

Testimony of

Mr. James F. Geiger

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Subcommittee on Antitrust, Competition Policy, and Consumer's Rights
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"The AT&T and BellSouth Merger: What Does It Mean for Consumers?"
Written Testimony of James F. Geiger

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I. Introduction

Chairman DeWine, Ranking Member Kohl and Members of the Committee, thank you for inviting me to testify today about the harms that consumers would likely experience if the proposed AT&T-BellSouth merger were allowed to take place.

I would like to begin by introducing you to my company, Cbeyond. I think it is important for you to understand who Cbeyond is to be able to understand why companies like mine--companies that focus on America's economic engine, its small business entrepreneurs--think this merger has the potential to quickly (and negatively) reshape the competitive landscape and dramatically reduce customer choice. But you are not going to hear just doom-and-gloom from me because I firmly believe that if this Subcommittee vigilantly uses its oversight of the Department of Justice to ensure that a thorough investigation takes place and that every case that can be brought under Section 7 is--in fact--brought, it is very possible to ensure that the potentially negative impacts of this merger never materialize.

II. About Cbeyond Communications

I am the President and CEO as well as founder of Cbeyond Communications. I have over 22 years of experience in the communications industry, and I serve on the Board of Directors of COMPTTEL, the national trade association representing competitive providers of communications services. Prior to founding Cbeyond, I was Senior Vice President and the Chief Marketing Officer for Intermedia Communications, a founding principle and CEO of FiberNet, a fiber-based metropolitan area network provider and began my telecommunications career with Frontier Communications where I held various sales and marketing management positions. Prior to Frontier, I was an accountant with Price Waterhouse.

Cbeyond was founded in late 1999 with the sole mission to deliver "big business" communications services to small business customers at prices they could afford and that we could deliver profitably. We define the market we serve as small businesses with 5 to 249 employees. Cbeyond correctly anticipated that this entrepreneurial class of customers, like large businesses, would embrace productivity-enhancing applications creating a need for more bandwidth. And we knew that they would seek a simple, integrated package of communications services from one provider with one bill and that it had to be affordable and easy to use.

We also knew that the technological, operational and financial infrastructures of the traditional telecom service providers and the early CLECs were built to solve a different problem (primarily the problem of providing reliable voice services) from a different era than was our focus. Cbeyond invested to create a new innovative network powered by Cisco, using advanced, next-generation IP technology and a software-based architecture that delivers converged voice and data applications over a single pipe-or as we say, "one pipe, one protocol, all services." By providing all services over a single, integrated IP-based network, we've been able to meet the needs of the underserved small business market while at the same time dramatically reducing what it costs to develop, integrate, and provide our products and services. We pioneered this infrastructure with Cisco and they remain an important technology partner today.

Cbeyond began providing service during 2001 in Atlanta, which is also the location of our corporate headquarters. Since 2001, Cbeyond has opened additional markets in Dallas, Ft. Worth, Denver, Houston, Chicago and most recently in Los Angeles. We currently serve over 22,000 small business customer locations, all of this attained through organic growth. Our strategy is to achieve deep market share penetration in our geographic markets while at the same becoming more operationally efficient and more in tune with the local small business community as we expand our network scope and penetration within a city.

As a result, Cbeyond enjoys a 99% customer retention rate and is one of the nation's fastest-growing providers of broadband services-growing organically over 35% year over year. Moreover, successfully satisfying small business customers has translated into financial success as well. Less than eight months ago, Cbeyond completed its initial public offering ("IPO") raising over \$70M with a share price of \$12. Today, Cbeyond trades at around \$20 per share, or just over \$500 million in market capitalization.

III. The Merger Will Enhance AT&T's Ability to Raise Rivals' Costs

The most obvious effect of the merger will be to directly eliminate retail competition between AT&T and BellSouth for many segments of the wireline business market. However, the merger will also significantly increase BellSouth's and AT&T's incentive and ability to use its expanded market power to discriminate against rivals that depend on BellSouth and AT&T for access to wholesale transmission facilities.

