Multiple Government Regulatory Reviews Burden Telecom Mergers with Too Many Conditions

by

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CenturyLink’s acquisition of Qwest is the latest merger of telecommunications carriers to undergo the process of regulatory approval by multiple government agencies. As the Qwest-CenturyLink merger continues to undergo repeated scrutiny by numerous regulatory bodies, it is useful to step back and consider the telecommunications merger review process itself, particularly the role of multiple state-level reviews of proposed mergers. The existing multi-level, multi-agency telecommunications merger review process involves costly, time-consuming, redundant reviews by federal and state regulators. And it often results in merging carriers being subjected to numerous approval conditions that are unrelated to specific harms posed by such mergers.

Considering today's fast-paced, dynamic interstate telecommunications marketplace, this expensive, delay-prone, overlapping governmental review process raises a host of public policy questions. Most especially, do repeated and overlapping federal and state regulatory reviews of mergers under "public interest" standards bring consumers greater protection and benefits? Or do they result in redundancies that hinder consummation of efficient transactions that could benefit consumers with more choices and innovation?
It is time to ask whether the existing process for telecommunications carriers to obtain merger approval is really in the "public interest" or whether, instead, it can be significantly streamlined to reduce regulatory delay and lost economic opportunity costs.

**The Qwest-CenturyLink Merger**

In a business deal worth some $22.4 billion, CenturyLink proposes to acquire Qwest, with the merged entity providing voice, video, and data services to residences and business customers in thirty-seven states. Since both companies already have extensive operations in rural markets across the country, the Qwest-CenturyLink merger would create what some call a "Super LEC" that could benefit from enhanced economies of scale and potentially become a stronger competitor to other national carriers and broadband service providers.³

Geographically, Qwest and CenturyLink operate in almost entirely separate areas across the country.² Thus, a merger would result in very little overlap of existing operations. The U.S. Department of Justice (DOJ) and the Federal Trade Commission (FTC) have both cleared the Qwest-CenturyLink merger, indicating the deal poses no market power or consumer harm complications.³

But in addition to a pending review by the FCC, the Qwest-CenturyLink merger must gain the approval of numerous state public utility commissions (PUCs). Although outside interest groups have lobbied for special conditions to be imposed on a merged Qwest-CenturyLink, the merger has been approved without conditions by regulators in states such as California, Georgia, Hawaii, Louisiana, Maryland, Mississippi, New York, Ohio, and West Virginia. So far the merger has been approved by regulators in twelve states in addition to the District of Columbia. Qwest and CenturyLink hope to receive approval from regulators in nine additional states as well as the FCC in order to close the merger in the first quarter of next year. Recent news reports indicate, however, that the Qwest-CenturyLink merger still faces multiple approval conditions before the deal is concluded.

Prospects for the Qwest-CenturyLink merger receiving final approval from the remaining states and the FCC remain likely – whether with or without unnecessary or excessive conditions attached. But one need not wait until the next merger approval case to consider whether redundant regulatory review of telecommunications mergers impose real costs and bring only illusory benefits.

**DOJ and FTC's Consumer-Welfare Focused Merger Review Processes**

Once telecommunications carriers publicly announce a proposed merger or acquisition, they must undergo an intergovernmental regulatory gauntlet to obtain the necessary approvals. Typically, proposed mergers are first reviewed by DOJ or the FTC to ensure that no anti-competitive conduct or consumer harm will likely arise from the transactions. Relying on jointly developed protocols, the two federal agencies decide which one will conduct a detailed investigation of proposed mergers and the process by
which both respective agencies grant clearance to proposed mergers that do not pose competition problems. Both DOJ and FTC reviews rely on the insights of antitrust law to analyze the competitive or anti-competitive effects of proposed mergers. Those insights have been developed through court rulings and economic studies, and are encapsulated by the DOJ Antitrust Division Chief's statement that "the vast majority of mergers are either procompetitive and enhance consumer welfare or are competitively benign." Both agencies have outlined the competitive considerations to be weighed in case-specific analysis of mergers in the DOJ-FTC Horizontal and Non-Horizontal Merger Guidelines.

**FCC Merger Review: "Regulation by Condition"**

Once merging telecommunications carriers pass DOJ-FTC hurdles, they must still seek FCC approval. In technical terms, this means merging parties must submit an application to the FCC to obtain license transfer approval by the FCC under its "public interest" standard. Unfortunately, obtaining such approval has proven problematic and delay-prone for merging carriers.

