THINKABLE MERGERS: THE FCC’S EVOLVING PUBLIC INTEREST STANDARD

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At the end of the decade there will be only a few leading communications companies. We intend to be one of them.¹

In a vibrantly competitive environment, having five instead of six BOCs will not be particularly problematic.²

I. INTRODUCTION

The Telecommunications Act of 1996 ("1996 Act")³ was intended to usher in a new era of competition in the communications industry.⁴ Despite the numerous changes the 1996 Act introduced, the Federal Communications Commission’s ("FCC" or "Commission") vague mandate to act in "the public interest" remained.⁵ Pursuant to Sections 214(a) and 310(d) of the Act, the FCC still must affirmatively find that the transfer of licenses and other authorizations underlying a telecommunications merger are in the public interest before allowing the transfer of licenses.⁶ Given the 1996 Act’s goal of heightening competition, the FCC will now only find a telecommunications merger⁷ to be in the public interest if the merger will enhance competition.⁸

¹ Letter from Ray Smith and Ivan Seidenberg, both of Bell Atlantic Corporation, to Bell Atlantic Shareowners, The New Bell Atlantic, (1997) (on file with the COMMLAW CONSPECTUS).
⁴ See generally 47 U.S.C.A. § 151 (1996) (prefacing the Telecommunications Act of 1996 as an act "[t]o promote competition and reduce regulation in order to secure lower prices and higher quality services for American telecommunications consumers and encourage the rapid deployment of new telecommunications technologies").
⁵ The phrase "public interest" originally appeared in the Radio Act of 1927. Erwin G. Krasnow, The "Public Interest" Standard: The Elusive Search for the Holy Grail, 1994 Comm. L.J. 289, 291 (1997) (explaining that convergence is rapidly changing the nature of communications law and policy). The boundaries between different communications services, and who is offering those services, are increasingly blurred. Since the early 1990’s mergers were thought to be necessary in preparation for the convergence of computers and telecommunications. See Erin M. Reilly, The Telecommunications Industry in 1993: The Year of the Merger, 2 COMM/LAW CONSPECTUS 95, 96 (1994). The telecommunications mergers referred to in this Comment are mergers between companies whose principal business is in telecommunications but may also have interests in, for example, the wireless industry or Internet access services. FCC merger approval for mass media mergers are often concerned with other content issues, preserving a diversity of voices for example. See generally Mike Harrington, A-B-C, See You Real Soon: Broadcast Media Mergers and Ensuring a 'Diversity of Voices', 38 B.C. L. REV. 497 (1997).
⁸ Compare Bell Atlantic/NYNEX Order para. 2 (defining the standard by saying "[i]n order to find that a merger is in the public interest, we must, for example, be convinced that it will enhance competition") (emphasis added) with In Re Application of Pacific Telesis Group and SBC Communications, Inc. for Consent to Transfer Control of Pacific Telesis Group and Its Subsidiaries, Memorandum Opinion and Order, 12 FCC Rcd. 2624, para. 2 (1997) (defining the standard by saying "[a] demonstration that benefits will arise from the transfer is not, however, a prerequisite to our approval, provided that no foreseeable adverse consequences will result from the transfer") (emphasis added) [hereinafter SBC/Pactel Order].
The recent merger frenzy in many American industries\(^9\) illustrates Judge Bork's paradox of competition—"although firms compete to win, the ultimate victory is monopoly."\(^{10}\) This is particularly true in telecommunications markets where the 1996 Act has been answered with increased consolidation.\(^{11}\) In fact, former FCC Chairman Reed Hundt thought it natural that in the transition from a monopoly environment to a competitive environment, telecommunications mergers would increase because they would allow firms to enter new markets\(^{12}\) cheaper and faster than de novo entry.

The FCC is caught in the throes of a conflict. While the Commission has been handed a Congressional mandate to increase competition in the telecommunications industry, the industry is routinely asking for FCC approval of mergers that, by their very nature, decrease the number of competitors in the communications sector.

The evolution of the FCC's public interest standard and its application to telecommunications mergers documents the Commission's response to this conflict and the arrival of the "pro-competitive merger."\(^{13}\) These pro-competitive mergers make FCC approval of the merger contingent upon certain conditions designed to enhance competition in the affected market(s). They also illustrate the Commission's ability to go beyond traditional antitrust law to promote competition.\(^{14}\)

Pursuant to former Section 221(a) of the Communications Act of 1934 ("1934 Act"), the FCC could approve the merger and acquisition of telephone companies even if it would violate antitrust laws.\(^{15}\) The Commission had the prerogative to approve or disapprove the merger based solely on "public interest" concerns.\(^{16}\) The purpose of Section 221(a) of the 1934 Act was to allow competing local phone companies to merge without antitrust scrutiny.\(^{17}\) The Commission was simply asked to determine if such a merger was in the public interest, or more specifically, in the interest of the customers being served by the two companies.\(^{18}\) As the House Senate Conference Report of the 1996 Act notes, "[i]n a world of regulated monopolies, this idea made sense."\(^{19}\)

In the 1996 Act, Congress repealed Section 221(a) because it could inadvertently undermine the 1996 Act's goal of enhanced competition in at least two ways.\(^{20}\) First, the term "telephone company" was not defined.\(^{21}\) Given the level of convergence in the communications sector many companies would try to argue that they were telephone companies to gain exemption from antitrust scrutiny.\(^{22}\) Second, if Section 221(a) were preserved, mergers between competing telephone companies would go forward without antitrust review, creating an anti-competitive environment.\(^{23}\)

The 1996 Act revoked the Commission's ability to

\(^{9}\) See Ian Simpson, Fear and Wonder Drive Record U.S. Merger Wave (visited on October 17, 1997) <http://biz.yahoo.com/finance>. Simpson reported that as of mid-October, U.S. mergers and acquisitions totaled $706.7 billion, topping the 1996 full year record of $649.6 billion. Id. As of mid-October of 1997, 18 of those mergers were worth more than $5 billion, above the 1995 full year record of 15. Id.

\(^{10}\) FCC Chairman Reed Hundt, The Hard Road Ahead-An Agenda For the FCC in 1997 (December 26, 1996).