Most "intra-modal" competitors (firms like Cbeyond) and so-called "inter-modal" competitors (like wireless carriers) rely on access to wholesale transmission facilities to move telecommunications traffic between geographically dispersed nodes in their networks. These transmission facilities are provided to an overwhelming degree by the incumbent local exchange carrier (e.g., BellSouth in Atlanta, and AT&T in Chicago or Dallas). As I discuss in more detail below, the Merger will foreclose competition in the wholesale transmission market, and--ultimately--severely undermine the potential for intra-modal and inter-modal competition within both the AT&T and the BellSouth incumbent local exchange carrier regions.

More specifically, this Merger will (1) directly eliminate AT&T as a competitive wholesale provider of local transmission services in the BellSouth territory; (2) increase the ability of the post-merger firm to prevent wholesale competition in the provision of local transmission facilities from the developing in the future; and (3) increase the incentive of the post-merger firm to harm competition while reducing competitors' and regulators' ability to stop the merged firm from harming competition and consumers.

a. The Merger Will Directly Eliminate AT&T As A Wholesale Competitor For Both Last Mile and Transport Facilities. There can be no doubt that, within the nine state region where BellSouth is the incumbent local exchange carrier, BellSouth enjoys what can only be called an overwhelming level of control over the transmission facilities that are necessary to reach business end user customers like Cbeyond's. This is demonstrated by our experience in recent years in attempting to find what is known in the industry as "alternative last mile" providers. An order issued by the FCC a few years ago, the Triennial Review Remand Order, had the effect of substantially increasing the prices for many of the transmission facilities that Cbeyond leases from the Bell companies like BellSouth. These are high-capacity data facilities known as T-1s, and we use them as inputs to simultaneously deliver both voice and data services to our customers.

After this FCC order, we began to seek out non-Bell providers of T-1 facilities that--we thought--might be able to provide us with more economical access to our customers. In the most densely populated cities we serve (Atlanta, Dallas, Houston and Denver), we were able to identify seven alternative access companies all of which provided connectivity using fiber optic cables. Of these seven, only five were potentially suitable partners for Cbeyond because the others did not offer data speeds designed for smaller businesses. When we compared Cbeyond's customer lists to the available service locations for the remaining five alternative last mile providers, we discovered that they could potentially provide replacement service for only 600 of our more than 25,000 T-1s (or 2.4%). Further, the companies providing these services tended to have unsophisticated order processing systems that made it difficult if not impossible to install customers with the speed they expected. In short, Cbeyond--despite a diligent search--was unable to find a viable alternative to Bell-company T-1s at a time when the pricing umbrella should have facilitated bringing new competitors into the market.

And Cbeyond is not alone in finding that there is really no such thing as an alternative provider of last mile transmission facilities for business customers. Sprint told the Commerce Committee last week about a similar

experiences that it had in attempting to find alternative last mile transmission facilities. Sprint's Robert S. Foosaner explained to the Commerce Committee that there were no markets in the BellSouth region--none--where BellSouth's share of Sprint's total last-mile business was not approaching (or well beyond) 90%.

In light of this information, you may be tempted to assume that the situation can't get worse so the merger should be approved. But this is not the case. While it is certainly true that AT&T is not a competitive option for Cbeyond's last-mile needs because its last-mile facilities generally serve very large enterprise-level business customers, AT&T's presence in the market serves as a real check on what would otherwise be BellSouth's unfettered ability to set prices. The reason for this is quite simple: BellSouth is acutely aware that AT&T, as its most well-capitalized competitor for both last-mile and transport facilities, pays close attention to market opportunities, and will begin to deploy additional facilities if BellSouth raises its prices too high. Accordingly AT&T's mere presence in the market has, until now, served as a check on BellSouth pricing, a check that will be lost if this merger is completed. In short, it is critical that AT&T be preserved as an independent competitor to BellSouth.

