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CenturyLink/Level 3 Merger Should Bring Pro-Competitive Public Benefits

by

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Introduction and Summary

The FCC is currently reviewing the proposed merger between CenturyLink and Level 3 Communications. There is strong evidence that the CenturyLink/Level 3 merger, if approved, would enhance competition in the enterprise broadband market. Just as important, the merger poses no downside for everyday consumers. Level 3 does not serve residential broadband or video subscribers. On its face, the proposed CenturyLink/Level 3 merger appears to fully satisfy the public interest standard for FCC approval. It deserves an expeditious review by the FCC.

The purpose here is not to endorse or oppose the proposed CenturyLink/Level 3 merger. Rather, the purpose is to identify key competitive and public interest factors connected to the proposed transaction – particularly those pertaining to the enterprise broadband market.

Enterprise broadband services use dedicated facilities to deliver high volumes of data with performance quality guarantees. These services, often referred to as business data services (BDS), are used by business enterprises – not residential consumers. Sophisticated businesses typically negotiate at arms' length with enterprise broadband service providers over terms and prices for customized service. Frequently, other telecom providers lease access to these dedicated facilities on a wholesale basis.

In its *Enterprise Broadband Orders* (2006-08), the FCC expressly concluded that the market for packet-switched enterprise broadband services was "highly competitive." Since then, cable entrants such as Comcast and Charter Communications have steadily increased their geographic footprints and market shares. Meanwhile, AT&T and Verizon remain vigorous competitors in the enterprise broadband market. For the most part, CenturyLink and Level 3 own and operate facilities in different geographic territories. If combined, CenturyLink/Level 3 would most certainly provide enterprise customers with a stronger competitive alternative to the market's current leaders and emerging competitors.

By combining network facilities, CenturyLink/Level 3 would be able to use its own network to more effectively and efficiently serve enterprise customers operating in multiple geographic locations. With a larger on-network presence, CenturyLink/Level 3 could fully serve and connect to more of its own business enterprise customers. Post-merger, CenturyLink/Level 3 would less frequently need to make business arrangements with its market competitors in order to effectively serve multi-location customers. This would create cost savings.

CenturyLink/Level 3's network expansion would reduce the frequency of data traffic handoffs to competitors. This would reduce operational and security vulnerabilities arising from network interfacing. CenturyLink/Level 3's larger on-net presence would increase its direct knowledge of enterprise broadband network functions, enabling swifter response to network malfunctions and ensuring quality of service guarantees are satisfied.

The FCC's *XO/Verizon Order* (2016) recognized the public interest benefits of more customized on-net offerings to multi-location customers. The order credited the benefits of reduced data handoffs to other providers as well as more prompt and accurate identification and resolution of service disruptions. Other FCC precedents recognize the public benefits of expanded broadband footprints and improved multi-regional service options. The Commission should recognize that these same public interest benefits are likely to be obtained if the CenturyLink/Level 3 merger is consummated.

There appears to be little likelihood that public interest harms would result from the proposed CenturyLink/Level 3 merger. With AT&T, Verizon, Frontier, Comcast, Charter, smaller cable providers, and other competitors such as Zayo all offering business enterprise services, the proposed CenturyLink/Level 3 merger poses no credible threat of market power abuses. And although Level 3 owns or controls fiber into about 34,755 buildings, the merging parties estimate that only 100 buildings would go from two in-building BDS connections to one connection without a competing provider operating within 0.1 miles.

Moreover, there is little geographic overlap between CenturyLink and Level 3's long-haul fiber facilities. If CenturyLink and Level 3's estimates are correct, then one or more competitors already serve every long-haul route where CenturyLink and Level 3 routes overlap. Nor does the proposed CenturyLink/Level 3 merger pose any likely competitive harm in the market for Internet backbone transit. Whereas Level 3 has a significant Internet backbone, CenturyLink does not even rank among the top dozen Internet backbone transit providers, according to market research reports.

Importantly, CenturyLink/Level 3 raises no vertical integration concerns related to the residential broadband or video services markets. Unlike CenturyLink, which serves 6 million residential broadband customers, Level 3 is *not* a residential broadband Internet service provider (ISP). Also, whereas CenturyLink serves about 318,000 residences with its PrismTV multi-channel video programming service and also plans to roll out an over-the-top skinny-bundle video offering, Level 3 is *not* a video service provider. The merger would nowhere reduce the number of ISPs or video service providers serving residential customers.

In sum, the proposed CenturyLink/Level 3 merger's emphasis on enhancing enterprise broadband competitiveness suggests public interest benefits should be realized. The limited extent of facilities overlap, CenturyLink's small share of the Internet backbone transit market, and the lack of any impact on residential broadband or video service markets make it unlikely to cause cognizable competitive harms. Any conceivable harm from the proposed merger appears less likely and less substantial than the likely benefits. CenturyLink and Level 3 should most certainly be able to establish that the proposed merger is in the public interest. Yet whatever the FCC ultimately decides, the CenturyLink/Level 3 merger deserves a review that is speedily completed within the Commission's 180-day shot clock.