\(^{11}\) See FCC Chairman Reed Hundt, Address at the Museum of Television and Radio (June 3, 1997). Industry analysts and business reporters have written extensively about the post-Act telecommunications merger trend. See generally Frances Cairncross, A Survey of Telecommunications, Economist, September 13-19, 1997 (a separately paginated insert) (surveying the difficulties in creating telecommunications competition). See generally Allan Sloan, The Lost World, Newsweek, June 9, 1997, at 52 (observing "the new telecommunications world is sure starting to look a lot like the old telecommunications world, full of giant companies about as eager to compete with each other as pay-phone operators are to refund your quarter when your call gets messed up. Instead of competing, the giants are combining by buying each other").

\(^{12}\) See FCC Chairman Reed Hundt, Thinking About Why Some Communications Mergers are Unthinkable, Address at the Brookings Institution (June 1997).

\(^{13}\) See Bell Atlantic/NYNYEX Order, 12 FCC Rcd. 19985, para. 2.

\(^{14}\) See id. paras. 178-9.


\(^{18}\) See id.

\(^{19}\) See id.

\(^{20}\) See id.

\(^{21}\) See id.

\(^{22}\) See id. Specifically, Section 221(a) would likely be used to gain antitrust exemptions for the cable/telco buyout provisions of the 1996 Act. Id. Any cable company owning any telephone assets being bought out by a Bell Operating Company ("BOC") would ask for antitrust immunity under this section. Id.

\(^{23}\) See id. The legislative history also speculates that by returning review of a competitive industry to the Department of Justice ("DOJ") it would get both the FCC and the DOJ back to their proper roles and end "government by consent decree." Id. The relationship between the FCC and the DOJ has been tense at times. Conflicts would arise when FCC li-
confer antitrust immunity. Nevertheless, the Commission continued to conduct an industry-specific analysis of mergers and their impact on competition. The FCC's authority to do so is rooted in the legislative mandate requiring the FCC to act in the public interest.24

The FCC's approval of the high profile Bell Atlantic/NYXEX merger25 created a new framework for approving telecommunications mergers and applied it to the merger of neighboring Regional Bell Operating Companies ("RBOCs").26 The Commission used this same framework to approve the failed British Telecom ("BT") merger with MCI. Though the terms and factors involved in both merger approvals were different, together they provide a new paradigm for FCC merger approval. Both mergers exemplify the FCC's new public interest test for telecommunications mergers in the post-1996 Act era.

In Section I, this Note will examine the history of the FCC's public interest standard and its inherent difficulties. Section I also explains how the Commission has interpreted the public interest standard in scrutinizing telecommunications mergers in the past. Section II focuses on three case studies—the Bell Atlantic/NYXEX merger and the failed SBC/AT&T and BT/MCI mergers. Section III concludes with an assessment of the future of the FCC's public interest standard and whether it has been served by the Commission's decisions. Section III also offers potential merger applicants suggestions for ensuring the FCC's public interest standard is met.

The public interest standard was originally intended as the Federal Radio Commission's ("FRC") guiding principle for the allocation of broadcast licenses.27 In the field of broadcast regulation, the FCC has enjoyed "ample leeway" in deciding the public interest obligations of both commercial and non-commercial broadcasters.28 Such public interest obligations have included the requirement that communications entities encourage the coverage of local public issues, allow opportunities for local self-expression, offer a minimum amount of children's and educational programming and include political broadcasts.29 The exact nature of the public interest standard seems to hinge on balancing competing economic, technological, political and social values.30 The public interest standard, however, is not without its limits. Its use must be limited to advance a legitimate communications policy objective.31

In the absence of ideological hegemony, debate over the FCC's public interest standard and its boundaries will likely continue. One legal scholar, for example, has attacked the standard as "a derangement of constitutional structure," mandating the Commission to act according to its version of the public interest.32 This delegation of power arguably gives the FCC all the power a government can possibly posses.33 Other legal scholars have challenged whether the public interest standard allows the FCC to assume additional responsibilities.34 While these arguments focus on the nature of the Commission's authority, the 1996 Act clearly gave the Commission a new pol-

24 See Bell Atlantic/Nynex Order, 12 FCC Rcd. 19985, para 2. The order states that "the public interest standard necessarily subsumes and extends beyond the traditional parameters of review under the antitrust laws." Id.
27 United States Department of Commerce, National Telecommunications and Information Administration for the Advisory Committee on the Public Interest Obligations of Digital Television Broadcasters, A Primer on the Public Interest Obligations of Television Broadcasters, Oct. 22, 1997, at 16 (on file with COMMLAW CONSPECTUS) [hereinafter Primer of Public Interest Obligations].
28 Id. (citing FCC v. Potomac Broadcasting, 399 U.S. 134 at 138 (1940) where the Court viewed the public interest as a "supple instrument for the exercise of discretion by the expert body which Congress has charged to carry out its legislative policy.").
30 See id. at 2.
31 See, e.g., NAACP v. Federal Power Commission, 425 U.S. 662, 670 and n. 7 (1976) (explaining that the FCC may regulate equal employment opportunity practices in the telecommunications sector as part of its public interest considerations because the diversity objective is part of the Communications Act, in contrast to the former Federal Power Commission which was not allowed to regulate such practices because such regulation would not further any Federal Power Commission objective).
33 See id.
34 See Robert L. Pacholski, The FCC and Reciprocity: An Ex-
icy directive - promote competition in the communications sector.\textsuperscript{35} The Commission, in response to this mandate, has used the public interest standard as a tool to reach this goal. Attorney Ronald Alan Wiener and Professor William H. Read have argued that this policy directive could be more easily realized if Congress explicitly amended the 1934 Act’s public interest standard to include pro-competitive antitrust principles.\textsuperscript{36} This pro-competitive public interest standard would apply not only to telecommunications mergers but to all FCC regulation.\textsuperscript{37} While Wiener and Read argue that Congress should have made this amendment explicit, the FCC has applied a public interest test designed to increase competition when considering mergers without this explicit redrafting.\textsuperscript{38} By retaining the Commission’s flexible public interest standard\textsuperscript{39} Congress provided the FCC with yet another tool to foster competition.