The impact of the proposed merger is even more insidious in the market for transmission facilities connecting carrier locations because in this market AT&T is a viable competitor to BellSouth on a huge percentage of routes across the southeast. In fact, eliminating AT&T's competitive influence on the pricing of these transmission facilities will eliminate what I would conservatively estimate to be 75% of the competitive transmission facilities that remain. This merger--should it be allowed to proceed--will take the only currently viable competitive telecommunications facility market in the BellSouth region and deliver it directly to the dominant provider: BellSouth. If this merger is complete, the final check on BellSouth's ability to price its competitors out of the market will be gone. The Antitrust Division should not allow this to happen.

b. The Merger Enhances the Ability of the Post-Merger Firm to Avoid Future Last-Mile Competition

For most of their existence, the Bell Companies have enjoyed an effective monopoly over last mile transmission facilities needed to reach end user customers, a monopoly that was built with legal protections and no risk because of rate regulation designed to let them get the network built. Since the 1996 Act made this public network much more accessible to competitors, the Bells have become quite adept at preventing the rise of alternative last mile networks by leveraging their pricing power over the current network. Such strategic conduct has been referred to as "reducing rivals' revenue."

The Bell Companies reduce their rivals' revenues by forcing companies like Cbeyond and Sprint-Nextel to purchase local transmission facilities pursuant to volume-term agreements that have the effect of "locking up" the market and preventing competitive providers of wholesale transmission from competing effectively. The net effect of these contracts is that the Cbeyond, Sprint-Nextel and other carriers commit to purchasing transmission services from the Bell Company that they would otherwise choose to purchase from competitors. The competitors accede to these commitment contracts in order to get any discount at all on the extremely high "off the shelf" prices that the Bell Company charges for the transmission facilities in locations where the Bell Company has a monopoly over transmission facilities..

Another feature of these contracts is that customers must pay high penalties if they fail to meet their volume commitments. This means that even if other competitors could offer a better base rate for part of the customers' transmission facilities needs, customers would still be unable to use these services from competitors because the high penalty imposed by the incumbent when the customers could not meet their volume commitment are far greater than any savings recouped from using transmission facilities provided by Bell Company's competitor in the wholesale market. While customers do not like these contracts, they have little choice but to sign them.

The source of the Bell Company's market power in this area is easy to see: over the range of output covered by the contract (i.e., commitments to buy circuits in multiple states/locations) only the Bell Company can supply all of any wholesale customer's demand. Thus, a merger that further expands the geographic territory in which one firm is dominant--like the AT&T-BellSouth Merger--further enhances the ability of the dominant firm to engage in behavior designed to prevent rivals from achieving the scale necessary to become viable competitors.

c. The Merger Increases the Post-Merger Firm's Incentive to Harm Competition While Reducing Competitors' and Regulators' Ability To Constrain this Conduct

The merger of AT&T's ILEC assets with the BellSouth ILEC assets will expand the size of the post-merger ILEC territory to 22 states. This expanded ILEC will be very difficult to control. To begin with, the merged firm would have an increased incentive to harm competition. A simple comparison of BellSouth before and after the merger illustrates the point. Today, if BellSouth were to discriminate against Cbeyond in the provision of bottleneck facilities, BellSouth would face a weakened competitor in the one market in which Cbeyond competes with BellSouth -- Atlanta. However, the post-merger BOC would face a weakened competitor in Atlanta, as well as Dallas, Ft. Worth, Houston, Chicago, and Los Angeles. By adding the BellSouth region to the merged firm, BellSouth can appropriate a larger portion of the consequences of anticompetitive conduct than would be the case absent the merger. These greater "benefits" from discrimination in turn increase the merged firm's incentive to engage in such conduct in Atlanta.

In addition, by eliminating BellSouth as an independent BOC, the merger would eliminate a benchmark against which to judge the reasonableness of AT&T's conduct. Benchmarking one BOC against another is an important means of policing BOC conduct. We at Cbeyond use this technique whenever possible in interconnection negotiations and in other contexts when dealing with BellSouth and AT&T. In fact, given that neither we nor the regulators have as much information about the BOCs' costs or networks as the BOCs themselves, the ability to compare one BOC's conduct against another is indispensable for detecting unreasonable practices. Unfortunately, by eliminating BellSouth as an independent BOC, the merger would eliminate this mechanism. As a result, competitors and regulators would be left with virtually no ability to constrain the merged firm from acting on its now increased incentive to engage in anticompetitive behavior.