The CenturyLink/Level 3 Merger: Focus on Enterprise Broadband Marketplace

According to reports of the proposed merger, in an exchange worth approximately $34 billion, shareholders of CenturyLink, Inc., would acquire a 51% interest in Level 3 Communications. CenturyLink provides broadband, voice, video, data, and managed services over a fiber network that spans 250,000 route miles in the United States. If approved, the merger would add to CenturyLink's fiber network some 200,000 more miles of fiber cable.

According to CenturyLink and Level 3, "[t]he transaction's focus is on enhancing the ability of the combined company to compete vigorously in the provision of enterprise services." Enterprise broadband services, often referred to as business data services (BDS), are sought after by business customers with unique communications and information technology needs. Enterprise services use Ethernet and other transmission technologies to deliver high volumes of data to business customers over dedicated network facilities – particularly fiber optics. These services typically come with performance quality guarantees to meet the particularized needs of business customers. Sophisticated business customers typically negotiate at arms' length with broadband enterprise service providers over contract terms and prices. Additionally, other telecom providers frequently lease wholesale access to these dedicated facilities. A 2016 notice of proposed rulemaking by the FCC stated that "[t]he vast majority of BDS sales are to other telecom providers, about 90%."

In its *Enterprise Broadband Orders* (2006-08), the FCC expressly concluded that the market for these packet-switched broadband services was "highly competitive." Pursuant to those orders, certain enterprise broadband technologies – such as Ethernet – were largely exempt from dominant carrier and tariff requirements designed for legacy telephone services. This policy encouraged investment in network upgrades by incumbents. It also promoted market entry and expansion by cable operators and other competitors. These market developments have given business enterprise customers additional price and service options.

Currently, AT&T and Verizon are highly competitive providers in the broadband enterprise market. Cable entrants such as Comcast and Charter Communications have steadily increased their market shares. And smaller cable providers and other competitors also offer business enterprise customers alternatives. CenturyLink/Level 3 would most certainly provide enterprise customers with a stronger competitive alternative to the market's current leaders and emerging competitors.

Public Interest Benefits Likely to Result from Enhanced Enterprise Broadband Competition

By combining network facilities, CenturyLink/Level 3 would be able to use its own network to more competitively serve enterprise customers operating in multiple geographic locations. With a larger on-network presence, CenturyLink/Level 3 could fully serve and connect to more business enterprise customers than either provider could if they remained separate. Level 3's fiber network appears to be located primarily outside of CenturyLink's incumbent local exchange carrier (ILEC) footprint. Conversely, CenturyLink's fiber network is limited outside its ILEC footprint. The addition of Level 3's 128,000 route miles of fiber in the U.S. to CenturyLink's 250,000 miles in the U.S. would thereby significantly improve the combined entity's geographic reach and on-net presence.

Providers with smaller on-net presence must make business arrangements with other market competitors in order to effectively serve enterprise customers – especially multi-location customers. Post-merger, however, CenturyLink/Level 3 would be able to reduce the frequency of data traffic handoffs to competitors. This would create cost savings. It would also reduce operational and security vulnerabilities arising from network interfacing. CenturyLink/Level 3's larger on-net presence would increase its direct knowledge of broadband enterprise network functions, enabling swifter response to network malfunctions and thereby ensuring quality of service guarantees are satisfied.

Analysis in FCC Precedents Lend Support to the CenturyLink/Level 3 Merger

Under Section 214(a) and 310(d) of the Communications Act, the FCC reviews mergers and acquisitions that involve license transfers. In reviewing such transactions, the Commission determines whether or not they will serve "the public interest, convenience, and necessity." The Commission applies a balancing test that weighs potential public interest harms of the proposed merger against potential public interest benefits. The parties to the merger bear the burden of proving, by a preponderance of the evidence, that the proposed merger, on balance, serves the public interest. There is an informal timeline or shot-clock of 180 days during which the Commission routinely – but by no means always – conducts its merger review.

FCC merger precedent recognizes the public interest benefits of more widely available multi-location BDS services. In the *XO/Verizon Order* (2016), the FCC recognized that the acquisition and control of additional fiber assets "will enable Verizon to better serve new and existing multi-location enterprise and wholesale customers." Among other things, the FCC's order credited the benefits of more customized offerings to on-net customers, reduced handoffs to other providers, and more prompt and accurate identification and resolution of service disruptions – all resulting from XO/Verizon's increased control of network facilities. In that order, the FCC also recognized that BDS provider ownership of fiber assets is superior to leasing them – due to cost-effectiveness and also because "multi-location customers prefer that their providers own the facilities on which they offer service."