II. THE PUBLIC INTEREST BECOMES PRO-COMPETITIVE

A. Judicial Review of FCC Public Interest and Competition Determinations

Since the early 1950’s the Supreme Court has recognized that the Commission’s mandate to act in the public interest was a broad policy that did not lend itself to exactitude.\textsuperscript{40} In 	extit{FCC v. RCA}, the Court upheld an FCC decision that authorized a radiotelegraph company to open two new circuits\textsuperscript{41} in competition with a company that already operated in those markets.\textsuperscript{42} Regarding the appropriate level of competition in the communications sector the Court noted that “what competition is and should be in such areas must be read in the light of the special considerations that have influenced Congress to make specific provision for the particular industry.”\textsuperscript{43} The Court, while admitting that the public interest standard is malleable, reminded the FCC that it acted at the will of Congress when determining what level of competition was necessary for the communications industry.\textsuperscript{44}

More recently, there is precedent for the FCC’s public interest standard to be interpreted broadly and include the special considerations of the communications industry.\textsuperscript{45} In 	extit{U.S. v. FCC}, the D.C. Circuit reviewed what it described as the most recent stage of the FCC’s nurturing of a “dynamic new medium: domestic satellite communication.”\textsuperscript{46} The FCC order under review granted a satellite company the authority to construct new domestic satellites and operate channels of communication over the new system as a common carrier.\textsuperscript{47} This company’s entry into the satellite industry provided increased capacity in a highly concentrated field.\textsuperscript{48} The court said that it was not the FCC’s principal responsibility to create

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\bibitem{36}Specifically, the amended section would read "[c]ompetition in communications best serves the national interest. Therefore the Federal Communications Commission shall act in the public interest, convenience and necessity with respect to radio frequency licenses, and in the public interest, convenience and necessity with respect to wireline common carriers by refraining from regulation where such regulation impedes competition. Competition shall be defined in accordance with the principles of federal antitrust law." William H. Read & Ronald Alan Weiner, FCC Reform: Governing Requires a New Standard, 49:2 Fed. Comm. L.J. 289, 321 (1997).
\bibitem{37}See id.
\bibitem{38}See Bell Atlantic/NYNEX Order, 12 FCC Rcd. 19985, para. 2.
\bibitem{39}See Pottsville Broadcasting Co., 309 U.S. at 138 (1940).
\bibitem{40}See FCC v. RCA Communications, Inc., 346 U.S. 86, 90 (1953).
\bibitem{41}See id.
\bibitem{42}See id. at 86.
\bibitem{43}See id. at 98.
\bibitem{44}See Symposium: The Independence of Independent
\bibitem{45}See United States v. FCC, 652 F.2d 72, 88 (1980).
\bibitem{46}Id. at 74.
\bibitem{47}See id.
\bibitem{48}See id. at 75.
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the maximum competitive environment possible, but to act in the public interest.\textsuperscript{49} The court understood, however, that an expert agency could not be expected to make perfect predictions concerning the future of the communications market.\textsuperscript{50} The Commission would be expected to use its expertise to forecast where the public interest lies in the future.\textsuperscript{51}

In the pre-1996 Act environment, the positive attributes of competition in the communications sector were not universally accepted. With the passage of the 1996 Act, the Commission has taken the hint from Capitol Hill that additional competition in the communications sector is synonymous with the public interest. As discussed below, the Commission has historically considered the competitive impact of its decisions as part of its public interest determination.

B. The FCC Applies an Increasingly Pro-Competitive Public Interest Standard

1. FCC Decisions on Telecommunications Competition

A number of pre-1996 Act decisions illustrate the FCC's gradual movement toward promoting competition. One of the Commission's seminal pre-AT&T divestiture decisions addressed customer premises equipment ("CPE").\textsuperscript{52} In Carterfone, the FCC found tariff restrictions prohibiting installation of CPE that was not harmful to the public network as unlawful and against the public interest.\textsuperscript{53} By granting competitors access to the network, Carterfone's public interest determination was a major step in the direction of telecommunications competition. In 1974, in another step toward competition, the Commission examined competitive issues between existing carriers and new entrants in providing point-to-point services, such as long distance, over microwave facilities.\textsuperscript{54} The Commission concluded that private line carriers should be able to compete fully and fairly without any protective measures for new entrants that cannot survive on their own merits.\textsuperscript{55} The Commission clearly stated that it was well within its authority to consider the impact of its decisions on competition as part of its public interest analysis.\textsuperscript{56} The Commission acted accordingly by deciding that in certain private line intercity services competition would be in the public interest.\textsuperscript{57}

In another pro-competitive decision, the FCC found an industry agreement giving AT&T competitors a discount on access and interconnection costs to be in the public interest.\textsuperscript{58} The "ENFIA" decision was another pre-divestiture decision where the public interest was satisfied by another move toward telecommunications competition. In a 1979 decision approving the merger of GTE and Telenet, the FCC explicitly considered the competitive consequences of its decision as part of its public interest determination. The Commission stated that any remedial conditions imposed on the merger were intended to advance four interrelated goals: (i) to ensure that GTE/Telenet would be an innovative and efficient competitor, (ii) to protect ratepayers and competitors from abuse, (iii) to ensure that once Telenet was a part of GTE it would continue to serve the "public interest" and (iv) to encourage competition.\textsuperscript{59}

The Commission cited the above GTE/Telenet analysis to support a "fulsome public interest analyses" in its Bell Atlantic/NYNEX decision.\textsuperscript{60} This same type of public interest analysis can also be found in FCC decisions directly addressing the BOCs. For example, in Computer III,\textsuperscript{61} the Com-
mission found the public interest to require non-structural safeguards to prevent cross-subsidization by the BOCs in their enhanced services. More recently, the Commission invoked the public interest standard in requiring local exchange carriers ("LECs") to permit competitive local exchange carriers ("CLECs") to connect their facilities to the LECs' facilities to provide "expanded interconnection."\(^6\)

The preceding FCC decisions about telecommunications competition illustrate how competition gradually became more important for the FCC. In the beginning, "public interest" seemed to be no more than the magic words the Commission used to protect its decisions from reversal. For decades, competition was only one of the things on a long list of considerations that the Commission considered. As the telecommunications industry developed, the Commission's public interest analysis became a refined competitive analysis implementing clear theories on how to promote competition.