IV. The Merger Will Allow Anti-Competitive Warehousing of Wireless Spectrum

In addition to the threat posed by the proposed AT&T-BellSouth Merger to wireline services, the proposed merger also poses a serious threat to wireless services. This is because the post-merger firm will have a dominant share of a prime block of spectrum that could be used to provide broadband wireless service. The post-merger firm, if allowed to warehouse this spectrum, will do just that.

As Mark Del Bianco, a telecommunications lawyer, pointed out in a recent editorial, BellSouth is the second-largest owner of 2.5GHz spectrum in the United States and controls spectrum in most of the 50 largest telecommunications markets. BellSouth also has substantial 2.3GHz spectrum that it acquired in auctions in 1997. These are precisely the spectrum ranges that are best-suited to the creation of a "wireless last mile" transmission via the emerging technology often referred to as Wi-Max. AT&T also has a large amount of 2.3GHz that it brought into its recent marriage to the former SBC, and it is important to note that--because of the exclusive nature of spectrum ownership--none of AT&T's 2.3GHz spectrum overlaps in any geographic location with any of BellSouth's 2.3GHz spectrum. With all this spectrum you might think that either AT&T or BellSouth (or maybe both) would have deployed some wireless last mile transmission facilities. But this is not the case. Neither company has yet developed any of the spectrum into a commercial line of business, though BellSouth is "testing" a wireless broadband service in nine smaller markets and has announced plans to use the spectrum as a backup to its wireline services. In short, the spectrum is--for all intents and purposes--being warehoused.

So what will be the impact of the proposed merger on this situation? The answer to this question is--I think--obvious. BellSouth and AT&T will have no discernable incentive to use their spectrum to compete with wireline services they already provide, and their control of the spectrum will amount to nothing more than a way to stifle the competitors (such as Clearwire) that plan to create an alternative last mile to compete with the Bell monopoly over last mile transmission facilities. Moreover, these are competitors that could be using, and contributing to the growth of, non-Bell alternative transmission networks.

Assuming that AT&T's licenses are spread equally around the U.S. and that BellSouth's licenses are located primarily in the BellSouth service area (as appears to be the case), then the pre-merger situation looks like this: 40% of the BellSouth spectrum and 30+% of the AT&T spectrum is located in-region where the Bells have a huge incentive NOT to deploy. As for the other 60% of the spectrum the combined entity would control, the Bell company record of competing against their out-of-region brethren is nonexistent. They simply don't do it. In short, absent action by the DOJ, this merger is likely to result in the permanent warehousing of a valuable public asset that would otherwise be used to enhance consumer choice and bring innovation to our telecommunications infrastructure.

V. The Committee Must Apply Vigilant Oversight to the DOJ In Order to Avoid the Potential Anticompetitive Consequences of this Merger

The Antitrust Division seemed strangely unwilling to exercise its authority when conducting its last round of investigations of giant telecommunications mergers of the kind the Committee is looking at here. In the case of the SBC-AT&T merger and the Verizon-MCI merger, the Division's "remedy" required nothing of the parties and did nothing to constrain prices. Astonishingly, it was left to the Federal Communications Commission to craft the only conditions placed on those mergers with any teeth. With the proposed AT&T-BellSouth merger, the Department of Justice is facing a much more dramatic consolidation of network power than occurred with last year's mega-mergers (a designation used then that seems quaint today). We are hopeful that the DOJ will take a harder look at this merger, and we ask that you demand this of them. Telecommunications competition in this country has made great strides over the last ten years, but all that has been gained could be lost if the former Bell monopoly is allowed to reform without effective oversight from the very agencies that the American public rely on to be their watchdogs in this area.

To conclude, the Committee asks, as the central question of this hearing, "what does this merger mean to consumers?" It is my fondest hope, as both an entrepreneur bringing innovative services to other entrepreneurs, and as an American citizen, that the message the Committee delivers loud and clear to AT&T and to the DOJ is that even our largest corporate citizens are subject to our time-tested anti-trust laws and the important public policies that support them. The best way to accomplish this is for the Committee to vigilantly use its oversight authority over the DOJ to ensure that a thorough investigation takes place, and every case that can be brought under Section 7 is, in fact, brought. Thank you for your time, Senators.