Additional FCC precedents credit the public interest benefits of multi-locational expansion. For example, the *Charter/Time Warner Cable Order* (2016) declared that "an expanded footprint may increase a firm's ability to compete for multi-location customers for business services that have operations beyond the firm's pre-transaction service area." And the *Time Warner Cable /Insight Order* (2012) recognized the benefits that come from a "broader service footprint" that creates increased "ability to compete, particularly for enterprise customers that have operations extending" across territories served by the merging parties.

The Commission should thus recognize that many of the same public interest benefits that were observed in the XO/Verizon merger and in other approved transactions are also likely to be obtained under the CenturyLink/Level 3 merger.

CenturyLink/Level 3 Merger Does Not Appear to Raise Competitive Concerns in the Enterprise Broadband, Long-Haul Fiber, or Internet Backbone Transit Markets

There appears to be little likelihood that public interest harms would result from the proposed CenturyLink/Level 3 merger. With AT&T, Verizon, Frontier, Comcast, Charter, smaller cable providers, and other competitors such as Zayo all offering services, the proposed CenturyLink/Level 3 merger poses no credible threat of market power abuses in the enterprise broadband market. By using the same methodology to ascertain merger-related reductions of in-building connections that the FCC recognized in the *XO/Verizon Order*, the merging parties have estimated that within CenturyLink's 37-state ILEC footprint only 90 buildings would go from having two BDS in-building connections down to one connection where there is not a competing provider within 0.1 miles from the building. And outside of CenturyLink's ILEC footprint, just ten buildings would go from having two BDS in-building connections to one where there is not a competitor within 0.1 miles. To put that figure into some perspective, Level 3 owns or controls fiber into approximately 34,755 buildings – about 82% of which are outside CenturyLink's ILEC footprint.

Moreover, there is little geographic overlap between CenturyLink and Level 3's long-haul fiber facilities. According to CenturyLink and Level 3, "all but three of the overlapping CenturyLink-Level 3 long-haul fiber routes are served by one or more of AT&T, Comcast, and/or Verizon." And each of the three remaining routes "are served by at least one other fiber competitor."

Nor does the proposed CenturyLink/Level 3 merger pose any likely competitive harm in the market for Internet backbone transit. The *XO/Verizon Order* observed that "transit prices have been declining sharply since the late 1990s" and concluded the relative positions of the merging parties in the Internet backbone transit were no cause for concern. That precedent lends support to the proposed CenturyLink/Level 3 merger. Although Level 3 is a leader in the Internet backbone transit market, CenturyLink does not even rank among the top dozen Internet backbone transit providers, according to market research reports.

CenturyLink/Level 3 Merger Would Have No Adverse Impact on Residential Broadband or Video Customers

Importantly, CenturyLink/Level 3 raises no vertical integration concerns related to the residential broadband or video services markets. CenturyLink currently serves about 6 million broadband residences. Level 3 is not a residential broadband Internet service provider (ISP). Thus, the merger would nowhere reduce the number of ISPs serving residential broadband customers.

Nor would the CenturyLink/Level 3 merger have any impact on the video services market. If approved, the merger would not reduce the number of multi-channel video programming distributors (MVPDs) serving residential consumers. CenturyLink serves about 318,00 residences with its PrismTV MVPD service, which reportedly passes about 3.2 million residences. CenturyLink is also reportedly pursuing a rollout of over-the-top (OTT) services – in particular, an Internet-delivered skinny bundle package – that would attract subscribers who are value-conscious or who have never subscribed to MVPD services. However, Level 3 is not an MVPD. And neither merging company is an owner of video programming content – a subject of scrutiny by regulators in recent communications and media-related transactions, including the AT&T/DirecTV and Charter/Time Warner Cable mergers.

Conclusion

It is highly probable that the proposed CenturyLink/Level 3 merger will produce valuable public interest benefits by enhancing competition in the enterprise broadband or BDS marketplace. FCC precedent specifically recognizes the public benefits of expanded multi-location service options and increased on-net service capabilities. Such benefits would likely result from the CenturyLink/Level 3 merger. Furthermore, the apparently limited extent of facilities overlap and CenturyLink's small share of the Internet backbone transit market make it unlikely that the proposed merger would cause cognizable competitive harms. And the merger would have no impact on residential broadband or video service markets at all. Even from an extra-precautious point of view, any conceivable harm from the proposed merger appears less likely and less substantial than the likely benefits.

CenturyLink and Level 3 should most certainly be able to establish, by a preponderance of the evidence, that the proposed merger is in the public interest. Of course, it is the role of the FCC to determine whether its public interest standard for merger reviews is satisfied. Yet whatever the FCC ultimately decides, the CenturyLink/Level 3 merger deserves a review that is speedily completed within the Commission's 180-day shot clock.

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