2. AT&T/McCaw and Emerging Communications Technologies

In more high profile decisions, such as the AT&T/McCaw merger, the Commission retained these pro-competitive public interest principles. The AT&T/McCaw merger created a significant competitor to BOC-affiliated cellular operators by giving AT&T a pivotal role in the future of cellular telephony.\(^6\) The applicants argued before the Commission that their proposed merger would help to foster the development of a competitive communications network.\(^6\) Since the merger united AT&T, the largest provider of long distance telephone service in the United States with McCaw, the nation's leading operator of conventional local and regional cellular services, both the DOJ and the FCC imposed conditions on the merger.\(^6\)

The Commission was urged by parties who filed comments on the merger to impose conditions that would act as a check on McCaw's alleged bottleneck cellular exchange and AT&T's market power.\(^6\) The Commission concluded that the "competitive component of [the] statutory public interest standard" would be satisfied by imposing two conditions: (i) that AT&T agree not to discriminate in favor of McCaw and against other competitors for cellular network equipment sold to McCaw's competitors under existing contracts and (ii) that AT&T/McCaw each take appropriate steps to prevent third party data from falling into the wrong hands.\(^6\)

The Commission admitted in AT&T/McCaw that the pro-competitive effects of a merger are as important as the anti-competitive effects in making its public interest determinations.\(^7\) The AT&T/McCaw merger brought a stronger competitor to the cellular industry by bringing together two companies with significant technological capabilities.\(^7\) As a result of the merger, consumers in the cellular industry would have more choices and benefit from more price competition.\(^7\) The Commission's lofty conclusion was that this merger would be "another significant step in fostering the economic growth of our nation, one that encourages AT&T's and McCaw's investment in this nation's telecommunications infrastructure... and has the potential of bringing U.S. consumers increased access to new telecommunications services at lower prices."\(^7\) It was the combination of pro-competitive commitments and the prospect of a new competitive market be-

\(^{62}\) These are services that employ computer processing applications and offer the subscriber different information or involve the subscriber interacting with stored information (voice mail for example).

\(^{63}\) Expanded Interconnection with Local Telephone Company Facilities, 9 FCC Rcd. 5154 (1994); vacated and remanded, Bell Atlantic Co. v. FCC, 24 F.3d 1441 (D.C. Cir. 1994).


\(^{65}\) In re Applications of McCaw and AT&T, for Consent to the Transfer of Control of McCaw Cellular Communications, Inc. and its Subsidiaries, Memorandum Opinion and Order, 9 FCC Rcd. 5836, para. 1 [hereinafter AT&T/McCaw Order]. Some have concluded that the AT&T/McCaw merger's greatest significance was that it would increase competition in cellular telephony and ideally, provide lower prices to the consumer. See Reilly, supra note 64, at 103.

\(^{66}\) See AT&T/McCaw Order, 9 FCC Rcd. 5836, paras. 2, 3 and 7.

\(^{67}\) See id. para. 20.

\(^{68}\) See id.

\(^{69}\) See id.

\(^{70}\) See id. para. 57.

\(^{71}\) See id.

\(^{72}\) See id. Furthermore, it was thought that the cellular interexchange market for mobile customers would benefit from AT&T/McCaw's equal access commitments. See id.
ing further developed that led the FCC to approve the AT&T/McCaw merger.

3. SBC/Pacific Telesis Group - An RBOC Marriage of a Different Sort

Immediately following passage of the 1996 Act, the Texas based RBOC, SBC, set out to consume the California based RBOC, Pacific Telesis Group ("Pactel"). SBC's buyout of Pactel was the first Bell acquisition of another Bell.74 In 1990, SBC joined with France Telecom and Grupo Carso to purchase 20.4 percent of Telefonos de Mexico (Telmex).75 SBC's purchase of PactTel would give it control over local phone lines in California and Nevada. Since more than half of all phone calls made to Mexico from the United States originated in either California or Texas, SBC would stand to benefit from profitable U.S.-Mexico traffic once they were allowed into the long distance market.76

It may be ironic that the SBC/Pactel merger would be approved in an environment of supposedly heightened competition. SBC and Pactel did not, however, share contiguous local access transport areas,77 ("LATAs") nor was there any indication that SBC and Pactel would directly compete with each other, as was the case in Bell Atlantic/NYNEX, making the competitive issues less controversial. The Commission set forth its standard for merger review by stating that "a demonstration that benefits will arise from the transfer is not, however, a prerequisite to our approval, provided that no foreseeable adverse consequences will result from the transfer."78 As discussed below, this was a far less exacting standard than was required in the Bell Atlantic/NYNEX merger.

While the public interest was not specifically invoked in the SBC/Pactel Order, the applications were made pursuant to section 310(d) of the Communications Act which specifically requires that any proposed transfer of licenses must serve "the public interest, convenience and necessity."79 Accordingly, the Commission applied the anti-trust doctrine of actual potential competition. The doctrine applies when a firm proposes to enter a market by merging with a firm that is already operating in that market "and, but for the merger," the firm would have entered that market in a way that would have reduced concentration.80 The doctrine has five elements: (i) the target market is, in fact, concentrated, (ii) few other potential entrants to the market are "equivalent" to the company seeking to enter by way of the merger, (iii) the company seeking entry by merger would have sought entry by other means but for the proposed merger, (iv) the firm had other means of entering the concentrated market and (v) the alternative means of entry would produce a great likelihood of a more competitive environment.81 The Commission concluded that the doctrine of potential actual competition was not satisfied by the parties opposing SBC's acquisition of PactTel.82 Since there were many other potential entrants that were functionally equivalent or stronger than SBC, and there was no indication that SBC would have sought entry by other means but for the proposed merger, the doctrine was held inapplicable.83

In the SBC/PacTel Order the Commission also considered, among other things, allegations of SBC's past anti-competitive behavior.84 The FCC noted that SBC's conduct, while designed to delay and minimize local telephone competition in Texas, did not violate the law.85 The Commission concluded with the notion that the best prevention of anti-competitive conduct is found in the stimulation of effective competition.86

As the Commission was preparing to create this competitive stimulus by implementing the 1996

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75 See id. at D4.
76 See id.
77 LATAs include all points served by any particular BOC within an existing community. During divestiture, LATA boundaries determined the allocations of assets and liabilities between the BOCs and AT&T.
78 SBC/PacTel Order, 12 FCC Rcd. 2624 (1997), para. 2.
80 See SBC/PacTel Order, 12 FCC Rcd. 2624 (1997), para. 17.
81 See id. para. 18.
82 See id. para. 23.
Act, it also considered any impediments the merger would pose to achieving the Act's goals. The FCC concluded that, despite the contentions of the parties opposing the merger, the merger would not inhibit SBC's compliance with any of the Act's provisions.\(^9\) The Commission did warn, however, that the approval of this merger should not be taken to mean that in the post-Act era all proposed mergers of major carriers will be approved.\(^8\) As discussed below, it meant it.