At the outset, the expansive scope of the FCC's "public interest" standard gives the agency broad latitude in setting conditions on mergers under review. The FCC professes that its public interest analysis "is informed by, but not limited to antitrust principles," extending to consideration of "whether a transaction will enhance, rather than merely preserve existing competition," embodying "a more extensive view of potential and future competition and its impact on the relevant market." The FCC thereby sets for itself an ambitious and rather open-ended merger review standard that presumes an extraordinary amount of agency predictive knowledge. The process readily invites agency activism by virtue of the opportunity to impose merger conditions under the open-ended review standard.

Unfortunately, the FCC's merger review process has been characterized by costly delays. The FCC has routinely exceeded its self-imposed 180-day shot clock for approving media and telecommunications mergers. For example, the XM-Sirius merger was finally approved by the FCC, with a heavy set of conditions, on day 412. Such delays expand opportunities for outside interest groups to lobby and wage public relations campaigns for special restrictions to be imposed on mergers. Agency inaction means increases in regulatory compliance expenses for the merging carriers. It also means that merging carriers are unable to vigorously pursue new market opportunities while they await completion of the review process, thereby incurring escalating opportunity costs. In addition, under mounting pressure to obtain FCC approval to consummate the transaction, merging carriers have sometimes had to agree to "voluntary" conditions negotiated behind-closed-doors.

The FCC merger review process aptly has been described as a process for creating "regulation by condition." Although the FCC insists that its public interest authority allows it "to impose and enforce narrowly tailored, transaction-specific conditions to ensure that the public interest is served," in some instances the FCC has adopted
merger conditions that it otherwise lacks authority to adopt through general rulemaking. In the AT&T-BellSouth merger, for instance, the FCC included a condition that the merged entity repatriate overseas jobs to the U.S., including some two-hundred jobs to the New Orleans area. Even if labor policy issues surrounding outsourcing are somehow within the FCC’s jurisdiction, those disputes are far more suited for consideration as public rulemakings for industry-wide regulation. They are ill-suited for a non-transparent, ad hoc decision-making process for setting special restrictions only on merging parties.

And the FCC has even adopted merger conditions that purport to bind non-merging parties. It has prohibited, for example, certain mobile satellite service business dealings with the top two (non-merging and non-party) wireless service providers as a condition for its approval of the Harbinger-SkyTerra merger. In this and in other instances, it is highly questionable whether the conditions adopted by the FCC relate to specific alleged consumer harms arising out of the mergers in question.

**Multiple State PUC Merger Review: Compounding Compliance Costs**

While FCC approval is pending, merging interstate carriers must typically obtain approval for their deal from all or almost all of the state PUCs in states in which one or the other of the carriers operate. For example, Verizon's sale of assets to Frontier required the approval of nine state PUCs, whereas the Embarq-CenturyTel merger required approval by eighteen state PUCs. As pointed out previously, the pending Qwest-CenturyLink merger requires the merging carriers obtain the approval of some twenty state PUCs.

Considered against the backdrop of two federal agency merger review processes, requiring multiple state PUC reviews of proposed telecom mergers means subjecting merging carriers to redundant regulatory proceedings and to burdensome over-regulation. For starters, merging telecom carriers seeking approval from a dozen or more state PUCs are saddled with significant compliance costs. At the state level, public hearings as well as private meetings with state utility commissioners, their staffs, and state-appointed "consumer advocates" or "public counsels," take up considerable amounts of company resources and employee hours. Lengthy, protracted negotiations between merging companies and regulatory officials and staffs give rise to additional direct costs, in addition to opportunity costs that merging companies experience while they remain in merger approval limbo. Compliance with state PUC requests for information above and beyond what such carriers are already required to provide under existing federal or state regulations also involves added costs, especially when various kinds of disclosures are requested by regulators in multiple states. And as discussed below, merging telecommunications carriers also incur costs from the compound effect of multiple regulatory agencies imposing multiple conditions on deal approval.
Repeating the FCC’s Mistakes: Compounding Condition Costs

State telecommunications merger reviews pose a number of problems that are similar to those posed by FCC merger reviews. State PUCs typically review telecom mergers under a "public interest" standard that closely mirrors the FCC's expansive "public interest" standard. As indicated earlier, both the FCC and state PUC merger reviews impose direct costs for review process compliance as well as both direct costs and indirect opportunity costs for review process delays. Also like the FCC, state PUCs are prone to using telecom merger approvals as opportunities for imposing "regulation by condition."

Consider, for example, the Oregon Public Utilities Commission's news release headline for one recent merger review: "Sale of Verizon to Frontier Communications Approved with Numerous Conditions." In this instance, "numerous" amounted to over fifty conditions being imposed by Oregon regulators for approval. The Oregon Commission's Chairman touted that the PUC was "requiring Frontier Communications to spend $25 million on expanding high-speed internet access to its Oregon customers by July 2013." (This broadband build-out "condition" coincides with another Oregon Commissioner's candid statement months earlier at an FCC workshop that the Oregon PUC leverages its authority in ratemaking cases to impose broadband build-out requirements on telecom service providers.)

