again, this concern is not related to the merger, but is likely to play in the Washington debates.

Conclusion

While it appears that the parties are re-creating Ma Bell, the world has changed a lot since 1984. Cable companies provide high-speed Internet access, wireless companies operate across the country, and the cost of transmitting calls across the world, or even around the globe, is not much greater than the cost of sending a call across the street. These changes all make a difference for the analysis of the competitive effects of the merger. While it is likely to be approved in a manner similar to the recent SBC-AT&T merger, and with similar conditions, the merger highlights the importance of a competitive wireless sector. There are likely to be two wired connections to most homes with the possibility of a third, if broadband over power lines can become a high-speed competitor. The experience of the introduction of a third and fourth competitor for wireless services in the mid-1990s shows the power of just a small amount of additional competition – prices declined substantially and usage blossomed. This merger will not have a large effect on the number of facilities-based competitors in most markets; that is why it is likely to be approved. Preserving the competitive nature of telecommunications services is important for the future, so regulators should be sure the merger does not affect wireless or broadband services.

About the Author

Gregory Rosston is the Deputy Director of SIEPR. He is also a Visiting Lecturer in Economics at Stanford University. Rosston's research has focused on industrial organization, antitrust and regulation. He has written numerous articles on competition in local telecommunications, implementation of the Telecommunications Act of 1996, auctions and spectrum policy. Prior to joining Stanford University, Rosston served as Deputy Chief Economist of the Federal Communications Commission and helped with the design and implementation of the FCC's spectrum auctions. He is a graduate of UC Berkeley and Stanford.

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