III. A NEW PUBLIC INTEREST STANDARD FOR THE COMPETITIVE AGE

A. Bell Atlantic/NYNEX - Making A Merger Pro-Competitive

\[\text{The Bell Atlantic/NYNEX Merger Order represents new thinking in how the FCC will evaluate telecommunications mergers.}\]

The $23.7 billion merger of Bell Atlantic and NYNEX, each with 13 million telecommunications customers, formed a telephone company that dominated local exchange service from Maine to Virginia,\(^9\) a region that accounts for approximately 25% of the population of the United States and a third of all domestic long distance phone traffic.\(^9\) The merger created a communications company second in size only to AT&T.\(^9\)

The DOJ completed its review of the proposed Bell Atlantic/NYNEX merger without taking any action on the antitrust issues presented.\(^9\) While antitrust chief Joel Klein concluded that Bell Atlantic and NYNEX were not direct competitors,\(^9\) the FCC found that Bell Atlantic did have plans to enter NYNEX's LATA\(^9\) and therefore should be considered a direct potential competitor to NYNEX.\(^9\) It was the FCC's conclusion that Bell Atlantic and NYNEX were, in fact, actual competitors that led the Commission to formulate narrowly tailored industry specific conditions on the proposed merger.

Without agreeing to these conditions, the Commission found that the applicants would not have been able to meet their burden of proving not merely that the merger would produce no adverse competitive consequences, but that it would actually enhance competition.\(^9\) Indeed, but for the conditions, the merger would have reduced competition. This new standard of review was anticipated by then Chairman Reed Hundt's address at the Museum of Radio and Television in New York City. Hundt explained that government has to be "extremely cautious and wary" in approving proposed mergers that involve markets previously closed to competitors.\(^9\)

I. A Conditional Merger

At the time of the Bell Atlantic/NYNEX merger the pro-competitive rules to facilitate local telephone competition were still being written. With local competition not yet a reality, the Commission concluded that only with certain conditions attached would the Bell Atlantic/NYNEX union enhance competition.\(^9\) The FCC admitted that the conditions to be imposed on the Bell Atlantic/NYNEX merger would not solve the anti-competitive issues raised by all proposed telecommunications mergers.\(^9\) Yet, their importance to FCC approval of the Bell Atlantic/NYNEX merger cannot be overstated. Commissioner Ness stated that she was "voting to approve this consolidation only because I believe that the conditions we have placed on the merger are ones that, as applied across the combined region, more than compensate for the loss of potential competition between

\(^{87}\) See id. para. 32.

\(^{88}\) See id. para. 33.

\(^{89}\) Separate Statement of Commissioner James H. Quello, In re Application of NYNEX and Bell Atlantic for Consent to Transfer Control of NYNEX Corporation and Its Subsidiaries, Memorandum Opinion and Order, 12 FCC Rcd. 19985, 20124 (1997).

\(^{90}\) See Mills, supra note 74.

\(^{91}\) See id.

\(^{92}\) See id.

\(^{93}\) See Klein, Criticized From Both Directions, Vol. 17 COMM. DAILY No. 215, Nov. 6, 1997. Judiciary Committee Chairman Hyde (R-IL) had "no opinion" on DOJ's antitrust position while senior committee Democrat Conyers (D-MI) called the DOJ's application of antitrust laws "weak...punny." Id.

\(^{94}\) See id.

\(^{95}\) LATA 132 encompasses New York City, Long Island and portions of West Chester County. See Bell Atlantic/NYNEX Order, 12 FCC Rcd. 19985, para. 17.

\(^{96}\) See id. See, e.g., Sloan, supra note 11, at 53 (reporting ". . . you can expand quicker by buying than by building. Take Bell Atlantic. . . [instead of competing with neighboring NYNEX, which is arguably the most vulnerable Baby Bell because of its high prices and crummy service, Bell Atlantic is buying it].")

\(^{97}\) See Bell Atlantic/NYNEX Order, 12 FCC Rcd. 19985, para. 2.

\(^{98}\) FCC Chairman Reed Hundt, Address at The Museum of Television and Radio (June 3, 1997).

\(^{99}\) See Bell Atlantic/NYNEX Order, 12 FCC Rcd. 19985, para. 178.

\(^{100}\) See id. para. 179.
Bell Atlantic and NYNEX" (emphasis added). Commissioner Quello remarked in his separate statement that the conditions imposed on the merger "underscore the Commission's unique role in reviewing telecommunications mergers pursuant to the public interest test in the Communications Act." The Commissioners' comments emphasize the importance of the conditioned merger. Certain telecommunications mergers necessarily diminish competition. Rather than reject the applicants, the Commission resolved to impose pro-competitive conditions, particularly in local markets, in an effort to offset any anti-competitive consequences of approving the merger.

The conditions imposed on the Bell Atlantic/NYNEX merger illuminate the major competitive issues considered by the FCC as it reviews telecommunications mergers and offer one method of addressing public interest concerns. One of the conditions imposed upon the merger was the requirement that Bell Atlantic/NYNEX produce performance monitoring reports so CLECs could determine whether they were receiving nondiscriminatory operational support system ("OSS") access. Performance monitoring reports were found to be a helpful tool toward ensuring competition because they offer competitors enforceable standards to ensure nondiscriminatory access to the incumbent local exchange carrier's network ("ILEC"). The performance reports would cover OSS access relating to the provision of unbundled network elements ("UNEs") as well as interconnection and resold services.