As the Oregon PUC's review of Verizon-Frontier deal illustrates, state PUCs have in some instances subjected merging telecommunications carriers to conditions that such regulators otherwise lack the power to enforce through industry-wide regulations. And some state PUC conditions for approval appear extraneous to any type of conceivable consumer harm arising from the merger at issue. For example, Oregon regulators justified imposing such merger conditions – including the broadband investment condition – under its "public interest, no harm" standard.

It may come as little surprise then that the staff of the Oregon PUC, while recommending against approval of the Qwest-CenturyLink merger, also insists that the Oregon PUC impose some fifty-seven conditions on any approval of the deal. One of those conditions is a broadband build-out investment requirement in the state of Oregon totaling $20 billion over the next eighteen months and $40 billion by July 2014.

Meanwhile, the staff of the Colorado PUC has also recommended that several conditions be attached to the Qwest-CenturyLink merger, including a broadband investment requirement that "the combined company will invest a minimum of $70 million in broadband infrastructure in Colorado over five years." Similarly, the Arizona Corporation Commission's approval is now imminent, being contingent on a recent agreement with Arizona Commission staff that "the combined company will invest a minimum of $70 million in broadband infrastructure in Arizona over five years." With several states still considering the Qwest-CenturyLink merger, it is possible other state PUCs may seek to use their merger approval leverage to impose broadband investment or other conditions on the deal.
Broadband deployment and adoption are laudable policy goals. Perhaps state regulatory agencies find their ability to achieve well-intentioned policy goals typically frustrated somehow by their own jurisdictional constraints. And for that reason, perhaps state PUCs find their merger review authority to be a tempting tool for fashioning conditions to meet those policy goals. But state PUC telecom merger review shouldn't be twisted into a roving policymaking power. Because of the \textit{ad hoc} nature of telecom merger reviews focused on the impact of two merging telecom service providers, state PUC telecom merger review is the wrong process for implementing general policy goals.

The willingness of state PUCs to impose merger conditions otherwise beyond their general rulemaking authority as well as conditions unrelated to perceived market power or consumer harms arising from the transaction makes the process inviting to outside interest groups who wish to manipulate the outcome. In recent years, state PUC merger reviews have served as a forum for various interest groups advocating stiffer telecommunications regulation or even re-regulation, labor policy, and more.

Even where a state PUC reviewing a telecom merger imposes conditions for the ostensible purposes of guaranteeing basic service at reasonable rates, state PUC activism is still questionable in many instances. State PUC consideration of merging carriers' backgrounds or financial assets as the basis for imposing merger conditions is tantamount to rewriting company business plans. The advanced telecommunications market has been characterized by financial risk-taking. One must remember, for instance, that consumers today are benefiting from broadband build-out that was constructed in substantial part thanks to heavily leveraged private financing. There is also a disconnect between requiring supplemental periodic accounting and other disclosures as a condition of approval and preserving basic telecom service. If a telecom service provider later struggles on the brink of bankruptcy, there is little that a state PUC armed with extensive informational reports could do about that kind of business situation once it has already happened.

\textbf{Over-Conditioning Merger Approvals with Diminishing Returns}

Where the FTC and DOJ have already cleared a telecommunications merger on competitiveness grounds, it is difficult to see how multiple state PUCs piling on extra conditions for approving the deal will bring any further benefit to consumers unless state PUCs are focused on specific, unique potential harms to their consumers relating to the merger. Once market power concerns are addressed by FTC-DOJ reviews, a law of diminishing returns kicks in with regard to subsequent FCC and state PUC merger reviews. There is little reason to expect seven, thirteen, or two-dozen government agencies will provide an optimum outcome that would not otherwise be reached through reviews conducted by one, two or even a few government agencies. And keep in mind that post-merger the FCC and state PUCs retain general rulemaking powers to address industry-wide telecom service concerns.
Requiring telecommunications mergers to be approved by multiple federal and state agencies raises the likelihood of merging providers being burdened with too many conditions. Regulatory agencies are established in order to regulate. And they have shown themselves prone to treat merger reviews as an occasion to do what they normally do: regulate.

The existing policy of federal and state telecom merger over-reviewing and over-conditioning can delay mergers that would make the market more competitive and help give merged carriers economies of scale and scope that could better create and deliver innovative services to consumers. When multiple government agencies' merger conditions are compounded, the resulting pile-up of restrictions and requirements can distort the dynamics that made a merger deal attractive to the carriers in the first place. Some prospective merging companies might consider the multiple government review process too costly, distracting, and uncertain to be worth enduring.