Another major condition placed on the Bell Atlantic/NYNEX merger concerned the pricing methodology the new entity would employ when selling UNEs to carriers seeking interconnection. The Bell Atlantic/NYNEX Order stipulated that these resale rates be based on forward looking costs. The Commission concluded that the forward looking cost requirement allowed CLECs to make informed investment decisions based on costs that reflect the market accurately. The Commission intended that CLECs benefit from the same economies of scale and scope as the new Bell Atlantic/NYNEX. The Bell Atlantic/NYNEX merger was also subject to review by state regulators. Former FCC Chairman Hundt, in his remarks to state commissioners on the Bell Atlantic/NYNEX merger, said that he hoped states would consider the technique the FCC used in approving the merger by imposing pro-competitive commitments to offset the anti-competitive effects that it could otherwise produce. Concerning the specific pricing provisions the FCC required, Hundt emphasized that it was important for all the state commissions to agree on a pricing methodology for interconnection. He reminded the state commissioners that without a competition policy that was "national in scope," local competition would remain elusive. Hundt defended the Commission's imposition of forward looking costs on the merger by arguing that such a methodology would constrain the ability of an ILEC to prevent competition by setting prices beyond the cost of providing the service. Furthermore, Hundt hoped that this pricing methodology would encourage new competitors to invest in facilities where it would be efficient to do so.

Hundt encouraged the state commissioners affected by the merger to meet with each other and federal regulators to discuss the pricing and other merger related issues. Despite these calls for cooperation, the pricing condition turned out to
be a controversial one. By November, AT&T accused Bell Atlantic of breaking its merger promises.\textsuperscript{116} In a formal complaint to the FCC, AT&T alleged that Bell Atlantic/NYNEX was not pricing unbundled elements using the forward looking costs method.\textsuperscript{117} This was the first formal complaint made since approval of the merger.\textsuperscript{118} The conditions placed on the Bell Atlantic/NYNEX merger approval will likely be grist for future debate as interested parties and the courts determine the exact terms of the conditions and their legal ramifications.

It is clear, however, that but for the merger, Bell Atlantic would have entered and improved competition in New York City somewhat. The conditions imposed on the Bell Atlantic/NYNEX merger were designed to make it easier for one of the other CLECs to grow faster than it otherwise would and thus improve competition as much as Bell Atlantic would have had it entered. While approval of the Bell Atlantic/NYNEX merger was still pending and the above conditions were still being formulated, Hundt made it clear that the imposition of pro-competitive conditions will not be enough to gain approval of every proposed merger the Commission is asked to review.

2. SBC and AT&T - Testing the Limits of Merger Approval

In Hundt’s address to state commissioners in early June of 1997, the chairman mentioned that “[g]overnment should also be aware that if it fails to develop clear and predictable guidelines, it will send a message of tolerance to those firms that wish to test the limits of merger policy in newly opened or changing markets.”\textsuperscript{119} Hundt hoped that once merger limits were in place, firms would spend less time developing merger strategies and more time thinking about how to compete effectively.\textsuperscript{120} Before the Bell Atlantic/NYNEX merger approval was completed and officially released to the public, Hundt was offered an opportunity to set some limits on the mergers that the Commission would accept.

In Hundt’s widely reported address to the Brookings Institute, the third speech Hundt made on telecommunications mergers in the summer of 1997, the chairman declared that an AT&T/RBOC merger would be “unthinkable.”\textsuperscript{121} Hundt’s statement received a significant amount of press coverage because it is virtually unheard of for the head of a regulatory body to publicly make a judgment on a merger before it is officially proposed.\textsuperscript{122} While Hundt’s assertion was a break with the norm, he later told reporters that he was merely responding to former AT&T chairman Robert Allen’s invitation to discuss hypothetical AT&T/RBOC mergers.\textsuperscript{123}

In his address Hundt invoked the Commission’s statutory authority under Sections 214\textsuperscript{124} and 310\textsuperscript{125} of the Communications Act as obligating the FCC to approve or disapprove telecommunications mergers.\textsuperscript{126} Hundt explained that an AT&T/RBOC merger would not gain Commission approval because they were precluded com-

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\textsuperscript{116} See AT&T Accuses Bell Atlantic of Ignoring Promises Made to Win Merger Approval, Vol. 17 COMM. DAILY No. 215, Nov. 6, 1997.

\textsuperscript{117} See id. See generally Iowa Utilities Bd. v. FCC, 120 F.3d 753, 794, 819 (8th Cir. 1997) (vacating the FCC’s interconnection order, and specifically its pricing rules, as exceeding the FCC’s authority).

\textsuperscript{118} See id.

\textsuperscript{119} Hundt, Address at the Museum of Television and Radio, supra note 98.

\textsuperscript{120} See id.

\textsuperscript{121} See Hundt, Address at the Brookings Institute, supra note 12.

\textsuperscript{122} See Mark Landler, In Unusual Move, F.C.C. Chief Criticizes a Possible Deal, N.Y. TIMES, July 19, 1997, at D1.


\textsuperscript{124} Section 214 commands no carrier to undertake the extension of lines “unless and until there shall first have been obtained from the Commission a certificate that the present or future public convenience and necessity require or will require the construction, or operation, or construction and operation, of such additional or extended line.” (emphasis added). 47 U.S.C. §214 (1994).

\textsuperscript{125} Section 310 holds, in relevant part, that “[n]o construction permit or station license, or any rights thereunder, shall be transferred, assigned, or disposed of in any manner, voluntarily or involuntarily, directly or indirectly, or by transfer of control of any corporation holding such permit or license, to any person except upon application to the Commission, and upon finding by the Commission that the public interest, convenience, and necessity will be served thereby.” 47 U.S.C. §310(d) (1994) (emphasis added).

\textsuperscript{126} See Hundt, Address at the Brookings Institution, supra note 12. Note that both of the sections Hundt cited mandate the Commission to act in the public interest.
petitioners - firms that would compete with each other in the absence of laws or other anti-competitive rules precluding them from competition.\textsuperscript{127} Hundt pointed out that such a merger would be considered and evaluated by the Commission as a horizontal merger.\textsuperscript{128} Hundt anticipated the argument that the level of convergence and technological change justifies mergers of this sort and declared "the presence of technological change and innovation does not mean that proposed combinations of precluded competitors are now 'thinkable.'\textsuperscript{129} After surveying the presence of AT&T in the long distance market and RBOCs in the local market, Hundt concluded that an AT&T/RBOC merger would be unable to meet the pro-competitive standard\textsuperscript{130} later set out explicitly in the Bell Atlantic/NYNEX order, regardless of the conditions placed on a merger between them.