**Bringing Discipline to State Telecom Merger Reviews**

Given the increasingly interstate nature of advanced telecommunications service, state regulatory reviews of telecom mergers are increasingly taking on the character of state regulation of interstate commerce. Express attempts by state regulators to impose merger conditions on interstate aspects of telecommunications service are almost certainly subject to federal preemption. (The Virginia State Corporation Commission, for instance, attempted to impose interstate special access rate restrictions as a condition for its approval of the Verizon-MCI merger. It later backed down in the face of FCC opposition and litigation pending at a federal appellate court.23)

But whenever state regulators withhold approval, they effectively preclude completion of mergers involving interstate telecom providers. So long as even one state PUC drags out its merger review process, consumers in other states who would otherwise stand to experience long-term benefits from service offerings provided by a merged entity are denied those benefits. This essentially makes one state PUC's delays in approving a merger an externality imposed on out-of-state consumers in the form of lost opportunity costs. The interstate scope of many telecom companies, both pre- and post-merger, makes lengthy state PUC reviews a burden on interstate commerce. That kind of interstate effect argues against state PUCs continuing to review telecom mergers, or at least continuing to review them without substantially reforming their review process to mitigate the ill-effects associated with the existing process. To the extent the states have a legitimate interest in considering potential harms to consumers that are claimed to arise uniquely from the particular intrastate competitive impact of the merger, they should do so in a much more focused fashion than they do now.

Although states have jealously guarded their jurisdictional claim over intrastate telecommunications ever since the Communications Act of 1934, telecom merger review can be severed from larger disputes over the fuzzy boundaries between interstate and intrastate telecommunications services. In recent years a number of states have opted against pushing state jurisdiction and regulation of
telecommunications to its maximum limits. Many states have instead opted for telecommunications deregulation as the best policy to promote innovation and competition in the intrastate market. Such states have enacted legislation removing state PUC authority over aspects of wireless, VoIP and other voice services. Removing or reforming state PUC power to impose and enforce telecom merger conditions need not be seen as a surrender of states’ turf to the feds, but can instead be viewed as part of an overall policy shift to less regulation.

Then again, for states to forego or narrow telecommunications merger reviews need not mean any reduction in state regulators’ rulemaking power. Removing or reforming state PUC authority to tack extra conditions onto telecommunications mergers can be accomplished while keeping fully intact state PUC rulemaking authority to address intrastate telecommunications problems.

**Rethinking Multiple Merger Review in Light of Qwest-CenturyLink**

When a merger such as Qwest-CenturyLink requires sign-offs by two dozen government agencies, the merging carriers will be confronted with negotiating their way through the regulatory "conditions" thicket in a number of states in addition to the regulatory reviews at the federal level. It is reasonable to ask whether the regulatory process we have in place is worth the price – or, put more affirmatively, whether it ought to be reformed substantially to achieve meaningful streamlining. Once DOJ or the FTC have cleared telecommunications mergers on market power and anticompetitive harm grounds, are multiple, overlapping, redundant, costly, delay-prone state and even FCC merger reviews necessary or helpful? Given today’s competitive, dynamic telecommunications marketplace, the answer increasingly appears to be "no."

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7 See 47 U.S.C. §§ 214(a), 310(d).
13 FCC, Memorandum Opinion and Order, WC Docket No. 09-95, at 7, para. 12.
17 See FCC, National Broadband Plan Workshop: State and Local Governments: Toolkits and Best Practices at 70 (September 1, 2009) (“COMMISSIONER BAUM: The only leverage we get is when they come by some kind of rate case we leverage them and ask them it would be really nice if you’d set aside several million dollars for deployment and put a fiber ring out there”), available at: http://www.broadband.gov/docs/ws_19_state_and_local.pdf.
18 See, e.g., Oregon PUC, Order, In the Matter of Verizon Communications Inc., and Frontier Communications Corporation, Joint Application for an Order Declining to Assert Jurisdiction, or, in the alternative, to Approve the Indirect Transfer of Control of Verizon Northwest Inc., UM 1431 (February 24, 2010), at 6, (“the standard for approval applied by the Commission is whether the transaction serves the public interest by causing "no harm"); id. at 6, fn.5 (“This is a lesser standard than the “net benefits” test employed under ORS 757.511 for energy utility acquisitions”).
19 See Oregon PUC Staff, Reply Testimony, In the Matter of CenturyLink Application for Approval of Merger between CenturyTel, Inc. and Qwest Communications, UM 1484 (September 3, 2010), available at: http://edocs.puc.state.or.us/efdocs/HTB/um1484htb154016.pdf.
20 For Oregon PUC staff-recommended conditions, see id. at 45 et seq.