Hundt concluded his trilogy of speeches on telecommunications mergers by focusing on the Commission's limits on the telecommunications mergers it would approve. To make such a clear pronouncement while another major merger was still under review clearly broke with government agency practice.\textsuperscript{131} The summer of 1997, however, was hardly normal for the Commission. Shortly after setting out a framework in the Bell Atlantic/NYNEX order for approving telecommunications mergers, the FCC applied that framework to a vertical merger.

\textsuperscript{127} See id. Hundt thought the term "precluded competitors" was more useful than the traditional "potential competitors" when the law, or the lack of pro-competitive rules, rather than inclination or capability, was the reason that two firms have not become actual competitors. \textit{Id.}

\textsuperscript{128} See id. Hundt explained a horizontal merger as typically involving "combinations of firms that operate at the same 'level' in an industry...sell[ing] the same or similar products to the same customers. See id. Hundt explained a vertical merger as typically involving "two firms at different levels in a distribution chain. See id. The chairman explained further that horizontal combinations "are often viewed with greater skepticism than vertical combinations." See id.

\textsuperscript{129} Id.

\textsuperscript{130} See id.

\textsuperscript{131} See generally Landler, \textit{ supra} note 122 (reporting that "these are extraordinary times in Washington, where the top antitrust post at the Justice Department has gone unfilled for months during a period of unprecedented consolidation in the telecommunications industry.").


\textsuperscript{133} See id.

\textsuperscript{3} BT/MCI - Applying the New Framework

MCI was uniquely positioned to receive bids from BT and eventually from both GTE and Worldcom. Financial analysts observed that the long distance business, in general terms, was threatened.\textsuperscript{132} MCI, however, was well positioned for the following changes in the information economy: (i) the emergence of a marketplace on the Internet, (ii) increased demand for data (possibly allowing packet-data systems, the Internet for example, to dominate the voice- or circuit-switched market) and (iii) the slowing of growth in the demand for voice services (except in the wireless industry).\textsuperscript{133} MCI was in step with these larger economic trends with its high proportion of business customers, a Systemhouse unit that specialized in handling Internet consumers and more Internet traffic than any other company in the world.\textsuperscript{134} It was MCI's unique position in a changing economy that led a chief telecommunications economist to remark, "[b]oth GTE and Worldcom bids are, deep down, Internet plays for the 21\textsuperscript{st} century."\textsuperscript{135}

The BT/MCI deal, and subsequent merger approval process, differed from Bell Atlantic/NYNEX in several respects. For example, BT/MCI, unlike Bell Atlantic/NYNEX, had gone through a similar approval process when they sought FCC and DOJ approval in July of 1994 for BT's initial 20% investment in MCI (this approval
process was dubbed "BT/MCI I"). At that time, the Commission found BT's investment to be in accord with the foreign ownership caps set out in Section 310 of the Communications Act. During BT/MCI I, the Commission made other positive public interest findings. In particular, the Commission found BT's 20% investment in MCI expanded MCI's ability to be an effective competitor domestically and, in return, contribute to the growth of the American economy generally. During BT/MCI I, both the DOJ and FCC had concerns about BT's ability to discriminate in favor of MCI and to the detriment of other competing U.S. carriers. Accordingly, in BT/MCI I, the DOJ imposed certain non-discriminatory commitments on BT that they revised for the 1997 merger. Although the DOJ recognized that both the U.K. and the U.S. were working toward a deregulatory telecommunications environment, the DOJ, pursuant to its antitrust obligations, found it necessary to modify the final judgment from 1994 by (i) imposing stricter reporting requirements, (ii) prohibiting MCI or its subsidiary Concert from using confidential information that would be competitively useful and (iii) extending the terms of the decree to the year 2004.

The Commission's subsequent approval of the failed BT/MCI merger illustrates how the Bell Atlantic/NYNEX framework was adopted to deal with uncertainties in the future of international telecommunications regulation. The FCC's regulation of international communications has, since the early 1980's, been concerned with the principle of reciprocity - treating foreign common carriers that want to operate domestically as U.S. common carriers are treated by the regulatory body in the home country. Robert L. Pacholski, in The FCC and Reciprocity: An Examination of the Public Interest Standard, charged that the FCC, under the public interest mandate of the 1934 Communications Act, had usurped U.S. trade policy from its proper forum. Furthermore, Pacholski argued, there is nothing in the Communications Act of 1934 to indicate that Congress intended the FCC to consider a policy matter as politically sensitive as international trade relations.

Pacholski would likely argue that the public interest standard does not authorize the Commission to make some of the international trade determinations it was asked to make in BT/MCI. While the Commission considered the international ramifications of the BT/MCI deal its focus from the outset was that in evaluating the effects of the proposed merger of BT and MCI, it would employ "the same competitive framework" applied in the Bell Atlantic/NYNEX order. The Commission clarified that the Bell Atlantic/NYNEX order should not be interpreted as meaning that agreement to pro-competitive conditions will always carry an applicant's burden of demonstrating a merger is in the public interest. As Hundt's SBC speech indicated, this would be particularly true given the size and economic power of both applicants in the BT/MCI deal.
BT, as Great Britain's largest telecommunications operator, and MCI, as the second largest long distance carrier in the U.S., were both considered to be significant suppliers in the U.S.-U.K. international transport market. While the merger of these two entities would obviously increase concentration in this market, the FCC concluded there was reason to expect certain mitigating factors to reduce the impact of this concentration if BT/MCI acted anti-competitively. These factors included (i) new transatlantic cables that would increase the capacity and thus lessen BT/MCI's share of capacity on the route and (ii) adherence to a condition imposed by the European Commission ("EC") that the merged entity sell some of its capacity.

While the FCC's conclusions and predictions about the international transport market indicated that the proposed merger would not lessen competition, pursuant to the standard of review set out in Bell Atlantic/NYNEX, the applicants had to prove the new BT/MCI entity would enhance competition. The Commission was convinced that the merger could enhance competition in domestic local exchange markets by strengthening MCI's financial and technical backing. By strengthening MCI as a local exchange market participant, the corresponding power of ILECs would be reduced, thus hastening the emergence of effective local competition.

In the alternative, the Commission also considered whether the merger would eliminate BT as a competitor in the domestic local exchange market. The FCC found that BT lacked the specific capabilities and incentives to be a major competitor in the U.S. local exchange market without a significant domestic partner. Therefore, its elimination from that market via the merger would not significantly harm competition.

On the issue of local competition in the U.K., some commenters urged the FCC to condition its merger approval on the introduction of equal access in the U.K. The British government opposed such a provision for fear that it would undermine its policy of encouraging facilities based competition. The FCC concluded that MCI would benefit from BT's presence in the local markets of the U.K. Pursuant to the Bell Atlantic/NYNEX methodology, the FCC imposed a condition that MCI not accept BT traffic from the U.K. to the extent that equal access had not been implemented in the U.K.

The Commission addressed a similar local competition issue when considering the unbundling of local exchange network elements and resale. BT, unlike ILECs under Congress's 1996 Act, was not required to unbundle network elements. The U.K. government again argued that such a policy would undermine its goals of facilities-based competition. The Commission, as expected, concluded that unbundling network elements fosters local competition and would limit BT's ability to exercise market power. The Commission, in this instance, was confident that the U.K.'s failure to mandate unbundling would be a short term problem and that World Trade Organization ("WTO") and EC regulation together with policies encouraging competition would mitigate its impact.

The FCC also concluded that BT's subsidiary, Concert, would be strengthened by the merger and create more competition in the global seam-


149 Pursuant to United States v. FCC, as described above, the regulatory body is required to survey market conditions at that time and is not expected to make perfect predictions. The Commission explicitly stated that "we are in the midst of rapid regulatory and market changes". BT/MCI Order, 12 FCC Rcd. 15351, para. 38. 'The Commission recognized that it had to evaluate the impact of the proposed merger not only when the WTO agreement and 1996 Act are being implemented but also after both have been fully implemented and some of their goals realized (BOC entry into the interlata market for example). See id.

150 See id. para. 14.

151 See id.

152 See Bell Atlantic/NYNEX Order, 12 FCC Rcd. 19985, para. 2.

153 See BT/MCI Order, 12 FCC Rcd. 15351, para. 15.

154 See id. para. 127.

155 See id.

156 See id.

157 See id. para. 183.

158 See id.

159 See id. para. 186.

160 See id. para. 191. The European Commission required the implementation of equal access by January 1, 2000. See id.

161 See id. para. 192.

162 See id. para. 194.

163 See id. para. 195.
less market. Since BT/MCI I, the Commission has recognized the global seamless market as an "emerging product of worldwide geographic scope." The global seamless market is loosely defined as a combination of voice, data, video and other telecommunications services that can be offered by a single source over an integrated international network that has the same qualities wherever provided. Global seamless services also offer the advantage of single-source billing, a major advantage for business and residential customers. The Commission recognized, however, that global seamless services were only available to high-end business customers at present. It was the FCC's interest in developing global seamless services, similar to its desire to see cellular technology and markets further developed in the AT&T/McCaw merger above, that made the market a relevant and important part of the merger analysis.

The applicants in BT/MCI were able to meet the burden of enhancing competition in the telecommunications market with significantly fewer conditions than the Bell Atlantic/NYNEX merger required. This was because there was competition in the international transport market and U.K. domestic market, unlike the New York City local service market.

As discussed, the two mergers were fundamentally different. Despite these differences the FCC consistently applied the heightened standard created in the Bell Atlantic/NYNEX Order to the applicants in BT/MCI. While the merger of BT/MCI was ultimately not consummated, the Commission's analysis in the BT/MCI Order proves helpful for other telecommunications companies forging international alliances.

IV. SUGGESTIONS FOR COMPETITORS

We've got to draw the line first...We're looking at the Bell Atlantic/NYNEX merger right now. We're cogitating about the BT/MCI merger right now. The way you draw lines in antitrust is you make a decision here, you make a decision there. They're like points, and when you connect the dots they're like lines.

The lines Reed Hundt references are being drawn through a public interest analysis that is much broader than the traditional antitrust analysis. Competition used to be one element the FCC considered when it evaluated whether public interest concerns would be met in a telecommunications merger. Competitive concerns now dominate the public interest analysis the Commission conducts when approving a telecommunications merger. The Commission, with a push from Capitol Hill, has found that it is not enough for the public interest to lie merely in not allowing a decrease in competition, but in actually promoting competition in the communications sector. The public interest standard allows the FCC the flexibility of imposing narrowly tailored conditions on telecommunications mergers to further specific policy goals.

Hundt's speeches on telecommunications mergers in the summer of 1997 indicate that merger issues will continue to rank high on the Commission's agenda. As various combinations seek FCC approval, the burden of proving enhanced competition will likely endure. The case studies illustrate that merger applicants will meet this heightened burden if they are willing to agree to conditions that will promote competition. Creativity in designing conditions further help applicants, in local markets particularly. The Bell Atlantic/NYNEX merger highlighted the major issues the Commission is concerned with in promoting local competition. These include OSS and network element pricing as well as other methods of facilitating CLEC entry into local markets. Merger applicants are also helped when they can illustrate that the competitor being eliminated would not have been that strong because there were other strong competitors or that the potential competitor would have been a weak one. Still other concerns, like anti-competitive behavior and emerging technologies and markets, will continue to be an important part of the Commission's public interest analysis in telecommunications mergers. Merger applicants benefit if they explain how their merger benefits emerging technologies in a way that would promote economic as well as technological competition and innovation.

Hundt set out one clear limit in barring an
AT&T/RBOC merger. Subsequent FCC chairmen will be tasked with drawing finer lines to determine when consolidation in the telecommunications sector has become anti-competitive. At some level, mergers run the risk of defeating the competitive goals of the 1996 Act. If this limit were fully realized the public interest would surely not be served. Future FCC chairmen and commissioners should be encouraged to enforce merger limits and not bow to industry pressure to always design conditions that make mergers pro-competitive. By enforcing merger limits the Commission should send a clear message to industry leaders that the FCC is more impressed with a company’s business plan when it concentrates on entering new markets and opening their own rather than looking for more business partners.

V. CONCLUSION

The FCC’s public interest standard has taken many different forms in response to political, economic, social and technological changes. These changes are illustrated by how the Commission has made public interest determinations when approving telecommunications mergers. The 1996 Act’s mandate to promote competition prompted the FCC to change the burden of telecommunications merger applicants to make mergers pro-competitive. Implementation of the Act caused the Commission to place competition at the top of its public interest concerns when evaluating telecommunications mergers. Whether the Commission’s actions advances the public interest remains to be seen.